

# Changing Banking for Good: What is the Cure for Misconduct?

Asad Ali Khan | April 2015

**Abstract:** The world of banking is awash with scandals of every conceivable variety. Benchmark manipulation, PPI mis-selling, cheating on taxes and foreign exchange manipulation are just some examples of bank misconduct. Common people are so far removed from elite decision-making that they have no role to play in the processes of change. This article argues that the league table for banks developed by the Conduct Costs Project provides a much-needed voice to the disempowered majority, i.e. common people who are routinely called upon to save predatory global banks in times of economic necessity. Notably, in November 2014, Mark Carney used the table as a barometer to gauge the penalties imposed on a sample of ten banks. Most of all, the league table provides depositors the option of boycotting serially offending banks such as HSBC and Barclays.

Not long ago, in the *Changing banking for good*<sup>1</sup> report, the Parliamentary Commission on Banking Standards (PCBS), a body established in the wake of the LIBOR scandal, was horrified by shocking and widespread malpractice in the banking sector. It concluded that, in addition to bankers, governments and regulators have contributed to the degeneration of standards.

The PCBS recommended wide-ranging changes relating to making senior bankers personally responsible and reforming bank governance by creating better functioning and more diverse markets. It also recommended reinforcing the powers of regulators to make sure that bankers do their job. Putting prolonged and blatant misconduct (which had been evident for a number of years) at the heart of the problem, the PCBS was of the view that its input would alleviate the industry's woes – it said that the “challenge for government is to follow through on the commitment to far-reaching reform.”

Almost two years on, unconvinced that the deficit of trust has been bridged, Dame Colette Bowe, of the Banking Standards Board<sup>2</sup> (BSB) issued a general warning<sup>3</sup> that the

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<sup>1</sup> <http://www.publications.parliament.uk/pa/jt201314/jtselect/jtpCBS/27/2702.htm>

<sup>2</sup> <http://www.bankingstandardsboard.org.uk/>

<sup>3</sup> <http://www.bankingstandardsboard.org.uk/assets/docs/2015/bsb-news-release2.pdf>

“banking industry must raise its game” because “trust in the system has been badly damaged and it’s no surprise that the public expects change after everything that has happened”. On the other hand, diminishing the weight of their own argument, they also offered a general concession to the industry:

*Banks recognise the urgent need to raise their game and build the necessary momentum for change. It won't happen overnight and it will be an uncomfortable journey but the time has come to win back trust.*

In May 2014, a report<sup>4</sup> was published in which it was recommended that a Banking Standards Review Council (BSRC) should be established and it should act independently to champion improved banking standards in the UK. Moreover, BSRC sought to protect the interests of customers and stakeholders with a view to preserving the integrity of the British banking system – an industry employing half a million workers domestically. But all that was a long time before the BSB began to couch its existence in the language of uncertainty, i.e. “it won’t happen overnight.” From the point of view of the reasonable person, time can’t stand still for the banks, if they were acting deceptively and intended to criminally defraud people, then corporate criminals should not be let off the hook and must face criminal charges.

In 2013, to correct the ills prevalent in the industry, the PCBS recommended a fivefold mechanism which turned on making individual responsibility in banking a reality, especially at the most senior levels; reforming governance within banks to reinforce each bank’s responsibility for its own safety and soundness and for the maintenance of standards; creating better functioning and more diverse banking markets in order to empower consumers and provide greater discipline on banks to raise standards; reinforcing the responsibilities of regulators in the exercise of judgement in deploying their current and proposed new powers; and specifying the responsibilities of the

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<sup>4</sup> <http://www.bankingstandardsboard.org.uk/assets/docs/may2014report.pdf>

government and of future governments and parliaments.

Criminal sanctions for misconduct in relation to the LIBOR fixing were incorporated into the statute book. Further benchmarks have also entered into the regulatory perimeter to widen the net of criminal liability (the benchmarks are WM/Reuters 4pm London Fix, Sterling Overnight Index Average (SONIA), Repurchase Overnight Index Average (RONIA), ICE Swap Rate, LMBA Gold Price, LMBA Silver Price; and, ICE, Brent index).<sup>5</sup> The Financial Conduct Authority (FCA)<sup>6</sup> and HM Treasury<sup>7</sup> are eager to expand safeguards to have a tighter regulatory framework which they see as a natural consequence of the reforms driven by in the *Wheatley Review of LIBOR 2012*<sup>8</sup>, the blueprint for reform as regards bank misconduct.

