

The Ethics of Banking and Financial Regulatory Authorities: a study of the Bank of England, the Prudential Regulation Authority, the Monetary Policy Committee and the Financial Conduct Authority

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Part I

Introduction and scope of application

This in depth review provides the reader with a fact findings analysis on the ethics of some of the most prominent banking and financial regulatory authorities in the UK: the Bank of England (BoE); the Prudential Regulation Authority (PRA)²; the Financial Conduct Authority (FCA) and the Monetary Policy Committee (MPC)³. Even though the Pension Regulator; the Payment Systems Regulator⁴; and the FPC are as important, due to time constraints these could not be included. However, please note that the Payments Systems Regulator and the FPC follow broadly the same policies of the FCA and the Bank of England respectively. Other Banking and Finance authorities have been included in the CSPL Regulators' Survey⁵.

Whereas ethical conduct within the workplace includes the existence and the quality of, policies related to whistleblowing, gender equality, career progression, bullying and harassing, creditors' payment, staff satisfaction surveys, and consideration for personal privacy of employees, these will not constitute the main focus of this inquiry, as they can be considered more measures of

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2 At the time this review started, October 15 2015, the PRA was still an independent subsidiary of the Bank of England. With the enactment of the Bank of England and Financial Services Bill the former will be incorporated by the latter, becoming a committee of the Bank (the PRC).

3 Please note, the Bank of England, the PRA and the FCA are also supervisory authorities. The distinction between regulation and supervision is blurred, but from a purely theoretical point of view regulation refers to the establishment of rules whereas supervision to their monitoring and enforcement.

4 Please note that the Financial Services (Banking Reform) Act 2013 required the FCA to incorporate the Payment Systems Regulator and this was done on 1 April 2014. The Payment Systems Regulator is now a wholly-owned subsidiary of the FCA.

5 A full list of responses received is available at www.gov.uk/government/publications/annexes-to-ethics-for-regulators-report

“organisational integrity”⁶ rather than being directly linked to the spirit of the Nolan’s Seven Principles of Public Life. Again, time constraints and terms of reference forced us to limit the scope of application to the broader picture rather than to the pointillist details of employees’ handbooks or codes of conduct. This notwithstanding, reference is made to the existence of these policies whenever needed.

In discussing the applicability of the Nolan principles to B&F authorities, certain issues have been intentionally left out.

For instance, this study is not concerned with conflicts of interest among supervisory and monetary functions when both are housed within a single authority. Lobbying has not been considered either. In the past, the CSPL (2013a)⁷ has warned on the double faceted function of lobbying: «Conducted properly, lobbying is an essential part of the process by which individuals and organisations make sure their views and perspectives are taken into account in public policy. But two main concerns are frequently expressed. In relation to the press and politicians Lord Justice Leveson concluded that these concerns amounted to “a genuine and legitimate problem of public perception, and hence of trust and confidence”». Even though the extent to which authorities resist or are influenced by lobbyists is an extremely important indicator of integrity, this would have required different tools of investigation and a greater amount of time, both unavailable to the Author. Nevertheless, this paper does analyse the broader problem of regulatory capture.

Finally, as stated in the terms of reference of the CSPL review, this review will not consider the effectiveness and efficacy of financial regulation, its quality and methodologies; and the need and the impact of regulation⁸.

The review is organised as follows: the first part will give a bird’s eye view over some critical issues that need to be taken into account to make a fair assessment of how banking and finance authorities live up to the Nolan principles; the second part will analyse how authorities apply the relevant principles; the third part makes recommendations.

6 For instance, the UN defines “ethics infrastructures” as including “measures to enhance and preserve organizational integrity, access to information that promotes transparency and accountability, and oversight by independent institutions and the public at large”. See UN Public Administration programme, *Ethics, Transparency and Accountability*, 2012, available at <http://www.unpan.org/DPADM/ProductsServices/AdvisoryServices/EthicsTransparencyandAccountability/tabid/675/language/en-US/Default.aspx>

7 CSPL, (2013) *Standards Matter. A review of best practice in promoting good behaviour in public life*, 14th Report., p 53. The Committee has also issued a specific report on the matter, see CSPL, *Strengthening transparency around lobbying*, 2013

8 See CSPL, *Ethics for regulators review. Project description*, 13 August 2015, available at CSPL blog www.cspl.blog.gov.uk

Methodology

Compliance with each principle will be assessed against some indicators. In choosing the indicators, consideration has also been given to previous CSPL reports, specifically to: the First Report to the Committee of Standards in Public Life; Standards Matters; Ethics in practice; Strengthening transparency around lobbying. The yardsticks used may be questioned and could have been broader. However, they seem to represent at least fair reference points to test how Banking and Finance authorities perform against the Nolan principles.

Reference will be made to cases that received public attention related to a possible breach of the principles.

Reference to relevant academic literature has been purposely kept to the minimum to focus on a facts finding analysis.

Accountability and other requirements that are already embedded into law will not be considered either, as the primary scope of this paper is to assess the extent to which Authorities go beyond statutory prescriptions.

In what follows the Bank of England, the FCA the PRA and the MPC will be collectively referred to as B&F authorities (Banking and Finance authorities).

The ethics of banking and financial regulators: some thorny issues

a. The legislative framework

Activities, procedures, powers, duties and governance of B&F authorities are strictly disciplined by laws and regulations, mostly at national, and with a limited extent, at European level too. For instance, the Bank of England is part of the European System of Central Banks and some of the powers of the FCA originate from EU legislation.

And yet, the common view on B&F authorities is that they retain too much discretion and enjoy too much independence. Whereas authorities do retain discretion over policies and decision making, they may act on the basis of instructions, and always within the four corners of the statutes. As it will be discussed later, their independence is a creature of the law and works within stringent accountability mechanisms which subject authorities to strict scrutiny. In fact, one may wonder whether there is any space left beyond laws and regulations to comply with the highly aspirational nature of the Nolan principles.

At national level, the Financial Services and Markets Act (FSMA) and the Bank of England Charter 1998 are the main pieces of legislation⁹. However, authorities will have to comply with, among the others, the UK Bribery Act, Public Law, Freedom of Information Act, and so on. They also have to take into account soft law, such as code of practices, Memoranda of Understanding, the regulators' code, principles of good corporate governance and other standards.

The Advisory Committee for Business Appointments (ACoBA) may be consulted for candidates applying for senior positions; and in making certain appointments, the Code of Practice for Ministerial appointments must be taken into account too.

Against this background, authorities strive to go beyond the black letter of the law to lead on ethical conduct, albeit with mixed results.

b. The “specialty” of banking and finance regulators

The protection of investors, of financial stability, and of market integrity are the main objectives of B&F authorities' regulatory and supervisory action. To pursue them, they enjoy a high concentration of powers, a fair degree of discretion, independence, and are subject to statutory confidentiality requirements to avoid market manipulation.

This may create some apparent tension with certain Nolan principles. For instance, too much transparency may hinder financial stability because market players may try to second guess regulators' decisions. It may also lead to market manipulation because of possible disclosure of confidential information, or it may unduly have a negative impact on the reputation of a firm which may then give rise to speculative market behaviour.

Most importantly, it may hinder policy effectiveness. For instance the Bank of England may want to delay the disclosure of certain items on its balance sheet to allow for covert liquidity assistance, or it may decide not to disclose upfront its intention to provide lender of last resort assistance in a given scenario. The FCA may want to delay the public disclosure of its enforcement action against a firm until it has reached a final decision. The MPC may not want to disclose internal disagreement on interest rate decisions to avoid speculation or expectations over future decisions.

⁹ These are constantly amended. Any reference to FSMA and the Bank of England Act shall be considered to include any amendments until January 2016.

B&F authorities need also to preserve their good reputation, not because they don't intend to be subject to accountability mechanisms rather because unfounded negative publicity that may derive from a superficial level of public scrutiny (especially when steered by the press) may hinder trust and credibility in their actions. This in turn may negatively affect market confidence.

Another possible effect of bad publicity is on staff morale. Feeling the constant subject of negative remarks by the press and the public in general, may affect staff productivity, loyalty and turnover¹⁰. Especially the latter has recently been one of the causes of poor regulatory performance.

c. The relationship with the regulatees and with the Government

The proximity of regulators with the regulated firms is another contested issue. On the one hand they need to be independent from (political and) business interference; on the other they need not be so detached from the regulated as to not understand their business. It shall be borne in mind that finance is a complex and fast evolving sector, driven by innovation and technology. So it is beneficial for authorities to be able to attract talents from the industry as well as to nurture a healthy relationship with the latter. In fact, the effectiveness of B&F authorities' action relies also on the trust placed on them by the regulated entities. The principles of the regulators code (which apply to the PRA and the FCA) are all informed by the need to engage fairly, in a cooperative and supportive way with the regulatees. Sometimes this is also stated in business plans and other documents from the regulators. Stakeholders' involvement is a cornerstone of better regulation. Finally, statutory practitioners and consumers panels have advisory powers. The above is also supported at political level as acknowledged once by the Chair of the Treasury Select Committee "I just want to remind anybody watching this hearing that the predecessor Committee, and I expect this Committee too, strongly supported the appointment of people from the industry with wider experience than just being academic economists, not that there is anything necessarily wrong with them, or people from a relatively closed circle who have worked in central banking. It is extremely important in discussing codes of conduct, which we will turn to in a moment that these are framed in a way that can create the flexibility to enable us to draw on the kind of expertise that you may have picked up."¹¹

10 See for instance the remarks from the FCA Board Review which noted that "Directors acknowledge that recent interventions (Davis, TSC, HM Treasury), and levels of public scrutiny and criticism have impacted negatively on culture and morale, influencing executives cautiousness, levels of defensiveness, and the willing to escalate issues and learn from mistakes, as well as, potentially, attracting and retaining talent". See FCA, *FCA board effectiveness: an independent evaluation by Boardroom Review limited*, October 2015, p 8.

11 See House of Commons Treasury Committee, *Oral evidence Appointment of Gertjan Vlieghe to the Monetary Policy Committee hearing, HC 497*, Tuesday 13 October 2015, p 1.

Proximity however may expose regulators to the risk of being “captured” by the regulatees and to lose their independence. Threats to independence arise also from revolving doors phenomena, namely the ability to join the regulators from and to leave the regulators for the industry.

Finally some of the authorities are funded by the same industry they regulate which may ingenerate a perception of lack of independence.

Statutes and internal codes of conduct provide safeguards for these problems, but they may not be sufficient in the current form.

B&F authorities may also be subject to political interference. In fact, some of their most senior members are appointed by the Treasury. Whereas the latter has to take decisions on the basis of personal independence and professional requirements and can only dismiss them for a limited number of reasons specifically listed by the law, the temptation to appoint favourable candidates may be difficult to resist.

Overall the government is interested in preserving the competitiveness of the UK as an attractive financial centre; in preserving financial stability because of the negative effects its impairment may have on the public purse and the economy as a whole; and in having sound and sustainable monetary policies as well as well-functioning financial markets.

As before, statutes, decision making mechanisms, and internal codes and procedures should limit to the minimum the risk of being influenced by political ends.

d. Issues related to potential conflicts of interest

Another matter that may create a perception of lack of independence is the composition of the boards. All the governing bodies of the authorities include independent directors chosen from external candidates. Whereas this may create potential conflicts of interests, its actual purpose is to bring diversity of knowledge and expertise to the board, and to hold executives to account.

Rules on conflicts of interest help mitigating possible undue influence.

Part II

Selflessness

Selflessness: holders of public office should act solely in terms of the public interest.

Acting in terms of the public interest imposes upon holders of public offices very stringent conduct obligations. For instance, this implies acting with selflessness, but also with probity; impartiality; away from political patronage¹²; conscientiously; and with equity.

Even though it is outside the scope of this paper to engage in a semantic and content analysis of the principle, nevertheless it seems appropriate to briefly discuss its wording. From a legal point of view, if one has to be judged against a standard, that standard needs to be very clear, otherwise in presence of uncertainty a finding of a violation of the standard may not be appropriate. In essence, this is one of the pillars of the rule of law. And it is with specific reference to selflessness that one may struggle in practice to pinpoint the exact content of the duty. For instance, on the basis of the given description the difference between the duty to act with selflessness, and the prohibition to act in conflicts of interest, as prescribed by the integrity principle, seems blurred¹³.

Also, whereas selflessness may appear as a positive attribute that should be nurtured and required (and it is often confused with altruism), it may instead connote a relatively weak trait of character to the extent that one's own sense of self is absent¹⁴. Yet it is a strong sense of self to be among the drivers for speaking up (or whistleblowing, as commonly known). Having a sense of self implies for instance, self awareness; it is comparable to the *gnoti te auton* of the ancient Greek tradition, knowing who you are and what do you stand up for.

It may be questioned whether selflessness in practice may also impinge upon holders of public office an enhanced duty of care.

Finally, one may interpret selflessness as not being selfish. However, this needs to be clearly contextualised as being selfish in private life does not necessarily equate being selfish in the

12 Despite various scandals and failings, the UK holds a long standing tradition of public sector integrity which is generally traced back to the Northcote-Trevelyan Report and which is often praised in political speeches as a national asset. Evidence of this can be found in the Public Administration Select Committee, *The Public service ethos. Seventh report of session 2001-2, Vol I*, available at <http://www.publications.parliament.uk/pa/cm200102/cmselect/cmpubadm/263/263.pdf>. The same words "civil servants" echo the idea of a strong public service ideal.

13 In the original report Selflessness was described as: "holders of public office should take decisions solely in terms of the public interest. They should not do so in order to gain financial or other material benefits for themselves, their family or their friends". Integrity was originally described as: "holders of public office should not place themselves under any financial or other obligation to outside individuals or organisations that may influence them in the performance of their official duties". Honesty instead read as follows: "holders of public office have a duty to declare any private interests relating to their public duties and to take steps to resolve any conflicts arising in a way that protects the public interest". See 1995 Nolan Report, p 14

14 This would stem for a pure semantic analysis.

professional one. Having regard to the CSPL definition of integrity, the following analysis has been conducted based on an interpretation of selflessness as a duty not to be selfish¹⁵ in the pursuing of the public interest.

With specific reference to banking and finance, the public interests involved in the regulatory and supervisory activities of B&F authorities can be found in their combined remits: preserving financial stability; maintaining trust in the financial system and ensuring the fair and correct behaviour of financial players as a way to protect investors.

More specifically, the PRA mandate, or general objective, is the promotion of the safety and soundness of PRA-authorized persons. The objective is advanced primarily by “seeking to ensure that the business of PRA –authorized persons is carried on in a way which avoids any adverse effect on the stability of the UK financial system and by seeking to minimise the adverse effect that the failure of a PRA-authorized person could be expected to have on the UK financial system”¹⁶.

The FCA strategic objective¹⁷ is to ensure that the relevant markets function well. The FCA operational objectives are: the consumer protection objective, which refers to the need to secure an appropriate degree of protection for consumers; the integrity objective, which refers to the protection and the enhancement of the integrity¹⁸ of the UK financial system and the competition objective, which relates to the need to promote effective competition in the interest of consumers¹⁹ in the markets.

The Bank of England is the Central Bank of the United Kingdom with the primary mission of promoting the good of the people of the United Kingdom by maintaining monetary and financial stability. In a nutshell, the Bank seeks to maintain public confidence in the monetary system; sets inflation targets; regulates and oversees the payment and settlement system; acts as a lender and

15 As selflessness is often discussed within the context of conflicts of interests, the word “disinterested” could have been employed. However it is still seen as inappropriate because holders of public officers should pursue a public interest, or they should be interested in the most objective outcome in case of decision making and enforcement or resolution powers.

16 Included in Sec 2B FSMA 2000. Please note, the version of the Bank of England and Financial Services Bill currently under discussion, does not seem to amend the PRA statutory objectives.

17 FCA objectives are included in Sec 1B FSMA

18 Integrity in this sense relates to: the soundness, stability and resilience of the system; its not being used for purposes connected to financial crime and affected by behaviour which constitute market abuse; the orderly operation of financial markets and the transparency of the price formation process. See Sec 1D FSMA 2000. The Financial Services (Banking Reform) Act 2013 amends FSMA 2000 in the sense of including an FCA continuity objective for those non PRA regulated activities (*ie*, the protection of the continuity of the provision of core financial services in the UK).

19 Sec 1G FSMA 2000 gives the widest possible definition of consumers, including both actual and potential users of financial services as well as all those who have rights or interests in financial instruments.

market maker of last resort in case of crisis and has primary operational responsibility for the management of financial crisis²⁰.

The Monetary Policy Committee sets interest rate at a level judged appropriate to meet the inflation target. This in turn enables the achievement of low and stable prices with benefits to the overall economy. More recently, the MPC has also been entrusted with quantitative easing powers²¹.

It could then be argued that the selflessness required to maintain financial stability and trust in the markets, as public goods, imposes upon members of B&F authorities a duty to understand the negative implications that a selfish professional conduct may have on the consumers of financial services and the economy as a whole, as well as on the reputation of the authority.

Under this light, the issue at stake seems to be how to embed the spirit of public purpose in employees' behaviour and attitude. Part of the answer may be the creation of an organisational culture which not only trains, rewards, nourishes good behaviour as well as sanctions misbehaviour but that inculcate also a sense of loyalty and belonging on their employees. This however needs to be balanced against the need to preserve staff private life²².

In order to address this, we need to consider how B&F authorities ensure that 1) members of staff are aware of the specialty of their role; and 2) how their behaviour is monitored and assessed.

To this end we will verify the existence of "values statement"; and wherever possible, *ad hoc* training programme; recruitment policies and their monitoring systems.

FCA

Value/Mission statements

The FCA narrative on who they are and what they do does not seem to convey immediately a strong sense of public interest or their commitment to highest standards of behaviour. In their website, which presumably is the first point of reference for perspective applicants (and for the public as a

20 With the enactment of the Bank of England and Financial Services Bill, the Bank of England will become a prudential regulatory authority and will exercise its functions through the PRC.

