

Financial Services Consumer Panel

**Evidence to the Parliamentary Commission on
Banking Standards**

August 2012

Executive summary

1. The Panel feels there is an urgent need to address failures in the UK banking industry. We have witnessed how consumers and smaller businesses have suffered detriment as a result of numerous banking scandals. This has undermined confidence in an industry which fulfils an essential role in society.
2. We think this Parliamentary inquiry into the banking sector is long overdue and has the potential to deliver positive change. The inquiry covers a very broad range of topics. In our response we have focused on the UK retail banking sector, as this is the area on which we are best placed to provide comments.
3. It is worth remembering that the FSA took on the conduct regulation of retail deposits in November 2009 when it was apparent that industry self-regulation was not working. At this time, the retail banking sector had problems with maintaining standards and, despite the efforts of the FSA, continues to do so.
4. Since the introduction of the FSA's regulatory regime, we have seen first-hand how the industry has questioned the interpretation of FSA rules and the key principles which underpin them. This suggests retail banks still fail to appreciate their responsibility to their customers and the corporate responsibility of large organisations. Beyond the well publicised mis-selling scandals, there are numerous examples where banks are failing to treat their customers fairly by, for example, failing to meet basic standards designed to protect consumers.
5. The Panel believes this Parliamentary Commission presents a unique opportunity to deliver reform which would ensure banks can provide a systemically important service, in a competitive environment, that meets the needs of their customers. To achieve this, we believe a number of steps should be taken:
 - All banking executives should be required to meet professional and ethical standards set by a respected professional standards institution. Where standards are not met, there should be a mechanism for imposing appropriate sanctions with individuals held to account.
 - The Financial Services Bill should do more to increase consumer protection by requiring banks, and other providers, to have a duty of care to their customers. The new Financial Conduct Authority (FCA) should also be empowered to consider the effect of its actions, and the actions of the industry, on consumers' ability to access financial services.
 - The Government and regulator should address market failures, which prevent effective competition, in order to create a dynamic retail banking sector which delivers good value and truly operates in consumers' best interests.

- This Parliamentary Commission should develop a vision for the future retail banking market, to ensure the technology based services currently being made available function in the best interests of consumers. This is important to avoid repeating today's failures.

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?

6. The Panel has long been concerned by apparently low levels of professionalism and poor corporate culture in UK banking institutions. This has been evidenced recently by the LIBOR scandal and the widespread mis-selling of interest rate swaps by a number of banks.
7. The poor professional standards of UK banks are not a new development, but have plagued the industry for some time. The widespread mis-selling of Payment Protection Insurance (PPI) to a large number of consumers is the most striking example. After years of mis-selling these products and challenging the regulators, banks are finally compensating their customers, at huge cost to the industry. According to data from the Financial Services Authority (FSA), in June 2012 £5.4bn had been paid out in redress since the start of 2011, yet there is still no noticeable reduction in the number of people complaining about the way this product was sold.¹ Indeed, we have seen a number of banks increase their provisions to meet the cost of future PPI complaints.²
8. Further evidence of the poor standards of UK banks is that 1.6m customers had reason to complain to their bank in 2011 (this figure excludes the significant volume of PPI complaints also received by banks).³ In the second half of 2011 65% of these complaints were upheld in the customer's favour, a rate which is significantly higher than all other financial services sectors.
9. In contrast to the banking industry, the investment advice sector has made a significant commitment to increasing professionalism as part of the Retail Distribution Review (RDR). Like the banking sector, the investment industry has been guilty of mis-selling products. Its commitment to increasing professionalism should, in the longer-term, benefit consumers and increase trust in the industry.

