

HOUSE OF COMMONS
ORAL EVIDENCE
TAKEN BEFORE THE
TREASURY COMMITTEE

PROJECT VERDE

TUESDAY 7 JANUARY 2014

CLIVE ADAMSON

Evidence heard in Public

Questions 1314 - 1444

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Oral Evidence

Taken before the Treasury Committee

on Tuesday 7 January 2014

Members present:

Mr Andrew Tyrie (Chair)
 Mark Garnier
 Stewart Hosie
 Andrea Leadsom
 Mr Andrew Love
 John Mann
 Mr Pat McFadden
 Mr George Mudie
 Mr Brooks Newmark
 Jesse Norman
 Teresa Pearce
 Mr David Ruffley
 John Thurso

Examination of Witness

Witness: **Clive Adamson**, Director of Supervision, Financial Conduct Authority, and former Director, Major Retail Groups Division, Financial Services Authority (2008-2011), gave evidence.

Q1314 Chair: Thank you very much for coming to give evidence to us this morning. If we include the Treasury Select Committee, there are now no less than six inquiries running into the Co-op, as I understand it; three triggered or being run by the Co-op: one by Sir Christopher Kelly, one an internal inquiry into inappropriate behaviour and one an independent review commissioned by the Treasury for which we still do not have terms of reference or even, as far as I am aware, an individual to run it, plus now the enforcement investigation that is taking place through the FCA. There has been quite a lot to investigate, hasn't there?

Clive Adamson: Indeed there is, yes.

Q1315 Chair: One part of it is that the appointment of Mr Flowers now looks an extraordinary decision. Do you regret having approved Mr Flowers?

Clive Adamson: I stand by the decision that I made at the time, Chairman. I am as surprised as all of us as to the events that unfolded around Mr Flowers' apparent misdemeanours, but perhaps for context I can take you through, if it would be helpful for the Committee, as to—

Chair: We will do that in a moment. I just want to clarify whether you regret it and whether you think it was a mistake. From what you have just said, it sounds as if you do not regret it and you do not think, given the way you were going about things at the time, that it was a mistake.

Clive Adamson: I do not think it was a mistake in terms of the decision that I made at the time with the information I had. No, I do not.

Q1316 Chair: We will come back to that in a moment perhaps as well. I asked Paul Flowers some very basic questions about the bank that he was chairman of. This had nothing to do with the subsequent revelations, but his answers to those questions were enough to make it clear that this man was unlikely to be suitable to run a bank. Did you try asking any straightforward questions?

Clive Adamson: During the meeting I had with him in May 2010, which was just before his appointment, I did indeed explore his experience together with why he was being put forward by the Co-op to be the chairman. Just to put it in context if I may, the reason that he was proposed to be put forward was that, at that time, the board of the Co-op Bank was 22 individuals. It was a somewhat unruly board and it was important that somebody was put in place to better chair that board. My view at the time was that Mr Flowers did have the competence to perform the role of non-executive chairman. Just to be clear, our view is the non-executive chairman does not run the bank. The role of the non-executive chairman is to run the board.

Q1317 Chair: It is helpful to have someone in charge as chairman who has a rough idea about the organisation he is running; by which I mean a rough idea of the order of magnitude of its size, for example, which after several years in the job, he did not.

Clive Adamson: In front of this Committee, I am as surprised as you were by the answers he gave. I can tell you at the time I saw him in 2010—

Chair: He did know?

Clive Adamson: He was certainly much more cogent. The individual that you had in front of you is not the individual that I saw in 2010. He was much more articulate. He was more cogent. He did appear to grasp the issues around the firm at that point.

Q1318 Chair: Can we go back to the first appointment in 2009? This was in the summer of 2009.

Clive Adamson: Correct.

Chair: This is only nine months before he was subsequently appointed chairman. Was there any intimation that he might be a successor for the chairmanship at that time?

Clive Adamson: No, there was not.

Chair: You were identifying him just as a possible non-executive and no more?

Clive Adamson: Correct.

Q1319 Chair: Who within the FSA conducted those interviews and what was their level of seniority?

Clive Adamson: That was conducted by two individuals, one individual from the supervisory team at the time. The second was an individual from our authorisation division.

Chair: The names are?

Clive Adamson: I would have to come back to you with the names. I can tell you the levels, if I may. The levels were what we call associate levels.

Chair: Relatively junior?

Clive Adamson: That is indeed relatively junior.

Q1320 Chair: What sort of questions were these people asking? Do you know what they were?

Clive Adamson: Yes. There is a note of that meeting, which I have reviewed.

Chair: I think the Committee had better see that note.

Clive Adamson: Indeed, yes.

Chair: You reviewed that, did you?

Clive Adamson: I looked at that and it was one of the reasons I decided that I wanted to personally see Mr Flowers at the time of his chairman's appointment. That was beyond what was required by our process at the time, but I felt it was important, as director of the division at the time, to see an individual who was in the process of being appointed chairman.

Q1321 Chair: Do you think that the process that you put in place nine months later was more rigorous?

Clive Adamson: Certainly I felt the meeting I had with him with two colleagues was more rigorous. The purpose of that meeting was to explore essentially how he would run the board, what his relationship with the CEO would be like and what the major issues facing the firm were at that time. I felt we did cover the ground. We also covered his lack of banking experience and that was the point he agreed he would appoint two deputy chairmen.

Q1322 Chair: Yes. Was that vetting process unanimous? How many of you were there?

Clive Adamson: In the 2010 meeting?

Chair: Yes.

Clive Adamson: There were three of us at that meeting.

Chair: Were you unanimous in your conclusions or was there dissent?

Clive Adamson: We were, yes.

Q1323 Chair: Have you read the recommendations of the Banking Commission in this area?

Clive Adamson: I have, yes.

Chair: Do you agree with them?

Clive Adamson: Completely.

Chair: You would acknowledge now in retrospect that the approved person's regime is a busted flush and not worth—

Clive Adamson: Yes. I think, notwithstanding—

Chair: A "box-ticking exercise" we described it as.

Clive Adamson: I would describe certainly at least part of it as a box-ticking exercise. I think we were learning the mistakes of that process during the course of 2009-10. We did make improvements to the process, but we completely acknowledge that further improvements should be made and, therefore, accept the recommendations of the Commission.

Q1324 Chair: At the time the Commission started looking at this, you had had this under review in the FSA for three years and nothing had borne fruit from those internal reviews, had it?

Clive Adamson: Some things have borne fruit. In 2010 we did make enhancements to the process so that more senior individuals from the organisation were required to attend interviews of senior individuals being appointed. That is one of the reasons that I did the interview at the meeting in 2010.

Q1325 Chair: Before I go too deep perhaps into the Banking Commission recommendations to which I might return in a minute—I know other colleagues will want to come in on this process of appointment—I just want to ask one further question. What checks do you think should be for the firm to make and to what extent are you relying on them

having done this? When we see this paperwork, are we going to see evidence that those checks were done and that you had made sure that they had been done?

Clive Adamson: There are lessons to be learned from what happened. To specifically answer the question, we would expect firms to conduct their own due diligence in order for them to recommend to us the candidate. In this case, as I said earlier, I am disappointed at some of the events that have surrounded Mr Flowers. At no time did anybody, whether within the firm or whether in public life, who knew the individual or indeed his other associations ever alert us to some of his misdemeanours.

Chair: I was not discussing the misdemeanours. I am just discussing his general suitability. After all, it did not take us very long as a Committee to discover that he was unsuitable to run a bank. I am asking you whether you saw evidence that those sorts of checks had been conducted by the Co-op.

Clive Adamson: As far as I am aware, we did not see evidence.

Chair: You did not?

Clive Adamson: We did not see evidence. The types of checks that we did at the time, and indeed do now, are around criminal records, past regulatory history—

Chair: This is all box-ticking stuff, isn't it? This is, "Is there something really serious?" Yes, you have to go through those hoops, but what we want to know is a qualitative judgment, isn't it? "Does this guy cut the mustard? Does he have much of a clue about how a financial organisation works?"

Clive Adamson: Yes, indeed, and that was the judgment that I stand by that I made in May—

Chair: A qualitative judgment, even though it was completely wrong?

Clive Adamson: It was a qualitative judgment from the information I had, yes.

Chair: But you do agree it was completely wrong?

Clive Adamson: I do not agree it was wrong with the information I had at the time. I think with some of the things that have subsequently emerged that were certainly unknown to us—

Chair: Okay, but the information you were getting was this box-ticking stuff, wasn't it? It was a sort of "rubbish in, rubbish out" operation to produce the qualitative judgment?

Clive Adamson: The content of the meeting I had with him was not box-ticking. That was substantive.

Q1326 Chair: You do not think that you had a misjudgment when you were cross-examining him in that meeting?

Clive Adamson: No, I did not. As I said, the individual that you had in front of you during your investigations is not the individual I saw in 2010.

Chair: He had managed to forget a good deal about the bank over the three years that he was chairman. It is an extraordinary state of affairs that you are asking us to believe, but I will leave it there for a moment.

Q1327 Mr Ruffley: What strikes me is that the trouble with the Co-op emerged not in 2008-09 when the crash occurred. If 2008-09 told us one thing, it was that the people in charge of major financial institutions quite often did not understand risk at all and did not understand some of the products they were selling. Given that, Mr Adamson, when you were approving the appointment of chairman of the Reverend Flowers, could you just give us a list of the technical questions that you were asking that satisfied you that he knew what he was doing? Just give us a list of the questions that you asked in the interview.

Clive Adamson: I asked a number of questions. They were partly, as I said earlier, around his view of the board and how he would run the board, his relationship with the chief executive, the—

Mr Ruffley: No, sorry, I will make myself clear: technical questions about banking and financial services. What questions about his technical expertise; not his governance capabilities, but what he knew about the subject.

Clive Adamson: We discussed the key issues facing the Co-op Bank at that time.

Mr Ruffley: Which were?

Clive Adamson: They were around capital, integration risk and transformation risk. He appeared to be on top of the concept. He agreed that he was not on top of the technical detail.

Mr Ruffley: When he was not on top of the technical detail, did that not make bells ring in the regulator's head?

Clive Adamson: No, it did not.

Mr Ruffley: Why not?

Clive Adamson: The reason is that the main purpose that I felt he was the right person at that time was in terms of his ability to run a somewhat large and unruly board. The fact that he was deficient in technical banking experience and financial services experience was completely recognised by me and by him. That was the reason we asked and he agreed for two deputy chairmen to be—

Q1328 Mr Ruffley: Yes. On that point, obviously you would have seen quite a lot of appointments of chairmen and deputy chairmen of a non-executive kind across a range of financial institutions. How many of the appointments you saw in other financial institutions, other than the Co-op, were as technically deficient as the Reverend Flowers, in your experience? Was anyone quite as ignorant of technical matters as him?

Clive Adamson: No.

Mr Ruffley: No. So he was the worst of the bunch?

Clive Adamson: Yes.

Mr Ruffley: You knew that at the time, presumably?

Clive Adamson: Yes.

Q1329 Mr Ruffley: Just so I am clear about this, how many times did you interview the Reverend Flowers for the chairman's job?

Clive Adamson: Once.

Mr Ruffley: Just once. Did anyone else interview him before that one occasion that you were present?

Clive Adamson: No.

Mr Ruffley: How long did the interview last?

Clive Adamson: It was, from my memory, about an hour, hour and a half.

Mr Ruffley: So three of you were interviewing him for an hour and a half?

Clive Adamson: Correct.

Mr Ruffley: That was it? There was no written information or written questionnaires that he answered at all?

Clive Adamson: No. That was completely in accordance—and bearing in mind that the fact of having the meeting itself was well beyond our requirements at the time.

Mr Ruffley: There is a full transcript of that interview, is there?

Clive Adamson: There is.

Q1330 Mr Ruffley: Good. We will be getting that. On the question of approving the appointment of someone like the Reverend Flowers, as a regulator didn't it occur to you to check up on how he was doing and, if so, how did you do that after the original approval?

Clive Adamson: At the time we did not formally supervise individuals and clearly that is one of the recommendations of the Banking Commission that we fully support. There were a series of meetings with him in the normal course of supervision of that firm.

Mr Ruffley: Which you were present at or other colleagues and other parties of the FSA?

Clive Adamson: Mainly colleagues. I was present at a small number of them.

Q1331 Mr Ruffley: You said you would do no formal checks, but you would informally check that the guy you waved through in April 2010 was not completely hopeless or incompetent?

Clive Adamson: Correct.