21 To put it simply, with quantitative easing measures the Bank issues electronic money to buy financial asset, usually government bonds, from the private sector so that the latter has more spending power. This new power can be used to buy corporate bonds and shares, which in turns allows for lower borrowing costs and increased wealth. See Joyce et al, *The United Kingdom's quantitative easing policy: design, operation and impact*, at BoE Quarterly Bulletin, 2011, Q3, p 200. The MPC has stopped QE purchases in February 2012 but "any funds associated with purchased bonds maturing have been reinvested" so that the overall stock of QE remains the same. See Quantitative Easing FAQ available on the Bank of England website.

22 The CSPL (2013) report considered the issue of private life and concluded that "public office-holders are entitled to privacy in their personal lives. But it is important to recognise that there can be circumstances in which private behaviour can affect the reputation and integrity of a public institutions, and which require an appropriate response. Such intrusion should only happen where there is a clear public interest to justify it, and should always be proportionate" (p 26).

whole), reference is often made to the need for “consumers to get a fair deal”, “the industry is run with integrity”, “we must consider the principles of good regulation when carrying out our work²³”; and on their regulatory perimeter. This notwithstanding, it is likely to think that an informed candidate and employee would delve more into FCA documents to find out about their culture.

More specific documents, such as their business plan, their annual report, their staff handbook, their code of conduct, and their corporate governance, lack a section on missions and values and there are no clearer indications of the requirement on FCA employees to put the public interest ahead of theirs. However the sense of belonging is recognised in their corporate responsibility section focused on “diversity and inclusion”, “community engagement” and “sustainability”. At the onset, the FCA specifies that “our role within the community is key and this approach helps our people to feel a sense of belonging to the FCA and to wider society”.

Reference is also often made to the specialty of their role in speeches and other documents from senior FCA representatives. For instance, in the Chairman foreword to the 2015/16 business plan it is stated that “As an organisation we are continuously looking at the way we work to make sure that we are meeting challenges head on and achieving the high standards expected of us”.

In a recent speech Tracy Dermott, FCA acting chief executive, said: “My team at the FCA make difficult and important decisions every day and we are acutely aware that all of these decisions have real life costs and implications not only on those we regulate but, more importantly, on the consumers and end users of their services”²⁴.

Finally, when asked by the CSPL Survey whether they had any further comment to make, the FCA noted that: “as a regulator we are conscious that we need to behave in a way that is beyond reproach, given the censure and enforcement roles we have over the community we regulate”.

Recruitment process

The FCA handbook includes the following statement in relation to the Recruitment Policy: “we believe the FCA’s success depends on having the right people in the right jobs within the organisation. The purpose of the FCA’s recruitment policy is to provide a framework to ensure we recruit, retain and develop the best person for each job”²⁵. The recruitment process is based on a set of principles which foster fair treatment of applicants; the commitment to recruit those “who not only have the right skills and behaviours for the job, but who also have a strong commitment to the

23 It is interesting to note that the principles of good regulation do not consider acting with integrity, contrary to what the principles for business require to both FCA and PRA authorised firms.

24 Speech by Tracy McDermott, *Independence, Confidence and Fairness*, at Bloomberg, 4 Feb 2016, available at www.fca.org.uk

25 FCA Employee Handbook, August 2015, Ch. 7.

FCA and our aims". However, in describing what is expected by the applicant there is no reference to their understanding or at least familiarity on the special nature of FCA's objectives²⁶. In the Job Descriptions of the positions advertised at the time of writing there is no reference, neither in the minimum nor the essential requirements, to any prior knowledge or understanding of the need to act solely in the public interest²⁷.

It shall be noted however that the FCA has a similar requirement for candidates to the Board whereby "they will be expected to conduct themselves in accordance with the Seven Principles of Public Life and a copy of the principles is annexed to their letter of appointment. Appointments of the Chair and Non-Executive Directors are conducted in accordance with the Code of Practice of the Office of the Commissioner for Public Appointments"²⁸. Also, this is how the FCA describes their employees characteristics: "While we do not specifically promote the seven principles to all staff, the FCA has identified a number of Cultural Characteristics (Strength as a Team, Professional Excellence, Curiosity, Already on the Case, Backbone) that all staff are expected to demonstrate as they go about their work. The importance given to the cultural characteristics and personal strengths of Judgment, Drive and Influence is represented by their inclusion as a core part of the FCA capability framework. In this way, they are embedded through the employee lifecycle, from recruitment and induction through to ongoing performance management and appraisal – how our people deliver is weighted equally with what they deliver. The cultural characteristics thus have a significant influence on how the FCA operates and help to ensure that the principles, particularly objectivity, selflessness, integrity and honesty, define our approach"²⁹.

Finally FCA employees are expected to follow "reasonable instructions, comply[ing] with the terms of their contract of employment and adher[ing] to the FCA's conduct policy, security and compliance standards"³⁰.

26 On the general FCA career webpage mention is made to the possibility of making "a real difference to the two million people who work in the UK financial services industry, the 40 million consumers of financial products and the stability of our economy as a whole" and also to the integral part played by their people to "our success as an organisation, working alongside industry, visiting firms and speaking to consumers everyday as we strive to ensure we are setting the standard for other regulatory bodies across the world". See www.fcacareers.org.uk

27 The Minimum requirements usually relates to prior experience, whereas the essential to personal skills such as "communication; collaboration and flexibility; ability to make good judgement; organisational and analytical skills" and so on. Also whereas the assessment process varies, at least in the first stage it is mostly competence based. However, the FCA response to the CSPL survey stated that the competency assessment is based on "alignment with our cultural characteristics and personal strengths as well as technical capability". The Website section on Employees profile features only a series of videos from current employees describing their roles within the overall FCA functions.

28 From FCA's reply to CSPL Ethics for regulators review: Regulators survey.

29 *Ibidem*

30 See FCA Employees Handbook, p 155.

Training

FCA seems to place great emphasis in training and personal development. In addition to the regular training programmes, “all permanent and fixed-term contract employees, as well as contractors, and their line managers receive a new joiner check list on which the code of conduct is a key item. New joiners are all required complete a full day’s FCA induction programme which brings attention to our responsibilities as a regulator, and our code of conduct”³¹. There are also a number of training modules which all must complete upon joining which include a module on FCA’s Duties & Powers.

Monitoring and Sanctioning

The FCA monitors employees’ performance against the “behaviours each employee exhibits in delivering on their objectives/working commitments. In attributing a relative performance rating, this behavioural aspect (how they deliver their work) is weighed equally with what they deliver. Ratings are moderated at a local, divisional and then FCA level to ensure robust and fair judgements”³²

It seems fair to say that any monitoring and sanctioning procedures for failure to act in the terms of the public interest would fall under the regular disciplinary procedures for misconduct, where, for instance, “fraud, theft, dishonesty or obtaining or attempting to obtain an advantage at the expense of the FCA or any person, firm or organisation that is regulated by the FCA” can initiate a disciplinary procedure for gross misconduct³³.

The FCA handbook includes a section on Personal Conduct which essentially warns employees of the compulsory nature of their code of conduct. The need to comply with the Code³⁴, which includes policies on conflicts of interest, personal dealing in securities and rules on gifts and hospitality, is explained in the following terms: “We are responsible for promoting and setting high standards of conduct, so our conduct both as an organisation and as individual employees is likely to come under close scrutiny. It is therefore essential that, in common with many other organisations, we have a Code of Conduct. This provides a framework for managing conflicts of interest and related matters. It also protects employees against any suggestion that regulatory decisions have been influenced by

31 From FCA’s reply to CSPL Ethics for regulators review: Regulators survey

32 From FCA’s reply to CSPL Ethics for regulators review: Regulators survey.

33 A non exhaustive list of behaviour that can lead to disciplinary procedures and possibly dismissal is included in the FCA Employees Handbook, at p 156-157.

34 See the Financial Conduct Authority Code of Conduct, April 2013, available at www.fca.org.uk

personal interests or that their investment decisions have been influenced by information made available in confidence to the FCA.”³⁵

Bank of England

Value/Mission statements

The public mission of the Bank is clearly stated on their webpage as the promotion “of the good of the people of the United Kingdom by maintaining monetary and financial stability”³⁶.

The idea that the Bank works to promote the good of the people of the United Kingdom is reiterated in all the relevant web pages. The Bank employees’ handbook contains a foreword by the Governor³⁷ which reaffirms the Bank’s mission and which makes reference to “the values to which the Bank aspires, our role as public servants, how we interact with the public, and the standards that guide our own behavior and our relations with our colleagues”³⁸. As part of the obligations towards the Bank, employees are expected to “follow the highest standards, both in work undertaken and in general behaviour”³⁹.

Reference to the core purposes, responsibility, philosophy, and core values, including a section on “ensuring the loyalty and commitment of our staff”, are clearly stated in the Handbook and are phrased to convey a strong sense of public duty. The Handbook also includes a specific section on “ethics policies (sic): our code and related policies”. In the Bank Code of Conduct mentions is made to “public service” and “public servant”.

Finally the Bank’s code is organised into 5 core values with three of the Nolan principles represented in section headings (Integrity, openness and accountability)⁴⁰. The first one is “Acting with integrity” and the first sentences of the chapter read as follows: “Selflessness is one of the principles of public

35 See FCA Handbook, p 175

36 www.bankofengland.co.uk. This mission remains almost unaltered since the Bank’s founding Charter of 1694.

37 The CSR literature usually evaluates positively the existence of accompanying letters/introductions/forewords by executive directors to codes and other self regulatory documents as a way to communicate the importance of the document and/or to set the tone from the top.

38 See BoE Staff Handbook, 2015, p 2

39 *Ibidem*, p 6.

40 Namely, acting with integrity; creating an inclusive working environment; demonstrating impartiality; being open and accountable; feeling empowered. Bank of England, *Our code, our commitment to how we work.*, version 1.0, June 2015. Discussion over code introduction and reference to the Nolan Principles, compliance and enforcement can be found in the Minutes of the Meeting of the Court of Directors of the Bank of England, of Wednesday 20 May 2015, p 3.

life. Our personal interests should never influence our decisions at work, and we must be free of any suggestion of inappropriate influence.”⁴¹

Recruitment process

Unlike the FCA Handbook, there is no specific section on the recruitment process on their Staff Handbook. On their website career section there is a specific page dedicated to “What is like to work at the Bank of England?”, with sub-headings related to different aspects of the working environment and how skills and intellectual ability of employees are rewarded.

As the purpose of the Bank is very clear throughout the website, as well as in their code and handbook, it is possible to argue that prospective applicants are aware of the specialty of their future role.

Training

Unlike the FCA Handbook, there is no specific section on training opportunities in the Bank Staff Handbook. General reference to training is made throughout the handbook.

The Bank response to CSPL survey includes a section on training which reads as follows: “Currently training and awareness-raising in relation to the Bank’s business ethics policies is covered as part of the induction process for employees. The new compliance function will oversee an on-going programme of training, awareness and understanding of Bank policies for all employees. This will be kept under regular review to ensure it remains current”.

Monitoring/Sanctioning

By the same token, the Bank has a specific performance management approach which monitors staff behaviour and understanding of their public role in the sense of putting “as much emphasis on values, and how we do our work as what we do. All managers go through an annual 360 degree feedback process based on the values we expect and everyone who works at the Bank is given a rating for their behaviours as well as for their delivery against their objectives as part of the annual performance review process. Both are taken into account when deciding on the overall rating for an individual and this is moderated through discussion with peers”⁴².

Finally the Bank is currently setting up a central compliance function to assist senior management in managing compliance with the Bank Code of Conduct.

The Bank disciplinary procedures punish misconduct as instances of loss of trust in employee’s judgement or behaviour, dishonesty and other examples of gross misconduct as well as “Serious

⁴¹ See Bank of England, *Our code, our commitment to how we work*, p 5.

⁴² Bank of England response to CSPL Ethics for Regulators survey.

breach of any of the policies and rules published to you by the Bank from time to time, including, without limitation Our Code”⁴³

Prudential Regulation Authority

Value/mission statements

As an (independent) subsidiary of the Bank of England, the PRA website is included in the Bank one. In the dedicated section there is reference to the statutory nature of the PRA as well as its objectives and its approach to regulation and supervision. The PRA is described as a regulatory body in what seems to be a disclaimer to differentiate it from Prudential plc. There is a specific section on the “PRA and the general public” which mentions PRA particular concerns “about the harm that firms can cause to the stability of the financial system”.

The PRA has a specific policy on conflicts of interest of the appointment member of the PRA Board which will be analysed in greater details under “Integrity”.

It seems plausible to argue that potential candidates as well as employees will be alert to the public interest underpinning PRA’s work.

Recruitment process

The PRA has a specific career section, which starts with a high level statement: “picture a safer economy for all, then help make it happen”, it continues re-stating the PRA objectives, explaining the meaning of supervision and what the role entails, and concludes stating that “after all, by promoting a safer and more robust financial sector, you are working to benefit every single person in the UK”⁴⁴. The minimum skills required to each applicant are being: “an analytical thinker”, “a tenacious problem solver”, “a confident communicator”, “professionally credible”.

Training

PRA staff is subject to the same handbook and code of conduct of the Bank staff. So the same policies apply.

Monitoring and Sanctioning

Same as above.

43 See Bank of England Staff Handbook (2015), p 45.

44 www.pra.bankofenglandcareers.co.uk

Monetary Policy Committee

Value/mission statements; Recruitment; Training; Monitoring/Sanctions

Like the PRA, the MPC website is hosted within the Bank and the Bank policies apply to MPC member, unless otherwise specified.

MPC members have a specific code of conduct which stresses the “special responsibility to promote the reputation and integrity of the Bank and its decision making processes. They must at all times avoid statements and conduct that could in any way undermine public trust in the Bank.”⁴⁵ The code then disciplines conflict of interests, secrecy and other matters concerned with the need to prevent public speculation over monetary policies decisions.

The unique nature of the Committee’s objectives, coupled with the specificity of the appointment⁴⁶ makes redundant any analysis of the understanding of the public interest involved.

Rather, the MPC composition may create conflicts of interest which will be analysed under “Integrity”.

Conclusions

Against definition problems, the analysis conducted aimed at verifying whether, and to what extent, the principle of selflessness is part of the regulators’ internal culture and is clearly conveyed to employees, both potential and existing. To this end a few indicators have been identified and each authority has been assessed against those.

The authorities considered are inherently diverse. The FCA is in charge of conduct of business regulation and supervision and at first glance seems to be very market –oriented, hence unable to convey immediately the underpinning public purpose that lies at the heart of its activities. The Bank of England is the central bank of the United Kingdom, whose twin mandate (monetary policy and financial stability) is able per se, at least in principle, to convey a strong sense of public interest to the outside world and internally. The PRA and the MPC are the Bank’s operative arm and yet they have their own identity.

The authorities differed also in how they communicated the public interest and how they require their staff to live up to it.

45 Code of Conduct for MPC Members, 21 May 2015.

46 The MPC is made up of 9 members. Five belong to the Bank (the Governor, the three Deputy Governors and the Bank Chief Executive) and four are independent members appointed by the Chancellor.

Integrity

Integrity: holders of public office must avoid placing themselves under any obligation to people or organisations that might try inappropriately to influence them in their work. They should not act or take decisions in order to gain financial or other material benefits for themselves, their family or their friends. They must declare and resolve any interests and relationships.

Some recent events have questioned the integrity of B&F authorities, undermining their credibility and trustworthiness.

For example, in the wake of the LIBOR and FOREX scandals there were allegations that the Bank of England knew the benchmark was being rigged and yet did not intervene to bring the manipulation to a halt⁴⁷. As a consequence to this, the Bank commissioned an independent review over “whether, between 2005 and 2013, any Bank official was involved in, or aware of, the conduct which is the subject of the FCA’s investigation into the FX market”⁴⁸. The review found no evidence to suggest that any Bank official was involved in any unlawful or improper behaviour in the FX market.⁴⁹

Also, on 5 March 2015 the SFO (Serious fraud office) issued a press release confirming an ongoing investigation into “material referred to it by the Bank of England concerning liquidity auctions during the financial crisis in 2007 and 2008” and that “The material is the result of an independent inquiry that the Bank of England commissioned into this matter.”⁵⁰

47 The different instances in which the Bank was allegedly involved are summarised in this Wall Street Journal article by David Enrich, *Bank of England Official received emails relating to LIBOR manipulation, Prosecutor says* available here <http://www.wsj.com/articles/boe-official-received-emails-relating-to-libor-manipulation-prosecutor-says-1432729106>.

48 See *Bank of England Foreign Exchange Market investigation. A report by Lord Grabiner QC* available here <http://www.bankofengland.co.uk/publications/Documents/news/2014/grabiner.pdf>. The specific terms of reference were “whether any Bank official, during the period July 2005 to December 2013: (a) was either (i) involved in attempted or actual manipulation of the foreign exchange market (including the WMR FX benchmark), or (ii) aware of attempted or actual manipulation of the foreign exchange market, or (iii) aware of the potential for such manipulation, or (iv) colluded with market participants in relation to any such manipulation or aware of any such collusion between participants; (b) was either (i) involved in the sharing of confidential client information or (ii) aware of the sharing of such information between participants for the purposes of transacting business in the foreign exchange market; or (c) was involved in, or aware of, any other unlawful or improper behaviour or practices in the foreign exchange market” p 42.

49 However, the reviewer “found that, from May 2008, the Bank’s Chief FX Dealer, Mr Mallett, was aware of the fact that banks were having open discussions about their fix positions in chat rooms with a view to matching them off. He was worried about the practice and thought that regulators may take an interest in it. (...).Notwithstanding his concerns, Mr Mallett did not raise them with an appropriate person at the Bank, with the FXJSC (on which the FSA sat) or with the FSA”. *Ibidem*, p 37. Mr Mallett has since then been dismissed for serious misconduct, however the Bank did not directly link his dismissal to the case in question.

