

Reducing Conduct of Business Risks in EU Banking

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Banking misconduct - an expensive problem

- ◆ Cost of misconduct from world's top 10 banks was £150bn (2008-12)
(source: <http://www.lse.ac.uk/newsAndMedia/news/archives/2013/11/ConductCostsProject.aspx>)
 - ◆ Includes fines for mis-selling, LIBOR manipulation, breach of money laundering rules, and non-regulatory compliance.
- ◆ Mis-selling through inappropriate sales incentives schemes is at the heart of the problem, for example:
 - ◆ UK – mis-sold payment protection insurance compensation payments £28.8bn and rising
 - ◆ Spain – compensation for mis-sold hybrid securities €2.9bn
 - ◆ Netherlands – compensation for customers of the failed DSB Bank €215m
 - ◆ Portugal – cost of bail out to Banco Espirito Santo €2.1bn

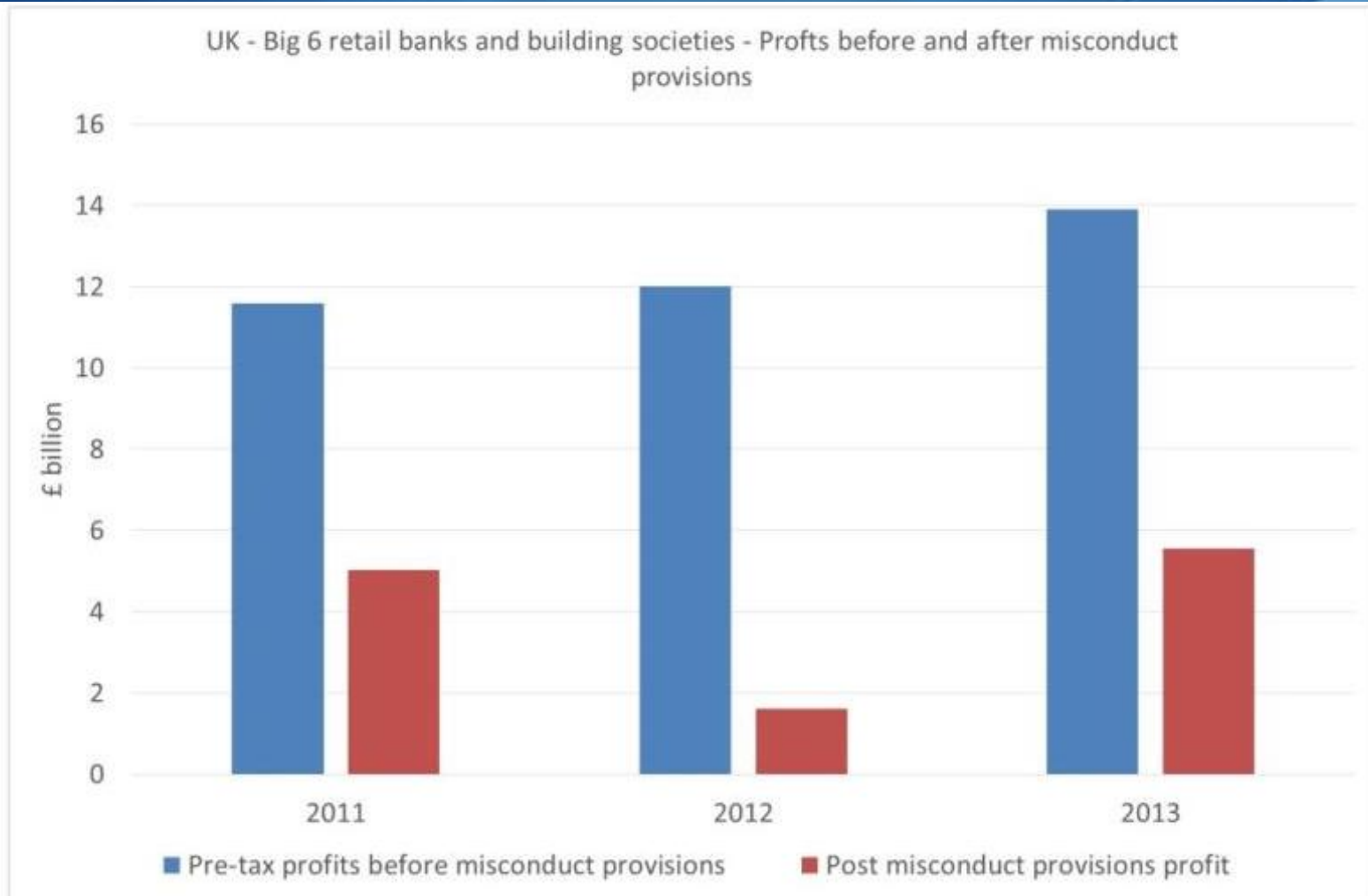
(source: http://www.consumersinternational.org/media/1529404/sales-incentive-report_riskybusiness_final2_151014.pdf)