Mr Ruffley: You formed a view on an ongoing basis that this guy was probably okay. There was nothing that he did after you had approved him that suggested he was incompetent, so far as your colleagues informed you of their dealings with him?

Clive Adamson: Correct. Indeed, at one of the meetings I attended in February—

Q1332 Mr Ruffley: The impression I am getting is that the FSA regulation—and hindsight is a wonderful thing—was not very rigorous. Could you tell me on how many occasions you vetoed/rejected a nomination put forward by a financial institution for a non-executive chairman, non-executive deputy chairman or non-executive director? How many occasions did you veto? What percentage of the cases in front of you would have been vetoed by your panel?

Clive Adamson: From 2008 to 2011—

Mr Ruffley: Your time there, yes.

Clive Adamson: —approximately one in 10 applicants for those SIF positions withdrew. To be clear, they were withdrawals during the process. From the three-year period thereafter, that became one in five.

Mr Ruffley: After you left and changes were made?

Clive Adamson: I did not leave, to be clear.

Mr Ruffley: Sorry, moved posts.

Clive Adamson: I changed my role to be Head of Conduct Supervision.

Mr Ruffley: Moved role, yes.

Clive Adamson: What we are talking about is application to the FSA during that six-year period. So in the first three years is one in 10 was withdrawn. What happens, if I can just amplify what I mean by that, is that the application process starts with a formal application. On some occasions candidates are subject to an interview. If, as a result of either their formal application or the first interview, we are not content we then proceed to a second interview at which there could be a formal declination. In virtually all, if not all, cases if we are minded to refuse, candidates withdraw from the process rather than subject themselves to being declined. That is why I refer to the one in 10 withdrawing for the first three years. Then, as the process did get tougher—notwithstanding the Committee's views here, I would submit that the process did get tougher—that is why one in five withdrew for the subsequent three years.

Mr Ruffley: Thank you.

Q1333 Mark Garnier: Good morning, Mr Adamson.

Clive Adamson: Good morning.

Mark Garnier: Just to put this in context, can you remind us how much the haircut is for the savings bondholders of Co-operative Bank as a result of the—

Clive Adamson: As a result of the restructuring?

Mark Garnier: Of the restructuring, yes.

Clive Adamson: Yes. As I am sure you are aware, it is quite a complex restructuring.

Mark Garnier: Yes, but if you are an innocent customer of Co-operative Bank and you have bought some of these savings bonds, how much will you have lost?

Clive Adamson: Depending on which particular bond you hold, in most cases the retail bondholders, to distinguish them from the institutional bondholders—

Mark Garnier: Sure, I take that point.

Clive Adamson: The retail bondholders, in my view, received as best a deal as we could get for them.

Mark Garnier: How much did they lose?

Clive Adamson: Again, depending which one they are in, most of them retained their income for 10 years and then suffer a haircut thereafter.

Mark Garnier: So they are pretty unhappy? They will be looking at you as responsible for their losses? They will have made losses, yes.

Clive Adamson: Yes, and—

Mark Garnier: No, that is fine. I just wanted to get the context of this, to remind people that there are individuals out there who have lost money as a result of it all.

Clive Adamson: There are indeed, but they have also retained a high level of income for the next 10-year period.

Q1334 Mark Garnier: Getting back to your role in this, it is very interesting hearing your earlier evidence about the process that you have gone through in order to appoint the Reverend Flowers first as a non-executive director and then as the chairman of the bank. As a member of the Banking Commission, I have come across various people in anecdotal conversations who talk about how tough the regulator is in terms of appointing directors and that it is a pretty gruesome process going through your approvals process in order to become a non-executive director of a bank, yet it seems extraordinary that the Reverend Flowers, just to be a non-executive director, had two relatively junior individuals interview him. Is that normal?

Clive Adamson: At that point, in 2008-09, that was normal.

Mark Garnier: 2009 I think it was.

Clive Adamson: That is why we improved the process from 2010.

Mark Garnier: Fully two years after the banking crisis erupted, you were still having an inappropriate process of interviewing?

Clive Adamson: Yes, I think I would agree that it was not as strong as it should have been.

Mark Garnier: Two years after we were seeing HBOS collapse, RBS collapse, you still felt it was appropriate to have juniors interviewing non-executive directors?

Clive Adamson: Yes.

Q1335 Mark Garnier: Okay, that is fine. Even despite all the arguments about corporate governance of banks, all of that, still two years after that?

Clive Adamson: Yes, I agree with that. I would also say that our primary focus was improving firm supervision rather than supervision of individuals during that first period.

Mark Garnier: Yes, but a lot of us would have regarded corporate governance as part of firm supervision. Holding the whole edifice together is important through corporate governance. Anyway, you then went on with your specific interview with two colleagues. I

want to be clear about this: you talked about the Reverend Flowers was happy to have these two non-executive vice-chairmen sitting beside him, sort of buffering between him and the knowledge he needs.

Clive Adamson: Yes.

Q1336 Mark Garnier: What was the form of that conversation? Did you say to him, “You have to have this” or was it a suggestion, that you said, “We think you should have this”?

Clive Adamson: No, it came out of the discussion that we had about his lack of experience and it was an agreement by both of us that he would appoint the two as deputy chairs.

Mark Garnier: He would appoint two deputy chairs?

Clive Adamson: Yes. He did not resist it.

Mark Garnier: But it was his choice who they were?

Clive Adamson: I cannot recall precisely the form of words, but it was an agreement between the both of us that it would be appropriate.

Mark Garnier: But who decided who they were? This is quite important because you have chosen a couple of people, one who has banking experience and the other who has insurance experience. Was he given the job of finding them? Was the board given the job? Did you guys pick a couple from—

Clive Adamson: No, he suggested them.

Q1337 Mark Garnier: He suggested two individuals. What also perplexes me about this is that this is a man who clearly has no idea how the bank works. He obviously was a teller at some point in his youth. Clearly he does not know anything about financial services institutions and particularly banks, but you liked him because he had a good way of controlling an unruly board. What you are suggesting is you are putting a powerful individual with a strong character in charge of quite a large board, which by the fact that it is large and unruly is likely to be slightly uncoordinated in its approach to things. What you are doing is you are saying you need somebody of strength of character to take over and run a board. Would you agree that if you have somebody with a strong character, that person can shepherd an unruly board into a corral and get them to follow a line of thought? You would agree with that? You are nodding.

Clive Adamson: They could do, yes.

Q1338 Mark Garnier: You would agree with that. How on earth is it sensible to have an individual that clearly knows nothing about banks and yet has a strong character and personality, without the knowledge of knowing how a bank works or what a bank even does given some of the evidence he was giving to us, he was then in a position to be able to drive that board forward in a direction that he felt was worth taking and where the board would not necessarily be able to gather itself together to resist his will? You would agree that was a problem?

Clive Adamson: It could have been. It could have been a problem. If I can also—

Mark Garnier: But I want to know why you thought it was a good idea to put the board of this organisation into that situation, where somebody of strong character but no knowledge was allowed to drive that organisation’s direction.

Clive Adamson: At that point, the problem with the board was its somewhat large and unruly nature and I think that is what we were looking to Mr Flowers to correct.

Q1339 Mark Garnier: But would it not have been better to raise the point that he did not know what he was talking about? The further evidence we have had suggests that, when we are talking about the purchase of the 632 Project Verde Lloyds' branches, Baker-Bates and Davies were against that. The two individuals who you approved presumably as the vice-chairmen, in order to support an ignorant chairman—I am sure he is clever in other respects, but on this particular subject he does not know what he is talking about—voted against something that clearly was not, in their opinion, a good idea and yet you were quite happy that these two individuals were overruled.

Clive Adamson: You are referring to events now in 2012, I think—

Mark Garnier: Yes.

Clive Adamson: —where it is indeed the case that those two individuals did vote against the Verde transaction.

Mark Garnier: But doesn't it illustrate the point I am trying to make, which is that, where you do have expertise, it is ridden over by somebody who has the strength of character in order to be able to drive his own agenda forward, as opposed to the collective agenda of the board?

Clive Adamson: I think just because two voted against does not necessarily mean that the board should not—

Mark Garnier: The two good ones voted against it. The two ones who knew what they were talking about voted against it.

Clive Adamson: The two with the most experience, yes.

Q1340 Mark Garnier: It is a pretty sorry state of affairs. Just one final quick line of questioning, if I might. Of the directors of the most recent board, which is obviously now only 10 people and they are much rulier, seven of them have been started since May last year, so they are all pretty much brand new, and only three of the old ones. Of the five senior management team—five of them again started last year—interestingly, three have contracts for services as opposed to employment contracts. What do you make of that structure of new and also the slightly unusual employment terms for three of the five senior management?

Clive Adamson: I am not aware of their employment terms. That is new information for me.

Mark Garnier: But what would it say to you as a regulator if three of the five senior management team are on contracts for services as opposed to more traditional contracts of employment? What would that say to you about the view that the senior management team or people going to work for this bank have of that organisation?

Clive Adamson: I am not sure I would draw particular conclusions from that. I think perhaps it is worthwhile—

Mark Garnier: Isn't it your job to draw conclusions from clues that are out there in terms of how an organisation is run?

Clive Adamson: Our job is to draw conclusions about the effectiveness of the board and the senior management team, and indeed about the capital position of the firm as the prudential regulator.

Q1341 Mark Garnier: Part of that though has to be the longevity of the people who are working there. Surely what you do not want to see is a high turnover of senior managers within these organisations, because you get lack of continuity.

Clive Adamson: Correct.

Mark Garnier: If three of the five senior management team are on contracts for services as opposed to employment contracts, which could have a year-long notice period if they wanted to leave, whereas a contract for services may have a far shorter one, does that not

suggest to you that some of these senior managers are quite nervous about working for this organisation and want to make sure that they have a quick parachute?

Clive Adamson: It may suggest that. Equally, it may not suggest that.

Mark Garnier: Has nobody looked into that?

Clive Adamson: As far as the FCA is concerned, we have not. You would have to ask the PRA whether they have.

Mark Garnier: I think probably we ought to. Thank you very much.

Q1342 Chair: From where did you glean the information that the board was unruly?

Clive Adamson: It was a result of the fact that it grew to 22 at the time of the merger with Britannia. There were a series of new members being put on the board from Britannia's side as well as the Co-op's.

Chair: It is not just numbers, is it? Other big banks have very large boards. I can think of one or two that are up in the 20s.

Clive Adamson: There were very few certainly of the size of the Co-op Bank at that time, which was still a medium-sized bank. It was certainly not a large bank.

Chair: So by "unruly" you should have said "over-large"?

Clive Adamson: It was over-large, correct.

Chair: Not unruly?

Clive Adamson: I think it was difficult to manage because of the two sides being put on there and bearing in mind that some of those did not have financial services experience.

Chair: Your solution to this unruly or excessively large board was to put a financial illiterate in charge of it, wasn't it?

Clive Adamson: There were three solutions, if I may suggest. First was the judgment that Mr Flowers was the right person at that time, with the information I had; the second was the appointment of the two deputy chairs; and the third was an agreement that the board was too large at the time of the merger and would over time be reduced in size. That did indeed—

Q1343 Chair: Yes, but the first of those fits the description I have just given, doesn't it? Flowers was the right man for the job. One of your solutions was to tame this unruly board by putting in a financial illiterate as its chair, a man you knew to be financially illiterate at the time.

Clive Adamson: As I said earlier, Chairman, it was agreed with him that he did not have sufficient financial services experience. So that is the case, yes.

Chair: At the time, it did not ring alarm bells with you, three years into the financial crisis?

Clive Adamson: As a non-executive chairman, given what we were looking for at the time, that was the decision and judgment I made.

Chair: We know that. Can I go back to the question that I asked at the beginning? I asked you at the beginning whether you now think that that was regrettable and you said "no".

Clive Adamson: I certainly think as of today he would not be approved because we would look for more experience.

Chair: That is not what I asked at all. I hope that if I took this decision I would regret it. It looks pretty catastrophic, but you do not seem to be regretting it.

Clive Adamson: To be clear and to answer the question, I do stand by the judgment I made. I think it was the right judgment at the time. Do I regret what subsequently happened? Yes, I do.

Chair: The information you had at the time was that this guy was pretty hopeless on the financial literacy front and that you had what you have described as an unruly board to

handle. You are telling us that one of your solutions, which you are still standing by on the facts you had at the time, was to put this man in charge.

