THE FINANCIAL SERVICES PRACTITIONER PANEL

RESPONSE TO THE PARLIAMENTARY COMMISSION ON BANKING STANDARDS CALL FOR EVIDENCE – August 2012

24 August 2012

Executive summary

1. We welcome the Parliamentary Commission on banking standards' ('Commission') inquiry and the Practitioner Panel is keen to contribute to transformational change in the sector. However, we think that the central issue is not a lack of professional standards, but rather one of "cultural imbalance" that has arisen in some parts of financial services over time.

2. We see three hypotheses running through the current questioning:
   (i) is the problem a lack of technical expertise?
   (ii) are there clearly defined standards of behaviour and ethics in banking? and/or;
   (iii) are there credible sanctions for failing to adhere to (i) and (ii) above?

3. We argue that there is sufficient technical expertise in banking, that ethical standards are clearly defined and that the sanction regime for non-adherence is strong (and improving). However, we accept that despite this, significant sections of the financial services industry have failed to adhere to these standards. We believe that the issues are cultural.

4. Specifically, we believe that the issues that have been occurring in the Financial Services sector are the result of some deficiencies in banking culture that have arisen as a result of the imbalanced pressures that have been exerted on the sector in recent years.

5. Successful banking involves balancing the often competing demands of (primarily) customers, shareholders and practitioners over time. Traditionally, these demands have been held in balance, enabling sustainable returns to each.

6. Historically, the 'bond' between practitioner and customer was the strongest of the relationships – formed through an era of "face to face" banking and markets, underpinned by personal and human relationships. Technology, the internet and the "big bang" of the 1980s have progressively distanced the practitioner of financial services from the end consumer. This "depersonalisation" has eroded the historical bond and hence weakened the influence of the end consumer in the decision making of large organisations.

7. At the same time that the customer's voice has become more removed from the decision maker, the pressure of the shareholder has (by default) become greater. This has created an imbalance within the culture of some financial institutions, which some management teams have failed to correct. The cultural imbalance has led to suboptimal outcomes all round in recent years.

8. The solution cannot be to return to face to face banking – most customers do not want this, and it would be unsustainable for banks to attempt to deliver it. Rather, the central challenge is how do we create a culture where people running banks deeply and thoughtfully consider the outcome of their actions on their customers and the broader community, while still delivering an attractive return for shareholders? The specific change is to seek to embed a

culture that is highly considerate of the human impact of decisions, in an environment where the customer may be “out of sight”, and hence “out of mind”.

9. It is the belief of the Practitioner Panel that culture can be measured, regulated and steered in a certain direction. We have examples to support this which we would be happy to provide. We believe that regulators and policymakers should seek to incentivise positive cultural change in this specific direction.

10. We feel that this inquiry and further consideration of the issues can provide a real opportunity to improve the reputation of UK practitioners.

Introduction

11. The Financial Services Practitioner Panel (‘the Panel’) was set up under the Financial Services and Markets Act to represent the interests of regulated firms in the work of the Financial Services Authority (‘FSA’). It consists of approximately 10 members drawn from a cross section of the larger regulated firms. The Chairman of the Smaller Businesses Panel sits on the Practitioner Panel to ensure that the interests of smaller firms are also considered.

12. The Panel very much supports and welcomes this Parliamentary Inquiry into banking standards and, in particular, believes that the Commission has properly set the tone in trying to identify and find solutions to the underlying problems for the banking industry. We feel that this is a refreshing approach to consider the issues, in addition to looking at the technical regulatory solutions to issues in the banking sector. Although the Government and FSA’s proposals are of great importance, we feel that one of the unaddressed central issues is an emerging cultural imbalance that has arisen in some of financial services over time. This inquiry provides a real opportunity for the banking industry and policymakers to address this imbalance.

Questions

Q1. To what extent are professional standards in UK banking absent or defective? How does this compare to (a) other leading markets (b) other professions and (c) the historic experience of the UK and its place in global markets?

