Financial Reporting Council

Sir Richard Lambert
Banking Standards Review
60 Gresham Street
London
EC4V 7BB

25 March 2014

Dear Sir Richard

Financial Reporting Council response to the Consultation Paper - Banking Standards Review

We welcomed the opportunity to meet you recently and agreed to follow up with a note on your proposed reforms. We particularly support your emphasis on improving standards of competence, ethical behaviour and conduct across the industry. Our response makes a number of suggestions which are based on our particular areas of experience and expertise.

First Steps

We believe that it is important to be ambitious in your overall objective to improve the standards of conduct within banking. That said, we agree that the new body should prioritise and focus on a number of key areas before widening its responsibilities over time.

Crucial to the new body's credibility will be its independence from the industry, in fact and appearance. We support the proposal that bankers should be in a minority on the board. Credibility is also highly dependent on the body's ability to secure an assured funding stream.

We would expect it to take some time to bring about a change in culture that is deeply embedded in the business. With this in mind, we recommend that, initially, you focus on the retail sector as this is mainly UK focussed and the culture is already more aligned to the standards you are proposing. Successes in retail can then act as a foundation stone for the investment sector. That said, the principles should from the start be promoted across the industry as a whole.

We also believe that, early on, it is important for the new body to establish how its responsibilities fit with the statutory regulators in this sector.

Standards

We suggest that initially, the focus should be to establish standards for what good ethical behaviour "looks like" combined with robust monitoring, to set early benchmarks of current performance and a basis for testing improvement.

The key to good standard setting is that the process is open and that no single voice is allowed to hold undue influence over the outcome. Any consultation has to involve all stakeholders fully, and demonstrably give proper weight to views from all sides. This takes time, but builds credibility in the outcome and ensures that the industry hears the case for change and not just its own views.

We consider that the new body should assess behaviour from the public as well as the customer's perspective. This will allow the body to focus more broadly on outcomes which will be beneficial to the market as a whole and to wider interests, such as those of taxpayers.

Reporting

Public reporting of progress is a most important driver of change and should be a medium term objective in say 2 – 3 years, when the institutions have got used to the new system. Any report should provide an overview of how much progress is being made on the level of compliance with the standards being proposed, and where further efforts are required to bring the necessary improvements.

If you adopt annual self-reporting, it is important that there is confidence and credibility in this process. To this end, we recommend that the new body considers how it ensures that the information provided by the institutions is suitably presented, relevant and proportionate.

We recommend that the new body tests some of the outcomes, to assess whether the explanations provided are reasonable and appropriate to ensure that the institutions have "complied" with the standards and the evidence supports the findings. This oversight should be based on published standards for such work.

Funding

It is essential that there can be no suggestion that those which the body oversees, can withhold funding as a mechanism of influencing it. This is particularly important given that membership is voluntary.

The FRC raises funds through a voluntary levy which enables us to operate our funding arrangements flexibly and at a modest cost. We consult on our levy proposals each year alongside the budget for the coming year, through extensive consultation with the levy groups. Once the budget has been set and published, and we have the necessary final data on the levy groups, we publish the finalised levy rates.

Secured funding will enable the new body to make decisions independently and allow it to plan its operations effectively.

Qualifications and training

We agree that effective training of the wide range of staff employed in the banking sector will be crucial to embedding the culture of ethics which the review seeks to promote. It is important that staff are trained relative to their role, discipline and environment and their training should also include an element of "customer" training.

We believe that the development and delivery of this training is the responsibility of the banks themselves once the new standards have been established. Some of the banking qualifications fall under the professional bodies – for example the Chartered Banker Institute (CBI) and Chartered Financial Analyst (CFA) Institute but these only account for approximately 25,000 people in the UK banking industry. We recommend that the professional bodies continue to press on with the roll-out of the foundation standards.

Aldwych House, 71-91 Aldwych, London WC2B 4HN Tel: +44 (0)20 7492 2300 Fax: +44 (0)20 7492 2399 www.frc.org.uk

The new body could review and comment on the quality and effectiveness of that training as part of the independent monitoring function envisaged above. The formalisation of the qualifications will slowly raise the competence standards within banking but it is difficult to envisage standards being raised to a sufficient level, when you are dealing with such a large and diverse group.

In summary, our experience tells us that it will take time to define standards of ethical behaviour; work with boards and senior management to design what "good looks like"; and implement these standards. Embedding standards will involve building trust with the banks which will also inevitably take time.

Ultimately, the new body can promote and help improve standards of behaviour, but in our experience, this will need the majority support of the industry. It would be regrettable if the new body is unable to make progress as more stringent regulation will be unavoidable and the next step to deter or curb unethical behaviour.

When we met we promised some material on FRC processes which may be a source of ideas for the new body. I have covered these at Annex A.

Stephen Haddrill

Stephen Haddrill
CEO
Financial Reporting Council
DDI: 020 7492 2390
Email: s.haddrill@frc.org.uk

Annex A – FRC Model

We operate a number of different models across the FRC which enables us to deliver our mission[1].

1. UK Corporate Governance Code & UK Stewardship Code

   The purpose of the UK Corporate Governance Code, issued over 20 years ago is to deliver the long-term success of a company. The Code is underpinned by the "comply or explain approach" which aims to provide sound and clear explanations to justify why companies have not followed a provision within the Code. The Listing Rules require companies to report to shareholders on compliance with the Code and we rely on investors to test the explanations, holding companies to account. The Code has a history of pushing out the boundaries of best practice of corporate governance in the UK.

   More recently in July 2010, we issued the UK Stewardship Code which sets out the principles of effective stewardship by fund managers and institutional shareholders on a "comply or explain" approach.

   If the new body opts for a similar approach, it should be combined with robust monitoring as it will rely on both the wider public and investors to test the explanations provided by the institutions.

   We publish an update on both Codes annually. This covers the impact and implementation of the codes which we receive through formal and informal feedback and provides valuable insight on the progress made by companies on the adoption of the Codes. We also highlight the areas in which there is more work to do.

2. Audit Quality Review (AQR)

   The objective of our AQR work is to monitor and promote improvements in the quality of auditing of all UK incorporated entities which are considered to be of major public interest. We conduct regular inspections of audit firms which includes a review the firms' policies and procedures supporting audit quality. The largest of these audit firms are subject to annual inspections and the other major firms are reviewed every three years.

   We publish results (both collectively and by individual firm) annually, reporting the key messages for audit firms and audit committees. This includes an overall assessment of the quality of the work on three levels - good with limited improvements required; acceptable overall with improvements required; and significant improvements required. Going forward, companies may be required to publish the results of the AQR review and grade in their financial statements.

3. Corporate Reporting Review (CRR)

   Through our CRR work, we check that financial information published by public and large private companies complies with relevant reporting requirements. We ask directors to explain differences from the reporting requirements, if we are not satisfied by those explanations with a view to persuading them to adopt a more appropriate accounting

[1] to promote high quality corporate governance and reporting to foster investment

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treatment. Alternatively, there may be another form of remedial action e.g. correction of the comparative figures in the next set of annual financial statements.

We publish our findings on a yearly basis which summarises our activities, setting out key findings and other information to help companies to improve their corporate reporting. In addition, we publish entity specific announcements in respect of entity investigations, most commonly where the directors have agreed that the accounts were defective and corrective action has been agreed. We also publish findings on more general areas of corporate reporting e.g. highlighting a particular area where improvements can be made including challenges that may arise from the introduction of new reporting requirements.

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