Clive Adamson: Yes, I am. Just to be clear of the reasons for that, his role was non-executive chairman. He was not running the bank. That was the role of executive management. I did think he had sufficient governance experience to be able to run the board with the help of the deputy chairmen.

Q1344 Chair: Was the issue of systemic risk high in your mind? Were you thinking, “Is the Co-op Mutual structure an appropriate one for institutions that carry systemic risk”?

Clive Adamson: Not explicitly at the time of that appointment, no.

Chair: Don’t you think it should have been, nearly three years into the financial crisis, seeing what had happened after Northern Rock, Lehman Brothers, RBS and HBOS?

Clive Adamson: We were certainly concerned about the risks posed by the merged group. Yes, we were.

Q1345 Chair: It does seem an extraordinary state of affairs, even in normal times, to put a man who does not have the knowledge to understand the subject matter as your solution to a problem of running a medium-sized bank with an unruly board. In these extraordinary times, frankly it seems like a negligent decision, a very poor decision indeed, that you took.

Clive Adamson: As I said—and I am happy to be responsible for the decisions I made at the time with the information I had—I felt that was the right decision. We can go on, if it would be helpful to the Committee, to take you through the risks we saw at the time with the group.

Chair: We might do later on, but I must bring in other colleagues.

Q1346 Mr McFadden: I want to go back to this issue of the two deputy chairmen or vice-chairmen. You said in response to Mr Garnier’s question that this idea came out of the discussion. I would like to explore that a little bit more. Did the FSA, as it was then, insist on the appointment of deputy chairmen with greater banking and financial experience as a condition of approving the appointment?

Clive Adamson: It was not as explicit as that. Just to remind the Committee, the context of that meeting was not a formal approval meeting, because at that time that was not required. At the time, I went beyond what was required to request to have a meeting with Mr Flowers. It was an agreement between us that he would do so, as opposed to part of a formal process.

Mr McFadden: But whose idea was it? Was it the regulator’s idea or did the bank offer this up as a way of kind of sweetening the pill of their suggestion of someone who did not have banking experience? Whose idea was it?

Clive Adamson: As I said earlier, it was a mutual agreement that came out of the discussion.

Mr McFadden: But it must have been someone’s idea to have these two guys. Was it your idea or was it the Co-op Bank’s idea?

Clive Adamson: It was not the Co-op Bank’s idea. In recollection, it came from Mr Flowers’ idea, because he recognised that he did not have sufficient technical experience. I think, as he has disclosed to the Committee, he put that agreement into practice afterwards. He viewed it as an agreement that would be necessary.

Q1347 Mr McFadden: Does that not ring alarm bells? Surely if you need two people with banking and financial services experience to justify this course of action, shouldn’t that have rung alarm bells with the director that you need this insurance policy, rather than

appointing somebody who would not need such an insurance policy and in whom you could have confidence, as the regulator?

Clive Adamson: Again, I do not think so. Again, the context at the time of why he was put forward by the Co-op Group out of five candidates to be the chairman, there was no hiding the fact that he did not have sufficient technical experience. There was no hiding of that. The discussion was around how that could be mitigated.

Q1348 Mr McFadden: Following the appointment, what contact or discussion did you have with these two deputy chairs? Did you meet them?

Clive Adamson: Personally I did not, no.

Mr McFadden: Between the two of you, the Co-op Bank and the regulator, you have decided that the appointment of Rodney Baker-Bates and David Davies as deputy chairs will help to compensate for the chairman's lack of banking experience, but then you never met them?

Clive Adamson: No.

Mr McFadden: Did you have any other contact in written terms about their view of how the bank was going or any discussion?

Clive Adamson: No. I do not think that would be unusual. We would expect all the individuals on the board, including deputy chairmen if they were appointed, if they do have concerns to raise them directly with us. That did not occur until Mr Baker-Bates came to see me in 2012.

Q1349 Mr McFadden: I am going to come on to this. We have already heard that these two voted against the Verde deal. When did you become aware that the two people who were on the board specifically because of their banking experience voted against the Verde deal?

Clive Adamson: In July 2012.

Mr McFadden: In July 2012. Rodney Baker-Bates left the group around that time, is that correct?

Clive Adamson: Correct.

Mr McFadden: Did you conduct an exit interview with him?

Clive Adamson: I did not, but I believe there was an exit interview conducted for him.

Mr McFadden: Who conducted the exit interview with him?

Clive Adamson: Members of the supervisory team.

Mr McFadden: Were you given a report on that discussion?

Clive Adamson: I believe I was, yes.

Q1350 Mr McFadden: Did he make clear in that discussion or in any other subsequent discussion with you that he thought the Verde deal was a huge mistake?

Clive Adamson: In my personal meeting with him in July 2012, he did think that the Verde deal was a step too far, yes.

Mr McFadden: How did he put it; "a step too far" or something worse?

Clive Adamson: I am trying to recollect the words he used. He certainly viewed that it was too far for the group. Given everything else going on at the group at that time, it was a mistake.

Q1351 Mr McFadden: There are two conversations. There is an exit interview with members of your team and there is also a meeting between you and Rodney Baker-Bates. The meeting between you and Rodney Baker-Bates, at whose instigation did that—

Clive Adamson: That was his instigation.

Mr McFadden: It was his instigation. Not only did he go through the normal exit interview, he asked to come and see you specifically to express his concerns about the Verde deal?

Clive Adamson: Correct.

Q1352 Mr McFadden: The Verde deal was then allowed to run on for a further nine months or so after that discussion.

Clive Adamson: Correct.

Mr McFadden: Why was that allowed to happen? What action did you take in response to him going out of his way as he is leaving to come and express his concerns?

Clive Adamson: To be clear, we felt at that time—and the context is that, at that point, the Prudential Business Unit had taken over the lead for the Verde transaction—neither the PB or the PRA or us in the FCA ever saw a business plan or formal proposal to us for us to formally consider for the Verde transaction.

Q1353 Mr McFadden: I think people listening to this would find it unusual at the least, if not more than that, that a director, who is on the board specifically because of his banking experience, leaves the board, comes to the regulator at his own instigation and says, “I am very worried about this deal” or something along those lines and your response is not to do anything about that.

Clive Adamson: Not quite. The issues he was raising were exactly the issues that Mr Bailey, who was leading at that point in the Prudential Business Unit, had communicated clearly to the firm would need resolution before either we or the PRA can formally consider it. The five issues that Mr Bailey raised, quite correctly, were around the capital position, the liquidity position, management stretch, integration and governance. Mr Baker-Bates raised nothing other than issues that were already being expressed by Mr Bailey to the firm.

Q1354 Mr McFadden: I just want to explore this. What did you do after the meeting when he told you this? Did you have a discussion with Mr Bailey? What happened after he flagged up these concerns to you?

Clive Adamson: I think Mr Baker-Bates also had the same conversation with Mr Bailey. As far as I am aware, it is exactly the same conversation.¹

Mr McFadden: He is blowing the whistle as loudly as he possibly can. He has come to see you and he has come to see Mr Bailey to express his concerns about this deal and yet it was still allowed to run on until the Co-op put itself into a very difficult position nine months later.

Clive Adamson: The issues he raised were no different from the concerns that Mr Bailey was expressing to the firm that had to be satisfied before either or both the two regulators would consider the transaction.

Q1355 Mr McFadden: David Davies left later in 2013. Did you have any discussions with him on his departure?

Clive Adamson: No.

Mr McFadden: Did he have an exit interview with members of your team in the way that Rodney Baker-Bates did?

Clive Adamson: I cannot recall. I would have to confirm that to the Committee.

¹ Clive Adamson has subsequently confirmed that Mr Baker-Bates met junior officials within the Prudential Business Unit of the FSA but did not meet Andrew Bailey.

Mr McFadden: Just to go back to this issue of the whole appointment of Mr Flowers and these two point men, wing men—whatever you want to call them—as deputy chairs. Is this a feature of mutuals where you have elected boards, you have member ownership and other specific features of the model, or is this something that you would consider in a “mainstream” high street bank, which we should, of course, acknowledge have also had spectacular failures with very different models of corporate ownership? Would you have appointed a chairman of Lloyds, HSBC or any of these banks who didn’t have banking experience with these two similar vice chairmen? Was that something you would have considered then?

Clive Adamson: I don’t think it is a particular feature of mutuals, I think what is somewhat unusual of the Co-op governance structure was partly the member representatives and partly the dual board structure of the group board and the bank board. We have cross-membership between them, so that was somewhat unusual.

Q1356 Mr McFadden: Has such a model of approval by you been done elsewhere?

Clive Adamson: Specifically what?

Mr McFadden: I mean, in banking terms, a non-experienced chairman compensated for by a deputy chairman with experience.

Clive Adamson: I can’t recall any other direct examples.

Mr McFadden: Thank you.

Q1357 Chair: Nuclear power stations have a good deal of risk about them, don’t they? Would you put a chairman in charge of an unruly board that was trying to run a nuclear power station who didn’t know anything about nuclear power?

Clive Adamson: I think it would depend upon the circumstances.

Chair: You might?

Clive Adamson: We might, yes.

Chair: We will draw our conclusions from that.

Q1358 Mr Newmark: If we can go on to the Britannia merger issues and focus a little bit on that. When did the FSA first become aware of the intention of Britannia and Co-op Bank to merge?

Clive Adamson: In August 2008.

Q1359 Mr Newmark: David Anderson, the former chief executive, told this Committee that he made the first approach to Britannia about a possible merger. Did he discuss this with the FSA first before making his approach?

Clive Adamson: I am not aware that he did. I was informed in August 2008 by the Britannia chief executive.

Q1360 Mr Newmark: Before approaching a bank that was potentially having huge problems, you are saying the Co-op itself did not seek to just have that discussion with you first? It is just a point of clarification, that is all. That is what you are saying?

Clive Adamson: I don’t think they approached me first. As I said, the Britannia CEO informed me first very shortly after—

Mr Newmark: When did the Co-op have a discussion with you then?

Clive Adamson: I think it was very shortly afterwards that both chief executives came to see me.

Mr Newmark: But the first point of contact was effectively Britannia?

Clive Adamson: Correct.

Q1361 Mr Newmark: What did the FSA understand to be the rationale behind the merger when the two chief executives came to speak to you?

Clive Adamson: The rationale for the merger was both boards thought it would be a good strategic fit and what that meant was in terms of branches, the customer base and the range of products. It was also felt that to have a somewhat larger mutually-owned bank would be beneficial for the market.

Q1362 Mr Newmark: Barry Tootell told us that one director of the Co-op had said at the time of the merger, “Perhaps Britannia needed this a little more than we do”. Were you at all aware of this view?

Clive Adamson: I wasn’t aware of that view has expressed by that individual. Certainly our view—

Mr Newmark: Effectively, instead of two negatives equalling a positive, your view was two positives equalling a double-plus positive?

Clive Adamson: Not quite. Our view was that the merger did make strategic sense. We did think that Britannia was running a higher risk business model and we did think it would be safer as part of a larger group.

Q1363 Mr Newmark: But there were some suggestions in the media when the merger between the Co-op and Britannia was announced in 2008-09 that it was a rescue operation of Britannia. You are saying that was not the case from your view.

Clive Adamson: It certainly was not in our view a rescue. If it had been a rescue it would have been treated differently. In our view, it was a merger proposed by two boards of directors. It was the case—

Mr Newmark: Yes, but there were problems with Britannia.

Clive Adamson: It was running a high risk model.

Mr Newmark: It was running more than a high risk model. There were problems with the balance sheet and so on, or not in your view?

Clive Adamson: Perhaps I can explain some of the background as to what we thought of the merger and how we assessed it, if that would be helpful, Chairman?

Mr Newmark: Yes, and just put it in the context of this is the height of the financial crisis and why it was a good time to do this merger. If you can give your answer wrapped up in that.

Clive Adamson: We thought at the time that it was a good strategic fit. We did think that Britannia would be safer in a larger group but it was—

Mr Newmark: Could it have survived alone at that time or not?

Clive Adamson: It is hard to speculate whether it could or could not, but at the time of the merger we thought it was an ongoing going concern firm, absolutely correct.

Q1364 Mr Newmark: Who came to that conclusion internally? Did you or did a group of you within your group decide that?

Clive Adamson: It was under my watch and I take responsibility for that. It was concerned by our ExCo three times. It was considered by the tripartite in late 2008/early 2009. As I said, even if it was in our view a good strategic fit, it was completely dependent upon whether it would be financially robust. We subjected the merged entity to the same capital framework that we used in October 2008 where we looked at the recapitalisation of the major banks. I can amplify it if it would be helpful. That capital framework was called the H64 framework whereby a firm had to maintain a tier 1 capital position of 8%, a stress tier 1 capital position of 6% and stressed core tier 1 capital position of 4%.

