Banking Regulation: A Delicate Balancing act between Safeguarding the Economy and Encouragement of Creativity in the Banking Sector

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List of Abbreviations

ABN AMRO .... Algemene Bank Nederland AMRO

ABS .... Asset-Backed Securities

ATM..Automated Teller Machine

AUM ....Assets Under Management

BCBS .... Banking Committee on Banking Supervision

BCCI .... Bank of Credit and Commerce International

BGI...Barclays Global Investors

BoE...Bank of England

CEO ....Chief Executive Officer

CET Tier 1 .... Common Equity Tier 1 Capital

CDO...Collateralised Debit Obligation

CLO .... Collateralised Loan Obligation

CMBS... Commercial Mortgage-Backed Securities

CDs ....Credit Derivatives

CRD..Capital Requirements Directive Regulation

DCO .... Dominion Colonial Overseas

DSO... Debit Securitisation Obligations

DPS ....Dividend Per Share

DCM .... Dual Control Mechanism

EPS..Earnings Per Share

EBRD ....European Bank for Reconstruction and Development

EU .... European Union

EURIBOR …. ....Euro Interbank offered Rate

FCA ....Financial Conduct Authority

FF&P...Fleming Family & Partners Ltd

FIS .... Financial Infrastructure System

FSA.. Financial Service Authority

FSCS.. Financial Services Compensation Scheme

FSMA .... Financial Services and Market Act

GDP.. Gross Domestic Product

GFC .... Global Financial Crisis

GSIB .... Global Systemically Important Banks

HSBC .... Hongkong Shanghai Banking Corporation

HQLAs.. High Quality Liquid Assets

IC .... Impairment Charges

IMF.. International Monetary Fund

IRFSs.. International Reporting Financial Standards

KPI .... Key Performance Indicator

LIBOR .... London Inter-Bank Offered Rate

LCR .... Liquid Coverage Ratio

M & A .... Merger and Acquisition

OPBT .... Operating Profit Before Tax

OCT.. Over the Counter Trade

PIDA .... Public Interest Disclosure Act

PPI .... Payment Protection Insurance

PRA .... Prudential Regulation Authority

QC... Queen Counsel

RPB .... Recognised Professional Bodies

ROCE... Return on Capital Employed

RBS .... Royal Bank of Scotland

RMBS.. Residential Mortgage-Backed Securities

SCB .... Standard Chartered Bank

SIB .... Security and Investment Board

SRO .... Self Regulatory Organisations

SWOT .... Strengths, Weaknesses, Opportunities and Threats

TA .... Total Asset

TIBOR... Tokyo Interbank Offered Rate

UBS .... Union Bank of Switzerland

UDT.. United Dominion Trust

UK... United Kingdom

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It would be an understatement to begin to say that this has been one long and winding challenging journey. But as well, it has been a rewarding and an exciting adventure of a lifetime.

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Most of all, I give all thanks to the Lord God Almighty the giver of life, knowledge, wisdom and understanding.

Dedication

I want to dedicate this piece of work to the memory of my late wife, **Funmilayo Adejoke Abolarin,** a companion of many years and an adept English literature teacher who taught me how to write prose.

I take responsibility for any grammatical error that may still be lurking somewhere within the thesis.

Declaration

I confirm that I am aware of Manchester Metropolitan University's policy regarding cheating, plagiarism and all other forms of academic impropriety. I confirm that the thesis submitted is my own original work. No part of it has been submitted for a degree to any other university or institution. To the best of my knowledge this thesis does not infringe upon anyone's copyright nor violate any property rights. I confirm that all sources consulted have been appropriately acknowledged and referenced in accordance with the Manchester Metropolitan University's referencing guidelines. I also confirm that none of the findings was falsified. I am aware that in case of doubt an investigation will be held.

Signature: ……..John Abolarin. Date 6th June 2022...........

Abstract

Although it has been well over ten years since some of the most advanced global economies witnessed an unprecedented financial catastrophe which some banks are still recuperating from their losses, since then a lot has been written about the crisis by academics and more are still going to be written in an effort to see to it that crises on that scale and with such devastating effects are reduced to the barest minimum if not eliminated altogether.

The study evaluated the desirability or otherwise of the ring-fencing policy as a suitable regulatory measure in response to the global financial crisis (GFC) particularly in the circumstances of the Global Systemically Important Banks (GSI-Bs) in the UK.

Through evaluation of the financial accounts of the case studies from 2004 to 2018, the study aimed to determine the varied long-term impacts of the GFC on the performance of four of the largest UK banks chosen as case studies, the Royal Bank of Scotland, Barclays Bank, Standard Chartered Bank and HSBC Plc. Lest we forget too quickly, the study lays out some of the direct consequences and costs of the downward journey of these banks since 2004 – 2018 and the difficult road back to recovery as a lesson on record for the future.

The question is concerned with whether structurally separating ring-fenced banks from their roots and with it, moving away cheap core deposits' funds from the non-ring-fenced banks is serving the best interest of the banking sector and by extension the UK economy or that there are better ways of keeping a rein on the bankers without unduly hurting the financial intermediation capabilities of the GSI-Bs in the UK.

A longitudinal multiple case studies strategy was adopted engaging both qualitative and quantitative methodologies in the data analysis.

The study suggests that a better approach could have been to use legislative powers to stop the banks from engaging in risky speculative investment trading while on application, licences could be given to qualified banks that are interested in incorporating a separate entity that could engage in speculative proprietary trading should they wish to do so. In effect, it is the risky investment elements that should be taken off the mainstream banks not the core deposit accounts.

That way, core depositors' accounts would be protected in the same way that the ring-fencing policy would do. The added advantages are that the cheap core deposits would then be available for the traditional corporate lending where huge multinational corporate customers' financial needs could be catered for. Also, the UK universal banks would have been able to retain their competitiveness in relationship with the other European counterparts that did not adopt the ring-fencing policy.

Chapter 1: General Overview: The Problem, Context, Content and Focus of the Study

1.1 Introduction

This introductory part of the thesis sets out the scene, stating the aims and objectives of the study, the hypothesis tested, the research questions, and the rationale for embarking on the study. It also highlights the wider socio-economic context in which the study situates, defining the area of law visited. Furthermore, it states the importance of the study and the expected contributions to knowledge. It concludes by tabling the structure of the thesis.

Although the study is primarily a doctoral law research, it sits within multiple disciplines including law, socio-economic policy, banking and finance, management and it engages with key financial accounting tools required to analyse the annual reports and financial accounts of the banks that were chosen as case studies for the research.

The research topic raises the point that there is a fine balance between safeguarding the economy by using legal restraints on banks and at the same time, it emphasises the importance of refraining from stifling creativity in the management of banks' funds through over regulation. Creativity in the sense of the discretion and options available to banks' management to resourcefully invest banks' funds at their disposal in order to increase the wealth of the beneficial owners of banks and generally, to assist in growing the economy.

The challenge that banks' regulators are thus faced with is the tension between the duty to protect the public against greed and recklessness on the part of the bankers who may be prone to taking undue risks in managing depositors' funds while at the same time, there is an understanding that the public interests are better served when the financial intermediation capabilities of banks are not unduly fettered by over-regulation [[1]][[2]].

Banks are increasingly recognised as the engine that drives the economy and the most important source of external funding needed to grow businesses and the

[1] J. Sinkey, 'Commercial Bank Financial Management 5th Ed' (Prentice- Hall, 1998, P. 13)
[2] D. Hillier, et al, 'Financial Markets and Corporate Strategy, 2nd European Ed' (McGraw-Hill, 2012, P. 4)

economy.[3] Given the importance of the banking sector to the economy therefore, rightly so, it is also held to be one of the most regulated institutions in the world.[4] Guiso, et al argued that there is a rational justification for government's intervention through regulation where there are incessant bank failures.[5] Persaud and Barth et al also extensively discussed the justification for government intervention through regulation based on a need for consumers' protection and mitigation against systemic risks.[[6]][[7]]

That said, since the new wave of the free market capitalism latterly promoted by Friedman and which took roots in the 1970s, some have argued that banking regulation took on a damaging laissez-faire approach which may have culminated in the global financial crisis in 2007 - 2009 [[8]][[9]]. Yet others argued that the era of the free-market economy policy ushered in a period of unprecedented prosperity since the end of World War II.[10] Doubtless, a contributory factor may have been due to the less restrictive regulation at that time which tacitly allowed high leverage (low equity ratio to high debt) in the banking sector and what appeared to be an abundant supply of cheap depositors' funds at that time which subsidised bank lending operations. [[11]][[12]]

The question then is, when could it be said that a particular piece of regulation has crossed the borderline transforming from being a necessary protective firewall meant to shield and alleviate the costs of taking undue risks into a law that has become an inhibitor of progress? Overregulation in this context refers to a situation where there are too many laws and regulations some of which are not really necessary because they are not adding justifiable value and their presence are rather hindering productivity and facilitation of trade and commerce.

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[3] F. S. Mishkin, et al, 'The Economics of Money, Banking and Financial Markets', (Pearson Educational, 2013, p. 151)
[4] Ibid (S. Mishkin et al)
[5] L. Guiso, et al., 'The Cost of Banking Regulation', National Bureau of Economic Research Massachusetts Cambridge, Working paper 12501, (2006).
[6] A. Persaud, 'Reinventing Financial Regulation: A Blueprint for Overcoming Systemic Risk' (Apress Publishers, 2015)
[7] J. Barth et al 'Rethinking Banking Regulation' (University Press, Cambridge, 2006)
[8] M. Friedman, 'Capitalism and Freedom' (University of Chicago Press, 1962)
[9] K. Popper, 'The Open Society and Its Enemies' (Princeton University Press, 1994)
[10] Please see page 145, Fig. 1 Gross Domestic Product 1948 – 2016 and Table 2 at page 146
[11] R A Admati, 'The Compelling Case for Stronger and More Effective Leverage Regulation in Banking' (2014) Vol. 43 (2) The Journal of Legal Studies.
[12] J. Cullen, 'Executive Compensation in Imperfect Financial Markets' (Edward Elgar 2014) p. viii

Generally, academics are not always united in their views on the effectiveness and adequacy of the law and regulations in the banking sector. Whilst some concluded that the banking sector was in fact already over regulated, others are of the view that more laws are still needed to stem the recklessness in the banking sector [13][14][15]. Writing in 2013, Baber was of the view that, given the economic contributory factors to the global financial crisis in 2007 – 2009, the regulatory response to the crisis may be inadequate.[16] Admati faulted the range of laws and regulations that existed before the 2007 – 2009 global financial crisis on the basis that the then existed regulatory architecture and with time, attempts to reform it failed to pay a well-deserved attention to the problematic issue of inadequate equity-cum debt ratio which she opined was prevalent within the banking sector.[17] She further contended that dealing with the thorny issue of high debt/equity ratio is central to maintaining stability in the banking sector and by extension, the economy.

Yet others advocated for caution, pointing out that the crisis in 2007 – 2009 was not a result of failure in the then prevalent regulation alone but the fault is partly shared by the ineffective supervisory strategies adopted by the regulators who were believed to have often failed to identify difficulties in the financial system ahead of their occurrence or sometimes failed to respond quickly enough when difficulties were spotted [18][19].

1.2 The Aims of the Study

The study evaluated the desirability or otherwise of the ring-fencing policy serving as a suitable regulatory measure in response to the global financial crisis (GFC) particularly in the circumstances of the Global Systemically Important Banks (GSI-Bs) in the UK. It has been about ten years after the GFC occurred in 2007 – 2009 and seven years after the enactment of the Banking Reform Act 2013. Through evaluation of the financial accounts of the case studies from 2004 to 2018, the study

[13] C. Goodhart et al. 'Financial Regulation or Over Regulation' (Institute of Economic Affairs, 1988)
[14] A. Hudson, 'Banking Regulation and Ring-fence' (2013) 107, 1 – 23 Compliance Officer Bulletin
[15] T. Arthur and P. Booth, 'Does Britain Need a Financial Regulator?' (The Institute of Economic Affairs, 2010)
[16] G. Baber, 'A Critical Examination of the Legislative Response in Banking and Financial Regulation to Issues' (2013) Vol 20 (2), 237 – 252. Related to Misconduct in the Context of the Crisis of 2007 - 2009
[17] Op. Cit., A. Admati (n. 11)
[18] A. Arora, 'The Global Financial Crisis: A New Global Regulatory Order?' (2010) 8, 670 – 699, Journal of Business and Law.
[19] Verrill, L. 'Regulation Hit the Rock?' (2008) 21 (1), 16 Insolvency Intelligence.

aimed to determine the varied long-term impacts of the GFC on the performance of four of the largest UK banks chosen as case studies. Lest we forget too quickly, the study lays out some of the direct consequences and costs of the downward journey of these banks since 2004 – 2018 and the difficult road back to recovery as a lesson on record for the future.

The stated aim of the study acknowledges that the global financial crisis had some long-term detrimental impacts on the financial performance in the banking sector. It also underscores the importance of the long-term effects of the other regulatory responses designed to reduce the consequences of likely financial crises in the banking sector into the future.

The global financial crisis has often been described as the worst of its kind in modern history. To forestall a total collapse of some of the UK's banks classified as Global Systemically Important Banks mostly affected by the crisis, the government was constrained to commit bailout packages which peaked at £1.162 trillion (including pledged cash support of £612.58 billion but which later reduced to £456.33 billion) as at 31st March 2010.[20] Out of these pledges, the government provided £123.92 billion in loans and shares acquired with cash transferred to the banks that took the government bailout.[21] Further, the government undertook a contingent liability wherein the government promised to provide cash support of up to £323.40 billion in the likely event that the need arose for the banks requiring additional cash support at a future date.[22]

Thus, the study evaluated the annual financial accounts of some of the largest UK banks that their collapse could have had the most damaging consequences not only to the UK economy, but also to the global economy. The banks in this category chosen as case studies are, RBS, Barclays, Standard Chartered Bank and HSBC Holdings Plc.

[20] National Audit Office, 'HM Treasury, the Comptroller and Auditor General's Report on Accounts to the House of Commons (July 2011) NAO Report: The Treasury's 2010-11 Accounts: the financial stability interventions
[21] Ibid.
[22] Ibid.

In order to appreciate the extent of the knock-on effects of the hard free fall that some of these banks had, the study evaluated fifteen years annual financial accounts of the banks mentioned from 2004 – 2018. It highlighted the extent of losses incurred, the consequences of the inability of some of the banks to pay dividends which in some cases spanned about ten years, a resulting huge redundances in some of the banks and the negative impacts on the wealth of the equity owners of the banks.

Over the period evaluated, thirteen Key Performance Indicators (KPI) were extracted from the annual financial accounts of the case studies. Among others, these include Operating Profit Before Tax, Operating Income, movements in the Total Assets, Earnings Per Share, Dividend Per Share, the state of the Liquidity Ratios of the banks, number of employees engaged over time, Annual Impairment Charges, Insurance Income, Earnings from Investment Banking and some other performance indicators discussed in Chapter 4. Some of the Key Performance Indicators chosen are markers of sensitive response to cost, asset accumulation or, reduction thereof and factors that had overall effects on the earning capacity of the banks chosen as case studies. Each of the KPIs selected has its own story to tell about the reasons behind the increase or decrease in the profitability of the case studies. This is amply discussed in chapter 4. Importantly, the study also evaluated legislative measures made at both national and supranational levels in response to the global financial crisis. These were designed to encourage stability in the banking sector through enhanced capital requirements, improvements in the liquidity ratio, enhancement of assets' quality and generally, to reduce the need for taxpayers funded bailouts to the banks in the future.

In the case of the UK, in addition to the need to follow the regulations imposed on the banks at international level, the ring-fencing policy was enacted into law which came into effect from 1st January 2019. The ring-fencing policy is an aspect of the protective measures introduced into the Financial Services (Banking Reform) Act 2013 following the financial crisis of 2007 - 2009.[23] While the Banking Reform Act was enacted into law on 18th December 2013, preparation for compliance with the policy was ongoing with mandatory compliance from 1st January 2019.

[23] Banking Reform Act 2013, Part 1 (2), (i) & (ii)

In effect, the affected banks had six years moratorium period to become ring-fencing policy compliant.

The effect of the legislation is to separate core depositors' accounts from risky investment banking activities in a non-ring-fenced bank into a safe ring-fenced bank. This would have the effect of preventing the banks from using insured core deposits to fund investment activities. From the effective date of the policy, core depositors' accounts were removed into a separate ring-fenced bank within the group so that in the event of any difficulty arising from the non-ring-fenced bank, the adverse effects of it will not spill over to the separate entity ring-fenced. It is held that this arrangement would make bailout of banks by the government less likely and avoid disruptions in the payment system within the economy if there arose difficulties in the non-ring-fenced bank.

These legal changes introduced into the banking sector are usually referred to as systemic risks (undiversifiable market risks) common to the participants in the banking sector. Undiversifiable market risks refer to macroeconomic factors that generally affect the profitability of all the market participants. Examples of such factors include changes in interest rates, taxation, legal requirements, inflation, and a natural disaster. [24][25] These factors are termed "Undiversifiable risks" because they are unavoidable. Market participants can only respond to mitigate the negative impact that they can come with. The ring-fencing policy affected the banks in the case studies differently as explained in Chapters 4 & 5 of this report.

Although the regulatory changes affected the banking sector generally, some banks had more difficulty dealing with the ensued challenges, while others thrived in the midst of it because they were more proactive and better equipped to respond to the challenges than others. Examples include HSBC and the Standard Chartered Bank discussed in Chapters 4 & 5.

Importantly, the study helps us to appreciate how other issues including the varied circumstances of each of the banks such as their sizes, business strategies, their market environment, leadership in the banks and the extent of their respective exposure to the American subprime securities affected the banks in different ways.

[24] C. Drury, 'Management and Cost Accounting 6th Ed' (Thomson, 2004, p. 563)
[25] G. Arnold, 'Corporate Financial Management, 3rd Ed' (Prentice-Hall, 2005)

HSBC Bank Plc, RBS and Barclays were listed as part of the Global Systemically Important Banks[26] by the Financial Stability Board (FSB) in 2011,[27] but eight years later, RBS fell out of the list due to massive reconstruction that had taken place in the bank.[28] The huge size of these banks during and after the crisis led to concern about the likely consequences to the economy of a possible collapse of any of these huge banks that was rated as one of the Global Systemically Important Banks. In the period leading to the global financial crisis in 2007 – 2009, each of these banks had total assets of more than £2 trillion except the Standard Chartered Bank. The huge size of these banks led to the concern that the collapse of any of them could lead to irreparable damages in the economy and capable of triggering crisis at the international level. [[29]][[30]][[31]]

This concern was real. As much as possible, part of the concerted efforts of the international community to forestall future government bailouts focused on ensuring that banks are resilient and capable of weathering future financial crises with little or no assistance from the public.[32] The need to shore up confidence in the banking sector by boosting its soundness, stability, equity capital and liquidity became more imperative.

1.3 Ring-fencing in Brief

The ring-fencing policy relates to a structural separation of core depositors' accounts from non-ring-fenced banks that undertake investment banking activities. This serves to prohibit the use of core depositors' funds in the risky investment banking division of banks considered to be GSIBs thereby protecting core depositors' funds and to

[26] C. Hofmann, 'Global Systemically Important Banks (GSIBs): Operating Globally, Regulated Nationally?' (2017) 2, (155- 179) Journal of Business Law.
[27] Financial Stability Board, 'Policy Measures: List of Global Systemically Important Banks', (2011)
[28] Financial Stability Board, 'Policy Measures: List of Global Systemically Important Banks', (2019)
[29] Royal Bank of Scotland, 'Annual Report and Financial Account' (2008, p. 175) – Total assets as at 31/12/2008 was £2.4 trillion. This figure has been criticised as over inflated
[30] Barclays Plc, 'Annual Report and Financial Accounts' (2008, p. 205) – Total assets as at 31/12/2008 was £2.05 trillion. This was also criticised as over inflated.
[31] HSBC Holding Plc, Annual Report and Financial Accounts' (2008) p. 1
[32] E. Ligere, 'Legislative Comment, The Future of Banking in the EU' (2014), 29, (5) 308 – 311, Journal of International Banking Law and Regulation

minimise the impact of the risk of systemic failure on the economy as a result of failure arising in the investment banking arm of a banking group.[33]

It is only banks that have average total of £25 billion core deposits over three consecutive years that are required to be compliant with the ring-fencing policy.[34]

Part of the objectives of the policy is to ensure that there are adequate plans in place for a controlled and orderly winding down of any of the big banks that may run into difficulties and as much as possible, to avoid ripple effects on the other banks. [35] This serves to enable the ring-fenced bank to continue to carry on undisturbed core banking activities in compliance with the ring-fencing policy. [36]

An important effect of the ring-fencing policy is that, by separating a ring-fenced bank from the investment banking arm of a group, the chances of a disruption that arises in the financial system affecting the retail banking services especially the payment system would be largely reduced.[37] The separation between the ring-fenced entity and the non-ring-fenced arm of a group also means that a need to use taxpayers' money to fund bailout and a need for the government to pay crystallised contingent liability under depositors' guarantee scheme are obviated assuming there were difficulties in the non-ring-fenced arm of the group only.

Ring-fenced banks are prohibited from dealing as a principal in risky investment banking services except where exempted.[38] The implication is that ring-fenced banks would only be able to act as agents on behalf of non-ring-fenced bodies regarding those aspects of investment banking services. Generally, RFBs are prohibited from dealing in commodities except when dealing in commodities is required for own use or consumption.[39] RFBs are allowed to securitise own assets and use derivatives for risk management purposes.[40] Ring-fenced banks may carry

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[33] Op. Cit., Banking Reform Act 2013, (n.23)
[34] Financial Conduct Authority, 'Ring-fencing: Guidance on the FCA's Approach to the Implementation of Ring-fencing and Ring-fencing Transfer Schemes (2015) Guidance Consultation 15/5
[35] Banking Act 2009, s.1, ss (2) (3)
[36] FSMA 2000 Part VII Banking Business Transfer Schemes s.106 B (3)(a)
[37] Banking Reform Act 2013, Article 142 B s.4(b) "To protect the continuity of the provision in the UK of Services provided in the course of carrying on the regulated activity of accepting deposit"
[38] Statutory Instrument 2014/2080 FSMA 2000 (Excluded Activities and Prohibitions) Part II Article 4.
[39] Ibid. Part II Article 5 (2)
[40] Ibid. Part II Article 7 (2) & Article 9

out corporate banking services, structured finance and traditional core banking activities.[41]

Restrictions are placed on ring-fenced banks from providing facilities to financial institutions, branches, and subsidiaries outside the EEA.[42] The rationale for all these restrictions is that transactions of this kind would subject RFBs to more difficulties in the likely event of a need to wind down a non-ring-fenced entity in a group or a subsidiary that are outside the EEA. This is if the ring-fenced bank was exposed to such non-ring-fenced arms of a group. Groups with RFBs are allowed to use similar brands if desired. Data sharing within a group that has a RFB is also allowed provided this provision does not lead to an outcome where there is a misleading impression of whether a group member is ring-fenced or not.[43]

As observed by Goodhart, an equally important implication of the ring-fencing policy is that the non-ring-fenced part of a group will suffer disadvantages relating to more expensive and difficult funding conditions for itself and for large customers.[44]

A matter of particular concern is that the UK universal banks may likely face adverse competition because of the inability of the non-ring-fenced arm to have access to cheap depositors' funds, unlike their European counterparts that are not faced with similar restrictions. The issues raised in this section are elaborated on under the literature review Section E, paragraph 2.38.

The notion of ring-fencing retail banks as stated on the preceding page was initiated by the UK government as part of new regulatory measures in response to the financial crisis in 2007 - 2009. It is an important component of the UK's regulatory response to the financial crisis in 2007 – 2009. So far, there is no other nation that is known to be following in the footsteps of the UK in this regard. While it is recognised that these are still early days following the implementation of the legislation from 1st January 2019, the research aimed to determine whether there are any potential detriments to the UK banks, bank customers and by extension the economy arising from the ring-fencing policy which may be strong enough to call for a policy review in the near future. It is hoped that this study will inspire other researchers and bank regulators to take a keen interest in the subject so that

[41] Op. cit. Statutory Instrument 2014/2080 (n. 38)
[42] Op. Cit., Ring-fencing Guidance para. 1.6 (n. 34)
[43] Ibid.
[44] C A. Goodhart, 'The Vickers Report: An Assessment', (2012) Vol. 6 (1), Law and Financial Market Review.

performance in the banking sector is kept on the radar in the next decade following the implementation of the policy. This is to determine in the ensuing years whether there are avoidable adverse effects on banks' performance and notable significant disadvantages to banks' customers that have a causal link to the policy on ring-fencing which should call for regulatory changes.

1.4 Research Objectives

The research objectives are concerned with defining and setting limits on the evidence used in the study.[45] It focuses on how the planned processes led to discovering the aims of the study. These are elaborated on in chapter 3 on methods and methodology.

Thus, the researcher undertook the following exercise to be able to achieve the aim of the study stated earlier.

(i) (a) as a background to the study, a review of extant literature was undertaken on the causes of the global financial crisis in 2007 – 2009,

(b) a review of the prevalent laws and regulations that existed before the financial crisis in 2007 – 2009 was undertaken to determine whether there were gaps in the laws and supervisory regimes then which may have contributed to the crisis. Also, a review of the newly introduced changes to the laws after the global financial crisis were conducted, evaluating their impact on the banking sector,

(ii) a theoretical critique of ring-fencing policy was conducted as it applies to the UK banking sector and against the backdrop of the UK's core competencies in the provision of financial services, a sphere in which the UK has comparative and competitive advantages.

Core competence is a term borrowed from business management which refers to cultivated or learnt specialist's skills, knowledge, expertise, capabilities, and

[45] M. Saunders, et al. 'Research Methods for Business Students 5th Ed'. (Pearson Education, 2009, p. 10)

attributes that can become a critical success factor in the management of an organisation in a rapidly changing business environment as happened in the aftermath of the global financial crisis,[46]

(iii) an evaluation was conducted of the effectiveness or otherwise of the ring-fencing policy as measures that are capable of deterring financial crises in the future, and

(iv) using the case studies approach, the annual financial accounts of RBS, Barclays, SCB, and HSBC Plc between 2004 – 2018 were evaluated to determine the impact of the global financial crisis on the performances of these banks over the period stated and impact of the new regulatory changes. This exercise aids our understanding of some of the direct costs of the downward journey of these banks in the period evaluated and the difficult road back to recovery as a recorded lesson for the future.

1.5 Research Questions

The research questions include, what are the likely benefits of the regulatory changes? Are there any aspects of the changes in the regulation that may have the potential to hurt the banking sector and the economy in ways that were not intended?

There is also the question of whether the ring-fencing route is appropriate in the prevalent circumstance of the UK. Or perhaps, there are other equally or even more effective ways of safeguarding the economy without unduly stifling creativity in managing the vast resources that are placed in the hands of the bankers for the benefit of the economy. It is without a doubt that there is a public interest justification for regulating the banking sector in certain ways to protect the economy.

Arguably, there are good economic reasons to support competition law, discouraging unhealthy monopoly situations in the banking sector.[47] On the other hand, this study raises the question on whether the UK is insidiously reverting to the discredited protectionist ideology of the Bretton Woods era, or perhaps, could it be the case that

[46] L. J Mullins, 'Management and Organisational Behaviour 11th Ed' (Pearson Education, 2016)
[47] A. Jones and B Suffrin, 'E C Competition Law 3rd Ed' (Oxford University Press, 2008)

the ring-fencing policy is going to prove to be one of the regulatory models that would ultimately be the panacea to myriad problems that were notable in the banking sector in the years preceding the catastrophe of 2007 – 2009?

Concern over reversion to protectionism ideology discussed in Chapter 2 is very real among bankers. For example, the Chairman of HSBC Group, Mark Tucker voiced out this fear when in 2017 he said,

> "*The threat of protectionism and a lack of inclusive growth all have the potential to disrupt economic activities*."[48]

1.6 Research Hypothesis

The hypothesis being tested: "Notwithstanding some benefits that may accrue from the ring-fencing policy, the banking sector and by extension the economy in the UK may likely face long term detriments arising from the implementation of the ring-fencing policy".

This researcher contends that the long-term effects of the ring-fencing policy need revisiting and objective evaluation. This is essentially what this research is about.

The research hypotheses and questions were derived from the literature review around the subject area.

1.7 The Importance of the Study

What is the significance of this study? Why is it important? Why would the outcome of the study matter to anyone?

The study would be important to the banking and law academics, banking sector regulators, supervisory authorities, policymakers in the government, and the public at large.

[48] HSBC, Annual Report and Financial Accounts, (2017, p. 5) – Mark Tucker was then the incoming Chairman of the bank.

This is because the study underscores the importance of the banking sector to the economy as the facilitator of wealth creation, helping in mobilising funds from individuals, corporate bodies and the public generally thereupon lending the funds thus gathered to borrowers to grow their businesses. This emphasises the financial intermediation role of banks and its pivotal position as the lever that turns the wheel of progress. This is by no means the sole purpose of the banking sector's existence.

Banks serve wide-ranging customers including small savers, salary earners, sophisticated investors, businesses and multinational corporations. In their role, banks generally facilitate payments for transactions on sales of goods and services between people and organisations dispensing with the need to carry cash about and notwithstanding the different geographical locations of the parties in the transaction.[49] Due to the huge capital outlay required to buy a home, most people would not have been able to afford to buy a home of their own in a lifetime without the assistance of a bank.

Given the important roles of the banking sector to the society, assorted stakeholders mentioned earlier would be interested in knowing that the financial intermediation capacity of the banking sector is not unduly hampered and that the banking sector is generally safe and stable. Potentially, this study may help to identify fault lines in the regulatory and supervisory architecture if there are any.

There is a recognition that an ailing banking sector could mean loss of jobs across the board within the economy where credit facilities may become scarce, as was the case during the global financial crisis in 2007 - 2009.[50] It could mean limitations on the availability of mortgage facilities thus pushing up prices in the housing market. Difficulties in the banking sector could trigger high costs of banking services in terms of bank charges. It could lead to instability in the economy as was the case in the ensued violent protests in Greece, Ireland, Portugal, and Spain for example, when unemployment and liquidity problems threatened people's sense of security in the wake of the 2007 – 2009 financial crisis. [51] Dislocation in the banking sector could worsen standards of living. In the worst-case scenario, failure in the banking sector and general economic hardship could ultimately precipitate a change of the government in power if the public believes that the government has become inept at

[49] A. Salz, and R. Collins, 'An Independent Review of Barclays' Business Practices' (Barclay Plc, 2013)
[50] D. Murphy, 'Unravelling the Credit Crunch' (CRC Press Taylor and Francis Group, 2009, p 28)
[51] ibid

managing the economy. Thus, a collaborative effort is required to ensure that the banking sector in the UK is healthy and thriving in the best interests of all.

There are two sides to the hard and long debates on the regulatory changes in the wake of the global financial crisis and thereafter, especially concerning the ring-fencing policy on imposed structural reform. As exemplified by Goodhart, Haynes, Campbell and Moffatt, the underlying assumption in the literature is that the policy on ring-fencing may perhaps be excessively costly to the banks and large corporate customers. [52][53][54]

The costs mentioned by these authors relate to one-off establishment costs of the ring-fenced banks. In addition, there are myriads other running costs including those related to additional heightened burden of compliance with supranational laws, regulatory fees, higher costs of compliance, costs of legal advice relating to what the new laws might mean and how they would affect the banks, hiked operation and transaction costs to the bank and their large customers.

In July 2013, while consultations were still ongoing regarding evaluation of available options on what to do to resolve the issue of 'too big to fail', through the HM Treasury, the UK government released a document on the monetised full economic impact and the cost implications of the adoption of the ring-fencing policy or its forbearance, not adopting the policy.[55] On pages 77 & 78 of the document, Option 1 relates to refraining from adopting the ring-fencing policy, in which case, there would be no additional direct or indirect cost to the economy provided there were no financial crises.

The Option 2 relates to implementation of the ring-fencing policy. It was estimated that the monetised costs to the main affected groups annually would be:

- Direct private costs to UK banks - about £1.7 billion - £4.4 billion annually
- Indirect cost on GDP about £0.4 billion - £1.9 billion annually
- Reduction in tax receipt about £150 million - £690 million annually

[52]Op. Cit., C. Goodhart, 2012, (n. 44).
[53] A. Campbell and P. Moffatt, 'Bank Insolvency: The Introduction of Ring-fencing in the UK: An Example to be Followed?' (2019) 4, 241 – 261 Journal of Business Law
[54] A. Haynes 'Banking and Financial Services Regulation' (2016) 37 (9) 265 – 266, Company Lawyer
[55] HM Treasury, Department for Business Innovation & Skills, 'Banking Reform: Draft Secondary Legislation' (2013)
https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/223566/PU1488_Banking_reform_consultation_-_online-1.pdf

- The assumed benefits of adopting the ring-fencing policy stated in the document are (i) greater financial stability (ii) reduction on the likelihood of government providing bailout as crises become less frequent and severe (iii) reduction in implicit subsidies to the huge banks and reducing probability of future crises by 15% which would generate annual benefit of £7.1 billion.[56]

These were the estimated costs and benefits of the ring-fencing policy computed in July 2013. Since the implementation of the ring-fencing only began in 2019, we do not have full record or data to see what the actual costs are.

Campbell and Moffatt's contention is that, given the improvement in the prudential regulation since 2009 after the crisis and the ongoing efforts directed towards recovery and resolution efforts in the banks following the global financial crisis, which arguably have led to significant improvement in the stability of the banks, they do not see how the enormous cost of ring-fencing can be justified.[57]

Hofmann sees it differently on the basis that the cost is worth it. The argument is that even though the costs of implementation of the ring-fencing policy may be expensive, the cost is worthwhile because it would be far lower than the costs of a rescue package where there is a bailout situation after a possible financial crisis.[58]

The outcome of a research previously conducted by Barth *et al* suggests that banks tend to be stronger and more stable when they have broad powers to diversify income sources. They argued that with bigger resource bases and wider investment outlets, banks can make the most of economies of scale thereby enjoying a reduction in the cost of capital and ultimately leading to better services to the economy.[59]

Considering the principle in Bart et al and Goodhart's proposals, the implication of the ring-fencing policy to the banking sector and especially to the huge conglomerate bank customers in dire need of huge capital outlay is the additional difficulty they may have searching for multiple sources of finance to meet funding needs since an important part of cheap funds previously available to a universal bank are now ring-fenced.

[56] Ibid.
[57] Op. Cit., Campbell and Moffatt 2019, (n. 53).
[58] Op. Cit., C. Hofmann, 2017, (n. 26).
[59] Barth et al, 'Bank Regulation and Supervision: What Works Best?' (2004) Vol 13 (2) 205 - 248

Although the ring-fenced part of the group can perform corporate lending, what the group will be missing out on is the reduction in costs of administration afforded by the economies of scale if there were no separation between the ring-fenced and non-ring-fenced parts of the group.[60]

The rationale behind the policy to restructure the banking sector as stated in the Banking Reform Act 2013 is an attempt to mitigate the adverse effects of future financial crises in the economy. This is especially so in light of concerns that some of the financial institutions in the UK such as the Royal Bank of Scotland, HSBC Plc, and Barclays Bank for example have over the years grown so big, such that if any of these financial institutions were faced with a crisis, they are considered to be too big to fail and too big to rescue without government's intervention, and if any of them were inevitably allowed to collapse, the impact of such liquidation could substantially damage the economy [[61]][[62]].

Thus, in the likely event of a financial crisis, the government would be forced to provide expensive bailouts, as happened in the wake of the last global financial crisis.

The problem this research is concerned with is to examine regulatory responses to the crisis and to determine whether the concept of ring-fencing is indeed in the best interests of the economy or that that part of the banking law is a disproportionate response that went far beyond what is necessary to safeguard the economy given that competitors in Europe that are of similar size are not faced with the restrictions imposed through the ring-fencing policy.

It is argued that the UK occupies a unique position that gives the country an edge, comparative and competitive advantages which make the UK stands tall above most other nations of comparable status on the world stage.

These comparative and competitive advantages include: the strength of the pound sterling and its attractiveness as a store of wealth for foreign investors and international governments that are willing to keep their nation's reserves in the UK; London is persistently rated as the leader among the world's leading financial

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[60] Op. Cit., C. Goodhart, 2012, (n. 44).
[61] I. Moosa, 'The Myth of too big to fail' (2010) 11 (4), 319 – 333, Journal of Banking Regulation
[62] R. Nattrass, 'The Too Big to Fail Problem: Fault Lines Open UP' (2010) 6 (353) Journal of International Banking and Financial Law

capitals;[63] United Kingdom's famed expertise in law; provision of financial services, wealth management facilities; her recognition as a nation of astute innovators; abundance of entrepreneurial spirit in the UK; the importance of English language as a medium of communication worldwide; the UK's political clout and soft power influence that cuts across the globe starting with allied nations such as America through to the commonwealth countries covering more than half of the world population; and, influence arising from historical alliances formed over a period spanning more than 200 – 300 years or so.[64]

This thesis argues that not many nations of comparable status as the UK combine all these attributes. In the circumstances of the UK, the fruits of these unique attributes are that they naturally attract funds and investors to the UK.

The application of the ring-fencing policy implies that part of the funds thus generated would be held in the non-ring-fenced body of a group whilst the other part of the funds would fall within the ring-fenced retail bank. By splitting up total available funds in this way, the capacity of both entities providing financial assistance to some of the largest multinational corporations and other huge institutions would be largely curtailed.

The argument is that, even where ring-fenced retail entities can perform corporate lending within the scope of funds available to them, there would be limitations as to how far they can assist huge conglomerate organisations with equally huge needs for financial assistance. For example, the extent to which ring-fenced banks can lend will among other factors be determined by the value of equity capital and liquidity they hold to support their lending as a separate legal entity. Just like every other bank, ring-fenced banks will need to build up their equity capital base over time.

These limitations could have been reduced if not avoided altogether had it been that it was only the risky investment arm of a bank that was removed instead of the other way round where core depositors' funds were removed from the mainstream bank. If the risky investment elements of a bank are removed, licences could then be given to qualified banks that are interested in incorporating separate companies that could engage in speculative proprietary trading, commodity trading and swap deals should they wish to do so. In effect, it is the risky investment elements that should be

[63] Z/Yen, 'The Global Financial Centre Index 22' https://www.longfinance.net/media/documents/gfci_22.pdf
[64] P. Mathias, 'The First Industrial Nation: The Economic History of Britain 1700 – 1914' (Routledge, 2001)

taken off the mainstream banks not the core deposit accounts. That way, core depositors' accounts would be protected in the same way that the ring-fencing policy would assist to do. The added advantages are that the cheap core deposits would then still be available for the traditional corporate lending where huge multinational corporate customers' financial needs could be catered for. Availability of the cheap depositors' funds would also assist in sustaining mortgage accounts that has very low yield to the banks. Also, the UK universal banks would have been able to retain their competitiveness in relationship with the other European counterparts that did not adopt the ring-fencing policy.

As well, this researcher contends that the financial sector encompasses banking, securities, the stock market, pension funds, insurance, credit card service providers etc. These subsectors have a symbiotic relationship, depending on one another. The point is that although the ring-fenced banks have the capacity to provide both corporate and retail banking services, by separating banks along ring-fenced and non-ring-fenced bank, the ring-fencing policy limits the support that comes from the ring-fenced banking to the entire financial system. This is because, to some extent, restrictions are placed on the ring-fenced banks from providing facilities to financial institutions, branches, and subsidiaries outside the EEA.[65] That prohibits RFB from supporting NRFB if they ran into difficulties.

The argument is that in addition to increasing equity capital and liquidity ratio, what the banking sector needs are effective monitoring and compliance regime. The absence of that effective monitoring system was attributed to being one of the primary causes of failure in the banking sector in the past.[66]

If the hypothesis in this study proves to be true, other researchers may take up an interest in this area of study, using different methods and methodology to test the same hypothesis. The collective efforts of such work may hopefully spearhead a policy change in the near future if it is considered desirable.

[65] Op. Cit., Financial Conduct Authority, 2015, (n. 34).
[66] Op cit., L. Verrill. (n. 19)

1.8 The Context of the Study: The Fallout of the 2007 – 2009 Global Financial Crisis

The global financial crisis in 2007 – 2009 was remarkably a monumental catastrophe[67] that at the time precipitated a general sense of deep concern and brought home the reality of potential harm that could arise in the economy when there is a failure in the banking sector.

Although the financial crisis happened more than ten years ago, issues around the crisis are still gaining currency. For example, attention towards those issues is accentuating given that the deadline for the full implementation of the Financial Services (Banking Reform) Act 2013 slated for 1st January 2019 is now with us. As well, in relationship to the existing collaborative efforts of the European Union to reduce the prospect of global financial crises, no one seems to be sure of how the exit of the UK from the European Union will unfold in the years ahead. Thus, discussion around stability in the banking sector as in other sectors is once again heightened.[68]

At the national level, the financial crisis led to assorted curative and preventative measures including nationalisation of banks where it was considered appropriate, provision of financial rescue packages and an increase in deposit guarantee schemes to safeguard depositors' interests.[69] There were also collaborative responses from closely linked economies. Part of the UK government's responses to the global financial crisis includes the introduction of the Financial Services (Banking Reform) Act 2013 with part of its provisions to be implemented by all affected banks on or before 1st January 2019 as stated earlier. The legislation is a comprehensive enhancement on the FSMA Act 2000. The changes introduced are discussed in Chapter 2.

The other side of the coin is the legitimate concern of the government over the huge losses and the resultant expensive bailouts during the financial crisis that may have prompted the government to take whatever step that may be deemed necessary to forestall future crises.

[67] F.S Mishkin, and S. G Eakins, 'Financial Markets and Institutions 7th Ed' (Pearson, 2012, p. 211)
[68] R. Plato-Shimar, 'Principles of Financial Regulation' (2018) 33 (3) 108 – 110. Journal of International Banking Law and Regulation
[69] Directive 2014/49/EU of the European Parliament and of the Council on Deposit Guarantee Scheme

Whilst news about regional banking failure and localised financial crises are not new in themselves,[70] the unique features of the 2007 – 2009 crisis are that it was global, it was nearer home, in fact, too close home for comfort. For example, in the UK, Northern Rock was the first casualty in a run-up to the events leading to September 2007 when the Northern Rock finally capitulated. Iceland had a taste of the bitter pill as one of its banks, Glitnir Bank went into receivership in September 2008.[71] The whirlwind that the financial crisis brought across Europe was such that hardly was any European State remained completely untouched.

In the past hundred years or so, there have been different waves of financial crises of varying degrees of intensity, such as the 1929 financial crisis in America[72], the debt crisis of the 1980s in Latin American countries especially Mexico, Brazil, and Argentina, and the financial upheaval of the emerging markets in the 1990s.[73] However, the immediate past financial crisis in 2007 – 2009 has been rated as one of a kind in terms of global spread, the magnitude of losses incurred by banks, and the unprecedented impact on national economies worldwide. The scale of the losses incurred by banks then was measured in trillions of dollars which gave genuine reasons for deep concern.[74] Some of the fallouts of the crisis then included bank failure, job losses, credit crunch, expensive financial bailout of banks aimed at stabilising the economy and stinging austerity measures that inspired public outrage. Whilst some financial institutions were rescued at an unprecedented cost, the collapse of others such as Lehman Brothers and Bear Stearns became inevitable.[75]

Huge losses were sustained especially concerning Collateralised Debt Obligations and hedge funds.[76] Following the crisis, the prospect of widespread unemployment as high as it was after World War II[77] triggered violent protests in Greece and France and it created a state of unrest in Ireland. Icelandic banks shared in the fallouts of the crisis as mentioned earlier. Royal Bank of Scotland and Lloyd Group found themselves in the eye of the storm as it were.

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[70] G R Hubbard, 'Money, the Financial System and the Economy 4th Ed' (Addison Wesley, 2002, p. 364) In the late 1990s, Russian States and Asian countries had serious financial crises so also was America in the 1930s
[71] S. Valdez and P. Molyneux, 'An Introduction to Global Financial Market 8th Ed' (Palgrave 2016, p 289)
[72] H. Kaufman, 'Financial Crises: Market Impact, Consequences, and Adaptability' (John Wiley & Sons, 1977, p.153)
[73] J O Joyce, 'The IMF and Global Financial crises' (Cambridge University Press, 2013)
[74] C. R Morris, 'The Trillion Dollar Meltdown' (Perseus Books, 2008)
[75] Op. cit., D. Murphy, p 28, (n. 50).
[76] Op. cit., C R Morris, 2008, (n. 74)
[77] J Galbraith, 'The Great Crash 1929' (Penguin Books, 1954)

While it is one thing to be supportive and commiserate with others in faraway places where they often experience one financial crisis after the other, it is a different scenario when this time around, the crisis is in one's own backyard. One of the foremost issues highlighted by the 2007 - 2009 global financial crisis which originated in America and mostly affected the world-leading industrialised nations that taught the world good banking practices is that no region in the world is immune to financial crises. The crisis also emphasised the reality of a contagion effect, how closely allied economies can be affected by difficulties they had no hand in creating. The crisis more than ever brought home what failure in the banking sector can potentially cost the economy.

A natural response to this catalogue of woes is to automatically assume that tighter control and more laws should be the solution.

This research focuses on the changes in the banking regulations and supervisory regimes with a view of determining whether the regulatory responses to the crisis including the ring-fencing policy introduced into the Financial Services (Banking Reform) Act 2013[78] in response to the financial crisis in the aftermath of 2007 – 2009 are in the best interests of the economy or whether there are parts of the legislation that went far beyond what is necessary to safeguard the economy in the long run. The concern is whether these laws would promote trade and commerce or hinder them.

Given the importance of the Banking sector to the economy and the dire consequences that could ensue in the likely event of a systemic failure in the banking sector, for a while there has been an intense debate among leading banking law academicians, banking practitioners, policymakers, economists, concerned laypeople, and corporate lawyers either in the classical ***structuralism*** camp such as Hudson[79] and Brink[80] or ***neo-liberalism*** theorists such as Arora,[81] Persaud,[82] Arthur & Booth,[83] Larosiere[84] and Haynes[85] regarding the propriety or otherwise of the

[78] Op. Cit., Financial Services (Banking Reform) Act 2013, (n. 23).
[79] Op. cit., A. Hudson (n. 14).
[80] B. Brink, 'The Tragedy of Liberalism: An Alternative Defence of a Political Tradition' (State University of New York, 2000)
[81] Op. cit., A. Arora (n. 18).
[82] A. Persaud, 'A Critique of Current Proposal to Reform Bank Regulation' (2010) 3 (147) Journal of International Banking and Financial Law.
[83] Op. cit., T. Arthur and P. Booth (n. 15)

government's action in imposing more legislative restraints on the banking sector as it did following the financial crisis in 2007 – 2009. Structuralism and Neo-liberalism socio-economic theories will be expounded in the literature review chapter 2.

Having had such a serious financial crisis which some may argue was avoidable, the debate is concerned with what should be the regulatory response to the disaster. More laws? Assuming making more laws is one of the available options, the next question would be what areas in the financial sector have holes that needed plugging? Then, what should be the nature of the laws required to safeguard public interests in the circumstances of the causes of the crisis? How far should these regulations go to safeguard the interests of the public without unduly hurting the economy in the process?

In consequence, safeguarding the economy and giving the banking sector a measured scope of freedom to exercise its expertise and talents in creatively managing the resources at its disposal is likened to a skilful balancing act between proportionate use of the accelerator and brake pedals in a vehicle. While it would be considered reckless not to have an efficient braking system in a vehicle, at the same time, indiscriminate placement of a foot on the brake pedal when the vehicle should be moving forward at 70 miles per hour would only guarantee that the vehicle goes nowhere quickly enough.

Assuming the brake is working properly, the essence of having a brake in a car is actually to enable the car to move fast as the driver is aware that he or she can stop the car at will if there is a need to stop the car. Similarly, assuming regulatory controls are working efficiently in the banking sector there would be less need to unduly hold down the banking sector by more regulations than are necessary.

During and in the immediate aftermath of the 2007 – 2009 financial crisis, there were debates focused on what caused the crisis and the appropriate way to respond to it. The literature review part of this thesis deals extensively with these debates.

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[84] J. Larosiere, 'Structural bank Reforms: An Illusion' (2015) Vol 30 (10), 636 Journal of International Banking and Financial Law

[85] A. Haynes, A. 'Banking Reforms Struggles On' (2015) 36, (2) 123 Statute Law Review

1.9 The Law: The Provisions of the Financial Services (Banking Reform) Act 2013

A significant part of the subject of this study is contained in the provisions of the Financial Services (Banking Reform) Act 2013. The legislation makes references to the Insolvency Act 1986, Building Societies Act 1986, Competition Act 1998, Banking Act 2009 and significantly enhanced the Financial Services and Markets Acts 2000.

At the onset, it is considered important to highlight the key provisions of the Financial Services (Banking Reform) Act 2013 in this section of the thesis since the legislation occupies a place of prime importance in the research.

Emphasis is placed on Part 1, which spells out what ring-fencing is about and what the policy is attempting to achieve. Also, emphasis is laid on Part 4 which is the section that holds accountable senior management staff of banks whose action, decision and failure to act could lead to serious consequences to the banks they manage. So, in addition to activities that are indictable in criminal law, Part 4 created indictable offences arising from mismanagement in the banking sector and it specifies stiff penalties for dereliction of duty on the part of the senior managers holding positions of trust in the banks.

The Banking Reform Act is a volume of 204 pages comprising eight parts summarised as follows:

1.9.1 Part 1 – Banking Reform Act 2013: Ring-fencing

This section of the Act revisits section 2B of Financial Services and Market Act 2000 which deals with amendments to the powers and functions of the regulatory institutions Prudential Regulation Authority (PRA). S.1(i) gives the body the mandate to see to it that the implementation and transition to ring-fencing regime do not cause disruptions to core banking activities.

This part also deals with modifications of the objectives of PRA as previously stated in section 11 of FSMA 2000 to reflect the new policy on ring-fencing.

s.4 also amends Part 9A of FSMA 2000 introducing Part 9B. In the Banking Reform Act 2013 this is cited as s.142A "Ring-fenced bodies". Thus, s.4 (i) defines a ring-fenced body as, "*a UK institution which carries on one or more 'core activities' to which it has Part A permission*".[86]

Core activities relate to deposit-taking banks, high street banks such as Barclays, RBS, and Lloyd Bank, the kind of services that most people are familiar with. These are high street banks that operate demand deposit accounts.

Within the meaning of the Building Societies Act 1986, s.4 (2) the Act excludes Building Societies from the ring-fencing rules.

The section indicates the general purposes of the ring-fencing policy in the following terms:

(a) to secure an appropriate degree of protection for the depositors concerned, or (b) to protect the continuity of the provision in the United Kingdom of services provided in the course of carrying on the regulated activity of accepting deposits.[87]

Other important matters under Part 1 relates to administrative issues and compliance.

1.9.2 Part 2 – Banking Reform Act 2013: Financial Services Compensation Scheme

This part deals with the administration of the Financial Services Compensation Scheme where issues about the insolvency of the ring-fenced body arise. These are concerned with categories of preferential debts and eligible deposits for compensation.

1.9.3 Part 3 – Banking Reform Act 2013: Bail-in Stabilisation Option

This part relates to the bail-in stabilisation option which applies to Building Societies. There is no need to emphasise this part as Building Societies are outside the scope of this study since they are excluded from the ring-fencing policy.

[86] Financial Services (Banking Reform) Act 2013 Part 1, s.4 (1)
[87] Financial Services (Banking Reform) Act 2013 s.4 (1)/ FSMA 2000 s.142B (4) (a & b)

However, that part of the Banking Reform Act 2013 is linked with the Banking Act 2009. In recognition of the potential devastating consequences that can come along with the failure of GSI-Bs, the Banking Act 2009 significantly addresses transitional contingent management resolution plans for about-to-fail banks such that, the failure of any of such mega bank poses little or no disruption to the financial system and losses arising out of failed banks are as much as possible not borne by the public but by beneficial owners of the banks.[88] Thus, the primary objective of this part of the legislation is to ensure that banks do not fail in a disorderly manner.[89]

The Banking Act 2009, Part 1, provides five special resolution mechanisms to either rescue a bank through restructuring (Bail-out) or to let go of a bank through liquidation (Bail-in option). The resolution tools that are available to the Bank of England Resolution Division are (a) transfer to a private sector purchaser (b) transfer to a bridge bank (c) transfer to asset management vehicle (d) bail-in option.[90]

1.9.4 Part 4 – Banking Reform Act 2013: Conduct of Persons working in Financial Services Sector

This part deals with regulation of senior management employees of banks, the functions of bank employees that require prior approval of regulatory bodies, vetting of candidates, changes in the responsibilities of senior managers, certification of qualified bank management official, rules of conduct and disciplinary procedures concerning senior managers.

Senior management function relates to regulated activity by an authorised person on matters that are concerned with (a) functions that require the person performing it to be responsible for managing one or more aspects of the authorised person's affairs, (b) aspects involving risks of serious consequences.[91]

This part of the legislation seeks to hold senior bank managers criminally liable for any dereliction of duty and for decisions and conducts which may put the bank at serious risks and losses. The legislation also makes it mandatory that regulatory

[88] Bank of England, 'Executing Bail-in: An Operational Guide from the Bank of England' (2021) Resolution
[89] P. Carabellese and D. Zhang, 'The Legal Nature of the Recovery and Resolution Plans' (2019) 30 (7) 380 – 398 International Company and Commercial Law Review
[90] Banking Act 2009, Part I Special Resolution Regime
[91] Financial Services (Banking Reform) Act 2013 Part 4, s.19 (1) (2)

bodies must be involved in the vetting and appointment of key bank operators. The vetting process imposes a responsibility on the regulatory authority to ensure that a prospective candidate to be appointed to a position of high responsibility in the bank has the appropriate qualifications and training, possesses a relevant level of competence, and has the personal characteristics required to hold a responsible post in the bank.[92] Part 4, s.63F requires authorised bodies such as PRA and FCA to give licences/certificates to qualified individuals before such a person can hold a responsible position in the bank.[93]

This is a welcome development as it would enhance the quality of the hiring processes and ensure that only the most qualified candidates are appointed to manage very sensitive management positions in the banking sector.

Part 4, s.36 provides the basis of an indictment of senior management personnel of banks and the terms of a custodial sentence for offences relating to recklessly putting a bank's assets at risk of crippling losses. The custodial sentence ranges from 6 months to 7 years.[94]

1.9.5 Part 5 – Banking Reform Act 2013: Regulation of Payments System

This section deals with the administration of payment systems and regulations related thereto. This is a vital part of the smooth running and survival of a bank. A payment system means a process of enabling the facilitation of transfer of funds services.[95] In recognition of the importance of administration of an efficient payment system in the economy, s.39 provides for the appointment of a new "Payment System Regulator".[96] S.49 to 53 specify the general duties of the Payment System Regulator. This part of the banking reform Act 2013 is an offshoot of the Banking Act 2009, Part 5 s.182 (1) concerning working towards avoidance of disruption to payment services arising from the failure of a bank.[97] The connection with the ring-fencing policy is that the section supports that part of the objectives of the ring-

[92] Financial Services (Banking Reform) Act 2013 Part 4, s.21 (2 a- d)
[93] Financial Services (Banking Reform) Act 2013 Part 4, s.63F (3)
[94] Financial Services (Banking Reform) Act 2013 Part 4, s.36 (1) (2) (3) & (4)
[95] Financial Services (Banking Reform) Act 2013 Part 4, s.40
[96] Financial Services (Banking Reform) Act 2013 Part 4, s.39
[97] The Banking Act (2009) Part 5, s.182 (1)

fencing policy which as far as possible aims to minimise incidences of bank failure that could cause disruption to core services.

1.9.6 Part 6 – Banking Reform Act 2013: Special Administration for Operators of Certain Infrastructure Systems

This section relates to the management of Financial Infrastructure Systems (FIS) responsible for the inter-bank payment system. This is an extension of Part 5. These areas are also important to the smooth running of the banking system.

1.9.7 Part 7 – Banking Reform Act 2013: Miscellaneous

Part 7 is concerned with defined functions and wide-ranging enhanced powers of the Prudential Regulation Authority (PRA) and the Financial Conduct Authority (FCA) to see to the protection of the public and the smooth running of the financial system in general in the UK.

As with other issues, a very important role of the regulatory authorities, the PRA & the FCA, is the duty to meet with the auditors of banks at least once every year.

This is a unique feature of the Financial Services (Banking Reform) Act 2013. Typically, auditors of companies are only responsible to members of the company they provide auditing services to but given the importance of the banking sector to the economy, there is this exemption in which auditors of banks are required to report directly matters of concern to the bank regulatory authorities. This is also a welcome development for three important reasons: (i) it will ensure transparency and unfettered flow of information; (ii) it will enable the regulatory authorities to be aware in good time in the event a bank has difficulty and, (iii) timely remedial steps could be taken when it becomes known that a particular bank is in difficulty.

1.9.8 Part 8 – Banking Reform Act 2013: Final Provision

This section contains Schedules 1 – 10. It contains interpretations, meanings of keywords used, powers to review, and powers to enact subordinate legislation. Schedule 1 relates specifically to ring-fencing.

1.9.9 Summary

The provisions in Part 4 relating to the vetting of prospective candidates of key managers by regulators and the provision in Part 7 which imposes obligations on auditors of banks to report directly to regulators are considered to be innovative and are highly welcomed ideas.

The incorporation of these ideas into the Banking Reform Act is seen to be some of the lessons learnt from the failures in the banking sector in the past. These aspects of the legislation are discussed further in the literature review chapter 2.

1.10 The United Kingdom Financial System

As would be noted in the previous paragraph **1.9** that dealt with the substance of the Banking Reform Act 2013, the legislation only covers deposit-taking banks which are otherwise referred to as commercial/retail banks. That is only a segment of the financial system. This section deals with how the banking sector, which is the focus of this study sits within the entire financial services sector. A distinction or classification of the participants in the financial system is important because of the differentiated role each of the subsectors plays.

The United Kingdom is reputed to have a well-developed industrial and commercial economy with a first-class world-renowned financial system that is the envy of other developed world economies.[98] More than 100 years ago, concerning the Bank of England, Professor Andreades of the University of Athens said,

[98] D. Palfreman and P. Ford, 'Elements of Banking, 2nd Ed' (Pitman Publishing, 1992, p. 43)

"…No existing bank can boast a history at the same time so long, so continuous and so distinguished; nor has any played so large and so worthy a part, not merely in the fortunes of a great nation, but also in the general financial activities of the world."[99]

Such glowing tribute coming from a foreigner suggests the extent of the high esteem others have about the UK financial system.

