Special report

Spring 2013

CHARTERED BANKER

The magazine for financial professionals

Beyond the blame game

LEADERS SEEK THE POSITIVES

Pioneers in banking professionalism

The Chartered Banker Institute leads the industry's effort to enhance its standards and culture, argues Chief Executive SIMON THOMPSON – and he welcomes the evidence that so many others are now following that pioneering trail.

For years, this Institute has campaigned for regulators and policy-makers to focus on issues of professional culture and standards in banking every bit as keenly as they must also address key operational behaviours governing capital adequacy and lending criteria.

At the Chartered Banker Institute we're therefore delighted that the sector is now moving so decisively towards that goal and looks set to build on much of the Institute's pioneering work. As the only remaining Institute of Bankers in the UK, we're leading the industry's effort to enhance standards and culture through embedding a Code of Professional Conduct, developing professional standards and enhancing banking qualifications.

After several set-piece inquiries – Cruickshank, Turner, Walker, Vickers, Wheatley and now Tyrie – Ministers are now urgently implementing plans to beef up their pivotal Financial Services (Banking Reform) Bill. In this Special Report, we examine the background and the new personalities who are taking charge of the UK's reformed regulatory machinery.

Our central purpose here is to discuss the key challenges we all face – and our positive proposals for meeting them – as the sector now reaches *Beyond the Blame Game* that has consumed the energies of two governments to create robust new regulatory machinery in the wake of the 2008 banking crisis.

"Independent research shows that bank customers overwhelmingly value and trust the Chartered Banker qualification – the Gold Standard."

This is no more than is desired and expected by banking's own customers. Over months and years, independent market research has shown that bank customers overwhelmingly value and trust the Chartered Banker qualification – the Gold Standard. Individuals and businesses alike are consistent in saying that they'd prefer:

- to work with a Relationship Manager who is a professionally-qualified Chartered Banker
- to bank with an institution in which all appropriate staff had passed their banking exams.

And recognition of these pronounced customer expectations is precisely one of the reasons why more and more people working in banking, both in the UK and increasingly in the world's financial growth centres, are now seeking to enhance their qualifications, professional status and career advancement with the Chartered Banker Institute.

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Special report

A harvest of challenges & solutions

While media and politicians still focus on retribution for the 2008 financial crisis, SIMON THOMPSON finds that banking leaders are moving decisively – led by the Institute – to enhance and extend professional standards to tens of thousands of individuals.

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As Parliament completes its banking regulation reforms and MPs prepare their "Phase Two" design of new machinery to embed higher standards of professionalism in financial services, the banking industry itself has an important duty to help move the debate beyond the current intensive "blame game".

That's the conviction of SIMON THOMPSON, Chief Executive of the Chartered Banker Institute. In a memorandum to the Parliamentary Commission on Banking Standards, he examines how policy-makers, regulators and the industry might enhance existing frameworks and mechanisms for setting, implementing and enforcing professional standards in banking.

He identifies two key challenges for the industry:

- First, how best to extend the reach of regulators to encompass the thousands of people in banking not currently covered by any requirement to meet agreed professional standards.
- Second, how to sharpen our focus on the professionalism of individuals in banking, where at present it is primarily concerned with the conduct of firms.

FOCUS ON STANDARDS

Thompson distinguishes between the industry's twin aims of raising professional standards and restoring public trust. He says he doubts whether it's possible to achieve both objectives simultaneously just by extending or strengthening the existing Approved Persons Regime under which the Financial Services Authority deems individuals to be "fit and proper" to perform statutorily defined controlled functions.

"I think these two aims must be separated," he says, "with policy-makers, regulators and the industry focusing on raising professional standards. If we succeed in raising standards of individual, institutional and industry behaviour, then our customers and society more widely may bestow trust upon us – but I am not sure that any reforms we propose or make will restore trust directly, nor will this happen overnight."

To raise professional standards, he advocates a twin-track approach. There should be an extension of the Approved Persons Regime to cover more individuals working in key retail and wholesale banking roles. And he seeks a corresponding extension of the current scheme under which the UK's eight FSA-Accredited Bodies, including the Institute, are mandated to ensure individuals in certain roles hold a Statement of Professional Standing.

It should be possible to achieve this enhancement relatively quickly, he says, because the mechanisms are already in place. "The greatest advantage in adopting this approach comes, in my view, from the fact that we have in banking a strong, independent regulator.

"The Financial Services Authority – and its successor Financial Conduct Authority (FCA) – is well staffed, well resourced and already operates a strong and intrusive monitoring regime."

> *"If we succeed in raising standards of individual, institutional and industry behaviour, then our customers, and society more widely, may bestow trust upon us."*

TWO KEY CHALLENGES

Thompson foresees two potential difficulties in extending the Approved Persons Regime. The first is identifying which additional key roles in banking should be included – and which excluded.

The current regime covers some 150,000 individuals in financial services, about 37,000 of them in banking. "It's hard to see this being extended to cover the majority of the roughly 450,000 individuals employed in banking in the UK, which would still leave large numbers not covered by a new professional standards regime."

The second challenge concerns the fact that the FSA (and its FCA successor) is primarily a regulator of firms, rather than individuals. "Regulating individuals requires a different approach to regulating firms, and the FSA/FCA's Professional Conduct unit would need to be significantly enhanced to support an extension of the Approved Persons Regime."

Meanwhile, the Institute's view is that the boards and senior management of banks should themselves have a duty to promote a positive culture of professionalism in their institutions, and produce evidence that this is the case.

"Raising standards in banking requires both individual and institutional engagement – an individual's behaviours at work are driven both by their own moral principles and the policies and norms of their workplace."