On the other hand, the banks are routinely able to buy their way out of trouble. On the civil side, the so-called “Guardian Homes” case<sup>9</sup> about mis-selling and fraud in relation to LIBOR was settled out of court and Barclays appears to have gotten off the hook. Moreover, even the FCA’s penalties’ system offers attractive discounts to offending banks and, despite the new criminal powers it now enjoys under the Financial Services Act 2012<sup>10</sup> as a result of the *Wheatley Review*, the authority is still content to fine persons who

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<sup>5</sup> [http://www.legislation.gov.uk/ukxi/2015/369/pdfs/ukxi\\_20150369\\_en.pdf](http://www.legislation.gov.uk/ukxi/2015/369/pdfs/ukxi_20150369_en.pdf)

<sup>6</sup> <http://www.fca.org.uk/>

<sup>7</sup> <https://www.gov.uk/government/organisations/hm-treasury>

<sup>8</sup> [https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/191762/wheatley\\_review\\_libor\\_finalreport\\_280912.pdf](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/191762/wheatley_review_libor_finalreport_280912.pdf)

<sup>9</sup> See (i) <https://globalcorporatelaw.wordpress.com/2013/10/19/libor-misrepresentation-and-amendment-part-i/>  
(ii) <https://globalcorporatelaw.wordpress.com/2013/10/19/libor-disclosure-and-open-justice/>  
(iii) <https://globalcorporatelaw.wordpress.com/2013/10/19/libor-misrepresentation-and-amendment-part-ii/>  
(iv) <https://globalcorporatelaw.wordpress.com/2013/10/19/libor-misrepresentation-and-amendment-part-iii/>  
(v) <https://globalcorporatelaw.wordpress.com/2014/01/20/flaux-j-vindicated-court-of-appeal-on-amendment-implied-representations-and-the-efficiency-of-libor/>

<sup>10</sup> <http://www.legislation.gov.uk/ukpga/2012/21/contents/enacted>

– like David Caplin<sup>11</sup> and Jeremy Kraft<sup>12</sup> – destroy the integrity of the financial markets.

As wisely observed a couple of years ago by Professor Bainbridge in his article *Reforming LIBOR*<sup>13</sup>, “the Wheatley regime is not perfect” and its success depends on “ongoing inputs from monetary policymakers.”

As we have repeatedly seen, the banks are unable, or perhaps unwilling, to keep out of trouble and the big scandals of a couple of years ago – that gave birth to hefty promises about better behaviour – are old news these days. Like its rival Barclays, HSBC, which is the largest British bank, has found it impossible to keep out trouble.

In 2012, US regulators hit HSBC with £1.2bn fine<sup>14</sup> for allowing drug traffickers to launder billions of dollars. These days in the UK, HSBC’s collusion with rich clients to help them dodge hundreds of millions of pounds in taxes seems to have intensified interest in cheating in the banking sector as a political issue (albeit it inexplicably lags behind the comparatively benign issue of immigration<sup>15</sup>). Somewhat weirdly, HSBC faces criminal charges in a whole host of countries but not in the British capital London where it is headquartered. Instead, we have learnt that the bank accepts past failure but it maintains that its sins have been atoned because of fundamental changes and co-operation with the authorities.

As established by *Panorama: The Bank of Tax Cheats*<sup>16</sup>, HSBC’s Swiss accounts involved 106,000 clients in 203 countries. Almost 7,000 clients were UK based and 1,100 of them

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<sup>11</sup> <http://www.fca.org.uk/static/documents/final-notice/david-caplin.pdf>

<sup>12</sup> <http://www.fca.org.uk/static/documents/final-notice/jeremy-kraft.pdf>

<sup>13</sup> [http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=2209970](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2209970), *Reforming LIBOR: Wheatley versus the Alternatives*

<sup>14</sup> <http://www.theguardian.com/business/2012/dec/11/banking-libor-fine-hsbc>

<sup>15</sup> See my commentary on immigration law at <https://asadakhan.wordpress.com/>

<sup>16</sup> <http://www.bbc.co.uk/programmes/b052sk1h>

had not paid their taxes. Of the \$118 billion total assets held in Swiss accounts 7,000 clients from the UK accounted for US\$21.7 billion. But there was no justice because only one tax evader was prosecuted notwithstanding the fact that evidence of wrongdoing had been in the public domain since 2007. On the other hand, rich individuals hiding their assets in Switzerland paid £135m in tax, interest and penalties. Strong arguments can be made about the rich being let off the hook for tax dodging and indeed Margaret Hodge MP attacked the bankers for their impropriety. For her, HMRC was also failing in its role as the UK's tax authority.

