

# **Potential Human Biases in the Irish Banking Structure: Weighing Risk versus Incentives.**



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MSc International Banking and Finance

January 2014

Dublin Business School

(Word count 15,853)

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## **Acknowledgements**

Firstly I would like to thank my supervisor Andrew Quinn. He offered constant encouragement and proved a terrific guide in terms of ideas. He was very engaging in discussion about the matter and his enthusiasm helped me through the whole process.

Secondly I would like to thank Miss Nicole Gross for providing the initial classes on Research Methods. She applied herself so thoroughly and wanted so badly to inform her students of the grinding process that proceeding to do dissertation might entail.

Lastly I want to thank my family and friends for having the patience with me over the last few months. It couldn't have been easy but I hope it's worth it now!

## **Abstract**

This dissertation is about the searching for potential human biases in the Irish banking sector. It tries to find out how individual decision makers deal with risk versus incentives in their day to day decision making. It involves interviewing bankers in different areas and listening to their views and perspectives. From the study of the researcher in human biases we try find out is there possible scenario's where there is less than optimal/rational decisions being made and are these decision makers aware of these biases.

'Human biases' comes from the relatively new study of behavioural finance and is inspired by the studies of Kahneman and Tversky in the 1970's. It has come into mainstream thought particularly over the last 5 years because of the global financial crisis of 2008. The Research involves trying to find out the decision making process of particular actors within banking and using the literature as a reference to investigate possible areas of perceived bias.

This study involved a lot of listening to the views of the interviewees and how they viewed their roles within banks. How they handled perceived risk and how did this compare to other risk takers i.e traders. We tried to keep an open view whilst interviewing as we didn't know the ins and outs of procedures. We tried to open their eyes to potential biases to see were they aware of them, how did they judge them and did this fit with their ideas of fulfilling their jobs.

We tried to bring all these together and see if there were any conclusions of this. Did incentives overly affect rational thinking? Who was the most risk conscious? Did they understand 'group herd' phenomenon? Had much changed since 2008? How did they explain the bank failure? And what would they do different?

The researcher hopes that this study will bring more light on the day to day decision making of the bank official. How they weigh up risk versus incentives. The difficulties that lie beneath making these choices and how perceived prudent procedures might not work so well in the world. And maybe this study will show how middle to lower bankers are not really in a position to alter targets or the way in which a bank is being run. But before this study started we did not know what results would throw up and that added to the enjoyment of this research.

# Introduction

- **1.1 Research Problem**

*The background of this issue is related to behavioural finance in the banking systems. Behavioural finance is a relatively new branch of study and that combines bits of economics and psychology. Economic theory has traditionally assumed that all individuals were rational in the choices but empirical research since the seventies led by Kahneman and Tversky has proved this wrong. It has come into more focus since the global financial crash of 2008. What this study was trying to see was is there human biases present in our own banking system or more importantly if present are they aware of these biases. This study is highly subjective and allows the interviewees to give their own point of view. It tried to weigh risk versus incentives in the day to day decision making of bankers.*

- **1.2 Suitability of the Researcher**

*I have studied Banking and Finance modules for the past year and this helped my understanding of the financial world. I was a keen follower of the financial crisis of 2008 and wanted to know more about its origins. I am a very keen reader of the riskiness of big financial entities and have been inspired by the writings of Nassim Taleb. He forecasted the big financial crisis of 2008 in the United States before it happened. I also have a high curiosity for things related to psychology and read anything that satisfies that need with regards to this.*

- **1.3 Recipients of the Research**

*Hopefully the recipients of this study will be anybody that has an interest in the robustness of our financial systems in Ireland. It could help people that are in positions of authority within banking and more importantly people dealing with the incentive structure within banks. Policy makers in government and how 'moral hazard' plays out in the day to day decision making of bankers. But probably more realistically for this study, I hope it just touches the fringes of this subject matter and will inspire more students/researchers to investigate this topic with more depth.*

- **1.4 Research Objectives and Hypothesis**

*I am interested in this topic because I think it is very relevant in today's world especially Ireland. The Irish government had to cover the losses of the Irish banks and I'm terribly afraid this will happen again. A lot has been made about capital requirements and new stringent rules passed by Basel III but not much attention has been given to individual decision makers within the bank. I am convinced that a 'Black swan' event will wreak havoc on Ireland's banks sometime in the future again. A black swan effect was popularised by Taleb and means an event that comes as a surprise, has a major effect, and is often inappropriately rationalized after the fact with the benefit of hindsight.*

*I also believe that banker officials do not truly understand the risk nearing positions they are in. I also believe that there is an over-confidence in the public domain that a banking crisis of this magnitude will not happen again in our lifetime. Although I do not see playing out the same way but historically bank crises' do happen that people think. We have an inability to*

*learn that we do not learn (Taleb 2013) and the hindsight bias is ever present in Irish media for trying to explain the recent banking failures.*

- **1.5 Dissertation Approach**

*Well firstly the researcher set out by trying to find the best available literature on this subject in Ireland and abroad. He studied the subject and tried make himself aware of the biases and how these might potentially impact performance of some professionals within banking. He tried to find out the perceived causes of the banking crisis in Ireland and tried matching them with the available literature on behavioural finance. As this was all subjective one could not possibly tell how these biases might play out until we interviewed the bankers themselves.*

*I then contacted friends and acquaintances and tried to organise interviews with people who might add value to this study. The researcher tried to target people with a high level of experience, high responsibilities and with an exposure to risk whilst performing their duties. Before interviewing these people, the researcher tried to get a general background of their job specification and tried to gear suitable questions from there. The researcher used qualitative data analysis methods in collecting this data. The collected data will then be interpreted in detail with a discussion of the data findings. The researcher then tried to refer back to my literature and see could I extract any conclusions. I then proceeded to write up my full dissertation from the literature review to the research methodology along with results and conclusions until I concluded with a piece of research that I was content with. He proceeded to added thoughts and recommendations to try enhance the study.*

*My approach to this dissertation is to keep an open mind when interviewing. Try approach each interview with an open mind and try seeing things from the banker's point of view. I have to try keeping my own personal biases at bay and I did this by trying to think that these individuals are in unfortunate positions.*

- **1.6 Dissertation Plan**

*I will research all available literature that is out there with regards human biases as it relates to finance. I will pay particular attention to Irish studies.*

- **1.7 The scope and Limitations of the research –**

*As I was relying on the generousness of the individual bankers to be interviewed, I did not get all of the positions I would have liked. I would have maybe liked to interview a top official with responsibility for risk management or a member from the Central Bank/regulator to get there view on things. I wanted to see the use of VAR techniques in the day to day running of the bank and how much importance is put on this but I didn't get to that point.*

- **1.8 Contributions to the Study**

*The major contributions to the study would be the individual interviewees. They supply the raw data. I can research what literature is out there already but as they are the ones working within the system, it is their opinions and experiences that make the study.*

## **1.9 Threats**

- *A failure of a bank, lead to a greater probability of the whole banking system failing.*
- *If you are in banking or lending, surprise events are likely to be negative for you. You lend and in the best circumstances you get your loan back – but you may lose all your money if the borrower defaults. In the event that the borrower enjoys great financial success, he is not likely to offer you an additional dividend.*
- *Banking in Ireland (Moody's report on Ireland 2013)*
- *Greatest single risk to the domestic economy is the 'health of the banking system and its ability to support the real economy'.*
- *The long term viability of the banking system will depend on 'boosting net interest margins, which have been in decline for more than a decade and weaning off the banks still heavily dependable on central bank funding'.*

## Literature Review

- *Right I tried to research all things related to human biases in the banking structure. In the end my research revolved around 3 authors. First was*

- **Charlie Munger**

*He gave a speech to Harvard Law school about 'The Psychology of Human Misjudgement'. Mr. Munger is a renowned investor and Partner to Warren Buffett of Berkshire Hathaway. Although Munger is not a professor, he is an avid erudite and tried to link his background in Law, his years of experience in investing and company management to try link the dots together in these fields. He listed out 25 human tendencies and wanted the reader to try be more aware of them. The ones that resonated well with this study and which I wanted to test out were : Reward and Punishment Super response Tendency,*

- *Linking/loving tendency, Munger (1995) states 'man will generally strive, lifelong, for the affection and approval of many people not related to him'. This had 3 general consequences that : 1. 'to ignore faults of, and comply with wishes of, the objects of his affection,*
  - 2. to favor people, products actions merely associated with the object of his affection*
  - 3. to distort other facts to facilitate love.*

*This is justified in my research as there might be a time when liking someone interferes with the smooth running of your professional duties.*

- *Doubt Avoidance Tendency, Munger states 'the brain of man is programmed with a tendency to quickly remove doubt by reaching some decision'. He also goes on and includes that an 'unthreatened man, thinking of nothing particular, is not being prompted to remove doubt through rushing through some decision' but when we get to 'Social Proof Tendency and Stress- Influence Tendency that usually triggers Doubt Avoidance tendency in some combination of puzzlement and stress.' This is particularly important in this study from the outset as many of the subjects have to make important decisions whilst not knowing all the facts. Presumably to do their jobs successfully they would have to remove some doubts to make these decisions quickly. It will be particularly interesting to see how interviewees see this theory.*
- *Reciprocation Tendency, – our sense of fairness will over ride our economic rationality. ( from the definition site) . Munger (1995) introduces it by saying 'the automatic tendency of humans to reciprocate both favours and disfavours has long been noticed....the tendency facilitates group cooperation for the benefit of its members'. Although this may seem harmless when used for the benefit for society is particularly dangerous when it is isolated and exploited. It hacks into the subconscious of the individual and could be particularly*

dangerous if bankers were the victims of such actions. The popularity of this tendency was brought to life Robert C. Cialdini in the book *Influence*, it was written to try to protect innocent victims of these tricks but it was also used by con artists and car salesmen to try to lure the customer into buying something they may not necessarily want. The main point with the researcher is that because bankers are in such a vulnerable position in lending out money they should be aware, in the researcher's opinion, of the potential to be tricked into doing favours for others because they feel they must inside and outside the organisation.

- *Influence from Mere Association tendency, this one is self-explanatory and can be used to great effect as it is usually under recognised and under rated. Munger (1995) states 'some of the most important miscalculations come from one's past successes'. With bankers having to assess the credibility of loaners, clients in private banking and new entrepreneurs the risk to be swayed by previous success, the contacts they have and the way they are perceived is one I hope the banks have systems in place so the human part of the process is limited.*
- *Over Optimism Tendency, this tends to be generally well cited in reasons of banking failure. But noticing it at the time of happening is one such thing and also to stop the spread of it as yet has not been given a solution. Demosthenes, the most famous Greek orator, cited by Munger (1995) that 'man displays not only simple Pain avoiding Psychological Denial but also an excess of optimism even when he is already doing well'. Bankers may be tired of hearing the over optimism as a cause of the bank failures but one withers to think when relative prosperity comes again in this country will any lessons be learned in this, with regard lending.*
- *Availability Misweighing Tendency – Munger (1995) starts the discussion on this with 'Man's imperfect, limited capacity brain easily drifts into easily working with what's easily available to it'. The researcher thought that this may be a particular issue with the private banking manager as he has people coming into him wanting to invest somewhere, and with property being in such abundance in this country, would it be an issue that other classes of investments would be ignored?*
- *Authority-Misinfluence Tendency. Munger (1995) begins by saying 'automatic as most human reactions are, with the tendency to follow leaders being no exception, man is destined to suffer greatly when the leader is wrong'. This turned out to be a particular issue within banking, as there was not much evidence of conscious thinking of how their job fitted into the overall structure. By blindly following authority to further one's career chances, individual were alleviating any responsibilities with regards the risks they were creating or how their decisions may impact the firm 10/15 years into the future. These were the ones that I found were testable throughout the interviews. The other person that greatly influenced a lot of this study was :*

### **Nassim Nicholas Taleb:**

*His main point would be that if the bankers themselves do not lose out directly if the banks go bust we will continue to have these problems (Taleb 2012). He advocates Hammurabi code: (Taleb: video 'Occupy wall street 2011')*

*The aspect of the Code is often characterised as being "an eye for an eye" philosophy, but Taleb argues that is not quite right. What it is really about is risk management. In a functioning society risk and reward are good things, but only to the extent that there is*

*symmetry; that if there is a downside to your actions, you must pay an equal price. Taleb (2013) argues that 'Banks have for quite some time been in the business of hiding risks, and those who develop their strategies have done so safe in the knowledge, conscious or unconscious, that if they win, they collect huge bonuses, but there is no come back on any individual if the result of their actions is to wreck the bank, or indeed the country. The banking crisis is thus the result of a flawed version of capitalism, in which there are no consequences for those who gamble. What one needs therefore is not a new criminal offence and an unwieldy and expensive show trial after the event, but to create a system which creates this symmetry of risk. The potential for a "de-bonus", so to speak'.*

*Black swan event: The theory was developed by Nassim Nicholas Taleb (2007) to explain:*

1. *The psychological biases that make people individually and collectively blind to uncertainty and unaware of the massive role of the rare event in historical affairs*

*He argues that 'Black Swan events are largely caused by people using measures way above their head, instilling false confidence based on bogus results.'*

*He cites overconfidence in their own knowledge, misweighing of small probabilities having unforeseen effects. He strongly accentuates that if banks are 'too big to fail' that they put the nation state in a very vulnerable position. He wrote a best seller the Black swan, 'The Impact of the Highly Improbable' back in 2007. Some of the points he made are:*

*'Banks are a special case of fraud. Managers extort the states (banks periodically loses more than all past cumulative profits, with losses covered by government) and the game continues'*

*'Banks are in the business of hiding risk. They pay themselves steady salaries and huge bonuses, and when the accumulated risks the banks have hidden come crashing down, you and I pay the price. In other words, gains are privatized and losses are socialized.'*

*'Capitalism is all about incentives, but it's also about disincentives'.*

*The banking crisis gave credence to Taleb's philosophy. Bankers thought they could predict the future. They wanted to make a lot of money very quickly and efficiently. Unbeknownst to them unfortunately, this meant taking enormous risks and society paid the price.*

*Taleb (2007) also stated that the problem with banking system: Absence of claw backs (people make profits hiding risk then get an annual bonus of values at year end when banks explode 8-15 years. The mismatch between bonuses and frequency of blow-ups.)*

*'While most human thought has (particularly since the enlightenment) has focused on how to turn knowledge into decisions. My new mission is to turn lack of information, lack of understanding, lack of knowledge into decisions, how as we will see, not be a turkey.'*

*This statement has particular influence on all of this study as decision makers in the banks are required to make decisions but sometimes under limited knowledge or understanding. If bankers knew how limited their own knowledge was and over confident they are in the projections they would be in a better place.*

*NNT – ‘optimism is highly valued. People and companies reward the providers of misleading information more than they reward truth tellers’.*

*Unbiased appreciation of uncertainty is the cornerstone of rationality but it isn't that what organisations want. The admission that one is merely guessing is especially unacceptable when the stakes are so high. Acting on pretend knowledge is often the preferred approach.*

*Black Swan world- error of successive and naïve specificity – ‘by focusing on the details of the past event, we maybe diverting the attention from the question on how to prevent future tragedies, which are still abstract in our minds.’ So what one might think as a significant risk, might not be at all. By trying to predict the next black swan are we vulnerable to the ones we did not predict?*

*Management's understanding of sub-ordinates did anything stupid is strangled because of an asymmetry of information (Taleb 2012)*

### **Daniel Kahneman:**

*He talks about effects of high optimism in decision making. And people taking credit for success but little blame for failures. Kahneman (2011): ‘Groups tend to be more extreme than individuals! When diversity of thought disappears within a group of people, popular opinion can feed back on itself and bubbles can be created.*

*Type 1 and Type 2 thinking. - Kahneman describes the two different ways the brain forms thoughts:*

- **System 1:** Fast, automatic, frequent, emotional, stereotypic, subconscious
- **System 2:** Slow, effortful, infrequent, logical, calculating, conscious

*Kahneman covers a number of experiments which purport to highlight the differences between these two thought processes, and how they arrive at different results even given the same inputs. Terms and concepts include coherence, attention, laziness, association, jumping to conclusions and how one forms judgments.*

*From the studies of these empirical psychologists they have shown that humans have unwarranted confidence in their decision making. Group think was mentioned and how to stop it would be for everybody to think about worst case scenario for a loan and all potential things that could happen.*

### **Irish studies on the Financial Crisis**

- *‘The role of Decision making biases in Ireland's Banking crisis’ Peter Lunn*

PD Lunn 'Groupthink usually refers to the tendency of individuals within a group to adopt a group's viewpoint rather than form an intellectual independent viewpoint.'

