Lingering conduct problems to test whether bank chiefs are genuine about cultural transformation

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Rachel Wolcott, Regulatory Intelligence

UK bank chief executives have arrived at a crossroads and the path they choose will test whether they are genuinely engaged in cultural transformation and fully signed up to their newly minted purpose, values and behaviour statements. It is a sensitive time for banks' nascent cultural transformation programmes, which are closely followed by regulators as well as industry analysts, investors and behavioural specialists. A recent Banking Standards Board bank culture survey shows UK banks "as a group, showed little change in 2019" with most large "banks running hard to stand still".

Missteps or failure to resolve conduct problems now will undermine claims to have transformed into customer-centric, values-driven enterprises.

"It's difficult to promote this image on the one hand of banks doing right by customer and then on the other not addressing some of the issues that led to the failings of the past. If you're championing that message you need to address the root issue. Banks are still flying the CSR banner in terms of highlighting what they're doing in communities, for example. But they are hindered by their past indiscretions. It does take awhile for culture to feed through. All banks are on a journey and customers will be a bit sceptical about whether it has changed," said Colin Jackson, a UK bank analyst at Goodbody Investment Banking in Dublin.

Most banks, particularly Barclays, Lloyds Banking Group, Royal Bank of Scotland and Virgin Money, have continuing conduct problems ranging from fraud, payment protection insurance (PPI) mis-selling, small- and medium-enterprise (SME) lending, mortgage prisoners to long-running customer disputes and class-action lawsuits.

"An organisation that has had these kinds of historic issues, until it has truly been through a cultural transformation, gotten rid of the people who are unable to transform or who intentionally did these things, how can anyone think that they've changed? An organisation that is genuinely trying to identify its values and, in the process is dealing with its skeletons, should be given the benefit of the doubt. Organisations that are just putting out PR statements developed in the boardroom claiming to have a purpose and values, but haven't done a full consultation looking at themselves, honestly I don't think that will result in profound change," said Ruth Steinholtz, an international values-based business ethics adviser and founder and managing partner of AretéWork.

The UK Financial Conduct Authority (FCA) has adopted random audits and floor walks where supervisors observe firms' cultures directly. Firms making claims about cultural transformation will need to demonstrate it. Firms failing to deal with "historical" misconduct within their new culture and values frameworks will be caught out.

"This is the what actually happens test. There are firms that doubt regulators walk the floor in the front office. There are firms where this is happening right now. Wake up. This is the way things happen now and if it hasn't happened to you, you may well be next. Regulators want to see how firms live the values they claim. Tell me the last time a junior member of your team questioned an assumption, let alone your judgement," said Roger Miles, a behavioural risk analyst.

Chief executives at a conduct crossroads

Bank chief executives face a choice in 2020. They could take actions to resolve fairly disputes and claims stemming from past misconduct. That then would set the tone for how such problems are solved in future and reinforce cultural transformation messaging. Alternatively, they could continue approaches that resulted in unfair customer redress schemes, customer claims being wrongly denied, and vulnerable customers hauled through the courts.

"They can't have it both ways. They say they want to increase trust, but they can't do that if they don't take responsibility for their actions and admit they got it wrong. I do think there has to be some sympathy for the reason they have difficulty admitting getting it wrong, which is they get slammed by the regulators every time they do," Steinholtz said.

The Cranston Review, which saw Lloyds Banking Group's handling of HBOS Reading victims criticised, may have been a catalyst for that very change in approach required to take Lloyds' cultural transformation work forward.

Lloyds' has invested in efforts to improve culture, making key hires and revamping its purpose, values and behaviour statement. Recent decisions by Antonio Horta-Osario, chief executive to increase HBOS Reading fraud victims' compensation, pre-empting further unflattering investigation results expected in the Dobbs Review, was deemed as a step in the right direction. Horta-Osario, at the behest of Andrew Bailey, FCA chief executive, intervened personally to resolve a mortgage prisoner case.

If this approach continues to influence Lloyds' engagement with mortgage prisoners, cases that come through the Business Banking Resolution Scheme (BBRS), PPI claimants and yet to be uncovered conduct problems, its chances of achieving meaningful cultural improvements may increase.

Barclays, RBS, Virgin Money and other UK banks have not made public any change in attitude towards legacy conduct issues, however. Banks, via UK Finance, contested the eligibility criteria for the BBRS, which is aimed at putting SME mistreatment in the past. Most banks have made few meaningful actions to help mortgage prisoners or customers whose loans were sold to debt collectors and vulture funds. That includes Lloyds.

David Duffy, chief executive at Virgin Money Holdings, in contrast to Lloyds' recent approach, has rebuffed the FCA's Bailey's specific requests to "deal with" some of its most troublesome and longstanding SME customer disputes.

A Virgin Money spokeswoman said: "We are confident our reviews of past business loans have been conducted rigorously and delivered fair outcomes to all affected customers, and decisions have been subject to external and independent review."

Conduct is not a historical problem

Labelling misconduct as "historical" will not insulate banks from their past. Banks cannot simply draw a line and proclaim: "That was then, this is now". If a bank is serious about culture change will be looking at legacy business to make amends with customers with lesser-known issues.

"The acid test for that kind of attitude would be if an organisation is proactively identifying historical problems as opposed to waiting on them to come to light and saying oh, that was in the past. There should be a proactive process of turning over the rocks and looking at the back book of historic business," said Frank Brown, a banking consultant at Bovill in London.

Making new products compliant with cultural expectations should be easy. Fixing products in the back book is harder, because it is potentially expensive.

"If you are changing a fee or an interest-rate on a product that was sold to hundreds of thousands of customers it is a significant hit potentially. If you're talking about living your values, to do that meaningfully means going into that historical back book and fixing the problems. They've done a few, like PPI, but they're not going through to see what else is there," Brown said.

Culture and conduct should to apply to all customers, not just new ones those in the regulated business. Many banks are making this mistake.

"If this this industry wants to be treated like adults, they have to behave like adults. That means stepping up and taking responsibility for that which is ethically within their scope of responsibility and not hiding behind the regulatory perimeter. Leaders need to step up and say if we're doing this business, we need to do it ethically whether we're required to or not," Steinholtz said.

Investors, analysts want more action on culture and ethics

Investors and analysts see the road ahead clearly. Banks need to make good on their cultural transformation, treat customers fairly, operate ethically and align themselves with environmental, social and corporate governance (ESG) principles.

"There's still work to be done on culture. When you read through the investor reports from all the large cap banks it's interesting to see there's a few [key performance indicators] related to culture or even carbon reduction. In the investment community, ESG is having a significant impact on how funds are evaluating investment opportunities and we're seeing more funds ruling out companies based on ESG factors alone. Banks are aware of this trend and are trying to reduce ties to high-carbon lending, for example," Jackson said.

Jackson expects to see more senior bankers' compensation linked to ESG metrics. The Bank of England has indicated banks should be rated on environmental metrics too. Culture is part and parcel of ESG and firms need to consider the costs of a poor culture more carefully.

"Culture needs to get on the balance sheet. The numbers should reflect the real costs of the business. If their products are doing harm, there's a cost to that," Steinholtz said.

Some UK banks have signalled their support for cultural change and are upskilling to achieve it. Ultimately, intentions must match outcomes or "what's actually happening".

"Certain kinds of firms — Lloyds, HSBC, Santander — are putting in a lot of work and are pushing on their internal knowledgebases and looking to redesign internal processes to make it work better. A lot of them use language, like embedding or first line of defence. What the regulator is really looking for is evidence, especially from market-facing people, that they've taken this on board and there is such a thing as consequences," Miles said.

Complaints Procedure

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