



UNITE RESPONSE TO THE TREASURY COMMITTEE EVIDENCE SESSION ON THE BANKING CRISIS

This response is submitted by Unite the Union. Unite is the UK's largest trade union with 2 million members across the private and public sectors. The union's members work in a range of industries including financial services, manufacturing, print, media, construction, transport, local government, education, health and not for profit sectors.

Unite, is the largest trade union in the finance sector representing some 180,000 workers in all grades and all occupations, not only in the major English and Scottish banks, but also in investment banks, the Bank of England, insurance companies, building societies, finance houses and business services companies.

Unite welcomes the opportunity to present written evidence to the Treasury Committee on the banking crisis and the call for evidence has highlighted a number of key issues which Unite will address. The union has made a number of submissions to the Committee and to the FSA on related issues and these are reflected in this response. Where we have addressed specific questions posed in the Committee's terms of reference these have been identified by paragraph number. Previously Unite has expressed deep concern about leverage and risk in its evidence to the Treasury's Select Committee's inquiry on Private Equity, all pertinent to this current inquiry on the banking crisis.

Unite notes the responses to the Committee's recommendations regarding the inquiry into private equity and would inquire what further steps the Committee intends to take in following up their recommendations.

1. EXECUTIVE SUMMARY

1.1 There needs to be tighter regulation of the market and strengthening of the framework which regulates the finance industry.

1.2 It is necessary to consider making the FSA a publicly accountable and independent regulatory body.

1.3 There should be trade union representation on the boards of all key agencies involved in the regulatory system.

1.4 There should also be an independent external oversight process to assess the probity and competence of senior executives and directors.

1.5 Unite is keen to work with employers and the regulator to ensure that remuneration and incentive schemes are fair and transparent. Claw back provisions should apply where senior people have acted irresponsibly and include for example the repayment of half of the bonuses of any such financial sector executive over the previous 10 years. This money was, in hindsight, wrongly paid as part of the Ponzi scheme which the “Masters of the Universe” perpetrated over the last decade at least. These falsely paid bonuses should be returned.

1.6 Unite believes that staff remuneration systems require a review. Unite has anecdotal evidence that staff are given greater incentives for selling loan products than savings products. Unite calls for a more ‘holistic’ approach, recognising that remuneration systems (and many other employment practices) do not work in isolation.

1.7 The taxpayers’ stake in the part-nationalised banks should allow for greater consideration of the important public role that banking plays in society and the economy. No money that is directly underwritten by the state such as final salary pension funds via Pension Protection Fund (PPF) or money in banks recently underwritten or controlled by the state, as well as those which are not, but would not be allowed to fail, should be put at risk by either short selling or investment in high leverage, high risk investment vehicles such as hedge funds, private equity etc.

1.8 Government intervention in the banking system must go further including requiring banks to lend to small businesses in order to limit the impact of the current recession on the UK economy.

1.9 Whilst the current crisis was triggered by sub prime mortgage defaults Unite remains concerned that the debt crisis is far wider and that private equity debt could be the next bubble to burst with devastating effect on pay, conditions, pensions and jobs. Unite is concerned to stop attempts to make workers pay for mistakes of others—particularly that of taking on too much debt. To help mitigate the situation and help protect pay, conditions and pensions, as well as jobs it is important to know what the risks are and when they may manifest themselves so that appropriate proactive action can be taken by government and others to prevent this happening. Unite thus calls for total transparency in relation to private equity debt.

1.9.1. Specifically this means that for every portfolio company that is controlled by one or more private equity funds full detail of debt and covenants, if any, should be disclosed.

1.9.2. An assessment of the risk that leverage buyout defaults will create further difficulty in the credit markets and for already troubled banks and financial service companies’ needs to be carried out. The identification of which banks hold the debt for portfolio companies at risk and all details, including the covenants, if any, should be disclosed.

1.9.3 Most importantly there should be full public disclosure of all the details including covenants of private equity debt, held on the books of the banks in which the state now has a significant share.

1.10 Investment funds whose strategies rely on high leverage should not be permitted to take important stakes or ownership of retail and investment banks.

1.11 Proprietary trading should be severely restricted in any bank in which the state now has a significant share or in any other financial institution determined to be so integral to the UK's financial system that it would not be allowed to fail.

1.12 There must be an acknowledgement of the social responsibility the finance sector has beyond the interests of shareholders. The more traditional relationship between bank and lender, consumer and company was a better model. Most fundamentally the objective of a stable financial system must be re-orientated to serve the real economy and fund long term investment. The government should use its influence on those not only where it has a direct interest but across the whole banking and finance sector, including for example, Barclays.