INDUSTRY-LED INITIATIVE

The Chartered Banker Professional Standards Board (CB:PSB), established in October 2011 by nine leading UK banks and the Institute, has already implemented an industry-led approach to raising ethical and professional standards in banking. The Board's Customer Advisory Panel provides significant external input which is currently being extended. The initiative has involved:

- Devising a Code of Conduct, subscribed to by banks accounting for some 75 per cent of UK banking employees. The nine member banks have adopted or aligned existing codes with the CB:PSB Code, and have established systems for identifying and dealing with breaches of the code.
- Developing detailed professional standards, setting out the knowledge, skills, values, attitudes and behaviours required for an individual to implement the code. "Seventy thousand individuals will meet the Foundation Standard for Professional Bankers by July this year, with many more to follow by year end."
- Aligning banks' learning & development, performance management and internal monitoring systems to support implementation of the code and professional standards.
- Creating systems to monitor and oversee implementation of the code and standards, including self-assessment, critical evaluation and external assurance.

THE WAY FORWARD

Meanwhile, the CB:PSB has prepared plans for the development of Intermediate and Advanced Level Standards which are being shared with key stakeholders including the

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regulators. It's anticipated that an Advanced Level Leadership Standard will also be developed this year. In addition, the Institute is investigating how a non-statutory Register might support a new professional standards regime. This requires a number of key questions to be addressed, including:

- **Aim and status:** what is the primary purpose of the Register and how would a non-statutory Register work?
- **Scope:** who should be included on the Register and how would individuals join, stay on and leave it?
- **Operation:** who holds the Register and what would it look like? What, if any, are its employment and other legal implications – and its relationship with existing regulators?
- **Discipline:** what sanctions will be imposed on individuals if they no longer meet the standards required, and how will the disciplinary regime operate?
- **Time and cost:** how long will it take to introduce a Register? What will be the costs of establishing and maintaining it and who will pay for this?

"We have in banking a strong, independent regulator that is well staffed, well resourced and already operates a strong and intrusive monitoring regime."

ENHANCED EFFECTIVENESS

The very strong support for this initiative from Chairs and Chief Executives of the CB:PSB member banks, embracing approximately 75 per cent of UK banking employees, makes it unnecessary, Thompson says, to "reinvent the wheel by establishing a new Banking Standards Review Council or similar body as is proposed by the BBA and some others".

More could be achieved more quickly if regulators, policy-makers and the industry agree to enhance the CB:PSB's work – first, by reconstituting the Board on an independent basis; and, second, by extending the Board's membership to all banks taking deposits or lending in the UK.

Thompson suggests enhancing the effectiveness of the CB:PSB by:

- creating a Register of Bankers (as above) based on the attainment of one or more of the CB:PSB's professional standards
- extending CB:PSB membership to all banks taking deposits or lending in the UK
- establishing robust investigatory and disciplinary systems to deal with breaches of the code or professional standards.

"Aspirational professional standards aimed at individuals, of the type being implemented by the CB:PSB," he says, "require the active support of boards and senior management if they are to be implemented on a broad enough basis to support an effective and visible raising of standards." Three things would help this process:

- **Requirement:** more senior executives and other key individuals in banks are required to hold relevant Chartered-level professional banking qualifications.
- **Encouragement:** large numbers of bankers in key customer-facing and customer-supporting roles are given greater encouragement to achieve relevant, professional banking qualifications.
- **Development:** competence is continually maintained and developed through Continuing Professional Development.

Thompson concludes: "Enhancing education and training alone will not ensure that appropriate values, attitudes and behaviours are maintained. Banks must align their learning and development, performance management, internal monitoring and other systems to support the implementation of a Code of Professional Conduct and professional standards. That's what CB:PSB member banks are already doing."

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European leaders broker an "historic deal" to create a banking union, but German objections and British exclusion sour the celebrations.

"Count us out" *say the Brits*

As European leaders take a big step towards a banking union, the UK determinedly insists it's "safer on the outside". It has won an agreement to protect London's supremacy as the EU's dominant financial centre handling the biggest slice of euro foreign Exchange transactions.

Keen to prevent this powerful role being gradually marginalised by a Frankfurt-based European Central Bank directly supervising 150-200 of the Eurozone's largest banks, the UK continues to refuse to join either the Eurozone or its nascent banking union.

Eurozone countries have acceded to UK-led demands for a "double majority" principle at the European Banking Authority, the EU regulatory agency that creates banking rules across all 27 member states. This means that EBA decisions are at least approved by a plurality of countries outside the banking union – safeguards intended to limit the ECB's power to impose technical standards on all EU banks.

Prime Minister David Cameron says: "The European Union, the Eurozone, needs a banking union, but Britain won't be part of this banking union and we have properly protected our interests in the single market."

The other EU states still outside the Eurozone are committed to joining, and can sign up to the banking union in the meantime, except Sweden and the Czech Republic, which have said they won't. And, along with the UK, Denmark still opts out of the Eurozone.

The "landmark deal" will put the ECB directly in charge of 150-200 of the largest Eurozone banks with assets of more than €30bn (£24bn), or representing more than a fifth of a state's national output. It will also have new auditing powers for the rest of the 6,000 banks that remain under national supervision.

The deal means a large number of French banks will be directly supervised by the ECB. But in Germany, where there's persistent unease despite Chancellor Merkel's endorsement, much of that country's fragmented but influential network of retail savings banks will continue to be controlled by German authorities.

The ECB will be able to intervene with smaller lenders and borrowers at the first sign of trouble. It will have powers to close down Eurozone banks that do not follow rules. And it paves the way for the EU's main rescue fund to come to the direct aid of struggling banks.

Despite the deal, it's clear that obstacles remain before it can be implemented by the target of March 2014. There continue to be legal doubts, for instance, about a joint deposit guarantee scheme and a joint resolution mechanism for winding up broken banks. There's strong opposition in Germany and other richer Eurozone nations to any further taxpayer-funded bailouts of indebted banks and governments.

