
10 February 2009 Sir Tom McKillop, Sir Fred Goodwin, Lord Stevenson of Coddanham and Mr Andy Hornby

Q1749 Mr Breed: As an ex-retail agent, do you believe you are fully qualified to run a bank?

Mr Hornby: I actually had been on the board of HBOS for seven years previously. I believe I had acquired a lot of banking knowledge during that seven year period. When you look at the balance of the team, I had a finance director with over 30 years banking experience, a head of corporate banking with over 30 years experience, a head of treasury and international with over 30 years banking experience and a head of retail who was a lifelong banker. When you look at the executive team, those five key people had over 150 years of banking experience.

Q1750 Mr Breed: Sir Fred, you were involved in banks in the past and looking at their regulatory systems and risk management systems. Did you ever override any recommendations from your risk management team or the Risk Management Committee in terms of pursuit of the expansion of the bank?

Sir Fred Goodwin: No. I would find this easier to reconcile in my mind if there had been a siren call that had been overlooked or overturned. As we go back through—and we have had occasion to do this more than once—the siren call is not there. It is easier now to go back and see things, but we did not see it.

Q1751 Mr Breed: The acquisition of ABN Amro was one of about 26 or 27 acquisitions that you made in a relatively short period of time. It has been suggested that the vast majority of those acquisitions were perhaps not as bad as ABN Amro, but they were not considered great value for money when looked at in the cold light of day subsequently. How do you respond to that?

Sir Fred Goodwin: It is difficult to respond. I think, of the 24, most of them would be extremely small. Some would be better than others. As to the generality of it, they were all acquisitions that we were happy to undertake. They all went through the appropriate governance process. A number of them would have been approved by our shareholders, as the ABN Amro transaction was, and they were all done for the best of motives. It is a reality in business that you have to make judgments, you have to try and predict the future and you do not always get it right. As to our previous acquisitions, I cannot think of one offhand that was a glaring mis-step in the way that ABN Amro clearly was.

Q1752 Mr Breed: But they were not startling successes either.

Sir Fred Goodwin: I do not think they need to be startling successes; just successes is fine.

Q1753 Mr Breed: Sir Tom, is it your understanding that if RBS had been allowed to fail rather than to be bailed out then all bonus contractual arrangements would have ceased with them, so there would have been no contractual future bonus systems?

Sir Tom McKillop: I could not answer that from a legal point of view, I just do not know the legal details of all the contractual arrangements.

Q1754 Mr Breed: If the bank failed and went into liquidation then surely all those contracts which were then entered into by the bank would have failed as well.

Sir Tom McKillop: That may be the case.

Q1755 Mr Breed: Is that your understanding, Sir Fred?

Sir Fred Goodwin: I could not be sure, but employee related contracts usually have preference in liquidation. I do not know is the answer.

Q1756 Mr Breed: Lord Stevenson? If they had failed then there would be no contractual arrangements in terms of service agreements.

Lord Stevenson of Coddanham: I imagine they would have a legal claim on the assets.

Q1757 Mr Breed: It would be the same as a creditor, which would be nothing.

Lord Stevenson of Coddanham: I cannot see where they would be in the queue.

Q1758 Chairman: Andy, you said in answer to Colin Breed that, in terms of the creation of the reliance in the wholesale market, you did something about it as chief executive, but you were a Board member before that, from 2001. Was there any time on the board when you voted against it?

Mr Hornby: No. In the period before I was chief executive—and Denis was chairman through this period—as reliance on wholesale funding was growing so we tried to increase the longevity of the wholesale funding. From memory the amount that was maturing within one year fell from 60% to about 47% of the wholesale funding as we tried to reduce the longevity. I accept the fact that with the benefit of hindsight we could have done even more.

Q1759 Mr Tyrie: Mr Hornby, you have said that you listened very carefully to siren voices, although presumably you shouldn't listen to siren voices but perhaps to air raid sirens. Lord Stevenson, you have said that you exercised good countercyclical caution. You have also said, Mr Hornby, that HBOS had very elaborate risk testing systems in place, or perhaps it was Lord Stevenson. Your ex-Head of Group Regulatory Risk tried to use those very systems to protect the bank and, when he tried, he says that he was subject to "threatening behaviours". Is that true?

Mr Hornby: Absolutely not.

Q1760 Mr Tyrie: He has made it up, has he, when he says, "My team and I experienced threatening behaviours by executives when carrying out our legitimate role . . . "?

