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Can We Tame the Bankers:

A Critical Review of the Functions of the UK's Banking Standards Board

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ABSTRACT

The global financial crisis has occurred for nearly ten years, the trust of banking industry still needs to be rebuilt and enhanced. Owing to the inherent limitations of hard-law regulation, the ethical approach for restricting bankers' behaviours in financial activities is widely supported by law scholars and practitioners. The Banking Standards Board as a new self-regulatory body has been established to promote high standards of behaviour and competence across UK banks and building societies. However, by reference to the lessons from the banking scandals in the recent decade, the ignorance of making the effort to emphasize personal responsibilities of bankers in the UK banks may negatively impact institutional effects of the Banking Standards Board in practice. This issue should be paid particular attention for the reform of the Banking Standards Board in the future.

1. Introduction

Imposing statutory duties and legislating hard laws are the main regulatory approaches of the regulators to prevent financial institutions' undesirable conducts in financial activities and to protect investors and consumers. Ever since the global financial crisis (GFC), however, a wave of scandals continues in global financial industry, which reflects that the existing regulatory model is not satisfactory. Against this background, both regulators and practitioners have agreed to rethink the approaches of regulation of banking industry, especially consider what the role of ethics and culture should be in financial regulation.

The occupational ethics in financial industry is mainly composed of two groups of rules, the first one is the standards of professional conduct released by professional self-regulatory institutes at both domestic and global levels. The other group of rules are the codes of ethics created by individual financial corporations like banking groups and investment companies. Specifically, the ethics or professional moral requirements can also be classified into two categories, namely the rules regulating the financial institutions and the standards directing the professional individuals' conduct. The

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interaction and compatibility of the two sorts of ethical rules may impact the effectiveness of the financial regulation in preventing the immoral and over-risky behaviours.

In respect of the unified standards of banking profession, this article will focus on the ethical rules of two typical and influential self-regulatory organizations. Firstly, the Chartered Institute of Bankers in Scotland, or known as the Chartered Banker Institute (CBI) is one of the prestigious professional associations of bankers in UK that has developed a series of conduct standards for professional bankers since the year of 2011. Meanwhile, the Chartered Financial Analysts Institute (CFA Institute), another influential self-regulatory organization of financial professionals in global level, has updated its professional ethical code as well for better integrity and justice in global banking. By means of comparatively considering the specific rules of the codes of ethics of the two above institutes, the limits of conventional approach of self-regulation will be analyzed. In the following two sections of this article, the functions and limitations of the ethical codes of banking groups will be illustrated by analysing a series of typical financial scandals during the post-GFC era. Finally, this article will examine the proposed rules of the Banking Standards Board (BSB) of the United Kingdom (UK) and consider to what degree the BSB standards can fill the gap between the corporate ethical codes of banking groups and the existing problems in practices.

2. The Limits of Hard Laws in Financial Regulation

Generally speaking, when the market fails to provide efficacious protection of the market participants, the external constraint mechanism, namely the financial laws and regulations will be necessary. However, the global financial crisis has shown that the conventional regulatory approach which aims at seeking a series of unified rules for all the participants in the market has failed to address the market failure. Therefore, it is necessary to reconsider the role and limits of hard laws in financial regulation.

In the first place, the process of lawmaking might be substantially impacted by the vested interests groups, which will to some extent ignore the fairness of the legislation for public interest[1]. Secondly, because the legislations have their own fixed structure, it may be quite difficult to cover all the potential possibilities and matters in the future. As a result, there must be a gap between what the law literally says and 'what the lawmakers would have wanted to say' [2] which will motivate the

[1] For example, the industry may influence the regulation by lobbying the regulator to make laws permitting subsidies for a certain industry or making particular control over entry of an industry, by which the certain interested group may be benefited from particular industrial legislation, and the other participants might be excluded from the market. George Stigler, 'The Theory of Economic Regulation' (1971), 2 BELL J. ECON. & MGMT. SCI 3, 4-5.

[2] Dan Awrey, William Blair, and David Kershaw, 'Between Law and Markets: Is There a Role for Culture and Ethics in Financial Regulation?'(2012), LSE Law, Society and Economy Working Papers 14/2012, 7 < http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2157588> accessed 5 December 2017.

participants of the market to carry out regulatory arbitrage[3]. In terms of the regulation of financial products of financial institutions, currently the widely-used regulatory strategy is imposing the duty of disclosure on the sellers. The problem of such a regulatory approach is that the complexity and innovation of financial products makes it difficult to sufficiently understand the rationale and risk in the financial products and transactions, which may weaken the regulators' ability to appropriately implement regulatory strategies to address practical issues[4].

