FS Risk and Regulation Briefing

Banking Standards Review Council

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Barclays, HSBC, Lloyds Banking Group, RBS, Standard Chartered and Nationwide have all agreed to establish a new body, called the Banking Standards Review Council ('Council'), following recommendations made by Sir Richard Lambert on 19 May 2014.

The new body will require participating institutions to commit to improving their culture and practices and to report annual on their performance to the public. The Council will be launched later this year. All retail and wholesale banks and building societies operating in the UK will be able to join on a voluntary basis. Its Chairman will be appointed by an independent panel led by Bank of England governor Mark Carney. Sir Richard will act as Interim Chair until the appointment is made.

Professional standards

The Council will develop a single, principles-based code of practice that will provide a template for the UK banking industry. The code will be designed to help guide behaviour in a number of areas, such as 'ethical conflicts of interest or moral ambiguity' and will be also used as a metric to benchmark the performance of banks against their peers. Participating institutions will only have to apply the code to the UK part of their global operations. The code will be based 'firmly' on regulatory principles to avoid confusion and duplication.

Sir Richard believes it would be 'inappropriate and counterproductive' for the Council to set specific standards that can be applied to all the different activities of banks. Instead, it will focus on identifying areas which could be improved by collective action, and where 'legitimate concerns have been expressed about current practices'. The Council will 'own' the standards it develops, which will have elements of aspiration within them.

Sir Richard envisages that these standards should be developed in a collaborative manner. Working groups comprised of both bank and non-bank members would draw-up the standards and present them to the Council for approval. Participating banks would then sign-up to conform to the standards on a voluntary basis, which will be governed by a 'comply or explain' approach.

The Council will consult on what specific areas it will attempt to drive standards. However, it has given some examples of where the new standards may be developed:

- fair and effective complaints mechanism
- good staff values
- incentives and behaviours
- practices to encourage employees to challenge poor behaviour and report any concern to management
- treating clients with respect
- transparent approach to fees
- benchmark and price provision mechanisms
- high-frequency trading.

Assessment

Banks will be assessed against three board categories:

- **Culture:** how well internal codes of conduct are understood by staff and how they have been embedded in the operations of the business (for example, in recruitment, training programmes, promotion and performance management).
- **Competence of staff:** the bank's recruitment and development processes (including its continuous professional development programmes) and practices to encourage employees to think through ethical dilemmas.
- **Outcomes for consumers:** client surveys, customer feedback and trends in customer complaints.

The assessment process will work as follows:

- The Council will work with each participating bank to develop a self-assessment framework.
- Data inputs would be collected by the individual bank.
- The Council will assess the data.

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- The Council will meet with independent non-executives from the bank to discuss its assessment – the purpose of the meeting is to highlight good practice and identify potential weaknesses.
- In its annual report, the Council will discuss the overall progress of the banking sector against the three headings above and would also comment on the performance of individual banks.
- Participating banks will be required to undertake the assessment at least annually; the assessment for smaller banks may occur less frequently.

The assessment metrics will be drawn from the regulators' high-level principles. The underlying framework will be developed with each participating bank in due course. The assessment exercise will not be solely quantitative in nature. Moreover, the Council will not engage in the publication of so called league tables of performance which it believes is too susceptible to 'gaming'. If the Council comes across wrongdoing it will report this to senior management of the bank and not to the regulator(s).

Certified persons

The Council will play a role in helping banks prepare for future regulations. Particular emphasis was given to the Certified Persons regime in Sir Richard's report, which is coming into force from 2015. Certified Persons are employees who are not currently 'regulated' through Significant Influence Function rules but are senior enough to cause significant harm to the bank or customers if they fail to do their job. Under plans, banks will be responsible for identifying and ensuring Certified Persons are 'fit and proper' for their appointed roles. The Council may support a bank in their assessment of a Certified Persons qualifications, training and level of competence. It could also work with banks to establish good practice in developing training programmes for this cohort.

Training

The Council will not accredit training programmes delivered by external providers or banks themselves as originally suggested in the consultation report. Instead, it will 'identify and champion good practice in training programmes across the whole banking sector' by picking out different themes to examine. For example, the Council sees a role for itself in helping raise standards in the training of ethical dilemmas. In general terms, the Council will be active in shaping the supply-side of training and professional standards, working with groups of stakeholders to drive an enhancement in the quality and the value of training.

Scope

The Council will be open to banks and building societies operating in the UK, irrespective of their ownership and size. If a bank joins, the retail and wholesale operations of the institution will fall within the Council's remit. However, global staff or the international operations of institutions will not be covered, as was originally indicated. 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'.

Organisation and cost

The Council will be managed through a governing council. This governing council will 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 should bring a real understanding of banks' full range of stakeholders and should include representatives of employees, customers, small businesses etc.

The estimated running costs of the new body will be £7-10 million annually, which will be paid by the seven sponsoring institutions. Variable costs will rise depending on the amount of members. These additional costs will be funded by the new joiners' fees, although there would be an element of cross subsidisation in order to make participation attractive to smaller institutions. For perspective, this rough cost estimate is broadly comparable with the running costs of the UK Takeover Panel and the UK Advertising Standards Authority.

What happens next?

Coming weeks: The seven sponsoring institutions will establish the Appointments Panel to get a process for selecting the Chairman under way. Mark Carney, governor of the Bank of England, has been appointed to chair the Panel. At the same time, the legal structure of the Council will be fully defined, along with the roles and responsibilities of the Appointments Panel, the governing council and Chief Executive.

Coming months: Other banks and building societies will be canvassed to join the Council. A transitional team will start working on the organisational design of the new body, and securing the appropriate infrastructure.

Other early priorities include:

- Agreeing with regulators on how best to align the Council's work with their mandate, and to design a high-level code of practice for the industry.
- Developing a communications strategy, and designing the branding that will enable banks and building societies to differentiate themselves from institutions that do not join the Council.
- Working with the professional bodies already active in banking on ways to add value to professional qualifications.
- Developing the framework and capability for assessing individual banks and building societies.
- Establishing practitioner panels with a view to identifying where standard setting would be most appropriate.

Coming years: The Council will start identifying and publishing examples of good practice in the industry, and begin to work on its priority areas for standard setting next year.

The Council will aim to publish a full report on the state of banking standards and good practice in the first half of 2015. 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.

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What should banks do now?

Many banks and building societies are already working on programmes to deliver higher standards of business conduct and culture across their business. The establishment of this new body and the greater public scrutiny that will be placed on standards will only accelerate this work.

Management should not wait for the Council to define what good looks like for their organisation. The responsibility for improving the behaviour of banks and building societies rests within the institution itself. It is up to management to define the values and purpose of the institution, 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. By doing this leaders will instil a culture that is open and accountable in its actions, and embrace the trade-offs that inevitably occur as a positive part of doing the right thing.

The right tone from the top is a vital ingredient in making high standards of competence and behaviour part of corporate DNA. Institutions need to identify where they are exposed to potential misconduct through a behavioural risk assessment and deploy remedial plans to correct inappropriate behaviours. If the new body delivers against the long term vision of the industry, it could play an instrumental role in helping the leadership of UK banks create a tone that rebuilds public trust. However there is no easy fix. We believe that putting this into practice will take time and significant investment from bankers, regulators and professional bodies alike. It will take a generation or so for the culture at banks to fundamentally change. Institutions need to put the interests of the customer at the heart of their business model and decision making processes, reward employees for doing the right thing, and empower their people to live their aligned personal and corporate values with consistency and with transparency. Ultimately it is actions such as these that will rebuild and restore trust with stakeholders – not more words.

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