



# Banking Standards Review

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## A letter to the Chairmen

Sir David Walker, Chairman, Barclays

Douglas Flint, Chairman, HSBC

Lord Blackwell, Chairman, Lloyds Banking Group

Geoffrey Howe, Chairman, Nationwide

Sir Philip Hampton, Chairman, Royal Bank of Scotland

Lord Burns, Chairman, Santander

Sir John Peace, Chairman, Standard Chartered

May 19 2014

Dear Chairmen,

You asked me last September to develop plans for a professional body to promote high standards in banking. I am now sending you my recommendations.

In the intervening months, my colleagues and I have interviewed executives in banks and building societies of every shape and size in order to inform our ideas. We have also spoken to Government, regulators, academia, industry, existing providers of qualifications and training, trade associations, and consumer and employee groups. In addition, we have talked to professional bodies in other walks of life to learn how they operate.

I published a consultation paper in February, looking for comment on my initial thoughts. This generated nearly 200 constructive responses, which in turn have significantly shaped the recommendations I am sending you today.

My conclusion is that there is a strong case for a collective effort to raise standards of behaviour and competence in the banking sector, and that the best way to deliver this is by setting up a new and independent body to drive the process forward.

There are big challenges to be overcome. The new organisation will be funded by the banks, but must remain independent of them. It must cover the whole banking industry if it is to be credible, but also recognise that there is very little in common between a small building society and a large investment bank. It must complement rather than confuse the work of the regulator, and it must rely on voluntary support rather than statutory backing for its ideas. I have tried to address these and other issues in the report that follows.

Raising standards of behaviour across this large and complex industry will require determined leadership by you and your colleagues, and is bound to take time. But my strong recommendation is that work should get under way immediately, and that the present momentum should be maintained and accelerated.

The next steps should include setting up an independent panel as soon as possible, in order to appoint the Chairman of the new organisation and approve the Chief Executive. Direct approaches should be made to a wide range of banks and building societies in order to secure their support. A detailed business

plan needs to be developed, and the subscription levels for different types of institution must be agreed. Dialogue should continue with the regulators in order to ensure that the new body is aligned with their activities.

I am grateful to you for the free hand you have given me in producing these recommendations. I am happy to do what I can to help in the coming months pending the appointment of the Chairman.

Finally, I would like to recognise the energy and flair of my colleagues in this exercise: Tom Barham of RBS, John Gall of Nationwide, Tom Sleight of Lloyds Banking Group, and Sabrina Sheridan, who kept the show on the road. I am very grateful to them all.

A handwritten signature in dark blue ink, reading "Richard Lambert". The signature is written in a cursive, slightly slanted style.

Richard Lambert



## What the Banking Standards Review Council will do

The objective of the Banking Standards Review Council (BSRC) will be to contribute to a continuous improvement in the behaviour and competence of all banks and building societies doing business in the UK. It will act as an independent champion of better banking standards in the UK, and be driven by the interests of customers and of the wider group of stakeholders with a concern for the well-being of the British banking system.

The recommendations set out in this document propose that it will do this by:

- Requiring participating banks and building societies to commit to a programme of continuous improvement under the headings of culture, competence and customer outcomes, and to report back on their performance to the public every year.
- Setting standards of good practice. That means identifying activities where voluntary standards would serve the public interest, and working with practitioners and relevant stakeholder groups to come up with agreed procedures. Examples could include whistleblowing protocols, the approach to retail sales incentives, banks' processes for handling small businesses in distress, or the management of high-frequency trading.
- Publishing an annual report setting out where progress is being made both by the sector and by individual banks and building societies, and where more needs to be done.
- Having a meeting once a year with non-executive directors or, in their absence, risk or reputation committee chairs of the larger banks and building societies to discuss the institution's progress relative to the previous year and to its peers.
- Working with the industry and its stakeholders to develop a single principles-based code of practice in alignment with the high-level principles now being considered by the regulators.
- Identifying and encouraging good practice in learning, development and leadership, with a particular focus on behaviour and ethics.
- Helping the banks to meet the obligations being placed on them by new legislation, such as the Certified Persons regime.
- Working with the professional bodies already active in the banking industry to increase the value placed on professional qualifications.

## What it will not do

- The BSRC will not act as a lobbyist for the banks and the building societies.
- It will not absolve the leadership of banks and building societies from their prime role in raising banking standards, and it will not attempt to do the work of the regulators.
- It will not handle customer complaints.

## Introduction

The consultation process has generated a substantial response, and widespread support for a new organisation dedicated to raising banking standards in the UK. The volume and tone of the submissions suggest that the time is right for such an initiative, and that many banks and building societies, along with the regulators and other interested groups, hope that it will succeed.

Inevitably there are points of disagreement among the different submissions. But most respondents say that the new body should have the following characteristics. It should:

- Have a focussed remit as a champion for better banking standards.
- Be independent of the banks and building societies, and never stray into advocacy on their behalf.
- Be transparent and open at all times. Since it will have no statutory powers, it will only achieve influence through the power of disclosure.
- Focus its efforts more on behaviour than competence in the banking system.
- Avoid duplicating the work of existing organisations that work in this area. It should start with a clear and concise mandate, and build credibility.
- Align its activities with the work of the regulators, and avoid bureaucracy, box-ticking and mission creep.
- Be more concerned with encouraging excellence and responsibility than with discipline, and as a matter of routine comment favourably or otherwise on the progress being made by individual banks and building societies.
- Work with the industry and its stakeholders to set out high-level principles of excellence and responsibility that apply across the banking sector.

These responses have caused the original proposals to be adapted in some important respects. For example, it is clear that the approach to training set out in the consultation paper would have led to bureaucracy and box-ticking, and duplicated work that is already being undertaken in the sector. So this has been changed. Elsewhere, the standard setting proposals have been developed.

There is no dispute about the general proposition that the banking sector taken as a whole has lost the trust of the public, and needs to earn it back.

The reason this matters is that banks and building societies play a crucial role in a market economy and a healthy society. They connect savers and borrowers, provide payment systems and allocate capital. Retail banking is an essential activity necessary for accessing other goods and services, and provides the arteries through which the lifeblood of the economy flows. More broadly, banks perform complex and vital functions in insuring against risk and channelling capital to where it is most needed.

Their role is especially vital in the UK, because of the sheer size of its banking system and the importance to the national economy of London's role as an international capital market.

Banks continued to provide vital services to their customers throughout the recession. But this was outweighed in the public perception by the evidence of poor values and malpractice on a wide scale, and by direct consumer experience of exploitative sales techniques. Too many banks, it seemed, had placed short-term profits and the chase for shareholder value above their role as custodians of institutions with great public responsibilities, with the damaging results that became all too clear six years ago and which are still lingering on today.

Bad news continues to make its way into the headlines: reports of manipulation in the foreign exchange market are only the latest example.

But there is reason to hope that the underlying trends are changing for the better, which they certainly need to do. The tone from the top of the major banks has changed in the past few years, with a greater public acknowledgment of banks' responsibilities to a wide group of stakeholders. The leadership itself has been changed in a number of the biggest institutions. And there is some evidence that all this is having an impact on the front line.

For example, the Financial Conduct Authority (FCA) reported in March that all the major retail banks had either replaced or made substantial changes to their sales incentive schemes, which had played such a major role in the mis-selling scandals of recent years. There is still much more to be done in this area, and in others. But most of the big institutions are now running programmes aimed at recalibrating their priorities and sense of purpose.

The overriding responsibility for improving the behaviour of banks must lie with the leadership of the institutions themselves, operating within the framework set out by the regulators. It is for them to define the values and purpose of the banks which they lead, to appoint and promote people who are aligned with its values, to decide which types of business they are happy to accept and which to turn away, and to do everything in their power to make sure that the tone set at the top reaches all the way down through these often very large organisations.

