

Raising Banking Standards

Executive Summary

Introduction

There are a number of potential mechanisms to strengthen standards and restore trust in the banking industry in the UK. This submission sets out at a high level the existing regulatory and legal framework around conduct and standards. It then seeks to outline the options for what else could be done, and sets out some of the issues and questions that would need to be addressed. The options can broadly be divided into three approaches:

- Strengthening the existing framework
- Adopting a top-down approach, focusing on the firms
- Adopting a bottom-up approach, focusing on the individuals

The likelihood is that none of these approaches on their own would be sufficient to restore trust. Therefore, they should be considered as ingredients that could be part of a range of measures or that could be used in conjunction with each other to amplify their effect.

Strengthening the existing regime

Consideration is already being given to how to strengthen or extend the existing legal and regulatory framework. There are, however, further steps that could potentially be taken. These include being clearer upon the expectations placed upon senior management and extending the number of roles covered under the existing Approved Persons Regime where gaps can be identified. This could include extending the regime to include more individuals involved in customer facing roles and those involved in significant wholesale market transactions or dealing. An alternative approach could be to apply the Approved Persons Principles to a broader set of employees, but stop short of expanding the Approved Persons Regime.

The BBA also sees scope for making improvements in the way that individuals are treated when they leave an institution and a withdrawal notice from the Approved Persons Regime is submitted to the regulatory authorities. For example, if an individual resigns before disciplinary proceedings are completed, even in circumstances falling short of a breach of a regulatory requirement of the type which usually requires reporting, banks could be required to include this fact in any withdrawal form.

Another potential option, which relates to the concept of a 'bottom-up' approach, is for the FCA to be more explicit on its views on training and competency, including professional development. This could include the new regulator making an assessment of whether there are other activities which would benefit from requirements similar to those applying from 1 January 2013 for those covered under the Retail Distribution Review.

A top-down approach

A 'top-down approach' would be aligned with the traditional model of governance. This would involve the development of a Code of Conduct which could be applied universally across all bank employees. The Code would not necessarily be prescriptive but instead provide a standard form that could be drawn upon and developed in light of business mix and character. Banks would then be required to implement the Code and report on its implementation. The Code would cover the organisation as a whole and include expectations on:

- the Board and senior management, recognising that the culture and ethics are set at the top of the organisation, since this ultimately is where responsibility lies;
- systems, controls and incentives, recognising that these are key checks and drivers on behaviour; and
- individuals, recognising that the individuals themselves are the 'first line of defence' in terms of ensuring high standards of conduct and protecting reputation.

Responsibility for the Code of Conduct could rest with one of the new regulatory authorities – most likely the FCA - possibly in conjunction with an advisory panel drawing together what the Consumer and Practitioner Panels of the FSA do today together with FCA and industry representation to create a forum to agree high level principles of conduct and monitor market trends that suggest areas where fresh thinking or interpretative guidance is required.

Alternatively, an independent Banking Standards Review Council could be established to monitor and uphold ethical standards. This would need to be independent of the industry – by which we mean an independent non-banking chairman and a majority of non-banking members, including customers of banking services and the public interest, but with industry support and input.

Consideration would need to be given to questions such as whether any independent Banking Standards Review Council would need a statutory footing, its relationship with the existing regulatory framework and the scope of its application. In order to be credible and

effective, it is likely to need to have some statutory or regulatory support, be independent of the industry and be universally applicable to all sectors of the banking industry. Under this approach, there would be an expectation upon banks to report on how the Code was implemented and enforced, including disciplinary action taken in respect of breaches of the Code. It is also likely that some form of assurance mechanism would be required.

The inter-relationship between the approach and the existing regulatory framework would need careful consideration, as a move to a 'three peaks' regulatory system would seem to cause unnecessary and confusing complexity. It is for instance difficult to see how the Banking Standards Review Council could have a role in individual cases of misconduct without duplicating the existing Approved Persons Regime and encountering difficulties with employment law and Human Rights legislation. There may also be scope for building in some of the activity of the current FSA Practitioner and Consumer Panels.

A bottom-up approach

A bottom-up approach is one that focuses primarily on the individuals employed in the banking industry. In some respects, it can be seen as analogous to the approach adopted in professions such as legal, accounting and medicine.

There are a variety of potential options and it should be recognised that there are already a number of initiatives in this area.

One approach would be to focus on the training and development of employees, and for this to identify professional standards expected in specific areas of business. Banks are already making efforts in this area; and therefore the question is what else could be done. An option would be for the industry to work collectively on standards and promoting awareness of these efforts. However, such an industry-led initiative may lack the necessary credibility. Another option would be to increase the independent oversight of training and development or for the FCA to take the lead in producing guidance or setting standards.

In any event, we would see benefit in greater coordination in the area of training and education. This could involve a Professional Standards Board. Consideration would need to be given to its remit, independence and governance, to ensure its credibility. The Professional Standards Board could have a role in recognising and promoting the various existing standards, professional bodies and institutes operating in this area. It could be separate to the potential Banking Standards Review Council envisaged under the 'top-down' approach, or be one and the same.

One question is whether there should be a broader register of bankers in some form. Such an approach would focus on the individual rather than the firm, but would still raise significant issues, such as the need for statutory support, its relationship with the existing regulatory regime, the scope of any register, what its disciplinary powers would be and how it would operate in a way that would not damage the UK's international position or cause 'restraint of trade' or 'free movement of labour' issues.

There are no prima facie insurmountable obstacles to an approach focusing on the individual, and a greater focus on the 'professionalisation' of employees within the banking industry is clearly desirable. However, a regime focused on the individual, based on their observing certain standards of behaviour and conduct, would not be effective if the organisations that employ them operate a culture that works against these standards. Careful consideration would therefore need to be given to how this would be overcome and what could be done, either to strengthen the existing regulatory framework or adopt a top-down approach, as discussed above. In effect, raising standards using a 'bottom-up' approach is likely to be a necessary, but not sufficient step to raise standards and restore trust.

