Lessons from LIBOR:
Wider implications of the scandal for the Financial Services Bill

The LIBOR-fixing scandal continues to dominate the news. Barclays’ record £59.5m fine from the FSA related to two distinct issues, set out by Bob Diamond in his letter to Treasury Select Committee Chair Andrew Tyrie:¹

- Barclays’ LIBOR rate submissions were inappropriately influenced by Barclays derivatives traders seeking to benefit their own trading positions; and
- Barclays reduced its LIBOR submissions to manage public perceptions about the bank’s solvency at the peak of the financial crisis.

It should be borne in mind that the current focus on Barclays has arisen largely because the bank was the first to settle with the UK and US authorities, rather than because its conduct was uniquely or particularly egregious. Various other major banks, including HSBC, RBS, Citigroup and UBS, are also under investigation in relation to LIBOR-fixing, which appears to have been an industry-wide problem.²

Separately, the FSA has announced that the UK’s four largest banks have been engaged in widespread mis-selling of interest rate swap products to small businesses, with “many people’s livelihoods affected” by the costs of paying off complex and inappropriate deals.³

The LIBOR scandal in particular has raised important questions of public policy. Some of these - such as possible changes to the LIBOR settlement process, or the separation of retail and investment banking - fall outside FairPensions’ remit. However, it has also brought the wider question of culture in financial services back into the spotlight. We believe that many of the issues highlighted by the scandal go beyond banks. Although policymakers should of course seek to address the specific failings exposed by recent events, they should also take a step back and ask whether the ‘big picture’ these revelations illustrate is adequately reflected in the proposed new regulatory regime. Below we highlight two key issues for examination in this respect, and draw attention to amendments to the Financial Services Bill which seek to address them.

1) Financial services: In whose interests?

At its heart, the LIBOR-fixing scandal is about attempts to further the interests of banks and their traders at the expense of the integrity of the wider market. The inappropriate behaviour of Barclays traders, and the absence of internal controls to prevent that behaviour, has reawakened

¹ http://www.telegraph.co.uk/finance/newsbysector/banksandfinance/9363389/Letter-from-Barclays-chief-Bob-Diamond-to-Andrew-Tyrie.html
² http://m.bbc.co.uk/news/business-18622264
³ http://www.bbc.co.uk/news/business-18640101
a sense that the dominant culture of financial services is driven by self-serving profiteering rather than by any sense of a firm's social purpose. Likewise, the mis-selling of interest rate swaps reflects a culture where products were recommended based on the firm's interests rather than those of customers - often at the customer's direct expense.

The LIBOR scandal was also a clear case of conflicts of interest not being managed: the FSA found that Barclays “had no specific systems and controls in place” to prevent the interests of its trading desks from inappropriately influencing its LIBOR submissions.4

These issues of firm culture and poor conflicts management are by no means confined to banking. The Kay Review, expected to report shortly, has been commissioned by government to consider whether the interests of investment professionals are effectively aligned with those of the savers whose capital they invest. There is considerable anecdotal and survey evidence that institutional investors are not effectively managing conflicts of interest which could affect savers, including in relation to shareholder engagement with listed companies on issues like executive pay.5

There is an urgent need to re-establish the principle that financial services exist to serve consumers and the real economy, rather than the other way around. Various amendments have been tabled which would contribute to this objective:

- **Amendment 107** would require the FCA to have regard to the principle that, where consumers put trust in a firm's discretion and are vulnerable to the exercise of that discretion, the firm must act in consumers' best interests. FairPensions strongly supports this amendment (a separate briefing is available on our website).6
- **Amendments 106A and 108C** would require the FCA to have regard to the principle that firms should act 'honestly, fairly and professionally' in accordance with the best interests of their clients. This reflects wording suggested by the Joint Committee on the Draft Bill and promoted by the Financial Services Consumer Panel.
- **Amendment 108D** would require the FCA to have regard to the principle that those managing other people's money will ordinarily owe them a fiduciary duty. This amendment is similar in effect to Amendment 107, but narrower in scope.

2) Shareholder oversight

The LIBOR-fixing scandal has also raised serious issues about bank governance and accountability. The resignations of Barclays Chairman Marcus Agius and Chief Executive Bob Diamond reflected a recognition that board oversight and internal controls had been inadequate.

Commenting on these issues, Vince Cable has placed the responsibility for ensuring good governance firmly at the door of shareholders. Writing in the Observer last week, he argued: “Regulators are a backstop: they don't own banks … shareholders have to get a stronger grip on weak boards and out-of-control executives.”

This approach to systemic governance failings at major banks reflects the conclusions of the post-crisis Walker Review. The widespread acceptance that shareholders had too often been 'absentee landlords', failing to scrutinise banks' risky business models or poor governance

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6 [http://www.fairpensions.org.uk/policy](http://www.fairpensions.org.uk/policy)
7 [http://www.guardian.co.uk/commentisfree/2012/jun/30/vince-cable-banking-scandal-coalition](http://www.guardian.co.uk/commentisfree/2012/jun/30/vince-cable-banking-scandal-coalition)
practices, led to the introduction of the UK Stewardship Code in 2010. Vince Cable’s remarks confirm that enhanced shareholder oversight remains a key plank of the government response to systemic abuse in finance.

Yet this is not reflected in the Bill as it stands, which gives no indication of the place of the Stewardship Code in the new regulatory architecture. The Code is overseen by the Financial Reporting Council (FRC), but regulatory oversight of the entities to which it applies will fall to the FCA. Stewardship matters both from the perspective of protecting long-term value for savers (part of the FCA’s remit) and from the perspective of controlling systemic risk (part of the PRA’s remit). Yet there is a risk that, far from being seen as everybody’s business, the stewardship agenda may be seen as nobody’s business, and will instead fall between the cracks in the new regulatory framework.

Three amendments have been tabled with the intent of addressing this problem:

- **Amendment 121B** would require the FCA to co-operate with the FRC to promote high standards of stewardship.
- **Amendment 121C** would require the FCA to publish a memorandum of understanding with the FRC.
- **Amendment 106B** would require the FCA, in assessing the appropriate level of care which firms should provide consumers, to have regard to the existing FSA requirement that asset managers disclose the nature of their commitment to the Stewardship Code.

FairPensions supports these amendments, in particular Amendments 121B and 121C.

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**Further information**

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**About FairPensions**

FairPensions is a registered charity that promotes Responsible Investment (RI) by pension schemes and fund managers, and seeks to ensure that the City acts in the long-term best interests of savers. RI generally involves shareholder engagement with companies to ensure that environmental, social and corporate governance (ESG) risks with the potential to affect long-term financial returns are monitored and managed. We are a member organisation, whose members include representatives of pension savers, a number of leading UK charities and thousands of individual pension fund members.