

Response of the Institute of Business Ethics to the Banking Standards Review consultation

Executive Summary

Though there were many causes to the banking crisis, failure by banks to live up to ethical values played a significant role. This is manifest not only in the belief at the time that it was acceptable for banks in the US to sell mortgages that their customers could not afford by falsifying their bank statements behind their backs, but also in the persistence in the UK of scandals such as those involving payment protection insurance, Libor, and now foreign exchange market rigging.

While policy-makers have focused heavily on regulation and governance, too little attention has been paid to building and maintaining organisational cultures based on ethical values. This would do much more than regulation to help prevent bankers from making poor choices which ultimately inflict serious damage both on their bank and on the broader community. We need to shift the focus away from costly compliance-based regulation and towards ethical values which will naturally encourage bank employees to display good behaviour even in situations not directly covered by regulation.

We therefore believe there is a strong case for a body charged with helping banks to improve their culture through high standards of business practice based on ethical values and driven by respect for the customer. Its creation should be governed by three main considerations.

1. The new organisation should have a clearly focused remit. It should be concerned with the culture, behaviour and business practice within banks. It should not seek to do other things which dilute this objective such as set professional standards of competence for individuals. Other professional organisations already exist for this. A simple organisation will also be easier to establish and can be set up more quickly.
2. Culture is ultimately a matter for individual banks and their boards. The new organisation can support them but the banks alone can develop and embed the desired culture. The new body should seek to avoid tasks which might appear to shift this responsibility away from them, for example by taking on a disciplinary role or by providing outside accreditation arrangements for training programmes which it does not

ultimately control. Key ways in which it should help banks are set out below.

3. The governance arrangements of the new organisation must endow it with the right level of integrity, independence and accountability. The consultation paper acknowledges that this is a difficult issue, but it must be addressed. The mechanism for appointing the board is key. Appropriate arrangements should be in place from the very start, so that it will be clear how successor boards will be appointed. We favour a Nomination Committee chaired by a senior figure such as the Governor of the Bank of England and drawn from a broad coalition of stakeholders together with key figures from broader society such as the law, academia and faith groups. The board of the organisation itself, however, should be made up of individuals serving in their personal capacity rather than as representative of a particular stakeholder group. As a matter of good governance, it should be subject to regular independent evaluation to ensure that it is functioning properly.

Based on these principles, the main activities of the organisation should be:

- to help banks develop a clear understanding - both at senior executive and operational level - of the link between values and behaviour and to put in place programmes which reinforce this link through building the right tone at the top, developing training and education support tools, and through the implementation of credible and robust codes of business practice,
- to provide independent appraisal of progress to show them where they may be falling short,
- and to publish an annual report each year setting out areas where the sector as a whole needs to improve based on understanding of best in class.

The new body should not be part of the regulatory process, and adherence should be voluntary. However, its stature and effectiveness would be enhanced if licensed banks and building societies were required to state publicly whether they adhere and if not why not. This is similar to the requirement on asset managers under the UK Stewardship Code.

The Institute of Business Ethics, which is a charity funded by business and dedicated to the promotion of high standards of business conduct based on ethics, has a long track record of practical experience in these areas and stands ready to offer help and advice as needed.

Specific answers

Question 1: Do you agree with this objective?

We agree that there is a role for an independent body whose objective is to promote high standards of behaviour within banks. We think, however, that its objective should be limited so that the new body's role is clear and so that it does not make itself a hostage to fortune in future crises.

The two most useful roles for this body are:

- first, to help banks design and embed ethical values through establishing the right tone from the top, training and education support tools, and codes of behaviour which properly reflect both the standards they wish to achieve and the expectations of the public, and ,
- second, to help banks identify situations where the standards applied in practice within their organisation differ from those set out in their code. This would involve regular independent surveys of member institutions aimed at uncovering the views and experience of employees. Where these surveys show that the desired standards are not being met in practice, it would be up to the board and management to take steps to correct this.

Similar surveys provide useful data for boards and management across a range of industries. See for example the Investing in Integrity programme operated jointly by the IBE and the Chartered Institute for Securities & Investment¹. It is crucial that they are conducted by a knowledgeable external institution. The particular complexities of banking call for a specialist institution with particular expertise in the sector.

