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## The Banks and Society: Rebuilding Trust

### ***Discussion and launch of ECCR's new report on the banking sector***<sup>1</sup>

ECCR and ECCR West Midlands Group organised the event on the evening of Tuesday 1 March 2011 at Wragge's Banking Hall, Birmingham.

Chaired by Rt Rev. David Urquhart, Anglican Bishop of Birmingham, the panel featured Damon Gibbons of the Centre for Responsible Credit and the Better Banking Campaign, Suzanne Ismail of ECCR, and Professor Andy Mullineux of the University of Birmingham Business School and Centre on Household Assets and Savings Management. Rev. Dr Giles Fraser of St Paul's Cathedral was unable to attend due to train service disruptions.

Meeting participants included members of national-level and West Midlands business and academic communities, churches and other faiths, and the public and voluntary sectors.

#### **Rev. Raymond Singh, Vice Chair, ECCR**

Raymond Singh warmly welcomed the panel and audience and thanked all those involved in organising the event, report sponsors CCLA Investment Management and Wragge & Co. for providing the venue. He spoke of ECCR's long-standing concern for, and work on, corporate citizenship and the importance of a Christian prophetic voice in challenging companies, while also developing good links with the business community. ECCR's report's focus on impacts on the lives of those hardest hit by the financial crisis was important, he said. ECCR hoped publication of the report would make a positive contribution to debates about banking policy, practice and reform.

#### **Rt Revd David Urquhart, Bishop of Birmingham**

David Urquhart also welcomed all present and conveyed apologies from Rev. Giles Fraser. ECCR's report *The Banks and Society* covered a broad range of complex issues, he said. He had formerly worked for a major company, had good friends in the banking industry, and fully recognised how dependent we all are on the financial sector. We needed enough knowledge of banking to be able to ask the right questions in engaging to make economic life as good as possible for all – especially now in an era of public sector budget cuts and rapid change.

#### **Suzanne Ismail, ECCR**

Suzanne Ismail outlined the origins of the report, largely as a response to many requests from ECCR's members for more clarity about the banking sector. There was much confusion about banks' operations and impacts.

Of the thirteen main areas of concern that *The Banks and Society* covers, Suzanne Ismail highlighted three key areas. First was financial exclusion. Banks do not serve all of society: 5 per cent lack access to a bank account, more under-use their accounts, and many people are deemed uncreditworthy. Financial exclusion can lead to increased inequality, she said.

The second major issue was banks' financing of businesses and projects with negative social and environmental impacts. The United Nations has recognised that prevention of dangerous climate change requires huge investment in renewable energy generation; banks could make a major contribution to this, but have not yet done so. Meanwhile they provide financing for companies involved in controversial and environmentally destructive projects, such as the Canadian oil sands,

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<sup>1</sup> [www.eccr.org.uk/Banksandsociety](http://www.eccr.org.uk/Banksandsociety)

which have had led Canada to abandon its Kyoto Protocol greenhouse gas emission reduction targets.

A third important concern was facilitation of corruption. Middle East leaders who had spirited huge sums out of their countries had been financially linked with UK banks. ECCR's report offered another notable example from Equatorial Guinea. Money laundering rules do not seem to be working, she said.

Overall, banks needed to be far more transparent, which would make them more comparable in their performance. With its report ECCR sought to broaden the debate to help people envisage what a more ethical banking sector would look like. The present situation represented both a challenge and an opportunity for banks.

### **Damon Gibbons, Centre for Responsible Credit and Better Banking Campaign**

Damon Gibbons observed that the true cost of the 2008 banking crisis was only just becoming apparent in terms of lost economic growth, unemployment, insolvency, mortgage problems, and public sector and welfare budget cuts. At least some of these were political choices. Banks have not denied responsibility for the crisis, but what are they doing moving forward?

Financial services are increasing in importance, as responsibility for a range of welfare outcomes shifts from the state to the individual household. For example, insurance policies and private pensions had expanded while state provision in such areas had been eroded. Rapid recent growth in reliance on credit meant borrowing from the future and accelerated the depletion of natural resources.

Four particular areas of social responsibility for banks were responsible lending, financial inclusion, financial education, and help with debt. While corporate social responsibility (CSR) thinking assumed 'win-win' outcomes, 'win-lose' outcomes were also possible. For example, offering more affordable credit might cost banks money. And banks might use financial education mainly as a public relations exercise. We should therefore be sceptical about banks' CSR claims.