The UK financial system comprises assorted classes of banks delineated by their functions. [[100]][[101]]

The financial system in the UK comprises the following institutions under the following general headings - Banks and banking institutions: this includes the Bank of England, deposit/clearing banks such as Lloyds Bank, Royal Bank of Scotland, Barclays Bank, Standard Chartered Bank, HSBC Plc (these are the class of banking institutions that this research is concerned with). These banks were traditionally known as Clearing and Deposits taking Banks.[102] Others that are under that classification include the Co-operative Bank and Trustee Savings Bank. These are categorised among banking institutions on the account that they have access to the Clearing House.[103]

Another class is the Discount Market. These are specialist banks that discount bills of exchange, earning their income from the commission and the differences in the discounted value of the financial instrument they trade-in.[104] Usually, they take deposits from the banking sector and lend such money on a short-term basis to the Government on gilt-edge securities and local authority bonds. There are also Finance Houses. This class of financial institutions specialise in financing hire purchase transactions. Also included are Savings Banks, Building Societies, Insurance Companies, Pension Funds, Investment Trust Companies and Unit Trusts, Special Investment Agencies such as Consortium Groups, Finance Corporations for Industry, Industrial and Commercial Corporations, Financial Markets including the stock exchange, Securities Brokers and Dealers, the Gilt-edge Market and Investment

[99] Andreades, A. (1909 Preface page) History of the Bank of England
[100] A. Arora, 'Practical Banking and Building Society Law' (Oxford University Press, 1997)
[101] D. Blake, 'Financial Market Analysis 2nd Ed.' (John Wiley, 2000)
[102] P. E Smart, 'Chorley & Smart Leading Cases in the Law of Banking 5th Ed.' (Sweet & Maxwell, 1983)
[103] P. Fidler, 'Practice and Law of Banking 11th Ed.' (McDonald & Evans, 1982, p. 2)
[104] J. Revell, 'The British Financial System' (The Macmillan Press, 1973)

Banking [105][106][107]. From this long list, it would be noted that the financial sector has wide-ranging specialist functions.

In the UK, investment banks used to be called merchant banks while Americans call them investment banks. However, nowadays they are mostly referred to as investment banks even in the UK.

Primarily, investment banks help in raising venture capital through consortium lending, lease finance and they provide advice to companies preparing to be listed on the stock exchange.[108] They typically do not have a large network of branches. Usually, they are based in London and they only keep accounts for a few high nets worth private and corporate customers hence they are called "Wholesale Bankers".[109]

The importance of financial institutions to the economic development of a nation cannot be overemphasised. In the case of commercial banks that this research relates to, their role in modern industrialised society includes enabling customers to deposit their money into current or other interest-bearing deposit accounts, lending money to their customers, and facilitating payment of cheques on behalf of their customers.[110]

Primarily, this research is concerned with the regular banks that most people have bank accounts with, through which they receive their pay and make day to day transactions. Until the promulgation of the Banking Act 1979, there was no clear definition of what a 'Bank', 'Banking business' and a 'Banker' meant. The Court has over time followed the definition suggested by Lord Denning M. R and Diplock L. J in *United Dominions Trust v. Kirkwood*.[111]

This was stated as,

> "… *accept money on current accounts, payable by cheques drawn upon such account on demand and collect cheques for customers…"*[112]

[105] Ibid.
[106] A. Saunders and M. Cornett, 'Financial Institution Management: A Risk Management Approach 7th Ed.' (McGraw-Hill, (2011, p. 17)
[107] P. Howells, and K. Bain, 'Financial Markets and Institutions 5th Ed.' (Pearson Education, 2007)
[108] Op. cit., A. Saunders and M. Cornett (n. 106)
[109] Op. cit., P. Fidler, 1982 (n. 103)
[110] E. Ellinger, et al., 'Ellinger's Modern Banking Law 5th Ed' (Oxford University Press, 2011, p. 213)
[111] United Dominion Trust v. Kirkwood [1966] 1 Q.B. 431
[112] Ibid (United Dominion Trust)

So, essentially, the court intended that these are the characteristics that should distinguish a 'Bank' and a 'Banking Business'—acceptance of deposits withdrawable on demand with the use of cheques. The decision of the Court of Appeal, in that case, was that, though the definition was not applicable in the circumstances of United Dominions Trust (UDT), it was nevertheless a bank and carrying out banking business, because the organisation had a reputation among other banks that they were operating as a bank.

Specifically, Part 4A FSMA 2000 makes it a prerequisite to obtain a prior authorisation licence before an incorporated body can carry out the business of banking in the UK.

In the context of this research, the case studies are clearly recognised as banks carrying out banking business with their Headquarters in the UK.

Before the 1980s, the financial activities of the distinguished financial institutions mentioned earlier had highly specialised functions. However, as noted by Howells and Keith, this banking model was at odd with other European countries such as Germany and France that favoured a universal banking model.[[113]][[114]][[115]] Part of the disadvantages to the UK banks before the 1980s was that they were competing against international financial institutions with very mobile capital and less restrictive laws in their home country.[116] This was part of the environment that gave rise to the growth of financial conglomerate institutions in the UK in the 1980s.

The implication was that the line of demarcation between the institutions became blurred as their services became merged under the umbrella of their respective parents' institutions.[117] Thus, from the 1980s, the merging of these assorted financial institutions led to the grotesquely big banks that are considered to be too big to fail and too big to rescue in the likely event of their failures which in itself has led to a hard and long debate on dealing with the attendant problems.[118]

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[113] Op. cit., P. Howells, and B. Keith, B. (n. 107)
[114] P. Alexander, 'Splitting Banks Divides Opinion in the EU' (The Banker, 2015)
[115] J. Brusden, 'European Commission Withdraws Bank Separation Proposal' (2017) https://www.ft.com/content/ddbedcd9-2dea-3b68-b8e2-2e1bc1eda13f
[116] Op. cit., (Howells and Keith (2007 (n. 107)
[117] S. Hefferman, 'Modern Banking in Theory and Practice' (John Wiley, 1996)
[118] Hupkes, E. 'Complicity in Complexity: What to do about the 'Too Big to fail' Problem' (2009) 9, 515, Journal of International Banking and Financial Law

In response to the global financial crisis in 2007 – 2009 which threatened the international banking system, assorted regulatory changes were introduced. The benefits and limitations of these regulatory changes including the ring-fencing policy are discussed in chapter 2 of this report.

Thus, one of the identified weaknesses of the ring-fencing policy stated earlier is that, once the ring-fenced part of a bank structurally separates from its universal banking roots, the non-ring-fenced arm is unable to have the full benefits of the cheap sources of finance embedded within the ring-fenced bank. Notably, there is a symbiotic relationship between all the participants in the financial system. The banking sector which is the attention of this research is only a subsector of the whole aggregate economy.

1.11 Contribution to Knowledge

Foremost, one of the unique strengths of this study is that it combined specialist's knowledge in variety of disciplines including law, economics, business management, accountancy, banking and finance which helped in working through the study. It is uncommon to see a law dissertation with the same level of combination of variety of subjects at that level especially the detailed accounting component.

There are still gaps in our knowledge in this area of study. The fact that even when the protagonists of structuralism and neo-liberalism agree on a need to have some form of reforms in the financial system, there remain unending debates that stem from the difficult question on how an optimal level of regulation could be achieved given the varied circumstances of assorted banks within the banking sector.[119] Thus, the second strength of the study is that it synthesised a variety of views on the subject to enrich the literature in this area of study.

Thirdly, as provided by this research, there is no previous definitive study that has come up with a measured impact of the global financial crisis on the banks selected as case studies spanning examination of accounting records for fifteen years as was achieved by this study. At least none that this researcher is aware of. This is

[119] M. Bagheri, and C Nakajima, 'Optimal Level of Financial Regulation under GATs' (2002) Vol. 5 (2) 507, Journal of International Economic Law

fundamentally the aim of this study and part of what this researcher hopes that he has contributed to knowledge.

Fourthly, sets of expansive primary data comprising thirteen Key Performance Indicators, covering a period of 15 years from 2004 – 2018 were built in connection with the case studies, Royal Bank of Scotland, Barclays, Standard Chartered Bank, and HSBC Plc. The data thus constructed may serve as a starting or a reference point for other researchers in the future and which they can build upon in similar research activities as this study.

The new primary data compiled by this researcher include Table 5, page 203 relating to RBS, Table 6 at page 216 relating to Barclays, and Table 8, at page 259 relating to SCB and Table 9 page 282 relating to HSBC Plc. These are tabulated extracts from the annual reports and consolidated accounts of the mentioned banks from 2004 – 2018.

Another contribution to knowledge by this study is that it helps us to understand how and why RBS and Barclays ran into difficulties during and in the aftermath of the global financial crisis, the implications to these banks, their journey to recovery and by extension, an evaluation of some of the impacts on the UK economy.

SCB which was classified as part of the global systemically important bank was not under any obligation to be ring-fencing compliant. This is because most of SCB's core banking customers that the policy sought to protect are outside Europe. Overall, SCB had a good performance over the period evaluated except in 2015 when the bank had an operating loss before tax of $1.5 billion.[120] Although HSBC also shared in the burden of the global financial crisis, the bank thrived during and after the global financial crisis. On the other hand, the statistics in Table 5 and Table 6 for RBS and Barclays indicate a downward trend in these banks' performance over the period evaluated.

If other researchers pick up interest in this area of study and keep under watch performance in the banking sector for the next 5 – 10 years, the outcome of a collective research endeavour may hopefully spearhead policy change on ring-

[120] Please see Table 8 on page 259 column 3

fencing in the future assuming that it is considered desirable to do so. Delanty and Strydom distinguish between knowledge, opinion, and common sense. According to these writers, what distinguishes knowledge from opinion and common sense is that knowledge should be supported with convincing evidence.[121]

This researcher supports the argument put forward by Delanty and Strydom that what constitutes acceptable knowledge would be a study that is based on evidence rather than mere opinions and assertions. The materials engaged in carrying out this study are robust objective documentary evidence that is outside the influence of this researcher.

1.12 Content and Structure of the Thesis

The thesis comprises six generic chapters. These include Chapter 1 which is the introductory aspect of the work; Chapter 2 contains literature review; Chapter 3 is about methods and methodology; Chapter 4 is concerned with the presentation of data and analysis thereof; Chapter 5 is a comparative evaluation of the results of RBS, Barclays, SCB and HSBC Plc; and Chapter 6 is summary of findings and recommendations.

Broadly, the introductory chapter lays out the general background of the study. It states the aims and objectives of the study, setting out the research questions, research hypothesis, the rationale, and the importance of the study. It also locates the study within the context of the 2007 – 2009 global financial crisis and regulatory measures put in place in response to the crisis. The introductory chapter indicates that the Banking Reform Act 2013 is one of the prime laws under examination being the legislative response to the financial crisis in the UK. Within the different components of the United Kingdom financial system, the chapter distinguishes the banking sector as the focus of the study. The introductory chapter concludes by describing the contribution of the study to knowledge.

The second chapter is the literature review section of the thesis. The literature review comprises five sections marked A – E. In relationship to the first three objectives of the study stated earlier, each of these sections deals with the following

[121] G. Delanty, and P. Strydom, 'Philosophies of Social Sciences: The classic and Contemporary Readings' (Open University Press, 2003, p. 6)

topics in successive order: (A) the approach adopted in conducting the literature review; (B) causes of the financial crisis in 2007 – 2009; (C) generic legal framework under which the banking sector operated prior to and in the aftermath of the global financial crisis; (D) the banking sector regulatory institutions concerned with the supervision, support, surveillance and enforcement of law and regulations in the banking sector. This section engaged with possible gaps in the existing legal framework and the supervisory institutions that may have warranted the adoption of the ring-fencing policy; and (E) the evolution of banking theories in the past one hundred years regarding structuralism and neo-liberalism, the drivers of economic policies. It conducted a critique of the ring-fencing policy, including evaluation of the effectiveness or otherwise of the ring-fencing as a measure capable of deterring financial crises in the future.

The third chapter relates to a report about the methods and methodology adopted for the research. This section focused on: (i) the research design; (ii) the underpinning research philosophy; (iii) methods of data collection; and (iv) justification for the approaches adopted.

The fourth chapter is concerned with the case studies group. The members of the group are Royal Bank of Scotland Plc, Standard Chartered Bank Plc, HSBC Plc, and Barclays Bank Plc. The chapter consists of four sections, each devoted to a member of the case study group. The chapter contains data built from the Annual Financial Reports and Financial Accounts for over 15 years from 2004 – 2018. It relates to the discussion and analysis of the consolidated data from the accounts of the group members.

The fifth chapter comprises a comparative analysis of the four case studies. The chapter evaluated shared characteristics among the case studies and contrasted their different circumstances. These are related to issues such as the dominant markets where each bank operated and how the different levels of risks exposure to the subprime financial instruments in the wake of the financial crisis in 2007 - 2009 affected the banks' performances differently. The chapter also discussed how the interactions between critical success factors including leadership skills, assets quality, and managerial capabilities available within each bank made the difference between success and failure in the process of managing these huge conglomerate banks during an unpredictable and acutely turbulent period as these banks faced in the past ten years or so since the global financial crisis began in 2007 - 2009.

The sixth chapter is concerned with the research findings, conclusions, and comments regarding possible future research in the area of study. The chapter reemphasised contributions to knowledge derived from this study by making a final pointer to the section containing the contributions to knowledge in this report.

Chapter 2

Literature Review: The Approach Adopted to Literature Review and Literature Review Questions

Section A

2.1. Introduction

Broadly, the literature review section deals with the existing body of knowledge on banking sector regulations and allied theories surrounding the subject, but more specifically, it concerns issues arising from the new regulatory changes including capital adequacy requirement, liquidity ratios, and the ring-fencing policy.

(i) This section states the aims and objectives of the literature review (ii) lays out theories on literature review (iii) states sources consulted and subject leaders whose works were consulted, and (iv) identifies steps taken to minimise incidences of bias and lack of rigour.

2.2. Aims of Literature Review

The literature review aims to link the study with previous studies and body of knowledge in this area of research. It is also to find answers to the theoretical questions stated in the objectives of the research as listed in chapter 1, page 10 - 11.

In conducting the literature review, therefore, the following key areas were kept in mind:

(i) (a) as a background study, to undertake a review of extant literature to determine the causes of the global financial crisis in 2007 – 2009,

(b) to undertake a review of the prevalent laws and regulations that existed prior to the 2007 – 2009 financial crisis in order to determine whether there were gaps in the laws and supervisory regimes then which may have contributed to the crisis.

Also, to undertake a review of the newly introduced changes to the laws after the global financial crisis, evaluating their impact on the case studies, RBS, Barclays, Standard Chartered Bank, and HSBC Holdings Plc.

(ii) to carry out a theoretical critique on the ring-fencing policy within the extant literature against the background of the UK's core competencies in the provision of financial services, a sphere in which the UK has comparative and competitive advantages,

(iii) to critically evaluate the effectiveness or otherwise of ring-fencing as a measure that is capable of deterring financial crises in the future.

2.3. The Objectives of the Literature Review

The objectives of this part of the thesis are concerned with how the research being reported relates to previous studies conducted by others and essentially, the issues that gave rise to the current research.[122] There are primarily two objectives for this literature review section. These include using the exercise to aid in the refinement of the research's overall aims and objectives which were stated in chapter 1, page 3 – 4, 10 -11 and to engage with the existing literature in order to facilitate its critical evaluation.[123] In a nutshell, the study evaluated the desirability or otherwise of the ring-fencing policy as a suitable regulatory measure in response to the global financial crisis. It also aims to determine the impact of the global financial crisis in 2007 – 2009 on the economic performances of some of the largest UK banks chosen as case studies from 2004 to 2018. In addition, the study evaluated regulatory responses designed to limit the effects of likely future crises on the banking sector.

The literature review section uses the historical reflexive method to present the report on the subject areas studied. For example, it highlights the state of banking regulations as it was in the past. The review touches on the evolutionary development of banking regulations to what it is currently, it identifies limitations within the current financial regulatory structure and it gives considerations on what the likely position of financial services regulations should aim to be in order to secure the economic well-being of the United Kingdom into a foreseeable future.[124]

The reason for this rear mirror review approach is a need to see some of the financial services regulatory models adopted in the past which either worked or failed. It also helps us to see why some of those policy choices worked and why

[122] M. Denscombe, 'The Good Research Guide 3rd Ed' (Open University Press, 2007, p. 325)
[123] J. Sharp, J. et al., 'The Management of a Student Research Project 3rd Ed.' (Gower, 2002)
[124] A. Jankowicz, 'Business Research Project 4th Ed' (Thomson Learning, 2005, p 161)

others failed. In so doing, this may assist in identifying policies that worked for a season possibly because of the economic circumstances of that time but which may have changed over time. It is also to identify why a reversion to those models now may be injurious to the economy. The prevalent circumstances during the Bretton Woods [125] era for example is far removed from what they are currently. This is more so due to the constantly changing business environment, innovations, technological advancement, and the world economy that has become more globalised in the past thirty years or so.[126] One of the consequences of globalisation is that trade boundaries were largely eliminated and previously existed customs and excise and other artificial barriers to international trade were removed due to the widely embraced deregulated economic policy that promoted the free-market enterprise, strong private property rights, and free trade. [[127]][[128]]

Gall *et al* identified other reasons for conducting a literature review which include the opportunity to discover new research possibilities that were previously unnoticed, prevention of repetition of research that others have carried out, and the prospect of gaining insight into research approaches and strategies.[129] Thus, whilst there is an abundance of previous theoretical works related to financial services regulations and critical reviews on the ring-fencing policy, the gap identified is concerned with the uncharted area regarding measuring or quantifying the impact of GFC on the performance of the selected banks on a long range basis as this study did (Examination of fifteen years accounting records). Understandably, the reason for that gap is because the full implementation of the ring-fencing policy only became effective recently in January 2019. The policy itself was enacted into law in 2013, in the Financial Services (Banking Reform) Act 2013.

The next paragraph deals with sources of existing literature on the subject, the contributors, and established authorities/leaders in the subject area which were widely consulted in this study.

[125] L. Rochon, and S. Olawoye, 'Monetary Policy and Central Banking: New Direction in Post-Keynesian Theory' (Edward Elgar, 2012)
[126] T. Friedman, 'The World is Flat: The Globalised World in the Twenty-first Century' (Penguin, 2006)
[127] Op. Cit., M. Friedman, 1962 (n. 8).
[128] D. Harvey, 'A Brief History of Neoliberalism' (Oxford University Press, 2005)
[129] M. Gall, et al., 'Educational Research: An Introduction 8th Ed.' (Longman, 2002)

2.4. Literature Sources Consulted and Some of the Subject Leaders

The literature sources consulted in order to gain insights on the subject area and which enabled this researcher to enter into the conversation around the issues discussed in this research comprise materials from academic journals such as Journal of Financial Intermediation, Journal of Financial Regulation and Performance, European Business Organisation Law Review, Journal of International Banking and Financial Law, Compliance, Law Review, Institute of Economic Affairs Research, and publications from Parliament including Hansard. Others are textbooks, unpublished doctoral theses, conference papers, Government publications, and Annual Financial Reports of the banks used as case studies for the research.

The list is by no means exhaustive but just to mention a few. Some of the identified prominent subject leaders in law and economics whose works were consulted include but are not limited to the following: law, economics, and finance professors including Arora, Haynes, Persaud, Cranston, Goodhart, Hudson, Ellinger et al., Tomasic, Grosse, Petitjean, Larosiere, Barth et al, Arthur, Booth, Friedman (Nobel laureate in Economics), Stiglitz (Nobel laureate in Economics), Howells, Bain, Blair (QC), Hadjiemmanuil (QC), Admati, and Cullen. Their works are listed among other people's works mentioned in the bibliography at the end of this report.

2.5. Approaches to Literature Review

Two main approaches to literature review have been identified. These are the deductive and inductive approaches. Deductive review relates to using existing literature to identify theories which are then tested by using data collated, engaging an appropriate research design to determine whether the hypothesis being tested is correct. On the other hand, the inductive approach involves the exploration of data to generate new theories.[130]

A deductive approach is considered more suitable in a situation where there is an abundance of literature to glean from and the time available for the study is limited, whereas with an inductive approach there may be a paucity of literature on the

[130] J. Wilson, 'Essentials of Business Research: A Guide to Doing Your Research Project', (Sage, 2010, p 7)

subject, time is not a constraint and risk is accepted in the sense that a theory may not emerge at the end of the study.[131]

In the circumstances of this research, the hypothesis being tested as stated in chapter 1, page 12 is,

> *"Notwithstanding the benefits that may accrue from the ring-fencing policy, the banking sector and by extension the economy in the UK may likely face long term detriment arising from the ring-fencing policy".*

There is an abundance of wide-ranging literature which is readily available in the field of study. This embraces financial law regulations and materials on banking and finance. As well, this study has a time constraint imposed. It is a three-year research programme. Under those circumstances, the adoption of a deductive approach in this study is considered justified.

Transfield *et al* classified the presentation of the literature review into two categories, namely, traditional narrative style and systematic review.[132] These authors are concerned that the traditional narrative style in presenting literature review is highly susceptible to lacking in thoroughness and it may suffer from bias and lack of rigour. In their opinion, a systematic review embraces the use of clear assessment criteria in the selection of articles to use, development of clear aims and objectives for the literature review, a comprehensive search for all potentially relevant materials, and presentation of the synthesised result in a balanced and impartial way.

In this literature review exercise, a reflexive historical narrative approach to research illustrated by Atkinson on creative writing was adopted in critically analysing theories on regulation.[133] This research tool was used to evaluate propositions put forward by lawyers, economists, policymakers, academicians, and banking practitioners on both sides of the debate concerning the appropriateness of the choice between ***structuralism*** and ***neo-liberalism,*** theories that inform the direction of policy decisions on regulation. This is especially concerning the arguments on the

[131] R. Snieder and K. Larner, 'The Art of being Scientist: A Guide for Graduates Students and their Mentors' (Cambridge University Press, 2009, p. 16)

[132] D. Transfield et al., 'Towards Methodology for Developing Evidence informed Management Knowledge by Means of Systemic Review' (2003) Vol 14, (3) 207 – 222, British Journal of Management.

[133] T. N Atkinson, 'Using Creative Writing Technique to Enhance the Case Study Method in Research Integrity and Ethics Courses' (2008) Vol. 6 (1) 33 – 50 Journal of Academic Ethics

desirability or otherwise of foisting the restrictive concepts of the ring-fencing policy on the banking sector in the prevalent circumstances of the UK economy.

A reflexive narrative approach is considered appropriate in the circumstances of legal doctrinal research which essentially depends on documentary evidence such as in this study. As pointed out by Atkinson, a reflexive approach is particularly suitable in case studies method which was the approach adopted in this study for evaluation of the annual accounts of selected banks included in the case study group.[134]

The nature of the research took into account the historical and evolutionary development of financial market regulations in the UK with a particular interest in socio-policy pathways to regulation from the late 1970s until the present (2019). Possible advantages of a reflexive narrative approach include its flexibility, spontaneity and also, it allows presenting originality of thought creatively.[135] On the other hand, a possible drawback may be gravitation towards being overly subjective where for example, the researcher has a blind spot to certain things and then exaggerates the importance of others as may occur in any qualitative analysis.[136]

2.6. Steps Taken to Minimise Incidences of Bias and Lack of Academic Rigour and Thoroughness

As pointed out by Transfield et al referred to earlier, crucially, an important part of a literature review that could be taken seriously begins with stating clearly devised aims and objectives of the literature review.[137] In addition to that would be the standard of selection criteria used to determine articles that merit inclusion in the research.

As evidenced by the first three pages of this chapter, it states the literature review's aims and objectives. The chapter also identified opinion leaders of international repute in the subject areas consulted regarding this study. The materials used are peer-reviewed papers, mostly from five-star journals. Conscious efforts were made by this researcher to avoid undue subjective views. The level of academic rigour

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[134] Ibid (Atkinson, T. N. (2008))

[135] R. Sommer and B. Sommer, 'Practical Guide to Behavioural Research: Tools and Techniques' (Oxford University Press 2002, p. 59)

[136] Ibid.

[137] Op. cit., Transfield, D., et al., 2003, (n. 132)

employed, the quality and appropriateness of the structure and style adopted in the presentation of arguments in reporting the research are left for readers and assessors to determine.

The next four sections will in succession deal with each of the identified financial services regulations and theories on regulation mentioned earlier.

Section B

A Review of the Causes of the Financial Crisis in 2007 – 2009 and the Estimate of the Extent of Losses Incurred By the Countries Affected Most By the Crisis

2.7 Introduction

Based on the available literature on the subject, this section reviews the causes of the global financial crisis in 2007 – 2009 and provides a general overview of the extent of losses incurred by the banking sector, using a sample of twenty-four countries among the foremost industrialised nations hit hardest by the global financial crisis.

This section of the thesis is linked to objective (i) sub-section (a) of the study concerning evaluation of the causes of the global financial crisis in 2007 – 2009.

Since the ring-fencing policy is part of the government's responses to the 2007 – 2009 crisis, it is considered that the starting point should be a review of the causes of the crisis in order to put into proper perspective what the ailments were relative to the medicine prescribed to cure the problem.

Secondly, a review of the causes of the crisis is considered important because it is the only means by which we can start to appreciate the fault lines, facilitate planning for financial crisis management and to come up with suggestions on effective solutions.[138]

2.8 Some of the Causes of the Financial Crisis

It has been more than ten years since the crisis occurred. Quite a lot has been written about the causes of the crisis since it happened. Doubtless, more is still going to be written about the crisis which is reputed to be the worst of its kind in known economic history.[139] This would be more so as policymakers and regulators seek to tighten perceived loopholes within the financial system, making new

[138] B Casu et al., 'Introduction to Banking 2nd Ed.' (Pearson Education, 2015, p. 251)
[139] Op. cit., D. Murphy, 2009, (n. 50)

regulations or modifying supervisory strategies in order to minimise instances of financial crises in the economy.

On the 19th November 2012 during oral evidence given before the Parliamentary Commission on Banking by Lord Adair Turner the Chairman of the defunct Financial Services Authority, (that was about five years after the crisis began) said the scale of the crisis and its impacts on the economy has only just started to be appreciated much more than it was understood in 2009.[140] Writing in 2016, which was seven years after the crisis ended, Mamica and Tridico held that the negative impacts of the crisis were still being carried over by some advanced economies such as Greece, Spain, and Portugal for example.[141] The argument is that, even now, issues surrounding the causes of the crisis are still relevant and they form part of the basis of this study.

There is a considerable number of reasons adduced as the causes of the global financial crisis which had its origin in the USA but later spread globally with devastating consequences [[142]][[143]][[144]].

Among several factors attributed as the causes of the financial crisis are: failings arising from the inadequate cross border and unified international financial regulation, products and services that escaped boundary of regulation and supervision, poor banking supervision,[145] securitisation of sub-prime mortgage assets, poor lending practices, failings in the administration/governance of financial institutions, general laxity in internal control mechanisms,[146] behavioural issues relating to corporate culture where there are tensions in power dynamics and internal politics, external socio-economic pressure leading to financial institutions

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140 A. Turner, 'Oral Evidence given before Parliamentary Commission on Banking Standards on 19/11/2012'
141 L. Mamica, and P. Tridico, 'Economic Policy and the Financial Crisis' (Routledge, 2016, p. 1)
142 A. Turner, 'The Turner Review' (The Financial Services Authority, 2009)
143 M. Baily, et al., 'The Origins of the Financial Crisis' (The Brookings Institution, 2008)
144 I. MacNeil, 'The Trajectory of Regulatory Reform in the UK in the Wake of the Financial Crisis' (2011) Vol 11, pp 483 – 526, European Business Organisation Law Review.
145 Op. cit., Arora, A. 2010, (n. 18)
146 R. Grosse, 'Bank Regulation, Governance and the Crisis: A Behavioural Finance Review' (2012) Vol 20 (1) 4 – 25. Journal of Financial Regulation and Compliance.

intentionally circumventing rules[147]and less than acceptable standards of the activities of credit rating agencies.[148]

Other than the spill over of the causes of the crisis that emanated in America, in the particular circumstances of the UK, the trigger of the crisis was loss of confidence in the banks and a reaction to the chain of events that started with the short-term money market freeze which began on 9th August 2007 thereby preventing banks in dire need of liquidity from accessing funds from the wholesale money market.[149] What compounded the problem for these banks included poor liquidity position, inadequate capital and underlying weaknesses in assets/nonperforming loans. As mentioned previously in Chapter 1, Northern Rock was the first casualty in September 2007. The underlying issue was the precarious liquidity position of these distressed banks, their inadequate operating capital, poor management decisions, weak assets, disproportionate nonperforming loan accounts and on top of that, in December 2007 to February 2008 major investment banks owned up that their structural credit assets were overstated and needed to be written downs.[150] Invariably, these write downs led to declaration of huge losses, which led RBS's share price to crash by 35%.[151]

2.9 Estimate of the Impact of the Global Financial Crisis on Stock Market Capitalisation in the Banking System

In the period leading to the global financial crisis, banks in the USA aggressively marketed mortgage facilities to high-risk segments of the market as they failed to verify the employment status of borrowers neither did they check whether the borrowers had other known means of income for the loan repayment. Transference of the inherent risks to investors globally through CDOs ultimately became the root cause of the 2007 – 2009 global financial crisis.

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[147] S. Ashby, 'The Turner Review on the Global Banking Crisis: A Response from the Financial Services Research Forum' (2009) Financial Services Research Forum https://www.nottingham.ac.uk/business/who-we-are/centres-and-institutes/gcbfi/documents/researchreports/paper61.pdf
[148] Op. cit., G. Baber, 2013 (n. 16).
[149] Financial Services Authority, 'The Failure of the Royal Bank of Scotland: Financial Services Authority Board Report' (December 2011, pp 314 - 315)
[150] Ibid.
[151] Ibid.

The traditional model whereby banks originated mortgages and held them down till they were fully discharged was replaced with a system of originating mortgages and then repackaged them into Collateralised Debt Obligations (CDOs) which were then sold to investors.[152] This model created erosion of bank lending standards as there were no incentives for the originator of the mortgages bothering about being circumspect regarding the quality of credits so advanced. The risks were simply passed on to investors in the ensued securitised instruments. Thus, CDOs became a major factor that created the financial crisis of 2007 – 2009 following the burst of the housing market bubble.

Table 1: The Impact of the Credit Crunch on the Stock Market Capitalisation of the Banking System Among Twenty-Four Foremost Industrialised Countries

Country	Bank Stock Market Capitalisation 1st Jan 2007	Bank Stock Market Capitalisation 31st March 2009	Estimated Reduction in Value over 2 Years ***	Percentage of losses over 2 years ***
	($ Billions)	($ Billions)	($ Billions)	
United States	1560.5	352.1	**1,208.4**	**77%**
United Kingdom	714.4	163.3	**551.1**	**77%**
China	667.4	525.3	**142.1**	**21%**
Japan	651.3	248.8	**402.5**	**62%**
France	372.8	97.8	**275.0**	**74%**
Hong Kong	345.8	131.5	**214.3**	**62%**

[152] K. Pilbeam, 'International Finance' (Palgrave Macmillan, 2013, p. 503 4th Ed)

Italy	338.1	99.3	**238.8**	**71%**
Switzerland	281.9	81.3	**200.6**	**71%**
Spain	306.2	112.0	**194.2**	**63%**
Canada	236.7	135.1	**101.6**	**43%**
Australia	225.7	139.7	**86.0**	**38%**
Belgium	184.6	17.0	**167.6**	**91%**
Germany	151.6	37.0	**114.6**	**76%**
Russia	126.0	23.9	**102.1**	**81%**
Sweden	108.4	39.3	**69.1**	**64%**
Singapore	68.3	34.5	**33.8**	**49%**
India	60.4	41.1	**19.3**	**32%**
Ireland	53.9	1.2	**52.7**	**98%**
Poland	51.2	20.2	**31.0**	**61%**
South Africa	48.2	33.0	**15.2**	**32%**
Portugal	38.3	10.4	**27.9**	**73%**
Indonesia	30.9	24.8	**6.1**	**20%**
Netherlands	22.7	1.8	**20.9**	**92%**
Argentina	9.2	3.7	**5.5**	**60%**
			$ 4,280	

Source: Pilbeam, K. (2013, p 500) International Finance (4th Ed)

*** - The 4th and 5th columns relating to the difference between banks' stock market values in 2007 and 2009 were calculated by this researcher.

The table indicates the level of the adverse impact the global financial crisis in 2007 - 2009 had on the banking sector related to the identified countries. These are countries for which statistics are available regarding their Banks' Stock Market Capitalisation for the period stated. This is not necessarily the full picture of the extent of damages caused by the global financial crisis in 2007 – 2009 because only twenty-four countries were sampled out of over 190 countries worldwide. Between the twenty-four countries identified, they lost nearly $4.3 trillion on their stock market value between 2007 - 2009. Also, the statistics do not measure the adverse ripple effects on all businesses generally including other businesses that failed due to the financial crisis. However, the statistics enable us to have a feel of the grim picture of the impact of the crisis on the banking sector in the countries that were hit hardest by the financial crisis.

As indicated on the table, generally America and European countries bore the brunt of the catastrophic event most. Comparatively, the worst-off countries that had their banks' stock market value almost wiped off clean were Ireland, Netherlands, and Belgium. In relative terms, the least affected country in this league table was China and the hardest affected was Ireland. China lost $142.1 billion which in relative terms was only 21% of their banks' stock market capitalisation value at that time.

Ireland had 98% of the bank stock market capitalisation value wiped out in one clean swoop. In terms of the scale of losses, America suffered the largest in monetary value having $1.2 trillion wiped off their banks' stock market capitalisation value. United Kingdom followed the USA in terms of the scale of losses, having incurred demurrage of $551 billion in the banking sector's stock market capitalisation value at that time. This is about a quarter of the average GDP of the UK.

A remarkable feature of the statistics is the spread of the adverse impact on the foremost industrialised nations worldwide.

2.10 The Contributions of Collateralised Debt Obligations to the Financial Crisis

While most of the reasons given earlier as the causes of the crisis may have contributed in some measures to worsen the global financial crisis in 2007 – 2009, it is argued that those reasons were almost secondary when compared with the scale of damages caused by the financial instrument, Collateralised Debt Obligations

(CDOs). For example, this is because there had always been financial crises in the past. There had always been incidences of poor or inadequate international financial regulation, there had always been tensions in the organisation environment where there were boardroom squabbles, etc. All these did not lead to a catastrophic global financial crisis as was the case in the crisis in 2007 - 2009. If at all there were crisis arising from these issues, the impacts were localised not a global catastrophe.

It is therefore contended that the causation of the global financial crisis arguably boils down to just one reason: the consequences of poor lending practices in America that had adverse spill over effects on the rest of the world but also fuelled by the weaknesses already on the ground in the banking sector in the UK.

The origin of the crisis has been linked to the practice whereby in America expensive homes were sold to individuals who clearly had no means of repayment of the loans through earned income.[153] The properties were acquired with the bank's money under an assumed hope and premise that with time, the property would significantly increase in value such that when repayment became due, it could be obtained through the sale of the property.

The crisis started to brew as a devised financial instrument called Collateralised Debt Obligations were designed to enable mortgage banks to relieve themselves of the burden regarding holding such mis-sold mortgages to their full term.

In the mortgage market context, the idea behind debt securitisation is an arrangement whereby a creditor (in this case the bank) using a debt instrument referred to as 'Collateralised Debt Obligation' drawn in favour of a third party (an investor) or a bearer, sells the instrument at a discount or a premium value above the underlying property mortgaged to the banker by a group of homeowners (the debtors) over mortgaged properties (the security) to the third party whereby the third party takes over the position of the bank to claim the sum due on the property at the maturity of the instrument or when the mortgage becomes due for full repayment.[154] The additional feature of this instrument is that it could be traded as the investor wishes or when a buyer or seller exercises an option to buy or sell the financial instrument.[155]

[153] J. Goddard, and J. Wilson, 'Banking: A Very Short Introduction' (Oxford University Press, 2016, pp 91-92)
[154] A. Hudson, 'The Law of Finance 2nd Ed.' (Thomson, 2013, p. 1296)
[155] Bessis, J. 'Risk Management in Banking 2nd Ed.' (2007, p. 183)

With this ingenious devise, the stage was set for the imminent catastrophe waiting to happen once the American banks doled out mortgage loans en-masse to people to buy houses regardless of their levels of ability to repay the loans.

What then followed was that the financial instruments (Collateralised Debt Obligations), were repackaged into large and very complex bundles according to their varying degrees of quality. The face values of these financial instruments are denominated in huge sums which could be as high as $500 million. They are called **Collateralised Debt Obligations** backed by the underlying mortgages as the supporting security.[156] The credit rating agencies became complicit in supporting this arrangement. The problem was that since the **CDOs** were tied to the mortgaged properties, a fall in the housing market would invariably negatively affect the recoverable sum from any realised property. An additional problem was that since they were held in large tranches, valuation becomes extremely difficult and complex.[157] The benefit though is that there is always a realisable amount from the property even if it does not cover the initial outlay. However, the other problem, which could potentially have surfaced was concerned with a situation where the underlying properties were unrealistically overvalued.

With the assistance of the **CDOs**, the original lenders did not have to hold the mortgages to their maturity as they can transfer the inherent risks onward to other investors who wanted to invest in the CDOs. This was how the American mistake and misfortune were offloaded and dispersed globally in what is now referred to as subprime or toxic assets**.** Sadly, hapless institutions outside America got their fingers burnt by investing in what has been described as "mispriced, miss-rated, misunderstood and mis-sold instruments".[158]

It is not too difficult to see that those who invested in the CDOs had no way of seeing the underlying properties located in America, their true worth and any other additional features of these properties, unlike the case in traditional mortgages such as we have in the UK. Investors in the CDOs can only trust the judgment of the Credit Rating Agencies concerning references given about the value and quality of the financial instruments.

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[156] Op. cit., Pilbeam, K. (2013, p. 489) (n. 152)

[157] D. Coskun, 'Credit-rating Agencies in the Basel II Framework: Why the Standardised Approach is Inadequate for Regulatory Capital Purposes' (2010) Vol 25 (4), 157 – 169, Journal of International Banking Law and Regulation

[158] Op. cit., K. Pilbeam, (2013, p. 488) (n. 152)

An example of the tragedy in the USA and one of the foremost casualties is the collapse of Lehman Brothers Holding, an investment bank established in 1850, the fourth largest investment bank in the USA. Lehman Brothers reputedly had 28,600 staff worldwide. The collapse of the bank was attributed mainly to exposure to Collateralised Debt Obligations.[159] Other major investment banks that were adversely affected by their involvement but managed to escape through reliance on funds and other support packages received from the Federal Reserve were Citigroup, Bank of America, Goldman Sachs, and Merrill Lynch.[160]

2.11 The Relevance and the Implications of the Causes of the Financial Crisis to this Study

First, it is remarkable that bankers in America would be so careless as to engage in the practice whereby huge mortgage loans were given so casually to borrowers disregarding known lending practices.[161] This was so much so that, at the time of giving out mortgages they were less concerned about the evaluation of the ability of the borrowers to repay the amount owed but placed reliance on recovering the sum so lent in the expectation that the value of the property would continue to increase anyway.[162]

It is agreed that the United States of America and the United Kingdom have a lot in common. For example, they share a close association with each other. They learn good practices from each other and have closely knitted economic ties.

The huge error in America in the years leading to the global financial crisis should now serve as an important lesson to bankers worldwide and a matter that regulators should pay close attention to. Even if considered to be a micro-prudential issue, preliminary evaluation of borrowers' ability to repay loans should always remain sacrosanct.

Secondly and very crucially, the investigation embarked on in this study is that given the nature of the causes of the catastrophic global financial crisis in 2007 - 2009 (as expounded earlier on) and as painful as they are, the line of inquiry in this study is

[159] Op. cit., K. Pilbeam, (2013, p. 501) (n. 152).
[160] Op. cit., D. Murphy, 2009, (n. 50).
[161] Ibid
[162] Op. cit., K. Pilbeam. 2013, (n. 152).

the question on the extent of the regulation needed to support the banking sector in the UK and the long-term impact of the restructuring in the sector.

The argument is not about a disregard for needed banking reforms, but the issue is, "What kind of overhaul is necessary for the banking sector?". Whilst there was a need to restore confidence in the banking sector, the question remains whether the kind of restructuring inspired by the ring-fencing went far beyond what was necessary to restore confidence in the banking sector.

2.12 Summary of the Causes of the 2007 – 2009 Global Financial Crisis

Some of the factors that contributed to the 2007 – 2009 crisis are: (i) inadequate unified international financial regulation,[163] (ii) devised financial products and services that escaped the radar of regulatory control,[164] (iii) poor lending practices,[165] (iv) failings in the governance/administration of financial institutions,[166] (v) external socio-economic pressure which led some financial institutions to deliberately flout the rules as was found in Barclays, RBS and HSBC especially and for which they were heavily penalised[167] (vi) untoward activities of credit rating agencies,[168] (vii) the contributions of Collateralised Debt Obligations, existed weaknesses in the banking sector in the UK prior to the crisis which included the problem of poor liquidity, inadequate capital, weaknesses in the underlying financial assets/nonperforming loans in the banks that suffered most from the global financial crisis and very importantly, (viii) failings of supervisory institutions. This is extensively discussed later under Section D.

[163] See page 45
[164] See pages 45 - 46
[165] See page 50
[166] See page 48
[167] See page 45 - 46
[168] See page 45 -46

Section C

Law and Regulation of the Banking Sector Prior to the 2007 – 2009 Global Financial Crisis

2.13 Introduction

This Section C is linked to objective (i) subsection (b) of the study, which is concerned with a review of the literature,

"to determine whether there were gaps in the prevalent laws and regulations that existed prior to the crisis which may have contributed to the global financial crisis in 2007 – 2009.

Thus, the overall objective of this section is to expound on the prevalent legal environment under which the banking sector operated prior to the 2007 – 2009 global financial crisis. This exercise should aid the process of discovering answers to objective (i) subsection (b) of the study as to whether there were gaps in the law that may have contributed to the crisis.

While Section C deals with the regulatory aspect of the law, the next Section D deals with the supervisory aspect of the law governing how the banking sector was policed, supported, and supervised.

Section C starts by identifying the sources of banking laws and regulations applicable to the banking sector and the analysis of the legal framework under which the banking sector operated and how they impacted the banking sector prior to the global financial crisis in 2007 - 2009. The section concludes with arguments for justification for banking regulation.

2.14 Sources of Banking Law and Regulations Applicable to the Banking Sector

Up until 2019, there were at least four major sources of laws and regulatory frameworks that were binding on the banking sector in the UK. These include: (i) harmonised regulations and directives received from the European Union, (ii) statute law (iii) regulations emanating from institutions with delegated authority such as the Bank of England and supervisory authorities including the Financial Services Authority (latterly the Financial Conduct Authority), Prudential Regulation Authority[169] and (iv) international accords and regulations originating from Basel Committee on Banking Supervision out of which came Basel I, Basel II, Basel III, and which are the underlying foundations of the current piece of consolidated regulatory framework labelled: "A Global Regulatory Framework for More Resilient Banks and Banking System".[170]

As pointed out by Tattersall et al, it is the directives emanating from the EU to implement the principles contained in the Basel framework that is legally binding among the Member States in the European Economic Area not necessarily the framework itself.[171] So, what makes Basel Accords legally binding is the directives from the EU that support the Accords and regulatory frameworks emanating from Basel Committee on Banking Supervision.

2.15 The Principal Laws and Regulations that Governed the Banking Sector Prior to the Global Financial Crisis in 2007 - 2009

In summary, the principal legal frameworks that were in force, regulating the banking sector prior to the 2007 – 2009 crisis are as follows:

- Banking Act 1979
- Company Act 1985 (The new Company Act 2006 came into force on 1st April 2010)
- Banking Act 1987 (This legislation is currently obsolete as the provisions contained therein have largely been consolidated into the Financial Services Markets Act 2000)
- Basel I 1988
- Financial Services and Markets Act 2000 (FSMA)
- Basel II 2004
- EU Directives

[169] C. Elliott, et al., 'English Legal System 19th Ed.' (Pearson Longman, 2018)
[170] Basel Committee on Banking Supervision, Basel III: A Global Regulatory Framework for more Resilient Banks and Banking System (2010)
[171] J. Tattersall, et al., 'Basel II: A Briefing for Practitioners' (2004) Vol. 21 Compliance Officer Bulletin

This list may not contain all the laws and regulations that governed the banking sector, but it provides the main thrust of the regulatory framework applicable in the banking sector prior to the global financial crisis in 2007 - 2009.

2.16 Regulated Areas in the Banking Sector and Applicable Laws and Regulatory Framework before the Global Financial Crisis in 2007 - 2009

This section deals with the scope of the regulated areas in the banking sector prior to the global financial crisis in 2007 – 2009. Due to the breadth and immensity of the range of laws and regulations applicable to the banking sector at the period under review, examination of this huge area of the law runs the risk of making a report on it to become boring, like reading a telephone directory. Thus, this section only provides brief highlights of the principal governing legislation and sundry regulations which were applicable at the time.

Before the crisis in 2007 – 2009, banks were bound to operate within the boundaries of generic laws such as case law, company law, contract law, tort, land law, insolvency legislation, criminal law, EU regulations, and civil law generally.

Just as other incorporated bodies, banks had to be compliant with consolidated provisions in the Company Acts 1947,[172] 1948,[173] and 1985. This legislation among other provisions covers matters relating to maintenance of capital, accounts and audit, issues around directors' duties, responsibilities, qualifications and fiduciary relationship with the bank. The Financial Services Act 1986[174] was enacted to regulate investment banking activities. Apart from these, there were others such as the Banking Act 1979 which introduced the Deposit Protection Scheme and widened the scope of the regulatory powers of the Bank of England.[175]

The Banking Act 1987 (now repealed) strengthened the position of the Bank of England as the general supervisor and regulator of deposit-taking institutions and

[172] Company Act 1947
[173] Company Act 1948
[174] Financial Service Act 1986
[175] Banking Act 1979, s. 21 and s. 22

reflected the changing environment in which the banking sector operated, stressing a new approach that did not regulate every aspect of prudential regulation.[176] The Banking Act 1987 have been substantially incorporated into Financial Services Markets Act 2000.

More specifically, financial regulation which affected the banking sector principally encompasses a broad range of activities including but not limited to the following: (i) setting up of accounting standards, (ii) bank capital requirements, (iii) insider dealing legislation, (iv) control on money laundering, and (v) rules on consumer protection and deposit insurance.[177]

While all these laws were there all along, they were not strictly adhered to.

2.16.1 Accounting Standards

It is considered very important to expound even if briefly, the impact of poor auditing and financial reporting services on financial institutions and how they can orchestrate failure in the banking sector. This section also discusses the standards of auditing and financial reporting required of auditing firms when providing financial auditing services to financial institutions.

Regarding unified accounting standards identified as part of the legal framework under which banks are required to operate, the effect of globalisation has brought to the fore the need to have standardised accounting reporting methods and financial reporting regulations styled International Reporting Financial Standards (IRFSs).[178] This agenda is supported by the Company Act 2006. For example, s.399 imposes a duty to prepare group accounts and s.406 stipulates that the preparation of the accounts must follow International Accounting Standards.[179]

The benefit of that arrangement to this research is that all the annual financial accounts of the banks examined have common features and the same format of reporting which facilitated comparison between the banks used as case studies.

[176] Banking Act 1987, s. 1 & s. 2
[177] S. Morris, 'Financial Services Regulation Practice' (Oxford University Press, 2016)
[178] A. Melville, 'International Financial Reporting 5th Ed.' (Pearson Education, 2015)
[179] Company Act 2006, s. 399 and s. 406

Also, the importance of a need for the adoption of impeachable accounting standards, transparency, and reliable auditing in the smooth running of the banking sector cannot be over-emphasised. The collapse of Enron, the Houston based energy company audited by Arthur Andersen, but which failed in 2001 highlights a recognition that a decline in auditing standards of any financial institutions could lead to irreparable damages and loss of confidence in the market. In the case of Enron, there was reported examples of violation of accounting standards under the Generally Accepted Accounting Principles (GAAP), instances of manipulation of derivative accounts, irregularities in the off-balance sheet arrangements, and reported cases of outright fraudulent practices and collusion among the executive directors which later exposed $43 billion out of $74 billion profit reported to be fictitious.[180]

As a follow on to the collapse of BCCI (Bank of Credit and Commerce International) in 1991 which highlighted flaws in the auditing and financial reporting standards in that bank and the impact of Enron's experience in the early 2000s as mentioned, Company Acts 2006 s.503 (3) and s.507 (1) impose strict requirements on financial institution's auditors concerning increased transparency, a requirement that senior statutory auditors must sign off the accounts of banks in their personal names. The Act also stipulates information that must be included in the financial reports, how they must be reported, and a commitment of a director of an accounting firm to be personally responsible for signing off the financial accounts of the financial institution.[181] It should be pointed out that the Company Act 2006 only came into effect in 2010 almost three years after the 2007 - 2009 global financial crisis began.

As it was later brought to the attention of this researcher, there were instances of grossly inflated derivative accounts in the financial accounts of the case studies in 2008 which in the case of Barclays worryingly reached almost £1 trillion but which the external auditors failed to pick up issues with. The concern is that, for that level of inflated figures to escape the scrutiny of the auditors is not only dangerous but was enough potential time bomb that could cause difficulties in the banking sector. This is discussed in Chapter 4.

[180] E. Lemus, 'The Financial Collapse of the Enron Corporation and Its Impact in the United States Capital Market' (2014) Vol. 14 (4) Global Journal of Management and Business Research: Accounting and Auditing
[181] Company Act 2006 s. 380, s. 503 (3) & s. 507 (1).

The next sub-paragraphs chronologically evaluate in turn, key legislation at both national and supranational levels that formed the legal frameworks under which the banking sector operated in the period leading to the global financial crisis in 2007 - 2009.

2.16.2 Basel Accords: Basel Committee on Banking Supervision

Under this heading, the background and the importance of the international collaborative efforts within the EU Member States in their work towards enhancing stability of the financial services sector both in the EU and globally in the pre-global financial crisis era are evaluated. The section highlights the evolutionary development of the joint efforts which produced Basel I and II before the global financial crisis. This cross-border collaboration produced the foundation upon which harmonised regulatory and supervisory legal frameworks that are still currently being refined on an ongoing basis were built.

The Basel Committee's name at inception in 1975 was the "Committee on Banking Regulations and Supervisory Practices".[182] The body was formed in response to disturbances in the international currency and banking market, especially following the collapse of Bankhaus Herstatt in West Germany in 1974.

At the heart of the establishment of the Basel Committee at that time was a recognition of the need to (i) foster international collaboration among governments by working through the central bank Governors of participating countries. This was with a view to harmonise regulations on banking supervision, (ii) to ensure that no bank escaped supervision, (iii) the need to suggest ways to encourage stability and efficiency in the banking system, and (iv) agreement on adaptable regulations in areas of concern such as solvency, liquidity and foreign exchange operations and positions of banks.[183]

The Basel Committee identified areas of weaknesses in the management of financial institutions that were internationally active and what could go wrong in a bank to

[182] Committee on Banking Regulations and Supervisory Practices (1975) Report to the Governors on the Supervision of Banks' Foreign Establishment
[183] Ibid, pp 1 – 4.

destabilise the system as a whole. As reflected in the 1975 Concordat, the Committee also recognised the diversity of the circumstances of the participating countries, which if not taken into account could then undermine the intentions of the body, assuming at the onset the Committee had insisted on a uniform rule. Thus, the pioneering Basel Concordat dated 26th September 1975 saw a need to work with the participating countries on the basis of their unique local practices, taking into consideration local regulations.[184]

2.16.3 Basel I: The Basel Capital Accord

In 1988, the BCBS came up with Basel I, the Basel Capital Accord. This Basel agreement rode on the back of the debt crisis in the early 1980s among some Latin American countries, including Brazil, Mexico, and Argentina. The debt crisis then highlighted the deterioration in the capital ratios of some banks, increasing international risks in the banking system.[185] This situation led to the BCSB focusing on the need to promote a drive for capital adequacy among banks doing international banking business, intending to boost soundness and stability in the international banking system.[186]

BCBS worked out a capital adequacy proposal, measured based on a weighted assets approach and a suggestion of a minimum capital ratio with a benchmark of 8%, to be implemented by the end of 1992.[187]

The importance of capital adequacy to a bank is that it protects depositors and other bank's creditors, adequate capital level reduces the risk of a bank's failure, it helps to lower the incentive for risk-taking and it keeps allocation of credit in check.[188] Apart from other risks that banks are faced with, such as foreign exchange risk, interest rate risks, and operational risks, Basel I recognised credit risk, which may arise from

[184] Ibid p. 3
[185] BCBS, 'History of Basel Committee' https://www.bis.org/bcbs/history.htm. Accessed 01/06/2020
[186] Basel Committee on Banking Supervision, 'International Convergence of Capital Measurement and capital Standards' (1988) BCBS
[187] ibid
[188] Op. cit., D. Coskun, (n. 157).

default or inability to repay a material level of loans and advances accorded to a customer or a group of customers. [189]

The prescribed minimum capital ratio of 8% of risk-weighted assets benchmark was an attempt to sensitise the banking sector to the need for financial discipline and to provide an easily understood means to enable banks to evaluate and compare capital adequacy within the industry. Basel I was roundly criticised for being rudimentary because the prescribed 8% capital ratio was considered arbitrary and static.[190] Besides, the methodology used to arrive at the 8% benchmark was considered inadequate as it failed to take into account the maturity of exposure and the changing nature of default risks.[191]

The importance of Basel I to this research is that, following the emergence of widespread economic deregulation policy in the 1980s, and the exponential rate at which banks were merging, issues around capital adequacy and liquidity with the attendant risk-taking in the banking sector at the time became a topical issue, especially as concerns were raised about Basel I's fitness for purpose. An example of what this means to the banking sector was a case of a disproportionate level of exposure of eight US commercial banks to Mexico, Argentina, and Brazil which reached about $37 billion in 1982. At the time these countries defaulted on capital and interest repayment, they had to seek assistance from the International Monetary Fund (IMF).[192]

The issue then was that the exposure of the US Banks to these Latin American countries reached 147%[193] of the capital of the banks affected, such that if ultimately the countries mentioned had for some reasons not been able to receive the desperately needed support from the IMF, those eight American commercial banks could have faced imminent insolvency.

Worse still, Chiu and Wilson pointed out that some of the banks that went down during the 2007 – 2009 global financial crisis reported capital ratios which were

[189] Op. Cit., Basel Committee on Banking Supervision (1988) (n. 186)
[190] Zufferey, J. 'Regulating Financial Markets in Times of Stress is a Fundamentally Human Undertaking' (2011) Vol. 8 (2) European Company and Financial Law
[191] Ibid
[192] I. Chiu, and J. Wilson, 'Banking Law and Regulation' (Oxford University Press, 2019, p. 333)
[193] Ibid.

significantly above the prescribed ratios. For example, Lehman Brothers in the US claimed it had 16.1%, Northern Rock, a British bank said they had 17.5%, the Icelandic Bank Kaupthing had also claimed they had 11.2%.[194]

The point is that the three banks claimed that they were Basel I compliant as they had a weighted capital ratio well above the stipulated 8%. Doubts were later raised about the accuracy in the computation of the capital adequacy requirement reported.

In summary, what this section clearly suggests is that, as far back as in the 1970s, following the collapse of Bankhaus Herstatt in West Germany in 1974 and the debt crisis in the early 1980s among some Latin American countries, including Brazil, Mexico, and Argentina that could have brought to ruin some American banks that were over exposed to those countries but for the intervention of the IMF that bailed out those countries, the importance of sufficient liquidity and capital adequacy in the banks that were internationally active were well recognised. That scenario inspired the creation of Basel I, in 1988. The criticism of that era has been that, though there was a recognition of the problems around insufficient liquidity and inadequate capital in major banks, the measures put in place then were at best very weak and inadequate.

2.16.4 Financial Services Markets Acts 2000

The context in which FSMA 2000 was evaluated under this heading is concerned with whether the provisions of the legislation and others before it were robust enough and potentially capable of sustaining the banking sector against financial crisis in the period leading to the global financial crisis in 2007 – 2009. If not, to determine what the probable gaps were.

This part of the study also sought to evaluate the attitude of the banking sector and supervisory agencies towards compliance with the legal frameworks in force at the time which may have contributed to failings in the banks that were engaged as case studies in this research. The case studies are the Royal Bank of Scotland, Barclays Bank, Standard Chartered Bank and HSBC.

[194] Ibid. (Chiu, I. and Wilson, J. (2019, p. 343)

As discussed under Section D of this chapter (the next section), the incessant failure in the financial services sector in the 1980s and 1990s under the watch of the Bank of England fuelled the need to establish a strong unified regulatory body that could have a general oversight on the financial services sector in the UK.

It may be useful to mention that that same period was the time the UK followed its European counterparts to embrace the universal banking model.[195] An important advantage of bringing together different facets of the financial services sector under one umbrella regulator was that, it was considered to be efficient and it made sense to have a unified regulator to serve in the role of regulating and supervising universal banks than having multiple regulators supervising different segments within a universal bank comprising deposit takers, insurers, investment firms, provident and mutual societies.[196]

By the same token, it was also considered sensible to have an integrated body of law designed specifically for the financial services sector. The FMSA 2000 became that integrated body of laws designed to govern the UK financial services sector while the Financial Services Authority was the regulator saddled with the responsibility to regulate, supervise, support and enforce the law within the financial services sector.

FSMA 2000 is comprehensive legislation that comprises 30 Parts and 22 Schedules (Sch. 22 has since been repealed) aimed at harmonising the regulatory structure of the financial services sector as mentioned in the preceding paragraph.

The Act had six primary objectives which are, to boost public confidence in the financial system, to encourage stability in the financial markets, to promote and increase public awareness about market information thereby assisting interested stakeholders with market information that could aid decision making processes, to ensure consumers' protection and, as far as possible, to reduce financial crime.[197]

In response to the global financial crisis in 2007 – 2009, FMSA 2000 has been going through reviews and it is still currently undergoing modifications.