50 SFO Press Release, *SFO is investigating Bank of England liquidity auctions*, 05 March 2015 available here <http://www.sfo.gov.uk/press-room/latest-press-releases/press-releases-2015/sfo-is-investigating-bank-of-england-liquidity-auctions.aspx>. The correspondent Bank of England one was issued the day before, see *Bank of England Statement on SFO investigation*, available here

The FCA has been under severe pressures from the media for being allegedly influenced by the Government in their regulatory and supervisory actions. Among the findings of an independent review over FCA board effectiveness, the assessors noted that “stakeholders management” constitutes a challenge⁵¹ and recommended that “the Chairman and the board need a clear and aligned view on the interpretation of the role and independence of the Board, which can then be translated for stakeholders in order to increase understanding”⁵². More recently, an internal document originally prepared for an EXCo (Executive Committee) meeting was leaked to the Financial Times, a newspaper, only to find out that the FCA had decided to abandon its review into

<http://www.bankofengland.co.uk/publications/Pages/news/2015/037.aspx>. On this and other issues related to the report and its costs, see the letter written by the Chairman of the Court of the Bank of England to Andrew Tyrie in response to Tyrie’s request for more information on the liquidity auctions. Anthony Habgood, *Letter to Andrew Tyrie in response to his letter of 12 March 2015*, of 17 March 2015.

51 More specifically the review stated that “Like most regulators, the FCA has a complex and demanding stakeholders landscape, which requires careful interpretation and management; the landscape is populated with powerful personalities and strong opinions, and is subject to conflicting and changing agendas (noted by all directors). It is also the subject of intense public scrutiny and media comment. Although constituted as an independent regulator, and following the UK’s Corporate Governance Code in many respects, Board powers are limited, and its remit is defined by the Government; this has a significant impact on the role and influence of the Board. External interventions, which can put pressure on the chairman, and/or bypass the Chairman and the Board entirely, can have dramatic effects on the organisation. All directors are aware that the political landscape is particularly difficult to manage. Recent intervention by HM Treasury and other bodies have raised questions from directors regarding the Board’s independence.” FCA, *FCA board effectiveness: an independent evaluation by Boardroom Review limited*, October 2015, p 3, available here <https://www.fca.org.uk/your-fca/documents/reports/fca-board-effectiveness-review-2015>. In the past, a similar criticism was raised to the Financial Services Authority (the FCA replaces the FSA): in the report on the HBOS failure, the FSA has been considered as subject to external influence. See *The Failure of HBOS plc (HBOS). A report by the Financial Conduct Authority (FCA) and the Prudential Regulation Authority (PRA)*, November 2015, available here <http://www.bankofengland.co.uk/prd/Documents/publications/reports/hbos.pdf>

52 FCA, *FCA board effectiveness*, 2015, (fn 51), p 4. The review has been commissioned as a response to the Treasury Committee 13th report inquiring on the communication incident related to the life insurance review. The committee was “surprised” to discover that results of the FCA internal review were deemed “satisfactory”, and urged the Board to “commission an external organisation to conduct a review of its practices and effectiveness”, and asked for the results of the review to be made public, p 66. The facts of the case are as follows: “On the evening of 27 March 2014, the Daily Telegraph published an article on its website describing a forthcoming thematic review by the Financial Conduct Authority (FCA) into the life insurance market. The same story appeared in the print edition of the Telegraph the following day. The story, based on an advance briefing given by the FCA to the Telegraph earlier that week, gave a misleading impression of the scope of the life insurance review, and was published before the FCA had made any official announcement of its own. When the markets opened on 28 March, the share prices of several leading life insurers began to fall heavily. Only when the FCA published a clarifying statement about the scope of the review—several hours later that day—did share prices begin to recover.” See House of Commons Treasury Committee, *Press briefing of the FCA’s Business Plan for 2014/15. Thirteenth Report of Session 2014-15*, March 2015, p 3, available at <http://www.publications.parliament.uk/pa/cm201415/cmselect/cmtreasy/881/881.pdf>. An independent review of the incident was previously being commissioned to Simon Davis, partner at Clifford Chance, a consultancy firm. The final review *Report of the Inquiry into the events of 27/28 March 2014 relating to the press briefing of information in the Financial Conduct Authority’s 2014/15 Business Plan* was made public on 20 November 2014, and is available at <http://www.fca.org.uk/your-fca/documents/reports/davis-inquiry-report>.

banking culture. The incident prompted speculation as to whether the decision came as a consequence to political pressures⁵³.

The appointment to the board of the MPC of Dr Gertjan Vlieghe⁵⁴ provoked public disdain and forced the Treasury Select Committee to intervene and to require amendments to the MPC code of conduct⁵⁵.

The risk of the PRA losing its independence following the enactment of the Bank of England bill was another matter of concern for the Treasury Committee who questioned the then PRA Chief Executive⁵⁶.

Integrity *per se* has the broadest possible meaning and it refers to our moral code and its rigour. In fact in principle integrity would include few of the Nolan principles that are enunciated alone, and yet it goes beyond selflessness and honesty⁵⁷. As such, guidance on its actual content may be

53 In response to a Freedom of Information request, the FCA insisted they had not sought any comments nor held any discussion with the Bank, the PRA, HM Treasury or any other body not to continue the culture review. They did inform the “PRA by email on 17 December 2015 of our decision to discontinue the project. The PRA acknowledged our email and did not comment on our decision. We have not received written comments, feedback or observations from the Bank of England, HM Treasury or any other outside body”. See FCA FOI 4350, available at www.fca.org.uk. Whereas the FCA shared a version of the proposed culture review with the PRA, this is certainly not enough to prove that the decision to drop the review came amid external pressures. See *Email from the FCA to the Clerk of the Committee 14 January 2016*, available at www.fca.org.uk. See also the Treasury Committee Hearing of Tracey McDermott and John-Griffith Jones on January 20, 2016 where the question of independence from political pressure resonated widely: House of Commons Treasury Committee, *Oral Evidence of Tracy McDermott and John Griffith-Jones, Financial Conduct Authority HC 515*, 20 January 2016; PRA response to the FOI request on “*When did the Prudential Regulation Authority ('PRA') first learn that the Financial Conduct Authority ('FCA') was considering discontinuing their thematic review of 'culture'?*” Released on 19 January 2016

54 Dr Vlieghe was a partner at Brevan Howan, an asset management company, upon his appointment.

55 Proposal rejected by the Bank’s Governor. Please see correspondence between Andrew Tyrie, Chairman of the Treasury Select Committee, and Mark Carney, Governor of the Bank of England.

56 See Treasury Committee, *Oral evidence: Bank of England Bill, HC 445*, Tuesday 20 October 2015, available at <https://www.parliament.uk/business/committees/committees-a-z/commons-select/treasury-committee/inquiries1/parliament-2015/bank-of-england-bill-15-16/>. Andrew Bayley, then PRA Chief Executive, affirms his satisfaction with the Bill provisions related to the PRA independence and separation requirements. In fact he confirms their importance saying that “there is all sorts of potential for conflict and muddle if you don’t get that right”, p 1.

57 The ever present instances of misconduct in the banking sector have forced judges to define integrity, a task usually assigned to philosophers or social scientists. See for instance *Batra v The Financial Conduct Authority* [2014] UKUT 0214 (TCC); *Hoodless and Blackwell v FSA* (2003), where the Tribunal observed that “integrity connotes moral soundness, rectitude and steady adherence to an ethical code. A person lacks integrity if unable to appreciate the distinction between what is honest or dishonest by ordinary standards”, as long as these standards are clear. In *Vukelic v FSA* (2009) UKFSM FSM067 at [23] the Tribunal somehow expanded the definition of integrity as a concept “elusive to define in a vacuum but still readily recognisable by those with specialist knowledge and/or experience in a particular market [23]. Following up on this, the Tribunal in *First Financial Advisors Limited v FSA* [2012] UKUT B16 (TCC) also referencing *Hoodless* draws a distinction between integrity and honesty: “even though a person might not have been dishonest, if they either lack an ethical compass, or their ethical compass to a material extent points them in the wrong

needed. As with selflessness, one may question the description given but in this case its content seems to be clearer. The CSPL sees it as a three pronged duty⁵⁸ which requires: 1) independence; 2) avoidance of conflicts of interests; 3) disclosure and resolution.

We shall examine independence first.

It is not possible here to give a full account of the established body of academic literature related to the independence of regulatory agencies⁵⁹. Also, both the content of independence and its definition vary according to the identity of the subject who is independent from another subject, and the instruments aimed at guaranteeing it. Thereby, it is not easy to adopt a single concept of independence that would be suitable for any type of B&F authority. Against this background, independence is usually characterised as having four dimensions: *institutional, functional, organizational and financial*⁶⁰. As unelected bodies, B&F authorities are institutionally independent and as such they have very stringent accountability duties (analysed below under the relevant Nolan principle). Independence is functional because it can be used as a valid tool to serve specific public policy goals. Organisational independence may be limited by statutory prescriptions; some of the B&F authorities are funded by the industry they regulate which may, in principle, raise some concerns.

More broadly the independence of B&F authorities can be defined as *“the ability of the agency to carry out its operations without undue political or commercial interference”*⁶¹. This definition is

direction, that person lacks integrity” [119]. In *Arch Financial Products v FCA* [2015] there is a further explanation of the distinction between integrity and honesty “a lack of integrity does not necessarily equate to dishonesty. While a person who acts dishonestly is obviously also acting without integrity, a person may lack integrity without being dishonest. One example of a lack of integrity not involving dishonesty is recklessness as to the truth of statements made to others who will or may rely on them or wilful disregard of information contradicting the truth of such statements” [200]. To a certain extent, and in a less legalistic jargon, the latter distinction had been made also by one participant to the CSPL focus group during the course of their 2013 review, see CSPL (2013) at par 3.8, p 23.

58 Please note, integrity was originally described as: “holders of public office should not place themselves under any financial or other obligation to outside individuals or organisations that may influence them in the performance of their official duties”. The description of some principles was amended in 2013 to reflect changes in understanding of the meaning of certain words. See CSPL (2013), p 22

59 For central banks, a seminal work is Lastra R, *Central Banking and Banking Regulation*, FMG, London, 1996

60 Amtenbrink F., *The Democratic Accountability of Central Banks - A comparative study of the European Central Bank*, Hart Publishing, Oxford, 1999, p. 17

61 Seelig S., Novoa A., *Governance practices at financial regulatory and supervisory agencies*, IMF Working Paper 01.07.2009. Central Bank independence is also enshrined into the EU Treaty, art. 130: “When exercising the powers and carrying out the tasks and duties conferred upon them by the Treaties and the Statute of the ESCB and of the ECB, neither the European Central Bank, nor a national central bank, nor any member of their decision-making bodies shall seek or take instructions from Union institutions, bodies, offices or agencies, from any government of a Member State or from any other body. The Union institutions, bodies, offices or agencies and the governments of the Member States undertake to respect this principle and not to seek to influence the members of the decision-making bodies of the European Central Bank or of the national central banks in the performance of their tasks”

particularly relevant for our purposes since B&F authorities are always at risk of being captured by their regulatees and being the subject of political pressures.

Given the nature of the activities they regulate and oversee, and given the financial importance that these have on the economy⁶², especially in the UK, B&F authorities are always under the political radar. In some cases they must coordinate their actions with, or receive instructions by, the Treasury. Besides, their institutional independence is a creature of law, and laws are influenced by the political climate and will⁶³ ⁶⁴. Their independence is also functional and constrained by the goals and tools set out in the law.

62 According to parliamentary research, “in 2014, financial and insurance services contributed £126.9 billion in gross value added (GVA) to the UK economy, 8.0% of the UK’s total GVA. London accounted for 50.5% of the total financial and insurance sector GVA in the UK in 2012. The sector’s contribution to UK jobs is around 3.4%. Trade in financial services makes up a substantial proportion of the UK’s trade surplus in services. In 2013/14, the banking sector alone contributed £21.4 billion to UK tax receipts in corporation tax, income tax, national insurance and through the bank levy”. See House of Commons, *Financial Services: contribution to the UK economy*, SN/EP/06193, 26 February 2015, available here <http://researchbriefings.files.parliament.uk/documents/SN06193/SN06193.pdf>. GVA is a specific measure of the value of a sector to the economy. GVA is used to estimate the GDP, which is an indicator of the whole economy. The GDP measures may use production, income and expenditure approaches. GVA measures are used to calculate GDP when the production or income approaches are used. See www.ons.gov.uk for further reference.

63 During the House of Lords discussions of the Bank of England Bill, Lord Sharkey (LD) overtly discusses both political influences and those of the Bank over the FCA. “The requirement that the PRA board has a majority of external members is an important provision. Its purpose is clear: it is to protect against and counter overwhelming influence by the Bank. Unfortunately, whether there is really a majority of independent board members is open to significant doubt. It depends on whether or not, as the Bank asserts, the CEO of the FCA can properly be described as either external or independent. As I said on Monday when discussing the status of her membership of the FPC, the CEO of the FCA has, at best, a qualified independence, not to be compared with the true independence of the truly external members. She depends for her job on the confidence of the Chancellor and of the governor. Her organisation is, in many respects, controlled—or can be controlled—or constrained by the Bank or its organs. The summary sacking of her predecessor, Martin Wheatley, by the Chancellor, with, no doubt, at least the agreement of the governor, is a clear and dramatic illustration of just how much independence the CEO of the FCA has when it comes down to it. When I raised the same point in the context of the FPC, the Minister disagreed. He asserted simply that the FCA was a completely independent body. The evidence for this is pretty thin, as others have noticed. As recently as August, the Adviser Lounge ran an article headlined: «Financial advice review shows FCA is not independent». It concluded that the regulator can be pushed, both formally and informally, into enacting the Minister’s will. It quoted an historical example. It noted that the former Housing Minister, Grant Shapps, intervened directly in the FCA’s mortgage market review consultation in December 2010—and Grant Shapps was not even a Treasury Minister”. Lord Sharkey’s opinion had been seconded by both Lord Tunnicliffe (Lab) and the Parliamentary Secretary, Lord Bridges of Headley (Con). See Official Report Bank of England and Financial Services Bill [HL], *Committee 2nd day discussion of Amendment 19*, 11 November 2015: col 1998-2001.

64 However, the reverse is also true. For instance the provisions included in the Bank of England and Financial services Bill related to the Bank organisation and the PRA desubsidiarisation currently under discussion came as a direct consequence of the internal reorganisation of the Bank as a “One Bank”. This is clearly stated, among the others, in the Treasury briefing paper to the HL for the Bill where, as noted by Lord Bridges, the PRA suggested governance would “conform with the governor’s “One Bank” strategy aimed at breaking down barriers within the Bank, «that could stand in the way of a unified culture and impede flexible and coordinated working across the Bank»”. *Ibidem*, col 2001-02.

Regulatory capture is a common phenomenon, but in banking and finance assumes an almost unique edge⁶⁵. The banking sector has, wrongly, a strong embedded culture of profit maximisation only which derives from its inability to acknowledge the public nature that lies at the heart of credit provision. The financial crisis has revealed that the industry's main purpose was serving shareholders' interests, not the public good. The banking business is based on running other people money (and "to make money") in fact, not on having a social license to operate. On the contrary, B&F authorities have no interest in the profit maximisation purpose of their regulatees⁶⁶ but are concerned about financial stability, trust and fair treatment of customers. These contrasting objectives (unlike for instance in the health sector where both the regulators and the regulated entities have a clear public purpose in mind) can create a greater tension among the parties and make the regulated firms particularly keen on gaining regulators' sympathy. However, regulators' need to understand their business implies proximity to them⁶⁷ and requires the appointment of experienced professional from the industry itself⁶⁸. Regulators may also want to move to the regulated sector lured by higher pay and different challenges (phenomenon known as "revolving doors")⁶⁹.

An OECD report from 2009, found that since its inception in 2000 the FSA had 36 different members of the Board. Of these 36, 26 had connections at board or senior level with the banking and finance industry either before or after their term of office whilst nine continued to hold appointments in

65 OECD, *Revolving doors, Accountability and transparency- emerging regulatory concerns and policy solutions in the financial crisis*, May 2009, p 16.

66 They are interested in their financial soundness as a condition for financial stability, however financial soundness is different from profit maximisation.

67 By way of example, in the foreword to the 2015/16 FCA Business Plan, the Chairman states that "we are also committed to working as efficiently as possible with firms to deliver value for money as well as the right outcome for consumers and financial markets".

68 It shall be noted though that the latter is not necessarily a shared practice among B&F authorities overseas.

69 In 2013 the Financial Times published an article by Patrick Jenkins titled *Reform call over "pitiful" pay rate at BoE's court*, which reported on the need to pay more non executive directors of the Court to reflect their increased workload and to boost their prestige. The article reports that the "eight external non-executives in the 12-seat "court" – as the BoE's governing body is named – are paid just £15,000 a year for a time commitment of three days a month. The chairman of the court, Sir David Lees, who works three to four days a week in his role, is paid £30,000", and that "Equivalent private sector roles are far better paid. The chairmen of the UK's big banks typically receive £750,000, while non-executives earn £50,000 to £100,000". The report produced by the Public Administration Select Committee (2002) stated very clearly that serving the public interest should not necessarily entail low wages. The Review of HM Treasury's management response to the financial crisis mentions the difficulty for the Treasury to retain high calibre staff due also to comparatively lower level of payments, but suggests that retention could be improved through non financial levers, particularly a greater emphasis on career development. See *Review of HM treasury's management response to the financial crisis 2007-2009*, March 2012 at p 8, available here https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/220506/review_fincrisis_response_290312.pdf

financial corporations while they were at the FSA. A further 3 members had connections with other non banking corporate boards, and the remaining seven had no such connections⁷⁰.

Revolving doors policies are those which impose limitations upon appointments and limitations upon leaving the office. For instance, the former (s.c. revolving in), would prescribe who cannot be appointed to a specific role because of their most recent professional background and/or for the existence of financial or other interests, and the latter (s.c. revolving out) would impose gardening/cooling off periods or approval requirements before moving to a private sector employer. They could go as far as requiring the existence of appropriate organisational requirements or limitations on roles' responsibilities to the private employer. Revolving doors policies would normally be applicable to the authorities' governing body and possibly to their senior staff.

As said, these policies would serve the purpose of avoiding inappropriate levels of proximity to the regulatees: migrations from the private to the public sector and viceversa are particularly dangerous not only because of the possible capture, but also because they can undermine public trust in the authority and can create "grey areas"⁷¹ where a perception of lack of independence is ingenerated.