A clause allows the ECB to take over supervision of a lender at the request of the European Stability Mechanism, the Eurozone bailout fund. This paves the way for an emergency injection of capital but would require unanimous approval. CB

"A crucial and very substantive step."

JOSE MANUEL BARROSO, European Commission President

"It cannot be praised too highly."

ANGELA MERKEL, German Chancellor

"We've properly protected our interests."

DAVID CAMERON, UK Prime Minister

"A very good deal."

GEORGE OSBORNE, UK Chancellor

"An historic agreement."

MICHEL BARNIER, EU Commissioner for internal market & services

"Expectations we cannot fulfil."

WOLFGANG SCHÄUBLE, German Finance Minister

"I am not convinced."

JENS WEIDMANN, President, Deutsche Bundesbank

"My message to the banks is clear," warns Chancellor George Osborne. "If a bank flouts the rules, the regulator and the Treasury will have the power to break it up altogether – full separation, not just a ring fence. In the jargon, we will electrify the ring-fence."

The Chancellor has thus accepted the arguments of the Parliamentary Commission on Banking Standards. Headed by Andrew Tyrie MP, it had concluded that "the latest revelations of collusion, corruption and market-rigging beggar belief – the clearest illustration yet that a great deal more needs to be done to restore standards in banking".

Osborne now wants powers to break-up banks that don't conform to strict new proposals – first proposed by Sir John Vickers' Independent Commission on Banking – to quarantine retail services from riskier investment operations. Banks that seek to undermine this ring-fence, he says, may be forced to break-up their retail and investment functions.

The Chancellor also says that changing banking's culture "goes beyond bonuses and fines – we need proper professional standards in the banking sector, just like we have for doctors and lawyers." The legislation, he insists, will give this country "the best, most open and transparently policed markets in the world…that will win business for Britain and attract investment". Simon Thompson, the Chief Executive of the Chartered Banker Institute, comments that he's "delighted the Chancellor now supports the Institute's campaign for professional standards in banking, an issue we first highlighted in 2008."

HOW THE "RING-FENCE" WORKS

The revised Banking Reform Bill includes these key measures:

- The ring-fence: The High Street activities of each UK bank will be put into a separate subsidiary from its riskier investment banking.
- "Electrification": Regulators will have conditional power to split up an individual bank completely, if the Bank of England considers that it is undermining the purpose of the ring-fence. Regulators will also conduct an annual review of UK banking to determine whether the ring-fence is effective.
- Faster switching: Individual customers and small businesses will be able to switch bank accounts to a rival within a week.

"We need proper professional standards in the banking sector, just like we have for doctors and lawyers."
GEORGE OSBORNE MP, Chancellor of the Exchequer.

Significantly, Sir John Vickers, author of the ring-fence idea, has himself welcomed the "electrification" proposal. And, for his part, Andrew Tyrie, who chairs the Parliamentary Commission, has consistently argued for tougher sanctions: "For the ring-fence to succeed," he says, "banks need to be discouraged from gaming the rules. All history tells us they will do this unless incentivised not to." Parliament needed to be assured that "we are not creating a paper tiger. Rules with real teeth are required."

The Government's revised Banking Reform Bill echoes the recommendations of the first of the Tyrie Commission's reports, produced just before Christmas. The Commission has already started hearing evidence for its second report, dealing with ways of imposing new statutorily-backed professional and ethical standards in the industry.

The Commission welcomes the ring-fence around retail operations as a contribution to making the banking system more secure. "It is essential," it adds, "that banks are restructured in a way that allows them to fail, whether inside or outside the ring-fence. Ring-fencing can also help address the damage done to culture and standards in banking."

But the proposals, as they initially stood, fell well short of what was required. "Over time, the ring-fence will be tested and challenged by the banks. Politicians, too, could succumb to lobbying from

"We will *electrify the retail ring-fence*"

TYRIE

The Government is taking steps to toughen up its reforms of banking regulation and supervision. Chancellor GEORGE OSBORNE has accepted the arguments of ANDREW TYRIE's Parliamentary Commission that: "We must not create a paper tiger. Rules with real teeth are required."

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banks and others, adding to pressure to put holes in the ring-fence.

"That's why we recommend electrification. The legislation needs to set out a reserve power for separation; the regulator needs to know he can use it. Furthermore, we need periodic reviews of the sector to reassure us that the ring-fence as a whole is working. Tougher measures may yet be required."

While the ring-fenced banks will carry out most of the essential economic functions that need protecting, says the Commission, "it is important to be clear that it is these functions that enjoy protection and not the bank itself or its shareholders or creditors. There should be no government guarantee of ring-fenced banks, nor a perception of one."

In the long-run, the ring-fence originally envisaged by the Government might not have provided an adequate degree of separation, it claims. "Nor may it be adequate to buttress banking standards. Additional powers are essential to provide adequate incentives for the banks to comply not just with the rules of the ring-fence, but also with their spirit." In the absence of measures to "electrify" the ring-fence, there was a high risk that it would simply fail.

That's why the Commission urged that additional reserve powers to implement full separation should be added to the draft legislation, plus a specific provision for enhanced Parliamentary scrutiny of the proposed use of delegated powers. It's "concerned that the ring-fence could be vulnerable to erosion over time. Pressure will come from many quarters. It is all too easy, and sometimes all too convenient, to forget the lessons of the past. This cannot be allowed to happen."

It wants the Bill to include a strengthened mandate for the new Prudential Regulation Authority (PRA) reflecting its duty to ensure a ring-fenced bank has operational independence on governance, risk management, treasury management, human resourcing, capital and liquidity.

Boards of directors should be under a legal duty to preserve the integrity of the ring-fence and the regulator empowered to require a "sibling structure" between a ring-fenced and a non-ring-fenced bank, with a holding company.