In recognition of the fact that FSMA 2000 is an all-embracing legislation that provided legal framework for the entire financial services sectors such as, Credit

[195] Op cit., Ellinger, E. P et al 2011, p. 73, (n. 110).
[196] The preamble to the to the FMSA 2000.
[197] FSMA 2000 Part 1 s.3 to 6A

Unions, Insurance Companies, Building Societies, Friendly Societies and assorted Financial Market Operators in an addition to the banking sector, stated below are some of the key features of the legislation specifically related to the banking sector which is the primary area of interest to this study.

Before the crisis, Part I of FSMA 2000 identified the now defunct Financial Services Authority as the official regulator of the financial services sector.[198] However, following the huge losses sustained during the crisis and the ensued public outrage at the attendant unprecedented support packages offered by the government at tax payers' expense to forestall the total collapse of the Global Systemically Important Banks, searchlight was focused on the performance and effectiveness of the FSA as the sole regulator of the financial services sector. [199]

For example, in his testimony before the House of Common Parliamentary Committee that reviewed the report into the failure of RBS, Lord Turner, the then Chairman of the FSA openly confessed that the supervisory model adopted by the FSA in the period leading to the global financial crisis was wrong and ineffective.[200] As well, in a report named after him published in 2009, the FSA Chairman also owned up that the supervision approach of the supervisory authority to the banking sector was fundamentally flawed as supervision of large complex banks such as the ones in the case studies should have been more intrusive, more systemic and more attention should have been paid to liquidity, capital adequacy and quality of the assets of these banks.[201]

Thus, under a new regime following the crisis, as from the 1st April 2013, Part 1A of the Act replaced the Financial Services Authority as the regulator of the financial services sector. A new simplified supervisory framework was designed comprising the Bank of England acting in the position of the overall supervisory agent, while the

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[198] FSMA 2000 Part 1

[199] The pledge by the government to support the banking sector facing financial crisis initially peaked at £1.162 trillion, but much later reduced to £456 billion as of 31st March 2011. RSB was the largest recipient of cash injection as they received £45.6 billion. https://publications.parliament.uk/pa/cm201213/cmselect/cmtreasy/640/64007.htm (paragraphs 94 - 96).

[200] House of Commons, "The FSA's Report into the Failure of RBS – Treasury", (2012, para. 97) n. 149 https://publications.parliament.uk/pa/cm201213/cmselect/cmtreasy/640/64007.htm

[201] Op. cit., Turner Review 2009, (2009, pp. 86 – 91), (n. 142).

Financial Conduct Authority and Prudential Regulation Authority each having clearly defined roles.[202]

S.1A provides the general duties of FCA which include ensuring that the relevant markets function well in such a way that advances consumer protection in addition to the duty to regulate the financial services sector and to formulate subsidiary rules which generally supports the six broad objectives of the Act stated earlier. Also, the FCA had the mandate to promote competition, as far as possible, to see to reduction in financial crime, a duty to consult practitioners and consumers and generally, to see to the soundness, stability and resilience of the UK financial system.[203]

Until comparatively recently, with the enactment of the Banking Act 1987 which introduced deposits protection scheme, consumer protection law was not in place for core banking customers.[204]

Issues about consumer protection were further consolidated through s.5 of the FSMA 2000 which required the Financial Services Authority to secure an appropriate degree of consumer protection in their supervisory role.[205] Consumer protection as it affects core banking customers relates to transparency in the market products and to ensure that how banks conduct their business is appropriate.

Similarly, under s.2B, the PRA has the burden to promote soundness in the financial system, to see to it that authorised person carry out their business in ways that avoided adverse effects on the continuity of the provision of services in the UK. The PRA has the additional responsibility to ensure that ring-fenced banks carry out their business safely in a way that avoids adverse effects that could cause disruptions to the provision of their services in the UK and that the business of ring-fenced banks is protected from risks emanating from within the UK and those that may come from abroad.[206]

Given the causes of the global financial crisis in 2007 – 2009 already discussed earlier under Section B, and the extent of the damages caused to the global

[202] FSMA 2000 Part 1A s.1A and s.2A
[203] FSMA 2000 Part 1 section 1 b – d.
[204] R. Cranston, 'Principles of Banking Law 2nd Ed.' (Oxford University Press, 2002, p. 76)
[205] FSMA 2000 s.5
[206] FSMA 2000 Part 1A s.2B (ss.3) (c) i, ii & iii

economy, the somewhat challenging and onerous responsibilities imposed on the regulatory institutions should be expected. This is especially in the face of supervisory failures of the BoE in the 1980s and 1990s discussed in Section D.

Going by the lessons learned from the failure of the BCCI in 1991 and in which the official liquidators of the bank, Deloitte Touche Tohmatsu attempted to shift the blame for the collapse of the bank on BoE based on an assumed wilful negligence and malfeasance in office on the part of the Bank of England,[207] a limitation clause was prudently inserted under s.2G of FSMA 2000. The exclusion clause says, "Nothing in sections 2B – 2D is to be regarded as requiring the PRA to ensure that no PRA authorised person fails."

Simply, this clause serves as an express notice to other financial services operators who may in the future want to follow in the footsteps of the BCCI liquidators, blaming regulators for a failure in their bank that such claims would not stand. The clause also serves as a notice to management of banks that they are primarily responsible for any failure in their banks and not regulatory/supervisory authorities.

Part II, IV, V and XXII of FSMA 2000 deal with regulated and prohibited activities including exercise of control over licenced person carrying out the business of banking. These sections of the Act deal with authorisation to carry out the business of banking, conditions precedent to be licenced to carry out banking business and circumstances that could lead to the withdrawal of authorisation to practice. It also set the rules that prohibits unauthorised person from carrying out activities that are regulated. Part V specifically deals with the qualification and vetting of senior employees or holders of specified sensitive duties by regulators and conduct expected from such high-ranking officers holding sensitive office in a financial institution. This part of FSMA 2000 was incorporated into Part IV of the Banking Reform Act 2013.

All these provisions of the Act are frontline defence mechanisms put in place to ensure that members of the public are not swindled by persons that may want to conduct banking business but have not been properly assessed and certified as fit and capable of running banking business.

[207] Three Rivers DC v Bank of England (No 3) (CA and HL) 2003 2 AC

Part XIV is concerned with enforcement of disciplinary measures against infringements by authorised person whilst Part XVI provides for Ombudsman Scheme meant to assist with informal dispute resolution between authorised person and members of the public.

Part XXII relates to appointment of auditors and their statutory duties. This part of the Act is without prejudice to Part 15 of Company Act 2006 from sections 380 – 430 which provide in detail requirements about the nature of accounts to be prepared by the banking sector, how it should be presented, what should be included in the financial accounts and key officers' report and the timeframe within which the audit report must be prepared etc.

Although Insolvency Act 1986 is a legislation that is generally applicable to all corporate entities, Part XXIV of FSMA 2000 and Part 2, s.90 – s.103 of the Banking Act 2009 provide 'customised legislation' for dealing with insolvency in the banking sector. The need for creating specialised legislation meant exclusively for the banking sector was heightened by a requirement to give effect to one of the objectives of FSMA 2000. This is concerned with "encouragement of stability" in the banking sector so that in the event of a bank becoming insolvent, there would be a set of resolution plans and orderly processes in place to either facilitate taking over of the bank by another bank through merger/acquisition or that the winding up of the business of the bank is conducted in such a way that it does not cause disruptions to the sector and especially the payment system.[208]

Part XXVII is concerned with offences relating to making misleading statement, insider dealing and money laundry while Part XXVIII is concerned with provisions that give powers to the Treasury to direct regulatory authorities to comply with UK international obligations.

In conclusion, FSMA 2000 is arguably a very 'rich' piece of legislation in the sense that it benefited from cumulative knowledge gained over the years from issues identified from failures in some banks in the past including the BCCI and JMB. As well, inclusion of provisions for consumers' protection in the banking sector was innovative. Similarly, the clear definition of roles between the BoE, FCA and PRA is a welcome idea. So also, inclusion of an express disclaimer to the effect that regulatory and supervisory agents have no obligations for the failure of a financial institution.

[208] The Banking Act 2009, s.90.

The palpable gap in the FSMA 2000 is its ominous silence on issues related to concerns about liquidity and inadequate capital in huge and complex major banks that were already strained by disproportionate debt/equity ratios. Apart from mentioning stability in the banks in general terms, FSMA 2000 is not specific about capital and liquidity adequacy. However, as discussed earlier, these are areas that are well under the control of international regulators that birthed Bases I, II, III and IV.

Banking regulation has come through a full circle. Before the 1980s, in the narrow banking era, subsectors within the financial system had distinctive regulations for each subsector. In the period 2000s, an umbrella legislation FSMA 2000 combined regulations of the entire financial system. In response to the global financial crisis, the Financial Services (Banking Reform) Act 2013 was made specifically for the banking sector.

2.16.5 Basel II, 2004: The New Capital Framework

Basel II released in June 2004 was a revision and a consolidation on the earlier Basel I accord, which aimed to further strengthen the soundness and stability of the international banking system.[209] The revised regulatory framework focused on three pillars: Pillar I – a minimum capital requirement that is risk-sensitive and hinged on categories of tiers of eligible capital which took into account operational risks, market risks, and credit risks. Pillar II – a supervision review process that took into account liquidity and systemic risks. And Pillar III, a requirement for banks to provide reliable information about their market exposure.[210]

The question is whether Basel II which was released in 2004 in addition to an array of other regulatory measures on the ground mentioned earlier adequately prepared the world's banking system for the looming catastrophic global financial crisis on its way in 2007 – 2009.

[209] Basel Committee on Banking Supervision, 'International Convergence of Capital Measurement and Capital Standards: A Revised Framework Basel II' (BCBS, 2004)
[210] ibid

In 2005, just two years before the financial crisis began, Tanega mentioned the then growing concern among regulators about banks' increasing exposure to securitised transactions (which ultimately led to the global financial crisis). Basel II, Pillar III sought to provide remedial protection against this risk by requiring banks to keep a capital reserve to hedge securitisation exposures.[211]

In 2010, practitioners, academics, and international governments were still grappling with why, how and what broke down needing fixing concerning the global financial crisis. Maxwell and Eichhorn contended that notwithstanding the best efforts and intentions of Basel I & Basel II, both failed to stop the crisis especially, in light of the near collapse of the financial system and more so that all the banks that failed claimed to have been compliant with the requirements of the two prior Basel agreements.[212]

Just as Admati also pointed out about the inadequate attention given by regulators to the problem of under capitalisation in the banks, the overwhelming nature of the global financial crisis in 2007 – 2009 made mincemeat out of the regulatory 8% capital requirement as a mechanism created to provide soundness and stability in the international banking system. Whatever provisions were made by the banks as hedges against risks associated with securitisation exposure devised under Pillar III of Basel II was like a drop in a bucket of losses incurred from exposure to CDOs, against which some banks are still counting their losses more than ten years after the crisis ended as indicated in chapter 4 of this report on the case studies.

2.16.6 Bank's Capital Adequacy Requirements Considering the Global Financial Crisis in 2007 - 2009

Regulations concerning the level of capital requirements in banks comprise two legs: (i) capital adequacy as a pre-requisite to starting a banking business, and (ii) capital

[211] J. Tanega, 'Securitisation Disclosures and Compliance under Basel II: A Risk Based Approach to Economic Substance Over Legal Form: Part I' (2005) Vol. 20 (12) 617 – 627 Journal of International Banking Law and Regulation

[212] A. Maxwell and M. Eichhorn 'Measuring Operational Risk in the Context of Basel II: Do Banks Move along the Spectrum of Available Approaches?' (2010) 25 (2) 83 – 88 Journal of International Banking Law and Regulation

adequacy concerning the relationship between owners' equity and the bank's exposure on loans and advances granted to bank customers on an ongoing basis.[213]

The first leg of capital adequacy requirements at the commencement of banking business stated under the old rule Schedule 3 criteria in the Banking Act 1987 [214] states that "the institution must have adequate capital." Provision about the level of resources required precedent to authorisation of licence is found under FMSA 2000 Part IV Permission and Schedule 6 s. 4. What would be considered a minimum threshold would be determined from time to time by the relevant licencing authority and the nature of the banking business involved.

Meeting capital adequacy requirements at the inception of the banking business is hardly the problem. It is the second leg of capital adequacy that can be problematic. This is concerned with keeping up with capital adequacy on an ongoing basis. Then, capital adequacy is tied to the relationship between owners' equity and the overall loan exposure to bank's customers.

Wadsley and Penn elaborate on the characteristics of the core capital which meets the capital adequacy rule. These include the ability to absorb losses and a requirement that it must have a certain degree of permanency.[215] Such would include fully paid-up ordinary share capital, general reserve, retained profit, and revaluation reserve for example.[216]

Addressing concerns over liquidity and capital inadequacy among credit institutions are part of the agenda of the Basel I Accord which tried to prescribe a benchmark ratio that should be the barest minimum applicable to all banks. This was stated as 7-8%.[217] The attempt to prescribe a benchmark for all banks has been subject to severe criticism on the ground that one size fit all model would be ill-fitting for banks with varied circumstances.[218]

As a follow up to the 1988 Basel I Accord, in 1989 the EU came up with an additional policy in support of the Accord styled "Own Funds of Credit Institutions" which

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[213] Op. cit., Cranston, R. 2002, p. 89, (n. 204).
[214] The Banking Act 1987 Sch 3
[215] J. Wadsley, and G.A Penn, 'The Law Relating to Domestic Banking 2nd Ed.' (Sweet & Maxwell, 2000, p.39)
[216] Ibid.
[217] S. Schwerter, 'Basel III's Ability to Mitigate Systemic Risk' (2011) Vol 19 (4) 337 – 354 Journal of Financial Regulation and Compliance
[218] K. Pakravan, 'Bank Capital: The Case Against Basel' (2014) Vol. 22 (3) 208 – 218 Journal of Financial Regulation and Compliance

further stressed the importance of capital and liquidity adequacy as a necessity to strengthen the banking system within the Member States. Other than the fact that the Directive did not commit itself to prescribing the minimum threshold of liquidity and capital adequacy ratios apart from the recommended ratios specified by the Basel I Accord, on the preamble page of the Directive, the policy gave allowances to Member States to adopt self-determined stringent provisions to safeguard the domestic banking sector. Member States were encouraged to strive to achieve greater harmonisation within the community, it pointed out that when supervising huge and complex banks, standardised mechanisms should be adopted on how consolidated own funds are determined taking into account varied circumstances of the credit institutions involved and the local economy. Article 2 of the directive lists types of funds that should constitute own funds for the purpose of determining liquidity and capital adequacy ratios.[219] These are, paid up capital, share premium accounts, balances on accumulated profit and loss account, revaluation reserves, contingent provision accounts for banking risks and fixed term cumulative preferential shares accounts.[220]

What Wadsley and Penn (in the year 2000 which was well before the global financial crisis) and Basel I in 1988 suggest is that all along there was a recognition of the importance of the need for banks to maintain adequate liquidity and equity capital. Whether that requirement was followed is a different matter. Part of the difficulties in the pre-crisis era was the inadequate attention given by the banking sector's supervisors to these elements which are vital to the survival of huge and complex financial institutions. For example, the failure of Johnson Matthey Bankers Ltd (JMB) in 1984 was caused by poor risks management and excessively lending to few creditors that defaulted. That case illustrates some of the dire consequences that could occur where bankers are lending in measures that are far disproportionate to the available equity support base.[221]

Although the failings in JMB later inspired law reforms which made it mandatory to report to regulators where a bank is exposed to a borrower or a connected group of borrowers of up to 10% of their capital or where such lending would expose the

[219] European Economic Community, "Own Funds of Credit Institutions", (1989) Directive 89/299/EEC
[220] Ibid.
[221] Op. cit., (Cranton, R. 2002, p. 63) n 189

bank to the risk of losing up to 25% of its capital, bankers were found to have often circumvented the rule. [222]

During the hearing before the House of Commons Committee commissioned to examine the Financial Services Authority's report into the failure of RBS, Lord Turner in his own words said,

> *"The basic fact that the capital and liquidity regimes were, to be blunt, rubbish, we knew already …The supervisory approach was wrong…"* [223]

The argument here is that, though bankers were primarily the architects of their own misfortune and ultimately responsible for their losses, the banking sector supervisory authorities did little to help if all along they were aware that there were gross irregularities in the banking sector's micro-prudential strategies, if they knew that there were undue risks taking in the banks and that Global Strategically Important Banks were operating under inadequate liquidity and capital ratios but did nothing to arrest the situation even when they had the power to do so.

The poor attention by supervisory agencies to issues around capital adequacy in the banking sector in the period leading to the global financial crisis invariably led to excessive risk taking whereby banks were notoriously using excessive debt capital to finance loans, overdraft, mortgages and other facilities to bank customers thereby endangering financial stability in the economy.

It was the global financial crisis in 2007 – 2009 that once again accentuated discussions around the importance of capital adequacy in the banking sector. Admati opined that adequate attention was not sufficiently paid to the importance of capital adequacy before the global financial crisis and even thereafter. In the attempt to review the law, regulators were still not doing enough to put the need for capital adequacy in the prime position it deserved.[224] Writing much later in 2019, Gurrea-Martinez and Remolina emphasised that capital adequacy is now increasingly recognised as one of the most important parts of international banking regulation.

[222] The Banking Act 1987 s.38 (1a and 1b) and s.38 (2)
[223] House of Commons, "The FSA's Report into the Failure of RBS – Treasury", (2012, para. 117) https://publications.parliament.uk/pa/cm201213/cmselect/cmtreasy/640/64007.htm
[224] Op. Cit., A. R. Admati 2014, (n. 11).

They suggest that banks that have a sound capital base tend to be more financially stable and are less likely to take excessive risks.[225]

In recognition of the contributions of liquidity and inadequate capital to the global financial crisis in 2007 – 2009, part of the Turner's review suggested that the overall quantity and quality of the global banking system must be substantially increased, and creation of counter cyclical capital buffers should be a matter of priority for banks that are exposed to other banks.[226]

The conclusion under this heading is that, although in the pre-crisis era there was a recognition that capital adequacy level in the banking sector is *sine qua non* to stability in that sector, the principle was not put into practice as much as it should have been.

Secondly, the need for more regulations and associated costs could have been obviated where regulatory and supervisory architecture are operating efficiently.

2.16.7 Argument for the Justification of Bank Regulation

Neo-liberalism ideology (discussed later under Drivers of Economic Regulation) suggests a laissez-faire approach to regulation and that as far as possible economic activities should be unrestricted by law.[227] This section of the study deals with a variety of reasons why banking regulation is imperative.

As pointed out earlier in this chapter, historically it has been the case that whenever there is laxity in the supervision of the banking sector or some impediments that prevented adequate regulatory oversight on the financial sector, the result tended to be that eventually financial crises occurred. The result of an earlier survey by Ramasastry and Slavova which cuts across international boundaries re-emphasised that lack of enforcement and effectiveness in the supervision of banks may lead to a

[225] A. Gurrea-Martinez, et al. 'The dark Side of Implementing Basel Capital Requirements: Theory, Evidence, and Policy' (2019) Vol 22 (1) Journal of International Economic Law
[226] Op. Cit., Turner, A. 2009, pgs. 53 – 68, (n. 142).
[227] C. Colclough and J. Manor 'States or Market? Neo-liberalism and the Development Policy Debate' (Oxford University Press, 1993)

situation where troubled financial institutions continue to operate even when insolvent or are no longer viable [[228]][[229]].

At the time of that study, which was in the late 1990s, the research of these authors suggested that financial institutions that ran into serious difficulties in the jurisdictions where European Bank for Reconstruction and Development (EBRD) operated mostly have well developed legal systems, but there was laxity in the implementation strategy. According to these authors, there was inadequate trained regulatory personnel to conduct periodic supervision and failure to take remedial actions when such would have helped.[230]

At about the same time in 1997, the Ex- Solicitor General of England and Wales, Prof Cranston, observed that notwithstanding that the economy was in a period of financial liberalisation, legal regulation of banking and finance in the UK witnessed significant tightening in view of the aggressive marketing and increased risks which were undertaken by bankers.[231]

As pointed out earlier, the level of capital requirement at the start of a banking business is hardly the problem, but it is the minimum threshold of capital and liquidity ratios as a going concern that can be an issue.

Part of the most important monetary policy tools used during the Bretton Woods era needed to manage liquidity and to control inflation in the economy was to either increase or decrease bank's liquidity ratios, or as may be required, adjustments to the interest rates thereby mopping up excess liquidity, or inducing increase in cash volume within the economy to dampen deflation.[232]

However, with the advent of liberalism and with it the adoption of the free market enterprise popularised by Friedman,[233] any attempt by regulatory authorities to influence the interest rate or banks' liquidity or capital ratios more than is necessary would be seen to be an insidious reversion to the once rejected Keynesian

[228] A. Ramasastry, and S. Slavova 'European Bank for Reconstruction and Development (EBRD) Survey Result' (1999) (7) 297 Journal of International Banking and Financial Law
[229] Op. cit., L. Verril, 2008, (n. 19).
[230] Op. cit., Ramasastry, A. and Slavova, S. 1999, (n. 228)
[231] Op. cit., R. Cranston, R. 2002, p. 63, (204).
[232] J. M. Keynes, 'The General Theory of Employment, Interest and Money' (Rinehart and Wilson, 1936)
[233] M. Friedman, 'Price Theory' (Aldine, 2007)

protectionist ideology and what is seen to be a disposition towards paternalism.[234] This is a notion that the government wrongly adopts a position of an overprotective father who enforces rules on his children under the assumed protection of the "best interests of their children" even if the children are not welcoming of such intrusion. This is what the tension is about. The importance of this area to this research is that, issues about the policy on ring-fencing would also fall within this contentious area of law that generated a debate as to whether it is appropriate to impose the policy on the banking sector in the way it did or that the riskier investment banking that should have been carved out.

The other side of the argument is that public interest justifies government intervention in the economy when appropriate.[235] The argument is that unlike other institutions or business organisations, a bank's failure would likely have a much more adverse impact on the economy than would be the case with any other business organisation because of the contagion effect a bank's failure can have on other facets of the economy, especially within the banking sector where there is interconnectedness and dependency.[236]

For example, in the absence of a Deposit Insurance Guarantee Scheme, depositors could lose their life savings or a very significant part of it which would naturally lead to outrage and social economic upheaval. Therefore, as a matter of prudence, and because of the importance of the banking sector to the economy, it is considered absolutely necessary to regulate the banking sector. For those who oppose ring-fencing, the question is not about resistance to regulation of the banking sector. The issue is concerned with the type of regulation. The question is concerned with, what area would the government control? Are there better ways of dealing with the concern addressed by the ring-fencing policy? Would the cost of ring-fencing in the long run be disproportionate?

These issues will be revisited under the section on theories on structuralism and neo-liberalism.

[234] J. S. Mill, 'On Liberty' (Penguin, 1974)
[235] Op. cit. L. Guiso, et al., 2006, (n. 5).
[236] A. Arora, 'Banking Law' (Pearson, 2014, p.168)

2.16.8 Conclusion

The review so far highlights the status of the prevalent regulatory framework that existed before the global financial crisis in 2007 – 2009.

The Banking Act 1979 is a very comprehensive piece of legislation which was enacted in response to the difficulties which arose in the banking sector in the mid-1970s. The aim was to put on to a statutory footing regulation of the activities of the banking sector, and to firmly entrenched the powers of the Bank of England in its supervisory role over the banking sector in anticipation of potential difficulties that may have surfaced following the emergence of banks that were growing bigger as a result of deregulation of the economy at the time.[237]

Similarly, at a supranational level, Basel I was introduced in 1988 to enhance the resilience and stability among banks that were internationally active, in response to the debt crisis that arose in some Latin American countries and with the intension of restoring confidence in the banking sector following the collapse of Bankhaus Herstatt in West Germany in 1974.[238]

FSMA 2000 created the new tripartite supervisory architecture comprising BoE, FCA and PRA. The legislation provided clear definitions of the role of the regulatory/supervisory institutions.

Basel II, which was introduced in 2004 focused on enhanced capital requirement, the need for banks to make special provisions against exposure to the risk of losses that might arise from the inter-connectedness among banks and the need to enhance the supervision regime in the banking sector.[239]

Lessons were learnt from issues that arose on the account of bank failures in the 1970s to the 1990s. As listed out under this section, substantial regulatory frameworks were developed in response to those problems since 1979. The big gap in the regulatory measures was the weak attention paid to insufficient liquidity,

[237] See page 56
[238] See pages 60 - 62.
[239] See pages 68 - 69.

inadequate equity capital and excessive debt/equity ratios which regulators knew at that time were deep-seated problems among huge complex banks and which eventually formed part of the factors that led to catastrophic global financial crisis in the end.

The next section evaluates the supervisory element of regulatory framework on the ground in the banking sector prior to the global financial crisis. It also discusses range of regulatory changes made in response to the global financial crisis including Basel III relating to fortification of supervision framework, enhancement of the quality of capital, mitigation on pro-cyclicality, integration of micro and macro prudential supervision and regulation on Liquidity Coverage Ratio.

Section: D

Banking Sector Regulatory Institutions: Supervision, Support, Surveillance and Enforcement

2.17 Introduction

The previous section was concerned with evaluation of the banking laws and regulations which imposed duties and obligations on the banking sector in the UK before the 2007 – 2009 global financial crisis.

This section evaluates the institutions that have the responsibility to police, support and supervise the banking sector in the best interests of the public. The primary role of these institutions is to ensure that banking law and regulations are effectively enforced so that ultimately the banking sector maintains the confidence of the public and investors.[240]

This section is linked with objective (i) subsection (b) of the research which seeks to establish whether there were gaps in the prevalent laws and regulations which may have contributed to the global financial crisis in 2007 - 2009. The section also evaluates regulatory changes at supranational level on quality of capital and Liquidity Coverage Ratio (LCR).

This section is particularly important to this study because it discusses the failure of the regulatory institutions and the Financial Services Authority which was the principal supervisory authority over the banking sector prior to the financial crisis. In the Turner's review, the FSA was severely criticised for its failure in the prudential and micro supervision of individual banks and in its failure to detect and warn the government of the impending crisis. This supervisory failure has been cited as a large part of the contributory factors to the associated problems that came with the 2007 – 2009 financial crisis in the UK. That led to the disbandment of the FSA that served as the supervisory authority in the period leading to the global financial crisis and it led to a policy change encapsulated in the government policy statement, "A new approach to financial regulation: the blueprint for reform. [[241]][[242]]

[240] Financial Services and Market Act 2000 (the preamble)
[241] Op. cit., A. Turner 2009 (n. 142)

2.18 The Scope of Banking Supervision Activities

In context, supervisory activities refer to matters about exercise of close oversight on financial institutions without being overly intrusive in its affairs except where appropriate to prevent banking sector crises.[243] Support is concerned with the provision of help to a bank in times of distress by the supervising institutions so that instead of folding up, the supervising institution helps to stabilise the distressed bank either nursing it back to life or assisting the bank with an orderly dissolution.[244] In the event of an inevitable winding up, the objective of the supervising institution is to avoid a contagion effect on the banking sector, bringing to the barest minimum the negative impact of the failed bank on the whole economy.[245] Surveillance activity includes a third party or secondary agents' collaborating in the supervision process.[246] One example is auditors whose work of examining the bank's annual accounts includes a requirement to report fraud or irregularities of any kind to the supervising institutions directly.[247] This has become a vital part of the supervisory framework of the banking sector, following the collapse of the Bank of Commerce and Credit International.[248] Enforcement refers to the processes of imposing sanctions on a defaulting financial institution for infringements of banking regulations and laws.[249]

Prior to deregulation in the 1970s, an important part of the reasons for the exercise of control over the banking sector was the need to protect the economy from harmful external influences such as unhealthy practices, and to enable policy makers to steer the economy toward a desired pathway by using monetary policy mechanisms such as interest rate and credit control measures.[250]

This section surveys the banking sector's supervision regimes in the UK, the lessons learnt in the supervision of the banking sector over time and the evolutionary developments of the banking supervision institutions and supervision policies in the UK. The section argues that banking supervision has come of age after the Bank of

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[242] HM Treasury, 'A New Approach to Financial Regulation: The Blueprint for Reform' (2011)
[243] A v. B (Bank of England Intervening) [1992] AII ER 778
[244] Banking Act 2009 Part 1 s.2 (a) Stabilisation Option (b) Insolvency procedure (c) Bank administration
[245] Banking Act 2009 Part 1, s.1
[246] Banking Act 1987 Part 1 s.41 (Investigation on behalf of the Bank) s.42 (Investigation of suspected contravention) s. 43 (Powers of entry in case of suspected contravention)
[247] Part 7, Banking Reform Act 2013, Banking Act 1987 Part 1 s.45, 46 & 47 Accounts and Auditors
[248] Price Waterhouse v BCCI Holdings [1992] BCLC 583
[249] The Financial Services (Banking Reform) Act 2013 s.71 (Compliance failure) s. 73 (Penalties)
[250] Hadjiemmanuil, C. (1996, p.1) Banking Regulation and the Bank of England

England Act 1946. In so doing, Section D highlights instances in the 1990s when fundamental mistakes were made by taking the direct supervision of the banking sector away from the Bank of England and giving it to the Financial Services Authority. As well, key milestones are identified when innovative features were incorporated into the financial system supervision models in the UK through the Financial Services and Markets Act 2000 and the reinforcement of those features in the Financial Services (Banking Reform) Act 2013 as we witnessed lately after the 2007 – 2009 financial crisis. Part of the aims of this section is to highlight what worked best and policies that failed woefully.

2.19 The Nature of Banking Supervision

It is not uncommon to assume wrongly that regulatory and supervisory activities relating to the banking sector are one and the same thing.[251] Some people use the terms 'banking regulation' and 'banking supervision' together or interchangeably.[252] Regulation and supervision are two distinctive roles though at times the two roles may to some extent fuse. Regulatory role means devising the law, making the rules and determining the regulations that govern the activities of the banking sector whilst supervisory role is concerned with activities relating to enforcement, compliance with the rules and regulations.[253]

The institutions involved in making regulations include parliament through enacted statutes, the Treasury, the European Union through directives, market makers through industry self-imposed rules and the Bank of England the apex bank, through directives to the financial system. For example, parliament makes the law, but it does not exercise direct supervision over the banking sector so also the Treasury. The Treasury maintains oversight on the financial system (at macro level) through the Bank of England. Although wholly owned by the Treasury on behalf of the government, through the Bank of England Act 1998 the bank became independent with autonomous powers to determine monetary policy through the Bank of England Act 1998. [254] The Bank of England can determine rules and regulations for the banking sector and as well exercise direct supervisory oversight over the financial

[251] Op. Cit., A. Arora, 2014, (n. 236).
[252] D. Singh, 'Banking Regulation of UK and US Financial Markets' (Ashgate, 2007, p. 47)
[253] Op. Cit., E. P Ellinger, E. P et al, 2011, p. 27, (n. 110).
[254] Bank of England Act 1998 Part 1A Financial Stability s.9a – 9g

system as a whole through the PRA and FCA.[255] So, in practice, the Bank of England and its subsidiaries combine the roles of "regulating" and "supervising."

The misconception about the two roles can typically come to light when there are complaints that the banking sector is unregulated. As pointed out earlier in Section C, there is a long history of the evolvement of laws and regulations governing the affairs of the banking sector. Similarly, there are agents that are empowered to maintain supervisory oversight of the banking sector activities and to enforce the statutory laws and regulations imposed on the banking sector, but one must admit that the era of deregulation ushered in the period of light touch regulation. The issue that has often been a subject of debate concerning supervision of the banking sector is the effectiveness or otherwise of the approaches to banking supervision in the UK.[256] This section focuses on the role of the Bank of England and its newly constituted subsidiary supervisory agents, which are Prudential Regulatory Authority (PRA) and the Financial Conduct Authority (FCA), the twin peaked model enunciated in the Banking Reform Act 2013.

As argued by Penn, a possible reason why some people assume that the banking sector was unregulated was due to the fact that until the Banking Act 1979, the duties which are now statutorily imposed on the banking sector were previously not placed on a statutory footing.[257] The reason for the previous stance on this was that there was a general recognition that the characteristics of banking institutions falling within the regulation vary very widely, and as such it was considered imprudent to impose rigid uniform statutory requirements on the banking sector.[258]

Therefore, previously, banking institutions generally yielded to the Bank of England's gentle or moral persuasion without a need for statutory regulations. This approach has been variously described as, "command and control" or a "soft touch" approach to banking regulation.[259] While this sort of approach worked since 1946 after the Bank of England assumed the responsibility to supervise the banking sector, the circumstances that gave rise to the collapse of Johnson Matthey Bank in 1985 started

[255] Ibid s.9h – 9n, Directions by Financial Policy Committee
[256] J. Gray, and J. Hamilton, 'Implementing Financial Regulation' (John Wiley & Sons, 2006, p. 2)
[257] G. Penn, 'Banking Supervision: Regulation of the UK Banking Sector under Banking Act 1987' (Butterworts, 1989, p.10)
[258] Ibid (Penn, G 1989, p 17)
[259] Op. Cit., Gray, J and Hamilton, J. 2006, p. 2, (n. 256)

to fuel discontents and increasingly caused concerns over the effectiveness of a soft touch approach to the supervision of the banking sector.[260]

Rightly so, over time, the banking sector is seen to be one of the most regulated sectors of the economy starting with meeting the licensing requirements in order to start a banking business.[261] The Financial Services and Markets Acts 2000 (FSMA) Part IV prohibits carrying out regulated activity in the UK unless authorised or exempted from doing so.[262]

In the debate, one view was that the banking sector was not regulated sufficiently because demands on the banking sector were not spelt out in detail in statutory regulations, whist economists such as Goodhart et al argued that the financial sector was probably already over-regulated.[263] Similarly, Arthur and Booth, renowned economics professors, reject as utterly nonsensical any claim that the banking crisis in 2007 – 2009 was the result of excesses of unregulated financial capitalism.[264] They also reject wholesale the popular notion that dislocations in financial and other markets were caused by too little regulation or that the crisis could have been averted by the exercise of greater regulatory powers.[265] They reasoned that it is an important intellectual mistake to associate all regulatory activities with the state. They argued that industry self-regulation such as professional body self-imposed regulations can just be as effective as statutory regulations. Following the financial crisis, not many people would agree with these economists on this issue now.

Regulation of the banking sector is not limited to control mechanisms put in place by the national authorities but also includes regulation at the supranational level such as the Basel Accords. For example, following the 1957 Treaty of Rome, the single market across the European Union required harmonisation of the regulatory systems among member states.[266] So, in addition to domestic laws and regulations, the banking sector was obliged to observe rules and regulations emanating from the European Union as already pointed out in Section B.

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[260] Bank of England Act 1946
[261] Op. Cit., L. Guiso, et al., 2006, (n. 5)
[262] FSMA 2000 Part II s.19
[263] Op. Cit., C. Goodhart, et al., 1988, (n 13)
[264] Op. Cit., Arthur, T and Booth, P 2010 (n 15)
[265] ibid
[266] Op. Cit., P. Howells and B. Keith 2007, p. 381, (n. 107)

As pointed out in Lord Turner's (the chair of the defunct FSA) report in the aftermath of the 2007 – 2009 financial crisis, what mostly failed was the system of supervision, not necessarily the legal framework. [[267]][[268]] The conclusion was that FSA had to go. FSA was generally mocked for failing to do a proper micro supervision of the banks. At that time, the supervisory structure was referred to as the "Tripartite supervisory regime" comprising BoE, Treasury and FSA. The criticism was that there was no clear demarcation on what each of these bodies should be doing.

Whilst the distinctive regulatory and supervisory roles can sometime overlap as stated previously, the next section focuses on the supervisory element, to determine the causes of the failure of the supervisory system in the period leading to the 2007 – 2009 financial crisis, the lessons learnt, improvements made and whether there are still more things to do to bolster the strength of the supervisory agencies that have oversight over the affairs of the banking sector in the UK.

2.20 The Hierarchy of Supervisory Institutions Overseeing the Banking Sector in the UK

As mentioned in 2.19, the established principal supervisory bodies having direct oversight of the banking sector in the UK include the Treasury, the Central Bank (the Bank of England) and its subsidiaries, the Financial Conduct Authority and the Prudential Regulatory Authority.

The very fragile nature of banking business and its high susceptibility to a real risk of collapsing, thereby creating instability in the economy, provides a justification for close monitoring of the sector.[269] Fragile in the sense that banks thrive when they enjoy public confidence but when that confidence is eroded it can mean a 'run' on the bank, such that depositors can start to queue up to withdraw their money before it becomes impossible to get their money back. Thus, even a misplaced and a needless bad press can all the same result in a disaster. The risk of market failure places enormous responsibility on the government to ensure that there is stability in the banking sector.

[267] Op. Cit., A. Turner, A. 2009, (n. 142)
[268] Op. Cit., C. Goodhart, et al., 1988, (n. 13)
[269] Op. Cit., J. Wadsley, and G. Penn, 2000, (n 215)

2.21 The Treasury

Recognition of the gaps and failings of the tripartite supervisory arrangements (the treasury, the Bank of England and the Financial Services Authority) during the crisis in 2007 – 2009 inspired the white paper, "A new approach to financial regulation" which provided new policy guidelines that placed the responsibility for financial stability both at macro and micro levels squarely on the shoulders of the Bank of England.[270] The problem with the old order of things was that, when the three different institutions mentioned were concurrently in charge of the financial system in the UK, no one was truly in charge of the 'fine detail' regarding focusing on individual banks at the micro level.

For example, this problem came to the fore when deficiencies were noted in the micro-prudential regulation of Northern Rock. As had previously happened in the case of Johnson Matthey Bank's crisis in 1984,[271] the problem repeated itself with Northern Rock in the sense that the bank continued to trade even when it was using short term-based deposits to finance long term loans. This continued for several years before the problem came into the open. As pointed out by Tomasic, it was possible for the bank to continue trading because the bank was solvent notwithstanding that it had liquidity problems.[272] The question was, "Who was supervising Northern Rock?" Why did no one spot the problem a long time before the crisis escalated?

This was one of the problems identified in the government White Paper, "A New Approach to Financial Regulation: The Blueprint for Reform". The then proposed policy identified different levels of banking supervision, clearly specifying the defined roles to be given to each level of supervisory institutions and assignment of the overall responsibility of the management of the financial system to the Bank of England.

Therefore, at the macro level, the Financial Policy Committee became responsible for overall policy matters. Responsibility for conduct of business now rests with the

[270] Op. Cit., HM Treasury 2011, (n. 242).
[271] Op Cit., R. Cranston, 2002, p 65, (n. 204)
[272] R. Tomasic, 'Corporate Rescue, Governance and Risk taking in Northern Rock: Part 2' (2008) Vol 29 (11), 330 – 337 Company Lawyer

Financial Conduct Authority and micro supervision of individual banks sits with Prudential Regulatory Authority.[273]

2.22 The Ascendance of the Bank of England to the Position of the Banking Sector Supervising Authority and a Review of Previous Remarkable Bank Failures

Historically, the Bank of England started off with the aim of mobilising funds for the monarch to enable King William to prosecute the war against Louis XIV of France and to facilitate military defence of England.[274] Following the defeat of the last Catholic King, James II, William inherited a poorly managed public finance that was in serious difficulty. [275] Thus, the primary aim of setting up the Bank England in the first instance was to assist the King to sort out the debt crisis. The bank collected taxes and paid interest on loans on behalf of the King. In return for a loan of £1.2 million, the King granted a Royal Charter to the Bank's promoters styled, "The Governors and the Company of the Bank of England" [[276]][[277]].

At that initial stage, the Bank of England competed alongside other privately established banks on Lombard Street in London and other banks operating in the hinterland. As posited by Roseveare, at inception, the Bank of England was named Bank of London but at the time, it did little or nothing that could be called the function of a modern central bank.[278]

The Bank of England may not have been seen to perform the role of a modern central bank at its inception more so that the aim of setting up the bank at that time was not necessarily to function as a central bank. This researcher however observed that the Bank of England maintained accounts for other private bankers-goldsmiths of that time due to the Bank of England's position of strength as the King's agent. The bank had a Royal Charter and the physical protection which the Bank of England could provide to the private banks by keeping in its vaults their precious metals such

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[273] Op. Cit., HM Treasury 2011, (n. 242)
[274] J Prager, 'Fundamentals of Money, Banking and Financial Institutions' (Princeton University Press, 1982, p.90)
[275] J. Kirk, and J. Ross, 'Modern Financial Regulation' (Jordan Publishing, 2013, p 5)
[276] Op. Cit., n 255 (Pager, J. (1982))
[277] J. Rogers, 'The early History of the Law of Bills and Notes: A Study of the Origins of Anglo-American Commercial Law', (Cambridge University Press, 1995, p.120)
[278] H. Roseveare, 'The Financial Revolution 1660 – 1760' (Longman, 1991, p.37)

as silver and gold used as a medium of exchange at the time. In that sense therefore, it could be argued that the Bank of England over time acquired influence which placed it naturally to become a Central Bank. A recognised function of a modern central bank is being the bankers' bank. It is further argued that, that function enables the central bank to be able to determine very quickly a bank that is well endowed and those that are showing early signs of liquidity problem.

In the 19th century, the Bank of England had an enhanced public service following the Bank Charter Act 1844 which granted the Bank the monopoly to issue banknotes.[279] This in itself was a significant milestone in the economic history of the UK. It was a response to the growing need of commercial life and encouraged reduced dependency on very expensive metals (gold and silver) as the instrument of exchange,[280] obviating the difficulties associated with transportation of a large amount of money in silver and gold. McLoughlin also traced the history of negotiable instruments used to facilitate payments, of which the most common today include banknotes and cheques.[281]

Thus, the Bank of England gradually grew into a position of pre-eminence in the banking sector, - *primous inter pares*, first among equals.

If the history is fast-tracked to the twentieth century, under the aegis of the Treasury (before the BOE became autonomous), the Bank of England became even more involved with assisting in formulating and implementing monetary policy after the second World War. Thereby, the Bank of England acquired a position of significant influence in supervising financial institutions within the financial system following the Bank of England Act 1946.[282] Following the enactment of this Act, the Bank of England was entrenched as the supervising institution mandated with oversight of the banking sector.[283] Section 4 (3) of the Act provides that, under the authorisation of the Treasury, the Bank of England, if they think it necessary and in the public interest, may issue directions to any bank.

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[279] M. Howard, et al., 'Butterworths Banking Law' (Lexis Nexis, 2006, p.7)
[280] D. Richardson, 'Guide to Negotiable Instruments and the Bill of Exchange Acts 5th Ed.' (Butterworths, 1976, p. 14)
[281] J. McLoughlin, 'Introduction to Negotiable Instruments', (Butterworths, 1975)
[282]M.J Artis, 'Foundations of British Monetary Policy' (Basil Blackwell, 1965)
[283] The Bank of England Act 1946 s.4 (3)

The wording of this section of the Act was criticised much later by Lord Bingham[284] as being too loose, imprecise and unclear as regard the extent of control the Bank of England should have over the banking sector.

The principal objectives of the Act are: (i) to bring the capital stock of the Bank of England into public ownership, (ii) to bring the Bank of England under public control and (iii) to set on a statutory footing the relationship between the Treasury, the Bank of England and other banks.[285] The Act empowers the Bank of England to seek information, give direction as it may consider necessary and to give advice as it may deem fit.[286]

Although the Bank of England had the privileged position of being the government's bankers, its governing body was in private hands.[287] The Bank of England's governors were traditionally drawn from the courts of the merchant banking community in the city of London.[288] Nonetheless, the government still exerted considerable influence over the bank as the Bank of England had to subordinate its decisions to the government economic policies. This went on through the Bretton Woods era from the World War I to the 1970s when the emergence of neo-liberalism caused the dismantling of structuralism ideology. Notwithstanding the deregulation in the 1970s through to the 1990s, regulation and supervision of the banking activities still resided with the Bank of England.[289]

The Banking Act 1979 widens even further the power given to the Bank of England to supervise deposit-taking Banks in the UK. The underlying assumption on which the Banking Act 1979 was enacted was that the prudential regulation was going to be the minimum benchmark of regulation that the banking sector had to comply with.[290] Although the Banking Act 1979 was enacted in response to the first EC Directive, part of the motivation for enacting the Act was to bring under the

[284] Bingham, Lord Justice, 'Inquiry into the Supervision of the Bank of Credit and Commerce International' (HMSO, 1992)
[285] The Bank of England Act 1946 s.1.
[286] The Bank of England Act 1946 s.4 (3)
[287] Op. Cit., Artis, M J 1965, (n. 282)
[288] Ibid (Artis, M. J. (1965)
[289] Op. Cit., Ellinger, E. P. et al 2011, p. 30, (n. 110)
[290] Op. Cit., A. Arora, 2014, p. 180, (n. 236).

supervision of the Bank of England secondary banks that were hitherto unregulated.[291]

The specific aims of the Act were: (i) to regulate the acceptance of deposits. The objective was to safeguard the public from the activities of people of dubious character who may want to defraud the public by taking deposits from people for less than noble reasons. So, entry into the banking market was controlled by vetting those who were licensed to accept deposits; (ii) to confer on the Bank of England the obligation to control institutions carrying out deposit-taking businesses; (iii) to afford protection to bank depositors; (iv) to regulate advertising, invitation of the public to make deposits; (v) to restrict the use of names and descriptions associated with banks and banking. The word 'bank' or 'banking' are seen to present an image of strength, hence the need to ensure that unscrupulous persons do not misuse the term bank as part of their business name to defraud the public, and (vi) to prohibit fraudulent inducement to make a deposit.[292]

These are specific objectives concerning supervision of the banking sector. It needs to be pointed out that this legislation followed closely on the economic deregulation of the 1970s to the 1990s. The assertion supports the view that, notwithstanding deregulation in the economy, the banking sector still remained one of the most regulated sectors of the economy.[293] It also goes without saying that a claim to the effect that the banking sector was unregulated is not entirely correct. The aims of the Act regarding the position of prime importance attached to the protection of depositors is not in doubt and the power given to the Bank of England to play that role could not have been clearer. Whether the Bank of England exercised that power and whether it indeed protected the interests of depositors at that time have been subjects of intense debate.

The crisis faced by Johnson Matthey Bankers Ltd (JMB) in 1984 marked another important watershed in the history of banking in the UK.[294] JMB was an investment bank that ran into trouble not because of speculative investment, the type the ring-fencing policy seeks to protect commercial banks from, but the bank became distressed because of poor risks management and deficient lending practices.

[291] Op. Cit., R. Cranston, 2002, p 65, (n. 204)
[292] The Banking Act 1979
[293] Op. cit. Cranston, R (2002, p 63 (n. 204)
[294] Ibid. R. Cranston, 2002, p. 65

Investigation about what went wrong revealed significant shortcomings in the way the banking sector was supervised by the Bank of England.

Hansard of 26th July 1985 demonstrates the outrage of the Honourable Members of Parliament at the shocking negligence of the Bank of England and in particular, against Sir Robin Leigh-Pemberton, the Governor of the Bank of England at the time. The Bank of England was accused of negligence in its supervision of what was described as a badly managed bank, (that is, the JMB). Part of the report states,

> *"…it ought to be the last day in public office of the governor of the Bank of England. His responsibility and culpability are awesome. He has presided over a fantasy so bizarre that it is believable only because it is true. He has supervised a bank that has financed fraud and provided money for the purposes of criminals.*[295]

The issue with JMB was concerned with poor lending practices in that a relatively few accounts accumulated bad debts of about £248 million.[296] Fraud was suspected. It needs to be pointed out that the problem JMB had was avoidable. It had nothing to do with the kind of risks that the ring-fencing policy seeks to address. In spite of the ring-fencing policy, banks generally can still be affected by the type of problems JMB had, which was poor credit control.

The issues in JMB raised questions about the ability of the supervisory authority to effectively monitor the financial sector. Again, the key issue was not concerned with whether the laws and regulations needed to control the banking sector activities were defective, but it was the implementation of the regulations that was problematic. In the instance of JMB, the bank lent out money nine times above the limit the bank was authorised to lend. The question is, "How did the bank expose itself to that extent, for that long, flouting prudential regulation without detection and redress before the situation spiralled out of control?"

The situation in JMB inspired major reforms in the way banks were supervised. The prevalent legal framework was revisited. The lessons learnt from the JMB debacle were incorporated into the Banking Act 1987, so that banks are prohibited from

[295] House of Common (1985) Debate 26/7/1985 Hansard vol. 83 cc 1442 – 50.
[296] Op. Cit., G. Penn, 1989, p 134, (n. 257)

lending beyond a proportion of their capital to a single entity or with their corporate subsidiaries.[297]

Part of the highlights of the significant causes of the crisis in JMB was that more than 10% of its capital was borrowed by relatively few customers.[298] Consolidating on the provisions of the Banking Act 1979, the Banking Act 1987 imposed a duty on the banking sector to (i) disclose to the Bank of England borrowing to any particular customer where the amount granted exceeded 10% of the bank's capital, [299] (ii) prohibition from lending more than 25% of their capital to one borrower[300] (iii) strengthened the role of auditors and relationship with banks' supervisors.[301]

Conversely, specific duties were imposed on the Bank of England to proactively supervise authorised banking institutions.[302] In recognition of the rapidly changing economic environment of that time, the Act required the Bank of England in her supervisory capacity to flexibly take into account this changing environment.[303] As well, the Act required the Bank of England to present reports annually about her activities under the Act to the Chancellor of the Exchequer, who would in turn table the same before Parliament for consideration.[304]

Notwithstanding all the powers given to the Bank of England in its supervisory role, the Bank of England still needed comprehensive, accurate and timely rendition of information to enable her to function effectively.[305] Examples of such information are prudential returns and relevant statistical information that should enable the Bank of England to understand the financial position of any bank under its supervision.[306] During the period leading to the enactment of the Banking Act 1987, this information was required to be supplied voluntarily by banks. However, in order to enhance the supervisory powers of the Bank of England, s.39 gave powers to the Bank of England to be able to demand for the information, rather than expect banks to voluntarily supply the information needed.[307] These powers enabled the Bank of

[297] The Banking Act 1987 s.38 (b)
[298] Op. Cit., G. Penn, G. 1989, p 134, (n. 257)
[299] The Banking Act 1987 s.38 (a)
[300] The Banking Act 1987 s.38 (b)
[301] The Banking Act 1987 Part II s.50 and s.51
[302] The Banking Act 1987 s.1 (1)
[303] The Banking Act 1987 s. 1 (2)
[304] The Banking Act 1987 s.1 (3)
[305] Op. Cit., A. Arora, 1997. P.44 (n. 100)
[306] W. Blair et al., 'Banking and the Financial Services Act 1998' (Butterworths, 1993, p 10)
[307] The Banking Act 1987 s.39

England to obtain information and to require production of documents from banks to support BoE's role as the supervisory authority.

What is more, s.40 of the Act gives the Bank of England a right of entry into a bank's premises to obtain information and documents.[308] The need for this power is because an insolvent bank may be able to continue trading by depending on short term loans from the money market operations to sort out immediate liquidity problems, but may not necessarily be able to resolve long-term liquidity issues.[309] With the powers given to the Bank of England it was believed that a defaulting bank may run into hiding for a while but not for too long.

This view is further strengthened by the outcome of decided cases such as *A v B (Bank of England Intervening)* [310], *Price Waterhouse v BCCI Holdings* [311] and *Bank of England v Riley*.[312] Briefly, the Commercial Court in A v B held that the Bank of England's statutory powers to order a banking sector institution to disclose documents which it reasonably required for performance of its supervisory functions overrode a court order restraining the institution from disclosing the documents to a third party on the grounds that such a disclosure would be a breach of the duty of confidence. Similarly, in the BCCI case it was held that the accountants were entitled to disclose confidential banking information to the judicial enquiry investigating the BCCI's collapse, on the grounds that individual's interest in confidentiality is subordinated to the public interest in disclosure when necessary for its statutory functions. While in Riley, it was held that a defendant in a proceeding brought under 1987 Act was not entitled to rely on the privilege against self-incrimination as a reason for not disclosing documents when required to do so by the Bank of England, pursuant to its statutory powers.

These cases closely follow a seminal *Tournier* case, where it was held that a banker's duty of confidentiality to his customer is not absolute but qualified. It was held that the duty of confidentiality to its customers may be suspended under four circumstances: (a) where the customer gives express or implied consent to disclose

[308] The Banking Act 1987 s.40
[309] Op. Cit., L Verrill, 2008, (n 19)
[310] Op. Cit., A v B (Bank of England Intervening) [1992] (n. 243)
[311] Op. Cit., Price Waterhouse v BCCI Holdings [1992] (n. 248)
[312] Bank of England v Riley [1992] 1 All ER 769, CA

(b) where public duty requires disclosure (c) disclosure under compulsion of law and (d) where the interest of the bank necessitates disclosure [313].

The foregoing demonstrates the powers given to the BoE to be able to examine banks' books in detail. Under these circumstances, failure to provide documents or required statistical information by a financial institution to enable the Bank of England to exercise its supervisory function is hardly a justifiable argument in the light of the enumerated decided cases.

Foremost, the argument is that up to this point the Bank of England had all the powers it needed to effectively supervise the banking sector, including the ability to demand rendition of documents and the power to physically enter a bank's premises to seek and obtain documents necessary for effective supervision of the banking sector.

The argument is that, given the powers contained under s.39 and s.40 of the Banking Act 1987 which was later incorporated into FSMA 2000 Part VIII A, 89H – 89J, power to call for information and s.122D power to enter premises under warrant, supervisors of Northern Rock for example and in some other cases failed to ask the right questions and that was why such banks could continue to trade for years without the supervisors knowing that there were serious problems beneath the surface which they were not aware of until the problem escalated beyond control.

Supervisory agents, auditors and compliant officers can only fully comprehend aspects of the financial status of a bank that is being supervised if the agents are able to obtain timely rendition of relevant documents about specific areas of the financial affairs of that bank. Banks' supervisors, compliant officers and auditors work with documents that contain needed relevant information. Without rendition of honest and accurate returns, auditors and bank supervisors cannot do much.

Other than statutory documents that a bank is legally required to supply, the bank can do no more except the BoE specifically request to be given prescribed documents to aid them in the diagnostic stage of problem solving and ultimately leading to effective supervision in the banking sector.

[313] Tournier v. National Provincial and Union Bank of England: CA [1924] 1 KB 461

Secondly, whether the Bank of England used these powers to maximum effect to forestall banks' collapse after the enactment of the Banking Act 1987 is now no longer in doubt, in the face of other banks' failures in the 1990s and especially the 2007 – 2009 financial crisis.

2.23 Banking Supervision Reforms in the 1990s - 2000

Notwithstanding the widened scope of the statutory powers granted to the Bank of England through the Banking Act 1987, four years after, in 1991, the collapse of the Bank of Credit and Commerce International (BCCI) further dented the credibility of the Bank of England's ability to identify and forestall difficulty in the banking sector. The crisis in BCCI was thought to be the worst mismanagement and fraud in the banking sector in the last century.[314] The outcome of the Inquiry set up to investigate supervision of BCCI under the Banking Act 1987 provided insight into deficiencies in the supervision of the banking sector in the UK. Lord Justice Bingham, the Chairman of the Inquiry set up for the purpose, pointed out that although s.4(3) of the Bank of England Act 1946 gave some generalised powers to the Bank of England to supervise the banking sector, the power was never exercised, and it was never understood to provide a statutory basis for the supervision of banks.[315] In Bingham's submission, since the 1900s to 1990 at best there was a broad framework of rules (some which were written and others unwritten) governing the banking sector and that the supervision of the banking sector was essentially based on an informal approach, under an arrangement whereby supervision of banks was built on mutual trust and cooperation between the Bank of England and the banking sector. [316]

The Bingham report roundly criticised the Bank of England for not doing enough (if indeed it did anything) to follow up leads on the wrongdoing in BCCI. On the other hand, it is arguable that the huge difficulty in supervising BCCI was not wholly the fault of the Bank of England. This is because the case of BCCI's collapse presented a much more complex supervisory challenge to the Bank of England, in the sense that BCCI was an international organisation with global spread and with multiple

[314] Op. Cit., A, Arora, 2014, p 171, (n. 236)
[315] Op. Cit., Bingham, Lord Justice 1992, (284)
[316] Ibid. (Bingham 1992)

supervisory agents. That challenge led to Bingham calling for international collaboration of bank supervisors.[317]

As if the BCCI crisis was not bad enough, in 1995 the Bank of England faced another round of criticism following the collapse of another investment bank, Barings Capital which was brought down by the illegal feature trading of Nick Leeson in Singapore, where he accumulated losses in the total sum of about £830 million.[318]

The Inquiry came to a finding that Barings' management and the external auditors failed to spot the looming danger because of the elaborate method of concealment, falsification of reports to the Headquarters in London and misrepresentation of profit planned by the principal character who caused the downfall of the Bank.[319] The report noted that there was a serious failure of internal control mechanism at the management level. So also, top level management in charge did not know or understand the operation of their business. The report concluded that the failings that led to the collapse of Barings were so elementary in nature. In the words of the report it says,

> *"Barings' collapse was due to the unauthorised and ultimately catastrophic activities of Leeson that went undetected as a consequence of a failure of management and other internal controls of **<u>the most basic kind</u>**."*[320]

The underlined and emphasised phrase is made by this researcher.

The description of the failings in Barings as a kind that is so elementary was a very polite way of saying that the members of the management staff in the organisation were grossly incompetent. The failure of the bank was not due to complexity of any kind but because identified senior management failed woefully to carry out their responsibilities or perhaps, they did not know what to do.

Barings' case demonstrated how quickly a bank's ailing financial condition can deteriorate within a short space of time if left unchecked. As of 31st December 1994,

[317] Ibid (Bingham 1992)
[318] E.A J George and A. Hardcastle, "Report of the Board of Banking Supervision Inquiry into the Collapse of Barings" (HMSO, 1995)
https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/235622/0673.pdf
[319] Ibid (Report on Baring p. 232 - 232
[320] ibid

Leeson had accumulated losses of £208 million against his employers and by 27th February 1995 (in just two months) the losses had escalated to £830 million. Just like JMB, it was perhaps possible to save the bank if the losses had been spotted when it was still within the range of £208 million.

The lessons learnt from the Barings' debacle have been incorporated into subsequent legislation including the Financial and Markets Services Act 2000 and the Financial Services (Banking Reform) Act 2013 relating to closer prudential oversights on the banking sector.

About the same time when the Barings difficulty was raging, in December 1996, it emerged that Natwest Bank lost £77 million in its investment banking arm caused by mispricing of derivatives. A former trader, Kyriacos Papouis was held responsible for the loss caused by about two years of hidden unauthorised trading by him.[321]

This situation in the Natwest Bank would appear to be another case of poor internal control.