The law already establishes the minimum requirements for appointments, including provisions related to independent members, but in principle authorities could increase that level by self regulatory instruments.

Moving on to conflicts of interest instead, it shall be noted that they may arise not only as a consequence to the revolving doors phenomenon, or to political influence, but also because of the existence of any other sort of ties, direct or indirect, with regulated firms and/or with their senior managers. They can also arise by virtue of the privileged position members of staff hold with respect to the activities of the regulated entities. One striking example of this is the access to information on listed firms and how this can impact investment decisions, previous or future, of B&F authorities employees.

Conflicts of interests become particularly acute at the top level. In this respect, the FCA/PRA report on HBOS's failure recommends that: "UK financial services regulators should also guard against the risks of actual or perceived conflicts of interest arising from the composition of their Boards. The

70 See OECD, *Revolving doors, Accountability and transparency- emerging regulatory concerns and policy solutions in the financial crisis*, May 2009, p. 30. Revolving doors have of course attracted a wealth of media attention. See for instance, Brooke Masters, *Enter the revolving regulators*, Financial Times, April 23 2012; and *FSA Managing director to join PWC*, Financial Times, 20 March 2012; *RBS's Sir Howard appointment stirs revolving doors concerns*, Financial Times 24 February 2015, More recently with former regulators openly discussing and defending their move. See for instance, Howard Davies, *What's wrong with taking a little spin in the revolving door?*, in Financial Times, May 31 2013; and *Wheatley defends FCA's revolving door into private sector*, in Money Marketing, 3 June 2015, available here <http://www.moneymarketing.co.uk/wheatley-defends-fcas-revolving-door-into-private-sector/>. See also the High Pay Centre Report, *The revolving door and the corporate colonisation of UK politics*, 2015

71 OECD (2009), p 9.

Review found no evidence that Mr Crosby exercised undue influence over the supervision of HBOS from his position as a member of the FSA's Board. However, relevant regulatory authorities should review their conflicts of interest policies to ensure that the risks associated with including serving industry practitioners as non-executive directors on their Boards are adequately managed". They should also have the "will to act" "free from undue influence, in particular when markets are benign and in the face of changing public policy priorities".

Finally, the US is currently legislating over conflicts of interests and revolving doors with the aim of imposing restrictions, among the others, on regulators moving to the private sector or to limit remuneration to those who want to move to the public sector⁷².

Among the possible integrity indicators, the following have been chosen⁷³: policies on "revolving doors"; rules on gifts and hospitality; existence of conflicts of interest policies including retention of financial interest before taking up job; policies on self dealing.

FCA

"Revolving doors policy" and applicability

Appointment to the FCA board is regulated by Schedule 1ZA sec (2) and (3) of FSMA 2000, whereas other rules related to appointment and recruitment are included in the Employee handbook. Provisions included in that handbook are applicable to all employees with no distinctions based on specific roles and seniority.

There seem to be no specific provisions in place that go beyond the legal requirements, such as prohibition based on previous employment in the financial services industry or organisational requirements on the subsequent private sector employer. By way of example, Schedule 1ZA Sec 3 (3) of FSMA requires the Treasury to take into account whether the person they intend to appoint as a

72 See Financial Services Conflict of Interest Act S. 1779, presented by Sen Baldwin, Tammy [D-WI]: *A Bill to prevent conflicts of interest that stem from executive Government employees receiving bonuses or other compensation arrangements from nongovernment sources, from the revolving door that raise concerns about the independence of financial services regulators, and from the revolving door that casts aspersions over the awarding of government contracts and other financial benefits*, available at www.congress.gov

73 Existence of policies on corruption and bribes could have been included too. However given their statutory nature they are largely present in all the institutions and reflect the terms of the relevant Act (UK Bribery Act 2010). Gifts and hospitality are more nuanced instead since they may be bribing vehicles and yet the Act focuses only on cases where it is possible to establish a connecting factor between the gift/hospitality and the advantage that may be received by the offeror. In this, the approach taken by the authority is key. As it will be shown all authorities have specific policies in this regards that go beyond the legal requirements. For a more detailed discussion on the Act, see Ministry of Justice, *The Bribery Act 2010, Guidance about procedure which relevant commercial organisations can put into place to prevent persons associated with them from bribing*, March 2011. Rules on appointment and dismissal of the relevant governing bodies and authorities' funding could have been considered too. However these too are already set out in the law and have been broadly discussed in the introductory paragraph. The reason why lobbying has not been included here is explained under "scope of application".

board member has any financial or other interests that could have a material effect on the extent of the functions as member that it would be proper for the person to discharge. Treasury appointed members are also prohibited from acquiring any financial or other interests that have a material effect on the extent of the functions as member; to receive directions by the Treasury, the Secretary of State or any other person. The FCA confirmed in its response to the CSPL survey to have a specific policy on recruitment of staff from the regulated sector and movement of former employment to the regulated sector, but those could not be found on their website.

Rather the focus is on the need to declare conflicts of interest which may arise from the holding of financial or other interests. These are included in the FCA Code of Conduct.

There is a specific policy on «Leaving the FCA»⁷⁴, which entitles the FCA to impose working limitations during the notice period, and which seems to be aimed at preserving insurgence of possible influences. This notwithstanding, it is important to stress out that it is a general policy and is only applicable to the notice period, during which the FCA can:

«exclude you from the premises of the FCA, and any regulated firm or other third party at which you may be working at the relevant time on behalf of the FCA; and/or:

- require you to carry out specified duties for the FCA other than your normal duties; and/or –
- require you not to communicate in your capacity as an FCA employee with firms or organisations regulated by the FCA, other third parties or FCA employees or officers.
- require you to refrain from attending internal and external meetings, or forums that may present a conflict or are commercially sensitive in nature.

In addition the FCA is entitled during the notice period to require that you:

- do not have contact with employees or third parties except as authorised by us
- do not to carry out all or part of your duties
- return to us all documents, computer disks and other property belonging to us»⁷⁵.

Rules on Gifts and Hospitality

Both versions of the FCA Code of Conduct⁷⁶ include a specific section on the acceptance of Gifts and Hospitality. It is interesting to note that in the 2013 version the relevant chapter starts by making reference to the UK Bribery Act and by embedding the policy into that framework. The 2016 version instead, frames the policy into the need for the FCA to “operate in a way that is public defensible, so

74 See FCA Employment Handbook, 2015, Ch 8, p 119

75 *Ibidem*, p 122

76 See FCA Code of Conduct April 2013 and January 2016

[the employee] must be cautious about accepting and giving gifts and hospitality that could give grounds for suggestions of undue influence". This is set against the need for the Authority to "know the industries and stakeholders with which the FCA interacts so the FCA encourages networking which contributes to improving our stakeholders relations".

The policy requires disclosure, recording and then surrendering to the Ethics Officer of any gifts received above a RRP value of 30£. The Ethics officer will then take action in relation to its donation to charity, use within the FCA or disposal. Gifts below 30£ can be retained by the employee, but must be disclosed and recorded. "Monetary gifts (including redeemable vouchers) MUST NOT be accepted. If a monetary gift is received, the recipient may ask for it to be donated to a charity of their choice"⁷⁷.

The code places responsibility on both the receiver and the relevant director for ensuring compliance with the policies. There is also a specific policy on the acceptance of prizes and on the giving of gifts and hospitality which should be exercised with caution.

Rules on hospitality are based on the same principles, *ie* acceptance and disclosure, so long as the hospitality is not of the kind that the press or others may interpreted to be "exclusive or expensive". In that case, "It is therefore not usually appropriate to accept such an invitation except, perhaps, where it would increase your effectiveness in discharging your role or otherwise significantly further the FCA's interests. There is no comprehensive definition of what constitutes exclusive or expensive hospitality, but it would include invitations to major sporting or cultural events, particularly if only a small number of people have been invited to attend. Directors may authorise acceptance of hospitality not covered in Table 4.2 and which could be regarded as exclusive or expensive if, in their judgement and having considered all the relevant factors, they consider it appropriate. (For directors, authority should be given by their line manager)"⁷⁸. Finally an employee must not seek nor accept preferential rates or benefits in kind for private transactions carried out with companies with which they have, or may have, official dealings as a result of employment with the FCA.

Overall, the rules are not exclusive and common sense should be used in assessing any situation not covered by the policy. As said, the policies apply to all members of staff.

Gifts and hospitality received by the Chairman and by executive members of the Board are also published on FCA website. Data are available starting from April 2013⁷⁹.

Conflicts of interest including retention of financial interest before taking up the job

77 FCA Code 2016, p 10.

78 *Ibidem*, p 12.

79 Here <http://www.fca.org.uk/site-info/information/what-we-spend/hospitality-and-gifts-log>

The FCA Code of Conduct, to which the Employees handbook refers to, includes a specific policy on conflicts of interests, applicable to all members of staff. In its essence, the policy is based upon disclosure and non exploitation, and considers both actual and apparent conflicts. The main aim is the protection of FCA reputation and the need for the FCA to publicly defend its actions. A register of interests of FCA Chairman and board members is publicly available⁸⁰. However a policy which requires the most senior managers, including Chairman and Board members, to sell participations they may have on regulated companies seems to be absent.

Whereas the policy is broadly left unchanged by the new code, it is interesting to note that the latter places more emphasis on individual responsibility⁸¹ and that it now includes conflicts that may arise from “personal association or personal interest or association of their immediate family”.

Conflicts of interest are indeed defined as the possibility that staff work may be: “affected by a personal interest, personal association or personal interest or association of your immediate family. It becomes significant if an independent third party might reasonably take the view that there is a risk of your resultant actions (or those of a personal associate) being affected, whether or not they are actually affected. Conflicts of interest may arise in various ways. For example, as the result of:

- a. a direct or indirect financial interest
- b. a direct or indirect financial interest held by a commercial undertaking with which you have connections
- c. a personal association or relationship with those affected, or likely to be affected, by the information or issue in question
- d. an expectation of a future interest (for example, future employment)
- e. in some cases, a previous association with the information or issue in question
- f. a relevant interest of an immediate family member, in the types of circumstances set out above at a-e
- g. an interest arising from a common interest grouping, such as a trade association or other public or private society. This list is not exhaustive, nor will all of the examples necessarily give rise to

80 See FCA Register of Interests available at www.fca.org.uk

81 For instance the incipit of the current definition of conflicts is “conflict of interest arises when your work for the FCA could be affected by a personal interest or personal association”, whereas it used to be “A conflict of interest arises when our work for the FCA could be affected by a personal interest or personal association”; or “you must not exploit, or reasonably appear to exploit any personal or professional relationship” (2016 version) against “None of us must exploit, or reasonably appear to exploit, to our personal advantage any personal or professional relationships with a Relevant Organisation” (2013 version)”. Also the 2013 version made reference to the fact that “Those providing information must be confident that it will be properly handled, and conflicts of interest must be identified immediately when they arise and be properly managed” (p 6), whereas no such a reference is made in the 2016 version.

significant conflicts of interest. If you are in doubt about whether a conflict has arisen, please consult the ethics officer (whose details can be found on the Hub)⁸².

The disclosure obligation arises also when a relationship with a particular product or service provider (for instance holding of assets; liabilities or share dealing) could give rise to a conflict of interest according to employee's opinion.

The interests that must be disclosed include, but are not limited to⁸³:

“• any post, other employment, or fiduciary positions that you hold, or have held in the past five years in connection with a relevant organisation or an organisation that presently, to your knowledge, has a contractual relationship with the FCA

• any other significant relationships that you have, including a professional, personal, financial or family relationship, held in connection with or capable of affecting a relevant organisation. This includes the names of organisations with which you hold:

— securities and/or related investments

— pension products

— investments with life assurance content

— mortgages

— endowment policies

— collective investment schemes

— holdings in investment portfolios (including where full or partial discretion is given to the investment manager)

— interests in hedge funds and private equity funds

For the purposes of disclosure under the code, your relationship is with the firm managing your investment rather than with a particular fund.

• the names of organisations with which you have entered into any ongoing formal loan arrangements under which you have borrowed a capital sum of £5,000 or more and which you expect to continue to exist for at least six months

• any individuals with whom you have a significant relationship who hold positions or are employed by the FCA, a relevant organisation or a firm connected with the FCA's business, such as a supplier or professional adviser.

• any of the above conflicts of your immediate family, to the extent to which you are aware of them”.

82 FCA Code of conduct 2006, p 2-3.

83 For a full list, see the FCA Code of conduct, p 3-6

Upon disclosure to the Ethics officer, the latter has to record it, and based on the conflict, the line manager can move the member of staff to another role or project⁸⁴.

Contrary to what suggested by the CSPL integrity principle, there is no requirement to resolve any interests and relationship.

Many of the conflicting situations are more specifically addressed by the policies on self dealing.

Policies on self dealing

The FCA code of conduct includes a specific section titled: “personal dealings in securities and related investments” which finds its *raison d’être* in the prohibition of insider trading, *ie* dealing on the basis of material non public information, as regulated by the EU Market Abuse Directive. The policy however goes beyond the law to impose higher standards of conduct upon FCA members. The general rule is that a member of staff cannot deal in securities unless has received specific clearance and in case of authorisation shall do so within a limited time frame (2 days). Clearance is not permitted whenever the financial instrument has been held for less than 6 months, or if relates to an FCA regulated firm. Further rules relate to specific types of instruments and bets and to persons who are significantly related to the member of staff.

In their response to the CSPL survey the FCA stated that “A modified version of the Code applies to non-executive directors, primarily to provide slightly different practical arrangements for monitoring their dealing in shares, reflecting the fact that such directors are not employees and do not have access to all the organisation’s systems”.

Bank of England

“Revolving doors policy” and applicability

Similarly to the FCA, rules on appointment and dismissal of the Bank governing body are strictly regulated by the law. Members of the Court of Directors are appointed by Her Majesty (Bank of England Act 1998, part 1 (1)) and there seems to be no “revolving in” restrictions upon Directors other than a general disqualification for appointment “if he is a Minister of the Crown or a person serving in a government department in employment in respect of which remuneration is payable out of money provided by Parliament” (Schedule 1 of BoE act 1998 par 5 (1)). If the person is subsequently appointed to a political role, he shall vacate office, which seems to imply that there are no restrictions on the taking up of Parliamentary posts.

The BoE Staff Handbook, which applies to all employees including those with more senior and executive roles, regulates the case in which a member of staff is leaving the office, but there are no

84 Project has been included in the 2016 version of the code.

limitations or prohibitions as to the new role. There is also a specific policy related to the taking up of company directorships or other positions while working at the Bank, which is generally discouraged or forbidden depending on the nature and role⁸⁵. Rules on disclosure and recording apply in this case.

Should notice being served by either party, the Bank may require the employee:

“3.1 to do other work within the Bank which in the opinion of the Bank is less sensitive in the circumstances; and/ or

3.2 not to attend for work for all or part of your notice period.

During any such period you will remain obliged to provide any assistance that may be requested by the Bank, but unless required or authorised to do so by the Bank you should not:

(a) attend the Bank’s premises;

(b) contact any of the Bank’s employees except where such employees are your personal friends and you are contacting them in a personal capacity;

(c) contact any customers or counter-parties of the Bank except where such customer or counter-party is your personal friend and you are contacting them in a personal capacity;

(d) make any public statements in relation to the Bank or any of its officers or employees; or

(e) engage in any other occupation (whether as employee or otherwise) outside your employment with the Bank.”⁸⁶

Further duties are imposed on staff leaving the Bank that aim at protecting the Bank’s interest. For instance during the following six months from the termination date, those who were entrusted with operational, management and analytical roles are forbidden from soliciting away or engaging with Key personnel of the Bank.⁸⁷

Rules on Gifts and Hospitality

The Bank “entertainment and gifts policy” is mentioned in their code of conduct⁸⁸ and refers to the need to apply, and be seen to be applying, “high standards of ethical behaviour to maintain objectivity and commercial impartiality and to protect against any suggestion of impropriety”⁸⁹.

85 Bank of England, Directorship policy, available at www.bankofengland.co.uk

86 See BoE Staff handbook, 2015, p 24

87 *Ibidem*, p 23

88 Section C2 of the Staff Handbook states that “you must not accept or offer in your official capacity, any fee, gratuity, gift, hospitality, entertainment or consideration of any kind, from or to a Bank customer, supplier or any other person, without authority from your Manager/Head of Division. If you are in any doubt about

Members of staff are also required to apply common sense and Executive Directors, Directors and/or Heads of Division may, where necessary, propose adaptation of the rules to suit particular circumstances of the work of their area. Stricter rules and standards will tend to be required when staff have a “direct commercial involvement with an organisation or individual through their work; for example, purchasing, tenders and contracts, financial market operations.”⁹⁰. Entertainment offers should be disclosed and authorised, even if the member of staff is invited as accompanying spouse or partner. Offer of entertainment deemed “excessive” should be refused. Here “excessive” is defined as “offers of entertainment that are time-consuming, over-frequent, part of a pattern of invitations to one area from a particular organisation that, taken together, appears inappropriate; or disproportionately lavish. Invitations to expensive or exclusive sporting or cultural events should not be accepted”⁹¹. Gifts acceptance is discouraged, but if necessary gifts up to a value of 30£ may be retained. Again, disclosure, disposal and recording rules apply. There are also specific provisions on speaking engagements.

In relation to senior managers and board members, “The Bank releases information about appointments, expenses, receipt of entertainment and gifts over £100 from external parties, excluding any information which the Bank considers confidential at the time. The data is released with a lag of around 3 months, currently available until end- August 2015” on the Bank website.

Conflicts of interest including retention of financial interest before taking up the job

The Bank of England has wide ranging policies on conflicts of interests which are also tailor made to role seniority⁹². There are specific policies on: directorship; financial relationships; political activities; community and charity roles; and personal financial transaction policies. These are all available on the Bank’s website⁹³ and overall require disclosure, recording and approval requirements.

accepting or offering a gift or entertainment, then you should discuss this with your Manager prior to doing so”.