3. The Role and Limits of Self-regulatory Bodies in Financial Industry: CBI and CFA

The self-regulation of global financial activities is theoretically established on the basis of the efficiency of information sharing mechanism among the market participants. However, in reality the market has limits which may undermine the effectiveness of self-regulatory approaches of financial markets. The following two examples, namely the analysis of the self-regulatory rules of the Chartered Banker Institute (CBI) and Chartered Financial Analyst Institute (CFA) will illustrate how the self-regulation and information utilization in the markets might be costly.

3.1 The Standards for Professional Bankers of the Chartered Baker Institute

Since the occurrence of the GFC, as one of the world-widely influential association of bankers, the CBI has been developing a set of self-regulatory rules covering all the professional practitioners in the member banks. In brief, the standards for professional bankers of CBI are categorised in three types of rules, namely the Chartered Banker Code of Professional Conduct (CBCPC, 2011), Foundation Standard for Professional Bankers (FSPB, 2012) and Leadership Standard for Professional Bankers (LSPB, 2014), each of them covers different groups of the practitioners in UK banking industry. As the general rules of the CBI regulatory system, the CBCPC (2011) sets out a self-regulatory framework which generally guides for employees of the member banks of CBI in the following domains: 1) integrity in treating all the stakeholders in practices; 2) duty of compliance; 3) prudence in risk management; 4) confidentiality and sensitivity in utilization of information; 5) continuous competence in professional skills and knowledge; 6) continuous fairness, trustworthiness diligence in acting[5]. In addition, as the supplementary rules of the CBCPC, further guideline in relation to the requirement of professional knowledge/skills and desirable behaviours in professional practices are developed by the FSPB (2012)[6]. In advanced level of the CBI rule system, the senior professional bankers with leadership responsibilities of member banks of the CBI is required to comply with the

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[3] Ibid.
[4] Dan Awrey, 'Complexity, Innovation and the Regulation of Modern Financial Markets' (2012) 2 Harvard Business Law Review 236.
[5] Chartered Banker Code of Professional Conduct 2011, part 2. Available at http://www.cbpsb.org/publications/chartered-banker-code-of-professional-conduct.html.
[6] Foundation Standard for Professional Bankers 2012. Available at http://www.cbpsb.org/publications/foundation-standard.html.

LSPB (2014)[7], which set outs a higher standard of conduct than the foundation rules. Particularly, the LSPB (2014) emphasises the requirement of bank managers' performance in managerial affair of the member banks[8].

In terms of implementation of the CBI rules, due to the lack of official regulatory power, the main approaches of implementation and monitoring of the CBI rules are based on the reputation pressure on professional individuals which is mainly determined by the CBI and internal monitoring by member firms. Firstly, all the member firms are required to establish an internal monitoring team who will be in charge of supervising the compliance of CBI rules on an annual and on-going basis[9]. Secondly, in the process of reviewing of the employees' behaviours, where an individual breaches the CBCPC (2011), or fails to maintain the standards, the member firm has the obligation to inform the issue to the CBI. Once the evidence supporting the complaint is considered as complete, the membership and the use of professional designations of the individual may be withdrawn by the CBI[10]. Therefore, it is unequivocal that the effectiveness of the CBI rules depends on individual practices of each member firm, where the corporate ethical rules must play a key role.

3.2 The Behaviour Standard for Bankers and Punishment Procedure of the Chartered Financial Analyst Institute

The reason why individuals are excluded by the new regulatory body is that '*the existing professional bodies would be doing the job'*[11]. In this point, the Chartered Financial Analyst Institute (CFA) which is the most influential international institute in financial profession has set out a detailed code of ethics and rules of procedure for professional bankers. According to the Code of Ethics and Standards of Professional Conduct (2014) (hereinafter the 'CFA Code'), the standards of professional conduct is composed of the requirement of professional knowledge and skills, duties to clients, duties to employees and the rules regarding conflicts of interest, etc[12].