13. In the Commission’s first question, we see three elements which need to be addressed. The first is one of technical expertise – do we believe that there is a lack of technical expertise, training, skills or understanding among practitioners holding various roles (front line staff to senior management) in UK banks? The second is whether there are clearly defined standards for practitioners – are there clearly defined standards of behaviour and ethics that practitioners are subject to? And third, where there are failings or lack of adherence in relation to either a lack of expertise or standards of behaviour, are there credible sanctions and deterrents in place?

14. We believe that levels of technical expertise in banking are high and that the majority of staff are well trained for their roles, are knowledgeable about their markets and products and have the necessary skills to undertake their jobs. The FSA’s work as part of the Retail Distribution Review (RDR) to improve the level of knowledge, skill and professional standards of retail investment advisers, has been an important step in ensuring that consumers can be sure they are receiving advice from knowledgeable professionals. The RDR has also strengthened the statements of principle in the Approved Persons Regime which now place more emphasise on personal accountability. As well as being trained to take on their positions, practitioners generally undertake ongoing continued professional development and there are a range of courses available for practitioners to keep skills and knowledge up to date.

15. Generally, we believe that the banking industry is staffed by a large majority of hardworking individuals who bring high levels of professionalism to their work and are well trained for the wide range of roles banking entails in both the retail and wholesale markets. However, there are a number of banking professionals who have failed to meet the expected level of professional ethical standards in their work.

16. UK banks operate under high levels of professional standards and regulatory rules, which set the expectations for the industry. Professional standards exist principally in the form of the FSA’s Principles for Business, set out at PRIN 2.1 in the FSA Handbook. These principles apply to all regulated financial firms and consider strong ethical requirements such as the requirement to act with integrity and to treat customers fairly. These principles are very similar to the well respected professional standards in other professions, such as the 10 principles of good conduct for solicitors contained within the Solicitor's Regulation Authority's (SRA) Handbook and the Hippocratic Oath for doctors. Practitioners are also subject to a number of other professional standards including:

    - Requirements and responsibilities of directors under Part 10 of the Companies Act 2006 (e.g., the duty to promote the long term success of the company and to consider the impact of the company's operations on the community and the environment);

    - Rules governing the type of person that can be an ‘approved person’ holding a significant influence function (CEO, Director, compliance oversight, etc.) at banks. For large institutions, these are often now subject to an interview process by the FSA to ensure parties have sufficient knowledge and skill to perform their functions and are suitable;

    - Training standards in the Training and Competence section of the FSA handbook; and

    - Standards set by professional bodies and organisations within the banking industry (e.g., the Lending Standards Board).