Notwithstanding the lessons learnt from Barings, another bank, Union Bank of Switzerland almost failed due to the unchecked activities of a staff. Supervision of the bank rested with the BoE/FCA in collaboration with Switzerland. In September 2011, UBS faced a very similar situation as in Barings and others only that the bank narrowly escaped dissolution but ended up with a staggering total loss of $2.3 billion.[322] Just like the facts in Barings' case, and trader Kyriacos Papouis in Natwest Bank, Mr Kwaku Mawuli Adoboli, an employee of Union Bank of Switzerland started to fabricate fictitious trades without real counter parties and he inflated the modest profits that he made. This started in October 2008. He concealed losses with elaborate but convincing lies. There was virtually no supervision by his managers. Other members of his team were unaware of his dubious activities, and although his trading limit was $100 million, at one point he exposed his employers to a potential loss of $12 billion.[323] His game was up on 14th September 2011 when he finally owned up to what he was doing. His four years' prison sentence was confirmed at

[321] Op. Cit., A. Saunders, and M. Cornett, 2011, p. 476, (n. 106)
[322] R v. Kwaku Mawuli Adoboli [2014] EWCA Crim 1204
[323] Ibid ([2014] EWCA Crim 1204)

the Court of Appeal on 4th June 2014.[324] The sentencing should serve as deterrent to bankers generally.

The troubling bit of this situation is that Mr Adoboli evaded detection for three whole years. He was never caught until he reported himself, possibly because of a troubled conscience. It also means that for three consecutive years the external auditors saw nothing amiss! Meanwhile, $2.3 billion went down the drain. If $2.3 billion could just vanish like that, wiped clean out of the books of a bank because of undetected activities of a single individual over a period of three years, the security of depositors' funds in banks should indeed be a cause for concern to the government and the public. It is self-evident that the problem lies mostly with faults in the internal control system. Admittedly, it would have been near impossible for BoE to discover the irregularities while it was happening.

Arguably, giving powers to an individual to commit one's employers to an exposure of $100 million without proper supervision should give real cause for concern to regulatory institutions and the public. As if that were not bad enough, lack of oversight on the activities of Mr Adoboli evidenced by his exposing his bank to a risk of a loss of up to $12 billion at a point as reported in this case is just mind blowing and clearly a poor practice to allow an individual to commit his bank to such an extent for such a long period without adequate supervision.

The argument is that these are some the areas of weaknesses in the banking sector that efforts and attention could have been focused on. It is agreed that it would have been very difficult for the BoE to detect the problem. Although the cases of Adoboli and Nick Leeson may be advanced as arguments to support ring-fencing policy, the point is that, if the underlying poor internal control system of a bank remains unchecked even a ring-fenced bank can run into difficulty with the wrong people at the helm of its affairs. Wrong people in the sense of individuals that lack the skill, competence and the integrity to be in charge of huge public funds.

As mentioned in the previous section, since these situations arose in the banking sector, the lessons incorporated into the law books include a provision that employment of postholders of designated senior managerial functions in the bank now requires prior vetting, certification and approval of the postholders by regulators

[324] Ibid ([2014] EWCA Crim 1204)

before a senior manager can assume the office.[325] This means, one has to have an acceptable level of experience and relevant academic training to be able to gain employment to perform a designated senior manager's role in a bank.[326]

An important question in all of this is whether the Bank of England was again found complicit in the failures after JMB and BCCI. The Inquiry into the Barings disaster reported that whilst the Bank of England examined the overall consolidated group accounts of Barings, the investment subsidiary of the group that caused the collapse of the organisation escaped the scrutiny of the Bank of England.[327]

In a desperate attempt to improve its image, early in 1996 the Bank of England commissioned a consultancy firm, Arthur Andersen, to review the "Supervision and Surveillance" arm of its services, to consider the suitability and effectiveness of its operations as it was and to make recommendations for improving the methods, organisational structure and the staffing of the supervision and surveillance arm of the Bank of England.[328] Notwithstanding that the Bank of England expressed commitment to implementing all the recommendations for improvement of its supervision and surveillance recommended by Arthur Andersen Consulting, it appeared no one was impressed.[329] The effort of the Bank of England in that regard was just considered to be too late.

The collapse of Barings in 1995 was considered to be one bank failure too many. The patience of the government and members of the public with the Bank of England had become so thin, it had worn out. There was clamour for reforms.

2.24 The Emergence of the Financial Services Authority (2000s)

In the period leading to May 1997, the New Labour Government under Tony Blair promised to overhaul the supervision structure of the entire financial system. The plan was to bring banks, insurance and investment services under the same umbrella with a supervision framework covering both prudential and the way the financial

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[325] The Financial Services (Banking Reform) Act 2013 Part 4 s.18
[326] The Financial Services (Banking Reform) Act 2013 Part 4 s.19 & s.21
[327] Op. Cit., Bingham, Lord Justice, 1992, (n. 284)
[328] M.J.B Hall, 'UK Banking Supervision After the Arthur Andersen Report' (1996) Vol 11 (525) Journal of International Banking and Financial Law
[329] Arthur Andersen 'Findings and Recommendations of the Review of Supervision and Surveillance' (BoE, 1996)

sector conducted their businesses.[330] The Labour government's manifesto and idea about changing the banking sector supervision landscape resonated well with the public, given the history of the difficulties in the banking sector narrated so far. And, in one rare moment, the opposition party agreed with the ruling Labour government to create a fully statutory regulator that would take over the supervision of the banking sector away from the Bank of England.[331] It was that promise that gave birth to the Financial Service Authority in 2000 (Security and Investment Board established in 1985 metamorphosed to become the Financial Services Authority). Whilst the Governor of the Bank of England welcomed the idea (expectedly, perhaps because it would be a relief from the apportionment of blame that had always come against the BoE each time a bank failed), the banking community was surprised and at the same time irritated by the move.[332] This was because it was an unusual move and unprecedented anywhere up till that time.

The argument for bringing supervision of all the financial services under one umbrella as opposed to several regulatory bodies was that financial services had become more integrated and globalised. As such, the UK needed a strong body that would be able to supervise global firms. It was considered appropriate to merge supervisory agencies into one body since financial services were no longer segmented along the lines of insurance, banking and investment services anymore. It was the era of universal banking. In any event, the Bank of England had not delivered the standard of supervision that was able to provide adequate protection to depositors and investors.

Others voiced concerns about the challenges of supervising such a complex huge market in addition to retail banking in an era of fast paced technological advancement and a globalised financial market.[333]

With the best intentions, while the government was planning to transfer regulatory and supervisory responsibilities to the newly created FSA[334] the Bank of England was being shored up, granted autonomy and given operational responsibility in the area

[330] E. Lomnicka, 'Making the Financial Services Authority Accountable' (2000) Journal of Business Law Jan. 65 – 81
[331] Op. Cit., Morris, 2016 p. 6, (n. 177)
[332] Ibid. (Morris 2016. P 6)
[333] Ibid. (Morris 2016. P 6)
[334] Bank of England Act 1998 Part III s.21

of decision making on monetary policy and to meet government's inflation target [[335]][[336]].

Apart from being novel, Blair QC said the idea of taking direct supervision of banks away from the Bank of England took everyone by surprise.[337] The question is, "Why was it a surprise to remove supervision of the financial sector from the Bank of England?" Foremost, it was the first of its kind. It was unheard of in other developed economies. Traditionally, the Central Bank occupies a strategic position in the financial system which enables it to be in a better position to supervise the financial sector. This is primarily because of the proximity between the BoE and commercial banks. As the banker's bank of last resort, BoE had the advantage of being able to gather market intelligence report about each bank than the FSA would have been able to obtain. This is because FSA did not keep the accounts for banks as BoE does.

For example, the Bank of England is a participant in the wholesale money market as banker's bank of last resort, assisting in supplying funds when needed to enable participating banks to settle accounts among themselves.[338] The FSA was not a participant in the wholesale money market. The FSA did not control the wholesale money market neither was it involved in inter-bank settlement. As well, FSA did not hold deposit/cash accounts for commercial banks as the BoE does.[339] The implication is that the BoE would be aware when a commercial bank starts to struggle to honour interbank commitments.

If for example, too frequently a commercial bank approaches the BoE to borrow in its capacity as "the bankers' bank of last resort" before the commercial bank can honour obligations to other banks, the situation presents an opportunity to the BoE to start to look more closely at the liquidity status of that bank (except when it becomes inevitable, a bank would rather seek other ways of resolving liquidity problem than to approach BoE for assistance). That was part of the advantages that FSA did not have.

[335] M. Blair et al., 'Blackstone's Guide to the Bank of England Act 1998' (Blackstone Press, 1998)
[336] Bank of England Act 1998 Part 2 s.10
[337] Op. cit., Blair, M. et al. (n. 335)
[338] Op. Cit., E. Ellinger, et al., 2011, (n.110).
[339] Royal Bank of Scotland, "Financial Report and Annual Financial Accounts", 2010, p. 128.

The significance of this important strategic position which BoE occupies is that it enables the BoE to be aware when a commercial bank is faced with an acute liquidity problem, whether it is temporary in nature or endemic.

A practical example of what this is about could be found in the Annual Financial Accounts of banks. For illustration purpose, we can use the Annual Report and Financial Accounts of RBS for 2010 to demonstrate what this is about.

On page 128, RBS reported the following extract from their Assets and Liabilities:

Assets:

(i)	Cash and balances at central banks	£49.8 billion
(ii)	Loans and Advances to banks	£87.5 billion
	Liabilities	
(iii)	Deposits by banks	£85.2 billion
(iv)	Settlement balances	£8.5 billion

What do these figures mean? These are typical items that would be found on the balance sheet of any commercial bank. Item (i) is the aggregated sum of cash held in the vaults of RBS including credit balances held with 'Central Banks' globally as at the balance sheet date. This is the most liquid part of RBS's 'Current Assets' on the balance sheet. Please note that the word 'Balances' and the term 'central banks' are pluralised. This is because the report is a consolidated account of all the network of branches in all the places that RBS operated globally as at the balance sheet date. Item (ii) is the consolidated debts owed by other banks to RBS as at 31st December 2010. Item (iii) represents aggregated sum of deposits held by RBS on behalf of other banks. This is the extent of aggregated debt obligations that RBS owed other banks. Item (iv) is the amount RBS owed which is in the process of collection by other banks.

Item (i) £49.8 billion included the credit balance that BoE held for RBS in the UK on the balance sheet date. Although we are not given the specific part of that sum that is held with BoE, it is out of that sum held by BoE for the bank that RBS would be making payments and daily settlement relating to cheques presented for clearing against RBS, standing orders and direct debits claimed from other banks, and any other claims from other banks. Payments received from other financial institutions would be credited into the same account to increase the balance while payments made out would deplete the balance on daily basis. As long as the daily balances remain in credit position, there are no problems but once this account starts to run into debit balances and RBS is struggling to resolve the situation, then BoE would have effective notice that RBS is beginning to have liquidity problem and may start to make enquiry, demanding explanation from the bank. This is the advantage that BoE had over FSA as a supervisory agent.

In BoE's capacity as the banker's bank of last resort therefore, the Bank of England is able to monitor inter-bank borrowing and thus able to determine a bank that is struggling, a bank that can be rescued in time of distress and those that have to be wound up or nationalised as was the case with Northern Rock and BCCI. Northern Rock was nationalised under the Banking (Special Provision) Act 2008, BCCI was allowed to dissolve whilst Bradford and Bingley Building Society went into public ownership.[340] As mentioned earlier, it should be noted that one of the criticisms Lord Bingham made against the Bank of England in regard to the BCCI collapse was that the Bank of England did not respond in time **<u>to the leads</u>** it had. It was not the case that the Bank of England was totally unaware of the difficulty in the BCCI, but it failed to respond in time.[341]

So, when the Bank of England was replaced with another body that did not have those advantages that the BOE naturally possesses, banking practitioners knew that that move was a grave tactical mistake and that the travail in the banking sector was not about to end too quickly. That would appear to be the reason the policy announcement to replace BoE as the overall supervisory agent at that time was shocking.

Notwithstanding all the faults attributed to the Bank of England in respect of the failed banks mentioned earlier, what the government could have done was to insist that the Bank of England reviewed their operational strategies because as stated

[340] Op. Cit., A. Arora, 2014, p 124, (n. 236)
[341] Please, refer to page 93 the last paragraph.

earlier, and also in paragraph 2.26 below, the Bank of England occupies a strategic position within the financial system that places it at an advantage to supervise the financial system. Although this vintage position does not guarantee absolute security, it does help in some practical ways as explained previously.

The government should have made the Bank of England overhaul its systems and approach to banking supervision. As a matter of fact, in 1996 on its own initiative the Bank of England had already commissioned a consultancy firm Arthur Andersen, to review their approach to banking supervision and to proffer suggestions on ways to improve their operational system as mentioned earlier. Arthur Andersen affirmed some of the methods engaged by BoE whilst in other areas they suggested ways to improve but sadly, the advice came too late. The politicians had promised the electorate that the regulation and supervision of the banking sector was going to be overhauled and so it was.

2.25 The Financial Services Authority 2001 – 2009: How Did it Fare?

The Financial Services Markets Act 2000 that sets up FSA runs into 321 pages. Some of the primary aims of FSA were: — (a) to instil market confidence; (b) to encourage public awareness; (c) to facilitate the protection of consumers; and (d) to bring about the reduction of financial crime.[342]

The FSA's policy was focused on creating an environment for financial stability; it planned to adopt a risk-based approach in its supervisory role. Thus, the aim was to imbibe a flexible and differentiated approach that reflected the general characteristics of each bank in terms of their sizes. This took into account the quality of management and whether the bank is an investment or a retail bank. It held senior management accountable. It aimed to prioritise consumer protection and an operating ethos which recognises the benefits of competition and innovation.[343]

At its inception, FSA merged together nine different supervisory agencies that had oversight on different facets of operations in the financial system. The activities of the agencies thus merged include the Security and Investment Board, the Building

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[342] Financial Services Market Act 2000 s.2 (a) (b) (c) (d)
[343] Joint Committee on Financial Services and Market Report April 1999 https://publications.parliament.uk/pa/jt199899/jtselect/jtfinser/328/32802.htm

and Friendly Societies Commission, the Insurance Directorate, the Supervision and Surveillance Department of the Bank of England, Self-Regulating Organisations, Investment Management Regulatory Organisation, Personal Investment Authority and Security, the Registry of Friendly Societies and the Features Authority.[344]

As pointed out earlier, the rationale for consolidating these regulators into one body was due to the prevalence of the universal banking model at the time. Having multiple supervisors overseeing different aspects of a bank would have appeared unwieldy. So, in some ways, it made sense that these organisations were merged.

This researcher argues that the FSA started out on a promising note. There was a high expectation that the FSA would deliver. It started with a clear agenda of what the body wanted to achieve as stated at the beginning of this section. It had the support of a comprehensive statute, the Financial Services and Markets Act 2000. It had the resources it needed to function. But crucially, it suffered from lack of the advantages that the Bank of England had. These advantages stated earlier include the status of BoE as banker's bank of last resort, a position that enables the BoE to know first-hand when a bank has a liquidity problem. However, in the period leading to the global financial crisis that occurred in 2007 – 2009, the FSA failed spectacularly in its supervisory role over the banking sector. The organisation was heavily criticised by Lord Turner's report for its failure to detect and warn the appropriate authorities of the impending catastrophe.

This researcher contends that some of the reasons the FSA failed are not too difficult to see. The FSA would necessarily have to depend on reports filed by the banks within its purview of control. Expectedly, these reports may not reach the FSA in good time. As Hudson suggested, bankers cannot be relied upon to file in negative reports that would likely affect their business interests.[345] On the other hand, on the account of the daily interbank positions that the Bank of England is aware of through the wholesale money market and the accounts held for banks, it can determine quickly enough whether a bank has liquidity problems or not. Thus, it is difficult to appreciate why the policy makers overlooked this significant point when supervision of the banking sector was removed from the Bank of England to the Financial Services Authority in 1998.

[344] Op. Cit., Morris, 2016 p. 7, (n. 177)
[345] Op. Cit., A. Hudson, 2013, (n. 14).

If for example, too frequently a commercial bank approached the BoE for financial assistance in its capacity as the banker's bank of last resort before the commercial bank can honour obligations to other banks, the situation presents an opportunity to the BoE to start to look more closely at the liquidity status of that bank. That was part of the advantages that FSA did not have as illustrated in the example given earlier.

As well, from the well documented report on the reasons for the collapse of RBS cited earlier, it is also clear that the FSA did not pay due attention to capital adequacy and liquidity rules in the banks under its supervision neither did FSA concerned itself with risks associated with the exponential growth in the banks through mergers and acquisitions which almost ruined the banks. There was laxity on oversight on prudential matters which led to cumulative weaknesses later found in the assets of the banks. In summary, the layback type of banking supervision that prevailed in the wake of deregulation continued during the tenure in office of the FSA which eventually proved disastrous to the banks and the economy.

2.26 Why Did the Bank of England and the Financial Services Authority Fail to Meet Expectations in their Roles as Supervisors of the Banking Sector?

The narrative so far has been that the Financial Services Authority partly failed because it lacked some of the strategic advantages that the Bank of England had. Then the next question should be, "Why did the Bank of England that had all the strategic advantages fail to effectively supervise the banking sector or at least failed to pre-empt the failings in the banking sector over the years?"

The Bank of England Act 1946 imposed a duty on the Bank of England to supervise the financial sector. [346] However, over the years the crisis in JMB, BCCI, Barings, Natwest bank and Northern Rock et al raised public outrage against the Bank of England for its failure to detect and prevent banking crises notwithstanding the position of influence it occupied and its access to information concerning the banking sector. This researcher posits that the lapses on the part of the Bank of England and latterly the Financial Services Authority were not due to lack of will power to succeed

[346] The Bank of England Act 1946 s.4 (3)

or lack of resources to function. The failings were purely about deficient implementation strategy.

To understand why the Bank of England and the Financial Services Authority failed in their respective supervisory roles over the banking sector, one has to look back at the reasons and how JMB, BCCI, Barings, Natwest, Union Bank of Switzerland and Northern Rock ran into troubled waters. This will enable us to determine if there was a common trend and emerging pattern as to why and how they failed.

To start with, the cause of JMB's failure was attributed to poor lending practices and flagrant flouting of prudential regulations. JMB lent nine times over the limit that the bank was allowed to lend. A relatively few borrowers accumulated bad debt of £248 million.[347] The situation continued over time until the bank ran into serious difficulties leading to its being rescued. The Bank of England was unaware of the situation and even if it was aware, it did nothing to stop it.

In the case of BCCI, the problem had to do with massive fraud that continued over a period of 15 years.[348] Lord Bingham in his comment said that the Bank of England had leads about the problems in BCCI, but as the supervising authority did nothing until the matter escalated and went beyond any remedy. In the first of its kind at the time, the Bank of England was sued for £1 billion by the BCCI official liquidator Deloitte Touche Tohmatsu for wilful negligence and malfeasance in office in its supervisory role over the BCCI.[349] The case eventually collapsed 12 years later, wherein BoE sought to reclaim costs from BCCI in the sum of about £80 million.

In regard to Barings, the problem also had to do with unauthorised derivative offshore trading in Singapore by an unsupervised member of staff who posted false profits and rendered fictitious returns to the Headquarters of the bank. The internal auditors detected the irregularities in the matter and raised the issue, but it was not followed up properly. The problem in Barings highlighted how things can go wrong very rapidly if not nipped in the bud quickly enough. The loss as at December 1994 was about £208 million but by the end of February 1995 the loss had escalated to over £830 million. There is no evidence that the Bank of England was aware of the situation even though the matter raged over a considerable length of time.

[347] Op. Cit., R. Cranston, 2002, p.65, (n. 204)
[348] Op. Cit., Three Rivers DC v Bank of England (No.3) 2003, (n.207)
[349] Ibid (Three Rivers DC v Bank of England)

Similarly, in the case of Union Bank of Switzerland, over a period of three consecutive years, an individual acting alone caused a colossal loss of $2.3 billion to his employer without it being detected by their external auditors.

This researcher would suggest that effective supervision of the banking sector from 'outside' will always be a mirage except there are enhanced internal control mechanisms within the individual banks.

In order to appreciate the scale of the volume of transactions undertaken by the banking sector and the enormous challenge that this can pose to supervising authorities, one needs to understand the statistics behind banking operations, the rapidity at which the operations take place and the fact that these operations are nowadays mostly paperless. For example, the Bank of England stated that on a daily basis, interbank payments in the banking sector are in the region of £500 billion.[350] Monitoring a banking sector that operates a payment system on such industrial scale can indeed be a huge challenge, even with the benefit of all the tools available to the banking sector's supervisors.

The extent of the challenge is further demonstrated in the case of Union Bank of Switzerland where there was a loss of $2.3 billion over a period of three years without the external auditors having the slightest clue that anything was wrong. The point is that it can take a considerable time for those working within the system of a big bank to fully understand how their bank functions and the inter-connectedness of different departments, let alone an outsider. An example of how this can work against a bank is further demonstrated in the case of Union Bank of Switzerland, wherein an individual's nefarious activities went undetected by his colleagues for three whole years. Had the internal control strategies been in good working order, those that were in a better position to discover the anomalies early enough were the colleagues working in that organisation.

It should be noted that in the instance of Barings the internal auditors spotted the irregularities early enough and they reported it, but it was not followed up at the management level. Typically, external auditors only examine the accounts annually, but the internal auditors are on the ground daily monitoring the operations of the bank.

[350] https://www.bankofengland.co.uk/about

With increased sophistication in computing tools and the huge challenges posed by the gigantic industrial scale operations that banks undertake these days, it is suggested that the starting point of effective control and supervision of the banking sector can best begin with enhancement of internal control mechanisms within individual banks and providing specialised training to dedicated staff in the internal audit department of each bank. Similarly, whistleblowing policy in banks should be incentivised. Currently, whistleblowing is not incentivised in the UK because of risk of abuses, which is understandable.

Under the Public Interest Disclosure Act 1998 (PIDA),[351] protection is available to workers in the public, private and voluntary sector organisations for act of victimisation, unfair treatment or unfair dismissal by an employer against a worker arising from disclosure of a wrongdoing at a workplace. PIDA works in tandem with the Employment Rights Act 1996.[352] Thus, potentially, an uncapped compensation may be awarded at the Employment Tribunal to a worker that suffers from unfair dismissal following exposure of criminality provided that the conditions stated under the protected disclosure s.43B to 43H are met. These conditions include provisions to the effect that a criminal offence has been or is being committed or likely to be committed. A person has failed or is failing to comply with a legal obligation.

Regarding the financial services sector, the FCA and PRA have their policies on whistleblowing. As a matter of general policy, the FCA and PRA are not inclined to giving financial awards to whistle-blowers owing to concerns that opportunists might be motivated by financial reward to maliciously pass misleading and speculative rumours which may needlessly damage other people's reputation.

On the other hand, as narrated by Cynthia Cooper, a former internal auditor with the now defunct WorldCom in one of the most intriguing accounting record fraud exposure which at the time was regarded as the biggest corporate fraud ever, whistleblowing can be a traumatic life changing experience for the whistle-blower, co-employees and investors when a multibillion pounds company crashes down irretrievably as was the case with WorldCom which at the time of its defunct

[351] Public Interest Disclosure Act 1998, s.43B – s.43H

[352] Employment Rights Act 1996, s.43B – s.43H (The provisions are exactly as in PIDA)

employed over 100,000 people and had its presence in 65 countries around the world.[353]

This researcher considers that it would be a double-edged sword dilemma for most employees faced with a choice between exposing a wrongdoing and risk ending own's career together with many other innocent professional colleagues or just play safe and get along working in an environment where someone or a group of people within the organisation are defrauding or carrying on with some illicit activities. For others like Cynthia Cooper, regardless of the extent of personal costs to self and to others, and regardless of whether there is a promise of a financial reward or there are no such promises, it would not present any difficulty whatsoever coming forward to expose a wrongdoing.

While there are no easy answers as this researcher equally identifies with the views of the FCA and PRA not to encourage frivolous allegations due to a promise of financial reward to whistle-blowers, following the rigorous assessment criteria set out in PIDA s.43B – s43H as stated in the previous page, this researcher argues for a system that favours compensating innocent people that may be affected by the exposure of criminal activities of others in the financial services sector. It is only a suggestion. This researcher admits that it may not always be feasible to compensate everyone that may be directly affected by whistleblowing exposure as may have been the case with WorldCom that had about 100,000 employees and an unknown number of investors that lost out because of the scandal, each case should be examined on its own merits. If incentivising whistleblowing is able to help in some measures to prevent failure in a bank, this researcher considers that the need to set up such structured reward system in the financial services sector is even more compelling given that failure in the financial services sector can be far more damaging than in other corporate entities because of the systemic risks that failure in the banking sector can cause the economy. This is only a suggestion as it is understood that the supervisory agencies already have their whistleblowing policy.

[353] C. Cooper, "Extra-ordinary Circumstances: The Journey of a Corporate Whistle-blower." (2008), New Jersey: John Wiley & Sons

The PRA laid out their operational strategies in a publication titled, "The Prudential Regulation Authority's Approach to Banking Supervision", wherein the PRA enunciates a three-pronged approach on how they plan to supervise the banking sector. These are, (i) judgement based approach – this is an approach whereby periodically the PRA intends to holistically review risks undertaken by each bank and come to a decision where there are perceived risks that run against the objectives and policies of the PRA such that, the bank concerned has to demonstrate how they intend to mitigate such identified risks and give their plan on how they intend to resolve shortcomings and problems highlighted in the PRA's review (ii) Forward looking – each bank would be assessed on the basis of current and foreseeable future risks and, (iii) Focus on key risks – attention will be given to banks that are more likely to cause harm to the economy in the event of their failure. [354]

Generally, the content of the document is considered to be pragmatic, well thought out and it brought the work of PRA on a good footing.

In particular, items 70 – 86 in the PRA regulatory book are concerned with rules applicable to capital adequacy. These are an expanded version of Basel III and the adjutant CRD IV buffer rules which banks in the EU are also obliged to comply with. As regard the UK ring fencing policy, the question remains, if in addition to complying with the ring-fencing policy, the UK banks are also going to follow the same rules as their European counterparts and even on a more stringent basis, would it not be unfair to the UK banks if unlike their European counterparts the UK banks are not allowed to have the benefit of retaining the "cheap funds" ringfenced?

Generally, the ideas and resolutions in the PRA regulatory book are detailed and reasonable on paper. It remains to be seen how the implementation of the strategic plan will work out in the years ahead with the PRA and FCA in charge of the regulation and supervision of the banking sector.

[354] Bank of England, 'The Prudential Regulation Authority's Approach to Banking Supervision' (Bank of England, 2018)

2.27 Regulatory Changes in the Aftermath of the Global Financial Crisis

This section discusses a range of regulatory changes in response to the global financial crisis. Especially with a focus on the ring-fencing which is an important aspect of the Financial Services (Banking Reform) Act 2013, legislation that was made in response to the global financial crisis in the UK. This section also discusses Basel III, part of the ongoing regulatory responses at supranational level to the financial crisis in 2007 – 2009, the final version of it was released in December 2017.[355]

In general, the focus of these regulatory changes embraced fortification of the supervision framework in the banking sector, enhancement of the quality of capital requirement (Basel III), mitigation on pro-cyclicality, integration of micro and macro prudential supervision and regulation on Liquidity Coverage Ratio (LCR).[356] While micro supervision focuses on individual banks, macro supervision refers to mechanisms introduced to make the international banking system work and safe.[357]

The section starts by briefly highlighting the processes through which the Banking Reform Act 2013, went through before it became law. The reason for doing this is to make a point about the keen public interest and rigorous debate generated by the ring-fencing policy before it became a law. It is also to underscore the point that the ring-fencing policy was a major decision. Arguably, taking such a huge step was a major decision that was considered worthy of the attention of the Parliament.

The key features of the Financial Services (Banking reform) Act 2013 were set out in chapter 1. To avoid tedious repetition, reference is only made to the sections that contain these aspects of the legislation in this section. Kindly refer to paragraph 1.3 pages 7 - 10 in chapter 1 concerning "Ring-fencing in Brief" and paragraphs 1.9 - 1.9.9 on pages 23 - 28 which set out the benefits of the Banking Reform Act 2013 and which identified concern with the ring-fencing policy. Those issues are discussed in the next section E, relating to critique of the ring-fencing policy.

[355] Bank of International Settlement (2017) Basel III: Finalising Post Crisis Reform
[356] Op. cit., BIS (2017)
[357] A. Keller, 'De-biasing Macroprudential Policy Part 1: An Evidence-based Approach and the Precautionary Principle' (2019) 34 (1), 5 – 16, Journal of International Banking Law and Regulation.

2.28 The Background to the Ring-fencing Policy

The law imposes obligations to do as required by an Act of parliament or the law may enforce restrictions on members in a jurisdiction from doing a prohibited act. Arguably, laws are devised for the common good of the populace in a jurisdiction but not everyone is bound to agree with the rationale for promulgating every law. However, once an issue becomes an Act of Parliament there are no reasons not to comply with the law unless and until it is repealed.

Loveland expounds on the rigorous processes that policy initiatives of the cabinet introduced to the House of Commons and House of Lords typically go through before they receive the final royal assent of Her Majesty the Queen, thus turning a Bill into law.[358] These processes include preparatory groundwork carried out by civil servants on a proposed policy issue. Then consultations with stakeholders at various levels, introduction of the Bill in the Commons followed by debates at both the Commons and in the House of Lords, law drafting processes by specialists and when considered necessary, refinement and amendments are all taken into account and the royal assent before the law is finally rolled out and its implementation within the jurisdiction becomes mandatory.[359]

The point is that before the ring-fencing policy which is an important part of this research became law, it did not go through any less rigorous process than described earlier. There were elaborate consultations and debates.[360] There were two principal commissions of enquiries which led to the government coming up with the ring-fencing policy. The first commission was headed by Lord Turner[361] and the second was led by Sir John Vickers. [362]

Notwithstanding the high degree of consultation and the considerable time given to debates invested in the process before the enactment of the policy into law, the ring-fencing policy was roundly criticised by wide ranging professionals including

[358] I. Loveland, 'Constitutional law, Administrative law, and Human Rights 7th ed.' Oxford University Press, 2015, pp 131 – 136)
[359] Ibid.
[360] P.Sikka, 'Written evidence submitted to parliamentary commission on banking standards'(Parliament 2013)
[361] Op. Cit., A. Turner, 2009, (n. 142)
[362] J. Vickers, 'The Independent Commission on Banking: The Vickers' Report' (Parliament, 2011)

academics, lawyers and bankers right after the publication of the Vickers' report.[363] These wide-ranging views on the ring-fencing policy are discussed in the next section E.

2.29 Basel III: Responding to the 2007 – 2009 Financial Crisis at Supranational Level

Basel III agreement confronted head on undercapitalisation, liquidity problem and issues with excessive leverage found in the banks in the period that led to the GFC. Distressed banks were found to have entered the GFC in a position of weakness, having high leverage, inadequate liquidity buffers, excessive credit growth, poor risk management and problems with governance.[364]

Basel III sought to address the weaknesses found in the earlier Basel agreements including the prescribed baseline capital requirements which has been soundly criticised as inadequate.[365] The accord sought to improve banks' capacity to absorb shock in the system, it sought to improve risk management, governance, enhancement of banking supervisors' powers, improvement on market discipline and transparency in risk disclosure.[366]

Rather than replace Basel I introduced in 1988 and Basel II introduced in 2004 discussed earlier in this chapter, "Basel III: finalising post-crisis reform" released in December 2017 is the outcome of many years of cumulative learning and refinement processes on perceived loopholes in Basel III's predecessors.[367]

Originally, Basel III regulatory capital framework was released in 2010, but even that continued to be developed and refined until the integrated and consolidated version was released in 2017. The overarching aim of Basel III is to strengthen the resilience of the financial sector so that they can have the capacity to absorb losses should one occur and so that the banks can sustain their growth through sound economic activities.[368]

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[363] J. Miller, 'Vickers' Report Slammed' (2011) 161 NLJ 1228 (2) New Law Journal
[364] Op. Cit., Bank for International Settlement (2017), n. 355
[365] Op. Cit., Adamati 2014, (n. 11).
[366] Op. Cit., Bank for International Settlement (2017), n. 355
[367] Ibid.
[368] Ibid. (p. 1)

Foremost, a matter of deep concern to the Basel Committee on the previous regulatory design was the wide variability in the methodologies adopted in the computation of Risk Weighted Assets (RWAs) among banks wherein some banks under-estimated the risk profiles of their assets leading to making their RWAs appearing modest.[369] Additionally, while these banks were reporting strong risk-based capital ratios, they already built up excessive 'on and off balance' sheet leverage.

The problem of variation in the ways RWAs were computed arose from Basel II accord when banks were given some level of discretion to use their internally determined risk management model to calculate RWAs in order to determine capital requirement level needed to back up their credit exposure. Such discretion granted to the banks was believed to have been flagrantly abused and sadly, rules were circumvented such that even when the banks indicated that they were compliant with 8% baseline capital requirement, the basis of their computation were later found not to have taken into account the riskiness of their performing and non-performing credit exposures.[370]

Part of the corrective measures introduced by Basel III is requirement for capital buffers to make banks to meet higher level of capital adequacy in addition to the baseline 8% risk asset ratio suggested in Basel I and followed in Basel II.[371]

Furthermore, there were macro-prudential regulations to address procyclicality risks arising from interconnectedness and dependency within the banking sector so that additional capital requirements were made obligatory for counterparty credit risks.[372] Such buffer capital was required to be at least 2.5% of Risk Weighted Assets but national regulators may wish to impose a higher percentage. These measures reconfigured capital requirements based on each bank's sensitivity to market risks. Stricter regulations were made for banks that are rated as Global Systematically Important Banks.

Banks are required to enhance their level of transparency and disclosure to investors. So also, the powers of banks' supervisors were increased so that they can determine

[369] Ibid.
[370] P. Yeoh, 'Global Banking Reforms: Mission Accomplished?' (2018) Vol 33 (9), 305 – 313, Journal of International Banking Law and Regulation.
[371] Op. Cit., Chiu and Wilson 2019, p. 372, (n. 192)
[372] ibid

the leverage ratio buffer and the acceptable constituents of Common Equity Capital Tier 1 and 2 of banks under their supervision.[373]

Dealing with the leverage issues, the new regulatory measures under the Basel III accord seeks to prevent banks from building up leverage in the banking sector so as to de-risk the banking sector and prevent damages to the economy. Basel III provided specific and measurable formula as a tool to guide the banks and to the banks' supervisors so that supervisors could use the tool as a measuring parameter to facilitate effective monitoring of the banks in this regard.[374]

$$\text{The prescribed leverage ratio} = \frac{\text{Capital Measure}}{\text{Exposure Measure}}$$

The minimum leverage ratio for banks is equal to 3%.

This index is expected to be calculated consistently at regular intervals which could be on daily basis or at least once in a month subject to the agreement with the banks' supervisors.[375]

Another thorny issue faced by some GSIBs in the wake of the GFC was their parlous liquidity condition. The gravity of the problem came to the fore when the short-term funding facilities from the wholesale money markets dried up. As would be discussed in Chapter 4, RBS and Barclays were in the class of banks that were hit hardest. But for the timely intervention of the UK government that supported RBS with a range of bail out packages, just perhaps, RBS could have by now become a history. Barclays was assisted with a cash infusion of £6.1 billion from Qatar government.

The regulatory response from Basel to resolve liquidity problem in the banking sector is encapsulated in the document, "Basel III: The Liquidity Coverage Ratio (LCR) and Liquidity Risk Monitoring Tools." The policy document aimed to promote resilience in the short-term liquidity requirements in the banking sector and to build the capacity of the banks so that they can meet sudden cash withdrawal needs of customers for

[373] G. Thieffry, 'The Impact of the Latest Basel Accords on Commodity Trade Finance: An Update' (2019) Vol. 34 (7) 237 – 242 Journal of International Banking Law and Regulation
[374] Op. Cit., Bank for International Settlement (2017), page 140, (n. 355)
[375] Ibid. (page 140)

up to 30 calendar days under stress scenarios.[376] This liquidity reserve to be kept in High Quality Liquid Assets (HQLA) is the product of net cash outflows minus expected in inflows in the next 30 calendar days. Examples of qualified HQLA include cash in stock, reserve held with zero-risk central banks, zero percent risk weighted securities issued or guaranteed by sovereigns, zero percent risk weighted assets including those that are held with the Bank for International Settlement, and International Monetary Funds.[377] The idea behind keeping such reserve funds in zero risk institutions and zero risk assets is to meet liquidity needs without any delay. However, zero risk assets held in such institutions hardly earn much if at all it does earn any income.

The foregoing examples of Basel III requirements are some of the key regulatory and supervisory responses made to the financial crisis in 2007 – 2009 which were built up from 2010 – 2017 in the period under quest to find lasting solutions to some of the problems in the banking sector including inadequate capital, poor liquidity, leverage, governance etc.

Although the impacts of the assorted regulatory measures that emanated from the EU to the banks may have induced some level of pressure on the banks' profitability because of the demand on them to increase their capital has cost implications, the imposed regulatory measures are considered proportionate and justifiable. As well, the requirement to tie down HQLAs in zero risk assets under the Liquidity Coverage Assets means reduction in profitability also because such assets held at zero weighted risks earn little or nothing at all.

However, by every means possible, it is imperative that depositors' funds should be protected. This is because, in the event that a bank failed for whatever reason, either due to fraud, risk taking, mismanagement, poor decisions etc, such that the owners' equity in the bank is unable to absorb the losses, depositors would be at risk of incurring losses outside of depositors guarantee scheme or the government coming to the aid of the bank through a bailout. This is the reason why regulators are working assiduously to reduce such incidences to the barest minimum even if they are not able to outrightly stop it altogether.

[376] Bank for International Settlement, 'Basel III: The Liquidity Coverage Ratio and Liquidity Risk Monitoring Tools, (2013) BIS.
[377] Op. Cit., Chiu and Wilson (2019) (n. 192)

In the particular instance of the UK banks and in relationship to this study, capital adequacy regulations are stricter in the UK than the Basel III requirements. Arguably, the regulatory and supervisory environment has improved considerably since the GFC. So also, there has been considerable recovery from losses incurred from the nonperforming assets over the past 10 years. There has been huge divestment from risky investments in Barclays and RBS. Hopefully, the issue around mis-sold products and regulatory fines have been put behind these banks.

With all these developments, the regulator may hopefully consider easing regulatory burden imposed on the UK banks regarding the ring-fencing policy in no distant future.

2.29.1 Conclusions

So far, this section of the thesis came to the following findings:

(i) Wide-ranging laws and regulations which increasingly widened the scope of supervisory powers accorded to the Bank of England have over the years failed to stop incidences of financial crises in the banking sector since the Bank of England Act 1946.[378] The Act empowered the Bank of England to seek information, give direction as it may consider necessary and to give advice as it may deem fit.[379]

(ii) Disturbingly, difficulties that arose in the banks that failed or ran into difficulties were not pre-empted by the Bank of England. With each bank failure, the Bank of England continued to face one embarrassing criticism after another.[380]

(iii) Worse still, the same error kept repeating after itself as was the case in Johnson Matthey Banks, BCCI, Baring Bank and Northern Rock.[381]

[378] Pages 85 - 92, Bank of England Act 1946, Banking Act 1979, Bank of England Act 1987, Tournier (1924), A v B (1992), Price Waterhouse v BCCI Holdings (1992), Bank of England v Riley (1992)
[379] The Bank of England Act 1946 s.4 (3)
[380] Pages 89 & 97; House of Common Debate 26/7/1985 vol. 83 cc 1442 – 50.
[381] Pages 88 – 89, 93 – 95.

(iv) The Financial Services Authority created in the 2000s to take over as regulator/supervisor of the banking sector failed, just as the Bank of England did in its supervisory role because prudential micro level supervision (focusing on individual banks) was grossly inadequate.[382]

(v) The failure of both institutions in providing effective supervision to the financial sector was not borne out of lack of will power to succeed or lack of adequate resources to carry out the task but due to ineffective implementation strategies employed. Micro level supervision was grossly deficient. The Bank of England was empowered to enter (under warrant) and demand for documents necessary to facilitate their supervision. [[383]][[384]]

(vi) The fast pace of banking transactions, the fact that most of the transactions are nowadays paperless and the huge volume of transactions in the banking sector, said to be worth about £500 billion daily, would ordinarily present huge challenges for banking sector's supervisors.[385]

(vii) As demonstrated by the failure in Barings, damaging losses could be incurred over a short period of time. In the case of Barings, the loss was £208 million in December 1994 but two months thereafter, in February 1995 the loss had escalated to £830 million.[386]

(viii) Bearing in mind that the focus of this Section (Section D) is concerned with a critical evaluation of the effectiveness or otherwise of the Regulatory/Supervisory institutions saddled with the responsibility to supervise, support and enforce banking regulations so as to maintain stability in the banking sector as stated under objective (i) b of the study, array of banks that failed in the period before the global financial crisis in 2007 – 2009 were examined. The conclusion was that, though the failure of BCCI and Baring Capital for example were not wholly the fault of the BoE, it is more likely that the supervisory institutions would have been able to assist the banks that failed if the BoE had been fully aware of the circumstances of those banks and had intervened early enough.

[382] Pages 102 - 104
[383] FSMA 2000 Part 8A, s.133 FB, The Banking Act 1987 s.40
[384] Pages 92
[385] Page 106 - 107
[386] Page 94 – 95.

(ix) This researcher came to a finding that effective supervision of the banking sector will continue to be elusive without the strengthening of internal control mechanisms within the banks and provision of an on-going training for dedicated staff within the internal audit and compliance departments of each bank. Basel III recognised this gap and robustly addressed it as discussed in paragraph 2.29. As well, if effectively implemented and adequately supervised, the policies put in place to address openness and transparency in reporting, quality of capital requirement and liquidity ratios may help in boosting the capacity of banks to withstand stress in the event of future crises occurring.[387]

The document, "The Prudential Regulation Authority's Approach to Banking Supervision, 2018" drafted by the BoE provides a good starting point on the reforms to the supervision approach of the financial sector in the UK. What the outcome of the practical implementation of the approach would be is going to be self-evident in the years ahead.

However, it is also recognised that with current level of changes th
at has taken place since the GFC, the banking sector and the supervisory agencies may now be better equipped than ever to deal with shocks in the UK financial system.

The empirical aspect of the study which involved analysis of the Annual Reports and Financial Accounts of the case studies is reported in chapter 4.

[387] Page 114 - 115

Section: E

Evolutionary Development of Regulatory Theories from Structuralism to Neo-liberalism: The Impact on the Banking Sector

2.30 Introduction

The aspects of literature review addressed in this section include: (i) the business of banking (ii) classification of banks and other financial institutions, and (iii) the drivers of financial services regulatory policy, choices between structuralism and neoliberalism socio-economic ideologies.

While there are some common grounds in the discussion in paragraphs 1.10, 2.31 and 2.32 relating to the description of 'Banking and the Classifications of Banks' which were evaluated under the topic, "The UK Financial System" in Chapter 1 on page 28, the materials in the paragraph emphasised different issues and served different purposes to those in 2.31 and 2.32 pages 123 – 126. Paragraph 1.10 highlighted the exclusivity of the class of banks that by law were required to be ring-fenced compliant by 1st January 2019 and why the case studies in this research fitted into that class of banks. On the other hand, paragraphs 2.31 and 2.32 addressed the pre-requisites for successful incorporation of a bank, the issues that gave rise to the merger of assorted banks, the supervision structure as it was previously and the circumstances surrounding the new policy to de-merge core depositors' account from non-ring-fenced banks.

The overarching aims of this section are linked to objectives (ii) and (iii) of the study stated in chapter 1 pages 10 - 11 relating to conducting a theoretical critique of the ring-fencing policy against the backdrop of the UK's core competences in the provision of financial services, a sphere in which the UK has comparative and competitive advantages.

The section also relates to the question about the efficacy or otherwise of the ring-fencing policy serving as a safeguarding measure that is capable of deterring future crises in the banking sector. It takes into account the costs of the ring-fencing policy to the banking sector and the economy vis a vis other methods available to deal with the difficulties found in the banking sector in the period leading to the GFC which include undercapitalisation in the banking sector, poor liquidity, leverage in the banks which placed the economy at risk, issues with compliance, poor supervisory regime, risk taking, issues with governance, poor management decisions and poor lending practices all of which were discussed previously.

Against that background is the topic of this study which is, "Banking Regulation: A Delicate Balancing Act Between Safeguarding the Economy and Encouragement of Creativity in the Banking Sector." The point is that where it becomes necessary for the government to intervene to correct anomalies in the financial sector, it behoves the government to do so in a temperate way such that it does not hurt the economy in a way that was not intended.

As pointed out earlier, prior to the 1980s, financial institutions were categorised under the type of services they provided. Over time, the distinction between commercial banks and other financial institutions increasingly faded as some commercial banks grew to become very large conglomerates providing assorted range of financial services.[388] Thus, rather than financial institutions providing specialist services, banks grew to become all round providers of financial services. That model of banking is commonly referred to as universal banking, with such banks having wide network of branches and wide geographical spread.[389]

Saunders and Walter gave four categories of universal banks: (i) banks whose core business includes accepting deposits, providing loans and providing other wide-ranging financial services through subsidiaries. Examples include the banks in the case studies (ii) a partially integrated universal banks that undertake commercial banking and investment banking under the same roof, which the ring-fencing policy opposes; (iii) a fully integrated bank providing all services within a single firm. Ring-fencing policy also rejects this class of universal banking; (iv) a holding company that controls separate subsidiaries set up to provide commercial banking, investment banking, and other financial services, such as Citigroup.[390]

This chapter attempts to distinguish the banking sector's general characteristics from other financial services providers, such as Insurance Businesses, Building Societies,

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388 A. Saunders and I. Walter, 'Universal Banking in America: What Can we Gain? What Can we Lose?' (Oxford University Press, 1993)

389 Op. Cit., Ellinger, et al 2011, p. 16, 73&75, (n. 110).

390 Op. Cit., Saunders, A. and Walter, I. 1993, (n. 388)

Pension Funds, Money lenders, the Post Office Saving Bank, the National Savings Bank, Merchant/Investment Banks and Municipal Banks.

Until comparatively recently, when the regulations governing these institutions and their regulators were merged, the regulatory framework and supervisory bodies given the responsibility to regulate each of these institutions were separate.[391] For example, within a regime of industry based Self-Regulating Organisations (SRO) and Recognised Professional Bodies (RPB), Investment Banking was overseen by the Securities and Investment Board (SIB).[392] The Bank of England had oversight on Commercial Banking while Building Societies were regulated by the Building Societies Commission. [[393]][[394]]

This part of the literature's review is a necessary precursor to the critique on "Ring-fencing policy" which relates to the second objective of the study stated earlier. In essence, the aim of this section is to facilitate understanding of the issues surrounding the evolutionary development of narrow banking into universal banking in the UK through the 1980s and into the 2000s and the situation which also gave birth to the Financial Services Markets Act 2000, a unified umbrella regulatory instrument that governs the banking sector and other financial services providers listed earlier. [[395]][[396]]

Against this background is the paradigm shift in the existing pattern of economic regulation to the free-market ideology which emerged during the Margaret Thatcher era of the late 1970s through to 1990s. While some considered the changes in the socio-economic policy of that era to be the factors that laid the foundations of a major economic breakthrough in the 1990s, others thought they were the reasons for the banking crisis in 2007 – 2009.[397] In turn, the crisis precipitated the policy on Ring-fencing encapsulated in the Financial Services (Banking Reform) Act 2013, a major part of this research.

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[391] F. Mishkin, and S. Eakins, 'Financial Markets and Institutions 9th ed') Pearson, 2018
[392] Op. cit., Morris, S. 2016, p. 2, (n. 177)
[393] Op. cit., Arora, A. 1997, (n. 100)
[394] J Mills, 'Wurtzburg and Mills Building Society Law, 14th Ed', (Stevens & Sons, 1976)
[395] Financial Services Markets Act 2000
[396] K. Mwenda, 'Legal aspects of Financial Services Regulation and the Concept of a Unified Regulator' (The World Bank, 2006, p. 37)
[397] Op. cit., Arthur, T. and Booth, P. 2010, (n. 15)

The context in which structuralism and neoliberalism are used under this section is more of analytical tools engaged to evaluate shifting patterns in attitude towards socio-economic policy made since the late 1970s/1980s through to the global financial catastrophe which occurred in 2007 – 2009. The terms were used merely to segment and evaluate different periods in history. Segmentation of the period assisted in evaluating the effects of the changes in policy decisions on the banking sector over time.

Structuralism is a term that has been used in different philosophical contexts including for example in sociology under "Structuralism in Linguistics" popularised by a Swiss theorist, Ferdinand de Saussure and also discussed in the context of "Cultural Anthropology", as expounded by Claude Levi-Strauss.[398] Structuralism and neoliberalism are paradigms that are also discussed in the contexts of political science/political economy and regulation. In their 1993 book, "**States or Markets? Neo-Liberalism and the Development Policy Debate**" Christopher Colclough and Mannor used the term "Structuralism" to denote "Protectionism, interventionism and State controlled economy." These are the same ways as they are used in the thesis. Similarly, Ogus, extensively discussed the concept of structuralism in the same tone in his book 'Regulation: Legal Form of Economic Theory' cited copiously in the thesis. Another book that threats the subject is D. Harvey, 'A Brief History of Neoliberalism' (Oxford University Press, 2005). All these materials are referenced.

Structuralism and neo-liberalism are seen to be the ideologies which in succession influenced government policy choices on economic and banking regulation since the aftermath of the World War II through to the period leading to the global financial crisis in 2007 – 2009. The importance of a review of these two ideological positions to this study is that they were the dominating schools of thought whose influences are believed to be the precursor to the events which cumulatively gave birth to the ring-fencing policy enshrined in the Financial Services (Banking Reform) Act 2013.

Related to the literature review exercise, this section reinforces how societal values and views can change over time in the light of new understanding and how that may impact on the making and remaking of laws.

[398] J. Ree and J. O. Urmson, 'The Concise Encyclopedia of Western Philosophy' (Routledge, 2005, p. 346)

As well, it took into account how global externalities such as the influences resulting from dependency and interconnectedness of associated economies gave rise to the ring-fencing policy in the UK.

2.31 The Business of Banking

As mentioned under paragraph 1.10, until the enactment of the Banking Act 1979 and the Banking Act 2009, the definition of 'Banker' and 'Banking Business' had always been problematic. [[399]][[400]]

For example, the Bill of Exchange Act 1882 describes a banker as

> *"a body of persons whether incorporated or not who carry on the business of banking."*[401]

What that piece of legislation implies is that at the time it was conceived, an unincorporated body could carry on the business of banking. While that legislation still exists in the law books, times have changed. That provision of the law did not make it a legal requirement for an institution that aspires to carry on banking business to be incorporated. However, as pointed out below in the Banking Act 2009, any institution that carries on the business of banking is now expected to be an incorporated body.

The Banking Act 2009 defines a bank as a UK institution which has permission under Part 4 of the Financial Services and Markets Act 2000 to carry on the regulated activity of accepting deposits.[402] As shall be discussed further down, not all institutions that take deposits are banks.

This implies that to carry on banking business in the UK, the institution must be a UK institution. That requires the banking institution to be incorporated in the UK.[403] Passporting enabled any incorporated body from the EU countries to trade freely in the UK [404]. This will now be subject to the outcome of the agreement post Brexit. Also, for other incorporated bodies outside of the EU, the implication is that a foreign

[399] F. Perry, 'Law and Practice Relating to Banking 2nd Ed.' (Penguin, 1972, p.13)
[400] G. Penn and A. Arora, 'The Law Relating to Domestic Banking (Banking Law Volume 1) Sweet & Maxwell, 1987, p. 25)
[401] Bill of Exchange Act 1882 s.2
[402] Banking Act 2009 Part 1, s.2 (1)
[403] Banking Act 2009 Part 1, s.2 (3)
[404] P. Craig, and G. De Burca, 'EU Law' (Oxford University Press, 2008, p. 725)

bank that wishes to carry on banking business in the UK must comply with the requirement to register in the UK. The institution must be licenced before it can commence banking business. The Act makes the point that banking business in the UK is regulated and that unless an institution is licensed to do so, it cannot accept deposits from the public.

This initial vetting of incorporated bodies licenced to carry on the business of banking is part of the protective measures put in place to safeguard the public from dishonest practices.

An earlier legislation, the Banking Act 1979 stipulates the minimum criteria for a "recognised bank" to be licenced. The institution must for a reasonable period of time have enjoyed a high reputation and good standing in the financial community.[405] This means that the prerequisite qualification for a bank to be licenced is, "a high reputation and good standing in the financial community." In the event the institution has not traded long enough to acquire the reputation demanded, allowance is given to such institution to practice if the control of the bank lies with another institution of appropriate standing in the UK.[406] This exception provides that the controlling institution must be a bank in its own right.

The objective of these legal requirements is to afford greater protection to bank customers so that the public is not swindled by unauthorised organisations. A few examples of such banks include Barclays Bank, Lloyds Bank, HSBC Plc, Royal Bank of Scotland, Santander Plc and Standard Chartered Bank Plc. It is within this range of class of banks that some are chosen as case studies for this research.

Part of the unique distinguishing feature of a bank in this category is that it accepts deposits from customers withdrawable by cheque.[407] Of course, there are other means of withdrawing funds from an account but withdrawal from an account by cheque is unique to commercial banks as expounded by Lord Denning and Lord Diplock in United Dominion Trust mentioned earlier under 1.10.[408] The Banking Act 1979 s. 7 makes acceptance of a deposit from the public without authorisation an

[405] Banking Act 1979 Schedule 2 s.1
[406] Banking Act 1979 Schedule 2 s.2 (b)
[407] Op. Cit., P. Fidler 1982, p 33, (n. 103)
[408] Op. Cit., United Dominion Trust v Kirkwood (n. 111)

indictable offence, which if contravened makes an offender to be liable to a term of imprisonment and or with a fine.[409]

It needs to be pointed out that there is an important exception regarding other institutions that can accept deposits even when they are not categorised as banks within the meaning of banking business as defined in the Banking Act 1979 and Banking Act 2009. The list of those granted that exemption are the Bank of England, the National Savings Bank, the Post Office, Credit Unions, Building Societies (within the meaning of the Building Society Act 1962), Stockbrokers and Stock Jobbers.[410] It also needs to be noted that notwithstanding the fact that some of these institutions have 'bank' as part of their names, they are not categorised as banking businesses within the meaning of the Banking Act 1979 and the Banking Act 2009 stated earlier. The importance of this distinction is that this category of financial institutions does not fall within the ambit of Ring-fencing banking operation policy.

An apt description of the fundamental nature of the business of banking is also derived from Foley v Hill.[411] In that case, the House of Lords stated that the relationship between a banker and customer is not that of a banker holding deposits on trust for the customer, but the relationship is a contractual one whereby the bank is obliged to give back on demand "the equivalent amount of money deposited" with the banker. Thus, the bank receives deposits from their customers to an account, which could be a current account or a form of deposit account. What the bank is obliged to do is to repay on demand the equivalent of the amount deposited not the actual notes previously deposited.

What that suggests is that the bank can trade with such deposits by lending them to other customers at a profit. The bank is not answerable to their customers for the profit thus generated. Also, the implication of Foley v Hill's case is that the nature of the contract between a banker and the customer is not a "custodian of funds" or bailment relationship that requires the bank to return exactly the money kept with the bank. For example, this is a situation wherein the banker would be keeping monies deposited for safe keeping as in bailee and bailor relationship. The depositor of an item (the bailor) delivers the item to another (the bailee) on terms which

409 Banking Act 1979 s.7
410 Banking Act 1979 Schedule 1
411 Foley v Hill (1848) 2 HLC 28

normally require the bailee to hold the item and ultimately redeliver it to the bailor or in accordance with his directions.[412]

Again, the relevance of the distinction between a bank and other financial institutions is to enable readers to appreciate the banking institutions that are affected by the Financial Services (Banking Reform) Act 2013 and those that are excluded from the policy on the ring-fencing and the reasons why they are excluded. Those excluded generally do not have an extensive clientele and asset base as those covered by the ring-fencing policy. The banks that fall within the ambit of the ring-fencing policy are considered to be of systemic importance because they are internationally active and have core deposit base that is well above the minimum threshold of £25 billion, the benchmark at which regulation about ring-fencing applies.[413]

It is also to enable the reader to appreciate the inherent credit risks associated with banks trading with their customers' money. As well, it is meant to assist in appreciating the colossal impact it can have on a bank's customer when a bank runs into difficulties and is unable to refund the money deposited by bank customers because borrowers defaulted.

In order to strengthen and safeguard the position of customers against the excesses of banks that already occupy a position of power, there are other legislation made to protect the interests of bank customers. This regulatory framework was discussed previously in Section D.

2.32 Other Financial Institutions

Suffice it to acknowledge the existence of other financial institutions mentioned under this heading, issues relating to them are not considered in any great length because they are not the focus of this study. As mentioned in chapter 1, the study focused more on deposit taking banks.

Other financial institutions within the financial system include but are not limited to the following: Pension Funds, Unit Trust Businesses, Building Societies, Savings Banks, Credit Card Providers, National Loans Fund and Mortgage Services Providers.

412 P. Atiyah, et al., 'The Sale of Goods 11th ed' (Pearson, 2005, p. 13)
413 Op. Cit., Financial Conduct Authority, 2015, (n. 34)

One way of classifying the financial sector is by a framework provided by the Wilson Committee Report that categorised financial intermediaries into three groups: Investing Institutions, Deposit-taking Institutions and Specialist Financing Agencies.[414]

An Investment Bank is defined as an institution which has permission under Part 4 of the Financial Services and Markets Act 2000 to carry on the regulated activity of (a) safeguarding and administering investments, (b) dealing in investments as principal, or (c) dealing in investments as agent.[415]

This provision of the Act covers merchant banking activities which include stock market activities, financing of long-term venture capital, export finance, factoring and leasing of a capital-intensive equipment. Unit and Investment Trusts involve pulling together funds from investors under a long-term contractual arrangement and investing such funds in a highly diversified investment portfolio in order to reduce risks.[416] Some of the activities related to investment banking also include high risk speculative derivative options, features and swap, the kind that primarily caused the financial crisis in 2007 – 2009.

The unique features of deposit taking institutions within the meaning of the Banking Acts 1979 and 2009 was discussed previously.

