HOW UK BANKS ARE CHANGING THEIR CORPORATE CULTURE AND PRACTICE FOLLOWING THE FINANCIAL CRISIS OF 2007-08

Ian W. Jones and Michael G. Pollitt

WP 482
September 2016

HOW UK BANKS ARE CHANGING THEIR CORPORATE CULTURE AND PRACTICE FOLLOWING THE FINANCIAL CRISIS OF 2007-08

Centre for Business Research, University of Cambridge
Working Paper No. 482

Ian W. Jones
Mansfield College, Oxford
ian.jones@mansfield.ox.ac.uk

Michael G. Pollitt
Judge Business School, University of Cambridge
m.pollitt@jbs.cam.ac.uk

September 2016

This working paper forms part of the CBR Research Programme on Corporate Governance.

Abstract

This paper looks at positive case studies of organisational change at significant UK banks in response to the financial crisis. We present examples of good practice, which specifically address the identified need to change the culture and practice of UK banking. Our aim is to identify cases that can be of value in teaching. Our research complements the existing research on ethical banking and on culture change in UK banking. We begin by reviewing some of the literature on the crisis as it relates to the culture of banking in the UK. We go on to document three case studies from each of five banks with a significant retail business in the UK – Barclays, Lloyds, TSB, Santander and Hoare. We finish with a conclusion that draws out some over-arching lessons on culture change in UK banking from our case studies.

Keywords: Corporate Culture, Barclays, Lloyds, TSB, Santander and Hoare

Acknowledgments

The authors wish to thank all of their interviewees who so generously gave their time and ideas to us. We interviewed 11 individuals, currently associated with 5 banks. We also wish to thank Michael Withey for excellent research assistance. We acknowledge the encouragement of Jon Stern and Peter Hiscocks and the financial support of the Centre for Compliance and Trust at the Cambridge Judge Business School. The usual disclaimer applies.

Further information about the Centre for Business Research can be found at: www.cbr.cam.ac.uk

1. Introduction

The UK Financial Crisis of 2007-08 is now very well documented. A number of high profile reports on the failure of financial institutions have carefully documented the anatomy of the crisis and explained the strategic and management failures that lay behind the crisis. [1] There have also been detailed investigations into the more general nature of the banking crisis. [2] The crisis, and the build up to it, significantly undermined trust in both banking and in capitalism more generally in the UK and it is clearly important and interesting to investigate the extent to which this trust is genuinely being repaired. UK Banks have now had 7 years to respond to the crisis, which could have resulted in the wholesale failure of the financial system in the UK. We have also had subsequent revelations about poor business practices (e.g. with respect to miss-selling of payment protection insurance (PPI)) and criminal activities relating to the rigging of markets (e.g. LIBOR and certain foreign exchange markets). Thus it is a good time to study what the banks are doing to respond to the failures that have been identified.

The principal aim of this research is to look for positive case studies of organisational change at significant UK banks in response to the financial crisis. This will allow us to present examples of good practice, which specifically addresses the identified need to change the culture and practice of UK banking. Our aim is to identify cases that can be of value in teaching. Our research complements the existing research on ethical banking[3] and on culture change in UK banking.[4]

Our paper proceeds as follows. We begin by reviewing some of the literature on the crisis as it relates to the culture of banking in the UK, in order to give a wider context for the case studies we highlight. We then discuss our research methodology and provide a brief introduction to the five banks we include in our research. In the subsequent five sections, we present three case studies from each of five banks with a significant retail business in the UK – Barclays, Lloyds, TSB, Santander and Hoare. We finish with a conclusion that draws out some over-arching lessons on culture change in UK banking from our case studies.

2. Literature Review

The literature on banking culture[5] and the UK financial crisis can be divided up into three parts. Each of these is informative in its' own way. First, there are the formal reports on the crisis (such as the 2009 Walker Review and the 2011 Independent Commission on Banking). These often involve in depth analysis of what went wrong and what to do about it, taking into account of the views of multiple actors within the system. Second, there are some excellent histories of the crisis at individual banks (such as RBS, Lloyds and HBOS), which often give some insight into the inner workings of banks and the individual decision makers within them. Finally, there are academic studies of the crisis, which attempt to provide genuinely independent analysis of what went wrong and what to do about it. Each of these sets of literature gives a fairly consistent picture of the cultural problem in UK banking. In this section we begin by examining the academic literature, and then discuss some of the books. We will cover some of the formal reports in the case studies, in particular the Salz Review (2013), which was commissioned by Barclays. Indeed the Salz Review has a very good review of the literature on culture itself, which emphasises the general lessons that can be drawn from it and how these specifically apply to banking.[6]

It is worth noting that there is also a general literature on culture and unethical behaviour. See for example, Trevino et al. (2014) who summarise the literature on what causes unethical behaviour in organisations. Among the many insights of the behavioural literature relevant to banking, is the significant role that leaders play in shaping behaviour; the need to align published codes of conduct with assessments of performance (or risk them having a negative impact); and the capacity for 'moral disconnection' whereby individuals don't see their 'bad' behaviour as wrong.

There is also evidence that pay effects performance. Banking is notable for its substantial use of individual sales based bonus payments to staff both in its retail and investment banking arms. The empirical evidence does support the view that group based incentives are better for corporate culture than individual based incentives. For instance, Blasi et al. (2016) examine the 100 best companies to work for, over the period 2005-07. They find that group pay incentives are associated with more information sharing, higher trust in supervisors and a more positively rated work environment. Frank and Obloj (2014) show that individual employee sales incentives are not necessarily in the financial interests of the bank, by examining a large number of loan decisions. They find that bank

employees at a retail bank can use their in-depth understanding of the sales incentives to manipulate their sales in ways, which improve their bonuses while reducing the overall return to the bank (e.g. by making the loan interest rate lower to improve their loan sales). They show that for managers with better knowledge of the bank in question (what they call higher 'firm specific human capital') the losses are higher. They attribute this to 'adverse learning'.

There have been some excellent academic studies on culture and the financial crisis. Spicer et al. (2014) report on the results of 57 interviews with executives and front line staff in 11 retail banks. They find that 'an aggressive sales culture' was a major contributor to the financial crisis. They discuss how regulators and governments have delegated much of the 'softer' cultural change agenda to the private initiative of the banks themselves. Banks have largely responded to this with culture change processes, but these remain 'fragile' and prone to failure. They also report a widespread view that culture change will take a generation and that significant change will take until at least 2019. The paper suggests that consistency all the way down the organisation (i.e. not just change at the top) and long-term commitment are necessary.

Lui (2015) examines the cultural reasons behind the crisis, by examining the behaviour of Northern Rock, RBS, Barclays, Lloyds and HSBC in the period 2004-2009. She finds evidence in support of her two hypotheses, namely: that the banks changed from having a customer focussed culture to sales driven one; and that there was evidence of 'greed, recklessness and dishonesty' in both retail and investment banking the run up to the crisis. In line with this, Fortado and Fadil (2014) offer an in-depth study of the introduction of a sales driven banking culture. They conduct interviews with the staff of Amalgam Bank in the US (one of the top ten largest banks). They find evidence consistent with the detailed observations of what happened in the UK. Thus giving front line branch staff sales incentives reduced the quality of the customer experience (because customers had to spend longer in the branch), sales quotas were perceived as unrealistic and caused tensions between managers and staff. The result was unhappy staff, increased turnover of employees and unfair management practices.

Cohen (2015) discusses what financial institutions need to do to restore the trust they have lost in the crisis. She suggests that it is important that corporate governance processes support culture change. She develops a set of suggestions to help do this. These include pervasive adherence to a set of values, which are then used for setting pay and promotion, and regular monitoring of the process of 'embedding' the values. As we discuss below, this is something that our case study banks are attempting to do.

There have been a good number of books on individual banks and the crisis. Fraser (2014) is based on interviews with approximately 120 employees of RBS. This includes a documentation of the culture of RBS, which was much too deferential to its crisis CEO, Fred Goodwin. This book presents the story of RBS as a classic morality tale of an over-reaching bank, driven by the ambition of its CEO and hubris he created around him (among senior staff, outside directors and major shareholders), which caused external voices not to be raised against his strategy. This view is supported in Martin (2013) who discusses how a 'previously modest, Presbyterian, cautious Scottish institution…went bust' (p.2). Again a significant amount of blame is heaped on Fred Goodwin, but the role of the regulator, the Financial Services Authority (FSA), is also criticised for its ineffective regulation.

Fallon (2015) discusses the Lloyds takeover of HBOS. This book documents how Lloyds, which had previously been the most conservative of the big 4 British retail banks, was persuaded to takeover HBOS in late 2008. HBOS had been fully nationalised in October 2008. The result was Lloyds-HBOS (now the Lloyds Banking Group, LBG) ended up being 43.4% owned by the taxpayer by early 2009, as the full extent of the losses at HBOS became clear. Lloyds undertook the merger partly under government pressure, but also because it allowed to fulfil its long held ambitions to expand its retail business in a way that never would have been allowed in normal circumstances.