2. SECURING FINANCIAL STABILITY

2.1 Financial stability is of crucial importance to all members of Unite. Whilst our members employed in the financial sector have additional, specific concerns, all Unite members have a direct stake in the fairness, transparency, democratic accountability and objectives of the financial system and its regulation. Most obviously the global financial crisis is wreaking havoc on Unite members and their families - in relation to their homes, jobs, pension funds¹, credit and local communities. It is important to note that whilst comment is made about the financial crisis "having an impact" on the real economy, it is also true that for many Unite members there is a real blurring of the boundaries between the finance sector and the real economy.

2.2 Real financial entities such as Private Equity Funds own, albeit for a short term, firms across the economy in manufacturing and services. These have been bought, restructured and disposed of as liquid assets regardless of profitability and output, with targets based on financial markets, rather than real value being placed on real production, productivity or jobs. Productive capacity has been eliminated to raise cash for share buy-backs and boost share price². Other companies demand rates of return equal to those obtained in global financial markets, as well as remuneration for decision making management being linked to short term share price movements and/or cash extraction rather than long term business success.

3. REGULATION

3.1 Unite is disappointed with the role the Financial Services Authority (FSA) has played in regulating the finance sector and in particular the apparent failure of the FSA to adequately monitor the practices and procedures of some of the largest financial institutions in this country. The financial system can no longer be a gravy train for the few at the expense of the many and their homes, pensions, livelihoods and communities.

3.2 There needs to be tighter regulation of the market and strengthening of the framework which regulates the finance industry together with increased powers to

¹ According to OECD figures as of October 2008 the total assets of OECD based pension funds had declined by over US\$3.3 trillion or 20% since end 2007 as a result of the deepening financial crisis with the impact being most severe in the UK, along with Ireland, the USA, Canada, Netherlands, Australia and Japan. The full impact has yet to be revealed given "the lack of clarity over the valuation of some illiquid assets" including the same structured products which are the root of the global financial crises. Direct exposure to these toxic assets may be "as high as 3%" of pension fund assets. Pension Markets in Focus OECD December 2008 Issue 5

² Financialisation: new routes to profit, new challenges for trade unions, IUF 2006

hold to account, including criminal proceedings, those who contribute to failings on a massive scale. The products, processes, practices and institutions of the global finance sector have been obscure to all stakeholders including Unite, and often purposely so, as has the regulatory regime and the lack thereof, as well as the decision making process about regulation. The finance industry has thus had a strong influence in the regulatory development. As a result *“the massive political lobbying of financial supervisory and regulatory authorities and policy makers by the financial industry has allowed light regulatory approaches to prevail. In that sense the current crisis should not be understood in technical terms only. The crisis exposed a more structural crisis of democracy and how policies and decisions that are supposed to serve the public interest have been undermined by private interests of the financial lobby”*³

3.3 Deregulation, weak regulation and lax enforcement of existing regulation have all encouraged irresponsible and greedy behaviour. While there is global consensus about the need for regulation, there is also a need for assessment of the purpose and function of the financial system. Regulation for more of the same should not be an option. Regulation should aim to protect social objectives such as the right to a decent pension and decent homes. Unite has long argued for a financial system that ensures that investment is for the long term, that it underpins a high productivity, high wage economic growth model meeting peoples' needs for goods and services.

3.4 As an example of the failings of the current regime, the internal audit division of the FSA identified a number of systemic failings in the supervision of Northern Rock, in particular the failure of the FSA supervisory team to deal sufficiently rigorously with Northern Rock's management in questioning the vulnerability of the bank's business model. Unite believes this was not an isolated incident but a systematic failure of the procedures and practices of the supervisory systems within the FSA. It is evident from the current financial situation that the FSA has failed as a regulator. It is necessary to consider in the regulatory overhaul to make the FSA a publicly accountable and independent regulatory body to include trade union representation as well as independent and academic experts.

3.5 Unite wants to see trade union representation on the boards of all key agencies involved in the regulatory system. It is essential that the employee voice is heard among those with only the interests of shareholders in mind. The trade unions are ideally placed to provide a 'checks and balances' overview on behalf of employees who have many valuable insights into the industry.

3.6 In addition, Unite would like to see some form of independent external oversight process to assess, prior to appointment, the probity and competence of senior executives and directors to run the large financial institutions which the taxpayer, through the Government, owns or part owns, on account of the significant impact these institutions can have on the economy at large.