Banking and the international context

Any proposal would need to take account of the international nature of banking in the UK. This is not just in respect of ensuring the UK's attractiveness as a place to do business, but also in ensuring a level playing field for both UK and overseas banks operating here.

It is vital that the UK remains an attractive place to do business. And, although some may view any initiative in this area as potentially adversely affecting this attractiveness, this need not be the case. A well-formulated, proportionate approach should, in fact, enhance the attractiveness of the UK as a place to do business. If the initiative made clear standards of professional conduct and enhanced trust, it should attract banks, capital and clients to the market. Of course, any initiative would need to be cognisant of the need to protect freedom of trade and free movement of capital, and these issues would need further consideration.

Ensuring a level playing field between UK and overseas banks must also be an important consideration. However, it is not an insurmountable obstacle, as UK and subsidiaries of overseas banks are already regulated by the UK authorities and subject to UK law. There are further questions regarding how the Code would apply to branches of overseas banks operating here; and how it would apply to the overseas operations of the UK banks and how it may interact with local requirements. These points also would require further careful consideration.

Raising Banking Standards – Context and Options for change

1 Introduction: Context and options for change

The Commission on Banking Standards has been appointed by both Houses of Parliament with a Terms of Reference to consider and report on:

- 1) Professional standards and culture of the UK banking sector, taking account of the regulatory and competition investigations into the LIBOR rate-setting process.
- 2) Lessons to be learnt about corporate governance, transparency and conflicts of interest, and their implications for regulation and for Government policy.

In addition, during the hearings of the Parliamentary Commission, issues surrounding the standards and trust in banking have been raised frequently by members of the Commission and those giving evidence.

Banking is an industry that must be based on trust and high standards of professional conduct. Trust and standards within banking must be supported and sustained by a culture that is well entrenched in everyone who works for the bank. There is a general recognition that this has not been the case in parts of the banking industry in recent years and steps must now be taken to remedy the situation.

There are a number of potential approaches to raising standards in banking, and within each there are a number of further elements that need to be considered. One option is to look at the existing regime and consider ways in which it could be strengthened. It needs to be recognised that in addition to the many financial stability measures devised since the outset of the financial crisis, the UK Coalition Government has also put in place a new regulatory architecture and that this includes the establishment of a conduct-focused regulator in the form of the Financial Conduct Authority. This will only obtain its formal powers later this year and is in the process of developing its approach to conduct regulation. It therefore may be that the answer to strengthening ethical and professional standards lies in large part with the new regulator.

Working in conjunction with the new regulatory authorities we see two possible means by which ethical and professional standards can be strengthened:

- **A top-down approach, for example, one focused on a Code** - this focuses on organisations as a whole and seeks to raise standards by requiring them to take

steps to improve the oversight, monitoring and control of employees. This approach could also be characterised as one focused on ‘tone from the top’ and is aligned with traditional method of corporate governance in limited liability companies. It is premised upon external oversight which could be provided by an independent Banking Standards Review Council.

- **A bottom-up approach, for example, one focused on Professional Standards** – this focuses on the individuals operating within the industry and seeks to raise their technical competencies and ethical standards. This approach is a feature of other professions, including the medical, legal and accounting sectors.

These approaches and the various elements within them can be combined, or used in conjunction with each other and the existing regimes. They could involve the introduction of reinforcement or disciplinary mechanisms; that is, the tools and sanctions available to a party to promote, monitor and enforce any initiatives to raise standards.

Set out below is an account of the potential approaches and a summary of some of the issues.

2. Existing Regulatory and Legal Framework

Regulatory Framework

The banking industry is already subject to a broad-ranging regulatory regime. This regime is evolving, particularly with the separation of the Financial Services Authority (FSA) into the Prudential Regulatory Authority (PRA) and the Financial Conduct Authority (FCA), and any steps to raise standards will need to take account of and be conducted within this context.

The regulatory authorities already make substantial demands of firms in the context of professional standards. These requirements focus on both the regulatory entities and the individuals operating within them. The primary mechanism the FSA currently utilises in relation to the behaviour of individuals is the Approved Persons Regime (‘APER’). This requires individuals with significant management roles and/or responsibilities (a ‘Significant Influence Function’ or ‘SIFs’) to be approved and registered with the FSA.¹ In addition to the SIF regime, there is also the concept of Customer Functions, which covers those interacting

¹ List of SIFs - CF 1 Director function; CF 2 Non-executive director function; CF 3 Chief executive function; CF 4 Partner function; CF 5 directors of an unincorporated association; CF 6 Small friendly society function; CF 8 Apportionment and oversight function (Non-MiFID business only); CF 10 Compliance oversight function; CF10a CASS operational oversight function; CF 11 Money laundering reporting function; CF 12 Actuarial function; CF 12A With-profits actuary function; CF 12B Lloyd's Actuary function; CF 28 System and controls function; CF 29 Significant management function.

or providing advice to customers.² These functions are considered to be Controlled Functions ('CFs')³ and those holding them must be registered and approved by the FSA. The approval process for those holding Controlled Functions already includes a 'fit and proper test' and, dependent on the role performed, a consideration of the individual's experience, competency and skills.⁴

Those discharging a Controlled Function are required under Section 64 of FSMA to observe the seven Principles; these include: that they must act with integrity; show due care and diligence; and observe proper standards of market conduct. (The Principles are listed in Appendix 1.)

As at 31st March 2012 there around 156,000 registered Approved Persons. It is recognised, however, that there are significant gaps in the current regime in terms of who is covered; and consideration is being given to how and in what respects it could be extended. For example, a number of individuals involved in alleged manipulation of LIBOR would not have been covered.

