Banks have a chance to right the wrongs of the last financial crisis

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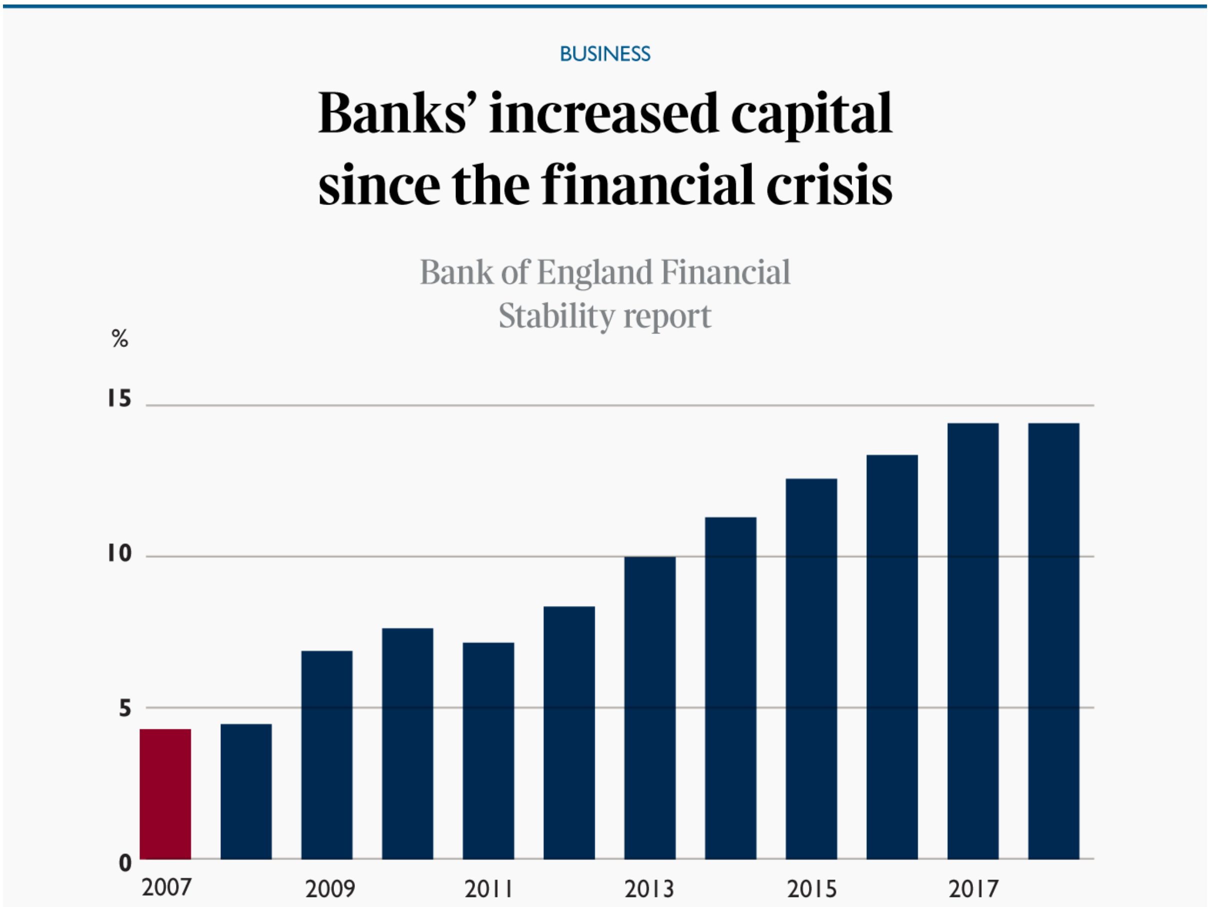
When the authorities designed new rules after the financial crisis their goal was to ensure that the damage caused to people's lives from the near collapse of the banking system did not happen again.

The policymakers' big fear was that people sitting in their seat when another crisis hit would lack their battle scars and so might give in to lobbying to relax the rules, not treat early warnings seriously or move swiftly to put out fires.

It has turned out differently, as coronavirus has hit relatively quickly after the financial crisis of 2007 to 2009. Many policymakers fighting the impact of Covid-19 on the economy were around a decade ago. That is especially the case in the UK: Andrew Bailey, the Bank of England governor, was a senior regulator, while Sam Woods, head of the Prudential Regulation Authority, was a Treasury official.



The crisis which started in America's subprime mortgage market spread fear through the world's banking system, leading to a drying up of lending between banks and pulling of credit to customers. That led to rules which required institutions to hold far more capital, restrictions in the UK between retail and investment banking and stricter lending requirements to individuals and businesses.

This time it is the other way round, with the virus having an immediate impact on businesses, which will inevitably damage the banking system. One lesson from a decade ago is the importance of swift action to help customers and there has been plenty of talk about helping the small businesses which are already reeling from a collapse in sales. Now will come the test of how banks actually behave.

In 2008 banks cut credit lines, took control of properties and imposed punitive charges on loans which emerged as having been in their contracts. Those actions were partly in response to banks' own fight for survival as the rules had allowed them to operate with woefully inadequate levels of capital.

Royal Bank of Scotland, which was state controlled after a £45.5 billion bailout, has faced years of accusations from former customers and regulatory investigations over whether it forced businesses to fail.

Some believe that RBS was acting in response to demands from the Treasury to limit losses to failing customers. But bad behaviour was also ingrained, especially over opaque terms of loans which many business customers would not have had a hope of understanding. RBS is not the only bank with this troubled track record. Lloyds, Barclays and Clydesdale and Yorkshire — now branded Virgin Money — have been criticised for their past treatment of small businesses.

Talk now about helping small businesses must be backed up by action, in the form of payment holidays with no nasty strings attached, relief loans which are straightforward to access, and more widely, good communication and generosity over existing contracts.

Thanks to the post-crisis measures, banks are in a far better position to help customers as their own health is more robust. But they need to be mindful of another new rule: the Senior Managers Regime, which puts executives personally on the hook for business decisions. Banking bosses need to know that there will be no excuses if they do not ensure their institutions are doing the right thing, and there must be no big bonuses or fat dividends from capital freed up from measures intended to help the public.

Banks have to act commercially and make decisions based on risk, but they also need to learn from the sins of the past. If financial institutions can come out of the coronavirus crisis as some of the good guys that have genuinely helped, they may be able to put right what is overdue from a decade ago: restoring people's faith in their banks.

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