89 Bank of England, Entertainment and gifts policy, p 1

90 *Ibidem*, p 2

91 *Ibidem* p 2

92 So for instance, in its response to the CSPL survey the Bank specifies that «The Bank’s Non-Executive Directors and those in the Senior Policy Group (covering the MPC, FPC, and PRA Board), are subject to the same Code of Conduct and underlying policies. The rules for this senior group of staff are more stringent in relation to some of the policies, for example the personal financial transactions and financial relationships policies, with the senior policy group required, amongst other things, to disclose annually their stock of assets. There are additional ‘conflicts of interest’ Policies for MPC, FPC and PRA Board members. The FPC Code of Conduct includes the provision that members are prohibited from donating to political parties. The interests of all members of the senior policy committees and of the Non-Executive Directors have to be declared and are listed on the Bank’s website».

93 Here <http://www.bankofengland.co.uk/about/Pages/humanresources/default.aspx>

With specific reference to “relationships with financial institutions that might be perceived to influence your judgement or affect your decisions”⁹⁴, disclosure duties arise with respect of the following: “a. holdings of securities or related investments in institutions regulated by the Bank, including stock options, share related reward schemes. b. holding a balance or deposit in a PRA-regulated bank of a value greater than the FSCS limit (currently £85k). c. holding an investment or pension product with a PRA-regulated insurer whose return depends on the profits of the insurance company – for example a ‘with profits’ policy. d. having any other financial relationship which could reasonably be considered to be a potential conflict of interest. This would include deferred remuneration arrangements”.

There is no specific definition of conflicts of interest, as the code is more focused on the possible source rather than their description. The Bank encourages members to consult with their manager or deputy secretaries whenever in doubt.

There is also a specific “personal relationship”⁹⁵ policy which aims at making the Bank aware of any outside interest that might influence staff judgement. The Bank can then make adjustment to avoid conflicts, as well as “any suspicion of collusion, founded or unfounded”. The close personal relationships that need to be disclosed are: 1) the existence of a family member or someone else connected to the member of staff, working in the Bank; 2) Personal relationships with a person or an organisation outside the Bank with specific reference to “financial, economic or political journalism; Bank-regulated financial institutions (including PRA-regulated firms); significant dealing counterparties; a firm that is holding or tendering for a contract with the Bank”⁹⁶.

Depending on the circumstances the Bank may decide to move the member of staff to a different role.

Policies on self dealing

The policy on “personal financial transactions” is extremely thorough and goes well beyond the Market Abuse requirements. In a nutshell the policy allows staff to keep previously acquired holding of instruments but these cannot be actively managed nor increased. They can be sold, but under Banks’ permission⁹⁷. There is a general prohibition over the purchase of financial instruments in any

94 Bank of England, Financial relationships policy, p1, available at www.bankofengland.co.uk

95 Bank of England, Personal relationships policy, p1, available at www.bankofengland.co.uk

96 *Ibidem*, p1

97 “If you have joined the Bank with holdings of such securities (or held them prior to the implementation of this policy) you will be able to retain them, exercise rights arising from them or sell them, but you may not acquire more or actively manage them. You must declare your holdings under the Bank’s financial relationships section of HRConnect (see the Financial Relationships Policy). If you exercise your rights in relation to your prior holding or sell these securities, you should report it via the transaction reporting system in HRConnect.

entity regulated by the Bank. There are provisions related to discretionary management, speculative / short term transactions⁹⁸, advice, prohibitions⁹⁹. Rules apply also to those transaction undertaken for or by connected person, where connected person refer to “spouse; civil partner; children or step children under 18 years, and any other person with whom you live in an enduring family relationship if you take or advise on financial decisions with that person”¹⁰⁰. Specific rules apply also in case of trusteeships of charitable organisations.

It shall be highlighted that a stricter policy applies to Members of the Court, MPC, PRA, EXCo, and FPC. In addition to the requirements set out for all members of staff, the former have: Annual

1.8 It is acceptable for a balanced discretionary portfolio to contain some financial securities provided you have no control over day to day investment decisions and provided that the terms of such arrangement are approved by the Secretary of the Bank in advance.”

98 “You should not undertake transactions whose main purpose is speculative (e.g. to make a capital gain or avoid a loss in the short term), or in betting on financial variables or indices.

1.5 Taking out a Contract for Differences (CfD), which includes ‘spread betting’ in relation to securities, UK indices / sectors or economic variables of direct interest to the Bank and its forecasting processes (e.g. commodity, currency markets) or the UK equity market as a whole is prohibited.”

99 “Reporting Officers will not approve transactions where you have - or might be perceived to have - relevant information that is not in the public domain, for example, ahead of decisions, publications or announcements made by any of the Bank’s senior policy committees (including the FPC, MPC and PRA Board). 2.3 Generally your Reporting Officer will not approve dealings which appear to be short-term and speculative and will question and may not approve a transaction that is subsequently reversed within three months - depending on the circumstances this may be treated as a breach of the Code. This is for the protection of both you and the Bank, as such transactions could result in a perception of an abuse of information much more easily than for other investments You are required to obtain prior permission for the transactions listed below. At least one working day’s notice must be given, via the transaction reporting system in HRConnect.

3.2 Transactions which must be pre-reported and cleared include:

I. Transferring funds into, out of, or between savings, deposit or investment accounts, National Savings instruments or Collective Investment Schemes and investments made via a peer to peer lending services, where the value of the transaction is more than £15,240.

II. Arranging a mortgage (including mortgage transfers, re-mortgaging, mortgage equity withdrawal, or switching from a fixed to floating arrangement, or vice-versa or extending an existing mortgage). “Arranging” in this context means entering into an agreement to borrow, or acquiring an option to borrow on stated terms and conditions.

III. Setting up a personal pension plan with a choice of funds or exercising an option under such a plan to switch funds. Switching between funds within the Bank’s Supplementary Pension Plan need not be reported.

IV. Dealings in securities and related investments, including those made in relation to a personal pension plan and investments in commodities, such as precious metals.

V. Purchases or sales of foreign exchange where the value of a transaction (or series of transactions) is greater than the equivalent of £15,240. Where regular FX purchases/sales are planned (e.g. to service running costs of a foreign property), or income from such property), a one-off permission can be sought for transactions.

VI. Any financial transaction not specified above but which, in the nature and spirit of these rules, could reasonably be seen as sensitive.

3.3 You should not split up financial transactions in order to circumvent these requirements.

3.4 Once approved, a transaction should be executed promptly”.

reporting duties; to place under full discretionary management their large portfolios and “a responsibility to make themselves aware of any transaction of the nature covered by these rules by a spouse or other connected person that could cause damage to the reputation of the Bank. The failure to seek approval for any such transaction may be treated as a breach of the Code. They must keep records of all their financial transactions, and of any connected persons, for at least 5 years and on request make them available to the Bank.”

PRA

Revolving doors policy and applicability

The appointment to the PRA board is strictly regulated by the law and the general rules applicable to Bank of England staff. In addition, Schedule 1ZB (10) of FSMA imposes upon the Court a duty to have regard to generally accepted principles of good practice related to the making of public appointments in appointing PRA board members. The Code of Practice for Ministerial appointment requires that the appointment be made on the basis of merit, fairness and openness and that the candidates meet the criteria set forth in the CSPL Seven Principles of Public Life “and will have no conflicts of interest that would call into question their ability to perform the role”¹⁰¹.

It is further stated in FSMA that “Before appointing a person as an appointed member, the court of directors must consider whether the person has any financial or other interests that could have a material effect on the extent of the functions as member that it would be proper for the person to discharge.” Sec 11 (2), includes a similar requirements to the FCA board, namely that “The terms on which an appointed member (“M”) is appointed must be such as –

- (a) to secure that M is not subject to direction by the Bank,
- (b) to require M not to act in accordance with the directions of any other person, and
- (c) to prohibit M from acquiring any financial or other interests that have a material effect on the extent of the functions as member that it would be proper for M to discharge.”

Rules on gifts and hospitality

Same as the Bank.

Conflicts of interest including retention of financial interest before taking up the job

¹⁰¹ See the Commissioner for public appointment, *Code of Practice for ministerial appointments to public bodies*, 1 April 2012, par 4.

PRA members of staff are subject to the same policies as Bank of England employees. However, a specific conflicts of interest policy applies to the appointed members to the PRA Board¹⁰². The PRA policy on conflicts of interest of the “appointed members” of the Board insists on the need to appoint candidates with the necessary expertise and qualifications but recognises that this enhances the possibility of conflicts. The main aim of the policy is to protect the PRA reputation from the risk that the appointed person is as such as to ingenerate the suspicion of not being fully independent, disinterested and impartial; or that the firm to which the person is connected to “may have an unfair competitive advantage by reason of assumed access to information or policy thinking”.

To this end, further obligations are imposed in addition to the statutory requirements included in FSMA and those of the Company Act. For instance, a) “The acceptability of a conflict should be judged by reference to the potential reputational risk to the PRA. This risk may be reduced by the conflicted board member recusing himself/herself from Board decisions and discussions, although not necessarily so. A reputational risk can materialise even where an individual has not had to recuse himself from decisions and discussions in the past; b) A conflict of interest as a result of holding a financial interest in a PRA authorised person would normally disqualify an individual from becoming a member of the PRA board, subject to a “de minimis” test; c) The policies are expected to be applied more rigorously in relation to executive directors and to non-executive chairmen. Unacceptable conflicts will, however, generally also arise in relation to Board members who are non-executive directors. Whether a conflict disqualifies an individual will depend on the nature and importance of the firm” and “a judgement should be made on a case by case basis whether the size, significance and nature of the firm’s business in the context of the PRA’s objectives is such as to require disqualification”. Full time consultancy arrangements with firms would normally disqualify the candidate, whereas part time ones will be assessed on a case by case basis.

Finally, the PRA articles of association include a specific section on conflicts of interests of directors.¹⁰³

Policies on self dealing

Same as the Bank, including the applicability of specific provisions to members of the PRA Board.

MPC

Revolving doors policy and applicability

102 Namely those members that are appointed by the Court of the Bank of England

103 See «Conflicts of interest» par 44ff of the Articles of Association of Prudential Regulation Authority Company number 07854923, available at www.bankofengland.co.uk

The four external members of the MPC are appointed by the Chancellor (FSMA par 13 (2) (c) who has to be satisfied that the person has knowledge or experience which is likely to be relevant to the Committee's functions. FSMA Schedule 3 par (5) (A) disqualifies a person for appointment if—(a) he is a Minister of the Crown, or a person serving in a government department in employment in respect of which remuneration is payable out of money provided by Parliament, or (b) he is a member of the court of directors of the Bank. A person appointed under section 13(2)(b) or (c) shall vacate office if he is elected. A Member of Parliament who is appointed to the MPC board must leave the office too, which implies that there are no *ex ante* restrictions to the taking up of the post.

Rules on gifts and hospitality

Same as the Bank.

Conflicts of interest including retention of financial interest before taking up the job

As with the PRA, the rules and policies applicable to Bank's staff do apply to the MPC too. In addition, the MPC has a specific code of conduct, which entrusts them with a "special responsibility to promote the reputation and integrity of the Bank and its decision making processes. They must at all times avoid statements and conduct that could in any way undermine public trust in the Bank"¹⁰⁴.

The Code includes provisions on: conflicts of interest; communication; purdah; statements; comments; secrecy; financial stability; speeches and other media plans; political involvement; lectures and academic journals; information services for MPS members; and other issues.

The policy on conflicts is as follows: "Members of the MPC may not retain any directorship, trusteeship, advisory post or other interest, whether or not remunerated, which is, or could be seen to be, in conflict with membership of the Committee. The acceptability of particular appointments and interests will be assessed on a case-by- case basis. Examples of clear conflicts of interest would be where MPC members provide their services as consultants or as non-executive directors to banks, securities firms, investment managers or other financial institutions or to any other body if their relationship involves, or could be seen to involve, the provision, directly or indirectly, of commercially valuable advice relating to the conjunctural position or to prospects in the UK or for the foreign exchange market. On appointment, members will be asked to disclose all relevant commitments and interests to the Governor and to the Chancellor. The Chancellor will decide whether the continuation of any commitment or interest is incompatible with membership of the committee; the Governor may offer advice in this regard. Members should also notify the Secretary of the Bank – who will consult the Governor as appropriate – in advance if they are planning to take on any new outside commitment or interest which might be seen as in any way in conflict with

membership of the MPC, or if a potential conflict arises in respect of any existing commitment or interest. The Governor may also choose to consult the Chancellor as appropriate. The Bank, through its press office, will answer specific factual questions about other commitments and interests held by MPC members and will disclose details of these in its Annual Report. It will also disclose the remuneration of MPC members.”¹⁰⁵.

Finally, the Bank of England Bill under discussion includes a specific provision on conflicts of interest of MPC members which imposes disclosure requirements of actual or potential conflicts and the possibility to not to participate in the discussion if the rest of the Committee sees the participation as inappropriate. This will bring the MPC conflicts of interest arrangements in line with the relevant provisions of the UK Company Act 2006.¹⁰⁶

Policies on self dealing

Same as the Bank, including the applicability of specific provisions to members of the MPC.

Conclusions

Against the CSPL definition of Integrity, the existence of Authorities practices that go beyond their legal requirements has been researched, with the aim of dissecting whether they were detailed and robust enough to ensure the relevant authority does act within the integrity boundaries.

Policies vary in the breath of details included, with some setting the bar particularly high, and yet they tend to converge towards the bottom. Other than what set out in the law, there are no specific prohibitions on revolving doors neither in nor out, and the assessment of the independence of the candidate is left to the discretion of the appointee and to the efficient functioning of the subsequent accountability mechanisms, such as the vetting from the Treasury Committee.

105 *Ibidem*, p 1.

106 The provision included in Part 1 (8) (6), is as follows: “13B(1) If a member of the Committee (“M”) has any direct or indirect interest (including any reasonably likely future interest) in any dealing or business which falls to be considered by the Committee— (a) M must disclose that interest to the Committee when it considers the dealing or business, and (b) the Committee must decide whether M is to be permitted to participate in any proceedings of the Committee relating to any question arising from its consideration of the dealing or business, and if so to what extent and subject to what conditions (if any). (2) The Bank must issue and maintain a code of practice describing how members of the Committee and the Committee are to comply with subparagraph (1). (3) The Bank may at any time revise or replace the code. (4) Before issuing, revising or replacing the code, the Bank must consult the Treasury. (5) The Bank must publish the current version of the code in whatever manner it sees fit.(6) The Committee must comply with the code when taking decisions under subparagraph (1)(b).”

By the same token, there are no duties to dispose of the instruments that may ingenerate actual or potential conflicts upon candidates to executive positions. The relevant policies aim at managing not resolving the conflicts in fact, contrary to what envisaged by the CSPL.

Even though one may wonder whether it would be fair and indeed effective to impose the resolution of conflicts or prohibitions over individuals from a specific professional background, probably more can be done, especially in presence of deferred remuneration and pension packages awarded to senior executives who join the B&F Authority. In these cases the benefits of the plans are likely to accrue once the Authority's member has left and will indeed potentially be impacted by the activities carried out when he or she was holding the public post. The law, which is indeed quite strict already, does not provide a solution for this risk either. Similarly, the revolving out phenomenon may be considered more carefully should the member of the Authority decide to move to an executive role within a regulated firm.

Accountability

Accountability: *Holders of public office are accountable to the public for their decisions and actions and must submit themselves to the scrutiny necessary to ensure this.*

Accountability and independence are strictly complementary. B&F authorities enjoy the highest possible degree of independence and as such are also subject to a high degree of public scrutiny. It is no surprise then that the accountability mechanisms to which the Authorities are subject to are disciplined by the law and are quite rigorous. Accountability aims at ensuring an indirect democratic control over the decisions taken by independent authorities, which is particularly relevant in the B&F context in consideration of both their regulatory and enforcement powers. Whereas these are delegated and framed by the law, they happen somewhat outside the “democratic circuit”, hence a primary goal of accountability is to make authorities responsible for their (technical) activities and results. This sort of public scrutiny however, may create some tension and needs to be carefully balanced against the risk of political interference into the merit of B&F decision making activities¹⁰⁷. Like a Janus mask, accountability can be the face of a necessary democratic tool or could be the façade for subjecting authorities to political will. This is why it needs to be carefully designed and wisely applied. In fact, if accountability mechanisms are well designed and functioning, they serve as a mean to strengthening independence in that they assure transparency and due process.

There are various indicators of accountability, related to internal and external scrutiny. Board composition, independence and ability to monitor; internal reviews and assessment processes, are all examples of the former. Press releases; Parliamentary hearings; cost benefit analysis; impact assessment; publications of minutes etc, are all examples of the latter. External scrutiny is usually linked to the public’s need to be informed, but in its more nuanced form it also refers to the participation from the regulatees in the rule making process. “a well designed system should allow those affected by the standards to participate in the standard setting process in order to prevent the standards from unduly hindering business operations”¹⁰⁸. Consultation papers issued by authorities are an example of this.

107 By way of example, the Governor expressed two overriding concerns related to the provision included in the Bank of England Bill of subjecting Bank’s accounts to the National Audit Office, related to: «avoid compromising the independence of the Bank, which would be at risk if the NAO could question policy judgments. The other was to preserve the role of Court as the Bank’s governing body». To this end, «The outcome was that the Court would continue to appoint a professional firm to undertake the financial audit of the whole Bank, including the PRA which had thus far been audited by the NAO. The NAO would be consulted about the appointment of the professional auditor and would have access to the audit outputs. It would also audit activities that the Bank undertakes under a Treasury indemnity. In relation to value for money the NAO would have an ability, consulting Court, to commence efficiency and effectiveness reviews at its own volition. However there would be a strong carve out for policy, to be written into legislation specific to the Bank of England». See Bank of England, *Minutes of the Court*, 15 July 2015, available at www.bankofengland.co.uk

108 See Ruder, Canfield and Hollister, *Creation of world wide accounting standards: convergence and independence*, in *Journal of Intl Law & Business*, 25, 2005, 517

The Parliamentary Commission on Banking Standards devoted many recommendations to the increase of B&F authorities' accountability as the new regulatory framework was still seen as weak¹⁰⁹.