The third category mentioned by the Wilson Committee is the Specialist Financing Agencies. This class of financial intermediaries includes developmental banks such as the Industrial and Commercial Finance Corporation which specialises in providing venture capital and long term finances for up to 20 years.[417] As a result of the short term nature of the deposits usually held by commercial banks, typically they are wary of lending long-term so as not to create a deposit/loan term mis-match as happened with Northern Rock, that ran into liquidity difficulties in the years leading to the financial crisis in 2007 – 2009 because they gave long term facilities against short term deposits.[418] Developmental banks bridge the gap that exists in the

[414] Wilson Committee Report, 'The Functioning of the Financial Institutions' (HMSO, 1980)
[415] Banking Act 2009 s. 232
[416] Op. Cit., A. Arora, 2014, p. 11 (n. 236)
[417] M. Collins, 'Money and Banking in the UK: A History' (Routledge, 1988, p. 446)
[418] Op. Cit., Tomasic, 2008, (n. 272)

provision of loans by commercial banks and long-range finances needed by industrial concerns.[419]

2.33 The Driver of Economic Regulation: Structuralism and Neo-Liberalism Socio-Economic Ideologies

This part of the study considers socio-economic ideologies that influenced policy direction on banking regulation especially in the aftermath of World War II.

The idea of making choices between free market economy (Neo-liberalism) and a government interventionist approach (also called Structuralism) has a long history dating back to the days of Adam Smith, the renowned eighteenth-century Scottish economist who described market forces as an invisible hand that should be left alone to regulate the market.[420] Adam Smith is renowned to have popularised the concept of division of labour, the law of comparative advantages, the theory on the law of demand and supply and, although he is a Scotsman (not an American), he is often referred to as the father of capitalism.

The importance of an evaluation of these ideologies to this study is that they help us to understand the background of the evolutionary development of the banking sector from a narrow banking model to a universal banking model wherein assorted specialist banks (listed in chapter 1 under paragraph 1.10 page 29) gradually started to merge and grew to become the huge banks that now pose systemic risk to the economy. Whereas in the years before and after World War II till the 1970s when structuralism model prevailed, there was a strict separation between investment banking services and commercial banking operations. However, following the era of deregulation in the late 1970s, the restrictions were lifted giving rise to enormous banks. Since the global financial crisis in 2007 – 2009 these super big banks have taxed governments, regulators and banking sector supervisors in no small measure.

A review of the circumstances that led to the merger of these assorted classified banks is also considered necessary as the global financial crisis of 2007 – 2009 was partly blamed on the lifting of the lid on the Glass-Stealgall Act 1933 (legislation in

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[419] Op. Cit., M Collins, M. 1988, p. 446, (n. 417)

[420] A. Smith, *'An Enquiry into the Nature and Causes of the Wealth of Nations' Dent edn 1933 Cited in G. Davies A History of Money (University of Wales Press, 1996)*

America) that imposed strict separation between commercial and investment banking.[421]

2.34 Structuralism

Structuralism is a protectionist ideology that advocates centralised economic planning and government intervention in economic activities with the aim of influencing the general direction which the financial sector and the economy should follow.[422] Structuralism has also been defined as a sustained and focused control exercised by a public agency over the activities that are valued by a community.[423] This form of approach to regulation is associated with economist, John Maynard Keynes. Structuralism was popular in the aftermath of the World War II, a period usually referred to as the Bretton Woods era.[424] This approach to regulation prevailed until the 1970s. Keynesian theory laid emphasis on the government establishing mechanisms to determine interest rates, exercises control over foreign exchange, capital movement, retains administrative control over export and import and generally uses licences to regulate the economy.[425]

The presumed advantages of protectionist ideology were thought to include predictability, stability, safety and facilitation of protection of the economy. Whilst these qualities may appear generally appealing, the downside of structuralism is the consideration that it unduly hindered entry into the market, caused inefficiency in resources allocation, was bureaucratic, distorted prices and placed undue reliance on the government to provide a subsidy when rendering public services.[426]

Until the late 1970s, in the UK, the economy, and by extension regulation and supervision of the banking sector were motivated by protectionist ideology. At the time, it was believed that the philosophy served the public interest better, as this approach to regulation enabled the government to step in where necessary in order to maintain stability in the financial sector.[427] Interventionism was viewed as

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[421] Op. Cit., R. Nattrass, (n. 62).
[422] Op. Cit., C. ColClough, C. and J. Manor, J. 1993, (n. 227)
[423] A. I Ogus, 'Regulation: Legal Form of Economic Theory' (Oxford Clarendon Press, 1994)
[424] Op. Cit., L. Rochon and S. Olawoye 2012 (n. 125).
[425] Ibid.
[426] Op. Cit., S. Hefferman, 1996, (n. 117).
[427] I. Johnson, and W. Roberts, 'Money and Banking: A Market-oriented Approach' (CBS College Publishing, 1982)

advancing the common good of the nation and promoting the collective determination of all. Ordinarily, such idealism appears faultless.

However, structuralism fell out of favour as this approach to regulation was considered to be inflexible and too burdensome.[428] Reflecting on the harsh reality of the economic environment of that era may have prompted Capie to ask rhetorically whether the interventionists' approach to regulation was "a cure worse than the problem".[429]

2.35 Neo-liberalism

In the early 1970s, economist Milton Friedman, a Noble Laureate in Economics resurrected the notion of liberalism.[430] Liberalism is a theory which was first popularised by a Scottish economist Adam Smith who raised the idea in his book titled "Inquiry into the wealth of Nations" published in 1776.[431] Friedman's idea on liberalism is usually referred to as Neo-liberalism. The Oxford Advanced Learner's Dictionary defines "*Neo*" as a new, modern or "a latter form".[432] So, neo-liberalism promoted by Friedman is regarded as a new form, modern or a later form of liberalism in the same genre as Adam Smith's theory.

In contrast to the structuralism approach to regulation, neo-liberalism economic ideology favours a laissez-faire approach to regulation, advocating the removal of barriers to commerce and instead suggesting active encouragement of free enterprise model.[433] Neo-liberalism favours deregulation, advocating privatisation, free movement of capital, goods and services, market determined rules and that so far as possible market activities should be unrestricted by law.[434]

What this means is that, to a large extent, in the developed economies there was a removal of barriers as to the limit of foreign currencies that could be bought or sold, thus facilitating movement of capital, goods and services. There was also a lifting of restrictions on cross-border ownership of interest in foreign securities. This allowed

[428] S. Picciotto, 'Globalisation, Liberalisation and Regulation' (1998) Conference Paper Sussex University
[429] F. Capie, 'Capital Controls: A Cure Worse than the Problem?' (The Institute of Economic Affairs, 2002)
[430] Op. Cit., M. Friedman, 2007, (n. 233).
[431] Op. Cit., Smith, A. 1776, (n. 420).
[432] A. S Hornby 'Oxford Advanced Learner's Dictionary' (Oxford University Press, 1998)
[433] Op. cit. M. Friedman, 2007, (n. 233)
[434] Op cit., ColClough & Manor, 1993, (n. 227).

the entrance of foreign investors and corporate entities seeking to widen their sources of additional capital outside their domains for expansion of their businesses.[435]

The importance of all these in the context of the UK's economy is that deregulation policy met a well prepared and sophisticated City of London, adequately equipped for global leadership in banking and finance. With the support of an evolving legal framework devised to regulate financial activities for centuries, banking business in the UK increasingly became more and more sophisticated. Arguably, this rich legacy of financial regulation may have paved the way and oiled the wheels of the famed British Industrial Revolution in the period 1700 – 1914 which paved the way to turn the UK into a world economic capital.[436]

In addition to this, the UK has a long history and a solid foundation in regard to the development of shrewdness in commerce generally, the shipping industry, aviation, banking, insurance and the associated legal environment that has become a model for many parts of the world that embraced the English common law system and the notion of the Rule of Law.[437] So also, for more than two hundred years, UK spread her tentacles to different parts of the world, including a large part of Asia (Indo-China), Africa, Australia, USA, Arabia, Canada, Caribbean Islands, New Zealand, the Middle-East and Europe, developing different levels of alliances, part of which culminated in the formation of the league of the Commonwealth nations, which the UK leads.

This outward drive and engagement with the outside world have meant that the English language has become widely used as a medium of communication and even adopted as the official lingua franca in many parts of the world. The argument is that this socio-political influence is not without its long-term benefits to the UK, one of which is that the forged alliances and bi-lateral relationships naturally attracted the governments and the people of these nations to the UK. Thus, with the lifting of frontier barriers and the resulting globalisation, the UK naturally became a haven where international governments may wish to invest their external reserves. As at 2019, the Bank of England kept accounts for about two third of the central banks of

[435] K. Matthews, and J. Thompson, 'The Economics of Banking 2nd Ed' John Wiley, 2008, p. 61
[436] Op. Cit., P. Mathias, 2001, (n. 64).
[437] A Carroll, 'Constitutional and Administrative Law 3rd Ed' (Pearson, 2003)

nations across the world.[438] As well, encouraged by a very strong and stable pound sterling, wealthy individuals world-wide can hope to benefit from private wealth management facilities that are widely available in the legal and financial sector in the UK.

There are three important reasons for taking these wider issues into account in this research. Foremost, this historical background explains part of the UK's many attributes which gave her unique *Competitive Advantages***.** Competitive advantages are attributes, extraordinary resources and capabilities that allow an entity to rise above its rivals in the same industry to generate exceptional long-run rates of return on its investments.[439] The factors enumerated are unique to the circumstances of the UK and makes the UK stands out among developed economies of comparable status. The combination of these factors gave the UK an edge in her ability to attract more investors to London.

Secondly, it is argued that banking business is one of the UK's core competences and an area of business in which the UK has comparative advantages. Core competences refers to cultivated or learnt specialist skills, knowledge, expertise, capabilities and attributes that can become a critical success factor in the management of an organisation in a rapidly changing business environment.[440] The phrase "Core Competence" is rooted in Human Resources Management but borrowed to describe the Banking and Finance acumen, including the high reputation which the UK as a nation cultivated over several centuries and which arguably makes London stand out as a leading world financial centre.

Law of Comparative Advantage finds usage in economics. The principle argues that output will increase if a nation specialises in producing goods or services in which it has a leverage so that the nation is able to produce the goods or services at a lower opportunity cost than others.[441] As indicated later in **Fig. 2 on page 147** in the UK the financial sector was the sixth largest contributor to the Gross Domestic Products (GDP) in 2015 hence a need to encourage the banking sector's expansion rather than shrinking the sector. The argument is that the UK particularly has both comparative and competitive advantages in banking and finance due to her history,

[438] https://www.bankofengland.co.uk/about Accessed 15/4/2019
[439] T. Hannagan, 'Management: Concepts and Practices' (Pearson, 2008, p. 150)
[440] Op. Cit., L. J Mullins, 2016, (n. 46)
[441] A. V. Deardorff, 'The General Validity of the Law of Comparative Advantage', (1980) Vol. 88 (5) 941 – 957 The Journal of Political Economy.

the legal environment, relative stability of the pound sterling and the ambient political climate in the country which naturally attracts investors to the UK. The argument is that it makes sense to exploit to the fullest these outstanding advantages in the best interests of the economy.

The third reason why all these wider issues are important in this research is that it is considered necessary to highlight the burden shared by both structuralism and neo-liberalism theorists on policy options that would serve the best interest of the UK economy.

2.36 Argument for and against Structuralism (Protectionism) and Neo-liberalism (Deregulation/Free Market Economy)

Although both schools of thought have the same objectives, seeking the best interest of the UK economy, they share different views on how best to achieve the common goals.

Depending on the position one adopts in the argument, a structuralism supporter may want to say, the points about the history, reputation and the implicit trust imposed by the investing world on the financial system in the UK makes a compelling argument as to why it is incumbent upon the UK government to retain that trust. If considered necessary, the UK government should ensure that it intervenes through legal restraints on the banking sector as may be deemed appropriate in order to maintain that position of trust and confidence the investing world has in the UK banking sector.

Thus, an interventionist (protectionism) supporter would hail the ring-fencing policy as a sensible proposal because the policy would safeguard banks' depositors' interest and importantly, it would obviate the need for government to provide expensive bailouts to banks in the event of another crisis. An interventionist would cite the cases of Adoboli of UBS and Nick Leeson of Barings to support the argument that, with the ring-fencing policy, core banking customers would be protected from the effect of potential huge losses that may be incurred through speculative trading, as happened in the instances of UBS and Barings Capital.

Furthermore, as did Hudson, a supporter of the ring-fencing policy pointed out that, before the 2007 – 2009 crisis, Citigroup comprised 2,000 entities. It was a newly created subsidiary that ultimately caused the insolvency of the organisation before it was rescued by the US taxpayer and as such, it was safer to break up the super big banks into smaller manageable banks.[442] A protectionist would conclude that but for the economic deregulation in the 1980s which enabled banks to venture into risky proprietary trading and hedge fund speculative businesses, the financial crisis would not have happened. To support such argument, a protectionist would claim that the whole cataclysmic financial crisis of 2007 - 2009 had its roots with the President Clinton's regime Financial Services Modernisation Act 1999 that removed the legal divisions that existed between investment and commercial banking, which was entrenched in the Glass-Stealgall Act 1933.[443]

Conversely, a neo-liberalism enthusiast (Free Market Economy) could also say, yes, by all means, the position of trust enjoyed by the UK's financial system should be protected but there are better ways of placing a rein on the bankers without hurting or hampering their financial intermediation capabilities.

Such measures could for example include: improvement in the quality of corporate governance so that the boards in charge of banks are made to comprise competent hands[444]; investing in training and development of compliance officers of banks; empowerment of internal auditors; enhanced incentives and protection of "whistle-blowers" as provided for in the Dodd-Frank Model[445]; keeping abreast with up to date technology as tools in the banking sector; enforcement of capital adequacy requirements and liquidity ratios as expressed in the Basel III accord in order to minimise propensity for taking undue risks [[446]][[447]] and a rigorous supervision regime by the regulatory authorities as opposed to the restrictions exemplified by the ring-fencing policy.

Furthermore, a supporter of the Free-Market Economy may accept that the economic deregulation of the 1980s – 2000s opened a door of vast opportunities in the

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[442] Op. Cit., Hudson, 2013, (n. 14).
[443] Financial Service Modernization Act 1999; Glass-Stealgall Act 1933
[444] K. J Hopt, 'Corporate Governance of Banks and Other Financial Institutions After the Financial Crisis' (2013) Vol. 13 (2) 219 – 253 Journal of Corporate Law.
[445] R. Garson and C. Fladgate, 'Whistleblowing: The Dodd-Frank Model – A Brief Primer and is it Replicable Elsewhere?' (2018) Vol. 33 (11), 705 – 707 Butterworth Journal of International Banking and Financial Law
[446] Op. Cit., S. Schwerter, 2011, (n. 217).
[447] Op. Cit., K. Pakravan, 2014, (n. 218).

banking sector, which as pointed out earlier, some allegedly caused the 2007 – 2009 global financial crisis eventually. However, the point is that being given economic freedom to exercise choices on how best to invest banks' funds does not include a licence to be reckless. It could be argued that antiquated restrictive regulations curtail entrepreneurial initiatives and fragmented banks will be ill equipped to effectively meet the needs of modern-day conglomerate organisations that require the support of well-resourced banks [[448][[449]].

A neoliberalism supporter would for example point to **Table 2 on page 146** of this report which indicates a phenomenal growth in the Gross Domestic Product (GDP) of the UK from £860 billion in 1980 to £1.923 trillion in 2016. The point is that the free-market policy tremendously favoured the economy over that period notwithstanding the financial crisis that followed in 2007 - 2009. It is arguable that the free-market paradigm ushered in a period of unmatched prosperity in the UK. It therefore does not make sense to throw away the bathwater with the baby. We should rather learn from the failures of the past than revert to imposing greater restrictions on the banks that are more than necessary to grow the economy as is the case with the ring-fencing policy. At least not in the current way that the ring-fencing policy operates. The suggestion is that it is the risky investment services such as proprietary trading that should be excluded from the mainstream banking not the core deposits.

To cap it all, a neo-liberalism theorist might point to the example of other jurisdictions such as America, which shares the same values and economic ties with the UK. America had a similar large-scale financial crisis in 1929 and similar concerns as there have been in the UK following the 2007 – 2009 financial crisis. They responded by enacting the Glass-Stealgall Act 1933 mentioned earlier with similar objectives as the ring-fencing policy.[450] It took 66 years for America to repeal the Act on recognition that the policy created gaps for unregulated shadow banking businesses to take over and exploit the resultant arbitrage position in the market.[451] From 1980 when deregulation took hold to 2007 when the crisis occurred is 27 years and from 1999 when the Glass-Stealgall Act was repealed to 2007 when the crisis occurred is a gap of about 8 years.

[448] M. Steger and R. Roy, 'Neoliberalism: A Very Short Introduction' (Oxford University Press, 2010)
[449] Op. cit., R. Nattrass, 2010, (n. 62).
[450] The Glass-Stealgall Act 1933
[451] Op. Cit., J. Larosiere, 2015, (n. 84)

Following the financial crisis in 2007 – 2009, there was a deafening outcry in which it was alleged that the repeal of the Glass-Stealgall Act brought about the calamity that the 2007 – 2009 financial crisis was.[452] Thereupon, Barack Obama administration responded by rolling out the Dodd-Frank Act in July 2010, which was in effect a resuscitation of the character of Glass-Stealgall Act. The Dodd-Frank Act covered areas of concern about systemic risks, the Volcker rule sought to protect core depositor accounts by prohibiting bankers from engaging in risky speculative investment banking, it covers derivatives and swap[453] and, importantly, its provisions include consumer protection.[454]

Although America was affected by the 2007 – 2009 financial crisis more than any other nation, only about 8 years after the Dodd-Frank Act 2010, the Donald Trump administration substantially repealed the Dodd-Frank Act through Choice Act 2017 granting exceptions to dozens of financial institutions. [[455]][[456]]

In the Financial Times of 24th October 2017, under the heading "European Commission Withdraws Bank Separation Proposal", it was reported that the Members of European Parliament were unable to secure a consensus over the proposal to separate investment and commercial banking more so because France and Germany were not particularly interested in the proposal.[457] In an earlier recommendation submitted in 2012 by the EU's Expert Group given the responsibility to assess the way forward on financial stability in Europe led by Erkki Liikanen the Finland central bank governor, the group suggested that the core banking operation should be separated from investment banking, just as the Vickers' report did in the UK.[458] Reviewing Liikanen's report in 2015, Gunnar Hokmark, the Repateur to the European Parliament on banks' structural reform, refused to support the recommendation but rather opted for an EU growth agenda.

He said,

[452] Op. Cit., M. Steger and R. Roy, 2010, (n. 448).
[453] s.715 restricts engaging in Swap activities
[454] The Wall Street Amendment and Transparency Act 2010
[455] The Financial Choice Act 2017
[456] M. Islam, et al 'After Wrangling in the Financial Sector Following the Great Recession' (2019) 40 (3), 81 – 87 Company Lawyer
[457] Op. Cit., J Brunsden, J, 2017, (n. 115).
[458] Op. Cit., Alexander, P. 2015, (n. 114).

"*We cannot proceed with a discussion about regulation of our main financial institutions without considering what sort of effect it will have on the European economy*." [459]

If the EU had adopted the ring-fencing policy, the number of banks in Europe that could have fallen within the ambits of the ring-fencing policy are almost the same as those caught up with the policy in the UK. Besides, as pointed out by Ellinger et al, for more than one hundred years, France and Germany have had universal banks that included investment banking within the fold of their operations without having the kind of difficulties that came with the global financial crisis in 2007 – 2009. As such, these two principal partners in the EU project were arguably not just keen on adopting the ring-fencing policy in the way the UK embraced it.[460] The argument is not about inclusion of risky investment businesses in the provision of core banking services.

Prior to the adoption of the ring-fencing policy, the largest concentration of big banks was in the UK, which is not surprising. The argument in this study has been that provision of financial services is one of the core competences of the UK. With the exception of a well-resourced HSBC, following the ring-fencing policy, which the EU avoided, the smaller UK banks (RBS and Barclays) will now be competing on an uneven playing field with the big banks in Europe that are not subject to the same stringent rules as the banks in the UK. This is more so that these European banks have access to the cheap core deposits which could have been ring-fenced if they had adopted the ring-fencing policy in the way it was adopted in the UK.

The conclusion is that the EU did not refuse to adopt the ring-fencing policy merely on the account of a small number of banks that would have been affected by the policy if it was adopted in Europe. Their decision was based on a well-considered analysis of the overall implications of the policy to their banks and economy.

This conclusion is partly premised on the statement made by Gunnar Hokmark, the Repateur to the European Parliament on banks' structural reform. As stated earlier, he refused to support the recommendation put forward by the commission led by

[459] Ibid
[460] Op. Cit., Ellinger et al., 2011, (n. 110)

Erkki Liikanen that suggested the adoption of the ring-fencing policy on the account that they could not adopt the policy until they fully understood the sort of effects the policy would have on the European economy.

In view of that position statement, it may be argued that the EU gave a well thought out consideration on the possible overall effects of the ring-fencing policy on their banks and the European economy. In the end, they rejected the policy. This is exactly what this research is about, calling for a more careful consideration of the wider implications of the ring-fencing policy on the UK's big banks and the economy.

The consequence was that Brussels chose to look for alternative ways to manage systemic risks posed by Global Systemically Important Banks as opposed to the ring-fencing policy adopted by the UK.

Thus, a possible argument is that if other large European economies such as Germany and France refused to restructure their banks through separation of investment and commercial banking, does it not amount to the UK putting her big banks at a disadvantage by restructuring its banks that built up clientele and assets globally over centuries of hard work? Would the UK banks not be at a disadvantage against their competitors from Europe and elsewhere, where they are not supportive of restructuring their large banks into a bank with the core deposits and a mainstream bank? Is the UK not unwittingly putting itself at a disadvantage by embarking on a project that has the potential to hurt its economy more than any other European country? Apart from Switzerland that was recorded as having held offshore customers' accounts and assets in their private banks valued at $2 trillion in 2008,[461] it is arguable that not many of the other European countries had extensive global outreach as much as the UK did in the period leading to the crisis.

In the case of Switzerland, it was not the case that Swiss banks opened extensive branches globally fishing for customers, but other nations and high net worth people brought their wealth to the Switzerland as a haven. The Swiss private banking system has often been subjected to scathed criticism on the basis that they provide secretive services for some clients who are criminals, tax evaders, corrupt politicians

[461] J. Goddard, et al., 'The Financial Crisis in Europe: Evolution, Policy Responses and Lessons for the Future'(2009) Vol. 17 (4), 362 – 380 Journal of Financial Regulation and Compliance.

who looted the treasury of their countries (especially in some third world countries) and people avoiding divorce settlement for example.[462]

Whilst it is agreed that the excesses of the bankers' and propensity for taking risk ought to be checked, the question remains whether the banking regulatory environment in the UK is not increasingly and needlessly becoming too hostile to the banking industry.

A better approach could have been to use legislative powers to stop the banks from engaging in speculative investment trading while on application, licences could be given to qualified banks that so wishes to open separate entities that could engage in speculative proprietary and commodity trading. Such newly licenced banks would then need to source fresh capital for speculative trading. In effect, it is the risky investment banking elements that should be taken off the mainstream banks. That way, core depositors' accounts would be protected in the same way that the ring-fencing policy would do.

The added advantages are that the cheap core deposits would then be available for the traditional corporate lending where huge multinational corporate customers' financial needs could be catered for. Also, the UK universal banks would have been able to retain their competitiveness in relationship with the other European counterparts that did not adopt the ring-fencing policy.

Notwithstanding UK's regulatory response to the 2007 – 2009 global financial crisis and the issues surrounding Brexit since 2016, as indicated by the Global Financial Centres Index, as of September 2017, London still maintained its position as a world leading financial centre.[463] The Global Financial Centres Index is a commercial think-tank publication that specialises in studying the competitiveness of financial centres around the world. The publication is widely cited in the Journal of International Banking & Financial Law. The body has consistently rated London as the leader of the world Financial Centres since 1997.

Arguably, the benefits of deregulation are undeniable. These include, it promotes an increase in efficiency and competition; boosts productivity and enhances innovations

[462] Ibid.

[463] Op. Cit., Z/Yen, 2017, (n. 63).

and technological advancement.[464] The ideals of the free-market model encourage new entrepreneurial ventures, promote proliferation of small and medium size enterprises, boost employment, attract foreign investors and generally brought about improvements in the standard of living of more people.[465]

China is an example of recipients of the benefits accruable from the free- market enterprise model. Although China has a very long history dating back to about 3000 years, they have always remained an agricultural economy and were hardly better than most third world countries until the 1970s reformation after the death of Chairman Mao, their leader. China jettisoned communism and embraced the free-market principles. The result is there for all to see today. China is now one of the leading world economies.

In the late 1970s to 1980s there was a change in policy towards state's intervention (structuralism) in Britain under Margaret Thatcher, the then prime minister.[466] A free market model was embraced, leading to deregulation and privatisation of state-owned assets.[467] The State-owned institutions were sold to private investors with the aim of increasing efficiency.

In tune with neo-liberalism ideology, the choice to deregulate the economy may have been a big leap from strict regulation and protectionist ideology to the free market model. The adoption of neo-liberalism was not without initial pains in the UK. Foremost, there were issues about negative equity with home owners and confrontation with workers' unions arising from resistance to de-unionising workers following deregulation of the labour market.[468] The Employment Act 1980 sought to restrict the powers of the unions[469] as there was growing discontent against the unions throughout 1978 – 79, when there were widespread series of industrial strikes that almost brought the nation to a halt.[470] The previously prevalent collective bargaining standards, whereby agreements were reached through the process of collective negotiations between employer or group of employers on one

[464] Op. cit., D. Harvey, 2005, (n. 128).
[465] J. Morrison, 'International Business: Challenges in a Changing World' (Palgrave Macmillan, 2009)
[466] Op. cit., D. Harvey, 2005, (n. 128).
[467] Op. cit., G. Arnold, 2005, (n. 25).
[468] I. T. Smith and G. H. Thomas, 'Industrial Law 8th Ed)' (Lexis Nexis, 2003 pp 39-40)
[469] S. Honeyball, 'Labour Law 8th Ed' (Oxford University Press, 2006, p. 9)
[470] ibid

hand and the trade unions on the other[471] were supplanted by Employment Protection Regulations which focused more on individuals' protection than group rights. [[472]][[473]]

Notwithstanding the difficulties at that time, with the benefit of hindsight neo-liberalism ushered in a period of prosperity in the UK as mentioned earlier. According to Booth, even those who oppose the free-market model do agree that the adoption of the free-market model has been very beneficial to the UK's economy.[474]

Doubtless the free-market model has disadvantages. The model is often criticised and challenged as a policy which only serves the interests of capitalists as opposed to the collective interest of the nation.[475] Stiglitz pointed out that a perfect market that can regulate itself is illusory and that the free-market model imposes a real burden on developing economies that are unable to favourably compete against developed economies in the global market.[476]

2.37 The impact of Neo-liberalism on the Banking Sector

The adoption of a neo-liberalism ideology in the UK in the late 1970s also meant a great deal to the financial institutions, as that policy choice altered the size and character of the banking sector in the UK. This was because as restrictive regulations were removed, this allowed financial institutions to gain more freedom than ever before.[477] The overall effect of deregulation to the banking sector since the 1980s through to 2000s was that some banks grew phenomenally to become large conglomerates.

For example, it was during this period that the concept of universal banking services started to emerge in the UK. As mentioned previously, universal banking is an approach to banking wherein a bank provides different types of specialist's financial services to customers under the same umbrella.[478] These are services previously

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[471] S. Deakin and G. Morris, 'Labour law 4th Ed' (Hart Publishing, 2005 pp 17 – 35)
[472] Employment Protection Act 1975
[473] Employment Rights Acts 1996
[474] P. Booth 'Were 364 Economists all Wrong?' (The Institute of Economic Affairs, 2006)
[475] Op. cit., Brink, 2000, (n. 80).
[476] J. Stiglitz, 'Stiglitz Report: Report of the Commission of Experts to the President of the UN on Reforms of the International Monetary Fund and Financial System' (The United Nations, 2009, p.132)
[477] M. Kohn, 'Financial Institution and Market'(McGraw-Hills, 1994)
[478] Op. Cit., Arnold, 2005, (n. 25).

classified as retail/commercial banking, mortgages and investment banking/merchant banking services. They are services that were previously provided by specialist financial institutions prior to adopting the deregulation model.

The scenario that led to the removal of the lid on strict banking regulation created an environment which eventually led to the merger of banks such as the creation of the Lloyds/TSB Group. It also led to the Royal Bank of Scotland Group acquiring more financial institutions, for example, they purchased ABN AMRO in 2007 (in conjunction with Santander Group and Fortis) which sadly led to the RBS running into serious liquidity problems that could have ruined the bank but for the government intervention.[479] The four banks evaluated had a long history of mergers and acquisitions. In some cases, it went well and when it went badly, it was really very bad. The group effect created offered the opportunity to these banks to provide wide ranging banking services including commercial banking, mortgage services, insurance services and investment banking services which were all previously regarded as distinctive areas of banking services that should be provided by specialist institutions only.[480] In view of the vastness of their assets that developed over time and the systemic risk that they pose to the economy, these banks are now considered to be "too big to fail and too big to rescue without government's intervention".[481]

While the large size has advantages, but it also presents several other worrying challenges and complications. For example, the large size makes the banks to be highly vulnerable. Along with that is the attendant dire consequences that could follow in the event of their failure. There can be immense complications in the supervision of such banks at home and across international frontiers as was in the case of the failed BCCI mentioned earlier in this chapter.[482] Sometimes, due to the immensity of the level of the operations of a bank abroad and domestically, there is a risk of the management losing internal control within the organisation as was the case with Citigroup that had about 2000 separate entities within the group before the global financial crisis. It was a newly established part of the group that brought the organisation to its knees.[483] So the complexity arising from managing jumbo

[479] Royal Bank of Scotland, 'Annual Report and Financial Accounts' (RBS, 2008)
[480] Op. Cit., K. Matthews, and J. Thompson, 2008, (n. 435).
[481] Op. Cit., C. Hofmann, 2017, (n. 26).
[482] Please see pages 104 - 105.
[483] Please see comment on this on page 134

sized organisations, operational risks attached to that, securing adequate level of capital and liquidity level necessary to keep the soundness and safety of the banks that gave rise to government's concern and which inspired a need to enact the Banking reform Act 2013. This was primarily to promote soundness in the financial system of the country and to make less likely situations that could give rise to a need for the government to provide expensive bailout as was the case during the 2007 – 2009 global financial crisis.

On the other hand, universal banking clearly benefited the economy in several ways. Foremost, the banks benefited from the effects of synergy. With improved wide-ranging sources of deposits and investment outlets, the banks had better cost of capital and they derived profits from the ensuing economies of scale as suggested by Barth *et al.*[484] Ultimately, all these factors led to the provision of cheaper banking services to customers and in some ways contributed to bringing about low interest rates. In the past 40 years or so of universal banking, small and medium size enterprises benefited more through increased access to banking facilities. Arguably, as banks prospered, that also meant more contributions in corporation taxes. As well leading to facilitation of improvement in both indirect and direct employment within the economy.

As mentioned previously, China, a once die-hard communist and agricultural dependent economy embraced the tenets of the free-market model leading to phenomenal growth in its economy.[485] As at 2018/2019, the four biggest banks in the world were in China.[486] On pages 149 is **Table 3** that contains the list of the ten biggest banks in the world including Barclays that ranks as number 20 on the list. The number one position among the biggest banks in the world is Industrial Commercial Bank of China with assets worth $4 trillion and 450,000 employees. Another of the biggest Chinese banks, holding the third position, had assets worth $3.3 trillion and 470,000 employees. None of the UK banks comes anywhere close to these. The largest UK bank, HSBC Plc, is in distant 7th position. HSBC Plc had $2.5 trillion assets and employed 235,000 staff members. Further down the line, the next bank to HSBC in the UK is Barclays Plc which held the 20th spot globally. Barclays had assets worth $1.4 trillion and total employees 84,000.

[484] Op. Cit., Barth, J., *et al* 2004, (n. 59).
[485] Op. Cit., J. Stiglitz, 2009, (n. 476).
[486] https://fxssi.com/top-20-largest-world-banks-in-current-year

It was not only China that became highly successful as a consequence of adopting the free market model. In the late 1970s through to the 1990s, the free-market model was also embraced in other parts of the world such as in New Zealand, USA, Sweden, fragmented Soviet Union States and in post-apartheid South Africa, leading to improvements in their economy.[487]

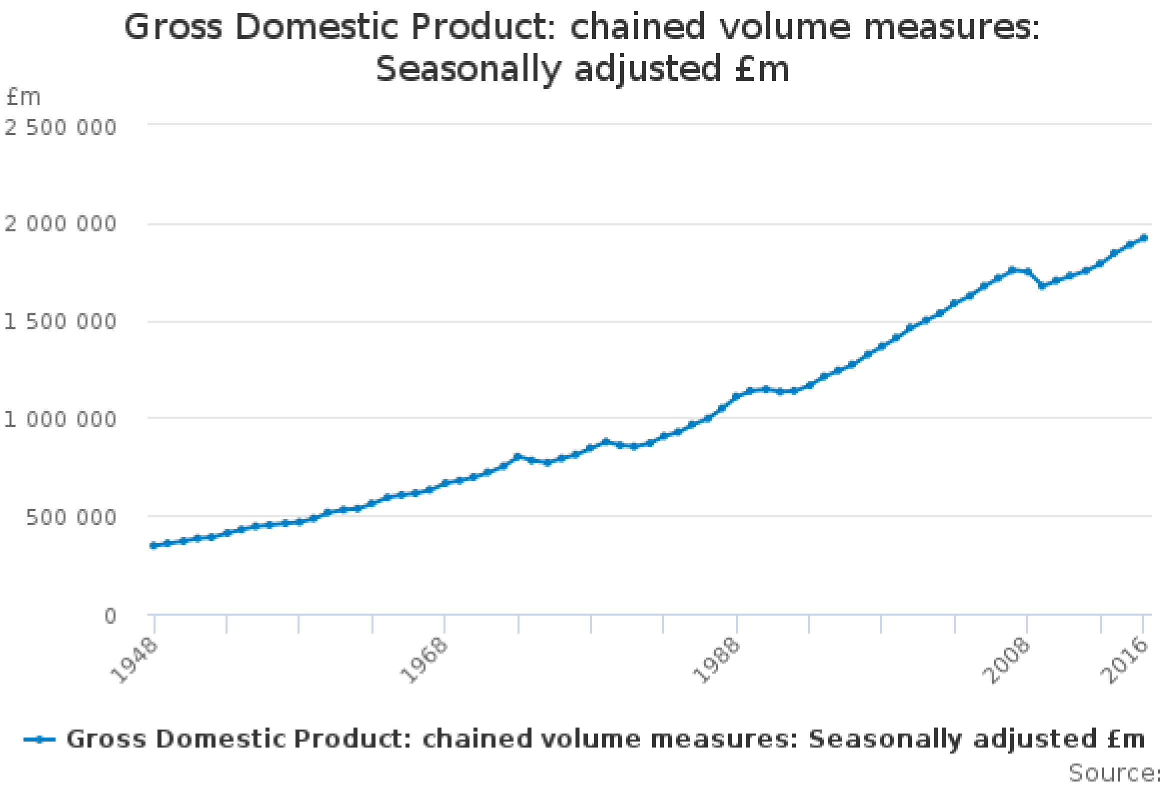
Specifically relating to the UK, **Figure 1** below is a trend series relating to the Gross Domestic Products from 1948 – 2016 which succinctly elucidate on the positive impact of the adoption of the free market model at home in the UK.

A statement to the effect that the free-market model has been beneficial and remarkably improved the economy in the UK is amply supported by economists cited earlier. Over time, the national GDP/Per Capital Income has been widely accepted as one of the most popular standards for measuring national economic growth or lack of it. For example, the International Monetary Fund accepts that performance measurement standard in its evaluation of growths in countries globally. That performance measurement yardstick usually forms part of the basis on which needy countries are assessed and can obtain assistance from the IMF.[488]

A major work on the GDP as a yardstick for mearing growth or lack of it was carried out by Prof Coyle of the University of Manchester. That work is referred to in the next chapter on method and methodology.

[487] Op. cit., J. Stiglitz 2009, (n. 476).
[488] Ibid.

Fig. 1



Office for National Statistics GB

https://www.ons.gov.uk/economy/grossdomesticproductgdp/timeseries/abmi/pgdp

A construction of the actual figures relating to the values of x, y axes of the graph are stated on the next page, **Table 2**.

As the heading of the graph suggests, the variables have been adjusted to incorporate time value of money. Generally, the time series indicate a fairly consistent growth in the GDP over the years since 1948 when the GPD was in relative terms, a mere £345 billion. This is with the exception of 1980/1981 when there was a dip in the GDP from £877 billion in 1979 down to £853 billion in 1981. Reduction in the GDP may be associated with the effects of the crippling industrial unrests at that time and possibly the situation may also have been fuelled by debt led expansion at that time.

Construction of Actual Figures Relating to the Value of x, y axes of the Graph are tabled below.

Table 2 - Gross Domestic Product Chained Volume Measures Seasonally Adjusted £ (m) 1948 - 2016

Year	**GDP £m**	**Year**	**GDP £m**	**Year**	**GDP £m**
1948	345,311	1985	966,495	2003	1,588,019
1968	665,784	1986	996,691	2004	1,625,567
1969	678,594	1987	1,049,581	2005	1,675,896
1970	696,970	1988	1,109,907	2006	1,717,055
1971	721,255	1989	1,138,425	2007	1,757,521
1972	752,283	1990	1,146,756	2008	1,749,216
1973	801,247	1991	1,134,296	2009	1,675,963
1974	781,509	1992	1,138,538	2010	1,704,364
1975	769,950	1993	1,167,308	2011	1,729,121
1976	792,356	1994	1,212,600	2012	1,754,736
1977	811,714	1995	1,242,548	2013	1,790,750
1978	845,821	1996	1,274,093	2014	1,845,444
1979	877,467	1997	1,325,543	2015	1,888,737
1980	859,674	1998	1,367,136	2016	1,922,626
1981	853,046	1999	1,411,112		
1982	870,197	2000	1,462,818		
1983	906,936	2001	1,500,034		
1984	927,580	2002	1,536,903		

Source: Office of National Statistics (Data based on the link below)

https://www.ons.gov.uk/economy/grossdomesticproductgdp/timeseries/abmi/pgdp

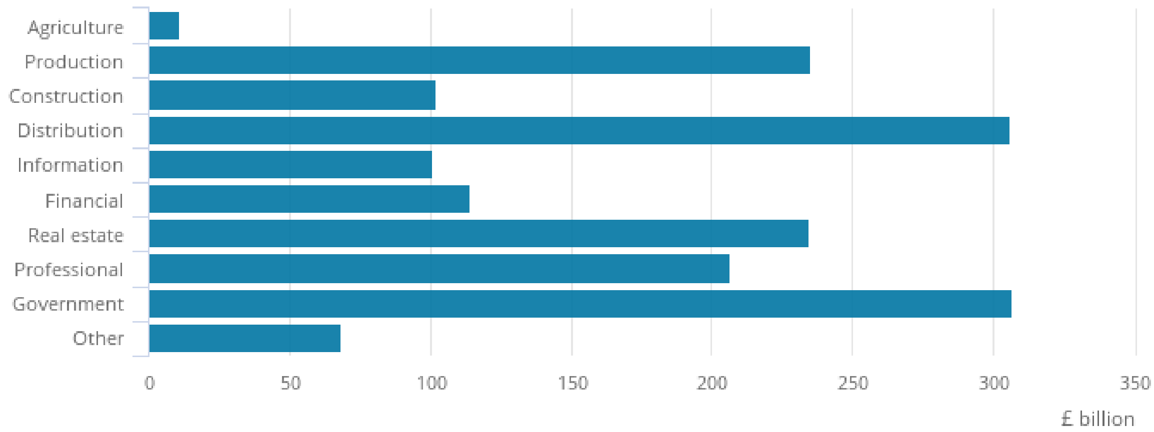
However, there was a full recovery by 1983 when the GDP picked up to £907 billion.

By 1987 when the free-market model had been fully adopted, the GDP had started to hit a trillion-pound mark at £1,050 billion. Ten years later, GDP continued to increase hitting £1,757 billion in 2007 when the financial crisis began. The GDP recovered by 2012 as it rose to £1,755 billion. In 2016, the GDP had reached £1,923 billion, more than double the GDP of £856 billion in 1978, just at the tail end of the structuralism regime.

As indicated in the heading of the above statistics, time value of money has been taken into account. Overall, the argument is that the free-market model has remarkably contributed to the improvement in the UK economy.

Fig.2

Figure 2.1: Breakdown of gross value added at basic prices, by industry, 2015, UK

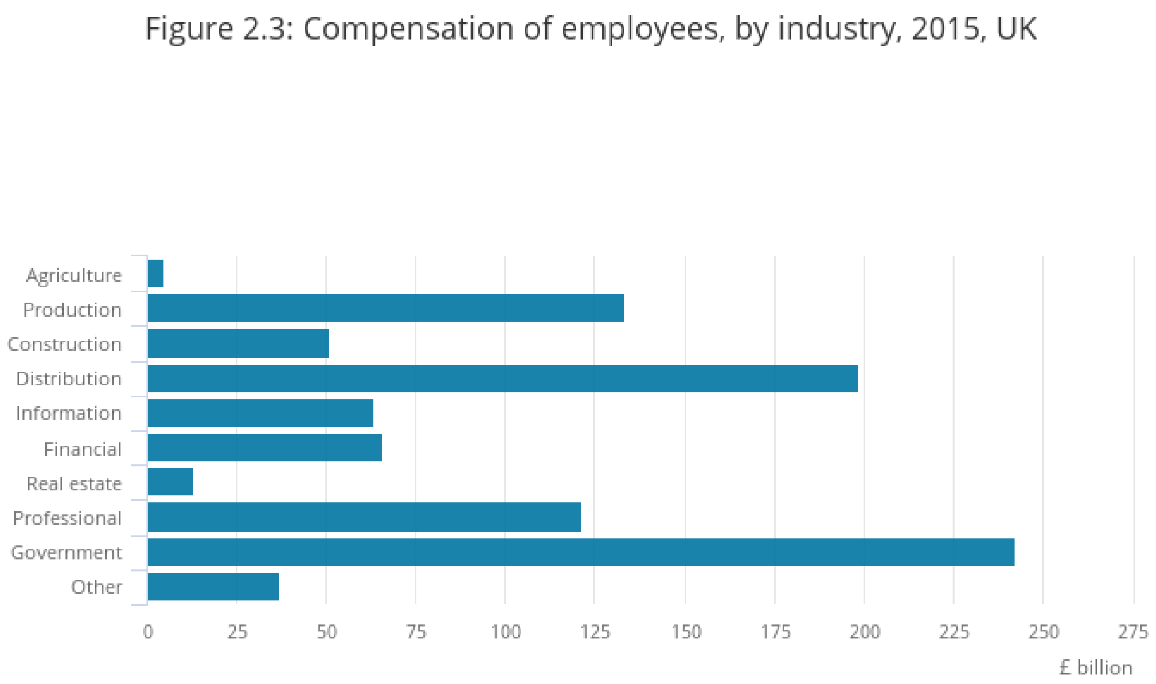


Source: Office for National Statistics

Please note that the label on this graph and subsequent ones from ONS indicating for example Figure 2.1 as captioned by the Office of National Statistics on this chart is not adjustable. For the purpose of this study and for references purposes, the title of the graph is Fig.2. Others in the series are also renamed with titles other than what ONS called the charts.

Fig. 2 indicates that the financial sector was the sixth largest contributor to the economy in 2015 having contributed £114 billion.

Fig. 3



Source: Office for National Statistics

Fig. 3 places the financial sector in the fifth position on the table of compensation of employees in 2015 having expended £66 billion on employees.

Fig. 2 and 3 demonstrate the importance of the financial sector to the economy and why rather than reverse the achievements of the past, the policy makers should rather seek ways to consolidate on the past achievements.

Table 3: The World Biggest Banks 2018/2019

Rank	Bank	Year of Establishment	Country	Assets $	No of employee
1	Industrial & Commercial Bank of China	1984	China	$4.027 trillion	450,000
2.	China Construction Bank Corporation	1954	China	$3.377 trillion	372,000
3.	Agricultural Bank of China	1951	China	$3.287 trillion	470,000
4.	Bank of China Ltd	1912	China	$3.092 trillion	311,000
5.	Mitsubishi UFJ Financial Group	2005	Japan	$3.069 trillion	106,000
6.	JP Morgan Chase	2000	America	$2.727 trillion	250,000
7.	HSBC	1865	UK	$2.558 trillion	235,000
8.	Bank of America	1998	America	$2.354 trillion	204,000
9.	BNP Paribas	1848	France	$2.336 trillion	203,000
10.	Credit Agricole	1894	France	$2.123 trillion	142,000
20.	Barclays Plc	1690	UK	$1.444 trillion	84,000

Source: https://fxssi.com/top-20-largest-world-banks-in-current-year Accessed 22/4/2020

In this league table, HSBC a UK bank is 7th in the queue and the next British bank on the list is Barclays which is the 20th in rank globally.

2.38 Would Ring-fencing Policy Established in the Banking Reform Act 2013 prevent Future Occurrence of Financial Crises in the Banking Sector?

This section deals with research objective number (iii) concerning evaluation of the effectiveness or otherwise of the ring-fencing policy serving as measures that are capable of deterring financial crises in the future.

Depending on the reason for the cause of the crisis, the ring-fencing policy cannot of itself stop all financial crises. Apart from the risk factors in investment banking that can induce crisis, there several other factors that can cause mayhem in the banking sector. It is accepted that the ring-fencing policy can stop potential crises coming the investment banking. The ring-fencing policy can also minimise the impact of financial crises on core banking customers and obviate the need for government to provide bailouts if the crises were induced by recklessness in the investment arm of the banking sector.

For example, some of the banks that failed in the past, including Northern Rock Plc and Bradford & Bingley Plc, they failed because of poor management and not because they were big or that it had anything to do with the provision of investment banking services.[489] So, notwithstanding application of the ring-fencing, any bank regardless of its size and whether it operates narrow or the wider universal banking model runs the risk of failing if it is poorly managed.

This researcher though accepts that into the foreseeable future, the Banking Reform Act 2013, especially Parts 1, 4, and 7, will go a long way to help in curbing avoidable financial crises. This is because these sections of the Act robustly addressed pertinent issues regarding moral hazards among bankers, it deals with identified gaps in the functions of supervisory organs, and it seeks solutions to the lapses found in the corporate governance within the banking sector prior to the financial crisis of the 2007 - 2009. Part 1 of the Act identifies the class of banks that falls

[489] Please see pages 88 – 89, 93 – 95 & 127 on Northern Rock, JMB p. 90, BCCI, 104 - 105, Barings Capital, 94 - 95, Bradford & Bingley 101.

within the ambit of the ring-fencing policy and it specifically gives PRA the responsibility for the smooth transition and implementation of the ring-fencing policy.

Another commendable aspect of the Banking Reform Act 2013 is Part 4 which deals with the issues of regulation and vetting of those that are to take up senior management roles in the banking sector.[490] By involving supervisory agencies in scrutinising those that are to hold key roles in the bank, this researcher accepts that this necessary step will lead to ensuring that the most capable people are given the roles of gatekeepers on financial issues of grave consequences which are of concern to the public. This part of the Banking Reform Act 2013 particularly seeks to make individuals personally accountable for decisions and dereliction of duty that could put the bank at risk of losses. Such responsible senior manager puts himself at risk of serving custodial sentence of up to 7 years with heavy fine in addition to a jail term should there be a system failure under his watch. This measure can serve as a deterrent to recklessness by such officers thereby leading to less incidences of needless financial crises in the UK.

Similarly, Part 7 addresses the enhanced powers and differentiated roles of regulatory authorities, the PRA, the FCA and the Bank of England. Unlike the tripartite supervisory arrangement in the period leading to the financial crisis, when there was no clear strategy as to how individual banks' books were to be scrutinised at micro-level, under the new regime those issues have been addressed. This researcher is of the considered opinion that resolving where responsibilities lie and specifying clear demarcation of responsibilities between the PRA, FCA and the BoE will go a long way to ameliorate the kind of rudderless supervisory regime which was in place during the period leading to the financial crisis in 2007 – 2008.

In Part 7, of particular importance is the requirement that auditors of banks to collaborate with banks' supervisory agents by reporting directly matters of concern in their audit role to banks' supervisory agents. For example, if this policy had been in place at the time leading to the collapse of Barings, it is probable that the bank failure could have been avoided. This is because, at that time, the auditors spotted anomalies in the books of the bank and pointed them out to the bank's management, but the management failed to pick up the issues until the bank had run aground.

[490] These Parts of the Banking Reform Act 2013 were discussed on pages 23 - 28, paragraphs 1.9 – 1.9.9

While this researcher acknowledges the importance of the provisions of the Banking Reform Act 2013 Part 1, 4 & 7 as elaborated hitherto, it is contended that, restructuring the banks in the UK and the ensuing dissipation of the benefits of synergy in the universal banking models is unnecessary. As indicated earlier, the four biggest banks in China are far bigger than the biggest banks in the UK. The Chinese adopted the best of the free-market model and put aside aspects that they considered unhelpful to their economy.

It may be argued that RBS was the world biggest bank before the crisis but later they ran into difficulties. RBS did not have to be in trouble but for the poor management and bad decisions. Prior to the crisis, the foundation on which RBS was standing was already badly compromised. HSBC was huge before and after the crisis. HSBC remained strong. With their eyes wide opened, RBS walked right into the eye of the storm when in conjunction with other banks they purchased the Dutch Bank ABN AMRO in a cash deal. As pointed out in chapter 4 of the thesis, if RBS had settled for cash/share deal to purchase ABN AMRO, their situation may not have been so precarious. There are examples of other equally big banks that did not suffer the same fate as RBS in the period leading to the global financial crisis and thereafter especially HSBC in the UK. Even though the Chinese banks were huge in the period leading to the global financial crisis, they did not fall as casualty to the crisis, rather they even grew bigger thereafter, creating more employment for their people in the process. In the case of the UK banks, tens of thousands of people lost their jobs in the process.

In the same way, America, one of the closet allies of the UK, did not wait for another 70 years before repealing some of the provisions of the Dodd-Frank Act 2010 in 2017 as pointed out earlier. Donald Trump administration began to have a rethink on the propriety of the inhibitive reforms in Dodd-Frank Act 2010, now repealed in the Financial Choice Act 2017.[491]

By separating the investment arm of a bank structurally, that is, incorporating the core banking arm separately, having its own management structure keeping it independent of the riskier investment arm, it is held that depositors' funds in the retail banking arm in the same banking group will be insulated from the

[491] Please see page 136 on partial repeal of Dodd-Frank Act 2010

consequences of a fallout that may arise from crises emanating from the investment arm.[492]

Undoubtedly, investment banking presents a real systemic risk which can be challenging to hedge. The objective of the Banking Act 2013 is that if the investment arm of a banking group runs into difficulties and needs to be salvaged, such a bank either survives or is allowed to be wound up, without adverse impact on the depositors' funds in the commercial banking side of the group's business and the economy as a whole.[493]

Therefore, with the ring-fencing policy, only the non-ring-fenced subsidiary within a group will be affected should a situation like a situation that arose in Barings Capital mentioned earlier occurred in a banking group that has an investment bank.[494] Thus, the public is safeguarded under such circumstances.

What ring-fencing cannot do is to hedge against the class of difficulty that Northern Rock ran into in 2007, resulting in its nationalisation. Northern Rock had a long period of poor credit management resulting in liquidity problems, because the bank pursued business model that used short term deposit to finance long term assets thereby resulting in maturity mismatch.[495] Neither will ring-fencing be of much use with the nature of problems the Royal Bank of Scotland had that necessitated a bailout of £45 billion. The issue with the bank was also poor management related, inadequate supervision, inadequate capital, poor liquidity, huge nonperforming loans error of judgment in the purchase of the rival Dutch bank, ABN AMRO in 2007 and accusation over building an extravagant Headquarters for the bank at a cost of £350 million while the bank reported an annual loss of £40.7 billion for 2008. This loss was the highest ever in the UK corporate history.[496] The CEO of the bank, Sir Fred Goodwin, subsequently had his knighthood annulled.

In previous research, Petitjean argued that rule-based regulation cannot on their own prevent bank failures, but effective regulation must be wholistic, risk-based in

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[492] Banking Reform Act 2013, Part 1 (2), (i) & (ii); Please see page 6 on "Ring-fencing in Brief"
[493] Banking Act 2009 Part 1 s.2 (a) Stabilisation Option (b) Insolvency procedure (c) Bank administration; Please see page 79 on the aims of the Banking Act 2009.
[494] Please see pages 90 - 91 regarding Barings Capital's difficulties.
[495] Op. Cit., R. Tomasic, 2008, (n. 272)
[496] The Guardian 'RBS Collapse: Timeline https://www.theguardian.com/business/2011/dec/12/rbs-collapse-timeline' (2011)

nature, emphasising efficient monitoring, supervision, quick intervention with strong international coordination.[497]

2.39 Summary of Findings and Conclusions

Very importantly, as would be discussed in Chapter 4 and 5, it should be noted that banks within the banking sector in the UK vary widely in many ways. For example, some banks are better managed and more resilient than others. Banks of different sizes in the UK felt the impact of the financial crisis differently. Many of the banks in the UK went through the financial crisis without the need to accept the government's bailout packages. Notably, the banks that benefited from the rescue packages are: Royal Bank of Scotland, Lloyds Banking Group, Northern Rock Plc and Bradford and Bingley. [[498]][[499]][[500]] Although banks such as Barclays Bank Plc and Standard Chartered Bank Plc for example did not have to make use of the government bailout packages, to varying degrees they were also affected by the global financial crisis.[501]

The extent to which RBS, Barclays Plc, HSBC Plc and Standard Chartered Bank were affected individually is discussed in chapter 4 and 5 of this report.

This section came up with the following findings from the literature:

- The overall effect of deregulation to the banking sector since the 1980s through to 2000s was that some banks grew phenomenally to become large conglomerates.[502]
- The empirical literature review exemplified by **Fig. 1** (on p. 145) and **Table 2** (on page 147) abundantly demonstrate that the emergence of neo-liberalism, the free-market model ushered in a period of unprecedented prosperity in the UK.[503]

- While large size has advantages, but huge bank size also presents several other worrying challenges and complications. These include increase in vulnerability as the

[497] M. Petitjean, 'Bank Failures and Regulation: A Critical Review' (2013) Vol 21 (1) 16 – 38 Journal of Financial Regulation & Compliance
[498] HM Treasury 'The Comptroller and Auditor General's Report on Accounts to the House of Commons: The Financial Stability Interventions' (HMSO, 2011)
[499] HM Treasury, 'The First Sale of Shares in Lloyds Banking Group' (HMSO, 2013)
[500] HM Treasury, 'The First Sale of Shares in Royal Bank of Scotland' (HMSO, 2017)
[501] Discussed under chapter 4 and 5
[502] Please see page 141
[503] Page 145

banks are more susceptible to failing. Supervision of complex multinational banking group can be very challenging.[504]

- The 2007 – 2009 crisis justifiably called for concerns and reforms in some ways. This especially include regulatory control over capital adequacy and liquidity in order to improve stability in the banking sector.

- A better approach to ring fencing could have been to use legislative powers to stop the banks from engaging in speculative investment trading while on application, licences could be given to qualified banks that so wishes to open separate entities that could engage in speculative proprietary trading, hedges, Swap and derivative activities. In effect, it is the risky investment banking elements that should be taken off the mainstream banks. That way, core depositors' accounts could have been protected in the same way that the ring-fencing policy would do.[505]

  The added advantages are that the cheap core deposits would then be available for the traditional corporate lending where huge multinational corporate customers' financial needs could be catered for. Also, the UK universal banks would have been able to retain their competitiveness in relationship with the other European counterparts that did not adopt the ring-fencing policy.

[504] Please see page 64
[505] Please see page 139.

Chapter 3

Research Design: Methods and Methodology

3.1 Introduction

Foremost, this chapter is concerned with the identification and development of the procedures adopted in conducting this research. It states recognised underpinning principles of research design and the variety of philosophical positionings that stand behind academic research.

More importantly, within that broad range of frameworks, this section evaluates how this research sits within these general theories on research design and philosophies of knowledge. Finally, the section provides justification for the choice of methods adopted in collating the data used for this research and why the philosophical approaches engaged in the analysis of the data thus collected are considered to be the most appropriate for this piece of work.

Except for the specific methods and methodology used for this research, most of the other approaches and strategies are only mentioned briefly. Not much emphasis is placed on writing about those approaches since they are not employed in this research. However, having said that, even though those methods, philosophies and strategies outside the scope of this research were not used, arguably some of them could as well be applicable to this research and may validly have been adopted in this research. That is why to some extent they are mentioned. This only serves to demonstrate awareness of their importance and the fact that they were taken into account prior to making choices on the methods and strategies considered most appropriate and used for this research.

3.2 Research Design

Research design is a structured plan and strategy aimed at eliciting answers to the research questions.[506] This part of the thesis is concerned with stating how this researcher carried out this research from start to finish. Thus, the aim of the

[506] F. Kerlinger, 'Foundations of Behavioural Research 3rd ed', (Rinehart and Winston, 1986, p 279)

research design explained in this section is concerned with providing outlines on what this researcher did in order to achieve the research goals.

Lincoln and Guba point out that research design entails a convincing presentation of an action plan that would persuade readers that the researcher is both competent to undertake the research and capable of employing a range of methods for a successful completion of the research undertaken.[507] It is also to demonstrate that the research is worth doing, is well planned and capable of being successfully executed.[508]

Bearing all these in mind, essentially, this part of the thesis is concerned with providing the narrative about the procedural approaches adopted and the choice of methods and strategies designed by this researcher to find valid, objective, and accurate answers to the stated aims and objectives of the research stated in chapter 1 of this thesis which are:

3.2.1 Aims of the Study

The study evaluated the desirability or otherwise of the ring-fencing policy as a suitable measure in response to the global financial crisis (GFC) in the circumstances of the Global Systemically Important Banks in the UK.

It has been about ten years after the GFC occurred in 2007 – 2009. Through evaluation of the financial accounts of the case studies, the research aimed to determine the varied long-term impacts of the GFC on the performance of some of the largest UK banks up till 2018. The study evaluated the regulatory response designed to limit the effects of likely financial crises on the banking sector in the future. The financial accounts of the banks were evaluated starting from 2004 – 2018. The years 2004 – 2006 were the good years before the crisis began, 2007 – 2009 was in the heat of the crisis, 2010 – 2012 was when multiple regulatory response started to take effect, 2013 – 2018 represented the recovering period and the time of moratorium granted to the banks to prepare for the implementation of the ring-fencing policy.

