

Have Banks in the U.K. Learned Lessons from the 2008 Financial Crisis?

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**List of Abbreviations**

ABCP Asset-Backed Commercial Paper

ABS Asset Backed Securities

AGM Annual General Meeting

AML Anti-Money Laundering

BIS Bank for International Settlements

BOE Bank of England

CAPM Capital Asset Pricing Model

CEO Chief Executive Officer

CDO Collateralise Debt Obligation

CDS Credit Default Swaps

CRO Chief Risk Officer

CFTC Commodity Futures Trading Commission

CMBS Commercial Mortgage Backed Securities

CRO Chief Risk Officer

FCA Financial Conduct Authority

Forex Foreign Exchange

FPC Financial Policy Committee

FSA Financial Services Authority

FSA Financial Services Authority

GCE Group Chief Executive

HBOS Halifax Bank of Scotland

IMF International Monetary Fund

Libor London Interbank Offered Rate

MTM Mark-to-Market

OBSV Off Balance Sheet vehicles

PCBS Parliamentary Commission on Banking Standards

PPI Payment Protection Insurance

RBS Royal Bank of Scotland

REPOs Repurchase Agreements

RMBS Residential Mortgage Backed Securities

ROE Returns on Equity

RWAs Risk Weighted Assets

SIV Structured Investment Vehicles

SPV Special Purpose Vehicles

VAR Value At Risk

**Thesis Abstract**

Almost ten years on from the global financial crisis this thesis asks whether banks in the U.K. have learned lessons from the 2008 crisis and if these systemically important institutions are now safer. Using original empirical research including elite interviews and documentary analysis this thesis outlines how banks have responded to the institutional and structural weaknesses highlighted by the crisis to the extent that we might identify examples of learning and change. The analysis suggests that following the financial crisis different banks have taken very different paths. While some institutions have become more risk averse and display positive signs of lesson learning others have shown little evidence of change. Discussions around agency, institutional path dependency and structural competitive pressures are used to explain these inter-bank variations.

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**Introduction**

**Overview**

The devastating events which beset financial markets in the summer of 2007 led to a huge contraction in global economic output and left the system of globalised financial markets on the brink of destruction. Mervyn King, the former Governor of the Bank of England has pointed out that while financial markets have been plagued by crises and crashes with an almost ‘depressing regularity’ throughout history, the events of 2007/2008 were unprecedented in both size and scale leaving almost no domestic economy unaffected (King, 2009: 1). Adair Turner (2009: 5) has described the 2008 financial crisis as ‘arguably the greatest crisis in the history of financial capitalism’. The extent to which the crisis gripped the entire global economy was compounded by the fact that many of the most senior bankers who wielded unprecedented power and influence did not fully comprehend the complexity of the risks associated with the markets they attempted to steer (Bell and Hindmoor, 2015a: 5).

**Research Question**

We are now ten years on from the crisis and this thesis asks the question:

***Have Banks in the U.K. Learned Lessons from the 2008 Financial Crisis?***

This thesis will establish a clear account of what has happened inside the U.K.’s largest banks following the 2008 crisis. Adopting a bank-centric approach the research asks what has been the motivation behind any of the behavioural changes post-crisis and what these changes, if any, tell us about the lesson learning within these systemically important institutions. Beyond ascertaining if individual banks have learned lessons from the financial crisis I will provide the reader with an understanding as to why some banks may be more prone to learning than others. For example, in the U.K. a number of banks were severely affected by the crisis and required large taxpayer-backed government bailouts. Conversely, a handful of institutions largely steered clear of the crisis suffering minimal losses which were quickly absorbed and offset by the group’s balance sheet. As such, I will examine if variations between institutions have had a significant impact upon the learning trajectory of banks post-crisis and whether institutional path-dependencies may make some banks more prone to learning than others.

In order to answer the core research question the thesis will be guided by a number of sub-questions:

• What does the literature on learning tell us about those conditions most conducive towards learning?

• Have banks made substantive changes to the structure and culture which pervaded institutions pre-crisis?

• What have banks identified as being the key changes needed within their own institutions?

• What have the banks said in relation to the financial costs associated with the implementation of those changes identified in the literature?

• What have banks said about their relationship with the regulators post-crisis?

• Is there evidence of peer-to-peer learning amongst the banks?

**Research Objective**

The primary purpose of my research is to evaluate whether and to what extent banks in the U.K. have learned lessons from the 2008 financial crisis. In addition the thesis will also ask what kind of lessons have been learned and what may account for possible variations in learning between banks. My research will focus upon addressing and testing the degree to which learning has occurred at the U.K.’s four biggest banks: RBS; Lloyds; Barclays and HSBC.

It is well known that banks were one of the key agents involved in the financial crisis yet it is too simple to conclude that ‘the bankers did it’. Almost a decade after the first shockwaves of the crash were sent rippling through the global economy this thesis also asks if the financial system is now safer and whether those factors which led to the crisis have been addressed. This is a crucial question because one of the lessons of the last crisis is that regulators are going to find it very difficult to manage the system if banks have gone rogue.

While the focus of my thesis is centred upon the question of whether banks in the U.K. have learned lessons from the 2008 financial crisis, it will also make an important contribution to wider debates surrounding financial stability, growth and the sound functioning of financial markets. To date, these debates have rested solely upon the role of regulation as a mechanism and deliverer of stability. For example, while regulatory reform post-crisis has been ‘substantial’ domestic and international efforts have simply failed to tackle the root causes of the crisis (Bell and Hindmoor, 2014: 344), with Adair Turner arguing that regulatory and political approaches to reform have been preoccupied with tackling the too-big-to-fail problem - a term used to describe a financial institution that has grown to such a size that its failure would result in catastrophic consequences for the real economy (2016: 3). No one has asked if the banks themselves have learned, what lessons (if any) they have learned, if the banks are now safer and what this means for financial stability.As such, my research will stress the important role which banks play in both the rebuilding of the global financial system and the sound functioning of financial markets by drawing causal links between institutional learning and financial stability.

The nature of the question posed in this research means that this thesis is intimately bound to the concept of learning. Therefore, it also asks what we understand by learning. Here we are not interested in banks saying that they have learned lessons and will change. We are not interested in rhetorical learning (although rhetorical learning is perhaps an initial and important stage); rather, we *are* interested in whether there is evidence that the banks have *really* undergone a fundamental reappraisal of those conditions which led to the crisis, what they did wrong and if there is any evidence that they have really made an effort (so far) to change their culture and decision-making processes and whether this shows up in the kind of things they are now doing and the kind of assets they have on their balance sheets. We are looking for evidence not only of lesson learning but of substantive change to the underlying principles, philosophies and institutional mechanisms.

At times this can be a complicated and difficult task as it is not always easy to see whether a bank which did something in the past and is now doing things differently is doing so simply because regulators are requiring it to do so; or in other words, they are being forced to change their behaviour in the absence of genuine lesson learning. Despite this, we can see how banks have reacted to the changes they have been required to make; we can look at the spirit in which they have taken on these changes and decide if they are doing more than the bare minimum.

We should not assume that there is a one-size-fits-all answer here. One lesson of the 2008 crisis is that banks went into it in very different shapes. Intrinsically, the thesis will establish an individual bank-centric approach to the research question in order to ascertain what has happened at the U.K.’s biggest banks post-2008. The research will ask which banks show the most evidence of learning and why. Even with such a small sample size can we speculate about why some banks have done more than others and discussions surrounding agency, path-dependency and structural competitive pressures will be used to explain changes, or a lack thereof. Moreover, a historical institutionalist theoretical framework will allow us to move between structural (financial markets), institutional (banks) and agential (bankers) explanations of learning.

**Limitations of the Research**

However, we must keep in mind that many of the factors which contributed to the financial crisis and global financial instability are currently being ‘played out’ by both domestic and international actors with many of these dynamics still unclear. Likewise, while the thesis will recognise that banks are capable of learning and change we must also acknowledge that institutions can also revert back to previous behaviours or may indeed change yet again in the future. As such, the analysis put forward by this thesis will be an interim assessment.

I do not suppose that the banks – and specifically U.K. banks – were the only cause of the crisis with the 2008 crash emanating from a plethora of businesses, markets, sectors and various sub-sectors. Thus, the study and investigation of these would similarly make an important contribution to current debates on financial stability and growth. Such examples of alternative areas of analysis could include the study of global imbalances within the economy, derivatives trading, securitization, the shadow banking sector[[1]](#footnote-1) – which as we shall see within our empirical chapters has grown significantly following the crisis - or the role of the regulators. While these examples represent just a handful of the various facets and markets from which the crisis evolved this thesis will nonetheless focus upon banking due to the huge role which *prima facie* evidence suggests banks played in the 2008 financial crisis.

Similarly, I recognise that this research could be further enriched by a cross-country comparison with other major banks located across Europe and in particular the United States, which is host to the most significant global financial centre outside of London. However, I must take into consideration the budget and time restraints put in place by the University for the completion of this research project. For these reasons, along with geographical proximity, a shared common language and ease of access, my thesis will focus specifically upon banks within the U.K.

Equally, this thesis does not attempt to add to the current debate on the nature of capitalism and the implications of the financial crisis for the present capitalist system. While I recognise that the varieties of capitalism literature (see Hall and Soskice, 2001) form an important part of the current discussions within political science upon the nature of capitalism and whether a reimaging of capitalism has – or indeed should have – taken place following the crisis, the thesis will not attempt to add my own interpretations, analysis or general musings on this topic due to the general constraints as discussed above. Instead, the thesis accepts the wider structural capitalist framework within which banks and markets actors currently operate.

Despite these limitations, the thesis will make an important original contribution to the field of political economy by offering an empirically rich picture of how interactions between agents (bankers), institutions (banks) and structures (financial markets) have operated in such a way as to elicit certain behavioural responses, biases and beliefs amongst our chosen banks and how these have been translated into real world outcomes.

**Methods and Theory of Work**

This research involves a series of empirical studies and will take as its primary subject the most prominent British banks of RBS, Lloyds, Barclays and HSBC. While these institutions represent a relatively small *N* or sample size our chosen four banks dominate the U.K. banking sector with 77 percent of current accounts and 85 percent of business accounts being held at one of these institutions (CMA, 2016). In addition to being central to U.K. domestic markets all of the banks surveyed in this thesis are also internationally important and have carved out for themselves a significant market share, operating across a number of jurisdictions and sectors. By assets alone these institutions are all ranked within the top 25 largest global banks and the ten largest European banks (relbanks.com).

Due to the nature of the sample size the thesis does not present a traditional case study analysis from which general musings and broad assumptions about the systemic nature of the U.K. banking sector can be drawn and applied. However, a survey of the banks presented in this thesis, while relatively small, will still make an important contribution to current debates on financial stability and growth due to the systemically important nature of these institutions and their status as being too-big-to-fail - as highlighted by their considerable market share and prominence within the wider banking system. As such, the question of whether RBS, Lloyds, Barclays and HSBC have learned lessons from the crisis is an important one, not least because of the potential risk which *prima facie* evidence suggest these banks still pose to the real economy given their size and role in both domestic and international markets[[2]](#footnote-2).

Therefore, the value of my research will lie in presenting an empirically rich original contribution to the literature which will penetrate the inner workings of my chosen banks post-crisis, exposing the nature of the power located within individual institutions, the dynamics of structural constraints, the logic of authority and control and the interplay between values, success and failures, and which will address the research question in depth. Moreover, because the thesis will seek to analyse the dynamic qualities of each bank on an individual basis it will not attempt to elucidate to the reader proportionate relationships between observable factors. I do not believe the small sample size to be a significant factor in the overall logic of the research’s major objectives.

Recent efforts to regulate and increase the understanding of banks and financialised global markets means that there is now a rich source of information available in the public domain. In addition to consulting the various documents and reports published by the banks I will collect official figures such as ratings, earning estimates and stock data from the financial companies database Bankscope. This information will be used to explain and disseminate key changes in the organisational logic and behaviour of banks post-crisis and their capacity for learning. The thesis will also utilise original elite research interviews with a number of participants including Sir Vince Cable, Dr Lawrence Tomlinson (former Serial Entrepreneur in Residence at the Department for Business, Innovation and Skills), the leading journalists and authors Ian Fraser and Ray Perman and an anonymous senior British banker. While the views of these participants are more representative as opposed to systemic they nonetheless contribute towards drawing an empirically rich understanding of the intricacies which have pervaded the banking world.

**Why this Question?**

It stands to reason that following the financial crisis we may have expected banks to have learned lessons given the huge financial and reputational losses which they sustained. However, the highly competitive nature of financial markets may limit both the capacity and motivation of banks to learn or to be selective when choosing which lessons to learn from. For example Bell and Hindmoor (2015a; 2015b) demonstrate how, in the run-up to the crisis, structural competitive pressures, shaped by agents and mediated through institutions, were able to determine individuals’ behavioural choices by incentivising certain business paths. Moreover, competition fostered by financial market structures, both at home and abroad, pitted banks against one another in a race to come up with evermore exotic financial instruments aimed at growing their balance sheets and making ever-higher returns for shareholders (ibid). Importantly, Bell and Hindmoor’s (2015a; 2015b) work demonstrates that competition between banks in the run-up to the crisis shaped and determined the policy decisions of institutions to their detriment.

Data gathered from the *World Bank Financial Development and Structure Dataset* (2015) reveal that banking today remains a ferociously competitive industry with Sam Woods of the Bank of England (BOE) noting that the margins of financial firms are increasingly being squeezed (Woods, 2017: 17). The International Monetary Fund (IMF) has also commented that, post-crisis, historically low interest rates and low growth have hurt the profits of banks resulting in increased risk appetites as institutions search for new yields (IMF, 2017: xi). As such, we can see that banks continue to operate in a highly competitive environment and are forced to respond to short-term market pressures with bankers risking losing their jobs and bonuses if they do not perform and meet targets. These intense competitive pressures may have subsequently undermined lesson learning and the assumption that banks will have learned and changed following the crisis. However, as will be discussed in greater detail below, agents and institutions can indeed learn and overcome these structural competitive pressures. Simply put, we do not know if the banks have learned and changed and if the banks are now safer. There is no obvious answer to this question and hence the importance of my research.

This thesis focuses specifically upon banks due to their central role in the global economy. However, the thesis does not presume that the next financial crisis will be bank-led or originate from within banking markets. Likewise, my research does not suppose that the presence of learning (or not as the case may be) at our four chosen banks will prevent future financial crises which may emerge from any number of facets or markets within the global economy. Indeed, both the IMF and the Bank of England’s Financial Policy Committee (FPC) have identified a number of potential threats to both global and domestic financial stability. For example, the IMF *Global Financial Stability Report 2017* details three broad areas of concern which have the potential to significantly disrupt markets. *First*, it is suggested that proposed tax and regulatory reforms in the U.S. could have a potentially destabilising effect upon markets by encouraging corporations to increase leverage and investment debt. *Second*, a reversal of current market trends and a shift towards protectionist policies in the West could prove testing for emerging markets particularly if capital outflows were to follow such swings leading to elevated stability risks. *Third*, the Chinese economy remains a cause for concern with the country’s domestic market still in need of rebalancing despite recent efforts. Moreover, China’s expanding credit markets along with a financial system which is largely dependent upon wholesale funding and suffering from a large assets-to-liabilities mismatch could lead to potential global spillovers (IMF, 2017: ix-xii).

Domestically the FPC’s *Financial Stability Report 2017* identifies relaxed mortgage lending conditions - including less rigid underwriting standards and higher loan-to-income ratios - , growing consumer debt in credit card lending, personal loans and motor finance, and an increasing credit expansion in the Chinese economy along with the overvaluation of assets by Chinese market actors as all posing significant downside risks (FPC, 2017). Likewise, potential unknown shocks and instability emanating from Brexit trade negotiations and the continued threat of major disruptions posed by cyber-attacks are similarly identified as having a potentially destabilising effect upon the domestic economy (FPC, 2017).

Moreover, there are numerous examples of crises over the past 30 years which were not bank-led. For example, the Latin American sovereign debt crisis in 1982; the United States savings and loans crisis in the 1980s; the 1987 stock market crash known as ‘Black Monday’; the Junk Bond crash in the 1980s; the Tequila crisis in 1994; the Asian financial crisis in 1997 and the Dotcom bubble in 1999 were all precipitated by conditions which were largely removed from the banks and banking markets (Anderson, 2013: 48-52).

As such, this thesis recognises that both past and future financial crises have been and may be triggered by events and circumstances which lie outside of the immediate behaviour of the banks and bankers. Likewise, banks are no longer as prominent as they were in the years preceding the crisis with domestic and global institutions reducing the size of their balance sheets and trimming back non-core businesses. Yet, the question posed by this thesis remains crucial because banks continue to be systematically important and lie at the very heart of the global economy with the BOE concluding that despite recent regulatory efforts banks remain ‘prime movers’ within financial markets (BOE, 2014: 1). What is more, we know that the unique ability of banks to create and lend their own debt to market actors can (amongst numerous other factors) subsequently determine the rate of economic production and growth in the real economy (Driga and Dura, 2014: 598). As a result, losses sustained by banks can be transferred quickly and have a ‘much larger effects [sic] on the real economy’ (Jakab and Kumhof, 2015: 55). Therefore, the question of whether banks have learned lesson from the 2008 financial crisis is crucial in informing current debates surrounding growth, the sound functioning of markets and regulatory reform post-2008.

**Expected Contribution**

The current literature dealing with the financial crisis is extensive with a number of journalists and bank insiders all detailing the events which preceded the 2008 crisis (Bernanake, 2015; Cohan, 2009 & 2011; Lewis, 2011; Sorkin, 2009). These accounts have been complimented by contributions from economists, political economists and social scientists who have attempted to unravel the wider financial system and to understand how the precursors of the crisis interacted with and compounded one another (Blinder, 2014; Davies, 2010; Stiglitz, 2010; Wolf, 2015). However, the main focus of this body of work has been detailing the many complex causes of the financial crisis and proffering a coherent explanation thereof. While banks have been heavily implicated in the crisis by a number of academic, media and political commentators there is a lack of systematic studies dealing with the issue of learning within banks post-crisis. No one has looked at the banks themselves and asked if they have learned lessons and if they are now safer. Instead, much of the relevant scholarship has been pre-occupied with the question of regulation, namely, the extent to which sanctions introduced by domestic and international regulators can bring banks under much closer and stricter supervision (BCBS, 2010; Harle *et al,* 2010; IIF, 2010; MAG, 2010; UEAPME, 2011; Meaulle, 2011).

While these various authors have succinctly elucidated the causes of the crisis and present a robust discussion and critique of the regulatory interventions and supervision since 2008, an element missing from the current literature is the question of self-directed reform which extends beyond that imposed by exogenous actors and the vital role which banks - as systemically important institutions – play in shaping and determining financial stability. But, as noted by Sam Woods of the Bank of England, while regulatory supervision post-2008 has been robust, reform also needs to be met with a ‘healthy dose of judgement’ on the part of the institutions with the letter of the law becoming redundant if not accompanied by a similar spirit (Woods, 2017: 20). Woods also argues that the ‘role of the supervisor is to observe’ whereas the role of the ‘firm - and the individuals running it – is to meet the intention’ of the regulation (ibid). Moreover, Alex Brazier of the FPC suggests that fierce competition in financial markets may lead banks and other financial actors to challenge and push regulatory boundaries (Brazier, 2017: 12). Baily *et al* (2015) have similarly suggested that banks are regulatory agenda setters with pressure from within the banking system resulting in constant innovation and evolution by the banks leaving regulators continually trying to catch-up with changes. Likewise, Woods also notes that banks will always be able to innovate faster than the regulator and have both the means and ‘commercial incentives’ to do so and concedes that regulators ‘will not spot everything’ and as such it remains the responsibility of agents and institutions to manage risk prudentially (Woods, 2017: 20-22).

As such, we may conclude that regulation alone will not be sufficient to ensure the safety and stability of banks - and subsequently the sound functioning of markets – with competitive pressures emanating from within banking markets leading to regulatory arbitrage. My thesis will make an important and original contribution by addressing the current gap in the literature and will move beyond questions of regulation and macro prudential practices and will instead focus upon the banks themselves as drivers of reform post-2008. Specifically, I will look to identify examples of institutional transformation which go beyond regulatory minimum requirements. Likewise, the thesis will look to address instances where banks have utilised and implemented targeted policy initiatives which directly address the causes of the crisis, explored within the literature reviewed in Chapter 2, and which may be indicative of the capacity of institutions to learn.

It will be argued that the importance of learning for banks is motivated by the huge financial losses incurred as a result of the crisis and the subsequent reputational damage inherited across the banking sector as a whole. The value of my research will be in demonstrating a clear connection between the causes of the 2008 crisis and the extent of the learning within U.K. banks thereafter. The thesis will contribute to the academic community by addressing a key gap in the literature which is at present poorly understood and under researched.

**Selection and Justification of Theoretical Framework**

In this section of the Chapter I will introduce the theoretical framework which will be used throughout the thesis. The decision to position this important part of the thesis within the Introduction has been done so as to allow later chapters to be dedicated to reviewing the current literature and presenting the empirical evidence on my chosen banks.

The research will use a theoretical framework first established by Bell and Hindmoor (2015a) which seeks to use the methods of political science to study the behaviour of agents within an institutional and structural context. The authors’ work builds upon an expanded version of historical institutionalism (H.I.) first developed by Bell (2011) and Bell and Feng (2014). Drawing upon institutional theory, and in particular H.I., Bell and Hindmoor (2015a) are able to draw distinctions between structures (financial markets), institutions (banks) and agents (bankers) in order to study how these ‘mutually-shaping interactions’ are played out through time (ibid. p21-22).

The framework established by the authors will inform my own research by providing a theoretical underpinning upon which the behaviour of bankers and banks and their capacity for learning will be examined. While my thesis does borrow from the theoretical framework established by Bell and Hindmoor (2015a) my own work will be distinct, applying the theory in a unique manner to the study of learning within banks.

Given the emphasis which Bell and Hindmoor’s (2015a) theoretical framework places upon agents, institutions and structures it is important that we, albeit briefly, examine what we mean and understand by these terms. In particular, one of the problems we face as researchers is that institutions and structures are often used interchangeably within the social sciences and are surrounded by a great deal of ambiguity (see Cortell and Peterson, 1999). According to Hodgson (2006: 18) ‘institutions are systems of established and embedded social rules that structure social interactions’. These rules form the basis of established norms, values and underlying philosophies which are simultaneously taken on and embodied, reproduced and reshaped by members belonging to a particular group (Fleetwood, 2008: 15). Within the context of this thesis institutions will be used to describe the banks which the thesis surveys.

Structures on the other hand are understood to be the broader situational environment within which institutions act and operate (Bell and Hindmoor, 2015a: 23). Structures are often used to explain how constituent parts of a whole relate to one another (Elder-Vass, 2006: 10) and may include power relations, material incentives and sanctions or ‘other rationalities or pressures’ which may shape the preference choice of agents (Bell and Hindmoor, 2015a: 23). Essentially, structures are the ‘templates for action’ and help to inform our decision-making process by endowing agents with information concerning the consequences of their actions (Lopez and Scott, 2000: 30). Within the thesis structures will be epitomised by the wider context within which banks operate, namely financial markets, and the various constituent parts which govern markets such as regulatory constraints and competition emanating from within market structures along with the rewards and disincentives associated with specified behaviours.

The central importance of defining and separating institutions and structures for the thesis is the ability that such a distinction will give us in isolating changes which have occurred at our chosen banks independently - and subsequently may be indicative of learning - from those which have been mandated by wider structural constraints in order to comply with regulatory standards. Similarly, by detaching institutions from structures we will gain greater insight into those conditions which may affect learning, or a lack thereof, but remain outside of the immediate environment and control of agents, such as structural competitive pressures.

Situating H.I. Theory

Before we move on to discuss the practical application of the framework to my own research it is important that we first situate the expanded H.I. theory within the broader literature and the institutionalist school to which it owes its origins.

Historical Institutionalism along with rational choice and sociological institutionalism belongs to the ‘new institutionalist’ school of studying the social sciences. While all three fields of thought are concerned with the study of institutional ‘rules’, ‘norms’ and ‘common understandings’ (Cairney, 2012: 70), what separates these contending theories is the extent to which they ascribe meaning to the ability of agents to shape and be shaped by contextual factors. For example, rational choice theorists suggest that agents are essentially self-seeking individuals who when faced with a particular decision or situation will always look to maximise returns whilst minimising the associated costs (Steinmo, 2012: 126). Rational choice theory sees institutions as essentially framing an agent’s decision-making process by presenting individuals with both the costs and benefits, which are imbedded within institutional norms and rules, of their behavioural decisions with ‘expected utility’ theory suggesting that an individual’s behaviour can be predicted due to their propensity towards maximising returns (Green and Shapiro, 1994: 17-30).

Conversely, sociological institutionalists see agents as being fundamentally social beings who behave in routine ways which are neither totally rational nor deliberately self-serving. Institutions are framed as being the ‘social norms that govern everyday life and social interaction’ (Steinmo, 2012: 126). According to this view, institutions act as a ‘key reference point’ for agents whom it is assumed will both ‘obey’ and be ‘guardians’ of predominant rules and norms (March and Olsen, 2006: 7). Sociological institutionalists suggest that when confronted by rules and principles agents will not look to maximise their own self-interest but will behave in a manner that is most appropriate or socially acceptable with individuals being free to interpret the ‘meaning of their institutional commitments’ (Peters, 2005: 26).

H.I. theorists situate themselves somewhere in the middle of these two contending schools believing actors to be simultaneously ‘norm abiding rule followers and self-interested rational actors’ (Steinmo, 2012: 126). Likewise, H.I. theory distinguishes itself from other new institutionalist theories, which Pierson (2000: 93) suggests overemphasise the paralysis of institutions over agents by limiting an individual’s ‘room to manoeuvre’, by developing a theoretical framework which allows us to study the delicate interplay between agents and the ‘formal rules, compliance procedures and standard operating procedures’ which govern institutions (Hall cited in Thelen and Steinmo, 2008: 188). Essentially, H.I. puts agents back into institutional analysis and allows us to study how interactions between agents and the institutions in which they inhabit are manifest in real world situations.

An Expanded H.I. Theory and the Importance of Agency

Scholars such as Blyth (1997), Hay (2006) and Schmidt (2008) have all raised concerns over the application of H.I. to the study of the social sciences with Hay (2006: 590) suggesting that H.I. theory tends towards the ‘lock-in’ effects associated with institutional path dependency. Likewise Blyth (1997: 230) also contends that institutions ‘constrain rather than enable political action’. Meanwhile Schmidt (2008: 313) purports that institutionalism holds an ‘overly sticky’ conception of institutions. Similarly, North (1990: 3) has argued that institutions while conceived by humans can act as a powerful constraining force that ultimately shapes and determines the trajectory of an agent’s behaviour.

The framework developed by Bell and Hindmoor (2015a) looks to address these shortcomings which Bell (2011) argues places too much emphasis upon the ‘*institutional*’ of historical institutionalism. By moving beyond traditional H.I. scholarship and firmly situating their theoretical outline within the structure/agency approach of studying the social sciences the authors place institutions, such as banks, as an arbitrator of the interactions between agents and structures. Importantly however, the scholars stress that agents are not simply banal actors but are found to be in possession of their own unique ideas and perceptions about the world which may determine how they will behave when confronted by structures (ibid. p24). Bell and Hindmoor (2015a) likewise point to the work of Streeck (2009) who has, due to the rapidly changing trajectory of capitalism over the past three decades, similarly called for the Academy to move beyond purely institutionalist approaches to political analysis and urges the need to contemplate both structural and institutional considerations.

Bell and Hindmoor’s (2015a) own theoretical framework utilises H.I. but like Streeck (2009) it looks to expand beyond traditional applications by removing the constraints typically associated with institutionalist scholarship. For example, while the authors acknowledge that one of the strengths of institutionalism is the recognition of agents as being responsible for creating institutions, Bell and Hindmoor (2015a: 25) also contend that institutionalist approaches tend to overplay the stifling effect of institutions and fail to recognise the authoritative and assertive nature of key agents and their ability to overcome institutional barriers. Such a view is similarly shared by Weyland (2008: 281) who also contends that institutionalist analyses tend to be are overly ‘static’ and ‘linear’ making it difficult to explain political change. Likewise, Schmidt (2008: 314) similarly argues that institutionalist approaches have been guilty of ‘subordinating’ human agency to structures resulting in ‘unthinking’ actors.

As such, Bell and Hindmoor (2015a: 25) stress the importance of ‘not losing sight’ or limiting the scope of agency in the analytical process. The authors reject traditional applications of institutional theory which they claim significantly limit the scope of agency and are better suited to the study of static institutions which are epitomised by continuity and predictability as opposed to the shifts and shocks of banks and other financial intermediaries. Demonstrating the importance of such sentiments, the scholars undertake a careful and detailed examination of both agents and institutions and the way in which they operated in the years preceding the financial crisis (ibid). In particular, the authors explore how these elite agents were, in the years before the crisis, able to exercise huge control and authority over their institutions, steering both the direction of organisations and revolutionising the banking industry (Bell and Hindmoor, 2015a).

Structures, Institutions and Agents

Importantly, Bell and Hindmoor’s (2015a) expanded H.I. theory does not abandon institutionalism but instead looks to cast a new light on how we view and conceptualise institutions and their role in the study of the social sciences. The contribution of the authors’ theoretical framework is of particular importance to my own thesis as it will equip my research with the freedom to move beyond the constraints of institutionally-based conceptions of learning allowing me to draw-out and make key analytical divisions between structures, institutions and agents the importance of which is emphasised by Bell (2011) who concludes that institutions are best viewed as taking on a mediating role between agents and structures and which it is argued often become conflated and lost within purely institutionalist approaches.

While Bell and Hindmoor’s (2015a) theoretical framework recognises the importance of structures in the analytical process it also avoids the trappings of overly structuralist scholarship, which tends to exaggerate the deterministic or constraining forces of structures by highlighting both the restraints and freedoms structures confer on agents (also see Hindmoor and McGeechan, 2013). For example, the authors demonstrate how the financialization of global markets from the mid-2000s onwards is, on the one hand, representative of the growing structural significance of international finance. Importantly however, the authors likewise show how this shift in the ‘scale and scope’ of global finance did not occur independently but was instead conceived of and arbitrated by key agents who, through a series of financial innovations and supported by governments who were keen to harness the perceived benefits of greater financial liberalisation, were able to shift the structural power of global capitalism towards agents and institutions, namely bankers and banks (Bell and Hindmoor, 2015a: 26-27).

Similarly, while the authors’ framework is situated within the tradition of institutionalism, the scholars look to broaden their approach beyond either the new institutionalist or structuralist school of political analysis and towards incorporating the work of Margaret Archer (1995; 2000; 2003) within their own theoretical construct. Utilising Archer’s work as a foundation the authors make four important analytical distinctions: *firstly*, agents, institutions and structures possess properties which are systematically different and separate from one another and as such are not ‘reducible’ to one another; *secondly*, agents operate within institutional and structural settings which are ‘pre-given at any point in time’; *thirdly*, agents, institutions and structures operate in a ‘dialectically, mutually constitutive relationship over time’; *fourthly*, institutional and structural effects are played out and arbitrated through agents (Bell and Hindmoor, 2015a: 24).

The practical application of Bell and Hindmoor’s (2015a) expanded H.I. theory to their study of the financial crisis situates bankers as being agents empowered by their proximate institutions and the structures in which they operate. Importantly however, institutional and structural factors are not merely supplanted by the agency of individuals, with the example offered by the authors demonstrating that once such institutions and structures had been created bankers became ensnared by ‘built-in’ institutional and structural incentives. In response, agents sought new market opportunities through financial innovation. However, this innovation left the banks and bankers exposed to the shockwaves triggered by the collapse in the U.S. housing market and the subsequent decline of asset-backed securities. Moreover, structural effects were then felt further when the systemic risks which had built up within the system led to contagion between institutions as failing markets quickly came to overtake and devastate the banks which operated within these wider structures (ibid. p24).

Despite the authors’ account of the financial crisis drawing-out the limitations imposed by structures and institutions they return to the importance of agency which is clearly manifest in their analysis in explaining inter-bank variations and the degree to which agents were able steer some institutions clear of the most harmful effects of the crisis and resist structural pressures to a certain extent (Bell and Hindmoor, 2015a: 25).

The authors build upon the work of Barnett and Durvall (2005), which suggests that structures have the power to distribute and align the costs or benefits of a specific path or action. However, while Barnett and Durvall (2005) suggest that agents may be less willing to challenge structurally-imposed power relations and hence may be more willing to accept certain structural factors, Bell and Hindmoor (2015a: 28), though accepting that resignation may be one resulting factor of the inherent power of mediating structures, contend that power can also be returned through the cognition of agents to 'create an ideational or discursive order' which equips actors with the ability to recognize and ‘align’ their self-interests with those of other agents by interpreting, manipulating and influencing structural power dynamics to such an extent as to skew the benefits of these structures to their own advantage. In this instance the unique structural power relations between agents, institutions and structures are not manifest through sanctions or a certain kind of coercive power but through agents’ own willingness to accept and support structural relations due to the perceived associated material payoff that an alignment with such distinctions would incur (ibid).

The scholasticism of the authors’ framework demonstrates how institutions can empower and ‘liberate’ agents which can in turn lead to structural change. Moreover, the analysis of the financial crisis offered up by the authors demonstrates the need to study agents, institutions and structures - which act as a mediating force of prevailing ideas and material interest - within political science in order to build a complete picture. As such, Bell and Hindmoor’s (2015a) expanded H.I. framework will equip my thesis with the theoretical tools needed to analyse and understand the structural and institutional context in which autonomous agents learn and which are not mutually exclusive. It is against this backdrop that this overall thesis, and its subsequent research questions and general theorising will be situated.

**The Chapters**

In Chapter 1 I will look at the idea of learning. Using literature gathered from across the social sciences I will ‘unpack’ the concept of learning and set out a clear definition of what learning entails, the mechanisms by which agents and institutions learn and how we account for structural considerations in the learning process. Particularly, the literature review will be used to identify the key characteristics of learning while also familiarising the reader with those conditions most conducive towards learning. Specifically, the Chapter will stress the importance of double-loop learning which dictates a definitive positive change in an organisation’s values, philosophies and behavioural procedures in response to the explicit recognition of a past mistake which has resulted in ‘dissatisfaction’.

Chapter 2 will provide the reader with a detailed account of the central causes of the financial crisis. It will consider how a series of socio-economic and socio-political synergies, coupled with a system predicated upon risk, combined to create the ‘perfect storm’. In particular, it will be argued that competition, along with a plethora of mutually non-exclusive causes, was a key factor in the financial meltdown of 2007/2008 and remains today one the greatest obstacles to learning. As well as situating the structural background against which learning may take place, the purpose of and importance of Chapter 2 is to create and detail a series of benchmarks against which the progress of banks can be assessed. Those factors which gave rise to and magnified the crisis will be the key measures against which learning will be tested.

Chapter 3 of the thesis will look to bring together the literature reviewed in Chapters 1 and 2 and will set out the key benchmarks or measures against which learning will be tested. In addition, the Chapter will also discuss structural and regulatory changes which have occurred post-crisis. This will be of particular importance to the thesis as it will allow us to isolate institutional changes which have originated endogenously, and subsequently may be indicative of learning, from those changes which have occurred independently of learning and in response to a changing regulatory landscape.

Chapter 4 will present the first of the empirical studies and will discuss the extent to which learning has taken place at RBS. The evidence presented in this Chapter will suggest that despite making some positive changes including reducing the Group’s bonus pool by 72 percent, retrenching the business portfolio on U.K. domestic retail markets and exiting or reducing exposure within a number of non-core businesses, including its investment bank, the Group have on the whole failed to learn lessons from the crisis. The evidence presented in this Chapter will suggest that a number of ‘fire-fighting’ missions have negatively impacted the Bank’s ‘learning space’ resulting in a failure to undertake a fundamental review of the Group’s underlying philosophies, objectives and standard operating procedures. Instead, it will be argued that the Group have been consumed with the trivial detail of specific failures which have diverted time and resources away from the overall ‘big picture’ learning.

Chapter 5 will present the empirical evidence in relation to Lloyds Banking Group and will suggest that despite a catastrophic merger with Halifax Bank of Scotland which resulted in a state-sponsored bailout worth more than £20 billion, Lloyds do appear to have learned lessons from the crisis. It will be demonstrated that post-2008 the Group have increased customer deposits and reduced short-term funding, reduced their leverage ratio, increased regulatory capital and exited multiple foreign markets. While Lloyds, like all the banks in this study, have not been without their problems, especially in relation to internal governance, the evidence presented will show that not only have those governance failures been fewer in number than some rival banks but that Lloyds have also been quick to deal with matters and thus preserve their learning space. Moreover, it will be demonstrated that in defending their learning space and acting decisively the Group have been free to concentrate on drawing lessons from the crisis which has resulted in a positive learning experience for the Bank.

In Chapter 6 we will look at Barclays who present a rather interesting case with the evidence suggesting that the Group may have undergone a double U-turn post-2008. For example, in the years which immediately followed the financial crisis, Barclays demonstrated little evidence of learning or change. However, after a series of governance failures, the most notable of which was the Group’s implication in the rigging of Libor, Barclays commissioned a deep and thorough independent evaluation of the business in the form of the Salz Review. As a result the Group launched a series of initiatives aimed at restoring trust in the Barclays brand, putting ‘values’ back into the business and de-risking the Group’s balance sheet. A significant part of this new regime would involve the scaling back of the investment bank which had been identified as being the driving force behind the nefarious culture which had infected the entire Group.

As such, it seemed that Barclays were beginning to show signs of learning and change. However, the evidence suggests that investors were not impressed with the new business model and soon began to grow impatient with the Bank leading to a boardroom coup in July 2015 which culminated in the termination of the Group’s Chief Executive Anthony Jenkins. Jes Staley, a career investment banker, was sought as his replacement who quickly began to rebuild the investment bank and roll-back many of the initiatives which resulted from Salz and had been implemented under the tenure of his predecessor. The narrative which unfolds in Chapter 6 is of particular interest in this regard as it stresses the impact hugely competitive structural pressures, and the interpretation of these structures by agents, can have on the learning trajectory of banks.

Chapter 7 will present the final empirical study of the thesis and will detail for the reader the evidence relating to HSBC. It will be shown that following the crisis HSBC have learned different lessons in relation to different areas of the business with this learning taking place at different speeds. Firstly, Archer’s (2003; 2012) thesis on the meta-reflexives will be used to explain how, in relation to the balance sheet, there appears to be evidence of learning despite the absence of notable change, with the Group learning that change in this instance is neither required nor productive. Conversely, evidence presented in relation to remuneration will suggest a rather conflated story of learning and change. This may be attributed, like their peers at Barclays, to structural competitive pressure and in particular the need to attract and retain the brightest banking talent. Evidence will be discussed which suggests that while all the banks in this study are subject to the same structural competitive pressures the effects appear to be more acute at HSBC and Barclays due to their exposure to non-E.U. markets. This has subsequently brought the Group into direct competition with other institutions which are not held to the same domestic and European regulatory standards. The contribution of the evidence presented in this Chapter will be important to the thesis as it leads us to two very important conclusions surrounding learning. Namely, that in accordance with Archer’s (2003; 2012) work learning may be possible despite tangible change and the fact that structures, interpreted through institutions by agents, clearly still matter.

The concluding chapter of the thesis will draw together the evidence presented in the empirical chapters and will tentatively determine that RBS, and to a lesser extent Barclays, have largely failed to learn lessons from the crisis. Conversely, the chapter will find that Lloyds and HSBC have generally demonstrated evidence of learning and change. However, it will be stressed that we must approach such conclusions with caution and avoid making generalisations as it will be shown that there is no single or uniform answer to the question posed by this thesis. Instead, it will be noted that each bank should be considered on its own merit with particular regard the complexity of institutions meaning that different banks have learned different lessons in relation to contending areas of both their own business and the banking sector in general.

Notwithstanding these institutional variations, the thesis will conclude that there are identifiable amongst our chosen banks a number of recurring themes or ideas which appear to have been factors in the learning trajectory of institutions. For example, it will be shown that ‘learning space’ - defined as both time and resources - has been a mitigating feature in learning amongst institutions. It will be shown that those banks such as Lloyds and HSBC who have, for reasons discussed in subsequent chapters, enjoyed greater learning space have likewise demonstrated an increased propensity towards the undertaking of a fundamental re-evaluation of their underlying principles, philosophies and key strategical practices in light of the causes of the crisis and which has resulted in tangible positive behavioural changes. Conversely, those banks whose learning space has been eroded have generally failed to present substantive evidence of learning and change. Importantly however, it will be observed that the degree of learning space enjoyed by an organisation has largely been determined by institutional interpretations and responses to organisational failures and crises.

The thesis will also find that dissatisfaction - defined as when institutional aspirations outstrip outcomes - plays an important role in learning with a degree of dissatisfaction needed to propel banks from a static state towards the progress of learning. However, it will be demonstrated that too much dissatisfaction can be crippling and retard the learning process with the level of dissatisfaction being particular to each individual bank.

Likewise, it will be concluded that both structure and agency matter in the learning process with structural constraints mediated by key agents having a bearing upon the learning of organisations. However, while the extent to which structural determinants influence learning at our chosen banks appear to be subject to the interpretations of situational agents, some structural pressures appear to be too great to overcome even when change is recognised as being desirable by these key agents. Subsequently, the thesis will conclude, using the work of Margaret Archer that in some cases learning can occur despite the presence of substantive change particularly when the associated cost of change is deemed to be too high. In this instance the thesis will find that institutions can learn but the lesson learned is about the cost of reform.

Due to the small sample size, as discussed above, we should avoid applying these conclusions to U.K. banks and banking markets in general with our chosen institutions being representative as opposed to systemic. Nonetheless, conclusions drawn by this thesis remain important due to the systemically significant nature of the banks surveyed – as demonstrated through both their domestic dominance and international magnitude – and which are still considered too-big-to-fail (Kay, 2016). Moreover, the bank-centric approach adopted by this thesis and subsequent conclusions will inform current debates on financial stability and growth, addressing a key gap in the literature, namely, the question of whether banks have learned from the crisis, if they are now safer and what the implication of this learning (or otherwise) may be for stability.

However, the thesis will conclude that it is important that we keep in mind that not only can banks change but that they can also change back and change again in the future. That is to say, we should not assume that institutions such as RBS and Barclays who have generally failed to learn lessons will not learn and change in the future. Indeed, as we shall see within the empirical chapters RBS and Barclays do present some limited evidence or ‘pockets’ of learning in certain areas of the business. Conversely, Lloyds and HSBC while generally displaying positive signs of learning may also change in the future to the detriment of financial stability. Essentially, the analysis presented in the thesis is provisional because while cultures at our selected banks may be set this does not mean that they are permanent.

**Chapter 1 – Literature Review – Theories of Learning**

**Overview**

This Chapter will deal with the broad concept of learning and will address what is meant by the term learning. The Chapter will provide the reader with an understanding and analysis of the current debates within the social sciences and how scholars from within various disciplines detail and situate the process of learning. The concept of learning is crucial to the question posed by this thesis because in order to both adjudicate and understand if and how learning has occurred within banks post-2008 we must first understand what learning is. To this extent the literature review will be used to identify the key characteristics of learning while also familiarising the reader with those conditions most conducive towards learning. This information will be important as it will allow us to identify positive examples within the coming empirical chapters and subsequently answer the guiding research question which for the benefit of the reader I will now reiterate:

• What does the literature on learning tell us about those conditions most conducive towards learning?

• Have banks made substantive changes to the structure and culture which pervaded institutions pre-crisis?

• What have banks identified as being the key changes needed within their own institutions?

• What have the banks said in relation to the financial costs associated with the implementation of those changes identified in the literature?

• What have banks said about their relationship with the regulators post-crisis?

• Is there evidence of peer-to-peer learning amongst the banks?

The concept of learning and how we measure and understand the process of learning is of central importance to this thesis because it is not assumed that banks will have learned lessons following the crisis. Indeed, there are two factors to which we shall return throughout the thesis which means that learning following the crisis is not a pre-given. The *first* factor is the issue of competition which was addressed in the previous chapter. While there has been a raft of regulatory changes post-2008 aimed at stabilising the banks and financial markets, such as increasing capital requirements and ring-fencing (see Chapter 3 for further discussion), the issue of competition within domestic and international markets still persists. As such, the extent to which learning can take place within the structural confines of high levels of competition between banks and the pressure to maximise profits in the face of structural constraints will be considered throughout.

The *second* factor which rules out the implicit assumption that banks will have learned lessons following the crisis is drawn from the literature on bounded rationality, associated with the work of Herbert A Simon (1957; 1958; 1983), which suggests that while agents are ‘intendedly rational’ they are ‘limitedly so’ (Simon, 1983: 22). Thus, while we may expect that banks would have learned lessons from the financial crisis such an assumption may be incorrect because according to Simon (1983:22) agents are ‘boundly rational [and] experience limits in formulating and solving complex problems and in processing (receiving, storing, retrieving, transmitting) information’. However, we should not assume that agents are totally ‘bounded’ or locked-in to certain behaviours because as Bell and Hindmoor (2015a) demonstrate, in the years preceding the crisis key agents within the banks were able to steer their organisations in very different directions, some increasing their appetite for risk while others became more risker averse. This thesis will then assume a ‘middle-ground’ and recognise that agents are neither totally rational – for if they had been the errors which led to the crisis would not have occurred - nor completely bounded because, as we shall discuss below, agents and organisations are able to learn.

A Definition of Learning

This literature review section of the thesis will demonstrate that ‘change’ is central to learning and often the end result of the learning process. Specifically, it will be established that in order to determine that learning is present at both the individual and institutional level there must be a clear and observable positive change in an organisation’s behaviour, attitudes and long-held beliefs (Cyert and March, 1963; Cangelosi and Dill, 1965; Argyris and Schon, 1978; Duncan and Weiss, 1979; Fiol and Lyles 1985; Levitt and March, 1988; Huber, 1991; Sabatier, 1988; Weick and Roberts, 1993). Consequently, the literature demonstrates that learning and change are inextricably linked to an ‘effective’ response to new information resulting in a series of ‘improved’ actions (Easterby-Smith and Araujo, 1999: 3).

However, it is not simply enough to observe that change has occurred at the banks in question and instead we must isolate change as a result of the process of learning from responses to exogenous structural factors, such as the changing nature of financial markets, investor appetite and regulatory requirements. As such, we will be looking to identify and make specific connections between change and the learning process. To this end, the importance of the literature review lies in identifying the key processes of learning against which causal inferences can be identified to the extent that we might isolate positive examples of learning and change.

Similarly, the Chapter will also look to test and confront this conceptualisation of learning and will ask if change is a necessary condition of learning.To this end,the Chapter will extricate the central debates and key theories of learning located within the field of political science, organisational studies, economics, psychology, educational studies, sociology and anthropology in order to not only answer the overarching research question but also to offer the reader an explanation as to why and how learning has or has not, as the case may be, occurred within the banks. The literature reviewed presented here has been selected following an extensive and thorough library-based examination of a range of works, including books, book chapters and journal articles. While during the course of preparing this review a wide collection of work has been studied, the literature presented in this Chapter is not an all-encompassing or exhaustive list. Instead, the review focuses upon a number of classic texts which have been selected due to their standing as key works which have served as the foundation and seminal writings within each individual discipline. Nevertheless, as the reader will observe where appropriate I also present and discuss more recent studies where academics have extended and built upon original works by applying the classical texts to their own scholarship.

At times the literature presented in this Chapter may risk underwhelming the reader. This is because while the conceptual language used by various scholars from across disciplines does indeed vary, there is to a certain extent a degree of repetition amongst and between the various disciplines, namely, that agents and institutions learn when things first go wrong and then set to out rectify the mistakes which results in a positive behavioural change. As such the literature presents a rather ‘common sense’ view of learning which risks disappointing the reader. Nevertheless, I am confident that the literature reviewed below, while at times repetitive, is an accurate reflection of the central theoretical debates surrounding the concept of learning located within the social sciences. The purpose of the review will be to not only carve out a definition of learning but it will also help us to understand the various conditions, markers and processes of learning. Furthermore, the thesis will apply the literature in a manner which focuses the subject of learning upon a bank-centric empirical study. Moreover, such a review of the literature is important as it gives my work rigorous academic underpinning against which my own thoughts, ideas and lines of inquiry can be built upon, tested and contextualised as I develop my own dialogue with the literature and its theoretical foundations.

As set out in the Introduction to this thesis, my research will address the interplay between agential and institutional learning. Indeed, Sabatier (1988: 149) stresses that it is not organisations that learn but those individual agents who make up an organisation. The author goes on to argue that over time agents’ attitudes, along with the long-held beliefs of collectives, are subject to refinement, alteration and change and when manifest within an institutional setting are capable of evoking change within an organisation (Sabatier, 1988: 149). Similarly, Bell and Hindmoor (2015a: 17) also stress that the ‘ideas’ and ‘behavioural biases’ of individual agents shape how they behave and interact within both an institutional and structural setting, with institutional characteristics and norms being determined by individual agents. As such, understanding how individual agents behave and, more importantly, learn within institutional and structural settings will be key in both measuring and understanding the capacity of banks to learn.

**The Framing of Learning in this Chapter**

Before we move on to look at the literature surrounding learning in more detail it is important that we first frame the analysis that is to follow. In order to do this we will turn briefly to consider Herbert A Simon (1957; 1958; 1983) and his work on bounded rationality. Classic economic theory suggests that actors are rational beings and have access to perfect information which informs their decision-making process (Simon, 1959: 254). Armed with perfect information and a rational mind mainstream economics suggest that it is possible to predict the behaviour of actors who will always look to maximise outcomes (ibid). However, Simon (1959: 256) rejects this notion arguing that due to the complexity and constant shifting nature of the economic environment and circumstances which frame the ‘choices that economic man faces’, perfect market information is rarely available. As such, Simon (1957; 1958; 1959; 1983) suggests that all humans are rational thinkers but that this rationality is bound by certain and sure limitations (Simon, 1983: 22). Subsequently, human behaviour, including learning, is premised upon the notion that while agents possess the ability to articulate responses to problems and are capable of multifaceted thoughts, these actions are framed and underpinned by a lack of access to complete information and as such agents are ‘boundedly rational’ in their decision-making processes (Simon, 1957; 1958; 1983).

The bounded rationality model devised by Simon (1957: 270) suggests that human choice to follow the ‘optimal path’ is hampered by man’s own lack of ‘wits’ and the ‘senses’ needed to determine and uncover such a path - assuming that an optimal route exists. Instead, the author argues that man’s decision-making process follows a ‘satisficing path’ which will deliver acceptable rather than optimal results and is framed by a series of ‘rational adjustments’ (ibid. p271). For Simon (1957: 257) the decision-making process to pursue the most rational choice and thereby maximise the optimal result is situated within abstract parameters which will determine choice and limit rationality. Within this framework individual agents are free to make rational choices but it is these options which are inherently limited or bound in their rationality as information is never complete leaving agents to make a series of trade-offs and re-adjustments about their environment (ibid). Consequently, the concept of bounded rationality in relation to learning will be explored throughout the literature review.

**Single- and Double-loop Learning**

Single- and double-loop learning theory is drawn from the literature on organisational studies and is most closely associated with the work of Argyris and Schon (1978; 1996). The relevance of organisational studies in application to my own work lies in the multi-disciplinary approach that the field has adopted over time including, but not restricted to, management, economics, business, history and psychology (Dodgson, 1993). Organisational studies offers us a robust and well-rounded theory in explaining not only how institutions learn but also how various mechanisms applied at the organisational level may improve or inhibit the learning trajectory of institutions. The multifaceted nature of organisations, including complex relations at the agential, institutional and structural level means that learning within an organisation can be a complicated and nuanced undertaking. However, the theoretical framework upon which organisational studies is rested means that it is excellently positioned to study learning and facilitate my own investigations.

Single- and double-loop theory suggests that the starting point for institutional learning is dissatisfaction, with undesirable outcomes causing the necessary stimulation to seek alternatives (Argyris and Schon, 1978: 18). According to the theory, when dissatisfaction arises an organisation will attempt to reconcile this discontent in one of two ways. *Firstly*, if the error identified can be corrected in such a way that it allows institutions to carry on working undisrupted and in pursuit of the same core policy intentions and outcomes, then the error detection/correction process is described as 'single-loop learning' (ibid. p2). However, if the appropriate correctional response to the error demands that the organisation significantly alter or modify its core objectives, strategies and institutional norms then this gives rise to a secondary response known as 'double-loop learning' (Argyris and Schon, 1978: 2).

Single-loop learning is concerned with making modest and incremental changes in light of new information which alters or amends current strategies of action in such a way as to preserve and maintain the current underlying ideas of a 'theory of action' (Argyris and Schon, 1996: 20). In single-loop theory, learning takes place when an institution identifies an error within either single or multiple facets of the organisation's standard operating procedures (ibid. p21). These routines are then modified and adapted in such a way as to maintain the direction and performance of the organisation that is in keeping with current institutional directives (Argyris and Schon, 1996: 21). In this instance the organisation's values and norms remain unaffected by changes as any alterations to the institution’s operating procedures will be done in such a way as to preserve the *status quo* (ibid).

Thus, single-loop learning suggests that the organisation only learns to the extent that it learns new strategies or procedures rather than question 'particular goals or values' (Usher and Bryant, 1989: 87). Single-loop learning can be identified when 'goals, values and strategies' remain unquestioned in light of competing or contradictory information with institutions focusing their attention on procedures and making these measures more productive (ibid). Consequently, single-loop theory suggests that learning does not necessitate an extensive search for information and is instead reducible to an exercise in the ability of an organisation to adapt and fit already established programmes to new circumstances and environments. Simply put, single-loop learning describes change at the margins of an organisation which, while important, does not go far enough and will not result in substantial change to an institution’s underlying core concepts or philosophies leaving room for potential errors to be repeated.

In terms of a practical application to my own thesis single-loop learning is desirable but only to the extent that it is a precursor to more substantive double-loop learning, with the magnitude of the financial crisis, and the banks’ role in the crisis, requiring a much more in-depth fundamental reappraisal of the way in which banks operate. However, single-loop learning will be of importance to my research by helping to determine whether what has occurred within institutions post-2008 represents a fundamental shift or if new policies have simply been introduced while the ends remain the same. One way of measuring single-loop learning in the context of my thesis will be to look at the balance sheets of the banks at the Group level. If the banks demonstrate evidence of single-loop learning we would expect to see certain key financial measure such as returns on equity (ROE), a key measure of profitability pre-2008, leverage ratios, capital levels, securitization and derivative trading, along with financial trading in general and the diversification of Group funding to remain broadly in line with pre-2008 levels, once we have adjusted for structural market changes, suggesting that the ends have remained the same with new policies, if any, consigned to altering the fringes of institutions.

In contrast, double-loop learning may be said to be present within institutions when the extent of the learning process effects a definitive change in an organisation’s 'values of theory-in-use' (Argyris and Schon, 1996: 21). An institution’s theories-in-use are described by Argyris *et al* (1985: 82) as being those group theories and philosophies which can be ‘inferred from action’ and are of particular importance to my research because according to Kerr (2010: 3) such a theoretical framework allows us to interrogate the relationship between how organisational ‘conceptions and philosophies’ are manifest in practical and strategic policies and standard operating procedures.

Double-loop learning within an institutional setting can be observed when an organisation first recognises discrepancies between the group’s theories-in-use and desirable outcomes (Argyris and Schon, 1996: 21). Again, like many of the theories to be examined in this Chapter, it is dissatisfaction resulting from a failure to produce favourable results which is the driving force behind learning. According to double-loop theory, following the identification and detection of failure the learning subject will reassess and alter its fundamental conceptions and philosophies in light of new information in such a way as to avoid further losses and deliver desirable outcomes once again (ibid). The organisation will then develop and implement a number of policies and procedures which will align strategic operations with these newly-conceived underlying group values and philosophies (Argyris and Schon, 1996: 21).

As such, we may assert that double-loop learning, unlike single-loop, and in keeping with the definition of learning proposed in this Chapter, would necessitate a clear and observable positive change in the banks’ underlying theories-in-use. Within my own thesis this will be tested by examining, through the use of documentary analysis, the language used by senior executives in relation to key strategic decisions which demonstrate a clear break with pre-2008 behaviour. Importantly however, Argyris and Schon (1978: 24) argue that within double-loop learning the detection and correction of error, while deemed necessary to produce favourable outcomes may not always be desirable. Therefore, we can anticipate that the documentary analysis may reveal that a change in a bank’s theories-in-use may not always be greeted with enthusiasm or positive language. Despite this, the literature suggests that under such circumstances double-loop learning can still be present (ibid). As with single-loop learning, analysis of the balance sheet will similarly be used to identify examples of double-loop learning with the literature suggesting that we should expect to see changes to the banks’ balance sheets beyond the constraints of regulation and structural market forces.

As both single- and double-loop learning share many of the same properties it is important that we are able to distinguish between the more cosmetic variation of learning, single-loop, and the more applied version, double-loop, in order to determine the extent to which banks have learned from the financial crisis. To this end Smith (2001; 2013) suggests that while both processes represent a degree of learning, single-loop theory professes adherence to a familiar routine and present norms with only minimal revision. In contrast, double-loop requires innovation and analytical inquiry into the organisation’s values and norms. Likewise, it is possible here to draw parallels with Hall’s (1993: 279) third-order change which similarly stresses a ‘paradigm shift’ in the underlying principles which guide policy objectives. For Hall (ibid), third-order change is a ‘disjunctive process’ which results not only in ‘discontinuities in policy’ but an overhaul in the thinking of how policies are made, perceived and evaluated.

However, Edmondson and Monigeon (1999: 160) have concluded that double-loop learning within institutions is extremely difficult and almost ‘impossible’ in highly pressurised situations when this form of learning is most suitable and greatly needed. This is because, according to the authors, when faced with a situation where the stakes are high and a great deal rests upon making the correct decision individuals are more likely to strictly adhere to company policies and organisational ‘theories-in-use’ for fear of sanction or personal recrimination (ibid). The consequence of such behaviour is that the organisation is inhibited from learning when learning is most sorely needed, with the process of individual reasoning leading to a breakdown in communication and a clear lack of information exchange (Edmondson and Monigeon, 1999: 160).

Likewise, Simon’s (1998: 28) satisficing theory also suggests that whenaspiration outstrips achievement businesses will turn to previously established procedures that will seek to uncover and yield acceptable solutions and results to questions ‘whose best answers are unknowable’. For Simon (ibid. p28-20) ‘real world’ optimization is an ‘impossible’ end to achieve as actors inhabit a world where both human ‘computational facilities’ and access to information are limited (Simon, 1957: 261). As such, agents and organisations are bound to be ‘satisficers’ in that they are predisposed to settle on what is ‘good enough’ not because it is necessarily a pleasing or desirable outcome in itself but because the approximations needed in order to adjust for deficiencies in computational skill and incomplete information is simply missing (Simon, 1998: 29).

This would suggest that the complex nature of organisations may inhibit their capability to learn under times of increased pressure. Only when institutions are able to move beyond the restrictions imposed by their own 'theories-in-use' will they have the freedom and innovation to learn and remedy problems. Here the literature suggests that banks need ‘space’ to learn. Space is understood as the dedication of both time and resources to the undertaking of a thorough and robust reflexive evaluation aimed at deconstructing the problem at hand and coming up with long-term sustainable solutions to the problem (ibid). However, those institutions that are simply firefighting, i.e. devising short-term solutions to problems as they arise, will fail to learn as they are not afforded the necessary ‘space’ to take on a detailed appraisal and thus they fail to fully understand and comprehend the underlying problem or the ‘bigger picture’. Importantly, the literature also recognises that structures can affect the learning process with highly pressurised external factors having a bearing on the ability of institutions to learn. Therefore, those banks which have experienced the most devastating effects of the crisis and the largest amount of fiscal and reputational damage may be less likely to learn as agents fall back and retreat upon already established theories-in-use. Likewise, if structural pressures are interpreted by the banks as being too great to overcome then this may also result in a retrenchment of theories-in-use.

The argument presented by Edmondson and Monigeon (1999) is of particular interest to my own thesis because, conversely, it would imply that those banks, which I will go on to argue, navigated the crisis with only moderate losses and can be deemed to have had a ‘good’ financial crisis; for instance Barclays and HSBC would have had a greater propensity towards more substantive double-loop learning. This is because according to Edmondson and Monigeon’s (1999) theory a successful navigation through the crisis may have afforded the banks the ‘space’ needed to learn with the successful management of the crisis removing many of the pressures which inhibit and stifle the innovation and space associated with double-loop learning. In this regard successful banks are not preoccupied with firefighting but are instead endowed with the freedom to step back and fundamentally apprise their ‘theories-in-use’ leading to important behavioural shifts, changes and improvements. In the empirical chapters to follow we would expect to see those banks which have navigated the crisis with only moderate losses and disruption demonstrating a greater propensity towards double-loop learning, a theory which will be tested throughout.

In the context of my own research, single- and double-loop learning would suggest that it is only through a robust and thorough examination of one’s own governing values that substantive and significant learning and change can take place. The practical implications of this means that I will be looking to evaluate the extent to which banks have undergone a fundamental reappraisal of both their standard operating procedures but also, more importantly, the institutionally-held governing values and beliefs. This may include the use of independent reviews and audits as well engaging in dialogue with institutional investors and shareholders, with those banks presenting evidence of a clear reorientation of group values post-2008 having a greater propensity towards learning. In this respect, I would expect to see the banks not only carrying out reviews but also designing and applying institutional systems aimed at changing and instilling a new set of governing values which have resulted from lesson learning expeditions while at the same time maintaining a system in which individual agency will not be stifled.

**Policy Learning**

As we can see, learning is premised upon a number of factors which will directly affect how, when and under what circumstances agents and the institutions which they encompass learn, how quickly lessons may be drawn from specific situations and how likely an organisation is to retain lessons learned. One such contingent factor is what for the purposes of this thesis I will refer to as ‘policy learning’. Policy learning is drawn from the discipline of political science and is most closely associated with the work of Richard Rose (1991; 1993; 2005).

Policy learning has been selected for my own research as it can help to better understand how institutional ideas, policies and norms, framed within a specific political epoch and sphere, may be transported across time and space in order to assist in the formulation of alternative organisational policies, rules and practices. Moreover, Day and Klein (1989: 350) argue that the central importance of Rose’s work lies in its ability to endow the researcher with a framework robust enough to tackle institutional learning within a ‘truly unpredictable’ structural setting. Policy learning is premised upon the notion that lessons can be drawn by examining previously established programmes already in existence elsewhere (Rose, 1991; 1993; 2005) and that through a careful and detailed assessment of existing programmes it is possible to determine expected gains if a similar policy was adopted elsewhere (Rose, 1991: 1).

For Rose (1993: 50) policymakers will always favour inaction over action, the status quo over radical new ideas and a stationary state over the uncertainty of progress. This is because, according to the functionalist scholar Karl Deutsch (1963: 111), whose work greatly influenced that of Rose, to follow the previously established routine way of doing things is efficient, if not always effective, while to ‘stick to what is known’ is always desirable as such a path leads to predictable and expected outcomes with ‘routine’ allowing policy makers the freedom to invest their time in matters which they believe to carry a higher value. Consequently, it may be suggested that procedure ordains policy makers with the ‘ability to afford not to learn’ (ibid).