This story has a prequel, which is discussed in Perman (2012), which is the story of HBOS itself, which had been a merger of two venerable institutions Bank of Scotland and Halifax. As the Amazon.co.uk introduction to the book puts it: 'In 1995 Bank of Scotland celebrated 300 years as Britain's oldest commercial bank…Voted 'most admired bank', respected by competitors, applauded by investors and trusted by customers…less than 15 years later it was bust…' Perman's thesis is that 'simple' banking rules were 'ignored', rules that had kept the bank in business for 300 years. The rules that were ignored are documented in

Moore (2015). Paul Moore was HBOS's head of group regulatory risk from 2002-2004 and was fired for blowing the whistle on HBOS's move into the high-risk strategy that eventually caused its failure.

Other books document the on-going cultural problems at UK banks. Brummer (2014) suggests that there has yet to be significant cultural change in UK banking, the bonus culture still drives behaviour and there are on-going crises such as PPI. He suggests that radical reform is still needed. Tett's (2015) general book is also relevant on this as she highlights the tendency for big banks to suffer from 'silo' effects, whereby the various bits of banks (such as risk management and sales) do not communicate effectively and obvious warning signs are ignored.

3. Research Methodology

Our approach to this research has combined our previous research experience with the need to respond to the sensitive nature of the subject material. The purpose of the research design is to create structured thinking that produces a control of the research and a consequent comparability across case studies as well as a comprehensive reflection of contemporary perceptions. It will draw on our experiences from our previous published work on business ethics, corporate governance in the UK and social capital building by multinationals[7].

Our original intention was to approach five banks and ask them for three examples, in their view, of successful culture change in their organisation. We would then conduct a series of semi-structured interviews to understand the nature of the case studies that they provided us with. We would supplement the case study information with public statements from the banks concerned, external comment and third party interviews. Our case studies are mainly drawn from retail banking at the banks concerned, but also relate to other areas such as investment banking and wealth management.

However, the UK banking system is still reeling from the effects of the financial crisis. Bank profitability among the 6 largest banks is still significantly below the level of 2007, before the crisis hit. More revelations about bad practice have surfaced since we began our research and the banks continue to be subject to on-going criminal investigations. This has understandably made banks very sensitive in talking to outsiders. In the interests of expediency we have therefore had to use a combination of our original bank interview approach, public statements, external comment and third party interviews to arrive at the fifteen cases that we

present below. We are very grateful to all insiders those who have spoken to us, and many of the good ideas for positive cultural change we highlight were given to us in our interviews. Any statements or sentences in quote marks without references within the case studies is wording we have taken directly from information we have received from our interviewees.

We present case studies from Barclays, Lloyds, TSB, Santander and Hoare. Together these five banks a wide range of different UK banks, with very different experiences of the financial crisis, different histories and different cultures. Barclays and Lloyds are members of the big four retail banks in the UK; TSB is a spinout from Lloyds, which was re-created as a separate company in 2014; Santander is now the UK's fifth largest retail bank following a series of acquisitions including Abbey National, Alliance and Leicester, and Bradford and Bingley which it bought following its nationalisation in 2008; Hoare is a small unlimited liability private bank which has existed since 1672.

Barclays, narrowly, managed to avoid participating in the nationalisation of major national banks, which occurred in October 2008. However it has subsequently been at the centre of the LIBOR scandal during which its employees were involved in rigging a key market interest rate. Lloyds was initially well placed following the onset of the financial crisis. However, during the crisis it merged with the failing HBOS. This eventually resulted in its part nationalisation. Subsequently, Lloyds has been at the centre of the PPI miss-selling crisis and has paid out an estimated £16bn in compensation payments (around than 2/3 of the total compensation paid). TSB was created following a European Commission ruling, which ordered Lloyds to sell a share of its business as part of the State Aid approval process for the UK government's capital injection into Lloyds.[8] This has recreated a brand with a long history. Santander is a key competitor to the existing top four retail banks (HSBC, RBS, Lloyds and Barclays) and has followed an aggressive growth strategy through acquisition and through current account competition, but has also been affected crisis and its aftermath. Hoare has been a traditional private bank serving high net worth individuals for centuries. It has a distinctive ownership structure, culture and business model, and has been affected positively by the financial crisis, because it has seen its business increase, as other banking institutions have had problems.

In identifying case studies of culture change, we are concerned to identify cases where the nature of the activity put in place by the bank is to do with changing behaviour and practice of individuals, rather than merely

about changing financial risk metrics (as these have been the concern of banking regulators). As we highlighted in our review of the literature, the analysis of the crisis identifies significant cultural failings in UK banking which needed to be addressed. With each bank, from which we present case studies, we begin by discussing some of their particular history through the crisis and the background to the three case studies we present. The selected case studies are a combination of suggestions from the bank concerned and our own choices. The final selected case studies are all ones highlighted publicly by the banks concerned and hence to the extent that they may not address the root of the cultural problems in banking they are all the more revealing. Our research experience has been that to follow through a positive story throws up enough information to enable the researcher to analyse and evaluate in a critical manner what organisations are doing.

For each of the cases, we have considered the impact of the crisis on banks concerned and any official criticism that they received. We have also looked at the published material in their annual reports, websites and CEO/Chair speeches/statements on how they have responded.

In identifying the cases of corporate culture change, we have sought to identify strategic or value management changes, which have been salient and/or successful. Our motivating example of this, which we mentioned to our interviewees, might be a case study around how the attitudes and practices of a particular sales team were altered (by re-training, reorganisation or pay arrangement changes). We have sought to corroborate claims about how attitudes have been changed with evidence provided by the bank or publicly. We have also considered newspaper comment and the views of third parties we have interviewed. All interviews have been carried out under the Chatham House rule, subject to us being allowed to identify the bank concerned.

4. Barclays

Barclays is a universal bank with a long and distinguished history in the UK dating back to 1690. It has a significant international presence in the US. It has a large and successful investment bank (Barclays Capital) and a strong retail business. It also owns a successful UK credit card brand, Barclaycard. Barclays was not initially at the centre of the financial crisis. It managed to avoid a UK government bailout in October 2008, by pre-emptively selling one third of its shares to a Qatar-based investment company, backed by the Qatar government. This move avoided it having significant input from the UK Treasury. Subsequently in 2012, Barclays was revealed to be at the heart of the LIBOR scandal. This is involved the trader manipulation, at the investment bank, of a key inter-bank interest rate against which many loans are priced, to the benefit of bank profits. In 2012 it was fined $360m in the US and £59.5m in the UK: both the Chair of the Board and the Chief Executive were forced to resign over the scandal. The incoming chief executive, Anthony Jenkins, vowed to change the culture of the bank and introduced a new code of values in January 2013.

We look at three case studies of culture change at Barclays which go to the heart of the bank's response to the financial crisis and its aftermath. These are: the comprehensive independent review of the bank that it commissioned from Anthony Salz, following the LIBOR scandal; the introduction of a new training programme, the Compliance Career Academy (CCA); and the new corporate values championed by CEO Anthony Jenkins. The three case studies are related to each other, as we shall see.

Salz Review

In July 2012 the board of Barclays commissioned Sir Anthony Salz to do an 'independent external Review of its business practices'.[9] The mandate was 'to determine how Barclays can rebuild trust and develop business practices that make it a leader, not only among its banking peers, but also among multinational corporates more generally.' [10] The report is an impressive document based on 600 interviews, which comprehensively reviews the business practices of Barclays and makes 34 major recommendations, over 244 pages, for how to rebuild its reputation.[11] The report took around a year to write. The report was commissioned following the departure of the CEO Bob Diamond in the wake of the LIBOR scandal, but continued under the incoming CEO Antony Jenkins.

‘The 34 recommendations are grouped into 5 key themes:

1. Setting high standards and transparently monitoring progress;
2. Enhancing the Board for greater effectiveness;
3. A new culture and set of values;
4. Cultivating strong, values-driven, appropriately incentivised staff;
5. Risk culture, framework and control functions.’

For example, **‘Recommendation 4: Bringing the values to life**

> Barclays should institute learning programmes which actively encourage frequent discussion of its chosen values among all staff, focusing on understanding potential conflicts and how to address them. These discussions should be tailored so as to be relevant to the work of individual staff members. To make Barclays’ commitment tangible to staff, senior management should lead and attend as many of these sessions as is practical. ‘ (p.94)

This recommendation has motivated the setting up the Compliance Career Academy (CCA) training programme for compliance function staff, which we discuss in the next case study.

The recommendations were progressed within the company via 11 separate programmes with clear lines of accountability as to who was responsible for taking forward action on implementing changes. The formal implementation of the Salz recommendations was completed by the end 2015 (with a closure pack and consultation with Sir Anthony). Thus the project has been moved to business as usual. However it is recognised that many of them will take years to be fully achieved and that there is a need for further embedding and observation over time. Each Salz sub-recommendation has been assigned to a business owner and a Corporate Relations (CR) executive committee (ExCo) representative, and is reviewed at the CR ExCo meetings each quarter.