Mr Newmark: Effectively, you had your own model for stress testing what would happen post-merger. Is that right?

Clive Adamson: Correct.

Mr Newmark: Do you think that model, with the benefit of hindsight, was a good model?

Clive Adamson: If I can give you the numbers that might be helpful, because I think that does indicate what we did. At the time when we subjected the firm to our stress test approach and our capital framework approach, it did suggest that under stress—and it is not a forecast it was under stress—the core tier 1 capital position could fall to 4.3% and the stress tier 1 capital position could be between 6% and 7%. It was tight but it did meet our framework at the time. Now, if you look at the—

Q1365 Mr Newmark: Again, sorry, I just want to understand this quickly. The thinking of the stress testing; we are in a financial crisis at this time so we are not quite sure where the bottom ends. You say that your stress testing model was fit for purpose at that time?

Clive Adamson: We believed it was and, just to indicate, the outcome for the Co-op by June 2013, the latest set of results, shows that its core tier 1 capital position fell to 4.5%. In other words the stresses did materialise. Now, that was not a forecast by us at the time but it did meet our capital framework at the time. For the benefit of this Committee, what is unusual about the Co-op Bank is indeed the stresses did materialise. Not only did the impairments materialise, but they also had PPI provisions that were more than forecast. The difficulty for the Co-op is that while, at the time in 2009, our capital framework, which was agreed with the tripartite, was if a firm could meet that 4% core tier 1 stress, which was considerably above the legal minimum at the time, then it would be okay to do a merger.

What has transpired with the Co-op is that, as a mutual, it is much more difficult to raise additional core tier 1 capital to restore its position to the capital framework that now applies quite correctly on the PRA.

Q1366 Chair: Sorry, just to clarify, when you say “transpired” everybody knew that a mutual would always have that problem. It is not some problem that subsequently transpired. It was just a mis-judgment, was it not?

Clive Adamson: No, it wasn't. If I can correct that; the judgment we made at the time with the capital framework that we used for mutuals and banks was if they could meet our capital stress framework that was acceptable. In effect it meant that firms could go down to a minimum core tier 1 capital position of 4% and survive. What has happened is that over time capital standards have been raised.

Q1367 Mr Newmark: That is answering a different question. He is saying you should have been aware all along that the Co-op, given its mutual status, could not access the markets in the same way as ordinary banks. I think that is point the Chairman is making. You have not answered his question.

Anyway, I have a different question. You talk about the tripartite discussions and so on and I am curious as to what discussions the FSA held with the Treasury and the Bank of England about the Britannia merger.

Clive Adamson: Those discussions were at the tripartite meetings. I wasn't in attendance at those, but they were discussed and the tripartite did give its agreement to the merger in January 2009.

Q1368 Mr Newmark: Were you aware of any differences between the Bank of England and the Treasury in their encouragement of the Britannia merger itself?

Clive Adamson: No.

Mr Newmark: You were not aware of any difference or you were not aware, period?

Clive Adamson: I don't believe there was a difference. I think the bank may have had a tougher approach to capital at the time but, as far as I am aware, as a result of the tripartite discussions, the tripartite as a whole did agree to the merger.

Q1369 Mr Newmark: One final question: were you aware of any separate independent discussions between the Treasury itself, separate from the Bank of England, with the Co-op on this particular merger? Were there independent meetings between Treasury Ministers and members of the Co-op on discussing this, independent of being in a formal tripartite meeting?

Clive Adamson: I am not aware of them directly. Indirectly, as I am sure you are aware, there was a Private Members' Bill that was introduced to Parliament in January 2009 by Sir John Butterfill and the purpose of that was to—

Mr Newmark: No, that is a separate question. My question is, were there discussions between any Ministers in the Government at that time and members of the Co-op regarding this particular merger?

Clive Adamson: Not that I am aware of.

Chair: There were no discussions with you?

Clive Adamson: No.

Chair: Or with anybody that you are aware of in the then FSA?

Clive Adamson: No, other than normal discussions on a tripartite.

Q1370 John Mann: Just recapping the facts. The Co-op has been going for 100 years, meandering along. It suddenly does something it has never done before. It merges and takes over the Britannia, which has a dodgy loan book in terms of its traditional model. The two organisations are coming together and the Co-op has a unique structure, even for mutual, because of the Co-op group. You approve a chairman who has a criminal record on two occasions—I make no moral judgment at all—for what I think is reasonable to describe as risk-taking behaviour. This does not concern you?

Clive Adamson: There was a disclosure by him of a spent criminal conviction from 1981 in relation to gross indecency. We were aware of that. I am not sure what the other one was you referred to. That is the only criminal conviction that we were aware of.

John Mann: You were not aware of any conviction in relation to drink driving?

Clive Adamson: No. To be clear, we didn't consider that spent criminal conviction to be relevant to his capacity to undertake the role.

John Mann: But you were not aware of a second criminal conviction for drink driving in 1990?

Clive Adamson: I was not.

Q1371 John Mann: I may have mis-heard, did you say the Co-op put forward five candidates to be chairman?

Clive Adamson: No, they considered five candidates. They put forward one candidate, which was Mr Flowers.

John Mann: Did you or any of your staff have any discussions over which one of the five they were putting forward?

Clive Adamson: No, we were informed that—

John Mann: That was entirely their decision?

Clive Adamson: Entirely theirs, quite correctly, because we do not think it is our role to vet lists of candidates.

Q1372 John Mann: Have you ever turned anybody down for a position in a bank?

Clive Adamson: As I said earlier, what happens in practice is that a candidate or a firm never put themselves in a position where they are turned down. They withdraw from the process if we express concerns. As I said earlier, the process has considerably changed as one in 10 withdrew—this is across financial services—

John Mann: Let's go back to the period of time we are talking about for the approval of the Reverend Flowers. How many people withdrew then?

Clive Adamson: That would be in the period where one in 10 withdrew during the process.

John Mann: One in 10 withdrew. One in 10 you regarded as unsuitable?

Clive Adamson: Not necessarily unsuitable, but we expressed concerns about them and so, rather than they or the firm putting their candidate through the next stage of the process, they withdrew.

Q1373 John Mann: One in 10 are not getting through the process and yet here we have a financial institution that has done something that it has never done in its history before; at the height of the financial crisis, with somebody with some question marks and no relevant experience—I just don't quite get here—in an hour and a half you approve.

Clive Adamson: There were no question marks. The only event on his application was a spent criminal conviction and, as explained, we didn't consider that relevant to his capacity for the role.

Q1374 John Mann: I can only conclude one of two things. One is that the individuals making the assessment are not up to the job or the culture in the regulator is such that it overrides concerns because it sees all the financial contagion and the situation with the Britannia, and that is the overriding pressure that is there, "We have to get this show on the road. The merger has been approved, or is getting approved. Therefore, let's push it on". Is that the culture that was there?

Clive Adamson: No, not at all. Bearing in mind I was put into the job in April 2008 to raise standards and I believe standards were raised considerably during my tenure of MRGD. The meeting I had with Mr Flowers, I think, was robust. There was certainly no culture where we were just putting things through.

Q1375 John Mann: Has the FSA come under any political pressure between 2008 and 2013 from Government Ministers in relation to the Co-op Bank and anything relating to the Co-op Bank?

Clive Adamson: I am not aware of any political pressure. There was certainly none put on me personally.

John Mann: I wasn't asking on you personally, I was asking on the FSA.

Clive Adamson: I am not aware of that. I think there was, to be fair, an atmosphere of political support for the Co-op but that is different from any interference in my decision making.

John Mann: What do you mean by "an atmosphere of political support"?

Clive Adamson: Only that there was support for the Co-op movement.

John Mann: What do you mean? Support by who? On what basis? For what?

Clive Adamson: I am not trying to infer anything untoward here. I am just saying that the connection of the Co-op movement to Co-op sponsored MPs, there was support for it but I

think that is very different from any political inference in our decision making. I can categorically say there was no influence on our decision making.

Q1376 John Mann: Culture is rather critical to what has been going wrong in banking in some people's view, including mine. Culture in the regulator could also be said to be something that has gone very wrong. I still do not get, even after the almost hour and a half of this hearing, how this particular one slipped through the net because it looks fairly obvious to me that this is going to be a difficult merger to take forward. It is going to need a strong hand at the tiller and yet you have put someone in who is very weak but who the Co-op clearly wants as opposed to other people. Something is not quite right in all of that and your organisation does not seem to want to carry any responsibility for this. I want to know, what is wrong in the regulator that has led to you making such elementary errors in this case.

Clive Adamson: If I can take you back to my earlier comments, I stand by the decision that I was involved with at the time. I think it was the correct decision at the time. Yes, improvements were necessary in our process, which we completely agree with. Those improvements were being made over the years subsequent to 2008-09.

Q1377 John Mann: How can you possibly say it was the correct decision at the time? What is your barometer for making that extraordinary statement? You only had an hour and a half interview. You didn't have all the information in front of you, clearly. What is your barometer for saying that is a correct decision at the time? What is going wrong with the regulator here?

Clive Adamson: I do not think that there was anything untoward about that decision. I have explained why the decision was made and what we were looking for at the time. The individual did not run the bank. He was a non-executive chairman. We did ask for and agree with him that additional support from the deputy chairman was needed. The events that have emerged around the individual were not known to us and, as I said earlier, I am as disappointed as anybody that nobody saw fit, from all the people who seem to know something about the individual, to tell us what happened.

Q1378 Chair: I regret to have to persist with this line of questioning but you have told us, if I can summarise, that he was the correct person at the time because, although he didn't satisfy one of the normal criteria for a top job, which is that they know something about it, he did satisfy the other, which is that he had the ability to run a board. Correct?

Clive Adamson: That is what I considered at the time, yes.

Chair: I know it is a crude summary but do you want to challenge it?

Clive Adamson: No, that is correct. Everything we saw thereafter—

Chair: Why are people who can do both so rare? Could you not try to find someone?

Clive Adamson: It is a very good question. They are rare, they are hard to find. If I can give you—

Chair: The other banks have them.

Clive Adamson: They do have them but, as I talk to boards and chief executives of firms, these individuals are very hard to find. It is not easy to find the requisite combination of board experience and financial experience.

Q1379 Chair: You have said that this was the correct decision at the time. Do you agree with Andrew Bailey's contention in an interview recently where he said that Mr Flowers would not get through now?

Clive Adamson: I do.

Chair: What has changed?

Clive Adamson: What has changed? I think at least two things have changed. The first is that, as both regulators have toughened their process—

Chair: It is the process?

Clive Adamson: Process and judgment.

Chair: The judgment is made on the basis of information collected by the process. What information would you have collected that you did not collect at that time? You said earlier this decision was made on the basis of the available information.

Clive Adamson: The information is, as I say, essentially the same as it was three years ago.

Chair: Then how would this decision be different?

Clive Adamson: Because today both regulators would insist upon financial services experience at the chairman level.

Chair: It is the judgment that you do need somebody who knows how to run a bank at the top of a bank?

Clive Adamson: It is now both regulators' judgments that we would require somebody with financial services experience to be in the chairman position.

Q1380 Chair: One further issue you raised in the last set of exchanges that we have just had. You said that you were aware of what you described as a "spent conviction for gross indecency". By "spent", do you mean something that you were obliged to disregard?

Clive Adamson: No. We regarded it, but it was from 1981 and we did not think that the nature of conviction was directly relevant to his ability to perform his role.

Chair: You would not make a habit of appointing people with convictions for gross indecency to the top of major financial institutions, though, would you?

Clive Adamson: No, we wouldn't. I think we have to be very careful—

Chair: It was relevant, was it not?

Clive Adamson: We have to be very careful to draw inferences from people's personal lives into their professional lives. Given this was 1981, we thought that that—

Chair: I agree. I agree with the point about time too, but do you think that this was something you should ignore?

Clive Adamson: I don't think we did ignore it.

Chair: Did you ask him a question about it?

Clive Adamson: No, we didn't.

Chair: No, so in what respect was it not ignored?

Clive Adamson: Well, we considered whether it was relevant to his ability to perform his role.

Chair: Then set it aside.

Clive Adamson: Yes.

Chair: That sounds like ignored to me but perhaps there is a distinction there.