In the words of the Institute of Business Ethics:

"Culture is ultimately a matter for individual banks and their boards. The new organisation can support them, but the banks alone can develop and embed the desired culture. The new body should seek to avoid tasks which might appear to shift this responsibility away from them, for example by taking on a disciplinary role or by providing outside accreditation arrangements for training programmes which it does not ultimately control."

Without the right kind of leadership, it is clear that little will change. And it is not just the tone at the top that is important. The drive for improvement has to have an impact at all levels of the institution.

Yet the consultation responses also showed support for the argument that as well as decisive leadership from individual banks, there is a strong case for collective action in this area. There are a number of reasons for this view.

The first is that, as we learned in 2008, the banking system has become much more integrated in recent years. Financial trouble in one institution can quickly spread to others. Reputational damage is also contagious, especially at a time when banks in general are held in such low public esteem. The problems of a particular bank or building society may be *sui generis*, but can still flow across to others in the system.

Then there is the way that dubious practices in the run-up to the crisis came to be justified as being the business norm. To quote Warren Buffet, "The five most dangerous words in business may be 'everybody else is doing it'." That was often the argument used, for example, to justify high-pressure sales techniques in retail branches, and it helped to encourage what has been described as a race to the bottom in the decades leading up to the crash. A single institution would find it difficult to reverse this trend: collective action is required.

This is an industry where individuals frequently move from one firm to another, and corporate loyalty tends not to mean much. If the sector as a whole does not attempt to raise the bar for good practice and behaviour, it will again be difficult to bring about change.

By working together, banks can take responsibility themselves for acting in the public interest. Rather than simply relying on the letter of ever expanding rulebooks, they can identify, celebrate and share good practice. Regulators set standards that must be adhered to by everyone at all times. The BSRC's standards, in contrast, will be voluntary and aspirational.

Given the right encouragement and incentives, the banks can change direction and embark on a race to the top, in which integrity and first-class behaviour are seen as what they should be: a powerful competitive advantage.

The fact that the Chairmen of the UK's six biggest banks and its biggest building society wish to take proactive steps in this direction and develop a collective approach to the challenge is itself significant. Between them, they are responsible for a large proportion of employees in the UK banking industry, and they are looking for change. The size and breadth of the response to the review consultation tells a similar story.

There is also a clear public interest in a collective approach to raising banking standards in this country. A loss of trust in the sector, as has been said, has serious economic and social consequences. And the UK's role as an international banking centre is an important source of comparative advantage to the country, and one that would be damaged by a continuing wave of scandals.

Moreover an over-reliance on statutory regulation, as opposed to voluntary action, will tend to reduce competition and build barriers to entry and innovation in the sector.

A collective approach requires widespread participation across the banking industry. The Parliamentary Commission on Banking Standards had no doubt about the importance of this point. In its words:

"An important milestone on the road to the successful development of a professional standards body would be that it could claim comprehensive coverage of all banks with operations in the UK. If banks were to decline to assist in a body's development, or to seek to resile from participation in due course, the credibility and effectiveness of the body would be significantly damaged."

The message here is clear. A decision by major banks or building societies not to engage with the BSRC would be a decision to diminish its chances of success before it gets to the starting gate.

This document is deliberately aspirational in nature. It is informed by the belief that the banking sector must voluntarily raise its game if it is to win back trust, and that there is a vital public interest in it doing so.

It sets out the proposed objectives of the BSRC, and the broad principles by which it will operate. There will never be a better moment to launch such a project. Banks know that the public requires change after everything that has happened in the past few years – and that they must take the lead. It is true that business cultures take years to change. But now is the time to raise aspirations, and to build the momentum that will be required for banks and building societies to play their proper role as engines of a healthy society.

So this is a call to action. And the first recommendation is that the BSRC should be brought into life as soon as possible, and seek widespread participation from the banks and building societies doing business in the UK.

#### Recommendation 1

The Banking Standards Review Council should be established with the aim of contributing to a continuous improvement in the conduct and culture of banks and building societies doing business in the UK, and of supporting high standards in the future



## Credibility

There should be no illusions about the difficulty of the task the BSRC will face in influencing the ethical standards of the same institutions that are providing its finance. In order to succeed, it will need to demonstrate its independence and its credibility from the start. And it will have to show that it is willing to set demanding standards, and to speak out when appropriate.

The Parliamentary Commission on Banking Standards made it clear that a new professional body should be funded solely by participating banks, yet remain independent of them (see Appendix A). This report proposes five ways of meeting this objective.

First, the proposed governance structure will put a distance between the banks and building societies and the executive of the BSRC.

The recommendation is that a small panel should be established to appoint the Chairman of the new organisation, which is likely to be a company limited by guarantee. This panel will be completely separate from, and independent of, the new organisation itself. It might include a senior central banker but no one from the commercial banking business itself, together with highly respected figures from other areas of public life. The panel will also ratify the Chairman's choice of Chief Executive.

All senior positions will be publicly advertised.

The governing Council of the BSRC will be small enough to be manageable, which means around 12 people including the Chairman. It should include bankers, to bring knowledge of, and credibility with, the sector, but they will always be in a minority – no more than three or four. Other members will bring a real understanding of a bank's full range of stakeholders – for example, people who are familiar with the interests of investors, consumers, employees, small business people, large corporates and the like. Council members will be acting in their personal capacity, rather than as representatives of particular interest groups.

The quality of the Council will be critical to the BSRC's success. The precise background of its members will be less important than the strength of their personalities and their integrity. There will be rigorous protocols for addressing conflicts of interest.

The mission of the Council will be to act in the public interest. It will not see itself in any way as an advocate for the banks or building societies.

At the outset, Council members should be appointed for different lengths of office – say, from two to five years – to ensure continuity over time. Below the Council will sit an executive management team that will run operations on a day-to-day basis.

The second support for the BSRC's independence will lie in the way that its budget is structured, which must ensure that the organisation can undertake its work without compromise.

The proposal is that the institutions will agree to provide funding for the first three-year period, and on a three-year cycle thereafter. The Council members will be responsible for overseeing the budget and for proposing necessary changes – if, for example, it seemed appropriate for the BSRC to broaden its mandate. The banks, as funders, will need some protection against dramatic increases in budgets. One way to achieve this might be to agree that the Council's finance and audit committee should always be chaired by one of the bankers on the Council.

Third, the BSRC will be transparent and open in everything it does. This will be integral to achieving credibility. Among other things, it should invite a thorough assessment of its own performance, perhaps

every five years, led by a respected independent figure. And although it will not be accountable to parliament, it should encourage the Treasury Select Committee to challenge its work on a regular basis.

Fourth, the BSRC will seek to reinforce its independence and credibility through its approach to disclosure. Its annual report will measure the progress of banks and building societies in winning public trust. It will include a list of any issues that have been raised over the year and the action taken to resolve them. It will comment on the progress, or lack of it, made by individual banks and building societies in their efforts to raise standards over the year. This will be an industry-wide report so it will not just confine its comments – favourable or otherwise – to the performance of banks that have agreed to take part in the project.

Banks and building societies will need to be challenged by the agenda that is to be set out by the BSRC, and by its publishing policy. If it is doing its job properly, it will make them feel uncomfortable if they fail to meet their commitments. Disclosure is a powerful tool, but only if it is exercised.

As part of its disclosure programme, the BSRC will also be seeking to identify and champion good practice in different parts of the banking sector.