[507] Y. Lincoln and E. Guba 'Naturalistic Inquiry'(Sage Publications, 1985, p. 210)
[508] C. Marshall and G. Rossman 'Designing Qualitative Research 6th ed.' (Sage Publications, 2016, p. 66)

The stated aim acknowledges that the global financial crisis had some long-term detrimental impacts on the financial performance in the banking sector. It also underscores the importance of the long-term effects of regulatory response designed to reduce the consequences of likely future financial crises in the banking sector. The banks selected as case studies are the Royal Bank of Scotland (RSB), Barclays Group, Standard Chartered Bank Group (SCB) and HSBC Holdings Plc

3.2.2 Research Objectives

(i) (a) as a background to the study, a review of extant literature was undertaken on the causes of the global financial crisis in 2007 – 2009,

(c) a review of the prevalent laws and regulations that existed before the financial crisis in 2007 – 2009 was undertaken to determine whether there were gaps in the laws and supervisory regimes then which may have contributed to the crisis. Also, a review of the newly introduced changes to the laws after the global financial crisis were conducted, evaluating their impact on the banking sector,

(ii) a theoretical critique of ring-fencing policy was conducted as it applies to the UK banking sector and against the backdrop of the UK's core competencies in the provision of financial services, a sphere in which the UK has comparative and competitive advantages.

Core competence is a term borrowed from business management which refers to cultivated or learnt specialist's skills, knowledge, expertise, capabilities and attributes that can become a critical success factor in the management of an organisation in a rapidly changing business environment as happened in the aftermath of the global financial crisis,[509]

(iii) an evaluation was conducted of the effectiveness or otherwise of the ring-fencing policy as measures that are capable of deterring financial crises in the future, and

[509] Op. Cit., L. J Mullins, 2016, (n. 46).

(iv) using the case studies approach, the annual financial accounts of RBS, Barclays, SCB, and HSBC Plc between 2004 – 2018 were evaluated to determine the impact of the global financial crisis on the varied performances of the banks over the period stated. This exercise aids our understanding of some of the direct costs of the downward journey of these banks and the difficult road back to recovery as a recorded lesson for the future.

Research objectives (i) – (iii) are essentially a literature review exercise. The first three objectives have been accomplished within chapters 1 and 2 of this report. Activities related to objective (iv) are extensively carried out in chapters 4 and 5 of this report.

According to Kerlinger, there should be two objectives in mind in designing a research plan which include: (i) identification and development of procedures and, (ii) the importance of quality and adequacy in the procedure in order to be able to obtain a valid result.[510] The procedures adopted are stated in the succeeding paragraphs.

3.3 Guiding Research Philosophies

This paragraph evaluates alternative research philosophies with an emphasis on the choice of research philosophies that underpin this study and provides justification of why that may be the case.

Guba and Lincoln defined research philosophies as worldviews or belief systems that guide researchers about the development of knowledge.[511] Easterby-Smith *et al*, identified three important uses of philosophical issues in research, namely: (i) to clarify research design (ii) to help to see in advance design that will work or not work, and (iii) potentially to help to suggest how to adapt research designs within the limitations of different subjects.[512]

The third point raised by Easterby-Smith et al acknowledges the need to adapt research design within the context of the subject area. Although the study is doctoral law research, it sits within multiple disciplines including law, socio-economic

[510] Op. cit., Kerlinger 1986, p 280, (n. 506)
[511] E. Guba, and Y. Lincoln, 'Competing Paradigms in qualitative Research'(Sage, 1994, pp 105 – 107)
[512] M. Easterby-Smith, *et al.,* 'Management Research 3rd Ed'(Sage Publications, 2008, p 56)

policy, business management, banking and finance, and it engages with key financial accounting tools required to analyse the annual reports and financial accounts of the banks that were chosen as case studies for the research.

Different authors use different classifications and terminologies when grouping research philosophies. Blaikie for instance lists seven of such which he labelled 'Approaches'. These are *positivism, realism, interpretivism, critical theory, structuration theory*, *feminism and critical rationalism*.[513] Tesch lists 28 approaches classified into four branches in a flow chart specifying options that may appeal to different researchers.[514]

Saunders *et al* chose four in the same class which they termed 'Philosophy'. These are *positivism, realism, interpretivism,* and *pragmatism*.[515] These relate to how collected research data should be analysed. Their argument is that individuals have preferences and assumptions about human knowledge (epistemological assumptions), the nature of realities as individuals sees it (ontology) and the extent to which individual's values influence their research process (axiological assumptions).[516]

What Blaikie called 'Approaches' Saunders *et al* labelled 'Philosophy' and instead Saunders *et al* used the term 'Approaches' differently to classify the notion of "*deduction, abduction and induction*".[517] Ritchie and Lewis have a list they called 'Paradigms' or 'Research traditions'.[518] In some cases there are overlaps in the meanings adduced to these concepts, and emphases are placed on some terms more than others. In other instances, the word 'Approach' and 'Philosophy' are used interchangeably. For example, Guba and Lincoln observed that a phrase "Approaches to qualitative research" implies that qualitative or quantitative are umbrella terms that may suggest superiority to 'Paradigm', but their position is that the terms qualitative and quantitative should be reserved for methods.[519]

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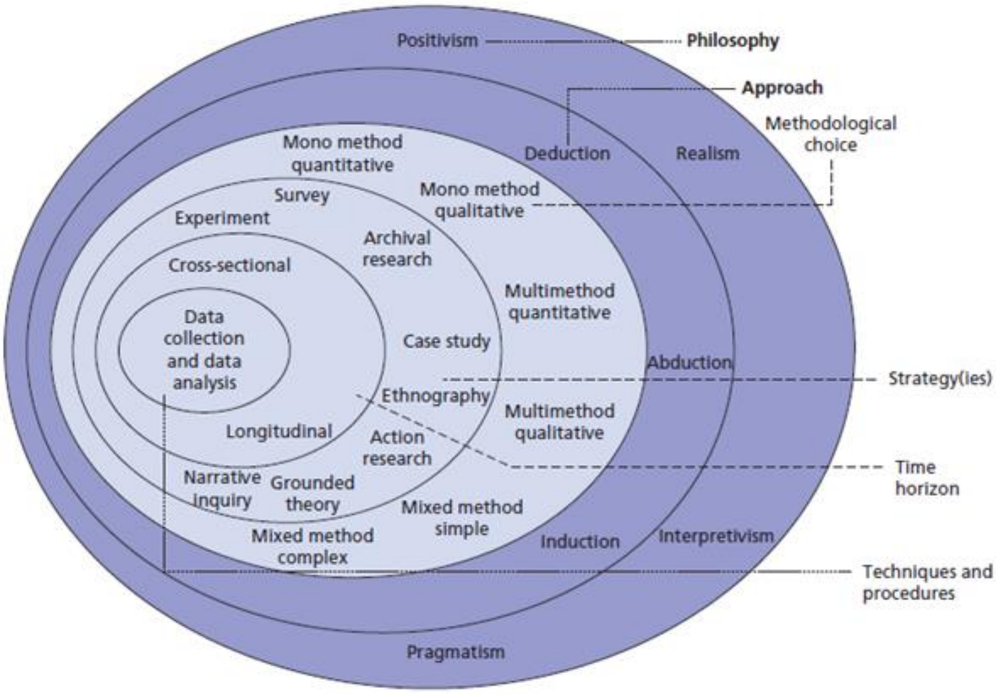
[513] N. Blaikie, 'Approaches to Social Enquiry' (Polity Press, 1993, pp 93 - 100)
[514] R. Tesch 'Qualitative Research: Analysis Types and Software tools', (Falmer Press, 1990)
[515] M. Saunders, et al., 'Research Methods for Business Students 7th ed.' (Pearson, 2016)
[516] ibid
[517] Ibid.
[518] J. Ritchie and J. Lewis, 'Qualitative Research Practice' (Sage Publications, 2003)
[519] E. Guba and Y. Lincoln, 'Competing Paradigms in Qualitative Research'(Oxford University Press, 2004, p 17) In Hesse-Biber, S and Leavy, P (eds)

This assortment of classifications and use of terminologies within the domain of philosophy in social sciences research can appear somewhat unwieldy and it becomes a treacherous terrain that has to be navigated carefully.

Therefore, for consistency and clarity, the 'onion' metaphoric model popularised by Saunders *et al* is preferred and adopted for this piece of work.

3.4 Fig. 4 Research Philosophy in the 'Research Onion Model'



Source: Mark Saunders, Philip Lewis and Adrian Thornhill (2016) Research Methods for Business Students

Looking at the diagram from the innermost circle, what the structure implies for this study is illustrated in Table 4.

Research 'Onion' Model Adapted and Applied for this Study

Table 4 - Analysis of the Research Onion Model

No	Category	Options	Approaches Applied in the Study
1.	Technique & Procedure	Assorted Ways of Gathering Research Data: • Questionnaire • Interview • Experiment • Observation • Documents	Documentary method is chosen in the collection of data for the research. This includes banks' annual accounts and government white papers on policy relating to ringfencing. The choice of method presents the best means of gathering reliable evidence to measure performance of banks in the case study.
2.	Time Horizon	• Longitudinal • Cross-sectional	The Longitudinal The research is longitudinal because it focuses on a few selected banks as case studies and it evaluates the banks' performances over a long period spanning 15 years from 2004 - 2018
3	Strategy	• Experiment • Survey • Archival Research • Case Study • Ethnography • Action Research	Case Study Case study strategy is adopted involving an in-depth investigation of the performances of four

		• Grounded Theory • Narrative Inquiry	banks over 15 years timeframe using multiple sources of evidence
4.	Methodological Choice	• Mono Method Quantitative • Mono Method Qualitative • Multi-Method Quantitative • Multi-Method Qualitative • Mixed Method Simple • Mixed Method Complex	Mixed Method Simple Mixed method is preferred because the research engages with both qualitative and quantitative analysis of available numerical data
5.	Approach	• Deduction • Abduction • Induction	Deductive A deductive approach is adopted to test the validity of the hypothesis proposed in chapter 1
6.	Philosophy	• Positivism • Realism • Interpretivism • Pragmatism	Interpretivism The study is essentially a qualitative approach that takes into account evaluation of the complex nature and interaction of phenomena in organisations in order to draw conclusions about the research questions faced by this researcher

3.5 Philosophical Positions

Saunders *et al* summed-up research philosophy as "a system of beliefs and assumptions about the development of knowledge".[520]

The word 'Ontology' has its roots in Greek, literarily meaning, "theory of the nature of reality".[521] Ontology seeks to answer the question on what the nature of reality is, whether reality is objective and independent of our perception of it, or whether it is constructed by those who experience it and whether it exists apart from our experience of it.[522] Objectivism is an ontological position which implies that social phenomena are external facts that are outside our influence while on the other hand, constructivism implies that phenomena and their meaning are socially constructed.[523]

Epistemology is about the kind of knowledge that is possible, what can be known, its limitations, and validity - the means of ascertaining whether a declared knowledge can be considered adequate and acceptable.[524] Delanty and Strydom distinguish between knowledge, opinion and common-sense. According to these writers, what distinguishes knowledge from opinion and common sense is that knowledge has to be supported with convincing evidence.[525]

What all these mean to this study is a need for this researcher to avoid generalised assertions that are not evidence based.

3.5.1 Positivism/Empiricism

Positivism, also referred to as logical positivism is an epistemological position which is typically associated with the scientific approach to research such that the collection of data is by means of objective reality, usually numeric in nature producing a law-like generalisation.[526]

The central claim of positivism is the view that the only authentic knowledge that is scientific is knowledge which emerges from the positive confirmation of theory

[520] Op. cit., Saunders et al., (2016, (n. 515).
[521] Op. Cit., G. Delanty, and P. Strydom, 2003, p. 6, (n. 121).
[522] N. Blaikie, 'Approaches to Social Enquiry 2nd' (Polity Press, 2007)
[523] A. Bryman, 'Social Research Method 5th Ed' (Oxford University Press, 2016)
[524] M. Crotty, 'The Foundations of Social Research' (Sage Publications, 1998)
[525] Op. cit., Delanty, and Strydom, 2003, p. 6, (n 121).
[526] Op. cit., Bryman, 2016, p. 20, (n. 523).

through the application of rigid scientific methods.[527] The assumptions of positivism are that science separates facts from values such that invisible theoretical entities are rejected.[528] It emphasises that reality has to be experiential and observable through human senses.[529]

Positivism holds that inquiry should be value free; time and context free; generalisations are possible; there is a single reality, there should be separation between the investigator and the subject of investigation.[530] Positivism assumes that there is order or structure to reality, it rejects metaphysical and value judgement from being scientific knowledge.[531] The assumption is that since the data collection process is value free the outcome of the research should be objective.

A research approach that adopts positivism implies collection of data should be by observable reality which, when analysed identifies a causal relationship within the data and produces law-like generalisation.[532] It is a process of gaining objective knowledge from the analysis of statistical data obtained under strict rules and procedures. The data may be collected through survey or questionnaire.[533]

David Hume (1711 – 76) is held to be the founding father of empirical research tradition.[534] This is a study approach that emphasises that only experiential knowledge gained through unbiased observation using physical senses is acceptable.[535]

The criticism of positivist-based methodology is that the questionnaire typically uses closed end questions, leading to limited outcomes; it can be very expensive and time consuming; data used may be outdated; difficulty with analysis for researchers with no prior statistical training or background.[536]

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527 R. Wacks, 'Understanding Jurisprudence 5th ed.' (Oxford University Press, 2017)
528 C. Robson, 'Real World Research 2nd ed' (Blackwell Publishing, 2002, p. 20)
529 N J. Blaikie, 'Designing Social Research 2nd ed ́(Polity Press, 2010, p. 97)
530 Op. cit., Lincoln and Guba, 1985, (n. 507).
531 Op. cit., Blaikie, 2010, p. 97, (n. 529).
532 J. Gill and P. Johnson, 'Research Methods for Managers 4th ed' (Sage Publications, 2010)
533 K. McCartan, and C. Robson, 'Real World Research 4th Ed' (John Wiley, 2017, p. 21)
534 Op. Cit., J. Ritchie, et al., 2014, p. 9, (n. 518)
535 Op. cit., Bryman, 2016, (n. 523).
536 A. Tashakkori, and C. Teddlie 'Mixed Methodology: Combining Qualitative and Quantitative Approaches' (Sage Publications, 1998)

Although in this research there are numerical data used to evaluate the circumstances of the case studies, the research was supported more by qualitative/interpretivism analysis.

3.5.2 Realism

Realism is also part of the scientific approach genre which studies the natural world through the prism of causation with the aim of identifying the structures that led to the generation of the world.[537] Robson suggests that part of the worldview of a realist is an approach that sees the task of scientists as inventing theories to explain the real world, to test these theories by rational criteria providing an explanation as to how and why a natural phenomenon occurred.[538]

As in 3.5.1, the approach adopted in this study depended more on interpretivism rather than realism.

3.5.3 Interpretivism

Social constructivism is often combined with interpretivism.[539] Ontology under qualitative philosophy believes that there are multiple constructed realities; the relationship between the researcher and those being investigated are inseparable, value-bound and generalisation is not always possible.[540] Lincoln and Guba put it humorously, "The only generalisation is: there is no generalisation".[541]

A quantitative methodology is often given more respect which may be because numbers tend to give the impression of factual accuracy.[542] It may also reflect the general tendency to regard science as related to numbers and implying precision.[543]

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[537] Op. cit., Bryman, 2016, p. 20, (n. 523).
[538] Op. cit., Robson, 2002, p. 20, (n. 528)
[539] D. Mertens, 'Mixed Methods and the Politics of Human Research: The Transformative-Emancipatory Perspective' (Sage Publications, 2003, pp 135 -164)
[540] Op. cit., Lincoln and Guba 1985, (n. 507).
[541] Ibid
[542] B. Berg, 'Qualitative Research Methods for the Social Sciences' (Pearson, 2001)
[543] Ibid

However, Dabbs argues that a qualitative approach should not be regarded as inferior since numeric data do not always tell the whole story.[544]

An interpretivism approach has notable advantages. It interprets outcomes based on a deep familiarisation with normal or typical life situations.[545] The worldview is that a qualitative approach provides a holistic understanding of a phenomenon, the factors involved, how they interrelate, identifying the less obvious issues as well as those which initially attract attention.[546]

Some of the advantages of qualitative methods include: the richness of the study; detailed data generated and the fact that there is tolerance of ambiguity and contradictions.[547]

The criticism of an interpretivism approach to research stems from its subjectivity, leading to the assumption that it is generally unreliable and generalisations based on a qualitative approach may be called to question.[548] Qualitative methods are usually considered overly descriptive with large amounts of data needing contextualising and the outcome can be hard to sell to others.[549] The importance of a qualitative approach in social research is well appreciated in the sense that numeric data (as in quantitative study) on its own can be meaningless unless it is interpreted or well explained.

In the light of the objectives of this study it is considered appropriate to use mixed methods. This is because a part of the objectives of the research related to textual evaluation while the other part of it relates to analysis of numeric data.

3.5.4 Pragmatism

Part of the methods of a qualitative paradigm is observation of participants. This requires the researcher to be directly involved with those being studied and thereby generating an in-depth understanding of what is taking place in the group or

[544] J. Dabbs, 'Making things visible' (Sage Publications, 1982)
[545] M. Miles, and A. Huberman, 'Qualitative Data Analysis: An Expanded Sourcebook' (Sage Publications, 1994)
[546] Ibid
[547] M. Denscombe, 'The Good Research Guide for Small-Scale Social Research Projects 3rd Ed' (OAU, 2011)
[548] Ibid
[549] J. Mason, 'Qualitative Researching' (Sage Publications, 1997, p. 145)

organisation that is being studied.[550] It is this sort of relationship and interaction with participants that birthed the idea of "***Interactionism*** or ***Pragmatism***" popularised by Dewy and Mead in the early part of the twentieth century. [[551]][[552]] This researcher suggests that pragmatism philosophy will be invaluable to ethnographic and action research strategies but not applicable in the circumstances of this research because the events researched into happened in the past.

3.6 General Features and Debates Around Qualitative and Quantitative Approaches to Doing Research and What that Means to this Study

Research methodology could either be positioned within quantitative/positivism or qualitative/phenomenological paradigms.[553]

Methodology refers to the systematic processes adopted in analysing the data and the underpinning variety of philosophies behind it as evaluated previously.[554] O'Leary suggests that methodological design embraces the philosophies underpinning the research, the methods/techniques that would be used to collect data and the tools that would be used to interpret the data i.e., questionnaires, interviews etc.[555]

Creswell points out that a research design which for example adopts a quantitative or qualitative research methodology infers that the researcher implicitly accepts the philosophical assumptions related to that approach to studying phenomena.[556]

In order to achieve the aims and objectives of the study, interpretivist's philosophy and a mixed method approach are engaged as pointed out earlier. The choice of approach reflects the fact that there is a combination of relevant features of quantitative and qualitative paradigms in the study. Apart from the numeric data evaluation, there are also aspects of the objectives of the research which relate to

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[550] Op. Cit., A. Bryman, 1998, p. 45, (n. 523)
[551] J. Dewey 'Creative Intelligence: Essays on the Pragmatic Attitude' (Henry Holt, 1917)
[552] G. Mead 'Scientific Method and the Individual Thinker'(Henry Holt, 1917, pp. 176 - 227)
[553] Op. cit., Denscombe, 2011, (n. 547).
[554] D. Silverman, 'Doing Qualitative Research 4th Ed' (Sage Publications, 2013)
[555] Z. O'Leary, 'The Essential Guide to Doing Research' (Sage Publications, 2009, p. 85)
[556] J. W. Creswell, 'Qualitative Inquiry & Research Design: Choosing Among Five Approaches 2nd Ed' (Sage Publications, 2007, p. 16)

critical textual evaluation of secondary documentary data. Essentially though, the qualitative approach played the dominant role.

Tashakkori and Teddlie contend that application of mix-method, combining qualitative and quantitative approaches is not only compatible but it enriches the research experience.[557]

The study employed a deductive approach in the sense that the focus of the data is to test the validity of the hypothesis stated in chapter 1 which is - "Notwithstanding some benefits that may accrue from the ring-fencing policy, the banking sector and by extension the economy in the UK may likely face long term detriments arising from the implementation of the ring-fencing policy".

In the past hundred years or so until the 1980s, a debated pertinent question has been whether enquiries in social sciences such as in anthropology, social psychology, economics, law and sociology (to name just a few) could apply methods and methodology that are traditionally associated with investigations in the natural sciences such as in biology, chemistry and physics.[558] There has not been a straight-forward yes or no answer as it has been argued that evaluation of chemical structure through statistical inferences are different activities from studying social structures or issues about human thought, feeling and human behaviour.[559]

That said, rating questions that allows respondents to indicate how strongly they agree or disagree with a statement and coding using the Likert scale model have made it possible for social science research to benefit from the advantages found in using quantitative tools.[560]

Writing in the mid-2000s, in the context of social enquiries, Manicas suggested that if subjectivity is avoided so that objective functioning system and methods are engaged to identify 'Social facts', the assumption is that there is no critical difference between natural and social sciences.[561] The point emphasised by Manicas is that the methodology applicable in science can find uses in social research.

[557] Op. cit., Tashakkori, and Teddlie, 1998, (n. 536).
[558] A. Chalmers, 'What is this thing called science? 4th ed' (Open University Press McGraw-Hill, 2013)
[559] Op. cit., Blaikie, 1993, p.12, (n. 488).
[560] Op. cit., Saunders, M. et al 2016, (n. 515).
[561] P. Manicas, 'The Social Sciences Since World War II: The Rise and Fall of Scientism' (Sage Publications, 2007)

After World War II, there has been increasing discontent and contention against logical positivism [[562]][[563]]. The argument is that the social world is far too complex to lend itself to theorising by definite laws in the same way as in the natural sciences.[564]

The argument is that both qualitative and quantitative methodologies can find uses in the circumstances of this study.

3.7 Methods

Methods refer to tools, various ways of collecting data that are used to carry out the objectives of the research whilst methodology is the systematic process adopted in analysing the data.[565]

Creswell suggests that in multiple case studies as planned for this study, the ideal number should not be more than four, otherwise there is a risk of a dilution of the analysis.[566] Glesne and Peshkin point out that there is always a desire to want to include more cases to satisfy the notion of 'generalisation', a term which they suggest holds little meaning for qualitative researchers.[567]

Case study strategy is increasingly becoming popular and widely used in business management and organisational behaviour.[568] The study has four case studies, the maximum number of case studies suggested by Creswell.

3.8 The Variety of Data Gathering Options Available to the Researcher

Creswell suggests five categories of data collection methods available to the qualitative researcher, namely: observations, interviews, questionnaire, documents

[562] C. Reichardt, and S. Rallis, (Jossey-Bass, 1994, pp 85 -92) Qualitative and Quantitative Inquiries are not Incompatible
[563] K. Howe, 'Against the Quantitative – Qualitative Incompatibility thesis or Dogmas Die Hard' (1988) Vol 17, 10 – 17
[564] Op. cit., Saunders, 2016 et al, n. (515).
[565] Op. cit., Silverman, 2013, (n. 554).
[566] Op. cit., Creswell, 2007, (n. 556).
[567] C. Glesne and A. Peshkin, 'Becoming Qualitative Researchers: An Introduction' (Longman, 1992)
[568] A. Mumford, 'When to Use the Case Study Method' (1997) European Case Clearing House, Autumn pp 16 - 17

and audio-visual materials.[569] Other authors classify audio visual materials as part of documentary data. [[570]][[571]]

3.8.1 Observation

Observation as a primary means of obtaining data involves systematic watching and taking notes of related activities of participants in a study.[572] Observation could entail combination of sensations including sound, touch, smell, taste and perception.[573] The researcher could be involved as a participant, watch from the side-lines as an outsider, or could alternate both positions.[574] Observing as a participant may have an added advantage of developing rapport with others which may enhance the prospect of success. This method of data collection would be particularly suitable in ethnography, case study and action research for example.

Part of the benefits of the observation method includes generation of reliable data, data are collected as the event occurs, opportunity to collect data that participants may not see as relevant or important, the direct experience can give useful insight, it is straightforward, and it only requires a bit of common-sense. [[575]][[576]] The disadvantages include: the researcher has to be at the site, only overt actions can be observed while inferences have to be made and it may be time consuming.[577]

The method is not applicable in the context of the study being undertaken because the current research is concerned with matters that had already taken place in the past.

3.8.2 Interview

Interview as a method of primary data collection is a purposeful conversation between the interviewer and interviewee(s) which could be one on one or a focus

[569] Op. cit., J Creswell, 2007 p. 130, (n. 556).
[570] Op. cit., M. Denscombe, 2011, (n. 547).
[571] Op. cit., Saunders, M. et al 2016, (n. 515).
[572] D. Gray, 'Doing Research in the Real-World 2nd Ed' (Sage Publications, 2009, p 396)
[573] Ibid
[574] Op. cit., J. Creswell, 2007, n 527
[575] N. Moore, 'How to Do Research 2nd ed' (Library Association Publishing, 1987)
[576] Op. cit., K. Howe, 1988, (n. 563).
[577] ibid

group of participants in which the person(s) being interviewed is/are able and willing to respond to questions from the interviewer.[578] The interview could be structured, semi-structured or unstructured.[579] This method could be useful in exploratory, descriptive, explanatory and evaluative research.[580] Marshall and Rossman suggest that the interview method may be the overall strategy or one of several methods.[581] While there are lots of benefits that could be derived from this method, it is also important to have a clear plan so that the session does not go adrift losing focus.[582]

Some of the advantages of the interview method are: its flexibility; it could be tailored to fit a study; allows inventive strategies; can yield a large quantity of data very quickly; follow-up and clarification are possible; enables interviewers to understand the meaning that everyday activities hold for people and it could be therapeutic and rewarding to the person giving the information.[583] The disadvantages are: it could be time consuming; responses are non-standard; inhibitions on the part of the interviewee; the interviewee may not be entirely truthful; sometimes, the interview method may involve invasion of privacy; it may go adrift losing focus; it can be costly in terms of time to both the interviewer and the interviewee.[584]

Interview methods could be invaluable to most research on society, culture and in business management. In the context of the study being undertaken, interviewing key stakeholders may have some values but it is not one of the critical success factors for the research being undertaken by this researcher. This is because, (i) the empirical part of the research took a rear mirror view of events that happened in the banks about fifteen years ago. If at all possible, detailed recollection of matters that happened over a period of that length would at best be very hazy (ii) most people that are currently working in the banks selected as case studies may not be working in those banks back then (iii) the subject of the empirical research is concerned with 'Performance' in the banks. It is thus considered that a better means of gathering data about performance in the banks would be the banks' annual reports and

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578 Op., cit., Saunders, M. et al, 2016, (n. 515).
579 Kvale, S. and Brinkmann, S. (2009) Interviews: Learning the craft of Qualitative Research Interviewing (2nd ed)
580 Op. Cit., D. Gray, 2009, p 396, (n. 572).
581 Op. cit., Marshall and Rossman, 2016, p 147, (n. 508).
582 Ibid
583 Op. cit., M. Denscombe, 2007, pp 202 – 203, (n. 122).
584 Ibid

financial accounts for the period under review, evaluated in light of other available relevant literature materials.

3.8.3 Questionnaires

The questionnaire method consists of a written list of questions designed to collect information by asking people about issues related to the research. Moore argues that a questionnaire survey is perhaps the most commonly used research method which could be relevant either in a small or large scale research.[585] The advantages of the questionnaire method include: they give room for scaling (Likert scale model); they can be flexible; low cost – written questionnaires can be mailed out; avoidance of potential interviewer's bias; they place less pressure for immediate answers; they give respondents a greater feeling of anonymity.[586] Some of the disadvantages of the questionnaire method are: low rate of response especially if the questionnaire is too long; accuracy and completeness of responses to questions may be an issue; there may be no room to correct error or misconception of a question; there is no control over the context in which the questions are answered; lack of qualitative depth to the answers leading to superficiality.[587] The questionnaire method can be useful in both qualitative and quantitative methods and they can be useful and relevant in the context of this study, but as mentioned under interview method, it is considered more appropriate to use documentary evidence obtainable from the annual reports and financial accounts of the banks selected as case studies.

3.8.4 Documents (Secondary Data Sources)

The documentary method of data collection includes using written sources but may also include audio visual sources.[588] Written forms of documents include government publications, white papers/report of inquiries; official statistics from the Office of National Statistics, newspapers and magazines; records of meetings; letters and memos; emails, diaries; books; journals; annual financial accounts of companies; website pages and the internet; court records; church records; welfare office

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585 Op. cit., Moore, 1987, (n. 575).

586 L. Kidder, and C. Judd, 'Research Methods in Social Relations 5th Ed' (CBS Publishing, 1986 pp 221 – 222)

587 Ibid

588 Op. cit. Denscombe, M. 2011, (n. 547)

records, just to mention a few.[589] The use of documents in research requires specialist analytic skills referred to as content analysis.[590]

Some of the advantages of secondary data sources include saving time and money, it can be obtained more quickly than having to compile a primary data and it can lead to unforeseen discoveries. Since they are permanent records, they can be rechecked.[591] Part of the benefits of using documents for research purposes is that it is unobtrusive, and it does not disturb the location.[592]

Some important considerations in using documents as sources of data collection are concerned with authenticity, whether the documents are genuine and credible and whether they are dependable, representative, and comprehensible.[593] The researcher would need to be satisfied that the documents relied on are genuine and not of questionable origin, that they are free from error, that they are typical of their kind and that their presentation is clear.[594]

Part of the disadvantages of documentary sources of data collection is that, sometimes the necessary documents are either not available or inaccessible or simply lost. At times it could be an issue with gatekeepers who may enforce restrictions.[595] At the same time, accessibility is one of the most important advantages of the documentary method of data collection.[596]

3.9 The Documentary Data Sources in the Context of this Study

This researcher used documentary sources to generate data for the research. Financial accounts and annual reports of four major UK banks that are considered to be systemically relevant are collated for the research. These are banks that have core deposits that are above the minimum threshold of £25 billion, the benchmark at which the regulation about ring-fencing applies. The bank annual accounts used

[589] U. Flick, 'An Introduction to Qualitative Research 4th Ed' (Sage Publications, 2009)
[590] Op. cit., Marshall and Rossman 2016, (n. 508).
[591] Op. cit., Saunders 2016 p. 331, (n. (515).
[592] Op. cit., U. Flick, 2009, (n. 589).
[593] J. Scott, 'A Matter of Record: Documentary Sources in Social Research' (Polity Press, 1990)
[594] Op. cit., U. Flick, 2009, (n. 589).
[595] ibid
[596] Op. cit., M. Denscombe, 2011, (n. 547).

are: The Royal Bank of Scotland, Barclays Bank, Standard Chartered Bank and HSBC Holdings Plc.

The analysis of these accounts helped to determine the extent of the impact of the global financial crisis on the banks evaluated. The analysis of the accounts took cognisance of likely costs of regulatory changes to the banks and the market environment under which each of the banks operated.

The annual financial accounts serve multiple purposes and have different users. Primarily, corporate annual financial accounts are addressed to the shareholders of the company.[597] The annual financial accounts and the Chairman/CEO's reports are typically embodied in the same document which is required to be tabled before the shareholders at the Annual General Meeting of the company for consideration. It reflects the performance of the company over the accounting period. Also, it indicates the bank's response to the challenges encountered during the accounting year and their plans for the future. Typically, in the annual report section of the document, the Chairman and the Chief Executive Officer of the banks would narrate the socio-economic and legal environment under which their banks operated. This would include the plan the bank has and how they intend to respond to those issues. The CEOs also do address how the bank plans to achieve their organisational goals into the foreseeable future.

Categories of stakeholders who may be interested in a bank's financial accounts include shareholders, the tax authority, workers' union (if there is any), investors, Companies House, and bank regulators especially the PRA and FCA.[598]

Part of the disadvantages of the annual financial accounts as a source of gathering information on the performance of the banks is that it is historical in nature and does not necessarily represent the current status of the company and thus, may not even represent what the future holds.[599] As well, some may argue for example that the annual financial accounts of a bank are susceptible to manipulation and may not reflect the true financial standing of the bank. This is probable, especially in the light of what happened in the case of BCCI, extensively discussed under the literature

[597] Op. Cit., G. Arnold, 2013, p. 17, (n. 25)
[598] F. Wood, and A. Sangster 'Business Accounting 2, 11th Ed' (Prentice – Hall, 2007)
[599] D. Cotter, 'Advanced Financial Reporting' (Prentice- Hall, 2012)

review. After that incident, banks' auditors are now required to be more vigilant and can be held liable for gross negligence in connection with auditor's report.[600]

The prime advantage of annual reports and financial accounts as a veritable source of data collection is its comprehensiveness. They contain information far above what could be generated from any other method of data collection. For example, the annual financial accounts of the Royal Bank of Scotland for the year ended 2016 has 463 pages, 2015 has 430 pages and 2014 has 516 pages. This presents a huge opportunity to extract relevant information for the study.

In order to access the annual accounts of the banks, some of which dated as far back as 2004, this researcher directly contacted the banks. Part of the backup plan was to contact the Companies House in order to get the old accounts in the event the banks are unwilling to cooperate. At the beginning of the research, part of the immediate concern then related to envisaged difficulties that may arise in getting annual financial accounts of banks and particularly the concern that it may be very expensive to pay for copies of very bulky financial accounts that run into over 500 pages and accounts that are more than ten years old.

As it turned out however, it was not difficult at all to access the electronic copies of the banks' financial accounts used. Bank officials helped. The researcher did not have to pay for the electronic copies. The annual financial accounts of the banks obtained and the policy statements on ring-fencing were altogether over 40 volumes with more than 20,000 pages. Handling such voluminous documents require a significant level of skill, knowledge of what one is searching for and where to look for it in the annual accounts.

Also required for this research were government white papers on the causes of the 2007 – 2009's financial crisis (Lord Turner's report); Vickers' report on 'Ring-fencing"; the report on the collapse of Barings Capital (an investment bank); journals, press reports, textbooks, case law, Banking Reform Act 2013 and information about UK's GDP. These documents were readily available as they are mostly within the public domain.

[600] Company Act 2006 s.507 Offences in connection with auditor's report

3.10 How the Stated Objectives in Chapter 1 were Achieved

This section is a brief outline regarding the action taken on how each of the stated objectives were achieved.

At the beginning of this study, this researcher planned to collate data from a large number of banks in the UK using inferential statistics to determine the impact of the global financial crisis and changes in banking regulations on the performance of the banking sector generally.

However, after further considerations the researcher changed his mind on the basis that analysis of the combined data of all the banks or a significant part of the banks would result in averaging outcomes, where weaknesses of some banks would be compensated for by the strength of others. This would not have served the objectives of the research. Eventually, the approached adopted evolved over time.

Secondly, although all the four banks evaluated have some common denominators in the sense that they are all UK regulated banks, they have varied markets and other factors that distinguished each of the banks. For example, the operational base of HSBC and Standard Chartered Bank are more rooted in Asia while Barclays and RBS are more focused on Europe and America. Thirdly, the impact of the global financial crisis on each of the banks evaluated are more pronounced on some banks than the others because of their different circumstances. As well, Standard Chartered Bank did not have to ring-fence because their core deposits customers that the ring-fencing policy sought to protect are outside the UK and the EU. The other three case studies (RSB, Barclays and HSBC) are under obligation to be ring-fencing compliant. So, it made sense to evaluate the banks separately and then make comparison where appropriate.

The threshold of core deposits that a bank needs to hold and at which the ring-fencing policy kicks in is £25 billion and above. Many banks did not fall within this criterion and as such were not affected at all by the ring-fencing policy. Thus, the focus of the study is on four of the biggest banks in the UK that are considered to be global systemically important. These are banks that their failure could cause serious damages to the economy of the UK and even beyond the UK borders.

In order to achieve the aims and objectives of the study, a longitudinal multiple case studies strategy was proposed for the study, engaging both quantitative and qualitative methodologies in the data analysis.

The study is a longitudinal approach because the study focuses on a few selected banks as case studies and the study takes a rear-view approach by evaluating the banks' performance over a long period spanning 15 years from 2004 – 2018. Although it took a considerably long time to extract the Key economic Performance Indicators of the banks selected as case studies and to evaluate the statistical data, the exercise was rewarding.

The empirical data collected on the financial accounts of the case studies does not cover 2019 when the ring-fencing policy started and thereafter.

At the time of the research, the available empirical data regarding the financial activities of all the banks examined as case studies only extended to the 31st December 2018. Although the Banking Reform Act 2013 which contains the ring-fencing policy became law in December 2013, the full implementation of the ring-fencing policy only took effect from 1st January 2019.

In view of this, one argument is that since there are no financial data of any quantity and for any length of time after the commencement date of the ring-fencing policy on the 1st January 2019, then we cannot at this point determine the full cost and impact of the ring-fencing policy on the performance of the banks that were evaluated. Such claim would be largely correct. It would also be correct to say that we cannot associate ring-fencing with all the difficulties that the banks in the case study group went through since the Banking Reform Act 2013 was enacted into law.

On the other hand, what may be incorrect would be an assumption that since we do not now have the financial data after the implementation of the ring-fencing policy which started in 2019 to work with, then we would not be able to conduct valid research on the ring-fencing policy or its financial impact on the banking sector.

Some of the reasons why we can still do quality research in this area of study, analysing the ring-fencing policy in light of the abundance of other materials that we have at hand include the fact that (i) we now know the causes of the global financial crisis. If we know the associated problems with the crisis, we can then pick up the bits and pieces together and reasonably determine the most likely solutions to fix the problem. We can reasonably determine how and why the ring-fencing policy can fit in or not fit in among the range of solutions designed to address the problems. We can reasonably work out what can and what cannot work (ii) what we do not have now is not too important than all that we already have. We have the benefit of the output of at least two Panels of Inquiry specifically set up to investigate the causes of the crisis (Lord Turner Panel) and the white papers produced by the Vickers' Panel that came up with the idea about ring-fencing. We also have the benefits of the FSA's voluminous report on the causes of the RBS' near collapse in 2008. There are others including the report on failed Barring Capital and BCCI. On top of all these, since the crisis began in 2007, there has been a lot of journal articles and books written on various facets of ring-fencing which were copiously cited in this report. This research is an addition to the works of several other scholars. The financial data produced and analysed in this thesis can serve as a foundation for further research in the future say, in another 5 years' time when additional data would be available for more analysis on the subject.

The research design for this study embraced multiple data and mixed strategy which involved evaluation of the data using both numeric and qualitative data. By engaging qualitative and quantitative methodology in the analysis, each of the approaches supported the other to arrive at the conclusions arrived at.

The qualitative approach took pre-eminence in the study, while the quantitative side of the evaluation only played a secondary role. This was considered imperative to the achievement of the objectives of the study because objectives (i) a & b, (ii) and (iii) required a qualitative approach as they were matters related to textual evaluation. Objective (iv) required quantitative tools for numeric evaluation of data and also qualitative approach to do a review in the 'round', contextualising all the information gathered on the subject.

The choice of a mixed methods approach reflects the fact that there was a combination of relevant features of quantitative and qualitative paradigms in the study. This is more so that apart from the numeric data evaluation there were also aspects of the objectives of the research which related to critical textual evaluation of secondary documentary data. Carrying out mixed methods in this way supports the view of Tashakkori and Teddlie that contends that application of a mixed methods, combining qualitative and quantitative approaches, is not only compatible but it enriches the research experience.[601]

Objectives

(i) *(a) as a background to the study, to undertake a review in the literature of the causes of the financial crisis in 2007 – 2009.*

In order to achieve this objective, materials that related to the 2007 – 2009, financial crisis were consulted. There are increasingly wide range of publications on this subject starting with Lord Turner's report on the financial crisis, journal articles, publications, textbooks, etc.

(b) To undertake a review of the prevalent law and regulations that existed prior to the financial crisis in 2007 – 2009 in order to determine whether there were gaps in the law and supervisory regime then which may have contributed to the crisis. Also, to undertake a review of the newly introduced changes to the law after the global financial crisis, evaluating their impact on the case studies.

In order to determine whether there were inadequacies in the legal framework that may have given room for the crisis to occur, some key legislation prior to the crisis were reviewed, including but not limited to the Banking Act 1979, Company Act 1985 & 2006; the Banking Act 1987 and regulations at supranational levels including Basel I (1988), Basel II (2004) and FMSA 2000. Post crisis legal response such as Basel III (2010 & (2017) Banking Act 2009, focused on Global Systemically Important Banks, policy document issued through the HM Treasury (2011), A New Approach to Financial Regulation: Blueprint for Reforms and the Financial Services (Banking Reform) Act 2013 were evaluated

(ii) *to conduct a theoretical critique on the Ring-fencing policy against the backdrop of the UK's core competences in the provision of financial services, a sphere in which the UK has comparative and competitive advantages.*

[601] Op. cit., Tashakkori, and Teddlie, 1998, n 511.

Doing a critique on ring-fencing involved descriptive critical analysis of literature on the subject. Evidence on this aspect was taken from literature materials including Journals and Articles, Textbooks, Government whitepapers and evidence from other jurisdictions such as America and Europe. Secondary statistics from the Office of national Statistics were used including those on Fig 1, page 145 and Table 2 on page 146.

(iii) *to evaluate the effectiveness or otherwise of ring-fencing and scaled down business operations policy as measures that are capable of deterring financial crises in the future.*

This objective is also an evaluation of the literature, drawing on resources from journals and other publications on the subject.

(iv) *using the case studies approach, the annual financial accounts of RBS, Barclays, SCB, and HSBC Plc between 2004 – 2018 were evaluated to determine the impact of the global financial crisis and regulatory changes on the performance of the banks over the period stated. This exercise aids our understanding of some of the direct costs of the downward journey of these banks and the difficult road back to recovery as a lesson on record for the future.*

This is an empirical aspect of the research which evaluated the annual reports and financial accounts of chosen banks in order to highlight the extent of the long-term impact of the global financial crisis on the performances of the case studies. Evidence was extracted from the Annual Reports and Financial Accounts of the banks. This was evaluated in the light of the market environment and regulatory changes under which the banks operated each year of the review. Journal and articles, the banks' websites, news reports and textbooks were consulted in order to contextualise the findings of the evaluation.

Thirteen key performance indicators were extracted from the annual accounts of the banks selected as case studies. The KPI are: Annual Total Income, Operating Profit Before Tax, Total Assets, Impairment Charges, Number of Branches, Employees, Earnings Per Share, Dividend Per Share, Total Deposit, Total Loans, Investment Banking Contributions, Insurance Income and Income from Wealth Management. These indices were used to draw a profile of the performance of each of the banks over a period of 15 years starting from 2004 to 2018. This related to evaluation of numeric data. This evaluation of data is in agreement with positivists' claim, and it follows empiricists' ideology about objective reality, obtaining evidence that is outside the researcher's influence and which is value free.

The first three years' accounts from 2004 to 2006 represented the good years immediately preceding the global financial crisis. This was when huge profits were declared by the banks. The next three years from 2007 to 2009 were the years when the crisis took place. Thereafter, the next three years 2010 to 2012 was the period of planned government's response to the financial crisis while the next six years from 2013 to 2018 was the period of moratorium granted to the banking sector to fully prepare to implement the ring-fencing policy contained in the Banking Reform Act 2013 which was the embodiment of the UK's legal response to the global financial crisis. A trend analysis was constructed around the Profitability ratios using charts to illustrate and analyse the numerical data generated.

Reliance was placed on the balance sheet, income statement, notes to the accounts and the comments in the director's report section of the annual financial accounts of each of the banks to help in drawing pictures of each bank's performance on a yearly basis. A notable difference between the statement of financial position or balance sheet and the income statement is that the balance sheet is a 'snapshot' of the variables comprising the assets and liabilities as at the last day of the accounting year. This was 31st December annually for the banks evaluated. On the other hand, the income statement shows the stream of income earned (for example, commission, interest on loans and overdraft, exchange, insurance premium) between two dates, usually 12 months apart.[602] The balance sheet is very fluid. It does not remain the same, it changes daily. As such, the income statement proved to be a rich source of information necessary for the analysis of the accounts.

[602] J. Berk, and P. DeMarzo, 'Corporate Finance 3rd Ed' (Pearson, 2014, p 29)

3.11 Profitability Models as Performance Measurement

Profitability ratios including ROCE, EPS, DPS, Profit Before Tax, Profit After Tax and Operating Income indicate whether an entity is performing satisfactorily or not in terms of income generated when these indices are compared with the previous years' performance or against a benchmark to determine whether there had been annual growth. Returns earned on the total capital employed is measured in percentages and can facilitate comparison in the organisation whether there is annual growth. ROCE is used to determine whether the income earned is commensurate with the resources expended to generate the income.

EPS, typically denominated in pence, measures profit attributed to each ordinary share. Importantly, the part of the earnings per share distributed to shareholders in the company is the DPS. The difference between EPS and DPS (the proportion distributed to the shareholders from the EPS) is the income retained by the business. In the years that the company's EPS is significantly high, other things being equal, the shareholders will benefit from an increase in the dividend paid out and at same time the bank would have a significant amount left as retained earnings to grow the business organically.

Correspondingly, when the income level is not particularly good, the shareholders will have little or no earning for the year. Where there is little or nothing left to distribute as dividend to shareholders from the income generated during an accounting year, it is likely that there is only little or nothing to retain in the business. As such, the bank would suffer a decline or stunted growth. This was sadly the case on many occasions with the banks evaluated as case studies, especially RBS.

Using profitability ratios in the way described has shortcomings: (i) it takes a retrospective view of profitability, (ii) the ratios are only meaningful when compared against a benchmark and it assumes that the benchmark chosen is suitable, (iii) it relies on the balance sheet assets which are typically book values at historic cost (this can be grossly undervalued), and (iv) profitability ratios are based on the balance sheet figures, ignoring economic factors.[603]

[603] G. Arnold, 'Corporate Financial Management' (Prentice-Hall, 2013, p 615).

While the disadvantages of a profitability model as a performance yardstick are important, they are not considered to be fatal to the research being undertaken because: (i) the study itself takes a look backward to see what happened in the past, (ii) it is generally recognised that grossly under-stated assets could be made to give an overly impressive performance of the bank as at when desired. This can easily be picked up if it is the case that the company re-values its assets too frequently or retained the historic value for too long, say for over 10 years depending on the policy of each bank.

Under ISA 545, 'Auditing, Fair Value Measurements and Disclosures', a company is required to declare a fair value for their assets.[604] However, in a manipulative accounting method usually referred to as 'accounting cushioning', a bank may want to grossly understate its fixed assets in the good years when profit is high. This will have the effect of lowering profit and as well, reduce tax bill for that period. Much later in the 'bad years' when profitability is low, the situation allows the bank to then overstate the relevance of an upward revaluation of the assets to cushion the effects of the poor performance in the bad years thereby giving shareholders a false impression of stability.

The key issue here is that the increased value attributed to fixed assets such as land and buildings are not revenue generated in the ordinary course of business operations for that period but a windfall from the property market that has nothing to do with the good business acumen of the bank managers. Part of the incentives that could motivate the bank management to engage in such activities is that it would help to boost stock price in the stock market in the years when operational performance is poor, it will enhance investors' confidence in that bank, and it would also help the directors to claim bonuses in the year that that operational performance is poor.

To reduce the effects of incidences like this and to help external auditors, tax authorities and financial analysts to determine the true picture of the profitability status of the bank, one of the key measures available to examiners is to request for the company's policy on assets revaluation to determine how often the assets of the bank should be professionally revalued and whether the bank has been consistent in

[604] G. Cosserat, "Modern Auditing 2nd ed' (John Wiley, 2006, p 319)

carrying out assets revaluation when they should do it. In the case of this research, reliance is placed on the auditors' doing their professional duty, that they took cognisance of this factor and fulfilled their obligations to the highest professional standards.

Notwithstanding the shortcomings that may arise by using profitability ratios as a performance measurement, other researchers have used the model successfully in the past in performance measurement related research. [605][606]

3.12 Analysis, Interpretation and Written Presentation

Wolcott suggests three components of data analysis in qualitative research: description, analysis and interpretation.[607] Description is concerned with summarising, presenting, and narrating the data including activities related to transcribing tape recording of interviews.[608] Analysis requires coding, while interpretation is about making sense of the data.

There are three widely used approaches to interpreting data: content analysis, grounded theory and narrative analysis.[609] There are as well others such as conversation analysis, discourse analysis, hermeneutics and deconstruction. Content analysis could be defined as a systematic evaluation of the characteristics found in a data set including for example, frequency of words, and recurrent patterns of phrases and themes within the data which ultimately enables the researcher to construct extant or emergent outcomes.[610] In the context of these case studies, content analysis was used to produce emerging themes from the trend analysis extensively discussed in respect of each of the banks in the case studies in chapter 4.

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605 J W Wilcox, 'The P/B – ROE Valuation Model', (1984) Jan – Feb, 58 – 66, Financial Analysis Journal.
606 J. Karr, 'Performance Measurement in Banking: Beyond ROE' (2005) Vol 18 (2) 56 – 70, Journal of Performance Measurement.
607 H. Wolcott, 'Transforming Qualitative Data: Description, Analysis and Interpretation'(Sage Publications, 1994)
608 D. Silverman, 'Interpreting Qualitative Data 5th Ed' (Sage Publications, 2014)
609 Ibid
610 Op. Cit., Easterby-Smith, M. et al., 2008, (n. 512).

Neuendorf suggests that content analysis could be imported into quantitative methods using SSPS software.[611] As mentioned previously under the documentary data sources, Neuendorf's suggestion supports this researcher's plan to use content analysis in evaluating secondary data sources in the context of quantitative method in the research being undertaken.

Glaser and Strauss' grounded theory is a three stage approach which involves developing categories within data sets; saturation of the categories to demonstrate relevance; and development of the categories into more general analytical frameworks with relevance outside the setting.[612] The aim of grounded theory is to generate or discover theory from the data or the life experiences of social actors.[613] Saunders et al suggest that grounded theory could be used in different contexts including a class of study being undertaken.[614]

3.13 Limitations and Justification of the Choice of Method Adopted

The immediate concern usually raised when documentary data sources such as companies' annual financial accounts and the national GDP are mentioned as the principal sources of data collection for major research is that annual accounts of organisations do not always reflect reality as they are highly susceptible to manipulations to accommodate how organisations manipulating their accounts want it to be seen. Sadly, a situation arose in the cause of this study in which the attention of this researcher was drawn to the bloating of the derivative accounts of the case studies in the year 2008 but the undue increase in the assets were reversed in 2009. In the case of Barclays, the inflated derivative account increased by almost a trillion pounds, yet the accounts were signed off by the Auditors. The worrying bit was that, when the anomaly was rectified, nothing or not much was said about it. The account was just corrected and that was it.

[611] K. Neuendorf, 'The Content Analysis Guidebook' (Sage Publications, 2002)
[612] B. Glaser and A. Strauss, 'The Discovery of Grounded Theory' (Aldine, 1967)
[613] Op. cit., Saunders, M. et al., 2016, (n. 515)
[614] Ibid

That was in 2008/2009. The effect of the new regulatory control after the crisis may now make it more difficult for the banks and Auditors to get away lightly with such practice.

Also, regarding the GDP, there are usually claims that statistics produced by government agencies can be biased and influenced by political considerations.

A major work on such criticism came from Harvard trained economist Prof Diane Coyle of Manchester University in her work, "GDP: A Brief but Affectionate History".[615] Coyle gave an anecdotal reference to the case of Greece where the government arraigned Greece's Head Statistician before the court for the offence of Treasonable Felony, with the Greece government alleging that the Head Statistician understated the Greece GDP putting at risk the inflow of financial support from the International Monetary Fund. It is as though the figures stated as the GDP by the Head Statistician of Greece was subject to his mood or personal control. Coyle also raised doubts about the factual accuracy of the constituents of the GDP.

First, this researcher accept that computation of GDP is not an exact science and secondly, that the risks of manipulation of accounts do exist, but also points out that one of the important lessons learnt from the failed Bank of Credit and Commerce International (BCCI) in the 1990s was the ability of the Official Liquidator of the bank to sue the auditors of the BCCI for misrepresentation and gross negligence by signing off the accounts of the bank, even when the bank was obviously in turmoil.[616]

The banks being studied are all public listed companies. Following the incident of the BCCI and especially in the light of the financial crisis of 2007 – 2009, greater transparency and scrutiny are now demanded from the banks in the UK. The auditors are made accountable and required to report key elements of the operations of banks directly to the banks' regulators.[617]

Company Act 2006 s. 503 (3) requires that,

> *"… the report (Audited Accounts) must be signed by the senior statutory auditor in his own name, for and on behalf of the auditors."*

[615] D. Coyle 'GDP: A Brief but Affectionate History' (Princeton University Press, 2014)
[616] BCCI (Overseas) Ltd v Price Waterhouse (No 2) [1998] PNLR 564
[617] Royal Bank of Scotland (2017) Annual Financial Accounts for 2016 at page 49

This provision commits a senior partner in a firm to certify that the audited account is a true and fair representation of the account audited.

Company Act 2006 s.507 (1) makes it an indictable offence if the auditor knowingly or recklessly allows a report to include any misleading, false or deceptive material to be included in the annual financial report.

A pertinent question is whether there are other credible means of determining the trend of performance in the banks which are available to external analysists apart from using their annual financial accounts. The answer is a very simple one: no.

In the context of this study, annual reports and financial accounts of the banks are considered to be the most suitable sources of data for this study because these documents contain consolidated accounts of the groups in the banks. The documents contain information that cannot be obtained elsewhere. Typically, the annual report contains the chairman's statement, Business Review, Governance, Capital and Risk Management, and Strategic Report given by the Chief Executive Officer of the bank while financial accounts provide information about the independent auditor's report, consolidated income statement, consolidated balance sheet, consolidated cashflow, accounting policies and notes to the accounts.[618]

Company Act 2006 stipulates the information that the annual reports and financial accounts must contain, how it must be presented and makes it obligatory for the directors to prepare a report.[619] The point is that these documents have the backing of the law and they are so comprehensive such that it is not feasible to obtain the information they contain through any other means. As such, they are the most suitable sources of getting the main data needed for this study.

Saunders *et al* point out that unlike national governments, non-governmental agencies and corporate bodies with huge resources, individual researchers do not have the resources and the time to collect detailed data sets as could be funded by the government and corporate bodies.[620] For example, some of the banks in the case studies operates in over fifty countries around the world. It would be unrealistic to expect a researcher to travel around the globe to collect data in those places solely for the purpose of conducting a study of this kind.

[618] G. Morris, 'UK Accounting Practice'(Lexis Nexis Butterworths, 2005, pages 62 – 66)
[619] Company Act 2006 s. 380 concerning Accounts and Reports and s.415 Duty to Prepare Director's Report
[620] Op. cit., Saunders, M. et al., 2016, p 316, (n. 515)

Using published accounts and statistics on GDP in the way proposed has drawbacks but it is arguably the best evidence available to generate the most comprehensive and near accurate data for the research undertaken.

Denscombe points out the benefits of official statistics and publications from government agencies as important sources of information for social scientists in the western world.[621] Denscombe is not in the least suggesting that government reports and publications in the Western nations are error free. In the current research, it is not considered that such risks are excessively out of proportion or that the risks are so high such as to unduly impede an objective outcome for the study.

An added advantage using the annual accounts of the banks in the case studies is that the effect of globalisation has brought to the fore the need to have standardised accounting reporting methods and financial reporting regulations styled International Reporting Financial Standards (IRFSs).[622] The benefit of that arrangement to this research is that all the annual financial statements of the banks examined have common features. Also, the accounts share the same format of reporting which facilitated comparison.

Analysing corporate financial accounts requires distinctive abilities. Banks' annual accounts/reports can be voluminous and complex. So also, banks' financial accounts have some distinctive features that differentiate them from conventional corporate accounts. For example, the extensive components and layout of the banks' financial statement are strictly regulated as stated earlier.

This researcher has a strong background in accountancy and financial management at higher education level which aided in collating the data and in the analysis of the accounts.

[621] Op. cit., M. Denscombe, 2011, n 522.
[622] Op. cit., Melville, 2015, n 163.

3.14 Training, Qualifications and Practical Work Experience of the Researcher in Law, Business Management, Economics, Accountancy and Banking & Finance

In addition to being a barrister at law and a corporate lawyer, the researcher has a strong academic background in banking and finance, economics, accountancy and financial management coupled with about 20 years' work experience in the banking sector. He is a Fellow of the Chartered Institute of Bankers. He also has behind him a couple of years in legal practice. The researcher has two master's degrees, one in business management received at the University of Liverpool and the other in law obtained at Manchester Metropolitan University. The additional advantages in conducting this research are the benefit of "insider's knowledge" on how commercial banks' operations work, supervision within the bank, internal auditing and control mechanisms in the banking system. The experience has been invaluable to this research. Although this researcher previously worked in the bank, currently, he has no specific interest nor any desire to work in the banking sector to warrant any bias in favour of the banking sector in this study.

3.15 Ethical Consideration

An on-line training was undertaken in the course of the 2017/2018 academic year preparatory to the commencement of data sourcing activities for the proposed research. An application was put forward to the appropriate arm of the university authority having oversight on ethical matters to consider granting approval for commencement of collation of the required data for this research. The application sailed through successfully without any difficulty. This was probably because the research does not require collection of personal data of individuals and the bulk of the required data is already within the public domain.

In social investigations, especially where health issues are concerned, it is recognised that increasingly, attention is nowadays paid to protecting participants in studies to ensure that suitable measures are in place to safeguard their privacy.[623] This study does not fall within that category of research.

This researcher is mindful of the need to maintain anonymity and confidentiality as appropriate. Also, the importance of maintaining an up-to-date reference list to avoid accusations about plagiarism was taken into account.

3.16 Conclusion

The importance of presenting the enumerated theories to this study is that, (i) foremost, they provided a "shopping list" of arrays of approaches to doing research that this researcher could choose from, (ii) they enabled the researcher to consider what approach might be fit for purpose or not in the context of the study, (iii) they emphasised the need to pay the most careful attention to the research design, that it ensured that the design is suitable for the study, (iv) also, they encouraged the researcher to justify the methods and methodology engaged in data collection, presentation, analysis and their interpretation. This is so that the product of the research could be impeachable and so that the study is worth presenting to the academic community and banks' regulators.