Q1381 Mr Mudie: Moving away from the chairman's appointment but taking the same attitude to due diligence, do you think that you were sufficiently adequate in your due diligence of this merger?

Clive Adamson: Yes, I do. To be clear, we think the responsibility for any due diligence that has been carried out should be done by the firms. It is not our responsibility.

Mr Mudie: Is that the situation now?

Clive Adamson: Yes. It would be the same situation now.

Mr Mudie: I interrupted you, sorry. Go on.

Clive Adamson: The role of the FCA as the regulator, and bearing in mind a transaction like this would be led by the PRA now or the prudential regulator, would be to consider any conduct implications.

Mr Mudie: No, but we are talking about then. Do you think it was adequate then?

Clive Adamson: By us or by the firms?

Mr Mudie: By yourselves, by the FSA.

Clive Adamson: Yes, we went well beyond what was required by our process. To be clear, at that point this was a merger between two mutuals. It was not subject to our FSMA change of control process. The actual formal process required for that merger was very light, legally, partly because of the Butterfill legislation that was passed. Technically, all that was required was agreement by the Co-op Bank board and a vote of the Britannia members. Our role technically was quite limited in that. I decided we should go well beyond what was legally required and treat it as close to a change of control as we could. That is why we did the analysis we did.

Q1382 Mr Mudie: All right. The FSA had accepted, in that period, in their report on RBS that, because of the lack of responsibility for agreeing and so on the AMRO acquisition, that led to certain errors and one of the errors was a lack of real due diligence, but you are saying you are very happy with the due diligence. You are content that you carried out the job adequately?

Clive Adamson: Yes.

Mr Mudie: You would not be changing that approach now?

Clive Adamson: Bearing in mind now it is the prudential regulator—

Mr Mudie: No, I am speaking about the overall—

Clive Adamson: I think our assessment of it was adequate and certainly well beyond what was required.

Mr Mudie: You would suggest to us that the regulators would approach due diligence in the same manner as they did for the Co-op and Britannia?

Clive Adamson: I believe so, yes. Clearly this will be—

Mr Mudie: Three things arose from that. One of them particularly was that they left to the senior management and the firms involved to do the due diligence. You would still accept that as being acceptable?

Clive Adamson: Doing everything else, I would, yes.

Q1383 Mr Mudie: All right, a number of questions then follow from that. Did the FSA instruct the Co-op Bank to undertake due diligence on any particular aspect of Britannia?

Clive Adamson: No, we didn't.

Mr Mudie: Were you satisfied with the final due diligence performed by the Co-op Bank and its advisers?

Clive Adamson: To be clear, we didn't use any due diligence that was done by them in our analysis. We had our own separate analysis.

Mr Mudie: I am not sure I understand that. I am simply asking, were you satisfied with the final due diligence performed by the Co-op Bank and its advisers? Were you satisfied?

Clive Adamson: It is not a direct question we asked ourselves at the time because we conducted our own analysis but, yes, we were satisfied.

Q1384 Mr Mudie: As I understood it, when we were discussing earlier the overall thing, you said they carried out the due diligence and you had to be satisfied with it. Did you specifically look at their due diligence and were you satisfied with it?

Clive Adamson: No, we didn't.

Mr Mudie: Would that be normal and would you accept that now?

Clive Adamson: Certainly at the time that was normal.

Mr Mudie: It is not normal now?

Clive Adamson: Today, as we continue to raise standards, I think we would want to look at their due diligence, but we would not necessarily rely upon their due diligence.

Q1385 Mr Mudie: Implicit in that answer is that you are accepting that the standards set at that time were lower than you would now accept?

Clive Adamson: As I said, we—

Mr Mudie: No, I am not trying to be funny. Are you accepting that the standards that applied at the time of the Co-op/Britannia merger were lower than you would accept now?

Clive Adamson: They probably were lower, but I would say again that we conducted our own assessment.

Mr Mudie: You conducted your own?

Clive Adamson: Our own analysis.

Mr Mudie: What does that mean? When you say “analysis”, analysis of what?

Clive Adamson: As I said earlier, the critical question for us was whether the combined entity would meet our capital standards. We were satisfied that it did.

Q1386 Mr Mudie: As time is short, KPMG told this Committee that the Co-op performed its own due diligence on Britannia's commercial real estate book. Were you made aware of this?

Clive Adamson: I don't believe so, no.

Mr Mudie: Was this arrangement normal practice?

Clive Adamson: I think that would be up to the individual boards whether it was.

Q1387 Mr Mudie: I am moving away from these questions but I am just at a loss to understand. In the market that was current at that time and the worry about real estate and property, you weren't told by the Co-op that they had done their own due diligence on this. They had passed it out to their advisers and you had not thought to ask who did it.

Clive Adamson: The critical question for us was two-fold. First, did it meet our capital standards, which it did. Secondly, KPMG, separate from whatever due diligence they did or did not do, were obliged to sign off on what is called the “fair value adjustments at the time of merger” and we were satisfied with that.

Mr Mudie: You were comfortable with the Co-op Bank performing its own due diligence on this particular area of work?

Clive Adamson: I think we would have been, given that KPMG also had statutory duty to sign off on the fair value adjustments.

Q1388 Mr Mudie: I am not an expert, but when they signed it off they would sign it off on the basis that the Co-op had done it. KPMG would not accept responsibility for doing it, I presume. You must have been aware at some stage, even if it is looking at the final signing of documents, that this was done by the Co-op themselves. Did that not raise any questions in your mind?

Clive Adamson: No, it didn't.

Mr Mudie: No. You find that acceptable?

Clive Adamson: Yes.

Mr Mudie: I am a party to the merger. I am taking over this firm and I say they are all right to the regulator and you say, “Oh, that’s good”. That is a layman attitude of how you are approaching regulation. Is that acceptable to you?

Clive Adamson: I think, given where we were at the time and the work that we did and the limited reliance we placed on external advisers, we were satisfied, yes.

Mr Mudie: I am not asking whether you were satisfied, I am asking you now, sitting here, are you telling this Committee, the British public and the Co-op bondholders who have lost a lot of money that you were content as a regulator when the Co-op said, “Oh, it’s okay”; “Oh well, fine”?

Clive Adamson: Yes.

Q1389 Mr Mudie: I have had this view since this started. In terms of the Lloyds merger, Project Verde and this Britannia one, what on earth were the regulators doing? Now you are telling me my worst fears are confirmed, that you as the regulator took the word of the Co-op who were taking over this firm without questioning the real sensitivity at that time that had to hit you in the face.

Clive Adamson: If I may, it absolutely did and that is why the stress analysis that we did at the time has proved to be pretty close to what happened.

Q1390 Chair: Is there any aspect of this huge road accident, as it might be summarised in the phrase of the Co-op, which would have been worse had it not been for the regulator?

Clive Adamson: Yes, I think there are aspects that we underestimated.

Chair: No, I am talking about things you picked up and managed to stop.

Clive Adamson: Yes, there are a number we managed to change during the course of the time from 2009-10. The capital position of the firm did improve between the time of the merger and April 2011 by about 1 percentage point. The board was reduced from 22 to 14 over that period. Yes, there were some things that we did improve over that period.

Q1391 Chair: Capital improvements were taking place right across the sector and were going to happen anyway, were they not?

Clive Adamson: They were different in different firms. The capital—

Chair: This was a global initiative. This was not something that was Co-op specific.

Clive Adamson: I think it was Co-op specific because we did point clearly out to the firm in May 2010, where we sent a risk assessment letter to the board, the risks that we saw around capital business model liquidity and so on. We very clearly expressed those and we did act upon them.

Q1392 Chair: You would argue that you brought something to the piece that improved matters but you would also, would you not, concede you did not bring enough in retrospect?

Clive Adamson: I believe we did do our job effectively at the time. Clearly, the review that has been announced by the Chancellor will look in detail at whether there was regulatory failure, but I believe at the time we did our job effectively. Things could have been better and I completely accept things could have been better, but did we do the job expected of us at the time? I believe we did.

Q1393 Andrea Leadsom: It does seem quite astonishing that we have heard witness after witness come along and tell us why none of it is their fault and you are just another one. You are the regulator. You are somebody who is absolutely paid to defend the British

taxpayer, the bondholders and those investors in the Co-op who subsequently lost a fortune, many of them very unable to do so. Does it strike you as odd that there is a complete lack of accountability for this entire problem?

Clive Adamson: I would say that accountability rests with executive management of the board. I accept complete responsibility for decisions that were made under my watch and I accept responsibility for doing the best for bondholders that we could do given the events that have occurred.

Q1394 Andrea Leadsom: You have been very clear that you feel you did a good job with regards to what was expected of you at the time. Are you therefore saying that at the time FSA senior executives were not required to think outside the box; they were merely required to tick the box?

Clive Adamson: No, I am not saying that at all.

Andrea Leadsom: That seems to be what you are saying because in effect you are saying it was perfectly normal to have a non-banker at the helm of a bank in those days and it was perfectly normal to not bother to challenge any of the due diligence that was done in house, let alone done by external advisers. All those things were perfectly normal and it never occurred to you, bearing in mind we were in the middle of the biggest financial crisis ever, to think that you might possibly challenge some of those assumptions. You just went along with what was normal.

Clive Adamson: No. As I hope I have explained, we did challenge all the assumptions and, as some of the other people who have been before you said, the challenge we provided to the merger was very rigorous. In relation to Mr Flowers, I think I have answered that question.

Q1395 Andrea Leadsom: In retrospect, was the due diligence work on Britannia flawed?

Clive Adamson: I can't answer that on behalf of the firm. I can answer it on behalf of the analysis we did, which did suggest that under a stress the core tier 1 capital position would fall to about 4.3%.

Andrea Leadsom: It was flawed in retrospect or it wasn't?

Clive Adamson: No, I think what has happened is that the stress events for this have crystallised. It is not flawed.

Andrea Leadsom: Was the analysis flawed or not? The due diligence work on Britannia, was it flawed or not in hindsight? Was it accurate at the time or was it not?

Clive Adamson: I can't speak on behalf of the firm's due diligence. I can speak on behalf of the work we did and I do not believe that was flawed.

Q1396 Andrea Leadsom: In the FSA's own report into the failure of RBS, the FSA admitted that it had not offered sufficient challenge to the ABN AMRO due diligence. Only 18 months later a deal is completed with Britannia. Do you see any similarities there? Do you anticipate that there will be accusations that perhaps the FSA should have challenged the due diligence that was done on the Britannia?

Clive Adamson: I can see that. What happened at the time of the RBS and ABN acquisition was very different to this merger we are talking about.

Andrea Leadsom: It is very different in terms of the organisation but is it very different in terms of the process? Is it not the case that—

Clive Adamson: It is completely different.

Andrea Leadsom: —18 months earlier, in the middle of a financial crisis, there is a very clear example of due diligence that has gone wrong? Would you not think, as any normal

person might, “Well, that didn’t go very well so let’s do a bit more due diligence, a bit more challenge in this instance”?

Clive Adamson: I think what was completely different was that the level of assessment the FSA did for the RBS/ABN acquisition was extremely limited. The level of assessment we did for this merger was much more substantial.

Andrea Leadsom: In what sense?

Clive Adamson: In the sense, as I hope I have explained, that we subjected this merger to the same test that we applied to the bank recapitalisation exercise in the autumn of 2008; namely this H64 test I mentioned earlier.

Q1397 Andrea Leadsom: You are saying your own due diligence was much better—

Clive Adamson: Our own analysis, correct.

Andrea Leadsom: —than the due diligence on the ABN AMRO, but you did not think to challenge the due diligence done by either KPMG or by the Co-op itself?

Clive Adamson: No, because we didn’t take that into account in our analysis.

Andrea Leadsom: Okay, but just for clarity; in future, faced with a similar situation, would you look at the KPMG and the Co-op due diligence?

Clive Adamson: We would, but that would not preclude us from doing our own analysis.

Andrea Leadsom: No. I accept obviously you need to do your own analysis, but what I am trying to get at is, were you to see the Co-op Bank do its own due diligence, would you then look at that in the future or not? Do you still think it is not relevant?

Clive Adamson: Yes, we would and it would be a factor we take into account. Again, I do not want to speak completely for the PRA—that would be Mr Bailey—but we would take into account our own analysis of the situation.

Q1398 Andrea Leadsom: Of course you would. It is standard practice to revalue a firm’s assets on acquiring them. Co-op Bank’s fair value adjustments to the acquired Britannia loan book amounted to a downward revision of £867 million, as reported in its 2009 financial statements. Who calculated that figure?