However, like the literature on single- and double-loop learning, policy learning similarly suggests that what transforms the policy maker from a perpetual state of stasis into an effective and active learner is dissatisfaction (Rose, 1991; 1993; 2005), which is a ‘necessary condition of lesson-drawing’ (Rose, 1993: 57). Dissatisfaction occurs when previously established routines become fractured and no longer produce predictable or desirable outcomes forcing policy makers to seek new alternative forms of knowledge. Like the theories-in-use thesis associated with double-loop learning, this search for alternatives then becomes the stimulus to pursue and implement new policies, programmes and ideas in approaching the way in which business is conducted as policy makers look to close the gap between aspirations and achievement (May, 1992: 341).

The degree of dissatisfaction determines the intensity of the search for alternatives, or in other words, the greater the dissatisfaction the greater the search for alternatives (Rose, 1993: 58). Equally, Sabatier (1988) also stresses the motivating force of dissatisfaction, with the present situation or outcome of a specific initiative propelling policy makers to seek changes. Accordingly, the policy learning literature may help us to explain why some banks may show a greater propensity for learning than others. In particular, we may hypothesise that those banks which have undergone the greatest dissatisfaction and experienced the greatest losses and upheavals may also be the greatest learners. However, such a view stands in contrast to the learning space theory, discussed in the above section, which suggests that those banks which suffered the least dissatisfaction are likely to be the greatest learners. As such, the empirical evidence will be tested against these two contending theories in order to determine the accuracy and validity of the hypotheses extended.

The literature on punctuated equilibrium, most closely associated with the work of Jones and Baumgartner (1993; 2005; 2009), also stresses a ‘crisis or trigger event’ which undermines the institutional status-quo as being the key driving force behind organisational change (Jones and Baumgartner, 1993: 10). According to the authors, policy change within institutions is typically a slow-moving and cumbersome task which following a prolonged period of stasis is prone to rapid and dramatic ‘bursts’ and shifts in policy orientation and structure (True *et al*, 2007). Jones and Baumgartner (1993: 10) draw upon the work of Herbert A. Simon and particularly his theory on bounded rationality. The authors (ibid) suggest that boundedly rational actors do not respond to signals proportionately due to the ‘great number of real tangible problems… which can only be attended to one at a time’. Due to the limited capacity of agents to process vast amounts of signals information inevitably becomes lost and key signals missed and left unanswered. This in turn leads to a build-up within the system until a point of punctuation or ‘burst’ at which point those signals which have gone unnoticed are now recognised. However, while Jones and Baumgartner (2005) argue that this burst subsequently entreaties policy makers to focus more intently on the cause of dissatisfaction and to move from general musings to the specific, which in turn leads to pointed changes and eventually equilibrium, the point of punctuation is typified by crises with signals only being recognised and responded to after the fact and at which point it is too late with the damage having already being caused. In practical terms for my thesis this means that we would be looking to the banks to isolate the causes of the crisis recognised within the literature, with specific policy changes aimed at directly addressing these key triggers.

However, Jones and Baumgartner (2009: 280) warn that there is often a time lag between a punctuated event and the associated equilibrium and change. As such, we should think of the so-called trigger event as an “explosive process” during which the shockwaves may not be immediately realised but are instead felt much further down the line. Resultantly, while we may not immediately witness a change to core policies at the banks in this study directly following the crisis, almost ten years later, we may assume that there would be present sufficient empirical evidence to give at least an interim assessment as to the extent of learning and change.

To aid us in the identification of lesson learning Rose (1991; 2005) outlines five key factors in the learning process. The *first* of these examples is *photocopying*, which occurs when an institution copies a policy or programme already in existence elsewhere with very few, if any, changes made between the original and the new policy (Rose, 2005: 82). However, Rose (ibid) warns that photocopying may not always prove successful because just as ‘institutions… are not the same’ policies cannot be ‘exactly’ the same either. Therefore Rose, (1991; 2005) stresses the importance of his *second* proposal of *copying*. Copying takes place when an institution adopts a certain policy from an adjacent organisation and uses this as a ‘blueprint’ in the formulation of new institutional policies (Rose, 2005: 82). Copying will typically allow for small variations and differences between the copied and the new policy (Rose, 1991: 21), but it requires a detailed and in-depth exploration of the seminal ideas and philosophies which underpin the subject policy (Rose, 2005: 83). Accordingly, we would anticipate that when copying a policy from either a similar institution or from a historical project within its own organisation, banks will disseminate amongst employees very specific details surrounding the implementation including administrative processes, standard operating procedures and key performance indicators used to evaluate the success of the chosen programme.

*Thirdly*, Rose (1991; 2005) discusses the proposal of *hybrid* learning. Hybrid learning takes place when several harmonious factors, extricated from two or more individual policies, are combined to create a new policy (Rose, 2005: 83). However, the author goes on to stress that hybrid learning is distinct and separate from his *fourth* proposal of *synthesis* learning insomuch as it combines similar factors from different policies which share the same objectives or orientation (ibid. p81). Synthesis learning on the other hand occurs when factors drawn from differing policies, which do not necessarily share a similar objective, are combined to create a new and alternative policy (Rose, 1991: 22). However, Rose (ibid) warns that because the nature of synthesis learning is an artificial policy with no proven track record, the expected return or results of which will vary and are impossible to predict. In application to my own thesis I would anticipate both hybrid and synthesis learning to be inclusive of examples of where new policies have originated from and may involve recruiting senior executives and other strategic planners from more successful banks in order to assist in the formulation of new policies.

Finally, *selective imitation* occurs when an institution selects a lesson or lessons from policies which are ‘congenial’ to the learning institution (Rose, 2005: 84). However, measuring selective imitation in my own thesis will not be without its challenges as Rose (ibid) associates political costs with such policies. For example, the author believes that recognising a policy implemented at a rival organisation or bank which has proven to be more successful can potentially harm the reputation of the learning institution (Rose, 2005: 84). In this respect, banks could attempt to conceal and mask where policy initiatives have been drawn from and may instead ‘cherry pick’ certain policies to be integrated into their own ‘independently’ made policies (ibid). A failure by the banks to recognise where policies have been drawn from, and the associated learning, will be overcome in this thesis through critical engagement with official documents such as bank annual reports and key speeches given by senior strategic decision makers in order to identify trends and patterns in policy making and the potential presence of selective imitation.

As such, we can see that the public policy learning framework is intimately bound to an evaluative process whereby learning is predicated upon making a judgement about a specific policy or programme in place within a given time or space. As May’s (1992: 335-336) thesis on instrumental policy learning stresses, ‘new understandings about the viability of policy interventions or implementation designs’ along with ‘increased understanding of policy instruments or implementation’ are central to the idea of policy learning.

However, Simon (1957: 259) warns that in order to achieve true optimal returns agents must be equipped with perfect information concerning the distribution of choice and the probability of outcomes that would stem from following a particular path or making a particular decision. In addition, this information also needs to situate the agent’s potential path choice within and across time in order to maximise the optimal values (ibid). As such, we may conclude, with caution, that lesson learning is not simply about ‘blindly’ borrowing or ‘blindly’ condemning that which has a proven track record of success or failure but that it is instead a reflexive critical analytical process contingent upon a specific application of the institutional as well as the broader structural settings where this new information has been previously used and will be imminently applied (Rose, 1991: 4). Hence, lesson learning within the context of the policy learning framework stresses the importance of an increased understanding of the application of newly-acquired information taken from a particular source and which can be applied and used to inform and improve conditions once implemented by the individual or organisational policymaker (May, 1992: 333-334).

In application of the policy learning framework to my research I expect that those banks which have demonstrated evidence of undergoing a fundamental reappraisal of their institutional policies and procedures, for example through the use of external independent reviews, may have a greater propensity towards learning. Indeed, the use of formal reviews as a means of measuring and testing learning within my own work is further strengthened by Rose’s (1991: 19-20) assertion that in order for an institution to enter into the evaluative process associated with learning, it must first gather a raft of new knowledge about policies or programmes which have an already proven track record in dealing with similar issues. Likewise, Baumgartner and Jones (2009: 280) also note that the ‘burst’ of a punctuated point in time often leads to the legitimisation of actors who are usually held outside of problem solving circles. In this instance the scale and magnitude attributed to a problem and the subsequent drive for change means that agents traditionally excluded from an institution’s central policy-making unit are now seen not only as a valuable source of information but are actively encouraged to feed into the solution of problems (ibid).

The objective of such an exercise is hugely informative with the by-product being that the subject learner’s own knowledge and understanding will be improved as agents and that the institutions which they embody are introduced to new ideas and experiences in how to effectively manage difficult situations as applicable conclusions are drawn from a discretionary application of new knowledge (Rose, 1991: 19-20). Essentially, and in light of the literature above, I will not only be looking at the behaviour of banks, which is important in the learning process, but will also be focusing on the underlying process behind any subsequent changes.

When utilising such principles within my own thesis I will not simply be looking to identify whether banks have undergone formal reviews but will instead be looking to critically analyse how the information gathered from such reviews has been used by the banks. Indeed, the mere presence of a formal review does not necessitate double-loop learning, the focus of this thesis, and may instead be akin to single-loop learning. Therefore, I will look to interrogate how banks have deployed the information garnered from such reviews to not only change their individual processes but also to shift and re-align their underlying values and group philosophies. Indeed, Etheredge (1981: 77) has argued that learning can only be said to have taken place if the subject demonstrates sufficient knowledge and an ‘increased intelligence and sophistication of thought’ when applying new forms of information to the framing or solving of a specific problem.

**Cognition and Schema**

This section will consider the literature on learning drawn from the discipline of psychology and in particular social psychology. The field of psychology is of importance to my research, and the broader subject of learning, because it recognises that learning is not only an individual but also an institutional process which must similarly take account of structures. As such, psychologists working within the field of education and learning seek to identify and explain how different institutional and structural variants may alter and affect how agents learn and how the methods and techniques for learning may be shaped and constrained by the environment we encounter.

Like the performance-based insights drawn from the literature on policy learning, learning within the discipline of psychology similarly proposes that human behaviour and learning can be greatly influenced and determined by the history of past events. For example, Bandura (1977: 192) suggests that all agents possess an intrinsic cognitive process that helps us to recognise certain key situational indicators and which to decide what behaviour is preferable or appropriate at a specific event or point in time. Moreover, it is this cognitive process that enables agents to determine the likely outcome of responses and the consequences of specified behaviours (ibid). As such, agents are endowed with an understanding of how they must behave or respond within certain institutional and structural contexts in order to achieve desirable outcomes and avert unsatisfactory results (Bandura, 1977: 192).

Moreover, these cognitive processes are formed upon and underpinned by a series of schemas which are responsible for storing knowledge and forming relationship paths between the stimulus and those previously held ideas and information (Fiske and Taylor, 1991: 139). A schema can be simply defined as a piece of information which has previously been established and is held in our memory concerning expectancies based on history about people, objects or situations (Pendry, 2008: 72).

Jitendra *et al* (2007) argue that schema-based learning takes place through problem identification and then a subsequent search for new information which will correct the upheaval encountered (a recurring theme which runs through much of the literature examined in this Chapter). According to Minsky’s (1975) *Frame Theory,* altering and adding information to the already established schema is possible when a series of cognitive process are utilised to inform pre-existing knowledge slots during the search for corrective information, a view which has subsequently been built upon and expanded by Desoete *et al* (2003) and Mayer (1999).

However, while to some extent learning is seen as an individual process, the literature on cognition and schema also recognises the potency of structures, something which the works examined so far risk underplaying. For example, learning and cognition is premised upon the assumption that all humans are social beings and as such must be assimilated into their respective groupings by acquiring the cultural rules or norms which govern a society and which are transmitted via structures (Elkjaer, 1999: 78). The success of an individual becoming a fully-functioning member of a particular group or society is rested upon their ability to interpret and understand social knowledge and to absorb the cultural history of that given group (ibid). This internalisation is aided by the schema which equips agents with a prior framework to which new, or similar, experiences and information can be grafted (Fiske and Taylor, 1991: 125). Once a schema has been established it will affect how quickly information is absorbed and assimilated into memory, how we distinguish situational characteristics in identifying new information and how we draw conclusions about the similarities and differences in new experiences with old memories and previous ideas (Fiske and Taylor, 1991: 122).

Here we can see how the literature on schema and cognition, in relation to structures and the transmission of information can be tied to bounded rationality. In this example, we see how agents are exposed to information which is immediately accessible and informs an individual’s understanding about the distribution of possible outcomes with agents being free to choose the option which they perceive will maximise returns (Simon, 1957: 257). Yet, in order to achieve the full potential of the information gathered this information must be ‘perfect’ and situate the agent’s potential path choice within and across time in order to maximise the optimal values (ibid). However, schema and cognition theory, like Simon’s (1957; 1958; 1983) bounded rationality, argues that agents rarely, if ever, have access to perfect information and are instead bound by their own previously held traits and beliefs which will shape and inform the way in which information is interpreted.

Therefore, the psychology literature suggests the need to look at how the banks have interpreted the financial crisis and what conclusions have been drawn from this information. In particular, I will be looking at what the banks themselves have identified as being the key causes of the financial crisis and what lessons they have identified and how these lessons may have altered previously held ideas[[3]](#footnote-3). The literature further suggests that we likewise ought to examine what information is being sought post-2008, how the schema ‘slot’ is being filled and where this information is coming from, as a means of identifying the extent to which social knowledge and cultural history has been absorbed. For example this might be information gained from the bank’s own past historical experience of the crisis, or it may be information attained from adjacent organisations that navigated the crisis with more success or greater losses, for a positive or negative lesson-drawing experience respectively.

However, we must also consider the banks’ own learning experience in relation to social structures which the literature suggests equips us with the cultural rules and norms to succeed. Indeed, as discussed in the previous Chapter, structures can be hugely constraining and can place immense pressure upon agents distorting and retarding the learning experience as actors and institutions are often wary or fearful of breaking loose from structures due to the stability and assuredness they give our social world by instilling what is expected of us in a given situation (Fiske and Taylor, 1991: 122). In our case financial markets bring both assuredness to the banks by determining what is expected of them but they also, due to their highly competitive nature, have the ability to severely punish and potentially destroy those banks which stray from the determined path as shareholders, to whom the banks owe a duty of care - which predominately translates into ensuring the best share price - have the potential to withdraw massive sums of capital on which the banks rely.

Given the fact that schemas are deeply embedded within our cognitive reasoning and shape our understanding and experience of the numerous social worlds in which we inhabit, along with the information we encounter, they could therefore be judged to inhibit rather than enable our learning. For example, when we encounter new information our social schema may quickly assimilate and 'rationalise' that new information to fit an already established or satisfactory information category potentially closing off agents from new and viable sources of information with the schema falsely interpreting new information (Elkjaer, 1999: 82).

Likewise, when we encounter information which is at odds with our pre-existing schema or information slot then our cognitive bias may cause us to disregard such information preventing us from achieving desirable outcomes. For example, in their investigation into the Columbia space shuttle disaster Boin and Fishbacher-Smith (2011: 84) found that NASA did not wilfully ignore or disregard safety concerns from engineers that the shuttle’s thermal protection system had been damaged and would fail upon re-entering the Earth’s atmosphere, but instead ‘did not know’ how to assimilate the information being relayed to them. Indeed, NASA’s past safety record was exemplary without the loss of a single astronaut and with similar technical issues afflicting previous space flights resulting in the most negligible results (CAIB, 2003). As such, Boin and Fishbacher-Smith (2011: 84) note that it was not ‘the loss of a safety culture’ at NASA which resulted in the disaster but a ‘disciplined adherence to proven safety systems’ which contributed to the catastrophe. In this example we can see how NASA, when confronted with new information which did not fit with an already established schema, rationalised that the information was erroneous and should be disregarded thus falsely interpreting the information and leading to disaster.

One potential way of overcoming the barriers to learning associated with cognition and schema may be found in the psychology sub-discipline of heuristics and signalling which looks at how information or signals are interpreted by individuals. The work on heuristics by Tversky and Kahneman (1974: 1124) asserts that when faced with uncertain events individuals turn to a number of heuristics or signals which will ‘reduce the complex tasks of assessing probabilities and predicting values’. However, like the literature on schema and cognition, Tversky and Kahneman (ibid) similarly state that while heuristics can help us to process complex information it can also lead to errors in judgement and undesirable outcomes.

Likewise, Hindmoor and McConnell (2013: 549-551) conclude that it is impossible for institutions, such as banks, to know what information and which signals are of particular salience, arguing that while some organisations assign a great deal of importance to new information and signals devising appropriate responses, other organisations, faced with the pressure ‘to deliver immediate goals’, such as banks who operate in a highly competitive structural settings, will tend to fall back upon the previously established way of doing things, thus disregarding and ‘downplaying’ the transmission of new signals and information.

A similar notion can also be seen in the literature on bounded rationality which suggests that human behaviour does and will fail to deliver desirable outcomes (Jones, 1999: 298). Moreover, when a failure to deliver the maximum or most favourable returns occurs this does not necessarily mean that the underlying or preceding choices made were irrational, but rather that an agent’s ability to follow the optimal route was inhibited or bound by a lack of access to full and complete knowledge regarding their structural and situational context (ibid) as is assumed by the rational choice and expected utility theories (Simon, 1957: 241).

Under such auspicious circumstances as those described by the literature on schema (Fiske and Taylor, 1991; Elkjaer, 1999), heuristics (Tversky and Kahneman, 1974), signalling (Hindmoor and McConnell, 2013) and bounded rationality (Jones, 1999; Simon, 1957) it would appear that learning would be hedged in and almost impossible with the potential for a large margin of error. However, Bracken *et al* (2005), writing from within the discipline of strategic management, suggest a number of practical ways in which such shortcomings may be minimised and overcome.

*Firstly*, it is proposed that no one individual should be responsible for interpreting and disseminating information (Bracken *et al*, 2005: 22). Instead, the authors suggest that multiple actors should be tasked with elucidating information with no single strategic decision maker having absolute autonomy or power and thus minimising the chances of information being misinterpreted or disregarded (ibid). This would suggest a need within my thesis to examine how key decision makers are being held to account. In particular, I will look at how corporate governance is structured within the banks and any changes which may or may not have been made to these structures post-2008. Moreover, it may be asserted that those banks which have more than one or multiple lines of defence in the decision-making process including a governance structure which holds all material decision makers to account through both a top-down and bottom-up oversight model would have a greater propensity to correctly interpret information which may otherwise be disregarded or falsely understood by pre-set cognitive biases.

*Secondly*, the authors propose that within an organisational setting, separate teams or divisions should be responsible for holding one-another to account (Bracken *et al*, 2005). It is suggested that such measures foster an environment of competition between divisions, the result of which is that individuals and teams will focus more intently upon the situational environment for key signals and dedicate themselves more fully to the interpretation of this information for fear of ‘letting the side down’ or risk being castigated as the ‘weak link’ within the organisation (ibid. p22). As such, those banks which implement and actively encourage such mechanisms as ‘whistle-blowing’ facilities and cross-divisional appraisals post-crisis would, as the literature suggests, have a greater propensity towards learning and change.

A *third* factor which the authors propose may better inform our understanding and interpretation of new information or signals is drawn from the field of behavioural economics and builds upon the classic work by Tversky and Kahneman (1974), dubbed ‘deep regret anchors’ (Bracken *et al*, 2005: 22). The basic premise of this idea is that individuals will look to minimise losses even at the expense of losing gains with past losses and a fear of future catastrophe, built into a previously established schema, acting as a barrier to potential useful information (ibid. p23). In this instance, past losses or ‘deep regret anchors’ cause the learning agent or organisation to effectively step back and appraise all relevant information before making a decision with such considerations being centred upon the fear of imminent catastrophic losses and ‘history repeating itself’ (Bracken *et al*, 2005: 23).

This may lead us to conclude that that banks which have recognised the causes of the crisis within both their own institutions and the wider banking industry, as discussed in Chapter 2, would have a greater aptitude for learning as this demonstrates an awareness not only of what went wrong but also what mistakes need to be avoided when moving forward. However, we will be looking to test not only if banks recognise past errors but also how they have implemented changes in light of this information and which may include independent group audits and appraisals. Analysis will also be carried out to see how banks’ learning experiences have been framed by structural factors such as dealings with shareholders and institutional investors as well as other banks and how these encounters have influenced the learning trajectory. For example, it may be the case that the banks’ own analysis sees structures as being the overwhelming cause of the financial crisis effectively absolving themselves and instead placing blame on external causes.

Like double-loop and policy learning, theories related to cognition and schema similarly propose that learning takes place through a process of error detection/error correction and that such a system will result in observable changes to an institution’s underlying theories, values and philosophies in additional to positive behavioural change. Nonetheless, we should keep in mind that learning is always situated by a certain kind of rationality, namely, bounded rationality. As a result, the learning experience, whether or not this is a positive or negative experience, may not necessarily produce the most optimal outcomes. Indeed we should remind ourselves here of Simon’s (1957: 259) thesis which suggests that agents become ‘satisfied’ with a particularly clumsy kind of rationality which is premised upon using rough approximations to compensate for key gaps in information.

This kind of rationality, for example, typically involves refining and limiting the ‘planning horizon’ by making assumptions concerning the optimal outcome of an agent’s decisions and the probable result of such a path, including an appropriate timeframe in which we can expect to see returns (ibid). The value of these probable and predicted outcomes will initially be very high and far greater than what can realistically be achieved. Agents will then take stock of early returns and initial indicators of performance before making incremental revisions to initial estimates, either upwards or downwards according to the feedback of information, until an outcome which is both acceptable and obtainable is reached (Simon, 1957: 259). This kind of rational adjustment, according to the author, is what humans find to be ‘good enough’ and what is employed through a variety or everyday decisions and situations (ibid. p260); the implication of this for my own research being that banks may not reach their optimal performance. However, a failure to produce maximum returns should not be considered a failure to learn, particularly when there is clearly evidence of learning which matches the criteria which has been set out thus far.

**Structure and Agency**

So far this Chapter has looked at how different scholars from across the social sciences define learning, how learning occurs and the different kinds of learning delineated within various disciplines. However, any attempt to understand learning and how these ideas may be utilised to adjudicate if and why banks have learned lessons from the 2008 financial crisis would be incomplete without contextualising the learning experience within both an individual and socio-cultural setting. Indeed, much of the literature reviewed thus far could be accused of overstating agency in the learning process and subsequently underplaying how and why learning might be inhibited by structures. To this end, the following section of the Chapter will address this issue and rebalance the debate. *Firstly*, it will be suggested to the reader that all learning, be it at an agential or institutional level, takes place within structural settings which have the potential to inhibit human ability to learn. *Secondly*, agents are indeed capable of overcoming structural forces in order to learn and change. *Thirdly*, it will be suggested that the learning process cannot simply be reduced to either a structural or agency based exercise but is instead akin to a constant state of interaction between both structures and agents. *Finally*, drawing on the work of Margaret Archer, and in particular her thesis on the internal conversation, I will suggest that, contrary to the literature reviewed so far, learning does not necessitate a clear or observable behavioural change and that structural constraints may result in agents simply learning that change would be harmful.

The structure/agency literature is drawn from the discipline of sociology. Its contribution to my thesis and our comprehension of learning is of particular importance because unlike theories of learning rooted within the discipline of psychology, which tend to overplay learning as being a purely individual experience (see Marton, 1975; Marton and Saljo, 1976; Watkins, 1983), or the social constructivist tradition, which emphasises social structures as being the key conduits in the learning experience (see Vygotsky, 1962; 1978), the structure/agency literature recognises the delicate interplay between both socio-cultural and individual considerations in the learning process.

The importance of considering both structure and agency in my research is highlighted by more recent contributions by Ashwin (2008: 151-152) in his application of the theory to learning within higher education institutions. The author suggests that a rejection of the structure/agency thesis would severely limit the ‘explanatory power’ of institutional and agency based research with an explicit focus upon both structure and agency greatly improving the ‘quality of explanations’ in detailed empirical research (ibid).

The roots of the structure/agency thesis can be traced back to critical realism which is most closely associated with work of Roy Bhaskar (1979; 1993) who suggests that agency follows structure. However, the author stresses that we should not suppose that agency is ‘locked in’ or predetermined by structural confines, instead structures are seen by Bhaskar (ibid) as a necessary precondition of agency. Indeed, the author argues that ‘society is both the ever present condition (material cause) and the continually reproduced outcome of human agency’ (Bhaskar, 1979: 44). As such, critical realism suggests that social structures are constantly adopted and taken on by individual agents who then reproduce and reinforce these structures through the medium of social rules, norms, cultures and traditions which are in themselves the product and exercise of human agency (Bhaskar, 1979: 44-45). Essentially, the critical realism literature suggest that the propagation of structures is reliant upon the actions of autonomous agents and that these very actions are in of themselves only made possible by these structures (Baert, 1998: 194).

However, Hartwig (207: 240) cautions that we must not fall foul to reducing human interaction to a single operating sphere and instead stresses that society is founded upon and constrained by a ‘stratified nature of reality’ with multiple and simultaneous interactions and facets of knowledge shaping the relationship between the ‘knower and [what is] known’.

As such, critical realism recognises that human agency, social interaction and how we understand the world in which we inhabit is not wholly independent of the ‘objects, processes, and events’ which construct our reality (ibid). Moreover, the contribution of Bhaskar (1979; 1993) to the discipline suggests that society is not the product of human endeavour but is instead a ‘necessary condition’ of human activity (Bhaskar, 1979: 45). Therefore, according to the literature, society should be viewed as a collection of various ‘structures, practices and conventions’ which individuals adopt and take on and which are subject to adaption and modification over time, but whose existence is also dependent upon human choice to adopt these various arrangements (ibid). The structure/agency theory presented in the critical realism literature attempts to formulate a model which considers the countless ‘structural conditions’ which underpin all human action and stresses that ‘society does not exist independently of human activity… but it is not the product of it’ either (Bhaskar, 1979: 45).

Standing in contrast to the work of Bhaskar (1979; 1993), Anthony King (2005: 216) suggests that while on the surface everyday human action may appear to be hedged in or underpinned by structural forces over which we possess little or no authority, agents do retain a sure degree of autonomy and are free to exercise certain behaviours in any way which they see fit.

King (2000) rejects Giddens’s (1988; 1995) structuration theory which suggests that agents, consciously aware of their own social systems, adopt a series of routine actions which reinforce pre-existing social structures. Instead, King (2005: 216) argues that even the most basic examination of one’s own everyday experience will highlight the numerous interactions between structures and our own sense of agency. While the author suggests that ‘family, class, income bracket, culture, religious background’ are all structural factors which may constrain the way in which we behave the extent to which we conform to and adopt these behavioural norms is ultimately determined by autonomous agents (King, 2005: 16). Moreover, the author goes on to suggest that

Life is not the struggle of the individual against structure, nor the reproduction of the structure by the agent, but an eternal round of interactions through which social relations between humans are made, transformed and destroyed

(King, 2004: 17).

However, while the work of King (2000; 2005) recognises the importance of structures and agency in human interaction, his work tends to overstate the ability of agents to overcome structures, which while not impossible, can prove extremely difficult to navigate and break free of. Indeed, we know that in the years preceding the financial crisis many bankers and banks became locked into the structures which they had created (see Bell and Hindmoor, (2015a) for further discussion).

Similarly, the work of Bhaskar (1979; 1993), like King (2005), also recognises the significance of both structures and agency, but tends towards a greater emphasis upon the constraining nature of structures, with human agency being relegated to a reproductive role with individuals exercising their agency but only to the extent to reproduce or modify the structures by which they are framed.

As such, my own thesis, while recognising the important contribution of both King (2000; 2005) and Bhaskar (1979; 1993), rejects both theories for presenting a definitive or conclusive explanation of the structure/agency debate. Instead, my work will look to occupy the space between these two scholars and strike a balance between individual autonomy, agency, and socio-cultural constraints and structures, thus espousing the mediating power of both structures and agents. As such, I will focus upon the work of Margaret Archer (1995; 2000; 2003; 2007; 2012) which will provide my own thesis with a rich theoretical grounding.

While my work draws heavily upon the theoretical framework first presented by Bell and Hindmoor (2015a), my thesis will diverge from this by using a unique application of the work by Archer (2003) on ‘the internal conversation’, which is discounted in the original text by Bell and Hindmoor (2015a).

While Archer’s (1995; 2000; 2003; 2007; 2012) work possesses a much greater balance between structures and agents than that of King (2000; 2004; 2005) or Bhaskar (1979; 1993) the author does tend to overemphasise the role of agency. Despite this, Archer’s work is important to my own thesis and our conceptualisation of learning as it develops a model which explains the way in which agents are able to exercise their autonomy, despite operating within already existing and predetermined structures, while at the same time recognising the potential constraining power of structures. To this end, my own theoretical conceptualisation of the structure/agency debate will draw out and focus upon Archer’s (ibid) emphasis on the delicate relationship and trade-off made between agents and structures, a model which Kahn *et al* (2012: 860) have suggested ‘offers a promising basis to help explain [the] interplay between personal and socio-cultural factors within… learning’.

When addressing the issue of agency it is important to remind ourselves of the temporal nature of agents and as such we should avoid making generalised statements. For example, different sets of agents can be located within different periods of time. Likewise, we should note that agents may learn, only to be replaced by another set who have not learnt, or similarly, agents who have not learnt are replaced by those who have. Such examples with be distinguished within the empirical chapters as appropriate.

Archer’s (1988) earlier work emphasises the importance of considering both structure and agency in social life with the author successfully separating agency, culture and structures by arguing that these critical domains are ‘substantially’ different and ‘autonomous’ from one another (ibid. pix). Moreover, the author goes on to suggest that to ignore these subtle differences and simply reduce society to one or another of these factors would be to reduce the complexity of social life into a ‘simple’ amalgamation which would undermine our very attempts to understand the human condition (Archer, 1988: ix).

Moreover, in her later work, Archer (2003: 130) suggests that all human behaviour is determined by an ‘internal conversation’ in which agents reflexively consider their position in relation to external social conditions, namely structures. According to the author all agents are free thinkers with a distinct personality unique to them and as such are able to determine their thoughts which are guided or underpinned by personal morals, values and goals (ibid). Because agents are bestowed with a unique set of personal characteristics and the freedom of thought, Archer (2003: 130) suggests that when confronted with structures individuals will exercise their power of reasoning, in accordance with their own personal position, to judge a situation before formulating strategic responses centred upon what they deem to be the most pleasing and of the greatest importance.

While an initial reading of Archer’s (2003) internal conversation thesis may appear to overstate agency it is important that we do not discount structural forces which can be particularly salient in shaping human interaction. For example, the author argues that in everyday life, we first gather information concerning our social context from structures before devising a unique response. In particular, our chosen response to structures will be centred upon both our personal objectives and, more importantly, the possibilities and limitations which those structures hold (ibid. p133). Moreover, our morals, values and goals will subsequently be revised and reinterpreted in light of structural constraints and opportunities as we devise and create appropriate responses according to what we believe will equip us with the greatest opportunity to achieve our ambitions (Archer, 2003: 133).

This would suggest that agents can be reflexive to the extent that they first consider their position in relation to structures and then exercise their autonomy in order to realise their goals but with structural constraints an ever present consideration. For example, we know that post-crisis banks operate in highly competitive financial markets (see Acharya and Richardson, 2009; Bell and Hindmoor, 2015a; Davies, 2010; HM Treasury, 2015a) and as such, actors while retaining their autonomy and agency, must also consider the possibilities and limitations competitive markets place upon them.

The importance of individual reflexivity and its bearing upon my own research in relation to learning is highlighted by the literature on educational studies. For example, in their study Booth and Anderberg (2005) stress a positive correlation between critical reflection and enhanced learning capabilities. The authors found that participants who were able to reflect critically upon their position and their own role within the wider system of education were more likely to consider a broad range of strategic factors located within educational structures and as such had a greater propensity towards being successful learners (ibid. p381). Moreover, Khan *et al* (2012: 865) also suggest that the learning capabilities of agents can be attributed to the extent to which individuals exercise their ‘personal powers’.

While Archer’s (2003) internal conversation model introduces the importance of individual reflexivity the author further elaborates upon this key issue by highlighting four distinct forms or types of reflexive consideration, namely *communicative reflexives; autonomous reflexives; fractured reflexives* and *meta-reflexives.* While communicative, autonomous and fractured reflexives are all important factors in the internal conversation, I will focus my attention upon meta-reflexives which will help us to address a major underlying question within my research and which stands in contrast to much of the literature already examined in this Chapter, namely, *is learning possible despite the absence of behavioural changes?*

Meta-reflexives describe agents who are able to consider their own reflexive position in the decision-making process. For example, an individual’s internal conversational is typified by a series of mental exchanges, namely, we ask ourselves a question internally and then seek out an internal answer (Archer, 2003: 255). However, meta-reflexivity occurs when we question the answer that we have provided ourselves with before and an internal deliberative process begins. With meta-reflexivity the internal conversation is no longer concerned with establishing a correct answer but about discovering and challenging the process we use to establish that particular answer (ibid). Importantly, Archer (2012: 206) stresses that in considering our own reflexive process, the meta-reflexive instinct leads agents to become acutely aware of the ‘situational logic of opportunity’ as structures, rather than being blindly internalised and reproduced, are instead problematized with actors demonstrating a greater understanding of both the possibilities and limitations of their own agency and structural forces (Archer, 2012: 207).

In application to my own thesis this would suggest that reflexive agents may, in reaction to the financial crisis 2008, first establish that learning is necessary, but following the internal deliberative process, which considers the ‘situational logic of opportunity’, calculate that the structural environment, in our case competitive financial markets, would punish them if they learn and change dramatically. As such, through the exercise of their own agency banks may choose not to alter their behaviour radically. Indeed, Caetano (2014: 6) argues that meta-reflexive agents develop a ‘critical vision’ that informs our understanding and development of behaviours which are deemed to be most appropriate and beneficial to our own position. In our case it may be that the banks have indeed learned lessons following the crisis but that the lessons learned are about the costs and dangers of reform. In this respect we may conclude that one of the outcomes of the financial crisis is that the banks may learn but that the lesson learned is about their own learning and that the outcome of learning may not necessitate positive fiscal results. In essence, Archer’s thesis on the meta-reflexives indicates that one of the lessons the banks may learn from the financial crisis is that it is better and more economical to not change. And while this may not necessarily be the most desirable outcome it is still representative of a greater understanding and sophistication of thought concerning their own experience of learning and could explain why some banks may still learn despite presenting little evidence of change.

From the literature on structure/agency and the work of Margaret Archer I will carry forward two important features which will be employed in the analytical process to follow. The first is the notion that banks and bankers are not separated or detached from the structures within which they operate, namely financial markets, yet, at the same time retain a great deal of autonomy. It is against this backdrop of individual and socio-cultural factors which learning will take place, with agents and structures being neither ‘co-extensive nor co-variant’ (Archer, 1995: 66). The second is the idea that the reflective capabilities of agents in the learning process do not necessitate a dramatic or observable behavioural change and that meta-reflexives about the learning process itself are important. In particular, it may be observed that along with a greater understanding and sophistication of thought concerning the ‘situational logic of opportunities’ (Archer, 2012: 207), presented by and embedded in financial markets, one of the lessons learned from the financial crisis by the banks is a greater understanding about their own learning abilities and processes and that a positive learning experience will not necessitate change due to the mediating power of structures.

**Conclusion**

This thesis asks the question whether banks have learned lessons from the 2008 financial crisis. To this end the literature review carried out in this Chapter has set out what we mean and understand by learning as well as detailing those conditions most conducive towards learning. While there are a number of contending typologies of the concept of learning, single- and double-loop learning will be crucial in answering the question posed in this thesis as it equips us with the theoretical tools with which to distinguish between more superficial (single-loop) and deeper (double-loop) conceptions of learning.

The literature on single- and double-loop learning stresses that single-loop learning, while perhaps an important precursors to more substantive (double-loop) learning, is a more ostensible kind of learning which fails to tackle the root cause of problems and is instead more focused upon making slight and incremental changes to the fringes of current practices and norms. On the other hand, double-loop learning stresses the presence of a reflexive and thorough evaluative process which results in positive tangible changes not only to current practices and mechanisms but also to the underlying governing philosophies and rationale.

In application to the research question posed in this thesis the literature would suggest that given the huge role which *prima facie* evidence indicates the banks played in the crisis double-loop learning is both desirable and necessary with single-loop learning, while important, simply not going far enough. As such, the importance of the contribution of the literature to my own thesis lies in its ability to allow us to identify and isolate examples of leaning which have resulted in a change of an institution’s policy objectives (associated with single-loop learning) with those which have produced a reorientation of strategic goals, values and underlying group principles (associated with double-loop theory).

The literature reviewed in this chapter of the thesis also stresses that all learning is predicated upon and framed by bounded rationality. Because agents rarely have access to perfect information they are prone to making clumsy approximations to compensate for key gaps in information. Moreover, the ability of learning subjects to process information, in our case banks and bankers, is further hampered their limited computational abilities. As such, while following the optimal path is desirable it is not always possible because actors are prone to settle for what is ‘good enough’ and as a result are ‘boundedly rational’ learners. In application to my thesis the literature on bounded rationality tells us that while learning may be desirable amongst the banks and bankers it may not always be achievable in reality because agents and the institutions which they embody have a propensity to settle and become ‘satisficers’ as opposed to pursuing optimal outcomes.

Moreover, the path towards maximising outcomes may be further complicated when we account for the fact that structures are also a mitigating factor in the learning process. For example, the literature reviewed here has also demonstrated the need for us to take account of the fact that learning is set within broader structural constraints, which while not impossible to overcome, exert a great deal of influence over the learning process. In application to my thesis this would suggest that we cannot presume that learning will have taken place because agents are not fully rational actors, are limited by their computational skills to process information and are hampered by the structural environment in which they operate which all have a bearing upon the learning trajectory of subjects.

The work of Archer on meta-reflexives shows us that while the desire to change may be one outcome of the learning process this desire may not necessarily translate into proportionate actions if the associated cost of change is perceived as being too high. In this instance the internal conversation while recognising that learning is needed also identifies that change - or to deviate too far from the established path - would place the learning agent at a disadvantage and thus prove to be harmful. In this instance learning is present despite the tangible change, with the lesson learned by agents and institutions being about their own capacity for learning and change. In relation to my thesis this would suggest the need to account for how agents and institutions perceive their wider structural environment (e.g. competition) and how constraints are being interpreted along with any associated costs of reform.

While establishing a number of benchmarks or measures of learning the literature presented here also endows us with a theoretical grounding which may explain inter-bank variations in lesson learning. *Firstly*, the literature stresses that dissatisfaction - this being when aspiration outstrips outcomes, and a desire to rectify unfavourable results will prompt learning which will in-turn result in a positive behavioural change. Therefore, we may hypothesise that those banks which have undergone the greatest dissatisfaction and experienced the largest losses and upheavals may also be the greatest learners as the level of dissatisfaction at these institutions will be will higher. *Secondly*, the literature indicates that learning requires space – being the dedication of both time and resources to the learning process. Subsequently, we may suggest that those banks which have been free from the burden of ‘firefighting’ post-2008 may have a greater propensity towards learning. These two important facets of the literature will be tested throughout the empirical chapters

**Chapter 2 – Literature Review - Causes of the Crisis**

**Overview**

While banking crises and crashes, such as the Latin American sovereign debt crisis, the junk bond crash and the Asian financial crisis, have plagued markets throughout history the extent to which the financial crisis of 2008 devastated the global economy was unprecedented with an almost instantaneous, extreme and crippling depression of economic activity affecting every corner of the globe (King, 2009: 1). Unlike previous crises, the 2008 crash was not the result of a downturn in economic activity in the real economy but was instead rooted in bank losses triggered by exposures to the U.S. subprime mortgage crisis, which subsequently spread to the real economy (Bell and Hindmoor, 2015a: 6), leaving Andrew Haldane of the Bank of England to conclude that financial markets had greatly increased the privatisation of return and the socialisation of risk (Haldane, 2011: 2).

This Chapter will review the literature on the causes of the 2008 financial crisis. As one may expect, the sheer magnitude and far-reaching consequences of the crisis has inevitably left us with a vast and rich vein of literature. Given the volume of this work it is inevitable that some texts have been excluded from the analysis to follow. However, after exploring the literature relating to the crisis, I am confident that the review below, which includes contributions from a number of prominent academics, journalists, bank insiders and politicians, is an accurate description of the key causes of the 2008 meltdown.

The primary objective of the literature review is twofold. *Firstly*, in order to judge if the banks have learned lessons from the crisis we must first understand the causes of the 2008 crisis. To this end, the Chapter will consider and explore those factors which are considered within the literature as being the key triggers of the financial crisis. *Secondly*, these causes will be carried forward into the thesis and used as a series of benchmarks or yardsticks against which learning can be tested. The exact or practical implication of these metrics and how they will be measured in the thesis will be explored in the following Chapter and something to which we shall return throughout the empirical chapters. While this Chapter offers the reader an exploration of those conditions which gave rise to the crisis it is worth noting that the analysis put forward in this section is not intended to be a comprehensive analysis of each and every contributing factor to the financial crisis, indeed there are a plethora of other triggers which presupposed the crisis. Instead, the objective of the analysis here is to examine the problems which, in light of the objective of thesis, can be isolated and individually managed by the banks and against which learning can be measured.

The importance of the analysis presented here lies not simply in highlighting the triggers of the financial crisis but how banks and their trading activities worked in such ways as to compound and then magnify the effects of the crisis. It will be demonstrated how failures within one particular facet of the banking industry were able to spread and pervade the entire system because of the unique way in which banks and the markets in which they operated were structured. As such, the Chapter will focus on the key vulnerabilities which built up over time within financial markets highlighting how structural flaws within the banks themselves, along with the regulatory environment, worked in such a way as to give rise to the key causal mechanisms which triggered the crisis and greatly amplified the associated costs.

However, as stated in the introduction of this thesis, I am not assuming or suggesting that because banks may have addressed those issues highlighted within this chapter and may present evidence of learning and change, that this will prevent future crises from occurring. Indeed, as previously discussed, we know that historically crises have emerged from a number of different facets within the global economy and, as such, future crises may not necessarily be tied directly to the banks. Likewise, we know that while banks can indeed learn and change they can also unlearn and change back. Therefore, even though the banks surveyed in this thesis may present evidence of learning in relation to those factors outlined in this chapter, this is not to say that future crises will not happen again. Yet, the literature reviewed here, along with the overarching research question, remains important due to the extent to which the banks, and those practices laid out below, played a role in the financial crisis.

**Causes of the 2008 Crisis**

Many of the causes in this Chapter are closely related, for example leverage and wholesale funding, and are not mutually exclusive with several of the triggers identified being interrelated and augmenting one another. As a result, the analysis in this section of the thesis is not intended to be read as a mono-causal exposition of the 2008 financial crisis. Indeed, attributing the crisis to an isolated or singular cause would only serve to mislead the reader. Instead, the aim of the Chapter is to unfold an accurate and detailed analysis of the delicate interplay between several key factors which cannot and should not be considered in isolation.

Excessive Competition

One of the key causes of the financial crisis identified within the literature, and from which many of the other triggers would flow, is the extent to which, over the course of the last several decades, banks were exposed to ever-increasing structural competitive pressures leading many institutions to re-engineering their balance sheets in order to protect their share price and precious return on equity (ROE), held by many financial analysists as the fundamentals of a bank’s worth[[4]](#footnote-4) and which became two key determinants of variable employee remuneration[[5]](#footnote-5).

Banks have always played a key role in the economy acting as a go-between for their customers in the transfer of payments, providing a safe and secure home for deposits and savings, and funding future investments through loans (Bell and Hindmoor, 2015a: 28). These activities provided banks with a steady yet modest profit stream which was further enhanced by favourable levels of equity capital and substantial cash reserves, proving for a banking system which was highly liquidised with low rates of leverage (Haldane, 2011: 3). However, deregulation under the neoliberal agenda, pursued on both sides of the Atlantic from the 1970s onwards, exposed banks to fresh levels of competition which had not been witnessed before as new rules meant that national, regional and international institutions were now all thrown into the same arena to vie for capital which had simultaneously become ever more liquid due to the erosion of capital controls (Gamble, 2014: 49). Technological innovation also equipped smaller challenger banks with the tools needed to launch an assault on their larger counterparts’ market share thus further ramping up competition levels as shareholder capital became evermore scare and sought after.

In Britain the ‘Big Four’ banks’ dominance of domestic markets, while still accounting for an overwhelming majority of the market share, was directly challenged by large international players who were keen to establish their brand in the U.K. as well as smaller domestic challenger banks and building societies who were also eager to enter the lucrative banking sector (Bell and Hindmoor, 2015a: 28). This was then further compounded by a belief amongst senior bankers that the only way to protect their business from diminishing ROEs and share price, as well as from a potential takeover from rival institutions, was to grow their balance sheets significantly (Perman, 2013).

These factors worked in such a way as to increase competition between the banks which was then realised on three mutually non-exclusive fronts. *First*, growth options became limited resulting in banks having to rely on their assets in place to generate profits (Bustamante and Donangelo, 2014: 2). While this method of profit generation had always been an integral part of banking what changed following the deregulation of the City of London was the extent to which activity of this kind, along with excessive financial trading (examined below), came to dominate more traditional banking models which, while not abandoned, were subsumed by trading operations as a key generator of profit. As a result, banks became proficient in creating and benefitting from the volatility of asset prices, buying up assets and creating speculative bubbles, making a profit before exiting the market and bursting the bubble thus contributing towards a financial system which was becoming increasingly predicated upon risk and volatility (Gowan, 2009: 9).

*Second*, increased competition within markets and between the banks resulted in reduced profit margins. In response, banks increased their leverage ratios (discussed below) as a means of protecting their margins but in doing so significantly eroded and reduced their ability to absorb losses and service debts by diminishing the capital ‘cushion’ which lower rates of leverage (i.e. higher capital holdings) had afforded them (Bustamante and Donangelo, 2014: 2). For example, banks would use their short-term capital to ‘gear-up’ their balance sheets and exploit asset bubbles in order to meet expected ROE targets (Haldane, 2011: 12). However, when this proved to be successful more short-term capital flooded into the system creating yet more incentive to engage in short-term risk-taking activities and increase leverage further (ibid). When the crisis hit banks found that their loss absorbing capacity had been almost wiped out due to ramped up leverage ratios which subsequently led to paralysis in the markets as banks were unable to service their debts due to diminished liquidity (Hale and Santos, 2013: 7).

*Third,* highly mobile capital, facilitated by the liberalisation movement, meant that in the years preceding the crisis shareholder value became highly skewed towards short-termism with average holdings in the U.K. and U.S. falling from approximately 3 years to 3 months in the decade before the crisis (Haldane, 2011: 12). This was further compounded by the rise of so-called “quarterly capitalism” (ibid) in which analysis by private investors, financial institutions and the media placed intense scrutiny on the banks’ ability to create shareholder value (Bell and Hindmoor, 2015a: 29). One of the results of this unrelenting analysis was that banks became swept up in so-called “herding behaviour” whereby institutions would seek to emulate successful rivals (Greenspan, 2013). Herding and competitive emulation was particularly harmful as on seeing the apparent success of their competitors, banks became evermore willing to ignore their own intuitive warning signs for fear of losing ground, thereby exacerbating market deficiencies by following what turned out to be erroneous and potentially harmful decisions(ibid. p26).

While structural market pressures are not something that can be individually isolated and managed by the banks themselves there are certain measures, such as rebalancing remuneration away from structures which are heavily skewed and linked directly to share price valuation and ROE figures, which may be indicative of learning.

True Belief in Efficiency of Markets

Another fundamental and underlying cause of the crisis can be found in the belief, and misplaced confidence, that in the years preceding the crisis the growing complexity of institutions and financial markets had been matched with an expansion of sophisticated mathematical algorithms which meant that risk had been effectively managed (Turner, 2009: 22). In particular, it was believed that the Capital Asset Pricing Model (CAPM) and the Value At Risk (VAR) methodologies had meant that financial markets and institutions were both efficient and accurate in determining prices (Davies, 2010: 185).

These models were of particular salience because they endowed senior bankers with a 'true belief' that markets were effective and that this was correctly reflected in mark-to-market (MTM) pricing, whereby assets are endlessly re-evaluated against the market, rather than book, price (Bootle, 2011: 18). Such risky behavioural strategies taken by key financial actors was not, contrary to the common depiction made popular by the media, solely motivated by greed or a ‘don’t care attitude’ but was instead the product of 'true believers' in the efficiency of markets who were seduced by the notion that these complex models had all-but removed risk from trading activities (Bell and Hindmoor, 2015a: 15).

In the sphere of economics, for example, it is well documented that the efficiency of financial markets is largely dependent upon the dissemination of information (Forstater, 2007: 78). Information is important to the sound functioning of markets as it allows investors to make decisions relating to the correct pricing of assets, identifying losses within the system and discerning both individual and market liabilities and exposures (Acharya *et al*, 2009: 5). However, risk models such as CAPM and VAR removed much of the need for individual investors to exercise their own discretion in calculating risk by promising a method which accurately priced assets (Davies, 2010: 185). This problem was further compounded by a deficiency in the internal governance structures of many banks which had either removed or allayed more traditional risk controls.

We now know that risk models used by many of the banks were seriously flawed with capital markets extremely under-priced, risk premiums being exceptionally low and a false assumption that risk had been effectively dispersed when in fact it had become more concentrated (Gowan, 2009: 21). Resultantly, information within the financial system came to be largely distorted by such models with financial actors basing their decisions on incomplete or inaccurate information (Blinder, 2014: 64-65). Indeed, Bell and Hindmoor (2015a: 16) argue that market actors became caught up in a certain kind of 'market euphoria' centred upon a belief that risk had been minimalised and quantified and that stability had been achieved. Moreover, such a view would appear to be supported by Friedman (2009: 147) who argues that bankers overwhelmingly favoured lower yielding, safer AAA securities over more hazardous, higher return AA rated securities, thus demonstrating both imprudence on the part of bankers and a belief in the accuracy of the markets to correctly interpret and price risk.

The problem of relying on the efficient markets hypothesis may have been further compounded when we consider that many of the most senior bankers who followed such strategies had backgrounds in economics (Davies, 2010: 178). For example, rational expectations – a branch of microeconomics - have long held that market processes and the institutions which embody these methods are much more accurate in judging and pricing risk than centrally imposed regulators (Engelen *et al*, 2011: 136). It is argued that such economic theories dominated the business schools and universities from which the top banks drew their graduates (Davies, 2010: 178). Furthermore, academia and market practice became increasingly intertwined as leading academics were no-longer confined to universities and increasingly came to hold senior consultancy positions within both federal financial institutions, such as central banks and private financial corporations (Engelen *et al*, 2011: 137). As such, this 'corporatization' of the economics profession gave credence to the business strategies employed by the banks and regulators in the run up to the crisis with many of the practices being used by these institutions going unquestioned due to the academic authority enjoyed by senior economists (ibid).

These factors combined to create a system which was centred upon asymmetric information resulting in the mispricing of risk and a rational reliance upon the market to make what we now know to be incorrect calculations. The mispricing of risk in turn led to inaccurate information under which markets and institutional actors wrongly allocated resources creating significant skews and instability that when the crisis hit determined both the scale and speed with which the downturn happened.

Leverage

There is little doubt that over the course of the last century banks dramatically grew their balance sheets often, as discussed above, in response to increasing competition with rival institutions. Indeed, Haldane *et al* (2010: 84) suggest that the balance sheets of the world's 1,000 largest banks grew approximately 150 percent between 2001 and 2009. However, this rapid expansion was not met with a growth of equity bases, resulting in large disparities in the capital ratios of many banks (Ibid). Intense competition coupled with greater free movement of capital meant that banks were experiencing ever diminishing profits with tumbling ROEs and share price valuations. In this pressure cooker environment banks sought to grow their balance sheets as a means of reversing their fortunes by significantly increasing their leverage. The banks were aided in their endeavours by regulatory stipulations, or a lack thereof, such as Basel II capital standards which Adair Turner (2016: 30) argues allowed banks to maximise ‘scarce’ capital in an effort to extend more credit into the real economy. As a result, banks became highly skilled in working within regulatory requirements to ramp up leverage ratios through the use of innovate and exotic financial products.

Banks would utilise off-balance-sheet vehicles, for example, which were frequently secured against long-term debts held in structured investment vehicles (SIVs) (Acharya and Schnabl, 2009: 83). One of the associated benefits of these financial instruments, which were greatly aided by an expansion into the so-called “shadow banking” sector, was that banks were able to move assets off their balance sheets and as such were no-longer required to hold capital against them. However, in order to make these conduits attractive to buyers, banks would have to extend liquidity and credit guarantees to counterparties effectively insuring the underlying credit by absorbing any potential risk and in effect bringing the items back on to the balance sheet without the necessary capital requirements (Acharya and Richardson, 2009: 201). As these instruments carried little need for capital banks were able to ramp up leverage ratios to levels five times higher than what would ordinarily be allowed on a balance sheet (Acharya and Schnabl, 2009: 83). For example, before the crisis RBS had a leverage ratio of 31:1; Lloyds 29:1; Barclays 33:1 and HSBC 24:1. However, these innovative products would ultimately prove costly for the banks as the creation and retention of risk remained with the banks themselves.

For instance, because many of the products carried with them implicit liquid and credit guarantees they were subject to the highest possible approval from the relevant credit rating agencies, typically having been rated AAA (Acharya and Richardson, 2009: 201). And because these instruments had the highest possible rating they were open to investment from lucrative money markets funds which gave banks access to readily available capital and thus, enabled them to fund the conduits with unusually low interest rates (ibid).

However, because liquid and credit guarantees gave investors a degree of recourse against the banks, investors could simply return the assets if or when losses began to occur (Acharya and Schnabl, 2009: 85). Indeed, in the third quarter of 2007 this is exactly what happened, as a downturn in the markets led many investors to simply return the assets to the banks who in turn were faced with the reality, due to the nature of MTM pricing, of moving these now largely diminished products back to their balance sheets which were now poorly funded and left with very little capital (Acharya and Richardson, 2009: 201).

Greenspan (2013: 52) argues that when dealing with assets banks have a natural propensity to avoid pooling products into a particular facet of highly leveraged portfolios and will instead look to diversify risk through a number of alternate mechanisms. However, in the decade preceding the financial crisis banks became exposed to highly leveraged products. Greenspan (2013: 52) speculates that the cause of this excessive risk-taking can be directly linked to the ‘true believers’ hypothesis, discussed above, and the notion amongst the banks trading in these assets that their products were structured in such a way and carried enough security that gearing up leverage ratios was safe.

However, at the time when greater liquidity risks had permeated the banking system, banks were gambling on their own liquidity by selling and borrowing against assets which in the event of a crisis or reversal of markets trends could prove difficult to move and thus exposing themselves to potential liquidity shocks (Davies, 2010: 53). As Friedman (2009: 146) has pointed out 'with leverage comes not only the promise of larger gains, but the risk of greater losses'. Thus, we can see that excessive leverage ratios are something which we should not consider in isolation but were emblematic of the wider structural and agent-led landscape at the time and in particular how excessive competition and a true belief in the efficiency of markets acted to reinforce such harmful practices.

Indeed, the build-up of excessive leverage within the financial system, and like many of the factors discussed in this Chapter, again demonstrates that banks and bankers were not the only actors whose behaviour gave rise to the crisis with regulators – whose job it was to monitor institutions, shareholders - who flooded the system with more and more capital – and a number of other actors and markets, such as wholesale funding and the shadow banking sector, all playing an important contributory role and are equally worthy of investigation and analysis. However, given the huge role banks and bankers played in the financial crisis 2008 and their continued contribution to financial stability, not only as key financial intermediaries but also as systemically significant institutions, the question of whether banks have learned lessons from the crisis remains crucial to current debates on financial stability, growth and reform.

Moreover, excessive leverage and the manner in which banks used innovative financial products to ‘gear up’ their balance sheets and circumvent regulatory stipulations in the years which proceeded the crisis further demonstrates the need to move beyond the question of regulation (as discussed in the Introduction) which has dominated the literature post-2008 and the importance of assuming a bank-centric approach which this thesis adopts. For instance, we know from earlier discussions in this Chapter that excessive competition drove many banks to increase their leverage. Likewise, we also know that while banks were perhaps not in compliance with the ‘spirit’ of regulation they were (generally) operating within the letter of the law. While post-crisis regulatory reform now requires banks to hold greater levels of capital and has introduced more stringent controls on leverage ratios (discussed in the coming chapter), competition within markets and between banks still persist (as discussed in the Introduction) meaning that banks have both the incentives and means to effectively sidestep regulation which may lead to future regulatory arbitrage[[6]](#footnote-6). Hence the significance of asking if the banks themselves have learned lessons from the crisis and the important original contribution which my thesis will make to the current literature.

Shadow Banking

The overambitious and undercapitalised business strategies associated with ever-increasing leverage ratios and competition-based financial innovations were greatly aided by the trade in and origination of shadow banking instruments which facilitated much of the banks’ inorganic and exotic growth strategies and which further exacerbated the crisis by exposing banks to new levels of risk which were almost impossible to calculate (Gowan, 2009: 13).

What distinguishes shadow banking from the more traditional banking sector can usually be defined in terms of regulation and in particular capital and deposit guarantees. For example, shadow banking instruments, such as Asset Backed Commercial Paper (ABCP) and Repurchase Agreements (REPOs), were particularly harmful because they did not carry the same implicit minimal capital standards and the requirement to increase equity in-line with assets, as were governed institutions located within the traditional banking sector (Bernanke, 2012: 4). This was further augmented by the fact that much of the shadow banking industry was located in tax havens which as is well established are themselves shrouded in secrecy, opacity and have little regulatory oversight (Hampton and Christensen 2002; Woodward, 2006; Palan *et al*, 2009; Urry, 2014).

The effect of this was that because such products were set-up with minimal capital they appeared to be a very efficient and lucrative investment to traders who quickly bought up these instruments which in turn both drove up demand and also flooded the banks with even more cheap credit (Bernanke, 2012: 4). The banks responded to market demands, and now access to ever readily available credit, by originating even more products and thus fuelling the cycle further (ibid).

The way in which the shadow banking industry was, and still is structured, meant that while there was an implied division between shadow and non-shadow banks, in practice the banks became intertwined with traditional ‘on-shore’ banks becoming heavily involved in the shadow and ‘off-shore’ banking system. For example, shadow banking instruments held by the banks were rarely kept ‘on balance sheet’ and were typically held in off-balance sheet Special Purpose Vehicles (SPV) and as such did not share the luxury of regulatory and state-sponsored security nets such as minimal liquidity requirements and certain capital safeguards provided by a central bank (Ramskogler, 2014: 56). Instead, shadow banks employed devices such as placing restrictions upon portfolios and relying on the prudence of rating agencies (Bernanke, 2012: 5).

This belief in the prudence of the ratings agencies to correctly price instruments and portfolios turned out to be disaster when competition between agencies led to products being priced according to the needs of the banks rather than at fair value (Lewis, 2011). As such, when markets began to falter in 2007 many banks had maintained their exposure to highly leveraged markets through off-balance sheet instruments and when MTM pricing undermined confidence in these products widespread flight from the market quickly occurred with investors scrambling to withdraw (Bernanke, 2012: 5). When the once-AAA-rated securities were downgraded as ‘toxic’ these assets became worthless leaving banks with little option but to bring them back on to their balance sheets which were by now significantly undercapitalised (Acharya *et al*, 2009: 21).

Turner (2012: 16-17) identifies four key ways in which shadow banking instruments contributed to and exacerbated instability within financial markets. *Firstly*, as shadow banking relied on MTM pricing as opposed to more traditional secured lending practices this led to asymmetries of procyclical credit creation. *Secondly*, shadow banking instruments intensified the problem of complex intermediation chains which are inherently prone to funding runs and maturity mismatches. *Thirdly*, due to the absence of explicit capital guarantees the risk between funding liquidity and market liquidity was heightened leading to greater chances of contagion across markets. *Finally*, because shadow banking relied heavily upon ‘self-referential’ pricing models, fair value assessments became skewed and blinkered thus further increasing procyclical instability.

Resultantly, we can see how shadow banking and the trade in off-balance sheet products which encapsulated these markets, coupled with a series of other mutually reinforcing factors such as a failure to correctly regulate and price risk and an increased willingness on the part of the banks to operate with enhanced leverage ratios, worked in such a way as to magnify and compound the effects of the financial crisis.

Wholesale Funding

As we can see, in the years leading up to the crisis shadow banking had come to play an increasingly important role in the global financial system. The expansion of the shadow banking sector along with investment banking and the growing magnitude of traditional ‘on-shore’ banking, was fuelled by a reliance upon short-term, often overnight, wholesale funding which facilitated a business strategy with a growing propensity towards risk. Indeed, many of the major global banks had increasingly come to rely on alternative forms of funding, as opposed to more traditional funding sources such as customer deposits and savings, in order to continue to pursue their expansionary goals linked to structural competitive pressures (Bernanke, 2010: 4). Much of this funding came by way of the wholesale markets in which banks and other significant financial institutions would lend and borrow money between one another on a short-term basis (Law *et al*, 2008: 464). However, in 2007/2008 funding of this kind proved to be the Achilles heel for banks when markets began to dry up.

Funding made available through wholesale markets meant that banks were able to develop a large maturity mismatch, namely by borrowing short-term in order to hold and fund long-term investments (King, 2016: 97). This was matched by a belief that wholesale markets were a relatively safe and secure way of funding long-term assets. However, when markets began to falter in mid-2007 panic and suspicion began to spread throughout wholesale markets as banks and financial institutions, keen to protect themselves from potentially bad debtors, began to withdraw credit (Bell and Hindmoor, 2015a: 44). In response, banks increasingly began to hoard liquidity, which along with cash reserves that had been grossly neglected, by shortening the terms of their interbank loans or calling in the debt of the loan in its entirety (Haldane and May, 2011: 353). As more and more banks began to cut their loans and withdraw credit others similarly followed suit leading to a ‘funding liquidity shock’ as overnight credit all but evaporated from the system (Ibid).

This problem was then further compounded by the fact that, as discussed above, many of the banks were now operating with significantly ramped up leverage ratios. While banks had presumed that in the event of a liquidity squeeze excessive leverage ratios could be, at least partially, offset by selling assets and thus increasing overall liquidity this turned out to be erroneous leaving the banks with a large maturity mismatch and unable to service their debts (Bell and Hindmoor, 2015a: 44). As Davies (2010: 53) points out, banks that relied upon the selling of assets in order to increase their liquidity pools were extremely vulnerable to MTM pricing which subsequently downgraded the value of assets. As the financial crisis began to gather pace and spread, confidence began to evaporate along with liquidity and shortly thereafter readily available capital had all but disappeared (King, 2016: 97). This was further exacerbated by the fact that many banks had failed to maintain adequate liquidity and cash reserves in the false assumption that interbank markets would continue to keep lending in the event of financial stress (ibid). However, this ultimately proved to be incorrect as a profound liquidity squeeze meant that wholesale markets all but dried-up.

One of the reasons why a withdrawal of liquidity from wholesale funding markets was so catastrophic was because of the systemic risks associated with such funding. Wholesale markets greatly amplified highly unstable and opaque linkages between the banks increasing the prospect of potential counter-party risk meaning that the failure of any one bank had the potential to bring down the entire system (Acharya *et al*, 2009: 28). When market confidence began to turn in mid-2007 these complex and opaque linkages manifested themselves as banks and other financial institutions struggled to fully understand or identify the extent to which they were exposed to counter-party risk and how losses at other institutions could have a potentially harmful effect on them. The result of this was, as we have seen, that markets became quickly illiquid as banks were unable to attain short-term funding, amplified by a lack of liquidity and cash reserves, leading to paralysis which spread across financial markets as a whole and the real economy (Ibid).

