Press Release
Steve Baker MP (Conservative, Wycombe)
24 February 2012

A Bill to make bankers bear their own commercial risks

On *Wednesday 29 February 2012*, following PMQs and any statements, Steve Baker MP will introduce a Bill to:

- enforce strict liability on directors of financial institutions
- enforce unlimited personal liability on directors of financial institutions
- require directors of financial institutions to post personal bonds as additional bank capital
- require personal bonds and bonuses to be treated as additional bank capital
- make provision for the insolvency of financial institutions
- establish a financial crimes investigation unit

The purpose of this Bill is to minimise moral hazard within the financial system by ensuring that those who take risks are held personally liable for the consequences. Since rules can usually be gamed by financial institutions, a principle underlying this Bill is to minimise scope for evasion.

Steve Baker MP said,

> “The public are rightly incensed at the injustices we see across the financial system but our economy must have responsible, innovative and enterprising financial services. It is essential that commercial freedom is maintained while creating a system in which remuneration is a just reward for success, not the unjust product of unrealised profits and bailouts.
>
> “My Bill would make directors of financial institutions personally liable for losses. It would ensure that losses came first out of institutions’ bonus pools then directors’ personal bonds before hitting equity. Directors would also be exposed to unlimited personal liability long before any suggestion of taxpayer bailout.
>
> “With key decision makers’ own wealth at risk, they would take responsible decisions instead of expecting rewards for failure.
>
> “It’s time to tell bankers, ‘Yes, innovate. By all means earn large rewards for providing valuable financial services. But bear your own commercial risks. Don’t expect the rest of us to bail you out.’”

Professor Kevin Dowd added,

> “The fundamental problem with our banking system today is the egregious social contract by which the gains from risk taking are privatised but the losses socialised and dumped on the taxpayer. This Bill would put a stop to this abuse by creating the strongest possible personal incentives for board members to ensure that their banks are managed responsibly.
>
> This is the key to resolving the financial crisis: with senior bankers’ own wealth most at risk, bankers would soon ensure that excessive risk taking would disappear.”

ENDS

Notes to Editors

Steve Baker MP was elected to Parliament in 2010, less than three years after joining the Conservative Party. After his Royal Air Force service, his software consultancy roles took him to banks and their regulators in the UK and abroad. He is Chairman of the *All-Party Parliamentary Group on Economics, Money and Banking* and a Director of *The Cobden Centre*, an educational charity for social progress through honest money, free trade and peace: www.cobdencentre.org.

The idea that directors should have unlimited personal liability for bank losses is an old and historically tested one. For example, the two greatest bankers of the nineteenth century, Nathan Mayer Rothschild (1777-1836) and John Pierpont Morgan (1837-1913), both operated highly successfully under unlimited liability. Unlimited liability meant that they could lose all their personal wealth: this made them conservative in their risk-taking and reassured counterparties who appreciated what they stood to lose if a deal went wrong. It also gave them a strong personal incentive in the long-term survival of their banks and made for a banking system that was much safer and more stable than the contemporary banking system.

These measures were brought forward with the advice of Kevin Dowd and Gordon Kerr of Cobden Partners. Dowd is co-author of *Alchemists of Loss: How Modern Finance and Government Intervention Crashed the Financial System* and formerly professor of financial risk management at Nottingham University Business School, and Kerr is the author of *The Law of Opposites,* recently published by the Adam Smith Institute.

1. Liability of directors of financial institutions

Board members of financial institutions would be strictly liable for any losses reported by their institutions: they would also be subject to unlimited personal liability for any such losses.

Board members of financial institutions are to be required to post personal bonds that would be potentially forfeit in the event that their banks report losses. The value of the bonds posted for each person concerned would be the higher of £2m adjusted for future RPI or 50% of the person's net wealth, whichever is higher.

Taken together, these measures create the strongest possible personal incentive for board members to ensure that their banks are managed responsibly. This is the key requirement to resolving the crisis: with key decision-makers' own wealth most at risk, they would ensure that excessive risk-taking would soon disappear.

2. Bonus payments to be deferred and liable

The payments of any bonuses that are awarded in any given year would be deferred for a period of 5 years. This bonus pool would be invested on beneficiaries' behalf in an escrow account.

Where the bonus took the form of stocks, these would typically accumulate dividend payments over time. Where they include stock options, such options would be exercised on maturity if they expired in-the-money and so then convert to underlying stock positions, and if they expired out-of-the-money they would become worthless.

Where the bonus took the form of cash, these cash amounts would be invested in an independent money market mutual fund with a horizon period equal to the period when the original 5-year deferment lapsed and payments could then be made to beneficiaries.

3. Use of personal bonds and bonus pool to make good bank losses

Should a financial institution report losses over any period, these losses would be made good in the first instance by drawing from the bonus pool.

Should a bank report losses that exceed the value of the bonus pool, then the whole of the bonus pool would be forfeit to the institution to make good the losses. Any difference remaining - the difference between the reported loss and the value of the bonus pool - would then be made good by drawing from the board members' personal bonds.

Should their bonds prove insufficient to meet the whole of the remaining loss, then all their bonds would liquidated to offset that loss, and any subsequently remaining losses would be passed to shareholders.

In the event that board members' personal bonds were forfeit to the bank, board members would be required to replenish their personal bonds within some specified short period. Failure to meet this obligation would trigger personal bankruptcy.

4. Additional measures

Additional measures would cover the definition of core capital, accounting standards, the definition of bank insolvency, a new fast-track receivership regime for banks, the end of state support and return of financial institutions to normal operations, authorisation to operate and provisions for criminal investigations and criminal liability.

For the purposes of this Bill, a financial institution is taken to be any company regulated under the Financial Services and Markets Act 2000.

Related speeches in Parliament

The monetary factors affecting jobs and growth: http://www.stevebaker.info/2011/10/a-speech-on-the-monetary-factors-affecting-jobs-and-growth/

If this is capitalism, I am not a capitalist: http://www.stevebaker.info/2011/12/capitalism/

Three flaws in the Financial Services Bill: http://www.stevebaker.info/2012/02/three-flaws-in-the-financial-services-bill/

Contact

Steve Baker: 07855 333023 or 020 7219 5099. Steve.baker.mp@parliament.uk