- Commission for investigation into the banking sector in Ireland (Nyberg 2011)
  - 'Groupthink' 'herding'
  - 'Regulators, central banks, civil servants and politicians failed to protect the people they served' (Nyberg I think)
  - 'Misjudgements that were embedded in collective psychology' (Regling, Watson 2010)
  - 'Cognitive biases such as extrapolation bias, offer a more plausible explanation for the observed behaviour.' (see Barberis 2010, for theoretical overview)
- 'In the review of remuneration policies and practices in Irish Retail banks/building societies.' Financialregulator.ie. Press release 01 December 2010.

*'Inappropriate incentive arrangements with bonus structures biased towards asset acquisitions and rewards insufficiently tied to risk management particularly the management of funding risk'.*

*'Inadequate response to reform with remuneration'*

*'Link between remuneration and risk management remains poorly defined poorly articulated and poorly governed'.*

- *There is little evidence that banks have self-consciously made a link between their risk appetite and their incentive structures. This exposes banks and, by extension the State, to the consequences of inappropriate risk taking;*
- *The governance and oversight of remuneration practices is poor. Non-executives need to step-up their scrutiny of remuneration arrangements, and in particular make sure that senior executives' remuneration is aligned to a bank's willingness and capacity to take risk;*
- *In the majority of banks, procedures to determine remuneration are not clear, well documented or internally transparent. There was little evidence of consideration of risk, or collaboration with risk management functions to ensure remuneration policies are aligned with long term strategic plans;*
- *Some banks are tightening their approach to paying guaranteed bonuses. There is also some evidence of tightening of severance pay, with some banks imposing stricter conditions on golden parachutes. There is, though, further to go*

### 'Banking supervision: our new approach' centralbank.ie Banking supervision 2011 update

*Findings: 'risk tolerance, objectives, values and long term incentives were not generally reflected in the remuneration policies of most banks'*

- **From Hubris to Nemesis: Irish Banks, Behavioural Biases, and the Crisis. M Dowling. B.M Lucey (September 2013)**

*He looks into the poor risk management by board of directors in Irish banks. He talked about the social interconnectedness in Irish corporate boards. He states that confirmation bias was a key issue with a degree of 'overconfidence being learned'. Crucially to the over enthusiasm of banking officials he finds evidence of 'only 2 percent of bad news' being mentioned in a CEO's annual report for an Irish bank prior to the crisis. This was also evidence of strong attribution bias. M. Dowling cites J Mercille (2013) in the very close relationship between the media and the financial system in Ireland.*

*Direct quote from paper:*

*'A final part missing from this analysis is the lack of awareness on the part of the Irish bankers as to how behavioural biases might cause their major borrowers to act irrationally before and after the advent of the financial crisis. This is, sadly, an aspect of lending often excluded from the learning that bankers undertake before commencing their careers. A lack of understanding of the biases of bank customers can lead to a bank taking risks that are not actively managed - the standard bank risk management approaches might not be designed to analyse some behavioural risks of borrowers'.*

*'Relying on small data samples to extrapolate continuing price rises; home bias: displaying excessive confidence and optimism about the home market; and herding: the tendency for the thoughts of a socially interconnected group to converge'.*

## **List of potential Biases and there definitions**

Confirmation bias – We interpret evidence to support our prior belief, and if all else fails, we ignore evidence that contradicts it.

Economic Reflexivity- the way that the economy changes people's behaviours, which changes the economy.

Fundamental attribution error – we attribute success to our own skill and failure to everyone else's lack of it

Hindsight bias – were unable to stop ourselves thinking that we predicted events, even though we are woefully bad at predicting the future. It is the ability to explain the past, gives us the illusion that the world is understandable.

Illusion of Control – we do things that make us feel in control, even if we're not

Affect Heuristic- we use feelings not logic to make snap decisions, even when we don't need to.

Anchoring- our habit of focusing one salient point and ignoring all others.

Limits of Attention- our ability to attend to multiple things and the way this is exploited.

Appeal to Authority- we tend to thoughtlessly obey those we regard as being in positions of authority.

Bias Blind Spot- we agree that everyone else is biased, but not ourselves

Moral Hazard- If someone's underwrites our failures we're more likely to take risks.

Self-Enhancing Transmission Bias- people tell others about their success more often than their failures and their listeners don't take account for this ( see underwriter and private banking manager)

Normalcy Bias- assuming that because something has never happened before, it won't ( or cant) happen in the future.

Restraint bias- Over estimating your ability to control impulses.

Bias Bias – the idea that you are less biased than you actually are.

Time Inconsistency: Systematic changes in individual preference over time whereby more immediate rewards, become more disproportionately more attractive.

Extrapolation bias: where predicting future outcomes based on the past, placing more weight on the most recent past.

Regret avoidance- attempts to explain why investors refuse to admit to themselves that they've made a poor investment decision so they don't have to face the unpleasant feelings associated with that decision.

Availability Heuristic – tells you that your perception of risk is going to be proportional to how salient the event comes to your mind.

## **Research Methodology and Methods**

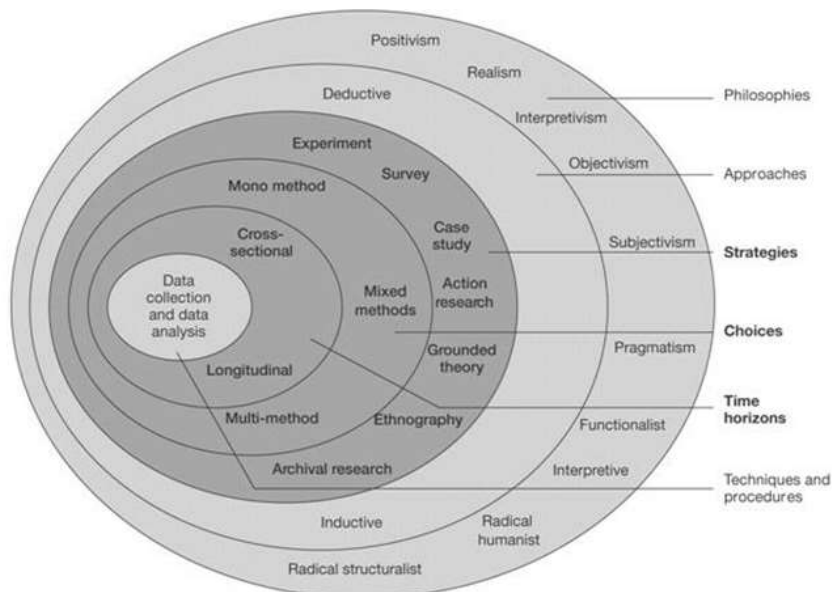
### **3.1 Research Questions**

- Are rewards and incentives properly aligned to help in the risk management process??
- What potential biases might come into play whilst doing your job and are you aware of them?
- Does the banking structure encourage decision makers to pursue particular tendencies?
- How do individual decision makers weigh risk v incentives?

### **3.2 Research Methodology**

Using the research onion see figure 1, this will map and develop the research methodology for this study. This will include selecting a suitable research approach, relevant strategies and philosophies as well as the techniques involved in the collection and analysis of the data.

Figure 1.



### 3.3 Research Philosophy

The first layer of the onion deals with the philosophical approach to conducting the research. The research philosophy according to Saunders, Lewis and Thornhill (2007 p.101), “contains important assumptions, these assumptions will underpin your research strategy and the methods you choose as part of the strategy.”

Developing a philosophical perspective requires that the researcher make several core assumptions concerning two dimensions: the nature of society and the nature of science (Burrell and Morgan, 1979). Society is viewed as unified and cohesive, whereas the sociology of radical change views society as in constant conflict as humans struggle to free themselves from the domination of societal structures (Burrell and Morgan, 1979). The other dimension, science, involves either a subjective or an objective approach to research, and these two major philosophical approaches are delineated by several core assumptions concerning ontology (reality), epistemology (knowledge), human nature (pre-determined or not), and methodology (Holden and Lynch, 2004).

Ontology is concerned with the nature of reality and assumptions researchers have about the way the world operates and the commitment held to a particular view (Saunders et al, 2009).

Epistemology is concerned with the study of knowledge and what we accept as being valid knowledge (Collis and Hussey, 2003). An Epistemological issue concerns the question of what is (or should be) regarded as acceptable knowledge in a discipline (Bryman, 2004). According to Saunders et al, (2007) there are three epistemological approaches to research philosophy: Positivism, Realism and Interpretivism.

### Positivism

The positivism approach is normally adopted by researchers that prefer to seek facts or causes of social or business phenomena using logical reasoning such as precision and objectivity as methods of investigation.

The positivism approach is normally adopted by a researcher that prefers to work with an observable social reality in order to come up with law-like generalizations similar to those produced by the physical and natural scientists (Remenyi et al, 1998), and in this tradition, the researcher becomes an objective analyst, coolly making detached interpretations about those data that have been collected in an apparently value-free manner (Saunders et al, 2003). Furthermore, the emphasis is on a highly structured methodology to facilitate replication (Gill & Johnson, 1997) and on quantifiable observations that lend themselves to statistical analysis (Saunders et al, 2003). The assumption is that the researcher is independent of and neither affects nor is affected by the subject of the research (Remenyi et al, 1998; Saunders et al, 2003).

### Realism

Realism states that real objects exist independent of human consciousness, but that knowledge is socially created (Saunders et al, 2007).

According to Blaikie (1993), whilst realism is concerned with what kinds of things there are, and how these things behave, it accepts that reality may exist in spite of science or observation, and so there is validity in recognising realities that are simply claimed to exist or act, whether proven or not. Similar to interpretive, realism distinguishes that natural and social sciences are different. From an organisational perspective, Hatch and Cunliffe (2006) describe the realist researcher as enquiring into the mechanisms and structures that underlie institutional forms and practices, how these emerge over time, how they might empower and constrain social actors, and how such forms may be critiqued and changed. Realists take the view that researching from different angles and at

multiple levels will all contribute to understanding since reality can exist on multiple levels (Chia, 2002).

### Interpretivism

My research philosophy will be based on interpretivism. Not realism, pragmatism or postivism because it believes in understanding human behavior rather than explain it. Saunders, Lewis and Thornhill (2009) sustain that interpretivism:

“advocates that it is necessary for the researcher to understand differences between humans in our role as social actors. This emphasizes the difference between conducting research among people rather than objects such as trucks and computers” (Saunders, Lewis and Thornhill, 2009, p. 116).

The improper matching of methodology to the research problem may produce spurious results and may ultimately have negative impact on the researcher’s professionalism and the authority of this research. We perceive that elasticity in “What to research?”, is gained only through an intermediate philosophical position, thereby allowing researchers to match philosophy, methodology, and the research problem.

### **3.4 Research Approach**

My research approach is that of induction rather than deduction because I am not testing any hypothese and do not know what results i will get. I am more interested in the way humans see the world and maybe see different explanations for some things/ reasons than preceding theory would give. Induction allows me to see the emotions that humans might attach to certain events and allow me some flexibilty as well. As it is not a focused interview the questions and topics need to be fluid. I want to get the subconscious feelings also out of the interviewees. This a very human based approach

#### Induction emphasises

– Gaining in the undertandings humans attach to events.

- A close understanding of the research context.
- The collection of qualitative data
- A more flexible approach to permit changes in research emphasis as the research progresses.
- Less concern with the need to generalize.

### **3.5 Research Strategy**

The next level of the research onion is the research strategy. Saunders et al, (2003) describes the research strategy as a generic plan guiding the way for the researcher to answer the research questions set forth. Each type of research strategy could be used for all three purposes: Exploratory, descriptive and explanatory (Yin, 2003). According to Collis and Hussey (2003), the types of research strategy available are: cross sectional studies, experimental studies, longitudinal studies, surveys, action research, case studies, ethnography, grounded theory, hermeneutics, and participative enquiry. The claim that one research strategy is better than the other research strategy is a myth (Saunders et al, 2007).

Elements of the research strategy for the human biases in the banking structure will involve grounded theory strategies. Saunders, Lewis and Thornhill (2007 p.142) "A grounded theory strategy is, according to Goulding (2002), particularly helpful for research to predict and explain behaviour, the emphasis being upon developing and building theory. As much of business and management is about people's behaviours, for example consumers' or employees', a grounded theory strategy can be used to explore a wide range of business and management issues. In grounded theory, data collection starts without the formation of an initial theoretical framework. Theory is developed from data generated by a series of observations".

### **3.6 Research Choice**

My research choice will be one of Mono method.

Gaining access to Individual informants:

I want to immerse myself in the Chameleon Approach as in trying to 'be one of them'. With prolonged engagement, come more acceptance, understanding and insight. I will do this by dressing informally, relaxed sociable voice and also converse about other interests before and after interview. I do not need to try the other tactics as in using incentives as I know the interviewees. I will not also use the tactic of emphasizing personal contribution and gratefulness as I do not the subject to be overly concerned about their discussion or answers and just want the interview process to flow naturally.

The researcher will choose Tactic 4 (Saunders et al 2009) of honesty and Openness when meeting subjects. The researcher will address a range of issues openly and honestly to negotiate and facilitate access. Will mention the procedures for reporting the study's results, the time scale of the research and the plans to anonymize the data (Shenton&Hayter, 2004)

Access to good sources = significant effect on nature and quality of data collected (Shenton and Hayer, 2004). I know the importance of choosing the right subjects. As this project has only 4 subjects, I want to be careful in identifying people who want to express an opinion and are interested slightly in these topics being discussed. It will be a mixture in a Non-Probability Sample.

Convenience/Haphazard/ and Judgement/Purposive Sample: The benefits of this are ease of access, no cost and good engagement. In this we sample with a purpose in mind. Sample is one that is selected based on knowledge of the population and the purpose of the study. Those being interviewed are fit a specific purpose or description.

### Validity

In semi-structured and in depth interviews a high level of validity may be achieved where these are conducted carefully due to the cope to clarify questions to probe meanings and to be able to expose responses and themes from a variety of angles (Saunders et al 2009)

**Validity-** 1.the extent to which data collection method or methods accurately measure what they were intended to measure. 2. The extent to which research findings are really about what they profess to be about.

In terms of research ontology (nature of reality) the research will involve a subjective approach to the study because the research will involve analysis of the banker's interpretation of risk versus incentives and their experiences and perceptions. The role of the researcher according to Saunders, Lewis and Thornhill (2007 p.109) is to, "seek to understand the subjective reality of the customers in order to be able to make sense of and understand their motives, actions and intentions in a way that is meaningful

### **3.7 Time Horizon**

*An important question to be asked when designing your research project is 'do I want my research to be a "snapshot" taken at a particular time or do I want to be more akin to a diary or a series of snapshots and be a representation of events over a given period?' This will, of course, depend on your research question. The 'snapshot' time horizon is what we call cross-sectional while the diary we call longitudinal.*

*The time horizon for this study will be cross sectional, the study of particular phenomenon at a particular time. The time constraints of my course does not allow for a longitudinal study. The main strength of longitudinal research is its capacity to study change and development (Saunders et al 2009). This type of study may also provide you with a measure of control over some of the variables being studied.*

### **3.8 Data Collection Method**

*In qualitative research, the researcher is the primary "instrument,, of data collection and analysis. Qualitative research has characteristics such as information being value laden and interpreted,*

*researcher involvement with emergent and evolving style. The goal of Qualitative is uniqueness and to develop patterns and theories for understanding*

Interviews reveal information about the worldview of a single individual. This is a flexible strategy that (with care) can be massaged during data collection as needed to heighten results. But interviews are a time-consuming form of data collection. To gather data from one person requires preparation, the time of the interview, and the time of transcription.

Qualitative data result from the collection of non-standardised data that require classification and are analysed through conceptualisation. Qualitative data collect information as written or visual images and report findings as words. Yet qualitative data collection is more than just conversations, records, or observations. Rigorous collection and analysis of the words and pictures, gathered as evidence about a topic, enhance the position of educators to build a convincing body of knowledge on which to improve educational practices. Data will be collected by voice recorder and this will be let known to all stakeholders. If there is a complication in accent and misunderstanding of words I tried my best to clarify the issue. I let the interviewee know after, that I tracked body signals and language and that I will be incorporating such things in to my findings. The advantages for me of audio recording were it allows interviewer to concentrate on questioning and listening. It also provides an accurate and unbiased record. The potential disadvantages maybe ;it may adversely affect the relationship between interviewee and interviewer. (Saunders et al 2009)

Qualitative coding is about data retention. My goal was to learn from the data, to keep revisiting it till I could understand the patterns and explanations. So I needed to retain the data records, or the relevant parts of them, until they were properly understood. Coding is not merely to label all the parts of documents about a topic, but the aim is to bring them together so they can be reviewed, and whilst thinking about the topic developed. Qualitative analysis can involve summarising, categorising and structuring data. The process of data analysis and collecting are necessary interactive.

The coding and the results will be purely set from me the researcher. I will inform the subject of the process involved and how intend I to dissect it and turn it into results.