Approved Persons may have their authorisations withdrawn and be banned from holding a Controlled Function by the regulatory authorities. The authorities further set principles and rules around the structure and conduct of individual regulated entities as part of their High-Level Principles that apply to a firm as a whole. These require, inter alia, that the firm must conduct business with integrity, with due care and diligence and treat customers fairly. (The High-Level Principles are provided at Appendix 2.)

The High-Level principles are supplemented by the rules on Senior Management Arrangements, Systems and Controls (often referred to as 'SYSC'). These rules cover, inter alia: Senior Management Arrangements; Compliance, Internal Audit, and Financial Crime; Risk Control; Conflicts of Interest; and whistleblowing.

²The customer function is the function CF30 and includes those: (1) advising on investments other than a non-investment insurance contract (but not where this is advising on investments in the course of carrying on the activity of, giving basic advice on a stakeholder product) and performing other functions related to this such as dealing and arranging; (2) giving advice to clients solely in connection with corporate finance business and performing other functions related to this; (3) giving advice or performing related activities in connection with pension transfers or opt-outs for retail clients; (4) giving advice to a person to become, or continue or cease to be, a member of a particular Lloyd's syndicate; (5) dealing, as principal or as agent, and arranging (bringing about) deals in investments other than a non-investment insurance contract with or for, or in connection with customers where the dealing or arranging deals is governed by COBS 11 (Dealing and managing); (6) acting in the capacity of an investment manager and carrying on functions connected to this; (7) in relation to bidding in emissions auctions, acting as a 'bidder's representative' within the meaning of subparagraph 3 of article 6(3) of the auction regulation.

³ Under Section 59 (Approval of Particular Arrangements) of the Financial Services and Markets Act 2000 ('FSMA')

⁴ FSA Handbook, FIT 1.3.1, The FSA will have regard to a number of factors when assessing the fitness and propriety of a person to perform a particular controlled function. The most important considerations will be the person's: (1) honesty, integrity and reputation; (2) competence and capability; and (3) financial soundness. Detailed guidance on these factors is provided in FIT 2.1-2.3.

In addition to the Approved Persons Regime, the High-Level Standards, the SYSC rules, and detailed Handbook, the regulatory authorities have a range of powers relating to the supervision and conduct of regulated entities, including the ability to commission an Independent Review by a Skilled Person of a regulated entity (or individual within that entity). These reviews are commonly referred to as Section 166 Reviews.⁵ These reviews may seek to address, report on and suggest remedial actions on wide range of topics, including concerns on the adequacy of systems and controls, anti-money laundering, client assets and to assess whether there have been or may be likely to be any breaches of regulatory requirements. The FSA may also conduct its own investigation, require remedial actions, impose fines and ultimately withdraw a firm's authorisation to engage in a regulated activity.

In addition to the above powers, the FSA has also introduced in recent years its Remuneration Code. The Code sets out the standards that banks, building societies and some investment firms have to meet when setting pay and bonus awards for their staff and aims to ensure that firms' remuneration practices are consistent with effective risk management.⁶ The Code is contained in and applied through SYSC 19A of the FSA's Handbook.

The Remuneration Code is primarily focused at those employees who hold significant management positions or are considered to be significant risk takers (these operating primarily in the wholesale market). In the retail market, the FSA has completed its Retail Distribution Review which looks at the sales processes and incentives surrounding the sale of retail products and bans the use of commission-based selling. It has also recently conducted a review of sales incentive programmes in financial institutions and will be introducing the requirement for these institutions to make significant changes.

The FSA and its successor organisations have committed to developing the use of the existing framework, and have identified early intervention and the enforcement of credible deterrents as key to this. The FCA's stated objectives include:

- Protecting and enhancing the integrity of the UK market.
- Securing an appropriate degree of protection for the consumer.

Both of these objectives address directly the issues of raising standards and restoring trust. The FCA will also have new powers in product intervention; to direct firms to withdraw or amend misleading financial promotions; and to publish warning notices. The new regime will focus more on ensuring the suitability of products. It will also focus more on wholesale

⁵ Section 166, the appointment of a skilled person, FSMA 2000

⁶ The Code is part of the FSA Handbook

market conduct than has previously been the case, and intervene and bring enforcement actions where necessary.

Consumer Protection

In addition to the above regulatory framework, which will be reinforced by the FCA's proposed approach, retail customers also have a variety of rights and protections. Bodies such as the Office of Fair Trading, the Financial Ombudsman Service and the Lending Standards Board already provide retail consumers with a high degree of protection and avenues for redress. Such protection and redress, however, is clearly not sufficient to address directly the main issue, namely reducing the instances where consumers need to complain. That requires action to raise professional standards and improve culture in the UK banking sector.

Legal Framework

In addition to the regulatory regime, those operating in banking are subject to the overarching criminal and civil legal framework. Indeed, many of the high profiles cases of misconduct in the financial services industry result in sanctions being applied through both the legal and regulatory regimes. The Fraud Act 2006 considers there to be three core definitions of fraud: false representation; failing to disclose information; and fraud by abuse of position. These definitions are clearly relevant, and are frequently applied to cases of misconduct in the financial services industry and have substantial sanctions associated with successful prosecutions.⁷ In addition, activities such as Market Abuse, commonly termed 'insider-trading', are covered in the Criminal Justice Act 1993 and FSMA and are in the process of being extensively revised under the EU's Market Abuse Directive to include a broader range of potential market manipulations.

In addition to the criminal legal framework, those serving as directors of a regulated entity that is incorporated under the Companies Act 2006 are subject to its Directors' Duties.⁸ These duties include a requirement to act in good faith, in a way that would be most likely to promote the success of the company (Directors' Duties under Section 172 of the Companies Act 2006 are set out in Appendix 3). Directors are also required to exercise independent judgement, act with reasonable care, skill and diligence, and avoid conflicts of interest.