However, as noted in the CSPL (2013a) Report: "Intelligent accountability may be easier to talk about than to achieve, but implies: • putting out good information in intelligible and adaptable formats, not just data; • creating a genuine dialogue with stakeholders (including the media); • building up a degree of trust over time that creates a virtuous feedback loop in which stakeholders can see policies being influenced and changed as a result of their input; and • being open, particularly in relation to reporting problems to avoid a culture of blame"¹¹⁰.

It is outside the scope of this paper to enumerate the different accountability mechanisms provided for by laws and regulations, and to comment on their strengths and weaknesses. This is not intended either to be a content analysis of the relevant accountability tools for B&F authorities to demonstrate their efficacy, or lack thereof. Rather, in light of the aspirational spirit of the Nolan Principles, what follows will investigate the existence, if any, of best practices used to address accountability deficits which may have arisen in the recent past.

FCA

Since its inception the FCA has been heavily criticised for, among the others, an alleged lack of accountability. Originally this stemmed mostly from criticisms over FCA's predecessor flawed approach to supervision and regulation¹¹¹.

In their investigation on the FCA¹¹² the Treasury Committee heard of issues related to the lack of transparency in the appointment process of FCA board members; lack of transparency around the agendas, plans and minutes of board meetings; and a lack of accountability and proper dialogue with consumers and regulated firms. The Committee then put forward recommendations aimed at addressing those issues, some of which have then been taken into consideration by Parliament. Even if not required to do so by the law, the FCA currently publishes detailed board minutes within six

109 See PCBS, *Changing banking for good*, Vol I, June 2013, par 215-222

110 See CSPL (2013a), p 47.

111 FSA's failure has been considered in various investigations, see for instance: FSA's Internal Audit report, *The supervision of Northern Rock: a lessons learned review*; *The failure of the Royal Bank of Scotland* FSA board report, and *The Failure of HBOS plc (HBOS)*. A report by the Financial Conduct Authority (FCA) and the Prudential Regulation Authority (PRA), November 2015

112 House of Commons Treasury Committee, *Financial Conduct Authority, 26th Report of session 2010-2012*, January 2012, available at www.parliament.uk/trescom

weeks of each meeting¹¹³, publishes business plans and annual plans which, read in conjunction, allow for greater accountability¹¹⁴. Other public documents relate to FCA corporate governance, its approach to advancing its objectives, its risk outlook, its regulatory strategy¹¹⁵ and even how they calculate their FOI fees¹¹⁶.

The FCA has published a set of key initiatives for improving transparency and good consumer outcomes, which will be closely monitored by the Consumer Panel¹¹⁷, and stakeholders can access the Annual Report of the FCA Complaints Commissioner to know how complaints against the FCA have been addressed and to what extent the FCA has adopted their recommendations (whenever the Commissioner decides to uphold a complaint)¹¹⁸.

The relationship with the statutory panels seems to have improved. This emerges both from minutes of the FCA Board meetings¹¹⁹ and from evidence gathered by the Treasury committee¹²⁰. The then

113 The first published minutes are from 28 February 2013. Minutes are available at <http://www.fca.org.uk/about/structure/board/board-minutes>

114 It is not clear the extent to which the FCA involves Practitioners Panel in the preparation of the Business Plan.

115 See for instance FCA, *The FCA approach to advancing its objectives*, December 2015; FCA, *Our Strategy*, 8 December 2014. www.fca.org.uk/your-fca/documents/reports/fca-our-strategy

116 The FCA has decided to exercise its statutory option to refuse FOI requests above a certain cost, and the limit has been set to £450. From the relevant document it is not clear whether they will decide on a case by case basis or whether they will reject any request above that threshold. See FCA, *Freedom of Information Act Fees Statement*, available at www.fca.co.uk

117 See FSCP, *Accessibility, advice and redress*, available here <https://www.fs-cp.org.uk/consumer-panel/accessibility-advice-and-redress>

118 However, please note the latter is a statutory measure.

119 Even though sometimes minutes are still too vague, see for instance the Board account of the meeting with the practitioner panels in which it is said that the Board discussed their comments, with no further indications: "The Board reviewed and discussed the reports from the Chairs of the Panels, noting in particular: (...) the comments from the Practitioner Panels in relation to effective and sustainable regulation, including how the FCA was responding to the points made, and interactions with the NAO on value for money". See FCA, *Board Minutes*, 21-22 October 2015. The minutes also show how the relationship with the panels has not always been smooth, see for instance the records of the Board on Jan 29 on the matter: "Monthly reports from the Independent Panels: The Board noted the Panel reports and that the key theme arising was the need for clarification of the Panels' relationships with the FCA. In response to a request by the Consumer Panel, the Board discussed the Panel's terms of reference and its public communications plan.

The Board agreed that it should not restrict the Consumer Panel's ability to comment publicly on issues and Mr Griffith Jones would contact the Chair of the Consumer Panel to clarify this.

The Board supported the role of the Panels to advise the Board and the Executive on matters and agreed that it was appropriate for the Panels to challenge the FCA from time to time. To that end, Mr Griffith-Jones suggested that the Panels' reports should also be addressed to and considered by the Executive Committee.

The Board noted that it was important to clarify the extent to which the FCA would share information with the Panels and as a result Mr Martin was preparing a note concerning the handling of sensitive information to be discussed with the Panels". FCA, *Board Minutes*, 29 January 2015.

Chairman of the FCA made clear that the FCA wanted to be more engaged with its stakeholders and also adopted a revised communication strategy.

It is still unclear the extent to which appointment processes are transparent¹²¹. For instance, following the earlier departure of Martin Weathley as a FCA Chief Executive the Government had to replace him. The announcement was issued in July 2015. The decision by the Government not to renew his mandate caused great speculation and the Authority was left with uncertainty for long time. This in turn created a leadership vacuum which was certainly not beneficial to the organisation¹²² (and its stakeholders). Over time it appeared that the Acting Head was running for the position, but only after some time she declined. The issue had been considered by an *ad hoc* FCA Board¹²³. The new Chief has been appointed in February 2016, but it was never really clear who the candidates were and why some have been preferred over others.

The FCA reaction to the communication incident in 2014, mentioned above under “integrity”, was to launch an internal inquiry and an external one, led by Simon Davis upon request of FCA Non

120 During their hearing of the FCA practitioners panel, the TC Chair asked the following: “It would be helpful if you could give us a preliminary view on the receptiveness of the board, particularly in the work of the non-execs on the board, to these exchanges with you. Are they receptive? Are they active? Are they doing their jobs properly?” to which António Simões, replied: “It is a very interesting point. I took over as the chair of the Practitioner Panel on 1 September, so I have chaired one meeting. One of my first decisions as the chair of the panel was to invite the non-executive directors to meet the Practitioner Panel to make sure that we are not just writing a report every month that goes— Chair: Into the ether. António Simões: —but that they actually have a relationship with us. Several of the non-executive directors are coming to have dinner with the panel in our next meeting, so that we have that direct channel of communication between the panel and the non-executive directors. That is happening. Many of them attend our panels, not just mine. The independent directors all have an invitation, and several of them attend our panels”. John Trundle, member of the Market Practitioners Panel somehow agreed: “What I would say is that the people they have are very skilled, very experienced and they have been very open and transparent with us. We have a very good dialogue with them”. See House of Commons Treasury Committee, Oral Evidence: Financial Conduct Authority Statutory Panels, HC 559, 28 October 2015, available at <http://www.parliament.uk/business/committees/committees-a-z/commons-select/treasury-committee/inquiries1/parliament-2015/fca-practitioner-panel-15-16/>

121 In their response to the TC Inquiry the Government rejected the suggestion that the Head of the FCA should be subjected to pre-appointment hearings, opting for pre-commencement hearings instead, as it happens with the MPC and the Bank. See House of Commons Treasury Committee, *Financial Conduct Authority report on the government response*, 28th Report of Sessions 2010-2012, p 13.

122 During the relevant hearings the FCA Chairman commented on the effect that the decision not to renew Martin Weathley may have had on the morale of the staff. There is also an extensive discussion on FCA independence from political pressures. See House of Commons Treasury Committee, *Oral Evidence Financial Conduct Authority*, HC 515, 20 January 2016. P. 3

123 See FCA *Board minutes*, 7 January 2016: “Mr Griffith-Jones updated the Board on the comments made by the Chancellor earlier that morning in relation to Ms McDermott. The Board noted that Mr Griffith-Jones had contacted all Board members to confirm that Ms McDermott had withdrawn from consideration for the CEO post on 9 December. Mr Griffith-Jones had spoken to Sir Brian Pomeroy as Senior Independent Director and Jane Platt, fellow CEO recruitment Panel members, before Christmas, and notified the remaining Board Members in the New Year. Ms McDermott explained the steps taken to update FCA staff and that an external announcement had been prepared.” There was no other business to be discussed.

Executives. The Davis report, which costed 3.8 mln including VAT¹²⁴, was made public by the FCA, despite the criticisms addressed to the authority. The FCA also decided to action upon it. They affirmed the intention to follow the recommendations given¹²⁵ and decided to complete additional work on three areas that deserved careful consideration. They also worked on a review of their strategy. Finally as a consequence to the individual responsibility the executive staff involved did not receive a bonus, and the executive members of the board saw their bonus cut by 25%. Other disciplinary actions had been initiated¹²⁶.

The FCA has also taken on board several of the recommendations from the Treasury Committee in the matter, articulating their actions in a detailed response to the Committee¹²⁷.

At the request of the Treasury Select Committee, FCA Internal Audit reports are submitted to them one year in arrears. Upon request of the Committee, the FCA has recently made public its latest internal audit reviews. These related to the internal management of the communication incident and the efficacy of FCA communication strategy¹²⁸, to the identification, handling and management of sensitive information, and to the introduction and subsequent implementation of a three lines of defence strategy, and on the operation and effectiveness of the Supervisory Oversight Function and to the UK listing authority. Some of the internal audit reports include major findings that the FCA is willing to address.

In 2014 the FCA had also commissioned an external firm to review board effectiveness¹²⁹, followed by a second one in 2015¹³⁰. Both had been made public. The FCA has indeed agreed to carry out internal reviews every alternate year (*ie* on a biannual basis).

During the Treasury Hearings over the dropping of the culture review, FCA executives acknowledged internal deficiencies and considered the need to take further actions.

Bank of England/ PRA

124 See FCA, *The Davis Review – The FCA Response*, 10 December 2014, p 3

125 Which led to 63 separate actions.

126 FCA, *The Davies review*, The FCA Response, 10 December 2014

127 See FCA, *FCA Response to the Thirteenth Report of the Treasury Committee, 2014/15 Press briefing of the FCA's Business Plan for 2014/15*, June 2015

128 FCA Internal Audit Report, *A review of the design and effectiveness of the FCA external communication strategy*, October 2014; FCA internal Audit Report, *the FCA's incident response and crisis management capability*, 24 October 2014.

129 See FCA, *Review of board effectiveness by Independent Audit Limited*, 18 June 2014

130 FCA, *FCA board effectiveness: an independent evaluation by Boardroom Review limited*, October 2010

The Bank of England has historically been criticised for a lack of transparency, and transparency is the bedrock of accountability. From a regulatory perspective the Bank moved from a City Club style of regulation¹³¹, where engagement with the regulatees was particularly intense, to a system where stakeholders would guess the next monetary policy move from the raise of an eyebrow of the Governor, to “constructive ambiguity” in decisions over financial stability, to the current policy of being “open for business” and “open about our business”¹³². Meanwhile the legislative framework has strengthened too and various accountability tools have been introduced and more are currently under discussion¹³³. Not least, the Bank of England Bill proposes to subject the Bank to “value for money” examinations by the NAO and by the Treasury in relation to its prudential regulation functions, which may create some controversy as reported above.

The PRA instead, created only in 2013 hasn’t so far experienced remarkable accountability criticisms. Today, as with the FCA, both the Bank and the PRA have stringent and well-oiled accountability requirements which include, among the others, press briefing, minutes publication, publications of annual reports and accounts, testimonies to the Treasury Committee, internal control mechanisms and so on. The Bank has decided to publish the minutes of the Court meetings, even if not required to do so by statute¹³⁴.

In a recent report¹³⁵, the National Audit Office, which scrutinises PRA accounts, expressed the view that PRA had set out its objectives and strategic approaches clearly. However, while acknowledging the difficulties in reaching a firm conclusion over the authority due to its recent establishment and to other problems, the Office raised concerns over the level of transparency of the PRA. The office says that “In practical terms the PRA’s accountability must be taken alongside of the wider Bank of England which we found in practice makes or approves resources decisions in relation to the PRA. Over the course of this review the Bank has complied with all NAO information requests. The fact that NAO doesn’t have statutory access to the financial information held by the wider Bank however presents a risk to reporting in future on the economy, efficiency or effectiveness of the PRA”¹³⁶.

131 See Rawlings, Georgosuli, Russo, *Regulation of Financial Services: Aims and Methods*, Institute for Regulation and Ethics working paper, April 2014 available here <http://www.ccls.qmul.ac.uk/docs/research/138683.pdf>

132 See Minouche Shafik, Goodbye ambiguity, hello clarity: the Bank of England’s relationship with financial markets, speech delivered at Warwick University available here <http://www.bankofengland.co.uk/publications/Pages/speeches/2015/801.aspx>

133 See the Bank of England and Financial Services Bill [HL] currently under discussion which intervenes on the Bank’s and its Committees’ governance, and subjects the Bank to the NAO scrutiny.

134 The Bill above does not seem to require the PRC to publish its minutes.

135 National Audit Office, *Report by the Comptroller and Auditor General on The Financial Conduct Authority and the Prudential Regulation. Regulating Financial Services*, 24 March 2014

136 *Ibidem*, p 9 par 14.

As a response to the 2012 Treasury Committee inquiry into the accountability of the Bank, the Bank accepted some, but not all, recommendations of the Committee¹³⁷. For instance they created an Oversight Committee with the view of challenging the Bank and conduct internal reviews (which was different from what suggested by the Committee). The oversight committee is now due to be abolished by the Bank of England Bill.

Outside the statutory requirements perimeter, in September 2014 the Bank of England created an internal "Independent Evaluation Office" (IEO). The IEO "aims to maintain public trust in the work of the Bank and to reinforce the institution's culture of learning, by: Supporting, where appropriate, external reviews of the Bank; Carrying out one off evaluations of areas of the Bank's work ; Facilitating broader Court oversight of the performance of the Bank's policy areas and strategy. The IEO reports directly to the Chair of Court and operates at arm's length from local business areas. Court sets the priorities and determines the work programme of the IEO."¹³⁸

So far there seems to be a constructive dialogue between the Office and Bank's committees. For instance the MPC replied swiftly to an IEO report on Forecast Performance¹³⁹ spelling out a series of initiatives that will be put in place as a follow up from their recommendations¹⁴⁰

The Bank also carried independent reviews over its functioning or policies. For instance in October 2012 they commissioned a review over the provision of emergency liquidity assistance in 2008-2009, conducted by Ian Plenderleight¹⁴¹, a review on the Bank's Framework for Providing Liquidity to the Banking System, conducted by Bill Winters¹⁴² and a review on the Monetary Policy Committee's Forecasting Capability conducted by David Stockton¹⁴³. The Bank replied to the reviews outlining a comprehensive plan to address their recommendations¹⁴⁴.

137 See House of Commons Treasury Committee, *Accountability of the Bank of England. Response from the Court of the Bank to the twenty-first report from the Committee*, HC 1769, 27th report of sessions 2010-2012, 23 January 2012

138 See <http://www.bankofengland.co.uk/about/Pages/ieo/default.aspx>

139 See Independent Evaluation Office, *Evaluating Forecast Performance*, November 2015

140 See MPC, *the Monetary Policy Committee Response to the Independent Evaluation Office evaluation of the MPC's forecasting performance*, in Inflation Report November 2015, p 44.

141 See *Review of the Bank of England's provision of emergency liquidity assistance in 2008-09. A report to the Court by Ian Plenderleight*, October 2012

142 See *Review of the Bank of England's framework for providing liquidity to the Banking System. A report to the Court by Bill Winters*, October 2012

143 See *Review of the Monetary Policy Committee's Forecasting Capability. A report to the Court by David Stockton*, October 2012.

144 See Bank of England, *Response of the bank of England to the three court-commissioned reviews*, March 2013

More recently they commissioned Lord Grabiner to investigate the alleged involvement of Bank staff into Forex manipulation¹⁴⁵. The employee involved in the latter case has subsequently been terminated by the Bank, although, it was claimed, not as a consequence to the investigation. The Bank responded to the investigation by implementing all its recommendations¹⁴⁶

Finally, in March 2014 the Bank has issued a strategic plan based on 14 actions that aims, among the others, at strengthening and improving accountability, and transparency at the Bank. In fact “open and accountable” is one of the Pillars of their 2014 strategic plan. For instance to enhance transparency within the Bank, it planned to “establish a Stakeholder Relations Group to ensure external economists and analysts have equal and timely access to information behind MPC, FPC and PRA decisions, in order to improve insight into the Bank’s current views and decisions”; they decided to “transform the Annual Report to make it more transparent, accessible and informative, assess progress against our policy objectives annually, and promote and respond to the independent reports commissioned to evaluate the Bank’s performance” and to be more engaged and approachable¹⁴⁷. On 11 November 2015 the Bank held an “open forum” to which all sorts of stakeholders’ representatives participated to discuss the most pressing issues related to the future of the Bank and banking supervision. With all the limitations that such a high profile event may entail, it was a remarkable initiative which also allowed for an open dialogue between the floor and the panellists via *ad hoc* IT tools. It is not yet known whether, or how, the Bank plans to follow up on it.

MPC

Two episodes have recently brought the MPC under the spotlight. Both however are examples of the well functioning of accountability tools.