Key parts of the response to Salz are the Enterprise Risk Management Framework, board oversight of progress against recommendations, internal and external reviews of progress with the embedding of culture among staff, changes to pay structures, quarterly monitoring of the balanced scorecard, monitoring of compliance with 'the spirit of law' is done in consultation with industry regulators.

The Salz Review is a root and branch examination of the business practices at Barclays. It cost a reported £17m and has been taken extremely seriously the company.[12] Some commentators have been sceptical about the extent to which its recommendations can led to deep cultural change, however analytically correct.[13] However as the review points out, the literature on culture change supports the view that learning about the need to change and how change is possible is an essential element of any successful change.[14]

Compliance Career Academy

The Compliance Career Academy (CCA) is a training programme that seeks to develop the technical, behavioural and experiential skills of those working in the regulatory compliance function of Barclays. Regulatory compliance failures have been seen as one of the key areas of weakness in UK banking in the run up to the financial crisis, both in terms of the failure of banking compliance to highlight the risks the banks were running and/or the failure of internal concerns about risk being to be taken seriously (as exemplified by HBOS, above). Those working in the compliance function are responsible for working with the business units of Barclays on ensuring that their plans for products, customers and markets are compliant and, for negotiating how businesses might adapt their plans to make them compliant, if initially not.

The CCA is an ambitious training programme aimed at three levels:
Level 1 –The Barclays/Cambridge Certificate in Compliance for Analysts and Graduates
This is a basic course on understanding the role of the compliance function, aimed at more junior staff. This covers around 400 staff.
Level 2 – Cutting-Edge Compliance – targeted at Assistant Vice Presidents-Directors
This is aimed at building excellence as trusted advisors to the business units. This covers around 1100 staff.
Level 3 – Leading Compliance – targeted at Managing Directors

This is aimed at encouraging ‘senior leaders to act as industry thought leaders that will stimulate and provoke broader thinking for the wider firm and the industry as a whole’. This covers around 35-40 staff.

In 2015, the CCA delivered 45,000 hours of training to 1,567 Compliance and Financial Crime employees globally. A key objective is to ‘develop courageous and values-led Compliance professionals who take a leading role in building the organisational culture as directed by the Group ExCo’ and the aim is be ‘a role model for Compliance across the Industry and put Barclays at the leading edge in the development of world class Compliance talent’. Prior to the introduction of the CCA, it was easy for the compliance function to just say no to new business while now the training encourages compliance staff to look at how they can say yes to new business provided it is done in the right way.

The Level 1 programme consists of 8 modules, with 2-3 days of training per module, leading to a certificate after 2 years. University of Cambridge faculty, based at the Judge Business School’s Centre for Compliance and Trust, and Barclays managers deliver the training.[15] By mid-2016 around 16 cohorts (of 20-30 people each) have started the programme and some are finishing. Four of the modules are technical and four are based on developing soft skills. The programme has attracted the (positive) attention of regulators such as the Federal Reserve of New York, who have observed the scale and ambition of the programme, where a central objective is to encourage ‘brave and open’ conversations about any risk management concerns. Level 2 training consists of 2 large summits per year and Level 3 training consists 2 meetings per year.

The participants have given the quality of the training very high scores. In the last three years staff turnover in the compliance function has dropped from 36% per year to 18% and this an indication of increased job satisfaction, conditioned by better training. The aim is to put all existing staff through the programme, followed by on-going training and then to continue to put new staff through Level 1 training. Before the implementation of the CCA training was less systematic and ‘more technical’.

Corporate Values

Following the appointment of Antony Jenkins as CEO in August 2012, he made a very public commitment to change the corporate culture of Barclays, beginning with a TRANSFORM programme in 2012, which led to a new set of values being launched in January 2013.

'There might be some who don't feel they can fully buy into an approach which so squarely links performance to the upholding of our values. My message to those people is simple: Barclays is not the place for you. The rules have changed. You won't feel comfortable at Barclays and, to be frank, we won't feel comfortable with you as colleagues.' (Antony Jenkins, address to all staff on 17th Jan 2013)[16]

'For the past 30 years, banking has been progressively too aggressive, too focused on the short term, too disconnected from the needs of our customers and clients, and wider society and we lost our way.' (Antony Jenkins, Barclays Annual Report 2012, p.9)

The Barclays Way outlines its core values:

- 'Respect signifies valuing those we work with – our colleagues and other stakeholders.
- Integrity demands that we act honestly, ethically and fairly.
- Service means ensuring our customers and clients are always uppermost in our minds.
- Excellence calls on us to use all our energy, skills and resources to deliver great service and outstanding sustainable results.
- Stewardship is about being determined to leave things better than we found them.'[17]

These values are currently prominently displayed in the atrium of its head office in London. A key part of Antony Jenkins programme for change was the use of a _'Balanced Scorecard': 'Barclays measures performance today not just on the basis of what we deliver but now also on how we deliver.' [18] Based on the '5 Cs': Customer & Client, Colleagues, Citizenship, Conduct, Company. [19] And the company emphasises: 'Helping People Achieve their Ambitions: In the Right Way'.[20] Good behaviours are spelled out in the Barclays Way,[21] while 'Reputational, Operational and Conduct Risk all part of overall risk assessment'.[22] The balanced scorecard approach has led the company to consider its global investments, and was possibly an influence in its recent decision to sell its African business.[23]

The Board's Reputation Committee was established in 2013 oversees the cultural change programme, made up of non-executive directors. Their oversight consists of regular 'deep dives' with the heads of individual businesses in order to assess progress on cultural transformation. The Executive Committee is responsible for execution in the context of the Salz Review recommendations. The process was supported by a cultural change programme, which all the 140,000 staff went through a cultural values programme, with 11 workstreams. The progamme in part covered governance risk and control and the chosen values (5Cs), with 1000 value champions being created. Chosen values are customer, client, colleague, citizenship, company and conduct (5 Cs). As part of the Barclays Way process, the Barclays Lens was introduced. This is an assessment tool, which tests whether 'we are taking 'stewardship' seriously and acting as a force for good'.[24]

The tool is based around five questions, the last of which is:
'Is this the right thing to do? (acid test):

- Does it reflect the Purpose and Values of Barclays, and is it consistent with the Barclays Way?
- Would I want someone to act like this on my behalf?
- Would you be comfortable seeing this decision/action on the front page of a newspaper?'[25]

This is now integrated into the staff Performance Management Framework for all staff. One indication of the general change in culture is the use of the internal 'Speak up' hotline. This gets around 700 calls per year, of which 400 are about bad language at work and 200 about questionable business behaviours. However, there is a recognition that the process of cultural change will take time.

As a footnote to this, Antony Jenkins was subsequently sacked as CEO in July 2015. Press comment at the time noted the conflict between the values that he had promoted (earning him the nickname: 'Saint Antony') and the need for profits at the bank (which went down between 2013 and 2015)[26], suggested that this put culture change in Barclays at risk.[27] However his policies do remain in force under the current CEO.

5. Lloyds

Lloyds (LBG) is the largest retail bank in the UK with a large share of customer accounts. This has come about following its merger with the failing HBOS at the height of the financial crisis. The then Lloyds-TSB confirmed its merger with HBOS on September 18, 2008. As we have noted this drew the previously conservative Lloyds into the financial crisis and necessitated its participation in the government nationalisation of UK banks in October 2008. This saw the government take a 43.4% share in Lloyds, reduced to less than 9% (as of mid 2016) as a result of subsequent sales. Since the financial crisis however, Lloyds has been at the centre of the Payment Protection Insurance (PPI) scandal (from 2008), which involved many buyers of loans being cross-sold insurance against being unable to make their loan repayments. PPI has been revealed to be a massively overpriced product, which in many cases clients did not know they were being sold within a bundled - PPI and loan - product. This has resulted in repayments of PPI premiums to customers who have lodged claims for miss-selling. Although many other banks also miss-sold PPI Lloyds has paid out by far the largest share of claims.

We examine three cases of culture change from Lloyds. These are Lloyds championing of banking competition in the area of current account switching; its attitude of contrition following the financial crisis, which opened it up to the large amounts of PPI claims; and how it is targeting reducing the number of customer complaints (not including PPI).

Promotion of Banking Competition

Lloyds have come under pressure since the HBOS merger to be seen to be promoting competition. This has been highlighted by the Independent Commission on Banking (established in June 2010) and the CMA inquiry into retail banking that began in 2013. This put Lloyds (and other major banks) under spotlight and raised the spectre of Lloyds being broken up (Lloyds did have to spin out TSB, discussed in the next section). Lloyds has chosen to respond with a pro-competition approach to current accounts, championing improvements to the ease of switching current accounts. Switching current accounts is currently very low with less than 3% of current accounts being switched each year (much lower than for other comparable retail products)[28]. Traditionally one of the barriers to switching was the time it took to complete the switching process from one bank to another. This involves issuing instructions for all standing orders and direct debits to be switched to the new bank account and the issuing of a new chequebook and bankcard. Switching is a collective

issue, because all banks need to participate in an easy switching system, in order to allow it to be fast, error free and hassle free from the point of view of the customer.