"If the ring-fence is permeable, or is perceived to be permeable, the risk of contagion will increase. Clear dividing lines are needed between the activities of ring-fenced and non-ring-fenced banks. A duty is needed on board members to ensure these lines are not blurred."

The Commission also says it's not persuaded by the Government's approach to leverage. "The primary duty of setting a leverage ratio should fall on the Financial Policy Committee (FPC), not politicians," it argues.

The report finally raises the prospect of a ban on proprietary trading (where banks trade securities for their own account) in line with the incoming Volcker rule in the US. But it concedes that banks should be allowed to sell simple derivatives, such as currency hedges, to small businesses from within the ring-fenced operation.

Tyrie concludes: "We're saying to the banks: help us make the ring-fence work. If not, the regulator may pull you apart." CB

> *"Banks need to be discouraged from gaming the rules. All history tells us they will do this unless incentivised not to."*
> ANDREW TYRIE, Chair, Parliamentary Commission on Banking Standards

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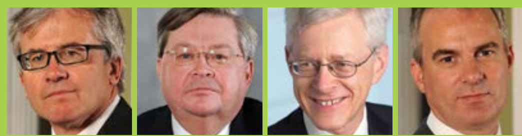
> *"The Financial Services Authority has been a victim of its own flawed 'light touch' political remit."*

BANK OF ENGLAND
MONETARY POLICY COMMITTEE

It decides the official UK base rate, directs other policy aspects such as quantitative easing and is primarily responsible for keeping the Consumer Price Index measure of inflation close to the government's target (2% as of 2011).

Chair:
MARK CARNEY, as Governor, takes over from Sir MERVYN KING in June.

Bank Members:
PAUL TUCKER Deputy Governor, Financial Stability
CHARLES BEAN Deputy Governor, Monetary Policy
SPENCER DALE Executive Director, Monetary Analysis & Statistics
PAUL FISHER Executive Director, Markets



External Members:
DAVID MILES former Chief UK Economist, Morgan Stanley
IAN McCAFFERTY former Chief Economic Adviser to the CBI
MARTIN WEALE former Director, National Institute of Economic & Social Research
BEN BROADBENT former Senior European Economist, Goldman Sachs

BANK OF ENGLAND
FINANCIAL POLICY COMMITTEE:

It identifies and monitors the wider economic and financial risks to the stability of the financial system as a whole.

Chair:
MARK CARNEY, as Governor, takes over from Sir MERVYN KING in June.

Bank Members:
PAUL TUCKER Deputy Governor, Financial Stability
CHARLES BEAN Deputy Governor, Monetary Policy
ANDREW BAILEY Executive Director & MD, Prudential Business Unit
ANDREW HALDANE Executive Director, Financial Stability
PAUL FISHER Executive Director, Markets

External Members:
ALASTAIR CLARK Treasury Senior Adviser for financial stability
LORD ADAIR TURNER Chairman, Financial Services Authority
MICHAEL COHRS former Management Board Member, Deutsche Bank
DONALD KOHN former Vice Chairman, US Federal Reserve
ROBERT JENKINS former CEO, Combinatorics Capital

FINANCIAL CONDUCT AUTHORITY

It's mandated to ensure financial markets operate with integrity; to promote effective competition; and to enhance consumer protection.
Chief Executive: MARTIN WHEATLEY became CEO-designate in September 2011. He'd served for five years as Head of Hong Kong's powerful Securities & Futures Commission

Photos courtsey of Bank of England and the Financial Conduct Authority

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PRUDENTIAL REGULATION AUTHORITY

It's responsible for promoting the safety and soundness of deposit-takers, insurers and investment firms with "significant balance sheet risk". **Chief Executive:** ANDREW BAILEY has been named as the CEO-designate of this new regulator. He replaces HECTOR SANTS.

"Light touch" becomes "hard fist"

As Ministers radically reshape the regulation of the UK's pivotal financial industry, the post-crisis carnage is leaving an early trail of victims and victors.

For the best part of a year now, the UK's new financial services regulators have been intensively planning and jostling each other in the ante-rooms of power.

They've been waiting for the passage of the Financial Services legislation to formalise their authority to replace the machinery so comprehensively smashed by the excesses that precipitated the 2008 banking crisis.

That legislation, still being fine-tuned as we go to press, is expected to clear its Parliamentary hurdles this spring. The essentials are already clear: the Financial Services Authority, which has patrolled the boundaries of sector conduct for virtually a decade and half, is being wound up – a victim of its own flawed "light touch" political remit.

The Bank of England is being given a greatly strengthened role to supervise a new structure of internal and external regulatory agencies, each with an explicitly "tougher" set of political ground rules.

That's accompanied by a significant leadership bloodletting. Ministers make more than a presentational point by reaching far outside the discredited City for candidates to carry their new brooms: Canada's respected central banker **MARK CARNEY** replaces Sir Mervyn King as Bank of England Governor; Hong Kong's trouble-shooter, **MARTIN WHEATLEY**, is drafted in to enhance sector integrity and exorcise the ghosts of the LIBOR scandal.

That's already left a litter of ambitious casualties. **PAUL TUCKER**, a Bank of England Deputy Governor, failed to reach the top job for which he'd been groomed; **ADAIR TURNER**, recruited to clear up the post-crisis mess as FSA Chairman, is sidelined; **HECTOR SANTS**, its Chief Executive, is off to Barclays. Expect more. CB

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THE PPI SCANDAL

£25bn costs *and rising*

It's become a runaway liability, business leaders warn, that's now being exploited by "ambulance chasers".

The cost of compensating people who've been wrongly sold payment protection insurance (PPI) by financial institutions could rocket to £25bn – almost double previous estimates.

