The voice of banking & financial services

Parliamentary Commission on Banking Standards
- Written evidence from the British Bankers' Association -

Introduction

1. The British Bankers' Association (BBA) welcomes the opportunity to make this written submission in response to the initial call for evidence issued on 26th July by the Parliamentary Commission on Banking Standards. The BBA represents 220 banks from 50 countries on UK and international banking issues.

2. The remit of the Commission is to consider and report upon: the professional standards and culture of the UK banking sector, taking account of regulatory and competition investigations into the LIBOR rate-setting process; the lessons to be learnt about corporate governance, transparency and conflicts of interest, and their implications for regulation and Government policy; and to make recommendations for legislative and other action.

3. The initial call for evidence identified a broad range of issues within this remit. We have aimed to provide a clear initial response to these issues and, in the limited time given to respond to the 26th July notice, to identify a number of additional steps that could be taken to reinforce professional standards within banks. We look forward to contributing further to the Commission's review as its deliberations progress.

4. A separate review of the framework for the setting of LIBOR is also in process under the chairmanship of Martin Wheatley, managing director of the FSA and Chief Executive-designate of the Financial Conduct Authority. The BBA has undertaken to engage fully on the review and plans to reply formally to the consultation fully within the four week deadline. We will also reflect on the observations and recommendations of the Treasury Committee.

Opening summary

5. Based on the questions set in the preliminary call for evidence we have adopted a broad perspective in this response. The points made in response to the individual questions can be summarised as follows:

   - The Parliamentary Commission's review takes place against an already substantial reform programme. Bank capital and liquidity standards have been vastly increased, reliance on wholesale funding reduced, and UK banks have been at the forefront of meeting these new standards; the FSA is being divided into a prudential regulator and a conduct regulator; the Bank of England is being given a better defined responsibility for financial stability and new macroprudential tools; banks are being required to reorganise their retail activities into a separately capitalised and run entity overseen by an independent Board; and changes are being made in corporate governance, risk management, remuneration and recovery and resolution planning.

   - Banks recognise that the incidence of product mis-selling and other compliance failures in recent years have significantly damaged the reputation of the industry and must be definitively addressed. Their long-term interests are aligned to ensuring products are fit for purpose in the first instance and that that all employees act with integrity in the normal course of business and in their dealings with customers and regulators, which the vast majority already do. The reorganisation implied by the advent of dual regulation by the PRA and FCA and the introduction of retail ring-fencing as required by the Independent Commission on Banking will of themselves require a reappraisal of culture, values, governance processes, incentives and expectations.

- Since the financial crisis the FSA has stepped up its Significant Influence Function (SIF) process and has adopted a far more intrusive approach to senior appointments; it would seem natural with the move to 'twin peaks' regulation for the Financial Conduct Authority to apply a more rigorous approach than previously to roles most relevant to business conduct.

- Training and competence falls within regulatory scope and of itself is the subject of considerable change. Under the Retail Distribution Review (RDR), for instance, the implementation of higher minimum qualification standards for retail investment advisers, including bank advisers, by the end of 2012 will underpin a step change in the promotion of professionalism across the investment advice sector.

- We would see it as a natural step for thought to be given to whether there is, more generally, a sufficiently strong compliance and risk management ethos and expectation of ethical standards espoused as part of relevant Board practices, internal corporate statements, training and codes of conduct, and the FSA's high level principles; also whether compliance and risk management ethos and ethical standards can be linked in more tangible terms to daily responsibilities and duties.

- The enforcement of sanctions in the event of fraudulent or unprofessional behaviour is integral to the maintenance of professional standards. The FSA already has extensive regulatory enforcement powers and the Serious Fraud Office (SFO) and Crown Prosecution Service (CPS) have responsibility for prosecution of criminal fraud offences. The new National Crime Agency will also provide more effective operational coordination for economic crime. We are keen to build on this and would support a firmer approach to enforcement.

- In determining what further steps are necessary we would see merit in the Parliamentary Commission considering whether current powers and measures already in train will fill the gap; also whether shortcomings are a result of statutory or regulatory deficits or a result of regulators and law enforcement agencies not utilising the powers already available to them as fully as they could.

- Our response to the questions set by the Commission builds upon these themes and identifies a number of areas where professional standards could be reinforced through additional steps in these areas. These initial thoughts are drawn together in our response to question six and illustrated in Appendix 1. The measures identified draw upon broader changes being made to the legal and regulatory environment in which banks operate and include suggestions specifically relating to the promotion of professional and ethical standards.

Question 1: To what extent are professional standards in UK banking absent or defective? How does this compare to (a) other leading markets (b) other professions and (c) the historic experience of the UK and its place in global markets?