ECCR's report challenged such claims, as did a new report from the Centre for Responsible Credit, *Held to Account: a review of Corporate Social Responsibility in retail banking from the consumer perspective*.<sup>2</sup> Despite finding examples of good practice, the latter report highlighted lack of consistency and of contextual information in banks' CSR reporting, making it hard to compare banks' social performance. Standards of verification were poor, and banks had not shown how dialogue with stakeholders had resulted in better practice.

Along with more effective self-regulation by banks, public policy intervention had an important role. New financial legislation offered civil society opportunities to influence outcomes. There was a key need to stimulate local economies and therefore to consider formal obligations concerning the disclosure of financial services provision in local communities, such as along the lines of the US Community Reinvestment Act.

### **Professor Andy Mullineux, University of Birmingham Business School and Centre on Household and Savings Management**

The UK government faces a dilemma with UK Financial Investments' 40 per cent stake in Lloyds Banking Group – the UK's largest retail bank – and more than 80 per cent in RBS, Andy Mullineux said. The government needs to maximise its revenue from these holdings. At the same time, its Independent Commission on Banking will make recommendations on restructuring the banks, with objectives of enhancing competition and financial stability, and this may conflict with the revenue requirement.

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<sup>2</sup> Available at [www.responsible-credit.org.uk/uiimages/File/Held%20to%20Account%20final%20February%202011.pdf](http://www.responsible-credit.org.uk/uiimages/File/Held%20to%20Account%20final%20February%202011.pdf)

Competition has decreased as a result of the banking crisis, and reversal of this would reduce the value of the government's holdings in the currently monopolising banks. The government thus faces a choice between maximising the value of its holdings in the short term and protecting taxpayer and consumer interests in the longer term.

Prior to the crisis, the government had made a 'Faustian bargain' with the banks, underpinning their monopoly profits through state subsidy in return for responsible bank behaviour towards risk and financial stability. Banks broke the contract by closing branches, reducing access to finance and taking excessive risk.

Banks fear heavier regulation and taxes. Hence Project Merlin. Banks have benefited very quickly from Merlin, which has not imposed substantial new requirements on them. The government should not have made such an agreement. Instead, banks should pay more for the implicit and explicit public insurance they benefit from, such as through increased taxation of their domestic business. A possible – although not inevitable – consequence of the latter, however, could be reduced lending to small and medium sized businesses and to households.

Although big banks had threatened to leave the UK, they could not take their retail branches with them. There was a good case for separating retail banking from international banking and wider financial services, as currently under consideration by the ICB.

### **Rev. John Paxton, ECCR West Midlands**

In Giles Fraser's absence, John Paxton shared with the meeting some of the former's thoughts on the banks by reading from his recent article on the subject in the *Church Times*.<sup>3</sup> The St Paul's Institute, which Giles Fraser leads, is an educational think tank that seeks to bring Christian ethics to bear on questions of finance and economics, so his voice would have been well received at this meeting.

'Given how much of the Bible is concerned with the right use of money, and the huge social impact that banks have on the way we live, one would have thought that churches would make the ethics of finance a high priority. But my experience is that, often, they do not,' Giles Fraser had written.

The article had commended ECCR's report as 'a great resource for churches to get people thinking about the moral issues involved, including clear explanations of the slippery line between clever tax-avoidance and illegal tax-evasion'. The report was, it said, 'a good place to start' in developing 'a greater literacy in the ways of the banking world'.

John Paxton suggested that underlying the broad range of concerns that the report covers were such questions as, What is a bank for – and who is it for? Do banks serve society? Many people were now uneasy about banks that we thought we knew gambling with others' money in high-risk and questionable ventures.

### **Discussion**

Having thanked the speakers, David Urquhart then opened the meeting for general discussion.

*The community finance sector has lent substantial money to small and medium enterprises (SMEs) in recent years, targeting local jobs for local people, when banks have been unable to do so. Since the crisis, many SMEs have become more disadvantaged. A key measure, as promoted by Better Banking, would be for 1% of bank profit to be targeted through the community finance sector for that market, and banks could then be more honest about limitations in their lending. What one recommendation would the panel select from the report?*

All three panellists highlighted the importance of transparency.