[623] Op. cit., M. Denscombe, 2011, (n. 547).

Chapter 4

Presentation and Analysis of Data Collated from Banks Selected as Case Studies

4.1 Introduction

This chapter is concerned with the presentation of data collated from the Annual Reports and Financial Accounts of the four UK banks chosen as case studies. The banks include: (i) the Royal Bank of Scotland Plc (ii) Barclays Plc (iii) Standard Chartered Bank Plc and (iv) HSBC Plc

These are banks that are identified as Global Systemically Important Banks by the Financial Stability Board (FSB).[624] The Royal Bank of Scotland made it into the list in 2011, but due to the massive reconstruction that took place in RBS, it was excluded in 2019 as also Lloyds Banking Group.[625] In view of the huge size of these banks, the collapse of any of them is recognised to be capable of causing systemic catastrophe not only in the UK, but the ripple effect thereof potentially spreading globally. The background issues raised in the introductory part of this chapter are applicable to all the four banks chosen as case studies. As such, except where there is a very good reason for it, these matters are not repeated separately when evaluating the financial accounts of the other banks in the separate sections allocated to each of case studies within this chapter.

To start with, this researcher considers it a great privilege to have access to the annual reports and financial accounts of the four banks chosen as case studies and wishes to emphasise that the products of the examination conducted and comments made about the financial accounts of these banks whether positive or negative are purely outputs of an academic exercise to illustrate what, how and why things could go well or go wrong in a huge bank that is global systemically important in the light of the aims of this research.

This researcher was not acting as a front for the tax authority neither did he investigate the books of account of the bank as a team member of the UK banking regulators. The intention was not to criticise the banks nor put doubts in the minds

[624] Op. Cit., Financial Stability Board 2019 list, n. 28.
[625] OP. Cit., Financial Stability Board 2011 list, n. 27.

of readers about the integrity of the bank, its members of staff and the accounts evaluated.

As such, the comments should not be taken beyond an inquisitive analysist's licence to evaluate how figures stated in one section of the financial statement or comments made by the executive officers made in the annual report corroborate another section or fail to hang together properly with the available evidence in that section.

This researcher has never been an employee of any of the banks in the case studies and is not acting as a front for the tax authority neither did he investigate the books of accounts of the banks as a current or past team member of the UK banking regulators

This researcher makes no claim to have exhausted all the elements in the financial reports that could be considered relevant to this research.

The data collated and its analysis are integrated within this chapter. This approach was adopted to allow the data and its analysis flow together seamlessly in order to avoid instances of disruptive forward and backward movements in-between chapters to connect data with analysis thereof. The Annual Reports and Financial Accounts evaluated cover a period of fifteen years from 2004 to 2018.

As already explained in the previous chapter, there are over three hundred banks operating in the UK. Some of these banks are excluded from the ring-fencing policy either by reason of their size or because they are Building Societies, or private banks.

The four banks were selected as case studies because they fall within the range of banks that are considered to be global systemically important banks and because they have the level of core deposits that makes it mandatory for them to be ring-fencing compliant by 1st January 2019. These are banks that have aggregate core deposits in excess of £25 billion, and as such, considered to be in the category of banks that could pose systemic risk to the economy in the event of their failure.

It should be recognised that some of the banks that fall within the ambit of the ring-fencing policy carry more risks than the others. For example, three of the four banks chosen as case studies, the Royal Bank of Scotland, Barclays Plc and HSBC had assets close to or in excess of two trillion pounds within the period evaluated. Thus, for those banks, the £25 billion core deposits threshold is a relatively "small amount".

The super big banks are the set of banks that are of immediate concern to the regulatory authorities. These are the banks where their failures could be more difficult to absorb in the economy. They are the banks classified as banks that are too big to fail and too big to rescue in the event of crisis. These are the kind of banks that the government felt compelled to rescue during the 2007 – 2009 global financial crisis. Concerns about risks associated with these banks are the reasons that gave birth to the ring-fencing policy in the first instance.

Thus, these are the same reasons that motivated the selection of these banks in the case studies group. The third bank, Standard Chartered Bank is a middle-level bank in the sense that it is not a small bank considering that it has assets in excess of £500 billion but not close to a trillion pounds as did each of the bigger players. That mid-range size is chosen as part of the case studies to represent that class of banks in the banking sector.

This chapter is divided into four sections A – D, with each section dealing with information relating to one bank at a time.

The aim is to present the ensuing data in a simple chart form and in a digestible narrative format so that even non-expert readers can easily follow the argument and appreciate the significance of the numerical data presented in light of the aims and objectives of the study.

This chapter is concerned with the fourth objective of the study stated in chapter 1 page 3 -4.

> "*the study aimed to determine the long-term impacts of the GFC on the performance of some of the largest UK banks up till 2018 and it evaluated the financial impact of the regulatory response designed to limit the effects of likely financial crises on the banking sector in the future*."

Thus, the financial accounts of the banks were evaluated from 2004 – 2018. The years 2004 – 2006 were the good years when huge profits were declared, the period 2007 – 2009 was in the heat of the crisis, 2010 – 2012 was when multiple regulatory response started, 2013 – 2018 represented the recovering period and the period of moratorium granted to the banks to prepare for compliance with the ring-fencing policy.

It should be noted that there are occasional instances in the financial accounts of the case studies where, after the balance sheet date, there were events that necessitated the banks to make further reviews, revaluations, reclassifications and amendments to items/assets in their financial accounts.

Banks are under an obligation to present accurate reports about their financial status which reflect a fair value of their assets, especially when an adverse market environment or new regulation causes impairment to their assets.[626] In the circumstances of the case studies, where such changes resulted in a significant adjustment to the financial accounts in the year that followed, this is taken into account.

For the benefit of external users and investors, Paragraph 27 of International Financial Reporting Standard 5 (IFRS) makes it a requirement that a new measurement basis would be applicable when an asset ceases to be classified as asset held on 'a going concern' basis or the value of the asset is adversely affected by some other circumstances. In this case, the basis of that measurement would be at the lower of the book value or the recoverable amount on the asset.[627] This situation would be applicable where there is an indication of impairment either because there is a fall in the market value of the asset or there are material adverse changes brought about by new regulation.[628]

The foregoing position was adopted in relationship to all the banks chosen as case studies.

One very clear example is concerned with the Royal Bank of Scotland's financial accounts for the year 2017. The financial accounts for that year were significantly altered in a review made in 2018. On that occasion, the recorded **Operating Loss** Before Tax for 2017 financial year was £1.2 billion[629] and the total assets were stated as £726 billion[630], whereas when the accounts were redrafted the following year, the Operating Loss Before Tax became **Operating Profit** Before Tax in the sum of £2.2

[626] R. Ball, 'International Financial Reporting Standards (IFRS): Pros and Cons for Investors' (2006) Vol 36: 5 – 27 Accounting and Business Research

[627] International Accounting Standards Board (IAS) 'Financial Accounting Foundation: Conceptual Framework for Financial Reporting' (IAS, 2010)

[628] B. Elliott, and J. Elliott, 'Financial Accounting and Reporting 18th Ed' (Pearson, 2017, p. 424)

[629] The Royal Bank Scotland, 'Annual Report and Financial Accounts' (2017, p.82)

[630] Ibid (2017, p. 84)

billion.[631] That is a change of £3.4 billion. Similarly, total assets which were £726 billion in 2017 accounts, increased to £738 billion after adjustments were made to the accounts.[632] This is an increase of £12 billion. This level of changes is considered significant enough to warrant being taken into account when doing the evaluation of the financial accounts of RBS for those two years. This is referred to in the body of the ensuing analysis. Another reason why it is considered important to take that level of amendments into consideration is that the tax paid by the bank for 2017 financial year was on the basis of the revised operating profit and not the operating loss previously recorded in the Financial Accounts prepared in 2017.

The same principle was adopted in the extraction of statistics and analysis thereof regarding Barclays Plc in the year 2012 when the total income, profit before tax and earnings per share were significantly re-stated for the same reasons. In other instances where insignificant adjustments were made due to events after the balance sheet date and thus the changed variables were stated differently in the following accounting period, the previously reported figures were left undisturbed in the statistics used. If the changed figures are considered not to be so significant as to distort the analysis, it is considered unnecessary to over complicate issues moving forward and backward adjusting and readjusting data on trivial amendments, more so that the restated figure will in any event inevitably even out itself in the next accounting year.

The general idea behind the approach adopted is to stick with figures that reflect the underlying economic performance of the bank annually while separately dealing with extraordinary items or one-off events that are not typical of the business operation of the bank. This is to avoid distortion or beclouding of the actual performance of the bank in each of the years under review. An example of that approach is reflected in the fact that this researcher worked more with Operating Profit Before Tax rather than Profit After Tax. This does not understate the importance of Profit After Tax as a key performance indicator, but it only demonstrates due recognition of a wide variety of factors that could influence computation of company tax which may not all be applicable every year.

[631] The Royal Bank of Scotland, 'Annual Report and Financial Accounts' (2018, p.176)
[632] Ibid (2018, p. 178)

Section A – The Royal Bank of Scotland Group

4.2 The Background of the Royal Bank of Scotland Group and the Nature of its Business Model Over Time

The RBS was established almost 300 years ago in 1727, in Edinburgh, Scotland.[633] Ever since, the Group Headquarters has remained in Scotland.

The RBS' financial year starts on 1st January and ends on 31st December annually. The accounts are denominated in pound sterling. The independent external auditors were Deloitte & Touche LL P, Chartered Accountants and Registered Auditors, Edinburgh. The firm audited RBS accounts for the financial years 2004 to 2015 of the years evaluated in this report. Also, Ernst & Young LL P, Chartered Accountants and Registered Auditors based in London served as the external independent auditors for RBS from 2016 to 2018.

It is worth mentioning that following the global financial crisis in 2007 – 2009 and the subsequent enhanced regulatory requirements, a more onerous burden was imposed on the independent external auditors to provide a more comprehensive report from their audit on a wide ranging issues including specific reports on the financial statement, the accounting report standard used, liquidity and insolvency risks, loans impairment provision, valuation of complex or illiquid financial instruments, estimate of future profitability and the scope of the audit.[634] These were general weakness areas in the business of the bank that nearly led to the total collapse of the bank in the autumn of 2008. Unlike in the previous years when auditor's report was limited to just about a page or two, the auditor's report in 2016 covered twelve pages. For the period evaluated, there was no adverse report from the auditors.

From the inception of the RBS to 1900, the bank grew to 130 branches, though there was only one branch opened in the city of London by 1900.[635]

However, the bank's presence became more pronounced in England in the 1920s – 1930s, as RBS purchased Glenn, Mills and William Deacons, an already established major commercial bank in England having a wide network of branches. In 1970,

[633] The Royal Bank of Scotland 'Annual Report and Financial Accounts' (RBS, 2005)
[634] The Royal Bank of Scotland 'Annual Report and Financial Accounts' (RBS, 2016, p. 278 - 289)
[635] Op. Cit., n 608 (RBS, 2005)

RBS merged with National Commercial Bank of Scotland. This strategic acquisition enabled RBS to become the largest bank in Scotland with over 700 branches in the 1970s.[636]

In the 1980s through to the 1990s, the free-market model and deregulation policy adopted during the Margret Thatcher era allowed RBS to grow even bigger, venturing into insurance business. In 1985, RBS established Direct Line, a motor vehicle insurance subsidiary.[637] It was during the famed free markets era that the RBS also foraged into the global platform by acquiring Citizen Bank of Rhode Island. In time, RBS also purchased Charter One and Mellon Bank all in the USA.[638] As pointed out in the literature review, this was the period that the universal banking model started to gain grounds in the UK.

In the 1990s through to the early part of the 2000s, business could not have been better for RBS. With the attendant ever-increasing number of branches and customers resulting from both organic growth and the acquisition of other financial businesses at home and abroad, RBS took the advantage of the giant leap in technological advancement in the 1990s to upgrade their operating systems to a comprehensive internet banking service by 1997. [639]

In the year 2000, RBS took the bold step to acquire Natwest Bank in a mega deal of £21 billion, the biggest takeover of its kind in the history of banking in the UK up to that time. Profitability was at an all-time high in 2005 when the bank recorded increase in group operating profit by 16% to £8.3 billion from £7.1 billion in the preceding year. In 2005, the group had a total income of £26 billion. Earnings per ordinary share rose by 175.9p. For RBS, the early part of the 2000s were the good years. It was the era of boom.

At that time, the unprecedented growth in the number of branches reached 2,278 in 2007[640] and the numerical strength of their customers' base clocked about 44 million in 53 countries across the world.[641] The growth necessitated changes in the mode of the banking operating systems of the bank. This included re-engineering of RBS retail banking operating procedures such that branch handling processes were

[636] ibid
[637] ibid
[638] ibid
[639] Ibid
[640] The Royal Bank of Scotland, 'Annual Report and Financial Accounts' (RBS, 2007, p.15)
[641] Ibid (2007, p.11)

replaced with a preferred centralised business operation. The objective was to strengthen co-ordination and to manage delivery of efficient services to the widening scope of their clientele. In addition, customers were segmented to facilitate tailor-made services to meet personalised needs.

Apart from the strong organic growth (meaning ploughing the profit made by the Group back into the business), RBS followed a culture of exploiting the benefits of merger and acquisition of other financial businesses for its expansion strategy. This view is strengthened by the earlier mentioned purchase of Glenn, Mills and William Deacons in the 1920s, merger with National Commercial Bank of Scotland in 1970, entrance into the USA market through the purchase of Citizen Bank of Rhode Island in 1980. Further purchases of other financial businesses in 1990 – 2000 include Mellon Bank, Charter One, in addition to venturing into insurance business by establishing Direct Line in 1985 as mentioned previously, and subsequent acquisition of Churchill Insurance in 2003 and then Privilege Insurance. For RBS, the icing on the cake was the purchase of Natwest Bank in 2000.

The ever-increasing appetite and aggressive mergers and acquisitions of other financial institutions later proved to be the undoing of RBS as some of the institutions purchased were later seen to be overpriced including ABN AMRO that had very weak underlying assets.

4.3 Constituents of RSB Group Prior to the Financial Crisis

RBS Group operated a universal banking model comprising the following members:

4.3.1 Insurance Brand (RBS Insurance)

The insurance arm of the business included Direct Line, Churchill, Privilege, Green Flag and NIG.

By 2005, RBS Insurance had its total insurance policies increased from 1.6 million to 25.9 million.[642] The insurance arm of the RBS was the market leader in car

[642] The Royal Bank of Scotland, 'Financial Accounts', 2005, p.39,.

insurance, having 8.7 million policies and held the second position in home insurance having 4.6 million policies.[643]

4.3.2 Wealth Management/Private Banking

This arm of RBS comprised:

(i) Coutts & Co

(ii) Adam & Company

Coutts & Co was the market leader in the provision of wealth management and private banking services in the UK having about 11,000 customers globally.[644] The bank maintained a strong presence in specially selected locations such as Dubai, Monaco, Switzerland, Singapore and Hong Kong, having twenty-three offices altogether. [[645]][[646]] Similarly, Adam & Co had relatively few offices. They had only five branches in the UK.

It needs to be emphasised that this is a niche market that focused on few but exceptionally rich institutions and wealthy individuals globally. This arm of the bank derived its income from managing the wealth of highly valued customers. In relative terms, that arm of the bank does not require extensive branches, a large number of employees or large office spaces.

4.3.3 Banks Within the Group

The financial institutions within RBS Group were:

Natwest Bank

RBS Holding (ABN AMRO)

Citizens (USA)

Charter One (USA)

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[643] ibid
[644] The Royal Bank of Scotland, 'Financial Accounts', 2007, p. 16.
[645] The Royal Bank of Scotland, 'Financial Account Accounts', 2006, p. 23
[646] The Royal Bank of Scotland, 'Financial Accounts', 2005, p. 76

Ulster Bank Group (Ireland)

As pointed out earlier, Natwest was purchased by RBS Group in 2000. ABN Amro was a Dutch bank purchased in 2007.

Charter One and Citizen Bank have a combined network of corporate and retail banking that covered about forty states in the USA, including Delaware, Massachusetts, Pennsylvania, Illinois and Rhode Island, to mention just a few.[647]

Through integration, the combination of these two banks made the bank to rank as the 8th largest commercial organisations in the USA in terms of deposit base. The bank had the 13th consecutive years of record profits in 2004.[648]

Bearing in mind that these banks in the USA were only part of the subsidiaries of RBS stresses the size of RBS and its influence globally at that time.

4.3.4 Strategic Divisions within the RBS Group

For administrative purposes, the RBS had seven divisions prior to the global crisis. This includes Corporate Markets, Retail Banking/Commercial Banking, Wealth Management, Citizens and Capital One, Manufacturing, RBS Insurance and Ulster Bank.

Corporate Markets Division of the bank carried out financial market operations and investment banking role.

In that role, the division undertook the following functions

- Structural finance and financial market products and services
- Acquisition finance
- Trade finance
- Leasing
- Factoring
- Treasury services
- Money markets
- Foreign exchange

[647] Ibid (RBS, 2005, p.33)
[648] ibid (RBS, 2005, p. 33)

- Derivatives
- Bond origination and trading
- Sovereign debt trading
- Futures brokerage
- Interest rate risk management services

The foregoing is the general background and business model of the RBS Group.

4.4. Table 5 Tabulated Data Extracted from the Annual Reports and Consolidated Financial Accounts of the Royal Bank of Scotland Group From 2004 – 2018 (Financial Year Ending on 31st December Annually)

Year	Total Income	Operating Profit Before Tax	Total Assets	Impairment Charges	Branches in the UK	Number of Employees	Earnings Per Share	Dividend Per Share	Total Deposit	Total Loan	Contribution Corporate Market	Contribution Insurance	Contribution Wealth Management
	£ (b)	£ (b)	£ (b)	£ (b)					£ (b)	£ (b)	**£ (b)**	£ (b)	£ (b)
1	2	3	4	5	6	7	8	9	10	11	12	13	14
2004	23.4	7.3	588	1.5	-	136,600	157.4p	52.5p	383	408	4.2	0.9	0.3
2005	25.9	7.9	777	1.7	2,274	137,000	175.9p	72.5p	453	488	5.2	1.0	0.4
2006	28.0	9.2	871	1.9	2,250	135,000	194.7p	77.3p	516	549	6.1	1.0	0.3
2007	31.1	9.9	1,901	2.1	2,278	226,400	78.7p	33.2p	995	1,049	5.6	0.9	0.4
2008	25.9	(40.7)	2,402	8.0	-	199,800	-	-	898	1,013	(8.7)	0.8	0.4
2009	38.7	(2.6)	1,696	14.0	-	184,500	-	-	756	820	5.7	0.06	0.4
2010	23.7	(0.2)	1,307	9.4	-	113,600	-	-	558	606	3.2	-	0.3
2011	21.8	(0.9)	1,433	7.2	-	113,700	-	-	581	587	1.5	-	0.3
2012	17.9	(5.6)	1,312	5.3	-	137,200	-	-	623	564	1.5		0.3
2013	19.8	(6.8)	1,020	8.4	-	106,100	-	-	537	506	0.7		0.3
2014	15.2	(2.7)	1,051	1.4*	-	110,027	-	-	452	421	-	-	-
2015	12.9	(2.7)	815	0.8*	-	93,659	-	-	408	364	-	-	-
2016	12.6	(4.0)	799	0.5	-	77,900	-	-	420	382	-	-	-
2017	13.1	2.2	738	0.5	-	69,700	6.3p	-	392	322	-	-	-
2018	13.4	3.4	694	0.4	-	65,400	13.5p	13p	384	318	-	-	-

4.5 The Constituents of Table 5

Table 5 is the tabulated data extracted from the Annual Reports and Financial Accounts of RBS Group for fifteen years starting from 2004 to 2018. **Appendix 1** at the back of this report provides references to the page numbers in each year's Annual Report and Financial Accounts of RBS Group indicating where the numerical data were extracted.

Whilst some of the columns on the table provide full and complete information, others do not. The reason for the 'incomplete' information regarding such columns is mainly due structural readjustment in the methods of operation of the Group's businesses, which necessitated merging some of the divisions within the Group that previously existed independently, and whose accounts were reported separately. In other instances, provision of the data stopped. For example, information on number of branches. A fuller explanation is provided in the section that provides written explanations on the significance of the data collated, what the numbers on the table mean or represent, their relationships with one another (if at all there is any relationship) and how the data provides answers to the objectives of the study.

Meanwhile, **Figures 5 - 10** here below are graphical presentation in Chart forms relating to the same information contained within Table 5. The Charts are designed to provide a visual aid which indicates visible trend of developments or lack of it regarding the defined variables over a period of fifteen years.

Beneath each of the charts is a brief summary of what they are about. They are aids to see at a glance what the charts illustrate. The scales of **'x and y'** axes of the charts are listed out in Appendices 5 to 10 at the back of this report.

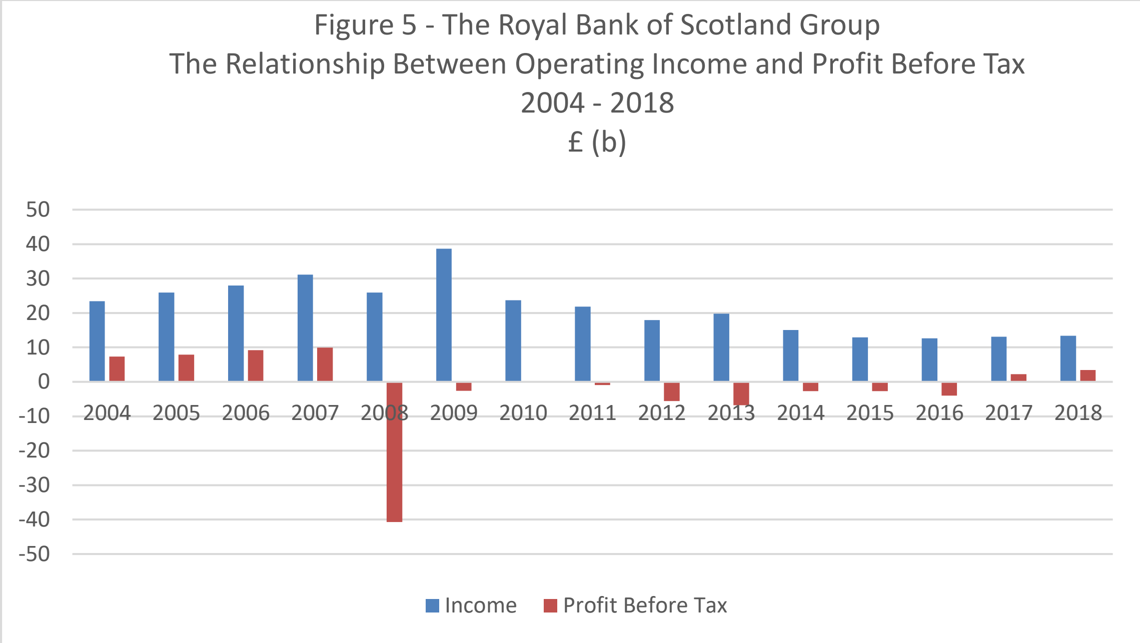

Fig 5 relates to columns 2 and 3 of Table 5. Income peaked at about £39 billion in 2009 and it started to decline to an average of about £13 billion from 2015 to 2018. Similarly, from 2004 to 2007, RBS recorded PBT of about £8 billion. Thereafter in 2008, RBS continued to declare operating losses for 9 consecutive years in a row until it broke even 2017 and 2018. The highest operating profit was about £10 billion achieved in 2007 while this was immediately followed by the largest operating loss of £40 billion recorded in 2008.

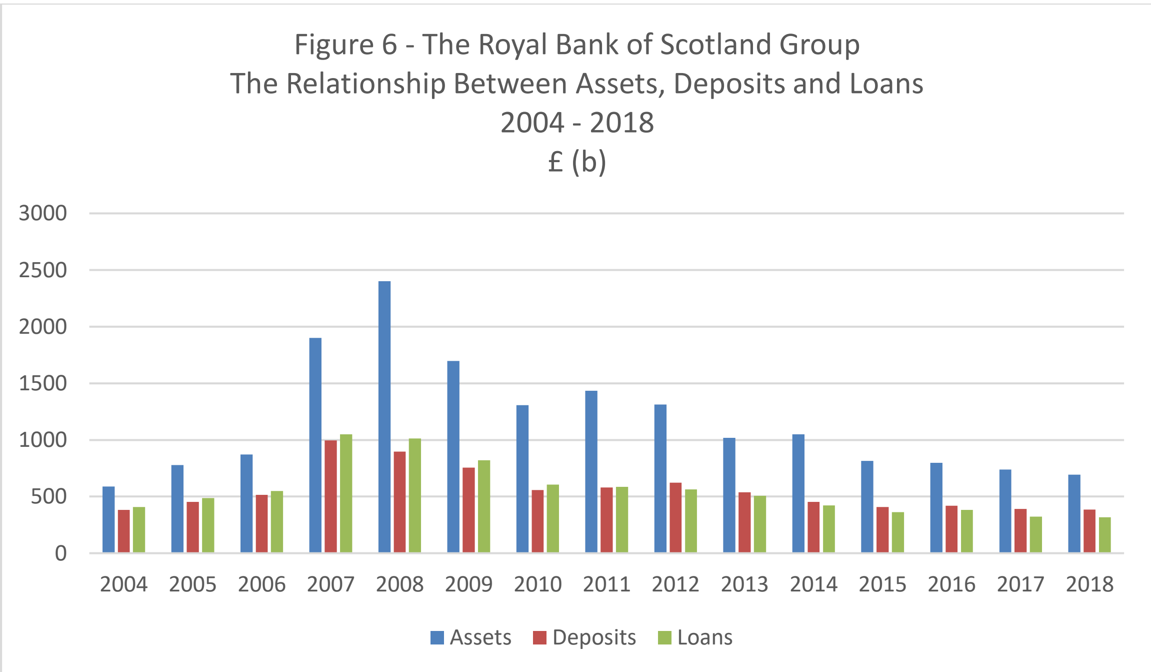

Figure 6 is concerned with columns 4 (Assets), column 10 (Deposits) and column 11 (loans) on Table 5. The assets grew rapidly from a modest £588 billion in 2004 to £2.4 trillion in only four years to 2008. Subsequently, from 2009 onward the assets declined almost steadily until it came to just about £700 billion in 2018. This was due to divestment and downward review of overstated derivative assets between 2008 and 2009. From 2004 to 2010 Loans exceeded Deposits, indicating poor liquidity. Liquidity only started to improve from 2011.

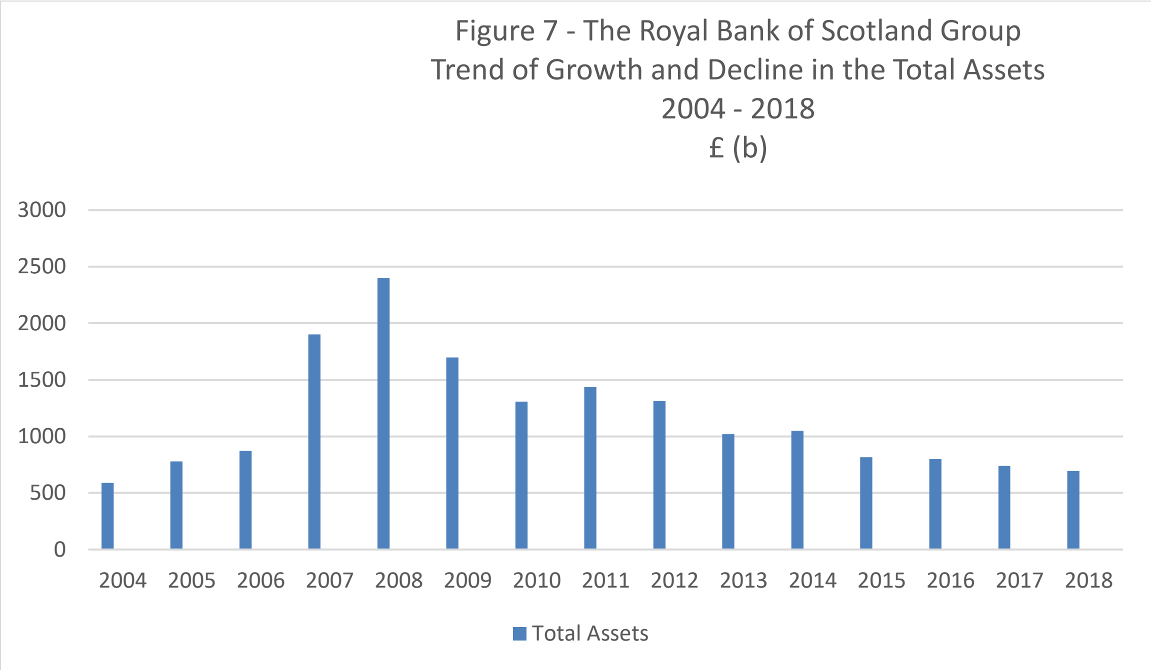

Figure 7 is concerned with column 4 relating to the growth and decline of assets. Total assets climaxed at £2.4 trillion in 2008 but continued a downward trend as the bank began restructuring and divestment.

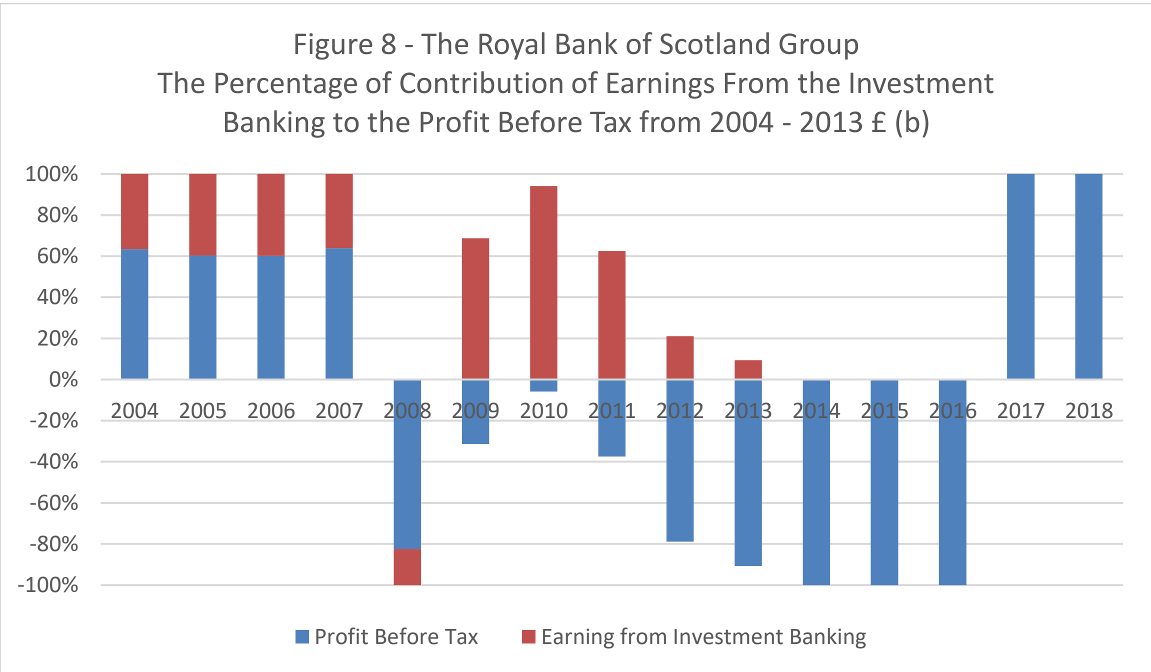

Figure 8 is concerned with PBT column 3 and column 12 relating to contributions from investment banking to the PBT. Except in 2008 when Corporate Market made a loss, from 2004 to 2013 the Division contributed more than half of the PBT earned by the Group.

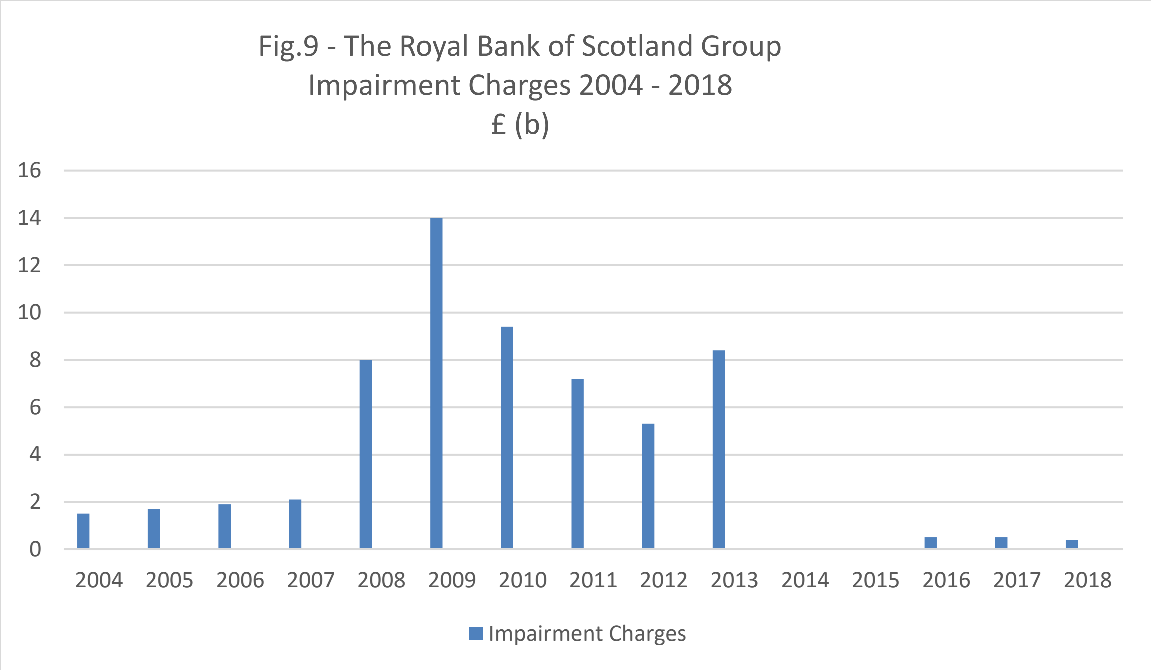

Figure 9 is about column 5 on the Table relating to impairment charges. Impairment charges is the amount set aside from the annual profit of RBS to defray potential losses or demurrage that may arise from assets held by the bank and nonperforming loans and overdraft accounts. While such charges were fairly consistent and moderate from 2004 – 2007 and 2016 – 2018, the sum charged to Profit and Loss account in 2008 – 2013 were remarkably high reflecting the turbulent time that RBS faced in those years and due to the poor quality of its assets/nonperforming loans.

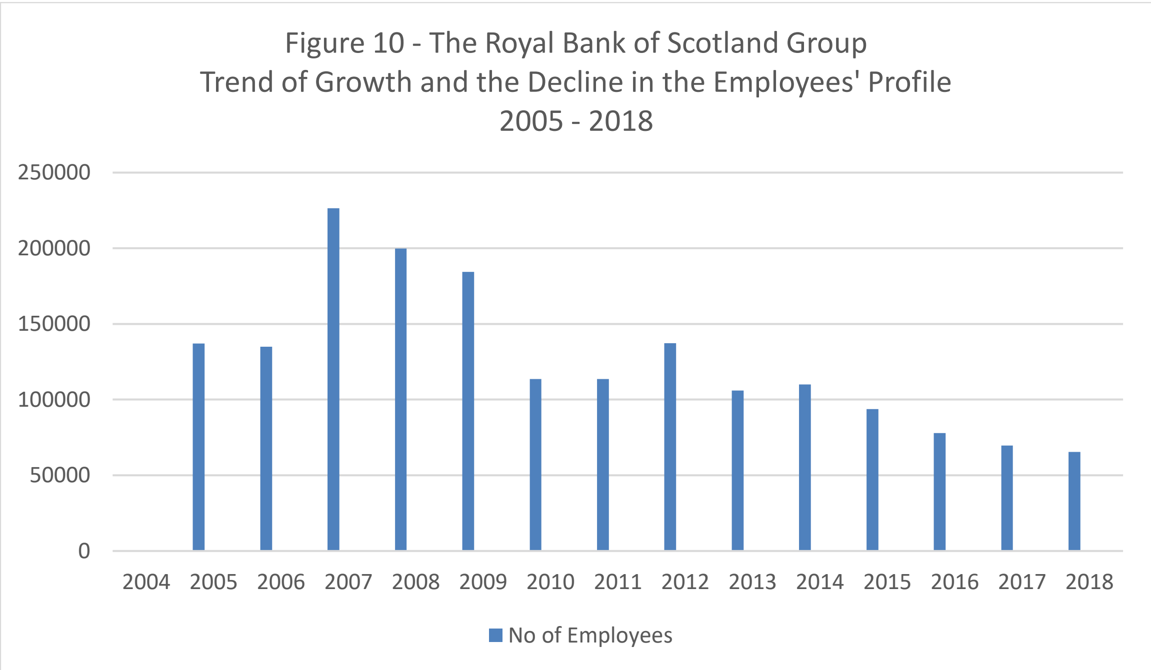

Figure 10 is concerned with the number of staff employed globally by RBS from 2005 to 2018. In 2007 the number of staff employed globally was at its highest, when the bank engaged about 227,000 people but by 2018, the number has reduced to a mere 66,000 staff members.

4.6 Analysis and Interpretation of Extracted Information Collated from the Annual Financial Accounts of the Royal Bank of Scotland in the light of the aim and objectives of the study

Table 5 comprises fourteen columns with the characteristics of each of the columns defined in the headings of each column in the Table. The Table is a numeric extract of key indices about the annual performance of the Royal Bank of Scotland Group for fifteen years starting from 2004 to 2018 as indicated on the first column on the table.

2004 – 2006 Accounts

In the period 2004 – 2006, operating income grew moderately and in relative terms, it was proportionate to the level of increase in the assets. The operating income of £23.4 billion in 2004 increased to £25.9 billion in 2005 (11% increase) and subsequently increased to £28 billion in 2006 (8% growth). The Profit Before Tax in that same period maintained similar growth pattern, the bank having made £7.3 billion, £7.9 billion and £9.2 billion in 2004, 2005 and 2006 respectively. The asset level started to show some signs of galloping increase rising from £588 billion in 2004 to £871 billion in 2006 (48% increase).

The number of employees at an average of 136, 000 for the three years remained within the rage of the bank's usual business. DPS and EPS were consistent in the three years. With the exception of the fact that in the three years under review, total loans exceeded the deposit balance, generally, the statistics for the period remained reasonable when compared with what later happened in the accounts.

2007 – 2009 Accounts

This was when the global financial crisis took place. Although the bank declared increasing income which rose from £28 billion in 2006 to £31.1 billion in 2007, and to £38.7 billion in 2009, total costs eroded all the gains and the year 2008 ended up with an operating loss before tax of £40.7 billion, the highest declared loss ever in the corporate history in the UK.

From 2006 to 2008 the asset increased by almost 300% to £2.4 trillion. In 2009, impairment charges climbed to a phenomenal proportion at £14 billion against £1.9 billion charged in 2006, £2.1 billion in 2007 and £8 billion in 2008. The number of employees reached its highest level of 226,400 in 2007. As the bank rolled in losses from 2008 to 2016, no dividends were paid for nine consecutive years. Signs of liquidity problem persisted till 2012 when the balances on the deposit accounts only started to exceed loan aggregate. Part of the reasons for the unprecedented operating loss in 2008 was due to the exposed weaknesses in the banks' assets and writing down of Goodwill (intangible asset) by about £33 billion.[649] Obligations under IFRS 5 require RBS to state its assets at fair value. The inclement economic environment, the all time low interest rate and the artificial bloating of the derivative assets necessitated revaluation of assets downward and especially the goodwill.

In the particular instance of the RBS, what proved to be the strength of the bank in its centuries of banking business operation was its policy on buying up other financial businesses for its growth through mergers and acquisitions.[650] This also proved to be the bank's greatest undoing in the years leading to the 2007 – 2009 global financial crisis after RBS in conjunction with Fortis and Satander purchased ABN Amro at a cost of about $98.3 billion, a transaction that its timing could not have been worse, and the price and method of payment criticised for being complicit in the ruinous deal.[651]

It was after RBS ran into difficulties in 2008 and bailed out with taxpayers' funds that questions were asked as to why such huge commitment to buy up ABN Amro in a consortium with others was not subjected to the scrutiny and approval of the bank's supervisors. Part of the lessons learnt from the crisis is that a deal at that level would now necessarily be brought to the attention of the bank's supervisor and independent assessors who are to pay close attention to the prudential risks involved before agreement to such acquisitions can go through in the future.[652]

The weaknesses of the nonperforming underlying assets in RBS reflects the exorbitant provisions made for impairment charges in 2009. In addition, the derivative assets were exaggerated due to distortions in the market price at the time.

[649] The Royal Bank of Scotland, 'Annual Report and Financial Accounts' (2008, p.174)
[650] The Royal Bank of Scotland, 'Annual Report and Financial Accounts' (2007)
[651] Op. Cit., (Financial Services Authority, December 2011, p 159, (n. 149)
[652] Ibid. (Financial Services Authority, December 2011, p 264)

In August 2008, following an announcement of a half year pre-tax loss of £691 million by RBS, the company also owned up on the fact that due to some error in the pricing of their derivative assets, the balance on the account was overstated and required a write down.[653] Consequently, in 2009 the derivative asset was eventually written down by a staggering sum of about £600 billion. This declaration led to a widespread indignation and a general public mistrust against RBS.

The group's asset of £2.4 trillion as at 2008 has since been criticised as grossly exaggerated through the group's derivative account.

The positions of the Derivatives Account Balances for five years are as stated below:

2006	£117 billion	P. 140 RBS Group Accounts
2007	£337 billion	p. 121
2008	£992 billion	p. 175
2009	£441 billion	p. 243
2010	£429 billion	P. 128

Looking at the figures, how a conservative balance of £117 billion in 2006 suddenly grew to become almost one trillion pounds assets in 2008 is indeed very disturbing.

Also, part of the difficulties RBS Group faced from 2009 to 2016 arose from the stringent conditions attached to the financial support the bank received from the government during the crisis. These incidences did not only adversely affect RBS Group's performance, as a matter of fact, they almost crippled the bank altogether.

In October 2008, RBS received a lifeline capital injection of £20 billion from the UK government and an additional £19 billion equity stake.[654] As a prerequisite for taking the bailout package, the European Commission imposed a four-year programme of divestment on RBS Group starting from November 2009. The requirement to dismantle RBS subsidiaries had a limited timeframe of only four years starting from 2009. This led to the sale of some of the RBS branch networks around the world including in England, Wales and Scotland.[655] Apart from the requirement to divest,

[653] Op. cit., Financial Services Authority, December 2011, pp 318 – 319, (n. 149),
[654] Op. Cit., J Goddard et al., 2009, (n. 461).
[655] The Royal Bank of Scotland, 'Annual Report and Financial Accounts' (2009, p. 4)

RBS did not meet up with the new regulatory capital requirements as such, RBS had to divest to in order to recapitalise.

The divestment programme led to the sale of the Citizens Financial Group, the US arm of the RBS Group. It also led to the downsizing of the RBS global market, resulting in the group being ultimately decimated from a £2.4 trillion business group to a mere £700 billion company by 2018.

2010 – 2013 Accounts

Following the downsizing in RBS, operating income continued to slide from £38.7 billion in 2009 to £23.7 billion in 2010 and subsequently to £21.8 billion, £17.9 billion and £19.8 billion in 2011, 2012 and 2013 respectively. The operating loss before tax continued to remain a cause for concern. It was getting worse, losses rolling over from 2010 – 2013 and in subsequent years till 2016. There was £200 million loss in 2010, £900 million in 2011, £5.6 billion in 2012 and worse still, £6.8 billion in 2013. Notwithstanding, as reflected by the financial accounts for 2012, core banking operations remained profitable making £6.3 billion OPBT and the commercial banking also yielded £5.3 billion. All these profits were sadly wiped out.

Given the huge amount of impairment provisions made between 2008 to 2013, it may be fair to say that this reflected the poor quality of the assets including subprime assets and other non-performing facilities. Some of the difficulties that the RBS faced then include the inclement business environment of that time, the poor quality of the assets that gave rise to huge impairment charges, divestments that resulted in substantial losses, charges, penalties along with the all-time low interest rate especially the low-income generation on mortgages in the period under review. The adverse impact of low mortgage rate hugely reflected on the poor economic performance of banks when related to a widespread hike in commercial banks' investments in the expansion of mortgage lending during the property boom era in the pre-crisis period, but which later became a burden as the mortgage facilities were not earning a commensurate yield on the level of banks' commitment to the mortgage assets.[656]

[656] J. Cullen, 'Securitisation, Ring-fencing, and Housing Bubbles: Financial Stability Implications of UK and EU Bank Reforms, (2018) Vol, 4 (473 – 118) Journal of Financial Regulation.

By 2013, the RBS's assets had come down to £1.020 trillion through downward asset revaluation and asset disposals. Total number of employees came down by more than half at 106,000 as at 2013. There was a slight improvement in the relationship between deposit and loan accounts as deposit increased to £623 billion against reduction in loan to £564 billion.

Due to the massive public fund of about £45 billion injected into the RBS, understandably there was public outrage and agitation to redress the problems in RBS. This was a top priority at that time. In the period 2008 to 2013, RBS witnessed some changes in their management and the bank continued to remain under the keen attention of the regulators.

In a 452-page report produced by the defunct Financial Services Authority in December 2011, the then banking sector regulator summarised their findings on the causes of the failure in RBS to six major issues. These include a string of poor management decisions made by an ineffective governing body of the RBS, inadequate level of capital which was then tolerated by the global regulatory capital framework in operation prior to the crisis, excessive reliance on short-term wholesale funding which covered up for the deficient liquidity in the bank, poor asset quality which was not previously subjected to any analysis by the supervisory authority, the acquisition of ABN Amro without exercise of due diligence and flawed or absence of effective supervision approach adopted by the regulatory authority at that time.[657]

2014 – 2018

In this period, operating income came to its all-time low at £12.9 billion in 2015, £12.6 billion in 2016, £13.1 billion in 2017 and £13.4 billion in 2018. The reason for this is not farfetched, there has been considerable restructuring through demerger and substantial divestments. There were relatively poor earnings from the assets as a result of nonperforming loan and interest rate was also very low. In addition, there was pressure on the banks due to the need to increase their capital and boost their liquidity position.

On a positive note, for the first time since 2007, the bank had a positive PBT in 2017 in the sum of £2.2 billion and £3.4 billion in 2018. Impairment charges came to about £500 million annually from 2016 to 2018 whilst the bank had a reprieve and

[657]Op. Cit., Financial Services Authority, December 2011, pp 21 – 22, (n. 149).

managed to recoup £1.4 billion in 2014 and £800 million in 2015 out of some of the previously written off bad debt. Total employee came down to 65,400 from a peak of 226,400. For the first time since 2007 the bank managed to declare dividends of 13p.

By 2016 to 2018, RBS had become a very 'lean' organisation with the balance sheet value massively reduced from a £2.4 trillion to a 'mere' £700 billion business.

RBS Group reached a point in 2017/2018 that the company came to the decision to retire some of the state aid previously given to boost the equity capital of RBS. Remarkably, as stated earlier, in these two years, RBS recorded a positive operating profit of £2.2 billion and £3.4 billion respectively. This was the first time in 10 years RBS had a bottom-line net profit. Bottom-line net profit in this context means net profit after taking into account all charges, deductions, appropriations, amortisation and taxes. Thus, in June 2018 the bank redeemed 925 million class B ordinary shares worth £2.5 billion which the government held through the Her Majesty's Treasury.[658]

Column 6 on Table 5 relates to the number of branches of the RBS Group in the UK. Only in three years were the numerical strength of the branches of RBS Group featured in the financial reports. In 2005 to 2007 the group had about 2,300 branches locally. At that time, the large number of branches was a mark of success and position of strength of the bank. However, the requirement to downsize and sell off some of the branches of RBS Group due to the bank obtaining state assistance (and other business exigencies including the need to improve on liquidity which necessitated disposal of branches) de-emphasised the importance of a large branch network in the financial reports of the bank.

Also, as technology improved so that many banking transactions could be carried out using online facilities and by mobile phone applications, this dispensed with the need to physically attend bank branches. So, the importance of large number of branches declined. In order to indicate the widespread usage of internet based and online services, it was reported that about three quarter of active RBS customers are regular digital users, and the digital lending platform allows customers to apply

[658] The Royal Bank of Scotland, 'Annual Report and Financial Accounts' (2018, p. 6)

digitally for secured and unsecured loans of up to £750,000 subject to eligibility criteria.[659]

In regard to column 12 relating to contribution from investment banking, corporate market made consistent contributions to the PBT at an average of £5 billion for about 5 years but as well, the division sustained a huge loss of £8.7 billion in 2008.

Under the new regulations, just as other banks, RBS was under intense pressure to improve their liquidity and equity capital position. Other than to make effort to raise capital from new issues which RBS attempted to do, to improve liquidity position and equity capital at the RBS, a rational thing to do would be to fall back on the non-core banking assets and sell as may be appropriate using the proceeds from such disposal to support liquidity and prop up the capital base. This is in addition to the requirement to divest as part of the conditions for taking State aid.

Quoting from the Financial Times, in March 2015, an Australian Business tabloid, 'Business Insider', reported RBS's plan to massively scale down its investment banking arm by laying off 14,000 out of its 18,000 investment banking jobs.[660]

Column 13 is the available statistics on contributions of the insurance division. The division generated average of £0.8 billion annually for six years.

Column fourteen is concerned with private banking services provided to super rich customers. An annual contribution of £400 million may at first sight appear small in the grand scheme of a bank with assets of about £700 billion. However, the significance of this £400 million net contributions can be appreciated more when one considers that this sector of the bank involves a relatively small group of customers. This is a niche market that does not require an elaborate network of branches, huge operating capital and large numbers of staff. This arm of the banking operation did not close but merged with the retail banking/commercial banking division of RBS.

[659] Ibid, RBS Financial Accounts' (2018, p. 9)
[660] L. Brinded, 'RBS Plans to Cut a Shocking Amount of Investment Banking Jobs' Business Insider, (2015) https://www.businessinsider.com.au/rbs-plans-to-cut-a-shocking-amount-of-its-investment-bank-jobs-2015-3

4.7 Conclusions: Final Review on the Performance of RBS in the Light of the Aim of the Study

Evaluating the annual reports and financial accounts of RBS, the bank's operational performance over a period of fifteen years (2004 – 2018) reveals a taste of what the sweetness of success can be but also, it demonstrates all that could go wrong in a mega bank, the crippling price of failure and the long hard road to recovery.

At the pinnacle of RBS's success in 2007 (if it could be called that), RBS Group served about 44 million customers worldwide.[661] This is more than double the number of customers RBS had in 2005. RBS business' operations extended to fifty-three countries across Asia-Pacific, Europe and America, regions which had a combined population of about 3.4 billion people and combined regional GDP of about $28 trillion.[662] In 2008, the assets of RBS hit £2.4 trillion with employees reaching over 220,000 people worldwide. Such was RBS status that it became the focus of serious attention by the UK government and authorities in Europe. This was more so because RBS assets were only £588 billion four years earlier but rapidly grew to £2.4 trillion in such a short space of time. It could be argued that perhaps RBS took on itself too much too quickly.

In hindsight, Fred Goodwin's tenure of office from 2000 to 2008 was characterised by aggressive drive for mergers and acquisitions some of which turned out to be unprofitable. The CEO was accused of adopting an overbearing leadership style that saw rational questioning on some of his positions on management issues as an unwanted opposition, he was accused of having inordinate pursuit of global influence, desirous of RBS competing at the highest level with giant global banks, a drive that in the end made RBS grew too quickly and temporarily became the world largest bank in 2007, but crashed badly almost before it reached the top.[663] Worse still, the erstwhile CEO was accused of actively encouraging and handsomely rewarding aggressive development, promoting sales of financial products some of which were later considered dubious such as the PPI insurance product that added virtually nothing in real value to the customers.[664] Although the immediate reward of those activities brought the share price of RBS from £4 in 2000 when Fred Goodwin

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[661] The Royal Bank of Scotland, 'Annual Report and Financial Accounts' (2007, p. 11)
[662] ibid
[663] L. Brinded, 'The Sorry History of the Near-destruction of Investment Banking at RBS (2015)
[664] Ibid.

took over to £18 in the height of his popularity, but by the time he left, the share price had come down to 67p and with it, bundles of unending litigation costs, penalties and fines which in 2014 alone gulped £9 billion.[665]

As stated in the literature review chapter, Admati's thought was that the generally prevalent Basel's prescribed equity capital level was the major issue with the high impact banks in the period leading to the crisis and its aftermath. The FSA's report on RBS's failure amply demonstrated that Basel I and Basel II on capital requirements were deeply flawed and inadequate for high impact banks. The FSA admitted its own failure for paying little or no attention to the evaluation of the equity capital levels among high impact banks before the crisis. Neither was FSA mindful to subject the quality of the assets of the bank to any critical review. In this wise, the fault line in RBS accounts only started to emerge following the financial meltdown in the autumn of 2008 when RSB faced liquidity pressure and had to be rescued by the State through bailout financial package. Huge impairment expenses on nonperforming loans also started to emerge in staggering proportion from 2008 – 2013 when the annual cost on impairment charges peaked at £14 billion as indicated on Table 5 column 5. Similarly, in regard to a benchmark of an acceptable liquidity level, even in the so-called good years when RBS was making substantial profit, total loans always exceeded deposits as indicated on columns 10 and 11 on Table 5 leading to RBS' over dependency on wholesale market funds to cover its back for liquidity needs until that source suddenly dried up exposing RBS' years of dangerous walk on the edge.

The immediate cause of the bank near failure in October 2008 was that RBS ran out of direly needed cash resources to continue in business. Then, in a reaction of the wholesale funding market to the large-scale accumulated losses incurred by the bank, there was a growing concern as to whether the bank had the capacity to continue to bear the growing losses.[666] There were doubts about RBS' ability to remain in business. So, in a chain of events starting with the short-term money market freeze on 9th August 2007 to the freefall of the share price of RBS by 35% in the period between 12th May to 2nd June 2008, followed by an announcement of a half year pre-tax loss of £691 million on 8th August 2008 (this was due to credit market write down of £5.9 billion), the wholesale funding providers generally became

[665] The Royal Bank of Scotland, 'Annual Report and Financial Accounts' (2014, p.7)
[666] Op. Cit., Financial Services Authority, December 2011, (n. 149)

reticent towards providing further assistance to the RBS which had by the 7th October 2008 reached a critical emergency situation direly in need of immediate cash resources to continue in business.[667]

It was under these desperate circumstances that the UK government intervened with a condition that Fred Goodwin should step down from his position as the CEO of the bank.

In 2005, Sir George Matthewson, the then Group Chairman, said that the bank had no further plans for large acquisitions, but the bank remained open to evaluating such opportunities, if and when they arose.[668]

In the late 1990s and early part of 2000s before their situation deteriorated, RBS had a high-level efficiency which was maintained across the group, reaping the benefits of economies of scale from acquisitions and integration of the financial institutions acquired by the group. This invariably yielded much more profit for the group than anticipated at acquisitions of the financial institutions.[669] It is true that RBS made many mistakes and the FSA acquiesced to those mistakes in the sense that the FSA failed to follow up any of the key areas of banking supervision as they should have done as attested to by their own report on the failure of the RBS. The FSA did not pay attention to governance of the bank, they did not have a handle over issues around equity capital and liquidity, they paid little or no attention to prudential issues and matters around asset quality.

The argument is that these failings did not happen overnight neither did they have to happen at all. Arguably, the leadership of RBS at the time of the crisis was wholly responsible for the near collapse of the bank and no one else. There were other banks that did not run into the sort of difficulties that RBS found itself. One of such banks is Standard Chartered Bank. Notwithstanding the size and spread of HSBC, the bank also stood the test of time during the crisis. It is not the case that they were not affected by the GFC and it is not the case that they did not have their own record of failings, but they did not take government bailout.

On a positive note, the implication of the changes in the circumstances of RBS is that the ring-fencing policy in addition to newly introduced capital and liquidity

[667] Op. Cit., Financial Services Authority, December 2011, pp 318 – 319, (n. 149)
[668] The Royal Bank of Scotland, 'Annual Report and Financial Accounts' (2005, p.4)
[669] Ibid (The Royal Bank of Scotland, 2005, p 4)

regulations coupled with the new supervisory architecture, these would most likely make RBS safer. However, the bank may still witness more contractions in their business activities as a result of taking the ring-fenced bank out of the mainstream non-ring-fenced bank. This would invariably adversely affect profitability of the bank as a result of the forfeiture of the benefits of economies of scale that would naturally arise due to the ring-fencing policy. Whilst the ring-fenced bank carved out of RBS may be able to carry out corporate financing, it is doubtful whether both organisations as separate entities would be in a position to meet the needs of huge conglomerate customers of the bank as RBS did in their prime.

As pointed out earlier, it is the risky part of investment banking that should have been taken out of the mainstream/non-ring-fenced bank rather than the core depositors' accounts.

Before the global financial crisis set in, an example of the huge benefits of large-scale operation to the bank, which enhanced profitability of the RBS greatly and provided a host of add-on benefits to the economy is found in the annual accounts of the group in 2006 wherein, in a consortium arrangement, RBS collaborated with other financiers to grant £750 million facilities to Pendragon, a national motor retailer group in Birmingham. In the same period, £450 million revolving facility was granted to a Yorkshire company, Croda towards the acquisition of Uniquema. Mitchells & Butlers, a pub and restaurant operator, benefited from £2 billion facilities to fund strategic acquisitions. Barchester Healthcare was provided with a structured facility of £1 billion. Similarly, £300 million revolving credit facility was granted to Manchester Airport and £30 million to SBS Marine to acquire about six vessels. WA Developments Group, which includes the UK's largest haulage company Eddie Stobart, benefited from invoice finance and refinancing packages to assist the group's growth.[670]

These are just few examples of business organisations that got huge funding from the RBS Group with an aggregate sum of about £4.5 billion in just one year. In light of the evidence presented from the RBS Group accounts, this researcher posits that a restriction from accessing core retail deposit accounts as it stands currently is unhelpful to RBS, their customers and the economy notwithstanding that ring-fenced banks can perform corporate lending.

