# Human weaknesses to blame for financial crisis, experts say

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One of the first in-depth 'insider' studies of the financial crisis has blamed 'human' failings for the meltdown and called for urgent reforms to prevent a repeat.

A report by an influential group at Nottingham University Business School has revealed industry figures place little emphasis on economic and market factors when asked to explain the collapse.

Instead they believe a dangerous risk culture — brought about by regulatory and management weaknesses and poor communication — was at the heart of the turmoil.

The study's findings are based on interviews with senior risk-management professionals and a subsequent roundtable discussion by a panel of industry experts.

Research author Dr Simon Ashby, an Associate Professor of Financial Services in the Financial Services Research Forum, said: "Every new report on the crisis seems to emphasise different priorities. But one problem with many of these reports is that they're produced by outsiders looking into the financial services sector rather than insiders looking out.

"It might be argued insiders have made such a mess of the system that they shouldn't have a strong voice in the debate, but this overlooks a valuable perspective. The fact is that many institutions chose not to participate in the excessive risk-taking that preceded the crisis and so have as much right to comment as anyone."

The forum is widely regarded as the UK's most inclusive body for furthering the understanding of financial behaviour. It is unique in bringing together all stakeholder groups, including regulators and government, to inform policymakers in the public, private and voluntary sectors.

Its research identified "human and social factors" — particularly weaknesses in risk management on the part of institutions and regulators alike — as key to the crisis.

One risk manager told researchers: "It's human behaviour. Everything else — governance, culture, capacity — comes off the back of that. It all comes back to the person."

Another said: "The culture of the whole organisation was sales-driven. The risk people weren't rewarded — there was no incentive for them to stand up and challenge."

Those questioned also criticised the role of regulators in encouraging a "box-ticking approach" that did nothing to incentivise the effective management of risk.

One said: "Regulators might have great theoreticians, but what they absolutely need is people who know how real life works. That's where they fall down."

Another added: "Regulators don't really get what's going on beneath the surface. They're not streetwise enough and don't understand some of the people aspects."

The report also challenges the notion that reforms such as greater capital requirements or caps on bonuses and payments might help prevent a future crisis.

Dr Ashby said: “Capital shouldn’t be regarded as the be-all and end-all. It’s just one of the many tools that can be used to control the effects of major loss events. To believe greater capital requirements will solve the problem is like encouraging motorists to fit bigger airbags rather than urging them to be safer drivers.

“As for bonuses, the issue is more complicated than simply blaming the crisis on ‘greedy’ bankers. High levels of compensation aren’t necessarily a bad thing. It’s the rules of the game that were at fault. Incentives arrangements were short-term and sales-driven, which encouraged senior management to take excessive risks.

“Bonuses should be awarded over longer-term performance horizons, aligned with risk-management and governance policies and reinforced by a strong risk culture.”

The report recommends sweeping changes in risk culture, including improved training, heightened awareness at board level and greater transparency for stakeholders.

Dr Ashby, who is also associate professor in the School of Management at Plymouth Business School, said: “The global financial crisis was ultimately caused by management weaknesses.

“As such, it could have been prevented — and if the right changes aren’t made now to make financial institutions more reliable then a similar crisis could well happen again.”

Forum Director Joanne Hindle said the study and its findings were deliberately “practitioner-focused” and intended to help map out a way forward for the industry.

She said: “Our recommendations are designed to ensure lasting change while still giving financial institutions the necessary freedom for innovation and growth.

“Risk management should be viewed as a mechanism for supporting business decisions rather than as costly red tape. There has to be a more strategic focus.”

Provided by Nottingham University

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