6. Professional standards in the UK banking industry are defined by a combination of:

- Statutory provision, e.g. in the form of directors' responsibilities and duties as set out in the Companies Act 2006;
- Listing Rules 'comply or explain' requirement in respect of the Corporate Governance Code;
- The FSA's SIF process and the Approved Persons Regime for senior executives and non-executives;
- The FSA's Training and Competence regime for employees carrying out specified activities with retail customers and other FSA Handbook requirements including COND, PRIN and SYSC;
- Relevant provisions within professional qualifications; and
- Further industry-based guidance and training.

7. The FSA's SIF regime exists to enable the regulator to exercise material influence over the running of a financial services firm in relation to the regulator's objectives, including or even particularly in relation to a firm's safety and soundness and its fair treatment of customers. The FSA assesses whether individuals are suitable for senior roles and oversees the appointment process by the firm. Pre-financial crisis, the authorisation process operated more as a register and judgements about individuals were based solely on probity; the aim since has been for the SIF process to become more intrusive and for the regulator to play a more active part in assessing suitability for holding a key oversight function and technical competence.

8. In revising the SIF process, the FSA determined that it would focus on the Chair, the senior independent director, the chair(s) of the Audit and Risk Committee(s) and on the principal executive functions – the CEO, finance director and chief risk officer – with the need to interview other individuals judged on a firm-specific basis. Under the regulatory regime being introduced under the Financial Services Bill currently before Parliament, the Prudential Regulation Authority (PRA) will have responsibility for running the process in respect of these roles, for those firms subject to dual regulation, with the involvement of the Financial Conduct Authority (FCA), which will also have a veto; and the FCA will lead the process for all other authorised roles, including those most relevant to business conduct and treating customers fairly, both retail or wholesale.

9. The role of the regulator however is to create boundaries within which banks and other regulated entities take responsibility for their own decisions. This includes the mix of skills and qualifications which they expect to see around their Board table and amongst their staff. Bodies such as the CFA Institute, the Chartered Institute of Bankers in Scotland, the Chartered Institute for Securities and Investment, the Chartered Insurance Institute and the Institute of Financial Services include ethical standards within their professional codes as do other professional bodies whose members have a significant representation in banking and financial services – the six UK accounting institutes, the Law Society and the Institute of Directors. Where the individual's expertise is not based on professional qualification, then it is incumbent upon the firm to ensure that they receive an appropriate induction which should include grounding in the firm's and the regulator's ethical, prudential regulation and conduct of business requirements. Ensuring staff competency across a bank or other financial services firm is also a matter of regulation and the FSA sets the standards of training and competence that firms are required to reach. Further work on key aspects of this is currently being undertaken and as of 31/12/12 the increased regulatory focus given to staff competency will be backed up by the introduction of closer monitoring of professional standards based on quantified data.

10. But it needs also to be appreciated that diversity is also important. Technical expertise alone, for instance, is not the sole characteristic of a good non-executive and other skills and backgrounds offer an important counterbalance to 'group think'. The imperative

therefore is to have the right mix of skills, experience and technical expertise not only in banking and financial services, but law, accounting, risk management and other, unrelated disciplines if the individual has other attributes from which the firm would benefit. A modern bank or financial services firm therefore has a need to draw upon a broad range of skills and expertise and a further factor to bear in mind is the global nature of the financial services sector hosted in the UK and its international workforce.

11. There are however clearly roles in which the clear achievement of a professional standard or some other form of training and competency is likely to be appropriate at a management level. Under the RDR, for instance, the implementation of higher minimum qualification standards for retail investment advisers, including bank advisers, by the end of 2012 will underpin a step change in professionalism across the investment advice sector. Retail investment advisers will need to attain a Statement of Professional Standing from an FSA accredited body and undertake a mix of structured and unstructured continuous professional development under new FSA rules.

12. We would see it as a natural step for thought to be given to whether there is a sufficiently strong compliance and risk management ethos and expectation of ethical standards espoused as part of:

    a) Board composition, competences and practices;
    b) The foundation courses of most professional qualifications and internal corporate statements, training and codes of conduct; and
    c) The FSA's high level principles which require integrity, skill, care and diligence, building relationships of trust with both customers and regulators, and so on.

13. There would also be benefit from a more tangible linking of compliance and risk management ethos and ethical standards to governance processes and the daily responsibilities and duties of all employees - particularly line management. Given London's role as a host to a large international banking sector we believe that whilst it might be difficult for regulators to mandate a detailed syllabus it should be possible for regulators to set a clear expectation of the behaviours that would be expected in key staff.

14. In regard to paragraph 12a) above, the Financial Skills Partnership has commenced a project intended to produce a resource which would aim to provide a sector-wide benchmark for standards around Board composition, competence and cultural lead and which we believe has the potential to provide at least a useful sector-wide reference point for reviewing Board practices to see whether they are conducive to setting the right strategy, culture and focus on compliance requirements and customer needs. This project has been in planning for over 12 months and formally got underway in May. Whether from the perspective of the training and professional standards requirements under the RDR, the move to dual regulation or preparing for ring-fencing it could not have been better timed in terms of the changing environment in which banks find themselves.