Yet, not everyone agreed with Hodge's aggression. Although a stern critic of the banks, mindful of criminal procedure and the right to a fair trial under the common law and the Human Rights Convention, in *Seven Deadly Sins*<sup>17</sup> the pioneer and director of the Conduct Costs Project, Roger McCormick, expressed profound concern about Hodge by observing that:

*The atmosphere was kangaroo court-like. The bankers were on trial before a group of politicians that had somehow morphed from being a Parliamentary Committee into a "Tribunal of the Proletariat", where the usual rules of criminal trials just did not apply.*

Interestingly, it is also true that Lin Homer<sup>18</sup>, the bureaucrat in-charge of HMRC, has previously been accused of "catastrophic leadership failure"<sup>19</sup> by the House of Commons Home Affairs Select Committee for her 2008-2011 stint as the Chief Executive of the disgraced UK Border Agency (an organisation that was abolished for its incompetence). Hence, unsavoury Home Office history may well be repeating itself at HMRC and question marks also hang over why Osborne and David Cameron appointed HSBC chair

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<sup>17</sup> <http://foreigners.textovirtual.com/ccp-research-foundation/271/184163/culpability-codes-ccp-insights-rm-april-15.pdf>

<sup>18</sup> [http://en.wikipedia.org/wiki/Lin\\_Homer](http://en.wikipedia.org/wiki/Lin_Homer)

<sup>19</sup> <http://www.theguardian.com/politics/2013/mar/25/mps-hmrc-chief-border-agency>

Stephen Green<sup>20</sup> trade minister and gave him a Tory peerage?

HSBC deliberately broke the law and colluded with its clients to aid their tax dodges. Rather than taking tax owed from undeclared accounts and paying it to the authorities, HSBC advised them to frustrate the purpose of Council Directive 2003/48/EC<sup>21</sup> (subsequently amended by Council Directive 2014/48/EU<sup>22</sup> of 24 March 2014) by finding loopholes in the law to sidestep tax liability.

Against this grim picture, Dame Colette Bowe and Lord McFall, the chairman and deputy chairman of the BSB are oddly optimistic in their assessment as regards changing the system. For them, banking is “not unique a special case.” Arguing that “spring is always a time of great promise”, they consider<sup>23</sup> their organisation to be:

*A new catalyst for positive change across the banking industry.*

They emphasise that they are not regulators and “are not here to draw up league tables or to name and shame.” They constrict their grounds of inquiry to “competence, culture and patterns of behaviour” in which headline news can play no part.

The BSB, moreover, advocates “lasting change right across the whole industry.” However, the critical error in their approach is that it gives refuge and surrogate protection to the crooked. It is very hard to isolate the criminality of those perpetrating fraud in the banking sector from the blame game.

The regulators are clear that accountability, which is unachievable without banks

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<sup>20</sup> <http://www.theguardian.com/business/2015/feb/09/ex-hsbc-boss-stephen-green-the-ethical-banker-with-questions-to-answer>

<sup>21</sup> <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2003:157:0038:0048:EN:PDF>

<sup>22</sup> <http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32014L0048&from=EN>

<sup>23</sup> <http://www.telegraph.co.uk/finance/comment/11531115/A-new-catalyst-for-positive-change-across-the-banking-industry.html>

accepting responsibility, is the need of the hour and a fudged and opaque system is doomed to fail the public trust.

The BSB's rejection of the yardstick (or "metric"<sup>24</sup>) of transparency offered by league tables (and naming and shaming wrongdoers) have been met with some criticism by Roger McCormick, who understandably lamented that:

*At some point, this organisation is going to have to move from telling us what it is going to do to actually doing something. One thing is clear, they will not be publishing tables relating to bank conduct performance that will enable the public to compare one bank with another. So that's good news for banks that might feel embarrassed about such information being available. What they don't do is tell us why they reject this approach (when others, such as the B of E and the FCA, seem to like it). Make of it what you will.*

Only recently in late October 2014, in its consultation on the fixed income, currency and commodities markets, the Fair and Effective Markets Review<sup>25</sup> (a tripartite mission involving the FCA, HM Treasury and the Bank of England that seeks to restore trust in the markets)<sup>26</sup> took the view that the approach developed by Roger McCormick:

*could provide a framework for further development in relation to industry-wide performance measures relating to conduct.*

Despite their enthusiasm for reform as regards misconduct in the banking sector, if we apply BSB's approach to other criminals such as sex offenders or terrorists then we would be doing away with the sex offender register or terrorist watch lists. Not a great idea by

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<sup>24</sup> (i) <http://ccpresearchfoundation.com/noticeboard?item=29327-consequences-of-misconduct-conduct-costs-not-just-fines>

(ii) <https://globalcorporatelaw.wordpress.com/2014/04/24/london-school-of-economics-lunchtime-workshop-on-benchmarking-and-metrics-for-bank-ethics-and-behaviour/>

<sup>25</sup> <http://www.bankofengland.co.uk/markets/Pages/fmreview.aspx>

<sup>26</sup> <https://globalcorporatelaw.wordpress.com/2014/11/01/femr-consultation-how-fair-and-effective-are-the-ficc-markets/>

any stretch of the imagination!