So far, following FSA instructions to invite customers to claim, UK banks have set aside nearly £13bn to cover the liability. Calculations last November suggested the final bill could reach £15bn.

Now a new assessment in *The Times*, based on FSA monthly PPI pay out figures and historic selling data, says banks may be forced to pay out £25bn in redress.

It's become such an apparently run-away liability that business leaders like the CBI's Director General, JOHN CRIDLAND, now urge a deadline for legal compensation claims.

Customers generally have six years from the insurance mis-sale to claim – or during the three years after they became aware they might have a case, even if the sale was more than six years ago.

It's "a huge scandal that should never have happened," Cridland agrees, "and it's right that consumers are able to get swift and proper redress. But banks are sending out tens of thousands of compensation payments and cheques and there's a real sense that the ball is now firmly in the court of ambulance-chasing claims management companies."

Designed to cover loan, credit card and mortgage repayments if a policyholder became ill, redundant or had an accident, PPI was widely mis-sold to applicants who didn't want or need it, or who would have been unable to make a claim.

More than 2.5 million people have already received payouts averaging £2,750 each. Banks are writing to those who suspect they're victims, inviting them to claim. And demand has been boosted by TV ads and text and phone messages from claims management companies, which take a share of payouts.

Increased third-quarter provisions by leading UK banks (reported in November) brought totals then to:

LLOYDS	£5.3bn
BARCLAYS	£2.2bn
RBS	£1.7bn
HSBC	£1.3bn

THE LIBOR SCANDAL

£1.6bn fines *and rising*

"Swift and decisive" reforms are needed to restore confidence in the benchmarking of £185tn-worth of worldwide contracts.

A score of banks in seven countries are named in investigations and court cases resulting from the so-called LIBOR rate-rigging scandal. The London-based scandal has undermined the credibility of the decades-old system to set daily benchmarks for financial contracts worth some £185tn worldwide.

Root-and-branch reforms recommended by one of the UK's top regulators, MARTIN WHEATLEY, will strip the British Bankers' Association of its long-established role as sponsor of the London Interbank Offered Rate. His 10-point overhaul, fully accepted by Ministers, will put an independently regulated administrator in charge and make rate manipulation a criminal offence.

The LIBOR crisis has already seen fines of more than £1.6bn imposed on three banks – £940 million on the Swiss UBS and £290 million on Barclays. More recently, RBS found itself landed with a fine of £387.5 million.

The scandal has forced the resignation of Barclays chairman, Marcus Agius, and the bank's chief executive, Bob Diamond, who told a Parliamentary committee he was unaware of the manipulation. Paul Tucker, Deputy Governor of the Bank of England, denied he'd ever encouraged manipulation in discussions with Diamond.

From at least 2005, rates were routinely manipulated by traders to benefit their own financial positions and later, during the 2007–2012 global financial crisis, to make their bank seem healthier.

The head of the Financial Reporting Council, Lady Hogg, leads a panel to select the successor to the trade organisation that had given banks "unfettered latitude" in submitting rates.

The Wheatley Review urges "swift and decisive" action to restore confidence in the benchmarking process. Among its recommendations are:

- managers overseeing LIBOR submissions should be approved by the regulator to make it easier to discipline them
- a "code of conduct" with submissions corroborated by trade data
- reducing from 150 to just 20 the number of benchmark borrowing rates in five currencies and four maturities
- more banks should be involved and individual rates submitted should not be published for three months to avoid banks deliberately lowering rates to mask their financial difficulties. CB

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Uncle Sam's long arm

The transatlantic "special relationship" is changing. The financial crisis and new politics are recasting what was always an edgy mix of admiration and rivalry. How will UK and US banks emerge from this turbulent time, asks Arthur Allan.

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Uncle Sam has wielded his cane again. The Royal Bank of Scotland is the latest UK institution to feel the smack of firm American government, in the shape of a long-predicted fine for its LIBOR misbehaviour.

This time, of course, Britain as a whole will be sharing the pain. Since RBS is 81 per cent owned by the Government, it's UK taxpayers who will effectively be paying the bulk of the fine.

That news did nothing for the reputation of RBS. At the same time, it focused fresh scrutiny on the way US regulators appear to be penalising British banks more harshly than their own.

Over the past year, UK institutions have been handed fines of more than $3bn for LIBOR fixing and breaching money-laundering rules, with more likely to follow. By contrast, JP Morgan got a mere slap on the wrist for poor governance that allowed the trader known as the "London Whale" to lose $2 billion in risky hedging activities.

The headline-grabbing language used by some US authorities in passing sentence has heightened suspicions of a political motivation. HSBC was accused by a congressional investigation of letting "drug kingpins and rogue nations" launder money, while Standard Chartered was denounced by another regulator as a "rogue institution" involved in a "staggering cover-up" over its transactions with Iran.

Professor Emilios Avgouleas of the University of Edinburgh Law School, who studies international financial regulation, believes US regulators have been playing to the gallery.

"It's easier to target bankers abroad than at home," he says. "When you offer blood to the crowd in the arena, the crowd doesn't really care whose blood it is, as long as it's bankers' blood.

"That said, it shouldn't be forgotten that the British banks have grossly misbehaved, especially vis-à-vis LIBOR."

In the States, financial institutions in general are now perhaps held in even lower esteem than in the UK – but if there's one thing Americans hate more than banks, it's British banks.

Mark Calabria, Director of Financial Regulation at Washington's Cato Institute, says public opinion has been stoked by the level of attention focused on the misdemeanours of UK-based players.

"If you're benchmarking for share of world finance, it's not clear to me that UK banks have been better or worse than anybody else," he says. "But I don't think the American public has a sense of how much bigger the footprint of London is than Paris or Frankfurt."