¹ Financial Services Authority's month PPI refund and compensation statistics see http://www.fsa.gov.uk/consumerinformation/product_news/insurance/payment_protection_insurance/_latest/monthly-ppi-payouts

² See, for example, Lloyds Banking Group 2012 half-year results - http://www.lloydsbankinggroup.com/media/pdfs/investors/2012/2012_LBG_HalfYear_Results.pdf and RBS 2012 half-year results - http://www.investors.rbs.com/download/announcements/Interim_Results_2012.pdf

³ FSA aggregated complaints statistics 2006-2011 see http://www.fsa.gov.uk/library/other_publications/commentary/aggregate_com

10. The level of professionalism in the banking industry also compares poorly to other sectors, such as the legal and accounting professions. All lawyers and accountants complete years of training and examinations before qualifying. The importance of ethical standards in maintaining trust in the profession is impressed on all trainees. Once qualified, an individual faces significant penalties if they fail to meet the required ethical standards, with the threat of being banned from practicing or sent to prison highlighting the importance attached to maintaining professionalism in these sectors.
11. In contrast, the Chartered Banker Institute is the only remaining banking institute in the UK.⁴ As an independent professional education body it has a statutory duty to work in the public's interest and is focused on raising standards across the sector. However, it currently has just 9,000 members, of which 4,000 hold the highest level of qualification. This reflects the fact there is no mandatory qualification requirement for bankers and membership of a professional body is not compulsory.
12. As we have outlined in paragraphs 17 to 21, we believe there should be mandatory professional and ethical standards for bankers who exercise control, leadership or a significant management function within a UK banking institution. This can only be beneficial in improving trust in UK banking and its position in global markets.

Q2. What have been the consequences of the above for (a) consumers, both retail and wholesale, and (b) the economy as a whole?

And

Q3. What have been the consequences of any problems identified in question 1 for public trust and in, and expectations of, the banking sector?

13. The Panel is concerned that the apparent low level of professionalism within the banking sector has been costly and damaging for a large number of consumers and destroyed significant shareholder value. This is seen most noticeably with the PPI mis-selling scandal we highlighted in our response to question 1, but also in the apparent lack of responsibility when offering sub-prime mortgages. We would be happy to share a fuller list of poor banking practices with the Commission if it would be helpful.
14. The poor practices amongst retail banks have also disadvantaged smaller businesses. This is seen most noticeably with the mis-selling of interest rate swaps where a recent FSA review '*found a number of cases of bad practice, including the possible mis-selling*'.⁵ Although a number of the UK's largest retail banks will be undertaking a past business

⁴ See <http://www.charteredbanker.com/home/>

⁵ Financial Services Authority, *Information on interest hedging products*, July 2012 see http://www.fsa.gov.uk/library/other_publications/interest-rate-swaps/interest-rate-products

review, this mis-selling threatens the survival of some of the UK's smaller businesses, a key sector for future economic growth.⁶

15. The Panel feels the seriousness of the detriment experienced by many banking customers should not be underestimated. Holding and operating a bank account has become essential to participating in a modern society. For many consumers this has left them vulnerable to poor practices. Unsurprisingly, the inconvenience and disadvantage felt by many banking customers has led to worryingly low levels of trust in UK banks. This is highlighted by a number of market studies, including a 2011 Accenture survey of nearly 4,000 current account customers which found that only 45% of people trusted their bank.⁷

Q4. What caused any problems in banking standards identified in question 1? The Commission requests that respondents consider (a) the following general themes:

- **the culture of banking, including the incentivisation of risk-taking;**
- **the impact of globalisation on standards and culture;**
- **global regulatory arbitrage;**
- **the impact of financial innovation on standards and culture;**
- **the impact of technological developments on standards and culture;**
- **corporate structure, including the relationship between retail and investment banking;**
- **the level and effectiveness of competition in both retail and wholesale markets, domestically and internationally, and its effects;**
- **taxation, including the differences in treatment of debt and equity; and**
- **other themes not included above;**

and (b) weaknesses in the following somewhat more specific areas:

- **the role of shareholders, and particularly institutional shareholders;**
- **creditor discipline and incentives;**
- **corporate governance, including**
 - **the role of non-executive directors**
 - **the compliance function**
 - **internal audit and controls**
 - **remuneration incentives at all levels;**
- **recruitment and retention;**
- **arrangements for whistle-blowing;**
- **external audit and accounting standards;**

⁶ Barclays, HSBC, Lloyds, RBS, Allied Irish Bank (UK), Bank of Ireland, Clydesdale and Yorkshire banks (part of the National Australia Group (Europe)), Co-operative Bank, Northern Bank and Santander UK will all be reviewing their sales of interest rate swaps.