Lloyds told us that they have pushed an effective switching system for the customer with the regulator and other banks. For them this has been part of their response to the financial crisis. It has allowed them to justify their leading market share (because their customers are free to switch easily) and provides market discipline on their customer service. They explained to us how they managed to work out how switching could be undertaken in 7 days in a way which avoids an expensive shared switching infrastructure (such as a 'portable' customer account number which was estimated to cost £8bn).

The final system (now implemented) has cost the banking sector a few hundred million pounds. It was devised by the bank's competition and payments team. The problem was that some direct debits can take up to 13 months to be changed, visibly delaying the switching process. The switching system, devised by Lloyds, allowed complete account switching in 7 days by a clever 'cheat': keeping the original account open for a period and redirecting any remaining un-switched transactions in real time to the new account. The customer would not need to be aware that the old account was still open. The running cost of system is only around £10m for the whole banking system (or around £5 per switch). Lloyds now expects on-line bank account opening and switching in 2-3 years, and an end to a business model that relies on customer inertia to be profitable (e.g. by offering much worse service to loyal customers and using attractive offers just to hook new customers). One reason for the current inertia in willingness to switch is based on the mistaken belief that switching banks will worsen how that the bank might treat you in get into difficulties and are a new customer. Once this is better understood by customers, competition is likely to increase.

Attitude of Contrition on PPI

The CEO Eric Daniels, speaking the UK Parliamentary Commission on Banking admitted that even though he had introduced a balanced scorecard approach in 2001: 'this was not effective in preventing widespread miss-selling of PPI by Lloyds.' [29] Lloyds also told the Commission: 'LBG believes it is essential to learn from the PPI experience and to make meaningful and lasting changes that will benefit both firms and consumers.' [30] It was acknowledged by several of our interviewees that the importing a US sales culture into financial services

in the UK, notably at Lloyds, was what created the pre-conditions for the PPI scandal.

Lloyds have since taken the lead on the response to the PPI crisis. The bank was involved in a joint legal case brought by the British Bankers Association (BBA) against the FSA[31], before the high court defending the industry against liability for PPI claims. The banks lost in April 2011. Lloyds was then faced with a choice: either pursue the case up to the Supreme Court or drop it and concede defeat. There was still a good chance that the Supreme Court would have ruled in the banks favour, because the banks had already won under similar circumstances at the Supreme Court over the fairness of overdraft charges. Lloyds chose to withdraw in the face of overwhelming public annoyance with banks and due to a desire to draw a line under the PPI saga, which it had played a prominent part in. The result of Lloyds' (and Barclays) withdrawl was that the joint action could not proceed and was dropped by the BBA.[32]

It was Daniels' successor as CEO (Antonio Horta-Osorio) calculation in 2011, that this was the right thing to do, and he received a lot of positive publicity from taking such a stance, and publicly stating that the bank had to change in order to restore trust. The Chair of the Board said in 2014: 'I see increasing evidence that we are returning to the qualities that historically made our bank a pillar of local communities, applying these qualities to meet the changing demands of our customers.'[33]

The 2015 Annual Report, for instance emphasises: 'the Group's commitment to rebuilding trust and changing our culture to ensure that colleagues are empowered, inspired and incentivised to do the right thing for customers, particularly when it comes to dealing with, and learning from, mistakes of the past.'[34]

The decision not to challenge the PPI ruling may have been a costly one. It is by no means clear that if the bank had understood the size of the final PPI claims bill, it would have made the decision it did. PPI claims went on to be consistently upheld individually by the Financial Ombudsman Scheme, the full value of the premium (not the value of the economic loss, which was much less) being repaid with 8% compound interest. This was because the onus was on the bank to prove it had not miss-sold the insurance, which in the absence of proper documentation it could not do. The result being payment of more than £24bn to customers since 2011[35]. The Financial Conduct Authority has so far failed in its stated intention to draw a line under PPI claims (as of mid 2016), by putting a time limit on claims. However the need for change at Lloyds continues to be publicly

acknowledged. In an interview in 2014 the head of Lloyds retail banking operation acknowledged the folly of past PPI sales incentives: 'It was the management teams that were around in the 2000s that would have developed those schemes'[36]

Targeting of Customer Complaints

Linked to PPI scandal, there has been a recognition at Lloyds that customer service was poor. This has led to a focus on dealing with the underlying causes of customer complaints. This was seen to be particularly important because the dealing of customer complaints is a key component of conduct risk management. As the bank states: 'Conduct risk affects all aspects of the Group's operations, all types of customers and other stakeholders. The Group faces significant conduct risks, for example, through products or services not meeting the needs of its customers; sales processes resulting in poor advice; failure to deal with a customer's complaint effectively where the Group has got something wrong and not met customer expectations; or engaging in conduct which disrupts the fair and effective operation of a market in which it is active.'[37]

Complaints became an issue, when complaints to the FCA rose, after the PPI scandal broke to 1.9 per thousand customers, compared to a benchmark of 1.0. The bank targeted getting this measure (excluding PPI complaints) down by 50% in three years. It did this by setting up a specialist team to target hitting the glide path of getting complaints down.

The bank acknowledged before Parliament in 2012: 'the need for more detailed root-cause analysis of customer complaints to help us detect issues earlier'.[38] The root-cause analysis undertaken as part of the targeting of complaints reduction highlighted: 'a lot of simple stuff'. The root cause analysis of complaints identifies particular actions that could be changed in order to reduce the common cause of certain complaints. As the bank reported to parliament: 'careful root-cause analysis has allowed a steadily improving complaints ratio (FSA reportable) which, ex-PPI, has fallen from 121,906 in the first half of 2011 to 96,276 in the first half of 2012, a reduction of 21%'.[39] The three-year were targets were achieved and were reported to be 50% below those of their major bank peers in 2015[40] - though recently complaints have begun to rise as the issue of packaged current accounts has surfaced (these involve a monthly current account fee in return for various add-on insurance and other products). One highlighted action taken was to approach the Financial

Ombudsman Scheme and ask them to send certain types of complaints back for the bank to deal with.[41]

TSB

Trustee Savings Banks (TSB) had a long and distinguished history in UK banking beginning in 1810. It was merged into Lloyds in 1995 to form Lloyds-TSB. In 2013, Lloyds was forced to create a new challenger bank as part of a competition judgement (from the European Commission). This judgement specified that it had to sell at least 600 branches as a result its acquisition of HBOS and resulting State Aid from the UK Government. The branches had to be within 2 miles of 46% of the UK population. The bank began its new life with a 4.2% market share and 4.5m customers. The branches were not necessarily the original TSB branches, but the new bank, has reconnected with the culture of the TSB original founders in Scotland.

The bank launched on high streets across Britain on 9th September 2013 (with 632 branches) and undertook an IPO in June 2014. The listed bank was acquired by the Spanish bank, Sabadell, in June 2015. As the bank says of itself: ‘ TSB was created to further competition in the UK retail banking market and will seek to do so through providing a different and better kind of service to its customers’[42]. It has ‘to be responsible, transparent, collaborative, straightforward and pioneering.’[43] Competition and culture change go together for TSB. As its founding CEO, Paul Pester, puts it: “It’s only by bringing real competition to our market that we will fix the culture. And it’s only by fixing the culture that we’ll fix trust.”[44] The attempt at being culturally distinctive is all the more necessary because TSB continues to depend on Lloyds for much of its IT systems, making it difficult to be technologically innovative, relative to other banks.

A good example of the impact that culture change has had at TSB is given in a recent court judgement on a wrongful dismissal case against a former employee, with the Judge in the case commenting: ‘I accept that the claimant found the change in culture difficult and the impact on her was particularly acute. She had been a very high performer under the previous hard sell regime and had been valued and rewarded for her efforts both financially and with recognition and praise…However, I accept that the respondent [TSB] had a genuine desire to change the culture and it was not unreasonable for an organisation that was striving to create a different culture and to be seen as focused on customer service

to take a firm line with those who it believed would not work within that culture.'[45]

We discuss three case studies of culture change at TSB. These are its Rewards Policy (as illustrated by the above quote); its model of making all employees 'Partners'; and its internal communications strategy.

Rewards Policy

A key way the new bank has set out to be distinctive is with its remuneration policy. This contrasts with Lloyds, which, as we noted, had been relatively slow to adjust its rewards packages, especially with respect to branch sales targets. At the time of TSB's creation it was still possible to earn more than 100% of base salary in bonuses, against daily sales targets posted on white boards in branches. A key reason for the changes outlined below was that the way staff were paid was given by 70% of customers surveyed with the question 'What do you most like/dislike about banks?', as given in customer surveys.