The body should also report publicly on the aggregate results of its surveys in ways that allow progress to be measured across the sector. This would expose patterns of weakness and inconsistency in standards between banks, which, although anonymised, would encourage laggards. We do not believe it is appropriate for an organisation involved in setting and measuring standards also to be involved in both training and accreditation. This could create conflicts of interest. Though the IBE assists companies with both the design and implementation of codes as well as with training, it is not, and never has been, involved in accreditation.

We agree that the organisation should be independent, though funded by the banks, that it should not be an advocate for them, and that it should take the perspective of the customer. Adherence should be on a voluntary basis, though we consider that all licensed banks and building societies should be compelled by

¹ See www.investinginintegrity.org.uk

regulation to state publicly whether they adhere, and, if not, why not. We also believe that banks which adhere to the new body should be required, as part of their commitment, to state publicly each year that they have undertaken an independent review of progress against their code, that their board has reviewed the result and taken any necessary remedial action. Adherents should also be required to report publicly on the number of instances where employees have been disciplined for breaches of the code, on the incidence of customer complaints and of employee whistle-blowing.

We do not believe that the organisation should be involved in measuring professional competence as well as ethical standards. This role would make it too complex and would risk diluting the primary objective of ensuring high standards of behaviour.

Question 2: Do you agree that there is a case for a collective approach calling for the participation of all banks doing business in the UK?

Yes.

Question 3: Do you agree with the proposed role of the new organisation?

Our answer to Question 3 is largely set out in our response to Question 1. We would add in respect of the reference to incentives, that there should be a clear linkage between variable pay and individual adherence to the code of ethical conduct. We also consider that the new body should not be involved in setting targets for individual banks. Rather it should help boards raise standards by contributing to the development of metrics and monitoring which enables them to understand the progress they are making. Oversight of culture is the natural role and responsibility of boards. Also, if the new body is involved in setting standards and targets for individual banks, it will risk being blamed for any shortcomings that emerge and its credibility could be undermined. Banks must take the responsibility for themselves.

Question 4: Do you agree with the proposed scope?

We consider that the proposed scope is correct for the time being so that the new body should aim to cover all banks and building societies doing business in the UK, but not the insurance, hedge fund or shadow banking sectors.

Question 5: Do these proposals go far enough to ensure the body has credibility?

The consultation document raises, but does not answer the question of accountability. This is critical, however. An organisation such as is proposed must have a governance structure which provides accountability and therefore

integrity, independence and credibility. Also, a chain of accountability is necessary to arrangements for appointing the board of the new body. The new body will lack authority if its board is seen as self-appointed, but it will lack integrity if it is appointed by the banks which fund it.

It is not desirable that the new body be accountable solely to politicians, since the development of high ethical standards in banking should be above party politics, especially while the government remains a major shareholder in the sector. Equally, if the new body is accountable only to regulators, it will be seen as merely an arm of regulation, whereas the purpose of introducing high standards of behaviour is to help ensure that employees make good choices in situations not directly covered by regulation.

The purpose of the new body is ultimately to serve the public interest by helping develop high standards of behaviour that make the UK banking system robust. It therefore seems sensible that the body should be accountable to the public, particularly those elements of the public which have an identifiable stake in banking. This would include not only government and regulators, but also shareholders who provide capital, consumers of financial products at both the retail and wholesale level, and employees. The question is how to turn this accountability into a governance structure through the appointment of an independent, neutral board.

The new organisation will not be helped if its board consists of a series of different stakeholders each of whom is fighting their representative corner. Each director should serve in a personal capacity and owe a clear loyalty to the organisation as a whole. However, board appointments could be made by a Nominations Committee of perhaps ten to twelve people on which the coalition of stakeholder groups was clearly represented alongside respected figures from broader society, including the law, academia and faith groups. The Committee should be chaired by a senior figure of stature such as the Governor of the Bank of England. Board positions should be advertised and open to competition, but the job of the Nominations Committee would be to ensure that the organisation had a well-balanced board of high calibre individuals each of whom recognised their obligation to the public interest.

The board of the organisation should itself be subject to independent external evaluation and the results communicated to the Nominations Committee.

Question 6: What are the pros and cons of aspiring to build individual membership over time?

We agree that, in the first instance, the body should for practical reasons relate to banking organisations rather than individual bankers. The paper argues

rightly that there is a risk of it appearing remote to individuals. However, the codes of business practice with which the body will be concerned will apply to all individual employees of banks. If the Codes are properly applied, this will make a profound difference at individual level. It is important that each member bank make this clear to its employees. Employment contracts should make it explicit that serious infringements of the code will result in dismissal or, in less critical cases, forfeiture of bonus.