### **3.9 Sampling Selection**

Sampling and selection are principles and procedures used to identify, choose, and gain access to relevant data sources (Mason, 2002). A sample is “a smaller (but hopefully representative) collection of units from a population used to determine truths about that population” (Field, 2005). There are two types of sampling techniques: probability or representative sampling and non-probability or judgmental sampling (Saunders et al, 2007).

*“Non-probability sampling (or non-random sampling) provides a range of alternative techniques to select samples based on your subjective judgement. In the exploratory stages of some research projects, a non-probability sample may be the most practical.” Saunders, Lewis and Thornhill (2007, p.226). Therefore suitable selective samples are chosen within the industry as follows: a branch*

*manager with over 30 years' experience, a trader with 15 years' experience, a head underwriter with 30 years' experience in lending and underwriting and private bank manager with 35 years' experience. These different backgrounds gave a very good mix of perspectives and insights and also showed very well the thought processes which all of them go through. Convenience sampling also features in this research into the Irish financial sector. The samples described previously will be relatively easy to access and are also in proximity for the researcher in conducting the study. Criticisms exist with convenience sampling based on the premise that there is bias in the samples which are not representative of the complete picture. "Although this technique is used widely, it is prone to bias and influences that are beyond your control, as the cases appear in the sample only because of the ease of obtaining them. Saunders, Lewis and Thornhill (2007, p.234).*

### **3.10 Research Ethics**

The ethical stance I pick is that of *Pervasive ethical transgression* - virtually all research involves elements that are at least ethically questionable. This occurs whenever participants are not given absolutely all the details on a piece of research, or when there is variation in the amount of knowledge about research (Punch, 1994; Gans, 1962).

'If the researcher is completely honest with people about his activities, they will try to hide actions and attitudes they consider undesirable, and so will be dishonest. Consequently, the researcher must be dishonest to get honest data.' Gans (1962: 44).

I tried my very best to let the reader know what activities were done or what implicit or explicit parts of the process had been undertaken. I was also very forthcoming with my interviewees and let them know what will happen to information.

### **3.11 Research Limitations**

Subjects might have been put off by the recordings. But I tried offsetting this by comfortable surroundings and reiterating long standing relationship. Findings will be limited to subject's knowledge of particular areas. Although I was relying on the generosity of individual interviews to be interviewed, they were very forthcoming about their honest assessment of situations. I would have liked to interview someone in risk management but this could not be done. Questions were set to try to be rich in information about things they will know, and keep in line with the things they might be dealing with on a day to day basis.

## **Data Analysis and Findings (interviewer in red writing)**

### 4.1 Summary of Interview with Trader (full interview in Appendices)

- They would lie to you. Its gas! I'd have lunch with CFO of Anglo in the middle of 2007 and they'd say 'everything's grand!' They were either not aware or plain stupid. I don't know. This kind of stuff always happened. Everybody was so invested.
- **Everyone has an incentive to keep the thing going (with regards to Irish banks reporting huge profits)**  
'Exactly! It happens in every business you know.'
- Fear and greed are the two primary emotions!
- Generally you wouldn't do anything to jeopardise the firm. You were part owner of the firm so I thought that was the best incentive of all. because it was relatively small, that felt a little bit more real
- If I was acting like a maggot and taking excessive risk I wouldn't have been there in the first place. I wouldn't have lasted very long (evidence of survivorship bias)
- It's not all as simple as stocks and limits and how much you were willing to lose. ( common financial theory not as clear cut in the real world)
- **Hiding risks?**  
Everything is so electronic. You couldn't hide anything. No matter what you wanted hidden. No matter what I did, there were probably 6 sets of eyes on it all the time.
- **Response to Group herd tendency?**  
You're responsible for your own stock. I might bounce an idea of someone else but the buck stops with you.
- So that will come back to the team rather than the individual and we were incentivised as a team rather than individuals.
- Risk is everywhere. You can't mitigate the risk away. You have to embrace it!
- You have to play percentages. There's a chance of rare occasion too. You have to accept that. Every day you buy a position in a big stock, isn't going to be the day that there is crash.
- **Perception of Bankers**  
They are not comfortable with any risk. Cultural mind-set!
- **Banks**  
They are trying to mitigate away all risk and just focus on earnings, assets under management and safe enough recurring revenue.
- **Is lending cyclical?**  
So it's totally a cycle, no doubt about it.
- **Anchoring to a target?**  
You would but you're not. We all learn the hard way as you go up through the ranks, we all took the big hits along the way, luckily enough we were able to make up what we lost. But that's what we do.
- **You as a trader would feel more emotionally attached to your positions?**  
But you are defiantly.
- As a trader, it's a constant battle, to check their emotions and fear and greed comes with that.
- **Conscious of human biases when you're trading?**  
You would and you wouldn't. 'Anchoring' maybe yes. But you get better at it. We make the same mistakes the whole time (answering Taleb's thoughts on we don't learn that we don't learn, the trader is probably the best at it)

- **We don't learn?**  
Because of whatever we're chipped. It's just in our DNA.
- In hindsight we haven't a clue on the quality of those books.
- **What would bank management tell you?**  
They'd tell you about work in progress, very little about quality. It was very much about the number and how much have we committed to lend, so the bigger the number the better.
- **Were you ever sceptical of them? (CEO's of Banks)**  
No you were not! They were the kings of the road. Why would you have been? Obviously it's easy to say it now. They were flying high, making loads of money.
- **Why did people trust them so much?**
- Because they were making money. We were all making money. There was great money being made. Earnings were going up every year! What was the problem? Everybody's your friend when you're making money.
- **Everybody believed the story?**  
There was hard cash being made also. They were highly profitable. They were built on a deck of cards. But who knows. That's markets, that's the way it works.

## 4.2 Private Bank Manager

- **Description of Job?**  
To put portfolio's in place that meet their needs over short , medium and long term.
- I can advise and I can give the best of the information we have.
- At the end of the day, the recommended strategy and the implementation of the strategy is down to the client.
- **Financial Intelligence.**
- In the last 15 years, from what I can see is that people are a lot more up to speed or that bit more knowledgeable to 15 years ago. They are requiring rationale and requiring an understanding.
- **'Fear of regret'** - The last thing I want is a client coming back and saying 'you never told me this, you never told me that'.
- **Changing nature of the risk profiling of a client.**
- I've had clients who'd have had an appetite for risk 10-15years ago and that's not the same appetite for risk they'd have now.
- Rather than knee jerk reactions when market cycles go down or people saying I don't know what I was getting into. **(contrast mis-reaction tendency)**
- I remember back to the Celtic Tiger, where people thought property was a one way bet. That you couldn't lose on property. They didn't realise all assets, all assets including cash, bonds, properties, equities, commodities, you name it all have risk.
- A feature of clients and Irish investor is that they would have invested in property and they would have been individuals who would have had total knowledge or supposedly total knowledge, in their own mind about property. **Could the private banker fall for mere association tendency here?**

- I would still advise in relation to managing risk. You have to diversify. **Diversification referenced almost gospel like.** You could lose all on the basis it has no spread in risk
- I would call myself a trusted advisor.
- You will never get it all right. But what you are trying to do is limit the downside and maximise what you are trying to attain in returns and that's really what we're working with our clients.
- If it's about selling a product I wouldn't be in this business for 30 years, It has to be about relationship.
- What are you are trying to do is make sure they survive and not totally blow up. **Awareness of the volatile environment they're dealing with.**
- We took a 20% loss. We got money back to the clients because they would have been in there for 8 to 10 years. **Example of being able to cut off a bad trade and limit the downside to a bad decision.**
- If you go back to the Lehmans' crisis, we had equity portfolios down 50%. Now someone could come into me and say I want to get out of there. Now the worst time because of emotions and fear is to get out of positions because of that. Because of the way cycles go they can be quite dramatic. So it goes back to if you understand your risk profiling, and the maximum and minimum these can fluctuate, you should have clients that are comfortable enough with you, to be able to stand the heat in the kitchen, and not have the panic button pressed.
- So the modelling we do would be the expected returns on those assets and also in terms of how we benchmark in institutions where risk/return studies are being done. Then it's the experience of success and measure of probability.
- So everything goes toward how we can get to the set target, reducing the risk.
- We try our best to bring down the risk weighting but also not bring down the return profile in terms of set goals. So it's all about the diversification and that's fed into a single risk model for our clients.
- **Crisis of 2008**  
Hopefully it will encourage a more diversified and global view of the wider opportunities that are out there.
- People saw property as a one way bet and it would never come down in price. They then borrowed for it and it compounded the problem.
- They want a safe pair of hands, with knowledge and expertise that is not betting the house – **Self attribution bias.**
- Most people would like to hear good advice. It's like any advice you get from your solicitor, doctor, dentist or whatever. **What gives the Private bank manager the confidence to say this?**
- My mantra is I want people to grow their wealth. One it's a long term relationship. Two the more they grow the more fees I probably get. So it's in everybody's interest.

### **4.3 Branch Manager (full interview in appendices)**

- You ended up with a keyset of risks, and you had to develop 'miticons', to make sure them risks didn't happen and they would be minimised. So really you take a department and identify all of its activities and plot them on a risk metrics. But actually I never came across anything called human behavioural risk. I mean you'd have risk of not having enough staff. People not turning up for work what would happen. It was more observational risk.
- Incentives  
It could go the whole way down. Performance pay was well very well structured. You were given a set of objectives at the start of the year, you would be seated down depending on what role you were doing and you would be given what they call KPI's. They would be set by top management.
- Anybody who was a member of the union had an option to opt out of accepting them KPI's
- Very few people opted out. You would be under pressure from management. But you couldn't stop them at the end of the day.
- Well if you were running your own shop, and you wanted to give staff sales targets and they were refusing to accept them. You wouldn't be happy with them, same with branch manager.
- So you have to remember targets were reset year on year by the management for the branch if they were too high or not. There was a good bit of research gone into that.
- Like they didn't have to go off and do crazy things to reach the targets or anything. It wasn't that bad even though the perception might be different. (1990's in ROI)
- **Was there a point where you would list all the potential bad things that could happen and not just what ye wanted to happen?**  
Yes if you were in loans especially, one year terms, where you look to see were some loans not performing or are they delinquent loans. If you were a lender in a branch that would definitely be part of it.
- There was probably too much emphasis/incentive on giving out new loans and with so many staff being switched from one place to another. You could have a loan that was made 5 years ago, that performing badly now, you could point to lack of accountability. that bonuses and incentives should be given over a 5 year average over a 1 year average. If you were a lender they shouldn't be rewarding you for last year's loans, it should be your last 5 year average.
- If you're a branch manager, the buck stops with you. Your responsible. Now who's accountable is a different question. You know should a loan officer be more accountable for the quality of the loans he/she sold over a period of time .Yes they should!
- **The loaners are the ones building the loans?**  
Exactly! But the branch manager at the time would have to sign off on that application as well at the times. The loan officer can't just sign off they would have a discretion or an amount alright. You find that in businesses that are too incentivised, moral ethics go out the window but I don't think that was an issue in my experience in Irish banking. But I was in the pre 1990s boom. A lot of it is market driven. That bonus system that the banks set up, you could say it ended up being a problem. To be honest with you, when things were normal and bonuses were normal and you went to work, you were given a set of KPI's, and you did your best and you worked hard.

- And it worked for a long time (**bonus and incentive scheme**). But it only went wrong in like a 2 year period, where the thing went out of control. The people that were managing the risk allowed it get out of control and incentives were getting stupid. A bit like what you'd see on Wall Street.
- When I look back I can nearly see it as a 2/3 period, where it just went crazy. (**Hindsight bias?**)
- That switching around of people was actually to stop the sort of risk of people getting too committed in an area, doing favours for people etc. HR would always say that kind of risk and that you have to move people around. So you don't have any pals or looking after people or anything.
- You could be making mistakes or covering up mistakes for a couple of years and you knew you were going to be moved. You knew that nobody would come after you for the mistakes that you made. So that was the downside to it. **Was it easy to do that?** yes
- **Do you think it came from people not looking over you properly?**  
Yes.
- **Technology wasn't in place?**
- Technology wasn't in place. Accountability wasn't adhered to. People got away with it. The more people got away with it, the more people would probably do it.
- **What would have slowed the percentage of bad loans on the books?**  
What would have stopped it would have been if you wrote a loan that your staff number was associated with it, and it went bad and you were in another branch, and somehow that affected your performance? But no it didn't really. I'd say there was a lot of people good at sales, good at getting new customers, but left a lot of bad stuff behind them too and were never held accountable for as long as they were getting more business.
- Everyone can't work in risk. In all of our training, in all of these courses, everyone had to do accreditation of risk. So we had loads of courses on risk.
- We were brought to loads of these conferences on risk. And they were so non-applicable to what we were doing, it was pointless. They'd go in one ear and out the other.
- If you're a bank manager in a branch you have to make decisions quick.
- But if you were talking about the running of a branch you're talking about a million little decisions a day. But there's nothing wrong with that. I never felt pressurised by that. I felt that was my shop. You can't bureaucratize everything.
- **Risk managers have to be seen to be doing the right thing but can they actually affect something happening? How can they stop something if the business is all about growth?**  
Good question. Your right! I know where I'm working now the head of compliance for the bank said 'I'm fed up, management won't listen to me. They just laugh at me.'
- **'In the history of banking they have lost, more than they have ever earned. Do you think people think about this in banks?'**  
I'd say they'd find it impossible to believe that. No if you were to think of all these things that you have asked me in going in to run a bank, sure you'd stay at home like.
- **Banks give off the impression that they are safe and conservative?**  
But they are! They are not giving off that impression consciously but they are safe places. That's against putting it under a mattress of putting it under a wall.

- The banking crisis. I'd struggle to know what you'd fix. . So if you were to think of yourself as branch manager in Tuam, Loughrea or wherever. I mean you have a responsibility for a shop that is franchise. Like you are given the rules of engagement on how you are supposed to do things. Your auditor measured. So there were reports coming out your ears. If you don't meet those you lose your job.
- **Biases you be conscious of in lending?**  
If I was too long in a certain area I'd be more biased. You know you get to know as many of the people in an area over the first two years that you will the entire time.
- **Over optimism tendency?**  
Yes big time! Where you were writing a new loan for a new customer and it's how your writing up the report. You can dress it up to look good.
- **Falling in love with an idea/business or character whilst lending?**  
What they did to counteract that was to bring credit scoring on certain financial information on your business and cash flow and all of that fit into the credit scoring system. That credit scoring system accounted for 80% of credit decisions. So if you felt you weren't going to get a loan. If we are deciding to give it or not? If I really like you I could write a really long story and it should work.
- **Human decision making/better systems?**  
Better systems. Take out the emotional part out of them things.
- **Influence from mere association?**  
Yes. It says itself. Golf club mentality. People like good news. See I think the old bank model that you had, you got to know people, go to different meetings and functions. Represent the bank and get to know people. But you certainly have biases to them if they are looking for a loan and you want to help them.
- **Has the banking model changed?**
- Oh yes. Taking the decision making away from the branch manager, while people might criticize that and people do in the papers. They say the bank manager can't do anything anymore. That's the reason they can't do anything. He can only lend 3k or 4k. It's all done by a department or system in Dublin now.
- **Irish banking crisis?**  
You couldn't make this story up, it all came full circle. The whole debacle in Ireland came from the ordinary person on the street who had bank shares. Because bank shares were such a great bet, all pension fund holders were holders of bank shares. So when you'd read in the press about the AGM in EGM's, you'd often here them on about institutional investors would be looking for certain points or for the bank to look a certain way. The investment funds and pension funds were probably meeting the banks managements at least every month and they'd be hammering the table and demanding profits. They'd be screaming and shouting demanding performance. They'd be threatening. They'd be saying we'll dump your shares in the morning. If it got vicious enough they would. If one of these institutional funds did it, especially the foreign ones, the banks could suffer a 'run of some sorts' and seriously suffer. So that's where the first pressure came. So bank board members would come back from these sessions and call in senior management to get their act together. It all went down the line until the fella at the branch being told to sell 200 credit cards and he can only sell 100. So that's one way of looking at it. The other way is then they brought in this bonus

scheme, people got too greedy and sold too much and sold without thinking about the risk of it. But I would comment and say it came from institutional investors demanding the performance and that sort of demands drove that behaviour down through the organisation. So for the ordinary fella in the branch, this is what was being asked of him.