15. Professional standards, and where they sit within the training and competence of the 1.4 million people working in banking and financial services in the UK need to be aligned to the broad nature of financial services in question and the more integrated way in which financial services are provided. Households and businesses have access to a far broader range of financial services than was the case in past decades and the skills involved in delivering modern banking services are much broader than may have been the case in the past. We also work in an environment in which 97% of the population hold a bank account. Customer needs therefore are very different to the days in which a local branch manager provided simple deposit, safe keeping and basic lending services

mostly to the middle classes. While we fully accept that a return to core values and a renewed customer-focus lies at the heart of several legislative and regulatory initiatives we need to make sure that all aspects of such initiatives are tailored to the modern environment and the demands placed on banking by households and businesses including SMEs not necessarily as prevalent in previous decades.

16. The enforcement of sanctions in the event of fraudulent or unprofessional behaviour is integral to the maintenance of professional standards. It should further be recalled that the Financial Services Act 2010 provided the FSA with greater enforcement powers. The FSA has the power to fine authorised persons and approved individuals for misconduct. The 2010 Act extended these powers to enable the FSA to suspend or limit an authorised person's permission or an approved person's approval. It also enabled the FSA to impose a fine on an individual performing a controlled function without approval in addition to being able to prohibit the individual from working in the financial services industry. It also included provisions in respect of the disclosure by the FSA of decision notices.

17. It is further relevant to note that the Serious Fraud Office has responsibility for prosecuting in the case of fraud and on 30th July confirmed that it considered existing criminal offences to be capable of covering conduct in relation to the alleged manipulation of LIBOR and related interest rates. The Government also outlined plans to improve the investigation and prosecution of fraud cases through the "Fighting Fraud Together" strategy. As a signatory to the strategy, the banking sector is working closely with Government to support its delivery. In addition to the Fraud Act, the enforcement agencies have powers available to them under the Proceeds of Crime Act, the Bribery Act or the Competition Act. It may be therefore that a strategic assessment is needed of the uses of these powers.

18. It is also the case that the Companies Act was updated in 2006 to provide that directors (including directors of banks) must act in a way most likely to promote the success of the company for the benefit of its members as a whole and in doing so must have regard to:

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

19. This enshrined common law procedure and enables Court action where the directors are viewed as having been negligent or in breach of duty. The Government is currently consulting upon whether, for banks, there should be a rebuttable presumption that directors of failed banks should not be viewed as fit and proper for a senior management position in another bank and whether criminal proceedings should be possible for a new offence of recklessness.

20. We are firmly of the view that notwithstanding the less intrusive approach to regulation which characterised the FSA's initial approach, the legislative and regulatory standards applying to UK banks - and the reputation that we have built for acting upon both international agreed principles and EU legislative requirement - mean that the UK regulatory requirements are seen as matching those in existence in other developed economies. Further additional reforms are being undertaken at a UK level which we do not expect to be replicated elsewhere – not least the introduction of a ring-fence division

between retail and investment banking - and we therefore believe that the starting point for the adoption of new measures should be an appraisal of the application of existing mechanisms. Effective supervision, with supervisors willing and able to challenge, and regulatory enforcement and the application of existing criminal sanctions are important components of the regulatory regime.

21. There has been a substantial increase in the FSA's Enforcement outcomes and penalties over the last two or three years and its general effectiveness, which had previously been lacking. The FSA has now become internationally acclaimed for being able to successfully investigate and prosecute highly challenging and large scale cases such as sophisticated criminal insider dealing rings, complex market manipulation cases and boiler room frauds. This success has in part been due to the joint partnership approach adopted by the FSA with the industry.

Question 2: What have been the consequences of the above for 9a) consumers, both retail and wholesale, and (b) the economy as a whole?

22. It needs to be appreciated that in some cases the conduct failures currently being reported took place before measures intended to improve compliance, the supervision of compliance and the renewal of focus on professional standards. That said, there have in recent years been too many instances of mis-selling and other compliance failures. We would very much endorse the observations made recently by Lord Turner in 24th July speech 'Banking at the Crossroads: Where do we go from here' that much greater emphasis must be given to ensuring that banking products are fit for purpose from the outset. Consumer redress is not a substitute for this. While the primary responsibility for this must rest with banks themselves, we also believe that the introduction of product intervention powers within the Financial Services Bill currently before Parliament provides an opportunity for the regulator to work with firms on a more constructive basis than has previously been the case. The Sergeant Review of Simple Financial Products also bears much promise and merits a collective participation to carry it forward from Government, regulators, the industry and consumer groups.

23. The result of recent market failures has been hostility towards banks on the part of many and the potential for damage to the UK economy since a modern economy is founded upon a depth in financial services. The uncertain environment which regulatory enforcement action creates can only have a detrimental effect on the attractiveness of the UK as a place from which to conduct financial services. Financial crimes against banks and their customers also have a bearing on confidence and while significant investment has been made in strengthening defences there is more that can be done including through partnership between industry and government.