Individuals may be disqualified from serving as a director on a mandatory or discretionary basis under the Company Directors Disqualification Act 1986. Individuals may be disqualified for a variety of reasons, including evidence of any misfeasance or breach of any

⁷ Including recommended jail sentences of 7-10 years

⁸ Companies Act 2006, Sections 171 – 177.

fiduciary or other duty by the director in relation to the company. The primary purpose of the disqualification sanction is to protect the public against the future conduct of companies by persons whose past records as directors of insolvent companies showed them to be a danger to creditors and others. In addition, HM Treasury is currently consulting on the possible extension of the sanction regime for directors of failed banks, including the introduction of a rebuttal presumption that the director of a failed bank should not hold in future hold a similar position, the extension of criminal sanctions to cover managerial misconduct, and the application of tests associated to strict liability, negligence or incompetence, or recklessness.

A number of high-profile cases provide some evidence that the current regulatory regime, consumer protections and legal framework, working together, can be effective in prosecuting those engaged in misconduct and imposing substantial sanctions. More can be done, however, to raise standards further and to restore trust, whether through strengthening the existing regime or by the introduction of new additional or complementary initiatives.

3. Strengthening the existing regime

Consideration is already being given to how the existing regulatory regime could be strengthened. This could include broadening the Approved Persons Regime so that it captures more individuals. For example, more Controlled Functions could be introduced, so that they were more granular in terms of roles performed and covered more individuals. The concept of the Customer Function (CF30) could be extended to include individuals involved in the sale/distribution of financial products to retail customers akin to the new Retail Distribution Review requirements. Another approach could be for the existing regime to be supplemented by a more overarching framework that captures more people through a general requirement to observe the APER Principles. These approaches would require further consideration of who would be subject to the extended regime.

Another area of improvement could be around the process for withdrawal of approval when an individual leaves an institution. For example, where an Approved Person is subject to disciplinary proceedings, they may resign before the process is completed and this is not necessarily reported on the withdrawal form to the FSA. This resignation before completion of process would be useful information for the regulatory authorities to consider if the individual sought another approved persons role and was subject to the Fit and Proper Test. Reporting could also include circumstances falling short of a breach of regulatory requirements. We would envisage that the withdrawal form would report only that proceedings had been initiated, not completed, and that no outcome had been determined

and as such the individual would be free to explain their reasoning and would not be 'banned' as a result.

A further possibility is for the regulatory authorities to be more explicit in their view on training and competency requirements, including a requirement for continuous professional development. For example, as part of the changes applying from 1 January 2013 under Retail Distribution Review, individuals are required to have a higher level of professional competency (including passing a 'Level 4 exam'), are required to hold a Statement of Professional Standard from an accredited body, undergo a minimum number of annual training (a Continuous Professional Development requirement) and sign a declaration annually that they have complied with the APER Principles. This approach - or something similar to it - could potentially be adopted for other sections of the banking industry.

It can also be questioned whether, historically, the regulatory authorities and law enforcement agencies have given sufficient priority to enforcement action. This is a matter upon which we commented in our response to the Parliamentary Commission's initial call for evidence last summer (see for instance paragraphs 16 to 21).

4. Other potential approaches

Although there may be some benefit in extending or strengthening the existing regime, it remains open to question whether this would be sufficient to achieve the aims of both raising standards and restoring trust. Therefore, it merits further consideration of what other mechanisms or approaches could be adopted. These can be characterised as 'top down' and 'bottom up'.

4A. A top-down approach

The 'top-down approach' is one that is most closely aligned with the traditional model of governance. This approach focuses upon the system by which companies are directed and controlled, where the Boards of Directors are responsible for the governance responsibilities of the Board including defining its culture and approach, providing the leadership to put it into effect, supervising the management of the business and reporting on conduct. Under this approach, the standards would be set and upheld externally, potentially through a new independent body.

Responsibility for the Code of Conduct could rest with one of the new regulatory authorities – most likely the FCA - possibly in conjunction with an advisory panel drawing together what the Consumer and Practitioner Panels of the FSA do today together with FCA and industry representation to create a forum to agree high level principles of conduct and monitor market

trends that suggest areas where fresh thinking or interpretative guidance is required. Alternatively, it could rest with an independent body; we explore this further below.

Code of Conduct for banks and a Banking Standards Review Council

Under this approach, an independent body could be established with responsibility for drawing up general conduct principles, monitoring how these are being applied in practice and how practitioner firms are enforcing their own codes of conduct. This could take the form of a 'Banking Standards Review Council'. In addition to preparing a Code of Conduct, and monitoring its application, the Council could receive and address application reports thereby ensuring that banks and their employees live up to the standards set out in the Code. Such a body would need to be independent of the industry – by which we mean an independent non-banking chairman and a majority of non-banking members, including customers of banking services and the public interest, but with industry support and input.

This would require consideration of a number of questions and options.

The first question that would need to be addressed would be the content of such a Code, and who it would cover, both in terms of the types of business and the individuals. As noted previously, recent years have seen examples of misconduct in both the retail and wholesale areas of banking, the loss of trust in the banking industry is general in nature rather than relating to one aspect of it, and the concept of high professional standards is a universal one. Therefore, it would be difficult to argue that the Code should only apply to one area of banking; account, however, may need to be taken of how it should apply in each area.

The content of any Code is something that would need careful consideration, both in terms of making any initiative effective but also in terms of ensuring that it is complementary to existing regulatory or legal requirements. The Code would be ascribed to at an organisational level and would set out the types of ethical standard and principle that banks should expect of the employee. One possible model would be the Lord George Principles of Business Conduct which read⁹:

1. To act honestly and fairly at all times when dealing with clients, customers and counterparties and to be a good steward of their interests, taking into account the nature of the business relationship with each of them, the nature of the service to be provided to them and the individual mandates given by them.
2. To act with integrity in fulfilling the responsibilities of your appointment and seek to avoid

⁹Lord George Principles of Business Conduct, as promulgated by the Worshipful Company of International Bankers.

any acts or omissions or business practices which damage the reputation of your organization and the financial services industry.