## 4.4 Head Underwriter

- You catch me at an interesting time as a bank; we haven't paid a bonus or salary increase since 2007.
- In terms of risk/reward, (a) its costly (b) we're learning from the boom of pre 2005, where fellas were no doubt getting huge bonuses for throwing out a level of lending which has nearly brought the country to its knees. Now having said that we have a myriad of schemes when you look at the risk, underlying risk, which in our business is lending: I would say there is a huge structure and focus around that since the mid 2000's.
- That's the role I'm in at the moment. What am I looking for? I'm looking for the borrower, in terms of character, their experience and sometimes you'll have different degrees of that at different times. I would look at the proposal. What are the plans? You know if someone is planning today to build a high specification residential development, I'm not interested. The country is a flood with property. **(there's some bias for this)**
- In my mind, it always comes back to me. Say it's a loan decision and I look at the pieces. I want to see what the deal is
- **Character of lender.**  
I'd be looking out for experience, by seeing how the person dealt with previous facilities, has we a track record with them.
- **Business plan versus character, how would it fair out?**  
Hard to say! It depends on the case. No matter how good the character, if the business plan is completely flawed, then it's a non-runner. If the business plan was to stack up and then you've got a character that can make it happen that's what we want. It's very hard to put a percentage on it. If you stuck me on it, I'd say 70:30 in favour of the business plan. They really have to come together.
- **The external circumstances that might impact your decision making in Lending?**  
The economy is the big piece. The whole country needs the economy, we all have a role to play in that.
- Whether we got cheaper funding or not, shouldn't change the fundamental decision. (of lending). I can't be saying I'll give it to him if I got cheaper funding and I won't if I don't or vice versa!
- I've moved around 15 times or so over 30 years and I wouldn't say that solely down to removing risk, it could be more to do with development of the character, gaining new skills and experiencing more.
- We have young families the two of us, they're interacting with each other, the other side of the coin is people do business with a person they like and that's natural as well. In some

respects it can suit a bank for me to have a strong relationship with you especially if you're a guy that's doing business, growing their business or whatever. They'll want their own banker to have a strong relationship with you because if we don't well you might say feck them and go with someone else. There is that point. But what you also said is valid. There is a danger if people are left to long that it becomes risky.

- **Reciprocal tendency. Awareness of it?**

If you look at the way we are structured internally with decision making and authority levels, you know we'd have different levels of discretion in doing things. You know something might hit me that's over my discretion which means I have to go up the line with it. So the ultimate decision maker is actually one step removed.

- **On decision to lend.**

I suppose one can only make a decision on the information they have in time. Whether rightly or wrongly, you make that decision!

- **Hindsight can be very cruel?**

Hindsight can be cruel. My view on it would be if someone made a good decision in fait and if I'm convinced it's going to happen, I'll recommend it. Unanticipated things happen or the thing doesn't happen. Now suppose the loan is gone wrong, Is the banker wrong there? I contend 'no' if he followed the process. Now where he is gone wrong if he knew in his heart and soul that this was going arseways and still go ahead and gave it. But I have to say if I moving into today's world, loans will go wrong. Now you hope that's a very small amount of them. But we're in the risk business things will happen. And should that come back to haunt me if it went wrong no I don't think so unless I've blatantly told lies to an underwriter or if I knew there was something wrong and I didn't tell them. I follow the procedure, I document it, but if I do something untoward, then absolutely I should be held liable.

- **'Group herd' was a term bandied around, with relation to the Irish banking crisis. Have you seen anything since that that tries to negate its influence it or an intervention of sorts?**

I would probably be critical of that. I remain critical in that I think senior management at times going back to what I'd said and that it still continues. Like a contrarian view not similar to senior management, they don't like that, and I do think it depends on the front line having the balls to say it. Sometimes what happens is, they take silence as agreement but sometimes people in today's world, it might be a great time to say it. Like the CEO might be saying that glass is there but I have a very strong view it shouldn't because of a, b and c. I contend that my opinion is every bit as valid as yours. But I might not say it because of fear. But If I do say it, somebody could say we need to get rid of that fella. So there's that! Even when the guy does say it, I think we should move the point to somewhere else because of a, b and c, the senior management don't like that. So that's an on-going battle but is there a quick solution for it? I wish there was some other way.

- A forward looking manager will try naturally to think we need diverse views in the workplace and ultimately they have the decision.

- **Overcoming groupthink. Solutions?**

You said get 5 people to think of the worst case scenario. WCS is we don't get paid. So we don't operate on that basis from day one, we won't do the loan.

- **You talk about the things that would stop a loan being repaid?**

If you were to start with that, we wouldn't underwrite anything. Because you would see that the worst case scenario here is we don't get paid. You would have to bring in some probability, what are the chances of that happening and that's what we try and do.

- **The pressure coming from the top saying ye have to make a certain amount of loans?**

I think that's where banks might have failed in the past. I contend and this is where I'd be the contrarian to bank chief executives where you have to make 100 loans or whatever the figure is. I should satisfy myself first. We should do the right things for the right reasons whatever the amount might be.

- **With regards to hindsight bias, it can be very cruel to a person in your position who has to make a decision. We could be looking back in 5 years and seeing loans that you're making now gone bad.**

I think if you operated on that basis you'd do nothing.

- **In essence going forward, I'd see the two big banks left in the economy as a big risk because if anything ever happens them, it affects the whole economy even still.**

True. True.

- Moral hazard is a big issue for us as an individual bank, especially on the mortgage side I think if you had 3 banks, fairly equal in size; you know it's a safer bet. I don't think that will be good for Ireland to just end up with two banks. It needs at least a 3<sup>rd</sup> bank.
- We spent a lot on centralising decisions that lead to smaller lending decisions which tend to be more consumer type loans or small business ones. Whereas the bigger ones are the process I described to you as being very hands on, front line person reviewing it with the business and reporting up the line to an individual and the systems in and around this is are very much human intervention.
- **Talk about over optimism/pessimism. Is it very hard for the human decision maker to stem the tide of these atmospheres?**

Yes it can be. So I have to say if our own CEO was here, his clear message to all front line bankers is 'I want you there and I want you lending money' on 2 criteria. 'I want you to lend money to people you think will pay us back', which is reasonable. Secondly, 'I want you to lend it profitably'.

- **24 hour approval on consumer loans that seems a bit risky?**

I am actually the contrarian view with regards this. We're talking about the fast decision; we got a 24hour promise. I would actually say, I think that's wrong. Wrong for us as a bank and sometimes be wrong for the consumer. Because if we rush the decision, we might get it wrong either way. We say 'no' when we should be saying 'yes'. Or we might be saying 'no' when we might be saying 'yes' when we should be saying 'no' which is probably the more likely one. Now in that case, grand we may promise the customer a 24hour but ultimately we've put a bad loan on the books, which is bad for the bank. It's actually bad for the customer as well. So look at his/her credit record here for a bad loan. So I'm not convinced that 24hours is the way forward, great if you can do it within the confines of what's in front of you. But I don't think it's good! There may be an occasion where you need more information before we make that decision. And if you are pushing me into a box that you can't ask for more information and you have to make that decision.

- Now just because I challenge up the line, doesn't mean the whole thing changes because there is a momentum because people more important than me would make a decision and that's fair enough. But I will give my opinion, if I don't think it's the right thing to do

## 4.5 Strong views from the 4 interviews

- *Lending is very cyclical no doubt about it.*
- *You can hide risks and not get punished.*
- *That they can control risks in investment management. They really believe in diversification. (private banking)*
- *Contrarian view is not encouraged.*
- *At times in the past there was huge pressure for banking performance from institutional investors.*
- *Risk management is there to look like it's doing a good job but its effect is limited.*
- *That risk theory has no real effect on what they do on a day to day basis.*
- *Trader said he looked for the main things in banks when investing. Business risks, balance sheet risk, quality of the book, the lending activity. He said in hindsight they knew nothing of the quality of the books.*
- *Strong views on loans that 25 years plus. More care and caution needs to be treated with them and those making those new loans.*
- *Loan officers should be held accountable for quality of loans (branch manager differing from the underwriter).*
- *Bad behaviour spreads. One person getting away with something increases the likelihood of the next person doing the same.*
- *General awareness from Trader and Branch Manager that risk theory doesn't do much.*
- *Nobody likes the 'group think solution'. They thought that they would never be able to do their jobs if they were briefed about all the possible things that could go wrong with a loan.*

*Trader was aware of the herd mentality. He accepted it. He discussed the implications of decisions made within his workforce to try counteract this i.e. how they were structured, stocks split up between them, trust in individuals to look after themselves.*

### Head Underwriter

*I don't believe that they don't care about competition. His views were full of mini contradictions and shows the tough situation the bank puts that person in. He stated the benefits of having strong relationships with customers but also tried to show it being formal as well. It is always a balancing act as they don't want to lose customers to competitors especially in a tightly fought market. There was an awareness of the reciprocal tendency but felt that it wasn't really applicable to him.*

### 4.6 Evidence of biases:

Confirmation bias: Could really be seen by Private banking on the role for diversification. Everything revolved around that and he believed it to the end. Looks for incidents that concluded with it.

Over optimism bias: accepted for crisis but not well understood. Over confidence in knowledge, yes! By private banking on solutions and managing risks ( see literature).

Behavioural convergence: Very hard to stop but only truly acknowledged by the trader. The underwriter mentioned the reasons why one would be afraid to offer a contrarian view to management. The branch manager mentioned the danger of bad behaviour spreading because of bad control of subordinates (not happy with that)

Time inconsistency: Systematic changes in individual preference over time whereby more eliminate rewards, become more disproportionately more attractive: definitely with regards branch manager saying it. It happened.

Extrapolation bias: Most definitely. Property was a big factor in discussions and bad loans

### **Branch Manager**

Branch manager doesn't fully understand hindsight bias believes he knew what was going on but from a thought process he has displayed, it clearly shows linking the puzzle together after the effect

### **Trader**

When the trader talked about incentives versus risk. He was very aware of the trade-off. He acknowledges that there was a huge incentive of taking more risk and he knew instinctively type 1 that they were all being monitored and there were certain limits in place.

### **Trading activities**

- 'Generally you wouldn't do anything to jeopardise the firm'.
- 'You were a part owner'  
There is an awareness there of his own decision making affecting performance of the business. Is it that the banks see themselves as more resilient? Why the confidence? Too big too fail? Conservative image they give off?

<u>4.7</u>	<u>INCENTIVES</u>	<u>RISK</u>
<u>TRADER</u>	<ul style="list-style-type: none"> <li>• <u>Work as a team for incentives</u></li> <li>• <u>Ownership of small company</u></li> <li>• <u>Can see impact of his decision's on balance sheet</u></li> <li>• <u>Constant trading resulting in quick informational feedback</u></li> </ul>	<ul style="list-style-type: none"> <li>• <u>Constant threat on job</u></li> <li>• <u>Survivorship</u></li> <li>• <u>Trader company potentially under thread of being unviable</u></li> </ul>
<u>BRANCH MANAGER</u>	<ul style="list-style-type: none"> <li>• <u>Run a good franchise</u></li> <li>• <u>Meet Targets</u></li> <li>• <u>Functioning Branch</u></li> </ul>	<ul style="list-style-type: none"> <li>• <u>Operations Risk</u></li> </ul>
<u>UNDER-WRITER</u>	<ul style="list-style-type: none"> <li>• <u>Make more loans</u></li> </ul>	<ul style="list-style-type: none"> <li>• <u>Making a good loan no matter what the atmosphere</u></li> </ul>

<b><u>PRIVATE BANK</u></b>	<ul style="list-style-type: none"> <li>• <u>Grow wealth</u></li> <li>• <u>Meet new customers</u></li> <li>• <u>Keep long-term relationships</u></li> </ul>	<ul style="list-style-type: none"> <li>• <u>Avoid massive down writing value of wealth</u></li> <li>• <u>Damaged relationships</u></li> <li>• <u>Less income from fees</u></li> <li>• <u>Legal proceedings from bad advice</u></li> </ul>
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<b>4.8</b>	<b>TRADER</b>	<b>BRANCH MANAGER</b>	<b>UNDER WRITER</b>	<b>PRIVATE BANKER</b>
<b>RECIPROCAL TENDENCY:  AWARE? SITUATION?</b>	√	√ √	√ √	-- X
<b>BEHAVIOURAL CONVERGENCE:  AWARE? SITUATION?</b>	√ 'Book stops here!'	√ 'Pressure for results!'	√ 'Difficulty in opposing authority!'	√ √
<b>OVER-OPTIMISM /CONFIDENCE:  AWARE? SITUATION?</b>	√ How to stop it? is the question!	√	√	√

<b>ANCHORING:</b>				
<b>AWARE? SITUATION?</b>	√ √	√	√	X

## 5.0 Conclusions

### **5.1 Summary:**

- ***Incentives a big theme and relatively well understood.***
- ***Biases not really recognised? Obvious human really.***
- ***Basic financial theory (risk reward) expectations referenced almost gospel like***
- ***A lot of self-justification doing my (good) job rationale.***

*Overall analysis of all potential risks in their jobs seems severely limited minus the trader. They are either not versed in how risky it all is (RE: Branch manager acknowledging that staff would find it hard to believe that banks have lost more than they have ever earned) or they don't care. My own view that is that 'absence of harm' in their positions does not drive decision makers to be introspective and risk conscious. Moral hazard and the recent bail out make it worse.*

*There is no incentive to think long and hard about big loans. No incentives were given to people who avoided doing stupid things.*

*Pure evidence of Nassim Taleb's statement of being able to hide risks in banks ' you could be covering up mistakes for a couple of years and you knew you were going to be moved in a couple of years or*

*you knew that nobody would come after you for the mistakes that you made. So that was the downside to it.'* (Branch Manager)

*There was also evidence of people in levels of authority not looking too hard to see if their subordinates were doing the right things. They were probably too worried about looking after their own targets. No real awareness of risk again.*

*The only allowances the bankers made for not engaging in type 2 thinking on decisions were:*

- 1. They made too many decisions in a day.*
- 2. If they thought about all these things they would never make decisions.*
- 3. Human biases never really occurred to them*
- 4. Very strong belief in knowing what is right.*

*Hindsight bias here: not convinced by bankers.*

### **Group herd Tendency**

*In PD Lunn (2013) recent paper, he describes behavioural convergence and quotes Nyberg 'distinguished herding which occurred between individuals or organisations from groupthink, whereby decision makers are unwilling to depart or dissent from decision of the group'. We have evidence that was a problem from the underwriter saying that fear of career in going against top management opinion. Trader pointing out that everybody was enjoying the ride because 'hard cash was being made'.*

- *Accepting goals from top management seemed very important even though if you were a member or a trade union, you had an option to opt out.*

### **Observations**

*While the buck so to speak stopped with the head underwriter, branch manager and trader. Only the trader showed full responsibility for his/her decisions. Whilst the branch manager talked about rules of engagement and the underwriter 'information given', they were all alleviating parts of responsibility. The confidence of the underwriter in knowing that some loans will go bad but knowing that there was not much he could do was alarming. Compared to the trader who decides a trade is going bad, can cut it. A lender cannot. In truth the lender should be much more risk conscious, emotionally attached/accountable to a loan as it much more risky. This is short term versus long term. There is nowhere to sell the loan on, well not in Ireland anyways. The question of the economy being a key factor in lending is also quite startling, after all the evidence of economists being useless at prediction (see literature). There is too much trust in this information because lack of disincentives to question it. The trader knows the dangers of getting 'too attached to a trade/idea' and he knows the symptoms from experiences of losses. He knows how human he can be. Bankers truly do not understand how risky they are whilst acknowledging how important they are to the country. This comes across as 'you need us'.*

*The term 'group herd' and 'over optimism' may all be well and good but can the individual decision maker learn from these mistakes. How do they stop this? There is no evidence of any structures put in place to stop this.(interview with underwriter).*

*PG Lunn (2013) in his recent paper talks about these behavioural biases and stated 'by recognising these behavioural biases will improve our ability to recognise future economic problems more quickly and help decision policies more quickly and help design policies to where necessary stop them.' I think that is a false hope for the author. It will be very hard for the policy maker who is outside of the decision making to see what human biases are in play. It has to come from the bankers themselves and the only way for them to be aware of these biases is to put them at real risk bearing positions like the trader.*

*The term Sales is very misleading. It should be building of a loan. You're the builder. The Constructor if you are the loan officer. You're the person who builds the loan and it's up to you whether it's built properly. Maybe decentralize everything. The researcher here thinks that the loaner should have the most responsibility and resources should be placed around him but that he is to be penalized if loans go bad and vice versa if loans go well, he will get his bonus. All the builder of a loan will know the true risk of the loan.*

*Key points of banking crisis in Ireland not really well thought out by interviewees. They see themselves as one step removed. They see decisions made further up the chain as being paramount to the crisis. They never really question their own involvement in the crisis and are actually always trying to show external factors as reasons of their bad performance when one such thing does happen.*