In regard of the enforcement of the duties included in the CFA Code, the Disciplinary Review Committee of the CFA Institute obtains the right and power to begin an investigation of any possible violation of the Professional Conduct Program through the sources including complaints from third

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[7] Leadership Standard for Professional Bankers 2014. Available at http://www.cbpsb.org/publications/leadership-standard.html.

[8] In brief, the requirements are focused on the ethical matters regarding 1) risk management of the bank; 2) decision making process; 3) design and application of incentive and remuneration schemes; 4) social responsibility; 5) effective long-term performance of the entity. *Ibid,* pp.4-7.

[9] Framework for Professional Standards 2014, pp.10. Available at http://www.cbpsb.org/publications/framework-for-professional-standards-copy.html.

[10] Part 4.2 of the CBCPC (2011).

[11] *Ibid*, pp.12.

[12] CFA. *Code of Ethics and Standards of Professional Conduct* (2014). Available at http://www.cfapubs.org/doi/pdf/10.2469/ccb.v2014.n6.1.

parties, self-exposure or any other accessible public information[13]. The most important issues that we should pay attention here are how the organization does work to impose sanctions on the guilty members and whether this approach is able to effectively restrain immoral or inappropriate behaviours in most cases. Pursuant to the Rule 1.6 of the *Rules of Procedure for Professional Conduct* (2014), in the circumstances where a covered person is deemed as a violation of any Governing Documents and/or the CFA Program Rules and Regulations, the Disciplinary Review Committee may impose sanctions including censure, suspension or revocation of membership/right to use CFA designation; in case of serious violations, the covered person even may be suspended or prohibited from participating in the CFA program[14], at the same time, the identifying information of the punished person may be disclosed to the public[15].

3.3 The Limits of Ethical Rules of Professional Associations

In nature, all above self-regulatory rules are making efforts to establish a kind of 'shared ethics' within the financial profession, the effectiveness of which is primarily on the basis of consistent identification of professional behaviours and the dissemination of reputational information within the marketplace[16]. However, in a practical sense, the real effect of the professional ethical rules is questionable which can be mainly explained from three dimensions: 1) the difficulties in detecting the violations; 2) weak enforceability of the ethical codes proposed by self-regulatory associations and 3) limited information sharing within specific marketplace.

In the first place, due to the complexity of modern financial transaction, technically the asymmetry of information between the clients and financial agencies are serious, which makes it hard for market participants to accurately detect bankers' violations in most cases[17]. In other words, it is difficult for professional associations like CFA to be timely informed with any non-compliance of the members. In the second place, even any violations are observed, concerning the ability of attracting its members, the associations are reluctant to impose rigorous sanctions on the members who violate the rules of ethics or conducts[18]. Thirdly, in terms of reputational mechanism, the mobility of financial and

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[13] CFA. Rule 2.1 of *Rules of Procedure for Professional Conduct* (2014), pp.7. Available at http://www.cfainstitute.org/ethics/conduct/Documents/2014_rules_of_procedure.pdf.
[14] *Ibid*, pp.7.
[15] *Ibid*.
[16] Dan Awrey, William Blair, and David Kershaw, 'Between Law and Markets: Is There a Role for Culture and Ethics in Financial Regulation?'(2012), LSE Law, Society and Economy Working Papers 14/2012, 19 < http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2157588> accessed 5 December 2017.
[17] *Ibid*, pp.17.
[18] For instance, presently the aggregate number of CFA membership is 127,756, the total number of industry-related cases from January 2000 to present is 1912, most of them were settled without disciplinary action. *See* CFA Institute, Industry-related Statistics, available at http://www.cfainstitute.org/ethics/Documents/Professional%20Conduct%20Program%20Documents/mem_discipline_stats.pdf. Additionally, between January 2000 to June 2013, there were only 13 individuals' CFA memberships were permanently revoked, which means that only 0.96 expulsion occurred per year. The statistics is available at http://www.cfainstitute.org/ethics/conduct/sanctions/Pages/industry_sanctions.aspx.

banking practitioners makes it hard to target the objects of sanctions. Moreover, the market participants may not have incentive to learn and disseminate the news about violations in marketplace, because most of them commonly make relationship-specific transactions in financial firms[19]. In other words, for most participants, they are unwilling to spend extra cost on sharing reputational information via the market.