3. To observe applicable law, regulations and professional conduct standards when carrying out financial service activities and to interpret and apply them according to principles rooted in trust, honesty and integrity.
4. To observe the standards of market integrity, good practice and conduct required by or expected of participants in markets when engaged in any form of market dealings.
5. To be alert to, and manage fairly and effectively - and to the best of your ability - any relevant conflict of interest.
6. To attain and actively manage a level of professional competence appropriate to your responsibilities, to commit to continued learning to ensure the currency of your knowledge, skills and expertise and to promote the development of others.
7. To decline any engagement for which you are not competent unless you have access to such advice and assistance as will enable you to carry out the work competently.
8. To strive to uphold the highest personal and professional standards.

Whilst a standard approach would benefit from the transparency it would bring, there is arguably a balance of advantage to be had in individual banks being able to adapt a *model* approach to reflect their business mix and character. There is for instance a distinction between retail banking on the one hand and wholesale and investment banking on the other and other specialist activities which banks may undertake; other factors such as the nationality of the parent company may also have a bearing on the best way in which to give expression to a core set of Code principles.

It is recognised that the simple presence of a Code of Conduct is unlikely to be sufficient to ensure that standards are raised and trust is rebuilt. The Banking Standards Review Council is therefore likely to need responsibility and processes for oversight and assurance.¹⁰ The

¹⁰ An example of this concept working successfully is the UK Code of Corporate Governance, a model of corporate governance and control based on the now 20 year old recommendations of Cadbury Committee which has been copied across the globe. The Code is often mistakenly referred to as self-regulation. However, companies listed on the Main Market of the London Stock Exchange are required to make disclosures against the Code's Principles and Provisions in their Annual Report and a number of these disclosures are subject to verification by the appointed statutory auditors. Finally, the decisions take by the Board of Directors under the 'comply or explain' regime are judged by the shareholders who through their ability to remove directors, block capital raising, approve remuneration schemes and approve the auditors, retain the ultimate sanctions within the corporate governance regime of listed companies.

Code would also need to contain details, not just on the expected conduct of individuals, but also on:

- The expectation on company Boards and senior management in terms of overseeing the implementation and receiving assurance. Given the important and complex role that the Board already plays in the governance of financial institutions, it would be necessary for any change in their role in this respect to involve a reorientation of duties rather than an addition.
- The expectations of the systems, controls and remuneration structures. These would need to be aligned with the Code and have a role in making sure it was promulgated across the organisation, any necessary training steps had been completed by employees, information upon compliance and breaches collected and that this information is reported to appropriate levels of senior management and ultimately the Board.
- The expectations on the individuals, both in terms of understanding the Code, including any required training or development initiatives, and abiding by it. This is aligned with the expectation that the individuals are the frontline and have a primary responsibility for reputation and conduct. These expectations may also include ensuring that employees understand any associated disciplinary proceedings and potential sanctions.

The content and status of the Code of Conduct also raises questions regarding the role of any Banking Standards Review Council that would develop, monitor and enforce the Code. It could be given statutory underpinning or be established on a non-statutory basis where banks would publicly commit to adhere to its requirements – with or without a regulatory expectation that they so do. A key question is the basis upon which any such Council operate? There are a number of options in this area, although it is clear that in order to be credible and effective any such body would need to be independent of the industry. This issue of independence also relates to its composition. In order to be credible and effective, the Council should have a majority of members from a non-banking background, including the chairman. There are also questions regarding how its members would be appointed and how it could be ensured that there was suitable representation of the broad constituency of customers of banking services and the public interest.

Relationship with existing regulatory framework

While it is envisaged that the Banking Standards Review Council should most likely be separate from the regulatory authorities, it will nevertheless be necessary to ensure that their responsibilities align and that unnecessary duplication and conflict is avoided. This is particularly the case in respect of the Approved Persons Regime. There may, however, be scope for building in some of the activity of the current FSA Practitioner and Consumer Panels.

There may be a case for some form of statutory underpinning or Royal Charter, though we assume its powers would be civil and not involve criminal sanction. Other questions include what would its powers of investigation and discovery be, and how would its sanctions regime differ from the existing processes and sanctions under the Approved Persons Regime? Thought needs to be given to the circumstances in which an individual could be disciplined under any Code where their actions did not involve a reportable regulatory breach. It is also arguable that the creation of a third regulatory body would introduce increased complexity for both the supervisors and the institutions without any corresponding benefit that could not be achieved more efficiently through other means.

Scope of application

The Code of Conduct, and its Council, would require a clearly defined scope in terms what types of institutions it would apply to (effectively addressing the core question, 'what is a bank?'), what account would need to be taken of the international nature of banking, and how it would apply to organisations and individuals.

As noted above, a universal Code, applying to all banks, would seem to be the best way forward. Consideration, however, would still need to be given to how a Code would work in the context of overseas banks operating in the UK, and how it would apply to organisations as a whole and the individuals who operate in them.

Banking and the International context

Any proposal in this area would need to take account of the international nature of banking in the UK. This is not just in respect of ensuring the UK's attractiveness as a place to do business, but also in ensuring a level playing field for both UK and overseas banks operating here.

The UK remaining an attractive place to conduct business is vitally important and, although some may view any Code of Conduct and its Council as potentially adversely affecting the

attractiveness, this need not be the case. A well-formulated proportionate approach to any Code and Council should, in fact, enhance the attractiveness of the UK as a place to do business. If the application of the Code raised standards of professional conduct and enhanced trust it should attract companies, capital and clients to the market. In this respect, parallels can be drawn with the UK law and judicial system, which draws people to London by virtue of the confidence in which it is held. Similarly, the UK approach to, and high standards of, corporate governance actively attract foreign companies and investors to the UK market.