*Bankers have a lot of faith in procedures and systems. This is an example of alleviating responsibility in my view by saying 'doing my job'. Go back to the Hammurabi code, the only person who truly knows how stable the loan is the builder of that loan. There are no disincentives in place that if that were to go wrong they would not be punished. Evidence of making a bad loan being negative on your career is weak. Whilst the underwriter said it is wrong that if you make a loan and you know in your heart for it to be flawed, this is not a good position to be in relying on the ethical nature of each individual loaner dealing with these risky decisions. The reciprocal tendency whilst noticed by the branch manager and the underwriter in hypothetical situations said in never occurred to them in their own careers. Trader nearly confessed he'd fallen for the 'kingpins' subconsciously because they were making hard cash. The scary point is when the trader says lending levels is all fashion and there will come a time again when banks will start lending and how they do prudently remains to be seen. The branch manager talked about the pressure banks were under from institutional investors to drive results and how as an employee it is not easy to say no to the targets been given to you by management. Nassim Taleb once said 'to succeed in banking you need absence of shame in hiding risk'. From these interviews it is hard to say otherwise. Beside from the underwriter who seemed highly competent and knew how hard it was to have a contrarian view in the bank.*

## **5.2 Compare and contrast**

### Differing aspects of good business

*Survival of the firm and himself was always important to the trader but growth was always the main word for banks. Why did they never feel vulnerability? Moral Hazard? It could be worse now because we, the taxpayers, bailed them out.*

*Correlating the two view points of the trader and the branch manager from the trader saying everything was about numbers and willing to play the game of investing. Then match that to the information given about the institutional investor pressure and profits being targeted aggressively. It showed that lower decision makers had no real influence on these targets.*

### **Trader**

*Trader said every day you put a position in a stock isn't going to be the day where there is a crash. This shows that the trader is always acutely aware that a crash might be just around the corner but is willing to play the game. Compare that to the underwriter who follows and watches how the economy is going. Trader is much more aware of the percentages. Underwriter knows it's his job to make loans full stop. There was no other talk about other likely scenarios. Is that because the bank is too big and it can't see the impact of his decisions i.e his new loan made is now someone else's problem. He never even mentions how much of a hit that loan could hit and still make a profit in nominal terms?.*

*The trader learns the hard way and would think twice about over reaching for targets. Targets were blindly followed said branch manager.*

*The trader dealt with people of banks for so long that it was hard to shout 'illegality' or say 'stop'. They were all in this together. Banks making huge profits served the stockbrokers well. Is this a form of reciprocal tendency? **Incentives** – everyone had a positive interest in keeping the thing going i.e. making bigger and bigger profits. Trader acknowledges this.*

*'It happens in every business' – is this the realisation of a human tendency? Is the bank there to solely make a profit or is it a strategic part of economy? Should they not be aware of the huge responsibility they have to the economy?*

*The trader brought it back to emotions- fear and greed. Are these terms paramount to the awareness of a trader??*

### **KEY POINT**

*The trader knew that there was a big incentive to take risk. 'While there was a big incentive to take risk' and he outlined why he didn't overburden himself with it:*

- 1. It was very hard to with modern technology.*
- 2. It wasn't in your interests. Ownership> Incentives.*
- 3. Effect of his decisions had impact on the firm's performance, but most importantly on survival.*
- 4. They were scrutinized and monitored in their performance. There was '6 pairs of eyes looking at everything you did'.*
- 5. Decisions they made felt real.*

### **Major points**

*They don't understand how to combat group herd. No evidence of wanting to see all possible external factors that may impinge on a loan being repaid.*

*Contrast that to each member of the bank and not one of them felt that.*

**Key observation**

*A lot of thought was put into how incentives were done. Even stopping individual from making bad decisions because they were incentivised as a team.*

## **5.3 Recommendations**

- More analysis of incentive based thinking over the long term and its affects.

Maybe the lender should be paid more than the branch manager. Main player but heavily penalised and the rest should just support that person and help make better decisions.

- The loan officer should be more accountable because he is the one building the loans. (RE : Hammurabi code, Taleb)
- From Taleb, if taxpayers are bailing you out, you can't earn more than a civil servant. (not really applicable to Ireland where civil servants get paid very well and are bank's compensation is relatively small especially now compared to US banks.)

### **More questions for trader**

Why were hedge funds/fund managers so intent on putting money into banks? Were they seen as ultra conservative? Did you ever witness undue pressure being put on senior management?

### **Other questions to ask?**

- If banks are such an integral part of a modern functioning economy, should they really be floated on public stock exchanges?
- Is the private banker's agenda to facilitate prospective theory? Are institutional investors trying to put unrealistic targets on bank management? Why do they always want to invest in banks? Has the reason that banks being the most liquid stock in the Irish market contributed to the incentive for people to invest into them? Maybe the size and float of ISEQ is a question to be answered.

## **5.4 Further Thoughts**

Perhaps the biggest threat to an underwriter is reciprocal tendency. It may not be at the lower level but definitely at the higher up level. Bankers have so much to lose.

If market forces were such a big deal, what structures are in place to stop that happening again?

**Branch Manager** Talks about when bonuses were normal, people went in did their job and achieved there KPI's, that wasn't a problem: but isn't that the thing with bank blow-ups. (see Taleb lit Rev). All

will seem rosy for so long because they don't see the risks that they are building up and then boom, they blow up.

Lots of traders blow up. What is the likelihood of a lender to blow up? Nil! Misconduct only one. 'Really intelligent sound lads blew up'. Is that the survivorship bias? Everyone stayed in lending that started there and maybe especially the ones that did the most sales. RE: Branch Manager on people being good at specific things.

Maybe in the long term, a lot of Irish bankers would be better off learning from US Failures of big corporations and how tendencies of like the liking/loving tendency come into play. In the crash of Salomon Brothers let his liking of his subordinate trader get in the way of him making the right decision. He forgave the trader for his unethical behaviour, whilst the trader continued to ask badly.

- A lot of traders know instinctively that it's a game. Because investors are putting money into Irish banks doesn't really mean they are stable. A lot of them know the instability of the situation and there is money to be made by a rising stock price and knowing that the government will eventually support them. (is that an assumption H)
- How can one say we're in the 'risk business' when they are not truly harmed by their own decisions.

#### **Quote from trader**

'Banks are not comfortable with any risk' Strikes me as scary because they are dealing with a lot of debt, huge importance to the economy. But yet some decision makers don't know if they are in the risk business. Not really knowing what role the bank is playing.

- Surprisingly public perception of the banks greatly bothered the decision makers and how the media viewed them.

No way of measuring /rewarding who stops bad things from happening. Preventing a loan decision/ stopping the bank engaging in some activities ( see risk compensation in Ireland article)

Is it really the job of the loaner to be fully responsible for the loan that they are building (quote Hammuarbai). Would you put the loaner on leash for 25 year loans to see if they are done well? Or maybe banks should put such big loans on their books and have it designed that after 5 /10 years the loan comes up for public auction again with other banks??

After way of looking at people in the banks would be the term 'rational ignorance'. Although it might seem a harsh tag if you read the definition of the word , one can see the resemblances of it in the interviews.

Rational Ignorance- Is the notion that because you are rational (and you are entitled to your decisions) you can choose to be ignorant that to make a sub optimal decision just because it can be justified. ( see underwriter interview)

#### **Questions for Further studies**

- Why doesn't risk by committee or trading by committee work? What relation from that can be made to banking?(better term)

- Do the media have a tendency of always mentioning banking in news bulletins and therefore elevating its importance in to our subconscious? (Association tendency maybe ??)

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## **7.0 Appendices**

### **7.1 Interview 1 – trader**

Trader

#### Description

He was trader for last 15 years trading. He is trading on his own now. He used to trade solely on Irish banks stocks. He probably knew more about Irish banks than most traders.

#### **Dealings with the bank?**

T: You would meet with the bank management a couple of times a year to see what the story was. In investor meetings all we were trying to do was get a price for hedge funds and fund managers, wanting to put a couple of million in, we would have a snoop around and try make money off that. It was just market making. That's all I was doing for a long time. I wasn't that scientific. You knew the fundamentals of the bank.

#### **Would the bank managers be honest with you?**

They would lie to you. Its gas! I'd have lunch with CFO of Anglo in the middle of 2007 and they'd say 'everything's grand!' They were either not aware or plain stupid. I don't know. This kind of stuff always happened. Everybody was so invested. It's hard now to look back and shout illegality because we were all in the middle of it. From that point of view, you'd have known what was going on. But it's very hard to question anything. Looking back it's very easy to say it. But when you're in the middle of it. I don't know.....

**You've dealt with these people for so long and know them. It's very hard to say stop. Does it go back to that everyone has an incentive to keep the thing going, That's it's very hard to say stop?**

Exactly! It happens in every business you know.

Are you aware of the speech by Charlie Munger on the psychology of human misjudgement, he said that human misjudgement is everything?

Yes, well fear and greed are the two primary emotions!

The 2 things that we are concentrating on this study is incentives versus risk, would you like to elaborate?

Obviously we were managing a fair bit of risk. Because we all or most of us had shares in the company, while there was a big incentive to take risk, and earn money, at the end of the day you knew that you were monitored for a start and there were certain things in place.

What would they monitor?

They'd monitor our VAR and gross amount of risk were taking in any particular stock, that was a set by the risk committee. You could take a lot of risk up to those limits but generally you wouldn't do anything to jeopardise the firm. You were part owner of the firm so I thought that was the best incentive of all. Yes everybody wants to make money, but you not doing something to blow the place up. You're part owner and because it was relatively small, that felt a little bit more real compared to having 20,000 shares in BOI with 2,000 employees. You had the protection of being a small firm.

How big was the company you worked for?

At its peak we had around 200 employees. Some had bigger shares than others.

It's a nice idea that people are part owners and I would have always thought that. Meaning the employees need to feel they are owners. But didn't Lehman have that?

Yes Enron had that. All there 401k were completely in the stock but that I think means more in a smaller company. So you could work in BOI and it has 14,000 employees, you've got €50,000 worth of options. Yes it's great but you're going for bonuses of 80k, so like whatever, whereas if you own a slice of a small company and it's that bit more tangible. So you know if you add €4million in revenue next year, so that means the company is now worth €20million and my stake will be worth half of it or whatever. You know it's more tangible in a small business. And I reckon it's different in bigger businesses but I haven't worked in bigger businesses. I don't know.

Would you have had much contact with the CEO of your company and top management?

Yes all the time. Just because of the size. The CEO is just over there. (at work)

And you know from meeting him what sort of character he is, his behaviour and his beliefs?

Exactly! But more importantly he knows what I believe in. If I was acting like a maggot and taking excessive risk I wouldn't have been there in the first place. I wouldn't have lasted very long. You build over time a relationship and an understanding. There is trust there and while you are in a position to abuse power, you aren't and you don't because you wouldn't last. Because in the end, everybody knows what's right or wrong at the back of it all. It's just common sense.

Going back to how you manage risk, I know there are measurements like VAR etc. Would there have been any stop losses?

We'd have our own stop losses for our own individual positions. Not put on us by anybody. Say you went to buy CRH, and you decide what our level is! That is the most amount of money we want to lose on that. It would be near enough to some technical level we all agreed on or you know they are your own self-imposed stop losses. A lot of Irish stocks are quiet illiquid, so that's one thing to impose a stop/loss but sometimes your left with positions your just going to have to dig in with. You know you are going to be looking at it in 3 months' time and it's right to sell, but it's just not possible. Stop losses and all these kind of things are relevant in liquid markets but in a lot of illiquid stock, you're like crap, that thing has gone through its stop loss. There is no point in selling it now.

What would the liquid stocks have been?

They would have been the banks traditionally, CRH and Ryanair. Then Semi-Liquid would have been Kerry, Glanbia. Then you would have had a whole raft of dogs, while they might have been grand companies but were very difficult to trade, totally illiquid. Companies like Your FBD's and your Abbey's.

Why were they illiquid? What is that there wasn't that much demand for them?

No it's the actual trade. It's no reflection on the underlining's of the business, they just didn't trade that much, very small free float or just very small investor base. There was just low activity in the market place on a daily basis. So sometimes you have to accept you buy some, you lose some, and you're stuck with them. Sometimes they are your best trade because they mightn't do anything for a year, then all of a sudden they might jump 30%, for no particular reason. So there was all these factors involved. It's not all as simple as stocks and limits and how much you were willing to lose. While you were looking for something, there were other forces at play.

I don't know what your incentives were. But if your incentives were much higher than what you owned in the company, do you think people would be tempted to hide these risks..

You couldn't like. Everything is so electronic. You couldn't hide anything. No matter what you wanted hidden. No matter what I did, there were probably 6 sets of eyes on it all the time. It wasn't like I'm going to buy some of them now, jot them into my diary and tip-ex them out if they go wrong. It's all electronic. There was no way I could do anything

Who were them eyes that you were talking about? Were they at the same level?

It was at the same level definitely including the operations manager and the risk manager. They were well paid respected professionals. They weren't young fella's that I could lean on or anything like that. And even then they had to do a report for the CEO. So you couldn't do it. Maybe back pre 2000's but when everything wasn't so technical, you know it's impossible.

Did you feel your trades were scrutinized at the start?

When I started in 1998, systems were so bad, things weren't scrutinized at all. I was just because the technology wasn't there. It was just me filling out my positions on a spread sheet, printing it off

every night. You know I could have been printing anything in there, but you know as technology improves, systems got better, there is nowhere to hide.

OK we'll develop a scenario, where everybody on the trading floor agreed on a price for a company, its prospects and its basic fundamentals. Could you see from an objective point of view, if all of ye were agreeing on one point of view that ye might be missing out on something else. Like the danger of herd mentality.

Rite, generally we divided up the stocks between us. You're responsible for your own stock. I might bounce an idea of someone else but the buck stops with you. So if two people are discussing a stock, it's usually a bad idea, risk by committee or trading by committee generally doesn't work. So you have to trust the individual. You know that your stock is better than the next guy or you should anyway. While some guy might be better at you at charts, looking at them might put you off or encourage you but at the end of the day the buck stops with you always. It's a better way to trade.

Would the management have been alerted if ye all had the same trades or thought the exact same thing?

Not really. You might see the skew on the book, if everybody was really long then you're in a little bit of a vulnerable position. So if 3 traders are up to their eyes in positions, which is the better one. And because we worked with each other for such a long time, we knew each other inside out so we worked it out. Generally one might say yours is the better one, I'll sell mine, and I might need to short something to hedge yours. You have to be looking at the gross book, if that got big enough, you would have management saying ye've got to yer upper limits, your daily VAR, what's the story? And between us we might say I'll get rid of mine. But generally we might know whose position was the best. While your position might be good, the other might be a better bet for the company, So that will come back to the team rather than the individual and we were incentivised as a team rather than individuals.

What would your opinions on VAR be and how to manage it?

I think it's useful. But there are flaws in it. And like everything it doesn't capture all risk. I don't think anything can. That's the nature of it. There is all types of risk, operational, client risk, it's just one measure (re VAR). It's not the be all and end all. I don't necessarily think it's a bad thing. Everybody has to accept that there is an element of risk in everything, drinking that coffee, crossing the road. Risk is everywhere. You can't mitigate the risk away. You have to embrace it!

So do you think it's better that people admit they are taking risk here to get rewarded? Instead of saying this investment has hardly any risk because our risk models are so good or that the risk involved is statistically insignificant?

That's bullshit. There is no such thing. You have to play percentages. There's a chance of rare occasion too. You have to accept that. Every day you buy a position in a big stock, isn't going to be the day that there is crash. 1 in 200 you might get one or whatever. So what you're in the game. That's the cost of being in business. And if you do trade 200 days, and you make money 180 days, so what? You should have enough if you're sized right and using your money properly, you should have enough money to take that hit.

Were the management always aware that one day that might come and we might have a big crash

The management changed while I was there. But generally they were all from market background and knew the score, they were quite encouraging, we had some bad days where we got steam rolled and they'd say just get back on the horse. It stemmed from them trusting us and we'd been doing it for a long time, and we've always done well. There has never been a year where we turned in a loss, nowhere near it. We always made money. That could have been a lumpy enough pattern. People could have been up a few quid or down a few quid but they trusted us enough which was encouraging and because the firm was management owned and small. Then when we got into the offices of a bank, who are not market, who are just financial, they are really different, the whole emphasis changed. They are not comfortable with any risk. Cultural mind-set!

Do you think Bank managements are fooling themselves thinking they can manage risk?

No they do limit it. But just don't know what to do with it. You know they are not comfortable with that part of the business. They are buying businesses that are certain marketable businesses that are kind of risky but they are too risk averse. You know they got so badly burnt between lending and everything. They are trying to mitigate away all risk and just focus on earnings, assets under management and safe enough recurring revenue.

Do you think it's cyclical?

Absolutely it's fashion. So like me a trader. People hear that and they think its dodge. But in 5 years' time, the bank might be like we're getting jack shit for our capital. Let's embrace a bit of risk. We have to start earning some money. So it's totally a cycle, no doubt about it.