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<sup>3</sup> 'Get to grips with banks' morality', *Church Times*, 25 February 2011, [www.churchtimes.co.uk/content.asp?id=108469](http://www.churchtimes.co.uk/content.asp?id=108469)

Suzanne Ismail (SI): For ECCR, lack of transparency had made it difficult to compare one bank with another when researching its report.

Damon Gibbons (DG): Disclosure is the driving force for change, as proved by the US Community Reinvestment Act. Banks disclose to their regulators on small business lending, home repossessions, and so on, but don't want the information publicly available.

Andy Mullineux (AM): The disclosure requirements of the Community Reinvestment Act empower activists. Jesse Jackson had urged community groups to buy a few shares in the big banks and turn up at their AGMs asking awkward questions.

*Transparency is necessary but not sufficient. Shareholder activism is good, but it is 'a gnat on the back of an elephant', because the traditional shareholder model is not based on democratic control but on making money. We need to either change the model or have stronger regulation. Where is work being done on re-mutualisation? We need to separate financial services from casino banking.*

AM: Some research has been done at Oxford University Business School. The main corporate governance conflict is between the interests of depositors and shareholders. So the mutual model is worth looking at, including credit unions and CDFIs (Community Development Financial Institutions), especially for local banking.

*In line with work referred to in ECCR's report, the crucial issue is that the right to create money supply – as banks' own property – should be taken away from the commercial banks and given to the Bank of England. This would replace the creation of money as debt with its creation as an asset. Fractional reserve banking has led to a huge edifice of debt to the banks without any increase in wealth.*

DG: This and previous financial crises can be linked to fractional reserve banking, to banks failure to hold sufficient reserves and to the moral hazard involved. But how money is used is the fundamental issues, which is about household decisions as well as bank decisions, and the policy framework in which this happens. The demand for credit comes, for example, from people being driven to demand mortgages as the main way they can secure housing. The solution probably needs to combine supply- and demand-side approaches.

AM: The Bank of England underpins banks' money-creation privilege and requires in return that the banks are trustworthy. The banks have broken that trust. Without fractional reserve banking we would have slower growth, reducing the alleviation of poverty.

*The presentations were very negative towards the banks. This is not the way to rebuild trust. A spokesperson for the banks is also needed. If all ECCR's report's recommendations were implemented, could banks still make a profit? It is already difficult enough to open a bank account [implying that addressing the Centre for Responsible Credit's concerns would make it even more so]. Nationalising the banks would be the only way to deal with the third speaker's concerns. In response to Barclays' 2.4 per cent corporation tax [referred to in Giles Fraser's article as read by John Paxton], every company can offset losses against future profits; why do we specifically criticise Barclays?*

David Urquhart (DU): Many people from banks were invited to this meeting but did not come. It was designed to be a dialogue of that kind. Successful business is essential for human flourishing. Trust was reduced when the banking industry became self-referring rather than a service industry, and as a result of the sector getting an enormous bail-out while others do not. There are people within banking trying to do a very good job.

AM: My view is that banks have broken a long-standing trust, but governments are also culpable for becoming too reliant on bank profits and under-regulating them. Banks still need to admit they have made a mistake.

DG: In mainland Europe, conferences have been taking place for years between consumer agencies and banks. Efforts to engage the UK banks in constructive debates were turned down flat, and the British banks did not want to talk. The situation has changed as a result of the crisis, but the responsibility for banks being absent today lies with banks.

SI: ECCR's report picks out good as well as bad banking practice. Yes, we need dialogue. ECCR has started dialogue with some of the banks around the report and hopes to talk to others soon. Being ethical does not necessarily mean losing money. However, if banks are acting in a morally questionable way, we should raise concerns whatever the impact on profits. There is starting to be a cost to companies that do not pay attention to these issues, such as arising from NGO (non-governmental organisation) campaigns about the Canadian oil sands, with shareholder resolutions at BP and Shell.

*Following the demise of bank managers, banks no longer see themselves as part of a supply chain mechanism and are therefore less willing to negotiate with business customers. Decisions are made in back offices. Banks won't listen to struggling small businesses. It is an uphill struggle to get more corporate responsibility in the banking sector. The Midlands has invented banks in the past. Isn't it time for a new bank?*

DG: Banks aren't interested in long-term relationships with customers any more. This is largely due to innovation within financial services. Slicing, dicing and spreading risk have led to nobody takes final responsibility for lending decisions or for outcomes for customers. The segmentation of financial services means that those who take risks do not necessarily bear the consequences.