3.7 All relevant organisations in the finance sector should also be required to have robust and properly resourced risk management structures, which would have dual reporting lines direct to the chief executive and the regulator. Risk management should be treated as a core activity for a financial institution.

3.8 Unite notes that last year the European Parliament adopted a report prepared by the Party of European Socialists on regulation of private equity and hedge funds. This report expresses cross party consensus on the need for further regulation and

³ Reregulation in the aftermath of the global financial crisis November 2008, Trade Union Advisory Committee to the OECD.

should thus be seen as laying down minimum standards for regulation. The recommendations include greater capital adequacy requirements for financial instruments and institutions (including private equity and hedge funds), limitations on the easy securitisation of leveraged loans ("originate and distribute") which have fuelled both the buyout boom and the financial crisis generally as well as more private equity and hedge fund specific measures such as limitations on debt levels in leveraged buyouts; measures to contain asset stripping of portfolio companies by private equity owners; greater transparency and disclosure rules for private equity; and ensuring that employees in private equity-owned companies have information rights.

4. LEVERAGE

4.1 Unite has continually raised concern about excessive leverage and the risk that this poses. The growth of the unregulated " shadow banking " sector including investment banks, off balance sheet structured investment vehicles set up by commercial banks and hedge funds and private equity all engaged in risky financial activities. All used leverage to magnify their returns, just, as it of course amplifies losses.

4.2 The crisis has reinforced our argument that this should no longer be subsidised by the tax system⁴. In particular that tax relief on interest repayments on debt should be abolished. The use of leverage by financial institutions should be tightly restricted. Consideration should be given to capping leverage levels.

4.3 Whilst the current crisis was triggered by sub prime mortgage defaults Unite remains concerned that the debt crisis is far wider and that private equity debt could be the next bubble to burst with devastating effect on pay, conditions, pensions and jobs. Unite is concerned to stop attempts to make workers pay for mistakes of others - particularly that of taking on too much debt.

4.4 Private equity buyouts took place in the context of an unprecedented stable economic environment. The global financial crisis and serious economic difficulties mean that when profitability declines companies find themselves with unattainable levels of debt. Unite has a number of concerns about the looming possibility of a crisis in highly leveraged buyout debt. In the summer of 2007 Unite warned that the overall economy could be seriously damaged by the high-risk nature of private equity

⁴ In relation to the tax treatment of debt and equity, tax relief on interest on debt should be abolished. In Denmark, the tax relief on interest payments has been eliminated with offsets elsewhere. Unite believes this model is worthy of consideration. The tax relief on interest on debt means that the portfolio firms acquired by private equity pay much reduced corporation tax. There is no reason why debt should be given more favourable treatment over equity; this is particularly so when debt is used for buyout purposes, and to fund dividend recapitalisation. Tax relief on interest on debt is an anomaly in Capital Markets theory (CMT). A purist approach to CMT would say there should be no difference between the treatment of debt and equity.

Arguably debt should be given less favourable tax treatment than equity given that leverage increases the financial risk of the firm and risk of default, shifting risk on to other stakeholders particularly workers, in terms of redundancy, erosion of pay and conditions including pensions. Leveraged buy-outs put new, additional financial costs and demands on the portfolio company and sources of finance have to be found to meet them. Unite is concerned that debt for acquisition and dividend recapitalisations also means less money for investment in fixed assets and training. Moreover highly leveraged buy-outs put pressure on public companies with a more traditional financial structure..... The knock on effect of debt may well squeeze investment and long term planning across the economy. This is hardly something that should be encouraged by tax relief.

Equity investors contributing part of their capital as shareholder debt can exacerbate the issue of tax reduction and should be addressed.

Unite agrees with Nick Ferguson that it is wrong that private equity executives pay less tax than their cleaner. Given that employees on a modest income bear marginal tax rates, including social security taxes, private equity partners should be taxed at the full 40% income tax rate.

leveraged buyouts of what is now a very substantial part of the economy. Unite pointed out that in less favourable economic circumstances, this could generate a high rate of failures of private equity owned companies, a calamity for enterprise that could in turn further damage the banking system of the UK. Moreover it would be likely to increase the risk of wage freezes and deterioration in conditions, with further risk of job loss and increases in firms going into administration.

4.5. Unite is more concerned than ever that whole swathes of the economy may be at risk in terms of jobs and pay as a result of previous private equity buyouts. In addition private equity leveraged buyouts put huge pressure on other companies who wished to avoid being taken over, to sell off or cut productive facilities while at the same time spending money on buying back its own shares or issuing dividends and increasing debt.