More complex cultural differences may underlie the recent rocky ride of the Brits in America. UK banks certainly underestimated the toughness of US regulators, who have a much stronger track record of criminal prosecution.

The complex and fragmented nature of the regulatory system is another factor. For instance, New York State's Department of Financial Services, one of the authorities that fined Standard Chartered, didn't even exist until little over a year ago.

HSBC's recent appointment of a former US Treasury official, Robert Werner, to a newly created role – leading on financial crime compliance – suggests it recognises the need to understand the system from the inside.

Calabria also suggests US banks were simply more aware of money-laundering rules – and more accustomed to having to work hand-in-hand with government in general.

"I don't think US banks like it, but they are used to the Government tasking them with law enforcement responsibilities," he points out.

"For instance, the US approach to internet gambling for offshore centres like Antigua has been, 'Let's make the banks stop it'. That's how US regulators deal with child porn: the bank has responsibility to track the credit card number."

At the root of the cries of foul play, of course, is the competition between London and New York – for years neck-and-neck in the race to be the world's leading financial centre.

Calabria believes the New York authorities would be mistaken to attempt to weaken UK banks through sanctions: "It's not like we could push out RBS or HSBC, for instance, and suddenly Citibank would come in and grab that business. It's more likely those transactions would go somewhere other than

> **"UK BANKS CERTAINLY** UNDERESTIMATED THE TOUGHNESS OF US REGULATORS, WHO HAVE A MUCH STRONGER TRACK RECORD OF CRIMINAL PROSECUTION."

New York. I think the New York regulators have been short-sighted in undermining the competitive position."

The fallout from criminal investigations will not be the only factor in determining the prospects for the two countries' financial industries. Much also depends on the progress of bank restructuring and regulatory reform in each territory.

US banks are widely seen to have undergone a more rigorous and painful restructuring than their UK counterparts. But UK and EU reform of the regulation is arguably moving faster.

America's Dodd-Frank reforms will see banks obliged to keep more capital on hand this year, as well as being subject to the Volcker rule, which prevents them playing the markets with their own money. But these laws are still crawling through the development process. While the re-election of Barack Obama dashed any industry hopes of a bonfire of regulations under a Romney presidency, the pace of change is slow.

Back at home, Avgouleas believes the cleaning up of the UK banks' balance sheet has not been as rigorous as it should, partly because further restructuring would mean pain for the taxpayer.

"Most of the efforts of regulators and politicians have gone into populist policies such as compensation, which frankly is a secondary issue in terms of the stability of the banking system," he declares.

"In contrast, the American banks have radically restructured and cleaned up their balance sheets. They are in much better financial health.

"Unless the British banks' balance sheet is radically restructured and a series of write-offs

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"AT THE ROOT OF THE CRIES OF FOUL PLAY, OF COURSE, IS THE COMPETITION BETWEEN LONDON AND NEW YORK."

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takes place to free them from toxic loans and other bad assets, they will never become globally competitive again."

Avgouleas salutes UK and European efforts to reform regulation: "In this respect the UK industry is in better shape than the US one, where regulatory reform is much more complex and nobody really understands what's going on."

But a recent missive from Brussels, barely covered in the UK media (see p6), has set alarms ringing for some. EU finance ministers agreed in December to give the European Central Bank power to supervise

the Eurozone's bigger banks. The move has the potential to create a more close-knit eurozone that could rig the single market to Britain's disadvantage.

Andrew Campbell, Professor of International Banking and Finance Law at the University of Leeds, sees a risk to Britain's financial industry.

"My major concern about this is that if the UK is not at the top table, contributing towards all the discussions for what is being proposed about a single banking supervisory authority, our position could become significantly weakened in due course – which could have an effect on the dominant role of the City of London and give New York a competitive advantage," Campbell says.

Meanwhile, in another part of Europe, the Basel Process is churning out new rules that will affect both countries' banks.

Bankers widely welcomed the recent relaxation on proposals for minimum liquidity and capital requirements. The deadline for banks to meet these rules was put back to 2019 – sparking scepticism about whether the rules would ever be implemented.

Calabria has a different concern. He believes Basel risks eroding healthy diversity.

"I think it's a real flaw to try to make countries' banking systems all look the same," he explains. "If they all start to hold similar assets, shocks to asset classes become systemic and everyone tries to sell at the same time. You want to try to diversify, so that when somebody's selling, someone else is buying.

"I worry that the Basel process is encouraging UK and US banks to look more alike. Ultimately, I think, that will be costly rather than beneficial." CB

TACKLING THE BIG ONE – TOGETHER

They may be pursuing their own paths on bank restructuring, but the UK and the US have agreed they need to work in tandem on the issue of failing global banks.

The first fruit of their efforts, a blueprint for the 12 biggest international banks, was unveiled by the Bank of England and the Federal Deposit Insurance Corporation.

Their proposals would consolidate the process for dealing with insolvency in a big bank – making a single regulator responsible, rather than have bodies in each country affected handling the subsidiaries.

According to Mark Calabria of the Cato Institute in Washington, it made sense for US and UK regulators to put their heads together: "The reality is that New York and London are the world's financial markets – everybody else is a rounding error.

"They are not as far along as they should be, but there's a recognition by both regulators that this is the bilateral relationship that matters."

But Calabria believes the regulators have their work cut out to finalise a process for so-called "cross-border resolutions" that would work efficiently in practice.

"The US law is not clean, even when the issue is 100 per cent domestic," he says. "Even if Lehman Brothers had had no foreign operations, there's no way it would have been resolved in the US bankruptcy court in a matter of weeks."

Professor Andrew Campbell of Leeds University agrees that the ultimate solution is a long way off, but says the joint approach was inevitable.

"There will still be a role for national supervision for national banks, but with the main banks operating in so many countries, the type of supervision we've had previously is no longer the right model," he says.