Ensuring a level playing field between UK and overseas banks must also be an important consideration. However, it is not an insurmountable obstacle, as UK and subsidiaries of overseas banks are already regulated by the FSA and subject to UK law. Consideration may have to be given to how the Boards of such subsidiaries approach their duties but there is no prima facie reason why the Code could not operate effectively. There are further questions regarding how the Code would apply to branches of overseas banks operating here, how it would apply to the overseas operations of the UK banks and how it may interact with local requirements. These points would require further careful consideration.

Organisations and Individuals

There are various options as to what the scope of the Code of Conduct and the Banking Standards Review Council should be, in terms of which individuals it would apply to. As noted above, adhering to proper standards of business conduct should apply to all working in the banking industry. However, not all employees within the banking industry are engaged in banking activity; for example, banks employ large numbers of individuals in Human Resources and Information Technology. One option therefore is for the individuals within scope to be those undertaking defined activities, for example traders or those selling financial products to retail customers. However, this would likely develop into something very similar to and perhaps ultimately indistinct from the Approved Persons Regime. It would also require detailed rules and guidance as to who exactly was covered, and this could create gaps and risk missing key individuals, particularly as banking activities and practices develop over time.

Another approach would be for the Code to apply to all individuals working in banking. This would recognise that how individuals and firms conduct themselves is a universal responsibility. There is a risk, however, a standard Code applied universally may end up being based on the lowest denominator of commonality and give no recognition of individual roles and responsibilities, or may be a disproportionate burden on individuals who have, for example, no customer interaction or who take no risks. A means of overcoming this would

be for a universal code to apply to all firms, but for firms to be entitled to adapt the standard model to their circumstances. Firms would implement according to their individual business activities and staff profiles. The Code would also be placed within the context of employment contract. Firms should also be required to report on how they have implemented the Code and the Council would be able to make judgements on how it is being implemented, hold firms to account for their decisions and, dependent on powers, require firms to make changes.

Monitoring and reporting

As noted above, any Code of Conduct would need to include details on the expectations of the bank Board and senior management, the systems, controls and incentive structures, and the individuals. Any Code and associated governance arrangement would be unlikely to successfully raise standards and restore trust if there was no monitoring or reporting.

Monitoring and reporting naturally divides into two aspects, the internal and external. To be effective, the internal aspect would require the Board and senior management to receive relevant high quality information of the implementation and operation of the Code. The provision of such management information focusing on conduct would enable the Board and senior management to monitor performance and make any necessary operational changes to ensure that standards are maintained. This is clearly in line with their existing governance responsibilities.

The external aspects of monitoring and reporting would be key in terms of rebuilding trust. There are therefore a number of options in this area which are worth considering. One option is that the reporting could be to the Review Council. This reporting could be used in assessing the overall conduct of business and the potential areas of improvement. In the event of regulatory involvement, it could also be used to inform the overall approach to a firm's supervision by helping the regulatory authorities identify any areas of weakness and helping them assess the overall culture of the firm.

Another option reflects the truism that transparency is key to creating trust. Given this, there is perhaps merit in considering a wider, more transparent reporting requirement. For example, firms could be required to publish some form of report on how the Code is implemented, monitored and reported on. This would allow both the regulators and other stakeholders to take a view on how the Code has been implemented and the overall culture of the firm. An added advantage of this approach is that it may create a momentum around raising performance to meet the market leaders and best practice levels.

It would have to be decided what would have to be reported above and beyond a simple compliance statement. This could include it setting out the key performance metrics that would have to be reported. The reporting could further include, for example:

- A description of the company Board and senior management's role in relation to the Code
- To whom the Code applies to and how this application varies according to role, including how these variations are decided
- How the Code is promulgated and monitored
- The systems for reporting
- How the controls and incentives framework support the Code
- How training and development programmes support the Code, including quantified metrics on training and continuous professional development
- How the Company uses professional qualifications and bodies to support the Code
- The levels of compliance with the Code and/or breaches of it
- The disciplinary procedures around the Code and how they were used throughout the reporting period

Whistleblowing

A further aspect to the upholding of ethical and professional standards is whistleblowing. Many banks already operate a whistleblowing system, in some cases operated independently of the bank by a third party. A Banking Standards Review Council could offer guidance on effective whistleblowing systems, and could provide a route for those who felt that standards of conduct were not being upheld to report these concerns by, for example, operating its own whistleblowing system.

The role of assurance and investigation

Although transparency and reporting may engender a degree of confidence, they may not be sufficient on their own to rebuild trust. This therefore raises questions regarding what level of assurance and potentially investigatory powers would be necessary.

There are a number of options in this area beyond simple self-assessment. These include:

- Self-assessment combined with some sort of self-certification (for example, by the internal audit), or attestation to the Review Council.
- A regime of voluntary assurance, whereby individual banks would not be required but encouraged to obtain external assurance at regular intervals, or explain why not. This approach is already used for example in relation to board effectiveness reviews, which under the Financial Reporting Council's Corporate Governance Code should be externally facilitated at least every three years.
- Assurance or verification could be mandatory, but with banks permitted to select who would supply this service.
- Assurance or verification could be part of the external audit process. This would require discussion with the accounting industry and the audit standard setter to understand what is expected and achievable in this context.

All of the above options would need careful consideration of the practical issues and how the process would work, the level of burden and cost it would impose on organisations and the nature of the benefits arising. One possibility would be that the Banking Standards Review Council would allow each bank to choose the relevant mechanism but be entitled to request a change.