4.6 Unite is now further concerned about the similarities to the sub prime crisis with the distribution of LBO debt throughout the financial system.

4.7 To help mitigate the situation and help protect pay, conditions and pensions, as well as jobs it is important to know what the risks are and when they may manifest themselves. So that appropriate proactive action can be taken by government Unite⁵ is calling for total transparency in relation to private equity debt.

4.8 Firstly, full details of debt and covenants for each portfolio company should be disclosed as well as the ability to make interest or principal payments on time, any danger of default on debt or bankruptcy, any cost cutting steps being considered to free up cash flow to make t debt payments, how would these affect workers for example in relations to wages and condition, pensions, job losses and alternatives considerations.

4.9 Secondly that an assessment is needed of how debt-laden company defaults may ripple through the economy and of the risk that highly leveraged buyout defaults will create further problems in the credit markets and for already troubled banks and financial service companies. This entails identifying who owns the debt for portfolio companies at risk; which banks hold what debt and what are the details, the covenants, if any.

4.10 There should be full public disclosure of private equity /highly leveraged buyout debt held on the books of the banks in which the state now has a significance share, this means disclosure of all the details including covenants if any.

4.11 Unite has actively opposed private equity involvement in the Bank of Ireland. Investment funds whose strategies rely on high leverage ratios should not be permitted to take important stakes or ownership of retail and investment banks. In a

⁵ Unite's submission to the recalled Treasury Select Committee at the end of 2007 made the following observations regarding PE transparency : "Even within the Walker report's narrow consideration of transparency, the benchmark used for comparison with the private equity industry is wrong. Transparency is at the core of the pact between business and society, and significant progress has been made on the accountability of public companies. The appropriate transparency benchmark should be the same transparency requirement on public companies not with the current standard of zero requirements for transparency from the private equity firm itself. There should not be two standards of transparency. Private equity should have the same obligations to disclose as if it were a public company.

The private equity firms (the partnerships) should also have to disclose the same information as if they were a public company. This would mean that they should have to disclose the remuneration of general partners (just as directors pay is disclosed in a public company). They would also have to disclose significant shareholders and the size of their investments. There should be a register of limited partners shareholders available (just as shareholders in a public company are). Finally, the private equity firm should produce group accounts of their holdings just as a public company would. This obligation should apply to all private companies including sovereign wealth funds.

situation of over leverage and de-leverage, institutions built on leverage should not be permitted in banking.

5. REMUNERATION STRUCTURES

5.1 The remuneration regime within the finance sector requires significant attention and overhaul (1.6). Unite has had concerns over a long period over a culture which rewards high risk strategies without due consideration of what is sustainable in the long-term.

5.2 The bonus schemes in many of the UK's largest banks have richly rewarded executive directors for taking short-term and risky decisions while having a hugely detrimental impact on workers in the industry.

5.3 It is necessary to tie executive pay and bonus structures to sustainable and long-term performance. Regulation should encourage long term investment and reward long term sustainable performance. Unite has long standing concerns about other corporate governance issues such as short termism. The use of stock options in executive pay should be restricted to avoid excessive focus in short term movements of share price as opposed to long term interest of the company

5.4 Where senior people have acted irresponsibly claw back provisions should apply and include for example the repayment of half of the bonuses of top executives over the previous 10 years. This money was, in hindsight, wrongly paid as part of the Ponzi scheme which the "Masters of the Universe" perpetrated over the last decade at least. These falsely paid bonuses should be returned.

5.5 Unite believes that staff remuneration systems require a review. Unite has anecdotal evidence that staff are given greater incentives for selling loan products than savings products. The union believes that this type of target-based selling, based upon encouraging the take up of debt by customers, is not necessarily in consumers' best interests.

5.6 The incentivisation and target driven culture associated with commission based selling and synonymous with the finance sector has faced much criticism from both trade unions and consumers groups. This type of selling can increase stress, lower morale and prevent positive employee engagement. Consumer groups believe that it increases the risks of mis-selling by employees in a drive to meet often unrealistic and unattainable targets; none of which does anything for consumer confidence or a motivated and productive workforce.

5.7 Unite calls for a more 'holistic' approach, recognising that remuneration systems (and many other employment practices) do not work in isolation. Such an approach is necessary to provide both a response on how the industry could better serve its customers but also to deliver fairness in its treatment of employees.

5.8 Unite is keen to work with employers and the regulator to ensure that remuneration and incentive schemes are fair and transparent.

6. PROTECTING THE TAXPAYER

6.1 Unite is convinced that the UK Government took the right steps to respond to the banking crisis as it unfolded, (2.1). This included the nationalisation of Northern Rock, although the case for intervention may have been justified sooner (2.2).