Banking misconduct - an expensive problem

- ◆ Not just inappropriate sales incentive schemes; rather we see deeply ingrained cultures.
- ◆ Deutsche Bank AG was fined £227m (€315m) by the UK's Financial Conduct Authority (FCA) last week for LIBOR and EURIBOR manipulation.
- ◆ Fine was so large because Deutsche Bank **repeatedly misled** the national regulator during the investigation.
- ◆ FCA: *"failings were compounded by them repeatedly misleading us. The bank took too long to produce vital documents and it moved far too slowly to fix relevant systems and controls"*.
- ◆ FCA: *"One division at Deutsche Bank had a culture of generating profit without proper regard to the integrity of the market. This wasn't limited to a few individuals but, on certain desks, it appeared deeply ingrained"*.

(source: <http://www.fca.org.uk/news/deutsche-bank-fined-by-fca-for-libor-and-euribor-failings>)

Misconduct is a prudential problem: UK case study



Misconduct is a prudential problem: UK case study

- ◆ **The size of the problem makes it prudential.** The six largest UK retail banks and building societies set aside £25.3 billion due to mis-selling and misconduct in the period 2011-2013, representing two-thirds of their pre-tax profit over the period.
- ◆ Banks and shareholders will hope now on a downward trend. The Big 6 have set aside £6.7 billion in 2014 (£8.4 billion in 2013). Total provision over 2011-14 is £32 billion.
- ◆ Banks are also failing to provide shareholders with clear visibility on what issues are covered by these provisions. What skeletons remain in their cupboards?
- ◆ Banks continue to list provisions in the hundreds of millions of pounds as “other” redress with little detail of the issues covered or how provisions have been calculated.
- ◆ Shareholders don't seem to be asking the right questions about how these provisions are calculated and whether banks' culture change programmes will be successful in stemming the tide of misconduct provisions.

Overall cost of misconduct

- ◆ Consumer detriment
- ◆ Lack of trust in the financial services sector
- ◆ Loss of confidence in banks for financial advice and products
- ◆ Impact on the market and competition
- ◆ Reputational damage for firms
- ◆ Prudential risks



What are the solutions?

- ◆ **Conduct risk as a prudential issue**
 - ◆ Conduct risk should be taken into account by prudential regulators.
 - ◆ Banks should provide clear disclosure about existing and likely provisions for the costs of misconduct.
 - ◆ Conduct risk should be included in stress tests.

- ◆ **Greater accountability**
 - ◆ Shareholders need to get involved in demanding higher standards and accountability of executives and board members.
 - ◆ Bank executives need to be clearly identified and those executives held to account when things go wrong.



What are the solutions?

◆ **Changing culture**

- ◆ Reform of inappropriate sales incentives schemes
- ◆ Ethical code of practice
- ◆ Professionalism – assessment of knowledge and competence

◆ **Disclosure**

- ◆ Competition on customer satisfaction
- ◆ Consumers as ‘co-regulators’
- ◆ ‘Know your business’ disclosure (complaints and fines data)
- ◆ Minimising consumer detriment using technology and empowering customers – see for example:

<https://www.fca.org.uk/news/occasional-paper-no-10>



What are the solutions?

- ◆ **Market studies & research** – understanding problems better
 - ◆ Issues around consumer access to, and understanding the quality and price of, Personal Current Accounts across the EU
 - ◆ Understanding the barriers to EU cross-border banking



What can EBA do?

- ◆ EBA lacks an overarching EU Directive
- ◆ For example, Article 25(9) of **MiFID II** legally obliges the European Securities and Markets Authority (ESMA) to develop guidelines specifying criteria for the assessment of knowledge and competence of an investment firm's employees giving investment advice or information about financial instruments or ancillary services to clients.
- ◆ However, **EBA's founding Regulation gives it a powerful consumer protection mandate to adopt guidelines and/or recommendations to minimise the types conduct of business risks we are discussing.**



What can EBA do?

- ◆ **Regulation (EU) No. 1093/2010**
- ◆ **Article 1(5)(f)** the “enhancing consumer protection” objective
- ◆ **Article 9** – “tasks related to consumer protection and financial activities ... (1)(c) developing training standards for the industry (d) common disclosure rules ... (2) adopt guidelines and recommendations”.
- ◆ European Commission Report on the Operation of ESAs: **“Give consumer protection tasks a higher priority and make full use of powers”** (at page 12) http://ec.europa.eu/finance/general-policy/docs/committees/140808-esfs-review_en.pdf

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The logo for Govan Law Centre, featuring the word "GOVAN" in a smaller font above "LAW" in a large, bold font, with "CENTRE" below it. A horizontal line is positioned under the word "CENTRE".

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