

CHARTERED BANKER

Professionalism, Ethics and Regulation

MODULE ASSIGNMENT

Important Notes

This assignment is **compulsory** and contributes up to **30%** of your overall examination mark.

Your answer should be 2,500 words long, plus or minus 10% (references and appendices are not included). The word count should be noted at the end of your assignment and on your assignment cover sheet. If your word count does not meet these limits, your tutor may return it to you unmarked and ask you to re-submit it.

For more detailed information, please refer to the **Assignment Guidelines**.

JOHNSTONE BANK PLC

Johnstone Bank plc is a regional provider of retail banking services for personal customers. The head office of the bank is located in an industrial city. The bank has a strong local customer base, with many factory workers operating their current and deposit accounts, personal loans and mortgages through its head office and branches. The 50 branch offices are all located within 100 miles of head office.

Although the solvency of the bank was not threatened by the credit crisis, its performance was adversely affected by aggressive competition from larger financial institutions and generally worsening economic conditions. The bank's conservative policies, with a focus on a strong balance sheet and steady rather than spectacular growth, helped it to remain profitable, though profits have fallen for the last three years.

In 2010, Bill Hayward retired from his position as Chief Executive Officer (CEO) of Johnstone Bank, having served the company for 35 years. He was widely regarded as a highly respectable businessman, although his closest colleagues considered him to be introverted, uninspirational and cautious. His persona was probably best reflected in the image of the bank as a safe investment for the shareholders but one that would never generate spectacular returns. The board of directors appointed former investment banker, Jane Parr, as the new CEO, a move that took financial commentators by surprise, as she had earned a reputation in her previous career as tough and uncompromising with a high appetite for risk. Within a month of her appointment, Jane Parr recruited two of her former colleagues to join her executive team as heads of marketing and field operations respectively.

Jane Parr decided to carry out a root and branch review of the management structure of the bank, as well as the products and services offered, with a view to enabling the bank to provide more products to its existing customers, expand the customer base into new market segments and reduce the risk profile of existing business. She worked on this review with her two new colleagues and three longer serving executives and submitted her report to the board of directors. The main points contained in the executive summary of the report are set out below.

Management structure

The report concluded that the bank must shed its image of being 'dull and boring' and become creative and innovative in order to prosper in the future. This starts with rebuilding the executive structure in order to provide inspirational leadership. At present the bank has three executive directors and six non-executive directors (NEDs). Three NEDS will have served the bank for six years by 2012 and have notified the bank that they will then stand down from their positions. In order to ensure that the board is equipped with the core knowledge and experience necessary to take the bank forward, only one of these NEDS will be replaced and the two newest executives will be appointed to the board.

The standing committees of the board comprise an audit committee, remuneration committee, nomination committee and credit committee. The credit committee deals exclusively with high value loans that do not fit the parameters of standard lending policy. It is proposed that the duties of the remuneration committee and the nomination committee be combined and that the credit committee be replaced by a risk committee that will be responsible for formulating a more holistic approach to risk management. All committees will be made up entirely of NEDs.

All directors will be remunerated according to their individual contributions to the success of the bank. Their remuneration should be structured to reflect achievement of medium to long-term objectives, with basic salary and fees set at 25% of their on-target earnings. This principle will be extended to those lower down the management chain: branch managers will be awarded points for contributions to sales of both core products and income from successful referrals of investment, insurance and life assurance customers to appropriate providers – the points will be a major determinant of salary increments and bonuses. Again, rewards will reflect performance so that branch managers can expect to double their basic salaries if they meet their targets.

Products and services

An activity-based costing analysis of the work undertaken by customer-facing staff found that 35% of deposit account customers held an average balance of less than £2,000. The customers operating these accounts were paid interest but their transactions and enquiries actually accounted for a disproportionate amount of time. It is proposed that bank charges be introduced on deposit accounts when balances fall below £100 in credit.

The tightening of market conditions following the credit crisis resulted in many of the industrial workers being unable to obtain credit due to concerns about future employment and their modest salary levels. Several similar-sized banks in other regions had introduced a credit card for those with impaired credit. Preliminary costings suggest that a card product could be introduced with an interest rate of 60-70% APR annually on outstanding balances.

Johnstone Bank has offered free banking to students of the University of Johnstone for over 20 years, providing them with a welcome pack comprising book vouchers, CD vouchers and an interest free overdraft for the first year of study. This is unsustainable, as many of the students move to other banks on completion of their studies. All student merchandising and subsidised credit will be withdrawn. Other public relations expenditure that does not have a direct impact on revenues, including sponsorship of the local professional football club and funding of the Johnstone Arts Festival, will be withdrawn.

Analysis of self-employed customers operating as sole traders and unlimited partnerships confirm that they represent a significant default risk should there be a further downturn in the economy. Those with unsecured overdrafts in excess of £10,000 will be asked to reduce their borrowing by at least 50% within one year or their overdraft facilities will not be renewed. If they wish to rollover the overdrafts, they will be required to secure the borrowing by a second charge over their residential properties in cases where sufficient equity is in place.

As many young people in the region are now struggling to get together a deposit for a mortgage, the customer base will be expanded with no increase in risk by developing a new mortgage product through which parents can offer their homes as security, which can then be consolidated with the security offered by their children, thereby delivering the prospect of a higher level of secured lending. These loans will also be supported by the personal guarantees of the parents if considered necessary.

The report conceded that its recommendations represented a significant shift towards a more commercial orientation and might be resented by customers who saw Johnstone Bank as a more community-friendly alternative to the larger players, but concluded that the bank had to face new realities and competitive pressures in order to sustain and then improve profitability.

Required:

Critically examine the regulatory and ethical implications for the board of directors of Johnstone Bank plc implementing these recommendations.