

## labour and employment lawflash

27 June 2013

### Report on UK Banking Urges “Radical Reform” to Raise Standards

*The report from the Parliamentary Commission on Banking Standards includes recommendations on remuneration, diversity, and whistleblowing.*

On June 19, the Parliamentary Commission on Banking Standards (the Commission) published its report “Changing banking for good” (the Report).<sup>1</sup> The Report, which is nearly 600 pages long, contains a number of recommendations aimed at raising banking standards in the UK. Whilst much of the initial media coverage of the Report has focused on the proposed criminal offence that would make it easier to send top bankers to jail for “reckless conduct”, the Report also contains important recommendations in respect of bankers’ pay, the role of chairmen within financial institutions, and ensuring that banks have an effective and robust whistleblowing regime.

Financial institutions with operations in the UK should be aware of the Report’s recommendations, which, if approved by the UK Treasury, could be enacted in UK legislation.

#### Background

Following a number of scandals involving the banking industry, the Commission was created in July 2012 to conduct an inquiry into professional standards and culture in the UK banking market. The Commission has taken six months to gather evidence from more than 250 witnesses and produce the Report, which has allegedly cost £850,000. The Report’s recommendations focus on the following themes: making senior bankers personally responsible; reforming bank governance; creating better functioning and more diverse markets, which ultimately will raise standards; and reinforcing the power of regulators.

#### Bankers’ Remuneration

The Report calls the remuneration structure in investment banking “thoroughly dysfunctional”. It claims that remuneration has incentivised misconduct and excessive risk taking, thereby instilling a culture where poor standards have become the norm.

The Report therefore calls for a radical reform of the way remuneration is calculated as well as new policies to end pay structures that reward failure and do not take into consideration long-term risk. The Report recommends the following:

- That a new Remuneration Code be issued to allow remuneration to be deferred for up to 10 years where it is necessary for effective long-term risk. Currently, banks must spread bonuses over three years; however, the Report considers this period to be insufficient because, in banking, it often takes a much longer period for profits or losses to be realised or for the full cost of misconduct (or any other problems) to be established.
- That legislation be introduced whereby, if the bank receives direct taxpayer support, the regulators would have discretionary power to cancel any deferred remuneration, entitlement to payments for loss of office, and

---

1. View the Report at <http://www.parliament.uk/business/committees/committees-a-z/joint-select/professional-standards-in-the-banking-industry/news/changing-banking-for-good-report/>.

unvested pension rights to which an executive may otherwise be entitled. Circumstances whereby deferral of remuneration in other situations would be justified (such as for misconduct or where a bank's profitability falls) should be a matter of contract that employers should give consideration to.

- That the way in which profits are calculated for bonus purposes be changed and that regulators should clearly set out the criteria for determining profits within the new Remuneration Code. The banks themselves must also disclose, in their annual reports, how they have determined remuneration and how they have accounted for risk in this determination.

Importantly, the Report does not support the recent European Banking Authority plan to cap bankers' bonuses at 100% of an individual's basic salary or 200% where express shareholder support has been given.<sup>2</sup>

## Women on the Trading Floor

In light of recent efforts to promote women to boardroom positions because of the recognised benefits that a diverse workforce can bring, the Report highlights the lack of women on the trading floor. It further recommends that the main UK banks should publish a gender breakdown of their trading operational staff and, where there is a significant deficit of women, set out what measures they intend to take to redress the balance in the next six months and annually thereafter.

## The Role of Chairmen

Evidence presented to the Commission suggested that the chairmen of banks were often "weak" and too close to the banks' chief executive officers to provide a genuine "check and balance" on all of the banks' executives. The Report highlights the very valuable role that a chairman should play within an organisation and, to support this, recommends that all banks should have a full-time chairman who would not usually be expected to have any other significant commercial roles.