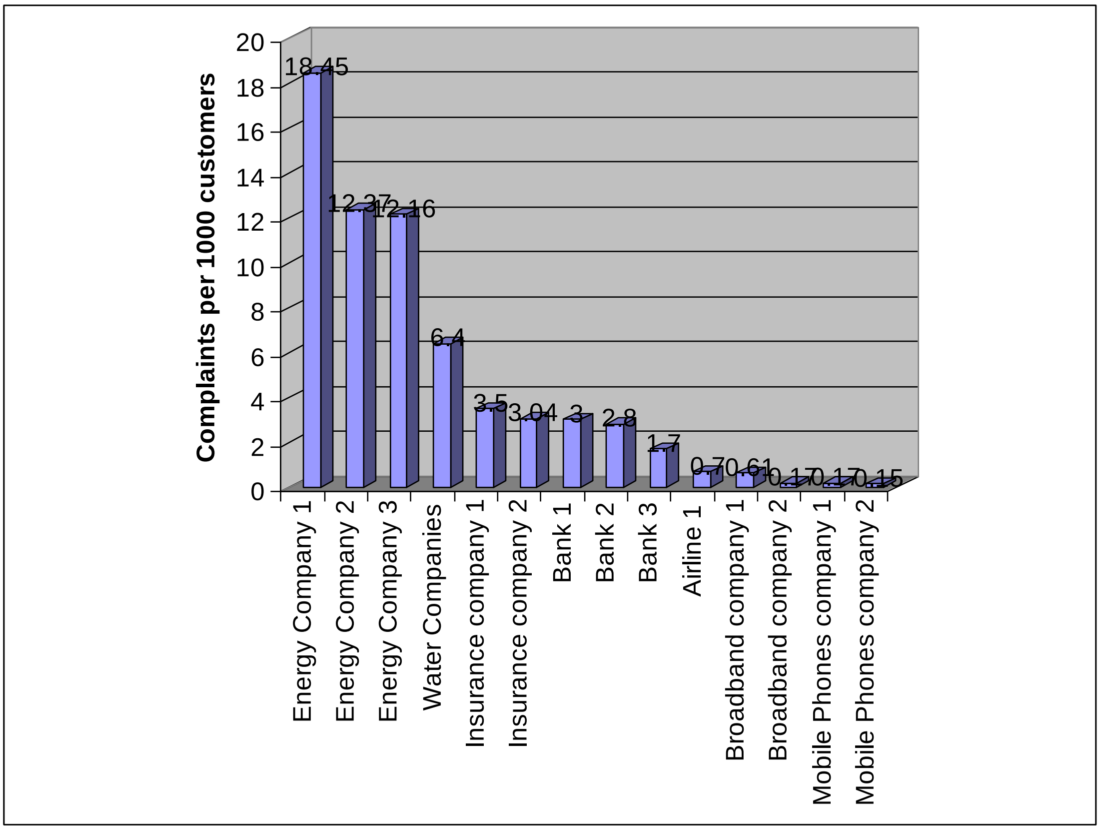
17. Banking professionals also have a range of professional bodies which prescribe good practice, ethics and conduct, and offer training and awareness of these standards (e.g., the Institute of Financial Services, Chartered Banker).

18. The FSA plays a similar role to the SRA for solicitors or the General Medical Council for doctors in upholding practitioner standards and preventing parties from acting in the profession should their standards slip. We feel that the FSA's enforcement regime and practice in the years subsequent to the financial crisis have much improved and is a strong deterrent for those parties who fail to adhere to the FSA's regulatory rules and principles. The FSA has strong enforcement powers to bring action (including criminal prosecutions) for breach of rules and principles, including holding individuals personally responsible for those breaches, and has increasingly sought to rely on breach of principles for enforcement action rather than breach of individual FSA handbook rules. We support a considered use of this approach and hope it will continue as the FSA transitions to the new regulatory bodies, the PRA and FCA.

19. The negative way in which banks are perceived in the news media often, in fact, overplays customers dissatisfaction with the banks and data shows that although complaints against banks are higher than they perhaps should be, this does not set them significantly ahead of other industries. The graph below (figure 1), prepared based on publicly available complaints data, provides an illustrative example of the level of complaints received by some of the larger UK banks compared to major players in other UK industries, such as energy and telecom. It shows bank customer complaints are comparable to insurance companies in terms of complaints, being generally lower than those against utility companies, but higher than telecom companies.

20. However, we concede that despite high levels of technical expertise, standards and strong regulatory enforcement, significant sections of the Financial Services industry have failed to adhere to proper professional standards. It is the view of the Panel that the reasons for this are cultural.

Figure 1 – Recorded complaints in various industries per 1000 customers / accounts



	Industry	**Specific example[1]**	**Complaints per 1000 customers / accounts**
1	Energy Company 1	2011 Npower reported complaints	18.45
2	Energy Company 2	2011 British Gas reported complaints	12.37
3	Energy Company 3	2011 E.ON Energy reported complaints	12.16
4	Water Companies	2009-10 OFWAT industry complaints per 1000 connections	6.4
5	Insurance company 1	Tesco GI & Pure Protection insurance, 1 March 2011 to 31 August 2011	3.5
6	Insurance company 2	Admiral Car insurance number of complaints opened H1 2011	3.04
7	Bank 1	RBS H1 2011 complaints	3
8	Bank 2	HSBC H1 2011 complaints	2.8
9	Bank 3	Lloyd's banking group H1 2011 complaints	1.7
10	Airline 1	Ryanair complaints in 2012	0.7
11	Broadband company 1	OFCOM complaints about TalkTalk (Oct - Dec 2011)	0.61