24. The exuberance in banking and some other financial services in the lead up to the financial crisis also contributed substantially to the economic downturn which followed, though we would maintain that it is inappropriate for NIESR and others to assign exclusive responsibility for all of the economic downturn to the financial crisis as opposed to building in an element in respect of the economic cycle.

Question 3: What have been the consequences of any problems identified in question 1 for public trust in, and expectations of, the banking sector?

25. The public loss of confidence in banking is palpable. This results from actions within the industry and the industry needs to take decisive action – and be seen to be taking decisive action – to achieve higher standards not only of regulatory compliance but good and reliable customer service. We agree with Lord Turner when, in the speech referenced above, he observed that much of the responsibility for restoring public trust in

banking must lie not with the regulators but with the leadership of banks – a point which must be undeniable. But we also agree that regulators, politicians, consumer groups and society at large have a part to play and would recognise as a matter for public debate what he described as the constraints under which banks operate and the need to 'honestly debate a crucial trade off'.

Question 4: What caused any problems in banking standards identified in question 1? The Commission requests that respondents consider (a) the following general themes:

- **the culture of banking, including the incentivisation of risk-taking;**
- **the impact of globalisation on standards and culture;**
- **global regulatory arbitrage;**
- **the impact of financial innovation on standards and culture;**
- **corporate structure, including the relationship between retail and investment banking;**
- **the level and effectiveness of competition in both retail and wholesale markets, domestically and internationally, and its effects;**
- **taxation, including the differences in treatment of debt and equity; and**
- **other themes not included above.**

26. If there is a common theme running through the items listed here, it is that many factors unwittingly combined to incentivise outcomes which can be seen to have contributed to firm and system-wide financial instability.

    - While there is little doubt that remuneration policies and practices pre-crisis failed to keep pace with innovative banking activities and as a result failed to reflect risk – and arguably have incentivised it – there are also grounds for saying that the EU, and the UK in particular, has not only acted upon but gone further than internationally agreed measures. For the example, the remuneration aspects of the RDR, through the implementation of adviser charging for retail investment advisers, designed to remove negative incentives, go much further than the anticipated MIFID 2 reforms.

    - The failure to develop and implement a consistent regulatory framework for an increasingly internationally active industry led to numerous instances of regulatory arbitrage which can be seen as drivers and amplifiers of the conditions which led to the financial crisis and should serve as a warning as we contemplate the implementation of the new regulatory structure. To limit such incentives in the future the UK should continue to act as a strong proponent for equivalent implementation around the world of internationally agreed rules and standards.

    - The question implies that financial innovation should in some way be viewed negatively. While it is undoubtedly the case that innovation complicates the control process and its regulation, it has also provided the means of bringing financial products to market that have removed substantial risks from business and households – ranging from foreign exchange and interest rate risk management, to the hedging of commodities prices, fixed rate mortgages and specialised insurances. There is however a need to find a means within the new regulatory framework to achieve a more stable platform for both service providers and consumers, while permitting the benefits of well-grounded financial innovation to be realised. This requires further work on the development of a suite of highly transparent, simplified products but also the agreement of a process around product intervention.

- We believe that the problems caused through the inter-relationship between retail and investment banking can be overstated since an evidenced-based view of the financial crisis shows that financial losses arose across the entire banking spectrum, from more traditional retail and commercial banks, big and small, through to building societies, universal banks and pure investment banks. This said, the Government's proposals for ring-fencing include provisions for the ring-fenced entity to have its own independent Board charged with establishing a culture appropriate to the retail-orientation of the business. It is incumbent therefore upon banks with significant retail and SME business to review their cultures, values and service provision in light of the financial stability objectives which sit behind the introduction of ring-fencing. This is in addition to the more general reassessment of risk and risk management taking place under the banking reform programme more generally.

- With the RBS sale of 318 branches and regional SME centres to Santander, the Lloyds Banking Group 'Verde' sale of 632 branches and key brands including TSB, and the advent of new entrants into the market place – Tesco, Metrobank, Virgin Finance, M&S, Asda - plus the prospect of other non-traditional service providers, we can expect to see a healthy injection of competition into UK retail banking. On the investment banking side, the UK already benefits from a market presence of more firms than most other countries.