Looking at the banks from the outside, you could see loan officers doing well pre crisis for 5-6 years, their allocation is increasing the whole time, isn't it hard for them to slow down with consideration for incentives?

Not really my area. I don't really have an opinion. Obviously there were some terrible decisions made. There are a lot of good companies out there that were lent money, that aren't performing well for whatever reason, because of capital restrictions or whatever. People are very happy to offer umbrellas but when it started raining they wanted the back. You have to partner with these clients accept there will be up's and downs. Like there are a lot of good businesses out there now just facing the wall because the banks are not playing ball. And obviously there are a lot of chancers out there that should have never gotten money. They all got targeted with the same brush now because there is an over emphasis on tidying up the loan book.

Do you think that risk management in banks is quite limited in what it can do?

I'd say they are quite basic. You would guess that their provisioning's are ancient. I'd say there is a lot more they can do to embrace technology, then it goes back to again, lads minding their own patch and stuff. But I would say that but I don't know much about it. It's just more opinion. I'd say there risk models aren't hectic, not so much in the corporate capital market but they need to use that technology in the retail lending. If a guy is in arrears after a month, probably not a 3% chance he's going to default it's probably more 20% chance. This kind of stuff! The data is there now and the

technology to do that. They are probably in the process of upgrading all of this stuff but it just feels it's not in the mainstream. Again I don't know, it's just an observation.

With regards yourself in trading, after 5 years of good targets being hit, would you find yourself trying to hit those targets again, even subconsciously (RE: anchorage)

You would but you're not. To think you can hit those every year. Jeez yes you make 20% in one year, wouldn't it be great to make 25%. But you're not going to risk the whole firm by trying to reach those targets. You're a risk professional at the end of the day. We're not stupid. We all learn the hard way as you go up through the ranks, we all took the big hits along the way, luckily enough we were able to make up what we lost. But that's what we do.

Would you feel that as a trader, when you take the big hit (re: Losses) you feel it emotionally. A risk manager might never feel that for 7/8 years. You as a trader would feel more emotionally attached to your positions, money involved and you would be much more risk conscious.

But you are defiantly. In fairness most good risk managers I work with, know that I care. That I'm not there to try lose money. They understand generally. I've worked with two guys primarily and I've no real problem and they know I care. I'm not a complete chancer.

Going back to Nassim Nicholas Taleb, he concludes that emotions rule over any theory with regard risk!

I was in Chicago Trading exchange for a year and a half. All the traders especially the good ones were all a bit extreme. But they would go to Las Vegas at the end of the year with 50k and just go mental because they were so disciplined in the actual professional trading. They need to get that 10% out of their system. But they were so straight, disciplined in their day job. So everyone has that side to them, and as a trader, it's a constant battle, to check their emotions and fear and greed comes with that. So sometimes you need to be able to stand back and that comes with experience. You have to make mistakes and stupid shit like. That's the best way of learning. It's just hoping that stupid shit doesn't blow you up.

What do you make of the argument 'earnings that make pennies consistently, then blow up out of nowhere'

Ya that's just trading.

Have you ever seen anyone blow up?

Absolutely.

Would it affect you?

Am you'd feel sorry for them and go jeez on a personal level. It depends how well you know them. It's a good lesson. Some of these guys are brilliant and smart, they just fucked up. You dig yourself a hold like in behavioural finance, your whole mind set changes when you have a position and then the minute you sell it, no matter what you lost you go 'what was I thinking'. You get sucked into this vortex of sorts, 'I'm down 20% now if I hold on now for another day, maybe!' It's just hope. It always right to cut again because you can always buy back again and the perspective it gives you is

unbelievable. It's amazing no matter how much your losing just cut it and step back for a day. And even if you're buying it back 5% higher, you just feel so much better and better perspective. The way the brain is chipped is unbelievable. And you know it's happening to you (RE:vortex) 'why am I digging myself a whole here' Next thing your falling with something that's completely wrong from the start. It's mad how it happens.

**Is that marrying yourself to an idea?**

Yes it is. You get better at it. You don't get too big. Any other position is not going to be so mentally demanding, like that you can't cut it. You know it's down to money management. Time & experience aswell.

**Would you be conscious of human biases when your trading?**

You would and you wouldn't. 'Anchoring' maybe yes. But you get better at it. You might say every eejit is looking at that price. Just go 10% above or below because if you really like it buy a little now and we will build into that level or whatever. These are things you just get better at over time. But we all make the same mistakes all the time. Only thing you can do is realise them quicker and cost you less money. We make the same mistakes the whole time.

**Why do you reckon we don't learn?**

Because of whatever we're chipped. It's just in our DNA.

**Would you know the exact mistakes you tend to make?**

Yes absolutely. You like a stock and you say I think it will get to here. You don't buy it. It's up 10% and your like I'll wait for it now to come back down. And it's even more right to buy it but you don't because it's up from where you liked. And you miss like 25% increase. That sort of thing all the time.

**Investing in banks, what would be the main things that you would be looking at?**

We rarely ran long term positions in banks. It was very much market making. We might have held a position in bank for 1 or 2 weeks over a dividend or something. It was all the main risk that people look for. Business risks, balance sheet risks, quality of the book, the lending activity. In hindsight we haven't a clue on the quality of these books.

**What would bank management tell you?**

They'd tell you about work in progress, very little about quality. It was very much about the number and how much have we committed to lend, so the bigger the number the better.

**What sort of statements would you be looking at?**

You'd get interim statements every 3 months, half year results, yearly results. After every IMF report you might have management run around to the brokers and internationally as well. You'd get to meet the management once or twice a year sometimes more. You'd try read the body language as well.

Were you ever sceptical of them?

No you were not! They were the kings of the road. Why would you have been? Obviously it's easy to say it now. They were flying high, making loads of money.

Why do you think in hindsight, people trusted them so much?

Because they were making money. We were all making money. There was great money being made. Earnings were going up every year! What was the problem? Everybody's your friend when you're making money.

It was a good story. Everybody believed the story?

There was hard cash being made also. They were highly profitable. They were built on a deck of cards. You could be looking at Google in 10 years' time and going what a load of crap. You know who knows? That's markets, that's the way it works.

Did you deal in options?

Very little. They tried to bring in warrants a couple of times, played around with those. Generally though no.

## Interview #2

### 7.2 Private Banking

Description of Job?

My responsibility is that I have a team of people in our bank Private Banking. And our responsibility is to look after and meet prospective clients that are introduced to us by our bank. So really my mandate is to meet with clients every day of the week, in the context of wealth management. All their banking needs and I suppose at the end of the day, put portfolio's in place that meet their needs over short , medium and long term.

Do they be new customers?

They could be long standing customers, new customers. They could be people that have won the lotto, sold land, could be a lot of different events, accumulated savings, companies and trusts. There is a wide array of circumstances.

When new clients come into you, would you assess what sort of risk they want or how would it go?

At the beginning, the first meeting is to get a feel of needs and requirements. 2 things I have to do is introduce who I am, my institution, what I'm doing as a bank, a private bank. So what we do is the most important thing. So if you want to do business and have a relationship, you got to know who you're dealing with etc etc. So after that it's very much a fact find and that is critical. It's like going to the doctors surgery, you got to know the goals, needs and the requirements, personal details, family details, all of that. It's a huge part of the relationship and getting to know the person and when

you've gone through that. So in a first meeting you'd be reluctant to narrow it down. We assimilate all the information, then the investment team and I would try getting a plan together, and from that plan, we call it a discussion plan, you get a recommended strategy and from that strategy you'd be looking to see do we implement all of it or some of it. How best does that fit with the needs of the client and how would we work through that. It could take 3 or 4 meetings, 3 or 4 months. It depends on circumstances, and for some it might be week or two. So that's how it would evolve in terms of the meeting.

**Would you see yourself as merely as advisors, providing as much information as possible but at the end of the day, the decision is with the client?**

Yes absolutely, I can advise and I can give the best of the information we have etc. But at the end of the day, the recommended strategy and the implementation of the strategy is down to the client. If he/she is comfortable about that or if I'm not comfortable with that, it's still up to them to go ahead.

**Do many people come in and say 'I got this offer somewhere else and can ye beat it?' How do ye handle them scenario's?**

No It would be up to us also to know what the competition are offering. We won't know everything but we can find out.

**Would it be from other traditional banks and stockbrokers?**

No we have clients that are dealing with stockbrokers. I have people dealing online. There are many facets where people will get the information and look at the various options and they can hit the post office also.

**So do you feel it's changed much over the last 10 years? Would the people who have traditionally gone to the stock brokers be using other avenues now?**

No from a normal customer relationship, the bank would have been the first port of call; post office would have been a local one on the ground. I would see the stockbrokers coming on in later in the food chain, in that regard. But now because of internet you can now get instant access to any information. So I think that has changed. But I think it is a good thing that it has changed. In the last 15 years, from what I can see is that people are a lot more up to speed or that bit more knowledgeable to 15 years ago. They are requiring rationale and requiring an understanding. Whereas 20 years ago, they might have just believed everything you said and not really understood the full facts. So they wouldn't understand the full risk. They wouldn't have been able to understand the full logic behind it. That has changed dramatically over the last 15 years in my view. And it's behaving of financial institutions such as ourselves that we ensure the client has that information. The last thing I want is a client coming back and saying 'you never told me this, you never told me that'. And we have got to go the ombudsman and it's a damaged relationship. It's like going to the doctor; you're looking for the right diagnosis, needs and issues that are there. People's circumstances changes as they go through their life cycles. If you're asking me in my last 10 years, I've had clients who'd have had an appetite for risk 10-15years ago and that's not the same appetite for risk they'd have now. They're pulling back and looking for different options to meet where they are now in there in their life cycle. I just met a client last week, we did business 15 years ago, very

strong example, 'I've been there and worn the t-shirt' now pull me back a bit, I need a little bit more conservativeness in my portfolio. These are the types of discussions. If you have these good meaningful relationships, you're going to have meaningful discussions as an on-going cycle. Rather than knee jerk reactions when market cycles go down or people saying I don't know what I was getting into. These are the type of conversations you should be having as part of a life cycle. We've had traumatic times in the last 4-5 years and we have people that are coming out of rough times. I remember back to the Celtic Tiger, where people thought property was a one way bet. That you couldn't lose on property. We probably had a generation of investor who just believed one asset and that was property and that was going to make them fine returns, with no risk at all. They didn't realise all assets, all assets including cash, bonds, properties, equities, commodities, you name it all have risk.

**That was one of the questions I was going to ask you, is that one of the discussions you'd have with clients is informing them about the concept of risk?**

Yes but a feature of clients and Irish investor is that they would have invested in property and they would have been individuals who would have had total knowledge or supposedly total knowledge, in their own mind about property. And me giving them advice about the egg in one basket or diversify, or not have it all in Galway in Ireland or whatever. And because this boom was happening.

**In these cases would you have to be very prudent, in case they came back to you and said, "you said this"?**

I would still advise in relation to managing risk. You have to diversify. If you have it all in a bank of Ireland share, in Galway or somewhere. You could lose all on the basis it has no spread in risk. No matter what I'm talking about with risk, a huge amount of it is the spreading of risk. Diversification. In layman terms is not having all your eggs in one basket. Whether its cash, stock or whatever. If you get very stock specific or country specific, it can create risk, where people don't even realise there's risk. And again it's part of my remit for being an investment advisor and I would call myself a trusted advisor, that's the thing I've done over the last 30 years is to be in that space. But at the end of the day, you impart your knowledge as much as you can but it's up to the individual to be comfortable or not comfortable whether where they see growth or see particular assets, you try work those sort of solutions. You will never get it all right. But what you are trying to do is limit the downside and maximise what you are trying to attain in returns and that's really what we're working with our clients.

**So do you go and find those investments yourself or are they brought to you?**

Well there are two aspects. It's important for me as an advisor to have as much knowledge as I have, the product solutions that are out there, my own private banking. We are also a banker in sense that I deal with Irish life, New Ireland, I deal with all of them. I am not restricted to just my own bank. So part of my remit would be to see all of the options out there, but circumstances are dependant. So really the offering we have as private banking is not just a bank offering, it's a market offering. So you and I may be talking about a market solution, maybe not my own banks solution, it could be Irish life or whatever. But I'm able to put that in as part of my remit.

So the bank you're working for as a profit making entity, would you not be incentivised to buy its own products?

No doesn't make a difference. I suppose critically, if that was my remit, everything I'm involved in would be just fruitless. Naturally it comes down to us, as a private bank, to create solutions and we will try creating solutions on our own platform. But you know there are solutions out there that we can actually use and we can work with whether it's a pension or investment or whatever etc. We look at everything. At the end of the day we bring solutions to clients. And if I can create solutions, and we do create/bespoke solutions ourselves in terms of bringing to fulfilment clients.

Would ye see yourselves as wanting to build long term relationships or long term investments compared to maybe other offering products by themselves and gearing towards short term performance?

Look, If it's about selling a product I wouldn't be in this business for 30 years, It has to be about relationship. I have to be able have a client that comes back to me in 5 years' time, good/bad or indifferent to what's happened out there, and trust what I've been doing or had been doing, fitted the goals/objectives of the client. Like everyone else, we would have had property in portfolios. You will get some bad and some good. What are you are trying to do is make sure they survive and not totally blow up. So it is important to me and my business and people, are on-going looking after these clients for 5, 10, 15, 20 years.

When ye are deciding on an investment, deciding what is the most ye want to lose here or when an investment is going bad, when is out?

For an example, there are a few property deals recently and we took a view that the property itself would not make money, so we actually got out of them, we took a 20% loss. We got money back to the clients because they would have been in there for 8 to 10 years. So we are looking at solutions, there is no point sitting in something and not doing anything if it's going bad. We have to be proactive.

But what if the customer wants to hold on?

If you go back to the Lehman's crisis, we had equity portfolio's down 50%. Now someone could come into me and say I want to get out of there. Now the worst time because of emotions and fear is to get out of positions because of that. Because of the way cycles go they can be quite dramatic. So it goes back to if you understand your risk profiling, and the maximum and minimum these can fluctuate, you should have clients that are comfortable enough with you, to be able to stand the heat in the kitchen, and not have the panic button pressed. We got to be working with clients on that basis in the doom of gloom of Lehman's etc, plenty of our clients will not be happy with our equity portfolio but because of the nature of our portfolio and the relationship stayed, they have now benefited from the fact that the markets have come back. But they were difficult times in terms of cycles.

Lead to my next question about contrast mis-reaction tendency. The clients seeing the turmoil, they then flip their risk profiles, does it happen much?

Yes and we have to be able to come back to our scenario where people can sleep at night. So the modelling we do, would be looking at all of the inputs, asset classes and expectations on equities, bonds etc and volatility and how the relationships between these can add to the downside or upside. The critical thing is what we are really looking for and we model that???? That is the tolerance. If you say to me I want absolutely no risk. If we have to pull back risk as much as possible and try develop from there and work out what the potential outcome might be. So the modelling we do would be the expected returns on those assets and also in terms of how we benchmark in institutions where risk/return studies are being done. Then it's the experience of success and measure of probability. So you have the model and we do Monte Carlo simulations on risk modelling in terms of portfolio's. We are looking at the downside, upside, median to get those target objectives. So all that comes down to the probability of success. Of the type of portfolio we decide on. So everything goes toward how can we get to the set target, reducing the risk. So in all those we try our best to bring down the risk weighting but also not bring down the return profile in terms of set goals. So it's all about the diversification and that's fed into a single risk model for our clients. That would be the main part of our conversation. So again that's a working plan and we work through it. We meet our clients every 6 months to review it and go through it. And it's on that basis that we look at lifecycle and progress, the good, the bad. It's a roadmap. That's the important thing! You've got to be on the road map for medium/long term clients.

**So from the outside, do you see the availability heuristic playing a part in Irish investing with regards to property? There are so many chances/choices to investing in property and we do have a culture with liking property and not many other domestic asset classes?**

Ye property has been a big factor. I think if there is anything we can see from this crisis is that any asset class has risk. It has bubbles. It can be a bond or it can be equity, it doesn't matter. They can get over heated. You can have a serious correction with regards asset price. So I think the good that will come out of this is that a generation will come out saying it's good to diversify. Hopefully it will encourage a more diversified and global view of the wider opportunities that are out there. And it's from that that you project your growth and return projections. And from there you can get a meaningful portfolio that will allow you to take knocks as you go through it. The last thing you want to do I wake up in the morning and 100% of your capital is wiped out. It didn't come from cash, bond or equity but it came from property. But it was in a way that people saw property as a one way bet and it would never come down in price. They then borrowed for it and it compounded the problem.