[1] 1-3 - http://www.dailymail.co.uk/news/article-2084919/Energy-bills-Millions-complain-charging-errors-inaccurate-meter-readings.html
4 - http://www.ofwat.gov.uk/regulating/reporting/rpt_los_2009-10supinfo.pdf
5 - http://www.tescobank.com/help/complaints-reporting.html
6 - http://www.admiral.com/car-insurance/your-policy/complaint-performance.php
7 - http://www.rbs.com/customers/complaints-data/the-royal-bank-of-scotland.html
8 - http://www.hsbc.co.uk/1/2/personal/contact/complaints-and-compliments/complaints-data
9 - http://www.lloydsbankinggroup.com/customers/complaints_H1_2011.asp
10 - http://www.ryanair.com/en/news/ryanair-no-1-customer-service-stats-april-2012
11-14 http://consumers.ofcom.org.uk/2012/03/ofcom-publishes-latest-telecoms-complaints-data-3/

12	Broadband company 2	OFCOM complaints about Sky Broadband (Oct - Dec 2011)	0.17
13	Mobile Phones company 1	OFCOM complaints about Orange Mobile (Oct - Dec 2011)	0.17
14	Mobile Phones company 2	OFCOM complaints about 3UK (Oct - Dec 2011)	0.15

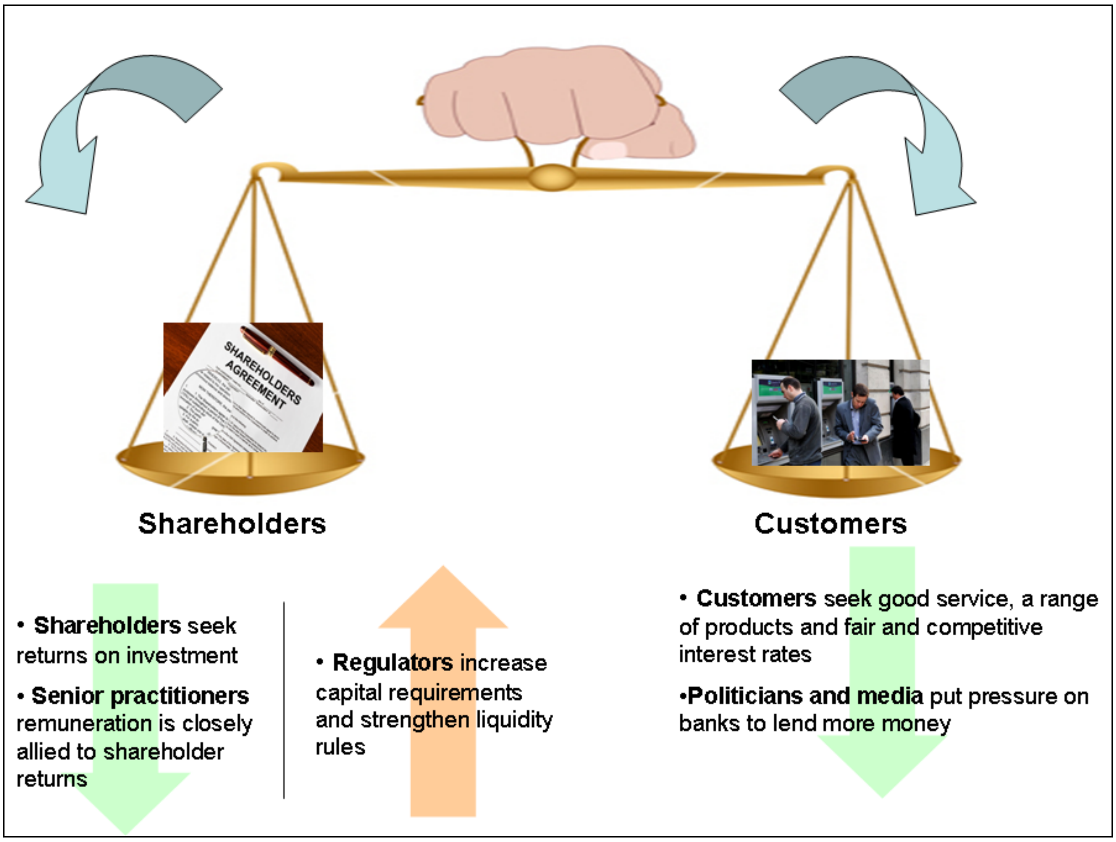
Q4. What caused any problems in banking standards identified in question 1?