- Taxation is a major driver of incentives and therefore of outcomes which are often at odds to the stated regulatory or supervisory objectives. The most obvious example relates to the differences in the treatment of debt and equity for tax purposes. Whilst a continued objective of prudential regulation has been to encourage greater holdings of equity the tax code continues to incentivise firms to fund themselves with debt.

and (b) weaknesses in the following somewhat more specific areas:

- **the role of shareholders, and particularly institutional shareholders;**
- **creditor discipline and incentives;**
- **corporate governance including**
    - **the role of non-executive directors**
    - **the compliance function**
    - **internal audit and controls**
    - **remuneration incentives at all levels**
- **recruitment and retention;**
- **arrangements for whistle-blowing;**
- **external audit and accounting standards;**
- **the regulatory and supervisory approach, culture and accountability;**
- **the corporate legal framework and general criminal law; and**
- **other areas not included above**

27. We would comment as follows on the specific areas identified in the initial call for evidence:

- The Stewardship Code was introduced by the Financial Reporting Council (FRC) in 2010 with the aim of using transparency to encourage institutional investors to engage actively in the corporate governance and due process of the companies in which they invest other people's money. We see the Kay Review of UK Equity Markets and Long-Term Decision Making, published this July, as a natural extension of this and believe that relevant aspects for investors (and also firms themselves) should be acted upon. The issues raised of course are not specific to banks and financial services.

- A perceived benefit of the 'bail-in' regime is that the potential loss in the event of resolution of a failing institution is that it will result in significant senior creditors, such as fixed income bond holders, taking a more active interest in the financial stability of the banks in which they invest.

- The Walker Review, reporting in November 2009, made 38 specific recommendations aimed at strengthening the corporate governance of UK banks and other financial industry entities. These required implementation by either the FRC, through review of the Corporate Governance Code or other FRC guidance, or the FSA through its supervisory approach, handbook rules or guidance. Walker was substantially about improvements to corporate governance in the areas identified in the question including Board effectiveness and qualification, the governance of risk, enhancing the disciplines around remuneration and, additionally, improving engagement on the part of institutional investors and fund managers. The FSA has also taken a closer interest in Board governance.

- The EU, and the UK in particular, has moved further than internationally agreed principles of remuneration and measures so far embedded in the Capital Requirements Directive have been built upon by the FSA's remuneration framework which aims to promote sound and effective risk management and greater symmetry between the economic incentives of individuals and shareholders (and backed up by measures enabling remuneration and dividend restrictions in the event of financial difficulty). In his final speech as FSA CEO, on 24th April, Hector Sants observed that 'too often reward structures continue to encourage short term-gain and excessive risk-taking', that senior executives' annual remuneration in the past had tended to be heavily influenced by operating profit, earnings per share growth and return on equity as distinct from return on assets and prudent management of leverage and that he wished to see firms place greater weight on non-financial performance measures, particularly the fair treatment of customers, in determining an individual's compensation

- The Public Interest Disclosure Act 1998, supported by relevant employment law, provides a framework of legal protection for individuals disclosing information in order to expose malpractice and matters of similar concern. It is based upon information being of the right type in order to be viewed as a 'qualifying disclosure' and being made to the right person and in the right way in order to make it a 'protected disclosure'. Qualifying disclosures include information concerning criminal offences, financial malpractice, impropriety or fraud, the failure to comply with a legal obligation, miscarriages of justice, professional malpractice, improper conduct or unethical behaviour, conflicts of interest without disclosure, health and safety, environmental damage and deliberate attempts to cover up any of these. Employment contacts and employee manuals or handbooks set out the procedure for making a protected disclosure and it is in the interest of firms to ensure that the arrangements are robust and work in practice. Our assessment is that the legal protections in respect of whistle blowing are sufficient and that banks have put in place procedures to reflect the intention of the legislation. There may, however, be a case for policies to be reviewed with the aim of ensuring that they are as operational as they need be, whether in terms of being communicated in clear terms, offer suitable reassurance and provide necessary details of who to contact outside of line management if necessary. FSA guidance and contact details would appear suitably accessible.

- While we would agree that the International Accounting Standards Board needs to complete its revision of IAS 39 on financial instruments, in respect of recognition and measurement, including own credit, expected loss provisioning and hedging, we do not believe that an evidence based comparison of IFRS and UK GAAP preceding the adoption of IFRS in 2005 supports the view that the international standards adopted are inherently inferior to IFRS. Similarly, while we support certain measures to strengthen auditing, such as the strengthening of the role of the Audit Committee, requiring periodic competitive tendering under the Corporate Governance Code and the re-establishment of the auditor-banking supervisor dialogue, we are of the view that other measures proposed e.g. by the European Commission in its 2010 audit green paper may potentially result in a weakening of the audit process, a lower level of assurance in respect of risk management processes and a loss of accountability.

- The approach to banking regulation and supervision is already the subject of radical change, nowhere more so than in the UK, where the FSA's move towards a more intrusive, judgement-led approach to supervision is being built upon through the introduction of 'twin peaks' regulation in which a designated focus will be given to both prudential regulation and financial conduct regulation. This will involve a further change in the responsibility assigned to both regulators and it is essential that they step up to the plate. As expressed in connection with the Financial Services Bill, however, we share the concerns of others about whether the accountability and due process arrangements being built into the regime match the responsibilities being assigned.