In sum, the lesson we learnt from the GFC is that the conventional law and regulation of financial market has been proved to be failure, the 'too-big-to-fall' has put the government and authorities in a very awkward position that legal sanctions against illegal corporate conducts can hardly make sense sustainably. Simultaneously, due to the limitations of the market itself, the ethical rules as soft law developed by professional associations currently are also unable to effectively constrain their members' excessive risk-takings or immorality in financial activities.

4. The Functions and Limits of Ethics in Financial Regulation

The limits of both hard law and self regulations show that it is necessary to explore a kind of alternative approach which may fill the gap between law and markets in financial regulation. The ethics developed in organizations may play a role in enhancing the integrity in financial market. Generally speaking, the ethics may provide a psychological basis of human and organizational behaviours which can directly or indirectly influence the economic result of business organizations.

Due to the unenforceability, the effectiveness of ethics generally depends on the effects that the ethics as the 'shared ethical rules' are able to be compatible to individual's ethics[20]. The existing achievements in social sciences have showed that the acceptance of a kind of ethics as shared rules will depends on a series of psychological and sociological factors which can summarised as the following points, namely the physical and psychological distance, the existence of personal liability and process of decision-making.

Firstly, just like the results of the Milgram Obedience Experiment shows that, the distance between the actor and people who are affected by such actions will decrease the moral intensity[21]. Secondly, due to the lack of personal liability for the immoral consequence, the individual's ethical awareness of his/her specific conducts will be significantly diluted[22]. Similarly, the complexity of the bureaucratic structure within a business organization may also dilute the ethical sense and moral judgement of each

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[19] Dan Awrey, William Blair, and David Kershaw, *Between Law and Markets: Is There a Role for Culture and Ethics in Financial Regulation?*, LSE Law, Society and Economy Working Papers 14/2012, pp.19.< http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2157588> accessed 5 December 2017.

[20] Ibid, at 13.

[21] See Stanley Milgram, *Obedience to Authority*, Harper & Row, 1974.

[22] Zygmunt Bauman's sociological analysis of the Holocaust shows that the individual liabilities may be considerably diluted in complicated modern bureaucracy, which played a role in completing the holocaust. Zygmunt.Bauman, *Modernity and the Holocaust*, Cambridge: Polity Press, 1989.

individual actor in specific actions. Thirdly, the process of decision-making may also influence the ethical intensity. Compared with rapid thinking before making a judgement, it is proved that contemplation may enhance ethics in decision-making[23]. Especially in the process of decision-making in financial institutions, careful thinking before making a judgement may allow individuals to consciously weigh ethics against self-interest[24]. Moreover, the conversation between the individuals in organizations may also make individuals rethink the ethical dimensions of the behaviours and it was also proved that the morally-oriented conversation can play a positive role in enhancing the ethics in decision-making[25].

Roughly speaking, above evidence and research achievements show that the processing approach of potential immoral behaviours, the realistic psychological pressure on the actor and the personal liability for the immoral behaviours may influence the effectiveness of ethics in preventing immorality in decision making process. The nature of the role of ethics in organizational behaviours is that the ethics created by the organization should be able to impose sensible pressure on individuals both psychologically and realistically, otherwise a so-called 'shared ethics' may not work well in enhancing the morality in business organizations.

5. The Regulatory Function of the Banking Standards Board: Rebuilding Banking Ethics

An early version of the Standards proposed by the Banking Standards Board (BSB) argues that because of the high mobility of the personnel in banking industry, fragmented guidelines of bankers' behaviours created by different corporations cannot successfully stably guarantee the integrity in the overall market[26]. What's more, there have been many cases in which the individuals are incentivised to pursue short-term revenue by carrying out risky transactions which may be opposed to customers' interests. Therefore, it is necessary to raise a unified standard to regulate the individuals' conducts[27]. For this purpose, a Banking Standard Review (hereinafter 'the Review') for establishing the Banking Standards Review Council (BSRC) which will be an independent organization promoting high standard behaviours in the banking sector of the UK was published as early as May 2014[28]. According to the Review, the main functions of this new organization can be summarised as below:

The Report have agreed that firstly, the new organization should be able to cover all the banks and building societies in the UK, but shadow banking system, such as hedge funds, insurance companies