Central to its' rewards strategy was the elimination of all front line sales incentives and the move towards a more general TSB Award for all staff, including executives. The TSB Award is a single rate of bonus, which has involved much less dependence of total remuneration for frontline staff on discretionary awards. The annual TSB Award is determined via a three step process[46]. First, this involves 'Gateway tests' of corporate profitability and risk management. Second, an overall corporate performance assessment focused on achievement of key customer service metrics determines the 'core' award (above base pay award) between 0 and 15% (with a 10% award for being on target). And third, an individual performance assessment ensures individual minimum performance standards are achieved and can double the 'core' award to 30% for exceptional performance.[47] The calculation of the 'core' award is open to objective verification by independent review, and published information permits employees to see progress against targets set during the year.

In addition to the TSB award there is also a 'Sustainable Performance Award' (SPA) for senior executives (around 150 employees), which can be 0 to 100% of basic salary (with, for example, a target award of 62.5% of basic salary for Executive Committee members).[48] The criteria for this award are similar to the TSB award, though they also include a target related to 'the management of operating costs'. This is a long-term incentive payment, which is paid over five years to the extent continuing "underpin" performance metrics are achieved, starting one year from the

date of the award, paid out of a declared pool. This contrasts with bonus payments of up to 200% at Lloyds.

There is also currently an additional individual Sabadell Integration Award for a small number of key executives (from 2015) to support the integration process of TSB with its Spanish owner. The award, for 2015, will be paid 50% in 2016 and 50% in 2017 but only to the extent that corporate targets relating to the integration are met.[49]

The new rewards approach was worked through intensively in 2014, via discussions with the staff unions. Base salaries did go up for some partners as bonus opportunity was reduced and there were individual discussions with some employees to deal with particular concerns. Base salaries did not go up 1 for 1, reflecting that base pay increases were more valuable than uncertain bonus payments.

The new reward structure can be contrasted with the one it inherited from Lloyds where staff could earn 40% of base salary against quarterly sales incentives. There is now a feeling in the organisation that the pay structure balances competitive reward with the positive culture of the bank. Customers seem to be responding with improvements in the bank's 'net promoter score' (an indexed score which gauges customers response to the question 'On a scale of 1-10, how willing would you be to recommend your bank to family and friends?'), which is monitored every month.

Partnership model

In 2015 the company introduced a new partnership model, which saw all of its employees become partners. This model is unique amongst major banks in the UK. The aim was to create an: 'engaged workforce of shareholding Partners'.[50] As the CEO goes on to say: 'We believe TSB's Partners will be the single greatest difference between TSB and other banks. Our successes in 2014 are a direct result of their ability, commitment, collaboration and belief in what we are seeking to achieve at TSB.'[51]

In practical terms every Partner was given £100 of TSB shares (to create the feeling of common ownership in the business) and encouraged 'to play an active role in shaping the Group's business and strategy'.[52] Partnership and the rewards structure are linked and in order to participate in the TSB Award staff had to retain their £100 of shares.[53] In addition to the shares partners were given a badge and a certificate of

partnership. The partnership model has continued with the Sabadell takeover although the £100 in "partnership shares" has not, given that TSB is no longer a listed company. Sabadell have been very interested in the corporate culture that its TSB brand is trying to create.

Partnership has helped with negotiations on changing working practices. The example that was given was when the night shift at the call centre in Sunderland needed to be changed. This required sensitive negotiations with the 24 staff affected in order to redeploy most of them and minimise redundancies. TSB has been monitoring staff satisfaction with a regular Partner Experience Survey and the feedback from staff about the new employee model is very positive, in line with good Customer Experience Survey results.

Internal Communications Strategy

As a complement to the Partnership model the company has attempted to develop its internal communications with its staff. It has worked hard on fostering two-way communications. Beginning in 2014 it introduced a Partner forum, 'The Link'. This 'forum of Partners across all levels, was established to gather and build on Partner feedback and enables meaningful dialogue between Partners and the Executive leadership.'[54] 'There are five regional Link Groups covering Britain, which together contain 101 Partners drawn from every part of our business. The outputs from every meeting are presented to the Executive Committee to help inform the Group's activity and strategic outlook.'[55] These regional Link Groups are spread across the country (Edinburgh, Sunderland, Birmingham, London and Gloucester) and consist of Partners in different parts of the business and of different seniority, who meet face to face 6 times per year to offer 'open feedback' with the aim to '[g]et under the skin of the major topics in our business'[56].

In addition the CEO is seen to be at the front of the business. Twice a month he conducts a live dial in. He speaks for 5-10 minutes on what he is doing and why it is important and then opens it up for live questions on the phone line. He gets straightforward questions and aims to give straightforward answers: for example, he has had to justify his own pay package. He has also taken advance feedback from the Link Groups on the annual report. He also fronts staff videos, such as those explaining the annual results.

Internal communications, media relations and community relations are combined at TSB, with the aim of 'authenticity'. TSB tries to be 'more conversational and less organisational' in its tone and 'inject friendly humour', in keeping with its aim to bring 'local banking' back to Britain, which is focussed on the customer, but organised in a different way. In doing so it aims to create 'a sense of belonging'. It wants its staff to know that good communication is a distinguishing characteristic of TSB.

6. Santander

Santander is a significant new bank in the UK following a series of mergers of medium sized banks. It is well regarded by its employees[57] and has a reputation as a formidable competitor to the big four retail banks in the UK. Santander did benefit from the crisis, acquiring distressed sales of Alliance and Leicester (on 16 September 2008) and Bradford Bingley (on 29 September 2008). Santander UK is wholly owned by its Spanish parent company. The company had a significant challenge in integrating the new businesses it acquired in the crisis. This required the creation of uniformity on the front line, in the product range and in the back office.

Initially, the bank defended performance-related incentives but later modified its approach and moved away from volume sales incentives at the branch level.[58] The bank has ambitious retail objectives and aims 'to become the best bank for all our stakeholders'[59] as discussed below.

Our three case studies start with its simpler products policy based on its 1|2|3 products. We then examine the framework for embedding its values known as 'The Compass'. We conclude with its employee risk management programme 'I AM Risk'.

1|2|3 Products policy

Santander UK has been recognized as a disruptive competitor among the major UK banks. It has actively sought to acquire new current accounts from existing banks with attractive product offerings. A key strategy for this has been its 1|2|3 products, which were launched in September 2011 with the 1|2|3 credit card, offering 1%, 2% and 3% cashback on various purchases. The 1|2|3 current account was launched in March 2012 offering tiered cashback on certain household bills and tiered credit interest (at rates of 1%, 2% and 3%).[60] These products aimed to be simple to understand and were, in part, a response to previous negative customer experiences at Santander.[61]

The policy of simpler product offerings is in line with its corporate values statement: *The Santander Way*, issued in 2013.[62] As the company has said: 'At the core of its transformation has been a programme to change its culture, so that all we do is Simple, Personal and Fair.'[63] As the bank points out: 'Simplification of our retail product range, which has helped customers and staff understand and take better advantage of our products.'[64] This has involved a smaller number of products and services and simplification of the sales process, with a view to enhancing customer experience.[65]

In line with the simpler products offering, Santander has strengthened its approval process for new products by 'establishing a Product Approval and Oversight Committee (PAOC), which is chaired by the Chief Financial Officer (CFO) and comprises senior representatives from all key functions in the organisation.'[66] It has a 'particular focus on guaranteeing that any new product or service sold achieves the right customer outcomes.'[67]

The 1|2|3 products 'are transparent, simple to understand, and offer genuine benefits to our customers through cash-back and market-leading interest rates on the current account.'[68] The data indicates that it has been successful in attracting new customers since the crisis. The bank reports that: 'In the first half of 2012, over 800,000 1|2|3 credit cards and current accounts were opened, 150,000 of which switched from other banks.'[69]

'The Compass'

'The Compass' was launched in 2014. This is outlined in the 2014 annual report (pages 6 and 7). The bank says that : 'It helps track our progress against our strategic priorities and the aim of meeting the expectations of our main stakeholders.'[70]

The compass on the first of its two pages[71], consists of four quadrants (representing its 4 key stakeholders): Communities, People, Shareholders and Customers. It outlines three objectives per quadrant. The compass is pointing at an overall aim, which is 'To become the best bank for all our stakeholders'. At its centre it has the bank's values 'Simple, Personal, Fair'. These are also explained beneath the compass. For the Customers quadrant the three objectives are: 'New customers put their trust in us'; 'Customers get the best experience'; and 'Customers reward us with their loyalty'.

The second page[72], explaining 'The Compass', is headlined by the statement: 'Our business model creates value for our people, our customers, our shareholders and our communities.' For each of the stakeholders in the four quadrants, there is a statement of what value is created for them and how this is done. Thus for customers value is created when 'We meet our customers' developing needs, by offering a reliable relationship that gives them confidence and control over their finances and wide-ranging access to credit and savings.' This is done when: 'We provide excellent customer service, products with ongoing value and minimal small print, and easy access via our website, mobile apps and modern digitally enhanced branches. For corporates, we offer a broad range of tailored products and services through our network and leading IT capability.'

