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Conduct Costs: the hidden numbers

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Colin Bamford
Barrister, Southsquare

The figures are staggering.
Their size raises the question whether, in their quest to appear tough on the banks, governments and regulators have not produced a blunt weapon which amounts to a form of general taxation:

1. The effect of these massive fines and compensation penalties has not been to reduce the returns to the banks' owners or senior employees. No major bank has announced that it will be unable to pay dividends or bonuses until it has made good the losses caused by these payments. Instead, the costs of meeting the penalties are passed on to the public in higher bank charges and fees.

2. Some of the compensation schemes (in the UK, at least) take the approach of paying out to all those who bought a demonised product, without the need to show loss in the way that a legal claim would require. For example, claims for the mis-selling of endowment policies linked to mortgage loans, did not take account of the fact that the returns on the investment, which were much lower than had been promised, represented one side of the coin. The other side was that the cost of the mortgage loan was also much lower than had been anticipated, as a result of the same environment of low interest rates. In many cases, the borrower/policyholder was pretty much in the same position at the end of the mortgage/policy period as he would have been in, had the investment returns been as predicted. The criticism that can properly be levelled is that most borrowers were unaware of this. They did not know, as they took the benefit of the low interest payments, that they would need to pay for it at the end of the term. The banks can perhaps be blamed for not explaining this. So can the then government, which claimed credit for holding mortgage rates at record low levels, without explain that the cost of this would need to be met on repayment day.

The compensation scheme has, arguably, over-compensated the borrowers concerned: they benefited from low interest rates for years, and were then compensated for low investment returns at the end of the period.

The effect of both of these processes has been to pass on to the consumer (the taxpayer in a different hat) the cost of making huge payments, either to those consumers deemed unfairly treated, or to the public purse, in the shape of fines and penalties.

The only merit in the process is that the tax is progressive. The greatest cost is borne by the customers who did not receive any compensation, perhaps because they were not misled into buying the products in the first place. This group probably consists of the section of the population that is the most financially sophisticated, and affluent.