This power to request change might be key to the credibility of any Review Council. There are also questions regarding what powers of investigation are necessary. Ultimately, these powers or lack thereof would form part of its statutory underpinning and its relation with the existing regulatory bodies. However, the FSA already conducts thematic reviews and has the power to request a 'Section 166' review and therefore there may be existing tools available in this area.

Enforcement and disciplinary procedures

The FCA has explicitly stated that in the future it will focus more on the concept of 'a credible deterrent' and with any additional Code of Conduct and Review Council there are questions regarding what disciplinary powers, if any, there should be; and who would fall within its remit.

If the Code's role was to raise standards primarily through reporting, transparency and assurance, it may be sufficient for the Council to have only limited direct enforcement powers. For example, it could require greater assurance from a firm if it felt that the level of reporting was inadequate or the content of the report caused concern. This would leave the

primary disciplinary mechanisms of firms and individuals with the regulatory authorities through the High-Level Principles, APER Regime and SYSC Rules. At the same time, the regulatory regime and approach could be strengthened or extended as discussed above, including potentially a requirement in some way to take account of the Code of Conduct or the Review Council's view on individual banks or behaviours.

During the course of the Parliamentary Commission's work, however, a number of people have commented that any new approach to ethical and professional standards would need the facility to 'strike people off' or 'blacklist' individuals to prevent them working in the industry.

As noted above, the existing APER regime already has the ability to withdraw permissions and make judgements on the fitness and propriety of individuals carrying out the relevant specified function covered by the regime. Within this existing regime, it is hard to conceive of a situation where an individual would have their authorisation withdrawn following proven misconduct but subsequently be approved to hold another significant influence or customer function. In addition, as noted above, the individual banks and the regulatory authorities could work together more effectively to ensure that if an individual resigns before an internal misconduct enquiry is completed by a bank that this is recorded in the withdrawal form and subsequent references.

However, this may be regarded as being insufficient or ineffective and it may be considered that more needs to be done in terms of setting up a 'register of bankers' that individuals could be removed from or some sort of 'blacklisting' be possible with the aim of preventing an individual from working in the banking sector (and perhaps all of financial services).

The setting-up of such a register would need careful consideration of a range of factors.

Firstly, there would need to be consideration of which individuals should be on such a register, and how it would differ substantively from the existing, or potentially extended, Approved Persons list. There would also have to be consideration about how such a list, if separate, would relate to the Approved Persons list to avoid duplication or contradiction.

The next question would be the fundamental one of on what grounds an individual would be struck-off or blacklisted and how this would differ from breaches of the existing regulatory or legal requirements. If they had breached more than one, there would be a further question of precedence, particularly between any Banking Standards Register and the Approved Persons list. One potential extension of an existing concept would be that the withdrawal

form or references could be lodged with the Review Council and that they may use this to develop some form of list that could be checked against.

If these questions were addressed, the disciplinary procedure would also require careful consideration of the need to preserve the concept of natural justice, due process, burden and standard of proof and the right of appeal. There are also clearly significant issues around how any regime would interact with employment law and Human Rights legislation, which need thorough investigation and consideration.

4.B A Bottom-up approach

The 'bottom-up approach' is one that focuses primarily on the individuals employed in the banking industry. In some respects, this approach can be seen as analogous to that seen in accounting, legal and medical professions. The focus on the individual recognises that they are the 'first line of defence' and that by raising their professional standards the industry as a whole would benefit and this would contribute to the restoring of trust.

There are a variety of potential options in how a bottom-up approach could work, and in how these could work in conjunction with both a strengthening of the existing regime and a 'top-down approach'. It should also be recognised that there are already a number of initiatives in this area, such as the work by the Chartered Bankers Institute and the Professional Standards Board ('CB:PSB'). The work already done in this area would need to be taken into account to avoid unnecessary duplication of activity.¹¹ There are also a number of Institute and Educational organisations looking at the area of professional education and training, such as the *ifs* School of Finance and the Chartered Institute of Securities and Investments. They have initiatives and programmes in progress and these should be taken into account.

There are a number of options in this area that could contribute to the raising of standards and the rebuilding of trust. The bottom-up approach is one that could be used particularly effectively to support both the strengthening of the existing framework and the top-down approach discussed above.

Training and Development

Banks already devote significant resources to the training and development of employees and they are already looking at how this could be developed further in relation to professional standards. For example, one UK bank has already committed to 50,000 of its

¹¹<http://www.cbpsb.org/>

staff obtaining the Foundation level qualification of CB:PSB. Effective training and development focuses not just on the passing exams and the attainment of qualifications, but also on continuous professional development and reinforcement through behaviours and culture. This is also something that many banks are actively developing and implementing. There may be value in considering what further work could be done in this area by the banks and whether there was scope for them to develop collectively an agreed approach to training and development that would seek to raise standards across the industry.

While the on-going work should be viewed as a positive development, there remain questions regarding whether such industry-led initiatives would be credible. An option could therefore be for the regulatory authorities to consider whether they should set out guidance or requirements around professional development and training. This is something FSA already does in certain areas, for example in relation to the requirements, discussed above, relating to providing financial advice under the RDR initiative. Any extension of this role would naturally raise questions around what would be the scope of such a regime (including how it would apply to different activities in banking), what the new authorities would expect in monitoring and reporting, and how any enforcement or sanctions regime would apply. Such a regime would have to be complementary to the existing FSA requirements around ensuring the skill and diligence is applied and that Approved Persons have the necessary skills and experience to discharge the role.

A Professional Standards Body

Consideration may need to be given as to the development of a board whose remit extended further than training and development. As noted above, the Chartered Bankers Institute and a number of banks have already developed a Professional Standards Board and a professional code of conduct for individuals (see Appendix 4). This Code is currently supported by a Foundation Standard Course for individuals. This focuses upon professional knowledge and skills, professional values, attributes and behaviours. The current focus of this work is on the retail and commercial banking sector.

