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Financial Regulation Strategy
HM Treasury
1 Horse Guards Road
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Dear Sirs

HM Treasury Consultation: Sanctions for the directors of failed banks

This is the Financial Services Consumer Panel's response to HM Treasury's Consultation Paper Sanctions for the directors of failed banks.

We agree that directors of financial institutions, including banks, should take responsibility for the risks taken as a result of the business' strategy and operations, as well as enjoy financial reward when the business produces profits and growth. The recent history of bank failures has served to emphasise the price paid by customers and taxpayers for directors' bad decisions and those same directors' ability to side step any real individual responsibility for their actions.

We strongly support tougher and more effective criminal sanctions for directors of UK banks - and of other financial institutions - whose actions have contributed to loss or detriment. However, we do not support the introduction of a "rebuttable presumption" which, to the extent that it had traction, could well have a perverse effect, discouraging the far-sighted and diligent from accepting key management positions. The presumption of guilt rather than innocence of directors of failed banks also offends notions of natural justice and due process.

We suggest that in addition, regulators should exercise more vigorously the sanctions already available to them to keep individuals without the necessary levels of fitness, propriety and competence from taking up or retaining positions of significant influence within the financial sector.

The Panel's responses to the specific questions in the Paper are set out below.

Q1: what are your views on the proposal to introduce a rebuttable presumption along the lines set out in paragraph 3.11 that the directors of a failed bank are not suitable to hold senior executive positions in other financial institutions?

We do not support the introduction of a rebuttable presumption as put forward in the

Consultation Paper. In our view such a move would be contrary to the principles of natural justice and could inadvertently have a perverse outcome. Innocent individuals would face an almost impossible legal hurdle to demonstrate that their actions did not directly contribute to a corporate failure and/or significant detriment.

Careful and far-sighted individuals may thus be deterred from accepting a significant management role, fearing the possibility of a lifetime ban should the bank fail through no fault of their own. By contrast, buccaneering and over-confident individuals who valued instant reward over long-term commitment would be unlikely to be deterred by what they would regard as an improbable set of circumstances and sanction. If it had any effect, a rebuttable presumption could perversely discourage the longsighted and diligent from accepting positions of influence, while failing to weed out the short-sighted risk-seeker: an outcome the precise reverse of that desired. The rebuttable presumption sanction would be of no help to consumers or to anyone else.

Q2: what are your views on the possible supporting measures discussed in this chapter aimed at clarifying management responsibilities and changing the regulatory duties of bank directors?

We support the introduction of more detailed regulatory guidance to make it clear that where an applicant for approval under the approved persons regime was a director of a failed bank, that fact would have a material bearing on the assessment of suitability and competence. We think that such a move could have a beneficial deterrent effect on firms seeking to appoint an applicant with a career history that included a 'culpable' directorship of a failed bank. The influence of the regulator should not be underestimated, even though it would be (rightly) under an obligation to provide evidential proof of any objection. It is improbable that a firm would persist with an application materially challenged by the FSA for fear of incurring longer-term regulatory disapproval or an unfavourable market reaction. In his speech¹ in April 2012 Mr Hector Sants noted that 39 SIF applications over the last two years had been withdrawn by firms in the light of serious objections by the FSA: so it does have teeth². We also think the regulator should re-appraise SIF individuals at set intervals and on other occasions if it believes that circumstances justify it.

It is surprising that there is currently any real ambiguity around the scope and level of directors' responsibilities as the existing principles of good governance must require clarity on this point. Financial rewards that are allocated on the basis of individual achievement or performance are surely related directly to individual responsibilities. If this is a 'grey area' however we support the introduction of measures to rectify this.

The paper sets out two approaches, one where, in essence, the regulator takes responsibility for ensuring that individual responsibilities are clear and one where the onus is on the firm and individuals concerned to do so, to the regulator's satisfaction. Overall we favour the latter approach. Firms are responsible for running their

¹ Speech by Hector Sants at the Merchant Taylors' Hall, 24 April 2012 at www.fsa.gov.uk

² Herbert Smith (9 July 2012), "Financial Services Regulation Notes: Sanctioning Directors of Failed Banks" at www.herbertsmith.com, makes this point

businesses, not the regulator and we would have thought that it would be in firms' own interests to ensure that management responsibilities were made absolutely clear.

As regards the proposed changes to regulatory duties of bank directors, the changes seem to follow closely the regulatory principles³ that have been in place for many years and should have been enforced. We have no objection to the introduction of the changes, but without swift and effective enforcement we doubt they will provide any significant benefit.

Q3: what are your views on extending criminal sanctions to cover managerial misconduct by bank directors?

We support the introduction of tough criminal sanctions for serious misconduct in the management of a bank, or other authorised financial institution. As we have explained in response to question 4, a great deal of thought needs to be given to what form these sanctions should take.

Q4: what are your views on the possible formulations of a criminal offence discussed in this chapter?

There are a number of options that could be debated. First, there is the possibility of a strict liability offence. This approach has been used successfully in non- financial services retail markets for many years and has the benefit of attaching to the point at which the fault lies. More recently the Unfair Commercial Practices Directive – through part 3 of the Consumer Protection from Unfair Trading Regulations 2008 – created a number of strict liability offences. Clearly any new measures would have to incorporate a clear and careful definition of the offence and a short list of 'defences', such as a director joining a bank board after it had failed, to assist with run-down.

Another possibility could be a more traditional offence with the two part test of actus reus and mens rea. Under Scottish law, the mens rea test of something done recklessly is sufficient to establish intent at common law, so this would be consistent with both current Scottish practice and one of the early basic principles of English common law.

One potential option could be the establishment of an independent professional body, mandatory membership of which should be debated, with its own civil and possibly criminal prosecution powers based on the concept of recklessness or wilful recklessness.

³ For example, a firm must conduct its business with due skill, care and diligence (Principle for business 2); and a firm must deal with its regulators in an open and cooperative way, and must disclose to the FSA appropriately anything relating to the firm of which the FSA would reasonably expect notice (Principle for Business 11).

We would like to see further consultation and debate around this issue soon.

Yours sincerely

Kay Blair
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Financial Services Consumer Panel