Whirlwind fines in late 2014 by the FCA, US CFTC<sup>27</sup> and Swiss FINMA<sup>28</sup> totalling \$3.3bn for misconduct in FX markets – subsequent to the fines imposed earlier for interest rate benchmark abuse – prompted Mark Carney<sup>29</sup> to emphasise that changes in “institutional culture” are imperative and he concluded that:

*The repeated nature of these fines demonstrates that financial penalties alone are not sufficient to address the issues raised.*

In his November 2014 speech entitled *The Future of Financial Reform*<sup>30</sup>, Mr Carney, who is the Governor of the Bank of England, also used the research of the Conduct Costs Project (at the CCP Research Foundation) as a barometer to gauge the penalties imposed on a sample of ten banks by authorities in the United States, the United Kingdom and the wider European Union.

Empowering consumers and imposing greater discipline on banks to raise standards is a stated aim of the five curative ingredients suggested by the PCBS. Because counter-measures such as criminal liability and financial sanctions have their limitations in relation to engendering cultural change, it is convenient for the public to know where they stand with the banks. Indeed, whilst there is no “cure” to the controversies of the banking world, on proper analysis comparing one bank with another is crucially important for selecting who we want to enter into business with.

In these turbulent times, this information forms the spine of the contractual relationship between depositor and bank. In other words, to enhance our ability to make suitable

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<sup>27</sup> <http://www.cftc.gov/index.htm>

<sup>28</sup> <http://www.finma.ch/e/pages/default.aspx>

<sup>29</sup> <http://www.bbc.co.uk/news/business-30079451>

<sup>30</sup> <http://www.bankofengland.co.uk/publications/Documents/speeches/2014/speech775.pdf>

choices, as members of the public we are clearly entitled to this vital information. After all, it has been reported (by accountants KPMG) that since 2011 the UK's big banks have paid 60 per cent of their profits<sup>31</sup> in fines and repayments to customers – the fines alone amounted to £150 billion the five years ending November 2013. It is therefore a small wonder that HSBC proposes to “put compliance and tax transparency ahead of profitability.”

In reality, a league table for banks is the same thing as having a corruption index for the world such as the one maintained by Transparency International<sup>32</sup>; which whilst not perfect nonetheless adds to the learning on the level of corruption and helps us choose our options. Since none of the banks report their misconduct to us and would prefer that we remain oblivious to their widespread wrongdoing, someone has to undertake the task of reporting the aggregate of misconduct and, if anything, Roger McCormick deserves to be applauded for quantifying the data that delivers the true picture to us. There will be no quick fixes for the banking world but greater knowledge and learning will empower us to filter the offending banks out of our daily lives.

One thing is for sure: hoping that the spring time will wash all the ills of the banking world away is not the cure envisaged by the PCBS in its *Changing banking for good* report. Equally, insofar as the notion that the BSB is the “new catalyst” for positive change across the banking industry is concerned, the point is completely stifled by the (delaying) caveat that change:

*... won't happen overnight.*

So, properly understood, the BSB's rhetoric is strewn with internal contradictions that undermine its official statements to the public about being a catalyst. (In scientific terms, something that increases the rate of change without itself undergoing any permanent

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<sup>31</sup> <http://www.bbc.co.uk/news/business-32198976>

<sup>32</sup> <http://www.transparency.org.uk/>

change.) After all, banks must not be emboldened in respect of their longstanding misconduct and the PCBS was entirely unambiguous that dilatory policies are “a risk which the UK, as a medium-sized economy hosting one of the world’s two most important financial centres, cannot afford.”

Just to answer my own question again, there is no cure for bank misconduct and, although attractive, sweeping legislative and rule based reform has not changed the culture of corruption in financial institutions. We can only hope that superior knowledge about bank behaviour will result in power being diverted into the hands of the public.

Therefore, a league table is a handy formula to evaluate the credibility of banks and learn (in a single glance) who the foremost offenders are.

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