⁷ Survey was undertaken in October 2011 see

http://www.accenture.com/SiteCollectionDocuments/Local_UK/Accenture-Restoring-The-Relevance-Of-Relationship-Banking.pdf

- the regulatory and supervisory approach, culture and accountability;
- the corporate legal framework and general criminal law; and
- other areas not included above.

And

Q5. What can and should be done to address any weaknesses identified? To what extent are such weaknesses subject to remedial corporate, regulatory or legislative action, domestically or internationally?

16. The Panel believes all the factors set out in question 4 contributed to the poor practices and failures in the UK banking industry. As we outlined in our response to earlier questions, the apparent low level of professional standards and inappropriate culture within UK banking institutions has directly led to consumer detriment in the retail market and undermined confidence in the sector.
17. The Panel believes many of the problems could be tackled by: establishing mandatory professional and ethical standards for senior executives; and enhancing effective competition, particularly within the Personal Current Account (PCA) market.

Establishing mandatory professional and ethical standards for senior banking executives

18. Given the socially important role the banking industry plays in the UK, we believe executives and senior managers that run UK banks should be required to meet mandatory professional and ethical standards. The establishment of professional societies has been the tried and tested way of maintaining professionalism in numerous industries across the world.
19. Institutions like the General Medical Council, the Law Society and the Institute of Chartered Accountants play a crucial role in establishing and monitoring the professionalism of their members. Key to the success of this model is a statute based, self-contained disciplinary system. Any individual that fails to comply with the requirements set by their professional society can be struck off the register and is unable to fulfil a similar role in the future. Furthermore, where evidence of deliberate abuse of standards or neglect of position has been identified, this is punishable through the criminal justice system. Employing a similar system for UK banking executives will increase personal accountability of senior managers. There is a strong case for all professional bodies in the financial services area being established on a statutory, or quasi-statutory, footing as for doctors or accountants.
20. We recognise that many banks operate in-house training centres for their staff and will feel it is unnecessary and expensive to subscribe to professional examinations. However, as Professor John Kay outlined in

the FT in February 2009, there is a big difference between company training programmes and professional education:

“Company training reinforces the culture of an organisation: professional education emphasises a historical and social context. The bond salesman asks whether a new product will be profitable for him and his bank: the doctor asks whether a new treatment will be beneficial to his patient. In the most trusted profession, medicine, the quality of education is clearly the responsibility of medical schools rather than medical employers.”⁸

21. The Panel believes the introduction and maintenance of ethical standards will benefit consumers by ensuring banks are being honest and open with them. Customers will have confidence that a bank will only try to sell a product which truly meets their needs, with any conflicts of interests properly explained so they can make an informed decision. Reward and remuneration structures employed within banks would also be aligned with the best interests of the customer, rather than encouraging product sales at any cost. This will change the dynamic of the UK retail banking industry

Enhance competition, particularly in the PCA market

22. The Panel recognises that, for a bank to be successful, it needs to take appropriate risks. However, the risks currently taken by banks appear to focus on circumventing rules and regulations rather than developing innovative propositions in the interests of their customers that will help the banks be more successful in a competitive market. Furthermore, individuals are incentivised to take excessive and inappropriate risks, with failures seemingly going unpunished. Much of this is caused by poor corporate culture within retail banks, but also by ineffective competition.
23. The Panel has expressed concern about ineffective competition in the UK retail banking market for some time. We have witnessed how this has created stagnation in the PCA market, which in turn has led to a number of poor consumer outcomes. We have set these out in detail in a report published by the Panel in March 2012.⁹
24. The Panel believes ineffective competition in the UK retail banking market has driven many of the failures identified in our response to earlier questions. The Panel would like to see the Government and regulator take forward five important steps to encourage competition and create a dynamic market which truly operates in consumers' best interests:
 - remove opaque charging by requiring transparency on the true cost of different banking services;

⁸ Sir John Kay, *Introducing professional standards for bankers*, Financial Times, 18 February 2009

⁹ Financial Services Consumer Panel, *Better banking services and the myth of 'free banking': towards a dynamic Personal Current Account market*, March 2012 see http://www.fs-cp.org.uk/publications/pdf/consumer_banking_position_paper.pdf

- empower consumers to shop around much more and switch their bank account provider without any hurdles or delays;
- tackle inappropriate cross-subsidisation within retail banking at the expense of financially vulnerable consumers;
- bring an end to inappropriate incentive structures which reward one-off sales and short-termism, rather than developing long-term customer relationships; and
- make it easier for new competitors to enter the retail banking market in order to increase consumer choice.