- As explained above, the Companies Act 2006 was updated to give a clearer set of responsibilities to directors in respect of a broad range of stakeholders; HM Treasury is currently conducting a consultation 'Sanctions for the directors of failed banks' which asks the question of whether the directors of failed banks should be presumed not to be fit and proper to undertake a similar role, underpinned by a clarification of their management responsibilities and relevant regulatory duties, and whether there should be a criminal offence in respect of 'recklessness' or other forms of underperformance, though the consultation also draws attention to the practical difficulties involved.

Question 5: What can and should be done to address any weaknesses identified? To what extent are such weaknesses subject to remedial corporate, regulatory or legislative action, domestically or internationally?

28. As outlined in our response to the preceding (and following) question, the banking industry and financial system generally has been the subject of a wide variety of reform initiatives since the outset of the financial crisis, some of which have now been adopted, but are still bedding in, some of which are still in the final stages of development and some of which are still subject to final decision-making. Our preliminary suggestions in terms of what can and should be done to address weaknesses in respect of the specific areas outlined in question four would include:

- While ostensibly not within the scope of a Commission on Banking Standards, we see an imperative need for the completion of the 'bail-in' regime and see this, and the special resolution regime, as one of the cornerstones of the banking reform programme. Establishing the means by which we can be said to have reached the point at which no bank need be viewed as 'too important to fail' constitutes a fundamental shift in the relationship between banking and society. The Commission therefore should lend its influence to ensuring that maximum priority is given to the completion of an appropriate bail-in regime across the European Union. While the prospect for this looks good, the draft Recovery and Resolution Directive is still at a relatively early stage in terms of it legislative passage.

- The Commission may care to consider in particular the overlapping relationship between companies legislation, the FRC's Corporate Governance Code, the FSA's Approved Persons Regime and principles as embodied in professional standards and industry-based guidance and training and whether there are fundamental gaps in these arrangements and/or there are specific changes in provision or execution which may improve their effectiveness.

- It will soon be three years since Sir David Walker published his final report. Given its clear relevance to the Commission's remit, there would seem merit in calling for a post-event evaluation of the recommendations made, the extent to which they have been acted upon and their expected effectiveness.

Question 6: Are the changes already proposed by (a) the Government, (b) regulators and (c) industry sufficient? Respondents may wish to refer to the Financial Services Bill and the Government's proposals for the Banking Reform Bill. They may also wish to refer to proposals by the Bank of England and the Financial Services Authority on how the Financial Policy Committee, Prudential Regulation Authority and Financial Conduct Authority will operate in practice.

29. As the question implies, there are very significant changes already being made to the UK regulatory framework, the structure of firms within the industry and the way in which the regulatory authorities go about their work. An appreciation of the extent of these changes, many of which are being taken forward under an international or EU umbrella, is a prerequisite to the question of whether further measures are necessary.

30. Key reforms include:

- ***Capital and liquidity****:* strengthening the quantity and quality of capital. Substantial increases under Basel III -and CRR and CRD IV – with minimum requirements to be supplemented by a capital conservation buffer, a further surcharge on large and complex organisations – bringing minimum Tier 1 capital to 9.5% - and a countercyclical buffer of up to 2.5%; also the introduction of a Leverage Ratio as a backstop and a greater emphasis on stress testing. For the first time globally applicable quantitative liquidity standards are being introduced in the form of a Liquidity Coverage Ratio (LCR) and a Net Stable Funding Ratio (NSFR). A review of capital requirements for instruments held in the trading book is currently underway. These changes are fundamental in scale and when taken together with the prospective addition of bail-in debt place banks on a substantially different footing to where they stood pre-financial crisis. The UK – whether in terms of the regulatory authorities or the banks themselves - is at the forefront of acting upon these changes. Reliance upon wholesale funding has also been reduced (a process encouraged by the structure of the UK bank levy which draws a distinction between long and short term funding).

- ***Crisis management:*** a number of regimes, including the UK, have put in place a statutory regime enabling the exercise of a number of tools to enable an orderly resolution of a failed institution to take place pre-insolvency; in the UK this intertwines with the FSA's Proactive Intervention Framework (PIF), the preparation of Recovery and Resolution Plans by individual institutions and the planned introduction of measures aimed at further enhancing primary loss absorbing capacity, including through the introduction of a 'bail-in' regime for bondholders and senior creditors. UK plans to introduce retail ring-fencing take this a considerable step further through requiring a substantial restructuring on a ‘business as normal’ basis.

- ***Deposit guarantee schemes:*** many jurisdictions, including the EU, have raised substantially their deposit guarantee limits, additionally removing co-insurance on the part of the depositor, and have improved the efficiency with which their deposit guarantee schemes could make compensation payments. The scheme remains industry funded and discussions are advanced in the EU on the introduction of an element of pre-funding so that there is a pool of working capital available in the event of need.