"In fact, when you look at the really big players, they are now globally owned and registered in one country purely for convenience – we don't really have banks that are 'American' or 'British' any more."

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The tale of the whistleblower

The issue of how whistleblowers are treated and what support they are offered by regulators and lawmakers has never been more timely, as Andrew Stone reports.

Being a whistleblower isn't easy. Just ask Paul Moore, sacked as HBOS Head of Group Regulatory Risk in 2004 after warning his employers that they were taking excessive risks. He turned whistleblower in the aftermath of the crisis, exposing the aggressive and reckless lending culture to Parliament in 2009, and he has suffered for it ever since.

"I know to my own detriment what happens as a result of becoming a public whistleblower," says Moore, whose career was left in ruins. "As a whistleblower you become like a leper, a pariah. I had an impeccable reputation in my profession, but since I went public I have not been offered a single consulting job or been approached by any headhunters. Even people who have worked with me and know I know what I'm talking about can't touch me because they feel it will impact on their career."

The resulting professional and financial pain has only been part of the difficulties he has endured, which he is writing about for a forthcoming book. There is nothing so wounding to a person, observes Moore, than being punished for doing the right thing. "It's a hard thing to live with personally. I've spoken to other whistleblowers and I know that there are lots of mental health issues."

Moore is not alone in having had a tough time following the decision to become a whistleblower. When UBS employee Brad Birkenfield exposed tax evasion at the Swiss bank in the US, he was jailed, although ultimately he received a record $104m IRS reward for his trouble.

The issue of how whistleblowers are treated and what support they are offered by regulators and lawmakers when they seek to expose wrongdoing is an especially timely one following a slew of fraud and mis-selling scandals, including alleged wrongdoing relating to LIBOR manipulation, money laundering, PPI mis-selling and the reckless (and sometimes criminal) lending that led to the financial crisis.

And as the UK's Financial Services Authority consults on the exact nature of the role and remit of the incoming Financial Conduct Authority (FCA), which comes into being on April 1, whistleblowing is one of the issues it is looking at, as part of the wider ongoing shake-up of the UK's financial regulation that aims to make finance cleaner and safer.

If the FCA (headed by former Chairman of Hong Kong's Securities and Futures Commission, Martin Wheatley) does hope to make it easier for whistleblowers to expose wrongdoing within the financial sector, it is likely to have its work cut out, says anthropologist and business journalist Joris Luyendijk.

The factors deterring whistleblowers are considerable, says Luyendijk, who has been speaking extensively to employees in the banking sector for his *Guardian* banking blog. There are strong cultural, legal, psychological and financial reasons why public whistleblowing is such a rarity, he says.

The great emphasis on performance and performance-related reward in sections of the financial world is one of the biggest factors preventing the exposure of wrongdoing, says Luyendijk. "If you look at the incentive structure of many people, particularly those in the front office in finance, there's no job security, zero trust and zero loyalty. If you know everyone around you can be fired in five minutes, it's not a nurturing environment for whistleblowing."

Banks are, by their nature, divided organisations locked in a kind of continual struggle between the money makers and the compliance people, he adds. "You could best see the banks as nations in a permanent state of civil war. Inside them there are people tasked with finding fraudulent activity, while others are tasked with making money. "

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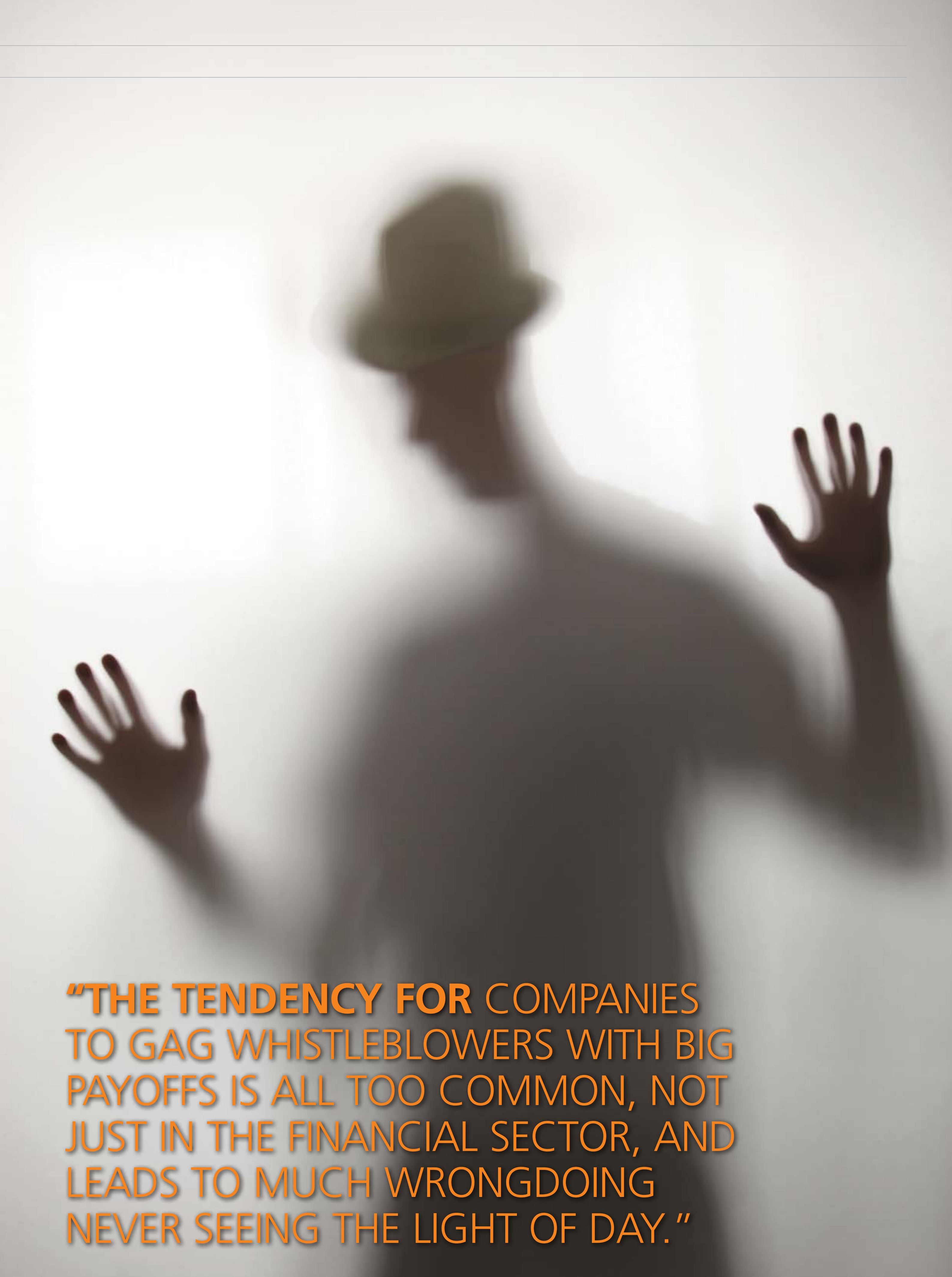

