Brief

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We can all learn from the collapse of the banks: the lessons from UBS on flawed top team behaviour, poor use of data, inappropriate reward and missing co-ordination

A surprisingly transparent and public account from a Swiss bank

Plenty has now been written about the collapse of the banking system. Much of it has been focused on the major flaws in risk management, balance-sheet strength and leverage as they apply to the banking sector. In all this, the main question answered is "What is wrong with banks?"

The banks themselves have said surprisingly little about the internal details of what went wrong - except for adhoc remarks made under pressure from parliamentary committees, senate hearings or shareholders.

Perhaps we might be surprised that the most candid account comes from a Swiss bank, UBS. The Swiss regulators demanded a warts-and-all review conducted by lawyers and published openly. The drily-titled *Shareholder report on UBS write-downs* is available from the UBS website. It makes very clear reading and does include four lessons of interest to leaders of all organisations.

Four significant organisational failures that could apply to any business, if not managed well

Among the key features of the UBS failures were:

1. ***The wrong executive team agenda***

   Strategically vital items were not getting airtime in meetings and when concerns were raised, they were not properly addressed.

   The Executive did not take regular looks at marketplace issues - there was no real discussion of the subprime assets until Q2 2007, even though the bank's own research team had already been publishing reports on concerns about such assets.

   There appeared to be no agreed roles among the executive team to bring strategically important issues to the table on a regular or adhoc basis. Executives stuck to their ‘own agenda’ or the standard material aligned with their functional role.

   When the subprime issue was eventually discussed, not only was it given little time, the discussion did not generate sufficiently well defined actions or follow-up. There were no options proposed or discussed with risks and opportunities for each. So although there was senior awareness of the growing risks in the marketplace in general, no action was taken about UBS's position in that market.

The report also identifies that peer-challenge was not a routine practice at these meetings. So even quite late, when there was public concern about the US housing market, there was little or no senior challenge to the way growth was continuing to be pursued or risk being managed in this area.

It was also clear that there were no opportunities for any real re-assessment of priorities outside the annual planning cycle, against a context that was clearly moving fast and needed immediate action. The plan was in place and the only task was to deliver it regardless.

2. ***Soft and missing data and feedback***

There was too much reliance by the Executive team on trusting the word of others, rather than looking at objective evidence. If an informal reassurance was given it was not backed up with evidence, nor was evidence demanded. When data did exist it was kept in the hands of technical experts.

The chosen key metric was the growth in the new areas of business. This was given a much stronger emphasis than, for example, balance-sheet strength, return or sustainable income.

Certain executives appeared to be allowed exceptional autonomy and this did not bear any relationship to the relative risks to the bank in comparison to areas of the investment bank that were held under tighter rein.

In particular, there was at no stage an integrated, robust and objective assessment of overall subprime exposure. There was a complete reliance on the "assurances of others". No outside view was taken, nor was any external data used - only data produced within the business.

3. ***Inappropriate reward and incentive***

Only one aspect of the business model was being rewarded – topline growth – with insufficient understanding of how the investment bank business models worked.

Following a review by an external consultant, which showed that UBS competitors were growing much faster in certain sectors, an ambitious new growth plan was presented without much internal opportunity to challenge. In particular it was recommended that key areas of business were invested in including, explicitly, several areas that were based on subprime products.

The consultants' report did not consider the risk associated with such expansion - and the key conclusions focused on the need to close the perceived gaps to competitors and to various benchmark growth rates. The 'risk' at issue here was seen to be the potential loss of customers, reputation and ranking.

Subsequently, topline growth was rewarded (using inappropriate metrics) at the expense of any focus on return, balance-sheet strength or sustainability of income. There was no adjustment for risk. In particular, there was no differentiation made between returns generated by skill and real added value, as opposed to those that were just a result of UBS's low cost of funding.

Added to that was the fact that bonuses were calculated based on the value of transactions on the day of the transaction - regardless of what happened in the days, months or years that followed. This was in effect an incentive to maximise immediate sales regardless of future risks and to minimise any checks on those being lent to or invested in.

4. ***Lack of strategic co-ordination across silos***

   Risks, investments and balance sheet were being looked at in silos, with little overall strategic view. This meant that systemic risk was being under-estimated or missed, and that leaders did not have a complete view of the whole situation.

   In particular, there was no comprehensive view of all subprime exposure, with separate and incomplete pieces of data held by different teams, related only to their own portfolio.

   This just reinforced the lack of effective teamwork at the executive level.

These flaws were all clearly identified in the report as being the responsibility of senior leadership. Special attention was drawn to: failure to address poor process, poor governance, culture and lack of focus on all aspects of the business model.

For a completely different take on the risk-taking that led to the banking sector collapse – see our *Brief* on the book by John Coates (ex-financial-market trader, investment banker and now a neuroscience professor): *The hour between dog and wolf: or risk-taking, gut feelings and the biology of boom and bust*.