Clive Adamson: I believe that would have been calculated by the firm and subject to the accountant’s review.

Andrea Leadsom: Did the FSA scrutinise those adjustments at all?

Clive Adamson: No.

Andrea Leadsom: In hindsight, were those adjustments prudent enough?

Clive Adamson: In terms of what has happened—though, again, if I can refer you to the June 2013 accounts, which show the impairments that have come through—they are very similar to the analysis we did back in 2009.

Q1399 Andrea Leadsom: You are clearly saying that you did everything that was expected of you and absolutely nothing more and you did not use any discretion, bearing in mind being in the middle of a financial crisis and having just been burned over ABN AMRO. Do you think it is right then for the taxpayer to continue to support the incomes of all those in the FSA who are clearly, if not responsible deliberately, at least responsible by virtue of not having worked out what was going on sufficiently and not having protected taxpayers? Do you think it is right that you should still be a senior executive in the FCA or should we be looking to recruit somebody who does not have the problem on their hands of what has now happened to Co-op bondholders?

Clive Adamson: Clearly, that would be a matter for others to look at as well as me. I believe that I am the right person.

Q1400 Andrea Leadsom: It is a question of accountability, isn't it? You have made a very good and consistent fist of saying it is not your fault, but you clearly did get it terribly wrong in hindsight, there can be no doubt about that, as did lots of other people. It is, of course, the regulator that the taxpayer and the bondholder look to to protect their interests and you failed to do that. I ask you again: not to personalise it to you, but is it right that all of those people in the regulator who, by omission or by failure to think outside the box, failed to protect the taxpayer and the bondholder should still be in work in the FCA?

Clive Adamson: I can perhaps correct you, if I may. We were not completely wrong. I believe our assessment was correct at the time and I have given you the numbers to evidence that. We went well beyond what was needed at the time as part of our attempts to improve prudential supervision during that period. I strongly believe that I did the right thing at the time, but I do feel complete responsibility for the decisions I made.

Q1401 Mr Mudie: The FSA admitted in their report on RBS that, at that time, they had a policy on due diligence that was inadequate in hindsight. Andrew Bailey said in 2011 they have changed all that and they were much stronger now, but you are saying to us that you stand by that inadequate level of due diligence or the FSA was wrong to say it was inadequate; you thought it was adequate?

Clive Adamson: What I am saying is that, whatever due diligence was done or not done by Co-op, we did our own assessment, which proved to turn out to be more accurate.

Q1402 Chair: Just to be clear on this point. You are saying that, unlike the RBS case where basically the FSA put their hands up and did not quite say that they were asleep at the wheel but they certainly said that they were not as alert as they would like to have been, that was not the case with respect to any aspect of the supervision of the Co-op. Is that correct?

Clive Adamson: I think it was very different. I am certainly not saying it was perfect. I am saying that we substantially improved what we did between the time of the RBS acquisition and the time of the Co-op.

Chair: Yes, we have that point aboard. You talked about judgment earlier. It is a question of judgment, isn't it, Mr Adamson?

Clive Adamson: Yes.

Chair: Was it basically okay, fit for purpose, what you were trying to do at the time or was it not?

Clive Adamson: I believe it was.

Chair: You are still arguing that it was?

Clive Adamson: I believe it was.

Chair: Unlike the FSA's with the advantage of hindsight response on the RBS case where they said what they were trying to do was inadequate.

Clive Adamson: I think at the time of the RBS/ABN acquisition it was completely inadequate. The level of assessment was not carried out at all. The level of work we did was, in my judgment, adequate at the time.

Q1403 Stewart Hosie: Mr Adamson, just on this Co-op/Britannia merger, to summarise where we are. You approved a merger between these two mutuals in the middle of a financial crisis, before we knew where it was going to end up, based on an assessment that would leave core tier 1 capital at just above 4%, when many of the assets that would lead to subsequent impairment were already in the bank, when the fair value required a write down of £800 million at the time. This is a merger between two mutual institutions who could not raise

money in the market when a non-mutual financial institution could. Do you ever wake up in the middle of the night and wonder why you let this happen?

Clive Adamson: I look at a lot of things and wonder how we made decisions. In this particular decision, I think it was the correct decision at the time and I stand by it. I think we did do a reasonable job at the time, which was a lot better than the job we did at the time of RBS.

Q1404 Stewart Hosie: What was the job then? What was the role at the time of the merger and, in particular, what discussions and relationship did you have with Co-op and Britannia in the early stages between 2008 and the final merger in 2009? What was the FSA's role?

Clive Adamson: The formal role was quite limited. As I explained earlier, this was a merger between two mutuals. That is not subject to our FSMA formal change of control regime. Technically, it only required the agreement of the Co-op Bank board and a vote of Britannia members. Our scrutiny of the documents was deliberately set by legislation to be quite limited. That was somewhat changed—

Stewart Hosie: Can I just stop you there? The final merger was almost two years after the run on Northern Rock—

Clive Adamson: Correct.

Stewart Hosie: —a small mortgage bank, an ex-mutual building society, which had systemic consequences. You are telling me that, two years after that, the role of the FSA at that point was still incredibly limited in the way you have described?

Clive Adamson: No, let me correct that if I may. Our formal technical role was very limited. I decided to go well beyond our formal technical role and subject it to a more intensive degree of assessment.

Q1405 Stewart Hosie: You concluded it was all right to allow the merger because core tier 1 capital would remain just above 4%.

Clive Adamson: It was tight. It was not just myself. I was the director responsible. It was considered by our ExCo and by the tripartite authorities on numerous occasions. We decided there certainly were not sufficient grounds where it fell below the line to object to the merger.

Stewart Hosie: Could you have blocked or vetoed the merger? Did you have the ability to do that given what you have just said?

Clive Adamson: If we had objected then I am sure the merger would not have occurred, yes.

Q1406 Chair: Just to be clear, whatever the legal or technical position is in the Act, in practice—

Clive Adamson: In practice.

Chair: —you are saying what everybody has acknowledged for years, that when the regulator raises an eyebrow that is the end of the deal?

Clive Adamson: Yes.

Chair: Correct?

Clive Adamson: Correct.

Chair: Right. This was a big issue with respect to a couple of other deals that took place.

Clive Adamson: Yes. I am absolutely convinced that if we had said that the merger was unsafe it would not have proceeded.

Chair: You were not going to be told by your lawyers you would be sued?

Clive Adamson: No. Well, they may have tried it but that would not have worked.

Q1407 Stewart Hosie: Neville Richardson has told us at the beginning the FSA was sceptical about this merger, but ultimately gave its regulatory approval. What caused the FSA to change its mind?

Clive Adamson: We did not change our mind. What we did was—

Stewart Hosie: Neville Richardson was wrong?

Clive Adamson: No, we challenged the merger. If he used the word “sceptical” he used that. I would use the words, “We challenged the merger”.

Q1408 Stewart Hosie: What convinced you that, “Heavens, we are not dreadfully keen that this is a good idea” to, “Yes, it’s a good idea”. What got you into that position?

Clive Adamson: We felt that the strategic fit was potentially a good fit. We did think that a larger mutual, if—and I emphasise the word “if”—it was financially sound, would be good for the marketplace, but it had to be financially sound. Although it was tight, it did meet our criteria.

Q1409 Stewart Hosie: I suppose this is the bit we are all struggling to come to terms with. Within a couple of years of that, many of these assets, which had all been subject to due diligence, which had been written down to some extent at the time, began to become badly impaired to the point there was a massive hole in the Co-op Bank book and the rest is history. What was it that the FSA were not looking at at the time that they should have been looking at to identify the real flaws in this new bank?

Clive Adamson: I am not sure there was anything that we should have been looking at. Again, without wishing to avoid responsibility at all, prudential supervision moved in April 2011 to the Prudential Business Unit and the PRA. The actual impairments came through in the accounts of 2012 and the first half of 2013. Until that point, it was not evident, I believe, that the assets were impaired.

Stewart Hosie: Does that show a weakness in the analysis you do?

Clive Adamson: I believe it did not show a weakness in the analysis we did in 2009 because our stress analysis indicated that the core tier 1 position could fall under stress to 4.3%.

Q1410 Stewart Hosie: Right. In 2009, two years after the run on the Rock, no one in the FSA was concerned about over-reliance on lending to property and all of the other reasons that we finally had the big crash, even though all of these things were evident in the books of Britannia, Co-op and the merged bank?

Clive Adamson: No, that is incorrect. We were concerned and we maintained our concern. In our ARROW letter in May 2010, which we did after the merger, we were very clear about the continuing risk that the merged group faced. We did comment clearly about the risk to the business model in an environment of low interest rates. We did comment upon threats to the capital position if the economic conditions continued. We commented upon the liquidity position. We commented upon the size of the board and we commented upon their conduct performance.

Q1411 Stewart Hosie: Just one final question.

Chair: And a quick reply.

Stewart Hosie: A very quick reply as well. At what point did the FSA indicate informally to Co-op and Britannia they would allow this merger to proceed in advance of giving formal approval?

Clive Adamson: There was no formal approval because this was not a formal change of control. I believe we told them in January 2009 that we and the tripartite were content to not object to it.

Stewart Hosie: Less than five months after this discussion had begun, you had come to a conclusion, notwithstanding everything going on around, that it was probably going to be all right?

Clive Adamson: Correct. We revisited that analysis on two subsequent occasions before the actual merger in August 2009 and we remained content.

Q1412 Jesse Norman: Mr Adamson, who sat on the panel evaluating Paul Flowers with you?

Clive Adamson: There were two individuals. One was a senior adviser at the time and another was a member of the supervision team.

Jesse Norman: What were their names?

Clive Adamson: The name of the member of the supervisory team was Reece Phillips and the name of the senior adviser was Graeme Hardie.

Jesse Norman: Right, thanks. Am I right in thinking that Mr Hardie then became a director of the Co-op Bank?

Clive Adamson: Correct.

Q1413 Jesse Norman: Would it be fair to say that the following occurred? You collectively reached a judgment that Mr Flowers was an acceptable candidate to be chairman of the bank. That is to say, you failed to detect his unsuitability. You let him through and Mr Hardie, who was one of the people evaluating Mr Flowers, then goes to work as a non-executive director of that institution. That is a question. I am wondering if you are going to say “yes” or “no” to that.

Clive Adamson: That is factually correct.

Q1414 Jesse Norman: That is factually correct, thank you. The question I want to ask you here is: do you approve of this revolving door in this case?

Clive Adamson: I think it is quite acceptable, particularly as Mr Hardie’s role was as a senior adviser. He was not a member of the executive. I believe he stepped down from his role before he was appointed as a non-executive director of the Co-op.

Q1415 Jesse Norman: You do not detect any possibility of a conflict of interest there, that somehow a person who has been in judgment on Mr Flowers might then be taken on to this institution almost certainly at the behest of Mr Flowers?

Clive Adamson: There is always a risk of a conflict of interest as people move from the regulator to the regulated. We are very careful about managing those conflicts, but I think it is healthy for people to move between regulated firms and the regulator and the other—

Jesse Norman: You were aware of this move? You approved tacitly within the FSA the move of Mr Hardie to the Co-op Bank?

Clive Adamson: I believe he would have been approved by us to take up that position.

Jesse Norman: You knew about that and, indeed, you were institutionally comfortable with it?

Clive Adamson: Yes, we are.

Jesse Norman: Okay, thank you. Were you aware of any prior closeness between Mr Hardie and Mr Flowers?

Clive Adamson: No.

Q1416 Jesse Norman: Were you aware of any Labour sympathies on behalf of Mr Hardie?

Clive Adamson: No.

Jesse Norman: Do you think he is in a position where he should be allowed to retain his job, given the fact that this judgment has spectacularly failed and there has been this evident conflict of interest?

Clive Adamson: As I said, there are potential conflicts of interest. I think in Mr Hardie's case he is an individual of integrity and he—

Jesse Norman: You have made that substantive judgment about Mr Hardie?

Clive Adamson: Yes. I have known him for a while. I believe he is a man of integrity and I believe he will add strength to the Co-op Bank board.

Q1417 Jesse Norman: It seems to me the problem is this. Either you saw that Flowers was financially incompetent or you did not.

Clive Adamson: We did.

Jesse Norman: Which was it? You saw that he was financially incompetent?

Clive Adamson: As I said earlier, we agreed with him and he agreed himself that he did not have sufficient banking experience.