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[23] Brian C. Gunia, Long Wang, Li Huang, Jiunwen Wang, J. Keith Murnighan, *Contemplation and Conversation: subtle influence on moral decision making(2012)*, 55 Academy of Management Journal 15-16.
[24] Ibid, at 15-16.
[25] Ibid, at 25.
[26] Sir Richard Lambert. *The Consultation Paper (February 2014)*, pp.5. Available at http://www.bankingstandardsreview.org.uk/assets/docs/consultation-paper.pdf.
[27] *Ibid*.
[28] Sir Richard Lambert. *Banking Standards Review* (19th May 2014). Available at http://www.bankingstandardsreview.org.uk/assets/docs/may2014report.pdf.

and professional individuals[29] are proposed to be excluded. Secondly, in terms of the specific standards of banking practice, currently the BSRC is expected to develop behavioural standards for different sectors of banking professions. Particularly, the Report emphasises that the BSRC should give priorities to the matters in which a clear public interest exists and which cannot be well addressed by statutory system[30]. Thirdly, as for the subject of training, due to both the special role of the BSRC and the complexity of the whole banking industry, it is agreed in consensus that the most efficient and feasible ways of improving the training are 1) identifying and championing the desirable conducts in the banking market and 2) specifying practical problems in each subsector and helping to improve them[31].

In a practical regard, currently the basic working process of the BSRC is mainly on a reputational mechanism basis, which means that the BSRC will collect both reports of poor and excellent performances from any member institutions and reward those institutions who develops good performance model for protecting not only the financial consumers' stake but also public interest in banking market. The working process of the new organization will be transparent to all the market subjects all the time, by which the firms will be incentivized, self-regulated and influenced by the market reputational mechanism[32].

6. The Role of Banking Ethics in Practices: Case Studies

6.1 JP Morgan Chase London Whale Scandal (2012)

6.1.1 The Summary of the Case

In April and May 2012, large trading losses[33] occurred at JPMorgan's Chief Investment Office (CIO), caused by the transactions at its London branch. Bruno Iksil, a trader for JP Morgan nicknamed 'London Whale', aggressively and riskily bought a great volume of credit default swaps (CDS) thinking that the bond would not default. At the same time, some hedge funds opposing betted to the JP Morgan's position of above CDSs and heavily bought such a high volume of them. Finally, the bonds defaulted which caused at least $2 billion loss to JP Morgan.

6.1.2 The Personal Liability of the Responsible Banker

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[29] *Ibid*, pp.10-12.
[30] *Ibid*, pp.19.
[31] *Ibid*, pp.21-22.
[32] *Ibid*, pp.19-20.
[33] Major losses of $2 billion were reported by the firm in May 2012 in relation to these trades. On July 13, 2012, the total loss was updated to $5.8 billion with the addition of a $4.4 billion loss in the second quarter and subsequent recalculation of a loss of $1.4 billion for the first quarter. Jessica Silver-Greenberg. *New Fraud Inquiry as JP Morgan's Loss Mounts.* Available at http://dealbook.nytimes.com/2012/07/13/jpmorgan-says-traders-obscured-losses-in-first-quarter/?_r=0.

According to the Code of Conduct dated June 2014 (hereinafter JPM-1)[34] and the Code of Ethics (hereinafter JPM-2)[35], firstly, any practitioner of the firm must act '*in good faith and with integrity, due care and diligence*'(JPM-2) and any over-risky trading activities by any individual practitioners of the firm may be regarded as violation against the Code of Conduct[36]. In regard of the sanctions or aftermath of such violations, both the Codes clearly state that any violation of the rules may give rise to termination of employment/immediate dismissal or even monetary damages[37] .

6.1.3 The Analysis of the Case

In the case of London Whale[38], the key issues are concentrated on the processes of investment supervision and risk-control on the senior management level. In other words, we should consider whether the Codes of Ethics/Conduct played a role in preventing such a serious fiasco. Firstly, the Report notes that the Firm's Chief Investment Officer, Ina Drew failed to ensure that the CIO management have carefully understood the portfolio of CDS investments and monitored its execution[39]. Secondly, Barry Zubrow who was the head of Risk Organization of the Firm also assumed responsibility to the loss, because under his leadership, the Risk Organization didn't '*equipped to properly risk-manage the portfolio*' and '*performed ineffectively as the portfolio grew in size, complexity and riskiness'*[40]. Thirdly, Douglas Braunstein, the Firm's Chief Financial Officer who inactively gathered additional information regarding the portfolio by which the risk ought to be appropriately noted, should also be responsible for the loss caused by the over-risky transactions[41].