Question 7: Is there a case for a more proactive approach to managing ethical issues, and if so how should it be managed?

Yes, definitely. The banking crisis was a major failure not only of regulation, supervision and governance but also of ethics and it is critical that the culture within banks is changed. This response has already mentioned a number of indicators which should be watched proactively, including customer complaints, the incidence of whistle-blowing, the management of whistle-blowing cases and the treatment of whistle-blowers, the number of employees disciplined for serious infringements of ethical behaviour expectations and the gap between the management's view of what is happening and what is actually happening on the ground.

Quite clearly there is an important link with remuneration. Arguably bonuses should only be paid to individuals who can demonstrate good citizenship with regard to a code of ethical conduct, but the incentives built into remuneration should also encourage ethical behaviour and act as a disincentive to unethical behaviour. This was not the case with Payment Protection Insurance. The banks involved, their shareholders and customers have paid dearly.

Banks should be free to choose the governance structure which enables delivery of a proactive approach. A separate ethics committee is one possibility, and could send a powerful signal but ethical issues pervade every part of a bank's operations and should not necessarily be compartmentalised in a way that might make them marginal. One solution might be to leave the choice of structure up to individual banks but require its effectiveness to be covered in the regular board evaluation.

Question 8: Do you agree with the proposal to build on best practice as set out in the regulators' guiding principles?

Yes. Our previous answers have given a series of indications as to how this might be approached. We also agree with the importance of face-to-face training.

Question 9: What would be the best way of assessing the implementation of a banks' code of conduct?

Analysis of the gap between what management believes is happening and the situation on the ground is the single most important method, alongside the determination and monitoring of key indicators, including those laid out in our answer to Question 7.

Question 10: Do you support this agenda [whereby the new body would set and monitor standards of in-house training]?

No, the new body should not take on itself judgements on the quality of training, largely because this is an enormous task across the industry as a whole and because of the risk it could lose credibility if training which it has endorsed is delivered badly in practice by in-house trainers over which it has no control.

Its role in providing information to boards and management about the gap between what they believe is happening and what is actually happening would be to signal to banks when their training was not delivering the right outcomes. It would then be up to individual banks to address problems which had been identified.

Question 11: Would you support the proposed relationship with the existing professional bodies being to provide a 'canopy' under which they operate, accrediting or in some way validating the training they offer to bankers?

No, for the reasons given in answer to Question 10.

Question 12: Is the proposal for assessing banks' and building societies' in-house training sensible and practicable? Could the new organisation play a helpful role in the certification process?

No.

Question 13: Do you think such a benchmarking exercise would be of value?

Question 14: Are these the right groups of metrics? Would you propose others?

Question 15: Would it make sense for banks to adopt a list of standard questions to add to their existing surveys?

Question 16: is self-reporting appropriate? Might other methods deliver better results?

Yes. The metrics are broadly correct and carefully crafted standard questions would help. Banks should report some key indicators as suggested above, including the number employees disciplined for serious infringement of the code of ethical conduct. They should also report that they have undertaken a gap analysis between expectations and practice as set out above and state whether they are taking necessary action, but it could be counter-productive to require disclosure of specific weaknesses as this may lead to information being withheld from the board and the independent surveyors. The new body should, as stated above, publish an annual report on an aggregate basis which should include evidence from public opinion polls of the changing level of public trust in the sector.

Question 17: Are there non-bureaucratic alternatives to this approach [to discipline] that might work better? Is there a role for kite-marking?

The new body should not have a disciplinary or an accreditation role for reasons given above. It should operate in ways that ensures banks are aware of lapses of culture in their own organisation and address them themselves, through internal disciplinary processes where appropriate.

Question 18: Do you agree with this proposition [that the new body should be a professional one bringing together bankers with a shared purpose and community]?

No. This is too ambitious a proposal at this stage. The organisation should have a simple focus on helping banks get the culture right. It is very difficult, in any case, to conceive of a single professional body that would unite the wide range of disciplines to be found in banking. In the first instance what is critical is that employees of a bank develop loyalty and a sense of long term commitment to their own organisation.

Question 19: Should the new organisation aspire to such a [thought leadership] role?

Yes, but only within its core remit which is to promote cultural change and high standards of ethical behaviour.