21. The Panel believes that the incidents of bad practice in the Financial Services sector are the result of the imbalanced pressures that have been exerted on the industry in recent years and the failure in some quarters to compensate for these changing pressures appropriately. Practitioners are subject to a number of influences, including:

    - Shareholders pressure for good returns on their equity investments on a consistent basis;
    - Customers seek good service, a wide range of conveniently delivered products and fair and competitive interest rates.
    - Practitioners are frequently incentivised at senior levels with reward closely allied to shareholder return – which further increases the shareholder pressure.
    - Politicians and media have recently exerted significant pressure on banks to make decisions that conflict with the pressure from shareholders (e.g., agreeing to lending that they would not otherwise do) and
    - Regulators have lately been exerting pressure on banks which may also conflict with pressures of shareholders. (e.g., increasingly capital and tightening liquidity standards at a very rapid rate).

22. Successful banking involves balancing these competing interests. In the ideal scenario, engaged Practitioners meet the needs of their customers. The customers reward them with their loyalty. This loyalty results in strong profitable returns to the shareholder. In meeting the customers' needs, the bank is also fulfilling its duty to the community that it also exists to serve. It is recognised that this balance is hard to find and that the interests of shareholders and customers can compete in the short term.

Figure 2 - The balanced influences of practitioners



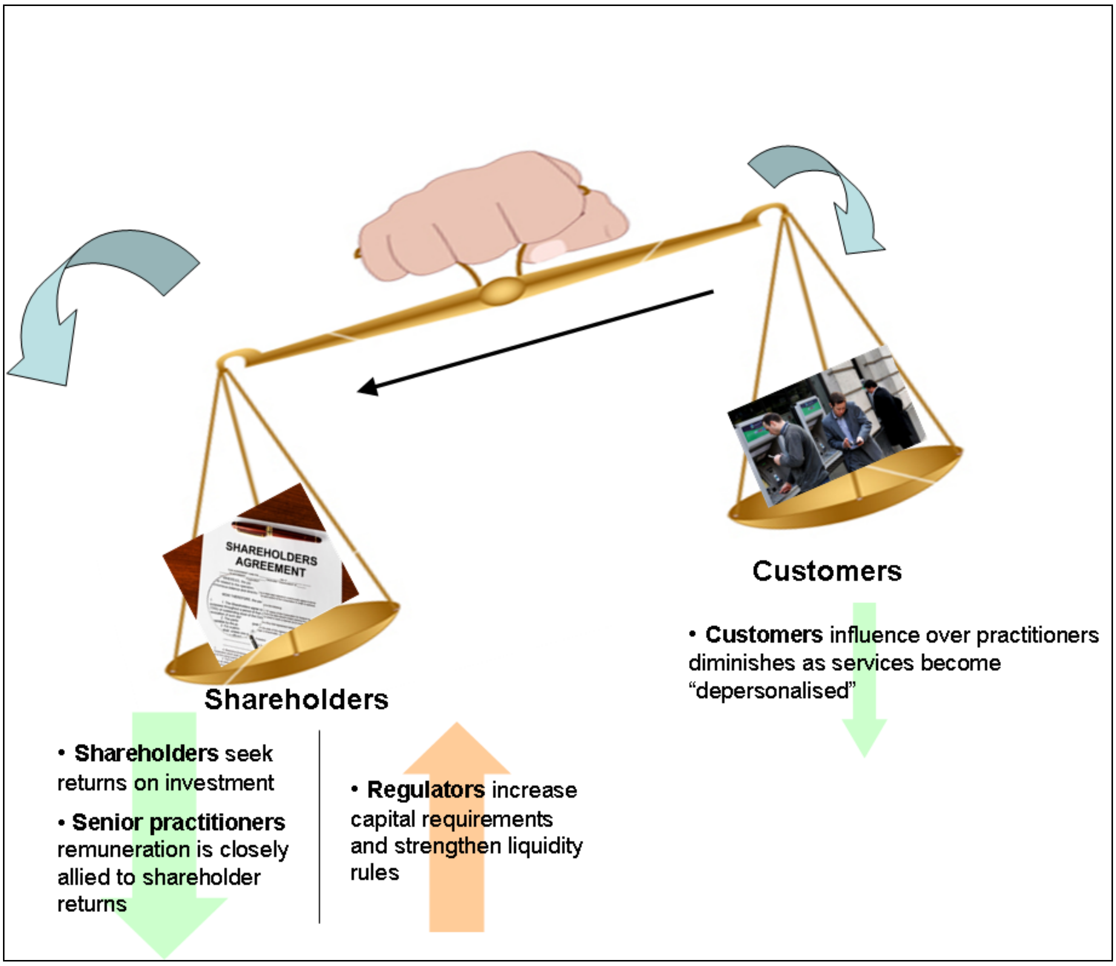
23. Historically, the bond between practitioners and customers was the strongest of the relationships. This resulted in part from practitioners' face to face contact with those customers which led to the forming of personal and human relationships. This is often typified by the notion of the 'golden age of banking', with examples of the caring and friendly local bank managers who maintained long term relationships with customers. In the common notion of this set up, such managers got to know the personal circumstances of their customers and were able to exercise a large amount of discretion in making loans and extending credit. Such a personal service created the perception of care, which many people using the service valued highly.