Fifth and last, the BSRC will seek to engage with, and win the support of, banks and building societies of every shape and size that are doing business in the UK. As the Parliamentary Commission on Banking Standards made clear, the strength and breadth of the membership will be a key determinant of its credibility.

It has got off to a good start with the support of the biggest UK banks and building society. But it will also want to bring in the challenger banks and smaller building societies, and in order to make that possible will ensure that the cost of participation for small institutions is modest. It will seek to win over the big investment banks and as many as possible of the foreign banks doing business in the UK, all of which have an interest in the well-being of the City of London.

A consistent communications strategy will play an important role in building credibility over time. The BSRC should be clear about what it intends to achieve, and be transparent in all its activities. It should find ways to differentiate between those banks and building societies that have agreed to support its efforts to improve performance, and any that have not. And its annual report should provide a full assessment of the progress being made both by the industry and by individual institutions.

By helping to strengthen the reputation of the UK as a place to do banking, by identifying and championing good practice wherever it can be found, and by encouraging banks of all kinds to raise their game, it should present itself as a newcomer with which banks and building societies of all kinds should want to engage.

#### Recommendation 2

The governance, funding and reporting arrangements of the BSRC should underwrite its independence and credibility. It must be transparent and open in all its activities, and seek widespread support from the industry.

## Scope

The consultation paper proposed that the new body should aim to cover all banks and building societies doing business in the UK, irrespective of their ownership and size. Since this was already a very ambitious agenda, hedge funds, insurance companies and components of the shadow banking system would not be included.

This brought a mixed response as well as more general support.

Some argued that the scope was too narrow, and that it should be extended to include shadow banking. Others suggested that it was too wide, and that the new body's efforts would be weakened if it tried to set standards on too broad a front. Those who argued this way usually said that the main focus should be on retail banking.

Some foreign banks suggested that in the mind of the public failings were largely attributable to those banks which had mis-sold retail products: by implication, the new body was not relevant to them. Others said that a step-by-step approach would make the most sense. The new body should initially focus on professional standards in retail banking, and then consider whether it wanted or needed to broaden its horizons.

It would certainly be an easier task for the BSRC to focus its efforts on retail banking, where important efforts to set and raise standards are already under way. These need to be supported and strengthened.

However, the loss of trust in the banking sector is not just the result of the mis-selling of retail products, and the need to raise standards of behaviour is at least as great on the wholesale as it is on the retail side. It was the LIBOR scandal that triggered the Parliamentary Commission on Banking Standards in the first place, and evidence of bad practice and worse in wholesale banking continues to accumulate. Most recently, management of high-frequency trading has come under the spotlight.

If it is to be both relevant and credible, the BSRC has to cover the full range of banking activities.

This is certainly what the Parliamentary Commission wanted to happen. It warned of "the risk that a professional body might concentrate on retail banking rather than wholesale banking", and added that in order to be credible the new body would need to be able to "claim comprehensive coverage of all banks with operations in the UK".

Moreover, and as explained later in this document, the BSRC should have a useful part to play when it comes to implementing the new banking regimes that have been set out under the latest legislation. These will have a significant impact on wholesale banking, which is another reason for the BSRC to engage with this sector of the industry.

Support for the BSRC should not be regarded as an admission of past failures. On the contrary, it should be seen as part of an ambitious commitment to the public interest – to improve customer service, and to help the UK to sustain and strengthen its position as one of the world's great financial centres. Foreign banks, like their domestic counterparts, have an obvious interest in this objective.

It is true that large numbers of foreign banks have gone about their business in London for years in a professional manner, and many of them have not been associated with the failings that have tarnished the sector as a whole. If the BSRC is to win their support, its costs must be proportionate, its approach must be un-bureaucratic, and its work must be relevant.

The same conditions must apply to the small challenger banks and building societies that operate in the UK.

One concern expressed in the consultation responses was that the BSRC might put up barriers to the free movement of international talent in and out of the UK, or to the entry of new competition. The project has been designed to ensure that this will not happen. As explained in the next section, the BSRC will be engaging with institutions rather than with individual bankers, and will not impose any constraints on the movement of people.

The consultation process has led to one important change from the original proposal. This is that it would not be sensible, as originally suggested, to attempt to cover global staff or the international operations of banks. Such an approach would throw up risks of conflict with locally applied codes or regulations and with equivalent bodies overseas, and could create technical problems over cross-border issues in relation to data privacy requirements. So the BSRC's interest should be limited to the UK operations of banks and building societies. They would of course be free to go further if they chose to.

A step-by-step approach to building the initiative makes absolute sense: trying to advance on too broad a front would lead to failure. But so, too, would an agenda that failed to meet the reasonable expectations of parliament and the public. The BSRC will need to cover wholesale as well as retail banking if it is to help rebuild public trust in banking in the UK.

#### Recommendation 3

The BSRC should seek to engage with all banks, both wholesale and retail, and building societies doing business in the UK. Its approach should be aspirational, and it should aim to make the relevant question not "Why would you support such an organisation?" but rather "Why wouldn't you?"

## Institutions or individuals

The consultation brought no clear consensus about whether the BSRC should open its doors to individuals, as opposed to dealing only with their employers: the banks and building societies. Some argued that it was essential that individuals should be included from day one – that banking should be seen as a profession like medicine or the law, in which participants take responsibility for their own professional ethos, and that this should start straight away.

Others said it should never happen. One reason given for this view was that such a move could undermine the existing professional membership bodies in the banking sector, and lead to unnecessary duplication.

A third group suggested that the question of individual membership was not central to the BSRC's mission, which was to raise standards in the banking sector. So the issue should be considered at a later date, if at all.

There would be obvious arguments in favour of the BSRC taking in individual members. That is what the Parliamentary Commission on Banking Standards appears to have had in mind, while academics like Baroness Onora O'Neill stress the importance of people feeling a sense of personal responsibility to their clients and the public that goes beyond the narrow interests of their employer. And the credibility of the new body could be enhanced if senior bankers personally signed up to its mission.

However, there would be real practical difficulties in taking such a step. What would the BSRC have to offer to individual members, and what qualifications would they be obliged to have? How would it go about disciplining poor behaviour, and what kind of appeals process would be necessary to ensure fair play? Would there be a risk of conflict with the regulators, or of creating barriers to entry for overseas talent?

For all these reasons, the recommendation is that the new body should engage with banks and building societies, rather than with individuals. The former is likely to be administratively simpler and command greater public support, and the latter would run the risk of duplicating the work of the existing professional bodies. Whether this should be changed over time is not something that needs to be decided now.

Of course if the activities of individuals within a bank act in a way that falls short of BSRC guidelines, the institution would be expected to take the action necessary to deal with the matter.

There is general agreement that the BSRC should work with the existing professional bodies – in ways suggested later in this document – to shift perceptions of the value of banking qualifications. For many employees in the industry, gaining chartered status or the like is no longer seen as an important part of fulfilling career ambitions. It would be in the public interest to change this view. If such an objective could be achieved, the question of individual membership of the BSRC would no longer be relevant: the existing professional bodies would be doing the job.

### Recommendation 4

The BSRC should engage with banks and building societies, rather than with their individual employees.



## Relationship with the regulators

A number of responses to the consultation stressed the need to spell out the relationship between the work of the new standards body and that of the statutory regulators.

The starting point is that the BSRC will seek to align its activities with those of the regulators, and complement their work rather than duplicate it. Everything it does will be built on the framework of their guiding principles, which are set out in Appendix B.

They are responsible for the prudential regulation, supervision and conduct of the financial system, and they have broad statutory powers to support these responsibilities.

The job of the BSRC, by contrast, will be to highlight and champion good practice in the UK banking industry. It will be concerned much more with excellence and responsibility than with discipline and, as explained later in this document, it will seek to set voluntary standards in areas where statutory regulation would not work.