Q1418 Jesse Norman: Good, okay. The way you attempt to handle this is by putting in place safeguards, notably Mr Baker-Bates and Mr Davies on the board as the financially competent people. You say, "This man is incompetent but the good news is we have some financially competent people on the board alongside him", except it turns out that on the one substantive issue where their financial competence is clearly called into play and on which they disagree, in a context in which boards very rarely are allowed to maintain disagreements, in which unanimity is generally required for a decision to be taken, they did not agree. This did not raise any alarm bells because you did not know about it. In other words, the system that you created to guard against the incompetence of Mr Flowers spectacularly failed as well.

Clive Adamson: I do not quite agree with that. As I said earlier, the issues that Mr Baker-Bates raised were precisely the issues that we wanted satisfaction about before we would consider the merger.

Jesse Norman: I am sorry, could you repeat that?

Clive Adamson: The issues that Mr Baker-Bates raised about the capacity of the firm to take on something else were precisely the issues that were raised with the firm that both regulators would need to be satisfied about to consider that merger.

Q1419 Jesse Norman: Right, but it did not show that the system that you had used, which was to hedge Mr Flowers around with people who knew what they were talking about, was not working. After all, it took a very long time for the deal to fall through after Mr Baker-Bates had had that conversation with you guys. I want to come back to this a third time or it may even be a fourth time. I understand it may be personally impossible for you to say that you got it wrong but, since Adair Turner and Andrew Bailey have both said that the FSA was far too lax in the period before 2008-2009, it seems to me that you ought to be in a position to say, "We institutionally got it wrong with the Reverend Flowers." Can you say that?

Clive Adamson: Again, I stand by the decision I made at the time.

Jesse Norman: I am not asking about your decision. I am saying, "We institutionally got it wrong. We, the FSA, got it wrong."

Clive Adamson: Would we now approve an individual—

Jesse Norman: No, I am asking the question: did you get it wrong? Did the FSA get it wrong? We know what the issue is. We have had it perfectly clear. We have gone through the

whole thing. Adair Turner has talked about raising of standards. We know that you would not have done it the same way now. The question is: did you get it wrong? Did the FSA get it wrong?

Clive Adamson: With the benefit of hindsight, yes, I think we did get it wrong.

Jesse Norman: Okay, that is helpful.

Clive Adamson: But that is different from—

Jesse Norman: Do you feel sorry about it? Do you think colleagues should feel sorry about it?

Chair: Could you finish that sentence: it is different from?

Clive Adamson: It is different from saying I have taken responsibility for the decision I made at the time. I think it was the right decision at the time.

Q1420 Jesse Norman: It is the almost precise logical equivalent of saying, “The operation was a great success but the patient died.” You said in an earlier answer that the FSA’s principle is to separate board management from overall leadership of an institution when looking at a chair of a bank. That was the standard you applied to the Reverend Flowers. You thought he would be a good manager of an unruly board, a split board as between the Britannia members and the Co-op members. You are nodding to this. I am hoping you are thinking I am saying a correct, accurate assessment of what you said earlier.

Clive Adamson: I think what I said was that the role of a non-executive chairman is not to run the bank. That is the role of the executive management.

Jesse Norman: Right, so you agree. Do you think it is to give overall leadership to the institution as well?

Clive Adamson: He should give some overall leadership, but the primary leadership of the institution should be given by the executive management.

Q1421 Jesse Norman: Fine, we are not disagreeing. It is a well-known fact in all institutions of this kind that the link between the chair and the CFO is absolutely vital because that is the constraint on a CEO who is operating out of control.

Clive Adamson: Yes.

Jesse Norman: Now, the link between the chair and the CFO can only be a good one if the chair is able to talk about the state of the financial situation in the institution with the CFO. Correct? The CFO has to be able to say, “I have all these concerns. Look at the numbers. What do you think?” The chairman goes, “Okay, great. Yes, let us go through it.” Am I right about that?

Clive Adamson: Generally right. I think that is something that we did discuss in 2010.

Jesse Norman: It turns out then, if that is true, that, contrary to your claim, financial experience in the chair is not optional. It is vital because the chair has to be able to have the capacity to engage intelligently, to quiz, to assess, to support the CFO in making substantive judgments about the balance sheet as part of an understanding of whether the chief executive and other members of the executive team are doing their jobs. Is that right?

Clive Adamson: As I said, I think in an ideal world the chairman should have both financial experience and wider leadership skills.

Q1422 Jesse Norman: The doctrine that you can separate board management from overall leadership or from running the bank in that sense that I have described is hopelessly wrong and sounds like it has been corrected. A final question, if I may, Mr Chairman.

Chair: It will have to be the final question.

Jesse Norman: It will be. The Co-op had loan impairments in 2012 of £970 million on the banking side. Were you aware of that when you handed over responsibility for the bank to Andrew Bailey in April 2011?

Clive Adamson: The major impairments came through in 2012-2013. There were some impairments in 2010 and 2011, but they were roughly in line with those in 2009.

Q1423 Jesse Norman: Right. Why, when the rest of the sector has already blown up a couple of years earlier, was the FSA so slow to pick up on this escalating disaster of loan impairments within the Co-op based on its own performance and also on the merger with Britannia?

Clive Adamson: The escalating impairments only occurred in 2012-13.

Jesse Norman: That is my point: why didn't you pick up on the fact that they were about to break, that that loan book was getting much worse that much more quickly?

Clive Adamson: It was not getting worse in 2011.

Jesse Norman: Your position then is that it only got worse in 2012, which was when it was formally recognised?

Clive Adamson: What appeared to be the case was that the actual impairments only started to be realised in 2012-13 of any size.

Jesse Norman: You are dodging the question by saying that. I am asking why you didn't pick up on what the true position was, not on what the apparent position of impairments was.

Clive Adamson: We pointed out in May 2010 to the firm that we would be concerned about the high-risk lending in the book and the impact on capital if that situation got worse. We were very clear to the firm in 2010.

Q1424 Mr Love: Can I refer the Committee to my designation in the House as a Labour and Co-operative Member of Parliament? Mr Adamson, can I come back to the issue of the governance structure of the Co-operative Bank? You mentioned the unusual nature of it. When you were supervising the Co-operative Bank did you have any concerns that you expressed about the governance structure of the Co-operative Bank?

Clive Adamson: Our primary concern was the size and composition of the board of the Co-op Bank. We did express that concern, yes.

Q1425 Mr Love: When Mr Marks came and gave evidence to us said that around a third of the membership of the Co-op Bank board were representatives of the Co-operative Group and the other two-thirds were made up of executives and what he called professional non-executive directors. Is that a balance that you would not consider to be unusual? After all, the representatives of the Co-operative Group are there to protect the shareholding. The others are there to enhance the role of the bank. Was there anything unusual with that structure?

Clive Adamson: It is not completely unusual. I think our concern was both the size of the board and the relative experience levels on the board, and both of those concerns we did make.

Q1426 Mr Love: Let me come on to experience because when the Reverend Flowers was asked about this matter he said that six or seven non-executives had banking experience. Were you well aware of that? The rumour appears to have gotten out that the only person with banking experience was Rodney Baker-Bates. Were you aware of the experience of the board of the Co-operative Bank?

Clive Adamson: Yes, we were. I believe by 2011 when the board had been reduced from 22 to 14, which we agreed with, six members of the board had some degree of financial services experience.

Q1427 Mr Love: I asked the staff here to provide me with the information about the board in 2011 and I was rather surprised to discover that Rodney Baker-Bates and David Davies were prior members of the board of the bank when they were made into deputy chairmen. We had rather gained the impression that they came on to the board at that time, but they did not, did they?

Clive Adamson: No.

Q1428 Mr Love: As well as Rodney Baker-Bates and David Davies with significant experience in banking or insurance, Anne Gunther, Peter Harvey, Paul Hewitt, Merlyn Lowther and Bob Newton all had significant banking and/or insurance experience. That does not include the two executives, Martyn Wates and Barry Tootell. Would you not say that that bank board had very significant insurance and banking experience?

Clive Adamson: In 2009, at the time of the merger, we believed the board was both too big and the proportion of individuals with financial sector experience was not sufficient. By 2011 that ratio had improved; so by then half the members had some degree of financial services experience.

Mr Love: In your view or in the view of the FSA or the FCA, whichever you were acting on behalf of, was that sufficient to reassure you that the board had the technical competence to carry out its functions?

Clive Adamson: I think at the time of the merger in 2009, to be clear—

Mr Love: No, I am talking about 2011.

Clive Adamson: In 2011 we thought the mix was better, but still was not perfect in terms of the degree of experience on the board.

Q1429 Mr Love: Much has been made about the mutual status of the organisations that make up the Co-operative Group but, of course, the Co-op Bank is and always has been a plc.

Clive Adamson: Correct.

Mr Love: In the view of the regulator, did that give the bank sufficient independence from the Co-operative Group to satisfy you that decisions were taken by the bank board on behalf of the bank board?

Clive Adamson: With the degree of cross-membership between the group board and the bank board, notwithstanding that, as you correctly say, the bank was a plc in its own right, there are question marks over the degree of influence on the bank by the group.

Q1430 Mr Love: Even though the bank has its own board, its own executive and its own chief executive officer, you were concerned that there was undue influence on the part of the Co-op Group?

Clive Adamson: At the time we were not concerned.

Mr Love: I am separating it out now. I am talking 2011.

Clive Adamson: Yes. In 2011, we were not concerned. As events have unfolded subsequently, I think there is a question to be asked about the degree of influence by the group on the bank board.

Q1431 Mr Love: Looking at the board for 2011, as I understand it there were five nominated board members to the bank from the Co-operative Group out of a board of 14.

Clive Adamson: Correct.

Mr Love: I come back to the question I was asking earlier on about getting the balance right in the Co-operative Bank board. Do you think that was an undue weighting towards the Co-operative Group in terms of balance on the board?

Clive Adamson: It is not necessarily undue. The question is what happened in the boardroom about how that influence was or was not exercised.

Mr Love: Could you elaborate that and explain to the Committee why you were concerned in relation to that?

Clive Adamson: To be clear, in 2011 we did not have that concern. We did think the board was better balanced than it was before. It did have more financial services experience on the board, so we were more content with it. The point I am making is that, as events have unfolded, the degree of influence by the group on the bank board is a question that needs to be asked and I am sure that will be looked at as part of the overall review of what has happened.

Q1432 Mr Love: A final question, not in relation not to the merger because that took place significantly before the bank board of 2011, but in terms of how the merger proceeded and the difficulties they were having and the Verde deal. Most of the decisions would have been taken by the bank board in 2011. Do you accept that?

Clive Adamson: Yes, correct.

Q1433 Chair: One other colleague wants to come in and I will let him in in just a second. That is Mark Garnier. Can I take you back to the exchange we had about the approved persons regime at the beginning of this session where you said you agreed with the recommendations of the Banking Commission that the APR was a busted flush?

Clive Adamson: Yes.

Chair: What we said was, as the primary framework for regulators to engage with individual bankers, the APR is a confused and complex mess. It fails to perform any of its varied roles to the necessary standard. You do agree with that?

Clive Adamson: Yes. To be clear, I think one of the aspects pointed out by the commission is that it was viewed as a gateway and, after the approval, the actual supervision of individuals was very limited. I absolutely agree with that.

Chair: Therefore, you presumably support what is now in statute as the solution, which is the senior managers regime and a new certification system?

Clive Adamson: Yes, completely.

Chair: Two completely new regimes.

Clive Adamson: Yes.

Chair: And that the APR should be scrapped?

Clive Adamson: Yes, I do. Yes. We believe the new senior person's regime will be very important in helping to raise standards.

Q1434 Chair: Why are you not already consulting on getting rid of the APR for other financial institutions seeing as you have decided and agreed with me that it was a dead duck as far as banks are concerned?

Clive Adamson: Well, my understanding is that the new Bill that has now gone through Parliament only puts into place a senior person's regime for deposit takers.

Chair: It extends it beyond deposit takers.

Clive Adamson: And some investment firms.

Chair: That was a mistake in the drafting of the Bill, which the commission has identified because the Bill even at a late stage did not have an accurate definition of a bank in it.

Clive Adamson: Yes.

Chair: In fact, it had a wildly inaccurate definition that would have excluded investment banks.

Clive Adamson: That is right. For those investment firms prudentially supervised by the PRA, the new regime will apply to those as well. Correct.

Chair: I am just asking the question: if the APR is unfit for purpose for banks, why do we think it will carry on being fit for purpose for other financial institutions?