Remuneration

One of the principle charges levied against banks in the aftermath of the financial crisis is the idea that questionable business strategies concerning shadow banking instruments, capitalisation and leverage ratios, to name but a few, were in part driven by remuneration structures and how employees were rewarded. It appears that employee compensation was increasingly skewed towards short-term and often high-risk trades, with an explicit focus upon increased ROEs and share price valuations being built into reward structures, thus incentivising individuals towards more ambiguous financial activities (Admati and Hellwig, 2013: 115).

In the years preceding the crisis variable remuneration, particularly within investment and trading divisions of banks, was increasingly linked to both the number of trades made by an employee and the net asset value of particular funds under management (Acharya and Richardson, 2009: 206). The higher the number of trades or the greater the value of a fund, the greater the bonus (ibid). As such, bankers had a strong incentive to take on excessive risks of which ramped up leverage ratios linked to Collateralised Debt Obligations (CDOs), Credit Default Swaps (CDS) and other securitization instruments offered the greatest prospect of high rewards (Davies, 2010: 156). The result of this was however to create a vicious circle whereby high equity yields and lucrative remuneration packages became mutually reinforcing (Haldane, 2012a: 5).

Similarly, higher ROEs and share price valuations, which were a frequent measure of increasing equity yields, were used as a standard for determining employee performance and target setting by senior management (Haldane, 2011: 12). In order to meet these targets and achieve the resulting lucrative bonuses, bank employees sought ever riskier, short-term yields on investments (Admati and Hellwig, 2013: 116). When employees met these targets, by delivering favourable returns, investors and the senior management of banks sought to boost their short-term profits further by increasing targets and thereby incentivising employees to engage still further in ever riskier behaviour (Haldane, 2011: 12), in what Haldane (2012c: 6) has described as a 'system with in-built incentives for self-harm’.

However, Mervin King (2009: 3) argues that the speculative nature of the banking system cannot be solely attributed to a minority of greedy or reckless traders or their senior managers, but is instead the product of a wider system of shareholders and investors keen to see favourable returns on their capital. Indeed, Haldane (2011: 12) draws attention to the fact that under joint stock banking, whereby shareholders are liable for any incurring debts, ownership and control are 'divorced'. Resultantly, it has been argued that in order to regain a certain amount of control over the business decisions of senior members of staff, shareholders have progressively sought to reorient senior pay and incentive structures to be in line with shareholder interests (Haldane, 2011: 12).

This is evidenced by the fact that when senior managers and their staff returned huge profits shareholders responded by increasing their investment in the bank, pumping more and more money into the system in the hope of replicating previous success and thus encouraging senior managers to enter into ever larger trades (Haldane, 2012c: 4). While King (2009: 3) concedes that these investors were not always fully aware and did not necessarily grasp the complexity of the trades that were being made on their behalf, it appears that when times were good and record profits were being reported, no-one stopped to ask what the downside risk of such returns were and whether such practices were in the long-term interest of the banks and their shareholders. Thus, overall risk within the financial system was increased by the creation of a culture whereby excessive risk-taking and questionable business strategies became the norm (PCBS, 2013: 9).

When markets began to fail in 2007 those investments which had appeared successful only a few months earlier quickly became the source of huge financial loss for the banks. However, because of the nature and structure of remuneration packages those employees responsible for making such trades were never held to account for their actions, with many bankers having already cashed in share options and withdrawn any associated cash prizes that had remained with the bank (Davies, 2010: 156). As such, it was shareholders and often the tax payer who were left to deal with the ensuing fall out as governments, faced with failing institutions, were left with little alternative but to nationalise compromised banks thus absorbing the financial penalties associated with these now costly trades (Ibid).

Corporate Governance and Risk

While excessive competition, rampant leverage ratios and the trade of complex financial instruments, facilitated by the shadow banking sector, are all seen as playing a huge contributory role in the financial crisis, it has been hypothesised that the consequences and extent of these factors could have been mitigated had the corporate governance structures of institutions, and in particular the element of risk management, been more robust.

Indeed, it has been suggested that a lack of risk management controls at a number of banks in the years before the crisis meant that many institutions had failed to implement even the most basic of business rules concerning diversification and capitalisation leading to portfolios which were highly concentrated, highly leveraged and extremely sensitive to volatility (Sabato, 2009: 3). This deficiency in best business practice has been linked to the way in which banks’ internal governance was structured and in particular the idea that traditional risk management controls, which relied heavily upon the prudence and sound judgement of highly specialised risk analysists had been subordinated to VAR and CAPM models as discussed previously (Turner, 2009).

In the years leading up to the crisis, for example, the role of Chief Risk Officer (CRO) became increasingly diminished at many institutions. A study in 2006 by Ellul and Yerramilli (2010) found that the CRO at 85 percent of banks surveyed was not in the top five highest-paid employees. Likewise, at 43 percent of banks the CRO was not a member of the executive committee and was scarcely seated on the board, with 33 percent of banks surveyed having no CRO at all (ibid). Sabato (2009: 14) notes that the growing exclusion of the CRO from the upper-echelons of corporate governance meant that it was very difficult for these key agents’ voices to be heard with often broken or fractured lines of communication with the Group Chief Executive (GCE) and other senior executives.

Moreover, the effectiveness of the CRO was often compromised by group reporting mechanisms which frequently saw risk managers answering to divisional or regional heads as opposed to the GCE directly. As such, the escalation of risk was dependent upon the judgement of senior managers, many of whom did not fully understand or were not sufficiently incentivised to escalate risks (Sabato 2009: 14). Likewise, because the CRO typically sat outside the inner circle of senior executives they frequently suffered from a lack of direct access to pertinent information and were instead dependent upon information via secondary sources the timing and accuracy of which could be open to errors. As such, CROs were frequently left with a fractured picture of group-wide risk making it impossible to make accurate judgements and identify risk in a timely manner (ibid). Furthermore,Kashyap (2010: 17)presents evidence which suggests that banks where the presence of the CRO was less prominent had a larger exposure to securities trades, larger trading books and a greater proportion of derivatives as an overall percentage of the trading book, all of which subsequently had a detrimental effect on the health of the bank when the crisis hit.

The associated costs of the diminishing role of the CRO coupled with a reliance upon VAR models were further exacerbated by banks’ internal governance structures. For example, deficiencies in the governance framework of banks meant that many aspects of internal risk management had become compartmentalised and ‘siloed’ with little communication between departments, heads and individual risk officers. The result of this was that while individual risk mechanisms may have maintained their effectiveness, the data generated and any possible correlation between a bank’s activities and risk failed to be communicated effectively leading to huge asymmetries in information (Ashby, 2010: 17). Furthermore, risk management teams found it increasingly difficult to both effectively communicate and feedback risk into the governance framework and access the support needed due to the dislocation between risk managers and the overarching governance framework (ibid).

Authoritative CEOs

A closely related factor to the failure of internal governance, and which further exacerbated many of the causes outlined in this Chapter, is the extent to which CEOs and senior executives wielded exceptional power and control over institutions and members of staff (Bank of England, 2015).

The Parliamentary Commission on Banking Standards (PCBS) has concluded that many banks exhibited major deficiencies in their internal governance which can be attributed to the authoritative and hierarchical nature which characterised many institutions (PCBS, 2013: 10). The report goes on to suggest that while some banks appeared to display effective internal regulatory oversight this was in fact a facade as non-executive directors lacked both the 'capacity and incentives' to question the decisions of senior managers and executives (ibid). Indeed, it has been argued that those individuals who were specifically tasked with holding senior managers to account consistently failed to do so and instead conducted themselves in such a way as to give further credence and confirmation to the business strategies being pursued (Davies, 2010: 146).

One of the reasons why such circumstances persisted may be attributed to the fact that those members of staff whose job it was to question and interrogate the strategies of senior management were unable to access executives due to a lack of status associated with the engagement of relevant technical information and as such were often held as outsiders in the complex and daunting world of finance (PCBS, 2013: 10). For example, many non-executive board members often did not have the relevant skills and understanding of financial markets, which by the mid-2000s had become a minefield of technical information, exotic financial products and contracts, to adequately judge or challenge a senior manager’s discretion and were frequently from a non-finance based background (Davies, 2010: 148). Moreover, those non-executive directors who were charged with overseeing the overall direction of the banks have been accused of not dedicating enough time to their duties but instead operating a very 'hands-off' or light-touch approach to internal governance issues (ibid. p149). Resultantly, the unique way in which non-executive directors and senior managers interacted meant that high ranking individuals were free to impart their own views upon the entire bank and lead the company in the direction they thought most appropriate with little or no opposition (Bell and Hindmoor, 2015a: 120).

Furthermore, many CEOs and managers had the sole power and authority to dismiss members of staff meaning that employees’ careers lay in the hands of these powerful key agents (ibid). Because of the unique linkages which epitomise the world of banking and finance, members of staff who had been dismissed from a company could quickly find their reputation and career damaged beyond repair with so-called “bad eggs” being shunned by the banking community thereafter (Bell and Hindmoor, 2015a; Moore, 2015). Thus, in the years preceding the crisis we find that employees within banks were increasingly reluctant to voice any concerns or challenge the business decisions of senior managers for fear of professional reprisals. This was then further compounded by a distinct lack of whistle-blowing facilities within institutions meaning that employees who were acting in such a way that was harmful or contradictory to good governance practices were often left to carry on until a point in time when irreversible damage had been caused (PCBS, 2013: 10). Those who did attempt to address their concerns and raise issues were often brushed aside or met with outright hostility (Martin, 2014: 237) as is illustrated by the case of Paul Moore.

Paul Moore was Head of Group Regulatory Risk at HBOS who after having raised concerns regarding the bank's position on risk was heavily reprimanded and subjected to personal verbal attacks before being sacked (Moore, 2015). Mr Moore states that when he raised concerns that the bank was engaging in unnecessary and harmful risk practices, and that his concerns be noted officially, he was warned that such an opinion was overstated and not in keeping with the bank's current operational goals and was subsequently dismissed (Medland, 2013).

The case of Paul Moore highlights the fact that while many key individuals within the banks may have been acutely aware of the technical warning signings that preceded the financial crisis the voices of these central figures were largely silenced by the domineering position of senior executives and the governance structures which facilitated them.

Excessive Financial Trading

As addressed previously, in the years preceding the financial crisis banks came up with a plethora of innovative financial products which allowed them to grow their balance sheets exponentially. This growth was fuelled, primarily, by an expansion of trading operations particularly within the investment banking divisions of institutions as investment divisions moved away from traditional activities such as wealth management and mergers and acquisitions towards trading operations which, by late 2007 had become a mainstay of all major global banks (Davies, 20110: 138). This propensity towards trading activities meant that banks significantly increased their exposure to ‘investment in [and] sponsorship of hedge funds or private equity funds [and] proprietary trading’ which were sought purely for their profitability (ibid. p80).

The expansion into and growth of financial trading meant that by the mid-2000s investment banking had become the engine of growth for many leading institutions (Davies, 2010: 80). This was facilitated by technological advances which reduced and all but removed the barriers which were once associated with both the cost and speed at which financial trades could be made (Engelen, *et al*, 2011: 50). Furthermore, technological and financial innovation combined to create a system, which in the decade leading up to the crisis, was characterised by an abundance of highly mobile capital and instantaneous trading and in which new and sophisticated financial products constantly promised the potential of unprecedented yields for investors (ibid).

Initially, the move towards high volume financial trading, and the associated growth of investment banking, was heralded as a success (Davies, 2010: 138). *Firstly*, it was believed that financial trades in innovative products had the effect of dispersing risk more broadly within the system thus allowing banks to shed some of the underlying exposures which have traditionally been associated with the holding or warehousing of products on balance sheets. *Secondly*, it was believed that trading in financial instruments allowed investors greater freedom to allocate capital towards investment which matched their specific risk appetites, thus increasing the volume and frequency in which private entrepreneurs would be willing to engage with the market (ibid).

However, the huge volume at which investment banks were trading meant that by 2007 the composition of bank balance sheets had significantly altered, and along with it the risk profile, with trading activities in the investment bank now dwarfing more traditional models meaning that when the crisis struck in the summer of 2007 many banks quickly found that their investment department had compromised the entire institution (Admati and Hellwig, 2013: 46).

This new investment banking model and the associated expansion of financial trading meant that many banks had turned to the unregulated sector, such as shadow banking, in order to fund their expansionary goals (Archarya *et al*, 2009: 27-28). However, the sheer scale in which banks were using the unregulated sector to develop and originate financial trades which would meet the demand of investors meant that the banks would unwittingly make a largely unregulated facet of the financial sector a cornerstone of the global economy (Ibid. p28). This was then compounded by the fact that financial trading and investment banking proved to be highly profitable which in turn spurred a greater appetite amongst the banks to increase their trading further (King, 2016: 24).

Indeed, when the crisis broke the magnitude and pace at which financial products were being traded meant that it was impossible to determine counter-party risk which resulted in a freezing of credit markets as the opacity of these financial products meant that it became impossible to determine institutional exposures between banks (Archarya *et al*, 2009: 28). While the banks did not abandon traditional activities the move towards greater financial trading and the associated expansion of investment banking resulted in a significant re-engineering of balance sheets which in turn meant that capital structures became extremely fragile due to the unregulated origin of many traded products (Wolf, 2015: 20).

While profits may have surged, the complexity which beset these institutions, due to their riskier trading activities, became their downfall. When investment banking activities turned sour contamination quickly spread to other ‘safer’ areas of retail and commercial banking, creating losses and fear of loss amongst depositors leaving many governments with little option but to nationalise and bail out severely compromised institutions (Haldane, 2012b: 9).

Too-Big-to-Fail

We have seen so far how in response to several of the factors outlined in this Chapter banks, in the years which preceded the 2008 crisis, grew their balance sheets exponentially resulting in the banking system being dominated by a handful of institutions which were collectively responsible for much of the retail and investment exchanges which took place on a daily basis (Martin, 2014: 319). Haldane and Piergiorio (2009: 9) have demonstrated that in 2008, 16 percent of all global banking assets were held by just five banks. Meanwhile, in the U.K. by 2007 the total assets of the nation's three largest banks equated to approximately 200 percent of the country’s GDP (Haldane, 2011: 10).

This problem was further exacerbated by the emergence of a number of challenger banks who threatened the market share in more traditional and safer markets, namely deposits and mortgage lending (Perman, 2013). While the balance sheets of these challenger banks remained relatively modest in comparison to larger banks, they did, nonetheless, make an impact by cutting precisely into the markets that were considered ‘safe’ for larger banks (Bell and Hindmoor, 2015a). The larger banks responded by growing their balance sheets even further, as we have already seen, through the use of exotic financial instruments including securitisation (Haldane and Piergiorio, 2009: 9). At the apex of 2007/2008 a small handful of global banks had reached such a size and magnitude that when the financial crisis took hold, these once modest institutions had been transformed into monolithic entities which, given the size of their assets, had ultimately become too-big-to-fail.

The term too-big-to-fail is usually applied when large institutions such as a bank accumulates assets to the extent that it is argued that its failure would lead to a systemic catastrophe destabilising the domestic or global economy and, as such, the host government is forced to take action usually in the form of a bailout (Brindley *et al*, 2008: 441). As a result, the rescue packages extended to failed banks post-crisis were done not out of some kind of kindness or sympathy but, rather, by intervening governments that recognised the fact that the consequences of letting the banks fail would be much more disastrous and costly than putting together a rescue deal (Bernanke, 2010: 20). However, the presupposition that a government will inevitably rescue and provide liquidity to institutions which are deemed too-big-to-fail in the event that investments turn bad has given rise to concerns that such a guarantee has removed hard budget constraints that would otherwise serve as a check on performance (King, 2009: 4) in turn giving rise to so-called “moral hazard”. Moral hazard is best described as the engagement in risky, undesirable or immoral behaviour which increases the likelihood that a loan will not be paid back (Mishkin, 2004: 33). Moral hazard resulting from an implicit state guarantee as a result of an institution becoming too-big-to-fail can be particularly harmful for both institutions and markets as it creates asymmetries in information and potential risk-taking.

For example, if creditors believe that troubled institutions will receive state support and will not be allowed to fail then the funding demands on the banks made by creditors will be much lower than if an implicit guarantee was not in place (Bernanke, 2010: 20). As a result of lower funding costs, banks are able to utilise their capital base to expand their operations further growing their balance sheets and becoming yet more deeply embedded within the financial system and thus exacerbating the too-big-to-fail problem (Haldane, 2012b: 4). This was precisely the case in the decade before the crisis whereby the balance sheets of some banks had reached critical mass resulting in suspicion by both investors and the banks themselves that in the event of a failure they would receive a state-backed bailout thus encouraging the banks to take on evermore risk.

Another major factor concerning the issue of too-big-to-fail, and the implicit state guarantee which accompanies it, is that it has an adverse effect on market discipline. For example, in the wake of the crisis it appears that investors were rewarding banks, particularly in the U.S., which were considered too-big-to-fail (Kay, 2016: 74). As such, and keen to garner institutional investment, senior bankers failed to devote both the necessary time and money to the correct pricing of risk with overzealous executives, keen to grow their business, mispricing some investments and thereby distorting the 'perfect' information upon which efficient markets rely (King, 2009: 4).

This had a twofold effect. *Firstly*, banks and other financial institutions unwittingly took on risks which they did not fully understand and did not adjust for the fact that prices had been distorted and miscalculated by inefficient markets (Bernanke, 2010: 21). *Secondly*, while the authorities and regulators will always try to curtail the extent to which banks engage in risky behaviour the problem of risk-taking will always be amplified without the appropriate market discipline to rein in market actors (Ibid). State guarantees meant that in the run-up to the crisis debt-holders were not adequately incentivised to correctly calculate risk price for themselves creating a certain moral hazard (Haldane, 2011: 11). What is more, the implicit state guarantee which encourages this too-big-to-fail attitude can endow shareholders with a certain assurance that institutions will be bailed-out if things go drastically wrong. Intrinsically, shareholders can become comfortable or complacent and fail to effectively hold the board to account thus exacerbating the problem further as senior executives are free to engage in riskier behaviour, and the associated moral hazard that comes with it, thus greatly amplifying systemic risk (Gup, 2004).

Silo Effect

The extent to which failures in one part of the global financial system and individual institutions quickly infected and spread to other areas and organisations highlights the extent to which linkages within the system and between institutions amplified the effects of the financial crisis (Davies, 2010: 100). In the wake of the crisis it has been suggested that the degree to which these linkages caused irreparable damage, to both financial markets and the banks which operated in them, could have been lessened if communication within individual banks had been more effective.

As outlined above, for example, post-crisis many institutions have been accused of being too-big-to-fail, amassing huge balance sheets and having expanded operations across several continents with multiple individual departments and thousands of employees. However, managing institutions of this size has undoubtedly caused problems for both communication and co-ordination leading to what is known as the ‘silo-effect’ (Tett, 2015). The silo-effect is typically used to describe an institution which lacks effective organisational oversight, clear and accurately articulated goals and thus one that experiences a breakdown of communication between departments within the group (Halvorssen, 2010: 18).

Haldane and Vasileius (2012: 4) argue that in the decade before the crisis this is exactly what happened with banks becoming highly complex and thus amplifying the possibility of causing a ‘catastrophe’ and untold damage to those who were engaged with these institutions. This was due in part to the extent to which banks became compartmentalised, embodied by multiple and separate ‘legal entities’, making it impossible to determine the extent of the relationship which the bank had formed and the resulting counterparty risk (Haldane, 2010: 18). As such, Haldane and Vasileius (2012: 4) believe that the key to avoiding complexity in institutions is to ‘simplify’ and ‘streamline’ the immediate environment by implementing practical measures such as enhanced communication channels like down-the-line reporting and whistle-blowing facilitates.

Bell and Hindmoor (2015a: 124) likewise argue that when organisations grow to such an extent that they outstrip old internal forms of oversight the central control embodied in the traditional role of CEOs and senior managers fails as complex asymmetries of information become lost within the sheer magnitude of the bank. As such, we may conclude that when an organisation grows in size so too does its internal complexities leading to the so-called “silo effect” whereby departments become cut-off from the main body of the bank, with middle managers effectively becoming the sole authority presiding over their own operations and free from internal supervision (ibid). Thus, the work of Bell and Hindmoor (2015a) like Haldane and Vasileius (2012) would appear to stress the need for enhanced communication mechanisms within large and complex institutions.

The silo effect, and the associated lack of effective communication, proved to be particularly harmful within banks because of the impact it had upon the ability of senior managers and CEOs to manage and maintain control over the organisation. For example, Halvorssen (2010: 18) suggests that conditions imposed upon an organisation by the silo effect include increased opacity and difficulties associated with access to ‘in-house’ information. Moreover, these factors are further compounded and magnified when we consider that silos are often formed within silos.

For instance, once a department grows to the extent that it becomes fragmented from the main body of the organisation, it is often the case that this silo does not remain a complete entity itself and instead becomes broken into several smaller silos (Halvorssen, 2010: 18). As a result, communication within the silo becomes fragmented and extremely intricate with multiple managers, teams and staff, whose communications are at best stretched and more often than not totally absent, finding it increasingly difficult to penetrate information held with an alternative ‘sub-silo’ (ibid).

Thus, the larger that the banks grew the more amplified the consequences of the silo effect became. Indeed, Haldane and Vasileius (2012: 17-18) argue that before the crisis banks grew to such an extent that they became unmanageable due increased complexities associated with the evolution of ‘opaque, intra-financial system chains of exposure’ making it impossible to accurately ascertain an institution’s exposures. Moreover, as the crisis began to take hold risk managers and CEOs had to go on prolonged and extensive information and fact gathering missions in order to find out what risks had been taken on and what assets were on the balance sheet (The Economist, 2009a). Such information should have been readily available and accessible within minutes, however due to the silo effect, gathering information became a vast project stretching to days’ worth of research and communication between departments (ibid). The result of this was that when banks needed to react quickly to the markets and know their own positions they were inhibited from responding to new threats due to asymmetries in information compounded by multiple internal silos (The Economist, 2009a).

Regulation

While the focus of this Chapter has been primarily upon the banks themselves and how banking operations contributed and led to the crisis, it is also important that we consider the role which supervisory mechanisms and in particular the regulators played in the events of 2008. However, we must note that unlike many of the causes examined so far regulation has a different status insomuch as it remains something outside the reach of banks and over which institutions have little or no control. As such, the issue of regulation is not something which will be central to my discussion of learning[[7]](#footnote-7).

Many of the causes outlined so far in this Chapter were only allowed to reach the magnitude and scale which they did because regulators did not act, or in other words, and to borrow Davies’s (2010) analogy, regulators were the guard dog that failed to bark. Indeed, Bell and Hindmoor (2015a: 222) argue that the institutional environment fostered by external powers whose responsibility it was to administer proper checks and balances not only failed to adequately monitor and rein in senior bankers but actually created a ‘supportive institutional environment’ which allowed many of these harmful practices to flourish.

One of the causal factors which led to such a set of circumstances can be attributed to the ascending power of global financial capital. For example, Clark (2016: 45) argues that following market liberalisation in the 1970s both the ‘economic weight’ and ‘political influence’ of banks and other large financial entities grew exponentially with cities such as London and New York becoming hugely influential and important in both domestic and international markets. This growing magnitude was met by reluctance on the part of regulators who believed that tighter controls could stifle innovation and limit the finance-led growth model which had become central to governments (Crouch, 2011; Hay, 2013).

For example, in the U.K., following the 1997 general election which saw the Labour Party victorious, , the newly-formed Financial Services Authority (FSA) took over responsibility for banking supervision and promised a more ‘light touch’ and ‘principles-based’ approach to regulation (Martin, 2014: 215-216). Indeed, it appears that post-crisis the prevailing thought at the FSA was that MTM pricing and market discipline was the most effective form of regulation that would allow the City of London to flourish (Bell and Hindmoor, 2015a: 224). Likewise, it was believed that banks, with in-depth knowledge and access to market information, coupled with huge risk management teams on which sat the brightest economic minds of the time would prove to be a more effective regulator than any independent body (Martin, 2014: 15).

Despite this however, the FSA still came under political fire as senior politicians, keen to protect the City’s competitive advantage (Bell and Hindmoor, 2015a: 225), sought to roll back the FSA’s powers further with an address made by, then, Prime Minister Tony Blair in May 2005 lambasting ‘over-zealous’ enforcement and promising to ‘reduce[d] regulatory burdens [for] business’ (Blair, 2005), which was echoed by Chancellor Gordon Brown who, as part of his Better Regulation Plan, promised ‘not just a light touch but a limited touch’ (Brown, 2005).

However, a 2015 report published by the Bank of England concluded that the FSA’s approach to regulation had significantly contributed to the collapse of both the Royal Bank of Scotland (RBS) and Halifax Bank of Scotland (HBOS), by failing to adequately ‘supervise…challenge or review’ the banks’ inner workings (Bank of England, 2015: 32). Moreover, the report goes on to state that the FSA’s role in the application of regulation at a more general level across the banking sector lacked substantive resources, failed to consider the primary areas of risk, particularly asset quality and liquidity, and showed insufficient attention to institutions’ risk management structures (ibid).

The role of the FSA and its contribution to the crisis in Britain was further compounded by the actions of auditors who were an important line of defence ensuring that banks were not over exposed and maintaining adequate checks and balances. However, post-crisis it appears that auditors themselves were lacking both the expertise and will to challenge banks on their spiralling balance sheets and lack of risk aversion with Lord Myners, in an interview with Professors Stephen Bell and Andrew Hindmoor, stating that the chairman of the audit committees at four major U.K. banks lacked the technical skill to even begin to grasp what was happening within the institutions and instead relied upon some kind character test whereby judgements regarding balance sheets were made based on if a person was ‘honest’ (Myners 2013 cited in Bell and Hindmoor, 2015a: 224).

Domestic regulation is however, situated within a broader international supervisory framework, namely those imposed by the Bank for International Settlements (BIS) or the Basel Committee (Perman, 2013: 206). At the time of the crisis, the Basel Committee, under the Basel II framework, dictated that banks should hold a minimum of 8 percent capital against risk-weighted assets (RWA) (BIS, 2006: 1). However, banks do not favour holding capital and as a result came up with novel ways to circumvent regulatory requirements, for example through the use of securitization and expansion into the shadow banking sector (Perman, 2013: 208). The result of this was that when the crisis hit many banks were massively undercapitalised and unable to absorb the losses which they had acquired (Brown, 2010). Thus, we may conclude that much like the U.K.’s domestic regulator and the auditors, the BIS simply did not go far or deep enough into the intricacies of bank policy and appear to have been out-of-step with institutional innovations and growth. Indeed, it appears that in the boom years before the crisis no-one, either through a lack of will or technical knowhow was willing or able to apply the brakes to the speeding juggernaut that was international finance.

**Conclusion**

As we can see the financial crisis of 2008 cannot be attributed to a single factor but should instead be considered as a series of inter-related failures which combined to create the ‘perfect storm’. Structural, institutional and agency based innovations in finance facilitated an exponential growth of markets and bank balance sheets which was accompanied by a sense of optimism and true belief amongst markets analysts, shareholders, politicians, regulators and bankers that risk had been dispersed, that liquidity and credit would remain free-flowing and that market discipline would ensure optimal conditions.

However, the evidence suggests that such assumptions and optimism, which we now know to be erroneous, gave rise to new kinds of systemic risk. At a time when bankers and other institutional investors should have been focusing intently upon the intricacies of in-organic growth models they were instead celebrating the triumph of financialization revelling in the seeming success of banks and other financial intermediaries. When markets began to stutter and stall these institutional investors who had being enjoying the triumph of markets quickly retreated leaving banks with the reality of diminished assets, a lack of access to credit and spiralling funding costs and with little option but to accept state aid.

The objective of this Chapter has been to not only examine the precarious agential, institutional and structural causes of the crisis but, by examining the literature, build a series of lessons or benchmarks[[8]](#footnote-8) which may be drawn from the crisis and which over the coming empirical chapters can be applied to my own research in such a way as to definitively answer the principle and guiding research questions. While it is true that the extent to which the banks in my own research engaged in the practices and contributory factors outlined in this Chapter vary, it is nonetheless important that we consider these factors against the broader empirical evidence. My thesis will make an original contribution to the literature reviewed and on topics of financial stability, growth and the post-crisis reform process more generally by adopting a bank-centric approach and asking whether the banks themselves have learned lessons from the crisis.

**Chapter 3 – Setting the Scene**

**Overview**

This section of the thesis will bring together the literature reviewed in the previous two chapters and will explore in further detail the theoretical and methodological rationale underpinning the research and which the following empirical investigations will be centred upon. The Chapter will guide the reader through the methodological practicalities of my research and how I will answer the question posed by this thesis, while deconstructing the overarching research question and situating my research within broader debates surrounding financial stability, growth and the role which banks play in the sound functioning of the global financial order.

We will explore the significance of learning and the causes of the financial crisis and what we can draw from these topics moving forwards into the empirical chapters. In particular, these two distinct areas of academic literature will be combined and brought together to create a series of practical measures which will be used to draw conclusions about the nature of lesson learning at U.K. banks. The Chapter will discuss both the depth and scope of the research. In particular, the research question will be ‘unpacked’ and described in greater detail by exploring a series of guiding research questions. In addition, the structural background against which these questions will be tested will also be accounted for.

**Research Questions**

While I am not assuming that banks will have learned the same lessons (or indeed any lessons) the Chapter will look to contextualise the causes of the crisis with the literature on learning in order to create a series of benchmarks or measures against which the extent of change can be judged. To this end I will now take the opportunity to remind the reader of the research questionsor lines of enquiry which will help us to definitively answer the overarching research question, namely:

• What does the literature on learning tell us about those conditions most conducive towards learning?

• Have banks made substantive changes to the structure and culture which pervaded institutions pre-crisis?

• What have banks identified as being the key changes needed within their own institutions?

• What have the banks said in relation to the financial costs associated with the implementation of those changes identified in the literature?

• What have banks said about their relationship with the regulators post-crisis?

• Is there evidence of peer-to-peer learning amongst the banks?

These questions will seek to outline how banks have understood and interpreted their role in the financial crisis as well as the position they hold in the wider structural framework of financialised global markets post-2008. A careful description drawn from official bank documents, analysis reports, and speeches by chairmen and other key agents, and articles gathered from the media will allow my thesis to make inferences of the banks’ attitudes and capacity towards learning by unfolding events and providing a detailed narrative of specific moments in time. As such, an examination of the structural and cultural forces which shape U.K. banks today, including common bank practices, norms, institutional attitudes and frames of reference, will be indicative of the extent to which banks have undergone a cultural shift post-2008 and their capacity to accommodate and encourage learning amongst employees at all levels.

**Structural Background to Research**

While the research questions outlined above will help to guide and focus the course of the research, the assessment of learning may at times be complicated due to the changing regulatory environment which has occurred post-2008 and continues to evolve and shift. As such, it is necessary to separate and explicate regulatory (exogenous) change from bank-led (endogenous) change as a result of learning. With this in mind we will now turn our attention to examine the changing structural environment in which banks operate post-2008.

Both domestic and international regulation is fundamental to the body of research undertaken in this thesis because of the great power and influence which regulatory arrangements have over the day-to-day operations of banks (British Bankers Association, 2015: 30). Moreover, following the financial crisis both domestic and international regulation has undergone massive restructuring and a raft of policy innovations (Bell and Hindmoor, 2015c: 457), with the British Bankers Association (2016: 1) estimating that since 2008 British banks have been subjected to more than 80 legislative changes to the way in which they are regulated. While a detailed and thorough analytical examination of these regulatory changes would be desirable such an analysis lies beyond the scope of this Chapter. However, below I detail the more prominent changes and in doing so will familiarise the reader with the wider structural context in which banks operate.

**[[9]](#footnote-9)Increased Minimal Capital standards –** Like many of their European counterparts the U.K. regulators adopted the minimal capital standards introduced by the Basel III initiative in 2011 which looks to raise capital and lower leverage ratios to 3 percent[[10]](#footnote-10) (Bell and Hindmoor, 2014: 346). Provisions made under Basel III include: the raising of total bank capital to a minimum of 10 percent of total risk-weighted assets; requirements that a minimum of 75 percent of all capital held be of Tier 1 standard; the introduction of two separate capital buffers of 2.5 percent respectively, including a ‘capital conversion’ and ‘counter cyclical’ buffer[[11]](#footnote-11) (ibid).

**Ring Fencing –** Introduced as part of the Government’s Banking Reform Act 2013 banks have been required to separate their retail and investment banking business. Thus, in the event of another financial crisis retail bank customers would be protected from risks associated with financial trading.

**Bail-in –** Again, introduced as part of the Banking Reform Act 2013 and largely presented as a solution to the too-big-to-fail problem, bail-in powers allow the Bank of England, in the event of a failure, to bail-in certain creditors who would be held financially responsible for some or all of the losses incurred by the bank.

**The Remuneration Code –** Under the Revised Code (2011) the Bank of England dictates that 40 percent of variable remuneration paid to material risk takers, including senior managers, strategic decision-makers and those members of staff in ‘control’ functions, will be subject to a deferral period of three years with this figure rising to 60 percent for senior managers or those receiving bonuses in excess of £500,000. Furthermore, at least 50 percent of all bonuses must be paid in the form of shares or other long-term performance instruments with guaranteed bonuses for staff being limited to one year (Prudential Regulation Authority).

**Clawback –** Introduced in 2015 by the City’s watchdogs the Prudential Regulation Authority (PRA) and the Financial Conduct Authority (FCA) clawback stipulations apply to all variable remuneration paid to senior management and material risk takers and makes provision for bonuses to be clawed back for a period of seven years in the event of employee misconduct or the failure to undertake appropriate risk mitigation[[12]](#footnote-12).

**E.U. Capital Requirements Directive (CRD IV) Bonus Cap –** While the European Union’s CRD IV directive sets out many regulatory provisions one of the most salient stipulations concerns banker bonuses. Under new legislation introduced in January 2014 banker bonuses are restricted to 100 percent of fixed salary with this rising to 200 percent of fixed pay with express shareholder approval (PwC, 2013: 1)[[13]](#footnote-13).

**Senior Manager’s Regime (SMR) –** Introduced under the Banking Reform Act 2013, and having taken effect as of March 2016, the SMR subjects all senior bankers to a statutory duty of responsibility to ensure that all ‘reasonable steps to prevent regulatory breaches in the areas of the firm for which they are responsible’ have been taken (HM Treasury, 2015b). However, critics have argued that the SMR does not go far enough and that the onus of responsibility remains with the regulators who in the event of failure will still have to prove that individuals failed to act accordingly (Treanor, 2015a).

**Bank Recovery and Resolution Directive (RRD) –** Under legislation passed by the E.U., the RRD sets out policies which equip the regulator, in this case the FCA, with a number of tools to ‘lessen the potential negative impacts on markets the firm’s customers and the financial system as a whole’ in the event of a potential bank failure (FCA, 2015). The powers extended to the City’s regulatory body (and the Bank of England), include ‘early intervention in the event of problems; planning to help the recovery of firms in financial difficulty; the resolution of failed firms in a way that reduces the costs to the public and mitigates the impact on the financial system’ (FCA, 2015). The RRD is aimed at removing the implicit state-guarantee and associated moral hazard which often accompanies banks that have become too-big-to-fail.

In addition to these changes which have affected the structures in which banks operate there are a whole host of other international and domestic regulatory initiatives which have been introduced post-2008 and which have, and will, affect the way in which banks conduct business. While it lies beyond the remit of this Chapter to detail the intricacies of such regulatory shifts, the coming empirical chapters will discuss specific regulations which pertain to, or have a strong potential correlation to, changes made at banks and the impact of such policies upon learning. These will be discussed in more detail as we move through our empirical chapters and where such initiatives are identified as being of particular salience.

While these structural factors may at times obscure or blur some of the evidence which will be examined in the coming chapters, the breadth and extent of the empirical analysis to follow will nonetheless allow us to draw conclusions about what has happened at the banks since 2007 drawing the reader’s attention to the ‘bigger picture’ of U.K. banking post-crisis.

**Why are we looking at this? Why the banks? Why this question?**

The question of bank-driven learning amongst U.K. institutions will inform current debates on financial stability and growth. For example the important relationship between the behaviour of banks and bankers has been highlighted by the literature reviewed in Chapter 2. Moreover, Bell and Hindmoor (2015a: 4) have concluded that the global economic crisis of 2008 was ‘essentially a banking crisis’. Similarly, exposures to the collapse of U.S. subprime markets, while not exclusive to banks, were a problem most closely associated with the banking sector (Lewis, 2011), with Clark (2015) also suggesting that austerity in the U.K. can be directly linked to the banking crisis of 2008. Likewise, Bell and Hindmoor (2014: 363) have further suggested that ‘large complex and interconnected financial systems are prone to serial, large-scale crises’ with banks being at the centre of such systems. Moreover, we know from the literature reviewed in Chapter 2 that the root causes of the financial crisis originated in the banking system before spreading to the real economy with the Bank of England’s Financial Policy Committee (2014: 6) suggesting that financial stability and growth are inextricably linked to the banking system.

The literature on the causes of the financial crisis and systemic economic stress in general would then appear to suggest a positive correlation between risk taking amongst banks and systemic economic instability. As such, we may assert that safer banks would lead to a more stable financial system. Therefore, the thesis will look to determine if banks are safer now than they were in 2008 by examining the empirical evidence of causal links between lesson learning and the extent to which the causes of the crisis have been addressed by U.K. institutions and which conclusions regarding financial stability and the sound functioning of financial markets can be drawn.

I will at this point reiterate for the reader that we should keep in mind that while banks did play a central role in the financial crisis 2008, banks, and particularly British banks, were just one of several actors that caused the crisis. Indeed, as highlighted elsewhere, my thesis could be enhanced by surveying others actors including hedge funds, offshore financial centres, derivatives trading, the shadow banking sector or global imbalances, which all played an important contributory role in the crisis and continue to pose a potential threat to the stability of markets.

However, given the huge role which banks played in the crisis and the central position which they continue to hold in the domestic and global economy, the value of my research will lie in asking if these systemically important institutions have learned lessons from the 2008 crisis and if they have changed. In doing so, my research will make an important contribution to current debates by addressing a key gap within the literature.

Again, I recognise that the bank-centric approach adopted in this thesis could be further complimented by a comparative study with the major European banks and institutions in the United States. However, my thesis will focus specifically upon the U.K. ‘big four’ banks of RBS, Lloyds, Barclays and HSBC. The decision to study these four institutions has been motivated by the prominence of these banks not only within U.K. markets but also internationally. Domestically, these institutions dominate the U.K. banking market, accounting for an overwhelming majority of current and business accounts, and operate across both retail and commercial markets. Internationally, these four banks are all ranked within the top 25 largest banks globally and the top ten largest banks in Europe (relbanks.com). Likewise, geographical proximity, a shared common language and constraints concerning time and the research budget put in place by the Academy for the completion of this work have also had a bearing upon choosing these institutions.

**Why Learning?**

In the Introduction to this thesis we determined that in the aftermath of the financial crisis debates surrounding the sound functioning of markets and economic stability have rested upon the issue of regulation. However, last time around banks were not in breach of domestic or international regulations (on the whole) but operated within regulatory structures to such an extent as to cause untold damage. As such, we may surmise that had banks operated and are continuing to do so on the fringes of regulation and have failed to correct their behaviour repeating the mistakes of the past then regulators may find it increasingly difficult to mitigate the banks’ behaviour on financial stability.

This is where the significance of learning comes into play. Sound financial markets need banks to recognise the lessons of past mistakes and to change their behaviour in such a way that mistakes will not be repeated. Indeed, while the structures in which banks operate have undergone considerable regulatory reform post-crisis, Bell and Hindmoor (2014: 351) raise concerns regarding the ideational limitations of such reforms. For example, despite the structural power of banks being significantly altered and reined-in post-crisis (Bell and Hindmoor, 2015a), the authors argue that banks have both the means and incentive to avoid and ‘sidestep’ regulation, forcing regulators into a never-ending game of cat and mouse in which banks are able to dedicate significantly more human and fiscal capital into negotiating regulatory burdens (Bell and Hindmoor, 2014: 356). Moreover, the prevalent role which banks continue to play in our domestic and global economy further highlights the need for lesson learning with the Bank of England Governor Mark Carney (2016) commenting that banks have the ability not only to trigger but also to ‘amplify stresses’ within the economy. Hence real reform of the financial system may require genuine bank learning and therefore the importance of my thesis.

One of the reasons why banks continue to hold such a predominant place within our economy is due to their role as the default financial intermediary offering such services as the processing of payments, high-street and commercial lending, investment, deposit insurance and risk management, all of which are fundamental in ‘macroeconomic stability and efficiency’ (Lall, 2012: 610). Moreover, the City of London in particular, despite fierce competition from financial centres such as New York and Hong Kong, remains the world’s premier international banking centre (BBA, 2015: 3), with financial and related professional services employing more than 2.1 million people across Britain (TheCityUK, 2015: 4). The banking sector’s UK total tax contributions for the 2014 tax year was £31.3 billion (BBA, 2015: 19), which equates to 5.5 percent of all UK tax receipts for the year (BBA, 2015: 19) and further highlights the central role which banks play in the domestic economy[[14]](#footnote-14).

Likewise, financial and related professional services are also the U.K.’s largest export, exporting £62 billion of services each year (BBA, 2015: 18), while accounting for approximately 45 percent of the U.K.’s total balance of payments (BBA, 2015: 18). Financial and professional services also contributed more than £180 billion to the U.K. economy in 2013, which accounted for 11.8 percent of all U.K. economic output for the year, while handling over £6 trillion in assets (TheCityUK, 2015: 4)[[15]](#footnote-15).

These statistics highlight the fact that while regulatory powers have indeed shifted and limited the structural power of banks post-2008, the pivotal role in which these systemically important institutions continue to play in both the domestic and international financial architecture persists today. Thus, despite regulatory efforts banks continue to have the potential to wreak havoc on a domestic and international scale, causing chaos and destroying financial stability as was so poignantly demonstrated by the 2008 financial crisis. Thus, we can see that while regulation is an important facet of financial stability, alone it is simply not enough to ensure the sound functioning of financial markets and hence the importance of bank-led learning and change. Thus, I suggest that the focus of the current literature on regulatory reform is excessive and leaves an important gap that my thesis will address.

As such, bank-led change and its contribution to financial stability rests upon the need for learning in order to avoid the mistakes of the past, which regulation alone does not insulate against. However, as discussed in Chapter 1, change and learning are inextricably linked. Importantly, the literature reviewed in Chapters 1 and 2, along with the ideas explored above, suggest that institutional lesson learning amongst the banks will lead to change and a safer, more stable, functioning financial system. As such, the coming empirical chapters will look not only to answer questions surrounding lesson learning post-crisis but will present the reader with an empirically rich picture of where the banks were in 2007/2008 and where they are today in terms of business strategies, goals and underlying principles.

**What Learning? What Counts? How do we Measure Learning?**

In Chapter 1 we reviewed a broad range of literature drawn from within the social sciences concerning the theoretical underpinnings of lesson learning. However, in light of the objective of this thesis it is important that we now set out how the theoretical constructs described in the literature may be translated into practical measures or benchmarks against which the empirical evidence can be tested.

**Double-loop learning theory** dictates that the presence of learning necessitates a clear and observable change in an institution’s underlying theories-in-use and group philosophies. Marginal changes are made to the way in which an organisation operates while the ends remain the same, and although an important factor it cannot be considered substantive learning. As such, within the empirical chapters to follow I will be looking to identify tangible changes to a group’s underlying principles, philosophies and strategic decisions which should be supported by tangible variations in how business is operationalised. Here I will look to identify evidence of what is being said about the direction of the bank post-crisis, how things may have changed, and how such sentiments are being upheld by specific policies. Double-loop learning will be crucial to my thesis as it will allow us to make distinctions (which at times can be tricky) between what is being said by the banks and what they really mean - being reflected in the kind of things they are now doing, the kind of assets they are holding, how profits are being generated and their overall business direction.

**Policy learning** stresses the importance of identifying evidence not just of behavioural change (which may be linked backed to single-loop theory) but of an evaluation of specific policies in place either at the host institution or a rival organisation which can be transported across time and space. As such, the key component of policy learning is the process of evaluation, which, as the literature tells us, should be accompanied by follow-up procedures and mechanisms aimed at upholding and implementing the results of this evaluative process. Within my own work policy learning and the evaluative process will be identified through the use of both in-house and independent reviews to gauge and see what banks, if anything, are saying about their own institutions, that of their rival organisations, and experiences of current or past policies. Likewise, the appointment of senior managers from more successful organisations may also be indicative of the evaluative process. As such, using documentary analysis, I will look at the language and discourse being disseminated by banks concerning the appointment of senior executives to identify examples of policy learning.

**Cognition and Schema** theories of learning suggests that in many instances learning is often hedged in with a large margin for error. However, the literature taken from the discipline of strategic management gives us three examples which can be clearly applied to our empirical research in identifying successful examples of learning. *First,* no one person should be solely responsible for decision making, interpreting or disseminating information. In my thesis I will measure this by looking at how strategic decisions are taken and how those who make decisions are held to account both before and after the 2008 crisis. I would anticipate that those institutions which have learned lessons to have added multiple dimensions to their governance structures which allows cross-divisional appraisal and which allows for information to run in both a top down/bottom up manner as a means of increasing checks and balances and oversight. *Second*, I will look for evidence of cross-divisional appraisals and enhanced whistle-blowing facilities in order to increase accountability. *Third*, I will look for evidence of what banks have identified as being the causes of the financial crisis. Importantly, I wish to ascertain how these triggers of the crisis have been addressed as the strategic management literature suggests that it is not simply enough to recognise the causes but that there must be evident correlation between lessons identified and policy follow-up.

**Bounded rationality** suggests that agents’ actions, including learning, are framed by the lack of access to perfect information upon which individuals depend to make rational choices and as such are ‘boundedly rational’ in their pursuits. Agents will fail to achieve optimal returns due to this lack of access and limitations associated with an individual’s own lack of ‘computational skills’. As such, agents are prone to making clumsy approximations in order to compensate for such failings. The literature on bounded rationality does not necessarily offer us any specific practical measures or benchmarks which can be applied against our empirical analysis but it does offer instead a theoretical construct which frames the learning process at our chosen banks. However, one factor which may indicate the ability of institutions to learn is a recognition by the banks themselves that they are boundedly rational and limited in their own capacity to learn.

**Structure and Agency** like the literature on bounded rationality does not necessarily have a set of criteria or empirical measures which can be used to identify the presence of learning; rather, they offer a theoretical explanation of how banks can indeed learn. Nonetheless, this learning does not always necessitate an observable behavioural change. In particular, the literature on meta-reflexives will be used to explain that one of the lesson banks might learn concerns their own learning trajectory and the costs and benefits associated with learning and change in relation to the structural environment.

**Causes of the Crisis - How do we Measure?**

The literature reviewed in Chapter 2 detailed the root causes of the financial crisis and how such occurrences contributed to the economic turmoil which beset markets in 2007/2008. The particulars reviewed in Chapter 2 will be utilised below to create a series of benchmarks which, in conjunction with those measures set out in the above section, will then be used within the coming empirical chapters to assess the extent to which lesson learning has occurred at the institutions under review. However, I would remind the reader that, as we know from the literature review carried out in Chapter 1, while agents and institutions can learn and change, learning is neither a static process nor does it have an end point. Therefore, we should keep in mind that just because banks may present evidence of learning and change in this thesis, that is not to say that they will not change again in the future or indeed, change back. As such, we should keep in mind that the picture regarding learning at banks is one which is still, in many ways, being played out. Furthermore, any assessment made in the coming empirical chapters regarding the progress of banks should be considered in light of the constantly evolving structural and institutional factors and which will be highlighted to the reader where appropriate.

The key measures of progress concerning the financial crisis are described below. Nonetheless, not every factor identified will be applicable to each bank, nor will each factor apply to the same extent, if at all. Likewise, some factors will simply not be an issue and as such we will allow for institutional variations.

**Excessive competition** between banks in many ways is the source from which all else flowed. Financial markets are still hugely competitive today, as is evidenced in the Introduction to this thesis (see IMF, 2017; World Bank, 2015; Woods, 2017), and it is clear that individual banks cannot necessarily change this. However, banks which place great importance on ROE targets and share price values, yet at the same time recognise the weakness and vulnerabilities of doing so, through official speeches, press releases and shareholder addresses, may show evidence of learning and meta-learning about their own position. In this respect, I will be looking at official documents whereby references to the weakness of such measures are explicitly addressed while at the same time recognising that markets may punish banks that are not competitive on these metrics. Not only would this be indicative of learning in that banks are recognising that competitive pressures played a role in the crisis but it would also be indicative of meta-learning in that institutions recognise the limits of their own learning. What is important is whether or not, and how, the banks recognise the salience of excessive competition.

**Efficiency of markets -** I do not believe it is sufficient to say that banks that continue to use VAR and CAPM risk models have failed to learn. This is because, despite their contributory role in the crisis, these models are still the most accurate and commonly used risk pricing models. However, banks that recognise the weakness of these models in official documents and enlist a second line of defence by encouraging senior executives to challenge the market wisdom of trades being made may be indicative of lesson learning.

**Leverage -** We would expect to see those banks that have learned lessons from the crisis to have lower leverage ratios than pre-2008 levels. The appropriate figures will be gained from Bankscope and I will complete a simple compare and contrast. We may conclude that operating within regulatory requirements post-crisis does not necessitate learning. Indeed, in the pre-crisis era leverage ratios were radically ramped-up without ever breaching Basel Capital standards. As such, I will be looking for evidence of banks that have gone beyond minimum regulatory requirements.

**Shadow Banking -** the shadow banking sector gave rise to a number of off-balance sheet vehicles. Therefore, banks with fewer off-balance sheet assets in relation to total assets would appear to be indicative of lesson learning. While this is not the most accurate measure as a decline in the value of off-balance sheet vehicles may be indicative of a devaluation of these instruments in general, this is the most accurate measure we have for ascertaining the extent to which banks are engaging with the shadow banking sector.

**Wholesale funding -** banks that have diversified their funding source, increased their equity base and have witnessed a decrease in wholesale funding as a percentage of overall funding post-2008 would be indicative of learning. Here, I will again use the database Bankscope to complete a simple contrast with figures from 2008 to the present.

**Remuneration –** assessing the extent to which banks have made changes to their remuneration structures and particularly variable pay could be potentially tricky as CRD IV rules have meant that the variable element of remuneration is now capped under E.U. directive. However, it is possible to assess variable remuneration against the minimum regulatory requirements. I will similarly utilise a comparison with remuneration structures up until the year 2014, the final year before CRD IV legislation took effect. I would expect those banks that have learned to have implemented changes which go beyond minimum regulatory requirements and pre-date the introduction of tougher regulation.

**Internal Risk controls -** the lack of robust risk management controls were a factor in the crisis. As such, I will look to the structuring of risk management post-crisis for changes. Banks that have fundamentally reappraised their internal risk management controls through the use of independent external audits and have followed this up with specific policies such as the appointment of specialist risk committees may have a greater propensity towards learning and change.

**Investment banking -** will look for a decrease in investment banking activity. However, isolating this factor could prove to be difficult as reduced profits generated by the investment banking divisions of banks may give a false impression that banks are retreating from such activities. As such, I will look to identify where there have been specific institutional initiatives that deliberately target the rundown of the investment banking division, for example, through the reduction of staff numbers, the closing of certain units and the running down of assets. Here, the literature suggests that a changing composition of bank balance sheets away from investment banking products and markets may be indicative of learning. As such, it is necessary that we examine how bank income is being generated post-crisis.

**Executives’ belief in business strategies –** I will determine the extent to which external perspectives are considered in the business strategies being pursued at institutions. This will include looking for independent reviews and audits and how the recommendations of these reviews are implemented. The presence of a review alone will not suffice to be classified as learning. Resultantly, I seek to identify tangible processes that have been implemented following such reviews.

**Authoritative CEOs -** here we will look for changes in hierarchical governance structures and in particular structures which allow more scope for senior executives to be challenged. This will include the promotion of separate divisions or departments to hold one another to account. I will also look for banks which have upgraded their whistle-blowing facilities and encourage whistle blowing as a means of holding executives to account.

**Too-big-to-fail -** the problem of too-big-to-fail is not necessarily concerned with the size of the bank but the moral hazard associated with banks reaching such a size that the banks believe they would be bailed out if need be and thus take on excessive risk as a result thereof. One way which learning may be detected here is through an increase in a bank’s loss absorbing capacities beyond the minimum regulatory standards i.e. an increase in capital buffers.

**The Next Financial Crisis**

There are of course certain limitations to the ideas espoused above concerning financial stability and the banks. While some of these concerns have been addressed in the Introduction I will take a moment here just to remind the reader of these theoretical and practical considerations. One such factor is the presumption that the next financial crisis will be bank-led or will originate from within the banking sector. While history has taught us that financial crises typically follow credit bubbles and rising asset prices (Kindleberger and Aliber, 2011: 273), the art of predicting crises is notoriously difficult. For example, in the wake of the financial crisis in 2008 Ben Bernanke (2009), former Chairman of the Federal Reserve, commented that no-one could have seen the crisis coming and was instead the culmination of a series of factors which came together to create the ‘perfect storm’. Likewise, in his memoirs, Alistair Darling (2011: 3) recounts that no-one saw the crisis coming and that of those people who claimed that they did they ‘failed to mention it at the time’. And while scholars such as Buiter (2009); Krugman (2009); Reinhart and Rogoff (2009) and Stiglitz (2010) argue that financial crises can be predicated and that, in particular, the 2008 financial crisis had an abundance of warnings signs, Hindmoor and McConeell (2013: 545) argue that such signs can be ‘ambiguous’ and that looking back with hindsight can distort the true nature of the conditions that unfolded in real-time. Indeed, even the IMF, while currently recognising that a new financial crisis may be on the horizon, is unable to pinpoint exactly when or where the next crisis might emerge from and can only point towards economic indicators which may precede a crisis (IMF, 2015).

Moreover, we know from history that a number of financial crises over the years have had many different key causal mechanisms or precursors which did not necessarily involve the banks specifically or the causes recognised in Chapter 2. Likewise, the most recent financial stability report by the FPC (2017) recognises that growing domestic consumer debt, the overvaluation of Chinese assets and uncertain trade conditions resulting from Brexit could trigger the next crisis. Globally, the IMF (2017) has identified the fallout from proposed tax and regulatory reform in the U.S., imbalances within the Chinese economy and cyber security as all posing a risk to financial stability. Indeed, City insiders such as Mark Boleat, Chairman at the City of London Corporation’s Policy and Resources Committee, believes that the next financial crisis will be triggered by a cyber-attack on a strategically important financial institution (Rushton, 2014). This has also been echoed by a British Bankers Association report that claimed that more than 70 percent of CEOs at some of the top banks and financial intermediaries believe cyber-security to be the greatest threat to their business (BBA, 2014: 4). Similarly, in June 2014, in response to the growing threat of cyber-security to financial stability, the Bank of England announced that it would be launching its controlled, bespoke, intelligence-led cyber security tests (CBEST) initiative aimed at identifying weaknesses and improving resilience in strategical areas of the financial system (Gracie, 2014).

As such, it stands to reason that the next financial crisis may not involve the same contributory factors as those in 2007/2008. Indeed, in this thesis I am only looking at one particular set of causes, namely the precursors to the 2008 financial crisis, and that the next crisis may have a different set of triggers. However, that is not say that the causes of the crisis identified in Chapter 2 were particular to the 2008 meltdown with many of these precursors being common to crises throughout history.

While I am not assuming that the presence of learning at our chosen banks will necessarily insulate the financial system from future crises and shocks, the research question being addressed here remains important because of the pivotal role which banks continue to play in ensuring financial stability as they are still the default financial intermediary (discussed above). Likewise, we know from previous discussion that the 2008 financial crisis was a bank-led crisis. Indeed, we may surmount that despite the potential of emerging risks and shocks from unknown sectors of the global economy, banks which have learned lessons from the 2008 crisis and have changed accordingly will be safer and more stable institutions. Given the strategically important position of banks in the global economy this would lead us to hypothesise the presence of a positive correlation between institutional learning at the banks in question and a safer financial system.

**Conclusion**

The remaining chapters of the thesis will now be dedicated towards disseminating and analysing the empirical evidence which will be set against the criteria outlined above. Chapter 4 will present the first of our studies and will examine the empirical evidence in relation to RBS. Chapter 5 will survey Lloyds, with Chapter 5 and Chapter 6 dealing with Barclays and HSBC, respectively. While the layout of each chapter will allow for institutional variations, the chapters will consider factors which may have determined the learning trajectory of banks in the areas of: governance and risk management, remuneration and changes to the balance sheet.

Before we move on to examine the empirical evidence and our banks in more detail I will briefly reiterate for the benefit of the reader what we can learn from these empirical studies and how my thesis will contribute to current debates on financial stability and reform.

The banks considered in this chapter account for a relatively small *N* or sample size and as such the thesis will not present a traditional case study. However, as highlighted above, while these banks are small in number they account for an overwhelming majority of the U.K. banking sector and dominate domestic markets. Moreover, the U.K. banking sector is the fourth largest in the world (in terms of assets held) and the largest in Europe (relabnks.com). Internationally, all four banks have significant reputations and operate across multiple markets within various countries.

Thus, while the thesis does not offer a traditional case study analysis from which general conclusions about banks or banking markets in general may be drawn and applied, the thesis will provide the reader with a deep and empirically rich picture of what has happened at the U.K.’s four major banks and the extent to which these systemically significant institutions have learned and changed following the 2008 crisis.

Moreover, while regulation has shifted post-crisis and has brought the banks under sticker supervision with enhanced capital requirements, tougher rules on remuneration and the introduction of ring-fencing (to name but a few), regulatory controls alone may not be enough to prevent these systemically important institutions from engaging in risky behaviour. For example, we know that banks have both the means and incentives to effectively sidestep regulation (Bell and Hindmoor, 2015a; 2015b) with the banks and not the regulators setting the regulatory agenda (Baily *et al*, 2015). Moreover, Sam Woods (2017) of the Bank of England and Alex Brazier of the BOE’s FPC have both raised concerns over the current regulatory ‘arbitrage’ which surrounds institutions. Similarly, Mr Woods and Mr Brazier have both concluded that effective regulation requires that banks meet both the spirit and letter of the law and that regulators are constantly forced to play ‘catch-up’ with the financial innovation of institutions. This would suggest that real reform may require genuine learning on the part of the banks.

However, we cannot assume that the banks will have learned lessons from the crisis despite the huge losses sustained with structural competitive pressures potentially undermining the learning process or causing banks to be selective in which lessons to learn from. For example, we know that in the run-up to the crisis structural competitive pressure led the banks to pursue increasingly risky business practices. Likewise, we have already ascertained that financial markets remain today fiercely competitive (World Bank, 2015) with banks having to compete for staff and capital and facing increasing pressure to make returns for their shareholders which, according to the IMF (2017: xi) has resulted in banks expanding their risk profiles in order to deliver expected returns. As such there is no guarantee that the banks will have learned lessons from the crisis or that regulation (which has been the focus of much of the academic debates post-2008) will be enough to ensure a more stable and robust banking system. The value of my thesis will lie in addressing this key gap and asking if the banks themselves have learned lessons from the crisis and if these systemically important institutions are now safer.

# **Chapter 4 – RBS**

# **Overview**

In 1998 RBS recorded a modest pre-tax profit of £1 billion, by 2007 this figure had grown to £9.9 billion. However, just one year later in 2008 and amidst the turmoil of the financial crisis the Group would post a record £25 billion loss, the largest in UK corporate history, and require a state sponsored bailout worth approximately £45 billion and which would leave the U.K. taxpayer as the majority shareholder.

During its 250 year history RBS had grown through the use of both organic and inorganic strategies, so that by 1998 the Group’s total assets were worth £77 billion. RBS’ success had always been centred upon ‘solid, steady development’ and a prudent attitude towards risk (Martin, 2014: 46). However, a series of domestic and international takeovers by the Bank throughout the late 1990s and 2000s meant that by 2007 the Group’s total assets were worth a staggering £1.9 trillion. RBS was now, by market capitalisation alone, ‘worth more than Coca-Cola and more than Sony and Apple combined’ (Fraser, 2014: xiii) and the world’s fifth largest bank (Rayner, 2009).

When the crisis hit in 2007/2008 RBS’ position was compromised by the fact that much of its expansion programme had been done so without the necessary due diligence (Lambert, 2011). A lack of internal governance and a Board which failed to hold the Chairman and his executive team to account (Wilson *et al*, 2011), coupled with financial incentives and bonuses which encouraged staff to prioritise ‘increasing revenues, profits, assets and leverage’ over ‘capital, liquidity and assets quality’, compounded RBS’ precarious situation (Lambert, 2011).

In their account of the crisis Bell and Hindmoor (2015a) detail the hazardous position which RBS’ aggressive expansion policy had left the Group in, revealing a balance sheet which was highly exposed, overleveraged and undercapitalised. The authors note that following their takeover of ABN Amro in 2007, just 43 percent of Group assets were being held in loans. Meanwhile, trading securities had risen to £112 billion, which was worth approximately 12 percent of total Group assets. As the crisis began to take hold, the Bank quickly found that its trading position and assets in-place had undermined the Group’s entire operation and stability as the Bank suffered huge trading losses (ibid. p110-112). The Group was then further compromised when the securitised assets it had purchased, which included £41.4 billion in U.S. residential mortgage backed securities (RMBS); £50 billion in commercial mortgage backed securities (CMBS); £8 billion in collateralised debt obligations (CDOS); £7 billion in collateralised loan obligations; £97 billion in ‘other’ asset backed securities (ABS) became toxic, losing much of their value practically overnight (Bell and Hindmoor, 2015a: 110-112). To make matters worse, investor appetite for these products similarly all but disappeared, meaning that RBS were left with assets which were now worth ‘fire sale’ prices and had and no-one to sell them to which drove down prices still further (ibid).

This combined with the fact that customer deposits had shrunk to an all-time low of just 35 percent, and with the Group borrowing almost £49 billion from wholesale markets on an overnight basis, meant that by October 2008 the Bank were ‘unable to get to the end of the day’, leaving the U.K. government little option but to step in (King, 2016: 37).

# Summary of Position Following Crisis

Now, almost ten years from the crisis, there is little doubt that RBS have undergone significant change, not least of which can be witnessed in the leadership of the Group with no single Board member from 2008 surviving today, including the influential and controversial former Group Chairman Fred Goodwin. However, this Chapter will suggest that, despite making some incremental changes following their re-capitalisation in 2008, RBS have ultimately failed to learn lessons. As such, it will be argued that much of the progress made by the Bank post-crisis can be attributed to exogenous structural factors and that subsequent change can be largely described by the single-loop learning theory.

For example, the Bank have been embroiled in a series of scandals which have exposed deficiencies in the Group’s internal governance mechanisms: in 2011 NatWest were fined by the FSA for failing to deal with customer complaints in a satisfactory manner; in 2012 Coutts Bank was fined by the FSA for failing to implement the appropriate anti-money laundering (AML) procedures on deposits and transfers of wealthy clients. The Group have also been implicated and fined for their involvement in the rigging of Libor, Yen Libor and Forex rates; failing to report share dealings; mis-selling PPI and not observing the appropriate industry standards when offering mortgage advice to clients.

It will be suggested that RBS have made some headway on remuneration, reducing the overall employee bonus pool by 72 percent at the Group level and 92 percent in the investment bank between 2010 and 2015. However, the evidence examined in this chapter indicates that the greatest changes to the way in which employees are remunerated at the Bank have come in response to exogenous influences and in particular the introduction of the European Parliament’s CRD IV Article 90(1)(ca) and (d), which looks to limit the amount of variable remuneration employees can receive and which may explain subsequent reductions in the bonus pool.