The regulators have an interest in the success of the BSRC. Martin Wheatley of the Financial Conduct Authority has argued that:

“The traditional regulatory mechanism for dealing with cultural weakness has always been to enhance the rules. To close loopholes in the law as and when they appear. To require more disclosure or compliance with specific processes.

“The problem with this approach is twofold. First: it is ‘static’. So it is closing stable doors after horses have bolted. Second – and perhaps counterintuitively – we know it can encourage the behaviour it seeks to stamp out.

“As an example, if we trace back to around 2005 to 2008, the breeding ground for many of the conduct cases we’re dealing with today – like PPI and benchmark manipulation – we find them occurring in a period that saw Financial Services Authority (FSA) guidance expand by some 27 per cent. In other words, growing the rulebook did not prevent cultural weakness.”

The fatter the rulebooks, the more likely it is that people will choose to be governed by the letter of what is written down, rather than by the spirit of what is intended. Banks will not earn trust simply by following the rules. They have to take moral responsibility for their own actions, and recognise that integrity is not something that can be imposed by regulators.

That is the argument for creating a new body that will help to define, advocate and embed standards of good practice in banking, and for doing it now – in the wake of the worst banking crisis in over a hundred years.

There will be limits to the degree of co-operation between a statutory body and a voluntary association. An important example is the sharing of information. The FCA has a memorandum of understanding with, among others, the Financial Reporting Council to “ensure the timely and focused exchange of relevant information that enable effective co-ordination and co-operation in the necessary areas”. It may be difficult to sign a similar agreement with a voluntary body like the BSRC.

But the FCA should be able to share aggregated, anonymous information – much of which is in practice already in the public domain – which will be helpful to the BSRC when it sets out its annual state of the industry report.

Beyond that, there needs to be some informal exchange of information between the regulators and the BSRC in order to avoid overlap and unnecessary bureaucracy. The BSRC would need to keep the regulators updated on its programme of work in order to avoid this.

The new body's prime point of contact will be with banks and building societies. If it comes across wrongdoing in its work, it will report this to senior management of the institution, which will in turn have an obligation to inform the regulator. The BSRC will be transparent and open in everything it does, and if it believes that a bank is falling short of agreed standards, it will be prepared to say so. Those standards will be based on the guiding principles of the regulators, who should therefore take an interest in any failure to meet them.

The work of the BSRC will complement that of the statutory regulators in a number of different ways.

First, it should develop a single, principles-based code of practice that will provide a template for the whole banking industry. This should be based firmly on the high-level principles that the FCA and the Prudential Regulatory Authority (PRA) are now developing. Among other things, this should aim to guide behaviour in the face of conflicts of interest or of moral ambiguity.

Participating banks and building societies could continue to produce their own sets of codes and values if they chose to do so. But the BSRC model would provide a benchmark against which they would test their own priorities. And adherence to its code of practice should be a matter of interest to the regulators, since it would be drawn from their overarching principles.

It is worth emphasising at this point that according to the FCA, the great bulk of conduct cases brought forward by the regulators are to do with breaches of high-level principles rather than with detailed rules. So these principles are not something to be carved on the walls and then ignored. They must be both relevant and meaningful.

Second, the BSRC should aim to play a useful role in the new regimes that have been created by the Financial Services (Banking Reform) Act, and which are expected to come into force in 2015. One obvious example is the new category of Certified Persons – the many thousands of bank employees who are not at the very top of their firm but who are senior enough to cause significant harm to the bank or to its customers if they fail to do their job properly. The regulators will be consulting on the detail over the rest of the year. But it is already clear that individual banks will have to identify these people themselves, and ensure that they are “fit and proper” for their appointed role.

In making this decision, a bank must take into account the Certified Person's qualifications, training and level of competence. The regimes apply to UK incorporated institutions. But the Government has declared its intention to bring branches of foreign banks and investment firms that operate in London into the net, with the proviso that this might not apply to small branches with few key decision makers based in the UK.

The responsibility will lie with the leadership of individual banks each year to identify Certified Persons and to ensure that they are properly qualified. This responsibility cannot be subcontracted out. But the BSRC can play a useful role in supporting this process, by acting as a clearing house for good practice when it comes to ensuring that Certified Persons have the qualifications needed to be deemed “fit and proper”.

It would do this by working with banks to establish good practice in developing the competence and training requirements of staff covered by the Certified Persons regime. It would liaise with the regulators to ensure that what was being proposed met their requirements. And it would cooperate with the professional bodies to help them design relevant training programmes and qualifications if they choose to do so.

The BSRC will be solely concerned with good practice, and it will be independent both of the banks and the regulators. As a neutral third party it should be able to perform a valuable service by helping to establish good practice in this new area.

In addition, the BSRC will complement the work of the regulators by developing voluntary standards of good practice for participating banks and building societies in ways that are described later in this paper. These will cover areas of activity where statutory regulation is either not appropriate or not possible, and where the public has an interest in a collective approach to high standards of behaviour.

Finally, the BSRC will also complement the work of the regulators by being an active and independent champion of good practice. Its annual report will analyse the progress being made by the industry on the path to higher standards, celebrating success and highlighting areas where more needs to be done. The regulators are in the discipline business: the BSRC will be in the excellence business, but it will be frank and open about the industry's shortcomings as well as its successes.

The BSRC's relationship with the regulators will develop over time, provided it succeeds in building credibility.

#### Recommendation 5

The BSRC will complement the work of the regulators by focusing its efforts on identifying and championing good practice. It should aim to align its work with theirs, and avoid duplication.

## Benchmarking

A prime objective of the BSRC will be to help individual banks and building societies to drive up standards of behaviour and competence through a process of internal and external assessment. With this in mind, one of its main activities will be to work with participating banks to encourage a process of continuous improvement in these crucial areas.

The consultation paper spoke of the need to move decisively away from a world in which behaviour of all kinds had been justified by the claim that it had become the norm. The idea is to encourage a change in direction: to ask each bank to think of ways in which it could aspire to do better, and encourage what would become a race to the top.

Good practice must be seen as a source of competitive advantage for successful firms, even if this involves forgoing profit in the short term. And the trade-off between maximising profits in the near term and building reputation over a longer period has been changed by recent regulatory actions. The level of fines and other conduct costs now being imposed has demonstrated that practices that may inflate profits in the short term can turn out to cause substantial damage over a longer time horizon.

Responses to the consultation brought broad approval for the idea that the BSRC should encourage a process of continuous improvement in this way, and also for the proposal that as part of this process the performance of each bank should be assessed and disclosed under three broad headings: culture, the competence and development of the workforce, and outcomes for customers. This would be an annual exercise for big banks: it could be less frequent for smaller institutions.

The metrics will be derived from, and intended to support, the regulators' high-level principles. These principles are now under consultation, and are set out in Appendix B.

It will not be enough to rely on quantitative measures: qualitative judgements will be needed as well to get worthwhile results. Some have argued that the BSRC should attempt to publish a league table showing the relative performance of banks and building societies, but this is not to be recommended. League tables lend themselves to gaming. And banks are not single entities: assessments will need to reflect different parts of their operations. Qualitative analysis is essential, and the onus will be on the BSRC to provide an assessment process that is seen to be fair by all parties.

The goal of the exercise is two-fold. One is to bring to the bank's leadership as objective an assessment as possible of where the institution is seen to be making progress in improving its performance, and where it still has work to do. Where comparisons are possible, it would help senior executives to know how their firm stood relative to other institutions in particular aspects of their business.

The other objective is for the bank or building society to make a commitment to its wider group of stakeholders about how it plans to manage continuous improvement in its business standards, and then to report back publicly on its progress.