Clive Adamson: As I said earlier, we have been improving as best we can the operation of the approved person's regime for other firms.

Chair: But it is a dead duck process. We all agreed it was useless and, as you have just said, you agree with that conclusion. Don't you think it is time that the FCA started to consult, after discussion with the PRA, on what to do about other financial institutions?

Clive Adamson: We would have preferred the new regime to apply to all financial services firms.

Chair: You would?

Clive Adamson: We would have preferred it.

Chair: That is an extremely helpful remark, which will be noted well beyond this room. In fact, it is crucial to the long-term regulatory structure for the financial services industry in this country.

Q1435 Mark Garnier: Can I just come back on a couple of points that you were talking about a little bit earlier? The first is you keep maintaining that, despite his lack of financial knowledge, the Reverend Flowers had extensive governance experience, which made him a good candidate to be chairman of the Co-operative Bank. Can you share with us what governance experience you felt was appropriate and where he got it from?

Clive Adamson: To be clear, I think what I said was that his experience would be helpful in his role as non-executive chair and I did feel he had the expertise to play that role.

Mark Garnier: You are going to share with us what that expertise was, I hope.

Clive Adamson: As is well documented, he had limited experience in terms of a governance role in major firms, if any. What I was trying to get across to the Committee was that my judgment was that he was an individual who could play that role and provide robust challenge to the board and the chief executive.

Mark Garnier: That was based on an hour and a half conversation?

Clive Adamson: Correct.

Mark Garnier: Really?

Clive Adamson: Yes.

Mark Garnier: In an hour and a half conversation, you assessed that a 65 year-old man was capable of being the non-executive chairman of a medium-sized financial institution?

Clive Adamson: To be clear, that is not uncommon. The SIF interviews we have for chief executives or chairs of any firm are roughly an hour and a half in length.

Mark Garnier: You must have gone through his curriculum vitae to have a look?

Clive Adamson: I did.

Mark Garnier: What stood out in his CV that made you think that he was an ideal candidate to be the chairman of the Co-operative Bank?

Clive Adamson: I do not think he was an ideal candidate. We were asked to judge the candidate put forward: did we think he was confident to perform the role?

Mark Garnier: Based on an hour and a half conversation only?

Clive Adamson: Yes.

Q1436 Mark Garnier: You are seriously saying to all those bondholders who have lost money, these nickel and dime savers who put their money into these bonds, that based on an hour and a half's conversation you think that this individual was the right person to be the chairman of this bank that went bust?

Clive Adamson: It has not gone bust, if I can correct that.

Mark Garnier: Well, sorry, it has been bailed out and bondholders have lost money.

Clive Adamson: Remember, the taxpayer has not contributed.

Mark Garnier: Sorry, it has still been bailed out. It has been bailed out by hedge funds. It has had to be rescued. There has been a rescue package. The fact that it has not been bailed out by taxpayers is completely irrelevant. Where the money comes from is irrelevant. The fact is it has been bailed out. I just want to be absolutely clear. You did no other research on this individual to see if there was anything you could—

Clive Adamson: That is correct.

Mark Garnier: Wow. I am absolutely stunned, absolutely stunned. You also—

Clive Adamson: To be clear, that is no different from the approach we would do today where we roughly spend an hour and a half. Admittedly, now it is both the FCA and the PRA would conduct a detailed interview for that period.

Q1437 Mark Garnier: I am pretty much speechless. There was something else that you did say on two occasions.

Chair: Nonetheless, Mark will come out with a further question.

Mark Garnier: No, I certainly will do as I gather my thoughts on this amazing revelation that it merely takes an hour and a half's chitchat with the regulators in order to be approved as the chairman of a bank.

Clive Adamson: I would not agree it is chitchat. From all my conversations with boards and senior executives today, virtually without exception they believe it is a tough process.

Mark Garnier: What are you talking about? When you are sitting down with him and you have done no research into his CV and his background, what do you talk about?

Clive Adamson: As I think I have explained to the Committee, the subjects we covered were the correct subjects.

Mark Garnier: You must have a basis on which you are going to ask those questions. You must have done a little bit of research. For example, he was the chair of the governors of Lidget Green Primary School. Did you ask him how that was relevant to him talking to the chief financial officer of the Co-operative Bank?

Chair: Or whether it was an unruly group of governors.

Mark Garnier: Yes, or a particularly tough congregation at one of his Sunday services. I am making some light comments, but this is a very serious point. How on earth can anybody conduct an interview with an individual about their suitability to be a chairman of a bank when you have not even read his CV?

Clive Adamson: No, I did read his CV.

Mark Garnier: What part of it—

Clive Adamson: The point I am making, if I may, is that the subjects—

Chair: Sorry, Mark, do just finish that question: what part of it.

Mark Garnier: What part of it stood out as illustrating that in his background there was something that directed you towards a certain set of questions that would reinforce an opinion you must have based on looking at his background?

Clive Adamson: Because the subjects we talked about is how he conducted himself in his previous roles.

Mark Garnier: As the chairman of Lidget Green Primary School, for example.

Clive Adamson: Or whatever his previous roles were, so what exactly his personal style was and how he would use that or not in his role on the board.

Q1438 Mark Garnier: You are talking about an unruly 22-person board and you are asking him in the space of an hour and a half based on—I do make light and poor Lidget Green Primary School probably will not thank me for mentioning it so many times, but he was part of the executive council of Bradford City Council. He was part of Rochdale Metropolitan District Council where he was vice-chair of social services. He did do other stuff, but what I am trying to get from this is how you make the link between his background and his skill to be able to deal with an unruly group of individuals based on more than just an hour and a half's conversation. It simply does not stack up.

Clive Adamson: All I can say is that it is the subjects we did cover, which I think were relevant to his role on the board. We did cover—

Mark Garnier: Can you give us an example?

Clive Adamson: We covered how he would run the board, what his—

Mark Garnier: Can you give us a bit of a flavour to how that conversation went?

Chair: Well, we are going to see the notes, aren't we? We are going to see the record of all this.

Mark Garnier: The transcript?

Chair: Yes. I think we had better see all the papers that were relevant to this appointment both in 2009 and then as chairman in 2010.

Clive Adamson: I am happy to do that.

Chair: Just one last question.

Q1439 Mark Garnier: Yes. It is quite an important one. You have mentioned on two occasions, first to Mr Ruffley and secondly to Mr Mann in their questioning, and I will quote exactly what you said, that you were “disappointed that associates, colleagues and those in public life did not come forward to share with the regulator what they knew about the Reverend Paul Flowers.” What did you mean by that?

Clive Adamson: All I mean is there have been various allegations about his role in previous areas where he has been involved and the point I make is at no time has anybody from any of those organisations or, indeed, people he has worked with in the Co-op ever come to us to indicate aspects of his behaviour that could be relevant to his role.

Q1440 Mark Garnier: Did you ever approach those organisations? Again, assuming you went through his CV, you would have seen his quite extensive contacts in the Methodist Church, the Lifeline charity, the Labour Party, the Labour and Co-operative movement. Did you ever approach any of those organisations in order to find out?

Clive Adamson: No, we did not.

Mark Garnier: You did not get any references on him at all and you are expecting those organisations—

Clive Adamson: Can I be clear why? We believe, and it is still the case, that it is the role of the firm who are putting him forward to conduct their due diligence.

Chair: All right, but did you ask them whether they had done it?

Mark Garnier: Yes, quite. What checks did you do on the firm?

Chair: Did you ask them whether they had done it, as simple as that?

Clive Adamson: I cannot recall. I believe not.

Mark Garnier: You did not check on the background process that reinforces the decision you made to say that this bloke was okay to be the chairman. Are you suggesting—

Chair: This had better be the last question.

Mark Garnier: This is the last one.

Chair: We had the last question some minutes ago.

Mark Garnier: It is the same question with different wording, Chairman. The important point is this. Are you suggesting that there is a veil of deliberate silence over this individual's background that has kept this information from you?

Clive Adamson: I think that is probably a step too far.

Chair: Describe the step that you would like us to be able to spot.

Clive Adamson: I personally believe that those people should inform us—and it should be true of anybody who has particular knowledge about somebody performing a senior role in financial services—if they do know something that they think is relevant to the performance of their role.

Chair: This is back to the whistle-blower problem and the fact that the culture of the FSA was so shot through that it had failed to inculcate or even examine the need to inculcate a whistle-blower culture in many of our financial institutions, another of the Banking Commission recommendations. Andy Love has a quick question he wants to ask and I also have a question.

Q1441 Mr Love: Just arising from that, the Reverend Flowers was chairman when they negotiated the reduction from 22 to 14 on the board, which was in accordance with your wishes.

Clive Adamson: It was.

Mr Love: What role did he play in that process?

Clive Adamson: What role did he play?

Mr Love: Yes, as a non-executive chairman.

Clive Adamson: I believe that he ensured that happened.

Q1442 Chair: I do have one remaining area I want to cover. It is again taking you back to some remarks you made earlier. When I asked you what value added the FSA had brought to the piece with respect to the regulation of the Co-op, you said that there were two areas you would like to cite. One was improvements to the board and the other was improvements to the capital position. There may be others and you may want to mention those in a moment, but I just want to probe a bit further those two.

On the first of those, your contribution appears to rest on the fact that you got the numbers down, 22 to 14, and that that had something to do with the appointment of Paul Flowers, who had been put in partly to perform that function. I hope I have this correct so far. Under sustained questioning, you have not told us anything in Paul Flowers' background, which you were looking at at the time, that you can say was giving you confidence he could run a board, have you? You have not touched a single item. What area of his experience gave you confidence he could run this board?

Clive Adamson: As I have tried to indicate to the Committee, it was less the appointments he previously had. It was more how he conducted himself in interview with me.

Chair: There was nothing that he was bringing to the table prior to the beginning of that discussion whatsoever that you were taking into account in making that assessment?

Clive Adamson: That is correct.

Q1443 Chair: I have to say that in the whole history of interviews for jobs at almost any level, starting with trying to get a university place all the way up to being chairman of the board of a major public company, that is unprecedented. I cannot think of a single post where people look only at what they hear in the interview. If you can think of one, let me know.

On the second issue, you said that there had been improvements to the capital position and you said you had succeeded in raising the core tier capital ratio by around a per cent. Was that correct?

Clive Adamson: Correct.

Chair: The risk-weighted assets are around £16 billion, so what we are talking about here is that is equivalent to raising capital of about £160 million?

Clive Adamson: Approximately, yes.

Chair: What were the losses, roughly, of the Co-op in the end?

Clive Adamson: In 2011 it was still profitable.

Chair: I am taking about the subsequent losses.

Clive Adamson: The subsequent losses in terms of impairments are around about £960 million for 2012 and 2013, plus PPI provisions, plus the write-off of—

Chair: On the IT?

Clive Adamson: Correct.

Chair: They are about 300 each; in fact, one of them has risen to rather more, but we are up at 1.6, aren't we?

Clive Adamson: Somewhat less than that. The extra PPI provisions were about £60 million and the IT write-offs were about £150 million.

Chair: I thought they were nearer 300, but you may be right. Okay, so we are talking about somewhere between £1 billion and £1.5 billion. This extra bit of capital is not taking us very far, is it?

Clive Adamson: No, it is not.

Chair: No. Therefore, the capital improvements were of pretty nugatory value in relation to the losses, weren't they?

Clive Adamson: In terms of the losses to come, correct.

Q1444 Chair: Yes. Looking again at the two areas where you say the FSA made a difference, where we are better off with a regulator than without, we have not succeeded in identifying very much yet, have we? I said a moment ago if you have other areas—those were the two that sprang to mind when I asked you this question earlier—whether you want to put any more on the table.

Clive Adamson: If I may, I would also come back on that point. In terms of the areas we were concerned about at the time, there was an independent review conducted by a third party on their corporate credit risk process. There was a review that we commissioned in terms of their quality of advice. All of those activities were carried out during 2010 and 2011. We believe there was very active supervision carried out during that time.

To come back on your point on the capital position, I go back to the fact that in our assessment in 2009—so the merits of the merger—I believe they did pass our hurdle at the time for the merger based upon the stress capital position.

Chair: This has been a very long and probably very arduous session for you and it is the first time you have appeared before a parliamentary committee as well. I want to express the gratitude of the Committee for you coming today and for doing your very best to answer some very difficult questions over a sustained period. This session has lasted rather longer than our sessions normally do and that reflects both an interest and a concern around this table for this subject. Thank you very much indeed.

Clive Adamson: Thank you.