Following the crisis, RBS, on face value, also appear to have made some good progress on the structure and composition of the balance sheet - reducing leverage, increasing customer deposits, decreasing wholesale borrowing and exiting 25 of 38 foreign markets while reducing the size of the investment bank by 78 percent (Dunkley, 2015) - I will similarly argue that these changes have to a large extent been motivated by structural dynamics, and specifically E.U. rules on state-aid which have required RBS to shed approximately £1 trillion of assets from its balance sheet, and as such cannot be considered symptomatic of a reflexive learning process in keeping with the double-loop theory.

# Factors Explaining RBS’ Failure to Learn

This Chapter will postulate that RBS’ failure to learn can be attributed to successive regulatory and governance failures which have led the bank on a series of ‘firefighting’ missions. The result of which has been that the Group’s attention and precious resources, including human and financial capital, have been diverted away from the search for, and evaluation of, new information and thus robbing the Bank of the precious ‘space’ in which learning takes place.

Edmondson and Monigeon (1999) – reviewed in Chapter 1 – suggest that in order for double-loop learning to occur, that being the undertaking of a deep and thorough reappraisal of an institution’s underlying ‘theories-in-use’, individuals and organisations must first have the ‘space’ to learn (ibid. p162). Space is understood as being the dedication of both time and resources to the learning process (Edmondson and Monigeon, 1999: 162). Simon (1983: 19) also contends that learning requires space. The author argues that in order for substantive learning to take place a learning subject must first have both the room and time to consider and evaluate new information as it is presented to him (ibid).

Both Edmondson and Monigeon (1999) and Simon (1999) conclude that without the necessary ‘learning space’ agents and institutions will be unable to accurately judge, evaluate or appraise their current working methods. Under such circumstances, the exchange of information and ideas will ultimately break down, leaving individuals or organisations to revert back to already established procedures and policies as the learning subject seeks reassurance in the status quo and thus failing to learn (Edmondson and Monigeon, 1999: 162). This Chapter contends that RBS’ failure to learn lessons can be attributed to the Group being denied this necessary space to learn with a series of internal failures consuming the Bank’s time and resources.

Furthermore, this erosion of the learning space and the subsequent reversion to pre-established institutional norms and methods has, in the case of remuneration, resulted in a series of institutional path dependencies surrounding the issue of competition over talent and pay, interpreted by key agents and established in the immediate aftermath of the crisis, persisting to such an extent as to cloud and distort the learning process. Indeed, institutional path dependencies may best explain why remuneration policies at the Group post-2008 appear to have been largely motivated by a fear of losing ground and talent to rival organisations despite RBS retrenching on domestic and European markets where competitors are largely held to the same regulatory standards.

The Chapter will conclude that these two factors may best explain why RBS have, on the whole, failed to learn and change, with the Group still being vulnerable to many of those institutional and structural weakness that were present in the run-up to the 2008 crisis. As such, the Group may yet prove to be a threat to financial stability and the real economy.

# **Governance**

This section of the Chapter will suggest that a series of internal governance and regulatory failures brought to light post-2008 has led RBS on multiple of ‘firefighting missions’, swallowing up huge amounts of time, resources and human capital as the Group struggle to contain a catalogue of governance issues. Moreover, it will be argued that such failures and the resulting expeditions to rectify these problems have ultimately robbed RBS of its precious ‘learning space’ (Edmondson and Monigeon, 1999; Simon, 1998), denying the Bank the opportunity to undertake a thorough and robust examination of the Group’s underlying ‘governing values’ and theories-in-use in-light of those deficiencies highlighted by the crisis and which, as previously discussed, forms a central part of the learning process (Smith, 2011; 2013).

# Board Structure and Composition

Following the crisis, RBS have significantly altered the composition and membership of the Board, with a total of 10 Executive Directors, including 1 Chairman, and 15 Non-Executive Directors departing the company since 2008. What is more, of those Board members who have left the Group, all have done so of their own will, despite some former members such as Fred Goodwin and Johnny Cameron coming under increasing pressure to do so, with none of the Board members in 2008 having a presence at RBS today (RBS, 2008; RBS, 2015). Likewise, the Group have also streamlined its governance structure by reducing the Board Committees from 7 individual commissions in 2008 down to just 3 committees by 2015, for a more simplified structure which has the potential to increase oversight by dismantling former silos and the associated pitfalls of such internal structures[[16]](#footnote-16) (RBS, 2011: 252; RBS, 2013: 38).

These changes may, on the face of it, be indicative of a bank which is receptive to an ever evolving governance landscape and keen to harness the ‘adjacent information’ which the recruitment of fresh talent brings (Rose, 1991: 13). However, we should be careful in drawing such conclusion with multiple governance failures, detailed in the coming sections, suggesting otherwise and may hold the key to explaining why more substantive double-loop learning has not occurred.

# Compliant Handling, Money Laundering and I.T. Failures

In 2011 both the Royal Bank of Scotland and NatWest banks were hit with fines by the FSA for failing to handle customer complaints in a satisfactory manner (Insley, 2011). The regulator fined RBS £2.8 million after it was revealed that a substantial number of customer complaints were handled incorrectly or were rejected without proper consideration or explanation, with many customers being denied access to an appeals process (ibid). Following an investigation the FSA revealed that of the cases which it had reviewed 53 percent demonstrated a failure to handle the complaint adequately, 62 percent were in breach of FSA requirements on timelines and 31 percent were deemed to have an unfair customer outcome (FSA, 2011).

Moreover, the FSA concluded that staff at both the Royal Bank of Scotland and NatWest banks were not given adequate training in complaint handling, with oversight of such matters being severely deficient (FSA, 2011). In an interview with the *Daily Telegraph,* Brian Hartzer, RBS’ head of U.K. Retail, commented that

we acknowledge the findings of the FSA investigation. It confirmed shortcomings in our routine complaint handling that we assessed in our own internal review and which we are committed to putting right

(Hartzer cited in Evans, 2011).

Likewise, in 2012 Coutts Bank, part of RBS’ private banking arm, was fined £8.75 million by the FSA after it was found that the bank had serious deficiencies in its anti-money laundering (AML) procedures (Treanor, 2012a). The FSA concluded that as late as 2010 the Bank’s AML legislation had presented ‘serious’ and ‘systemic’ failings which resulted in an exceptionally high probability that Coutts had been handling the proceeds of crime (FSA, 2012a). The FSA found that AML breaches at Coutts were ‘significant’ and ‘widespread’, with the Bank failing to implement sufficient controls when dealing with new or ‘politically exposed persons’ with a lack of consistency in the level and application of oversight safeguards (Kar-Gupta, 2012).

It was found that AML arrangements were significantly out of step with current best practice legislation and procedures (FSA, 2012a). Commenting on the matter, Coutts were keen to stress that there was no evidence which suggested money laundering had indeed taken place but conceded that the systems put in place by the Bank to combat such abuses was ‘totally inadequate’ but that subsequent actions had been taken to rectify the problem (Treanor, 2012a).

While these incidents came to light in the immediate aftermath of the crisis, and at a time when it could be argued RBS were only just starting out on their learning journey, the significance of events is nonetheless important due to the subsequent knock-on effect on the Group’s learning ability. For example, following each of these failures RBS’ response was to carry out a separate and distinct review of the appropriate business area, requiring the dedication of both time and resources. In this respect, the learning space was eroded due to RBS’ attention being diverted away from the ‘bigger picture’ learning - concerning the causes of the crisis - and was instead consumed by the immediate problem at hand. As such, attention was drawn away from the task of undertaking a large-scale, timely and reflexive evaluation of the Group’s underlying theories-in-use, as associated with double-loop theory, with the failure at Coutts, Royal Bank and NatWest highlighting not only a deficiency in internal governance standards but also how such events can erode the space needed to learn which the literature identifies as being a key condition of the learning process.

A further incident which may have compounded this effect includes a catastrophic computer failure in 2012 which would culminate in fines for the Group totalling £56 million (Dunkley *et al*, 2014). Following a problem on the Bank’s centralised I.T. system, approximately 6.5 million customers belonging to the Group’s Royal Bank of Scotland, NatWest and Ulster Bank were effectively locked-out of their accounts, resulting in many clients being left unable to carry out even the most basic banking functions (FCA, 2014a). The majority of those affected were retail customers and as such were potentially more economically vulnerable to fluctuations in access to banking services (BBC News, 2014a).

The Group was eventually fined a total of £56 million after the FCA and the PRA levied penalties of £42 million and £14 million respectively (Treanor, 2014a). However, during a research interview with journalist and author Ian Fraser, Mr Fraser pointed out that in this case RBS did appear to have learned from past mistakes with the Group currently

investing millions in I.T., which would leave the bank with one the most sophisticated and cutting edge customer service platforms in the U.K. They have entered into partnerships with scores of the world leading fintech players… [they are] doing some interesting things in I.T.

(Ian Fraser. Interviewed 10th August 2016).

The subsequent investment in I.T. systems, as highlighted by Ian Fraser, would appear to be out of step with the argument presented so far in this section and does indeed suggest the presence of learning in this instance. However, while it is true that there may be ‘pockets’ of learning within the Group, this example does not detract from the overall argument presented here.

# Libor, Share Dealing and ‘Sanctioned’ Transfers

Further evidence of the failure to learn and the subsequent erosion of the learning space can be seen in 2013 when RBS’ governance framework would once again be called into question over allegations of the Bank’s involvement in the Libor rate rigging scandal in both the U.K. and U.S., with fines by both City and Wall Street regulators totalling approximately £390 million (BBC News, 2013a). Following an investigation by the FSA and Commodity Futures Trading Commission (CFTC) it was revealed that RBS employees had been complicit in the manipulation of the inter-bank lending rate, along with a host of other U.K. banks, including Lloyds and Barclays, in order to profit a small group of inside traders (ibid).

Following the publication of transcripts of conversations between traders at RBS and other institutions at home and in the U.S., it was revealed that Group employees had been deliberately influencing Libor for at least 3 years between mid- 2007 and late-2010 (BBC News, 2013b). As result of RBS’ involvement John Hourican, head of RBS's investment bank, subsequently left the Group[[17]](#footnote-17).

Commenting on the incident RBS stated that since 2011, when events were first brought to their attention, the Group had undertaken a number of key actions including ‘strengthening the systems and controls governing [the] submissions of LIBOR and other trading rates’; creating an independent and ring-fenced rate setting team; introducing new ‘preventative and detective’ statistical controls which monitor submissions for irregularities and establishing a ‘Rate Setting Review Board’ tasked with overseeing the submissions process (RBS Online, 2013).

Similarly, in July 2013 RBS were fined £5.62 million by the Financial Conduct Authority (FCA) for failing to accurately file reports relating to share dealings being carried out by the Group’s investment bank (Rankin, 2013). Following an investigation by the City regulator, the FCA concluded that RBS had failed to correctly report share transactions between November 2007 and February 2013 (FCA, 2013a). Furthermore, the outcome of the investigation revealed that from November 2007 to February 2012 the Group failed entirely to report some 804,000 transactions which accounted for approximately 37 percent of the Group’s trades of this kind (ibid)[[18]](#footnote-18).

As such, it was determined that RBS had significantly violated regulatory reporting requirements, with the FCA concluding that the event had brought to light clear deficiencies in the Group’s internal management controls (FCA, 2013a). While commentators have agreed that RBS’ conduct was neither ‘deliberate’ nor ‘profit making’ the incident does highlight the fact that the Group failed to adequately manage internal checks and balances, a key cause of the crisis, over a prolonged period (Rankin, 2013).

Moreover, it was revealed that in 2010 RBS were made aware of the problem but failed to tackle the issue, with breaches in reporting controls occurring as late 2013 (ibid). In response to the fallout, RBS admitted that there had been a failure within their internal reporting structures and that the Bank would make ‘significant investments’ in improving controls to ensure that such matters would not persist (RBS cited in Wilson, 2013a).

Furthermore, in December 2013 it was announced that the RBS would be fined again, this time to the tune of £75 million, by U.S. regulators for providing transfers with sanctioned countries such Iran, Sudan and Cuba between 2005-2009 (Scannell, 2013)[[19]](#footnote-19). Investigations by the U.S. Treasury found that RBS had deliberately ‘instructed employees to list the actual name of the Iranian financial institution rather than the Bank Identifier Code in the beneficiary bank field of the payment instructions’ so as to conceal the intended country of receipt from authorities (BBC News Online, 2013). This allowed RBS to deal with nations explicitly sanctioned by the United States, with RBS providing

written instructions containing a step-by-step guide on how to create and route US dollar payment messages involving sanctioned entities through the United States to avoid detection

(BBC News Online, 2013).

This incident, along with deficiencies relating to Libor and the mis-reporting of share dealings, once again suggests that not only have RBS failed to learn lessons in relation to internal governance and oversight, with some events occurring up to five years after the global recession and the institutional shortcomings which it highlighted, but that these failures may in themselves have contributed to the Bank’s lack of learning. For example, while strategic and policy reviews form an important part of the learning process, as highlighted by the policy learning literature, the fact remains that these events have elicited a specific response from RBS which has required the devotion of time, resources and capital which could have otherwise been dedicated towards the undertaking of a Group wide critical reflection aimed at re-evaluating RBS’ underlying theories-in-use in response to the challenges and institutional failures stressed by the crisis. Thus, these failures and the resulting costs may account for a lack of substantive learning in relation not only to governance but also to other elements of the business with precious resources or ‘space’ being diverted away from the big picture learning.

# Mortgage Advice, PPI, Global Restructuring Group and Forex Rigging

Further evidence of governance failures at RBS were highlighted in August 2014 when the FCA revealed that it would be fining the Bank £14.5 million for failing to follow industry best practices when giving mortgage advice to customers (Press Association, 2014). The FCA fine came following a 2012 investigation into the Bank’s selling of mortgages, when it was discovered that NatWest had failed to give customers suitable advice when applying for a mortgage (FCA, 2014b). A subsequent review of sales carried out by the regulator highlighted that approximately 50 percent of NatWest mortgage customers had been either misinformed or given advice that was unsuitable or wrong (ibid).

In many cases it was determined that NatWest staff had failed to adequately assess the financial background of clients before making a mortgage offer, with staff neglecting to carry out ‘affordability assessments’, ‘failing to advise customers who were looking to consolidate debt properly’ and not offering customers suitable advice on the term of their mortgage (FCA, 2014b). Moreover, like their previous sanction issued by the FCA over failing to adequately report share dealings, discussed above, it was revealed that RBS had been warned about the issue previously when in 2011 the FCA brought it to the attention of the Group’s management that it was concerned that staff were failing to meet approved standards when giving advice and approving mortgages (Pickford, 2014). When the FCA discovered that a year later no action had been taken to rectify such shortcomings it undertook further investigations and subsequently fined RBS (ibid).

Commenting on the issue Group Chief Executive Ross McEwan said that such failings were ‘unacceptable and should never have happened’, adding that since the incident the bank had ‘completely overhauled [their] processes’ and that bank staff had undergone ‘extensive’ training in order to remedy the situation (McEwan cited in BBC News, 2014b).

However, in a research interview conducted with a senior career British banker, who was interviewed under the condition of full anonymity, the participant commented that

they are still at it [extending residential mortgage loans without the proper due diligence], making silly cheap loans without proper customer checks…Banks are still desperate to get money lending and get money flowing and to grow and meeting target [sic]

(Participant A. Interviewed 2nd February 2017).

Furthermore, when asked if this kind of behaviour could explain why the number of impaired loans had grown at the Group following the crisis despite RBS significantly increasing the number of residential mortgage loans as a percentage of gross loans, which are typically considered to be a much safer type of loan and as such we would expect to see lower impairment rates, Participant A stated that

yes, I think this is exactly why impairments have risen, they are desperate to lend and keep money flowing, again it comes back to these cheap silly loans which I know they are still doing…I’ve seen them make some suicidal deals, one of which affected me personally

(Participant A. Interviewed 2nd February 2017).

Similarly, and like many of their contemporaries discussed in this thesis, RBS became implicated in the PPI scandal when, following an FSA investigation, it was revealed that the Bank had mis-sold customers Payment Protection Insurance (PPI) on their loans, mortgages and credit cards (Brinded, 2013). The FSA’s investigation revealed that many customers who had been approved products had often come under great pressure from the banks to take out PPI insurance, and in some case the insurance premium was simply added without the express knowledge or permission of the client (Wearden, 2011). Of all the banks caught up in the scandal RBS had the second largest exposure at £5.3 billion and second only to Lloyds[[20]](#footnote-20) (Dunkley, 2016c). Speaking to Greig Cameron of *The Herald Scotland*, Group CEO Ross McEwan commented that

At the peak of the financial crisis, RBS was the biggest bank in the world…When the crisis broke the bank was involved in a number of different businesses in multiple countries that have subsequently faced heavy scrutiny by customers and regulators...The scale of the bad decisions during that period means that some problems are still just emerging. The good news is we are now a much stronger bank and can manage these costs while still supporting our customers

(McEwan cited in Cameron, 2014).

Mr McEwan’s comments highlight the fact that the majority of claims being levied against the Bank relate to the pre-crisis period, and as such the PPI saga does not necessarily constitute a failure to learn. However, the fact remains that RBS have had to commit vast resources, including the establishment of a specialised team dedicated to resolving complaints and the assembly of a massive compensation pot worth billions, to cleaning up the fallout from the mis-selling of PPI. As a result, it may be suggested that the burden of the PPI scandal, and its drain on the Bank’s resources, may have negatively impacted upon the Group’s learning space by consuming human and financial capital that could otherwise have been dedicated towards learning from the key lessons of the crisis outlined in Chapter 2.

However, in 2014 RBS would once again become shrouded in controversy when it was announced that it would be closing its Global Restructuring Group (GRG), after a 2013 Report published by former government advisor Lawrence Tomlinson alleged that the bank had been profiting from businesses in distress by unnecessarily pushing some companies into default (Brinded, 2014a). Dr Tomlinson’s report alleged that once a business had been moved into the specialist unit it became

trapped with no ability to move or opportunity to trade out of the position – they are forced to stand by and watch anr [sic] otherwise successful business be sunk by the decisions of the bank

(Tomlinson, 2013: 2).

It is purported that RBS would profit from these business by charging handling and advisement fees which were ‘beyond what can be considered reasonable and to such an extent that it is the key contributing factor to the business’ financial deterioration’, RBS would then buy up the failing companies, now hugely devalued, assets (ibid).

RBS refuted the claims and in 2014 employed the services of Clifford Chance LLP law firm to independently review the allegations made by Dr Tomlinson’s report. RBS CEO Ross McEwan subsequently announced that The Clifford Chance report had found

no evidence of the serious and damaging allegation that [RBS]…had set out to deliberately defraud…business customers

(McEwan, 2014).

Nonetheless, the Group were then subject to further allegations which suggested that RBS were guilty of falsifying the files of customers moved into the GRG, including ‘editing of customer emails, call transcripts and how it presented its ‘central file’(decisionmarketing.co.uk. 2015). Moreover, Ian Fraser commented that this abuse had taken place on an ‘industrial scale’ (ianfraser.org. 2016), forcing Ross McEwan, appearing on the radio show *LBC*, to once again defend the Bank and its position, stating that the allegations were ‘just not true’ and challenging Mr Fraser to ‘show me what difference it would have made to the actual case that was held and the outcome’ (McEwan on LBC 24th November 2015).

During a research interview I asked Lawrence Tomlinson for his thoughts on this matter and he told me that

when I gave my reports and I tried to discuss this with RBS prior to its release all I got was aggression…the chief exec comes out on the front foot very aggressive with me and I’m thinking, hang on a minute mate, I’m trying to help you. The obvious answer from any Chief Executive would be thank you very much, I’ll look into this and I’ll get back to you…instead all I get is hostility and aggression

(Lawrence Tomlinson. Interviewed 28th November 2016).

In a further incident, in May 2015 RBS would announce that it had reached a settlement with U.S. authorities over its involvement in the rigging of foreign exchange rates, agreeing to pay fines totalling £535 million (RBS.com, 2015). Following an investigation by U.S. regulators RBS admitted that between 2007 and late 2013 they colluded with other banks to manipulate Forex rates and had worked to conceal the true nature of profits which had been generated as a result (Binham *et al*, 2015). Commenting on the issue Ross McEwan stated that

The serious misconduct that lies at the heart of today’s announcements has no place in the bank that I am building. Pleading guilty for such wrongdoing is another stark reminder of how badly this bank lost its way and how important it is for us to regain trust…We are determined to learn the lessons from our past mistakes and to hold those responsible fully to account for their actions

(McEwan, 2015b).

While the Forex scandal did result in some positive behavioural changes at the Bank, including restricting employee access to chat rooms and I.T. messaging services, banning mobile phones on the trading floor and improving the disclosure of information to clients, all which form an important process in RBS’ learning journey, these reforms have been confined to the fringes of the business, with the underlying principles and core values remaining broadly unchanged[[21]](#footnote-21). As such, it may be possible to conclude that though this example does indeed present some evidence of single-loop learning, which is often an important step towards more substantive double-loop learning, the Group have failed to show basic evidence of learning and change in relation to the culture and structure of the Bank in keeping with the theme of this thesis.

Not only does this event, along with the other multiple examples discussed above, represent a series of firefighting missions which have preoccupied the Group’s attention acting as barrier to learning by preventing vital information exchange, it also highlights RBS’ failure to adequately manage risks through its internal governance structures. RBS have failed to detail how much timehas been dedicated towards the resolution of events or the exact financial costs, measured in terms staff, lost working hours and reputational damage, thus making it difficult to quantify the extent to which time and resources have been spent on these breaches. However, the events detailed above nonetheless suggest not only the absence of learning, but also that the Group’s learning space has been severely impacted, as time and resources, both human and financial, have been consumed by a number of firefighting missions. Moreover, this may also suggest that while dissatisfaction is crucial in the learning process, as evidenced throughout the literature reviewed in Chapter 2, in the case of RBS it appears that too much dissatisfaction can indeed impair learning by eroding the learning space.

# **Remuneration**

This section of the Chapter will argue that despite making some impressive strides in relation to remuneration, with the Group bonus pool falling by 72 percent between 2010 and 2015 and 92 percent within the investment bank (RBS, 2015: 66), RBS have ultimately failed to learn. It will be demonstrated that most significant or tangible changes have come in response to exogenous structural factors, namely the implementation of CRD IV and external pressures from the U.K. Government as the majority shareholder. It will similarly be argued that this failure to present substantive evidence of double-loop learning, and change in relation to the culture and structure of remuneration at the Bank post-2008, can be attributed to a series of institutional path dependencies - concerning competition and the recruitment of talent and interpreted by ‘situational agents’ (Bell, 2011) – working in such a way as to distort learning and prevent change.

Before we move on to examine the empirical evidence in relation to pay at RBS, I will briefly remind the reader of two major regulatory changes, detailed in Chapter 3, which have dictated the level of variable pay at institutions post-2008 and which will be a particular importance to the argument set out in this section. First, the Bank of England’s Remuneration Code (which came into effect on the 1st January 2011) dictates that at least 40 percent of all variable remuneration paid to strategically important persons or material risk takers should be subject to a deferment period of at least three years. For senior managers and personnel receiving bonuses in excess of £500,000, 60 percent of awards should be locked away for the three year deferral period (Prudential Regulation Authority). The second important regulatory change regarding remuneration has been the introduction of the E.U. Capital Directive (CRD IV) Bonus Cap. Under CRD IV (introduced 1st January 2014) all European headquartered banks are required to cap variable remuneration at 100 percent of annual pay or 200 percent of fixed salary with the majority consent of shareholders (PwC, 2013: 1).

At the outset of this Chapter I suggested that a series internal governance failures had led the Group on various firefighting missions which had subsequently eroded RBS’ learning space. In this section, I posit that the governance failures highlighted above, and which resulted in the erosion of time and resources, has led the Group to fall back upon certain institutional norms or path dependencies with endogenously originated remuneration policies closely resembling models in place in the immediate aftermath of the crisis.

Simon (1957: 259) has argued, in order to achieve optimal results, a learning agent needs access to ‘perfect’ information which will help them determine the path towards the most favourable outcome. However, when the exchange or transmission of information breaks down, as is the case when the learning space is eroded, agents are left with key gaps in their information path and as such will rely on making clumsy approximations to compensate. As such, agents and institutions often fall back upon pre-established paths or the *status quo* as associated with the so-called ‘satisficing’ behaviour (Simon, 1998). In this instance, it is those path dependencies forged in the wake of the crisis - relating to competition and pay – to which the Group have reverted to due to a perceived lack of alternatives.

A very distinct strand within the literature on institutional path dependency is the idea of ‘imprinting’ (Stinchcombe, 1965). Imprinting suggests that institutions may continue to adhere to certain behaviours in spite of evidence which suggests that these practices are outdated, erroneous or inefficient. This is because, according to Marquis and Tilcsik (2013: 3), certain behaviours or organisational norms formed and adopted at a time of heightened institutional sensitivity – described as being the immediate period following ‘transition, upheaval, and instability’ - such as in the aftermath of the crisis, tend to give an organisation meaning, direction and a sense of purpose (ibid. p9). As such, these practices are ascribed great importance and institutional value to the point that they become ingrained and ‘infused’ within an institution’s very identity, persisting beyond their natural lifespan (Selznick, 1957: 16-17). These ideas then become a ‘lasting part of the organisation’ despite the presence of contending information which may prove such practices flawed or unproductive (Marquis and Tilcsik, 2013: 2). Moreover, once a particular idea or behaviour has been imprinted on an organisation, this will tend to persist to the extent that the ‘influence of early experience resists extinction to a high degree’ (Immelmann, 1975: 22). Therefore those ideas formed at the time of or in the immediate aftermath of the crisis, surrounding remuneration, may have a greater propensity to resist change due to the institutional value ascribed to these practices and beliefs despite contending information.

This may explain why concerns over structural competitive pressures in relation to pay have persisted at RBS despite the Group retrenching operations on U.K. domestic markets which due to regulatory equivalency standards we would expect to have become less competitive with a more level playing field being guaranteed by the adoption of CRD IV[[22]](#footnote-22).

It will be observed that when we take account of the Group’s remuneration structure we witness relatively little change between 2008 and 2013 - the final year before the E.U. directive CRD IV would come into effect – with awards made during this period appearing to be out-of-step with performance and which may be indicative of so-called ‘imprinting’ as the Group revert to a pre-established order.

# Annual Incentive

In 2008 variable remuneration at RBS was divided along three distinct lines; short-term annual incentive; long-term incentives and options (RBS, 2007: 106-107). Under the short-term annual incentive (AI hereafter) executive directors could typically expect to earn a maximum annual award of between 160 percent and 200 percent of base salary, with the exception being the Group Chief Executive and Chief Executives of the Corporate Markets and Retail Markets division who would be eligible of a bonus of up to 250 percent of base salary (RBS, 2007: 106).

Immediately following the financial crisis RBS did show some positive signs that a re-evaluation was underway, announcing that from 2009 onwards any award made under the AI would be deferred into RBS shares and held for a period of three years with the award also being subject to clawback provisions (RBS, 2008: 159). RBS claimed that such an initiative would ‘align the reward of participants with the long-term interests of shareholders’ (RBS, 2009: 226). The maximum potential number of shares made under the AI would be 6 million for the Group Chief Executive and 3.75 million for the Group Finance Director (RBS, 2010: 251).

However, while such provisions may upon first reading be indicative of positive change at the Group, we should note that depending upon the performance of RBS stock, employees could potentially earn a maximum bonus which would be substantially greater than the previous upper limit of 200 percent or 250 percent of base salary respectively (RBS, 2007: 106; RBS, 2010: 251). Following these modifications in 2009 the structure of the AI would remain unchanged until 2014 when the Group would be forced to amend its policies in order to meet CRD IV requirements.

As such, we witness relatively little change in the overall structure and composition of the AI following the crisis. What is more, it would appear that RBS have retained a degree of consistency with pre-crisis norms and which may be indicative of an adherence to certain path dependencies with the Group becoming ‘satisfices’ and which may be indicative of failure to learn in relation to this key element of pay.

# Long-Term Incentive

The second element of variable remuneration in place at RBS in 2008 was the Long-Term Incentive Plan (RBS, 2007: 106). This was divided between two separate awards, namely the Medium-term Performance Plan (MPP) and Options (RBS, 2007: 106-107). Under the MPP employees would be eligible for awards payable in the form of shares or share equivalent awards of up to 100 percent of base salary for Executive Directors and 150 percent of salary for the Group Chief Executive (RBS, 2007: 106). Under the ‘Options’ element, employees would be eligible to receive share options of up to three times base salary which would be subject to a three year performance condition (RBS, 2007; 107).

In 2009 RBS announced that it would be overhauling its long-term incentive plan and that from 2010 onwards both the MPP and Options would be replaced by a single long-term bonus (RBS, 2009: 226). Under the new long-term incentive all awards would be structured as performance vesting deferred shares with participants having an option to receive either shares or market value share options, with all rewards being subject to clawback stipulations (RBS, 2009: 226-227). The maximum potential of awards under the new long-term incentive plan would remain at 400 percent of base salary (RBS, 2010: 25) with this figure being revised down in 2013 to 300 percent (RBS, 2012: 326).

This would suggest that between 2008 and 2013 the way in which employees were rewarded at RBS remained broadly in-line with pre-crisis models and while there is some evidence of change, these modifications have been consigned to the fringes of pre-existing structures as the Group fall back upon and revert to pre-established underlying theories-in-use. Moreover, these remuneration structures have allowed RBS to continue to make exuberant bonus payments to select members of staff which appear to be out-of-step with performance, and which may be indicative of a lack of cultural transformation, with analysis suggesting that such awards have been largely motivated by perceived structural competitive pressures which have in-turn ‘imprinted’ upon the Group, creating a series of institutional path dependencies.

In 2009, for example, just months after the financial crisis had taken hold and RBS had reported record losses, the Group clashed with the UK Government, who was set to become an 84 percent stakeholder in the Bank, over plans to award employees predominantly in the investment bank bonuses totalling £1.5 billion (Inman, 2009). Given the precarious economic situation of both RBS and the British economy as a whole, ministers warned the Bank that plans to make multi-million pound awards to staff would send the wrong message to U.K. taxpayers and that more reserved rewards would be appropriate (Treanor, 2009). RBS responded by stating that any attempt to cap the bonuses of investment bankers would result in *en-masse* resignations, adding;

Depending on UKFI's approach to recommendations made by the board in respect of that bonus pool, this requirement may adversely impact RBS's ability to attract and retain senior managers and other key employees and thereby place RBS at a significant competitive disadvantage against its competitors as well as increasing the risks facing RBS and weakening management's ability to deal with them

(RBS cited in Inman, 2009).

Again in 2009, the Bank caused outrage when it acquired eleven fixed investment income traders from Bank of America Merrill Lynch at the cost of approximately £5 million by guaranteeing the traders first year bonuses of £500,000 each (Aldrick, 2009). What is more, just months earlier RBS had poached Antonio Polverino from Merrill Lynch to head up the Group’s *Financial Institutions and Strategic Financing* division with the promise of £7 million in guaranteed bonuses for the former bond trader (Fraser, 2014: 348). Stephen Hester, then Group Chief Executive, told reporters that while such payments were not desirable, they were essential in attracting and retaining talented staff members, adding that to be the best and provide maximum return for their shareholders it was inevitable that RBS would have to pay more than acceptable (Hester cited in Telegraph, 2009).

Likewise, in late 2010, despite the U.K. Government holding an 84 percent stake in the Bank and RBS reporting a third consecutive year-end of loss at £1.13 billion (BBC News. 2011), the Group rewarded more than one hundred of its investment bankers with bonuses in excess of £1 million, and total bonuses for the Group that year reaching almost £1 billion (Treanor, 2010a). Again, Stephen Hester defended these payments, telling the press that he would like to pay his investment bankers more and that the bonus pool agreed between RBS and the government was hindering RBS’ ability to recruit and retain the brightest banking talent who would ultimately generate bigger profits for both the Bank and Government (Hester cited in Treanor, 2010b). Mr Hester added that RBS was paying its investment bankers significantly less than its rivals, and had the government allowed the Bank to solely determine its own investment pool then RBS could have recruited staff that would have lifted the Group’s profits by approximately £1 billion (Hester cited in Treanor, 2010b). Meanwhile, Mr Hester was himself awarded a bonus of £2.5 million in cash and shares for his performance in 2010, bringing his total remuneration for the year 2011 to £6.8 million (Quinn and Wilson, 2011).

In 2012 RBS would again attract criticism over its remuneration policies when the Group announced plans to reward employees, again chiefly within the investment bank, bonuses totalling £250 million, despite a series of events and fines for its role in the rigging of the Libor exchange rate and a serious I.T. meltdown[[23]](#footnote-23) (Parker and Jenkins, 2013). Penny Hughes, Chair of the *Group Performance and Remuneration Committee*, once again stressed competitive pressures as a mitigating factor in the level of remuneration determined at the Group stating that the Committee continued to receive ‘regular encouragement’ to ‘improve the delivery of market competitive remuneration’, adding that the level of ‘restraint’ currently shown by the Bank on remuneration was reflective of the ‘the nature of our ownership’ (RBS, 2012).

While at times these events appear a little dated they are nonetheless pertinent to the argument being presented in this section because, while remuneration at RBS has undoubtedly undergone change and reform following the introduction of CRD IV, competitive pressures have continued to play a major role in shaping both remuneration and the Group’s ability to learn and change, with those path dependencies forged in the years immediately following the crisis persisting today as competition continues to be a mitigating and persistent factor in relation to pay.

In 2013 RBS announced from 2014 onwards it would be consolidating both the AI and long-term elements of its variable remuneration into just one single award, the Variable Pay Award (VPA) (RBS, 2013: 77). The VPA would see the Group use its full regulatory allocation of variable pay, that being 100 percent of fixed salary, and thereby meeting the requirements set out in CRD IV (RBS, 2014a: 77). Although remaining compliant with CRD IV, RBS have not welcomed the European regulation stating that the introduction of a ‘hard cap’ on bonuses is not something that RBS can endorse or approve of but would endeavour to remain amenable with both the ‘spirit’ and ‘letter’ of the law (RBS, 2013: 67).

While the introduction of CRD IV has inevitably resulted in an overall reduction in the Group bonus pool of £203 million between 2013 and 2015 and £166 million in the investment bank[[24]](#footnote-24), it may be suggested that were it not for intervention by the UKFI, the body which manages the U.K. taxpayer’s stake in RBS, the bonus pools could have potentially been higher. For example, under CRD IV banks must seek shareholder approval for annual bonuses in excess of 100 percent of base salary with the upwards limit being 200 percent of base salary. In April 2014 RBS followed the likes of Barclays and HSBC[[25]](#footnote-25) and sought shareholder approval to increase variable pay to the upper limit of 200 percent of base salary telling shareholders that

The Board believes the best commercial solution for RBS is to have the flexibility on variable to fixed pay ratios that is now emerging as the sector norm. This would also allow RBS to maintain the maximum amount of compensation that could be subject to performance conditions including claw back for conduct issues that may emerge in future

(RBS, 2014b).

However, the UKFI rejected the Board’s recommendations, meaning that annual variable remuneration would be capped at a maximum of 100 percent of base salary (BBC News Online, 2014b). RBS responded by saying that it ‘acknowledges’ the decision taken by the majority shareholder but warned of the potential impact such a conclusion could have on the ability of RBS to ‘remain competitive’, warning of the ‘commercial and prudential risk’ which it must ‘try to mitigate within the framework of a 1:1 fixed to variable compensation ratio’ (RBS, 2014b).

Again, RBS’ comments over the UKFI’s intervention in how employees are rewarded suggests not only a failure to learn, with the input from institutional stakeholders being opposed by the Bank, but that this failure may be attributed to the imprinting of certain path dependencies concerning competitive pressures despite the introduction of CRD IV. Indeed, Marquis and Tilcsik (2013: 2) tell us that once a certain idea or notion has been imprinted on an organisation it ‘will remain despite [a] changing external environment’ and thus, this may explain why we continue to see the Group citing structural competitive pressures as a mitigating factor when calculating awards.

# Fixed Share Allowance

Likewise, 2014 would also see the introduction of a new Fixed Share Allowance which would provide employees with set pay awards reflective of their ‘skills and experience’ (RBS, 2014a: 76). Under this entitlement employees can earn up to 100 percent of base salary in shares which will vest after a five year period[[26]](#footnote-26) (RBS, 2014a: 76). However, City commentators have argued that the use of such role-based allowances have effectively allowed banks to circumvent CRD IV as awards, either cash or shares, can be adjusted year-on-year in accordance with individual performance (see Schafer and Arnold, 2014a; Armitage, 2014; Allison, 2014). In his annual letter to shareholders Sandy Crombie, Chairman of the Group Performance and Remuneration Committee, commented that the use of such role-based fixed allowances were

in line with market practice…[and that RBS had] a duty to reward our people fairly, and [a] responsibility to ensure that we are running a commercial business with the best available talent

(Crombie in RBS 2014a: 73).

As such, we can see that while RBS have indeed complied with the letter of the law, it appears the Bank’s remuneration practices are not necessarily in keeping with the spirit of CRD IV and as such fails to present substantive evidence of learning with the Group, like many of its competitors, seeking to circumvent regulatory powers aimed at tempering variable remuneration. Equally, this is particularly salient when we consider the fact that both bonuses and attempts to undermine, erode and roll-back regulatory frontiers were key causes of the crisis. Indeed, this evidence would suggest that RBS are once again struggling against the tide of regulatory controls with those institutional path dependencies surrounding competition and remuneration again appearing to be the mitigating factor in how remuneration is structured and bonuses awarded.

# General

It is against this backdrop that RBS have continued to attracted widescale criticism, with the Bank making substantial bonus payments despite underlying Group losses. In 2014 the Group announced that it would be making provisions to pay staff £588 million in bonuses notwithstanding losses of more than £8 billion in 2013 and £3.4 billion in 2014 (Farrell, 2014). In an interview with the BBC, RBS Chief Executive Ross McEwan recognised the sizeable loss against which such bonuses were being paid but again cited competitive pressures as being key driver of the Board’s decision, telling reporters that

underneath that loss we've got a very profitable business…I need to be fair paying for our people so I can actually keep them onboard [sic]

(McEwan 2014 cited in BBC News Online, 2014a).

Likewise, in 2015 the Group would announce that, despite losses of £2 billion, bonus provisions for the year would be £373 million (RBS, 2015). Ross McEwan, who in 2015 would himself become RBS’ highest earning CEO since the crisis with a remuneration package of £3.8 million[[27]](#footnote-27), commented on the awards saying that ‘I know how it looks but I need to be pragmatic’ and that provisions being made within the bonus pool were being done so in an attempt to retain key staff who would inevitably ‘jump ship’ if salaries were not competitive (McEwan, 2016 cited in Hills, 2016). However, Ian Fraser has refuted such claims and instead argues that this can be best explained by a

sense of entitlement among top bankers in terms of how much the deserve to be paid and usually there’s a complacency among the investors to the extent they will just go along with it and sign it off or vote in favour of the remuneration report….as a bailed out bank there was an assumption that the greed would be diminished and they would cease paying outrageous bonuses to investment bankers or others but obviously that hasn’t come to pass

(Ian Fraser. Interviewed 10th August 2016).

The analysis carried out above suggests that while RBS have indeed changed the way in which employees are remunerated following the crisis, resulting in a reduction in the overall bonus pool, these changes have come largely in response to exogenous regulatory constraints, namely CRD IV, with little endogenously originated change, and as such fails to present evidence of a substantive self-reflexive learning process as associated with the double-loop theory. Moreover, we can see that competition over pay interpreted by key agents at the Bank have created a series of institutional path dependencies which have been a mitigating factor in determining both the level and structure of pay at the Bank and which have persisted to-date and which have in turn impacted negatively upon learning and change.

While I have not attempted in this section to refute the claim that there remains a level of competition between banks to recruit and retain staff, we should keep in mind that though competition may indeed be a structural factor, it is institutions, and the agents that embody these organisations, which are the key driver of structural change (Archer, 2003; 2007). As such, official speeches to both shareholders and the press citing competition as being a mitigating factor in the Group’s remuneration policies indicates that RBS have failed to learn from one of the key lessons of the crisis, namely that excessive competition between institutions and the proliferation of such by organisations, can harm the structural environment in which they operate. This may lead us to conclude that the structures and the way in which these structures are interpreted by agents will and do play an important role in learning.

Similarly, the Group’s approach towards remuneration post-2008 along with those overriding ideas concerning competition may also offer us insight into the how the Group interpret the costs associated with learning and change. For example, we know from the review carried out in Chapter 2 that remuneration and the ‘bonus culture’ at banks was a key cause of the crisis. However, the evidence examined in this section would appear to suggest that the perceived costs – measured in terms of the Group’s ability to ‘attract and retain talent’ - of implementing significant change to the way in which employees are remunerated remains high and is viewed as having the potential to harm and negatively impact the Group.

# **Balance Sheet**

We will now turn our attention to the balance sheet element at RBS, which upon first reading presents some evidence of positive change and potential learning. However, deeper analysis of the Bank’s position will reveal that, much like remuneration, the majority of this change has come in response to exogenous structural factors. As such, this section will argue that while RBS’ balance sheet has undergone significant reshaping following the crisis, with the Group exiting a number of markets and divesting its business (The Telegraph 2012; Slater 2012), these changes have largely come as a result of domestic and European provisions concerning the Group’s 2008 bailout. What is more, RBS appears to lack the endogenously self-evaluative process associated with double-loop theory which ultimately suggests the absence of learning.

In 2008 RBS would be forced to accept the first of several tranches of U.K. state aid after the Bank revealed catastrophic losses of more £24 billion (Werdigier, 2009). Matters were further complicated when it was revealed that the Group were holding more than £325 billion of toxic assets on balance sheet and as a result would be the first British bank to enter the U.K. government’s assets protection scheme (ibid). The Bank would go on to receive more than £45 billion in state aid spread over several instalments, leaving the U.K. taxpayer as the majority shareholder. As a result of this receipt, RBS would be forced to accept the conditions set forth by European Commission on state-aid and which would require the Group to divest several businesses and reduce its balance sheet from £2.4 trillion to a more conservative £1 trillion (Quinn, 2013; BBC News Online, 2015).

# Group Funding

In 2008 RBS’ total liabilities and equity was £2.4 trillion with total customer deposits accounting for £639 billion or approximately 26 percent of RBS’ total funding. Comparative figures for 2015 show that total liabilities and equity had fallen to £815 billion with customer deposits accounting for £334 billion or 42 percent of total funding. This demonstrates that in the years following the financial crisis RBS have increased their total customer deposits, which as we already know is a much more stable funding source, as a percentage of total liabilities and equity by 16 percentage points.

Moreover, in 2008 short-term funding, including short-term borrowings, money market and other short-term funding, was worth £433 billion or 18 percent of total liabilities and equity. However, in 2015 short-term funding as a percentage of total liabilities and equity had decreased to 9 percent, being worth £75 billion. Thus, we can see that between 2008 and 2015 RBS have significantly decreased their reliance on short-term borrowing and in particular the use of (often) overnight borrowing on the money markets, which we already know was key contributor to the crisis, while at the same time increasing total customer deposits substantially[[28]](#footnote-28).

Figure 4.1. Group funding as percentage of total Group assets and liabilities 2008/2015.

# Regulatory Capital

In 2008 we know that the Group’s Regulatory Tier 1 capital was £69 billion with a Tier 1 Regulatory Capital Ratio of 10 percent. Meanwhile, the Group’s Total Regulatory Capital was approximately £98 billion with a Total Regulatory Capital Ratio of 14 percent. Figures for 2015 show that Regulatory Tier 1 Capital was approximately £47 billion and Total Regulatory Capital £60 billion. The Tier 1 Regulatory Capital Ratio was 19 percent with the Total Regulatory Capital Ratio being 24.7 percent.

However, we must be cautious in drawing conclusion from these figures due to the changing regulatory landscape. As already established in Chapter 3, regulatory capital requirements were much less stringent in 2008 compared to today’s standards. For example, Basel III (introduced in 2011) changes both the amount of regulatory capital which must be held by institutions and how Tier 1 Regulatory Capital is defined, which subsequently changes the definition of Total Regulatory Capital. El Radi (2014: 8) highlights the most prominent changes to the definition of Tier 1 Capital, noting that

The elements/instruments to be included in Tier 1 capital should be sufficiently loss absorbent on a going-concern basis; i.e.: (i) subordinated; (ii) have fully optional non-cumulative dividends or coupons; and (iii) neither have a maturity date nor an incentive to redeem. Innovative instruments which was limited to 15% of Tier 1 capital [will be] phased out.

Essentially, these changes look to introduce stricter capital requirements by limiting what assets can be used by the banks in building their Tier 1 Capital, with an explicit focus upon the holding of more long-term instruments. Likewise, certain instruments and products no-longer qualify as regulatory capital (for further discussion see El Radi, 2014). Furthermore, Basel III would also dictate that banks must have a minimum Regulatory Tier 1 Capital Ratio of 6 percent and a Total Regulatory Capital of 8 percent (BIS.org, 2010). As such, while definitions of Tier 1 and Total Regulatory Capital have changed, making a like-for-like comparison is extremely difficult, these figures still make an important contribution to my thesis as we are able to draw conclusions about the spirit within which regulatory requirements concerning capital have been met. For example, the Group’s current regulatory capital allocation in relation to Basel III demonstrates that in 2015 RBS’ Regulatory Tier 1 Capital Ratio exceeded regulatory minimum requirements by 216 percent. Likewise, the Total Regulatory Capital Ratio exceeded the minimum standards set forth by Basel III by 200 percent and as such may be indicative of learning with Bank going beyond regulatory minimum standards. Moreover, as we can see from figure 4.2., RBS currently have the greatest capital ratios of our comparator group.

Figure 4.2. Regulatory capital percentage in excess of Basel III minimum standards 2015.

While we can see that RBS are currently operating within guidelines and have gone beyond minimum regulatory standards, and are outperforming their peers on this metric, we must not lose sight of the fact that a great deal of RBS’ restructuring post-2008 has come as a result of stipulations attached to their state-backed bailout. For example, under E.U. mandated rules on state aid, RBS would be forced to shed over a £1 trillion worth of assets from its balance sheet and disinvest a number of business in order to increase competition. This has undoubtedly had a positive effect on capital holdings, and subsequently, leverage[[29]](#footnote-29), calling into question the correlation between a reduction in leverage and learning. Instead, it may be suggested that a reduction in the ratio is merely a by-product of the disinvestment project[[30]](#footnote-30) driven by regulatory conditions being imposed exogenously and as such cannot be considered as evidence of lesson learning.

# Return on Equity and Earnings Per Share

Similarly, the Group also appear to have made some good progress on return on equity (ROE) figures. Between 2004 and 2008 we know that the average ROE at RBS was 15.4 percent. For the period 2008 to 2014 this figure was -6.79 percent with ROE recovering in 2015 to 11 percent. Moreover, the Group have announced a much more sustainable projected future ROE target of 12 percent (RBS 2014: 13).

However, despite taking some positive steps on Group funding, regulatory capital and ROE, between 2008 and 2013 RBS reported consecutive operating profit losses with the average loss for this period being approximately £9 billion, including a record loss of £25.6 billion in 2008. While RBS did return to profit in 2014, recording an operating profit of £2.4 billion, this was subsequently offset by an attributed loss of £3.4 billion. Likewise, in 2015 the Group once again reported a pre-tax loss of £2.7 billion, taking the Group’s total losses since the financial crisis to approximately £50 billion.

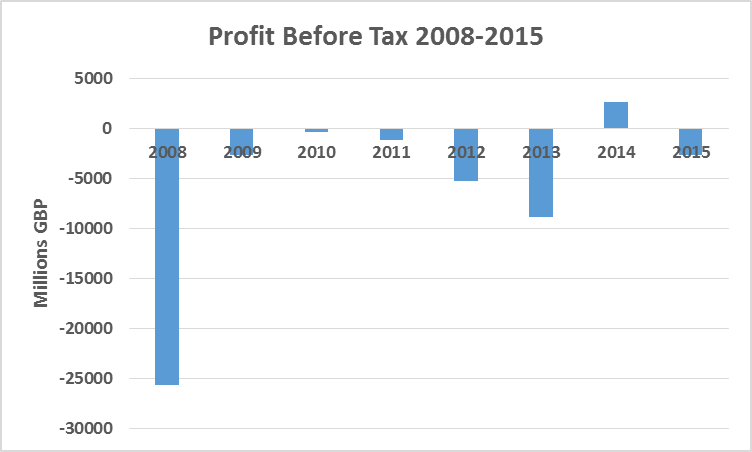


Figure 4.3. Yearly pre-tax profit millions GBP.

Given the losses recorded by RBS following the crisis, and the negative ROEs which have predominantly been recorded post-2008, it is not surprising to find that earnings per share and share price valuations have also fallen. For example, in 2007 the average share price valuation of RBS stock was 5880p with earnings per share being 771p. However, following the crisis the average year end share valuation (2008-2015) has valued RBS stock at 229p with average earnings per share (EPS) for the period 2011-2015 being -64p[[31]](#footnote-31).

# Derivatives

The Group have made progress on the extent to which derivatives have played a role in the structure and composition of the balance sheet. In 2008 RBS held £971 billion in derivatives and which accounted for approximately 40 percent of the Group’s total balance sheet. However, in 2015 this figure had been reduced to £254 billion and accounted for 30 percent of the total balance sheet, representing a reduction of 10 percentage points over a seven year period, and may be indicative of a scaling back in the extent to which RBS are engaged in this potentially harmful form of financial trading. However, comparable figures show thatRBS continue to have the highest percentage of derivatives of our comparator Group with Lloyds (3.6 percent), HSBC (11 percent) and Barclays (29 percent) all outperforming RBS. However, the use of derivatives by banks and other financial actors are a controversial issue. On the one hand, derivatives can allow banks to significantly ramp up their leverage ratios and place undue demands for liquidity upon both institutions and markets, making derivatives potentially harmful particularly when used for investment purposes (Mayer, 1999). Conversely, derivatives can allow institutions to effectively ‘hedge’ their exposure to price fluctuations which may be contained elsewhere within their trading book (Tuckman, 2016: 65).

# Loan/Deposit Ratio

Likewise, the Group appear to have made some progress on their loan-to-deposit ratio. For example, in 2008 we can see that RBS’ gross loans totalled £885 billion, with total deposits being worth £897 billion. As such, we can conclude that in 2008 gross loans extended by the Group was the equivalent of approximately 98 percent of total deposits. However, figures for 2015 show that gross loans were worth approximately £313 billion, or 76 percent of total deposits which totalled £408 billion. This suggests that that in the years following the crisis RBS’ lending, as a proportion of deposits taken, decreased by approximately 22 percentage points and may be indicative of learning. For example, we know that loan-to-deposit ratio has a corresponding effect on a bank’s liquidity, the higher the ratio the greater the chance that a bank could become illiquid if depositors simultaneously withdrew their cash. These figures demonstrate that since the crisis RBS are operating with a much more conservative loan/deposit ratio. However, these figures should not be considered in isolation and must instead take account of the broader regulatory environment. In particular, increased minimum capital standards set out by Basel III will have undoubtedly had an effect upon the loan/deposit ratio.

Figure 4.4. Gross loans as percentage of deposits 2008-2015.

Thus far, the figures presented do appear to suggest a degree of learning present within the balance sheet element at RBS, with a diversified funding base, reduced reliance on wholesale markets, plans for more sustainable ROE targets, Regulatory Tier 1 Capital levels beyond minimum standards and a more conservative loan/deposit ratio. On the face of this evidence alone, the hypothesis put forwards in this Chapter - that RBS have failed to demonstrate evidence of learning in relation to the balance sheet - would appear to be erroneous. However, further investigation and analysis of the balance sheet will reveal that these changes have largely been motivated by exogenous factors.

# Loan Quality/Impairments

While the loan/deposit ratio has been reduced, the quality and type of loans being extended by the Group would, on first reading, appear to be of a much safer asset class. For instance, in 2008 gross loans were worth £885 billion with £139 billion of these loans being allocated towards residential mortgages, which as we already know are a particularly stable asset-backed loan and carry a much lower risk to the lender[[32]](#footnote-32). From these figures we can see that in 2008 residential mortgage loans at RBS’ were worth 15.7 percent of gross loans made. Equivalent figures for 2015 likewise demonstrate that gross loans extended were worth £313 billion with £123 billion or 39.4 percent of gross loans being dedicated towards residential mortgage loans.

Figure 4.5. Residential mortgage loans as percentage of gross loans 2008/2015.

However, while the number of residential mortgage loans has increased as a percentage of gross loans, the overall quality of loan being made by the Bank has significantly decreased. For example, in 2008 total impaired loans were worth approximately £21 billion or 2.4 percent of gross loans extended. In 2015 totalled impaired loans stood at £12 billion or 9.8 percent of gross loans made. Therefore, we may conclude that while RBS are dedicating a greater proportion of gross lending towards residential mortgages, the quality of loans being extended by the Group on the whole appear to have diminished, with impairments as a percentage of gross loans rising by approximately 300 percent in the seven years following the crisis, suggesting an absence of learning[[33]](#footnote-33). In contrast to our comparator group, over a comparable period, Barclays saw an increase of 9 percent, while Lloyds and HSBC had decreases of 77 percent and 3.8 percent respectively. As such, while we should exercise caution in drawing a conclusion about impairment rates which may reflect more adverse economic conditions post-crisis, we can clearly see that RBS are being significantly outperformed by our comparator group. RBS have the highest percentage of impairments of any of our banks and have witnessed the largest post-2008 increase.

# Total Assets

As established in Chapter 2, one of the principal causes of the financial crisis was that many institutions had become compromised by the sheer size of their balance sheets and the associated problems of ‘too big to fail’. Indeed, data shows that in 2008 RBS had total assets worth £2.4 trillion and trading liabilities of £54 billion or 2.25 percent of total assets. Comparable figures show that in 2015 total assets were worth £815 billion with trading liabilities of £20 billion, that being approximately 2.5 percent of total assets.

Figure 4.6. Trading liabilities as percentage of total assets 2008-2015.

This shows that while RBS have significantly reduced the size of their balance sheet, trading exposures being carried by the newly streamlined Group have remained broadly in-line with pre-crisis figures and have actually increased marginally as financial trading continues to play an important role in the Group’s portfolio.

# Off Balance Sheet Vehicles

While trading exposures have remained broadly in-line with pre-crisis levels, the use of off-balance sheet vehicles, and the associated costs of using such instruments in relation to leverage and the shadow banking sector, has similarly risen post-2008 and again suggests an absence of learning. Off balance sheet vehicles are particularly problematic because by their very nature they conceal the contents of those products held within them, making it difficult to know the kind of assets being held or their worth and thus circumventing certain regulatory requirements that would apply to ‘on balance sheet’ items. In 2008 off-balance sheet items at RBS were worth £433 billion or approximately 18 percent of total Group assets. In 2015, comparative figures actually show a marginal increase with off-balance sheet items being worth 18.7 percent of total Group assets or £152 billion and thus may suggest an absence of learning in keeping with the overarching Chapter hypothesis. While RBS are currently being outperformed on this metric by Lloyds (14 percent), they are outstripping both Barclays (27 percent) and HSBC (33 percent).

While positive change is clearly observable in many elements of the balance sheet, and may be indicative of a degree of learning, the Group continues to show little improvement in the areas of loan quality/impairments, trading liabilities and off-balance sheet items, with a reduction in total assets and leverage ratios and the relationship between these reductions and learning being questionable. Moreover, any progress made by RBS and the potential correlation between this progress and learning must be considered in light of the Group’s E.U. mandated disinvestment associated with its 2008 bailout[[34]](#footnote-34). Additionally, while the Group have complied, for the most part, to the letter of the law concerning exogenous stipulations attached to the bailout, it would appear that the Bank have been less than enthusiastic about such procedures and that this compliance has not been met with a similar ‘spirit’ and which may be telling of the relationship between RBS and the regulators, with regulatory stipulations being viewed by the Group as a hindrance to their competitive advantage. As such, I suggest that RBS’ disinvestment, and the associated positive effect on the Group’s balance sheet, is not representative of the self-reflexive learning process associated with double-loop learning which this thesis is concerned with, and as such we should conclude that learning is absent in this instance.

# General

In 2012 RBS announced that it would be going ahead with the sale of its insurance business, Direct Line, which incorporated several household names such as Churchill and Green Flag (BBC News, 2012a). The sale was subsequently completed in February 2014 as the Group sold off its remaining 28 percent stake in the business (Knight and Dunkley, 2014). However, Jill Treanor of the *Guardian* newspaper highlights the fact that RBS had little desire to shed itself of Direct Line and did so only because of those stipulations imposed by the E.U. (Treanor, 2012b). Furthermore, RBS itself stated that that the disinvestment of Direct Line was done so solely to comply with the European Commission State Aid requirements (RBS, 2014: 97). Likewise, Joe Rundle of ETX Capital also highlights the fact that while the sale of Direct Line was completed in a timely manner, it came against the backdrop of mounting political pressure (Rundle cited Kollewe, 2014).

While the initial disinvestment of Direct Line would come at a relatively early stage in RBS’ learning journey, the pertinence of this issue in relation to my thesis, and the overarching narrative being told in this Chapter, lies in setting the tone of what was to come and to establish a timeline of events which demonstrate that changes to the structure and composition of the Group’s balance sheet have occurred independently of learning and primarily as a direct result of structural regulatory considerations.

In September 2013, and again as part of the stipulations attached to the state aid received in 2008, came the announcement that the Group would also be selling more than 300 of its branches to a consortium of investors in a sale which would see the revival of the redundant Williams and Glyn brand (BBC News, 2013c). The sell-off would effectively offer the consortium a preferential bond which would later convert to shares worth an approximate 30-40 percent stake in the Company, with an upper limit of a 49 percent share being in place (Treanor, 2013a). In 2015 Emma Dunkley and Martin Arnold of the *Financial Times* reported that RBS had been approached by a number of investors interested in buying Williams and Glyn, and that the Group would sell the bank in early 2016, preparing a public offering in the event that an investor could not be found (Dunkley and Arnold, 2015). However, in April 2016 RBS announced that it was doubtful that the sale would be completed before the December 2017 deadline set out by the European Commission, and warned that it could take until 2019 until Williams and Glynn would be ready as a standalone entity (Dunkley, 2016a). While the Clydesdale and Yorkshire Banking Group and Santander have both submitted bids to buy the bank, as of December 31st 2016 the Group had yet to find a buyer and the sale is currently under review by the Prudential Regulation Authority (Dunkley, 2016b).

While it is not the suggestion of this thesis that RBS have deliberately sought to jeopardise or in any way slow down the disinvestment of Williams and Glynn, we should note that Lloyds, who have similarly been forced to shed parts of its business due to its receipt of state aid, have completed their own disinvestment projects in a timely manner and in many cases before the imposed deadline, which stands in stark contrast to RBS’ experience.

Additionally, in early 2014, and as part of its retrenchment to shed over a £1 trillion from its balance sheet, RBS announced that it would be jettisoning a significant part of its investment bank (Scuffham, 2015). Under the plans, RBS declared that it would be looking to reduce operations in the bank by approximately two thirds and reduce risk weighted assets by £107 billion (Arnold, 2015a). The move is expected to mean that, upon completion, four out of five jobs in the investment banking unit will have been lost, with the most hard hit operations being those centred in Asia and the U.S. as RBS look to exit twenty-five of the thirty-eight countries where it operates (Treanor, 2015b). To date, the retrenchment of the investment bank is still ongoing, with RBS commenting that it is committed to reshaping the division, including reducing the size of the business (RBS cited in Lewin, 2016). However, Matt Scuffham of *Reuters* reported that during his tenure as Group Chief Executive both Stephen Hester and the Board clashed with politicians on several occasions over the selling-off of the Group’s investment Bank, with Hester saying that a strategy which sought to reduce the Bank and focus primarily on domestic markets would hurt RBS and its share value, and that the Bank would become a ‘second best Lloyds’ (Hester cited in Scuffham, 2014). Moreover, in 2015 the investment bank generated profits of approximately £1.7 billion, which accounted for 38 percent of Group profit before tax and subsequent write-downs[[35]](#footnote-35). In comparison, in 2008 the investment bank had similarly contributed approximately 35 percent to overall Group profit before tax and write-downs. As such, we can see that despite plans to shrink the size of the investment bank, RBS is still largely dependent upon the division as a key generator of Group profit, with the contribution of the investment bank witnessing a modest increase between 2008 and 2015.

This would suggest that the downsizing of the investment bank, along with other notable disinvestment projects undertaken at RBS following their bail-out, have not only been largely motivated by structural constraints imposed by the E.U. directive, but have also failed to be realised in a timely fashion or remain incomplete. Indeed, while the operations being carried-out by RBS have clearly shifted post-2008, there is little evidence to suggest that the Group’s underlying theories-in-use have changed accordingly and as such should be largely discounted as being reflective of learning in keeping with the conceptualisation set out in Chapter 1.

Moreover, these examples along with Mr Hester’s comments regarding the run-down of the investment bank, and particularly his focus upon share price valuations and losing ground to competitors, further highlights RBS’ attitude towards associated costs of learning and change, with short-term financial losses clearly taking precedence over the long-term economic stability of the bank, and indeed financial markets on the whole, with the Group failing to recognise the inherent vulnerabilities concerning the size and complexity of institutions. Similarly, the evidence assembled here may also offer us insight into RBS’ relationship with the regulators post-2008, which has been rather confrontational, with the evidence suggesting that regulators and regulatory stipulations are seen by the Group, and key agents, as hampering RBS’ economic performance.

In 2015 RBS would complete the sale of its U.S. subsidiary Citizens Finance. RBS’ disposal of Citizens had begun a year earlier in September 2014 when the Group sold a 25 percent stake in the bank, subsequently selling a further 50 percent in March 2015 (Trotman, 2015). In October 2015 RBS confirmed that it had sold its final share in the bank through a public offering, with RBS CEO Ross McEwan announcing on the Group’s website that

the sale of Citizens is a critical part of our capital plan and further improves our CET1 capital ratio. A strong capital position is the essential platform on which we will continue to build a simpler, stronger and more efficient UK focussed bank that can better serve the needs of its customers

(McEwan, 2015a).

However, while the disposal of Citizens came fourteen months earlier than originally expected, Ben McLannahan of the *Financial Times* points out that the sale, while completed in a timely fashion, was once again done so in accordance with the E.U. directive concerning the Group’s state sponsored bailout (McLannahan, 2015), something to which RBS and their CEO have failed to recognise in press releases relating to the sale.

Also in 2015, RBS announced that it would be selling part of its private banking firm Coutts International to Swiss bank UBP (Matthew, 2015). RBS confirmed that the sale would see it jettison that part of the bank which dealt with client relationships outside of the UK, although it would retain the UK centred arm of Coutts, effectively splitting the bank (Arnold, 2015a). While Alison Rose, CEO of Commercial and Private Banking at RBS, said that the move was part of RBS’ strategy to ‘become a more UK focused business’ (Rose cited in Matthew, 2015), Forbes noted that as late as 2011 RBS were desperately trying to grow Coutts bank with plans to ‘double the size of the business within several years’ (Forbes.com, 2015). Instead, Forbes believed that the sale of Coutts had been motivated solely by former Chancellor George Osborne as part of the U.K. Government’s initiative to separate and rid RBS’ of some of its international business (ibid).

Again here, evidence suggests that the sale of Coutts and Citizens Finance have been to a greater extent motivated by forces which are exogenous to RBS and as such should be largely discounted as being evidence of learning in keeping with the double-loop theory. Furthermore, this section appears to support the hypothesis extended, namely that changes to the balance sheet structure and composition post-crisis appear to be strongly linked to exogenous structural factors particularly the disinvestment stipulations associated with the Group’s state backed bailout as opposed to a self-reflexive learning process. Moreover, RBS appear to have been resistant to such changes and have failed to meet deadlines on certain projects, further questioning the presence of learning.