24. Although we agree that this level of personal service was good for the customer, we believe these arrangements no longer meet the majority of customers needs, nor are cost effective to operate today. It is also questioned how confident we can be about the fairness or consistency of the personal discretion bank managers exercised in previous eras for all customers. It is possible that past banking relationships may be considered unfair and inconsistent by today's standards. The customer outcome may have depended more on the strength of the personal relationship, than the merits of the customer's circumstances.

25. However, various factors have progressively distanced practitioners of financial services from the end customer and have eroded the bond of trust between practitioner and customer. Customers influence over the decision

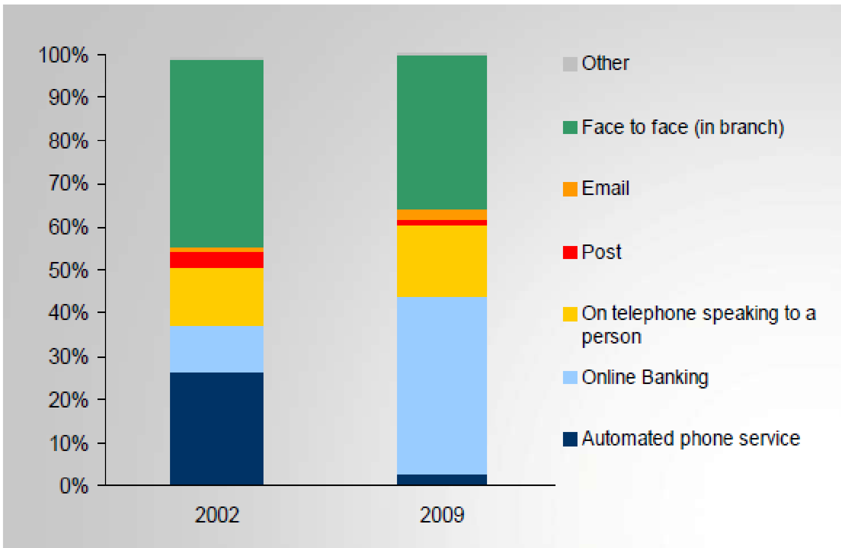
making in (particularly) large organisations has been weakened as explained below.