The Compass framework was communicated to staff via a series of senior executive roadshows, communication packs and newsletters. The bank reports that in May 2014 the staff were given the opportunity to make suggestions on how to improve the bank in line with its values. This resulted in 650 suggestions across the Compass quadrants.[73]

'I AM Risk' programme

In order to help embed its new risk culture, within the context of 'The Santander Way' the bank launched the 'I AM Risk' programme in 2015. The idea was to align the framework for dealing with risk with the Santander 'values of being Simple, Personal and Fair.'[74] The programme helps manage the risks arising from employee conduct with respect to: 'products and services not meeting our customers' needs; failing to deal with complaints effectively; and the risk that we sell our customers unsuitable products or we do not give them the right information to make informed decisions.'[75]

The bank expects all of its employees to take 'personal responsibility for managing risk by doing our part to:

- Identify risks and opportunities
- Assess their probability and impact
- Manage the risks and suggest alternatives
- Report, challenge, review, learn and speak up'.[76]

The programme helps 'ensure that every business area is accountable for the management of the risks arising from their activities.'[77] It is meant to be a 'part of everyone's life as a Santander employee, from how we recruit them and manage their performance to how we develop and reward them.'[78]

In 2015 this involved:

- 'Reinforced I AM Risk messages through enhanced communication, education and training at all levels
- Embedded risk management across the whole employee life-cycle, including our recruitment practices
- Increased and promoted our range of escalation channels
- Updated the mandatory risk objectives for all our people including our Executive Committee
- Measured change through a range of measures including 'speaking up' escalation channels, surveys and mandatory training completion rates
- Improved how we identify and manage risk in our change and strategic planning processes.'[79]

7. C Hoare & Co.

C Hoare & Co. is one of the oldest private banks in the City of London, having been founded in 1672 by Sir Richard Hoare. It is still family owned and 8 family partners (5 of whom are directors) share unlimited liability in respect of the bank's operations.[80] The bank has had many distinguished clients in its history, including Samuel Pepys, Lord Byron and Jane Austen. The bank is small with total assets of around £3.6bn in 2015[81] (a fraction of all the other banks we discuss) and has just two branches in the centre of London. The bank is very conservative in its choice of clients, its lending policy and its dividend distribution policy. The bank has had a good financial crisis (it also had a good South Sea Bubble in 1720!). Between 2005 and 2015 total assets have trebled, while funds under management have increased by a factor of six and profits have increased by a factor of four.[82] This is partly because the bank was 'a safe port in the storm'[83], this allowed it to pick up 'several hundred'[84] new customers. Its capital base has increased from £75m to £250m. The bank loans only 40% of its deposits and has 20% of its asset base on deposit at the Bank of England. Its return on capital over this period has exceeded that all of the major banks in the UK by some margin.

For our three Hoare case studies, we don't focus on cultural change following the crisis, but on the essence of the bank's culture and how it has been maintained and reinforced by the financial crisis. We examine how the bank sustains its core values and culture; its approach to customers and emphasis on client care; and its resourcing and focus on quality business growth. These three are intimately related.

Sustaining values and culture

The Bank's values are 'empathy, social responsibility, honesty and excellence'.[85] The Bank states that it 'continues to focus on conducting business in a manner consistent with its long held core values, prioritising customer service and safety, while ensuring that sufficient profits are retained to maintain a capital base at least in line with expected future requirements.'[86] We unpack what the focus on customer service and on financial safety further in the two subsequent case studies.

In a recent newspaper interview the current Hoare CEO, Jeremy Marshall (not a family member or partner), said: 'Hoare has strong Christian roots too and our core defining motto at the bank is to treat our customers as we would wish to be treated. That's an extension of the Christian principle.'[87]

Hoare's values are deeply embedded. Actions that are taken have to be consistent with the long-held values. A key part of embedding the values deep in the organization is that the small scale of the bank means that the partners' values are easily transferred to front line staff. This is in contrast to a large bank, where corporate values set at the company level, had to pass to the business level and then down to the branch level, increasing the likelihood that they are lost on the way.

Hoare gives a significant part of its annual profits to its Green Bottle charity (in 2015 this amounted to 6.4% of after tax profits)[88], supporting social projects such as a prison project in Peterborough. This donation is much more than the partners take out of the business in dividends.

Customers and emphasis on client care

One of the defining characteristics of the financial crisis has been the way banks abused their position of trust with their clients in the run up to financial crisis. This involved a significant emphasis on cross-selling products to current account holders and to small business clients. There was also a significant attempt to expand the number of bank clients by extending loans and mortgages to customers who previously would not have been considered credit-worthy (the was a significant part of the undoing of Northern Rock and HBOS). By contrast Hoare's approach to its clients is rather different. As the CEO put it in an interview: 'We are deliberately boring, deliberately small and we are a public utility. We put the customer first, and not ourselves. Banking should be socially useful.'[89]

Hoare operates a target number of customers of 10,000 or around 1,000 per partner. In this way a partner is able to 'know' each of their customers. This limit on customer numbers allows Hoare to maintain both the credit quality of its, generally, high net worth customers and the quality of its customer service. The bank is deliberately choosy about its customers, but as the CEO says: 'We don't have any hard and fast limits on whom we choose or how much people have to earn or own to become customers. Take the example of a young entrepreneur who has a big stake in a business but doesn't have much money now. If we like the look of him or her, then we might take them on.'[90] The financial crisis has allowed it to improve the quality of its customers as new high quality customers have been allowed to replace some less good ones.[91]

Hoare's guiding principle on customer service, as stated in the Guide to the Bank, is: 'We treat all customers as we would wish to be treated.'[92] One practical example of this is that the bank is committed to dealing with its customers with respect, and will therefore drop customers who are rude to staff.[93]

Resourcing and directing quality business growth

The bank has a very conservative attitude to risk, in spite of the rapid growth it has experienced in recent years. It has been 'conscious of the risks inherent in the growing investment management and advisory business.'[94]

In managing its financial risk, the bank is very concerned to manage reputational risk. 'The bank's standing in the eyes of its customers, counterparties, employees and the general public is of critical importance to the Board. It is the Board's view that reputational risk arises as a consequence of other types of risk, and as such potential reputational impact is considered when any risk is assessed.'[95]

In spite of the significant increase in the size of the bank over the last 10 years, the partners continue to act very conservatively with respect to dividends. In 2015 the 8 partners shared a dividend of just £6000, on after tax profits of £23.2m. As the former CEO and partner, Alexander Hoare, comments the objective is 'to keep our business small [and] the family poor.'[96] This is in line with the bank's stated aim of 'ensuring that sufficient profits are retained to maintain a capital base at least in line with expected future requirements.'[97]

A key way that risk is managed is in the pay structures. Thus company believes that bonuses should be small ('no employee's subsistence is dependent on an annual bonus payment'[98]) and that 'individual targets are not aligned directly to bonus payments'.[99] Furthermore, '[i]n awarding an overall annual performance rating, the Bank places a higher weighting on the values and behaviours demonstrated than on the achievement of financial objectives.'[100]

8. Conclusion

Several of our interviewees commented that following the de-regulation of the City of London in 1986 (the 'Big Bang' in financial services), UK banks changed from being conservative, customer oriented, bureaucratic institutions to sales led organizations. At that point banks started to hire sales managers with experiences in other industries to sell financial products, incentivized by monthly sales bonuses. Bank branches began to have posters prominently advertising a range of financial products. The result was a wholesale change to the culture of banking, which culminated in the financial crisis, the aftermath of which is still being felt. Another interviewee commented that retail banks are fundamentally 'stock' rather than 'flow' businesses, i.e. they can only make safe returns to their stock of assets and should not have strong incentives to increase revenues by increasing their flow of business. This was in line with the fact that the run up to the financial crisis had seen an excessive focus on 'growth' rather than underlying profitability.

What has changed since the financial crisis is that banks have stopped assuming that they could focus on profit growth and that other 'hygiene factors' (such as whether their products were being sold responsibly to those who needed them) would naturally take care of themselves. This has forced banks to visibly commit to a 'balanced scorecard' approach, which explicitly measures and incentivizes reputation enhancing non-profit behaviours, via attention to client surveys, employee satisfaction and risk metrics. This has been accompanied by commitments to put customers back 'at the centre' of banking operations.

A key insight from all our banks was the need to simplify the product offerings of banks in order to make them better and easier for customers. The complexity of financial products and reward structures was a major contributor to the management problem in banks, the complexity of regulation and the scope for miss-selling. One bank gave the example of its credit card division, which since the crisis, had reduced its number of products by over 90%.

In spite of all the impressive individual initiatives that we have observed at individual banks, we did not get the impression that any of the 'problem' banks that we have looked at had fundamentally tackled the issue of pay and incentives or the 'cult' of the CEO. Major banks still pay very high salaries and huge bonuses to large numbers of staff without a clear analytical justification. The academic evidence and the experience of the last 10 years is that finely calibrated bonus schemes, of the type

that major banks still have, do not improve overall bank performance and could be replaced by much simpler, flatter pay structures. We saw no evidence that banks were using any kind of econometric analysis to back up their bonus scheme calibration.