On 28 July 2015 Dr Vlieghe was appointed to the Monetary Policy Committee. Prior joining the Committee he was a partner in an asset management firm (Brevan Howan), from which he received a fixed share of the equity profits over the firm’s overall business as part of his remuneration. He could not sell the stake at his will because the firm is private and his stake could have only been redeemed with the consent of the firm. The appointment created public concerns because of the apparent conflict of interest: the firm’s profit would have somehow been affected by monetary

145 See above at footnote 46.

146 See Bank of England, *Foreign Exchange Market Investigation: Bank of England’s response to Lord Grabiner’s recommendations*, 26 February 2015

147 See Bank of England, *Strategic Plan Background Information*, 18 March 2014, p 2

policy decisions because part of firm's business is to trade on the short end of the bond market, *ie* where interest rates decisions are likely to have a high impact.

Upon appointment Dr Vlieghe was being questioned thoroughly by the Treasury committee, and before the actual taking up of the office he asked his previous employer to be bought out, which was agreed. During the hearing he discussed in great details why the public perception of conflict was unfounded and how he had made it clear to both the Treasury and the Bank from the onset that his stake may have been a source of concern. Exercising the discretion that the Code allows to both, the Treasury and the Bank came to the conclusion that there was no conflict. The lack of conflict was justified on the grounds that: "Mr Vlieghe was not joining the regulatory side of the Bank - and Brevan Howard is not in any event regulated by the Bank. In relation to MPC decisions the interest was judged not to be relevant -it would require Mr Vlieghe to have a very close knowledge of Brevan Howard's trading position to know how the MPC's decisions would affect its trading performance, and as previously noted Mr Vlieghe had resigned from the partnership. The Secretary's conclusion was that it should not be required that Mr Vlieghe renounce his interest as a condition of joining the MPC."¹⁴⁸ In the end, the Treasury was satisfied with Dr Vlieghe's appointment. The committee though had requested the Bank to change the code of conduct for MPC. The request was objected by the Governor but taken into consideration by the Chair of the Bank's Court¹⁴⁹. In a nutshell this shows how accountability mechanisms have paved the way for a constructive, open and objective dialogue among the parties.

The second example relates to the review into the lack of transparency of the MPC. Within the broader efforts to make the Bank more accountable and transparent and following up on a specific request by the Treasury committee, the Bank commissioned a former member of the Federal Reserve System, Kevin Warsh, to investigate practices and procedures that could improve MPC's transparency¹⁵⁰. Specifically, those related to the possibility of keeping the recording of the MPC meetings and possibly publish a full transcript over time. The terms of reference also asked to consider the relative merits of alternative ways of improving transparency.

The recommendations that followed were based on 4 areas: making sound policy decisions; communicating judgments effectively; ensuring accountability for its actions; and creating a fair and accurate historical record. The MPC decided to accept Warsh's recommendations and "announced the following changes to its practices: publication of both the minutes of its policy meetings and (in

148 See Mark Carney, *Letter to Andrew Tyrie on the MPC Code*, 3 September 2015

149 See House of Commons Treasury Committee, *Oral evidence Appointment of Gertjan Vlieghe to the Monetary Policy Committee hearing*, HC 497, Tuesday 13 October 2015; and House of Commons Treasury Committee, *The appointment of Dr Gertjan Vlieghe to the Monetary Policy Committee of the Bank of England Second Report of Session 2015–16*, 13 October 2015

150 See Transparency and the Bank of England's Monetary Policy Committee, review by Kevin Warsh, December 2014

the relevant months) the *Inflation Report* at the same time as its policy decisions, starting in August 2015; publication of written transcripts of the meetings at which monetary policy is decided, and related staff policy briefing material, with an 8-year lag, as of the March 2015 policy meeting; alteration of its 2016 meeting schedule to provide scope to move to eight policy meetings a year; plan to hold four joint meetings between the Monetary and Financial Policy Committees in 2016. Alongside these measures, the Bank also proposed a simpler structure for its governing bodies and a clearer commitment to accountability”¹⁵¹.

Today MPC minutes include enough details to show board’s dynamics with due regards to confidentiality.

Conclusions

The need to hold into account executive members of B&F authorities is a fundamental democratic tool that counterbalances their institutional and operational independence.

Tools already embedded in the law risk being empty shells if the Authorities are not receptive. What we have seen so far is that authorities respond well to the Treasury Committee requests and that in some cases Authorities are also able to go beyond what is required. In those fewer instances in which they resisted changing, they did not do so arbitrarily but with the clear focus of preserving their necessary independence. Authorities have also been willing to take initiative, to start self assessment processes and to put the relevant evaluations in the public domain.

The understanding of conflicts of interest may require some technical knowledge which the general public lacks. It is then important that communication from the authority on the matter is appropriate as to avoid a negative impact on public trust.

151 See Bank of England, *News Release Bank of England announces measures to bolster transparency and accountability*, 11 December 2014

Objectivity

Objectivity: *Holders of public office must act and take decisions impartially, fairly and on merit, using the best evidence and without discrimination or bias.*

Objectivity shall certainly be applied to both enforcement and policy making activities of B&F authorities. However, against the set definition, objectivity is best analysed within the context of their enforcement actions because decisions over monetary policy and financial stability will naturally entail a certain level of subjective judgement. What comes into consideration in this case is the objectivity of the process that brought about the actual policy. Transparent procedures, consultation papers, impact assessment, policy making documents, board composition and dialogue, and accountability mechanisms are the gatekeepers of fair and substantiated decisions. A further indicator of objectivity may be the quality and type of approach taken by regulators in discharging their functions. This would require an analysis of principle, risk, forward looking and judgement based regulation but it falls outside the scope of the CSPL review. To our aims, it is important to highlight that as a consequence to the crisis B&F regulators stood ready to admit their approach to supervision had failed to achieve the intended outcomes and decided to amend it promptly. Both the FCA and the PRA also publish policy documents detailing their approach to supervision. The FCA also launches investigations on regulatory failure.

In their supervisory roles, the FCA and the PRA have the powers to enforce their rules and challenge firms on other grounds¹⁵² and can do so either directly or via an independent office. The underlying rationale for their powers rests in the need to achieve their statutory objectives. Whereas laws and regulations set forth the statutory powers for supervisory and regulatory actions, B&F authorities retain discretion over the *quomodo*, ie over the design of processes and procedures. That is why it is of extreme importance that in using discretion authorities are objective, fair, and just and that decisions are based on the best evidence. In a nutshell, both substantial and procedural due process must be observed. However, B&F authorities may find it difficult to gather enough evidence to prove individual culpability, especially when the person works for a complex and large organisation. It is not surprising then that, at least in the past, the FSA was rarely successful in bringing individuals to account for misconduct¹⁵³. By way of example, the authority should prove that the person failed to

152 For instance the FCA can question firms over the inclusion of unfair terms in standard forms consumer contracts.

153 Exemplary to this, is the Pottage case (Pottage v Financial Services Authority - [2012] All ER (D) 26 (Sep)). Despite the extensive investigation of the FSA and the amount of evidence gathered, upon appeal the Upper Tribunal found that "the FSA had established serious flaws with respect to a number of weaknesses in the operational risk framework, serious deficiencies in management information and a number of deficiencies in the compliance monitoring arrangements in place in the firm in 2007. However, it fell to be determined whether the FSA had made out its case of misconduct against the applicant." See par 140 of the judgment and the relevant digest published by Lexis Nexis.

take all reasonable steps to ensure that the firm complied with regulations and standards, or that there were serious flaws in the internal governance or on the management of the event, which is tantamount as entrusting the authority with the difficult task of scrutinising the details of firms' internal controls and functions. In light of the difficulties in proving that the person had fallen below the standards of reasonableness, the Parliamentary Commission of Banking Standard suggested the burden of proof be reverted, which means senior managers would have individual responsibility for proving that they had fulfilled their regulatory obligations, rather than regulators having to prove that they had not¹⁵⁴. This had been included in the initial version of the Bank of England Bill, but was subsequently scrapped because it was seen as unfair, as fostering a ticking box culture, as giving incentives to managers to game the system, or for the most talented people not to take on the job, and, not least, it would go against the ancient common law principle of "innocent until proven guilty"¹⁵⁵.

Enforcement decisions will be reviewed by the Upper Tribunal in case of appeal. In case of mediation and settlement, process transparency and due process should be guaranteed too.

Another issue relevant to objectivity relates to the criteria used to select which cases will be investigated. Investigations are time consuming and resource intensive so the authority will inevitably make a judgement as to which prioritise. Unless the criteria are clear, there may be a perception of arbitrariness. Referral criteria should strike the right balance between objectivity and consistency with the final aim of enforcement, namely (credible) deterrence. However, the actual meaning of "fairness" in this context may not be entirely clear as the then FCA head of enforcement, Tracy McDermott, highlighted: "Consistency in the way that the FCA assesses which cases should be investigated by EFCD is important. The process must also be fair. However, fairness does not require that no firm is ever investigated unless every other firm meeting the same criteria has also been investigated. The decision to conduct an Enforcement investigation, rather than using a supervisory tool in a particular area is not, in the view of the FCA, fundamentally a matter which goes to the question of fairness. Rather, this is a question of how the FCA puts into practice its risk-based approach, how it uses its resources effectively and efficiently and how best to achieve credible deterrence."¹⁵⁶. In fact, in deciding whether to start an investigation supervisors will also have to make a careful judgement as to whether a supervisory action should be preferred. This again puts them at risk of making arbitrary decisions, or at least of being perceived as arbitrary.

154 See PCBS, *Changing Banking for Good*, ch 6, Vol 2.

155 See the HL debate of 11 November 2015 from column 2015 onwards.

156 See *A Practitioner's Guide to Financial Services Investigations and Enforcement*, 3rd Edition, Sweet and Maxwell, 2014.

Finally, in December 2014 the Treasury conducted a review of the B&F authorities enforcement decision making process with a view to seek whether the arrangement and processes support the fair and effective use of enforcement powers¹⁵⁷. The report made several recommendations for improvement but acknowledged stakeholders' overall satisfaction with current arrangements.

In what follow we will focus on the enforcement activities of the FCA and the PRA. Therefore the Bank's and MPC's policy making processes will not be analysed. However objectivity is strongly enshrined in the Banks' culture to the extent that the Deputy Governors declaration upon taking up the appointment is the following¹⁵⁸: «I, A B, having been appointed to the office of a director of the Corporation of the Governor and Company of the Bank of England do solemnly and sincerely declare that in the said office I will be indifferent and equal to all manner of persons: and I will give my best advice and assistance for the support and good Government of the said Corporation: and in the execution of the said office I will faithfully and honestly demean myself according to the best of my skill and understanding».

The indicators considered are the existence and clarity of enforcement policies and the objectivity of the relevant decision-making mechanisms; and whether the same applies for settlement processes.

FCA

The FCA is extremely transparent on its enforcement procedures and criteria. The FCA handbook includes chapters on "decision procedures and penalties" and on "enforcement guide". Both are also available on the FCA website. There is also an "Enforcement Information Guide" which provides a snapshot of all the relevant information, including stylized information on the actual process.

The FCA also publishes details on the composition and functioning of their Regulatory Decision Committee (RDC). This is an independent body comprised of representatives from the industry, business, and consumers¹⁵⁹ operationally separated from the FCA. RDC members represent the public interest and are accountable to the FCA board.

The enforcement process works as follows: 1) FCA internal investigators are appointed; 2) they scope the discussion with the firm and start the actual investigation; 3) following the investigation work, there is an internal legal review of the case by a lawyer who has not been part of the investigation; 4) if appropriate a Preliminary Investigation Report is sent to the firm or the individual who have 28 days to respond; 5) If, following their investigation, it is believed that action is justified,

157 See, HM Treasury, *Chancellor launches review of enforcement decision-making at the financial services regulators*, News Story, 6 May 2014, available here www.gov.uk/government/news/chancellor-launches-review-of-enforcement-decision-making-at-the-financial-services-regulators; and HM Treasury, *Review of enforcement decision-making at the financial services regulators: final report*, December 2014

158 See Bank of England Charter 1998, Schedule; Form of Declaration.

159 See RDC Members' biographies, available at www.fca.org.uk/about/structure/committees/rdc-biographies

investigators submit case papers to the RDC; 6) If the RDC finds there is no case, either before or after representations, the FCA closes the investigation, issuing a notice of Discontinuance; 7) if the RDC thinks there is room for enforcement, the enforcement process starts and terminates with a statutory notice (warning; supervisory and decisions). The FCA website page on the RDC has a specific heading on “making fair decisions” which basically refers to the independence of the RDC¹⁶⁰ from the FCA and the Investigation team, to its composition, and to the possibility for the firm to have access to all the material considered by the panels¹⁶¹.

The penalties chapter of FCA handbook includes detailed guidance as to when action will be initiated: “The FCA will consider the full circumstances of each case when determining whether or not to take action for a financial penalty or *public censure*. Set out below is a list of factors that may be relevant for this purpose. The list is not exhaustive: not all of these factors may be applicable in a particular case, and there may be other factors, not listed, that are relevant.

(1) The nature, seriousness and impact of the suspected *breach*, including:

- (a) whether the *breach* was deliberate or reckless;
- (b) the duration and frequency of the *breach*;
- (c) the amount of any benefit gained or loss avoided as a result of the *breach*;
- (d) whether the *breach* reveals serious or systemic weaknesses of the management systems or *internal controls* relating to all or part of a *person's* business;
- (e) the impact or potential impact of the *breach* on the orderliness of markets including whether confidence in those markets has been damaged or put at risk;
- (f) the loss or risk of loss caused to *consumers* or other market users;
- (g) the nature and extent of any *financial crime* facilitated, occasioned or otherwise attributable to the *breach*; and
- (h) whether there are a number of smaller issues, which individually may not justify disciplinary action, but which do so when taken collectively.

(2) The conduct of the *person* after the *breach*, including the following:

- (a) how quickly, effectively and completely the *person* brought the *breach* to the attention of the FCA or another relevant regulatory authority;

¹⁶⁰ It shall be noted that concerns were expressed in the Corporate Governance review as to the lack of involvement of the Board in these matters. More specifically the report mentions that “The FCA Board’s decision to remain apart from individual regulatory matters is a reasonable one which avoids any risk of undermining management and/or the RDC. However, if the FCA were a corporate, its board would be involved in decisions that had the potential to have significant impact on reputation or strategy”. Par 51 p 7. However, RDC accountability to the Board should help mitigating this concern.

¹⁶¹ See <http://www.fca.org.uk/about/structure/committees/rdc>

- (b) the degree of co-operation the *person* showed during the investigation of the *breach*;
 - (c) any remedial steps the *person* has taken in respect of the *breach*;
 - (d) the likelihood that the same type of *breach* (whether on the part of the *person* under investigation or others) will recur if no action is taken;
 - (e) whether the *person* concerned has complied with any requirements or rulings of another regulatory authority relating to his *behaviour* (for example, where relevant, those of the *Takeover Panel* or an *RIE*); and
 - (f) the nature and extent of any false or inaccurate information given by the person and whether the information appears to have been given in an attempt to knowingly mislead the *FCA*.
- (3) The previous disciplinary record and compliance history of the *person* including:
- (a) whether the *FCA* (or any *previous regulator*) has taken any previous disciplinary action resulting in adverse findings against the *person*;
 - (b) whether the *person* has previously undertaken not to do a particular act or engage in particular *behaviour*;
 - (c) whether the *FCA* (or any *previous regulator*) has previously taken protective action in respect of a *firm*, using its own initiative powers, by means of a variation of a *Part 4A permission* or otherwise, or has previously requested the *firm* to take remedial action, and the extent to which such action has been taken; and
 - (d) the general compliance history of the *person*, including whether the *FCA* (or any *previous regulator*) has previously issued the *person* with a private warning.

(4) *FCA guidance* and other published materials:

The *FCA* will not take action against a person for *behaviour* that it considers to be in line with *guidance*, other materials published by the *FCA* in support of the *Handbook* or *FCA*-confirmed Industry Guidance which were current at the time of the *behaviour* in question.

(5) Action taken by the *FSA* or *FCA* in previous similar cases.

(6) Action taken by other domestic or international regulatory authorities:

Where other regulatory authorities propose to take action in respect of the *breach* which is under consideration by the *FCA*, or one similar to it, the *FCA* will consider whether the other authority's action would be adequate to address the *FCA*'s concerns, or whether it would be appropriate for the *FCA* to take its own action."¹⁶²

162 See *FCA Handbook*, DEPP 6/4, Release 2, January 2016

It shall also be noted that FCA powers extend beyond the administrative reach to include the possibility of bringing charges to the Criminal and Civil courts. Those are covered in separate sections of the Handbook.

A shorter list of their referral criteria is also indicated on their website together with a list of alternative options to enforcement¹⁶³.

The FCA makes very clear the criteria underpinning the use of their discretion. The overarching question FCA staff would have to answer in deciding to initiate action is whether enforcement investigation is likely to further FCA's aims and statutory objectives. And in doing so the FCA provides a list of factor to consider, such as: 1) the strength of the evidence and the proportionality and impact of opening an investigation; 2) what purpose or goal would be served if the FCA were to end up taking enforcement action in the case; 3) relevant factors to assess whether the purposes of enforcement action are likely to be met. Each criterion is then explained in great details on their website¹⁶⁴.