Q6. Are the changes already proposed by (a) the Government, (b) regulators and (c) the industry sufficient? Respondents may wish to refer to the Financial Services Bill and the Government's proposals for the Banking Reform Bill. They may also wish to refer to proposals by the Bank of England and the Financial Services Authority on how the Financial Policy Committee, Prudential Regulation Authority and Financial Conduct Authority will operate in practice.

The Financial Services Bill

25. The Panel is generally supportive of the proposed changes to the structure of financial regulation proposed by the Financial Services Bill. However, we are concerned that the Bill, as currently drafted, does not sufficiently enhance consumer protection standards as originally intended or tackle failures in the banking sector.
26. Historically, customers could trust their bank managers to act in their best interest. This is no longer the case, with the recent banking scandals damaging consumers' trust in the industry. Although the Bill requires firms to give consumers an appropriate level of care and provide accurate and timely information, we do not feel these requirements go far enough to truly protect consumers' interests. Indeed the Bill requires consumers to 'take responsibility for their decisions' without placing a corresponding requirement on firms to act in the best interests of their client.
27. The Panel believes the Bill should require banks, and other financial institutions, to have a duty of care to their customers. This would require banks to act honestly, fairly and professionally in the best interests of their customers and to manage any conflicts of interest.¹⁰ Both

¹⁰ The Panel has proposed a number of amendments in relation to duty of care:

Adding two sub-clauses to 3B(1) to read (Clause 5, p.29, line 15):

"(g) the principle that, where appropriate, authorised persons should act honestly, fairly and professionally in accordance with the best interests of consumers who are their clients"

"(h) the principle that, where appropriate, authorised persons should manage conflicts of interest fairly, both between itself and its clients and between clients"

and amending 1C(2) to read (Clause 5 p17 line 2):

(e) the general principle that those providing regulated financial services should be expected to provide consumers with a level of care that is appropriate having regard to the degree of risk involved in relation to the investment or other transaction and the capabilities of the consumer in question, having regard to the general duty to provide those services honestly, fairly and professionally in accordance with the best interests of the consumers in question.

requirements are already included in the FSA's principles for business, yet consumers have still been subjected to poor practices by banks as these do not have sufficient prominence.¹¹

28. The Panel believes that promoting a duty of care requirement to the face of the Bill will signal a clear message from Parliament that it is no longer acceptable for a bank to unfairly profit at the expense of its customers. Appropriate enforcement of this duty by the FCA, would help rebuild consumer trust.
29. Given that access to retail banking services has become an essential part of participating in a modern society, any inappropriate restrictions on consumer access could have a significant impact on certain groups. The FSA has been unable to look into the Panel's concerns on restrictions being introduced by some banks to limit access to cash machines for consumers with basic bank accounts, or wider restrictions on consumers' ability to access transactional services, due to the limitations set by statute. The Panel therefore firmly believes the Bill should empower the FCA to have regard to consumers' ability to access services and products which are affordable and appropriate to their needs.¹²

The Government's banking reform proposals

30. The Panel supports the Government's intention to protect retail banking services from shocks in the financial system. However, we feel the Government should revisit the Independent Commission on Banking's (ICB) ring-fencing recommendations in the light of recent banking scandals. It should consider whether greater separation of retail and wholesale/investment banking services, than currently proposed by the Government, would better protect consumers. The Panel feels the disadvantages of full separation identified by the ICB may now be overstated.¹³
31. The Panel also thinks the Government should be seeking to introduce the proposed banking reforms sooner than the 2019 deadline. We feel it would be prudent to proceed with reforming the UK banking sector as quickly as possible to ensure it is well placed to survive any further shocks in the global financial system.