Disclosure is not an objective in itself. The annual reports of big banks now run to several hundred pages, and it would be difficult to argue that the vastly increased size of these documents has led to a much greater understanding of each bank's business.

So this will not be an exercise in pumping out numbers. Instead, the BSRC will work with each participating bank and building society to develop a framework against which it will assess itself and report back to the public. And in its own annual report, the BSRC will comment on the progress or otherwise of the sector as a whole, and of individual banks.

Under the heading of culture, participating banks would be required to provide the BSRC with regular evidence of how well their stated values and codes of conduct were understood by their staff, and how

far they had been embedded in the operations of the business – for example, in recruitment, training programmes, promotion and performance management. The BSRC would also look at the openness of a bank's reporting systems, and how easy and safe it was for employees to raise concerns, including the design and use of whistleblowing procedures. Other relevant issues would include levels of diversity and feedback from employee and union representatives.

In their consultation responses, some banks argued that oversight of incentives should be left entirely to the regulator. But incentives shape behaviour, and are therefore relevant to a new body that is intended to encourage higher standards across the banking system. So the BSRC will take an interest in what good practice looks like in determining the shape of incentive packages in different areas of banking activity.

However, it will not attempt to bear down on the overall levels of compensation. That is the responsibility of the banks' boards, their owners, and in some cases the regulators.

When it comes to the competence and training of the workforce, the new body would look at a bank's recruitment and development processes, including its continuous professional development programmes, and it would also be interested in the proportion of staff that were seeking to achieve professional qualifications.

Above all in this area of training and development, the BSRC would be looking for good practice in encouraging employees to think through ethical dilemmas, and to take responsibility for their actions. Respondents to the consultation argued that ethics cannot be taught in the same way as a foreign language, and that online box-ticking is not the best way to undertake the task. Banks could learn from each other about good practice when it comes to mentoring and providing guidance on ethical issues in the workplace, and the BSRC should facilitate this process.

For retail banks and for building societies, particular weight should be given to the third category of metrics – those that reflect customer outcomes. These would include direct measures such as client surveys and customer feedback of interactions with bank staff, and the process would have to take into account the fact that banks measure their individual performance in different ways.

Trends in the number of customer complaints upheld by the Financial Ombudsman would also be relevant, as would the process of dealing with complaints. Relationships with, and interventions by, the regulators would be taken into consideration, along with the nature and size of any financial penalties or other conduct costs that might have been imposed.

Most of this information would be of the kind that is already being collected by the banks anyway. It would be drawn from internal reports along with staff surveys and interviews, and the intention would be to impose as few extra burdens on the banks as possible. They would be encouraged to include common questions in their internal surveys, in order to facilitate comparisons between different institutions.

The BSRC will also gather information from external sources, such as public announcements from the regulators and consumer surveys. The viewpoint of investors would be relevant, too (see Appendix C). And it should have a budget of its own to undertake surveys of all kinds when that seemed appropriate. It will use this information to validate the bank's internal assessment.

The process would work like this.

The inputs would be collected by the individual bank or building society using a self-assessment framework laid out by the BSRC, and supplemented by any external datasets or research. The bank's report on this material would then be assessed by the BSRC, and published.



The BSRC would as a matter of routine have an annual meeting with independent non-executives from the bank, where they existed, or with the chair of the risk or reputation committee, in order to discuss its assessment. The purpose would be to highlight success and identify any potential weakness.

In its own annual report, the BSRC would discuss the overall progress of the banking sector in these areas, highlighting where progress was being made and where more still needed to be done. And it would also comment on the performance of individual banks and building societies, again focusing on the rate of progress being made and suggesting areas for further improvement.

By publicly committing themselves to this process of continuous improvement, by reporting back on their progress, and by helping the BSRC to provide a constructive challenge to their outputs, the banks and building societies will demonstrate their determination to win back public trust.

Recommendation 6

Banks and building societies will work with the BSRC to raise standards of conduct over time in the ways described above.

The Financial Stability Board published in April a helpful selection of indicators of a sound risk culture. In summary, they are:

- **Tone from the top:** The board and senior management are the starting point for setting the financial institution's core values and expectations for the risk culture of the institution, and their behaviour must reflect the values being espoused.
- **Accountability:** Relevant employees at all levels understand the core values of the institution and its approach to risk, are capable of performing their prescribed roles, and aware that they are held accountable for their actions in relation to the institution's risk-taking behaviour.
- **Effective communications and challenge:** A sound risk culture promotes an environment of open communication and challenge in which decision-making processes encourage a range of views.
- **Incentives:** Financial and non-financial incentives support the core values and risk culture at all levels of the institution.

## Professional Standards

The consultation paper set out six points that would need to be kept in mind when it came to designing voluntary standards for the banking industry. These were generally supported in the responses.

- Standard setting has to be a collective effort if it is to be successful. The argument for developing standards is that banks and building societies want to work on a level playing field, with accepted norms of behaviour.
- One size does not fit all. High-level principles should cover the whole industry, but standards set for the retail side may be irrelevant on a trading desk.
- Where good practices exist, they should be encouraged and strengthened, as opposed to being challenged by new initiatives. There is no point in reinventing the wheel.
- Nothing should be proposed that might impede the development of innovative new competition.
- London is an international banking centre. The free movement of talent in and out of the City should not be constrained by aspirational standard setting. Since the BSRC will be dealing with institutions and not individuals, this will not in practice be a problem.
- The process needs to be challenging, but it must also be kept simple. Box-ticking has to be avoided. The new organisation should start off small, and only add to its activities if and when its credibility grows.

It would be counterproductive for the BSRC to attempt to set specific standards that applied to all the different activities of the banking industry. That would lead to massive complexity, to box-ticking, and to poor outcomes.

Instead, the BSRC should set clear priorities for its standard setting work. It should look for areas of banking activity where legitimate concerns about current practices have been expressed and where voluntary standards would be both practical and helpful. It should focus on issues in which there is a clear public interest and which do not lend themselves to statutory regulation. It will need to collaborate with the regulators as well as with different stakeholders in setting its priorities, in order to determine where its efforts would be most usefully deployed.

The idea is to identify areas where current practices could be improved by collective action, and where the common pursuit of aspirational standards would benefit both banks and regulators and serve the public interest.

It will be up to the BSRC to decide where its priorities lie and it should not attempt to spread its net too widely, especially in the early days. But it will need to make an early start in developing standards, since momentum is important.

The BSRC should own the standards, which will have elements of aspiration within them. Working groups made up of both bank and non-bank members would draw up the standards, and present them to the Council for approval. Participating banks would sign up to conform to the standards, which should be supported by a “comply or explain” formula.

A number of different issues came up during the course of the consultation that might lend themselves to this kind of approach. They included:

Across all segments of the industry: effective processes to encourage employees at all levels to challenge poor behaviour and report any concerns up the management chain; whistleblowing procedures; fair and effective complaints resolution mechanisms; good staff values, incentives and behaviours; good practice in the development of ethical judgment in the workplace.

On the retail side: the approach to sales incentives; treating clients with respect, for example by rewarding rather than punishing their loyalty; a transparent approach to fees. For small and medium-sized enterprises: processes for handling small businesses in distress; clear feedback on lending decisions.

On the wholesale side: bonus clawback procedures; transparent index, benchmark, and price provision mechanisms; governance of behaviour in general; reasonable tests of client readiness to transact complex products; the management of high-frequency trading.

These are intended as no more than initial suggestions. The BSRC would need to consult with a wide group of stakeholders to establish its priorities.