# **Conclusion**

The analysis carried out in this Chapter suggests that, despite some tentative evidence of learning, RBS have ultimately failed to learn from the 2008 financial crisis. Moreover, the most substantial changes to the Group’s operating procedures have come in response to exogenous structural factors - which along with their interpretation by agents clearly matter in the learning process - and resultantly cannot be considered reflective of double-loop learning.

This lack of learning can be attributed to a catalogue of events linked to internal governance failures. While dissatisfaction is clearly important in the learning trajectory of agents and institutions, it appears in the case of RBS that too much dissatisfaction has robbed the Bank of the precious space needed to learn. Moreover, not only have RBS failed to learn from successive failures but these incidents in themselves highlight the distortionary impact of such events upon learning, eroding learning space and ultimately preventing the reflective process which double-loop learning requires. As a result, RBS, in relation to remuneration, have fallen back upon certain path dependencies which have been imprinted upon the Bank.

The lack of learning at the Group would suggest that RBS are still exposed to many of those institutional weakness highlighted by the crisis, and which in-turn have potential ramifications on the financial stability of the domestic economy and beyond due to the systemically important nature of the Bank. Moreover, there is a certain irony in RBS’ failure to learn, with the Bank experiencing the greatest lessons amongst our comparator group, measured in terms of losses and subsequent failures, yet, as we shall in coming chapters, have demonstrated the least reform.

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# **Chapter 5 – Lloyds**

# **Introduction**

Lloyds Banking Group (Lloyds hereafter) was formed in 2009 when Lloyds TSB successfully acquired Halifax Bank of Scotland (HBOS) in a takeover bid worth an estimated £12 billion (LloydsBankingGroup.com, 2016). Lloyds TSB had entered the crisis in good financial health, recording pre-tax profits of £4 billion and £2.2 billion in 2007 and 2008 respectively. The Bank had always had a reputation as being a well-run, conservative, even boring, bank with its conservatism often making it the butt of jokes amongst City highfliers. Lloyds TSB had largely avoided the lucrative trappings of the U.S. subprime market and its investment bank was far from a ‘bulge bracket’ player, instead concentrating upon more traditional activities such as wealth management, as opposed to the high-frequency trading which had overtaken investment banking models at many rival institutions (Bell and Hindmoor, 2015a: 115). As such, when HBOS ran into trouble, Lloyds TSB were one of the few banks in a strong enough position to take over the failing institution. However, the merger would prove to be a disaster as the newly-formed Lloyds was quickly overcome by the sheer magnitude of bad exposures contained, primarily, within the HBOS book and which left the Bank on the verge of collapse. Following a series of failed attempts to raise capital, and with legacy losses mounting, Lloyds had little option but to accept financial assistance from the U.K. Government who, in February 2009, would become a 43 percent stakeholder in the Bank (ibid. p114).

However, in 2011, just two years after its rescue by the U.K. taxpayer, Lloyds would announce a business-wide re-evaluation of the Group’s strategic direction. The result of this appraisal would be the publication of the Strategic Review 2011, which has been the defining moment in the Group’s post-crisis recovery and provides us with a number of tangible policy initiatives that have fundamentally transformed and overhauled the business and which is indicative of learning.

# Overview

This Chapter will suggest that, on the whole, Lloyds have indeed learned lessons from the 2008 financial crisis, with the Strategic Review 2011 being a key conduit of this learning and change. For example, as a result of the business direction and policies set out by the Strategic Review, Lloyds have significantly altered and improved their internal risk governance framework by delayering the management structure so that responsibility is not held by any one single person or committee. Likewise, the new framework has a much ‘flatter’ structure whereby specialist sub-committees, previously held outside the upper echelons of senior management, are able to make direct challenges to the Board, the Audit Committee, Board Risk Committee and Group Chief Executive. As such, the escalation of potential new risks, as well as ongoing concerns, are fed into a much more open governance structure, empowering the Board and GCE with up-to-date and focused information regarding business operations, with the exchange of information having greater potential to run both ways.

Likewise, the way in which Lloyds reward employees has also undergone significant change post-crisis. The primary focus of this change has been to place much greater emphasis upon long-term sustainable growth as employee remuneration has been aligned with shareholder interests. In particular, Lloyds have restructured variable pay to include the use of more long-term options, such as shares, as well as introducing a £2000 cap on all cash bonuses, with variable remuneration for Executive Directors being paid exclusively in shares. Similarly, the Group’s balance sheet has been significantly restructured following the Strategic Review. Reliance upon wholesale funding has been lessened with the Group increasing customer deposits by 20 percent and decreasing short-term funding by 8 percent. The Bank has also retrenched operations, reducing its overseas presence from thirty to just six countries.

# Factors Explaining Lloyds’ Ability to Learn

It will be argued that the Group’s ability to successfully learn from the financial crisis can be attributed to two central factors, namely; the ‘learning space’ theory, as associated with the literature on single and double-loop learning, and factors synonymous with Rose’s (1991; 2005) policy learning framework, in particular ‘synthesis’ learning.

One of the reasons which may explain why Lloyds have been successful learners, as opposed to some of their counterparts like RBS, is that Lloyds were in many respects starting from a strong position. One thing that the newly formed Group could take from the previous Lloyds TSB model was that for the most part Lloyds TSB had gotten things right, with only approximately 20 percent of those losses suffered by Lloyds Banking Group in the aftermath of the crisis being attributable to Lloyds TSB (Treasury Committee, 2009: Ev432). Moreover, the Bank have experienced relatively few governance failures post-2008. As such, the Group have not only been afforded the necessary ‘space’ needed to engage in the analytical process, which we know is central in the learning process, but the success of the Lloyds TSB model has provided the right context for learning to take place in. Likewise, when governance failures, either contemporary or historical, have presented themselves, and which may have potentially hampered learning, Lloyds have dealt with these matters quickly and decisively, further freeing-up and preserving the learning space.

It will be suggested that the creation and preservation of this learning space has endowed Lloyds with the ability to utilise factors associated with Rose’s (1991; 2005) policy learning framework. For example, the commissioning and subsequent utilisation of the findings of the Group-wide Strategic Review, which has been the catalyst for learning at the Group and from which subsequent change has stemmed, would appear to be in keeping with Rose’s (1991: 2005) thesis on synthesis learning.

Synthesis learning suggests that learning and change may be present when several factors drawn from either endogenous or exogenous sources and have a proven track record, either positive or negative, are combined to create new policies. Accordingly to the literature, these policies should subsequently be underpinned by very specific operating procedures and performance metrics which are used to evaluate and ensure that a new policy is both efficient and adhered to (Rose, 1991). The analysis carried out below will highlight to the reader examples of where Lloyds have evaluated and made use of ‘adjacent information’ from their own institution, rival organisations and other exogenous sources in order to evaluate the Group’s underlying theories-in-use, subsequently formulating appropriate policy responses. Furthermore, it will be demonstrated that these policies have been instilled by a number of key performance indicators as a means of ensuring the implementation and uptake of new policies. Thus, the Chapter will argue that Lloyds’ ability to learn, which can be attributed to these two non-exclusive factors, is representative of a bank that is now safer and as such poses a significantly reduced threat to the global financial order.

# The Strategic Review 2011

The Strategic Review 2011 would investigate and detail how Lloyds would transform itself to become a ‘strong and more resilient bank’ by ‘creating a simpler, more agile and responsive organisation’ that could regain ‘customers’ trust’ which had been lost following the disastrous merger of HBOS, while focusing upon the Group’s U.K. businesses and changing markets (Lloyds, 2011a: 1). The decision to undertake the Strategic Review 2011 was motivated by three key underlying contextual factors. First, increasing customer expectations, following the Bank’s bailout, concerning simplicity and transparency meant that the Group would focus on providing a more open and transparent organisation. Second, a changing regulatory environment would mean that the Group would need to meet greater capital and liquidity requirements. Finally, challenges coming the wider economy concerning risk and asset pricing would require the Group to deleverage and increase costs efficiency (Lloyds, 2011a: 9). The Review would also identify many of the weakness brought into focus by the financial crisis and would detail Lloyds’ future strategic direction including how the Group would overcome the shortcomings highlighted by the crisis.

Specifically, the Group’s new strategic direction would focus upon four key elements: *Reshape the business portfolio to fit asset capabilities and risk appetite* – including targeting a sustainable ROE of between 12.5 percent and 14.5 percent, retrenching the business on its core U.K. businesses and reducing non-core assets; *Simplify the Group to improve agility and efficiency* – through the delayering of management structures, centralising control functions and creating a simpler legal structure; *Making sustained investments to be the best bank for customers* – including the investment of £500 million annually in growing the core business; *Strengthening the Group’s balance sheet and liquidity position* - targeting a core tier 1 capital ratio prudently in excess of Basel III and exceeding regulatory liquidity requirements, reducing wholesale funding along with government and central bank funding (Lloyds, 2011a: 1-9).

However, the Review would also contain a number of specific subsets detailing how particular facets of the business and lesson from the crisis would be targeted and dealt with, which will be highlighted for the reader accordingly. As such, while the Strategic Review 2011 now seems like a rather dated document given the speed at which banking and finance move, the importance of the Review remains so due to this key document being a catalyst for the Group’s subsequent learning experiences and, in many respects, from which all else has followed. It will be suggested that changes stemming from the Review provide us with a number of palpable examples of a fundamental reappraisal of the Group’s underlying theories-in-use and which is indicative of double-loop learning and change (Smith, 2001; 2013).

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# **Governance**

In this section of the Chapter I will premise that an examination of governance at Lloyds reveals evidence of positive double-loop learning and change. For example, in the immediate aftermath of the financial crisis the Group explicitly recognised and identified ineffective and deficient internal risk controls as being a key contributor to the 2008 crash (Lloyds, 2009: 2). Likewise, in 2011 newly appointed Group Chief Executive Antonio Horta-Osorio told delegates at the Bank of America Merrill Lynch Conference that one of the most dramatic factors in separating those banks which navigated the crisis successfully and those who failed were internal risks controls, with successful banks being more in-tune and risk aware than their counterparts who experienced the greatest difficulties (Lloyds, 2011b, Slide 7).

In the years following the crisis we can see that both the Group and key agents within the Bank correctly identified one of the central causes of the 2008 meltdown, as highlighted by the literature in Chapter 2, and which is suggestive of the presence of single-loop learning. Importantly however, the Group have moved beyond the single-loop process, enshrining lessons learned, relating to deficient governance and risk controls, in a number of tangible policy initiatives and which may be indicative of more substantive double-loop learning.

One of the central tenants of Lloyds’ restructuring following the crisis, and which is set out in the Strategic Review 2011, is a commitment to ‘strengthen’ both the management team and governance structure (Lloyds, 2011a: 1). Specifically, this would include making new additions to the executive as part of the Group’s commitment to deliver ‘improved control’ (Lloyds, 2011a: 6). Likewise, Lloyds would also announce a ‘delayering’ of the Group’s governance structure to create a ‘flatter’ and more simplified organisation with the aim of making senior management much more accessible to both customers and frontline staff, thus eliminating barriers between different parts of the business – a factor which has been synonymous with the silo effect discussed in Chapter 2 (Lloyds, 2011a: 3).

# New Additions to Management Team

On this first promise Lloyds certainly appear to have delivered results, with a simple study of the membership and composition of the Group’s Board showing thatno Non-Executive or Executive Directors who sat on the Lloyds TSB and HBOS Boards in 2008 held a position on the Board of Directors as of 31st December 2015 (Lloyds, 2009: 103; Lloyds, 2014: 58). Likewise, Anthony Watson is the only surviving member of the 2009 Board to hold a Chair today (Lloyds, 2008; 2009: 2015b)[[36]](#footnote-36). Departures from the Group, including two Chairman - Sir Victor Blank who left in September 2009 and his replacement Sir Winfried Bischoff who retired in April 2014 – and one Group Chief Executive, Eric Daniels, who parted ways with Lloyds in February 2011, are by no means exceptional and are characteristic of the kind of turnover of personnel we would expect to see from a large organisation like Lloyds. However, what is of particular interest is both the recruitment process behind new appointments and who Lloyds have hired to fill their most senior positions and which may be indicative of the Group’s ability to harness ‘adjacent information’ described by the work of Rose (1991; 2005) and subsequently evidence of peer-to-peer learning.

When Sir Blank and Sir Bischoff left the Bank in 2009 and 2014 respectively, the Group established a specialist sub-committee, made up of both independent and Non-Executive directors, to oversee the selection and appointment of a new Group Chairman (Lloyds, 2009: 102; Lloyds 2013: 82). Meetings to discuss potential candidates were made open to all Non-Executive directors, who were encouraged to attend these specialist sessions, and the committee received advice throughout the proceedings from the Group Human Resources Director and the Head of the Secretariat (Lloyds, 2009: 102; Lloyds, 2013: 82). The sub-committee met several times in the case of both appointments to discuss fine grain details concerning shortlists, role specification and the proposed terms and conditions of the appointment. In addition, institutional stakeholders, including the UKFI, were consulted throughout the decision making process and gave their full confidence to the final decision made, with Norman Blackwell succeeding Winfried Bischoff (Lloyds, 2009: 102; Lloyds, 2013: 82).

Likewise, in February 2011 when Eric Daniels stepped down as Group Chief Executive, Lloyds adopted a similar approach in searching for a suitable appointment, once again establishing a specialist sub-committee of the Board to deal with the succession process (Lloyds, 2010: 117). Between the months of September and November 2010 the committee met on a weekly basis and were supported by the Group HR Director and the Head of the Secretariat and considered internal, external and international candidates (Lloyds, 2010: 117). The end result of the Committee’s endeavours was to appoint Antonio Horta-Osorio as Group Chief Executive.

While the succession process used to appoint Winfried Bischoff, Norman Blackwell and Antonio Horta-Osorio may not upon first reading appear exceptional, and is perhaps in-keeping with what we would expect from a major bank or business, what sets Lloyds’ recruitment of these executives apart from their peers is the relationship with institutional stakeholders, and in particularly the UKFI. For example, throughout the process the input and approval of the UKFI – who are responsible for managing the U.K. taxpayer’s stake in the Group – was expressly sought at each stage of the strategy and went beyond a simple shareholder vote on candidates. Moreover, the active participation of the UKFI and Lloyds’ encouragement of such stands in stark opposition to that of RBS which, as we have seen in the previous Chapter, has been somewhat of a confrontational relationship, and may be evidence of Lloyds’ ability to learn.

By way of illustration, literature taken from the field of strategic management, reviewed in Chapter 1, suggests that an organisation may be more prone to learning when strategic decisions are taken out of the hands of any one individual (Bracken *et al*, 2005 : 22). Moreover, the literature argues that an organisation will have a greater propensity to learn when institutional stakeholders are consulted and are directly involved in the decision making process (ibid). In this instance we can see that the UKFI were explicitly consulted on such matters and have played a part in the decision making process. What is more, beyond this example the UKFI have also backed and voted in favour of all suggested resolutions at the Bank’s Annual General Meetings between 2011 and 2015 (UKFI online), meaning that the Group have consistently had the backing of the majority shareholder and which may be indicative of learning as described by the strategic management literature. Thus, it may be possible to conclude that the recruitment practices described above, and in particular the involvement and participation of the UKFI in various aspects of the business, which goes beyond what we would typically expect from a majority shareholder, may suggest the presence of learning with this key institutional stakeholder being an active participant in decision making processes at Lloyds.

Similarly, the appointment of Antonio Horta-Osorio and other prominent senior executives, including Juan Colombas (appointed November 2013) and George Culmer (appointed May 2012), and once again in keeping with the objectives set out in the Strategic Review (Lloyds, 2011a: 6), may also suggest the presence of learning as described by the work of Rose (1991; 2005) on synthesis and hybrid learning. According to the author, both hybrid and synthesis learning may occur when an organisation draws upon ‘adjacent information’ from other institutions (ibid) and which may include the recruitment of senior executives or other material risk takers from rival institutions who subsequently impart their own experience, both positive and negative, upon the Group[[37]](#footnote-37) helping to inform policy decisions and strategic direction.

While both Mr Colombas and Mr Culmer have brought with them a wealth of experience to the Bank, with over fifty years of practise in financial services and banking between them[[38]](#footnote-38), perhaps the most prominent example of Lloyds drawing upon adjacent information, and the closely associated peer-to-peer learning, is the recruitment of Antonio Horta-Osorio as Group Chief Executive. Before joining Lloyds, Mr Horta-Osorio worked for some the world’s biggest banks, including CitiBank, Goldman Sachs and Santander, where he oversaw and ran a number of operations and departments (Kollewe, 2010)[[39]](#footnote-39). In addition, during his time at Santander, Antonio, with Juan Colombas as his CRO, oversaw the successful integration of Bradford and Bingley and Alliance and Leicester into the Santander Group (Kollewe, 2010).

While Antonio Horta-Osorio brings with him a vast experience of operating at the highest level of banking and across multiple brands offering a plethora of financial products, Mr Horta-Osorio, along with Mr Colombas, also has an intimate knowledge of managing and overseeing the successful assimilation of an already established banking brand into a larger group, a particularly important feature given Lloyds’ history. This was noted by Lloyds’ Chairman at the time, Sir Win Bischoff, who commenting upon Antonio appointment, stated that

We are delighted to have attracted someone with his [Horta-Osorio] experience…as well as his track record in integrating three well respected UK retail banking franchises

(Bischoff in Lloyds, 2010a).

Similarly, the takeover and integration of Bradford and Bingley and Alliance and Leicester would mean that Mr Horta-Osorio would likewise bring with him to Lloyds valuable experience of working closely with the U.K. government, a salient factor given the UKFI’s position as a majority shareholder in Lloyds. As head of Santander overseeing the takeover, Antonio was required to work with government officials and regulators at a time of heightened instability and with huge time constraints to ensure the smooth transition of the failing institutions into the Santander group and thus preventing the nationalisation of the floundering banks, a factor which won Antonio admiration both within government and the banking fraternity at large (Dunkley and Jenkins, 2017).

The appointment of Antonio and his former CRO may be indicative of peer-to-peer learning, with the Group harnessing adjacent information as the previous experience gained from policies implemented at other organisations who have positively navigated similar situations, namely the integration of several businesses into one organisation and building a working relationship with the government and regulators, being transported across time and space and with the potential to inform Lloyds’ own learning journey[[40]](#footnote-40).

Moreover, this line of argument may be further strengthened when we consider that Mr Horta-Osorio has a proven track record of prioritising long-term economic value of the brand before more, potentially harmful, short-term profits. For example, during his tenure at Santander Mr Horta-Osorio was charged with achieving a combined 10 percent market share for the Abbey National, Alliance and Leicester and Bradford and Bingley brands. However, realising that a targeted 10 percent within the timescale set by Santander was both unsustainable and could potentially expose the Group to undue risk, Antonio re-negotiated the deadline set by the Board. After incorporating the three brands into the Santander product umbrella Mr Horta-Osorio and his team would go-on to return a consistent and stable market share of approximately 14 percent (Kollewe, 2010).

This would appear to suggest that in appointing Antonio Horta-Osorio as GCE Lloyds have selected a candidate who has demonstrated both a willingness and ability to resist structural competitive pressures which, as established in the Introduction and Chapter 3 of the thesis, persist today, and steer the Group clear of riskier, yet higher rewarding, business strategies. This is particularly important because, as we already know, powerful and authoritative agents had, in the run-up to the crisis, and continue today, to have the ability to steer and shape institutions. Thus, the recruitment of a GCE who has a proven track record of resisting competitive pressures and recognising the inherent vulnerabilities of such structural constraints may prove to be a valuable learning experience for Lloyds and again is in keeping with the adjacent information thesis.

Moreover, as will be discussed in greater detail below, Antonio has not simply been a passive actor at the Group but has encouraged a number of strategic decisions which have enhanced and defended the Group’s learning space, with Brummer (2015) noting that it was Horta-Osorio who was instrumental in bringing a close to the PPI saga at the Group and which is argued below has been a key factor in the Group’s ability to learn. This would likewise affirm that while structures are indeed important, agency, and in particular how situational agents interpret structures, can have a powerful bearing upon an institution’s learning trajectory.

# Delayering of Management and Risk Governance Structure

Another central pillar of Lloyds’ restructuring following the crisis, which was set out in the Strategic Review 2011 and identified as being a key change needed following the crisis, was the imperative to ‘delayer’ the Group’s risk governance structure (Lloyds, 2011a: 1). In doing so the Bank proposed that it would bring senior management closer to both frontline staff and minimise barriers between departments within the business (Lloyds, 2011a: 1). Indeed, analysis of the Group’s risk governance structure following the Strategic Review suggests a series of changes which have resulted in a more robust control framework which maximises performance through increased integration of the management structure, while at the same time allowing its various divisions to operate with a certain degree of freedom, albeit within very strict capital and risk parameters. As such, the revised Group risk governance structure, in keeping with objectives of the Strategic Review, post-crisis may be indicative of learning.

In 2009 the risk structure at Lloyds was divided along three distinct lines, namely, the first line of defence; the second line of defence and the third line of defence. The most senior feature of the first line of defence rested solely with Group Board who sat atop of this structure (Lloyds, 2009: 58). However, by 2015 responsibility for the most senior branch of Group risk governance had been divided amongst six separate bodies, as opposed to just one as in 2009, namely the Nomination and Governance Committee, Responsible Business Committee, Audit Committee, Risk Committee, Remuneration Committee and Group Board, including the Group Chief Executive (Lloyds, 2015b: 68).

As discussed in Chapter 2, one of the major causes of the financial crisis was that the authority of the most senior figures often went unchallenged, allowing managers to ride roughshod over junior colleges even when strategic decisions were erroneous. However, the devolvement of power and authority away from one, to six separate committees suggest greater accountability at the most senior level as each committee is well-placed to challenge, guide and temper the strategic decisions of one another. Similarly, this new decentralised structure indicates the potential for allowing expertise within certain areas of the Bank to flourish by removing the unchecked authority of senior management and the potential for staff with expert knowledge to be railroaded into business strategies which they believe to be flawed, which, as discussed previously, was a contributing factor in the crisis.

Likewise, in 2009 we know that the second line of defence consisted of a number of committees and Divisional Risk Officers. However, by 2015 we observe that this second line of defence had been upgraded with the inclusion of a number of additional committees covering six key area of risk. However, what is of particular significance is how the structure and function of the second line of defence has changed and been reoriented post-crisis. As a case in point, in 2009 the main function of the second line of defence was to report to, and support committees located within the first line of defence. However, an important feature of the updated 2015 model is the addition of powers to launch independent challenges on the first line of defence[[41]](#footnote-41). Similarly, from 2014 onwards Executive and Non-Executive directors upon leaving the Group would be compelled to provide the Chairman and Board with a written statement addressing any concerns that they may have regarding the Bank’s governance and the overall strategic direction (Lloyds, 2015b: 68).

Again, this may suggest that not only have Lloyds achieved their goal set out in 2011 of ‘delayering’ the Bank’s risk governance structure, but they are also demonstrating evidence of increased accountability by adding multiple dimensions to their governance framework and encouraging across divisional appraisals of strategic planning through the use of independent challenges and which has the potential to increase internal oversight[[42]](#footnote-42).

In addition, the reshaping of the first and second line of defence suggests that new and existing managerial networks have been strengthened by directly linking senior figures located across all departments to one another and the Board. Indeed, the upgrading and reshaping of the governance structure suggests that oversight at Lloyds is now stronger than in 2009 as the performance of different departments and business areas are brought under closer scrutiny through internal critique and assessment. This has been made possible by a risk governance structure which is clearly more self-reflexive, joined-up and flatter post-crisis and which may also address the silo effect with greater permeation between departments. As such, it can clearly be observed that Lloyds have made substantive structural and cultural changes to the Group’s risk structure post-2008.

# Controversies

While Lloyds may demonstrate evidence of learning in relation to certain aspects of the management team and structure, the Bank, like many of their peers, have also come under a great deal of scrutiny and criticism as a number of high profile governance failures have threatened to undermine the progress made to date. However, while it is true that Lloyds, like their rivals, have been affected by some governance issues resulting in dissatisfaction, the number and sheer scale and magnitude of these failures have been much less severe than those experienced by many of their peers. Moreover, when faced with serious failures which have threatened to undermine the Group’s ability to learn, Lloyds have dealt with these challenges in a timely and decisive manner which has subsequently protected and preserved the Group’s ‘learning space’ and may explain why the Bank have been successful learners.

# Trading Sanctions, Customer Complaints and ‘Making the Sale’

In January 2009, for example, Lloyds were fined £231 million by the United States Department of Justice after it was brought to light that Lloyds TSB had been involved in criminal activities relating to the concealment of payments and transfer of funds to accounts in sanctioned countries including Iran, Libya and Sudan (Clark, 2009). A Report published by Global Witness details how Lloyds TSB had, for almost two decades, been involved in the so-called ‘stripping’ of customer details from dollar wire transfers, with specialist teams dedicated to removing customer account particulars in order to circumvent U.S. stipulations (Global Witness, 2009: 22)[[43]](#footnote-43). As such, Lloyds TSB were in direct violation of U.S. law which forbade financial transactions with sanctioned countries (Ibid)[[44]](#footnote-44).

Meanwhile, in May 2011 the Group were fined £3.5 million by the FSA over failings concerning how its Bank of Scotland brand handled customer complaints between 2007 and 2009 relating to the sale of certain investment and savings products (Reuters UK, 2011). Following an investigation, the FSA concluded that Bank of Scotland had wrongly rejected almost 45 percent of these complaints, stating that: ‘This fine reflects Bank of Scotland's serious failure to treat vulnerable customers fairly’ (FSA cited in Lumsden, 2011).

Likewise, in 2013 Lloyds would receive a record fine of approximately £28 million for ‘serious’ retail conduct failures following an investigation by the FCA (FCA, 2013b). It was found that between 2010-2012 employees at Lloyds TSB, Bank of Scotland and Halifax came under immense pressure, known by frontline staff as the ‘sell or be demoted’ incentive plan, to sell to customers a raft of financial products including investments and insurance (Hawkes and Armstrong, 2013). While bonuses for meeting tough monthly targets included champagne and ‘a grand in your hand’, staff who failed to meet targets were publicly lambasted in front of colleagues and faced the threat of demotion, leading to one such example where an employee sold products to himself, his wife and another colleague in order to avoid ridicule and public humiliation (ibid). Commenting on the incident, the FCA’s director of enforcement and financial crime, Tracey McDermott, said

staff were put under pressure to hit targets to get a bonus or avoid being demoted, rather than focus on what consumers may need or want…Financial incentive schemes are an important indicator of what management values and a key influence on the culture of the organisation, so they must be designed with the customer at the heart (FCA, 2013b).

Commenting on the issue, Lloyds said that ‘the group recognises that its oversight of these particular schemes during the period in question was inadequate and apologises to its customers for the impact that they may have had’ (Lloyds cited in BBC News, 2013d).

While these incidents appear to stand in contrast to the hypothesis extended in this Chapter, comments made by the City regulator suggest that learning may indeed be present at the Bank despite these failures. For example, the FCA (2013a) noted that following the incident Lloyds had made ‘substantial changes’ and since put in place policies which should ‘right many of these wrongs’, with an official statement by the regulator explicitly recognising that policies subsequently introduced by the Group being ‘substantial’ and that they were confident that such strategic initiatives were adequate to address the key problems highlighted by this incident (ibid).

Moreover, the literature on learning tells us that an organisation has a greater propensity towards learning when changes in the underlying theories-in-use are upheld by specific policies. For example, in response to this occurrence Lloyds shifted how success was measured and rewarded within the Bank, moving staff bonuses away from ‘making the sale’ to one which prioritises customer satisfaction and improved customer service (Lloyds, 2013: 33) and which may similarly suggest a cultural shift in relation to performance related pay at the Group[[45]](#footnote-45). Likewise, comments made by the regulator further suggest that Lloyds dealt with the issue in a decisive and timely manner and as a result were able to protect their learning space - time and material resources - and as such it may be possible to conclude that while this incident represented a failure of governance at the Group, it also proved to be a positive learning experience causing sufficient dissatisfaction which ultimately resulted in tangible policy outcomes guaranteeing the space required to learn by potentially preventing future breaches.

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# Libor, Rate Rigging and PPI

In July 2014 Lloyds’ governance and business best practice procedures would once again be called into question as it was handed a fine of £105 million by the FCA for its part in the rigging of Libor and other ‘benchmark rates’, most notably the Bank of England REPO rate (FCA, 2014c). Like their counterparts at RBS and Barclays, Lloyds became embroiled in the fixing of the Libor rate between 2006 and 2009 in order to profit a small bunch of insiders. However, in addition to their role in Libor, the Bank were also found guilty of trying to manipulate the Special Liquidity Scheme extended by the Bank of England between 2008 and 2009[[46]](#footnote-46). The FCA commented that while the rigging of Libor by the Bank was not unique given the gross misconduct of other U.K. banks in this area, Lloyds had gone to new lengths of rate rigging by trying to defraud the British taxpayer of millions of pounds in fees (FCA, 2014c). The scandal would eventually cost the Bank more than £218 million in fines imposed by both UK and US authorities.

While the rigging of Libor and other benchmark rates does indeed represent a gross failure in the internal governance model at Lloyds, we must note that the incidents detailed here predate the 2011 Group Strategic Review which, it is argued, is when the Group’s learning journey essentially took hold and began. Commenting on the issue in July 2014 the Bank stated that the actions of those individuals involved was ‘totally unacceptable and unrepresentative of the cultural changes that the Group [had] implemented’, with the persons involved having either left the Group or having been suspended (Lloyds, 2014b). Lloyds would later go on to sack eight members of staff over the rigging scandal and claw back more than £3 million in bonuses (Hosking, 2014).

Like the other banks in this study, Lloyds have also been heavily implicated in the mis-selling of Payment Protection Insurance (PPI) which has to date reportedly cost the Bank approximately £16 billion in compensation claims, the largest of any U.K. bank (Wallace, 2016a). While the exact date of the mis-selling of PPI is open to debate, Brummer (2015: 225) notes that Lloyds, under its former inception and businesses, had been fighting City regulators and consumer groups over the mis-selling of PPI since 1998[[47]](#footnote-47). In 2011 Lloyds, thanks in no small part to the new Chief Executive Antonio Horta-Osorio[[48]](#footnote-48), gave up its legal battle with the FSA and set aside an initial £3.2 billion to compensate customers who had been mis-sold PPI (Treanor, 2011a). Commenting on the issue, António Horta-Osório said that ‘it is the sensible, prudent and right thing to do’ and that ‘we believe it draws a line under this issue’ (cited in Treanor, 2011a). Moreover, Brummer (2015: 225) notes that it was Lloyds’ decision to drop its legal battle with City regulators and consumer groups in 2011 that not only set the tone of future claims against the Bank itself but for the whole banking industry. For example, after Lloyds dropped their legal battle, the British Bankers Association, who had jointly been fighting the case for UK banks, likewise surrendered shortly thereafter, forcing a number of banks to make similar provision as Lloyds in the face of ensuing claims. Moreover, Sir Vince Cable noted in a research interview that

There has been a genuine attempt in some of the big banks to change the culture. Lloyds I think have genuinely tried to get back more to the kind of relationship banking, they have tried yes

(Sir Vince Cable. Interviewed 28th October 2016).

The conceding of the PPI case by Lloyds and Mr Horta-Osorio’s comments surrounding the Group’s capitulation may further be indicative of why the Group have been successful learners despite historical failures. For example, the Group’s wishes to ‘draw a line under [the] incident’ by making compensation provisions and bringing what had already become a lengthy legal battle to a decisive conclusion would suggest that Lloyds were able to defend and carve out for themselves the necessary space to learn despite some short-term economic losses. As a result of the preservation of the learning space – measured in terms of the dedication of time and resources – the Group have been free to focus on the ‘big picture learning’ associated with causes and lessons from the financial crisis and which culminated in a reflexive Group-wide evaluation in the Strategic Review 2011. As such, Lloyds have largely avoided the mistakes of the some of their peers, such as RBS, who have been embroiled in a series of fire-fighting missions which have retarded the learning process.

Despite some obvious governance failures, the evidence presented in this section of the Chapter does indeed suggest that Lloyds have learned from the crisis. Specifically, the evidence indicates that Lloyds have been successful learners due to the degree of dissatisfaction experienced by the Group, which is clearly an important factor in learning. The level of dissatisfaction experienced by Lloyds has been sufficient to prompt learning but, unlike their counterparts at RBS, dissatisfaction has not been overwhelming, with the Group largely avoiding multiple governance failures which may otherwise have placed the Bank’s learning space under undue pressures. Moreover, when faced with large scale issues or challenges which have posed a significant threat to the Bank’s time and resources, Lloyds have acted decisively and accepted short-term losses, drawing a line under issues, and thus preserving the learning space. This protection of the learning space has subsequently allowed the Group to dedicate the necessary time and resources to learning from the crisis, not only in relation to governance issues but across all facets of the Group typified by the objectives set out in the Strategic Review 2011, which have subsequently been upheld by a series of policy initiatives associated with Rose’s (1991; 2005) synthesis and hybrid learning theses and which has utilised examples of peer-to-peer learning.

# **Remuneration**

Another example of where the Bank has learned lessons is in the area of remuneration. In the immediate aftermath of the financial crisis the then Chairman Victor Blank recognised the contributory role which remuneration had played in the crisis but was keen to point out that the short-term high risk/high reward culture which had underwritten the financial crisis was located predominantly within the investment banking sector, an area which both the HBOS and Lloyds TSB brands had had only minor exposures to (Lloyds, 2008: 3). Nonetheless, the former Chairman assured shareholders and the public that the newly formed Lloyds would instil prudence in its remuneration structures across all of its principal brands, despite pay within these business already being positioned at ‘median or below levels offered by [their] competitors’ (Lloyds, 2008: 74). Additionally, Lloyds would also pledge that the caution which had served the Lloyds TSB principle brand so well in the years preceding the crisis would continue to be the central feature of the Group’s remuneration structure moving forwards (Lloyds, 2008: 3).

While those comments made in the immediate aftermath of the crisis by the Group and its former Chairman may now appear dated, their pertinence to the observations of this thesis, along with the argument being presented in this Chapter, can be seen in the fact that these sentiments, expressed by key agents, appear to have become entrenched within the Group, with Lloyds maintaining a commitment to ‘prudence’ over pay. Moreover, the evidence examined in this section will likewise suggest that not only have Lloyds demonstrated a prolonged and continued adherence to restraint over pay, but that the exercise of prudence on the part of the Bank has been underpinned by a series of policy initiatives and revisions producing tangible change which may support the overarching Chapter hypothesis.

# The Annual Incentive

In 2009, remuneration at Lloyds was divided along three distinct lines, namely: the Annual Incentive (AI); the Long-Term Incentive Plan (LTIP); and Base Salary. The AI award would allow executive directors to earn a bonus with a maximum potential of up to 200 percent of base salary, with the GCE eligible for an award up to 225 percent of base salary (Lloyds, 2009: 111). Likewise, the AI would be measured equally against two objectives: profits before tax and economic profit and the balanced scorecard objectives (Lloyds, 2009: 111).By 2015, the Remuneration Committee had revised down the maximum potential made available under the AI award which would be limited to 100 percent of base salary (140 percent for the Group Chief Executive) and would be measured against the same objectives (Lloyds, 2015b: 88).

As we have already established in previous Chapters, the introduction of the E.U. CRD IV Directive dictates that all variable remuneration is subject to a maximum potential ratio of 1:2 of base salary, and, as such, this may explain why Lloyds have lowered the maximum award made available under the AI. However, as we can see, while the Bank would be permitted under CRD IV to extended the bonus to a maximum potential of 200 percent of base salary (with shareholder approval), Lloyds have opted to keep the AI award at just 50 percent of the maximum potential and 70 percent for the GCE, suggesting that current remuneration practices, in relation to the AI, are well within the maximum potential set by the E.U. Indeed, Lloyds are the only bank in this study who have not sought shareholder approval to extend variable remuneration to the maximum 1:2 ratio, demonstrating not only the Group’s commitment to prudence in relation pay, but also that the Group have voluntarily exceeded minimum regulatory standards on pay.

Moreover, while the qualifying criteria and composition of how the AI bonus is determined has remained broadly in-line with 2009 metrics, one area where we witness a definitive change is how awards are made to employees**.** For example, in 2009 all awards made under the AI were paid exclusively in cash (Lloyds, 2009: 112).However, in 2015 payments were delivered in the form of both cash - made immediately available - and deferred payments of cash, shares, notes and similar debt instruments (Lloyds, 2015b: 88). This deferral of awards may be attributed to regulatory requirements which state that at least 60 percent of variable pay is deferred and that 50 percent of variable pay should be payable in shares and other similar options (bankofengland.co.uk).

However, further analysis of the AI award may yet demonstrate evidence of learning. For example, in 2011 Lloyds introduced provisions which would limit any cash payments made under the AI to a maximum of £2000, and would be applicable to all colleagues across the Group with the exception of Executive Directors, who would receive any variable remuneration in the form of deferred shares exclusively (Lloyds, 2015b: 83). We may assume that senior managers and material risk takers will, on the whole, typically be eligible for a cash bonus which would exceed £2000, even when regulatory stipulations have been accounted for. Given that cash payments for Executive Directors have been totally eliminated since 2013 (Lloyds, 2013: 100), this would suggest that Lloyds have re-engineered their remuneration structures to be more risk averse by ‘building-in’ incentives which reward long-term sustainable growth and move the bonus culture at the Bank further away from the short-termism which proved so fatal for many banks in 2008. Therefore, it may be possible to conclude that Lloyds have learned lessons from the financial crisis, with such provisions not only exceeding regulatory minimum standards but also being more conservative that many of their peers at rival banks as will be detailed in coming Chapters.

# Long-Term Incentive Plan

In 2009, the maximum award made available to executive directors under the LTIP was 275 percent of base salary (Lloyds, 2009: 105). However, in 2013 the Remuneration Committee raised the maximum potential to 300 percent of base salary (Lloyds, 2013: 100) with provisions for discretionary awards of up to 400 percent of salary being introduced by the 2015 Annual Remuneration Report[[49]](#footnote-49) (Lloyds, 2015b: 89).

The empirical analysis reveals that while the maximum potential for bonuses has indeed risen post-crisis, the qualifying criteria for awards, along with how bonuses are both calculated and paid, appears to have undergone a fundamental reappraisal and overhaul with the Group introducing a series of long-term risk adjusted metrics which may yet demonstrate evidence of learning. For instance, new rules introduced by the Bank’s Remuneration Committee in 2010 would mean that following an initial vesting period of three years any shares awarded under the LTIPwould be subject to a further holding period of two years, bringing the total period over which shares would be deferred to five years (Lloyds, 2009: 106). While detractors may argue that these stipulations concerning the vesting of awards is simply in-keeping with requirements set-out by The Remuneration Code (2011), which requires a vesting period of three years, we can clearly see that Lloyds have voluntarily chosen to hold awards for an additional two year period. Likewise, while CRD IV requires awards to be deferred for a period of five years, we should note that Lloyds first announced such measures in 2010, taking effect from 2011 onwards. As a result, vesting stipulations introduced by the Group significantly predates CRD IV, which only required similar measures to be in place by January 2017. Indeed, the introduction of a five year vesting period by Lloyds was done so at a time when CRD IV was still in its infancy, and had yet to take any substantive form, with many of the key terms yet to be realised. This would appear to suggest that deferral stipulations attached to the LTIP have been endogenously originated and are currently in excess of regulatory stipulations, and as such indicative of learning.

A second element of the LTIP which may also demonstrate evidence of learning can be witnessed in how awards are paid. For example, Article 94 of CRD IV states that in addition to at least 60 percent[[50]](#footnote-50) of all bonuses being deferred, at least 40 percent of variable pay must also be subject to deferment period of not less than three to five years[[51]](#footnote-51), with at least 50 percent of awards being payable in non-cash options (Eversheds Sutherland, 2016).Once again, however, it appears that Lloyds have gone beyond regulatory requirements, with 100 percent of all LTIP awards made to Executive Directors and material risk takers, namely those key agents who have the greatest potential impact upon the stability of the Group, being subject to deferment, with all awards being payable in the form of shares and other non-cash options. This would suggest that while bonuses made available under the LTIP award have remained approximately in-line with those witnessed in the immediate aftermath of the crisis, what has changed is how awards are made, with greater emphasis being placed upon the long-term risk adjusted performance of the Group and is indicative of the Group’s commitment to prudence over pay.

Moreover, the Group’s cautious approach to remuneration and the implementation of long-term risk adjusted metrics would in 2012 lead the Group Remuneration Committee to deny the vesting of awards made under the LTIP. The Committee judged that awards made in 2010 had not met the new stringent requirements applied to the bonus and, as such, 2010 share awards would not be paid (Lloyds, 2012: 99). In 2013 the Committee met again and this time it was determined that awards made under the 2011 LTIP were ‘credible’ but failed to fully realise Group targets and, as such, bonuses would vest, but would be subject to a maximum rate of 54 percent of their total value for members of the Group Executive Committee including Executive Directors (Lloyds, 2013: 101).

This would indicate that while Lloyds largely avoided the trappings of excessive remuneration which incentivised short-term risk taking at other institutions pre-crisis, changes made to the LTIP, which it may be argued was reasonably risk averse before the crisis, indicates that the Group have sought to build into the award added measures to ensure that bonuses are aligned with the long-term risk adjusted performance of the Group[[52]](#footnote-52). Thus, encouraging more responsible business strategies and which indicates that sentiments expressed by the Group over prudence in the area of remuneration have been upheld with specific policy initiatives. Moreover, such changes may be symptomatic of learning and greater risk aversion. Likewise, the Group’s decision to both limit and prevent the vesting of shares to employees when standards have not been met demonstrates that the Bank are willing to enforce the code of conduct built into the remuneration structure, which encourages and ensures a commitment to a sound long-term growth strategy recognised in the Strategic Review 2011.

Similarly, it has already been established elsewhere in this thesis that banks operate within highly competitive structures, namely globalised financial markets, and as such, institutions continue to face pressure, in particular from their shareholders, to maximise returns. However, while it would appear that Lloyds recognise the importance of economic measures, including shareholder return, in determining awards made available under the LTIP, evidence from the Bank’s remuneration structure would suggest that post-crisis economic measures of performance have been somewhat subordinated. For example, in 2009 the LTIP was measured by three key metrics, namely, *earnings per share; economic profit; absolute share price growth* (Lloyds, 2009: 113). However, in 2015 LTIP awards would be judged on four separate factors including: *absolute total shareholder return* (25 percent); *economic profit* (25 percent); *cost-to-income ratio* (10 percent) and *strategic measures* (35 percent) (Lloyds, 2015b: 105).

As we can see, in 2009, 100 percent of the LTIP award was determined by economic measures alone. In contrast, 2015 saw economic measures account for just 65 percent of the award with the remaining 35 percent being judged by non-financial metrics. Again, this demonstrates that though economic factors are still an important measure of Group and individual performance, something which is representative of the wider competitive structures within which banks operate, Lloyds have shifted some of the importance of this measure from their LTIP and have instead included a number of non-fiscal metrics in the award. Indeed, commenting on remuneration Lord Blackwell, Group Chairman has said that

Our approach to reward is intended to provide a clear link between remuneration and delivery of the Group's key strategic objectives, supporting the aim of becoming the best bank for customers, and through that, for shareholders…We are embedding a performance-driven and meritocratic culture where colleagues are rewarded for behaviours aligned to the long term sustainable success of the business, our commitment to rebuilding trust and changing the culture of the Group

(Blackwell cited in Brinded, 2016).

These factors along with Lord Blackwell’s comments suggests that the Group are committed to striking a balance between profitability and the wider goals laid-out by the 2011 Strategic Review, and in particular the imperative to ensure that bonuses made available to employees do not foster an environment in which individuals are incentivised to take risks which lay outside the Group’s strict risk parameters (Lloyds, 2011a: 1).

In addition to these factors, Lloyds’ ability to learn in relation to remuneration may be further enhanced by the fact that the Group have retrenched operations on domestic markets[[53]](#footnote-53) and as such, while still exposed to a degree of competition over pay, are not subject to the same competitive pressures as their peers with larger international exposures. For example, as we shall in coming chapters, one of the biggest determinants in relation to learning and remuneration appears to be structural competitive pressures with those banks, such as Barclays and HSBC, who have maintained or increased their international presence post-2008 appearing to being exposed to greater competition over the recruitment and retention of banking talent and which has adversely affected their ability to learn in relation to pay[[54]](#footnote-54).

# Fixed Share Award and CRD IV

I have argued thus far that Lloyds have taken a number of positive steps in relation to remuneration which are indicative of learning. However, there are certain elements of the Group’s pay structure which do not necessarily fit the hypothesis being extended here and which may be representative of those competitive pressures which still persist despite the Group’s retrenchment. For example, and as discussed in the previous Chapter, in response to the introduction of CRD IV many of the U.K’s largest banks including Lloyds, along with RBS, Barclays and HSBC, have introduced ‘Role-Based Allowances’ for employees deemed material risk takers. As highlighted previously, many financial commentators have argued that such mechanisms effectively allow banks to circumvent and outmanoeuvre the maximum ratio for variable pay set out by CRD IV. As a result, the introduction of fixed pay awards by the Group may leave Lloyds open to criticism that, while complying with the letter of the law, they are not necessarily in-keeping with the ‘spirit’ of tougher new regulations.

While the introduction of new role-based allowance by Lloyds does not necessarily fit with hypothesis being extended in this section of the Chapter, I do not believe that this factor alone is enough to undermine the premise being presented in relation to remuneration. Indeed, the analysis above suggests that not only have Lloyds exercised prudence in relation to remuneration, with a number of tangible changes and policy initiatives being evidence of this conservatism, but that risk and pay have been deliberately aligned with the wider long-term interests of shareholders, and which may subsequently lead to a more risk averse and conservative organisation. Moreover, the Group continue to operate well within the regulatory maximum pay levels, despite the actions of their peers, which suggests not only the presence of learning within this facet of the Bank but also a more amenable relationship with regulators than some of their contemporaries reviewed in this thesis.

# **Balance sheet**

In 2009 Lloyds would require a state-sponsored bailout worth approximately £21 billion and which would make the U.K. taxpayer a 43 percent stakeholder in the Bank (National Audit Office, 2010: 3). In the same year the Group would also fail an FSA stress test which simulated further economic upheavals within financial markets. The Group’s balance sheet, in particular its funding and liquidity position, was then further brought into question when Lloyds announced that it would be recording a year end loss for 2009 of £6.3 billion.

However, just one year later the Group had begun to transform itself, announcing that it would be recording a year end pre-tax profit of £2.2 billion for the first time since the Group’s conception (ProactiveInvestors.com, 2011). Moreover, Eric Daniels, former Group Chief Executive, commenting on the issue, told reporters that a return to profitability was a direct result of the Group’s efforts to solidify income growth, reduce the number of impairments within the wholesale business and rundown and restructure the Group’s existing book along with improved risk measures being applied to the new business (Daniels cited in Treanor, 2010c).

While the return to profit in 2010 is somewhat of a dated reference, the salience of this incident is of particular importance to the narrative presented in this Chapter because, while the Group Chief Executive’s statement does not explicitly address the issue of learning within the Bank, Mr Daniels’ comments do point towards the aptitude of the Group to recognise past failures and areas of weakness, a key component of the learning process. This aptitude for engagement with the learning process demonstrated by the Group would result in the 2011 Strategic Review which, as will be discussed below, has overhauled the Bank post-financial crisis.

# Group Funding

In 2009[[55]](#footnote-55), for example, Lloyds’ total liabilities and equity was approximately £1 trillion, with customer deposits, made up of current and savings accounts, accounting for £406 billion or 39 percent of total liabilities and equity. However, by 2013, and before the E.U. mandated sale of TSB and Intelligent Finance (I.F. hereafter), we can see that total group funding had decreased to £842 billion, with the customer deposits base increasing to £436 billion and accounting for approximately 51 percent of total Group funding. By 2015, the customer deposit base was worth £418 billion which, again, accounted for approximately 51 percent of the Group’s total liabilities and equity at £806 billion.

Figure 5.1. Group funding as percentage of total liabilities and equity 2009/2013.

Thus, we can see that in the years 2009-2015 Lloyds increased their total customer deposit base as a percentage of group liabilities and equity by approximately 12 percentage points. This demonstrates that over a six year period following the crisis Lloyds have significantly strengthened their funding position by increasing total customer deposits. Moreover, the figures presented above show that the re-engineering of this particular facet of the balance sheet began before the sale of TSB and I.F. and as such should not be considered as an exogenous factor and instead suggests the presence of learning at the Bank. In comparison, in 2015 total customer deposits at RBS were worth 42 percent of total liabilities and equity with Barclays being 41 percent and HSBC 53 percent.

Likewise, short-term funding including ‘other deposits’, short-term borrowings, money markets and short-term funding decreased between 2009 and 2015, from £190 billion in 2009 to £80 billion in 2015. In real terms these figures demonstrate that short-term funding at Lloyds has decreased by approximately 10 percentage points over a six year period following the financial crisis, with short-term funding, excluding customer deposits, being worth 18 percent of total Group funding in 2009, with this figured reducing to just 10 percent in 2015[[56]](#footnote-56).

Once again, these figures may indicate the presence of learning at Lloyds and are particularly important when we consider the 2009 takeover of HBOS and specifically the shortfall of customer deposits and an over-reliance on wholesale funding which Lloyds inherited through the HBOS brand[[57]](#footnote-57). Moreover, when presenting the findings of the Strategic Review 2011 at a KPMG conference, Group Chief executive Antonio Horta-Osorio explicitly recognised the inherent vulnerabilities which an over-reliance on wholesale markets can place upon a bank, telling delegates that a dependence upon wholesale markets had been ruinous for Lloyds and had left the Bank close to ‘running out of money’ and that moving forwards this was just one of the key changes which would be implemented at the Group (Horta-Osorio cited in Perrin, 2014).

The Strategic Review 2011 also identified the need to ‘strengthen the Group’s balance sheet, funding and liquidity position’ and specifically that Lloyds would reduce its reliance upon wholesale funding (Lloyds, 2011a: 28). This demonstrates that not only have Lloyds recognised the vulnerabilities synonymous with the inter-bank markets but, importantly to this thesis, have addressed such shortcomings within their own business model, resulting in tangible outcomes, namely a reduction in the reliance on short-term funding and especially so-called ‘overnight’ money markets. Similarly, evidence suggests that the comments made by the Group Chief Executive pertaining to this issue have been upheld by a series of policy initiatives which is in keeping with Rose’s synthesis learning framework detailed above.

# Regulatory Capital

If we consider the Group’s capital resources we can see once more that Lloyds have made significant gains in strengthening their capital position and increasing their loss-absorbing capacity[[58]](#footnote-58). For example, in 2009 the Group were holding a total sum of Regulatory Tier 1 Capital of £47 billion which carried a Tier 1 Regulatory Capital Ratio percentage of 9.6 percent. Likewise, the Bank’s Total Regulatory Capital in 2009 was £61 billion and equated to a Total Regulatory Capital Ratio of 12.4 percent. In contrast, 2015 saw the Group report Regulatory Tier 1 Capital of £36 billion, which converted to a Regulatory Tier 1 Capital Ratio of 16.4 percent. Likewise, in 2015 Lloyds had a Total Regulatory Capital of £47 billion, which accounted for a Total Regulatory Capital Ratio of 21.5 percent. The Group’s Total Regulatory Capital currently stands at 168 percent higher than minimum requirements[[59]](#footnote-59) with Regulatory Tier 1 Capital being 173 percent above Basel III standards and which are the second highest of any of the Banks in this study behind only RBS[[60]](#footnote-60).

Furthermore, the Strategic Review 2011 identifies the need for a ‘robust’ regulatory capital ratio (Lloyds, 2011a: 8), with Antonio Horta-Osorio telling investors that ‘higher capital and higher liquidity’ were key lessons which the Group had drawn from the crisis (Horta-Osorio cited in Lloyds, 2011b: slide 12). Given Mr Horta-Osorio’s comments, along with the fact that the Bank has made changes to their capital structure which exceed both the minimum regulatory requirements and the deadline for the implementation of such provisions, it may be possible to conclude that the Bank have indeed learned lessons from the financial crisis in two particular areas.

*Firstly*, given the large excess reserves of capital which have been built-up by the Bank, the second largest of any bank in our study[[61]](#footnote-61), we may conclude that the Group recognise that more stringent capital allowances are needed to preserve the health of the Bank during times of crisis, with the Strategic Review stating that the Group would ‘always maintain prudent levels of capital in excess of regulatory requirements’ (Lloyds, 2011a: 33). *Secondly*, by building a capital buffer which is far in excess of regulatory stipulations, it may be suggested that the Group recognise that compliance with regulatory minimum standards, which we know proved to be erroneous in 2008, are not sufficient to guarantee the long-term well-being of the Bank, and as such the Group have implemented capital ratios which go beyond the minimum requirements, a key factor in learning. Furthermore, we can see that those sentiments expressed in the Strategic Review 2011 have been upheld by a series of policy initiatives which likewise point towards lesson learning as detailed by Rose (2005), who states that learning associated with the ‘synthesis’ thesis will generally see lessons learned upheld by a series of guidelines, standard operating procedures and institutional policy norms.

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# Total Assets

In 2009, the newly formed Lloyds had total group assets of approximately £1 trillion and trading liabilities of £28 billion, or 2.8 percent of total assets. In contrast, by 2015 the Group had reduced its total assets to £806 billion with trading liabilities being worth £13 billion, or 1.6 percent of total assets. However, while some critics may argue that such a reduction should be attributed to the 2014 E.U. mandated disinvestment of TSB and I.F., figures from as early as 2010 demonstrate that Lloyds had already begun the long process of reducing both the balance sheet and the percentage of trading liabilities.

Figure 5.2. Total group assets 2009-2015 million GBP.

Figure 5.2. demonstrates by 2011 total group assets had been reduced to £980 billion with trading assets (Figure 5.3.) also being lessened to £22 billion, or 2.2 percent of total assets. As such, while a reduction in trading liabilities and the overall balance sheet may indeed have been motivated by disinvestment stipulations put in place by the E.U., we can clearly see that Lloyds have embraced both the letter and spirit within which the E.U. directive has been sought by reducing the balance sheet and trading liabilities in timely fashion and which may be indicative of learning. Moreover, the Group also have the smallest percentage of trading liabilities, outperforming RBS (2.5 percent), Barclays (6.6 percent) and HSBC (5.8 percent) on this metric.

Figure 5. 3. Trading liabilities as percentage of total assets 2009-2015.

# Loan/Deposit Ratio

Moreover, analysis of the loan/deposit ratio may further support the hypothesis that following the crisis Lloyds have exhibited behaviour which is indicative of learning, adopting a more conservative balance sheet and reducing their exposure to the turbulence of financial markets. For example, in the 2011 Strategic Review Lloyds articulated that it would it would target a ‘lower loan to deposit ratio’[[62]](#footnote-62) by increasing ‘the number of commercial and retail deposits’ (Lloyds, 2011a: 43). In 2009, gross loans totalled £660 billion, with total deposits being £596 billion. As such, these figures show us that in 2009 gross loans were worth 110 percent of total deposits. Comparable figures for 2015 demonstrate that gross loans were worth £453 billion, or 90 percent of total group deposits which were £498 billion[[63]](#footnote-63). While these figures demonstrate significant restructuring of the balance sheet - in keeping with targets set out in the 2011 Strategic Review, and which may be indicative of learning, with gross loans as a percentage of total deposits decreasing by 20 percentage points post-2009 - we should note that Lloyds do have the highest loan/deposit ratio of any of the banks in this study, with RBS (76 percent), Barclays (86 percent) and HSBC (62 percent) all out performing the Bank on this measure alone.

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# Loan Quality/Impairments

Despite this, the fact remains that,not only have Lloyds reduced the number of loans being extended as a percentage of total group deposits, but that the quality of these loans have also improved. For example, in 2009 residential mortgage loans totalled £362 billion, with 52 percent of gross loans being dedicated towards this kind of lending. In 2015, residential mortgage loans totalled £312 billion or 68.8 percent of gross loans, demonstrating that post-crisis the Group are dedicating a greater percentage of lending towards safer residential mortgages.

Figure 5.4. Residential mortgage loans as percentage of gross loans 2009-2015.

Similarly, if we consider the total impaired loans made by the Group, we can see that in 2009 Lloyds incurred impairment charges against loans of £65 billion, which tells us that the impairment rate of gross loans in 2009 was 9.9 percent. However, by 2015 the total of impaired loans had fallen by 77 percent and represented just 2 percent of gross loans extended at £9.5 billion[[64]](#footnote-64). These figures may indicate that the quality and calibre of the loans being made by the Group are of a much higher worth, with a lower rate of total impairments against loans. In comparison, impairment rates at RBS for the financial year ending 2015 were 9.8 percent (an increase of 300 percent on 2008 figures), Barclays 3.6 percent (an increase of 9 percent on 2008 figures) and HSBC 2.5 percent (a decrease of 3.85 percent), demonstrating that Lloyds had marginally the best performance on lending impairment rates but have the greatest decrease in total impairment following the immediate post-crisis period.

Again, the Strategic Review 2011 specifically stated that the Group would target lower impairment rates as part of the Bank’s plans to ‘reshape the business portfolio to fit asset capabilities and risk appetite’ (Lloyds, 2011a: 28). Once more, this would appear to suggest the presence of learning in keeping with synthesis learning with key strategic initiatives being underpinned by specific policies[[65]](#footnote-65).

Likewise, Figure 5.5. demonstrates that, for the most part, the fall in impairments once again pre-dates the 2014 E.U. mandated sale of TSB and I.F. and suggests change has occurred in response to endogenously as opposed to exogenously originated factors.

Figure 5.5. Loan impairments as percentage of gross loans 2009-2015.

# Return on Equity and Earnings Per Share

Analysis of Return on Equity (ROE) figures suggests a break with the hypothesis extended so far, with the data failing to present strong evidence in support of learning. For example, in 2009 Lloyds had an average ROE of 10.73 percent. Between the years 2010-2013 Lloyds slumped into negative ROEs, with the average for the period being -3 percent, and it was only following the disinvestment of TSB that the Group returned to positive ROE figures. In 2014 and 2015 this figure was 2.75 percent and 1.15 percent respectively. While the Strategic Review 2011 announced targeted ROE figures of between 12.5 percent and 14.5 percent (Lloyds, 2011a: 1-9), it appears that the Group have failed to achieve these targets.

Unsurprisingly, earnings per share (EPS) have also fallen during the same period, with the average EPS in 2009 being 7.5p. By 2015 this figure had fallen to 0.8p. While these figures do not necessarily undermine the hypothesis put forwards in this Chapter, this clearly demonstrates that there remains some areas of the balance sheet where lesson learning is an incomplete process.

# Profits and Share Price Valuations

The hypothesis that Lloyds have adopted a more conservative balance sheet post-financial crisis, and the associated relationship with learning, may be further strengthened when we consider the Bank’s profits earnings and in particular the share price valuation. For example, while earnings per share have remained low following the crisis, the Bank was quick to return to profit, posting a pre-tax profit of £1 billion in 2009. The Bank subsequently reported pre-tax losses of £3.7 billion and £606 million in 2011 and 2012 respectively, but returned to profit once again in 2013, 2014 and 2015, most recently recording pre-tax profits of £1.6 billion. This suggests that Lloyds are now operating a balance sheet and business model which has not only consistently returned profit post-crisis but has done so with a balance sheet that is better capitalised and less reliant upon wholesale markets than pre-crisis levels and is indicative of the presence of learning.

Moreover, share price valuations would appear to support such a hypothesis with the prevailing market sentiment, best represented in share price valuations, showing incremental, yet sustained growth. For example, in 2009 Lloyds average share price was 79.5p, with a year-high of 109p for the month of April. In 2010 the share price began to fall, with an average of 62.5p. This trend continued through 2011 with an average for the year of 44.8p, and again in 2012 when the stock fell to 35.3p, with May of that month recording the lowest stock valuation since the crisis at just 25.0p. However, in 2013 the stock began to recover with the average for the year being 65.2p. The average value grew again in 2014 to 77.3p, followed by 78p in 2015.

Figure 5.6. Average yearly share price 2009-2015.

Thus, we can see that after falling share price valuations from 2009-2012, Lloyds have now recovered and sustained their stock value, which has grown consistently at a steady rate from 2012 up until 2015 when the stock recovered almost all the value lost since 2009[[66]](#footnote-66). While we must recognise that share price valuations are subject to a number of exogenous structural factors, such as investor confidence not only in the stock itself but also in markets in general, these figures may show that market sentiment and elite actors recognise the strength and robustness of the re-engineered Group balance sheet, which may well further support the hypothesis that Lloyds have demonstrated an ability to learn lessons from the crisis.

# Derivatives

As we can see from Figure 5.7., in 2009 derivatives were worth approximately 4.8 percent of Group liabilities and equity. By 2015 this figure had dropped to 3.6 percent. From 2009, the percentage of derivatives grew until reaching a peak in 2011 at 6.7 percent, before beginning a steady decline and reaching its lowest yearly average in 2015. Once more, this may be indicative of learning, with Lloyds working to reduce the number of derivatives held on balance sheet since its peak in 2011. Moreover, the Group are currently holding a significantly lower number of derivatives than any other bank in this study, with its closest rivals being HSBC at 11 percent[[67]](#footnote-67).

Figure 5.7. Derivatives as percentage of total liabilities and equity 2009-2015.

# Off Balance Sheet Vehicles

Despite this, when we consider off-balance sheet vehicles as a percentage of total Group liabilities and equity we witness a reversal in the trend which has been observed thus far, with the Group marginally increasing off-balance sheet vehicles. For example, in 2009 off-balance sheet items were worth 13 percent of total assets. This figure would fall between 2010 and 2013, before rising again in 2014 and peaking at 14 percent in 2015. However, we should once again note that despite this small increase, the Group are significantly outperforming their peers on this metric with RBS (18.7 percent), Barclays (27 percent) and HSBC (33 percent) all operating with much higher exposure to these potentially volatile entities.

Figure 5.8. Off-balance sheet items as percentage of total group liabilities and equity 2009-2015.

As we can see, analysis of the Group’s balance sheet demonstrates a changing composition and structure of the key financial indicators towards a stronger and more robust business, which suggests the presence of learning in keeping with the double-loop theory. For instance, not only does the Strategic Review 2011 represent a fundamental re-evaluation of the Group’s underlying theories-in-use, resulting in tangible change, but it also details specific policies objectives and benchmarks which have underpinned the Group’s new strategic direction, ensuring the successful implementation of those strategies articulated and which is in keeping with Rose’s (1991; 2005) thesis on synthesis learning - factors which both may explain why Lloyds have been successful learners in relation to the balance sheet element, with a more sustainable business model which subsequently poses a diminished risk to financial stability.

# Return to Private Ownership

Given Lloyds commitment to re-engineering the Group balance sheet, which is in-line with a more cautious and robust underlying business model, there is little surprise that the Bank has begun the journey back to private ownership with the U.K. Government selling down its 43 percent stake in the business. In September 2013, the UKFI successfully completed the sale of a 6 percent stake in the Bank, raising approximately £61 million in profit for the Treasury (telegraph.co.uk. 2013). Following this, and over the next two years, the U.K. Government would go on to ‘drip-feed’ a proportion of its remaining shares into the market, so that by December 2016 it held less than a 6 percent stake in the Bank (Dunkley, 2017), and had by 2015 raised more than £16 billion in revenue for the Treasury (Farrell, 2015).