AM: I doubt that a new municipal bank is the way forward. We can build on CDFIs and credit unions.

*One thing banks are for is to facilitate saving, and this is central to the UK's banking crisis. The crisis resulted from an over-reliance on importing money. UK banks were brought down when the New York money markets dried up, preventing the banks from covering their cash flow. Central banks in Germany and the US are regionally accountable, whereas appointment to the Bank of England's Monetary Policy Committee is entirely centralised. Democratisation and reform of the Bank of England are needed.*

AM: Generally the countries with the strongest savings banks, which have not moved into commercial property, are those with the best local banking, and Germany is one of them.

*There are flaws in the economic growth model being followed. Money has been moved out of the public domain, but it has all gone to the top. It's a moral issue when the top 1 per cent are making massive gains. Excessive rewards to the top bankers are losing people's trust.*

DG: If public service provision reduces, making people more reliant on financial services, access to these services will not be even. Wealthy people will get easy and cheap access, poorer people less so. This will harm social mobility and increase inequality.

*Is there any evidence to support the oft-heard claim that, if large bonuses are not paid, bankers will move to another country to work? Have we been 'sold a pup' on this?*

AM: HSBC has paid much higher bonuses in Asia than in London. It will be interesting to see whether this has any effect on banker mobility.

DG: There is a case for international regulation to create a level playing field. Voluntary solutions on bonuses will not work.

SI: Patrick Gerard has done interesting research on executive pay, available on his blog at [www.performanceandreward.blogspot.com](http://www.performanceandreward.blogspot.com). He argues that there is not a finite supply of talent in

the banking sector, but rather this is under the control of the banking industry itself. He challenges the idea that the pool of talent is as limited as some claim, and he advocates a cap on bonuses.

*Voluntary codes have proved ineffective. Independent monitoring is essential. The UK bank regulators need to pick up the excellent ideas in ECCR's report. We need to challenge the myth that taxpayers bailed out only Lloyds and RBS, whereas in fact we bailed out all the banks because they hold bonds in each other, and all benefited from the bank lending guarantee scheme. Hence current anger about levels of tax being paid. Bondholders as well as shareholders should have been made to take some of the hit from the crisis.*

AM: Levy regimes – designed to encourage deposit taking – and tax regimes could be modified to encourage banks to issue more of the right sort of bonds. And the IMF has questioned whether interest on debt should continue to be deductible from tax; a change to this could discourage bank leveraging.

*The need to rebuild trust goes wider than the banks and includes government. At the root of the crisis was also the housing bubble, and besides the banks it was the government that benefited from this (and not most people buying homes) by taxing house buying and selling and inheritance.*

AM: Governments encourage home ownership as a way to achieve social cohesion and have encouraged people to buy who could not afford it.

DG: Trust needs to be rebuilt across the board. The crisis has revealed deep fault lines, which require truth and honesty to confront. Yet rather than condemning banks, civil society needs to work with the financial services sector to bring about change so that banks operate in a way that is most useful to society.

SI: We all share responsibility for the crisis and all have to face up to the need for change.

### **Summing up: David Urquhart**

The panel have identified transparency as a priority. There has been a widespread view that banks should address their core social purpose. Governance is also a key question. Wider moral issues have been identified, including concerns about economic growth and housing, about who benefits and who loses, and about how money is used. Discussion has ranged from detailed attempts at solutions to these very basic questions for us all. The debate with bankers needs to continue, both regionally and nationally. All humanity needs to focus on rebuilding trust. The diverse range of citizens attending this event shows the extent to which the moral questions we face are a shared responsibility.

Thanks to the panel and to all attending.

### **Looking to the future: Barbara Hayes, ECCR West Midlands**

Thank you to Bishop David for his able chairing this evening. This is the first time an ECCR report has been launched outside London. It is important that this particular report has been launched outside the purview of the City of London, because the issue affects us all throughout the country. Tonight's audience has included laypeople as well as many with real expertise in this area. ECCR nationally will continue this discussion with the banks and others, and ECCR West Midlands will engage with the finance sector locally. We will stay in touch with those present tonight who have asked us to, and ECCR always welcomes new members and new support. It is a good time to influence developments, with the Independent Banking Commission report due in September 2011.

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