Having selected its priority areas, the BSRC would collect the data necessary for a full understanding of the subject and then work with practitioners and stakeholders to define what good practice looks like in the chosen area. If appropriate, it would turn this work into a standard that signatories would be expected to meet and surpass. All banks and building societies would be asked to report on whether they complied with the agreed standard, and the BSRC would highlight the outcomes in its own annual report.

The standards would need to be kept under review to ensure that they remained relevant in the face of changing circumstances. Over time, the BSRC will aim to raise the bar on its published standards, assisted by feedback from stakeholders.

Of course industry standards are only part of the answer to the challenge of promoting and achieving high ethical standards. In the words of the Committee on Standards in Public Life in its response to the consultation:

“Many of the requirements for high standards require action at an organisational level. But high standards also require individuals to take personal responsibility – by observing high standards themselves, by demonstrating high standards to others through their own behaviour and by challenging inadequate standards when they see them. Mindlessly following rules and processes is not enough if people do not also engage their judgment about what is important.”

Creating that kind of ethos is one of the biggest challenges faced by bank leaders in the years ahead. The BSRC will help them in this process, by identifying and championing good practice, and by challenging them to do better.

#### Recommendation 7

The BSRC should work with the industry and its wider group of stakeholders to identify specific areas of banking activity where voluntary standard setting would benefit customers and advance the public interest. The standards it develops should be kept under review, to ensure that they remain relevant in changing circumstances.

## Training

Three clear messages emerged from the consultation process on the subject of training.

The first was that it would not be a good idea for the BSRC to get involved, as had originally been suggested, in wide-ranging assessments or accreditation of training programmes delivered by external providers or by the banks themselves. Respondents said that other organisations were already doing the job, and there were just too many different training courses on offer to make accreditation possible even if it was desirable.

The second was that the BSRC's focus in this area should be more on standards of behaviour than on competence within the banking system. Of course, the two qualities cannot be completely separated. But as was pointed out in a number of the responses, competence is primarily a technical matter relevant to specific banking roles, and one that is addressed in good measure through a number of regulatory requirements or certificates of practice. Raising standards of behaviour, by contrast, is something for which the banks themselves must take prime responsibility, and where the precise nature of what is required is much harder to define. The task could be helped by a collective effort to identify standards of good practice.

The third message was that the BSRC should seek to work through existing professional bodies in the banking sector, helping to strengthen them where necessary, rather than starting new initiatives itself from scratch.

All three of these messages seem sensible, and have accordingly been adopted in this set of proposals. In its assessment of individual banks, the BSRC will want to understand the progress being made through training programmes to support better standards of behaviour and capability. But rather than engaging in the detailed accreditation or assessment of vast numbers of training programmes, it should be looking for good practice in a number of different areas, and spreading the word.

So the mission of the BSRC should be to identify and champion good practice in training programmes across the whole banking sector, picking out different themes as its programme develops.

The consultation process identified a number of areas where work of this kind could be valuable. For example, a number of respondents argued that ethics cannot be taught in the same way as a technical subject. One way of addressing the subject is by presenting employees with difficult moral dilemmas and asking them to think their way through to a decision they can sensibly live with. Banks can and do attempt to inform these decisions by publishing their own sets of values – “that’s not the way we do business round here”. But too often such values have turned out to be little more than worthy statements with little or no impact on behaviour.

One useful project for the BSRC would be to work with the banks to identify and promote good practice in this area. Can moral dilemmas be worked through online rather than by way of personal guidance from senior managers? That is the approach taken by many big institutions, but online questionnaires can all too easily turn into a superficial box-ticking exercise, to be completed as soon as practically possible. How do other industries address this challenge? Are there lessons to be learnt from the public sector, or from non-governmental organisations? What is the best way of integrating ethical decision-making into day-to-day activities in a fast moving business environment? What do the best programmes look like? There would be a collective interest in raising the bar in this important respect, and there are plenty of other examples for the BSRC to explore in greater detail.

In more general terms, the BSRC will need to be very active in shaping the supply side in all aspects of training, working with groups of stakeholders to drive an enhancement in the quality and therefore the value of training programmes. In their consultation submissions, some banks said that the standards

delivered by external providers needed to be improved, and the BSRC offers an opportunity to address that challenge.

Recommendation 8

The BSRC should work with its different stakeholders to identify and promote good training practice across a wide range of banking activities. Where possible, it should build on existing foundations.



## Relationship with existing professional bodies

Most respondents to the consultation agreed with the proposal that the new institution should provide a canopy under which the other professional bodies that are active in the banking sector would continue to operate and grow. The BSRC will have an interest in ensuring that these organisations raise standards in the development, qualifications and the disciplining of their members. And it could provide a forum where these bodies could discuss common issues or raise concerns with banks and building societies.

This means that the BSRC should aim to support and not duplicate the work of the professional bodies. In the words of one respondent, the new body “could perform a useful role in shifting perceptions of the value of banking qualifications. Currently, for most employees in the industry, gaining or maintaining chartered status (or similar) is not seen as integral to fulfilling career ambitions.”

One big bank put it this way: “Given that the quality of training and qualifications from existing professional bodies varies significantly, we see a role for the new body in raising the bar in this area through establishing the key components to be covered by providers”.

The existing professional bodies are proudly independent and have been in existence for a long time: some have Royal Charters. So they will need to see clear benefits for themselves and their members in any new arrangement. That would come from a collective effort to raise the value of professional qualifications in the eyes of banks and their staff. Success, over time, would result in professional banking qualifications gaining the kind of currency that has been achieved in professions like accountancy. Individuals would believe that they were a necessary pathway for promotion to more senior roles, and their employers would make them a requirement.

Under those circumstances, the professional bodies would grow in status and membership. Their work will not be relevant for all banks and building societies. For example, some of the challenger institutions say they are determined to develop their own people to meet their particular aspirations, and wish to keep themselves apart from traditional banking organisations. But taken across the sector as a whole, the professional bodies do have an important part to play in the effort to raise standards of good practice and competence.

The fact is, though, that the number of people with banking qualifications has fallen over the past 25 years, both as a proportion of what has become a much larger industry and in absolute terms. So although more than 100,000 individuals employed in UK banking today hold a qualification from, or are members of, a recognised professional body for bankers, this is a minority of the total workforce.

The Chartered Banker Institute in its submission listed a number of explanations for this decline, including a general change in banking culture from stewardship to sales; increasing career specialism, which has resulted in fewer generalist bankers with all-round experience; greater use of technology, which has reduced the demand (though arguably not the need) for professional judgment; and the search for cost efficiencies, for example by outsourcing activities linked to customer service and outcomes.

It could be argued that many of these explanations for the falling numbers are themselves the result of trends that have not brought great benefits for customers – and that an effort to create greater value in professional qualifications would therefore be worthwhile.

One issue that has become evident during the course of this review is that the focus on training for bankers tends to lie on the technical requirements of the job in hand. There is often very little emphasis on how that job fits in to the broader activities of the institution, and even less on the broader societal role of banking. In the biggest institutions, large numbers of people work in product silos, without a view of the broader horizon. That is a problem, and one that the professional bodies – which work across broad sections of the whole banking industry – could help to address.

How might the BSRC help to raise the bar?

First, it should work with the industry to decide which professional bodies should be invited to come under its canopy. Should it restrict itself to those with a strictly banking specialisation, or should it – as some have suggested – broaden its remit to include the much wider group of professionals who are active in the banking industry, ranging from lawyers to IT specialists? The first option looks the more practical for the purposes of this exercise.

Second, it should work with the relevant professional bodies to determine how best it can help to challenge, encourage and support them in their efforts. It will be important to involve the banks and building societies, which employ their members, in this work.