6.2 Unite remains concerned however that some of the senior level managers who were at the helm prior to the crisis, remain in place and that this is having a detrimental impact on staff morale within the organisation.

6.3 It is disheartening for employees who see colleagues being made compulsory redundant to see those perceived to have been implicated in the collapse of the organisation continue to receive salary and bonus.

6.4 Lending decisions made within Northern Rock must continue to be scrutinised and a proper review of the repayment of taxpayer's money must not come at the expense of improper treatment of those in mortgage arrears or pressure on employees to reach targets that may have an adverse effect on consumers.

6.5 The intervention by government and the recapitalisation programme, and part nationalisation of major high street banks was again a necessary step to stabilise the UK finance sector and the wider UK economy (2.3).

6.6 Unite is also very concerned at the extent to which banks moved away from what was their core business historically – lending money to companies and individuals – and instead increasingly focused their people and resources on proprietary trading in order to enhance profitability and pay large bonuses. It has been reported that, in many instances, the trading positions became so complex that they were beyond the capability of senior management to fully understand the risks entailed. Unite calls for the Treasury Committee to conduct a study to determine the role played by proprietary trading in creating the banking crisis. In light of the clear risk to the public purse, Unite believes that proprietary trading should be severely restricted in any bank in which the state now has a significant share or in any other financial institution determined to be so integral to the UK's financial system that it would not be allowed to fail.

6.7 The taxpayers' stake in the part-nationalised banks should allow for greater consideration of the important public role that banking plays in society and the economy and this should be reflected in the appointment and remit of the relevant board members of these institutions.

7. PROTECTING CONSUMERS

7.1 It is also unacceptable for banks to put increased pressures on small businesses by limiting the availability of funds. (3.1)

7.2 The banks now appear to have adopted a particularly cautious approach to lending which is not helping small businesses in these difficult times. According to the Federation of Small Business around one third of small businesses are still struggling to obtain affordable credit from banks and 35% are considering reducing employee numbers. This is despite the Government's injection of funds into the banking system.

7.3 Government intervention in the banking system must go further including requiring banks to lend to small businesses in order to limit the impact of the current recession on the UK economy.

7.4 The banking crisis has inevitably had a major impact on competition on the high street, (3.3). This is most obvious in the proposed merger between HBOS and LTSB.

7.5 The potential merger will create a 'superbank' which will control one third of all lending, current accounts and savings accounts available to consumers and businesses in the UK. For a sector which claims to be one of the most competitive in the world this does not bode well for consumers.

7.6 While Unite has raised concerns over the merger on job security and offshoring, it remains the only deal on the table. Unite will work with the new bank and other trade unions to limit the number of compulsory job losses with our key demands being no compulsory redundancies, an end to the offshoring of jobs overseas, and continued investment in training.

7.7 The finance sector has been badly damaged in recent times and much of this is self inflicted. It is however vital that the sector regains its integrity and rebuilds consumer confidence. To do this Unite believes that there must be an acknowledgement of the social responsibility the sector has beyond the interests of shareholders (3.8).

7.8 The Unite Social Contract for Financial Services highlights 5 key demands of the sector and Government.

- Recognition of Unite as a key stakeholder in the future of the financial services industry;
- To ensure the employment security of employees in the finance sector;
- To protect and improve the terms and conditions of employees, including pension arrangements;
- End the remuneration packages of senior executives which reward short-termism and irresponsible risk taking;
- Overhaul of the regulatory structures of the financial services sector to include trade union involvement in order to enhance the accountability of finance institutions.

7.9 The current financial crisis is the biggest challenge facing the industry in modern times. Unite is playing its part in rebuilding a successful and responsible financial services sector. Finance workers are central to this and Unite must be recognised as a key stakeholder.

8. PURPOSE AND OBJECTIVES OF THE FINANCIAL SYSTEM

8.1 Re-regulation should address the objectives and purpose of the financial system within the economic policy context and economic growth model. Financial regulation should not be seen in isolation. Most fundamentally the objective of a stable financial system must be re-orientated to serve the real economy, fund long term investment , provide returns and with wage increases reflecting productivity growth. The government should use its influence on those not only where it has a direct interest but across the whole banking and finance sector, including for example, Barclays.

The more traditional relationship between bank and lender, consumer and company was a better model. A higher share of national wealth should be returned to workers as wages reducing the need for such high levels of personal debt. The financial system should be democratically accountable to wider social objectives.

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January 2009