## Whistleblowers

The Commission was surprised by evidence it received related to banking staff ignoring and failing to report misbehaviour within financial institutions. To improve this, the Report recommends the following:

- Banks should ensure that staff members have clear information about what to do when they suspect wrongdoing. This means reviewing employment contracts, policies, and codes of conduct to ensure that relevant documentation clearly sets out the institution's whistleblowing procedure and circumstances in which staff would be expected to "blow the whistle".
- In addition to formal whistleblowing policies, banks should have in place mechanisms for staff members to raise concerns about practices even if they are not making a specific allegation of wrongdoing.
- A senior nonexecutive board member, ideally the chairman, should be appointed within each bank to take responsibility for the effective operation of the bank's whistleblowing regime. This person would be personally responsible for ensuring that whistleblowing procedures are adequate and that complaints are dealt with appropriately. Importantly, this person would also be personally accountable for protecting whistleblowers against detrimental treatment. This may mean that the appointed whistleblowing director is required to approve any significant employment decision regarding the whistleblower—for example, any changes to role, responsibility, or remuneration or possible disciplinary action—before any such changes are implemented.
- If a regulator is concerned about the potential impact of encouraging whistleblowers by financially incentivising them, as happens in the United States, the regulator should carry out research into the impact that the US regime has had in encouraging whistleblowing and exposing wrongdoing.

---

2. For more information on the European Banking Authority's guidance on bonus caps, see our 24 May 2013 LawFlash, "European Banking Authority Guidance on Financial Services Bonus Cap", available at [http://www.morganlewis.com/pubs/LEPG\\_LF\\_EBAGuidanceOnFinancialServicesBonusCap\\_24may13](http://www.morganlewis.com/pubs/LEPG_LF_EBAGuidanceOnFinancialServicesBonusCap_24may13).

## Conclusion

The British Bankers' Association has described the Report as "the most significant report into banking for a generation." Whilst the remit of the Report was to make recommendations for reform, the UK Treasury will now consider the Report and is committed to producing a full response within a month. Its response is expected to include proposals for legislative action where it is needed to implement the recommendations.

## Contacts

If you have any questions or would like more information on the issues discussed in this LawFlash, please contact any of the following Morgan Lewis lawyers:

### London

Matthew Howse	+44 (0)20 3201 5670	<a href="mailto:mhowse@morganlewis.com">mhowse@morganlewis.com</a>
Nick Thomas	+44 (0)20 3201 5561	<a href="mailto:nthomas@morganlewis.com">nthomas@morganlewis.com</a>
Rachel Ashwood	+44 (0)20 3201 5557	<a href="mailto:rashwood@morganlewis.com">rashwood@morganlewis.com</a>

## About Morgan Lewis's Labour and Employment Practice

Morgan Lewis's Labour and Employment Practice includes more than 275 lawyers and legal professionals and is listed in the highest tier for National Labor and Employment Practice in *Chambers USA 2012*. We represent clients across the United States in a full spectrum of workplace issues, including drafting employment policies and providing guidance with respect to employment-related issues, complex employment litigation, ERISA litigation, wage and hour litigation and compliance, whistleblower claims, labour-management relations, immigration, occupational safety and health matters, and workforce change issues. Our international Labour and Employment Practice serves clients worldwide on the complete range of often complex matters within the employment law subject area, including high-level sophisticated employment litigation, plant closures and executive terminations, managing difficult HR matters in transactions and outsourcings, the full spectrum of contentious and collective matters, workplace investigations, data protection and cross-border compliance, and pensions and benefits.

## About Morgan, Lewis & Bockius

With 24 offices across Europe, the United States, and Asia, Morgan Lewis provides comprehensive litigation, corporate, transactional, regulatory, intellectual property, and labour and employment legal services to clients of all sizes—from globally established industry leaders to just-conceived start-ups. Our international team of lawyers, patent agents, benefits advisers, regulatory scientists, and other specialists—more than 1,600 legal professionals total—serves clients from locations in Almaty, Beijing, Boston, Brussels, Chicago, Dallas, Frankfurt, Harrisburg, Houston, Irvine, London, Los Angeles, Miami, Moscow, New York, Palo Alto, Paris, Philadelphia, Pittsburgh, Princeton, San Francisco, Tokyo, Washington, D.C., and Wilmington. For more information about Morgan Lewis or its practices, please visit us online at [www.morganlewis.com](http://www.morganlewis.com).

This LawFlash is provided as a general informational service to clients and friends of Morgan, Lewis & Bockius. It should not be construed as, and does not constitute, legal advice on any specific matter, nor does this message create an attorney-client relationship. These materials may be considered **Attorney Advertising** in some jurisdictions. Please note that the prior results discussed in the material do not guarantee similar outcomes. Links provided from outside sources are subject to expiration or change. © 2013 Morgan, Lewis & Bockius. All Rights Reserved.