Third, it should set broad quality criteria for recognising the professional bodies that chose to go under its canopy, seeking to exert influence without at the same time causing conflict with Royal Charters, educational regulators and the like. It should not seek to accredit individual professional qualifications. But it should provide a forum in which the banks and building societies and a wider group of stakeholders would collaborate with the professional bodies to work out how best to add value to the qualifications and memberships that are on offer.

It is the professional bodies' job to determine the conditions of their membership, and the content of their training. And it will be up to them to decide whether they want to come under the canopy provided by the BSRC. But if they do so decide, the BSRC in return for its independent support will want to be able to nudge them in the direction of the qualities that will add value to their work.

These will include consistency and rigour of qualifications, and some degree of discipline over their own members. This last point is obviously a particular challenge for any voluntary organisation, which is what these bodies are. But if membership is to have real value, unprofessional behaviour by individual members cannot be ignored.

The BSRC will also have a particular interest in the approach the professional bodies take to help their members work their way through ethical dilemmas and assume moral responsibility for their actions. Their work should be aligned at all times with the guiding principles set by the regulators, and with any standards established by the BSRC.

The BSRC will devote a section of its annual report to the progress being made by the professional bodies in changing perceptions of the value of banking qualifications, and strengthening their membership. This will be an opportunity to highlight the good work that is being done, and to identify areas where improvements are necessary.

It will also need to work with the Chartered Banker: Professional Standards Board to build on the standards the CB:PSB is now establishing for bankers at a basic, intermediate and senior level. This is a valuable initiative and a helpful foundation on which the BSRC can build for the future.

#### Recommendation 9

The BSRC should support and not duplicate the activities of the professional bodies, and should work with them and with the banks and building societies to change perceptions of the value of their programmes.

## Organisation and cost

It is envisaged that the BSRC will be established as a company limited by guarantee, with a mission to act in the public interest. Legal advisers are working on the precise details.

An initial estimate is that the body will cost somewhere between £7m and £10m to run in a full year. This is based on the seven sponsoring institutions joining from the outset, and with the variable costs increasing as more banks and building societies became signatories to the BSRC. These additional costs would be funded by the new joiners' fees, although there would be an element of cross subsidy in order to make participation attractive to small institutions. For perspective, this rough cost estimate is broadly comparable with the running costs of the Takeover Panel and the Advertising Standards Authority.

The BSRC should be staffed by a small number of highly capable people. They will have to be able to interact effectively with senior executives and board members of banks and building societies, and their performance will be fundamental to the BSRC's success.

The BSRC will also have a budget to commission surveys when appropriate as part of the benchmarking process, and to track the progress of the sector from year to year.

It will be for the Chief Executive to produce a detailed business plan once the mission of the BSRC has been agreed.

## Next steps

It will be important to keep a sense of momentum behind this project. So in the coming weeks, the seven sponsoring institutions will need to establish the Appointments Panel and get a process for selecting the Chairman under way as soon as possible.

At the same time, the legal structure of the BSRC will be defined in greater detail, along with the roles and responsibilities of the Appointments Panel, the Council and the Chief Executive.

Over the summer months, preliminary approaches will be made to other banks and building societies to seek their support in principle for the BSRC. A transitional team including bank secondees and, perhaps, professional services consultants will start working on the organisational design of the new body, and securing the appropriate infrastructure – office, equipment and so on.

The aim should be for the new organisation to be starting to take shape in the final quarter of this year, with the recruitment under way of a Chief Executive and the first of the Council members. A detailed business plan should be delivered over the same period.

Among early priorities will be the need:

- To agree with the regulators about how best to align the BSRC's work with theirs, and to design a high-level code of practice for the industry.
- To develop a communications strategy, and design the branding that will enable banks and building societies that sign up for this project to differentiate themselves from any that do not.
- To work with the professional bodies already active in banking on ways to add value to professional qualifications.
- To start developing the framework and capability for assessing individual banks and building societies.
- To establish practitioner panels with a view to identifying where standard setting would be most appropriate.

The BSRC should aim to publish a full report on the state of banking standards and good practice in the first half of next year. This will set out its priorities for the following 12 months, and provide the starting point for its first full annual report, covering the performance of the sector and of individual banks and building societies, in 2016. Next year, it will also start identifying and publishing examples of good practice in the industry, and begin to work on its priority areas for standard setting.

## The future

Fast forward five to 10 years and, for just this once, take an optimistic viewpoint.

In this imaginary world, balance sheets of banks doing business in the UK have been restored to health. Credit is flowing through the arteries of the economy in the way that it is supposed to, and British banks have been fully returned to private ownership.

The shape of the industry has changed significantly. Retail banking is very largely conducted online, but physical branches still exist to support individual customers and small businesses. A swarm of innovative newcomers has significantly widened the banking choices available to the public.

On the wholesale side, banks are carrying more equity capital than they had grown used to, and have shed their riskiest businesses. This means their own cost of capital is down, as well their targeted return on equity. As a consequence of all this, bankers' compensation is still high – but not as eye-poppingly so as in past decades.

More bankers have professional qualifications of one kind or another. These are more rigorous and challenging than formerly, and are seen increasingly as a necessary step on the way to a successful career. Bankers at all levels have a clear understanding of the role their institutions play in society, and of their responsibilities.

Banks and building societies want in as visible a way as possible to demonstrate their determination to deliver rising standards of behaviour and capability – because their clients expect them to do no less. Good practice is seen everywhere as a competitive advantage, and the Government does not place mandates with banks that do not publicly commit to meeting and surpassing the accepted industry standards.

London remains at the top of the league table of international capital markets. It faces much increased competition from around the globe, but in an uncertain world its reputation for integrity has turned out to be a powerful magnet. Just as litigants come to London from around the world to see justice done, so international financiers prefer to channel their business through a marketplace they can trust. Other financial centres are beginning to adopt what have become known as the London standards.

The BSRC is seen as an uncontroversial fact of life, like the Takeover Panel or the Advertising Standards Authority. In the event, it has not placed great bureaucratic burdens on the shoulders of participating banks, and it has successfully nudged them along a path of continuous improvement. Banks have not liked being told they were not as good as they thought they were, but this approach has certainly spurred them into action.

The prime drivers of this outcome have been bank leaders, who have recognised that they have to balance the search for shareholder value with their position as custodians of a vital public interest. The regulators have played an important part too, by robustly pursuing their high-level principles but also by insisting that bankers must take moral responsibility for their own actions.

And the Banking Standards Review Council has played a helpful role in this whole exercise. Its annual report is taken seriously for its views of the industry's performance in the past year, and of the sector's current standing with the public. Its standards, which the banks seek to meet and surpass, are providing seriously useful information about the norms of good practice in sensitive areas. The BSRC is confident enough to speak out, when it thinks appropriate, on matters of public interest.

Bankers are no longer embarrassed to say what they do for a living, and politicians have found other footballs to kick.



Is this all too much to hope for? Perhaps. Realising this vision will require an enormous amount of heavy lifting by the banks and building societies in the years ahead, and by everyone who works in them. It will also require a different approach to their customers, and a much broader view of their role in society.

But this is what the public has a right to expect. It is what success would look like. And it is what the country needs.

## Appendix A

### **Framework as set out by the Parliamentary Commission on Banking Standards:**

- There should be no public subsidy for the new body, either directly or indirectly.
- It would need to establish independence from the outset, through its forms of governance and through its personnel at senior levels.
- It should never allow itself to become a cosy sinecure for retired bank Chairmen or City grandees.
- It must eschew any role in advocacy for the interests of banks individually or collectively.
- It should not be seen as a substitute for the regulatory and legislative reforms needed in banking.
- It should not be a monopoly supplier of particular training to the banking industry: rather, it should help to shape the curriculum for qualifications and accreditation.
- It should cover all forms of banking in the UK.
- Initial practical proposals for such a body should be tabled at an early stage.