"THE TENDENCY FOR COMPANIES TO GAG WHISTLEBLOWERS WITH BIG PAYOFFS IS ALL TOO COMMON, NOT JUST IN THE FINANCIAL SECTOR, AND LEADS TO MUCH WRONGDOING NEVER SEEING THE LIGHT OF DAY."

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Seen in this light, it's possible to argue that the tougher regulation being imposed by national, European and other international regulators on banks may, paradoxically, only widen this divide, he adds. "You could say that more regulation on banks forces them, in an indirect way, to take more risks to pay for the compliance."

Chris Skinner, industry commentator and Chairman of networking group the Financial Services Club, sees a lack of support for whistleblowers from regulators, together with weak corporate law as further impediments to potential whistleblowers.

"In the US under Dodd Frank, you have to take the bank to court yourself and only if the Feds believe you have a good case, will they join your case and if you win you get a percentage," says Skinner.

"That says to me right now there is not really the will to help whistleblowers and there's even less structure and chance of getting the authorities on your side in Europe and the UK."

As a result, the career risks of whistleblowing are still too high, says Skinner. "There should be an independent third party you can go to confidentially and get due diligence done without your name being associated and also with the understanding that you will be supported by the authorities if you have a case."

Moore adds that the tendency for companies to gag whistleblowers with big payoffs is all too common, not just in the financial sector, and leads to much wrongdoing never seeing the light of day.

Although it is very early days, the FCA is promising to help whistleblowers in the UK financial sector once it comes into being, including a dedicated phone and email contact specifically for whistleblowers. In its document *Journey to the FCA*, it sets out its aim to "improve the way we gather intelligence...including listening to comments from consumer organisations and whistleblowers…creating a bolder organisational culture, and adopting a new style of supervision."

It promises that the information received will be analysed and investigated and adds that "we will place significant value on whistleblowing alerts and seek to provide as much useful feedback to the whistleblower as possible".

"WHERE PROFIT IS THE SOLE MEASURING STICK OF EVERYTHING YOU ARE BOUND TO END UP WITH PEOPLE DOING BAD THINGS."

An FSA spokesperson said the existing whistleblowing hotline had more than 3,000 calls last year, although it does not track directly what proportion or type of calls resulted in exposure of wrongdoing. He added that the FCA will be open to all relevant sources of information into wrongdoing: "In speeches Martin Wheatley has said we are open to using a wider range of sources in future for information from whatever source is appropriate."

Much more needs to be done, however, to create a more open culture and a legal approach both inside and outside of banks and other regulated financial businesses if whistleblowing is to be truly encouraged, says Moore.

"There should be additional protections for those in control functions. They should report to a specialist oversight and assurance non-exec who represents them on the board and spends two to three days a week there. If there is a desire to dismiss someone from the control function, there has to be a proper hearing.

"I think we also have to phase in proper competence and credibility of the control function. We need to have a proper, chartered, professional qualification for these people."

It should also be incumbent on companies to carry out thorough and robust investigations when wrongdoing is alleged, he adds. "There is a big risk if you take the statements of the manager, who tells you everything is fine, at face value without calling in the auditor or compliance officer to check. Self-serving statements without corroboration should bear no weight."

Corporate law, which was not designed for balance sheets the size of countries, also needs to be amended. The huge potential rewards resulting from the scale of these balance sheets can be corrosive for the moral judgement of the individuals in charge of them, says Moore.

"We need to find a way of changing the way company law works to recognise that if profit becomes a person's exclusive goal they will become morally and legally relative if they can get away with it. Where profit is the sole measuring stick of everything, you are bound to end up with people doing bad things or losing perspective about right and wrong."

Another fact of human nature makes the act of whistleblowing a risky option – the tendency to shoot the messenger and to shun the insider who goes against the prevailing culture even though they speak the truth, says Moore.

Despite the difficulties, however, he refuses to accept that the difficulties should prevent employees, banks, investors or regulators from the vital task of trying to improve transparency, openness and honesty. "The banks are vital to the economy and we have not got the checks and balances right yet," says Moore.

He is philosophical about his own bruising experiences, believing he is the better for it, despite the financial and emotional damage he has suffered. "It has been an intensely painful experience but on the other hand we get transformed by trouble and so it has been a very graceful experience too.

"Mother Theresa once said, 'If I lose my reputation, at least that's one less thing to worry about.' It has been cathartic in that way and I'm glad I did it. I think I've been doing some good and there's more good still to be done." CB

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