Deferred pay was widespread, but behavioural economics [101] is particularly scathing about the effectiveness of such 'long term incentive plans' (LTIPs). These can deliver 40% of salary over 5-7 years.[102] Individuals engage in hyperbolic discounting, which means they strongly discount deferred rewards, reducing their effectiveness and massively increasing their cost to shareholders[103]. On the other hand, recent evidence suggests that paying people up front, with the threat of ex post repayment of the bonus can be extremely effective even at low claw-back rates (c.8%)[104]. Even TSB, which had deliberately cut its bonuses and introduced a core award for all staff, was somewhat disingenuously presenting this as meaning that executives were 'on the same percentage bonus' as frontline branch staff, when there were other bonuses for executives.

As one of our interviewees observed, it would require a maths degree to work out how one's individual actions translate into final income (due to the combination of group bonus, personal bonus and long term incentive plan, each assessed on multiple criteria). One bank reports that five payment elements with executive pay split 40%-8%-26%-18%-8% paid over different periods and combining fixed and variable elements.[105] If this is the case, clearly pay schemes in banking are still not fit for purpose, in spite of very well documented changes at major banks. Those of us used to being paid in overtime pay, a periodic promotion, or recognized with a certificate and an Amazon voucher, understand the outcomes of our actions. These incentives remain powerful, cost effective for the organization as whole and supported by empirical evidence.

We did detect a recognition that pay structures need to change. Another of our interviewees commented that in an organization of many thousands of employees, 'about 200' do not share the values that the bank had been trying to instill in the aftermath of the financial crisis. The problem, they observed, was that these were the best-paid (and most profitable) employees of the bank and that if their bank moved first to change the basis of their remuneration it would suffer. However the interviewee recognised that in time it was inevitable that both the nature of pay and the culture surrounding it would change. This underlined the observation that the process of culture change would take a generation and was still a work in progress.

There was also an expectation that financial services could be on the cusp of major technological change. With 80% of revenue in retail banking being generated from 20% of customers, banks remain vulnerable to attempts to target these highly profitable customers. One of our interviewers pointed out that customer expectations of banking have changed significantly as a result of the ‘Amazon effect’. Many customers want to be able to do things on line from their smart phone. They don't see why they should have to go to branch and wait for banking services or make an appointment, when they can order things off Amazon and have them delivered the same day. This is leading to banking innovation that sees banks using software to remotely recognize clients and make use of other networks (such as Uber) to collect key documents. The impact of this on the nature of bank-customer relations has yet to become clear, but the days of cross-selling in branch are numbered. This is in the context when Google and Apple have huge cash piles available for investment, which could be invested in banking, and start-up banks such as Atom Bank (which uses face recognition software for identification) have found it easy to raise capital in the market.

Notes

[1] See for example the excellent reports on the high profile failures of Royal Bank of Scotland - RBS - (FSA, 2011) and Northern Rock (House of Commons Treasury Committee, 2008).

[2] For instance, the Walker Review of corporate governance in banking (Walker, 2009).

[3] Van ‘t Klooster and Meyer (2015).

[4]Spicer et al. (2014).

[5] Where culture is defined as ‘the ideas, customs, and social behaviour of a particular people or society’ (Source: Oxford Dictionaries online).

[6] See Salz (2013, Appendix B, ‘What is Culture and How Can it Go Wrong?’).

[7] Our previous work has analysed the corporate compliance programme at SmithKline Beecham (Jones and Pollitt, 1999); the development of corporate governance in the UK following the Cadbury report (Jones and Pollitt, 2002, 2004); and the community projects of Anglo American, Vodafone, Diageo and GSK (Jones, Pollitt and Bek, 2007).

[8] See http://europa.eu/rapid/press-release_IP-09-1728_en.htm

[9] Salz (2013, p.2).

[10] Salz (2013, p.2).

[11] The Salz review set a standard, which other banks went on to recognise. Lloyds, for instance, did an analysis of its own business practices against its 34 recommendations in 2013 (see Lloyds Annual Report and Accounts 2013, pps.13 and 90)

[12] Dominic O’Connell, ‘Agenda: Bonuses push Barclays’ two tribes further apart; Speak up, Rolls-Royce’, *Sunday Times*, 16 February 2014.

[13] Christian Wuestner, ‘’Customers don't want a relationship with their bank anymore’’, *European Financials Daily*, 28 May 2013; Simon Nixon, ‘Barclays Salz Review Falls Short Where It Counts’, *Dow Jones North American Equities Stories*, 4 April 2013; Dominic O’Connell, op cit.

[14] Salz (2013, p.186-188).

[15] See 'The Professionalisation of Compliance: News from the Frontline', *Compliance Matters,* Vol.2 (1), July 2014, pp.1-3.

[16] See http://www.telegraph.co.uk/finance/newsbysector/banksandfinance/9808042/Antony-Jenkins-to-staff-adopt-new-values-or-leave-Barclays.html, which includes a copy of the memo.

[17] Barclays Annual Report 2014 p.82.

[18] Barclays Annual Report 2014, p.6.

[19] Barclays Annual Report 2014, p.6.

[20] The Barclays Way, p.7.

[21] See The Barclays Way, p.7.

[22] Barclays Annual Report 2014, p.7.

[23] See http://www.bbc.co.uk/news/business-35695601

[24] The Barclays Lens, p.2.

[25] The Barclays Lens, p.3.

[26] See Barclays Annual Reports 2013, 2015.

[27] Josh Ryan-Collins, 'Antony Jenkins' sacking from Barclays may be the death knell for banking reform', *The Guardian*, 10 July 2015.

[28] CMA (2015, p.D2-D5).

[29] Parliamentary Commission on Banking Standards (2013, p.327).

[30] http://www.publications.parliament.uk/pa/jt201314/jtselect/jtpcbs/27/27ix_we_j04.htm

[31] See http://www.moneysavingexpert.com/news/reclaim/2011/04/ppi-decision.

[32] See http://www.moneymarketing.co.uk/bba-will-not-appeal-ppi-judicial-review/

[33] Lloyds Annual Report and Accounts 2014, p.7.

[34] Lloyds Annual Report and Accounts 2015, p.82

[35] See https://www.the-fca.org.uk/consumers/payment-protection-insurance/monthly-ppi-refunds-and-compensation, Accessed 29 June 2016.

[36] Alison Brittain quoted in http://www.thisismoney.co.uk/money/markets/article-2861275/ALISON-BRITTAIN-INTERVIEW-Lloyds-banking-Britain.html (4 Dec 2014).

[37] Lloyds Annual Report and Accounts 2014 p.136

[38] http://www.publications.parliament.uk/pa/jt201314/jtselect/jtpcbs/27/27ix_we_j04.htm

[39] http://www.publications.parliament.uk/pa/jt201314/jtselect/jtpcbs/27/27ix_we_j04.htm, question 19

[40] Lloyds Annual Report and Accounts 2015, p.12.

[41] Lloyds Annual Report and Accounts 2015, p.143

[42] TSB Annual Report and Accounts 2014, p.3.

[43] TSB Annual Report and Accounts 2014, p.3.

[44] http://www.epe.admin.cam.ac.uk/man-helm-tsb-and-his-secret-banking-success

[45] http://www.mfgsolicitors.com/2016/01/27/tsb-ordered-to-pay-out-7532-to-a-former-manager-after-change-in-banking-culture/

[46] TSB Annual Report and Accounts 2014, p.72.
[47] TSB Annual Report and Accounts 2015, p.40.

[48] TSB Annual Report and Accounts 2015, p.41.

[49] TSB Annual Report and Accounts 2015, p.42.

[50] TSB Annual Report and Accounts 2014, p.7.

[51] TSB Annual Report and Accounts 2014, p.8.

[52] TSB Annual Report and Accounts 2015, p.34.

[53] TSB Annual Report and Accounts 2014, p.66.

[54] TSB Annual Report and Accounts 2014, p.36.

[55] TSB Annual Report and Accounts, 2014 p.36.

[56] Spicer et al. (2014, pp.132-33).

[57] See http://www.cipd.co.uk/pm/peoplemanagement/b/weblog/archive/2014/03/25/what-you-can-learn-from-santander.aspx, which reports an assessment of Santander based on an employer-review website.

[58] Santander UK Annual Report 2015, p.150.

[59] Santander UK Annual Report 2014, p.6.

[60] Stantander UK Annual Report 2014, p.11.

[61] See http://www.thisismoney.co.uk/money/saving/article-2231847/Whistleblowers-reveal-Santander-targets-staff-pushed-hit.html

[62] See Stantander UK Annual Report 2013, p.10.

[63] Spicer et al. (2014, p.128).

[64] Santander UK Annual Report 2015, p.38 (Risk review).

[65] Santander UK Annual Report 2015, p.154 (conduct risk review).

[66] http://www.publications.parliament.uk/pa/jt201314/jtselect/jtpcbs/27/27v_we35.htm, sec.56.