Mr Hornby: I have absolutely no recognition of what he might be referring to. I assume you are referring to the period way before I was chief executive. I really do not know what is being referred to. All I can say is that in my experience of watching HBOS executives interacting with risk professionals

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both before and after I was CEO, I saw people in a constant dialogue and really trying to face head on into issues. I do not recognise that behaviour.

Q1761 Mr Tyrrie: He says that board minutes failed to record his expressions of concern that the bank was going too fast. Is this true, Lord Stevenson?

Lord Stevenson of Coddendam: No, it is not true.

Q1762 Mr Tyrrie: He has made that up as well, has he?

Lord Stevenson of Coddendam: I think that is using an emotive phrase. People say things. I am familiar with the episode and the issue. I think I am right in saying that as a result of the allegations we commissioned a very extensive independent study of everything together with the FSA which clarified this, which is the basis on which you are getting such a robust response from us. If I am right about that, I think it would be absolutely in order, though I shall check, for that to be made available to you.

Q1763 Mr Tyrrie: So all these completely unsubstantiated allegations the FSA themselves would not recognise, is that what you are saying?

Lord Stevenson of Coddendam: The allegations were made.

Mr Hornby: If you go back to 2005, there were a whole series of reviews that we were constantly doing internally often with external help and always in conjunction with the FSA. The FSA personally reviewed the sales culture you are referring to and we made sure that we implemented all the recommendations with very close co-ordination with the regulator. It is as simple as that. That would be the case with all the various risk management reviews that have been done over the last eight years.

Q1764 Mr Tyrrie: Did the FSA uphold your repudiation of all his allegations?

Mr Hornby: The FSA—this is before I was chief executive so I cannot speak for every point of detail here—were very clear that our action plans that we put in place on the back of all the various risk reviews that had been done were logical and they monitored our performance against them.

Q1765 Mr Tyrrie: Is it not the case that the FSA in their report wrote, “There is a risk that the balance of experience among senior management could lead to a culture which is overly sales focused and gives inadequate priority to risk”?

Mr Hornby: That clearly is in the report. We went through everything with them in huge detail. If you look at the balance of the senior team, we had colossal banking experience, an average of 35 years.

Q1766 Mr Tyrrie: I am not challenging that there are experienced people there; I am challenging that they used this experience effectively. I am not suggesting that your bank could have possibly escaped the crisis, all banks have been hit; I am challenging the view that you did not take reasonable steps in light of very clear warnings that were being made from within your bank.

Mr Hornby: As we outlined in our submission, we did try and make radical changes. We have all accepted the fact that the balance sheet growth that had been built up over many, many years meant that we did end up over-reliant on wholesale funding. We would have liked to have predicted an even greater contraction in wholesale funding markets. I think it would be difficult. I accept the fact we did not fully prophesize it. I do not believe that was because we were not listening to the risk function.

Lord Stevenson of Coddendam: We are talking here about our retail business. At any point in time, of course, we are reviewing our risk management and the balance between sales and caution at any point in time. Just to be absolutely clear and we would be happy to supply backup on it, we did a clear review of it, at the end of which the FSA regarded the matter as closed. We are very happy to give you all the information you need to back that up.

Q1767 Mr Tyrrie: So it is the FSA that also got it wrong, is that your suggestion? I hope you do not disagree with the view that the statements of caution he was making on the points of substance were wrong, that you should have gone hell for leather with all these sales and that the balance of risk that you took at the time was right. You began with an apology today.

Lord Stevenson of Coddendam: I do not disagree with that at all. It is the right frame of mind for any banking. It is a balance.

Q1768 Mr Tyrrie: So you got it wrong but in your defence you are saying the FSA got it wrong as well, is that right?

Lord Stevenson of Coddendam: No. What you have referred to were some allegations that were made which were independently investigated and the FSA were satisfied with them. I am very happy to provide you with all the backup to that.¹

Q1769 Mr Tyrrie: I will just ask the same question again. You agreed that you got it wrong, that you did not correctly assess the risk. Everyone is agreed that banks did not do that. You are therefore presumably agreeing that Mr Moore correctly identified one of these risks to which due attention was not paid. Is that correct?

Lord Stevenson of Coddendam: I would say it is not correct. I understand the thrust of your question. The fundamental mistake, if that is the word, that HBOS along with many other banks in the world made was failure to predict the wholesale collapse of wholesale markets. Mr Moore’s allegations were nothing to do with that. They concerned a perfectly reasonable area for concern which I and my colleagues have been constantly concerned about, which is the balance between the sales culture on the one hand and caution and integrity on the other. The area, as we have said in our submission, which has caused HBOS problems has been the collapse of wholesale markets.