Commenting on the sell-down of the UKFI’s stake in the business and the Bank’s journey towards full private ownership, the Group stated that

The Government has already been able to progressively reduce its stake in the group… returning over £16bn to taxpayers at a profit. This reflects the hard work undertaken over the last four years to transform the group into a simple, low-risk and customer-focused bank

(Lloyds cited in Wallace, 2016a).

# Disinvestment

This return to private ownership along with the re-engineering of the Group’s balance sheet and a series of disinvestments should not be considered in isolation. In particular, because in 2009 the Group would become recipients of state aid as part of the U.K. Government’s bailout of the Bank and as a result Lloyds, under E.U. mandate, would have to disinvest a part of its business in order to meet competition rules (Treasury Select Committee, 2014: 10). Under the disinvestment plan – known as project ‘Verde’ – the Bank identified approximately 600 branches which would be carved out of the existing business and be rebranded and sold off under the TSB name (Treasury Committee, 2014: 10).

In 2011 Lloyds began negotiations with the Co-operative Group over the possible sale of its newly resurrected TSB brand. However, these negotiations ultimately proved unsuccessful and in June 2014 Lloyds opted to make an initial public offering of TSB shares which would see the Group shed more than a 38 percent stake in the bank (Salmon, 2015). In June 2015 the sale of TSB was finally realised when the Group’s remaining shares were sold to Spanish bank, Banco de *Sabadell* for around £680 million (Lloyds, 2015a). Commenting on the sale, Lloyds Chief Executive, Antonio Horta-Osorio, highlighted the fact that not only did this represent a ‘significant and positive step for the group’, but stressed that the sale had been realised ahead of the E.U.’s deadline[[68]](#footnote-68) and further demonstrated the Group’s turnaround since its 2009 bailout (Horta-Osorio cited in Goodway, 2015). The accelerated sale of TSB was one of the principle objectives set out in the Strategic Review (Lloyds, 2011a: 2) and suggests that Lloyds have not only exceeded regulatory stipulations concerning the disinvestment of the TSB brand but that sentiments articulated surrounding the sale have been reinforced by direct policy action.

While it is true that the sale of TSB is centred upon exogenous structural factors, it would be inaccurate to attribute the re-engineering of the Lloyds balance sheet and disinvestment of certain areas of the business as moves motivated purely by outside forces. Instead, the re-composition of the balance sheet and subsequent stability has its origins before the portioning-off of the TSB brand, as demonstrated by the key financial metrics examined above, and has been underpinned by a series of ‘capital assertive’ disinvestment projects, as outlined in the Strategic Review (Lloyds, 2011a: 1), including the sale of several subsidiaries and non-principal businesses, particularly within international private banking.

In March 2013, for example, Lloyds announced that it would be selling-off a 20 percent stake in St James’s Place, a wealth management business (Coates, 2013). The Group had inherited a 60 percent share in the company through the HBOS book, and it was estimated that the initial sale of its 20 percent stake would be worth approximately £400 million and contribute significantly to strengthening the Group’s capital position (Treanor, 2013b). The disposal of St James’s Place from the Group’s balance sheet would continue throughout 2013, until December of that year when Lloyds announced that it would be selling its remaining 21 percent stake in the company for £670 million, which would mark Lloyds’ exit from the firm entirely (Gray, 2013).

Again, though it is true that under the Basel III Capital Adequacy Framework banks and other financial institutions holding greater than a 10 percent equity share in another financial organisation are subject to stringent rules and certain fiscal burdens, the selling-down of Lloyds entire stake in the wealth management business goes beyond regulatory requirements and as such may be indicative of lesson learning as discussed in Chapter 2.

Moreover, in October 2013 the Group completed the sale of its international private bank, headquartered in Geneva, to Union Bancaire Privée, UBP (Lloydsbank.com. 2014). The deal would be worth a reported £100 million and would see Lloyds exit markets in Geneva, Zurich, Monaco, Gibraltar and Uruguay (Wilson, 2013b). In the same year, it was also announced that the Group would be selling its Miami-based private bank to Banco Sabadell for £8 million (Lloydsbank.com. 2014). According to Harry Wilson (2013) of the *Daily Telegraph,* the sale of both the Swiss and Miami- based private banks would see the Group shed more than £8 billion of combined assets and over £764 million from the Group’s overall balance sheet. The sale would also see the Group close and exit the private banking sector in Dubai and South Africa. However, it would retain those businesses oriented towards the ‘mass affluent’ and ‘affluent’ customers within the U.K. and Channel Islands (Lloydsbankinggroup.com. 2013). To date Lloyds have reduced their international presence from 30 to just 6 countries (Lloyds, 2014a: 5; Lloyds 2015b).

As we can see, a series of disinvestment initiatives pursued by Lloyds following the crisis appear to support the hypothesis extended in this Chapter that the orientation of the Group’s underlying business strategy has been significantly altered and refocused. Indeed, the goals set forth in the Group’s Strategic Review 2011 have been supported by a shift in business strategic purpose and which the evidence above points to, with the Group’s underlying theories-in-use being significantly altered in response to both the financial crisis and the resulting internal strategic evaluation.

# **Conclusion**

The evidence examined in this Chapter may lead us to conclude that Lloyds have indeed learned lesson from the financial crisis. The analysis carried out above suggests that not only have the Bank recognised and identified the causes of the financial crisis within both their own institution and the wider banking industry, but have consistently implemented policies which are reflective of these sentiments.

In particular, it has been argued that Lloyds’ learning experience essentially began with the publication of the Strategic Review 2011, with this key document being the catalyst for the Group’s subsequent learning experiences and from which all else has flowed. Indeed, it has been demonstrated that the Group have consistently met and surpassed the goals and objectives set out in the Review. Likewise, we can note that much of the policy and strategic planning which has occurred at the Group post-financial crisis is in excess of regulatory minimum standards and as such may be indicative of double-loop learning. Likewise, the Strategic Review 2011 has not only equipped the Bank with a series of benchmarks or metrics against which success can be measured, in keeping with the synthesis learning theory, but is also indicative of the Group’s willingness and ability to engage and learn from adjacent information.

Lloyds’ propensity towards learning may be explained by the learning space theory. For example, the Bank appear to have enjoyed greater learning space because the Group have not suffered post-crisis failures to the same extent as some of their counterparts, such as RBS, which would otherwise have robbed them of time and resources crucial to the learning. Moreover, when confronted with incidents which have threatened to undermine space the Group have acted swiftly and decisively and have been quick to rectify these issues, thus preserving the learning space even where this has meant incurring short-term losses. The surrendering of the PPI legal battle is a case in point. The Group accepted short-term penalties, in the form of customer compensation, but in doing so were able to free-up time and resources which were subsequently made available for the dedication to the learning process, and as a consequence we can clearly observe lesson learning and change across the Group. In relation to one of our underlying research questions, this would tell us that ‘space’ is a condition most conducive to learning.

Lloyds’ decision to surrender its legal battle over the PPI case also brings us to another factor which has been synonymous with the Bank’s learning journey, and likewise addresses one of our guiding research questions, and that is that agency, as well as structure, matters in the learning process. For example, the decision to capitulate the PPI legal battle was taken and motivated largely by the newly appointed Chief Executive, Antonio Horta-Osorio. In doing so, the GCE was responsible for freeing-up the necessary resources, crucial to the learning space, which were then subsequently applied to lesson learning concerning the causes of the crisis. The lessons drawn from this learning have then been underpinned by factors synonymous with Roses (1991: 2005) thesis on policy learning, which have effectively instilled and shored-up these lessons. This demonstrates that while structural constraints, such as regulatory stipulation, do indeed have a role in learning, agency and the individual choice of key agents clearly still matter.

# **Chapter 6 – Barclays**

# **Overview**

Barclays navigated the 2008 financial crisis with a reasonable amount of success. The Group were able to continue to report pre-tax profits in 2007, 2008 and 2009. In September 2008, Barclays were one of the few banks in a strong enough position to take over the failing U.S. giant Lehman Brothers. In a move which has since been dubbed ‘the deal of the century’, Barclays acquired £73.5 billion of the failing bank’s assets for a mere £168 million (Bell and Hindmoor, 2015a: 117). However, this initial success led to a certain degree of compliancy with the immediate lessons of the crisis largely going unrecognised, something which I will argue in this Chapter may be attributed to the Group lacking the necessary dissatisfaction to propel them from a static state towards the progress of learning.

Yet, in July 2012 following a series of misconduct cases, most prominently brought to light in the Libor and Euribor rate fixing scandals, Barclays commissioned the Salz Review (Salz hereafter), an independent evaluation of the Group’s business practices. The objective of Salz was to undertake a ‘deep dive’ into all facets of the business and come up with a series of policy initiatives which would help Barclays recapture the trust of its customers and peers and make the Bank a market leader (Salz, 2013: 2). Following the report, Barclays promised major reform and went about enshrining the recommendations made in Salz by launching a new Group-wide strategic plan named the Transform Programme (Transform hereafter). Transform would see the ‘majority’ of those recommendations set out in Salz aligned to a series of financial and non-financial metrics which would look to remedy the shortcomings highlighted by the review (Barclays, 2013: 58).

However, while the publication of Salz, and subsequently Transform, would on face value appear to suggest the presence of learning within Barclays, being a fundamental reappraisal of the Group’s underlying theories-in-us upheld by a series of policy initiatives, the story of learning at the Group has been rather mixed with subsequent regulatory scandals including: the fixing of Forex rates, events pertaining to money laundering, tax evasion and reporting compliance issues all questioning the extent to which substantial double-loop learning has occurred.

In the aftermath of Salz/Transform, Barclays have re-engineered their balance sheet. The Group have reduced their reliance on short-term funding, regulatory capital has been increased and the investment bank has been shrunk. Despite this, anecdotal evidence suggests that recently there has been a degree of backsliding on the reform agenda particularly in relation to the investment bank. For example, reports in the financial media, along with statements by key agents within Barclays, suggest that the investment bank may once again become the bedrock of the Group’s business strategy, ultimately undermining the learning which has taken place to date. Discussions around structural competitive pressures, the primacy of shareholder value and the agency of the Group Chief Executive are used to explain subsequent changes.

*Prima facie* the Group appear to have made some positive progress relating to remuneration - reducing total Group remuneration by 53 percent between 2010 and 2015 and 63 percent within the investment bank – however, the most fundamental shifts appear to have come in response to tougher new regulatory standards, namely CRD IV. Moreover, the Group have utilised ‘role-based allowances’ to circumvent the regulation of pay and have been vehemently opposed to such rules which may be indicative of a failure to learn. Additionally, comments made by leading figures within the Group appear to suggest that structural competitive pressures and Barclays’ ability to ‘attract and retain’ the best banking talent may explain these shortcomings.

As such, there is no ‘one-size-fits-all’ answer to the question *Have Barclays learned from the financial crisis?* Indeed, learning at Barclays is a highly complex and multifaceted phenomenon. I will suggest that in order to fully understand the learning trajectory of Barclays we must analyse individual facets of the business on a case-by-case basis and consider the relevant structural, institutional and agency based factors which have determined the extent to which learning has taken place.

One such contingent factor which may explain Barclays’ learning trajectory, particularly in relation to the investment bank and employee remuneration, is Archer’s (2003) work on the internal conversation (discussed in Chapter 1). According to Archer (ibid) all human behaviour is determined by an internal conversation whereby agents will reflexively consider their own position and that which is desirable, against a host of factors including the structural environment, constraints, social norms and expectations which informs the decision making process. According to Archer (2012) this leads an agent to become meta-reflexive whereby an individual becomes aware of their ‘situational logic of opportunity’, that being, a greater understanding of both the possibilities and limitations of their own agency and the structures which surround them. In the case of Barclays I will argue that while change is desirable by the Bank, and has to some extent been achieved, Barclays’ internal conversation and situational logic of opportunity has determined that the associated costs of learning, encapsulated by structural competitive pressures, have been deemed too high and as such we witness some backsliding on reform agenda.

# Libor, Euribor, Salz and Transform

While Barclays navigated the financial crisis with a certain degree of success it would be wrong to assume that the Group avoided many of the trappings which compromised their counterparts so fatally. For example, in their account of the crisis Bell and Hindmoor (2015a: 117) note that by 2008 Barclays were operating with leverage ratio of 36:1 and that gross loans accounted for just 28 percent of total assets, with the majority of these loans being dedicated towards corporate and commercial lending. Furthermore, a series of acquisitions across North America had meant that the Bank was carrying approximately £700 million in exposures to the U.S. subprime market; were holding ‘£4.6bn in US residential mortgage loans; £9.9bn in US subprime and Alt-A RMBS; £2.8bn in US commercial property loans; and £1.2bn in Commercial MBS’ (ibid). The Group’s balance sheet also included extensive securities trading and a heavy reliance upon wholesale funding with total deposits accounting for just 23 percent of total assets in 2007 (Bell and Hindmoor, 2015a: 117).

The authors also note that was it not for the Group’s acquisition of Lehman’s £73.5 billion of assets at ‘fire sale’ prices, which were then subsequently written up by £2.3 billion, along with a £7 billion private capital investment from financiers in Qatar, which is currently under investigation by the U.K. Serious Fraud Office and FCA over claims of fraud with four former employees facing criminal charges[[69]](#footnote-69), the Group would have fared much differently in the aftermath of the crisis.

Despite this, the fact remains that Barclays did come through the crisis largely unscathed and in much better health than some of their rivals, growing the business when others were retrenching, avoiding state sponsored bailouts and continuing to record profits at a time when rivals were making record losses. As such, the successful navigation of the crisis appears to have resulted in the Group suffering insufficient dissatisfaction to propel the Bank towards learning with Barclays, in the immediate aftermath of the crisis, continuing to operate in a ‘business-as-usual’ manner with any changes to the Bank being confined to the very fringes of the organisation with little change in the overall structure and composition of the business and which is typically associated with single-loop learning. However, in 2012 Barclays became embroiled in the Libor scandal when, following an investigation that would last almost 4 years, it was revealed that a number of the Bank’s traders had been willingly and deliberately rigging the London Inter-Bank Rate (Libor). Barclays along with RBS and a handful of other European banks were heavily implicated in the investigation which stretched back to as early as 2003 and would lead to both criminal and civil hearings (McBride *et al*, 2015).

In a similar vein the Group were then investigated, and again fined, for their involvement in the fixing of the Euro Interbank Offered Rate (Euribor) (Reuters, 2016). Damning email exchanges between Barclays traders and colleagues at rival institutions were subsequently published, demonstrating not only blatant evidence of the crime in question, but also the flagrant disregard for the integrity of markets and the law which had overtaken some bankers, with one email from a Barclays employee saying ‘If you aint cheating, you aint trying’ (anonymous cited in Titcomb, 2015). Following an investigation by regulators in both the U.K. and U.S. Barclays agreed to pay more than £290 million in fines to the authorities for their role in the scandals (Binham, 2015). A number of employees were subsequently sacked and sentenced to prison terms of between two and six years (Reuters, 2016a), with further trials set for 2017 (Ridley, 2016).

It would appear that Barclays involvement in the Libor and Euribor scandals would result in sufficient dissatisfaction at the Group as shortly thereafter the Bank commissioned Anthony Salz to undertake an independent review of the Bank’s ‘values, principles and standards of operation’ with a view to providing a ‘comprehensive roadmap for cultural change at the bank’ (Salz, 2013: 1). However, while Salz and the resulting Transform Programme initially suggest evidence of learning, deeper analysis of the Group’s performance across the areas of governance, remuneration and the balance sheet suggests that learning and change is still rather lacking within some areas of the business.

# **Governance**

Like all the banks in this study, Barclays have not been without their regulatory compliance and oversight issues. For example, while it is true that on the surface Libor and Euribor appear to have driven learning at the Group by causing sufficient dissatisfaction, the illustrations examined below suggests that there is present at Barclays the distinct lack of tangible change to the overall structure of the Group’s governance architecture. This section of the Chapter will therefore argue that despite Salz/Transform Barclays have failed to present evidence of learning and change. It will be posited that this failure to learn may be attributed to Transform lacking substantial reforms and policy initiatives aimed at remedying those failures highlighted by Salz which can on a wider scale be tied to structural competitive pressures regarding remuneration.

# Benchmark Rigging: Libor, Euribor and Forex

Salz (2013: 8) concluded that the remuneration structures in place at Barclays at the time had created a results-driven culture at the Bank which paid little attention as to how these results were delivered. Moreover, the review also suggested that this lack of oversight coupled with an inherently skewed bonus culture meant that individuals were both incentivised and largely left unchecked to operate in questionable ways and which ultimately led to breaches such as Libor and Euribor with ‘pay…[being] the primary tool to shape behaviour’ (ibid).

Sentiments of this kind were further expressed in a letter from the then GCE Bob Diamond to Andrew Tyrie MP, Chairman of the Treasury Select Committee, assuring Mr Tyrie that the Bank had taken ‘decisive action’ to guarantee that LIBOR submissions at Barclays would be ‘protected from inappropriate pressure’ and that such actions would prevent future abuses (Diamond, 2012). However, Mr Diamond failed to explicitly recognise the inherent dangers of the Group’s remuneration structures and the role which these institutional arrangements played in the rate rigging scandals identified by Salz (2013: 8). Moreover, while Barclays promised ‘decisive action’ to ensure such breaches would not happen again, Harry Bradford of the Huffington Post noted that the culmination of this action resulted in employees being made to watch a 12 minute video on the subject of values, ethics and transparency (Bradford, 2012). Similarly, Salz also noted that

Following the LIBOR event, Barclays initiated a review of all of its business activity involving benchmark rates or indices. Lessons learned studies were also conducted after other loss events…However, it is not evident that they were carried out consistently, promptly or following the same approach

(Salz, 2013: 158).

This failure to recognise the potential harmful impact of the Group’s remuneration structures in the case of Libor and Euribor along with insufficient follow-through on certain lesson learning initiatives would later give rise to another case of benchmark manipulation when Barclays were found guilty of rigging the Forex rates between 2009 and 2014, over two years after the original Libor and Euribor scandals had come to light. Thus, suggesting that the Bank have failed to make substantive changes to those structures which pervaded the crisis.

In 2015 Barclays agreed to pay the FCA £284 million and U.S. regulators £99 million following an investigation which alleged that the Bank had conspired to fix Forex rates over a five year period and up to a year after Transform was launched (Bourke, 2015). Investigators on both side of the Atlantic allege that Barclays’ staff would deliberately ‘hold’ a customer’s Forex trades in an attempt to better their own position regardless of the best interest of the customer. If markets then moved in a direction which would mean that Barclays and the trader in question, by way of a bonus, would gain, the trade would be executed (Chon and Martin, 2015). If the markets moved in such a way that would benefit the customer, but not the Bank, then traders would disregard the transaction blaming a computer error with senior executives telling staff that ‘if you get enquiries [about rejected trades] just obfuscate and stonewall’ (anonymous cited in Chon and Martin, 2015).

In a statement issued by Antony Jenkins, the Group Chief Executive said

The misconduct at the core of these investigations is wholly incompatible with Barclays’ purpose and values and...[t]his demonstrates again the importance of our continuing work to build a values-based culture and strengthen our control environment. We remain completely committed to that effort

(Jenkins, 2015).

However, Mr Jenkins and Barclays failed once again to implement specific policy initiatives in keeping with those sentiments expressed, which as we have previously established in Chapter 3 is a key determinant in the learning process, instead going on to cite the importance of Transform in changing Barclays’ culture which, as will be discussed below, itself lacks tangible policy initiatives associated with the double-loop theory. Moreover, the GCE emphasised the fact that it was individuals who had been responsible for committing these infractions and not the Group at large (Jenkins, 2015). However, as noted in Chapter 1 organisations learn when those agents who embody that organisation learn, as such the failure of individual agents to learn lessons may also be indicative of a wider Group failure to learn and change[[70]](#footnote-70).

# PPI

Like the other banks in this study, Barclays too became embroiled in the PPI scandal when in 2011 a court ruling concluded that banks had been aggressively selling PPI on loans and credit cards for over a decade (Weardon, 2011). To date, the PPI scandal has cost Barclays approximately £7.8 billion in compensation (BBC News Online, 2016) and, with a recent court ruling extending the deadline until 2019, this sum looks set to rise (Dunkley 2016d). However, we should note that in many cases the mis-selling of PPI predates the financial crisis and the publication of Salz/Transform and as such this incident in itself does represent a failure to learn.

# Tax Avoidance

In 2013 Barclays would hit the headlines again when the publication of Salz revealed that the Group’s Structured Capital Markets (SCM) division had been involved in large scale tax avoidance and had generated over £1 billion of income for the Bank between the years 2007-2011 (Treanor, 2013c). Salz revealed how the SCM had been almost exclusively tasked with designing tax avoidance schemes which had benefited Barclays by allowing them to circumvent their tax obligations (Salz, 2013: 73). Commenting on the incident HMRC stated that Barclays tax avoidance had been both ‘aggressive’ and ‘highly abusive’ (www.gov.uk, 2012) with one Barclays insider telling the *Guardian* newspaper that ‘exploiting legal loopholes was not seen as something questionable but rather the *raison d'etre* of the Structured Capital Markets department’ adding that ‘tax avoidance was so big it became the engine of growth for the whole of the investment banking arm’ (anonymous cited in Lawrence, 2009).

In response to the damming evidence revealed by Salz Barclays subsequently closed the SCM division (Barclays, 2013b: 6). However, just a few months later Barclays would once again be embroiled in a scandal surrounding tax avoidance when in November 2013, almost ten months after the implementation of Transform, the Group were accused of promoting the use of offshore financial centres amongst its commercial African clients (ActionAid UK, 2013a).

It is alleged by the NGO ActionAid UK that Barclays not only deliberately promoted the use of these so-called secrecy havens, stressing the favourable tax regimes, but would also arrange the necessary legal paperwork to shift a company ‘offshore’ (ibid)[[71]](#footnote-71). In a written response to ActionAid UK, Barclays GCE Antony Jenkins stated that

[a]ny tax planning we undertake must comply with our Tax Principles…These state very clearly that our tax planning must support genuine commercial activity and be of a type that the tax authorities would expect…Barclays does not encourage businesses to set up in any particular jurisdiction

(Jenkins, 2013).

However, ActionAid UK accused the GCE of effectively ‘dodging’ the issue, instead pointing to a series of ‘tax principles’ which are deliberately vague and unspecific in their application, adding that they have within their possession evidence which suggests that Barclays have and continue to promote the use of offshore financial centres for the purpose of minimising tax burdens (ActionAid UK, 2013b). This would suggest that despite Salz and Transform being promoted by Barclays as a vehicle for cultural change, the Group have continued to exhibited behaviours which appear to be at odds with the ‘spirit’ of regulation regarding taxation and compliance and as such suggests a failure to learn and change. In addition, this incident may also shed light upon how Barclays see their relationship with the regulators post-2008, with such an incident having the potential to undermine the authority of such bodies despite compliance with rules[[72]](#footnote-72).

# Elephant Deal

In 2015 Barclays were once again in the crosshairs of the FCA, this time for failing to carry out the proper due diligence and financial crime controls on a huge private transaction worth a reported £1.9 billion, known in the banking industry as an ‘elephant deal’ because of its colossal value (Binham and Dunkley, 2015). The deal involved the transfer of funds by politically exposed persons who wished to remain anonymous and would earn Barclays a £50 million commission (Treanor, 2015d). The FCA concluded that in their eagerness to complete the deal Barclays failed to carry out the necessary checks on the clients and ignored its own controls on the handling of large transactions, even going as far as to offer the client £37.7 million in compensation if their identity was ever revealed (ibid). The deal was principally carried out by the Wealth & Investment division, which has subsequently been retrenched into the retail bank[[73]](#footnote-73), and landed the Group a fine of £72 million which included a £52.3 million disgorgement of the commission earned on the deal (Treanor, 2015b).

In a press release Barclays commented that they had

cooperated fully with the FCA throughout and continue to apply significant resources and training to ensure compliance with all legal and regulatory requirements

(Barclays, 2015c).

However, like previous regulatory breaches that have occurred in the aftermath of Salz/Transform, there has been a distinct lack of tangible changes or mechanisms put in place to ensure that future abuses do not occur despite statements to contrary. Likewise, Barclays have failed to comment on the number of staff involved in the deal and whether those responsible have been sanctioned (Salmon, 2015). Similarly, there is no evidence to suggest that the Bank have reneged or backed out of the deal which is set to last several decades as multiple transactions are carried out over a number of years, a decision which may have been driven by those competitive pressures addressed in the Introduction to this thesis and the fear of losing ground to competitors and which continue to persists today.

# Dark Pool Trading

In January 2016 Barclays were hit with further penalties and reputational damage when it was fined approximately £50 million by the U.S. Securities Exchange Commission over its use of so-called trading ‘dark pools’. Dark pools were originally devised as means of protecting investors by allowing certain trades to be made in private and thus sheltering actors from potential market reactions to the purchases of stock (Treanor and Rushe, 2014). However, Eric Schneiderman, attorney general of New York, stated that Barclays had made

false statements and omissions in connection with the marketing of their…dark pools and other high-speed electronic equities trading services

(Schneiderman cited in Neate, 2016a).

Indeed, Barclays had led investors to believe that their trades would be carried out in secret and thus protecting the investors from high frequency predatory trading[[74]](#footnote-74) (Rennison, 2016). However, Barclays failed to carry out the proper due diligence on its dark pools meaning that the secret trades could be identified by algorithms and stock purchased by rival investors before the dark pool trade could be executed, as Andrew Verity of the BBC put it ‘[t]he problem with the dark pools was that they were too damn light’ (Verity, 2016).

# Money Laundering

In 2016 an internal whistle blower would once again call into question Barclays’ due diligence when it emerged that the CRO of Barclays France, Philippe Hebert, had raised serious concerns over anti-money laundering and selling practices at certain Barclays France branches. In a letter obtained by the *Financial Times* to Barclays France CEO Tony Blanco, Mr Hebert claims he had increasing concerns relating to the implementation of anti-money laundering procedures and best practices, stating that he believed there to be

serious mismanagement at cashier level and…particularly poor handling of this situation by the various control services and lines of defence, even though it carries serious risks of money laundering, especially at branches already known to be at risk (such as Biarritz)

(Hebert cited in Arnold and Jenkins, 2016).

The letter goes on to detail several incidents in which best practice procedures and internal governance were lacking including: failing to identify one wealthy client as a ‘politically exposed person’; allowing customers to make several successive large scale withdrawals under the €10,000 threshold[[75]](#footnote-75); a failure to adequately investigate the detention of staff by police over suspicion of money laundering and mis-selling of costly investment and insurance products which were inappropriate for clients (Grandhi, 2016). Barclays responded to the claims saying that

[w]e were already aware of these allegations. We are satisfied that the concerns were already identified and under investigation and action being taken in accordance with our standard processes

(Barclays cited in Arnold and Jenkins, 2016).

However, in his letter Mr Hebert referenced a previous correspondence with the Barclays France CEO stating that he had already raised concerns but that he felt that such issues were not being ‘taken seriously enough’ and that there had yet to be a single disciplinary action taken (Hebert cited in Arnold and Jenkins, 2016).

This once again suggests that Barclays have failed to learn despite the promise of Transform to implement a ‘cultural revolution’. Moreover, this incident along with those described above suggests that while Salz/Transform may upon first reading appear to present evidence of learning there remains an obvious lack of tangible policy initiatives aimed at upholding those sentiments articulated by the Bank with Barclays failing directly address subsequent regulatory breaches and which leaves us to conclude the absence of learning and change in keeping with the double-loop theory. Moreover, the failure to learn combined with the fact that many of these regulatory breaches exposed the Bank to risks that were unknown and given the role which systemically important institutions like Barclays can and have played in the transfer of risk to the real economy mean that Barclays may yet prove to be a threat to the wider stability of financial markets.

# The Failure of Transform

This apparent lack of learning and change in relation to Group governance and oversight may be attributed to the failure of the Transform programme to implement detailed policies aimed at tackling specific regulatory breaches. Instead, Transform relies upon just a single non-specific measure of good governance and best practice, namely, the balanced scorecard which was described by Barclays as being a ‘crucial piece’ of the restructuring plan (Barclays, 2013c: 10).

Transform, for example, asserts that at the heart of its ‘cultural revolution’ is the balanced scorecard which sets out the Group’s key performance indicators (ibid). In relation to culture and conduct the Bank have just one specific KPI measure; to consistently achieve a score of 6.5/10 in the YouGov survey by 2018 (Barclays, 2013c: 244). This measure is essentially a ‘conduct reputation survey’ which includes input from

MPs, business and political stakeholders, media, non-governmental organisations, charities, think tanks and other general opinion formers (drawn from academia, public sector, arts/leisure, professionals and religion)

(ibid).

However, a simple review of the Group’s balanced scorecard reveals that in 2013 Barclays scored 5.2/10 on the YouGov survey (Barclays, 2014c: 11), in 2014 this figure rose to 5.3/10 (ibid) and 5.4/10 in 2015 (Barclays, 2015a: 11). While these figure show that Barclays have made year-on-year improvements in relation to their culture and governance KPI, these numbers nonetheless suggest that Barclays are on-course to miss their own target under current circumstances. If Barclays continue to make the current year-on-year improvements the Group would not hit their targeted 6.5/10 until 2029.

I posit that the failure of the balance scorecard to achieve its desired outcome is due to its application being directly tied to employee remuneration. As a result, we witness that over time the significance of the balanced scorecard has gradually been eroded and diluted, particularly at senior levels, with this metric coming to play an increasingly smaller role in determining the bonus pool.

When the balanced scorecard was launched in 2013 it would have a maximum weighting of 35 percent in determining both the Annual Bonus and Long-Term Incentive Plan (Barclays, 2013c: 105). However, in practice, data shows that for executive directors between 2013 and 2015 the balance scorecard element of the long-term incentive would in-fact contribute to just 20 percent of the total award weighting and from 2016 onwards this would decrease to just 15 percent, while remaining at 35 percent for the annual bonus (Barclays, 2015a: 92).

This would suggest that not only are Barclays on course to miss their own targets, designed to overhaul culture within the Group, but have rolled-back the significance placed upon incentives which were conceived with the purpose of increasing Group best practice and compliance. Moreover, as we shall discuss below the Group’s remuneration structure continues to place a greater emphasis upon economic measure as a key determinant for bonuses, thus moving the importance back towards a results-based culture as opposed to how these results are delivered and which may explain why we witnessed subsequent failures despite the presence of Salz/Transform.

In sum, the evidence presented in this section indicates that Barclays have failed to identify the specific features within their own governance structures which have allowed regulatory breaches to both occur and persist. This coupled with the various regulatory failures outlined above would suggest that there is present at Barclays a distinct lack of improved policy action and change, and as such it may be possible to conclude that learning is absent within the facet of governance and oversight with the distinct lack of change to the pre-crisis structure and culture of the Bank which proved so damaging.

# **Remuneration**

Following the financial crisis Barclays, like many of their competitors, have sought to address the issue of remuneration which, as discussed in Chapter 2, played a significant role in the events of 2008. However, this rebalancing of executive pay has taken place, like the balance sheet element below, against the backdrop of structural constraints, most notably competition in the form of rival organisations and increased regulatory requirements both of which have determined the extent to which reform has taken place. As such, while Barclays have made some impressive strides in relation to pay, with total remuneration at the Bank falling by 53 percent between 2010 and 2015 and 63 percent within the investment bank over the same period (Barclays, 2015a: 85-88), we cannot ignore the fact that the most significant changes appear to have come in light of tougher new regulatory standards, specifically CRD IV, and as such may be indicative of a failure to learn in keeping with the double-loop theory.

In this section I will argue that Barclays’ failure to learn in relation to remuneration may be attributed to structural competitive pressures, specifically the threat of competition from international rivals to attract and retain the brightest banking talent. Moreover, I will posit that the exposure to these pressures can be attributed to the Group’s overall strategic direction, which has seen Barclays maintain a vast international presence[[76]](#footnote-76) which, according to GCE Jes Staley, is now ‘very focused… on both sides of the Atlantic’ (Staley, 2016). I will suggest that the Group’s strategical repositioning has maintained Barclays’ pre-crisis exposure to competition for talent from international rivals, and particularly those institutions located in the U.S.[[77]](#footnote-77), who are not subject to the same regulatory stipulations and which may explain why we witness little evidence of learning and change[[78]](#footnote-78). Moreover, much like RBS and HSBC (discussed in the coming chapter), the ability to recruit and retain talent may also shed light on the associated costs of learning and change with the Group’s perceived diminishing ability to compete for talent being seen as huge penalty or cost, and subsequently an obstacle, of change.

As such, it will be demonstrated in this section that competitive emulation in relation to pay, along with responses to shifting regulatory requirements, have been the underlying feature of Barclays remuneration structure post-crisis which explains why the Group have, on the whole, failed to learn lessons.

When the crisis hit in 2007/2008, Barclays’ remuneration structure was very much ‘performance based’ (Barclays, 2007: 144), with the Group using bonuses to ‘drive a high performance culture’ (ibid. p145). In 2008, Group remuneration had four main elements namely, Base Salary, Annual Performance Bonus (annual incentive) and Executive Share Award Scheme (ESAS), Performance Share Plan (long-term incentive) and Pensions (Barclays, 2007: 146). While base salary and pension benefits are important elements of employee pay it is the variable elements which are of central interest to this thesis.

# Annual Incentive

In 2008 the annual incentive (A.I.) was worth a maximum of up to 250 percent of base salary, with 75 percent of the award typically paid in cash and the remaining 25 percent being deferred into shares and held for a period of three years (Barclays, 2007: 147). However, awards in 2007 demonstrate that cash bonuses made to executive directors totalled £10.1 million, with the average payment being worth £2 million (ibid. p151), or approximately 314 percent of the average base salary and way in excess of the ‘typical’ bonuses available under the A.I. (Barclays, 2007: 146).

As we can see, at the time of the crisis Barclays had in place an annual incentive which allowed the Group to make huge bonus payments which were in excess of Barclays’ own ‘typical’ range. As such, it may be suggested that the A.I. encouraged employees to pursue short-term economic gains by incentivising staff with excessive bonuses and which is symptomatic of the short-termism that infected banks pre-2008. Indeed, Salz (2013: 7) concluded that at Barclays ‘there was an overemphasis on short-term financial performance, reinforced by remuneration systems that tended to reward revenue generation’.

However, by 2015 Barclays had reformed the A.I. which was now only worth a maximum of 80 percent of fixed pay, with awards in excess of £500,000 being subject to a 60 percent deferment under the Bank’s Share Value Plan (SVP). Likewise, bonuses below £500,000 would be subject to a 40 percent deferment, and in both cases the holding period would total 3 years and 6 months (Barclays, 2015a: 92). These changes would, for the most part, be in-keeping with the PRA’s Remuneration Code (2011). Although, we should note that Barclays did extend the holding period by an additional six months beyond the regulatory minimum of three years.

While these figures demonstrate that Barclays have significantly reduced the potential maximum made available under the AI, as a percentage of base salary, by 175 percentage points, it is worth noting that up until 2013, the final year before the E.U. mandated introduction of CDR IV, the annual bonus was still worth a maximum of up to 250 percent of base salary (Barclays, 2013c: 100). This suggests that the limiting of the award may be directly tied to tougher new regulatory requirements and as such would fail to present evidence of independent learning associated with the double-loop thesis. Indeed, much of Barclays’ rescaling of both the annual award and long-term incentive, discussed below, has, by their own admission, been largely influenced by the introduction of both the Remuneration Code (2011) and the European Parliament’s CRD IV legislation with Sir John Sunderland, head of the Remuneration Committee, telling investors in 2014 that

our variable pay decisions were taken against a background of significant regulatory developments with Barclays being subject to both UK regulatory requirements… [and] CRD IV

(Sunderland cited in Barclays, 2014c: 78).

Similarly, like the other banks in this study, with the exception of Lloyds, in 2013 Barclays also sought express shareholder consent to increase the variable pay ratio to its maximum of 1:2 of base salary (Barclays, 2013c: 100; Barclays, 2014c: 103-104)[[79]](#footnote-79). Again, this would indicate that while Barclays have reduced the maximum potential award made available under the A.I. in-line with regulatory requirements, the Group have also expressly sought the ability to reward employees with the absolute maximum variable remuneration allowed under present conditions and which may be indicative of an absence of lesson learning as the Group continue to operate at the fringes of regulation.

Moreover, in the Group’s 2013 Strategic Review Barclays assured investors that it would ‘continue to pay for performance – and [would] continue to pay competitively for the best talent’ (Barclays, 2013b: 10). Likewise, in the 2013 Annual Report Sir John Sunderland noted that changes to the Group’s bonus structure had not been

matched by our peers, most notably the major US banks who are among our primary competitors. As a result, our lack of pay competitiveness [has caused] demonstrable damage to our business, especially outside the UK. The global resignation rate for senior staff in 2013 was significantly above that in 2012. This was particularly marked in the Investment Bank with a near doubling of resignations of senior staff in the US

(Sunderland cited in Barclays, 2013c: 89).

Again, these comments would further suggest that the restructuring of Barclays’ remuneration policies have come not just in light of new regulatory requirements, but also in the face of huge structural competitive pressures which have impacted negatively upon the Group’s ability to learn, with the fear of losing talent to rival international organisations appearing to be an underlying feature of Barclays’ remuneration code. Moreover, staff resignations in relation to pay may be symptomatic of the associated costs of reform, with the Group losing valuable talent to rival organisations who are not held to the same domestic and European regulatory standards.

Despite this, the Group have demonstrated some signs or ‘pockets’ of learning notwithstanding their overall approach to remuneration. For example, in their official response to Salz (2013: 8), which had concluded that remuneration at the Bank had incentivised short-term economic performance, Barclays stated that it would introduce policy initiatives which would look to align employee rewards not only with performance but with how such objectives were achieved (Barclays, 2013a: 8). As a result, it was determined that from 2013 onwards Group remuneration would include a series of non-financial measures or benchmarks which would be encapsulated in the ‘balanced scorecard’ and would carry a weighting of 35 percent in calculating the A.I. award and 35 percent for the long-term initiative (ibid. p3).

We should note however that the calculation of the A.I. is still heavily skewed towards financial metrics which continue to make up over 50 percent of the award weighting and which allowed the Group’s two executive directors, Antony Jenkins and Tushar Morzaria, to walk away with bonuses of £1.1 million and £900,000 in 2014, and £505,000 and £701,000 respectively in 2015 (Barclays, 2014c: 86; Barclays, 2015a: 85).

This may lead us to conclude that while Barclays have demonstrated some tentative signs of learning in relation to the A.I. the greatest changes have come in response to the introduction of CRD IV with the use of financial metrics continuing to be the standard for the Bank’s remuneration policies and is indicative of a failure to learn and change in keeping with the double-loop thesis.

# Long-term Incentive Plan

The second element of variable remuneration at Barclays in 2008 was the long-term incentive plan (LTIP) (Barclays, 2007: 145). The LTIP would be measured over a three year period and paid entirely in shares, with the maximum potential value of awards typically being the highest of either 150 percent of base salary or 75 percent of base salary and target bonus (ibid. p147). In 2008 the amount awarded under the LTIP would be determined by two factors: economic performance, accounting for 50 percent of the award, and total shareholder return, accounting for the remaining 50 percent (Barclays, 2007: 147).

While the LTIP award would have a distinctly long-term outlook we can see that in years leading up to the financial crisis Barclays were operating a long-term variable remuneration structure which was centred entirely upon economic measures and which potentially worked to create an environment which encouraged excessive risk-taking. Indeed, Salz (2013: 8) concluded that in the years preceding the crisis, remuneration at Barclays increasingly determined the behaviour of employees which often resulted in questionable decisions which largely went unchecked. Thus, we can see that the long-term incentive was distinctly results-driven and paid little attention to how such ends were delivered.

In contrast, however, by 2015 Barclays had updated the LTIP which it was claimed by the Group would

[reward] growth in shareholder value over a multi-year period…discourage excessive risk-taking and inappropriate behaviours and [foster] a long term view and align executive Directors’ interests with those of shareholders

(Barclays, 2012: 84).

Under the reformed LTIP performance would no-longer be the sole measure of awards, with the Group introducing the balanced scorecard and personal objectives which would determine 35 percent and 15 percent of the total award respectively, with the remaining 50 percent being measured by financial performance metrics (Barclays, 2015a: 85). Likewise, the maximum award made available under the LTIP would also witness a 30 percentage point decrease with the LTIP being limited to a maximum of 120 percent of base salary (Barclays, 2014c: 90).

However, while the maximum allowance of the LTIP has decreased between 2008 and 2015 it may be argued that such a reduction has been largely motivated by structural factors, namely, CRD IV. For example, in 2011 the maximum potential award was set at 500 percent of base salary before being reduced to 400 percent for 2012 and 2013, the final year before the implementation of CRD VI (Barclays, 2011: 58; Barclays, 2012: 84).

Similarly, while the introduction of the balanced scorecard and personal objectives in the calculation of awards may represent some limited evidence of learning, it is worth noting that from 2016 onwards the weighting of the balanced scorecard element would decrease by 20 percentage points while ‘financial’ measures would increase by 20 percentage points (Barclays, 2015a: 85). Moreover, as noted above, in reality the balance scorecard has played a much smaller role in the calculation of awards for Executive Directors. Though this reduction in the contribution of non-financial measures does not necessarily represent an absence of learning it does cast doubt over the extent to which we may conclude that learning is present in accordance with the double-loop theory set out in Chapter 1.

This retreat or rolling-back of learning and change may once again be attributed to competitive pressures which, as we have already seen, have been a constant feature of remuneration at Barclays following the crisis, with sentiments expressed by the Group appearing to suggest that competitive pressures have factored heavily in the restructuring process of Group remuneration. For example, in his 2015 Remuneration Report Crawford Gillies, the newly appointed Chairman of the Remuneration Committee, noted that the ‘volume and pace of regulatory change’ in 2015 had further accentuated the ‘competitive disadvantages attributable to the lack of a global level regulatory ‘playing field’ under which Barclays were now operating and that as such it was necessary to revise the ‘performance measures of [the Group’s] LTIP  to ensure they are appropriate given [Barclays’] strategy’ (Gillies cited in Barclays, 2015a: 84).

# Role-Based Pay

Like all the banks in this study Barclays have also utilised role-based allowances or ‘Role-Based Pay’ (RBP) with the Group introducing this new element of remuneration in 2014 as a ‘key action’ in response to CRD IV (Barclays, 2013c: 90). Under the RBP initiative certain employees are eligible to receive a monthly cash payment, notwithstanding executive directors and the Group Executive Committee who would be paid in shares, alongside their salary which reflects the ‘breadth and depth’ of responsibility (ibid. p95). While Barclays have been clear to state that the RBP award is not ‘adjusted for performance’ (Barclays, 2013c: 95), the fact remains that the award is reviewed annually and is subject to both upwards and downward revisions according to the ‘business and economic environment’ (ibid).

The introduction of RBP indicates that Barclays, like other banks in this study who have utilised such awards, while being in compliance with the letter of the law have not truly embraced the spirit of tougher new regulations on pay with such awards, as discussed in previous chapters, accused of being used to circumvent regulation. Accordingly, it may be suggested that RBP is further evidence of a failure to learn in relation to the role of regulators in the global financial order. Furthermore, Barclays also appear to have failed to learn from its own evaluation carried out by Salz (2013: 10) which concluded that Barclays needed to move beyond the ‘confrontational approach [to] regulators’ which dominated the Bank pre-crisis. However, such an award clearly calls into question the spirit with which Barclays have met regulatory standards and which may denigrate the relationship between the Bank and the regulators.

Like the annual bonus and LTIP, the introduction of RBP and the suggested subsequent failure to learn may also be attributed to structural competitive pressures. For example, in the 2013 Remuneration Report, commenting on the introduction of CRD IV, the Group stated that the new regulations would impact its ‘competitiveness in the global market for talent’ (Barclays, 2013c: 90) and as such would introduce the RBP as means to ‘remain competitive for global talent’ (Barclays, 2014c: 81). Moreover, when Jes Staley was appointed as Group Chief Executive in December 2015 Barclays announced that it would be granting him RBP of £1.1 million in order to remain ‘commensurate with market pay levels’ (Barclays, 2015a: 83), adding that RBP for the coming year, for all employees eligible, would be determined by ‘market practice and ability to recruit’ (ibid. p113).

These statements suggest that it is structural pressures which are exercising the greatest influence over Barclays’ remuneration practices with the Group clearly aligning pay with that of rival organisations. Furthermore, such sentiments as those discussed above would appear to support the assertion that lesson learning, on the whole, has been impeded by competitive pressures with structures clearly being an important factor in the learning trajectory of the Group, as Barclays have failed to make substantive changes to both the structure and culture of remuneration post-2008.

# **Balance Sheet**

The balance sheet element at Barclays breaks with the above section, insomuch as we do indeed witness some evidence of learning and positive behavioural change post-crisis. However, this learning has been slow and has, on the whole, only emerged following the publication of Salz/Transform. As such, it would appear that Barclays’ successful navigation of the crisis resulted in the Group lacking the necessary motivation to search for alternatives - in-keeping with the dissatisfaction thesis explored throughout the literature presented in Chapter 1 – and which subsequently lead to some initial complacency. Indeed, the evidence suggests that between roughly 2008 and 2012 the Group increased their exposure to risk on many of the metrics used in this thesis, with learning being either marginal or totally absent. However, following the publication of Salz/Transform we witness a general positive behavioural shift with learning either taking hold or accelerating quickly from 2013 onwards, with Sir David Walker, the former Group Chairman, concluding that 2013 had been a ‘pivotal’ year in restoring Barclays’ reputation (Barclays, 2014b).

However, recent anecdotal evidence in relation to the status and future of the investment bank has called into question the extent and longevity of these changes, with the investment bank witnessing a resurgence following the appointment of Jes Staley as group chief executive. Structural competitive pressures linked to the primacy of shareholder value and diminishing share price valuations, along with the individual agency of the position of GCE, will be used to explain why, despite evidence of positive double-loop learning and change, we may be witnessing a degeneration and reversal of those changes.

# Group Funding

In 2008 total Group liabilities and equity stood at approximately £2 trillion with customer deposits being £335 billion or approximately 16 percent of liabilities and equity. In 2015 total Group liabilities and equity equated to £1.1 trillion[[80]](#footnote-80) with customer deposits being worth £418 billion or 41 percent of liabilities and equity. As we can see, Barclays have significantly improved their funding position post-2008 with the customer deposit base increasing by 24 percentage points. An examination of the intervening years would also appear to support the hypothesis extended in this section.

Figure 6.1. Customer deposits as percentage of total Group liabilities and equity 2008-2015.

Figure 6.1., for example, demonstrates that between 2009 and 2012 the percentage of customer deposits as share of Group liabilities and equity remained broadly the same experiencing only a 2 percent rise. However, in 2013 we witness a sharp increase with customer deposits growing by 7 percentage points before suffering a small decline in 2014 and then again witnessing a marked improvement in 2015 growing by 10 percentage points. Similar figures for our comparator group reveal that Barclays and RBS (42 percent) share a similar position while Lloyds (51 percent) and HSBC(53 percent) are outperforming the Bank.

While Barclays have not specifically articulated an objective to increase customer deposits as a proportion of overall Group funding, the 2013 Strategic Review[[81]](#footnote-81) did address the issue of funding stating that Barclays would seek

to maintain a diversified funding base. Our expectation is that our wholesale unsecured funding volumes will come down and the mix will change over the next three years, in particular towards secured funding

(Barclays, 2013b: 9).

This would suggest that while the Group have lacked policy initiatives which specifically target the increase of customer deposits, the Strategic Review clearly recognises that a more diversified funding base is desirable. Moreover this coupled with the figures presented above suggest that learning may indeed be present in-keeping with the causes of the crisis detailed in Chapter 2.

Given the increase in customer deposits it is surprising that we find that Barclays reliance on short-term funding, including money markets and other deposits, has witnessed only the smallest of decreases post-2008. For example, in 2008 this source of funding was worth £298 billion or 14.5 percent of Group liabilities and equity. However, figures for 2015 reveal that short-term funding and other deposits were worth £152 billion or 13.6 percent of liabilities and equity. On first reading this would appear to suggest that despite the literature on the causes of the crisis and the conclusions of Salz (2013: 222), which identifying short-term funding and an over-reliance on wholesale markets as being a key cause of the crisis, Barclays have failed to learn, decreasing short-term funding only nominally from 2008-2015.

Figure 6.2. Short-term funding as percentage of total Group liabilities and equity 2008-2015.

However, data for the intervening years displayed in figure 6.2. may yet prove the hypothesis extended in this section correct. For example, between 2008 and 2010 short-term funding peaked at 29 percent in 2010 before levelling off between 2011 and 2012 and which may be explained by regulatory changes in capital standards. However, 2013 marks the beginning of a huge decline with short-term funding as percentage of total liabilities and equity falling 9 percentage points in just three years. This suggests that the theory extended in this section of the thesis may indeed be correct, namely that learning in relation to the balance was vastly accelerated following the publication of Salz/Transform.

# Trading Liabilities

Likewise, figure 6.3. shows that between 2008 and 2012 trading liabilities as a percentage of total assets rose year-on-year, with the exception of 2011 when trading liabilities actually fell to 2.9 percent, reaching an eight-year high in 2013 of 8.4 percent. Nonetheless, following this peak figures have subsequently fallen to 7.1 percent in 2014 and then 6.6 percent in 2015. Again this would suggest that while trading liabilities as a percentage of total assets have risen between 2008 and 2015, there has been a marked decline in this figure from 2013 onwards and which demonstrates evidence of a positive downwards trend in keeping with hypothesis extended in this section. In comparative terms, Barclays are currently being significantly outperformed by RBS (2.5 percent), Lloyds (1.6 percent) and HSBC (5.8 percent) who all have smaller trading liabilities as a percentage of total assets.

Figure 6.3. Trading liabilities as percentage of total assets 2008-2015.

# Loan/Deposit Ratio

However, when we examine the data for gross loans extended as a percentage of total deposits between 2008 and 2015 the evidence suggests a break with the hypothesis. For example, we can see from figure 6.4. that from 2009 onwards there has been a small but steady decline in the value of loans being extended with no clear acceleration of this policy following the implementation of Salz/Transform. Indeed, we see the biggest decrease of 14 percentage points occurred in the three years between 2009 and 2012. In comparison, in the three year period 2013 to 2015 we witness a decrease of just 4 percentage points. However, we should note that while these figures do not necessarily fit with the hypothesis extended so far, the data does suggest the presence of learning with Barclays reducing gross loans as a percentage of total deposits by 17 percentage points between 2008 and 2015[[82]](#footnote-82).

Figure 6.4. Gross loans as percentage of total deposits 2008-2015

# Loan Quality/Impairments

Likewise, when we examine the type of loans being extended at the Bank we witness a similar picture. For example, while we can see from the above figures that gross lending has been reduced at Barclays, this has also been accompanied by an increase in residential mortgage loans. Figure 6.5. demonstrates that that between 2008 and 2015 Barclays have increased residential mortgage lending as a percentage of gross loans by 10 percentage points. While figures for the period 2013-2015 do not, like above, demonstrate a marked acceleration of policies, these figures do however demonstrate evidence of learning, with the Group dedicating a greater percentage of its lending activities towards this comparatively safer asset class. Moreover, Transform would reinforce the Group’s commitment to this kind of lending, telling investors that Barclays would continue to target ‘high-return businesses such as UK mortgages’ and is indicative of one of several key changes identified by the Group as being needed post-2008 (Barclays, 2013d: 2).

Figure 6.5. Residential mortgage loans as percentage of gross loans 2008-2015.

Likewise, when we consider the quality of loans being extended at the Bank, measured in terms of the number of impaired loans as a percentage of gross loans, we can once again observe evidence of learning in keeping with the hypothesis extended. For example, while it is true that between 2008 and 2015 impaired loans as a percentage of gross loans actually increased marginally, data for the intervening years suggest that from a peak in of 7.2 percent in 2010 the Group have reduced impaired loans as a percentage of gross loans. Moreover, this downwards trend once again gathered pace post-Salz/Transform with the largest year-on-year reduction coming in 2014, and as such may be indicative of learning in keeping with suggestion extended thus far. However, we should note that between 2008 and 2015 total impaired loan as a percentage of gross loans increased by 9 percent, while Lloyds and HSBC have witnessed a decrease of 77 percent and 3.8 percent, respectively, RBS have seen increases of over 300 percent.

Figure 6.6. Impaired loans as percentage of gross loans 2008-2015.

# Return on Equity and Earnings Per Share

We know from the literature review in Chapter 2 that excessive return on equity targets were one of the contributory causes of the financial crisis as the banks, seeking ever higher ROE, looked to increase the level of risk which was deemed as acceptable. In 2008 Barclays had a targeted ROE of between 15-20 percent and achieved an average ROE of 15 percent, the highest of any bank in this study. In 2007 this figure had been 20 percent. However, by 2015 the Group were operating with an ROE of -0.54 percent. Moreover, between 2012 and 2015 average ROE at the Group was -1.67 percent. In his annual Chairman’s letter, John McFarlane addressed the Group’s continued poor ROE performance stating that the Group’s ROE was ‘below our required return and needs to be improved’, adding that the reason behind these figures could be attributed to a ‘£1.5 billion drag of the non-core portfolio, £4.0bn in litigation and conduct charges relating to historical matters…and £1.5bn in corporate income taxes’ (McFarlane cited in Barclays, 2015a: 2). Likewise, earnings per share have also being less than favourable during this period. In 2008 EPS stood at 59.3p, for the period 2012-2014 average EPS was just 0.47p with figures for 2015 being 1.9p.

Based on the figures set out above it is difficult to draw a clear and empirically robust conclusion. Indeed, we know from business best practice and Mr McFarlane’s comments that negative ROE is undesirable for any business or bank. While Barclays have reported negative ROEs from 2012 onwards, 2013 being an exception with and ROE of 0.99 percent, we do know that the Group’s targeted ROE is 11.5 percent (Barclays, 2013d: 1) which would represent between a 3.5 and 8.5 percentage point reduction on 2008 targeted levels. Commenting on the Group’s targeted ROE Antony Jenkins noted that ‘improving returns and dividends to shareholders’ and ‘delivering for broader society’ were inextricably linked and that in the past Barclays had been too focused on the short-term, adding that this figure would bring long-term sustainable return to shareholders which in itself would deliver

a better Barclays, better for our customers and clients, better for our shareholders and better for Britain and the essence of this is really about on the one hand improving returns to shareholders…I really don’t see that there is a trade-off between good business and things that are good for shareholders I think the two things are aligned

(Jenkins cited in BBC, 2013).

As such it may be possible to conclude that while Barclays have yet to hit their targeted ROE, there is evidence that the Group are aware that pre-crisis ROE targets were damaging for the Bank, a key lesson of the crisis discussed in Chapter 2, and have since put in place specific policies aimed at addressing this imbalance and which may be indicative of double-loop learning.

# Derivatives

Barclays have also made good progress on the extent to which derivatives contribute to the overall balance sheet. In 2008 derivatives made up approximately 47 percent of total group assets. By 2015 this figure had declined by 18 percentage points to just 29 percent of total group assets. However, unlike some of the other metrics explored in this section of the Chapter the most marked reduction came between the years 2008-2012, falling 16 points in just 4 years. While these figures do not necessarily support the hypothesis in this section, the data does nonetheless suggest the presence of learning.

In addition, Salz (2013: 59) concluded that in the run-up to the financial crisis, derivatives contracts had been sold to investors without the necessary ‘attention to customer needs’, which in itself may have been fuelled by the bonus culture at the Bank. However, the Report went on to state that since the crisis Barclays, in relation to the sale and use of derivatives contracts, had significantly improved its ‘sales processes to ensure that risk is appropriately explained’ and which may explain why we have witnessed a reduction in the volume of such products, with Salz’ (ibid) conclusions supporting the assertion that learning is present in relation to this metric.

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# Regulatory Capital

In 2008 Barclays were holding £37 billion of Regulatory Tier 1 Capital. This equated to a Regulatory Tier 1 Capital Ratio of 8.6 percent. For the year ending 2015 the Group were holding £52 billion of Regulatory Tier 1 Capital which equated to 14.7 percent[[83]](#footnote-83). As such, we can see that in 2015 Barclays exceeded the Regulatory Tier 1 Capital requirements by 145 percent. Likewise, when we examine the Group’s Total Regulatory Capital we witness a similar picture emerging. For example, in 2008 Total Regulatory Capital stood at £58 billion or 13.6 percent. In 2015 Total Regulatory Capital stood at £66 billion or 18.6 percent which means that Barclays’ current Total Regulatory Capital exceeds Basel III standards by 132 percent. In the context of learning this is important because, as outlined in Chapters 1 and 3, going ‘above and beyond’ minimum regulatory requirements may be indicative of learning and change. Similar figures of our comparator group show that Barclays are currently outperforming their rivals at HSBC but are lagging behind both RBS and Lloyds[[84]](#footnote-84).

# Investment Bank

Like HSBC, Barclays have maintained an annual pre-tax profit in each subsequent year following the crisis. In 2008 Barclays recorded a pre-tax profit of £5.1 billion, with the investment bank contributing approximately £2.5 billion or 50 percent to this total. Comparable figures for the year 2015 show pre-tax profits to be £5.4 billion, with the investment bank recording a pre-tax profit of £1.6 billion and contributing to 29 percent of Group pre-tax profits. If we exclude results for the year 2010, which is considered by Barclays to be an outlier year[[85]](#footnote-85), we can see that once again that the greatest reduction in the investment bank’s contribution to overall pre-tax profits ensued from 2013 onwards.

Figure 6.7. Investment bank contribution as percentage to overall group pre-tax profit 2008-2015.

As established in Chapter 2, excessive financial trading, typically executed through the investment banking division of banks, precipitated and compounded the effects of the financial crisis. However, the data examined above suggests that this factor has been addressed by Barclays and as such may be indicative of lesson learning, although, as will be discussed below, the future of the investment bank and the extent to which it contributes to the Group is currently under question.

# Off Balance Sheet Vehicles

While this section of thesis has argued that Barclays have, on the whole, learned lessons from the financial crisis, there remains certain elements of the balance sheet which do not support the overarching hypothesis. For example, one of the lessons explored in Chapter 2 was the compounding effect which shadow banking had on the financial crisis. While it can be difficult to measure the extent to which banks are engaging with the shadow banking industry, the most accurate and widely accepted metric is the use of off balance vehicles (OBSV) which are the product of choice used by financial intermediaries wishing to partaking in shadow banking activities (Erturk, 2016).As such, it would stand to reason that a reduction in the use of OBSV would be indicative of lesson learning. However, data suggests that following the financial crisis Barclays have increased their use of OBSV.

In 2008 OBSV were worth 15 percent of total group assets. However, in 2015 this figure had risen by 12 points to 27 percent of total group assets. While data for the years 2008-2012 demonstrate only a modest increase of just 3 points, with an average yearly figure of 17 percent, the most dramatic increases have occurred from 2012 onwards rising from 18 percent in 2012 to 27 percent in 2015, an increase of 9 points bringing the sum of off balance sheet items to almost one third of total group assets.

While these figures do not necessarily support the overarching hypothesis extended in this section we should not discount the argument as the evidence overwhelmingly suggests that learning and change is indeed present within the balance sheet element. Moreover, this learning appears to have taken place in light of a Group-wide evaluation encapsulated in Salz and the resulting Transform programme and as such would be indicative of learning in keeping with the policy learning literature which tells us that evaluation should be followed up with specific policy initiatives.

# Share Price Valuations

Similarly, in 2007 Barclays’ average share price valuation for the year was 660p. In 2008 this figure had fallen to 336p with a year high of 477p for the month of February. In 2015 the Group’s average share price valuation was 249p with a year high of 380p in July. However, while Barclays, like all the banks in this study, have suffered a decline in their average share price valuations following the financial crisis, and which may be reflective of the turbulence within global financial markets post-2008, average valuations between 2008 and 2015 (Figure 6.8.) demonstrate that Barclays’ stock has recovered very little since 2008. In comparison, Barclays have suffered a share price loss of 25 percent since the crisis (or 62 percent on 2007 valuations), with HSBC, who like Barclays did not require a state sponsored bailout, suffering similar losses at 29 percent. RBS have experienced the greatest loss at 92 percent, with Lloyds almost recovering their position suffering only a 2 percent reduction.

Figure 6.8. Average yearly share price valuations 2008-2015.

While we must exercise caution when drawing conclusions in relation to share price valuations which are sensitive to a number of structural factors, anecdotal evidence suggests that depressed share price valuations may have the effect of exerting pressure on the Board to abandon its newly incarnated and more risk-averse business strategy as the primacy of shareholders, measured in terms of stock valuations, along with an acute awareness by the Board of the mobility of investor capital comes to dominate strategic decisions at the Group.

# Learning in Retreat?

The key metrics above suggest that, on the whole, learning is present at Barclays. However, the future of the investment bank may yet undermine this learning with the primacy of shareholder value, structural competitive pressures and the individual agency of the GCE all being contributory factors may explain why learning could be in retreat. This section of the Chapter will demonstrate that despite some positive progress on the investment bank, Barclays may have begun to commit a U-turn on policies and which may undermine learning. For example, we know from above that the Group have made some good progress on the rundown of the investment bank. In 2008 the division generated approximately 50 percent of total group pre-tax profits and was not only institutionally important, with approximately three-quarters of total group assets being held by the investment bank, but was also systemically significant being ‘one of the largest investment banks in the world’ (Salz, 2013: 4). While the investment bank had always been institutionally important to Barclays, Salz concluded that the division had also become a reputational and operational vulnerability with many of the central factors which contributed to the crisis, such as excessive financial trading and lucrative remuneration, being either largely contained or originating within the investment bank (ibid. p5).

Barclays’ official response to Salz in 2013, simply stated that the Group would address the ‘underlying causes of issues’ in the investment bank and ‘apply lessons learned more broadly’ (Barclays, 2013a: 10). In May 2014, and under the stewardship of Group Chief Executive Antony Jenkins, the Bank announced that it would be looking to ‘exit or run down’ approximately £115 billion of risk weighted assets (Barclays, 2014b). Moreover, almost 80 percent of these assets would consist of RWAs from the investment bank as the Group sought to remove approximately £90 billion from the division (Barclays, 2014b). Barclays would also target RWAs within the unit to not exceed 30 percent by 2016 (ibid).

Commenting on the plans GCE Antony Jenkins stated that the move would mean a ‘significantly more balanced’ Group as the Bank sought to simplify its operations and concentrate on areas in which the Group had

capability, scale and competitive advantage [and that i]n the future, Barclays will be leaner, stronger, much better balanced and well positioned to deliver lower volatility, higher returns, and growth

(Jenkins cited in Barclays, 2014b).

In addition, Barclays would also implement a number of initiatives which signalled their intent to rundown and shift the focus of their business model away from the investment bank. For example, in May 2014 the Bank announced that it would be shedding approximately 7,000 employees from the investment bank over a two year period with approximately 2,000 jobs to go immediately (Treanor, 2014b). In March 2015, disappointed by the investment bank’s lacklustre performance, Mr Jenkins told reporters that he would make further cuts to the division if it did not improve its profitability (Slater and Scuffham, 2015). Mr Jenkins went on to say that ‘every business within the group has to deliver the ROE (return on equity) that we require of it’ adding ‘[w]e won't hesitate to continue to optimise capital allocated to the investment bank, the cost base and revenues to generate those returns’ (Jenkins cited in Slater and Scuffham, 2015).

Furthermore, in July 2015, the Bank announced that it would be cutting a further 2,500 jobs within the investment banking division including 150 senior roles (Slater, 2015). In October of the same year the *Financial Times* reported that two bank insiders had told the FT that Barclays were planning to accelerate the rundown of the investment bank and deliver the restructured investment banking division ahead of Mr Jenkins 2016 schedule (Arnold, 2015b).