After the occurrence of the scandal, above main responsible persons who were respectively in charge of investment strategy, finance and risk control of the Firm were imposed penalties in different ways. Firstly, the Firm has replaced the CIO staff bearing responsibility for the loss, the Firm accepted Ina Drew's resignation and replaced all of the heads of above three departments of JP Morgan Chase[42]. Secondly, in terms of monetary punishment, the Firm also accepted Ina Drew, the head of CIO's waiver of amounts of her compensation[43].

In aspect of the regulation of investment banker's conducts, it may be significant to consider whether those over-risky investment activities were exactly the indirect aftermath caused by the compensation

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[34] Code of Conduct: http://www.jpmorganchase.com/corporate/About-JPMC/document/FINAL-2014CodeofConduct.pdf
[35] Code of Ethics: http://www.jpmorganchase.com/corporate/About-JPMC/code-of-ethics.htm
[36] *See* the Code of Conduct, pp.12.
[37] *See* the Code of Conduct, pp.8.
[38] The analysis of the London Whale Scandal (2012) is mainly based on the detailed report by JP Morgan Chase which is available at http://files.shareholder.com/downloads/ONE/2272984969x0x628656/4cb574a0-0bf5-4728-9582-625e4519b5ab/Task_Force_Report.pdf.
[39] *Ibid*, pp.7-8.
[40] *Ibid*, pp.8.
[41] *Ibid*, pp.8.
[42] *Ibid*, pp.14-15.
[43] *Ibid*, pp.14.

system or incentive mechanism of the Firm. From the point of view of the Report, there is no necessity of significant adjustment of current compensation system of the Firm, because even if the trader only earns fixed salary, he/she is also expected to concern about the achievement of their performance, which signifies that there still should be a personal incentive to carry out risky activities[44]. However, the lesson from the London Whale case is what detailed standard should be taken into account when the compensation committee measures the achievement or performance of front office personnel. In fact, the compensation committee should not only consider the quantitative standard of a trader's performance but the qualitative aspect of the investment activities, namely how the profits are produced, this revamped testing approach may be achieved by reference to the input of risk management team of the firm[45].

In all, the London Whale case is a referential incident for us to rethink the detailed testing approach of the performance of any professional practitioners of banking institutions, losses or profits to the Firm '*are not necessarily the measure of success*'[46]. Although we can see that the terms or statements like 'due care' or 'prevent excessive risky activities' have been included by the Codes of Ethics/Conduct, the skill and awareness of risk control in daily investment activities should also be clearly emphasised by compensation system.

6.2 Goldman Sachs Fraud (2010)

6.2.1 The Summary of the Case

Goldman Sachs as a global leader in investment banking was troubled with a world-shaking financial scandal in 2010. On 16th April 2010, Goldman Sachs was accused by the SEC for the fraud tied to a series of collateralized debt obligations (CDOs) transactions which caused more than 1 billion dollars to investors[47]. As early as 2007, Goldman Sachs created a package of CDOs (known as 'Abacus 2007 AC-1') based on the performance of subprime residential mortgages-backed securities (RMBS) and sold them to institutional investors. Paulson & Co. (Paulson) a well-known hedge fund who has predicted the downside of the US housing market at that moment, helped to select the underlying securities of Abacus 2007 AC-1 and prepared to take a short position of them later. For earning profit from the predicted default of RMBSs, Paulson entered into credit default swaps (CDS) with Goldman Sachs which guaranteed the hedge fund's short interest in the CDOs. As the broker of the transactions, Goldman Sachs was promised to earn 150 million dollars as the transaction fee from Paulson & Co in the situation that the CDOs were successfully sold to investors. By January 2008, with the slump of

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[44] *Ibid*, pp.91.
[45] *Ibid*, pp.91-93.
[46] *Ibid*, pp.93.
[47] Joshua Gallu, Christine Harper, *Goldman Sachs Sued by SEC for Fraud Tied to CDOs*, Bloomberg Business, April 16, 2010. Available at http://www.bloomberg.com/news/articles/2010-04-16/goldman-sachs-sued-by-sec-for-fraud-over-mortgage-backed-cdos-shares-drop.