Figure 3 - The imbalanced influences of practitioners



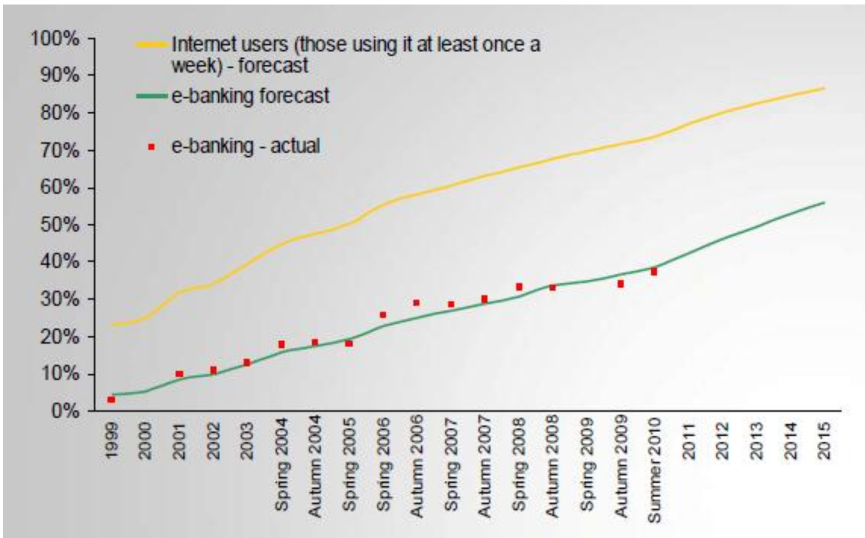
26. The Panel feels that one of the key causes of this "depersonalisation" in the retail market has been the decline in human contact between bank practitioners and their customers through attendance at bank branches and personal telephone contact. Instead of meetings with bank managers and bank counter staff, customers are increasingly utilising communication technology to access bank services. Figure 4 (below) shows that between 2002 and 2009 we saw a marked jump in the preferred use of online banking, from around 10% use in 2002 to around 40% use in 2009. At the same time, we saw a 10% drop in the preference for face to face contact with banks at branches. Figure 5 (below) shows that industry experts expect this trend to continue in coming years, particularly with improvements in online banking and, for example, access to services using mobile phones.

Figure 4: Survey of customers preferred method for contacting banks



Source: Monitise / The Future Foundation / nVision Research
Base: 1,000 respondents aged 18+ UK

Figure 5: Percentage of people who do at least part of their banking via the internet - nVision forecast, Summer 2010-based projection



Source: nVision Research
Base: 1,000 respondents aged 18+ GB

27. While this data shows less personal contact in the retail banking market, we believe that a similar paradigm exists in the wholesale banking market. The so-called "big bang" in wholesale market trading of banks and investment firms of the 1980s took away the physical trading floors that relied on personal contact and relationships between the parties and introduced electronic exchanges and trading platforms. Interbank trades now take place almost anonymously via computer trading servers. Customers, who include institutional investors such as pension funds and insurers, are also increasingly able to take part in computerised trading in a number of markets. They are

able to use bank trading interfaces available over the internet to place trades and take positions in the market. In the wholesale markets generally, a large proportion of trades are now placed via computer algorithm, instead of being placed over the telephone with a broker known to the customer. What was once the basic tenant of the London stock exchange "my word is my bond" is no longer given credence. As practitioners and customers no longer exchange so many words, fewer bonds can be created.

28. In both retail and wholesale markets, depersonalised, remote contact with banks has been affected for sound reasons and provides much greater efficiency and corresponds more closely to the majority of customers needs. Benefits such as 24/7 access to current account services, for example, are highly valued by customers who use these services. Consequently though, customers being "out of sight" will inevitably result in them to some extent being "out of mind", especially when directors of large banking institutions are making decisions at the strategic level.