¹ HC (2008–09) 144–III, Ev 664

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Q1770 Mr Tyrrie: You are saying that even with the advantage of hindsight you got the balance between the sales culture and the risks that it might generate correct. You are unrepentant about the judgments you made even with the advantage of hindsight. Is that correct?

Lord Stevenson of Coddendam: You are forcing me into a corner.

My Tyrrie: I was just trying to get a straight answer

Lord Stevenson of Coddendam: The truth is that there is no absolutely correct balance in any part of our business or any other bank's business. I think if you were to examine our retail business over the last few years you would find that we had not got it very wrong, particularly the thing you are talking about. Just to be absolutely clear, going right back to what both Andy Hornby and I said at the beginning, we fully accept that we failed to predict what happened in wholesale markets.

Q1771 Mr Tyrrie: You said that you had not got it very wrong which must mean that you got it roughly right. Is that right?

Lord Stevenson of Coddendam: Right. The other side of which is—

Q1772 Mr Tyrrie: Why are you apologising if you got it roughly right? I am left bewildered now.

Lord Stevenson of Coddendam: It is apples and lemons. We are apologising for what happened to our business and we have made it plain that the key factor that affected what happened to our business was the collapse in the wholesale markets. That is not the issue that Mr Moore is raising and you are raising.

Q1773 Mr Mudie: There are shades of Adam Applegarth here, ie there was nothing wrong with you, it was the market and the extreme credit crunch, the breakdown of wholesale markets. Is that what you are saying?

Lord Stevenson of Coddendam: No.

Q1774 Mr Mudie: What are you saying? We did not bring you here, contrary to what the press think, to cause you public humiliation. We brought you here to find out what happened, to hear how we avoid it happening and what steps we should take. There are two chairmen here. What is causing the anger in the public's mind is that you are in denial. Your group risk manager said you were selling too fast, too much and it was very risky and you sacked him. You come to this Committee and you say to Andrew, "He got it wrong. We got it right." You are the ex-chairman and he is the ex-chief executive officer who got it right. Why are you the ex-chief executive and ex-chairman if you got it right?

Mr Hornby: What our submission clearly says is that the balance sheet growth that had been put on over many years, from the inception of HBOS in 2001, meant that we were overexposed to wholesale funding when the wholesale funding markets closed. That is indisputable.

Q1775 Mr Mudie: That is Adam Applegarth.

Mr Hornby: The balance sheet growth that we put on, no one is taking away responsibility for that and we are very clear on that in our submission. I think the point which Denis is making and which I completely comply with is about the complete closure of wholesale markets in the way that they did completely close. We did take a lot of premeditated actions in order to try and reduce our reliance on those markets. Clearly if we had seen the fact that they were going to close entirely coming we would have done even more even earlier and even quicker. We do accept the fact that the building up in the balance sheet over many, many years meant that we were reliant on wholesale funding. The contrary point is that we did try. We would have liked in retrospect to have done even more. We did take action to recognise the risk there.

Q1776 Mr Mudie: Nobody is suggesting you did not. You ran a business in a way that got caught out when the market conditions changed. I interrupted you and said Adam Applegarth. He got abused right, left and centre for his extreme model. You ran not exactly the same sequence but a flawed model. You ran something that when the market conditions changed your business is in a very bad way and you are an ex-chief executive officer.

Mr Hornby: Yes. It actually goes back many, many years in that the former Bank of Scotland business was largely reliant on wholesale funding that did not have a retail deposit base in the UK.

Q1777 Mr Mudie: I know that. We are all aware of that. Just accept it. Do not try and equivocate, et cetera, et cetera. You did something that was applauded whilst you were making a lot of brass. It turned out to be dodgy when the market conditions changed. We can move on when you say that is it to decide how we can adjust external factors or even internal factors to prevent this sort of thing happening again. Is that not the way forward?

Mr Hornby: I completely agree. We have already said that the building up of reliance on wholesale markets was what has left us vulnerable.

Q1778 Mr Mudie: That means risk. What Andrew is questioning is the fact that you sacked a barrister, a fella who had been complimented at various times by various people. A senior figure prevented him from putting something in the board minutes which said you were running a risk here. He says in his memo to us, "When I was Head of Group Regulatory Risk at HBOS, I certainly knew that the bank was going too fast (and told them), had a cultural indisposition to challenge (and told them) and was a serious risk to financial stability . . . and consumer protection (and told them)." That is what he is saying. You equivocated when Sally asked you and you further equivocated when Andrew asked you. You sacked this fella. He took you to an industrial tribunal and he won. We are told you paid him undisclosed damages and put a gagging order on him. In fairness to a bank learning lessons, it

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seems to us in the Committee with this document that you did not want anybody being blunt with you about the risks you were running.