The regulators

32. We believe the Government's banking reform proposals underestimate the significant changes which are needed in the retail banking sector to increase competition. For example, the Government has cited the sale of Northern Rock plc to Virgin Money as an *'important step forward in*

¹¹ See the FSA's principles for business: <http://fsahandbook.info/FSA/html/handbook/PRIN/2/1>

¹² The Panel has proposed the following amendment to the Financial Services Bill:

Adding a sub-clause to 1B(5) to read (Clause 5, p.16, line 15):

"(c) the ease with which consumers can have access to financial services and products which are affordable and appropriate to their needs".

¹³ Independent Commission on Banking, *Final report: Recommendations*, September 2011 see <http://bankingcommission.s3.amazonaws.com/wp-content/uploads/2010/07/ICB-Final-Report.pdf>

encouraging new entrants to the banking sector.¹⁴ In reality, the products offered by the two institutions have been merged and provided under the Virgin Money brand. The Panel does not feel this represents an increase in competition or consumer choice as suggested by the white paper.

33. As we have outlined in paragraphs 22 to 24, we believe the regulator, working with the Government, should urgently take forward five important steps to increase competition in the UK retail banking market. These steps are important to ensure UK retail banks compete fairly for business based on price and service standards, leading to better consumer outcomes.

Q7. What other matters should the Commission take into account?

34. The Panel is aware of a number of technology based banking services which are currently under development, including by firms not typically associated with providing day-to-day banking services. This includes the *o2 wallet* and *PayPal inStore app* which appear to replicate the services provided by a PCA.¹⁵ The emergence of near-field communications is also changing the way consumers pay for items through the contactless payment systems offered by some banking institutions.
35. These services could be beneficial to consumers, by improving competition and service, but there will also be risks. The Panel believes the Commission should consider how the introduction of technology-based banking services should be regulated, to avoid replicating the current market failures. For example, these services could have an adverse affect on people without access to, or the ability to use, technology-based services. This could lead to an increase in the number of excluded consumers. As the Payments Council cheque debacle has demonstrated, the removal of 'traditional' transaction services in favour of new technological developments is not necessarily in the best interests of all consumers.¹⁶
36. We also suggest that the Commission considers the role of Credit Unions in the retail banking landscape. Credit Unions offer an alternative banking model which is popular in a number of European countries including Ireland. These Unions typically operate at a local level and many focus on providing a good customer service. Credit Unions have the potential to offer an attractive alternative to the traditional banking model but only if there is effective competition regulation in the UK retail banking market that enables them to compete with established banks.

¹⁴ HMT & BIS, *Banking reform: Delivering stability and supporting a sustainable economy*, June 2012

¹⁵ See <http://www.o2.co.uk/money/wallet> and <https://www.paypal-marketing.co.uk/instore/>

¹⁶ The intervention of the Treasury Committee and widespread condemnation forced the Payments Council to reverse a decision to withdraw the use of cheques from the UK payments industry see <http://www.parliament.uk/business/committees/committees-a-z/commons-select/treasury-committee/inquiries1/parliament-2010/cheques>

Annex - The Financial Services Consumer Panel

The Panel is an independent statutory body, set up to represent the interests of consumers in the development of policy for the regulation of financial services. It works to advise and challenge the FSA from the earliest stages of its policy development to ensure the latter takes into account the consumer interest. The Panel also takes a keen interest in broader issues for consumers in financial services where it believes it can help achieve beneficial change/outcomes for consumers.

Since the Panel was established in 1998, we believe it has helped deliver significant, positive benefits for consumers. We support the FSA where we believe policies can help consumers and challenge the FSA forcefully when we feel consumers would be disadvantaged.

Members of the Panel are recruited through a process of open competition and encompass a broad range of relevant expertise and experience. There are sixteen members of the Consumer Panel, including the Chair Adam Phillips and Vice Chair Kay Blair. Current members have experience of consumer advice, campaigning, communications, market research, journalism, the law, financial services industry, financial inclusion, European issues, financial regulation and compliance and later life issues.

Further information is available on the Panel's website; <http://www.fs-cp.org.uk>