Another potential option may lie in developing more coherence to the professional standards and training industry through the broadening out of the Professional Standards Board. Currently, while there are a number of different bodies doing positive work in this area, there is no overarching body that recognises them all.¹² Its relationship with the FSA and any reporting requirements would need further consideration. A further option would be that if

¹² Different bodies have different status. For example the *ifs* School of Finance has the ability to award degrees by virtue of its recognition by the Privy Council, whilst the Chartered Institute of Securities and Investment, whilst also holding a Royal Charter, does not have degree awarding powers.

some form of Banking Standards Review Council was formed, as described above, its remit could include the oversight and development of professional standards and the various training providers. In either event, the focus should be on ensuring that the level of training and qualifications are appropriate to the role performed. A more 'catch-all' approach would risk being disproportionate, not take proper accounts of the different areas and roles in banking, and potentially ultimately counter-productive, as it likely not focus enough attention on those roles and individuals where the needs were greatest.

In order to elevate the Professional Standards Board various issues would have to be addressed. It is likely that in order to be credible, the body's governance would have to demonstrate a high-degree of independence from the industry. This would mean, for example, that its governing Board would have to be at a minimum chaired by someone independent of the banking sector and would have to include a number of similarly independent Board members. This is already the case with the Lending Standards Board¹³, whose Board includes public interest members. There are also questions around its exact role and status within the regulatory framework, many of these are similar in nature to the issues discussed under the 'top-down' approach.

A further issue, as discussed above, is the question of whether there should be a register or blacklist.

A holistic approach

An increased focus on training and development will be a necessary part of any effort to raise standards. However, a regime focused on the individual, requiring them to observe certain standards of behaviour and conduct, would not be effective if the organisations that employ them operate a culture that works against these standards. Therefore, careful consideration would need to be given to how this would be overcome and what could be done either to strengthen the existing regulatory framework or adopt a top down approach, as discussed above. In effect, the raising standards using a 'bottom-up' approach is likely to be a necessary but not sufficient step to raise standards and restore trust.

If it is considered by the Parliamentary Commission that both a 'top-down' and a 'bottom-up' approach is needed, then a further question is whether the two initiatives should be progressed separately, with the establishment of a Banking Standards Review Council and a Professional Standards Board, or combined and a single body given responsibility for upholding both ethical and professional standards.

¹³ <http://www.lendingstandardsboard.org.uk/staffdirectors.htm>

British Bankers' Association

January 2012

APPENDICES

Appendix 1 – Approved Persons Principles

- Statement of Principle 1 - An approved person must act with integrity in carrying out his controlled function.
- Statement of Principle 2 - An approved person must act with due skill, care and diligence in carrying out his controlled function.
- Statement of Principle 3 - An approved person must observe proper standards of market conduct in carrying out his controlled function.
- Statement of Principle 4 - An approved person must deal with the FSA and with other regulators in an open and cooperative way and must disclose appropriately any information of which the FSA would reasonably expect notice.
- Statement of Principle 5 - An approved person performing a significant influence function must take reasonable steps to ensure that the business of the firm for which he is responsible in his controlled function is organised so that it can be controlled effectively.
- Statement of Principle 6 - An approved person performing a significant influence function must exercise due skill, care and diligence in managing the business of the firm for which he is responsible in his controlled function
- Statement of Principle 7 - An approved person performing a significant influence function must take reasonable steps to ensure that the business of the firm for which he is responsible in his controlled function complies with the relevant requirements and standards of the regulatory system.

Appendix 2 – FSA High-Level Principles

- 1) Conduct its business with integrity.
- 2) Conduct its business with due skill, care and diligence.
- 3) Take reasonable care to organise and control its affairs responsibly and effectively, with adequate risk management systems.
- 4) Maintain adequate financial resources.
- 5) Observe proper standards of market conduct.
- 6) Pay due regard to the interests of its customers and treat them fairly.
- 7) Pay due regard to the information needs of its clients, and communicate information to them in a way which is clear, fair and not misleading.
- 8) Manage conflicts of interest fairly, both between itself and its customers and between a customer and another client.
- 9) Take reasonable care to ensure the suitability of its advice and discretionary decisions for any customer who is entitled to rely upon its judgment.
- 10) Arrange adequate protection for clients' assets when it is responsible for them.
- 11) Deal with its regulators in an open and cooperative way, and must disclose to the FSA appropriately anything relating to the firm of which the FSA would reasonably expect notice.

Appendix 3 Section 172, Companies Act 2006 – Directors' Duties

Directors to act in good faith, in a way that would be most likely to promote the success of the company (Directors' Duties under Section 172 of the Companies Act 2006 set out in Appendix [X]), for the benefit of its members as a whole, and in doing so have regard (amongst other matters) to:

- (a) the likely consequences of any decision in the long term;
- (b) the interests of the company's employees;
- (c) the need to foster the company's business relationships with suppliers, customers and others;
- (d) the impact of the company's operations on the community and the environment;
- (e) the desirability of the company maintaining a reputation for high standards of business conduct; and
- (f) the need to act fairly as between members of the company.

Appendix 4 - Chartered Banker Code of Professional Conduct

I will demonstrate my personal commitment to professionalism in banking by:

1. Treating all customers, colleagues and counterparties with respect and integrity;
2. Considering the risks and implications of my actions and advice, and holding myself accountable for them and for the impact these may have on others;
3. Complying with all current regulatory and legal requirements and following best industry practice;
4. Treating information with appropriate confidentiality and sensitivity;
5. Being alert to and managing potential conflicts of interest which may arise whilst performing my role;
6. Developing and maintaining my professional knowledge and skills; and
7. Acting, at all times, in a fair, honest, trustworthy and diligent manner.