- ***Banking supervision:*** Many jurisdictions have taken the view that banking supervision needs to be more intensive than had been the case in the period directly preceding the financial crisis. In the UK, this includes the adoption of a more judgement-led, strategic approach under the FSA’s enhanced supervision programme and a strengthening of cross-border cooperation. At an EU level this has been supported by the formation of the European system of supervisors and will be underpinned by the adoption of a single rulebook to be drawn up by the European Banking Authority.

- ***Conduct of business regulation:*** it is also the case that the UK is moving towards a ‘twin peaks’ form of regulation in which the Financial Conduct Authority will be given designated responsibility for conduct of business regulation across retail and wholesale markets. This will build upon customer-focused initiatives undertaken in recent years and give more bite to regulatory activity in respect of conduct. A key facet of this will be a more interventionist approach with the regulator seeking to identify emerging threats of customer detriment at an earlier stage as opposed to simply ensuring customer redress after the event.

- ***Retail Distribution Review:*** the implementation of higher minimum qualification standards for retail investment advisers, including bank advisers, by the end of 2012 will underpin a step change in professionalism across the investment advice sector. Retail investment advisers will need to attain a Statement of Professional Standing from an FSA accredited body and undertake a mix of structured and unstructured continuous professional development under new FSA rules. The new adviser charging requirements will see a fundamental change in how remuneration is set for financial advisers. The level of remuneration will, in future, be agreed between the customer and their adviser, rather than set by product providers by way of commission as is often the case now.

- ***Macroprudential regulation:*** the UK is in the process of establishing a Financial Policy Committee within the Bank of England with responsibility for deploying macroprudential limits on the banking system and monitoring risk within the financial system as a whole. At an EU level, the European Systemic Risk Board has been given a more limited mandate but will have responsibility for assessing system-wide risk in a way which ties in with enhanced oversight envisaged under the EU’s Shadow Banking initiative. A consultation on the macroprudential tools to be made available to the FPC is due shortly.

- ***Corporate governance and risk management:*** banks are substantially strengthening their corporate governance arrangements and in some jurisdictions, including the UK, greater emphasis has been placed on risk management through measures such as the establishment of a Board-level risk committee and the appointment of a senior, independent Chief Risk Officer (CRO). Changes were made to both the FRC Corporate Governance Code and the FSA Approved Persons Regime following the Walker Review. EU reforms on remuneration under CRD III have been fully implemented.

- ***Market infrastructure:*** There have been substantial improvements in market infrastructure and transparency through encouraging derivative trades to be centrally reported and/or cleared through central counterparties. These measures will reduce counterparty risk and interconnectedness between financial institutions.

- ***Other regulatory reforms:*** there are other significant changes which relate to credit rating agencies, hedge funds, securities markets and other aspects of governance, including accounting and auditing.

26. These changes will change substantially the environment in which banks operate and the incentive structures implicit to their business and reward structures. The very substantial changes to the capital and liquidity regimes alter fundamentally the economics of different lines of business and align cost much more closely to risk. The crisis management measures change substantially the paradigm in which banks operate and make it entirely clear to shareholders, senior creditors and management that no bank will be viewed as being too important to fail and in the process ensure that financial stability, regulatory compliance and fiduciary duty is central to the Board decision-making process. The need for more intrusive supervision is widely recognised and in the UK we are giving the regulators additional macroprudential tools and the means of ensuring that separate attention is given to prudential supervision and conduct of business considerations. This has been backed up by corporate governance and risk management changes and other market infrastructure and regulatory reforms intended to reduce the prospect of systemic risk.

27. We believe that it would be entirely consistent with the strategic objectives of these reforms to ask whether more can be done to ensure that firms internalise the shift in priorities implied and put in place processes intended to ensure the maintenance of professional standards at all times. This would have several aspects and could imply the following additional specific steps beyond those already being acted upon or in the final stages of development:

    1) Completing the final elements of the changes to capital and liquidity standards and implement further remuneration changes in hand.

    2) Ensuring that a review of culture, values, responsibilities and incentives lies at the heart of the reorganisation required through the introduction of retail ring-fencing and the dual regulatory focus on prudential supervision and conduct of business in the UK including support for the Financial Skills Partnership in its initiative to create a sector resource on Board composition, competence and practices.

    3) Building upon the FSA's renewed emphasis on the SIF process and Approved Persons Regime with a more broadly scoped approach to regulatory vetting for key roles, including by the FCA, and also to the regulators satisfying themselves that directors and key staff are assigned the right roles and responsibilities.

    4) Building upon the increased emphasis placed on ethics within professional qualifications for retail investment advisors through an increased emphasis upon Board oversight of the competence and training programmes in place for all staff and review on the part of the regulatory authorities.

5) Entering into dialogue with the Government and the regulatory and law enforcement agencies on strategy in support of the utilisation of enforcement powers in instances of professional misconduct including the use of existing powers within existing legislation, whether the Fraud Act, the Proceeds of Crime Act, the Bribery Act or the Competition Act.