29. The weakened practitioner-customer bond has distanced the customer's voice from decision making and the pressure of shareholders has by default become greater. The relationship of trust has also broken down on the customers' side, which particularly became clear during the financial crisis. Prior to 2007, some banks made significant numbers of loans to customers beyond that which was prudent and which customers would be feasibly able to pay off (not understanding their customers' circumstances).

30. Likewise, the increasingly remote relationship between customer and Practitioner has led some customers to act less responsibly in dealing with their financial services providers. For example, some customers took advantage of cheap credit and borrowed in excess of their ability to repay loans and mortgages while banks offered these. More recently, we have seen examples of some customers being encouraged to make claims (e.g., PPI or personal accident) against banks and insurers without regard to the full validity of their claims.

31. Some practitioners have managed to keep customers front of mind, and continue to deliver both solid returns and good customer outcomes despite these pressures. However, other management teams have failed to redress the imbalance within their organisations. The cultural imbalances in some banks have led to suboptimal outcomes for all parties and have resulted in forms of bad practice that are currently damaging the reputation of all UK banks and weakening the economy.

Q5. What can and should be done to address any weaknesses identified?

32. It is clear that the solution to the banking cultural imbalance is not to attempt to turn back the clock to purely face to face banking, or manually operated markets. Although some customers still find it useful or desirable to attend bank branches or speak to practitioners on the phone, a large and increasing number of customers place significant value in remote banking services. Further, attempts to re-instate personal bank managers for every customer

would not be economically sustainable for banks. Likewise, Markets would not be viable if not operated by computer.

33. Rather, we believe the central challenge for the industry, regulators and policymakers is to consider how we create a culture where those people making decisions in financial institutions are deeply and thoughtfully considering the outcomes of their actions for customers and the broader community, while still delivering attractive returns for shareholders. We are convinced that if Financial Service Practitioners meet their customer needs, this will lead to superior economic returns over the long term. We do not see a conflict between these two pressures in the long term.

34. The Government and FSA have spent significant time since the 2007 financial crisis addressing many of the issues that contributed to the crisis. However, almost all the focus thus far has been on technical standards, rules and sanctions. For example, we note that in the HM Treasury June 2012 "Banking Reform" paper, which consults on the recommendations of the Independent Commission on Banking, there are 109 references to bank "capital", yet only 7 references to "behaviour" and one reference to "culture". Policymakers must now further seek to address cultural imbalances. It is the belief of the Panel that culture can be measured, overseen and steered in a certain direction. We are aware of practice at some financial institutions where the culture of staff is measured and actively steered. It is possible to record and understand the degree to which people are considering the human impact of decisions as well as the profit impact.

35. We are happy to provide examples of how some organisations are defining, measuring and influencing their culture to deliver superior outcomes.

36. The FSA has attempted to make in-roads into the issue of culture in recent years, for example, as part of the 'Treating Customers Fairly' (TCF) regime. While some believe that these efforts were not entirely successful, it is our belief that perhaps the FSA has further to go in seeking to address issues of culture. We believe that Regulators should consider how best to incentivise positive cultural change in banks. This must start by firms considering where they are currently imbalanced and progressing to a situation where all levels of practitioners in a bank consider the human consequences in all of their decisions. The regulator faces particular challenge in incentivising this in a way that goes beyond mere 'box ticking', to become a thoughtful consideration of outcomes by staff at every step in decision making processes. One proactive step the FSA may take is to seek out good examples of culture and publicise and promote these as examples to other banks and regulated firms.

37. We also believe that the 'tone from the top' is extremely important within any organisation. This is because culture inevitably reflects the ethos or philosophy of the leader to a degree. Hence, the character of leadership is particularly important in ensuring good cultural values are permeated throughout financial services firms.

38. We feel that this inquiry and further consideration of culture issues can provide a real opportunity to recover the reputation of UK banking practitioners, as well as improve the outcome for practitioners, shareholders, customers and the economy as a whole. The Panel stands ready to contribute to this important debate and assist the Commission is seeking workable solutions.