By the 31st December 2015 Barclays’ investment banking division had exited nine countries, including operations in Russia, Brazil and Asia, retrenched cash equities trading to its London and New York markets and suspended local currency trading outside of the Group’s non-core regions (Barclays, 2015b: 2). Moreover, the Group had essentially hit its 2016 target of reducing RWAs within the investment to no more than 30 percent almost a year early, with figures for 2015 showing RWAs within the division to be worth £108 billion or 30.1 percent of total group RWAs. Moreover, as discussed above, the investment bank had similarly come to play an increasingly smaller role in Group profit generation.

While on face value this evidence would suggest the presence of learning, with policy initiatives and outcomes clearly being aligned to the conclusions of Salz, recent developments within Barclays may yet undermine such a conclusion and instead point towards a retrenchment of the investment bank.

Despite the investment bank making some impressive strides under the stewardship of Group Chief Executive Antony Jenkins, in July 2015 Barclays announced that it would be terminating Mr Jenkins’ contract amid rumours that the GCE and the Head of Investment Banking, Tom King, had clashed over the future direction of the division in a fiery exchange of words (Arnold, 2015c). It was reported that following a highly charged disagreement Mr King went on to tell some members of the Board that he intended to retire due to his exacerbation over Mr Jenkins plans for the future of the division (ibid). Antony Jenkins’ employment at Barclays was terminated shortly thereafter.

Mr Jenkins’ dismissal sparked a series of rumours over the future direction of the investment bank and the extent to which it would feature in Barclays’ future (Moore and Goodway, 2015). Indeed, shortly after his dismissal reports began to circulate that the Board had moved against the former GCE following unannounced plans that Mr Jenkins had planned to shrink the investment bank further still (ibid). Those close to the Bank told reporters that the Board were unhappy with Mr Jenkins future plans for the investment bank, which was seen by the Board as Barclays’ flagship product for attracting and managing large international clientele, and that this was the true motive behind his dismissal (Moore and Goodway, 2015).

While Barclays tried spuriously to quash these rumours, telling reporters that Antony Jenkins’ dismissal would not ‘signal a major change in strategy’ for the Group (Barclays cited in Arnold, 2015c), John McFarlane, Group Chairman, did admit to reporters that the investment bank was a crucial part of the Barclays Group (Treanor, 2015a). Rumours that the run-down of the investment bank would be halted or even reversed were then given further fuel when in October 2015 Barclays announced that it would be appointing Jes Staley, a career investment banker, as the new Group Chief Executive (Arnold and Jenkins, 2015).

Shortly after joining Barclays Mr Staley, in a memo to staff, stated that he remained committed to running down and managing RWAs within the investment bank and would ‘complete the necessary transformation and repositioning of the Investment Bank to a less capital intensive model’ (Staley cited in Savage 2015). However, while *prima facie,* Mr Staley’s plans for the investment bank appear to present no radical divergence from those put in place by his predecessor, deeper analysis of the new CEO’s plans may be indicative of a reversal of the learning which took place under Mr Jenkins with evidence suggesting that Barclays may once again be planning to place the investment bank at the centre of their business strategy.

In a speech given to investors on Wall Street Mr Staley commented that

[a]t the heart of Barclays’ strategy is to build on our strength as a transatlantic Consumer, Corporate and Investment bank anchored in the two financial centres of the world, London and New York

(Staley cited in Gale, 2016).

City commentator Adam Gale (2016) suggests Mr Staley’s comments leaves little doubt that the investment bank, focused on both U.K. and U.S. markets, will be the Group’s main source of profit over the coming years.

In addition, in his first annual results presentation Mr Staley told investors that the Group’s investment bank was a ‘bulge-bracket Investment Bank’ adding that Barclays’ were a ‘top tier’ player in the investment banking league (Staley cited in Moshinsky, 2016b). Sarah Butcher, a City analyst, notes that the language used by Mr Staley is clear sign of where the future of the investment bank lies, suggesting that Mr Staley sees Barclays competing with likes of other large investment banks such Goldman Sachs and J.P. Morgan (Butcher, 2016). Such factors appear to suggest that the investment bank may yet witness a resurgence thus threatening the learning which has already taken place.

Likewise, further analysis by Ms Butcher (2016) posits that while Barclays have reduced RWAs within the investment bank, this figure will rise following the run-down of the Group’s non-core business, with figures suggesting that RWAs within the division will rise to 40 percent of total group RWAs following the rundown. Under such circumstances, RWAs within the investment bank would be in excess of the 30 percent target set under Mr Jenkins’ tenure as CEO with Jes Staley telling investors that

to significantly reduce RWA further would reduce the investment bank’s core functionality and ability to compete in the top tier

(Staley cited in Moshinsky, 2016b).

Similarly, a recent recruitment drive within the division further suggests that the investment bank may be undergoing a resurgence. For example, in February 2016 it was reported that Barclays had recruited 150 senior staff to bolster its U.S. investment banking operations (Wallace, 2016b). Just one month later in March 2016, and around the time that Mr Staley was outlining his future plans for the bank, Barclays announced that it had recruited nine senior mergers and acquisition specialists who would be joining the investment bank from CMC Capital (Wallace, 2016c). Commenting on the recruitments Crispin Osborne, co-head of banking in Europe the Middle-East and Africa for the Group, noted that the appointments ‘will further help to drive the momentum of our EMEA Banking business’ (Osborne cited in Wallace, 2016c).

This apparent reversal of fortunes within the investment bank along with Mr Jenkins termination and a potential shift away from those lessons learned surrounding the investment bank following the publication of Salz and Transform appear to be explained by structural competitive pressures, the primacy of shareholder value and individual agency. For example, shortly after Mr Jenkins was terminated as GCE rumours began to surface that both the Board and senior management team had lost confidence in Antony Jenkins, telling reporters that the former GCE was ‘under-ambitious’ in his plans for the investment bank which was threatening Barclays’ competitive position (anonymous cited in Arnold, 2015c).

Indeed, commenting on Mr Jenkins’ dismissal Group Deputy Chairman, Sir Michael Rake, told members of the press that a significant number of Board members had grown unhappy with Mr Jenkins’ strategy for the Bank adding that the prevailing sentiment amongst the Board was that cost-cutting should go deeper and faster and that the performance of the investment bank had become sub-standard (Rake cited in Brinded, 2015).

These comments suggest that the future plans for, and the performance of, the investment bank were clearly seen by the Board as being explicitly linked to Mr Jenkins personally with the subsequent ‘sub-standard’ performance of the division clearly being viewed by senior executives and non-executive directors as the sole responsibility of Antony Jenkins and thus suggesting that the individual agency and autonomy of the GCE was, and clearly still is, important.

Similar sentiments were also expressed by Sir Vince Cable during a research interview with Sir Vince telling me that

Barclays made a big effort to change their culture when Jenkins was appointed but then he didn’t last the course because he wasn’t giving his shareholders big enough returns, there’s an attempt to change culture but it hasn’t been all that successful…because of impatient shareholders

(Sir Vince Cable. Interviewed 28th October 2016).

Moreover, the apparent primacy of shareholder value and structural competitive pressures surrounding the performance of the Group may also explain the apparent revival of the investment bank with Mr McFarlane, the Group Chairman, commenting on the termination of Antony Jenkins stating that

[i]t became clear that existing management plans had shareholder value creation too far out in the future. Barclays [sic] shares stand where they did six years ago and the dividend is flat

(McFarlane cited in Moore and Goodway 2015),

adding that the priority of the new GCE should be improving ROE within the investment bank (McFarlane cited in Patrick, 2015).

These comments indicate that at the forefront of Barclays’ decision to terminate Mr Jenkins’ contract, and the apparent strategic reorientation of the investment bank, was both the primacy of shareholder value and the competitive position of Barclays which, in the face of the reform process, had grown untenable. However, in an interview Sir Vince Cable noted that such behaviour could be particularly harmful when we consider that it was these very dynamics that ‘was driving the aggressive behaviour of the banks pre-2008’ (Interviewed 28th October 2016), and which may be representative of the wider costs associated with change. Indeed, City commentator Lianna Brinded concludes that

Ultimately, investment banking staff, shareholders and members of the board realised that even though they had asked the reformer [Antony Jenkins] to change their bank, they grew tired of the taste of the medicine prescribed. As McFarlane said in his interview with the BBC: "it's not just a reduction in costs, it's a change in the way we do things that's required here."

(Brinded, 2015).

However, while an apparent reversal in the direction of the investment bank may upon first reading suggest that learning has recently dissipated at the Group, I would posit that Barclays have not failed to learn or have ‘unlearned’ lessons, but have instead learned that the associated costs of learning are simply too high with structural competitive pressures – including but not limited to shareholder value creation – being the driving force behind this. Archer’s (2007; 2012) thesis on the meta-reflexives can be used to explain why it is possible that despite this apparent backsliding on the reform agenda leaning may still be present.

Archer, for example, suggests that following a period of reflection an agent or institution may become aware of their ‘situational logic of opportunity’ with the learning subject recognising both the opportunities and constraints which structures place upon them. Though these structural constraints can be overcome the agent or organisation must make a decision based on all available information, including the associated costs of not complying with the situational logical of opportunity. In the example of Barclays, the evidence suggests that the Group have concluded that the cost of non-compliance, which is epitomised by the Group’s inability to recover or substantially offset the erosion of its share price post-crisis, is simply too high. Indeed, Archer herself concludes that the ‘situational logic of opportunity is…predominant…The prizes go to those who can manipulate concomitant cultural compatibilities’ (Archer, 2007: 54). In this example, Barclays have learned that the ‘price’ of learning is simply too high with ‘situational logic of opportunity’ being too narrow to pursue a reform agenda that sees the investment bank shrinking and leading to those changes already implemented within the division beginning to unravel.

# **Conclusion**

The evidence examined in this Chapter suggests that there is no one-size-fits-all answer to the underlying research question posed by this thesis. Instead, the evidence examined above suggests that we should consider individual facets of the Group and instances or pockets of learning on their own merit. For example, it may be possible to conclude that the Group have failed to present strong evidence of learning in relation to governance with a series of events suggesting an absence of change which may be attributed to a failure to enshrine ‘lessons learned’ through specific policy initiatives.

Despite this, we can see that on the whole the Group do appear to have learned lessons in relation to the balance sheet element yet, certain key metrics such as derivatives trading do not fit with this broader idea. Likewise, the apparent resurgence of the investment bank, if proved correct, would further undermine the assertion that learning is present on the balance sheet despite an overall positive behavioural change post-Salz/Transform.

When we consider remuneration we can see that the Group have generally failed to learn and that unlike those lessons drawn in relation to the balance sheet or the failure to learn in relation to governance this may be attributed to structural competitive pressures principally over competition for talent.

These varying factors and results stress the importance of considering both the intricacies of the Group and the learning process in general when answering the overarching thesis question. Moreover, despite Barclays undertaking a fundamental review of its underlying theories-in-use in the form of Salz, lesson learning at the Group, in many instances, appears to be either absent or incomplete. Once again, there is no single explanation for this outcome and instead different theoretical explanations must be applied to the varying elements of the Group in order to understand the learning process at Barclays and its impact upon financial stability.

**Chapter 7 – HSBC**

**Overview**

In comparative terms, HSBC had what can be considered a rather successful financial crisis. The Group avoided state assistance, did not need to undertake private capital raising and were able to continue to report pre-tax profits throughout the immediate crisis period and beyond. While this successful navigation of the crisis endowed the Group with the ‘space’ needed to learn it also meant that HSBC lacked the necessary dissatisfaction which we now know drives the learning process. As such, we witness little change to the overall structure and composition of the Group in the years following the crisis.

Despite this, I will contend that following subsequent moments of ‘dissatisfaction’ HSBC have, on the whole, learned lessons from the 2008 crisis. However, the Group appear to have learned different lesson in relation to different areas of the business with learning taking place at different speeds. It will be argued that HSBC’s strong position going into, and in the wake of, the financial crisis has led to contending typologies and variations of learning throughout the business. As such, while we can identify positive double-loop learning within certain areas of the Group there is no one-size-fits all explanation for this change. Instead, and much like the preceding Chapter, it is necessary to consider individual facets of the business upon their own merit in order to understand how and why learning has unfolded in such a way and why in some areas of the business learning remains incomplete.

Position Following the Crisis

While the Group came through the crisis little regulatory or reputational damage a series of governance failures post-2008, including criminal proceedings over money-laundering; the mis-selling of investments; exchange rate rigging; and the facilitation of tax avoidance, has meant that HSBC have subsequently experienced the necessary dissatisfaction which has prompted learning. This learning has resulted in a series of tangible policy outcomes aimed at addressing these regulatory shortcomings. Ideas surrounding the policy learning literature will be utilised to explain why the Group may have learned in relation to this particular facet of the business.

Post-crisis remunerative practices on the other hand paint a rather mixed picture. In the one instance, the Group recognise that in order to attract and retain the brightest banking talent they must be competitive on pay and that a failure to do so would put them at strategical disadvantage. On the other hand, the Group have shifted how remuneration is calculated moving away from purely economic measures alone and have utilised share awards, requiring that shares be held for a specified qualifying period and in the case of executive directors until retirement, undoubtedly giving variable pay at the Group a distinctly long-term outlook post-2008. Despite this, the Group have also been vocal critics of tougher new regulation aimed at tempering variable pay and, like other banks in this study, have utilised so-called ‘fixed pay allowances’ in order to circumvent new legislation.

Theoretical explanations surrounding structural competitive pressures will be utilised to explore such variations in learning. For example, the literature on structure/agency suggests that while agents retain the autonomy to shape and influence structures, these structure can also be difficult to overcome, with the competitive pressures built-in to such structures potentially leading to agents and institutions adapting their behaviour in order to avoid sanction, in this case losing banking talent to rival organisations.

Conversely, when we consider the balance sheet element at the Group we witness a different picture. HSBC’s balance sheet had served them well through the crisis and in the immediate aftermath. However, following a stagnant share price and a fear of losing ground to competitors as the ‘fog’ of the financial crisis began to lift, in 2011 HSBC undertook a strategic review which would look at how best to improve the Group’s capital allocation and cost accountability. Consequently, the conclusions of this review would determine that generally the business was in good health but would require minor modifications - including the retrenchment and exit of some businesses along with expansion and rolling forwards of others and the re-orienting of the business towards emerging markets particularly in Asia - as means of retaining the Group’s financial strength.

As a result, we witness relatively little change in the Group’s key financial metrics which present limited divergence from pre-crisis figures. However, utilising the work of Margaret Archer (2003; 2007; 2012) on the meta-reflexives I will explore how this apparent lack of change, which upon first reading appears to be more akin to the single-loop theory, may yet present evidence of learning with the Group recognising that to deviate or move too far from the already established path could potentially place them at a strategical disadvantage. In effect the lessons learned from the crisis and subsequent review in relation to the balance sheet is that radical change in this instance was neither needed nor desired.

While it is possible to conclude that HSBC have on the whole learned lessons post-2008 it is important that we are we take account of and are sensitive to the individual nuances which make-up the business and which may explain these variations in learning. As such, there is no single or uniform answer which best explains the pace and degree to which learning has occurred at the Group. Thus, it is important that we look towards distinctions within the literature on learning on case-by-case basis to explain learning at the Group.

**Governance**

HSBC navigated the financial crisis without any serious regulatory or internal governance breaches and as such in the immediate aftermath of the crisis we witness little change with the Group continuing to operate in a business-as-usual manner. This moment of quiet contentedness may be explained by what I have referred to throughout as the ‘dissatisfaction theory’ which runs throughout the literature explored in Chapter 1 and which argues that dissatisfaction is central to the learning process, propelling individuals and organisations from stasis to learning[[86]](#footnote-86). Thus, it appears that HSBC’s successful navigation of the crisis, while endowing the Group with space needed to learn, failed to promote the necessary dissatisfaction to seek alternatives.

Despite this, a series of regulatory scandals prominently brought to light in the post-crisis era, while highlighting serious shortcomings at the Group, have proven to be valuable experiences which have spurred learning at HSBC. For instance, weaknesses in the Group’s governance framework highlighted by failures have resulted in a series of ad-hoc policy responses. While at first these policies appear to be more reactive than preventative, the prescriptions made by the Bank in answer to such breaches have nonetheless resulted in tangible outcomes and change aimed at remedying such flaws. Therefore, it may be possible to conclude that HSBC demonstrate evidence of substantive double-loop learning with those regulatory failures revealed post-2008 causing the necessary level dissatisfaction to propel the Group towards learning.

Money Laundering and Trade Sanctions

The first of these incidents which would cause HSBC to move from a static state towards the progress of learning would come in 2012 when the U.S. Senate Permanente Sub-committee on Investigations revealed that the Bank had seriously breached anti-money laundering controls which had enabled a Mexican drug cartel to launder illicit funds (Roberts and Kynaston, 2014: 656). During the ensuing criminal investigation U.S. prosecutors accused the Bank’s Mexican arm of failing to implement satisfactory anti-money laundering procedures against approximately £452 billion worth of wire transfers and £6 billion worth of currency purchases (Smythe, 2013)[[87]](#footnote-87).

During the investigation the Bank also admitted to devising and utilising methods to circumvent trade sanctions, which prevented exchanges with countries such as Iran, Cuba and Sudan, allowing potentially questionable customers to move hundreds of millions of dollars between these jurisdictions and the U.S. (Mazur, 2013)[[88]](#footnote-88). Proceedings subsequently revealed how HSBC staff had coached colleagues in Iran on how to disguise payment messages so that the nature and country of its origin could be concealed thus avoiding detection by U.S. authorities (ibid).

In 2013 the Group reached a settlement with U.S. authorities and agreed to pay a fine of £1.2 billion as part of a deferred prosecution agreement (Smythe, 2013)[[89]](#footnote-89). Addressing HSBC staff on the issue Chief executive Stuart Gulliver told colleagues that it was right that HSBC be held to account for what went wrong and that the Group would prevent further breaches by ensuring that more stringent safeguards be implemented (Blackden, 2012). In a press release HSBC further added that

We have learned a great deal working with the Subcommittee on this case history and also working with U.S. regulatory authorities, and recognize that our controls could and should have been stronger and more effective in order to spot and deal with unacceptable behaviour. We believe that this case history will provide *important lessons* [my emphasis] for the whole industry in seeking to prevent illicit actors entering the global financial system…HSBC has already taken concrete steps to augment the framework to address these issues (HSBC, 2012a).

Indeed, sentiments expressed by the Group concerning ‘important lessons’ and learning were consequently upheld as HSBC announced two extremely important and observable changes to its governance structure and which may be indicative of learning. For example, the policy learning literature suggests that learning may be present when an organisation utilises targeted policies aimed at closing the gap between ‘aspirations’ and ‘achievements’ (May, 1992).

*Firstly*, in 2012 the Board announced that it would be introducing an additional Board Committee with the establishment of the Financial Systems Vulnerabilities Committee (FSVC) (HSBC, 2012b: 302). The working remit of the FSVC is to oversee and give guidance on the Bank’s procedures and control framework pertaining to potential vulnerabilities which may leave HSBC open to exposures from financial crime, including, but not limited to, money-laundering and terrorist financing (HSBC.com (c)). In particular, the FSVC has responsibility for ensuring that current policies which deal with such issues are fit for purpose while ensuring that programmes meet all regulatory and law enforcement requirements (ibid).

At a shareholder’s meeting Group Chairman Douglas Flint told attendees that the FSVC had been formed in order to detect and prevent any future failings relating to those issues highlighted by U.S. investigations (Collinson and Neate, 2013). Meanwhile, in an interview with reporters Mr Flint added that the Committee would ensure that HSBC would continue to hold itself and staff to the ‘highest behavioural and compliance standards’ (Flint cited in Jaegar, 2013), with Stuart Gulliver, GCE, commenting that such a move would strengthen HSBC’s ability to ‘enforce the highest standards, in particular in relation to combating financial crime’ (Gulliver cited in Jaeger. 2013).

This would suggest the presence of learning with HSBC clearly recognising the problem and subsequently seeking to remedy the issue through the establishment of a specialist committee aimed at addressing not only the structure but culture of the Bank. However, this critical reflection did not simply end with the formation of the FSVC as the Committee has itself been proactive in identifying future risks and devising policies aimed at tackling vulnerabilities.

For instance, in 2014 the FSVC undertook a ‘deep-dive’ into the Bank in order to ensure that current polices were fit for purpose. The Committee subsequently identified three key areas of weakness and devised new policy initiatives aimed at addressing these strategical flaws including; developing an updated anti-money laundering policy framework, the establishment of a new Group-wide policy on dealing with sanctioned countries and enhancements to the Group’s cyber security capabilities (HSBC, 2014: 282-283).

Thus, the establishment of FSVC suggests the presence of learning at the Bank with the Committee enjoying genuine powers within the Group to the extent that they are able to shape and construct tangible policy outcomes. What-is-more, the FSVC appear to be engaged in an ongoing evaluative process which has produced targeted policies. However, while the establishment of the FSVC is a significant step in HSBC’s learning journey, this example does not necessarily represent double-loop learning. While the changes made are substantial and may in the future give rise double-loop learning, it would appear that while the institutional means have clearly changed, the ends may have remained and as such, could be reducible to of single-loop learning. Therefore, further investigation of the Group’s governance structure is required.

The *second,* major area of change in relation to the short-comings identified by U.S. authorities and which may be indicative of substantive double-loop learning would be the installation of an independent monitor at the Bank who would advise and feedback on the Group’s internal procedures and compliance with anti-money laundering controls (Rushe and Treanor, 2012). In addition, in 2013 the Bank also appointed five high profile independent experts all with backgrounds in anti-money laundering and the prevention of illicit financial flows and who would advise and feedback to the Board and FSVC on emerging threats and internal controls. The panel would consist of; Nick Fishwick - former senior official in the Foreign and Commonwealth Office in security intelligence and counterterrorism; Bill Hughes - former head of the U.K.’s Serious Organised Crime Agency; Dave Hartnett - former head of HM Revenue & Customs; Sir Jonathan Evans - former head of MI5; Stuart Levey- former Under Secretary for Terrorism and Financial Intelligence in the US Department of the Treasury and (Thompson 2013; Thompson and Kortekaas, 2013). Kathleen Casey – former Commissioner of the US Securities and Exchange Commission – would be subsequently appointed in 2014 (HSBC Online). The Group would also go on to appoint an additional 1,600 regulatory and compliance staff members (Roberts and Kynaston, 2014: 656).

While breaches in anti-money laundering procedures brought to light post-2008 represent a gross failure of internal governance, the evidence gathered above indicates that HSBC have subsequently implemented significant changes to their regulatory framework and which are directly linked to the failings in Latin America. This suggests that despite initial shortcomings following the crisis, HSBC have indeed learned lessons post-2008 with the Group closing the gap between ‘aspiration’s and ‘achievements’ in-keeping with policy learning framework. Although learning in this instance does not necessarily pertain to the financial crisis itself, wider lessons concerning the systemic abuse of the banking system for questionable financial activities, vulnerabilities surrounding banking best practices and institutional oversight and related questions concerning global financial stability may, however, be drawn from such instances.

Mis-selling and Rate-Rigging

Though HSBC appear to have taken steps towards remedying deficiencies in their anti-money laundering controls the Bank have also been plagued by a number of other regulatory and governance failures post-2008 and which may be indicative of the wider cultural vulnerabilities which infected banks in the years leading up to the crisis. While many of the incidents discussed below occurred in-part in the pre-crisis era they nonetheless came to light post-2008 and, importantly to this thesis, have caused sufficient dissatisfaction, driving learning and leading to tangible change.

In 2011, for example, following an investigation by the FSA, it was revealed that one of HSBC’s subsidiary companies, NHFA Limited, had knowingly sold investment products to elderly customers which were unsuitable due the customer’s age (Wilson, 2011). As a result of the investigation HSBC were fined £10 million and order to pay a further £29.3 million in compensation to victims who had been mis-sold the products between 2004 and 2010 (ibid). In an interview with the journalist and author Ray Perman, Mr Perman commented that that this incident was typical of the

Sales culture in banking which promotes sales over customer service, the idea is that you make money for yourself and you make for your bank rather than you deliver to the customer a product or service which is of intrinsic benefit to the customer

(Ray Perman, Interviewed 9th August 2016).

Likewise, in 2012 HSBC revealed that it would be putting aside approximately £300 million to recompense customers who had been mis-sold interest payment protection products, better known as interest rate swaps (Brinded, 2014b). While HSBC were not the only British bank to be implicated in this incident[[90]](#footnote-90), the Group did have the largest exposure of any U.K. bank with estimates suggesting that HSBC customers accounted for approximately 27 percent of victims (ibid)[[91]](#footnote-91).

Further to this, and like all the banks in this thesis, HSBC also became embroiled in the mis-selling of PPI and to date have set aside £1.7 billion in compensation for victims (Farrell, 2016). However, it is worth noting that by 2007 HSBC had stopped selling such products and were by far the least implicated of all U.K. banks in the PPI scandal (Robertson and Kynaston, 2014).

Additional turbulence relating to internal governance at HSBC would hit in 2012 when the Bank became involved in the rigging of Libor and other interest rate markets (BBC news. 2015a)[[92]](#footnote-92). Following an investigation by U.K. regulators it was revealed that HSBC employees, along with staff from several other prominent British banks, had been conspiring to manipulate Libor along with other interest rate markets between 2007 and 2011 (ibid). It was subsequently discovered that employees had been fixing rates at the request of colleagues in order to hedge markets for their own gain and receive performance related bonuses based on such actions (TheTelegraph.co.uk. 2014).

Commenting on the rate rigging scandals specifically, and post-2008 governance failures in general, GCE Stuart Gulliver said that the Bank ‘had lost its way’ and that it must ‘take concrete steps to resolve [such] issues’ (Gulliver cited in Brinded, 2012). The Group went to tell reporters that

In response to this risk, we are progressing a number of initiatives which seek to address the issues identified, including creating our new global management structure, enhancing our governance and oversight, increasing our compliance function resource, emphasising our values and designing and implementing new global standards as outlined elsewhere

(HSBC cited in Brinded, 2012).

Moreover, speaking in relation to HSBC’s catalogue of failures Chairman Douglas Flint commented that HSBC were determined to hold itself and staff to the ‘highest behavioural and compliance standards’ and would implement mechanisms which would ensure and ‘enforce the highest standards’ (Flint cited in Jaeger, 2013).

This emphasis placed on the highest behavioural and compliance standards being driven by HSBC’s two most senior agents led in 2013 and 2014, respectively, to the establishment of two additional board committees; the Conduct and Values Committee (CVC) and the Philanthropic and Community Investment Oversight Committee (PCIOC) (HSBC, 2013a: 330; HSBC, 2014; 276). And which are indicative of the Group identifying and targeting the need for structural and cultural changes.

The CVC would build upon and replace the Corporate Sustainably Committee and would be given an expanded remit which would have it supervise the design and implementation of policies and procedures which would ensure that HSBC ‘consistently adheres’ to the highest corporate and ethical values (HSBC, 2013a: 330). Moreover, the CVC is charged with ensuring that business at the Bank is conducted in a way which enhances the HSBC brand by ensuring that the Group deal ‘openly’ and ‘fairly’ with its customers, chooses the right customers to do business with and conducts that business in such a way as to not harm or cause distress to the communities in which it operates (HSBC.com. (c)).

Much like the FSVC discussed above, the CVC has not been a passive actor but has instead been proactive in their duties taking a number of practical steps which suggests evidence of substantive double-loop learning. For example, in 2014 the CVC undertook a series of ‘deep-dives’ which involved interviews with leadership teams and functional specialists, focus groups with line managers and staff and reviews of management information handling. The objective of these proceedings being to better understand what drives employee behaviour at the Group (HSBC, 2014: 287). One of the key policies resulting from the evaluations would be that from 2015 onwards the CVC would take responsibility for managing whistleblowing facilities at the Group. Specifically, the CVC would pledge to protect whistle-blowers by guaranteeing anonymity and voluntarily adopting the recommendations and standards on whistleblowing set out by the Parliamentary Commission on Banking Standards (ibid). The Committee would likewise recommend and oversee the implementation of a new and enhanced whistleblowing framework based on these recommendations.

In addition, the PCIOC was established in December 2014 and has the responsibility of overseeing HSBC’s philanthropic and community investment projects which operate in conjunction with the Group’s corporate sustainability objectives (HSBC, 2014: 276). Duties in 2015 included ensuring that the appropriate procedures surrounding the approval of charitable donations were observed.

The formation of these supplementary committees, and in particular the CVC, along with the policies which they have instigated to-date, suggests the presence of learning with the Group implementing procedures aimed at addressing both cultural and structural change at the Bank. For example, it may be argued that these committees, and the powers that they enjoy, have become important tools in fighting future abuses and ensuring the ‘highest behavioural and compliance standards’ by adding additional and specialist oversight to the Group’s overall governance structure. Moreover, while these breaches in governance detailed in this section do not necessarily relate specifically to the 2008 crisis, the Group’s ability to identify, seek out solutions and rectify areas of weakness which pose a threat to both the reputation of HSBC but also the stability of the wider financial system is clearly observable. Again, this suggests that in relation to governance following some initial complacency, linked to the Group’s successful navigation of the crisis, HSBC have demonstrated an ability and willingness to learn following post-2008 dissatisfaction and which appears to be best described by the policy learning literature with sentiments expressed by the Group being upheld by specific policy actions.

Tax Evasion

Further evidence of learning is highlighted by HSBC’s involvement in a tax evasion scheme through its Swiss subsidiary. In December 2008 HSBC I.T. expert Herve Falciani was arrested by Swiss authorities over claims that he had stolen files from the Bank with names of some of the Group’s Global Private Banking customers who it is alleged HSBC had helped to avoid and evade their tax duties (Dunkley, 2015). The data in question was subsequently passed on to French, American, Greek, British, and a host of other E.U. countries’, authorities who launched investigations into HSBC (ibid). Subsequent regulatory and criminal proceedings were then taken following allegations that the Bank had not only been complicit in helping clients to evade taxes but actively encouraged customers to do so by providing them with the necessary tools (BBC News. 2015b)[[93]](#footnote-93).

Tax expert and prominent academic Richard Brooks commented on HSBC’s activities saying that ‘I think they were a tax avoidance and tax evasion service. I think that is what they were offering,’ adding that ‘they knew full well that people come to them to dodge their tax liabilities’ (Brooks cited in Chang, 2015).

In response to the allegations and related investigations the Group released a statement saying

HSBC has implemented numerous initiatives designed to prevent its banking services being used to evade taxes or launder money. In the past, the Swiss private banking industry operated very differently to the way it does today…We have taken significant steps over the past several years to implement reforms and exit clients who did not meet strict new HSBC standards…Under the tax transparency initiative, we also enhanced both our ‘know your customer’ (KYC) procedures, including an independent validation by auditors, and our anti-money laundering (AML) procedures to ensure a more complete consideration of a new client’s source of wealth

(HSBC, 2015).

As is the case above, sentiments such as those expressed by HSBC in the wake of the Swiss private bank scandal have produced a series of practical measures which would suggest the presence of learning, in-keeping with policy learning thesis, with the Group closing the gap between aspirations and achievements. For example, in 2012 the Group’s Global Private Banking arm implemented a new ‘tax transparency policy’ which contained within it provisions for the Bank to close or refuse accounts to customers which it deemed were using or intended to use the account for the evasion or avoidance of tax (HSBC, 2015).

HSBC also reviewed all existing accounts against a series of benchmarks intended to identify tax non-compliance with those accounts deemed as having failed the new test being either closed immediately or put into special measures to close the account as soon as possible (ibid). While this de-risking exercise inadvertently swept-up and closed the accounts of a number of customers who clearly posed no risk to the bank or global financial stability, including a number of high profile charities, individuals, Mosques and even the Vatican's U.K. ambassadorial office, and which is perhaps a sign of HSBC’s overzealousness, the results of the reforms are clearly evident (Tims and Collinson, 2015).

In the Swiss Private Bank alone, for instance, the Group reduced customer accounts from 30,412 in 2007 to 10,343 in 2014 (HSBC, 2015). Likewise, in 2007 the Swiss Private Bank held assets worth approximately £80 billion, by 2014 this figure had been significantly reduced down to an estimated £45 billion, representing a reduction of almost 56 percent (HSBC, 2015). As such, these reforms have clearly resulted in tangible changes which may be indicative of learning.

Though HSBC have been plagued by a number of governance and regulatory failures, the evidence presented above suggests that learning is indeed present. Furthermore, the analysis indicates that these failures have caused dissatisfaction at the Group which has proven to be the impetus for learning. Indeed, while in the immediate aftermath of the crisis the Bank lacked the motivation to learn, which may be attributed to their successful navigation of the crisis and a sense that they had for the most part developed a governance model which was effective, it appears that ensuing failures brought to-light in the post-crisis era have acted as the touch-paper for subsequent changes in the Group’s underlying theories-in-use.

This would appear to reinforce the idea that, and in-keeping with literature reviewed in Chapter 1, a degree of dissatisfaction is needed in the learning process. While the lessons learned in relation to governance may not be directly linked to nuanced events which precipitated the 2008 crisis the Group may be said to have learned wider lessons pertaining to financial stability and the sound functioning of global financial markets as a result of the events discussed in this section.

**Remuneration**

The story of learning in relation to remuneration at HSBC is somewhat mixed with no clear pattern. On the one hand, the Group have indeed demonstrated evidence of learning and change with a number of endogenously originated policies since the crisis aligning employee remuneration to the creation of long-term shareholder value. Conversely, the Group have frequently clashed with shareholders over pay issues and have openly objected to and derided regulatory stipulations aimed at tempering remuneration, although ultimately complying with the letter, if not the spirit, of the law.

One factor which may explain why HSBC’s position on remuneration is rather complicated is the fact that while the Group recognise the need for reform, as evidenced through positive endogenous changes, they are also fearful of losing ground to rivals, namely their ability to attract and retain talent. The literature on structure/agency and in particular competitive pressures which are inherent to the structures within which banks continue to operate, as discussed in the Introduction to this thesis, will be used to broaden our understand of learning at HSBC in relation to remuneration.

Like many of the other banks in the study, in 2008 remuneration at HSBC was divided along four distinct lines: salary, annual bonus (AB), long-term incentive plan (LTIP) and other benefits (HSBC, 2008: 316). As with previous chapters the focus of our analysis will be centred upon variable remuneration, in the case HSBC that is the Annual Bonus and Long-Term Incentive Plan.

Annual Bonus

In 2008 the annual incentive, known simply as the Annual Bonus (AB), carried a maximum potential award of up to 400 percent of salary (HSBC, 2008: 316). At least 40 percent of the AB would be deferred into shares with the remaining 60 percent being paid in cash (HSBC, 2007: 323). In 2009 the Group would make minor changes to the AB announcing that from 2010 onwards all share awards would be subject to a 100 percent clawback stipulation (HSBC, 2009: 335).

Aside from this slight change, which would appear to be in-keeping with the single-loop theory, the AB would then remain broadly unchanged until 2014 when the award would undergo restructuring in light of new regulatory standards, namely CRD IV. For example, under the new remuneration structure the maximum award of the AB would be worth up to 67 percent of base salary[[94]](#footnote-94) and would be payable in both cash and shares (HSBC, 2014: 303). Furthermore, any cash bonuses would be limited to 50 percent of total awards with the remaining 50 percent being payable in shares (ibid)[[95]](#footnote-95). Likewise under the Group’s 2014 remuneration code at least 60 percent of the AB, both cash and shares, would be deferred and subject to a vesting period of three years in line with CRD IV requirements (HSBC, 2014: 303).

Although we can see that under the 2014 remuneration framework the AB has undoubtedly undergone significant restructuring, we must also consider the effect which structural factors, namely tougher regulatory requirements, has had on the Group’s decision to implement changes. For example, in his 2013 annual shareholder address Simon Robertson, Chairman of the Group Remuneration Committee, noted that

The main drivers of change in remuneration policy and practice within the financial services industry are the new regulations under CRD IV… This situation has necessitated a review of our remuneration policy

(Robertson in HSBC, 2013: 378).

Similarly, the Remuneration Committee’s 2014 shareholder statement also addressed regulatory reform, specifically CRD IV, and the extent to which these changes were influencing Group decisions on remuneration stating that

The consequential changes to…remuneration rules…have influenced how we pay our senior executives and those of our employees identified by the PRA as having a material impact on the institution’s risk profile

(HSBC, 2014: 300).

The Committee went on to add that

The number and volume of regulatory changes that have been and are being proposed in connection with remuneration are, in the Committee’s view, excessive…Regulatory uncertainty and complexity is contributing to a general misunderstanding about how our remuneration polices work and the impact of those policies on employee performance

(HSBC, 2014: 302).

This would suggest that while the maximum potential of the AB has been significantly reduced, along with limiting the use of cash bonuses and the inclusion of retention periods on awards, these changes appear to have come in-light of and in reaction to exogenous regulatory changes and as such cannot be considered learning as in keeping with the theme of this thesis. Moreover, sentiments such as those expressed by the Remuneration Committee are indicative that HSBC have been uncomfortable with the role which regulators have played in the reshaping of remuneration labelling changes as ‘excessive’. Again, this may also be symptomatic of the absence of learning in regards to the relationship between the Bank and regulators because, as already discussed in Chapter 2, resistance to regulatory change and an increasing willingness to ‘roll-back’ supervisory frontiers were one of the causes of the 2008 financial crisis with unheeded regulatory expertise proving costly for both the banks and wider financial system.

The evidenced presented here appears to present a rather one-sided argument, namely that the Group have failed to learn lessons. However, the second feature of HSBC’s variable remuneration, the long-term incentive plan, may yet prove the hypothesis extended in this section correct with the LTIP suggesting a rather complex and nuanced picture of remuneration and learning at the Group.

LTIP

In 2008 the LTIP was worth a potential maximum of up to seven-times base salary (HSBC, 2008: 318). In 2011 HSBC reviewed its remuneration strategy and revised the maximum potential of the award downwards to that of six-times annual salary (HSBC, 2011: 259). The maximum award would then remain so until 2014 when the Group once again restructured their remuneration in light of the introduction of new regulatory stipulations, namely the European Parliament’s CRD IV Article 90(1)(ca) and (d). Under the 2014 structure the LTIP would be reduced to a maximum of 133 percent of salary, this being 2/3 of the maximum opportunity of 200 percent of fixed pay allowed under CRD IV (HSBC, 2014: 303).

Like the AB, discussed above, these changes would suggest that in the wake of the financial crisis 2008 modifications made to the long-term element of variable remuneration have undergone only the slightest change with more radical shifts occurring in-light of exogenous structural factors. As such, changes made to the maximum award available under the LTIP cannot be considered learning due to their apparent external nature. However, before we can conclude that learning in relation to the LTIP is absent we must consider how the long-term incentive has been calculated post-2008 and which may yet demonstrate evidence of learning.

In 2008 the LTIP was calculated using three key metrics namely; total shareholder return (40 percent); economic profit (40 percent); and growth in earnings per share (20 percent) (HSBC, 2008: 318). Thus, we can see that in 2008 the calculation of the LTIP was based solely on financial measures. However, in 2010 the group announced that from 2011 onwards the LTIP would also include a series of non-financial measures accounting for 30 percent of total award and which according to the Group would be introduced as a means to ‘incentivise senior executives to deliver sustainable long-term business performance’ (HSBC, 2011: 256). This structure would remain broadly in-line until 2013 when it was determined that from 2014 onwards a total of 40 percent of the LTIP’s weighting should be directed towards non-financial measures with the remaining 60 percent being determinable by financial metrics (HSBC, 2014: 314).

From this we can see that following the financial crisis HSBC have introduced a series of non-financial measures into the LTIP award which were absent pre-2008. Moreover, the inclusion of these metrics would appear to suggest the presence of learning with the Group shifting how awards are calculated away from purely economic measures, which may have encouraged short-term risk taking pre-crisis, towards a more sustainable model which places greater emphasis upon the means and manner in which results are delivered. Indeed, commenting on the changes delivered in 2014 the Remuneration Committee noted

Performance should be judged not only on what is achieved over the short and long-term but also, importantly, on how it is achieved, as we believe the latter contributes to the long-term sustainability of the business

(HSBC, 2014: 300).

Likewise, further evidence of learning may be present when we consider how awards are paid under the LTIP. For example, in 2008 bonuses linked to the LTIP were received in the form of performance shares measured over a three year vesting period (HSBC, 2008: 318-319). However, as part of the restructuring of the LTIP in 2011 the Group determined that it would continue to make awards in shares but following the three year vesting period[[96]](#footnote-96) recipients would be required to hold any awards until retirement (HSBC, 2011: 256). HSBC claimed that such a policy would ‘thereby enhanc[e] the alignment of interest between the senior executives of the Group and shareholders’ (HSBC, 2011: 256). In 2014, the Group announced that the vesting period for awards made under the LTIP would increase to five years, in keeping with requirements set-out by CRD IV (PwC, 2015), but, importantly, would retain the condition that vested awards should be held until retirement (HSBC, 2014: 303). Commenting on the decision to retain this rather important feature of the LTIP award the Remuneration Committee noted that this facet of the award would

incentivise sustainable long-term performance through the use of pre-grant performance measures and aligns with shareholder interests by requiring shares to be held for the duration of employment

(HSBC, 2013a: 383).

This indicates that while the maximum potential for awards made under the LTIP saw only a minimal decrease before tougher regulatory legislation was introduced in 2014, awards are now effectively ‘locked away’ for much longer periods of time, in this case until retirement, which in most circumstances will far exceed the five year regulatory minimum requirement, and is far greater than the voluntary holding period instigated by any of the other banks in this study. Thus, HSBC have directly tied shareholder value creation and the long-term sustainability of the Group to employee remuneration thereby minimising the short-term high risk/high reward culture which pervaded the banking industry pre-crisis.

General

The measures discussed above clearly demonstrate an alignment between the long-term sustainability of the Group and employee remuneration and which may imply learning. However, further empirical analysis of the evidence once again presents a rather conflicting story. For example, complacency towards the role played by shareholders along with structural competitive pressures over the Group’s ability to recruit and retain the best banking talent may explain why despite some positive steps there is no clear picture of learning at the Group which remains a complex story.

The literature on single and double-loop learning reviewed in Chapter 1 tells us that learning is most likely to occur following a thorough and robust examination of one’s underlying theories-in-use. Central to this evaluative process is engagement with certain institutional investors, for instance shareholders and regulators. However, post-2008 HSBC have frequently clashed with shareholders over the Group’s remuneration practices with often heated exchanges taking place between investors and the management team as the Group continue to make exuberant bonus payments.

Although in 2008 some of HSBC’s most senior executives chose not to receive their bonus, the 2008 AGM saw a lively and often fractious exchange between shareholders and the Board over issues relating to remuneration (Roberts and Kynaston, 2015: 636). Outrage was caused when the Remuneration Committee put forwards proposals to award the Bank’s top six executives a total of £120 million of bonuses over a three period (Wray and Weardon, 2008). In a heated exchange between shareholders and the Board, dissenting shareholders questioned the Bank’s decision to award such huge bonuses considering both the current global economic situation and the Bank’s own poor performance which included a drop in share price and huge write-downs connected to the Group’s exposure to the U.S. subprime crisis (ibid). While the motion ultimately passed, 18 percent of the votes cast were either in opposition to the resolution or abstentions. A further vote which would ultimately lead to provisions for larger future bonuses would similarly receive a 15 percent rate of either abstentions or votes against the motion (Wray and Weardon, 2008).

Likewise, at the 2010 AGM shareholders would again come in to conflict with the Board over announced remuneration plans with 23 percent of shareholders voting either against new proposals or abstaining from the vote (Kollewe and Treanor, 2010). Similarly, at the 2011 AGM one-fifth of investors rejected the Board’s recommendations on pay despite a nine month long negotiation between John Thornton, Chairman of the Remuneration Committee, and major institutional investors (Treanor, 2011c). Then, in 2013 HSBC suffered yet another shareholder rebellion, albeit a much smaller one, when 11 percent of shareholders rejected the Remuneration Committee’s Report and recommendations (Neate, 2013).

Further shareholder unrest relating to remuneration hit HSBC again in 2014 as one-in-five voted against proposed changes to the way in which employees were remunerated despite the fact one week earlier the Bank had backed down over plans to pay Group Chairman Douglas Flint a share bonus of £2.25 million, later revising this figure down to £1 million (Arnold, 2014a). Notwithstanding, shareholders were keen to voice their concerns that the Bank’s introduction of new ‘fixed pay allowances’ in response to CRD IV were favouring targets based on the current year’s performance rather than the long-term[[97]](#footnote-97). Likewise, investors accused the Group of using so-called role-based pay allowances to ‘effectively sidestep’ the bonus cap by making such payments unfixed and sensitive to the overall bonus pool, something which the Group would deny (Arnold, 2014a)[[98]](#footnote-98).

This would suggest that despite mounting pressure from shareholders and regulators, HSBC continue to place variable pay at the core of their remuneration packages, clashing with shareholders and allegedly devising new ways to avoid regulatory constraints. This failure to positively engage with important actors and effectively subordinate the input of institutional investors, namely shareholders and regulators, may be indicative of a failure to learn. Indeed, Ray Perman has questioned the very nature of the bonus culture in general noting that

I don’t think that if you matched the sort of very high salaries they are paid now with the performance of the banks over the past decade you would conclude that very high salaries and high incentive bonuses have necessarily improve[d] the perform of the bank…it would be very difficult to sustain an argument that the high level of remuneration is important for the good management of banks

(Ray Perman. Interviewed 9th August 2016).

This failure to learn and address the issue of remuneration may well be explained by structural competitive pressures as the Group who, fearful of losing ground to competitors, feel the need to defend their agency to determine their own remuneration practices.

What is more, the Group’s strategical positioning post-2008[[99]](#footnote-99) may have exacerbated structural pressures by exposing HSBC to additional competition over the recruitment of talent. For example, it has been hypothesised elsewhere in this thesis[[100]](#footnote-100) that structural competitive pressures have been most acutely felt by those banks that have maintained or increased their international exposure post-2008. Following the crisis, and as part of the Group’s Strategical Review in 2011, HSBC announced a ‘pivot into Asia’ which would see the Group maintain its large international exposure by reorienting some areas of business on emerging markets in South East Asia. With this move the Group have undoubtedly come into greater competition with rival institutions which are not subject to the same domestic and European regulatory stipulations and which may explain why the Group have been more sensitive to pressures over pay.

For example, following the clash with shareholder at the 2011 AGM Chairman Douglas Flint, told those in attendance that

Our best people are highly marketable…It would be irresponsible to allow our comparative advantages to wither by ignoring the market forces that exist around compensation, even though we understand how sensitive this subject is

(Flint cited in Treanor, 2011c).

However, such sentiments have been challenged by the author Ian Fraser who has commented that that

There’s this canard that you can only get talent if you pay huge bonuses…the reason I say it’s a canard is that one of the best managed banks in the world, which is Handelsbanken, doesn’t pay any bonuses not any member of staff let alone the chief executive or treasury desk nobody…there’s this sense of entitlement that banker [sic] have, they bullied their management into thinking the whole thing’s going to hell in a handcart unless they receive these bonuses

(Ian Fraser. Interviewed 10th August 2016).

Mr Flint’s remarks pertaining to the pressure of competitive pay structures were then further echoed in 2013 when the Chairman told reporters that ‘we have to be competitive’ and that new European legislation on performance related pay ‘could have a highly damaging impact on our competitive position’ adding that ‘we will comply with the law, but will we be able to make ourselves competitive’ (Flint cited in Aldrick, 2013). Sentiments of this kind were again reiterated by the Chairman of the Remuneration Committee, Sir Simon Robertson, who commented that

changes in the rules on remuneration and the application of a cap on variable pay…presents significant challenges for the HSBC Group…most of our international peers and domestic competitors do not have to comply with similar restrictions. This situation has necessitated a review of our remuneration to ensure that HSBC can remain competitive

(Robertson in HSBC, 2013: 378).

Furthermore, addressing CRD IV specifically and HSBC’s ability to compete for talent, Sir Simon commented that the E.U. Directive would

present challenges for HSBC in ensuring that the total compensation package for our employees in all of the markets in which we operate remains competitive, in particular, relative to other banks not subject to these requirements… HSBC must continue to retain and attract talent in key non-EU markets where our international peers and their domestic competitors do not have to comply with the CRD IV pay cap

(Robertson in HSBC, 2014: 300-301).

Again, in 2015 the newly appointed Chairman of the Remuneration Committee, Sam Laidlaw, addressed the issue of regulation and HSBC’s international presence, this time in relation to new rules due to be implemented by the Prudential Regulation Authority, stating that

The new PRA Remuneration Rules are more stringent than the rules in force in the EU, US and Asia-Pacific, making it challenging for UK banks to attract talent with transferable skills or from other industries. We believe more regulator co-ordination is required to ensure there are globally consistent remuneration standards and a level playing…There is still a wide divergence in local regulations governing remuneration structures globally. This presents significant challenges to HSBC

(Laidlaw, 2015: 287-288).

Indeed, in a research interview with a prominent British banker these sentiments were similarly shared with Participant A, when asked if they thought losing talent to rival institutions was real, they commented

Absolutely! There’s always a push to keep your best talent and fear of losing them. So I think yeah, that is a genuine thing. I think I am more valuable now than I was before the financial crisis, if you kept your nose clean and met your numbers you are definitely more sought after now so yeah. I could easily go to another bank and say give me a job and they would and this actually happened with a colleague of mine, he was another good lad, kept his nose clean and was pretty bombproof and one day he decides he wants to go work for [omitted on Interviewee’s request] and they gave him a job just like that. If you’re a good performer there are always opportunities to move around

(Participant A. Interviewed 2nd February 2017).

These statements made by the HSBC’s executive team, and echoed by my interview participant, demonstrate that, much like Barclays discussed previously, structural competitive pressures have been a key determinant of the kind of awards utilised, despite the orthodoxy of this view being challenged by Ian Fraser, and as such may explain why learning at the Group has not gone further. While all banks in this study have expressed some concerns over their competitive position HSBC, along with Barclays, appear to be particularly vocal concerning the issue. This can be best explained by HSBC’s large international exposure and particular its pivot into Asia (Arnold, 2015d) which has seen the Group maintain its international exposure which in-turn has brought it into contact with other institutions who are not held to the same regulatory regime, as demonstrated by sentiments expressed by those at the most senior level.

While the structure/agency literature notes that agents are capable of overcoming structures it appears that in this instance HSBC and situational agents within the Bank, much like their counterparts at Barclays, have been unable to overcome structural pressures with the cost of learning, in this case the Group’s ability to retain and attract talent, being interpreted as too high. However, the perceived diminishing power of the Group to compete for talent with international rivals may have some credence when we consider a study by the *Financial Times* which revealed that of the top five highest paid bank CEOs in 2014 only one of those came from a European headquartered bank (Financial Times, 2014). Moreover, in a similar study Mike Krantz (2016) of USA Today revealed that of the top ten highest paid bankers of 2015 none were from European or U.K. headquartered banks.

As we can see the story of remuneration at HSBC is rather mixed. While it is clear that in some areas lesson have been learned, in others learning remains absent. As such, the empirical analysis of remuneration practices at HSBC suggest that learning at the Bank is somewhat conflated and must take account a number of competing factors, most notably structural pressures which are clearly important in the learning process.

**Balance Sheet**

This section of the Chapter will consider the balance sheet element of the Bank. The analysis below will reveal that HSBC’s successful navigation of the crisis appears to have validated the Bank’s overall business strategy. As such, we witness little change in the structure and composition of the balance sheet in the years which immediately followed the crisis.

In 2008 Stephen Green, former HSBC Chairman, pointed out that while the bank had not been immune from the crisis, they had to a large extent avoided the most devastating effects due to the Group’s robust balance sheet and funding structure. The, Chairman noted that

we have built our business on very strong foundations…which demonstrate our ability to withstand the storm…our strategy has been tested and remains intact…If anything, the current crisis validates our renewed focus over the last few years...Our strategy has served HSBC well and positions it for long-term growth with attractive returns

(Lord Green in HSBC, 2008: 8-11).

Likewise, in 2010 incoming Chairman, DJ Flint, expressed similar sentiments commenting that HSBC had a certain ‘continued success [in] many of the markets in which [they] operate’ (Flint in HSBC, 2010: 4-6). The new Chairman again emphasised that HSBC’s strategic position meant that it had ‘neither sought nor received support from any government’ (ibid). Meanwhile, Group Chief Executive Stuart Gulliver noted that ‘shareholders [would] continue to benefit from HSBC’s universal banking model’ and that ‘conservative management of the balance sheet’ had meant that the Group had ‘remained strongly profitable’, stressing that ‘HSBC’s financial performance [had] not been materially affected by events to date’ (Gulliver in HSBC, 2010: 7-9).

Yet, in 2010, as markets began to return to a degree of normalcy, the Group announced that it would be undertaking a review which would consider the Bank’s strategic direction specifically in relation to the balance sheet. The Review was motivated by a stalling share price and an acute awareness of being overtaken by ‘more agile competitors’ (HSBC, 2011b: 1), which appear to have caused sufficient dissatisfaction to propel the Group towards learning. The result of the 2011 Strategic Review would not announce any radical shifts or alterations in the way in which HSBC did business, but, concluded that the Group ought to roughly maintain its overall financial and economic exposures in many key markets and businesses.

Instead, the Group would simply look to reposition itself in order to capture the ‘flow between the developed world and emerging markets’ by establishing a ‘credible presence’ in both regions (HSBC, 2011b: 2-3). In particular, the Review announced a ‘pivot into Asia’ citing strong macro-economic indicators which suggested that South East Asia and specifically China would become ‘the most important region for HSBC’ over the next thirty years (ibid. p9). While this reorientation would inevitably result in the retrenching and disposal of some areas of the business[[101]](#footnote-101), and the expansion of others. The Group maintained that it would preserve its positon on a capital, liquidity and a diversified funding and customer base stating that ‘we are not going to change that’ (HSBC, 2011b: 4).

As such, the key financial metrics, which we have used throughout this thesis, have undergone very little change between 2008 and 2015 with this lack of divergence being even more pronounced when we compare the years 2011, the year of the Strategic Review, and 2015. Importantly however, I will argue that the narrowness of this change should not be considered as a failure to learn, with evidence, when considered in-light of the literature on meta-reflexives, suggesting that learning may indeed be present despite the absence of substantial or radical reform.

This hypothesis is in-keeping with the literature reviewed in Chapter 1 which suggests that a learning organisation, following a deliberative internal process, may conclude that it is of a greater benefit to not undergo dramatic change due to structural circumstances. Indeed, the ‘situational logic of opportunity’ put forwards by Archer (2007; 2012) proposes that learning may indeed be present within an institution, despite the absence of substantive change, when the learning agent determines that change is either unnecessary, harmful or of little benefit (Archer, 2012: 207).

Group Funding

In 2008 total liabilities and equity at the Group were worth approximately £1.7 trillion with total customer deposits being £753 billion or 44 percent of total Group funding. In 2015, liabilities and equity had marginally decreased to £1.6 trillion with total customer deposits having increased slightly to £871 billion or 53 percent of total Group funding[[102]](#footnote-102).

Figure 7.1. Customer deposits as percentage of total group liabilities and equity 2008-2015.

Likewise, in 2008 short-term funding, inclusive of short-term borrowings; money market funds and other deposits were worth approximately £82 billion or 4.8 percent of Group liabilities and equity. In 2015, short-term funding at the Group was £39 billion which accounted for just 2.4 percent of total Group funding, in 2011 this had been 3.7 percent.

Figure 7.2. Short-term funding as percentage of total group liabilities and equity 2008-2015.

From these figures we can see that in the seven years following the crisis HSBC have increased customer deposits significantly and which were already clearly high. While this does not necessarily fit with hypothesis extended in this section of the Chapter it does nonetheless demonstrate evidence of learning. However, the data presented above does show that in relation to short-term funding the Group have broadly maintained exposures, which were relatively modest to begin with[[103]](#footnote-103), with Figure 7.2. showing a marginal decrease of 2.4 percentage points between 2008 and 2015.

Moreover, as part of the 2011 Strategic Review HSBC announced that they were committed to their prudence on short-term funding, which they identified as being a key cause of the crisis, telling investors that ‘if you’re reliant on the wholesale market, you’re reliant on a…shift that can take place very, very quickly’ (HSBC, 2011b: 4). While we can see that in relation to short-term funding HSBC have reduced their reliance on wholesale markets, this decrease has been relatively modest and does not represent a significant or radical shift from the pre-established path. As such, this may be in-keeping with meta-reflexives thesis extended in this section. Likewise, one of the conclusions which we can draw from our chosen banks in this thesis is that institutions appear to have learned in relation to funding with our entire comparator group decreasing short-term funding and increasing customer deposits post-2008[[104]](#footnote-104).

Regulatory Capital

In 2008[[105]](#footnote-105) HSBC held Regulatory Tier 1 Capital of £64 billion which equated to a Regulatory Tier 1 Capital Ratio of 8.3 percent. In 2015, the Group’s Regulatory Tier 1 Capital was £103 billion and carried a Tier 1 Regulatory Capital Ratio of 13.9 percent. Thus, we can see that HSBC are currently holding a Tier 1 Regulatory Capital Ratio which is in excess of regulatory standards demanded by Basel III by 131 percent. Likewise, in 2008 the Group’s Total Regulatory Capital was approximately £88 billion with a Total Regulatory Capital Ratio of 11.4 percent. In 2015 Total Regulatory Capital was £128 billion with a Total Regulatory Capital Ratio of £17.2 percent. Again, here we can see that HSBC are currently operating with a Total Regulatory Capital Ratio which is 115 percent higher than minimum regulatory standards. However, HSBC are being outperformed by all the banks in this study on this metric alone[[106]](#footnote-106). Indeed, these figures show us that one of the key changes which appear to have been identified by all the banks in our study is the desire to carry regulatory capital which is in excess of regulatory minimum standards, with all the banks in our comparator Group holding above minimum reserves.

Trading Liabilities

Data collated on trading liabilities as a percentage of total Group liabilities and equity shows that in 2008 HSBC had trading liabilities worth £167 billion or 9.7 percent of total assets. In comparison, figures for 2015 show that trading liabilities were worth £95 billion or 5.8 percent. As such, we can see that over the course of the seven year period following the crisis trading liabilities as a percentage of total group funding have fallen by 3.9 percentage points. While detractors may argue that this decrease may fall outside of the hypothesis extended here, these figures do nonetheless suggest the presence of learning with the Group incrementally strengthening the balance sheet and reducing the trading liabilities to total group liabilities and equity ratio.

Figure 7.3. Trading liabilities as percentage of total Group liabilities and equity 2008-2015.

Moreover, the data shows that, much like customer deposits, in 2008 trading liabilities as a percentage of total group assets formed a relatively conservative part of the Group’s balance sheet. While these figures do not rival the prudence of Lloyds or RBS, HSBC are outperforming the only other bank in this study to not receive a state sponsored bailout, Barclays, who are currently operating with trading liabilities of 6.6 percent.

Loan/Deposit Ratio

However, figures pertaining to loan/deposit ratio at the Bank may yet support the hypothesis extended so far. For example, in 2008 gross loans totalled £646 billion which accounted for approximately 69 percent of total liabilities and equity. In contrast, figures for 2015 show a modest decrease in gross loans as a percentage of total group funding at £631 billion or 62 percent of total funding, representing a decline of 7 percentage points. Yet, if we consider data for 2011 we can see that this decrease is reduced to a marginal 3 percentage points.

Figure 7.4. Gross loans as percentage of total deposits 2008-2015.

Again, in the 2011 Strategic Review, HSBC clearly states its intention to preserve the loan/deposit ratio telling investors that ‘we continue to have a substantial surplus of deposits over loans and that will remain the case’ (HSBC, 2011b: 4). Moreover, in contrast with our comparator Group we can see that HSBC have by far the most conservative loan/deposit ratio at 62 percent outperforming RBS (76 percent); Barclays (86 percent) and Lloyds (90 percent).

While gross loans as percentage of total deposits have witnessed a small reduction at the Group post-2008, the value of loans being extended towards residential mortgages, which as we know are a much safer loan, has also increased. For example, in 2008 residential mortgages at the Bank were worth £164 billion or approximately 25 percent of gross loans. In 2015, residential mortgage loans were worth £185 billion or 29 percent of gross loans and show a small increase of 4 percentage points. However, once again if we contrast figures for 2015 with those of 2011 we can that the Group have maintained their level of exposure on this metric.

Figure 7.5. Residential mortgage loans as percentage of gross loans 2008-2015.

While the data above demonstrates some movement following the crisis we can see from Figures 7.4. and 7.5. that these shifts are far from radical, particularly if we contrast data for 2015 with that of 2011. As such, these figures do not suggest sweeping reform but rather incremental positive changes to the already existing underlying theories-in-use. As a result, it may be the case that the Bank have, following a reflexive process, learned that radical change is not necessary in relation to these facets of the balance sheet and which may be indicative of learning in keeping with meta-reflexives hypothesis.

Loan Quality/Impairments

Given the shift towards increased residential mortgage lending it is unsurprising that we find that the number of impairments at the Group has also decreased. Figures for 2008 show that total impaired loans were worth approximately £17 billion or 2.6 percent of gross loans. Meanwhile, data for the year 2015 demonstrates that total impaired loans were equivalent to 2.5 percent of gross loans extended being worth £16 billion. While these figures only show the smallest reduction in the percentage value of impaired loans post-crisis we must note that HSBC had the lowest number of impairments of any of the banks in this study in 2008 and that figures for 2015 show that they had the second lowest number of impaired loans as a percentage of gross loans behind Lloyds at 2.1 percent.

Figure 7.6. Impaired loans as percentage of gross loans 2008-2015.

These figures would appear to support the hypothesis extended in this section of the Chapter, that learning is present despite the absence of substantive change. Indeed, the literature on meta-reflexives may suggest that HSBC have learned but that the lesson learned in this example is that it would be of greater benefit to the Group to not deviate too far from those underlying theories-in-use which served them so-well in the wake of the crisis.

Return on Equity and Earnings Per Share

Figures collected from the database Bankscope demonstrate that in 2008 HSBC had a ROE of 5.52 percent. Between 2004-2007 the average ROE had been 15.3 percent. In 2015 this figure was 7.6 percent. While these numbers show that ROE at the Group has risen following the crisis, evidence of learning in keeping with hypothesis may still be present. For example, the 2011 Strategic Review would set a targeted ROE of 12-15 percent[[107]](#footnote-107) despite a small group of institutional investors ‘that thinks 12 to 15 is too low’ (HSBC, 2011b: 4). In response, HSBC remained steadfast and insisted that a targeted ROE of 12-15 percent was prudent.

This appears to suggest that HSBC remain committed to delivering those kind of conservative ROE figures which served them so-well in the years leading up to the crisis and have resisted pressure from institutional investors to deliver targets which are incommensurate with the Bank’s own objectives. This may be indicative of learning in keeping with met-reflexives as once again the Group continue to target operations which are broadly in-line with pre-crisis measures.

As we would expect, given reduced ROEs, earnings per share (EPS) have also fallen following the crisis. Again, in the four year period from 2004-2007 average EPS was 0.77p. However, from 2008-2015 average EPS had dropped to 0.48p.

Profits and Share Price Valuations

Unlike their competitors at RBS and Lloyds, HSBC, along with Barclays, were able to maintain a pre-tax profit in every year following the financial crisis[[108]](#footnote-108). Indeed, even amongst the turmoil of 2008 and 2009 when global markets were still in fluctuation, HSBC recorded pre-tax profits of £6.2 billion and £4.7 billion respectively. While pre-tax profits have decreased from the £16.3 billion recorded in 2007, in 2015 the Group did return a pre-tax profit of £12.7 billion with the average pre-tax profits for the period 2008 to 2015 being £11.6 billion.

