Financial services firms must work out a fairer means of remuneration which benefits company, customers and shareholders

CATS WHO WON'T GET THE CREAM

Britain's financial services industry is getting some of its worst press in living memory. When Gillian Tett, capital markets editor of the *Financial Times* ranks the corporate culture in many banks as "akin to warring Afghan tribes", what chance is there for ethics and integrity?

At the SII's recent annual conference, she highlighted some crunch issues facing senior managers trying to steer a decent ship through increasingly choppy waters.

Fat-cat pay is a festering sore, colouring views of the City. Earlier in the SII's annual conference, the FSA's Hector Sants highlighted how institutional risk is being increased by a pay and bonus structure that rewards people for success but does not penalise them for failure. "It is important," he said, "for boards to recognise that structures where traders receive immediate rewards but do not bear the consequences of losses are a risk to shareholders." Firms should ensure that employees and shareholders share the risk in both the upside and the downside.

Sants was expressing delicately a harsher view, voiced by the *Evening Standard*'s Anthony Hilton, another conference speaker, that "one of the main reasons we now have a financial crisis is that too many brains were addled by greed."

Tett cited an example from the SII's new elearning programme, Integrity Matters. "Imagine for a moment," she wrote in her column the day after the conference, "that you are a banker, who stumbles across a juicy new instrument called the 'lemming' product that your sales team could sell to retail clients for a fat profit. This product, however, looks risky, even though it has been rubber-stamped by your compliance department, since investors will suffer big losses if stock markets fall more than 30 per cent. Would you go ahead and approve the sale of lemmings, even if investors did not understand the risk? Or would you dig in your heels and insist that the lemming structure was reviewed or carried a high-profile health warning?"

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Out in the light

This question was posed to the "sombre-suited participants" at the conference and, said Tett, "in some senses the results were cheering: more than 70 per cent of the audience voted to block the lemming deal in an anonymous poll, taken after the participants had discussed the issue with neighbours."

But the SII has also discovered that the proportion of participants who block risky trades falls dramatically when they do not discuss the issue with others first. Tett believes the world would be a better place if bankers were forced to talk about their business with a wider pool of colleagues. She suggests taking a leaf out of the book of other organisations – such as the Army – "to find ways to ensure that specialist silos can interact with each other at all levels to ensure some mutual oversight, rather than just at the top.

"It is not just sunlight that can be a good disinfectant. So too, can common sense and talk – particularly given the lemming-like deals that have proliferated in recent years."

Hilton believes that the FSA's involvement in pay could be the start of something big. Shareholders on their own, he said, "are clearly never going to secure reform, because memories are short and executives quickly sink back into their old ways.

"But the FSA has the clout as part of the assessment process to put a risk loading on bonus schemes it dislikes, that is so heavy it makes them uneconomic. If it has the courage to do this, we may begin to get somewhere. I despair of ever getting banks to realise that incentivising staff to do deals, make loans and expand the balance sheet regardless of quality is asking for trouble." ■

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