Settlement

Chapter 5 of FCA enforcement guide deals specifically with settlements.¹⁶⁵ There is also a specific FAQ section on the FCA website¹⁶⁶. The same applies to mediation¹⁶⁷. Settlement processes and criteria are less transparent than those underlying enforcement actions. However, settlement should still be regarded as part of the formal regulatory process. In fact settlement discussions do start once the enforcement process has been initiated and happen without prejudice to the latter. The FCA guide explains that "the FCA will only engage in such discussions once it has a sufficient understanding of the nature and gravity of the suspected misconduct or issue to make a reasonable assessment of the appropriate outcome. At the other end of the spectrum, the FCA expects that

163 Here www.fca.org.uk/firms/being-regulated/enforcement/how-we-enforce-the-law/referral-criteria

164 www.fca.org.uk/firms/being-regulated/enforcement/how-we-enforce-the-law/referral-criteria

165 See FCA, *The Enforcement Guide*, 1 April 2014

166 www.fca.org.uk/firms/being-regulated/enforcement/how-we-enforce-the-law/settlement-mediation?category=settlement

167 Mediation is the process of appointing an independent third party (a mediator) to facilitate negotiations and agreement. The mediator does not decide the case. The FCA will appoint a mediator when "in circumstances where settlement might not otherwise be achieved or may not be achieved so efficiently and effectively" See FCA, *The Enforcement Guide*, par 5.20. However, "Mediation is unlikely to be appropriate in cases involving allegations of criminal conduct", or when the FCA is "required to take urgent action – for example, where an injunction is required to prevent conduct continuing. Aside from these restrictions there are relatively few disciplinary cases in which mediation will not be available." See FCA, Settlement and Mediation FAQ available here <http://www.fca.org.uk/firms/being-regulated/enforcement/how-we-enforce-the-law/settlement-mediation?category=mediation>

settlement discussions following a *decision notice* or *second supervisory notice* will be rare.”¹⁶⁸ Settlement discussions do not involve the RDC, unless for instance, this is relevant “to an application for an extension of the period for making representations”¹⁶⁹. In fact settlement discussions are carried out and taken by two senior FCA members¹⁷⁰. The FCA considers settlement to be in the public interest, especially when it can lead to earlier redresses for consumers and when it gives rise to the perception of timely and effective action, as well as to send timely messages to industry and the market. As mentioned above, it seems that the FCA retains substantial discretion in deciding whether or not starting settlement discussion without the need to involve the RDC. In the FCA review of board effectiveness it was noted that “Where proceedings are settled, rather than contested, the RDC plays no part, but we are told that there are internal governance processes within Enforcement to oversee the agreements to settle and that the Board is informed of major settlements via the quarterly reports from the Director of Enforcement and Financial Crime”¹⁷¹. The Treasury Review included recommendations on settlement too.

PRA

PRA’s enforcement policy is spelt out in a Statement of policy¹⁷² which has been recently amended to take into account PRA disciplinary powers over actuaries and external auditors¹⁷³. A shorter version is also available on the PRA website. The statement of policy is of statutory nature (sec 395 (5) of FSMA requires authorities to issue a statement of procedure in relation to the issuance of statutory notice decisions) and in fact it is more focused on the actual procedures than on the explanation of the rationale used to exercise discretion. The statement does not comment on the guiding principles related to the desirability of enforcement *vis a vis* the use of supervisory tools, nor discusses in great length the overall PRA approach to enforcement.

168 FCA, *The Enforcement Guide*, par 5.7

169 *Ibidem*, par 5.9

170 See HM Treasury, *Review of enforcement decision-making at the financial services regulators: final report*, December 2014, p 27

171 FCA, *Review of board effectiveness by Independent Audit Limited*, 18 June 2014, Par 51 p 7-8.

172 PRA, *The Prudential Regulation Authority’s approach to enforcement: Statutory statement of policy and procedure*, January 2016

173 See PRA, *Engagement between external auditors and supervisors and commencing the PRA’s disciplinary powers over external auditors and actuaries*, Policy Statement, January 2016. The document sets out the relevant policy taking into account the outcome of a previous Consultation Document.

Unlike the FCA's RDC, PRA's enforcement decision making body comprises senior members of staff¹⁷⁴. There are four Decision Making Committees (DMC) responsible for issuing statutory notices:

- (a) The PRA Board excluding the Financial Conduct Authority Chief Executive Officer (Board)
- (b) Supervision, Risk and Policy Committee (SRPC)
- (c) Supervision and Assessment Panel (SAP)
- (d) Panel of Heads of Departments and Managers (HMP)

The DMCs will make decisions by having regard to the relevant facts, the law and the PRA's priorities and policies¹⁷⁵. The decision making framework works as follows:

Statutory decisions will be divided into one of three categories. PRA staff will determine into which category each proposed decision falls.

Type A	Decisions which: (i) the PRA expects to have a significant impact on a firm's ability to carry out its business effectively or (ii) the PRA considers could have a significant impact on its objectives.
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Type B	Decisions which: (i) the PRA expects to have a moderate impact on a firm's ability to carry out its business effectively, (ii) the PRA considers could have a moderate impact on its objectives or (iii)
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174 The perceived lack of independence of the committee has been the subject of some concern among the regulatees expressed in their responses to a PRA consultation document. However in deciding to continue to adopt this model, the PRA specified that "The PRA considers the decision-making framework to be fair and proportionate. The framework was developed with due consideration of legal obligations on the PRA. Officials of the PRA will be familiar with the sectors on which they will make decisions. The policy and procedure makes it clear that the relevant decision-making committee (DMC) will include at least one person who has not been directly involved in the development of the case being considered. It is also the responsibility of each member of a DMC to make a reasoned judgement based the evidence presented. For these reasons, the PRA considers the membership of the committees suitable and capable of reaching proportionate decisions". See PRA, *The Prudential Regulation Authority's approach to enforcement: Statutory statement of policy and procedure*, April 2013, p 3.

175 See PRA, *The Prudential Regulation Authority's approach to enforcement: Statutory statement of policy and procedure*, January 2016, p 8

may set a sensitive precedent but which would otherwise have fallen under Type C.

Type C

Decisions which: (i) the PRA expects to have a low impact on a firm's ability to carry out its business effectively, (ii) the PRA considers could have a low impact on its objectives, or (iii) relate to which a precedent has already been set.

The choice of which DMC will take a decision will be determined by the category of the firm in conjunction with the anticipated impact of the decision on a firm's ability to carry out its business effectively and/or the impact on the PRA's objectives. In summary, the more significant the firm and the greater the decision's impact, the more senior the composition of the DMC¹⁷⁶.

Further indications as to the actual functioning of the DMC, its powers and procedures are clearly detailed in the document.

The PRA may decide to exercise its statutory right¹⁷⁷ to "outsource" enforcement in addition or in alternative to its own investigations. This means that investigations including the "gathering and analysis of evidence and interviews of individuals"¹⁷⁸ will be conducted by a third party, which may also be the FCA. The process will then work as follows:

"The PRA will:

- inform the subject of the investigation that it has done so, and to whom the matter has been outsourced;
- take reasonable steps to ensure that the investigator makes clear when making first contact with the subject of the investigation, or any other person in relation to whom FSMA powers are proposed to be exercised, that the investigation is being carried out on behalf of the PRA; and
- ensure that any Notice of Appointment of investigators required under section 170 of FSMA sets out who the investigators are, and where the investigators are individuals, of which organisations they are officers or employees.

As the end-product from an outsourced investigation, the investigator provides to the PRA a report setting out what evidence it has uncovered, and to what extent the evidence is indicative that one or

176 *Ibidem* , p 8

177 See FSMA sec 167-169 , which apply to the FCA as well.

178 See PRA's enforcement policies, available here www.bankofengland.co.uk/prs/Pages/supervision/regulatoryaction/enforcement.aspx

more of the PRA's regulatory requirements has been breached"¹⁷⁹. The PRA will then decide whether or not to exercise its supervisory or enforcement powers.

Settlement

The PRA enforcement statement includes one chapter on settlement procedures. The Authority recognises the advantages of early settlements and "In exercising its discretion, the matters to which the PRA may have regard include: (a) its statutory objectives; (b) the terms of this policy and any relevant guidance or other materials issued by the PRA; (c) the facts and circumstances of the case in question; and (d) the public interest"¹⁸⁰. As for the FCA, settlement falls within PRA regulatory action and will be brought to conclusion only "if the terms of the settlement would, in PRA's view, represent an appropriate regulatory outcome. Generally, the PRA will require a settlement to be sufficiently comprehensive to enable it to terminate the totality of its investigation and all proposed disciplinary or other enforcement action pursuant to it against the person under investigation"¹⁸¹. In exercising its discretion "The PRA will not normally agree to enter into substantive settlement discussions or conclude a binding settlement agreement until: (a) it has a sufficient understanding of the nature, seriousness and impact or potential impact of the suspected breach of its regulatory requirements; and (b) it is able to make a reasonable assessment of any action, including remedial or disciplinary measures that should be taken in consequence of it."¹⁸²

As for the actual settlement procedures, these will be conducted by one or more PRA investigators (but it is not clear whether they are part of the relevant DMC), and/or any of the PRA staff responsible for the conduct of the matter. Once both parties (the PRA and the firm/person) are satisfied with the outcome, a "proposed settlement agreement" will be put in place, but the very final decision to approve the agreement will have to be taken by the DMC unanimously. A decision as to whether the settlement should be made public will also be taken.

Finally, "Subject to the stage the enforcement process has reached when a binding settlement agreement is concluded, the agreement may provide for the subject of the PRA's action to waive and not exercise any subsisting rights: (a) to contest or further to contest that action, including the facts and matters set out in any statutory notices which have been or are to be given to them by the PRA; (b) to make representations to the relevant DMC; (c) to be given access to 'PRA material' or 'secondary material' pursuant to section 394 of the Act; (d) to object to the giving of any decision

179 *Ibidem*

180 PRA, *The Prudential Regulation Authority's approach to enforcement: Statutory statement of policy and procedure*, January 2016 p 38.

181 *Ibidem* p. 39

182 *Ibidem* p. 39.

notice; (e) to refer the matter to the Tribunal and/or otherwise seek to challenge any aspect of the matter, including by way of a claim for judicial review.”¹⁸³

Conclusions

The objectivity of B&F authorities has been investigated with specific reference to their enforcement procedures.

Authorities’ approach to enforcement varies in the constraints, clarity, publicity and rationale for the use of discretion. Overall, settlement procedures are less clear than the enforcement ones.

B&F authorities possess a high concentration of powers. Regulation, supervision and enforcement, comparable to the legislative, executive and judiciary powers, are conducted under one roof. This makes even more poignant the need for authorities not only to act with objectivity but also to be beyond any suspicion of arbitrariness. Especially because the firms investigated do not enjoy the full protection of laws in the same way they would have had had the procedure being conducted in a tribunal. And in fact there is no mention of the rights attached to the firm while being investigated. Controlling and monitoring powers of the authority where enforcement has been outsourced is relevant too.

183 *Ibidem* p 40.

Openness and Honesty

Openness: *Holders of public office should act and take decisions in an open and transparent manner. Information should not be withheld from the public unless there are clear and lawful reasons for so doing.*

Honesty *Holders of public office should be truthful*¹⁸⁴.

Some of the indicators of honesty and openness have been discussed already, among which transparency, accountability, impartiality and public disclosure of internal and third parties' assessment.

It should be reminded here that openness and transparency are no panacea. They may not necessarily make authorities trustworthy *per se*. Whereas openness fosters and encourages in fact scrutiny by third parties and transparency allows authorities to operate "under the sun", they can both lead to unconstructive questioning, government interference and suspicion¹⁸⁵. Also sometimes too much transparency may hinder policy effectiveness, especially central banks' ones. Excessive public scrutiny and suspicion may have a deleterious impact over the authorities' reputation, which in turn affect the credibility of their role and the morale of their staff.

What follow will briefly investigate if and to what extent, B&F authorities engage with the public on their decision making processes. Where applicable, how do they set their fees and how do they use the money from the fines is also relevant.

B&F authorities have strict confidentiality requirements which are embedded into law (FSMA and Bank of England Charter 1998). They are also bound to follow the principles of good regulation which do include transparency. The underling rationale is the protection of market integrity from speculative behaviour which may arise from the disclosure of sensitive information. B&F authorities, as other regulators, have also a duty to protect the "private life" of the people they engage with. So for instance, staff policies related to record management are publicly available. There can be exceptions to confidentiality rules, but these too are strictly regulated. In fact in disclosing information B&F authorities will have to comply with the "public interest test" from the Information Commissioner Office' s guidance. Strict confidentiality rules stem also from EU law.

It should be borne in mind that confidentiality relates not only to information received but also produced (for instance in relation to an investigation). Market players act on the basis of policy expectations henceforth authorities need also be very careful with their communication strategies.

184 The initial definition of Honesty was as follows: "holders of public office have a duty to declare any private interests relating to their public duties and to take steps to resolve any conflicts arising in a way that protects the public interest". See 1995 Nolan Report, p 14

185 See CSPL, (2013), p 47

For obvious reasons the Bank of England has a very strict secrecy policy which states that: "The strictest secrecy is to be observed with respect to information of any kind acquired in the course of your duties relating to the affairs and concerns of the Bank of England, of Her Majesty's Government, of other customers or of other persons, companies or organisations with which the Bank may have dealings"¹⁸⁶. This includes the need to obtain prior permission to take part in public discussion, engage with the press or otherwise, on the affairs or policy of the Bank.

Despite most B&F duties are statutory, it is very difficult to find a consolidated version of FSMA on their website. The FCA website cross refers to legislation.gov whereas the Bank publishes only a consolidated version of all the Acts that apply to them (which is very useful) where an extract from FSMA is included. Unfortunately the legislation.gov website does not publish an updated consolidated and easy to read version of the Act. This lack of transparency may run against the openness principle because it makes it difficult for the lay person to have easy access to the law.

The FCA is very transparent in what can and cannot be disclosed. They have a dedicated section on their website which explains their legal requirements and their own policy¹⁸⁷. They also have a specific section that explains how they engage with the public and which documents they publish. These are divided into areas (corporate documents; papers; handbook publications; and other documents) and are: annual reports; business plans; call for inputs; consultation papers; policy statements; discussion papers; feedback statements; guidance consultation; finalised guidance; thematic reviews; market studies; occasional papers; quarterly consultation paper; handbook notice, policy development updates; factsheet; information sheet; final notices and decision notices.

Board minutes are public too.

PRA/Bank/MPC publications are divided into: speech and articles; interviews; monetary policy; markets; financial stability; minutes; and Parliamentary Committee hearings. So for instance the monetary policy publications include: inflation reports; minutes of the MPC; letters on monetary policy; bank liabilities' and credit conditions survey; inflation attitude survey.

Those authorities whose funding comes from the industry have publicly available documents on how they set their fees. The use of the proceedings from fines is now regulated by statute.

The Bank has a specific chapter in their code of conduct on "being open and accountable" which includes details on: Record keeping; freedom of information act; press and media engagement; social media; information security; data protection act; and use of the Bank's resources and IT. The Bank also published an abridged version and the full results of their staff satisfaction survey¹⁸⁸.

186 See Bank of England, *Declaration of Secrecy*, available at www.bankofengland.co.uk

187 See www.fca.org.uk/site-info/information/information-we-can-share

188 In which 43 % of their staff was favourable to the statement "the Bank is open and transparent in its communication with its people"; 31% neutral and 26% unfavourable. See Bank of England, Viewpoint staff survey result, July 2015

The FCA has a very clear communication strategy which has recently been the subject of an internal audit that only found minor issues to be addressed¹⁸⁹. As a consequence to the press briefing incident, the FCA communication strategy has been the subject of an external inquiry (The Davis report) whose findings have been made public¹⁹⁰. The strategic plan of the Bank which places emphasis on openness and transparency has been mentioned above.

Conclusions

To a certain extent, openness and honesty are natural corollaries of objectivity and integrity.

Here the extent to which authorities are open and transparent in their decision-making activities has been investigated. Both authorities publish a wide range of documents and engage in consultation processes prior adopting a policy. Board minutes are published, taking into account confidentiality requirements. Internal and third parties assessments are in the public domain too and authorities are transparent in their setting of fees.

189 FCA, *FCA internal audit report: A review of the design and effectiveness of the FCA's external communications strategy*, October 2014

190 See above, at footnote 50.

Leadership

Leadership: *Holders of public office should exhibit these principles in their own behaviour. They should actively promote and robustly support the principles and be willing to challenge poor behaviour wherever it occurs.*

CSPL definition of leadership is centred upon the behaviour of each individual holding a public office, which makes it a very aspirational principle and as such difficult to measure in practice. It also doesn't seem to distinguish between public and private life. The last part of the definition encourages public sector employees to speak up whenever they witness instances of misbehaviour (in the workplace).

And yet in any organisation the tone comes from the top. Had the definition been focussed on the organisation, we would have conducted an analysis of their corporate governance, the role of the board and the extent to which it is able to implement ethical principles. We could also have analysed whether or not B&F authorities' requirements related to the senior managers' regime are the same as those imposed on the regulated firms or if they are stricter. Since some of the authorities are registered companies, it could have been interesting to analyse whether or not they comply with the corporate governance code.

However, as said above, the aim of the definition is to impinge upon every single holder of public office a duty to behave according to the principles of public life and in doing so, to exhibit leadership.

PART 3

RECOMMENDATIONS

- 1) Make clear in Job Descriptions and in other relevant documents that the Authority acts in the interest of the public and as such expects the highest possible standards of behaviour by their employees, irrespective of roles and functions.**
- 2) As part of their contract, distribute to and train all members of staff on the 7 principles of public life, alongside their regular ethical training where present.**
- 3) When possible, adopt a “comply or explain” approach to the Nolan Principles. Compliance should not merely be a tick boxing exercise, and a section on the annual report could be included on how the Authority has complied with the standard. This may also allow for a more tailor-made approach in the principles’ implementation.**
- 4) A substance over form approach to ethical behaviour is welcome, as long as there are clear indicators of how a culture of ethics has been transferred from the top to the bottom.**
- 5) The CSPL could consider redrafting the definition of selflessness to make its meaning clearer.**
- 6) Policies on conflicts of interests and revolving doors should be tailored to the different roles and backgrounds with an increased level of scrutiny and severity for the most sensible roles and the most striking conflicts. However, within their rigour, measures should allow for a fair, just and necessary flexibility.**
- 7) Whereas financial interests related to the holding of instruments issued by regulated firms are insulated during the terms of a mandate, there is little management or resolution of conflicts that may arise after the person has left the role, especially with respect to external board members. For instance stock options, pensions schemes, and deferred remuneration do not seem to receive a specific treatment.**
- 8) The correct understanding of conflicts of interest usually requires technical knowledge which the general public may lack. It is then important that communication from the authority on the matter is appropriate as to avoid a negative impact on public trust.**
- 9) Authorities should make sure that procedural and substantial due process is guaranteed when taking enforcement actions. With due respect to confidentiality, there could be more clarity in the settlement criteria. Outsourcing of investigation should be strictly monitored too.**
- 10) At the time of writing, the New Bank of England bill does not provide for the publication of PRC minutes. The Bank should consider the possibility of publishing at least an extract.**

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