Lord Stevenson of Coddendam: I understand exactly what you are saying. First of all, I remember the incident very well. It was taken very seriously by the Board at the time, with the Chairman of the Audit Committee, Tony Hobson, doing it. We commissioned an independent study into it. I am very happy to provide all the materials to the Committee about it. I do think that in a number of areas it is a fact that very carefully arranged risk management systems developed over the years with our regulator did not spot scenarios coming out that have come up. The stress testing did not stress test adequately. I am being very open. There is nothing in denial about that. I am just being very open about it. How that is changed in future is a hugely important issue.

Q1779 Mr Mudie: Not only did you sack him, the person you appointed in his place had never carried out a role as a risk manager of any type before. The individual had primarily been a sales manager and was a personal appointment of the Chief Executive Officer and was against the wishes of other directors. Does that not worry you, if that is true?

Lord Stevenson of Coddendam: It is not true. The board took it very seriously. It was a major preoccupation. The board was briefed on it by the chairman of the audit committee with personal responsibility on it. We delayed the appointment of the person you are talking about, who is an outstanding executive, until the independent review had been carried out and until the FSA and ourselves were happy with it.

Q1780 Mr Mudie: Andrew made the point that, at the end of the day, you sacked your group risk fella for the warnings he gave you. Now, four years later, it turns out he was right and you were wrong.

Mr Hornby: This incident you are referring to was with the former chief executive back in 2005.

Q1781 Mr Mudie: You were on the board then.

Mr Hornby: I was on the board. When James proposed the appointment, as he did, of Jo Dawson to take on that role, I, along with many others, thought it was a very good appointment. She had huge banking experience built up over many years.

Q1782 Mr Mudie: In risk?

Mr Hornby: In many matters very pertinent to risk management.

Q1783 Mr Mudie: We are arguing about risk. You sacked this fella and then you appointed someone else who this gentleman is suggesting had no—and I did not mention a girl or her name in fairness to the individual—risk experience of any kind. Your chairman says that the individual who gave us this is telling lies on this point. Can you just confirm that you are saying she had risk experience?

Mr Hornby: No. What I said was she had many years of working in the banking industry, including in risk management.

Q1784 Mr Mudie: How come your chairman said she did?

Mr Hornby: She had not had a formal risk title, but she had many years of working in the banking industry within risk. If you talk to the chief executive who took the decision, he made sure he strengthened the risk function alongside in response to the report and in response to all the other actions.

Q1785 Mr Tyrie: You have made specific denials on a wide range of issues raised by Mr Moore which taken together appear to challenge all the substantive points that he has made, that the risk culture was out-of-kilter in your bank and you appear to be blaming everything on the collapse of the wholesale markets. You will correct me if you think I have misinterpreted what you have just been saying. His allegations are very specific and detailed. He said at paragraph 2.13, for example, “I told the Board they ought to slow down but was prevented from having this properly minuted by the CFO. I told them their sales culture was significantly out of balance with their systems and controls.” Is it true that he was prevented from having his concerns properly minuted?

Lord Stevenson of Coddendam: I am not aware of that communication. We took it very seriously. We had over a nine month exercise investigating it. May I suggest that we make that available to the Committee? You would be free to talk to the FSA about it who were involved in it. The one thing I can assure you, there is no denial, anything to do with risk is taken very seriously by the board.

Q1786 Chairman: Paul Moore said that prior to HBOS, from 1995 to 2002, he was a Partner with KPMG’s Financial Sector Practice specialising in regulatory services and advised a number of FTSE100 companies. He says in paragraph 3.19 that he was dismissed by the then Chairman, James Crosby, who said, “The decision was mine and mine alone” but refused to explain why. He then goes on to say that what this has led to is “. . . millions of people in excessive debt, 10,000s who will lose their jobs and many more whose balance sheets have been impacted by the precipitous fall of the HBOS share price . . .” That is his accusation which is on the record. To be fair to yourselves, if we engage in this correspondence it will help us because we want to be fair to everyone.

Lord Stevenson of Coddendam: Yes.

Q1787 John Thurso: I want to look at the issue of corporate governance and the role of non-executive directors. Before I do that, can I say to you all that my constituents will appreciate the full apology you have given because I have rarely had so much anger expressed to me over the last few days. I did not know that my constituents knew the Treasury Committee existed let alone what was going to be happening today. It is because so many businesses