**In the media, pre crisis it most have given a skewed view of the world to investors. Media only showing the winners. Your job must be about bringing them back to a realistic view?**

Yes but the downside to that is that safe haven is cash. My problem with cash is it could be a loser going forward. Now that's hard for some people to understand. If you take that there is no inflation at present. But you're looking at austerity to get growth, you're going to have some inflation coming in. So the ECB mantra is about 2% but even at 2% if you have rates which we are seeing at 1% or even less etc. In terms of saving you are going to be in a situation where you take DIRT or other taxes off that. You are going to have an asset that is not even going to keep pace with inflation over the next couple of years. So the result of that is purchasing power will actually decrease quite significantly. So you have to sit down with people and give the best you can with regards all the asset classes. So you have to look at the needs and requirements that are coming from the clients and you

are really trying to build a portfolio that can take knocks, can take the good days and the bad days but come through with the probability of outcomes that will meet the goals and objectives.

### Discussion of Investment strategies

Many people we meet are solid down to earth people. They are working in their own business. You are looking for a safe pair of hands to look after the wealth they have accumulated. A lot of them are taking business risk as entrepreneurs, taking risks in other areas. In some cases, they might say don't be ultra conservative, I'm young enough, I want to take risks. So a lot of people would say I'm taking a lot of risk in my company. They want a safe pair of hands, with knowledge and expertise that is not betting the house. So in the wealth scenario that I'm looking at, it's one to make sure it's there and its intra generational. It's very important. I've seen a lot of wealth eroded in one generation. How can you make sure that it's around for the next? Most people want to keep accumulating and if they're not spending it, they're passing it down. That's harder than it sounds. If you're taking extra risk with regards to the passing down there could be destruction. A lot of the work we're doing is with families and business people on the business diversification and the portfolio modelling. Can we manage that risk? It can still do other things in terms of greater risk etc. But it's to make sure we are working with them, with the totality of their other business risks.

### So really you're not just advising on just the investments, you're looking at the whole business situation?

I've got entrepreneurs, stock people they are brilliant with regards taking risk. But they don't want me to add to some of that, they would probably prefer me to pull them in a bit and maybe want me to be the steady Eddie. Then I have other clients who are very comfortable with me adding risk to their portfolio, Asia real estate whatever. And I'm willing to work with you on that. So again it comes down to having the whole understanding. But if it goes wrong you have got to be able to live with it and we'll work through that. But if it goes well, do we stay in that, we come to a different stage or do we move on with the profit that we have actually accumulated. That's the conversations and there is no one the same. Everyone has different connotations. Why I get excited by it, as an institution, I believe the whole totality that we can bring is a strong brand. It's a strong solution based answer to many of the questions were asked.

### Do you think the investment advisor is at advantage compared to the client he's meeting i.e he has nothing to lose by offering advice but still gets paid?

No I've never at with clients who would feel that. Most people would like to hear good advice. It's like any advice you get from your solicitor, doctor, dentist or whatever. There are charges to be made. People accept that. But it's on the basis that you're looking to get professional advice.

### From your side, is it about showing that you care?

Absolutely, my mantra is I want people to grow their wealth. One it's a long term relationship. Two the more they grow the more fees I probably get. So it's in everybody's interest. The last 5 years haven't been in my interest either because if asset values go down or fees go down etc. So everything is about how can we grow the wealth and manage that wealth, this generation or next generation, it's a long term relationship!

### Do people come in with unrealistic goals much?

Yes all the time. Saying I want a 10% return with no risk. Saying I want a 10% return to keep my lifestyle. You have to work through that and see what risks you take to get that return or some might say I don't want any risk whatsoever and a 7% return. So you have to work through all those situations to arrive at the most realistic roadmap you can take. So absolutely, with the low interest rates over the last few months have been quite significant for many people the ECB rate is 0.025. The lowest they've ever been in the Eurozone. So critically you've been looking at deposit rates at 3.5, 4's right down to 1. That's a huge down step. So many people are now looking at, what do I do with regards maintaining income and maintaining living standards.

### Influence from mere association tendency. People seeing what their neighbours are investing in and wanting to get involved?

What your neighbours are investing in, may not be right for you. So that's why I always say "it's about you". I have a lot of people who would have invested in the Middle East who would have heard that from friends. You have got to be very careful.

### Is it hard to show people that investments no matter how frequently they performed will in history, may not do in future?

History is only given you a record of past performance. It's a help. The last 5 years isn't going to be the same as the next 5 years. It could be totally different.

### 'Anchoring' would you see your own decision making being hindered by a specific measurement of 'VAR' or other risk measurements

I go back to our procedures. You have to look at return expectations. So yes the history is there, you got to look forward. You got to look at the data to see the realistic expectations here in the asset classes going forward. And with the history and hindsight you can see whether their underperforming or over performing. It's based on expected returns.

## 7.3 Branch manager interview #4

Branch manager with 30 years' experience

- Experience- Branch manager, business unit manager, head of customer service, general manager of customer service with overseas bank.

What I'm doing my dissertation on is human biases in the banking structure, and what I'm concentrating on is risk and incentives. It involves weighing the two of them against each other, interviewing bankers from investment, branch management, trading and lending. Talking to them about different situations and see would they tell me more? So the biases I would be looking out for would be confirmation bias, group herd etc. There's a lot of them but just trying to notice them. With regards risk would you have any dealings with it, with regards decision making

Every year in the banks they would have what you call an ORM. Which is an operation risk measure. It didn't matter which area you were in whether in London or Customer service. You had to identify the risk for that department. You had to grid them, line up them in priorities and likelihoods to happen. You ended up with a keyset of risks, and you had to develop 'miticons', to make sure them risks didn't happen and they would be minimised. So really you take a department and identify all of its activities and plot them on a risk metrics. But actually I never came across anything called human behavioural risk. I mean you'd have risk of not having enough staff. People not turning up for work what would happen. It was more observational risk. The subject you are researching I wouldn't have thought about it. It's an interesting one.

**With regards banking and lending, is it only really the top managers that are incentivised?**

No it could go the whole way down. Performance pay was well very well structured where I worked. There was a lot of investment put into from top to bottom. You were given a set of objectives at the start of the year, you would be seated down depending on what role you were doing and you would be given what they call KPI's. They would be set by top management. You could say they start at the top where they have a strategy. You often have that in the organisation where they have what would you call 20/20, a 7 year strategy. The strategy wouldn't be changing every year. Then they identify what key measurement you'd want from each business unit. So each department would have to do its strategic plan then and the staff in that department depending on part would customise for that section. So if you were in credit card sales, but if you were in a back operations area, it might be accuracy or lack of errors etc. Then it came to the individuals if you were a junior, senior or middle person in that department, you would have set of KPI's. Typically you would have 10-12 of KPIs and usually they would be in 3 areas business (sales, financials) customer KPI's and people KPIs. Hard KPI's would be numbers. Soft KPI's would be contributing to the team, display good professionalism and supporting your KPI's, you'd have a personal development plan. So they would help you identify your technical competencies and your behavioural competencies. If you're working with me, we'd have to meet every quarter or more if we were having a problem with you and I might have to give you KPI's for 2 weeks to get you back on track. The whole idea of these meeting are if you weren't going well with you, I wasn't waiting till the following November, in that you were well warned. I would say Hubert it's not going well, you're not doing this and that and supposing i should be giving you whatever support you need to achieve them. So as a system it worked well.

**So if you are a manager and you get your goals sent down from top management, we expect you to meet these goals. So people on the field making loans would find would they receive their targets directly or would it be a consultation with both parties to see what's reasonable.**

Anybody who was a member of the union had an option to opt out of accepting them KPI's. If you opted out of them KPI's, you weren't entitled to any bonus at the end of the year if your branch had a good year, that was the cost for you to be honest very few people opted out. You would be under pressure from management. But you couldn't stop them at the end of the day.

**Could you elaborate on the point on 'pressure from management'?**

Well if you were running your own shop, and you wanted to give staff sales targets and they were refusing to accept them. You wouldn't be happy with them, same with branch manager. It should be like running your own shop for the branch manager.

Was there a situation where a worker might say I'm not comfortable making these targets or they felt they were forcing loans on customers?

No, not so much. Maybe the targets were too high in a small town. But you see there would be a fair bit of planning gone into that. So you have to remember targets were reset year on year by the management for the branch if they were too high or not. There was a good bit of research gone into that. Local markets would have different targets. 95% of branches would be meeting those targets if you were putting any decent effort in at all. Like they didn't have to go off and do crazy things to reach the targets or anything. It wasn't that bad even though the perception might be different.

Would there ever be a scenario where if you were briefing the staff at your branch and you were discussing lending projects, was there a point where'd ye would list all the potential bad things that could happen and not just what ye wanted to happen?

Yes if you were in loans especially, one year terms, where you look to see were some loans not performing or are they delinquent loans. If you were a lender in a branch that would definitely be part of it.

Say if you were a branch manager for 5 years in a certain area and some of these loans were 25/30 years long, how did you deal with these sort of issues?

That was a problem alright. That definitely was a problem. There was probably too much emphasis/incentive on giving out new loans and with so many staff being switched from one place to another. You could have a loan that was made 5 years ago, that performing badly now, you could point to lack of accountability. I suppose we often talked about that bonuses and incentives should be given over a 5 year average over a 1 year average. If you were a lender they shouldn't be rewarding you for last year's loans, it should be your last 5 year average.

So in that sense, if you're a new branch manager coming in, sees these bad loans, is the responsibility now on the branch manager or loan officer?

If you're a branch manager, the buck stops with you. Your responsible. Now who's accountable is a different question. You know should a loan officer be more accountable for the quality of the loans he/she sold over a period of time .Yes they should!

Because potentially they are the ones building the loans?

Exactly. But the branch manager at the time would have to sign off on that application as well at the times. The loan officer can't just sign off they would have a discretion or an amount alright. You find that in businesses that are too incentivised, moral ethics go out the window but I don't think that was an issue in my experience in Irish banking. But I was in the pre 1990s boom. A lot of it is market driven. That bonus system that the banks set up, you could say it ended up being a problem. To be honest with you, when things were normal and bonuses were normal and you went to work, you were given a set of KPI's, and you did your best and you worked hard. And you got promoted and

maybe you got a small bonus at the end of the year. I mean a small bonus right! Like it might be a few hundred quid or something or maybe a thousand. You felt good about that and I believe it contributed to the organisation and I don't think you were doing anything stupid, like selling stuff you shouldn't have been selling. And it worked for a long time. But it only went wrong in like a 2 year period, where the thing went out of control. The people that were managing the risk allowed it get out of control and incentives were getting stupid. A bit like what you'd see on Wall street. Whereas an average worker might only get 30k but because these people were doing all of these loans or all these sales it just went mad.

**But this is all in hindsight?**

When I look back I can nearly see it as a 2/3 period, where it just went crazy.

**Going back to the branch and a new manager coming into an area, would one of the risks to performance be that the new manager would not know the characteristics of the area well enough?**

That switching around of people was actually to stop the sort of risk of people getting too committed in an area, doing favours for people etc. HR would always say that kind of risk and that you have to move people around. So you don't have any pals or looking after people or anything.

**There is an awful amount of human contact. And you are building relationships with the bank there is a bias here called reciprocal tendency, where ones does a favour for another, and expects more in return. Can you see how that manifests itself in dealing with customers or other employees?**

You could be making mistakes or covering up mistakes for a couple of years and you knew you were going to be moved. You knew that nobody would come after you for the mistakes that you made. So that was the downside to it.

**Do you think it was very easy for people to be able to do that?**

It was.

**Do you think it came from people not looking over you properly?**

Yes

**Or technology wasn't in place?**

Technology wasn't in place. Accountability wasn't adhered to. People got away with it. The more people got away with it, the more people would probably do it.

**What do you think would have stopped the whistle-blower effect?**

Ah no what would have stopped it would have been if you wrote a loan that your staff number was associated with it, and it went bad and you were in another branch, and somehow that affected your performance? But no it didn't really. No not really. I'd say there was a lot of people good at sales, good at getting new customers, but left a lot of bad stuff behind them too and were never held accountable for as long as they were getting more business.

Would there ever be a situation where the loan officer with only experience in sales was put in situation of branch management but no experience of risk, credit controls etc. Would that ever happen?

Everyone can't work in risk. In all of our training, in all of these courses, everyone had to do accreditation of risk. So we had loads of courses on risk.

A bit of theory here and we can discuss. You don't really understand risk until your emotionally hurt by it. Losing your own wealth trading etc. risk managers can feel it because their funds are not at risk?

We were brought to loads of these conferences on risk. And they were so non-applicable to what we were doing, it was pointless. They'd go in one ear and out the other.

In your position would you ever be incentivised to make quick decisions on a day to day basis?

If you're a bank manager in a branch you have to make decisions quick. Now does it mean that if a fella came up to me and asked me for a million euro loan, that I'd make a quick decision, no. And that would have to go through a process. And you were expected to do that. You would have all your documentation. But if you were talking about the running of a branch you're talking about a million little decisions a day. But there's nothing wrong with that. I never felt pressurised by that. I felt that was my shop. You can't bureaucratize everything.

Do you feel that risk managers have to be seen to be doing the right thing but can they actually affect something happening? How can they stop something if the business is all about growth?

Good question. Your right! I know where I'm working now the head of compliance for the bank said 'I'm fed up, management won't listen to me. They just laugh at me.'

It's a fact that in the history of banking they have lost, more than they have ever earned. Do you think people think about this in banks? Are they given history lessons on how banks go bust? Or do they believe that banks are ultra conservative?

I'd say they'd find it impossible to believe that. No if you were to think of all these things that you have asked me in going in to run a bank, sure you'd stay at home like.

It's all hindsight?

It is.

I know the banks give off the impression that they are safe and conservative?

But they are! They are not giving off that impression consciously but they are safe places. That's against putting it under a mattress of putting it under a wall.

But you can look at from another angle and say your lending money to the bank!

What's the alternative?

That's it yes. You could get into investments. But you are probably still going to deal through the bank?

Ya

OK the points you make are all valid, but how would you improve the structure of this going forward? So it wouldn't happen again, a banking crisis. I'd struggle to know what you'd fix. You say to me do people know of banking failures? And I'd say they do, people that come in at management level, you're thought all of that. Did it help me and all of the people that are branch managers to avoid making mistakes that contributed to the trouble in the bank. Not a bit. Sorry I'm just trying to connect it to your human biases. So if you were to think of yourself as branch manager in Tuam, Loughrea or wherever. I mean you have a responsibility for a shop that is franchise. Like you are given the rules of engagement on how you are supposed to do things. Your auditor measured. So there is reports coming out your ears. If you don't meet those you lose your job. If I was to do your dissertation I would get into the day to day decision making of lending. So what are his biases? Is it because ye are on the same football team? Is it because I like you or you happen to be a good lad? Maybe I dislike you and no what papers you give me, I won't give you the loan. Decision making in a bank is like decision making in a hotel or Supervalu.

So if you were head of lending what sort of biases would you try being conscious of?

If I was too long in a certain area? I'd be more biased. You know you get to know as many of the people in an area over the first two years that you will the entire time. We moved 11 times and that was what happened.

I'm going to mention some tendencies/biases and you can tell me whether you think they are an issue. Liking/loving tendency?

Yes definitely (see previous notes)

Envy/Jealousy Tendency?

No haven't come across it.

Over optimism tendency?

Yes big time! Where you were writing a new loan for a new customer and it's how your writing up the report. You can dress it up to look good.

How would you be rational when dealing on these loans, instead of falling in love with an idea/business or character?

What they did to counteract that was to bring credit scoring on certain financial information on your business and cash flow and all of that fit into the credit scoring system. That credit scoring system accounted for 80% of credit decisions. So if you felt you weren't going to get a loan. If we are deciding to give it or not? If I really like you I could write a really long story and it should work.

Going forward, do you think there needs to be more much responsibility put on human decision making there or more emphasis on better systems?

Better systems. Take out the emotional part out of them things. If you have the cash flow and your showing your business can make profits, then you should get the money. At the end of all these reports, there should not be a commentary, so you write wonderful things here and paint a wonderful picture that may not be 100% true.

#### Influence from mere association?

Yes. It says itself. Golf club mentality. People like good news.

See I think the old bank model that you had, you got to know people, go to different meetings and functions. Represent the bank and get to know people. But you certainly have biases to them if they are looking for a loan and you want to help them. Just because you would get to know them and also they would help you develop your network in the community also.

#### Do you think it has changed?

Oh yes. Taking the decision making away from the branch manager, while people might criticize that and people do in the papers. They say the bank manager can't do anything anymore. That's the reason they can't do anything. He can only lend 3k or 4k. It's all done by a department or system in Dublin now.