However, despite the Group consistently returning profits in each year following the crisis, HSBC stock has ultimately suffered a decline from a yearly average of 800p in 2008[[109]](#footnote-109), hitting a high of 901p in September of that year, to 564p in 2015, with a year high of just 648p in April 2015. In 2013 the Group recoded its most successful yearly stock valuation post-crisis at 698p with a year high of 748p in July of that year.

From these figures we can see that HSBC stock has fallen by approximately 29 percent between 2008 and 2015. In comparison, Barclays, who similarly did not require a state sponsored bailout, have suffered a 25.8 percent decline, RBS have suffered a 92 percent decrease, while the value of Lloyds’ stock has made the greatest recovery currently down just 2 percent since the Group’s inception.

Derivatives

We can see that in 2008 derivatives at HSBC were worth £329 billion, or as proportion of total Group liabilities and equity, 19 percent. In 2009 this figure reduced significantly to 10 percent of total assets where it has broadly remained for the past seven years. In 2015 derivatives were worth £189 billion or approximately 11 percent of total liabilities and equity. Figures for our comparator Group demonstrate that HSBC have the second lowest proportion of derivatives held on their balance sheet behind Lloyds (3.6 percent) but are significantly outperforming both RBS (30 percent) and Barclays (29 percent).

Figure 7.7. Derivatives as percentage of total group liabilities and equity 2008-2015.

These figures are indicative of learning in accordance with the meta-reflexives tradition with the Group, following a substantial decrease between 2008 and 2009, broadly maintaining their exposure across the seven year period following the crisis. Moreover, in the 2011 Strategic Review Stuart Gulliver, Group CEO, noted that HSBC was not a bank that had ‘made all of its money in structured derivatives’ and that the Group would concentrate on growing its commercial business which was the ‘heartland of HSBC’ (HSBC, 201b: 2). This would suggest that following the Strategic Review HSBC had little desire to increase its exposure to derivatives contracts and has instead sought growth in other areas which may be considered safer, with the numbers presented in figure 7.7. appearing to support such an assertion.

Off-Balance Sheet Vehicles

Yet, when we consider the use of off-balance sheet vehicles (OBSV) by the Group we witness a break with the hypothesis extended so far, insomuch as we can clearly observe a marked increase. For example, the data presented in Figure 7.8. demonstrates that in 2008 OBSV were worth £470 billion or 27 percent of total Group liabilities and equity. Between 2008 and 2013 the data shows very little fluctuation. However, in 2014 this figure grew to 30 percent and then again in 2015 to 33 percent with OBSV being worth £539 billion.

Figure 7.8. Off-Balance sheet vehicles as percentage of group liabilities and equity 2008-2015.

While these figures show a great deal of convergence between 2008 and 2013, subsequent rises in 2014 and 2015 demonstrate an overall increase in the use of OBSV by 6 percentage points since the crisis and 5 percentage points since 2011 and stresses the need to exercise caution in drawing conclusions in relation to the argument presented thus far. Despite this marginal rise however, I am confident that the data does not undermine the hypothesis extended in this section of the Chapter. However, we should note that HSBC have the highest exposure to OBSV of any of our comparator Group, with RBS (18 percent), Lloyds (14 percent) and Barclays (27 percent) all outperforming the Bank.

This break with the section hypothesis may suggest that while, on the whole, the balance sheet element presents evidence of learning, this learning has only manifest itself in relation to certain aspects of the business and would certainly fit with the wider Chapter hypothesis that the Group have learned different lessons in relation to different aspects of the business with learning taking place at disparate speeds.

Investment Bank

Unlike some of their peers in this study, such as Barclays, we know that HSBC’s investment bank accounted for a much smaller proportion of the overall business and played a less significant role in profit generation. For example, in 2008 the investment bank managed assets worth £627 billion and made a pre-tax profit of £2.3 billion, contributing approximately 37 percent to overall Group pre-tax profits[[110]](#footnote-110). By 2015 this figure had risen marginally, with the investment bank recording pre-tax profits of £5.3 billion and which accounted for 41 percent of overall Group pre-tax profits.

Despite the investment bank being a steady and reliable source of income for the Group and establishing itself as a market leader after having advised and managed several high profile mergers and acquisitions (Arnold and Noonan, 2016)[[111]](#footnote-111), in June 2015 HSBC announced that it would be shrinking its investment banking operations and thereby instigating a key change within the Group[[112]](#footnote-112). The decision to shrink the division in the face of its success may be further indicative of learning at the Group, namely, addressing the issue of high volume financial trading that came to dominant investing banking pre-2008 and would become a precursor to the crisis.

Indeed, commenting on the Group’s decision to trim back the investment bank GCE Stuart Gulliver noted that ‘HSBC has an unrivalled global position… with strong funding and a low risk profile; and strong internal capital generation’ and that shrinking the investment bank, which had organically grown over the years, would reaffirm HSBC’s commitment to a more prudent and ‘holistic’ banking model (Gulliver cited in HSBC 2015b). The Group further commented that the

new structure will deliver the best outcome for our clients by bringing our country, sector and product teams closer together—and improve returns for our shareholders by improving our profitability and generating efficiencies

(HSBC cited in Patrick, 2016).

The evidence examined above suggests that despite HSBC having a relatively stable and robust balance sheet circa 2008 the Group have overwhelmingly presented evidence of learning. Moreover, this learning has, for the most part, been in-keeping with the meta-reflexives thesis with current indicators at the Group demonstrating a great deal of convergence with the pre-existing underlying theories-in-use, particularly evident from 2011 onwards. As such, it may be possible to conclude that HSBC have indeed learned lessons from the crisis but that the key lesson learned here is that sweeping reform in this instance were undesirable and that the Group should not stray too far from the overall strategical and economic direction which had served the Group so well previously. Moreover, sentiments of this kind have similarly been shared by journalists and academics alike with Damian Reece of the *Daily Telegraph* observing in 2011 that in the wake of the crisis HSBC announced no ‘grandiose plans’ but simply remained intent on ‘making HSBC do what it does best, better’ (Reece, 2011). Likewise, Professor John Kay, writing in the *Financial Times*, noted that post-2008 HSBC had returned to ‘boring banking’ which served it so well in the years preceding the crisis with any exotic activities quickly being ‘hived off’ post-2008 (Kay, 2015).

**Conclusion**

The analysis carried out in this Chapter of the thesis suggests that on the whole HSBC have indeed learned lessons from 2008 financial crisis. However, the examination proposes that different lessons have been learned in relation to different areas of the business with this learning taking place at different speeds and in some cases remains incomplete. Nevertheless, it may be possible to conclude that learning is present at the Bank with HSBC demonstrating, on the whole, tangible positive changes in the Group’s underlying theories-in-use and which suggests a more stable and risk averse banking model than we observe in 2007/2008.

Theoretical explanations drawn from the literature on learning have been deployed throughout in order to help us understand variations in the Group’s learning. For example, ideas surrounding dissatisfaction as being the central driving force of the learning journey have be used to explain why, after following some initial complacency, the Group have subsequently learned lessons. However, while it has been argued that the lessons learned in relation to governance have not been explicitly linked to the financial crisis, those lessons drawn may be connected to wider learning surrounding bank stability and the sound functioning of financial markets.

Conversely, inherently structural competitive pressures and the ability to retain and attract the best banking talent can explain why, in relation to remuneration, we witness a rather unclear picture of learning. In particular, the Group’s commitment to being an international facing bank, typified by its so-called ‘pivot into Asian’, may explain why these competitive pressures have manifest themselves much more acutely than at other institutions in this study who have retrenched operations on domestic U.K. markets post-2008.

Finally, the balance sheet analysis demonstrates that while the Group have indeed restructured the composition of the balance sheet, the key financial metrics or measures have broadly remained. This may be best explained by the literature on meta-reflexives which suggest that learning may be possible despite the absence of radical change.

# **Conclusion**

**Overview**

The central role which banks played in the 2007/2008 financial crisis has been well documented with the crisis producing a plethora of scholarly literature. Academic inquiry into the causes of the financial crisis and its aftermath has similarly been matched and even eclipsed by media reports with journalists and bank insiders all offering their own account of what went wrong and how the problem might be fixed. Even Hollywood seems to have become obsessed with the financial crisis, producing a number of films telling the factual, and sometimes not-so-factual, stories of bankers and regulators and their role in the crisis and its immediate aftermath (notable highlights include Michael Moore’s *Capitalism: A Love Story* (2009) and the 2015 adaption of the Michael Lewis international bestseller ‘*The Big Short’*). However, while these various contributions have chartered the origins and regulatory answers to the ‘biggest financial crisis in 80 years’ (Turner, 2016: xi) no one has asked how the banks themselves have responded and if lessons have been learned and what, if any, these lessons mean for the wider stability of global financial markets.

At this point I will briefly reiterate for the benefit of the reader the importance of my thesis and its contribution to wider debates within political science surrounding post-crisis reform and stability. As noted above, to date, academic debates on financial stability have largely rested upon the question of regulation and efforts by the regulators to bring financial institutions and markets under closer supervision. As such, the current scholarship fails to ask if the banks have learned from the crisis and if they are now safer. However, this is an important question due to the systemically important nature of banks, and the banking sector, to the wider economy. One lesson we can take from the last financial crisis, and something which has been echoed by the regulators themselves (see Baily *et al*, 2015; Bell and Hindmoor, 2015a; Brazier, 2017; Woods, 2017) is that banks have both the means and incentives to roll back supervisory mechanisms with effective regulation being dependent upon these systemically important institutions complying with both the letter and, more importantly, the spirit of supervision. As such, we may conclude that regulation alone is not sufficient to ensure the stability of markets with the banks themselves having an important role to play. Hence the importance of asking the question posed by this thesis.

This thesis has sought to make an original contribution to the field by adopting a bank-centric approach to this under-researched and largely neglected area of political science. In doing so I hope to have opened a debate concerning the role and everyday practices of banks as part of the wider global financial architecture by examining individual institution’s underlying theories-in-use, key financial metrics and responses to the recurrent shortcomings highlighted by the crisis.

This Chapter will conclude the thesis and in doing so I will bring together for the reader the wider debates and key issues which have presented themselves in the preceding chapters. The Chapter is loosely structured around four key areas. *Firstly*, I will address the underlying research question building for the reader a detailed and thematic response to the principle question posed in this thesis. *Secondly*, I will reflect upon my research and consider further avenues of inquiry which may stem from the research. *Thirdly*, I will contemplate the process which has allowed me to deliver the thesis to the reader and take account of my own ontological, epistemological and methodological choices in pursuing this research. *Finally*, I will conclude the thesis by situating my own research and its contribution within the field of political economy.

# **Answering the Research Question**

The central purpose of the thesis was to establish a clear account of what has happened inside the U.K.’s largest banks following the 2008 financial crisis and evaluate whether and to what extent banks have learned and changed. Moreover, the thesis has sought to establish what these changes, if any, tell us about the institutional capacity of banks to learn and the impact of learning upon the wider financial stability of markets. In order to do this the thesis had one central research question:

*Have Banks in the U.K. Learned Lessons from the 2008 Financial Crisis?*

The thesis has found that the financial crisis of 2008 affected the banks surveyed in this study in very different ways leaving institutions in various positions of health. We have seen that for some, such RBS and Lloyds, the crisis proved to be devastating and left the banks close to ruin, while others, such as Barclays and HSBC, navigated the crisis with a degree of success and generally can be considered to have had a ‘good’ crisis. Given the unique position of individual institutions following the crisis it is of little surprise that we find that in the years following the 2008 meltdown there remains a great deal of divergence between institutions with different banks taking very different directions post-2008. For example, it is possible to conclude that in general RBS and Barclays have failed to present strong evidence of learning (although both banks do present limited ‘pockets’ of change). Meanwhile, Lloyds and HSBC both appear to have learned lessons from the crisis (although the extent of this learning can be questioned within some areas of the respective businesses). As such, there is no single or uniform answer to the question *Have Banks in the U.K. Learned Lessons from the 2008 Financial Crisis?* Instead we find that different banks have learned different lessons in relation to contending areas of both their own business and the banking industry in general.

These institutional variations have meant that while several of the causes of the crisis have been addressed by the banks in this thesis, many of the precursors outlined at the onset of this research have failed to be adequately tackled by institutions. The result of this means, that there is still a great deal of uncertainty about the level of systemic risk posed by the banks to the financial stability and integrity of markets. This thesis has shown that the reason for this institutional divergence can be attributed to a series of contextual and structural factors and how these dynamics have been interpreted by institutions and key agents within the banks themselves.

I would remind the reader that I am not presuming that the extent to which banks have learned lesson from the 2008 financial crisis will prevent or insulate financial markets from future crises. Indeed, as we discussed in earlier chapters both the IMF (2017) and FPC (2017) have highlighted a number of emerging threats to global financial stability which are not necessarily bank-driven or tied directly to banks or banking markets explicitly. Likewise, this thesis has only surveyed one set of actors in the financial crisis (the banks and more precisely the U.K. big four banks) and one set of causes. Indeed, as we noted in previous chapters, there were other actors and other causes, such as the role of global imbalances in the economy, which also deserve further investigation. However, due to the constraints placed upon this PhD research by the University my thesis has concentrated upon one set of actors and one set of causes. Yet, the question posed by this thesis remains important because of the systematically significant role of banks within the economy. Furthermore, many of those factors which contributed to the crisis, and are outlined in Chapter 2, have also played a role in previous crises too. As such, while the next financial crisis may not involve the banks directly, if the causes of the 2008 crisis have been addressed by the banks, and if these institutions are now safer, we would expect them to fair much better in future crises leading us to hypothesise that bank learning may make for a more robust and sound functioning financial system.

In addition to the overarching research question, the thesis has also been underpinned and guided by a series of sub-questions. This section of the Chapter will directly address and answer this sub-set of questions drawing a series of conclusions for the reader which will, in turn, address, answer and feed into the overarching research question and subsequent conclusion.

1. What does the literature on learning tell us about those conditions most conducive towards learning?

The evidence examined in the empirical chapters of this thesis suggest that there are present several factors drawn from the literature which inform our understanding of those conditions most conducive towards learning.

1.1 Learning Space Theory

The *first* of these conditions is what I have come to call ‘learning space theory’. Learning space theory contends that in order for an organisation to learn the subject must have space to undertake critical reflection of the institutional underlying theories-in-use, guiding principles and standard operating procedures. Space is understood in this thesis as the dedication of both time and resources (human and fiscal capital) towards the critical self-reflexive process.

The importance of space in the learning process is evidenced by the case of RBS. In this regard, Chapter 4 shows that a series of governance failures have effectively eroded and robbed the Bank of its learning space with time and resources being diverted away from ‘big picture’ learning concerning weaknesses exposed by the crisis. Conversely, those banks that were able to maintain their learning space - responding to regulatory breaches which threaten to undermine learning space with targeted policies aimed at remedying the problem and closing potential gaps for future abuses – or whose space did not come under the same pressures as that of RBS, have demonstrated the greatest propensity for learning. As such, those banks that have preserved their learning space are freer than those who could not concentrate their efforts and resources upon a more nuanced and reflexive process, examples of which include Lloyds and HSBC.

1.2 Dissatisfaction Thesis

A *second* contending factor drawn from the literature which informs our understanding of those conditions most conducive towards learning is what I have referred to throughout as the dissatisfaction thesis. While at times the dissatisfaction thesis may appear to be a rather obvious precursor to learning it has been nonetheless vital for the importance of this thesis and academic rigour to test and explore this idea.

The dissatisfaction thesis runs throughout much of the literature reviewed in Chapter 1 and contends that learning takes place when results no longer keep pace with desired outcomes. The ensuing void between that which is desirable and that which is achievable then leads to dissatisfaction which becomes the impetus for learning and change as the learning subject seeks to close this gap.

While we might have expected the financial crisis to have caused sufficient dissatisfaction to prompt learning, the crisis alone does not appear to have caused adequate dissatisfaction to propel the banks from a static state towards the progress of learning. Instead, only after suffering a secondary internal crisis have the banks demonstrated substantive evidence of learning, although the extent to which learning and change has been implemented differs significantly from institution to institution.

Contrary to the work of Richard Rose (1993) those institutions surveyed in this thesis which suffered the greatest losses and dissatisfaction did not demonstrate a larger propensity for learning. The case of RBS reveals that when the level of dissatisfaction proves to be too great dissatisfaction is no longer a valuable tool in the learning process and instead hinders the subject’s progress who is subsequently overwhelmed by the degree of failure.

Ultimately, while dissatisfaction is clearly a condition that is conducive to learning the level and degree to which dissatisfaction takes place and is experienced by institutions clearly matters, with too little dissatisfaction - the case of Barclays and HSBC immediately post-crisis – failing to provide enough motivation to learn, while too much dissatisfaction – the case of RBS – proving to be crippling and retarding the learning process. What is more, the desired level of dissatisfaction, enough to propel learning while not overwhelming the subject, appears to be specific to each institution and dependent upon their ability to effectively deploy resources and utilise the learning space.

1.3 Structure and Agency

This brings us on to a *third* conclusion: both structure and agency matter. Constraints mediated through the structural environment and interpreted by key agents within institutions have been shown to impact and determine the learning trajectory of our chosen banks. Regulatory changes to capital and liquidity ratios, how banks reward and pay their employees, ideas surrounding competition, the lack of a level international playing field and competition for highly-mobile investor capital are all key structural factors which have influenced the learning process. Institutional variations in the extent to which these structural dynamics have constrained and shaped policy responses to the crisis can be explained by differing institutional ideas, behaviours, path dependencies, learning spaces and levels of dissatisfaction at organisations.

Likewise, the Historical Institutionalist (H.I.) analytical framework upon which this thesis is centred allows us to move between structural and agential explanations of institutional learning. The constructivist tradition in which H.I. is rooted stresses that in times of crisis we should move beyond a purely structural approach and consider the ideas and behaviour of key agents who both directly and indirectly generate ‘new institutional blueprints’ and ‘new institutional arrangements’ which will impact upon the learning trajectory of organisations by how they interpret, construct and problematize certain structural factors (Baker, 2015: 3). Agents therefore, along with structures, are equally important in shaping and driving institutional learning and change. Agential explanations of the extent to which our chosen banks have learned and changed include CEOs and other powerful situational agents whose ideas and behaviours concerning the interpretation of structural factors have influenced the learning trajectory of banks.

1.4 Upholding Learning with Specific Policy Initiatives and Measures

A *fourth* factor which has run throughout this thesis and which has been found to be conducive to the learning process is the idea that those banks which have demonstrated the greatest propensity for learning and change have upheld lessons learned with specific policy initiatives and performance measures which have been realigned to match newly-acquired underlying theories-in-use resulting from the learning experience. Equally, in cases where we observe an absence in learning we similarly witness a distinct lack of tangible policy outcomes which, following periods of dissatisfaction, have failed to address those institutional and systemic failures which have been presented post-2008.

Again, while this may seem like a rather obvious condition of learning it is nonetheless important with evidence suggesting that targeted policy formulation following the crisis has been an important factor in determining the learning trajectory of institutions post-crisis, even when policy initiatives, in the case of the meta-reflexive literature, prescribed little or no change. As such, it is possible to conclude that one of the institutional-based conditions most conducive towards learning is the use of specific and targeted policies aimed at upholding lessons learned.

1. Have banks made substantive changes to the structure and culture which pervaded institutions pre-crisis?

Many of the conclusions and examples used to highlight the ideas presented in this thesis transcend and overlap a single research question and as such we cannot neatly compartmentalise those inferences and must instead consider these issues on their own merit and take into account how contextual factors have interacted and shaped broader structural, institutional and agential changes which have taken place.

2.1 Governance and Managerial Framework

The restructuring of risk governance and management frameworks has been identified throughout the thesis as being one of the key structural and cultural changes which has taken place. However, we must exercise caution in drawing general inferences with varying institutional responses, ideas and interpretations of the crisis meaning that there is present a great deal of disparity between the banks surveyed.

The thesis has found that those institutions with the greatest propensity for learning and change have typically made substantial changes to their governance and managerial framework. Prominent examples include the delayering of risk governance structures at Lloyds, which has had the desired effect of making the organisation ‘flatter’ by building in mechanisms which allow information to flow in both a top-down/bottom-up manner – thereby addressing problems associated with the silo effect – and the appointment of additional committees and expert individuals to the Board at HSBC with the ability to affect and shape change. In contrast, those banks such as RBS and Barclays that have displayed little or limited evidence of learning and change are less likely to have made substantive changes to pre-existing managerial structures and risk governance despite clear evidence of dissatisfaction.

2.2 Remuneration and the Long-term Outlook of Bonuses

Another facet where the thesis has witnessed substantive changes to the structure and culture that pervaded institutions pre-2008 is the area of remuneration and particularly the distinctly long-term outlook which some banks have given to their variable remuneration packages post-crisis[[113]](#footnote-113). However, and much like the above, these changes cannot be applied at a general level to all the banks with differing institutional approaches to remuneration being evident, further reinforcing the notion that different institutions appear to have learned different lessons in relation to different areas of their businesses.

Institutions such as Lloyds and, to a lesser extent, HSBC have restructured remuneration to include the use of more long-term options such as shares and other non-cash alternatives and have extended retention periods. In doing so they appear to have addressed the high-risk/high-reward short-termism that pervaded pre-crisis bonus models by incentivising key agents to seek out decisions and behaviours which are in the long-term interest of institutions and have subsequently presented evidence of learning and change.

Conversely, we have not witnessed similar changes at RBS and Barclays with the greatest shifts in remunerative practices appearing to come in response to tougher regulatory standards and in particular CRD IV and the Remuneration Code 2011 with neither bank implementing substantial endogenously-originated changes to their bonus structures. This suggests not only a lack of learning in relation to pre-crisis models but that once again we may observe institutional divergence and the differing extent to which the learning trajectory of organisations has been affected by contextual factors.

1. What have banks identified as being the key changes needed within their own institutions?

I will use this section to highlight a number of institutional changes which have been identified by individual banks and our comparator group as a whole. As with previous sections many of these examples overlap with those factors already discussed, thus further highlighting the interconnected yet nuanced nature of the banking industry.

3.1 Changes to the Balance Sheet

The thesis has outlined a number of specific balance sheet factors which have been identified and targeted by the banks surveyed in this research. For example, in this thesis we have consistently seen policies aimed at increasing customer deposits with all the institutions significantly growing the deposit base while decreasing reliance upon short-term wholesale funding[[114]](#footnote-114). While some of the institutions surveyed in this thesis have specifically cited the increase of customer deposits as being a key objective others have spoken more broadly about improving the funding and liquidity position of the Group. As a result, and as noted above, all the banks surveyed are now operating with much more conservative capital and leverage ratios. Likewise, the loan/deposit ratio of our comparator group has also been reduced with the number of loans being dedicated towards residential mortgage lending similarly increasing post-2008. Given the reorientation of bank lending post-crisis it is not surprising to find that the percentage of impaired loans at Lloyds and HSBC has decreased. At RBS and Barclays this figure has increased due to a number of institutionally-specific factors, although as noted in Chapter 6 Barclays has demonstrated evidence of a downwards trend from 2013 onwards. Trading liabilities as a percentage of total assets have similarly been decreased at Lloyds and HSBC with Barclays again demonstrating a downwards trend from 2013 onwards despite an overall increase. While the use of derivatives has been reduced across all the banks in this thesis the use of off-balance sheet vehicles has generally increased, which again demonstrates that banks are perhaps not as central to the global economy as they once were.

We have noted, however, that these changes have occurred against a shifting regulatory and economic context which has undergone substantial change following the crisis. For example, Bessis (2015: 110) has discussed the impact of higher capital requirements, tighter lending controls and the increasing costs of liquidity. As such, we might conclude that banks no longer operate under the same structural conditions as they did in 2008 and as such we must take account of these changes and the extent to which they may have affected learning at our chosen institutions. Nonetheless, and despite these regulatory and economic variations, we can still draw important conclusions surrounding bank learning, reform and the future stability of markets by looking at the spirit and extent to which banks have embraced and responded to the changes and challenges of a shifting economic and regulatory context.

While these key financial metrics generally point towards more robust balance sheets amongst our comparator group and which may prove for a more stable financial system with reduced systemic risk posed by the banks, there remains a great deal of institutional variation in the extent and pace of learning. Therefore, we must consider institutional nuances when contemplating the extent to which learning has taken place.

3.2 Investment Banking

The thesis has presented how attitudes towards the investment banking divisions of our chosen banks have likewise differed. Those institutions where the investment bank played a much smaller role in profit generation pre-crisis such as Lloyds and HSBC, have rolled back their respective investment banking divisions. Meanwhile at RBS and Barclays where investment banking teams played a much larger role within the Group pre-2008, the shrinking of the investment bank has been met with a degree of hostility and scepticism which, in the case of Barclays eventually led to the revival of the division. Given that many precursors to the financial crisis originated from the investment banking divisions of institutions its stands to reason that those banks which have shrunk their investment banks pose a lesser threat to the stability of financial markets.

Thus, we may conclude that while we should not lose sight of institutional variations when drawing conclusions surrounding the extent to which our chosen banks may or may not have learned in relation to the investment banking divisions of their organisations, there is present at our chosen banks a certain institutional path dependency, namely with the banks surveyed in this thesis returning to those models which were predominant in the years preceding the crisis.

1. What have the banks said in relation to the financial costs associated with the implementation of those changes identified in the literature?

The research has struggled to positively identify or quantify the exact financial cost of those changes identified in the literature. This is partly because banks tend to be very guarded in disclosing regulatory and compliance costs (Noonan 2015) with most disclosures being ad hoc and varying in the degree of information communicated. Moreover, there is also a great deal of institutional variation in the extent to which individual organisations disclose information. For example, Laura Noonan (ibid) of the *Financial Times* has noted that ‘Barclays…are among the big banks that disclose no data at all’. As such, much of the information we have regarding the associated cost of change has been produced by specialist such as auditors and lobbying groups. For example, Edmund Parker and Mayank Gupta (2015) of the Mayer Brown international law firm, have highlighted the costs of meeting regulatory requirements on the recruitment and retention of banking talent noting that following the introduction of ‘suffocating’ regulatory requirements many bankers have left banks for more ‘lighter regulated’ markets, with senior talent, who may have been best situated to deal with tougher new regulatory requirements, choosing to move to institutions who operate in a more ‘risk-friendly’ environment. Moreover, *Thomson Reuters Regulatory Intelligence Services* have calculated that the costs of meeting regulatory requirements have in some cases been as high as £3 billion (however we should note that this figure also includes various fines paid to the regulators concerning governance compliance issues) with banks dedicating on average 59 percent of their time and resources to compliance issues[[115]](#footnote-115).

Despite this, there are inferences which may be made in relation to how banks see the cost of learning and change. For example, the thesis found that there was a great deal of concern regarding competition being articulated by the banks and how implementation of structural changes associated with the lessons learned from the crisis could negatively impact the ability of institutions to compete for both talent and footloose investor capital. Sentiments concerning the diminished position of institutions, either perceived or real, while not explicitly placing any financial cost upon the implementation or adherence to structural changes, reveal certain institutional ideas surrounding the cost of reform with the fear of losing ground to rivals being anecdotally identified as the greatest cost of change.

1. What have the banks said about their relationship with the regulators post-crisis?

The thesis has identified varying institutional relationships between the banks and regulators with differing attitudes and stances being adopted on certain issues. Regulatory requirements on higher capital and liquidity have been positively embraced. Conversely, regulatory stipulations concerning variable remuneration have generally been met with a degree of scepticism and in some cases outright hostility. Regulatory requirements concerning the disinvestment of parts of those banks which received state-aid has produced differing results. For instance, on the one hand, Lloyds has complied with the requirements and has run down certain projects in a timely manner and in many cases before the required deadline; meanwhile, RBS, has viewed such requirements as an intrusion, has failed to meet deadlines and has generally had a more confrontational relationship with regulators. Likewise, the thesis has found that while many banks appear to be operating within the letter of the law the ‘spirit’ of regulatory change has not necessarily been embraced.

While institutions have not necessarily or explicitly addressed their relationship with the regulators post-crisis, sentiments expressed concerning key regulatory changes and the subsequent behavioural reactions which have stemmed from such are a key indicator of how the banks view the role of regulators following the 2008 meltdown with the thesis revealing learning in some areas of regulatory changes and an absence or lack of learning in others. Once again the thesis revealed varying degrees of institutional learning.

1. Is there evidence of peer-to-peer learning amongst the banks?

The thesis has revealed limited evidence of peer-to-peer learning at the institutions surveyed in this study. The most prominent examples of where peer-to-peer learning is evident have been found in instances where banks have recruited key agents from rival organisations, thus resulting in a transfer of knowledge gained through past experiences. Likewise, organisations that have appointed experts from particular fields in which there have been found to be institutional weaknesses or shortcomings have similarly demonstrated evidence of peer-to-peer learning with the specific knowledge of these specialists being subsequently imparted to the recipient organisation. However, in both cases this ‘adjacent information’ remains with the person in question and as such the transfer of knowledge is largely dependent upon the individual’s ability to exercise their agency and affect learning and change at an institutional level.

This thesis has endeavoured not to proffer any one of the various structural, institutional or agential factors discussed as a sole explanation as to the extent to which banks have, or have not, learned lessons from the 2008 financial crisis. Similarly, the thesis does not claim that any one of these factors should be ascribed greater gravitas in explaining the learning trajectory of banks in this study. Indeed, there is no one-size-fits-all answer that can be applied to the research question, to the banks in general or to individual institutions. The thesis has argued that there is present a great deal of inter and intra bank variation in the extent to which learning has occurred. Likewise, the learning trajectory of our chosen banks cannot be explained by a single factor. Instead, we should consider the myriad of issues, which are both mutually shaping and non-exclusive, on a bank-by-bank basis and which have shaped the dynamic of institutional responses to the crisis.

**Limitations and Future Directions**

The aim of this thesis has been to examine how lessons drawn from the financial crisis have been understood andmediated by institutions and key agents and the wider impact of the resultant behavioural changes on financial stability. As a result of this undertaking I have identified within my thesis several weaknesses and possibilities for future research.

Selection of Banks

An obvious limitation within my research is that while the thesis has utilised detailed empirical studies to highlight institutional and agential responses to the financial crisis and how these mediating ideas have shaped the learning trajectory of the banks, it draws upon a rather narrow group. Indeed, as highlighted in the Introduction, the relatively small *N* or sample size means that we cannot treat our chosen banks as traditional case studies and should avoid making broad inferences[[116]](#footnote-116). As already discussed, the banks selected for this thesis were chosen due to their systemically important nature; for instance, they dominate the U.K. banking sector - which is in itself the largest banking market in Europe and the fourth largest in the world (relbanks.com) – and are amongst the top 25 largest banks internationally and the top ten largest banks in Europe.

Despite the small sample size, the thesis has highlighted and discovered a number of wide-ranging factors which help to explain some ideational and behavioural responses to the crisis. As such, it would be valuable to explore these conclusions in further detail by applying them to a wider group of banks.

A comparative study of banks in North America would prove particularly useful given the role which U.S. banks played in the financial crisis. Moreover, New York is a leading global financial centre, arguably second only to London, with three of the world’s top five largest banks by market capitalisation being headquartered in the U.S. Thus, we can see the important role which American institutions played and continue to play in the global economy, which adds further impetus for an undertaking of this kind. A study of this nature would have the desired impact of testing the ideas and conclusions explored in this thesis beyond a U.K.-centric approach to ascertain as to whether the issues explored in my current research persist at a transnational level or if the U.K. banking system is unique, if there are any country-specific variations in banking cultural and behavioural norms, and what are the implications of these possible future findings for global regulatory scrutiny and oversight?

Research Interviews

A further limitation of my research has been the lack of bank representatives and regulators interviewed. While interviews have not been, and were not intended to be, the backbone of my research methodology the thesis would have benefitted from greater insider knowledge of these key agents. To compensate for this shortfall I had to resign to using secondary empirical data namely official speeches, press releases and interviews granted to journalists. While these secondary sources proved to be useful and allowed me to make casual inferences, direct contact with these central figures would have been preferable. Many of the interview invitations extended to both bankers and regulators were simply ignored or rejected.

On two separate occasions I had two different senior bankers accept my invitation for an interview only to later cancel and withdraw their participation from the study along with any potential for future interviews. The one banker who did agree to speak with me did so on the strict condition that I do not mention the person’s name, their role within their current organisation or the name of the bank for whom they now worked. In addition, I was granted interviews with a handful of prominent journalists and authors, policy experts and a former government minister.

Of those individuals that were interviewed many had previous contact and dialogue with key bankers and regulators and were willing to share their own insight and experiences recalling conversations that had been shared with these key agents and were for the most part happy to answer questions based upon these reflections. As such, I was able to gain some ad-hoc anecdotal evidence which helped me situate my own research. Future research would need to overcome such shortcomings by incorporating the perspectives of a wider group of policy makers and bankers. This could be achieved by fostering and utilising those relationships that I have now built with these ‘gate-keepers’.

Disaggregating Banking and Finance

In this thesis I have used the term ‘banking’ and ‘finance’ in their broadest sense. However, the use of these contextual terms also reveals a weakness of my research and of the wider political economy literature as a whole. Specifically, that banking is just one of several constituent parts of the current international financial architecture which is itself made up of numerous sectors, sub-sectors, markets, contracts and trades which are executed by multiple actors including banks, insurers, off-shore entities, traders and hedge fund managers to name but a few. While many of these activities are currently incorporated into existing banking models – with such activities typically being located in the investment banking divisions of institutions –all form part of the much broader umbrella term ‘finance’[[117]](#footnote-117). However, these activities all carry with them varying degrees of risk and uncertainty. As such, in order to better understand the risk which international finance, of which banking is just one small part, poses to the real economy it is important that we free these terms from their current ontological position.

I propose that by adopting a similar analytical process as used in the balance sheet section of the empirical chapters it is possible to breakdown and disaggregate international finance into its different constituent parts. This process could then be used measure the extent to which certain financial centre case studies, such as the City of London or New York, are currently being exposed to risk. In this instance risk would be measured in terms of the losses sustained to the varying sectors and subsectors of finance in the 2008 crisis[[118]](#footnote-118) and the degree to which centres are currently exposed to these operations.

Such future research would contribute to and extend not only current ontological conceptions of international finance within the field of political economy, as well as addressing epistemological concerns, but would also allow us to draw a risk profile of specific case study financial centres and thus better understand the risk that hosting such a centre poses to the host and global economy.

**Reflections on the Research Process**

The analytical framework developed Bell and Hindmoor (2015a) and upon which this thesis rests has proven particularly useful. While the authors’ theoretical grounding is situated within the broader H.I. tradition Bell and Hindmoor’s expanded H.I. framework is deliberately broad and has allowed my research to move between structural, institutional and agential explanations of learning. This has been especially valuable as when faced with tricky and difficult concepts I have not been tied to a rigid set of criteria with the framework allowing a certain amount of freedom to differentiate and address the non-exclusive and mutually shaping relationship between contextual factors. However, there are also weaknesses with the current framework. The generally loose or expansive approach taken by Bell and Hindmoor (2015a) means those researchers adopting such theoretical underpinnings may find that at points they will have to invest time and energy exploring the margins of the framework especially when faced with certain situational specifics which are not easily identifiable. At times, the thesis was perhaps guilty of losing sight of the theoretical framework which on occasions tended to fade in and out particularly in the empirical chapters. However the expanded H.I. theoretical framework developed by Bell and Hindmoor (2015a) meant that preference shaping interactions between structures, institutions and agents could be explored in greater detail. Therefore, such theoretical considerations should be taken into account in further research projects.

**Concluding Thoughts**

The thesis has investigated if and to what extent banks in the U.K. have learned lessons from the 2008 financial crisis and has sought to explain why these shifts have, or have not, taken place. It has been found that different banks have learned different lessons in relation to contending parts of their own businesses and that these institutional variations are best explained by competing structural, institutional and agential explanations. The conclusions offered by this thesis are important because they stress the need to examine the non-exclusive and mutually-shaping relationship between these contending contextual factors and the extent to which they have shaped the learning trajectory of banks and the impact thereof on financial stability.

The focus of my research and the conclusions reached in this thesis, aided by the analytical framework laid out in the Introduction, is important because it offers the reader an empirically rich, bank-centric contribution to the current literature on financial reform post-2008. Moreover, by placing the banks at the centre of this research the thesis offers political economists, and beyond, a unique vantage point from which such issues can be studied. Situating my own research within this wider context stresses the need to consider the mediating forces between structural and institutional reform and those preference-shaping key agents placed at key junctures of the political economy. By studying how banks and bankers interpret their situational responses to the immediate environment we can gain greater insight into how these systemically-important institutions and actors may shape the future stability of financial markets.

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1. We should note that shadow banking like many of the various markets and business sectors mentioned here are not totally divorced from the regulated banking sector. See Lysandrou and Nesvetailova (2014) for further discussion. [↑](#footnote-ref-1)
2. However, as is noted below, there is no implicit assumption that learning or otherwise amongst our chosen banks will prevent future crises which could potentially emerge from various sources. Likewise, while banks can learn and change they can also change again in the future and to the detriment of financial stability and as such the conclusions drawn in this thesis of an interim nature. [↑](#footnote-ref-2)
3. While the following Chapter will review the causes of the crisis I am not assuming that the banks will have learnt the same lessons or indeed, any lessons, rather I will be using the literature on the causes of the crisis as a benchmark against which I can judge the extent of learning and change. [↑](#footnote-ref-3)
4. Chapter 3 of the thesis will present a more robust discussion of structural competitive pressures, both before and after the crisis, and will compare and contrast the level of competition in the years leading up to the crisis and to date. Chapter 3 will also talk about the key metrics used to judge and measure structural competitive pressures. The purpose of the current discussion is to familiarise the reader with how excessive competitive pressures between the banks contributed to and exacerbated the causes of the financial crisis. [↑](#footnote-ref-4)
5. As will be discussed in the empirical chapters to follow. [↑](#footnote-ref-5)
6. A factor which may explain the growth in off-balance sheet items and the shadow banking sector discussed in the coming empirical chapters. [↑](#footnote-ref-6)
7. The following Chapter will look at and detail regulatory changes post-2008 more broadly and isolate the impact regulation may have on banks post-financial crisis. [↑](#footnote-ref-7)
8. The specifics of which are outlined in the following Chapter. [↑](#footnote-ref-8)
9. List adapted from British Bankers Association (2016) unless otherwise stated. [↑](#footnote-ref-9)
10. The Bank of England would subsequently raise the minimum leverage ratio to 3.25 percent with effect of June 2017. Given the cut-off date for this thesis this increase will not be reflected in balance sheet analysis of our chosen banks. See Binham and Tetlow (2017) for further discussion. [↑](#footnote-ref-10)
11. We should note that the countercyclical buffer would not come into effect until 5th July 2016 and as such the balance sheet analysis carried out in the coming empirical chapters pre-dates this stipulation. [↑](#footnote-ref-11)
12. The PRA and FCA are currently in consultation over plans to raise the current clawback period to ten years from the date of bonus payment. [↑](#footnote-ref-12)
13. We should note that the European Banking Authority have judged that certain Role-Based Allowances may also fall under variable remuneration and as such are subject to CRD IV requirements. However, the EBA have determined that it is only role-based allowances that are ‘discretionary, not predetermined, not transparent to staff or not permanent’ which should be considered as variable remuneration (EBA, 2014: 9). As a result, any allowances which do not fall under this criterion may continue to be paid to staff free from CRD IV stipulations, meaning that the banks in this study are free to make use of so-called “role-based pay”. [↑](#footnote-ref-13)
14. Although the benefits of such a large financial sector have been question by Christensen *et al* (2016). [↑](#footnote-ref-14)
15. We should note that the source of these statistics i.e. the British Bankers Association and TheCityUK are trade and professional lobbying associations respectively and as such these figures could be accused of being self-serving and are similarly contested. [↑](#footnote-ref-15)
16. See Chapter 2 for further discussion. [↑](#footnote-ref-16)
17. It must be stressed that Mr Hourican was in no way directly implicated in such matters nor is there any evidence that he had any prior knowledge as to what was happening. [↑](#footnote-ref-17)
18. The reporting of such transactions is particularly important to the effective functioning of markets because, while there is no evidence that RBS’ transgressions led to any nefarious activity, such failures can often facilitate criminal acts such as insider trading and other questionable market based behaviour (Wilson, 2013a). [↑](#footnote-ref-18)
19. We should note that Lloyds, Barclays and HSBC have all been found guilty by regulators for similar dealings. [↑](#footnote-ref-19)
20. In this case exposure to the scandal has been measured in terms of the size of the compensation package which has been set aside. [↑](#footnote-ref-20)
21. Most notably, RBS have failed enhance whistle-blowing facilities at the Bank which may have, and may yet still, prevent future governance failures. [↑](#footnote-ref-21)
22. The presence of certain institutional path dependencies at RBS may also explain why competition has been more punctuated at the Bank than at rival institutions such as Lloyds who have similarly retrenched operations on domestic markets. For example, due to equivalency standards, in relation to pay and compensation upper thresholds - being implemented at both a U.K. and E.U. level - we would expect those institutions who have retrenched operations on domestic and European markets to be less sensitive to competition than those banks that have maintained or extended their international exposure, such as Barclays and HSBC, and which has subsequently brought them into competition with rival institutions that are not held to the same regulatory standards. [↑](#footnote-ref-22)
23. Discussed above. [↑](#footnote-ref-23)
24. We should note that the controversial ‘fixed share allowance’ (discussed below) does not fall under ‘variable remuneration’ and as such is excluded from these figures. [↑](#footnote-ref-24)
25. Lloyds are the only bank in this study who have not sought shareholder approval to increase fixed pay to the upper limit of 200 percent of base salary. [↑](#footnote-ref-25)
26. It should be noted that like RBS, Lloyds, Barclays and HSBC are also utilising so-called ‘role-based allowances’ with Lloyds and HSBC similarly rewarding employees in shares exclusively. Barclays are the exception paying staff in both cash and shares. [↑](#footnote-ref-26)
27. £1 million of which Mr McEwan would later give away to charity. [↑](#footnote-ref-27)
28. However, we should note that changes to minimum capital standards introduced by Basel III, along with the definition of Tier 1 capital, may have affected the efficiency of borrowing on wholesale markets. As such, we should not consider these figures in isolation. For further discussion see Agur (2013). [↑](#footnote-ref-28)
29. Which is the inverse of the capital ratio; if capital levels are down leverage ratios will be up by definition. [↑](#footnote-ref-29)
30. Discussed in more detail below. [↑](#footnote-ref-30)
31. The data set provided by Bankscope, from which I have retrieved these figures, only holds data concerning EPS dating back to 2011. Upon consulting RBS’ own annual report and accounts 2008-2011 it appears that the Group, from 2011 onwards, changed the way in which EPS are reported meaning that comparable data is not available. [↑](#footnote-ref-31)
32. The exception being so-called subprime mortgages most closely associated with U.S. markets and which as we have previously seen were laden with a plethora of risk and uncertainty. [↑](#footnote-ref-32)
33. As already discussed above, research interview Participant A noted that RBS were continuing to make ‘silly’ loans without the necessary due diligence and which may explain such a rise in the rate of impairments. [↑](#footnote-ref-33)
34. To reiterate for the reader, as part of their 2008 bailout deal RBS would be forced to shed over £1 trillion of assets from its balance sheet and disinvest a number of businesses in order to increase competition within banking markets. [↑](#footnote-ref-34)
35. As highlighted above these write-downs would see the Group report its eighth consecutive year-end loss. [↑](#footnote-ref-35)
36. Further analysis of the departure of executive and non-executive directors shows that in the period 2009-2015 a total of 9 Non-Executive Directors have departed the Bank (Lloyds, 2009: 103; Lloyds, 2014: 58). Likewise, over the same period the Group had a total of 5 Executive Directors leave the Bank (Lloyds, 2011b: 182). It should be noted however, that all those members who left the Board during the years 2009-2015, including all Executive and Non-Executive directors, resigned of their own accord or simply failed to offer themselves up for re-nomination. [↑](#footnote-ref-36)
37. See Chapter 1 page 24-25 for further discussion. [↑](#footnote-ref-37)
38. For example, upon his arrival at Lloyds Mr Colombas had over thirty years’ experience within the banking and finance sector and previously served at Santander U.K. operations as Chief Risk Officer under Antonio Horta-Osorio. Moreover, prior to joining Santander Mr Colombas held a number of senior risk and control positions at various institutions at banks and financial intermediaries across the globe (Lloyds, 2015: 57). Mr Culmer was appointed the Group’s Chief Financial Officer in May 2012 and had previously worked as a chartered account with his duties across a 20 year career in finance including strategic and financial planning at organisations both in the U.K. and across Europe and North America (Lloyds, 2015: 57). [↑](#footnote-ref-38)
39. Furthermore, Antonio has also held positions at the highest level including; Chief Executive Officer at Alliance & Leicester plc, Chief Executive Officer of Santander UK, Executive Vice President at Banco Santander and Head of Capital Markets when at CitiBank (BloombergBusiness.com, 2015). [↑](#footnote-ref-39)
40. Indeed, given the performance of the Group, measured in the balance sheet element of this Chapter, it would certainly appear that there has been a successful assimilation of the HBOS and Lloyds TSB brand. [↑](#footnote-ref-40)
41. Although we should note that to-date there is no official evidence that these powers have been evoked. [↑](#footnote-ref-41)
42. While it is true that the work of Bracken *et al* (2005) argues that organisations which include multiple layers or lines of defence generally proved us with an example of an institution with a greater propensity to learn, we should note that while the Lloyds new governance structure does not necessarily fit this model the Group have increased the potential for top-down/bottom-up accountability which the authors stress is key in learning, allowing information to flow more efficiently and thus overcoming pre-set cognitive biases. [↑](#footnote-ref-42)
43. We should note that all the banks in this study have been found guilty of similar breaches with RBS, Barclays and HSBC all having been investigated and subsequently fined. [↑](#footnote-ref-43)
44. While it was the Group who were ultimately held responsible for these actions we should not that the incident in question predated the formation of Lloyds Banking Group and the Strategic Review 2011 which, has been argued in this Chapter, represents the starting point of Lloyds learning journey. [↑](#footnote-ref-44)
45. Discussed in more detail in the following section. [↑](#footnote-ref-45)
46. At the height of the financial crisis struggling banks were extended cheap loans by the central bank with low fees (BBC News, 2014c). Lloyds sought to profit from these loans by manipulating short-term rates in order to drive the value of the loans down and thus reduce what would be payable by the Bank (BBC News, 2014c). [↑](#footnote-ref-46)
47. Like the manipulation of Libor and Repo rates, much of the of the criticism levelled against the Bank predates the Group’s formation in 2009 and in particular the 2011 Strategic Review and is instead the result of legacy issues which the Bank’s former businesses and brands were exposed to. [↑](#footnote-ref-47)
48. Brummer (2015: 225) notes that it was Mr Horta-Osorio who was instrumental in bringing about a close to the PPI saga and that despite some initial reservations from the Group, Lloyds agreed with Antonio’s judgement that it would be more beneficial in the long-run to surrender its legal battle and agree terms of compensation. [↑](#footnote-ref-48)
49. Because the LTIP award is paid in deferred shares and not cash it is subject to discount under the CRD IV rules and allows the Group to make awards in excess of the 1:2 ratio. [↑](#footnote-ref-49)
50. Under the PRA’s Remuneration Code (2011) this had previously been 50 percent. [↑](#footnote-ref-50)
51. In the case of senior managers this will rise to seven years under new rules set to be introduced by the PRA. [↑](#footnote-ref-51)
52. However, we should note that while the LTIP does indeed encourage a more risk averse long-term approach to business, it is still possible for employees, particularly the most senior members, to earn exuberant bonuses and which have attracted the attention and criticism of the financial press. For example see: Partington (2015); Salmon (2015b); Treanor (2014). [↑](#footnote-ref-52)
53. Discussed below. [↑](#footnote-ref-53)
54. An exception to this hypothesis would appear to be RBS who while retrenching operations on U.K. markets continue to cite competition pressures over talent and pay as being a key driver of remuneration practices. However, I suggest that RBS are an outlier in this respect with the Group’s failure to learn being attributable to a series of institutional path dependencies which have negatively impacted learning and has been previously discussed. [↑](#footnote-ref-54)
55. Lloyds Banking Group was formed in January 2009. As such, the balance sheet analysis will take the year ending 31st December 2009 as its starting point. [↑](#footnote-ref-55)
56. However, as discussed in the previous Chapter, when considering short-term funding, in particular wholesale funding, we should take account of changes to capital standards and the definition of Tier 1 capital. [↑](#footnote-ref-56)
57. See Perman (2013) for further discussion. [↑](#footnote-ref-57)
58. As has already been established in previous Chapters, a comparative analysis of the amount of regulatory capital held by the banks post-crisis is complicated due the regulatory landscape which was substantially different pre-2008 including how Tier and Total capital is defined. [↑](#footnote-ref-58)
59. The Base III framework stipulates a minimum Regulatory Tier 1 Capital Ratio of 6 percent and a Total Regulatory Capital of 8 percent (BIS.org, 2010). [↑](#footnote-ref-59)
60. See Chapter 4, page 127, figure 4.2. for comparison. [↑](#footnote-ref-60)
61. See Chapter 4, page 127, figure 4.2. [↑](#footnote-ref-61)
62. Although we should note that a specific value was not given to this target. [↑](#footnote-ref-62)
63. However, we should exercise caution here as a lower loan to deposit ratio may be reflective of increased minimum capital standards discussed in Chapter 3. [↑](#footnote-ref-63)
64. We should note that these comparative figures for the year 2009 and 2015 do not account for wider structural factors and in particular fluctuations in both the domestic and global economy which may impact impairment rates. [↑](#footnote-ref-64)
65. However, once again we should note that while Lloyds would explicitly target lower impairments as part of its initiative to reshape the business portfolio in keeping with the Group’s wider risk appetite, the Bank failed to quantify a specific target impairment rate. [↑](#footnote-ref-65)
66. Indeed, it may be possible to speculate that Lloyds share price may have seen greater recover were it for the so-called ‘drip feeding’ of shares back into markets by the UKFI which meant that there has been a steady supply of shares and thus potentially having the effect of deflating prices (see Dunkley and Arnold, 2017 For further discussion). [↑](#footnote-ref-66)
67. However, as noted in the previous Chapter we should exercise caution in drawing conclusion surround derivatives, which while increasing leverage may also be used as effective tools for hedging certain exposures. [↑](#footnote-ref-67)
68. This stands in stark opposition to RBS’ own E.U. mandated sale of Williams and Glynn which is yet to find a buyer. [↑](#footnote-ref-68)
69. Barclays had previously been fined £50 million by the FCA in 2013 for misreporting the deal and failing to disclose certain fees. However, in 2017 the FCA reopened its case which is pending at the time of writing (BBC News. 2017). [↑](#footnote-ref-69)
70. See Bell and Hindmoor (2015a); Sabatier (1988) for further discussion. [↑](#footnote-ref-70)
71. The use of tax havens by large commercial companies operating within developing states for tax advantages is of particular concern because tax revenues are an important tool in providing health, education and infrastructure which many developing countries are sadly lacking (Shaxon, 2012). [↑](#footnote-ref-71)
72. Indeed, as was previously discussed in the Introduction to this thesis while banks were, on the whole, in compliance with regulatory standards, before the crisis, constant friction between the banks and the regulators significantly undermined, eroded and denigrated the authority of the regulators. As such this incident may share similar parallels with the pre-2008 environment. [↑](#footnote-ref-72)
73. Although we should note that retrenchment of the Division is in no way connected to the deal in question. [↑](#footnote-ref-73)
74. Predatory trading is particularly harmful as it has the potential to significantly push up the value of stock before it can be bought and thus diminishing an investor’s return (Rennison, 2016). [↑](#footnote-ref-74)
75. In one case a client was permitted to make 38 sequential transactions. [↑](#footnote-ref-75)
76. Since the crisis we have seen the Group organisational structure shift towards a two pronged attack. On the one hand we have Barclays U.K. – the ring-fenced U.K. bank focused on U.K. consumer and business banking – and on the other, Barclays International – with focus upon transatlantic wholesale and consumer banking with presence across Germany, Tokyo, Hong Kong, Singapore and Mumbai (Staley, 2016). [↑](#footnote-ref-76)
77. For a discussion of regulatory changes to pay and compensation in the United States following the crisis see Ferrarini and Ungureanu (2011). [↑](#footnote-ref-77)
78. Indeed, evidence from our comparator group would appear to suggest that those banks which have maintained or transitioned into a more internationally focused business model, particularly outside of the E.U., are more sensitive to structural competitive pressures regarding employee remuneration with both Barclays and HSBC (as we shall discover in the coming chapter) directly citing competitive pressures as being a key factor in their remuneration policies. Lloyds, on the other hand, who have post-2008 retrenched operations on domestic markets appear to be the only Bank who have shown substantial evidence of learning in relation to remuneration. While detractors may argue that the case of RBS does not fit with this hypothesis, with RBS also retrenching operations on domestic markets post-2008, I would suggest that the RBS is unique insomuch as the failure to learn in relation to remuneration can being attributed to series of institutional factors such as the erosion of the learning space which has resulted in a falling back upon institutional path dependencies. [↑](#footnote-ref-78)
79. In-line with requirements set out by CRD IV. [↑](#footnote-ref-79)
80. This reduction in Group liabilities and equity has been driven by a number of disinvestment projects including: the 2009 sale of its fund management arm, Barclays Global Investors, to BlackRock Global for around £9 billion (The Economist, 2009b); the 2011 closure of its in branch Financial Planning (Steger, 2011); the sale of its Russian commercial and retail business, Expobank, in July 2011 for an undisclosed sum (Treanor, 2011b); the 2012 disposal of a 19.6 percent stake in the U.S. fund manager BlackRock worth £3.8 billion (Schäfer and McCrum, 2012). Likewise, between 2014 and 2016 Barclays would continue its disposal of non-core businesses with sales of: its United Arab Emirates based retail bank to the Abu Dhabi Islamic Bank in 2014 for £107 million (BBC News, 2014d); the Group’s Spanish retail, wealth management and commercial banking arm to Caixabank in a deal worth £960 million (Buck and Sharman, 2014); the 2015 sell-off its U.S. wealth and investment management unit, which had been acquired as part of the Lehman’s 2008 deal, to Stifel Financial Corp and which would see the Group dispose of around £40 billion of assets (Wursthorn and Stynes, 2015); the 2016 sale of its Barclaycard business in Portugal and Spain, with assets of around £1 billion, to Bancopopular-e (Bray, 2016); the announced sale of its French retail and wealth management business to the private equity firm AnaCap, although Barclays would hive-off and retain its French investment bank in 2016 (Moshinsky, 2016a); the 2016 disinvestment and sale of the Group’s Asian wealth management and investment business centred in Hong-Kong and Singapore to Oversea-Chinese Banking Corp for around £228 million and which would see the disposal of around £13 billion of assets (Weinland, 2016); and the announcement of plans to exit African markets with the proposed sale of the Barclays Africa division, of which the Group have already sold a 12.2 percent stake in May 2016 (Arnold and Englan, 2016). [↑](#footnote-ref-80)
81. The Strategic Review is an annual review of the business which informs the Annual Report. [↑](#footnote-ref-81)
82. Again we must exercise caution here with tougher capital requirements introduced by Basel III perhaps explaining the decline between 2009 and 2011. [↑](#footnote-ref-82)
83. Like in our previous chapters, the shifting nature of regulatory capital requirements post-crisis complicates the accuracy of making comparisons between 2008 and present. [↑](#footnote-ref-83)
84. See Chapter 4, page 127, figure 4.2. [↑](#footnote-ref-84)
85. The substantial increase in income and profit contribution of the investment bank for this year is attributed to the completed integration of the Lehman Brothers brand into the Group and the subsequent ‘write up’ of assets contained on the Lehman’s book. [↑](#footnote-ref-85)
86. Indeed, it may be possible to conclude that a degree of ‘dissatisfaction’ is not only desirable in the learning process but is in fact needed with learning only following once an organisation has experienced a degree of dissatisfaction. For example, we note in previous chapters that Lloyds’ and Barclays’ learning experience – epitomised by the undertaking of strategic reviews, much like HSBC, either began or accelerated markedly following a certain dissatisfaction. However, in the case of RBS it would appear that the level of this dissatisfaction has been overwhelming and crippled the learning experience. [↑](#footnote-ref-86)
87. Further reputational damage to the Bank was then caused when it was revealed that HSBC Mexico had become known in the criminal underworld as ‘the best place to launder money’ (Pachico, 2012). [↑](#footnote-ref-87)
88. We should also note HSBC are not alone on this with all the banks in this study being found guilty of such breaches. [↑](#footnote-ref-88)
89. It is widely believed that sanctions against the Bank could have been much more severe were it not for former Chancellor George Osborne and the FSA intervening and negotiating a more favourable deal for the Group (see Neate 2016b; McLannahan, 2016 for further discussion). [↑](#footnote-ref-89)
90. Indeed all the banks in this thesis have been embroiled in the scandal to some extent. [↑](#footnote-ref-90)
91. We should note that this incident pre-dates the financial crisis with the majority of products being sold between 2005 and 2008. [↑](#footnote-ref-91)
92. At the time Libor was, and still is, considered to be one of the most important interest rates within the global economy acting as the cornerstone for multiple financial trades and deals each day (BBC News, 2015a). [↑](#footnote-ref-92)
93. For example, the Bank supplied one wealthy client with a foreign cash card so that untaxed monies could be withdrawn abroad and avoid the attention of domestic revenue inspectors (Evans, 2015). In another case HSBC wrote to clients advising them how to evade the European Savings Directive, offering them products which were specifically designed to circumvent the European initiative aimed reducing tax evasion (Evans, 2015). [↑](#footnote-ref-93)
94. This being 1/3 of the maximum variable pay opportunity of 200 percent under CRD IV. [↑](#footnote-ref-94)
95. Once again, this is in-keeping with the requirements set out by CRD IV. [↑](#footnote-ref-95)
96. Which would be in keeping with requirements set out by the Remuneration Code (2011). [↑](#footnote-ref-96)
97. Fixed pay allowances and their controversial use as means of circumventing regulatory stipulations has been discussed elsewhere in this thesis. Likewise, we should note that all the banks in this study are currently utilising such awards. [↑](#footnote-ref-97)
98. The Group would go on to cause further controversy by announcing that in 2013 it had paid 239 of its bankers bonuses of in excess of £1 million (Treanor, 2014c). [↑](#footnote-ref-98)
99. Discussed in more detail in the coming section. [↑](#footnote-ref-99)
100. See Chapter 6, page 192, footnote 78. [↑](#footnote-ref-100)
101. In July 2011, HSBC announced that it would selling almost 200 of its New York based branches to First Niagara in deal worth approximately £670 million (Thomas and Braithwaite, 2011). However, the Group would retain roughly 116 branches across the state of New York (ibid). Likewise, in August of the same year HSBC agreed a deal to sell it credit card business in the U.S. to Capital One Financial in a deal worth approximately £1.7 billion (Goff and Thomas, 2011) and would see the Group shed approximately £19 billion of credit card loans (Rushe, 2011). Further disposals also included the sale of the Group’s Japanese private banking arm, with assets of approximately £1.9 billion, in October 2011 to Credit Suisse (Simonian, 2011); the 2012 sale of insurance businesses in Hong Kong, Singapore, Argentina and Mexico with the disposal shedding the Group of approximately £830 million of assets (Wilson, 2012); the disposal of its ship brokerage and consultancy firm, HSBC Shipping Services Ltd, disposing a further £4.5 million of assets in August 2012 (Arnason, 2012); the 2012 sale of its property advise service, worth approximately £4.4 million for an undisclosed figure (CityAm); the 2012 sell-off of its entire 15.6% share in the Chinese insurance company Ping An for approximately £6.3milion, making for the Group an estimated profit of £2 billion (Davies et al, 2012). Moreover, in May 2012 the Group announced that it would be disinvesting a further £2.9 billion of assets with the sale of part of its businesses located across Latin America to Banco GNB Sudameris in a deal worth approximately £270 million (BBC News, 2012b). In December 2013 HSBC announced that it had sold its entire 8% stake in Bank of Shanghai to Banco Santander SA for an undisclosed fee and which would see the Group dispose of £334 million of non-core assets from the balance sheet (HSBC, 2013b). Likewise, in 2014 the Group would also sell approximately £8.4 billion of its Swiss private banking portfolio to investors in Liechtenstein (Arnold, 2014b). [↑](#footnote-ref-101)
102. Because HSBC report all financial data in US Dollars, all figures have been converted to GBP using the Bank of England’s ‘daily spot exchange rates against Sterling’ as of 31st December 2015. Available online at: <http://www.bankofengland.co.uk/boeapps/iadb/Rates.asp?TD=31&TM=Dec&TY=2015&into=GBP&rateview=A&POINT.x=11&POINT.y=15> [↑](#footnote-ref-102)
103. Indeed, figures demonstrate that HSBC were, and continue to significantly outperforming our comparator group on this metric alone. [↑](#footnote-ref-103)
104. Although tougher regulation on minimum capital standards and the definition of Tier 1 capital may have had an effect on wholesale borrowings. [↑](#footnote-ref-104)
105. Like our previous chapters measuring any potential changes in the amount of regulatory capital being held by HSBC both pre and post-crisis is difficult due to the shifting regulatory landscape. As such, we will discuss the application of regulatory capital against current stipulations, namely Basel III. [↑](#footnote-ref-105)
106. See Chapter 4, page 127, Figure 4.2. [↑](#footnote-ref-106)
107. This figure is broadly in-line with our comparator Group who have all announced target ROEs of between 11.5 and 15 percent post-crisis. [↑](#footnote-ref-107)
108. Although, as we noted in Chapter 6 Barclays would have potentially fared far worse were it not for the acquisition of Lehman Brothers’ assets at ‘fire sale prices and a capital injection from investors in Qatar. [↑](#footnote-ref-108)
109. In 2007 this yearly average had been 901p. [↑](#footnote-ref-109)
110. In comparison Barclays’ investment bank contributed 50 percent to overall Group profit in 2008. [↑](#footnote-ref-110)
111. The Global Banking and Markets, HSBC’s investment bank, is also ranked as one the top ten most successful investment banks in Europe the Middle East and Asia (Noonan, 2016). [↑](#footnote-ref-111)
112. Indeed, it was revealed that HSBC would be reducing the Group’s risk weighted assets (RWAs) by approximately £195 billion (HSBC, 2015b). The majority of the savings would be targeted in the Group’s investment bank and would focus on running down RWAs within the division to ‘less than one-third’ of overall Group RWAs (HSBC, 2015b). [↑](#footnote-ref-112)
113. Even when regulatory changes have been accounted for. [↑](#footnote-ref-113)
114. Again, even when regulatory changes have been accounted for. [↑](#footnote-ref-114)
115. However, we must exercise caution in drawing conclusions from such sources which may serve a particular agenda and are open to contestation. [↑](#footnote-ref-115)
116. I have stressed throughout this conclusion that there is no one-size-fits-all answer to the research question and instead we should consider each bank on case-by-case basis and take account for institutional variations and nuances. [↑](#footnote-ref-116)
117. We should note that banking, with tougher regulatory stipulations and vastly reduced balance sheets are no-longer as central to the global economy as they once were and hence the importance of undertaking a future study of this kind. [↑](#footnote-ref-117)
118. Although, as we have noted previously, the next financial crisis may be different and have a different set of causes of precursors. [↑](#footnote-ref-118)