## Appendix B

### Financial Conduct Authority: Principles of Business

These 11 Principles set out the fundamental obligations of all firms under the regulatory system.

1. Integrity. A firm must conduct its business with integrity.
2. Skill, care and diligence. A firm must conduct its business with due skill, care and diligence.
3. Management and control. A firm must take reasonable care to organise and control its affairs responsibly and effectively, with adequate risk management systems.
4. Financial prudence. A firm must maintain adequate financial resources.
5. Market conduct. A firm must observe proper standards of market conduct.
6. Customers' interests. A firm must pay due regard to the interests of its customers and treat them fairly.
7. Communications with clients. A firm must 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. Conflicts of interest. A firm must manage conflicts of interest fairly, both between itself and its customers and between a customer and another client.
9. Customers: relationships of trust. A firm must 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. Clients' assets. A firm must arrange adequate protection for clients' assets when it is responsible for them.
11. Relations with regulators. A firm must deal with its regulators in an open and cooperative way, and must disclose appropriately to the appropriate regulator anything relating to the firm of which that regulator would reasonably expect notice.

### Prudential Regulatory Authority: Fundamental Rules

- The PRA is currently consulting on nine Fundamental Rules. These rules aim to express the PRA's objective of promoting the safety and soundness of regulated firms.
- A firm must act with integrity.
- A firm must act with due skill, care and diligence.
- A firm must act in a prudent manner.
- A firm must at all times maintain adequate financial resources.
- A firm must have in place sound and effective risk strategies and risk management systems.
- A firm must organise and control its affairs responsibly and effectively.
- A firm must deal with its regulators in an open, co-operative and timely way and must appropriately disclose to the PRA anything relating to the firm of which the PRA would reasonably expect notice.
- A firm must prepare for resolution so, if the need arises, it can be resolved in an orderly manner with a minimum disruption of critical services.
- A firm must not knowingly or recklessly give the PRA information that is false or misleading in a material particular.

## Appendix C

### The role of investors

Investors have an interest in the brand value of the banks in which they hold shares. Reputational risk is harder to measure than solvency or liquidity risks. But as the events of the past few years have shown, bad behaviour and poor ethical standards can jeopardise shareholder value.

In its most recent statement, the Financial Policy Committee warned that “conduct costs looked to be a larger and more uncertain headwind to capital generation than previously thought”. The Financial Stability Review at the end of last year estimated those costs at over £20bn for the UK banks alone since 2011.

The question is whether investors should attempt to get a clearer perspective on such risks – and if so, how.

There is a precedent in the way they have sought information on the environmental impact of companies, and their vulnerabilities to green regulation.

Until recently, these environmental issues were largely ignored both by companies and by their investors as being too difficult to address. But as reported by the Economist, this position has now changed drastically. More than half the companies listed on the world’s 31 largest stock exchanges publish some form of environmental data: in some countries, like the US and the UK, large firms are required to do so. One very large group of investors has sent out questionnaires to 5,000 companies asking a series of questions such as “If you do not have any emission reduction initiatives, please explain why not”.

The data are still patchy. To make sound decisions, investors need standardised, comprehensive information that is consistent over time, and this is not readily available. But this is the direction in which the marketplace is moving.

Greenhouse gas emissions are much easier to measure than business ethics. They can be quantified in a reasonably consistent way and they do not change in nature from one corner of the globe to another. Neither of these conditions applies to bank standards.

But investors and the BSRC will have a common interest in actions that help to strengthen banking reputations, and bank boards will pay attention if their owners become dissatisfied with their progress. So the BSRC should work with investor groups to identify what measures of a bank’s conduct they might find it helpful to observe, and how such measures could best be made consistent over time and across different institutions.

## Appendix D

### List of individuals and organisations that responded publicly to the consultation

Accenture	Confederation of British Industry
Accord	Consumer Council
Age UK	Co-operative Bank
Airdrie Savings Bank	Malcolm Crow
Alliance for Finance	Darlington Building Society
Association for Financial Markets in Europe	Darlington Building Society Staff Audit Team
Association of British Insurers	Jonathan Davis
Association of Corporate Treasurers	Deloitte
Association of Foreign Banks	Deutsche Bank
Dr. Philip Augar	James Dempsey
Bank of America Merrill Lynch	William Dixon & David Wilson
Barclays	Adrian Docherty
Joel Benjamin	EA Consulting Group
BNP Paribas	Ecology Building Society
British Bankers' Association	Nermine El Tahri
British Chamber of Commerce	Alderman Peter Estlin
Annie Brown	EY
BSI Group	Liz Field
Building Societies Association	The Finance Foundation
Philip Bull	Financial Conduct Authority Practitioner Panel
Byrne Dean Associates Limited	Financial and Legal Skills Partnership
Cambridge Building Society	Financial Ombudsman Service
Catalyst Development Ltd	Financial Reporting Council
Cattellyst Consultancy	Financial Services Consumer Panel
Lindsay Cook	FinCris
Chartered Banker Institute	Jane Fuller
Chartered Banker: Professional Standards Board (CB:PSB)	Jon Golding
Chartered Banker: Professional Standards Board	Nahum Goldmann
Independent Advisory Panel	GoodCorporation
Chartered Financial Analyst	Grant Thornton UK
Chartered Institute for Securities & Investment	Habib Bank UK
Chartered Institute of Internal Auditors	Handelsbanken UK
Chartered Institute of Management Accountants	Deborah Henderson
Chartered Institute of Personnel and Development	Holmesdale Building Society
Chartered Insurance Institute	HSBC
CIFAS	IARB
Citi	ifs University College
City HR Association	Institute and Faculty of Actuaries
The City UK	Institute of Business Ethics
The City Values Forum	Institute of Chartered Accountants in England and Wales
Clifford Chance	Institute of Customer Service
Close Brothers	Institute of HR Maturity
Committee on Standards in Public Life	International Capital Market Association
Community Investment Coalition	International Compliance Association

Investment Management Association  
Investment Property Forum  
Ipsos Mori  
Chris Jackson  
JP Morgan  
Tom Keatinge  
Markus Krebsz  
Lafferty Group  
Law and Ethics in Finance Project  
Leeds Building Society  
Lending Standards Board  
LEXLAW Solicitors & Advocates  
Professor Sir Andrew Likierman  
Lloyds Banking Group  
London School of Business & Finance  
LSE Conduct Costs Project  
Professor Ian Lyndsey  
Professor Christopher May  
Metro Bank  
Professor Richard Moorhead  
Huw Morris  
Professor Andy Mullineux  
National Association of Pension Funds  
Nationwide Building Society  
New City Initiative  
Newcastle Building Society  
Nomura  
Nottingham Building Society  
OneSavings Bank PLC & Kent Reliance  
Robert J. Owen  
Penrith Building Society

David Pope  
Alistair Price  
Professional Risk Managers' International  
Association  
Public Concern at Work  
PWC  
Royal Bank of Scotland  
Real Estate Finance Group  
ResPublica  
Revd Dr Fiona Stewart-Darling  
Risk Reward Ltd  
Robin Brownsell  
Professor Roger Steare  
Royal Institution of Chartered Surveyors  
Sainsbury's Bank  
Santander UK  
Jon Smith  
Vic Smith  
Standard Chartered Bank  
TFL Online Limited  
Lawrence Tomlinson  
Transparency International UK  
Alastair Tyler  
UBS AG  
Unite the Union  
United Kingdom Accreditation Service  
Virgin Money  
Which?  
Professor Sam Whimster  
Yorkshire Building Society