6) Completing work on the proposed presumption that the directors of a failed bank are not viewed as suitable for similar positions in other financial institutions and, subject to overcoming the practical difficulties, the introduction of a new criminal sanction for recklessness. Of course, care must be taken not to discourage candidates from taking on directorships in challenging circumstances.

7) Ensuring that the advent of the FCA – and the Sergeant Review of Simple Financial Products – puts in place a regime in which there are more checks and balances within the system so as to ensure products are fit for purpose in the first instance than to rely upon post-event customer redress. Simple outcomes, however, can require complex structuring under the surface.

8) Conducting a three-year evaluation of the Walker Review, changes then made to the Corporate Governance Code and Approved Persons Regime, and company practice to see whether a further initiative is need to redouble compliance.

9) Reviewing whistle blowing procedures to ensure that they are not only legally compliant but operational in practice.

28. It is further relevant to note that, although not specific to banks, the Kay Review of UK Equity Markets and Long-term Decision Making published on 23rd July proposes the development of the Stewardship Code with the aim of incorporating a more expansive form of stewardship which would include a focus on strategic issues, corporate governance and long-term decision taking; the report also reinforces the view that fiduciary standards should be applied to all relationships in the investment chain independent of the classification of the client and looks to apply more generally the expectation that directors' remuneration should relate incentives to sustainable long-term business performance.

Question 7: What other matters should the Commission take into account?

27. As outlined above, banking reform measures currently underway, whether in terms of capital and liquidity standards, the new macro-prudential capability invested in the FPC, the configuration of UK banks, other financial stability measures, or the way in which the new UK financial authorities plan to conduct themselves, will significantly alter the way in which banking is organised, regulated and supervised in the UK. This programme commenced shortly after the onset of the financial crisis – at international, European and national level – and taken together the measures will result in a very substantial shift in primary obligations, values and incentives. But many of the reforms have been in place for only a short period of time or are still in the process of finalisation.

28. The task for the Parliamentary Commission therefore must be to sift through these measures and to ask which should be viewed as largely having completed the job – but need more time for implementation or bedding down – and which can be said to fall short or otherwise require reaffirmation or strengthening. The question therefore is whether the answer lies in additional statutory powers or responsibilities on behalf of the various authorities (and enforcement agencies involved) or in the provision of a strong Parliamentary steer towards a greater utilisation of powers and responsibilities which may already exist.

29. The raising of professional standards is integral to the change process currently being conducted within the banking industry. We have therefore sought to look at the reforms being undertaken with this in mind and to draw together further actions which could be taken to bring about a step change consistent with ensuring that as banks emerge from this period of change there can be greater confidence in their having the right value structure and the practical tools of ensuring that this is upheld by all staff.

British Bankers' Association
22 August 2012

APPENDIX 1: GOVERNANCE AND PROFESSIONAL STANDARDS IN BANKS

	SHAREHOLDERS	BOARD AND RISK FUNCTIONS	COMPLIANCE CULTURE	COMPLIANCE AND INTERNAL AUDIT	REGULATORS	PROFESSIONAL STANDARDS
Current position	Large shareholders engage actively with banks. It is envisaged that the bail-in arrangements for senior creditors will increase the active involvement of debt holders.	Boards set the tone for the whole of the company through risk appetite. Board level committees consider key reputational risks through Committee structure. Risk functions set risk policies and authorise risk limits on different parts of the business. The FSA has recently undertaken reviews of Board governance at banks.	Staff understand the importance of a compliance culture and importantly this forms an element of their remuneration. Staff have accessing to a whistle blowing regime which is taken seriously by senior management.	Compliance has a role to play in ensuring compliance with legislation and internal policies and procedures. Internal audit is last line of defence and key for ensuring that internal policies and procedures are adhered to.	Responsible for ensuring firms have the right systems and controls in place to be able handle issues.	Legal obligations on directors including fiduciary duties Firm responsible for ensuring directors and employees have right attributes and competencies for role FSA vetting for SIFs and Approved Persons Professional standards through external qualification relevant to role and responsibilities or internal training
Recent changes	Stewardship Code	Walker Review	Remuneration changes	[Is one of the international bodies currently undertaking a review.?]	Enhanced supervision, twin peaks regulation and changes to SIF process Approved Persons	Minimum standards for retail investment advisers and the monitoring of standards by the regulator under the

					Regime	Retail Distribution Review; further emphasis placed on ethics by chartered institutes
Scope for development	Kay Review of UK Equity Markets and Long-term Decision Making	Post-Walker evaluation Financial Skills Partnership Board composition, competency and behaviour initiative	Remuneration changes Whistle blowing procedures		Greater emphasis on checks and balances to ensure that financial products are market compliant than post event consumer redress Greater emphasis on conduct roles in the SIF regime and the approved persons regime	Regulatory oversight of the prevalence of professional qualification and/or competency Tie-in between individual ethics and responsibilities, company values, regulatory principles and shareholder expectations