[67] http://www.publications.parliament.uk/pa/jt201314/jtselect/jtpcbs/27/27v_we35.htm, sec.56.

[68] http://www.publications.parliament.uk/pa/jt201314/jtselect/jtpcbs/27/27v_we35.htm, secs. 47-9.

[69] http://www.publications.parliament.uk/pa/jt201314/jtselect/jtpcbs/27/27v_we35.htm, secs. 47-9.

[70] Stantander UK Annual Report 2014, p.6.

[71] Stantander UK Annual Report 2014, p.6.

[72] Stantander UK Annual Report 2014, p.7.

[73] Stantander UK Annual Report 2014, p.6.

[74] Stantander UK Annual Report 2015, p.38.

[75] Stantander UK Annual Report 2015 p.40.

[76] Stantander UK Annual Report 2015 p.39.

[77] Stantander UK Annual Report 2015 p.39.

[78] Stantander UK Annual Report 2015 p.45.

[79] Stantander UK Annual Report 2015 p.45.

[80] Hoare Pillar 3 Disclosures 2015, p.7.

[81] Hoare Pillar 3 Disclosures 2015, p.24.

[82] C Hoare and Co., Annual Accounts and Consolidated Financial Statements for 2015 and Consolidated Financial Statements for 2005.

[83] CEO Jeremy Marshall, quoted in Margareta Pagano, 'The Bible-smuggler's son and the case for moral banking; C Hoare & Co's Jeremy Marshall says there is nothing bad in having lots of money if you 'don't waste it on big yachts', *Financial News*, 3 September 2014.

[84] Margareta Pagano, op.cit.

[85] Hoare Pillar 3 Disclosures 2015, p.41.

[86] Hoare Pillar 3 Disclosures 2014, p.8.

[87] Margareta Pagano, op.cit.

[88] Hoare Annual Report and Consolidated Financial Statements 2015, p.11.

[89] Margareta Pagano, op.cit.

[90] CEO Jeremy Marshall, quoted in Margareta Pagano, op.cit.

[91] http://www.barrons.com/articles/SB50001424053111904571704577407973233243382

[92] All staff are given this, see: http://www.barrons.com/articles/SB50001424053111904571704577407973233243382

[93] Margareta Pagano, op.cit.

[94] Hoare Pillar 3 Disclosures 2015, p.9.

[95] Hoare Pillar 3 Disclosures 2015, p.10

[96] http://www.barrons.com/articles/SB50001424053111904571704577407973233243382

[97] Hoare Annual Report and Consolidated Financial Statements 2014, p.4.

[98] Hoare Pillar 3 Disclosures 2014, p.44; Pillar 3 Disclosures 2015, p.43.

[99] Hoare Pillar 3 Disclosures 2014, p.44; Pillar 3 Disclosures 2015, p.43.
[100] Hoare Pillar 3 Disclosures 2014, pp.43-4; Pillar 3 Disclosures 2015, pp.44-5.

[101] See Chetty (2015) for a recent review of key lessons from behavioural economics.

[102] Lloyds Pillar 3 Report 2015, p.105.

[103] See Frederick et al. (2002) for a discussion.

[104] See Fryer et al. (2012).

[105] Lloyds Pillar 3 Report 2015, p.105.

References

Blasi, J. and Freeman, R. and Kruse, D. (2016), 'Do Broad-based Employee Ownership, Profit Sharing and Stock Options Help the Best', *British Journal of Industrial Relations,* 54 (1): 55-82.

Brummer, A. (2014), *Bad Banks: Greed, Incompetence and the Next Global Crisis*, London: Random House.

Chetty, R. (2015), 'Behavioral Economics and Public Policy: A Pragmatic Perspective', *American Economic Review: Papers & Proceedings*, 105(5): 1–33.

CMA (2015), *Retail banking market investigation: Updated issues statement Appendices*, London: Competition and Markets Authority.

Cohen, M.S. (2015), 'Governance as the driver of culture change and risk management', *Journal of Risk Management in Financial Institutions*, 8(4): 347-357.

Fallon, I. (2015), *Black Horse Ride: The Inside Story of Lloyds and the Banking Crisis,* The Robson Press.

Flint, D. (2013), *Rethinking Banking for the 21st Century,* Speech to Conservative Parliamentary China Group, House of Commons, London, 19 March 2013.

Fortado, B. and Fodel, P.A. (2014), 'The yin and yang of introducing a sales culture: the Amalgam Bank Case', *Competitiveness Review*, 24(5): 444-462.

Frank, D.H. and Obloj, T. (2014), 'Firm-specific Human Capital, Organizational Incentives and Agency Costs: Evidence from Retail Banking', *Strategic Management Journal*, 35 (9): 1279-1301.

Fraser, I. (2014), *Shredded: Inside RBS, the Bank That Broke Britain*, Edinburgh: Birlinn Limited.

Frederick, S., Loewenstein, G. and O'Donoghue, T. (2002), 'Time Discounting and Time Preference: A Critical Review'. *Journal of Economic Literature*, 40 (2): 351–401.

Fryer, R.G., Levitt, S.D., List, J. and Sadoff. S. (2012), *Enhancing the Efficacy of Teacher Incentives through Loss Aversion: A Field Experiment.* National Bureau of Economic Research Working Paper 18237.

FSA (2011), *The failure of the Royal Bank of Scotland*, London: Financial Services Authority.

House of Commons Treasury Committee (2008), *Run on the Rock*, London: Treasury Select Committee.

House of Lords/House of Commons (2013), *Parliamentary Commission on Banking Standards - Minutes of Evidence*, HL Paper 27-VIII/HC 175-VIII.

Independent Commission on Banking (2011), *Final Report Recommendations* Sept 2011, London: Independent Commission on Banking.

Jones, I.W. and Pollitt, M.G. (1999), 'From Promise to Compliance: A study of the development of an 'Integrity' value at SmithKline Beecham', *Long Range Planning,* 32(2): 190-198.

Jones, I. and Pollitt, M.G. (2002) (eds.) *Understanding how business ethics issues develop*, Basingstoke: Palgrave.

Jones, I.W. and Pollitt, M.G. (2004), Understanding How Issues in Corporate Governance Develop: Cadbury Report to Higgs Review', *Corporate Governance*, 12 (2): 162-171.

Jones, I.W., Pollitt, M. and Bek, D. (2007), *Multinationals in their communities: a social capital approach to corporate citizenship projects*. London: Palgrave Macmillan.

Lui, A. (2015), ‘Greed, Recklessness, Dishonesty: and/or dishonesty? An investigation into the culture of five UK banks between 2004 and 2009’, *Journal of Banking Regulation*, 16 (2), pp.106–129.

Martin, I. (2013), *Making it Happen: Fred Goodwin, RBS, and the men who blew up the British economy*, London: Simon and Schuster.

Moore, P. (2015), *Crash Bank Wallop: The Memoirs of The HBOS Whistleblower Paul Moore,* New Wilberforce Media Ltd.

Perman, R. (2012), *HUBRIS How HBOS Wrecked the Best Bank in Britain*, Edinburgh: Birlinn Limited.

Spicer, A., Gond, J., P. Patel, K., Lindley, D., Fleming, P., Mosonyi, S., Benoit, C. and Parker, S. (2014), *A report on the culture of British retail banking*, Cass Business School and New City Agenda.

Tett, G. (2015), *The Silo Effect: Why putting everything in its place isn’t such a bright idea*, London: Little, Brown.

Trevino, K.L., den Nieuwenboer, N.A., Kish-Gephart, J.J. (2014), ‘(Un)Ethical Behavior in Organizations’, *Ann. Rev. Psychol.,* Vol.65, pp.635-60.

van’t Klooster, J. and Meyer, M. (2015), *Ethical Banking: The Key Concepts*, mimeo.

Walker, D. (2009), *A review of corporate governance in UK banks and other financial industry entities - Final recommendations*, 26 November 2009, London: HM Treasury.

Bank Documents

Barclays Annual Report 2013

Barclays Annual Report 2014

Barclays Annual Report 2015

The Barclays Lens 2014

The Barclays Way September 2013

C Hoare and Co. Annual Report and Consolidated Accounts 2005

C Hoare and Co. Annual Report and Consolidated Accounts 2014

C Hoare and Co. Annual Report and Consolidated Accounts 2015

C Hoare and Co. Capital and Risk Management Pillar 3 Disclosures 2014

C Hoare and Co. Capital and Risk Management Pillar 3 Disclosures 2015

Lloyds Banking Group Annual Report and Accounts 2013

Lloyds Banking Group Annual Report and Accounts 2014

Lloyds Banking Group Annual Report and Accounts 2015

Lloyds Banking Group Capital and Risk Management Report 2015

Salz Review – An Independent Review of Barclays’ Business Practices April 2013

Santander UK Plc Annual Report 2013

Santander UK Plc Annual Report 2014

Santander UK Plc Annual Report 2015

TSB Annual Report and Accounts 2014

TSB Annual Report and Accounts 2015