#### Summary on the Irish banking crisis?

You couldn't make this story up, it all came full circle. The whole debacle in Ireland came from the ordinary person on the street who had bank shares. Because bank shares were such a great bet, all pension fund holders were holders of bank shares. So when you'd read in the press about the AGM in EGM's, you'd often here them on about institutional investors would be looking for certain points or for the bank to look a certain way. The investment funds and pension funds were probably meeting the banks managements at least every month and they'd be hammering the table and demanding profits. They'd be screaming and shouting demanding performance. They'd be threatening. They'd be saying we'll dump your shares in the morning. If it got vicious enough they would. If one of these institutional funds did it, especially the foreign ones, the banks could suffer a 'run of some sorts' and seriously suffer. So that's where the first pressure came. So bank board members would come back from these sessions and call in senior management to get their act together. It all went down the line until the fella at the branch being told to sell 200 credit cards and he can only sell 100. So that's one way of looking at it. The other way is then they brought in this bonus scheme, people got too greedy and sold too much and sold without thinking about the risk of it. But I would comment and say it came from institutional investors demanding the performance and that sort of demands drove that behaviour down through the organisation. So for the ordinary fella in the branch, this is what was being asked of him.

## **7.4 Head underwriter interview #4**

### Underwriter.

30 years banking experience. 15 years as a lending officer.

You catch me at an interesting time as a bank; we haven't paid a bonus or salary increase since 2007. In terms of risk/reward, (a) it's costly (b) we're learning from the boom of pre 2005, where fellas were no doubt getting huge bonuses for throwing out a level of lending which has nearly brought the country to its knees. So in effect, nobody in our bank has got a salary increase since 2007. Now having said that we have a myriad of schemes when you look at the risk, underlying risk, which in our business is lending: I would say there is a huge structure and focus around that since the mid 2000's.

Banks are really dealing with a lot of downside risk. If your thing is lending, the best thing that can happen is you getting repaid but if unexpected things happen, it will probably negatively affect the bank. Example if a loan goes well, the company that received the loan will not go back and say here are 20% of our profits from that loan, they'll just pay the principal and the interest.

Exactly.

Ok what are the key decisions you think about when making a loan from the offset?

That's the role I'm in at the moment. What am I looking for? I'm looking for the borrower, in terms of character, their experience and sometimes you'll have different degrees of that at different times. I would look at the proposal. What are the plans? You know if someone is planning today to build a high specification residential development, I'm not interested. The country is a flood with property.

If the economists in the bank were to say the economy is definitely going to pick up. Would you go back to your own decision making or listen to the information you're being given?

In my mind, it always comes back to me. Say it's a loan decision and I look at the pieces. I want to see what the deal is. If it's a trading business or property, whatever it might be. Go back to the high specification deal, if it depends on a fella being able to sell 100 apartments in Castlebar and I'm not convinced he can find buyers then I won't do the deal. If he's coming to me, and saying he has sold 95 of them sold already, then it's a materially different deal.

If he said he had other banks/lending institutions are willing to lend at a particular rate, would that impact your decision?

I don't care! I really don't care. It has to stack up from my point of view. Like telling me another bank will do it, when I clearly won't? That's fine.

In terms of character, what sort of things would you be looking out for?

I'd be looking out for experience, by seeing how the person dealt with previous facilities, has we a track record with them. Sometimes you won't, sometimes it will be a new customer.

Will it help much if you dealt with them before?

Like if you have dealt with me for 20 years and you have never reneged on anything. Everything you've done is OK, it might not have run perfectly but you might have been honourable through it all. If your experience has made it happen.

If you were to weigh business plan against character, how would it fair out?

Hard to say! It depends on the case. No matter how good the character, if the business plan is completely flawed, then it's a non-runner. If the business plan was to stack up and then you've got a character that can make it happen that's what we want. It's very hard to put a percentage on it. If you stuck me on it, I'd say 70:30 in favour of the business plan. We could spend the day arguing over that. They really have to come together.

**What would be the external circumstances that might impact your decision making in Lending?**

I suppose the economy is the big piece. If you're looking at it, like the whole country needs the economy, we all have a role to play in that. Banks have a role to play in that, entrepreneurs have a role to play, Government has a role to play in it.

**Could it come from top level management, that we have more funding so let's lend more?**

It's funny. Is that not going back to the question of cheaper funding being your decision to lend more? Think back to your man in Castlebar, whether we got cheaper funding or not, shouldn't change the fundamental decision. If it is a trading business, whatever that might be, am I happy he can do whatever he says he can do? If I can get cheaper funding or not is kind of irrelevant. I can't be saying I'll give it to him if I got cheaper funding and I won't if I don't or vica versa!

**Do you think it could be a common pitfall, for a person in your position, somewhere else in the country?**

No I don't think so. I'd be surprised, because it shouldn't impact the deal. The deal is the deal. You know where it might come into play, if the bank had a risk appetite and we decide hypothetically, we're going to allocate 10% of our capital to hotels. Now if we get closer to that figure and I get 2 hotel deals, it may force me to decide which is the stronger of these 2. We're nearly capped at our internal metrics. That might be the only place where something like that might impinge and to be honest do I have loads of examples of that? No I don't think so. It would rarely happen.

**One of the things they tend to do in banks is move people around from branch to branch because they don't want people to get too familiar in a situation e.g. branch management, they seem to view this as a way of alleviating risk, by trying to stop the reciprocal tendency.**

Well I've moved around 15 times or so over 30 years and I wouldn't say that solely down to removing risk, it could be more to do with development of the character, gaining new skills and experiencing more. Seeing other parts of the bank. So there's a whole host of reasons. I think in the ideal situation you wouldn't leave the same person in the same position for 30 years. It's an interesting one because you can look at it in two ways. The one outlined is fair challenge or you could say that I've being dealing with you for 20 years, I might become a director in your business, you know, does it compromise me at some stage? We have young families the two of us, they're interacting with each other, the other side of the coin is people do business with a person they like and that's natural as well. In some respects it can suit a bank for me to have a strong relationship with you especially if you're a guy that's doing business, growing their business or whatever. They'll want their own banker to have a strong relationship with you because if we don't well you might say feck them and go with someone else. There is that point. But what you also said is valid. There is a danger if people are left to long that it becomes risky.

## Discussion of 'Persuasion' the book

- Reciprocation tendency
- Doing favours for one another.

It might be something that ye as lenders have to be aware of. Discuss

It can happen.

After one person does one a favour, they often feel the entitlement to reciprocate in some small way. Which is good for society, but is dangerous when exploited. You being a lenders in such a risk bearing situation, it might be overly dangerous.

Ok, that's fair comment! But if you look at the way we are structured internally with decision making and authority levels, you know we'd have different levels of discretion in doing things. You know something might hit me that's over my discretion which means I have to go up the line with it. So the ultimate decision maker is actually one step removed. But even though me and you have a very good relationship, I'm your primary banker, in 95% of chances I don't have the power. I can't say that decision is done Hubert. Now there-in lies the faceless decision maker behind the scenes, doesn't meet you, doesn't know you.

So a scenario here, if you were a lending officer for last 5 years, lent out a considerable amount of loans, they are going good and you move to another area. You got your bonus, you got well paid. It's now not your problem with them loans. Do you think there is a risk there to hide bad loans for short term incentives? And would it be tracked back to you?

I suppose one can only make a decision on the information they have in time. Whether rightly or wrongly, you make that decision.

### Hindsight can be very cruel?

Hindsight can be cruel. My view on it would be if someone made a good decision in faith, go back to the Castlebar example, if I'm convinced it's going to happen, I'll recommend it. I'll give you the money and then it goes wrong. You can run into a planning permission issue. You hit a rock when digging the ground. Unanticipated things happen or the thing doesn't happen. Go back 2006/07 the economy turns, and suddenly sales aren't there because people can't close them. Now suppose the loan is gone wrong, Is the banker wrong there? I contend 'no' if he followed the process. Now where he is gone wrong if he knew in his heart and soul that this was going arseways and still go ahead and gave it. But I have to say if I moving into today's world, loans will go wrong. Now you hope that's a very small amount of them. But we're in the risk business things will happen. And should that come back to haunt me if it went wrong no I don't think so unless I've blatantly told lies to an underwriter or if I knew there was something wrong and I didn't tell them. But as far as following the process and as far as I can see into the future, I think we should sell some loans. I follow the procedure, I document it, but if I do something untoward, then absolutely I should be held liable.

### Bonuses who gets them?

No one has got bonuses in the last 6 years.

When bonuses were in fashion was it just the people at the top or what percentage of people got them?

It was actually the whole organisation. The people at the top got more obviously for the numbers being delivered or whatever. I suppose at the time there was an incremental pay scale, all banking people had very clear goals, aimed at getting a percentage increase in salary/bonuses or whatever the case might be. It wasn't based on one person liking one more than another. It was based on performance, clear goals set and that ran through the whole organisation.

Do you think there was a lot of luck involved in the performance goals being met? Right place, right time, economy doing well? It's very hard to measure the actual effect a person's decisions had on overall shareholder value?

You're always going to have that. You can be lucky. Something's happen, right place right time! So that's where a manager has got to try manage that. Like if I'm managing two people, you and somebody else, you might fall lucky in somethings and the other could be working harder than you. Putting in the effort than you and for whatever reason it didn't fall his way or a customer was about to do something and then whatever. So that's where as a manager you got to bring some subjectivity. And that's always there.

I suppose looking back over the last financial crisis, 'group herd' was a term bandied around, with relation to the Irish banking crisis. Have you seen anything since that that tries to negate its influence it or an intervention of sorts?

I would probably be critical of that. I remain critical in that I think senior management at times going back to what I'd said and that it still continues. Like a contrarian view not similar to senior management, they don't like that, and I do think it depends on the front line having the balls to say it. Sometimes what happens is, they take silence as agreement but sometimes people in today's world, it might be a great time to say it. Like the CEO might be saying that glass is there but I have a very strong view it shouldn't because of a, b and c. I contend that my opinion is every bit as valid as your's. But I might not say it because of fear. But if I do say it, somebody could say we need to get rid of that fella. So there's that! Even when the guy does say it, I think we should move the point to somewhere else because of a, b and c, the senior management don't like that. So that's an on-going battle but is there a quick solution for it? I wish there was some other way.

But if you were to combat that, would you get more diverse characters with different backgrounds and opinions? From the outside it doesn't look like the bank encourages that.

I agree. A forward looking manager will. They would naturally think we need diverse views and ultimately they have the decision. Go back to the situation where you say the point should be moved. The third party could be our boss and he/she could say 'I've listened to all of your inputs and I'm going to make a decision'. That's fair enough. But they are the exception!

Overcoming groupthink, if you had 5 people deciding whether to go ahead with a project, get each of them to come up with the worst case scenario of what might happen 5 years down the line. It will broaden people's view of the riskiness and help each other's view a loan properly?

Think of the question there. You said get 5 people to think of the worst case scenario. WCS is we don't get paid. So we don't operate on that basis from day one, we won't do the loan.

Would ye not try to talk about the things that would stop a loan being repaid?

If you were to start with that, we wouldn't underwrite anything. Because you would see that the worst case scenario here is we don't get paid. You would have to bring in some probability, what are the chances of that happening and that's what we try and do.

But what if there is a certain amount of pressure coming from the top saying ye have to make a certain amount of loans?

I think that's where banks might have failed in the past. I contend and this is where I'd be the contrarian to bank chief executives where you have to make 100 loans or whatever the figure is. I should satisfy myself first. We should do the right things for the right reasons whatever the amount might be. Not you saying to me I have to make 100 loans because who is to say a 100 is the right number.

With regards to hindsight bias, it can be very cruel to a person in your position who has to make a decision. We could be looking back in 5 years and seeing loans that you're making now gone bad.

I think if you operated on that basis you'd do nothing.

In essence going forward, I'd see the two big backs left in the economy as a big risk because if anything ever happens them, it affects the whole economy even still.

True. True.

People talk about this 'moral hazard' but I never saw it as simple as that.

No moral hazard is a big issue for us as an individual bank, especially on the mortgage side. But you're right! We've seen that. Like if you look at it, what we've seen the banks get a rattle and you can see the impact it has on the economy. Now you can look at it both ways. You can say we are down to two banks, maybe a 3<sup>rd</sup> if you count Ulster Bank. Personally I think the country needs 3 banks, I'm not sure if it needs 6 or 7 because I don't think it's big enough. But I think if you had 3 banks, fairly equal in size, you know it's a safer bet. Unfortunately the way it is today, ok you have BOI close to standing on its own two feet. Allied are 100% government owned and you could say Ulster are 100% owned by the British government. And there is always the fear that the UK or parent RBS might pull out of Ireland. And I don't think that will be good for Ireland to just end up with two banks. It needs at least a 3<sup>rd</sup> bank.

Would you say in the last 10 years, especially 5, that banks are trying to put more emphasis on systems and take more of the power away from the human decision maker?

It's an interesting one. We spent a lot, and I assume the others have as well, on centralising decisions that lead to smaller lending decisions which tend to be more consumer type loans or small business ones. Whereas the bigger ones are the process I described to you as being very hands on, front line person reviewing it with the business and reporting up the line to an individual and the systems in and around this is are very much human intervention. Whereas you can go online today

and you want a car loan and assuming you meet all the criteria/the scorecard, your employed, got a salary and the salary is sent through the account or whatever. You're going to get that loan. There is really little or no human intervention in that because there is a scorecard built behind that, that puts in reasonable metrics that you have to meet. Even some of those will go wrong.

Talk about over optimism/pessimism. Is it very hard for the human decision maker to stem the tide of these atmospheres. That goes back to talking about the contrarian view in a group.

Ya it can be. Go back to the bank, suppose we're battling against the tide here, like if you go to the streets today and asked are the banks lending, I'd suspect you'd get 'no'. But funnily enough as a front line banker I'd say that's not fair because we are lending. And the ones we are declining, we were right to decline them. But the nosier element is the one that gets declined. Because the lad that gets the loan won't be shouting about it because he might not want people to know he's borrowing in the first place or whatever, he'll be quitter. So maybe that's the frustration for me. But against that there are offices/personnel there looking at what we're doing or what we're not doing for that matter whatever the case might be. So I have to say if our own CEO was here, his clear message to all front line bankers is 'I want you there and I want you lending money' on 2 criteria. 'I want you to lend money to people you think will pay us back', which is reasonable. Secondly, 'I want you to lend it profitably'. But I think the other issue is when you look back to the tracker mortgages, they were priced so bad, you'd never make money on them. So I think if our CEO was sitting here that's what he'd say. And I think quite rightfully so. I want you lending money because that's how we make money. Our business we buy/sell money. I want you to lend it, to lend it those that will give it back to us and lend it profitably. Which is fair enough, like your in a sweet shop, your job is to sell sweets.

With regards to the fast decisions on 24 hour approval on consumer loans, that seems a bit risky. Do you want to discuss?

I am actually the contrarian view with regards this. We're talking about the fast decision, we got a 24hour promise. I would actually say, I think that's wrong. Wrong for us as a bank and sometimes be wrong for the consumer. Because if we rush the decision, we might get it wrong either way. We say 'no' when we should be saying 'yes'. Or we might be saying 'no' when we might be saying 'yes' when we should be saying 'no' which is probably the more likely one. Now in that case, grand we may promise the customer a 24hour but ultimately we've put a bad loan on the books, which is bad for the bank. It's actually bad for the customer as well. So look at his/her credit record here for a bad loan. So I'm not convinced that 24hours is the way forward, great if you can do it within the confines of what's in front of you. But I don't think it's good! There may be an occasion where you need more information before we make that decision. And if you are pushing me into a box that you can't ask for more information and you have to make that decision.

Your making 1 day decision for a loan that might be 15 years .

Exactly. That's my point. It could be a 25 year loan or a mortgage. I understand the marketing angle. And when it works it's great, where we should be doing the loan and the answer is yes, then it's great. It's great for the bank, it's great for the customer and everyone is happy. All I'm saying is if you

were making a lending decision, should you be boxed into time limit, what happens next year if someone says 24hours is too much, then 12, 6, 2 and 1, you know where does it stop. And you know that's my challenge back to the organisations. Like I understand the desire, I understand the marketing message they are trying to get out.

If you read 'Anglo republic' it shows how they were looked upon favourably for making quick fast decision on huge loans.

They made decisions like this over lunchtime. You want 10million, Grand! We'll give it to you, analysis nil. That's where I'd challenge them. That's my point. Now just because I challenge up the line, doesn't mean the whole thing changes because there is a momentum because people more important than me would make a decision and that's fair enough. But I will give my opinion, if I don't think it's the right thing to do. But there's my view!

## 7.5 Costs Associated with Dissertation

### **Binding**

€50

### **Printing & Stationary Costs**

€40

### **Total Cost Incurred**

€90

## **7.6: CONFIDENTIALITY AGREEMENT (SAMPLE)**

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