US housing market, 99% of the portfolio was downgraded which finally caused over 1 billion dollars loss to investors. Correspondingly, the opposite CDS position yielded around 1 billion dollars profit to Paulson[48].

6.2.2 The Personal Liability of the Responsible Banker

It is quite manifest that in fact the hedge fund had expected to gain profit through the protection from CDSs with Goldman Sachs, thus the hedge fund had strong economic incentive to select the underlying securities which were expected to default in short future. Undoubtedly, there was a conflict of interest between investors and Paulson. However, Goldman Sachs and its responsible individuals failed to disclose it to investors. Therefore the SEC filed a charge against Goldman Sachs and one of its ex-vice presidents Fabrice Tourre who substantially participated in the operation of above transactions with securities fraud[49]. Eventually, the United States District Court for the Southern District of New York ordered Goldman Sachs and Tourre to pay $550 million and $650,000 civil penalties respectively to the US government and SEC[50]. In addition, as the inescapable individual being responsible for the illegal transactions, the court also required Tourre to give up his $175,463 bonus of 2007[51]. In 2012, Fabrice Tourre resigned from Goldman Sachs.

6.2.3 The Analysis of the Case

According to the Goldman Sachs Code of Business Conduct and Ethics (hereinafter 'the Goldman Sachs Code'), any individuals who are employed by the Goldman Sachs and involved in disclosure procedures must act in consistent with the public policy, any misstatement, omission to other parties is prohibited[52]. In the situation that any responsible individuals violate the rules of the Goldman Sachs Code, the firm has the power to immediately terminate the employment of the certain individual and the in the circumstance where he/she violates the laws, civil or criminal penalties may also be triggered[53]. In this regard, the outcome of this fraud case has shown that the responsible senior executive, Tourre was sanctioned by the court.

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[48] SEC Charges Goldman Sachs with Fraud in Structuring and Marketing of CDO Tied to Subprime Mortgages, 2010-59, April 16, 2010. Available at http://www.sec.gov/news/press/2010/2010-59.htm.
[49] According to the findings of the Court, Tourre as the direct responsible individual has participated in transaction device, preparing legal documentations, negotiating with transaction parties like Paulson and contacting investors through the whole process of the deal. Securities and Exchange Commission v. Goldman Sachs & Co. and Fabrice Tourre, April 16,2010, pp.2.
Available at http://www.sec.gov/litigation/complaints/2010/comp21489.pdf.
[50] Bob Van Voris, *Ex-Goldman's Tourre Ordered to Pay $825,000 in SEC Case*, Bloomberg Business, March 12, 2014. Available at http://www.bloomberg.com/news/articles/2014-03-12/ex-goldman-vp-tourre-ordered-to-pay-825-000-in-sec-case.
[51] ibid.
[52] Goldman Sachs Code of Business Conduct and Ethics, pp.6, available at http://www.goldmansachs.com/investor-relations/corporate-governance/corporate-governance-documents/revise-code-of-conduct.pdf.
[53] ibid, pp.4.

In December 2010, the Compensation Committee of Goldman Sachs launched a reform, namely The Goldman Sachs Long-Term Performance Incentive Plan (December, 2010)[54] (hereinafter the Long-Term Incentive Plan) for the purpose of restricting short-term speculative and over-risky behaviours of all employees of the firm. The Long-Term Incentive Plan significantly strengthens the link between the award for employee and the long-term result of his/her performance. Firstly, the award vested under the Long-Term Incentive Plan includes not only cash bonus but also equity-based awards like stock options and any other awards which are approved by the Compensation Committee[55]. Secondly, the vesting of a certain award should be determined on the basis of the achievement of specified performance goals to the firm and the measurement of individual performance is based on a series of indexes like the stock price, earning per share of the firm over a long-term period, such as a fiscal year or longer[56]. Accordingly, the Compensation Principles of Goldman Sachs which is the basic guideline of the compensation policy of the firm, also emphasises that '*Cash compensation in a single year should not be so much as to overwhelm the value ascribed to longer term stock incentives that can only be realized through longer term responsible behaviour*'[57], which aims at encouraging employees to perform for the long-term value creation, rather than immediate interest. This new approach for assessing the performance of the employees can be regarded as a response to the short-term immoral scandals like the Goldman Sachs Fraud in 2010.

Moreover, the new incentive mechanism of Goldman Sachs also pays more attention to the sanction on wrongdoers. Pursuant to the Compensation Principles, it is stated that the effective compensation should '*discourage excessive or concentrated risk trading*'[58], any misconducts of individuals which result in legal or reputational harm or negative financial impact on the firm, the equity award should be clawed back or forfeited, even the covered person has left Goldman Sachs[59].

6.3 HSBC Money Laundering (2012)

6.3.1 The Summary of the Case

In 2012, HSBC Holdings plc and HSBC Bank USA N.A. (HSBC Bank USA) (together, HSBC) – were accused of violations of anti-money laundering rules in the US. According to the investigation by the judicial agency in US, during 2006-2010 HSBC Bank USA failed to implement effective anti-

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[54] The Goldman Sachs Long-Term Performance Incentive Plan (December, 2010). Available at http://www.goldmansachs.com/investor-relations/financials/archived/8k/pdf-attachments/12-23-10-8-k.pdf.
[55] ibid, pp.3.
[56] ibid.
[57] Goldman Sachs' Compensation Principles, pp.1, which is available at http://www.goldmansachs.com/investor-relations/corporate-governance/corporate-governance-documents/compensation-principles.pdf.
[58] Goldman Sachs' Compensation Principles, pp.1, which is available at http://www.goldmansachs.com/investor-relations/corporate-governance/corporate-governance-documents/compensation-principles.pdf.
[59] ibid.

money laundering program which should be capable of strictly monitoring the suspicious transactions from the affiliates of HSBC Group[60]. According to the investigation records, HSBC Bank USA permitted drug traffickers to launder hundreds of millions of dollars through HSBC subsidiaries and HSBC Group illegally conducted transactions on behalf of customers in Cuba, Iran, Libya, Sudan and Burma all of above countries were subject to sanctions enforced by the Office of Foreign Assets Control (OFAC) at the time of the transactions occurred[61]. HSBC Group was required to forfeit USD 1.256 billion and was fined USD 665 million.

6.3.2 The Ethical and Cultural Dimension of the Case

As mentioned above, transparency and integrity are the foundation of banking industry. In practical term, the compliance department of the bank should be responsible for guaranteeing the source of money is legal and valid. However, HSBC Group working with sanctioned entities didn't truly record the transaction message. In fact, as early as the 1990s, HSBC Group affiliates worked with sanctioned entities to insert cautionary notes in payment messages including "care sanctioned country", "do not mention our name in NY," or "do not mention Iran." HSBC Group became aware of this improper practice in 2000. In 2003, HSBC Group's head of compliance acknowledged that amending payment messages "could provide the basis for an action against HSBC Group for breach of sanctions". The HSBC Group also removed those information identifying the countries from U.S. dollar payment messages; deliberately used less-transparent payment messages, known as cover payments; and worked with at least one sanctioned entity to format payment messages, which prevented the bank's filters from blocking prohibited payments. Ironically, the chief compliance officer (CCO) of HSBC resigned without paying fines.

7. Concluding Remarks

The above case studies of the ethical rules for bankers in practice have shown that the enhancement of personal liability and responsibility in banking industry is a particularly important mission for rebuilding the trust and order of global financial markets. The ethics in a banking firm works well on the basis of the psychological impact on individuals in the process of decision-making, therefore the incentive and punishing mechanisms of given ethical codes of banks will restrict misconducts of bankers or responsible persons. Although the regulatory scope of the BSB excludes the regulation over the individuals in banking corporations, the BSB rules should still play a role in encouraging the development of ethics in the firms. For this purpose, it is proper to recommend that the 'Professional Standards' of the Banking Standards Board should effectively encourage the employees in all the

[60] The Department of Justice of the United States, 'HSBC Holdings Plc. and HSBC Bank USA N.A. Admit to Anti-Money Laundering and Sanctions Violations, Forfeit $1.256 Billion in Deferred Prosecution Agreement', December 11, 2012,< http://www.justice.gov/opa/pr/hsbc-holdings-plc-and-hsbc-bank-usa-na-admit-anti-money-laundering-and-sanctions-violations> accessed 5 December 2017.
[61] ibid.

levels of the industry to challenge the poor behaviours and develop good staff values and incentives within the firms.