[670] The Royal Bank of Scotland, 'Annual Report and Financial Accounts' (2006, p 17)

Even if ring-fenced banks can carry out corporate lending involving invoice financing, consortium lending, leases to facilitate acquisition of capital-intensive assets such as vessels and aircrafts, the resources available to the newly registered ring-fenced core banking may not be adequate to meet these demanding and capital-intensive services. Where ring-fenced banks are allowed to carry out corporate banking, as pointed out previously in the literature review, just like other banks the ring-fenced bank would need to build up adequate equity capital and liquidity level sufficient to be able to meet up with demands of multinational companies in need of huge financial support.

The argument is that without the benefit of huge resources at the disposal of RBS gained through access to retail deposits, it would not have been feasible to be able to provide such high-level assistance on such a huge scale to those organisations mentioned. The multiplier effects of the huge support to those organisations can be estimated by calculating the number of people that gained employment in those organisations, taxes paid at various levels, improved scale of operations and potential increase in profitability across those organisations, in addition to the resultant growth in the economy.

It is not the case that Manchester Airport, Pendragon etc cannot get alternative sources of funding, but the question is, at what cost? A probable alternative to source huge finance is to approach the capital market. This could be much more expensive and arguably a much more complex route, involving underwriters, accountants, specialist legal services, and other onerous requirements at the primary stock market. On the other hand, with access to retail banking deposits, the cost of capital would understandably be cheaper. These benefits would in turn be passed on to the borrower, leading to cheaper and possibly better services to the end users of the services. Losing out on that benefit is part of the costs of the ring-fencing policy.

It may be argued that operation of universal banking that included multifaceted financial services was not the only cause of the crisis in 2007 - 2009. Poor supervision of the banking sector and defective regulation hugely contributed to the problems. Universal banking has been practiced in Germany for over a hundred years and so also in France.[671] Although following the global financial crisis in 2007 – 2009, the USA enacted the Dodd-Frank Act in 2010 which has similar characteristics to the Steal-Glass Act. A significant part of Dodd-Frank Act was repealed in 2017, with coming into force of the Financial Choice Act 2017. The European Union neighbours refused to adopt the ring-fencing policy in the same way as the UK. What that means is that the foremost banks in the UK would be at a disadvantage competing with the banks in Europe and America that are not subject to the ring-fencing policy. Worse still, at additional costs, multinational corporations in the UK with huge financial needs may have to be seeking financial assistance from multiple sources instead of dealing with just one or relatively few banks where complications arising from perfecting security against loans and advances can be minimised.

[671] Op. Cit., R. Cranston, 2002, n 189.

Section B: Barclays Plc (Group Accounts)

4.8 Barclays Plc: Historical Background, Size and the Structure of the Bank

Barclays Group is a public limited liability company registered in England and Wales. The Registered Office of the bank is 1, Churchill Place, London E14 5HP.

The bank's financial year starts on 1st January and ends on 31st December annually. The accounts are denominated in pound sterling. The external auditors were PricewaterhouseCoopers LL P, Chartered Accountants, London, UK and KPMG LL P, Chartered Accountants, 15 Canada Square London E14 5GL.

By assets, Barclays Plc is the second largest bank in the UK and the 20th biggest bank in the world as at 2018/2019.[672] Due to its huge size, Barclays was considered to be one of the financial institutions that posed systemic risk to the economy in the event of its collapse. [[673]][[674]] At the bank's zenith in 2008, Barclays Plc's assets stood at £2.1 trillion.[675] The bank had about 160,000[676] employees globally, and in 2008, the bank had 1,733 branches across the UK. By 2009[677] it served about 48 million customers globally.[678]

Barclays had a very humble beginning. The highly inspiring and rich history of Barclays began in April 1690 when a 21-year-old young man, John Freame of Cirencester in Gloucestershire veered from his family's textile merchant occupation venturing into the goldsmith/banking business on Lombard Street, London.[679] In the formative years of the bank, the original partners were Quakers whose uppermost business pursuit and ethos were then focused on gaining and protecting the trust of the English merchants of their time.[680]

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[672] Please see Table 3 on page 149 https://fxssi.com/top-20-largest-world-banks-in-current-year Accessed 22/4/2020
[673] Barclays Bank Plc, 'Annual Report and Financial Accounts' (2006, p. 8)
[674] Op. Cit., Financial Stability Board, 2019, (n. 28).
[675] Barclays Plc, 'Annual Report and Financial Accounts' (2008, p. 205)
[676] Ibid (2008, p.23)
[677] Barclays Plc, 'Annual Report and Financial Accounts' (2009, p.4)
[678] Barclays Plc, 'Annual Report and Financial Accounts' (2008, p.4)
[679] M. Ackrell, and L. Hannah, 'Barclays the Business of Banking: 1690 – 1996' (Cambridge University Press, 2001)
[680] Barclays Plc, 'Annual Report and Financial Accounts' (2015, p.6)

Over time, Barclays went through different phases of registration status and name changes. The bank was named Barclays & Company Ltd when it was first incorporated as a company limited by shares on the 20th July 1896 in England and Wales under Companies Act 1862 to 1890.[681] The bank had its name changed to Barclays Bank Plc on 1st January 1985 when it acquired public limited liability (Plc) status pursuant to the Barclays Bank Act 1984.[682]

From 2018, the new structure of the bank comprises a newly incorporated Barclays Bank UK Plc which is the ring-fenced bank formed as a result of the Banking Reform Act 2013. Barclays Bank Plc comprised its International Division, the Head Office and Treasury Functions Division. The ring-fenced bank, Barclays Bank UK Plc and Barclays Bank Plc operate alongside each other, but they are independent of each other in line with the ring-fencing policy. Barclays Bank UK Plc, Barclays Services Ltd and Barclays Bank Plc are all subsidiaries of Barclays Plc.[683]

The ring-fenced bank, Barclays Bank UK Plc was incorporated on 19th August 2015 with registration number 09740322. The implication is that, though the ring-fenced bank is part of the Group, it is economically independent so that the group members cannot rely on the funds in the ring-fenced bank. It has a separate board independent of the group. The ring-fenced bank as a separately incorporated entity is under legal obligation to file its separate returns to the Company House in addition to the returns filed along with the consolidated group accounts of the group members.[684]

4.9 The Nature of Barclays' Business Model and International Outreach

Prior to the global financial crisis in 2007 – 2009, Barclays provided wide ranging generic and specialist financial services which included wealth management, credit card facilities, mortgage services, retail and commercial banking, insurance services, investment banking and investment management services.[685] As at 2006, by market capitalisation, Barclays was known to be one of the biggest financial services

[681] Barclays Bank Plc, 'Annual Report and Financial Accounts' (2006, p. 148)
[682] Ibid (2006, p. 148).
[683] Barclays Plc, 'Annual Report and Financial Accounts' (2017, p. 134)
[684] Barclays Bank UK Plc, 'Annual Accounts' (2020)
[685] Barclays Bank Plc, 'Annual Report and Financial Accounts'(2005, p.1)

providers in the world, operating in over fifty countries world-wide.[686] Barclays is reputed to be the first financial institution that pioneered elaborate branch banking, the first to operate Automated Teller Machines (ATM) and the first financial institution that helped to shape modern international trade finance.[687]

Barclays Bank operated the universal banking model with far and wide global outreach in many countries in Asia, Africa, Europe, United State of America and in South America. Mostly, Barclays is into these businesses either as a joint venture or wholly owned subsidiaries. As at 31st December 2005, Barclays had twenty-eight principal subsidiaries out of which sixteen were in the UK with the other twelve spread worldwide.[688] Prior to the global financial crisis in 2007 – 2009, Barclays followed a business model which embraced expansion through organic growth by ploughing profits back into the business and the bank had a long history of growing its businesses through mergers and acquisitions. Growing its business through mergers and acquisitions is not new to the bank. For over one hundred years, mergers and acquisitions strategies served the bank's interest very well especially when such activities were limited to takeovers of commercial banking institutions. The increased appetite for far- and wide-ranging acquisition of other financial institutions eventually proved to be the undoing of the bank in the past twenty years or so.

For example, in 1896, Goslings Bank, Gurney's Bank and Backhouses Bank came together in a merger to join Barclays Bank under the name Barclays and Co. Similarly, in 1918, Barclays acquired London Provincial and South Western Bank, in 1919, British Linen Bank joined Barclays, in 1925, National Bank of South Africa, the Colonial Bank and the Anglo-Egyptian Bank came together under Barclays (Dominion Colonial and Overseas, (Barclays DCO), in 1975 Mercantile Credit joined Barclays,[689] in 2000 Woolwich became part of Barclays and so was Lehman Brothers in 2008. These are just a very few of the many mergers and acquisitions that Barclays was involved in in the past 100 years or so. These mergers and acquisitions across different parts of the world could not have been less than a hundred of them. After deregulation of the 1980s, mergers and acquisitions became too frequent and widely

[686] Op. Cit., Barclays Plc 2006, p. 148, (n. 681).
[687] Op. Cit., Ackrell, M. and Hannah, L. 2001, (n. 679).
[688] Barclays Plc, 'Annual Reports and Financial Accounts' (2005, p.209)
[689] Op. Cit., M. Ackrell and L. Hannah, 2001, (n. 679).

diversified into businesses that had little or nothing in common with core banking business.

In 2012, Barclays was embroiled in London Inter-Bank Offered Rate (LIBOR) manipulation scandal that led to serious damages to the credibility of the bank and which attracted huge fines. But for some of these wider issues including investment banking transactions that went sour, complicity in the manipulation of LIBOR rates, exchange rates fixing scandal, accusation over money laundering, illegal tax avoidance schemes and sale of questionable financial instruments that Barclays Bank got itself involved in in the past 30 years or so as reviewed later in this thesis, the bank which has been in operation for about 330 years would have easily passed as one of the oldest and finest financial institutions not only in the UK, but in the world.[690] The impact of the fines on the economic performance of the bank is discussed in the financial analysis.

In the course of its very long existence spanning over three centuries, Barclays did not only weather the storms of several financial crises detailed in the literature review, but the bank also survived the impact of two World Wars. The bank thrived in those difficult years.

Barclays was also adversely affected by the 2007 – 2009 global financial crisis just as other banks and financial institutions in the UK were. However, unlike the RBS that took the UK government's bailout packages with the attendant adverse consequences expounded on in Section A, Barclays sought a different route for assistance by seeking external cash ingestion of £6.1 billion from Qatar's government. Barclays also sold several of its businesses to resolve its liquidity crisis and to shore up the inadequate capital status of the bank.

Although Barclays maintained some marginal growth in its income generation capacity during the period of the crisis, most of the profits ended up being eroded by huge impairment charges caused by the poor quality of its financial assets, low interest rate, fines for infringements and losses incurred on sale of assets. As indicated below on Table 6 column 9, the bank was only able to pay modest dividends to shareholders all through the period of the global financial crisis.

[690] Op. Cit., A. Salz and R. Collins, 2013, (n. 49)

As mentioned previously, in the heat of the crisis, whilst RBS accepted a government bailout option which turned out to be like the proverbial poisoned chalice, shrewdly, Barclays rejected the offer of a bailout package from the UK government. Instead, Barclays sought and negotiated for a cash ingestion from Qatar's government which yielded a loan package of £6.1 billion to Barclays.[691]

About ten years thereafter in 2017, the UK Serious Fraud Office (SFO) brought up a criminal case for unlawfully obtaining financial assistance from a foreign government against the bank and four of its former directors. The FSA also accused the bank of inadequate disclosure on fees paid for arranging the infusion of capital from Qatar's government. Southwark Crown Court in London promptly dismissed the case against Barclays. A further attempt was made by the UK's anti-fraud agency to reinstate the case in the High Court on the account of an alleged loan of £2.3 billion granted by Barclays to Qatar and which Qatar reinvested in Barclays.[692] This is concerned with providing assistance to buy own shares. That case against Barclays was also dismissed.

It is not too difficult to see why these cases were dismissed. Foremost, for a criminal indictment to validly lead to a conviction, two legal tests must be met. This is concerned with satisfying the court about the (i) *Actus Reus* and, (ii) the *Mens Rea* of the case.[693] The first leg is concerned with the fact that the accused committed an offence that is known to law (indictable offence). The second leg which is the mental element is that, in so doing, the defendant had a "guilty mind", that is, the accused either had the 'intention' to commit the crime or that the accused negligently or recklessly committed the offence.[694]

It may be difficult to persuade the court that the bank committed an offence by seeking a loan for its survival from another country that is not an enemy nation. It would have been difficult to persuade the court about a criminal intent if there were no corrupt personal gains in the transaction. If the first leg of the prerequisite conditions for a guilty verdict failed, the second leg stood very little chances of leading to a conviction except if there was a case of corrupt enrichment established against those who arranged the finance. In such event, it is the individuals behind

[691] R. Davies, 'Barclays Avoids Trial Over £6 billion Qatar Rescue package' (The Guardian 26/10/2018) https://www.theguardian.com/business/2018/oct/26/barclays-avoids-trial-over-6bn-qatar-rescue-package
[692] Ibid
[693] D. Ormerod and K. Laird, 'Smith, Hogan & Ormerod Criminal Law 15th ed' (Oxford University Press, 2018)
[694] M. Jefferson, 'Criminal Law 12th Ed' (Pearson Education, 2015)

the crime that would bear the consequences not Barclays. Secondly, in the case of providing financial assistance to buy own shares, though there is a general prohibition against public company giving financial assistance to buy own shares, it is not an absolute rule.

There are some exceptions to the general rule. One of such exemptions is found in the Company Act 2006 s.678 (2) b where it says,

> *"…the giving of the assistance for that purpose is only an incidental part of some larger purpose of the company and the assistance is given in good faith in the interest of the company."*

This legal provision was available to Barclays to defend themselves against the litigation brought against Barclays.

In the circumstances of Barclays at that time, the bank was in a dire situation. Under a private arrangement, the bank secured some cash ingestion of £6.1 billion from Qatar's government and much later after the storm was over, Barclays granted a loan of £2.3 billion to Qatar government's nominee company to purchase shares in Barclays on behalf of Qatar government. So, the circumstances under which the loan was given are totally different to the usual conditions that apply when approaching the capital market to buy stocks. The loan to purchase the shares was given in good faith and it was in the best interest of Barclays to grant the loan as it did. Barclays benefited more and owed its survival to the £6.1 billion given to support Barclays by Qatar government at a very crucial time. It is therefore unsurprising if on the basis of the provisions of the Company Act 2006, s.678 (2) b, the court dismissed the cases against Barclays. The reasons for the dismissal of both cases are not too complicated. Taking legal advice from appropriate professionals may have obviated the need to take the matter to the court.

In view of the onerous preconditions imposed on RBS by the European Commission before RBS could take the much-needed bailout financial packages and the consequential decimation faced by the bank as stated under Section A, the argument is that it made a lot of commercial sense for Barclays to seek alternative ways of dealing with the liquidity problems that came with the global financial crisis in 2007 – 2009 than to follow the disastrous path that RBS took.

In conclusion, Barclays' longevity spanning over three hundred years should be seen as a remarkable achievement, and that durability is in itself a testimony to the ruggedness of this extraordinary British-Branded iconic global financial institution that has been out of favour in the eyes of the public in recent time due to Barclays management's contributions to the global financial crisis.

4.10 Table 6 – Tabulated Data Extracted from the Annual Reports and Consolidated Financial Accounts of the Barclays Group From 2004 to 2018 (Financial Year Ending on 31st December Annually)

Year	Total	Operating	Total	Impairment	Branches	Employees	Earnings	Dividend	Total	Total	Investment	Contribution	Contribution
	Income	Profit	Assets	Charges			Per	Per	Deposit	Loan	Banking	Insurance	Wealth
		Before Tax					Share	Share			£ (b)		Management
	£ (b)	£ (b)	£ (b)	£ (b)		000	(pence)	(pence)	£ (b)	£ (b)	12	£ (000)	£ (000)
1	2	3	4	5	6	7	8	9	10	11		13	14
2004	14	4.6	538	1	2,891	83	51.0p	24.0p	330	343	1		0.1
2005	17	5.2	924	2	3,545	120	54.4p	26.6p	316	300	1.3	0.6	0.2
2006	22	7.1	997	2	3,627	132	71.9p	31.0p	339	313	2.2	0.6	0.2
2007	23	7	1,227	3	1733UK	135	68.9p	34.0p	386	386	2.3	0.5	0.3
2008	23	6	2,053	5		156	59.3p	11.5p	450	510	1.3	0.2	0.7
2009	29	4.6	1,379	8	1700 UK	144	86.2p	2.5p	399	461	2.5	-	0.1
2010	31	6	1,490	6	-	148	30.4p	5.5p	424	466	4.8	-	0.2
2011	32	5.9	1,564	6	-	141	25.1p	6.0p	458	479	3	-	0.2
2012	29*	7*	1,490	4	-	139	34.5p	6.5p	464	466	4	-	0.3
2013	28	5.1	1,312	3	-	140	16.7p	6.5p	483	468	2.5	-	(0.1)
2014	25	5.5	1,358	2	-	132	17.3p	6.5p	486	470	1.4	-	-
2015	25	5.4	1,120	2	-	129	16.6p	6.5p	465	441	1.6	-	-
2016	21	3.2	1,213	2	-	119	10.4p	3.0p	471	436	2.7	-	-
2017	21	3.1	1,129	2	-	80	-	-	467	402	2	-	-
2018	21	3.5	1,133	2	-	84	9.4p	6.5p	395	326	2.6	-	-

Note: The asterisk ** in column 2, Year 2012 concerning £29 billion total income and Column 3 regarding £7 billion Operating Profit Before Tax are receipts which were not part of the ordinary trading income but proceeds of sale of non-core assets. This is explained further under the analysis.

4.11 The Constituents of Table 6

Table 6 above contains the tabulated data regarding the financial summaries extracted from the Annual Reports and Financial Accounts of Barclays Bank over a period of 15 years starting from 2004 to 2018. The first three years' accounts from 2004 to 2006 represent the good years immediately preceding the global financial crisis. The next three years from 2007 to 2009 were the years when the crisis took place. Thereafter, the next three years 2010 to 2012 was the period of planned government's response to the financial crisis while the next six years from 2013 to 2018 was the period of moratorium granted to the banking sector to prepare for the full implementation of the ring-fencing policy within the Banking Reform Act 2013. The legislation was the embodiment of the UK government's response and intervention agenda regarding the global financial crisis.

Appendix 2 at the back of this report contains page reference numbers indicating the pages in the Annual Reports and Financial Accounts where the financial summaries were extracted.

The Table comprises fourteen vertical columns with self-explanatory headings indicating the variables contained in each column. The horizontal rows are the values of Key Performance Indicators (KPI) recorded on an annual basis.

Figures 11 – 18 below are graphical presentation of the variables on Table 6 in chart form to illustrate visually the relationships between the variables indicated on the headings of each chart. Beneath each chart is a summary providing at a glance the result generated from the chart.

The numerical values of both 'X' and 'Y' axes of each chart are presented in Appendices 11 to 17 at the back of this report.

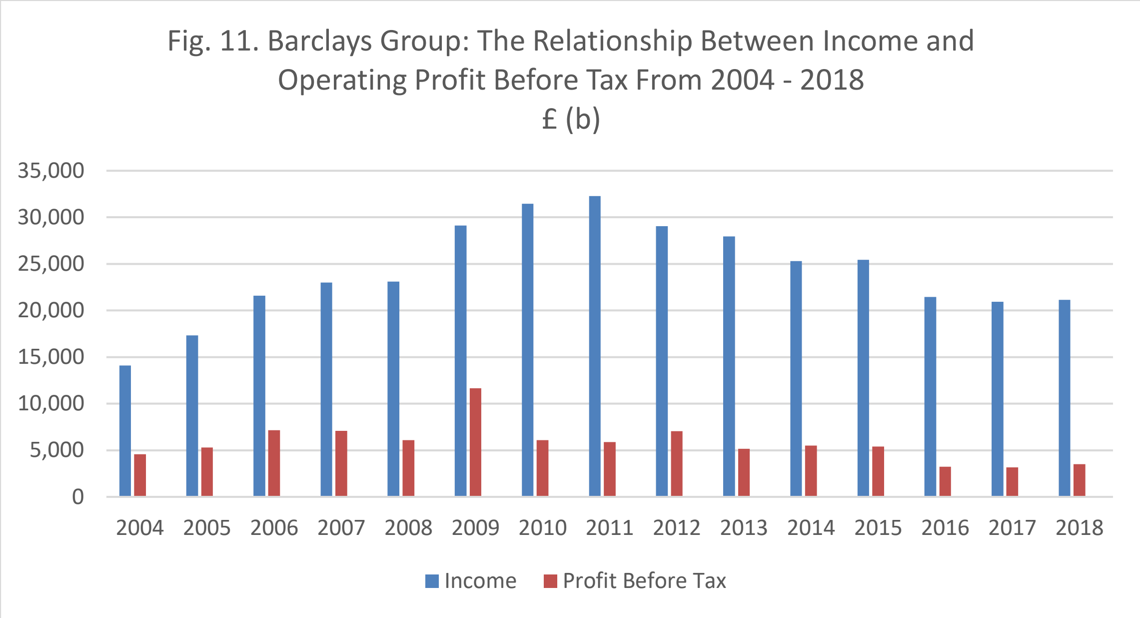

Fig 11 shows the relationship between the Barclay Group's annual income and annual operating Profit Before Tax listed on columns 2 & 3 of Table 6. Generally, the chart indicates a steady growth in the annual income which peaked at £32 billion in 2011. Thereafter, from 2012 income began to slide and did not recover in any significant way before 2018. Remarkably, PBT did not grow in proportion to the increase in annual income. The reason for this is that the overhead costs, fines, levies and other charges kept increasing at a faster rate than the annual income. As well, interest rate was low, the underlying assets were overblown in 2008, there were weaknesses in the assets including Nonperforming Loans.

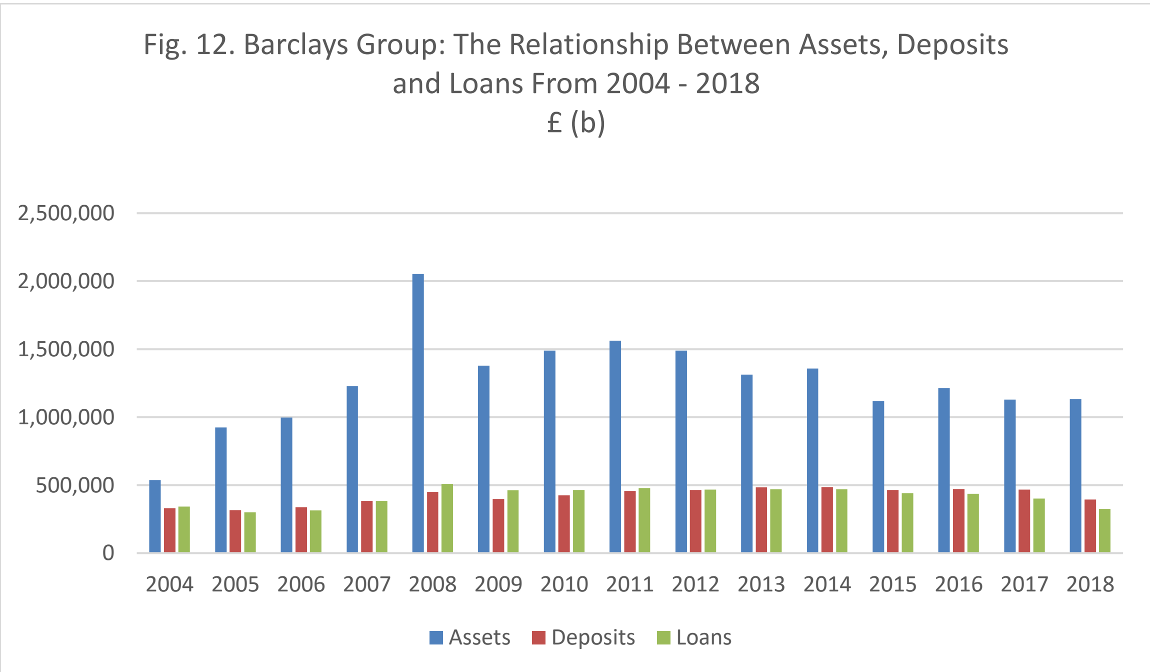

Fig. 12 is the chart relating to Barclays Group's assets, deposits and loan profile as they stood on the balance sheet date, 31st December annually listed in columns 4, 10 & 11. The total assets grew rapidly from a modest £538 billion in 2004 to a peak of £2.1 trillion 2008. The bank struggled in 2008 to 2011 to keep deposit above aggregate loan profile. Total loan should not have exceeded the total deposit. This is indicative of poor liquidity position. However, from 2013 to 2018 there was a recovery in which deposits exceeded loan for five consecutive years.

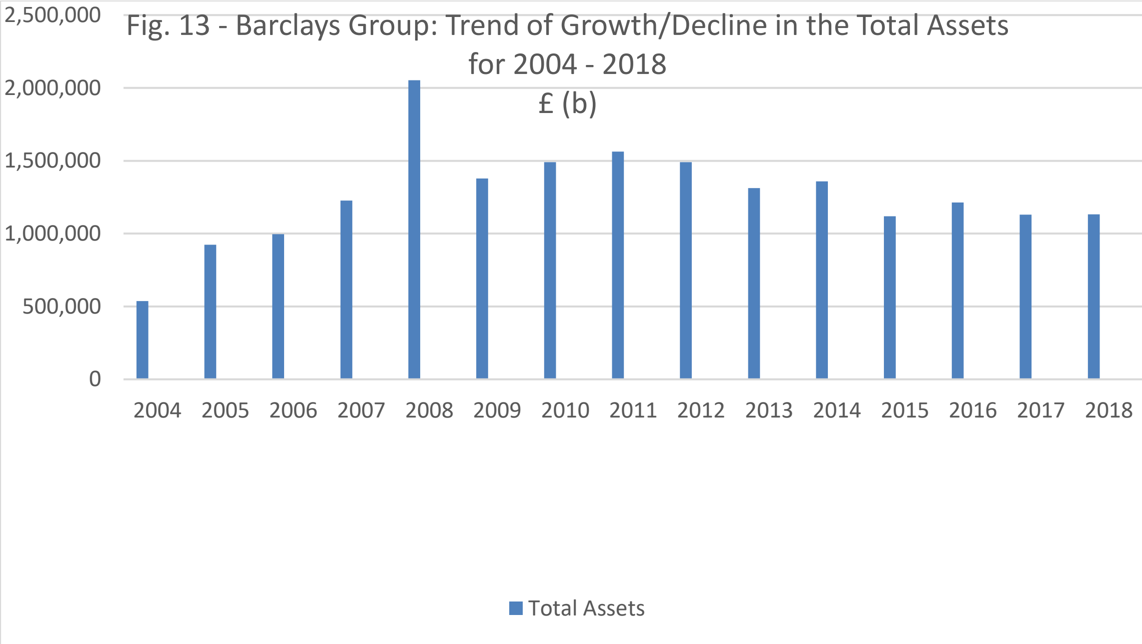

Fig. 13 is a graphic display of the movements in the Barclays Group's total assets on annual basis as listed on Table 6 column 4. After a deep fall in the bank's asset by £700 billion in 2009, the subsequent undulating movements in the value of the assets remained well controlled from 2010 - 2018. The substantial dip by about £700 billion was due to revaluation of derivative assets which was previously overstated.

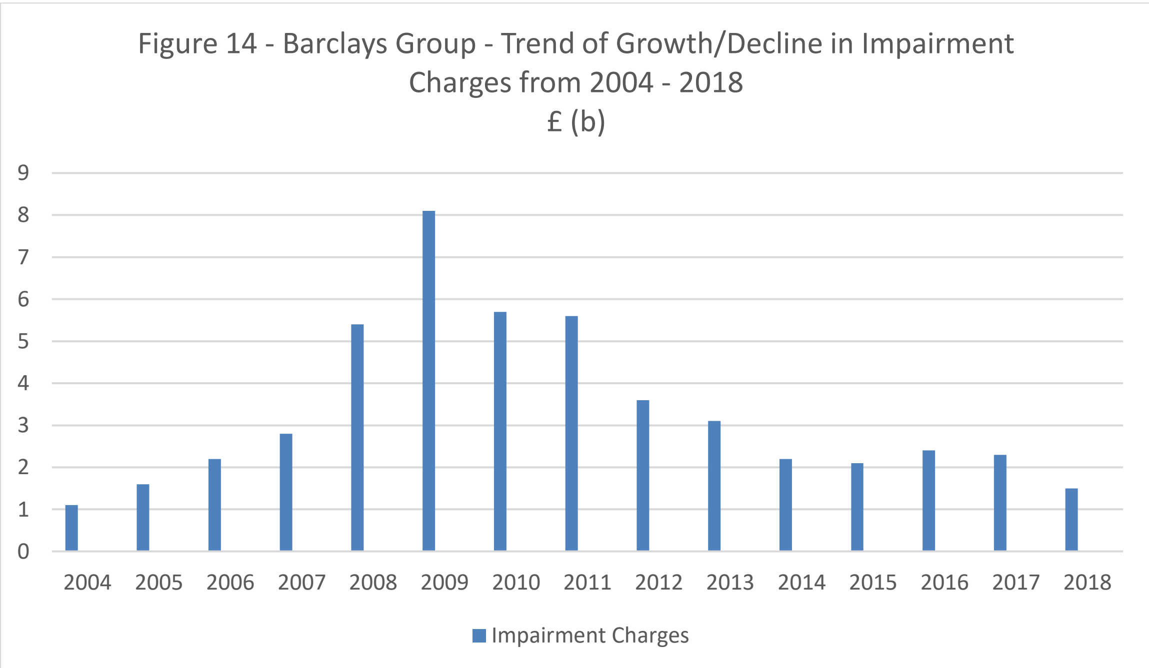

Fig. 14 is concerned with Barclays Group's provisions for impairment charges on annual basis over a period of 15 years as listed under column 5. The worst tide of impairment charges was between 2008 to 2011. The worst of it all was when the bank made a provision of £8.1 billion impairment charges in 2009. This indicates an expectation of a significant fall in the value of the bank's assets due to devaluation in assets and increase in the nonperforming loan facilities.

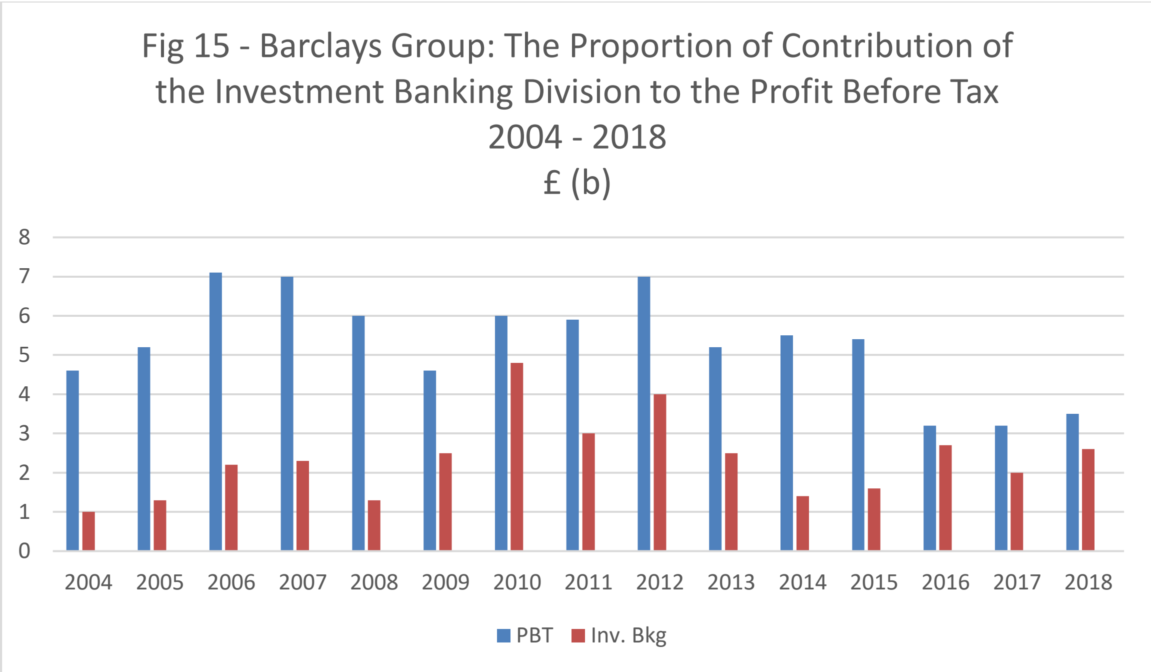

Fig. 15 is a chart on the contribution of investment banking income to the PBT of Barclay Group from 2004 to 2018 as stated in column 12 on Table 6. Remarkably, investment banking contributed 79% to the PBT of Barclays in 2010, 82% in 2016, 65% in 2017 & 74% in 2018. These statistics underscore the importance of the investment banking division of the bank to the profitability of the bank. Whilst that arm of the bank's business was initially profitable, through mismanagement and exponential growth beyond what Barclays was prepared to handle and several scandals that Barclays was embroiled in, that division of the bank was substantially reduced from 2015.

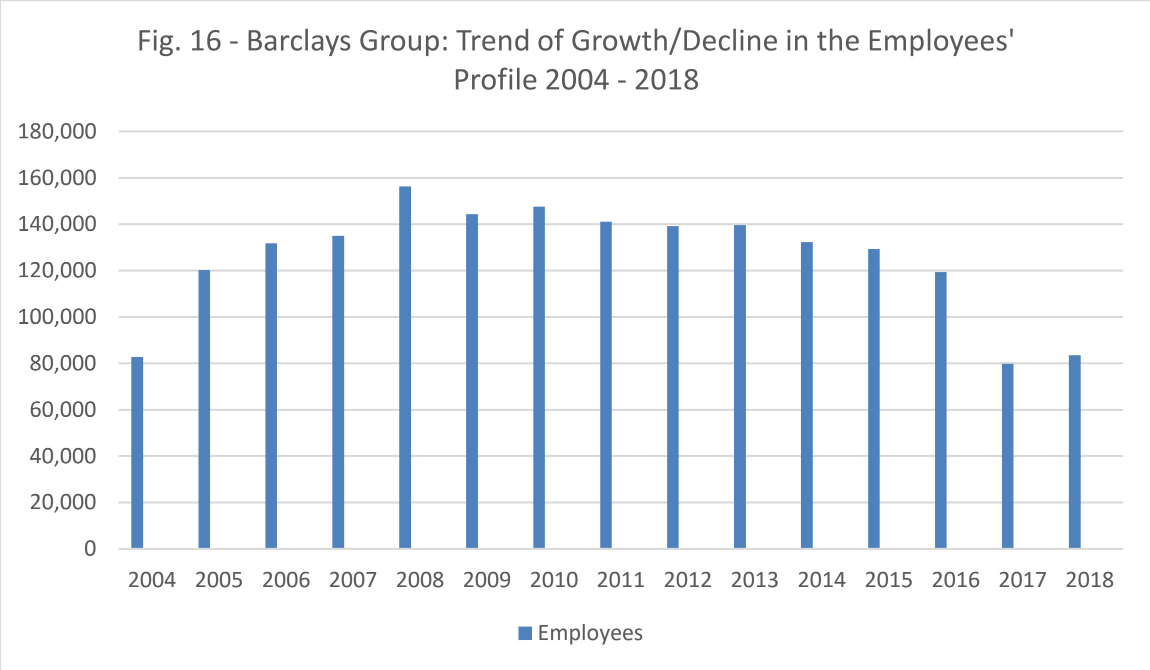

Figure 16 is a graphical presentation of the growth and decline in the annual level of employees of Barclays Group as listed on column 7. At its highest, Barclays Group had about 153,000 staff members which reduced to 83,000 by 2018. The decline followed a huge divestment and discontinued operations of several of the bank's businesses across the globe.

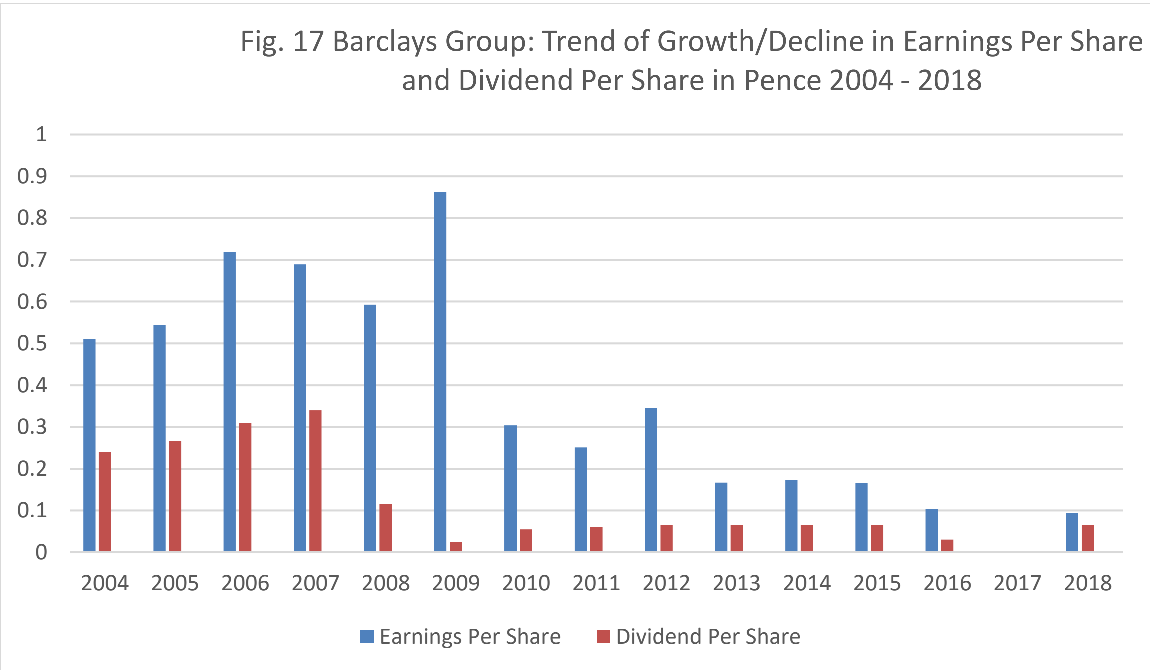

Figure 17 shows the decline in earnings per share over the years understudy and the relatively low dividend paid per share over same period. There were no dividends paid in 2017.

4.12 Analysis and Interpretation of the Extracted Information Collated from the Annual Financial Accounts of Barclays Bank Plc in the light of the Aim and Objectives of the Study

Some of the Key Performance Indicators (KPI) examined in order to draw conclusions from the data include income generation level of the business, operating profit before tax, changes in asset level, impairment charges, earnings per share, dividend per share, deposit held in relationship to loans and advances, and a summarised contribution to income received from the investment banking, insurance and wealth management services divisions of the Barclays Group.

Income and profit could be thought of as synonymous terms, but they are not.[695] In the context of this study income is differentiated from profit. Income is defined as the combination of revenue received as interest on loan accounts, advances, fees and commissions received for services provided, earnings from insurance premiums less direct costs and impairment charges.[696] On the other hand, Profit Before Tax is the aggregated income less total operating expenses (associated direct and indirect costs) before tax.

The trend in the level of income generated by a business is an important performance indicator that enables assessors to see whether the business is gaining or losing its hold on its market share. More importantly, this performance marker enables managers to assess whether their assets are being effectively deployed to generate sufficient income level that meets the bank's budget and whether costs are justified by the level of income being generated by the business.[697]

4.12.1 Analysis for 2004 - 2006

In the case of Barclays Group, steady growth in income level was maintained from 2004 to 2006. In 2005, the bank had 23% increase in its income level above 2004 and about 25% increase in the year 2006. As at 2004, the annual income was £14.1 billion which increased to £17.3 billion in 2005 and £21.6 billion in 2006. This

[695] D. Alexander et al., 'International Financial Reporting and Analysis' (Cengage Learning, 2014, p.62)
[696] Barclays Plc, 'Annual Report and Financial Accounts' (2007, p. 176)
[697] E. McLaney and P. Atrill, 'Accounting and Finance 8th Ed' (Pearson, 2016, p.70)

growth in the income level reflects the corresponding substantial increase in the Barclay's assets which increased by 72% between 2004 and 2005.[698]

The increase in assets was largely due to the purchase of 57% controlling shares in a top South African bank, Absa Group Ltd, in 2005.[699] A significant feature in the financial accounts of Barclays Plc in the period before the crisis shows that the bank exploited opportunities to acquire interests in other financial institutions. Other examples besides the purchase of Absa Group include EquiFirst Corporation which was purchased for about US$225m in 2006, Indexchange Investment AG which was purchased for about €240m on 8th February 2007,[700] and purchase of part of Lehman Brothers' businesses in North America.[701] These purchases provided the explanation for the significant jump in the assets of Barclays from £996 billion to £1,227 billion in 2007. The subsequent increase from £1.2 trillion to £2.1 trillion in 2008 as indicated in Table 6 has been criticised as inflated value. This is fully discussed in the 2007 – 2009 review. The increase to £2.1 trillion was mostly due to a sudden jump in the derivatives account from £120 billion in 2007 to £968 billion derivative assets in 2008, a difference of £848 billion.[702]

The operating profit before tax also grew commensurately with the income level having had PBT of £4.6 billion in 2004 which increased to £5.2 billion in 2005 and £7.1 billion in 2006 respectfully. This positive performance is further demonstrated by the growth in the earnings per share and dividend paid out in that period.

Other performance indicators on Table 6 for the period 2004 – 2006 including earnings per share and dividend per share indicate all-round growth in 2004 - 2006. For example, EPS in 2004 was 51.0p. It increased to 54.4p in 2005 and 71.9p in 2006. These were years of good harvest which enabled a dividend of 24.0p, 26.6p and 31.0p to be paid to shareholders in 2004 – 2006. Now with the benefit of hindsight, in 2004 – 2006 impairment charges were under control. Impairment charges relate to a provisional amount set aside to defray possible future demurrage in assets and provision for non-performing accounts and unsecured loans that may run into difficulty.

[698] See Table 6 Column 4
[699] Barclays Plc, 'Annual Report and Financial Accounts' (2005, p.6)
[700] Barclays Plc, 'Annual Report and Financial Accounts' (2006, p.225)
[701] Barclays Plc, 'Annual Report and Financial Accounts' (2008, p.12)
[702] Ibid (2008, p.9)

If provisions for impairment charges are growing very high too quickly, it would give the bank management and the bank supervisors cause for concern, as an increase in impairment charges means more financial assets are facing devaluation or that more loans and advances accounts are becoming non-performing thus provisions are made for those accounts against risks of possible losses.

With widespread use of mobile phone banking apps and on-line real-time access to bank accounts, increase in the number of bank branches is no longer seen as a particular strength of a bank. In 2004 – 2006 increase in the number of bank branches was seen as one of the important parameters for measuring growth and achievements of a bank. In 2004, globally the number of Barclays branches grew from 2,891 to 3,627 by 2006. After 2009 only a passing reference was made to the numbers of Barclays' branches in the UK which was stated to be above 1,700. From 2010 – 2018, Barclays stopped mentioning the size of the network of branches the bank had.

The aggregate number of employees in 2004 increased from 82,700 to 131,700 in 2006.

As indicated in columns 10 and 11 of Table 6, in the years 2004 to 2012, total loans and advances were more than the deposit accounts. This implies stress in the bank's liquidity ratio and increased risk level. It is a marker of Barclays' struggle to keep in control the increasing level of loans and advances accounts relative to the total deposit accounts. The aggregate loans and advances are not expected to be more than the total deposit accounts. The liquidity problem in Barclays was at its worst in 2008 when loans and advances exceeded deposit by £60 billion and in 2009 when loans exceeded deposit by £62 billion.

This precarious liquidity position and requirement to bolster capital requirement under Basel III led to massive divestment from non-core banking businesses in America, Europe and South Africa. A whole division, Barclays Global Investors was sold. From 2012 Barclay started to regain control of liquidity for the next six years. In 2018, deposit was more than loans and advances by £69 billion.

The years 2004 - 2006 were the good years of banking operations for Barclays, before the global financial crisis of 2007 – 2009 set in.

4.12.2 Analysis for 2007 - 2009

In the period of the global financial crisis in 2007 – 2009, the intense decline in the economic performance of Barclays is remarkably palpable. A casual look at the income level shows only a slight increase of 7% in 2007 having achieved an income level of £23 billion. Then there was only 0.5% growth in income in 2008 when the income level increased to £23.1 billion and a further increase of 26% in 2009 when the income level attained £29.1 billion. However, within the £29.1 billion income in 2009 was an income of £6.3 billion made from the sale of Barclays Global Investors, a division of the bank.[703] Thus, this income was not derived out of the ordinary day to day business of the bank. It was an income derived by disposing some of the bank's assets.

Therefore, the increase in income recorded between 2007 – 2009 for Barclays is only small and pales into insignificance when viewed against the backdrop of the fact that assets of the bank increased from £997 billion in 2006 to £2.1 trillion in 2008. The point is that, if £997 billion assets generated £21.6 billion income level in 2006 and PBT of £7.1 billion, all things being equal, assets of £2.1 trillion would be expected to generate an income level that is about twice the amount earned in 2006 instead of the relatively small sum of £23.1 billion income and £6 billion PBT earned by the bank in 2008.

The reasons for the inconsistency in the income level and the lacklustre profit before tax earned in the period under review are not farfetched. There was substantial increase in the balance sheet figures which arose from £997 billion in 2006 to £2.1 trillion by the end of the year 2008. That large increase was due to overstated derivatives account and the purchase of Lehman Brothers that was then burdened with subprime assets. Included in the huge balance sheet figure is a considerable jump in the derivative accounts which was only £120 billion in 2007 but astronomically increased to £968 billion by 2008, a difference of about £848 billion. The historical balances on the derivative accounts revealed the following on the balance sheet dates from 2006 – 2011.

2006 – Derivative Financial Instruments - £141 billion on page 12, 2006 Accounts
2007 – Derivative Financial Instruments - £120 billion on page 177, 2007 Accounts

[703] Barclays Plc, 'Annual Report and Financial Accounts' (2009, p. 3)

2008 – Derivative Financial Instruments - £968 billion on page 205, 2008 Accounts

2009 – Derivative Financial Instruments - £417 billion on page 206, 2009 Accounts

2010 – Derivative Financial Instruments - £420 billion on page 74, 2010 Accounts

2011 – Derivative Financial Instruments - £539 billion on page 177, 2011 Accounts

Foremost, the bulk of the overstated value of the derivative instruments was because of distortions and inflated prices of the derivative instruments. Secondly, the ballooned balance sheet figures and the derivates were also largely due to Barclays' merger and acquisition of some financial institutions in 2007 – 2008 especially the takeover of the investment trading arm of Lehman Brothers that included large swathe of derivatives valued in hundreds of billion pounds in 2008.[704] Some of the other financial institutions acquired during that period as stated earlier on, which caused the expansion of Barclays assets include Absa Group Ltd in South Africa, Equifirst Corporation, Indexchange Investment AG. At that time, it transpired that Barclays took an over optimistic view of the value of these instruments. Hence, within a year thereafter in 2009 when reality settled in, derivative assets were revalued downward leading to a massive write-down in 2008 from £968 billion to £417 billion in 2009, making a difference of about £551 billion net of trading on that account for that year. In essence, the revaluation cleaned out about £551 billion out of the balance sheet as at 31st December 2009.

The overall effect is that the income as at 2008 was not commensurate with the huge balance sheet figure of £2.1 trillion. At the same time, there was a general low interest rate which caused reduction in the yield on the assets held, there was growing nonperforming accounts which induced large impairment provisions that peaked at £8 billion in 2008, there was also inclement business environment caused by the overheated economy brought about by the global financial crisis. As well, there were fines for regulatory breaches and remediation for mis-sold financial products. The cumulative effects of all these took its toll on the profitability of the bank in that period.

In September 2008, Barclays took over several of Lehman Brothers' businesses including the skyscraper headquarters of Lehman Brothers in New York at a cost of

[704] Op. Cit., B. Casu, et al., 2015, p. 267, (n. 138).

almost £1 billion, Lehman Brothers Canada Inc, Sudamerica, Uruguay and New Jersey data centres. In addition, Barclays took over Lehman Brothers' investment banking division and the trading operations. In the process, the securities, trading liabilities, private investment management business and responsibility over 9000 former employees of Lehman Brothers were all taken over by Barclays. [[705]][[706]]

As well, Barclays needed some time to settle in as the new owners of Lehman Brothers' business operations and all other businesses purchased at that time. Sufficient time would be required to be able to turn around the businesses that Barclays took over assuming they were able to do so especially in view of the inclement business environment at the time and the fact that Lehman Brothers was overpriced.

Acquisition costs under various headings such as legal fees, arrangement fees, valuation fees, commissions, charges, taxes etc on several financial institutions purchased at that time including a huge institution like Lehman Brothers can be expected to be very high.[707] The details of these costs are not explicitly specified in minute detail in the accounts of Barclays. Also, the company's policy on how such costs were treated by the Barclays was not specifically indicated in the annual report.

However, there are two broad methods on how to deal with such costs. (i) The full costs of mergers and acquisitions under different subheadings may be fully absorbed into the profit and loss account in the year in which costs were incurred. (ii) Alternatively, Barclays may opt to use amortisation method.[708] Under that method, the costs may be spread equally on a straight-line basis over a period of say 5 years or more, so that the total costs would be written down gradually and totally defrayed by the end of the 5th year or at the end of a predetermined number of years. Barclays may also use a method by which deduction may start low and then subsequent annual charges getting higher util the costs are fully paid at the end of

[705] Ibid. B. Casu, et al., Pearson, 2015, p. 267, (n. 138)
[706] D. Teather, et al., 'Barclays to Buy Lehman Brothers' Assets' (The Guardian, London 17/09/2008)
[707] A. Docherty and F. Viort, 'Better Banking: Understanding and Addressing the Failures in Risk Management, Governance and Regulation' (John Wiley, 2014, p. 215) These authors cited examples of instances of high transaction costs including an example of when Barclays paid a fee of £366 million to raise £7 billion capital in 2008
[708] Op. cit., G.D. Morris, 2005, p. 468, (n. 618).

the fifth year, or it could start with large amounts and gradually reducing the annual contributions towards the costs over a period of 5 years till the costs are fully paid. The relevance of this analysis to the study is the cost implications and how they affected profitability of the bank in the period under evaluation. If Barclays adopted the first method, then this may have had significant impact on the income and profit before tax for the year because that would have meant that the full costs for all the financial institutions acquired in that period were charged to the profit and loss account for the year which could have resulted in a significant reduction in the profit for the year.

In addition to all of these was the general dislocation in the market during the global financial crisis which no doubt affected the general performance of Barclays in those years as much as they affected other financial institutions. This is more so with the credit crunch, the burden of reduced interest income from mortgage accounts as a result of low interest rate on mortgages and the pressure on banks to meet up with capital and liquidity requirements.

In 2009, Profit before tax crashed down to £4.6 billion from £7.1 billion in 2006. But for the income of £6.3 billion made from the sale of Barclays Global Investors in 2009, Barclays would have had a negative PBT in 2009. Impairment charges rose to an all-time high in the sum of £8.1 billion against £2.2 billion in 2006 before the crisis began. It may well be the case that a large part of the costs of acquisitions mentioned earlier came through in 2009 leading to the very low PBT in 2009.

As mentioned previously, the expectation is that at least the aggregate loans and advances should not exceed the level of deposits but for five consecutive years in 2008 – 2012, Barclays was unable to put the disparity under control. This is indicative of poor liquidity position of Barclays at that time.

These statistics serve to further demonstrate the inclement environment under which Barclays operated at the time of the global financial crisis. The dividends paid out to shareholders in 2009 was a mere 2.5p against 11.5p paid in 2008 and 34.0p paid in 2007.

4.12.3 Analysis 2010 - 2012

The background to the period 2010 – 2012 was that it marked a time of intense debate regarding what should be the appropriate level of regulatory response to the 2007 – 2009 crisis. This is exemplified by the work of the following scholars, Grosse, R (2012), Hudson, A (2013), MacNeil, I. (2011), Moosa, I, (2010), Arora, A. (2010) and Persaud, A. (2010). All these works were referred to in the literature review. It was the period that the Vickers' Independent Commission on Banking report was published.

In addition to the burden of the global financial crisis on Barclays, there was the damaging allegation of criminal manipulation of London Interbank Offered Rate (LIBOR) which some employees of Barclays were deeply enmeshed in. [[709]][[710]] In June 2012, it came to light that in collaboration with others, some employees of Barclays were involved in manipulating the all-important LIBOR which served as the benchmark interest rates used in the determination of interest rates for derivates, mortgages, overdrafts and other complex financial instruments.[[711]][[712]] It later came to light that this unethical practice was far widespread than initially envisaged as the scandal extended to EURO Interbank Offered Rate (EURIBOR) and Tokyo Interbank Offered Rate (TIBOR).[713]

The very damaging impact of the fines imposed on the bank for this misdeed is discussed later in this section. At that time Barclays appointed the services of consultants to assist the bank to evaluate its business ethos and practices.[714]

By 2012, the draft Bill which accepted Vickers' recommendations, and which would be the basis for a new legislation on banking law, the Banking Reform Act 2013, had reached an advance stage. By then it had become clear that government policy favoured removing core deposits from the investment banking. Well before the Bill

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[709] G. Baber, 'Interbank Offered Rates: HM Treasury's Decisive Act' (2013) Vol 20 (2), 237 – 252, Company Lawyer
[710] Op. Cit., A. Salz and R. Collins, 2013, (n. 49).
[711] M. McKee, 'The Implications of Moving to SONIA' (2020) Vol 35 (6), 223 – 230, Journal of International Banking Law and Regulation
[712] O. McDonald, 'Should LIBOR Come to an End?' (2019) Vol 40 (8), 237 – 238, Company Lawyer
[713] Op cit., Baber, G. 2013, (n. 709)
[714] Op. cit., Salz, A. and Collins, R. 2013, (n. 49).

was enacted to law in 2013, Barclays was committed to restructuring as far back as 2010 when it reported restructuring charges of £330 million.[715]

In 2010 and 2011 income picked up slowly, increasing by 8% in 2010 (£31.5 billion) and a further 3% in 2011 leading to £32.2 billion income earned in 2011. This was the highest revenue generation recorded by the bank. However, that growth was not sustained. As from 2012, income levels started to dwindle, by coming down to £29 billion in 2012. Low interest rate was biting hard, there was also pressure on the bank to improve liquidity and equity capital. As well, the cost of the non-performing accounts was hard on the bank.

Whilst income increased in 2011 and 2012, albeit only mildly, PBT was not responding to that growth due to relatively high impairment charges and the burden of penalty charges of £850 million charged against the bank for interest rate hedging products and £1.6 billion fine for mis-sold PPI.[716] This situation and other events in the bank at the time led to the Chairman of the bank Marcus Agius and the CEO Bob Diamond, stepping down from leading the bank. The bank only managed to keep up with paying a static 5.5p, 6.0p and 6.5p dividends to shareholders in 2010, 2011 and 2012.

4.12.4 Analysis for 2013 - 2018

From 2011, assets had started to drop from £1.6 trillion to £1.3 trillion by 31st December 2013 due to disposal of assets as stated previously. This was achieved through divestment, de-risking and de-leveraging of the bank. For example, Barclays reduced legacy assets in Exit Quadrant portfolios by £40 billion, Investment Bank legacy assets reduced by £17 billion and similarly, there was a write down in the derivatives account which had a deficit of £23 billion.[717]

In January 2013, ring-fencing had become law though there was another six years moratorium before the full effect of that law was to take place. However, the bank had to work towards meeting the demand for stricter capital requirements. Thus,

[715] Barclays Plc, 'Annual Report and Financial Accounts' (2010, p.6)
[716] Barclays Plc, 'Annual Report and Financial Accounts' (2012, p.9)
[717] Barclays Plc 'Annual Report and Financial Accounts' (2012, p.9)

Barclays went forward in restructuring and de-risking its activities.[718] The bank recognised the need to work towards compliance with both the ring-fencing policy and the provisions of the US Dodd-Frank Act relating to its investments in the USA. Barclays set for itself a target to be fully compliant with the ring-fencing policy by the spring of 2018 instead of on the 1st January 2019 as set by the law.[719] In a plan towards achievement of this goal and the need for a general overhaul of the bank's image and business strategy, the bank then launched a new strategic business plan termed "Transform Programme". This project had an initial cost of £1.2 billion.[720]

Income in 2013 fell by about 4% from £29 billion in 2012 to £28 billion in 2013 and PBT went down by 25% from £7 billion in 20012 to £5 billion in 2013.

Further to the Transformation Programme started in 2013 under the leadership of David Walker, the Chairman, and Anthony Jenkins the Group Chief Executive, in 2014 Barclays went through what John McFarlane, the subsequent Chairman of Barclays described as one of the largest restructurings in history.[721] In promoting a vision of a safer banking model in keeping with the new thinking then, Barclays engaged in wholly owned subsidiaries, as at 31st December 2015 which numbered 564 business entities out of which joint venture companies were 288.[722] These wholly owned and subsidiary companies performed specialist financial services including, but not limited to, investment banking, leasing, security realisation outfits, assets management services, trusteeship, holding companies, nominee services, capital margin financing, capital security services, export financing services, industrial development services and investment trust.

The names of the businesses including the percentages of Barclays Plc's stake in each of the companies and the parts of the world where they situate are listed out on pages 341 – 347 of the Annual Report and Financial Accounts for the year 2015.[723]

The explanation given by the bank for this level of unprecedented spread of investments in 2014 hitherto not seen in its history of over three hundred years was that they intended to deliver the divestment of non-strategic assets and businesses

[718] Barclays Plc, 'Annual Report and Financial Accounts' (2013, p.4)
[719] Barclays Plc 'Annual Report and Financial Accounts' (2014, p.2)
[720] Barclays Plc, 'Annual Report and Financial Accounts' (2013, p. 12)
[721] Barclays Plc 'Annual Report and Financial Accounts (2016, p. 2)
[722] Barclays Plc 'Annual Report and Financial Accounts (2015, pp.341 – 347)
[723] ibid (2015, p.341 – 347)

in order to release capital to support growth in core banking and to strengthen the Group's capital position.[724] In the end, the bank incurred total losses of £12 billion in the disposal of the classified non-core business arm of Barclays.[725]

The obvious intention of the management of the bank in promoting this level of vast diversification was to keep Barclays in a position of strength and safety as required by Basel III. It was also Barclays' leadership's proposed solution to dealing with the nagging problem of what Moosa called the mythical "Too big to fail and too big to rescue" banking model. [726][727]

By creating almost six hundred subsidiaries and joint ventures world-wide in this way, the question remains whether the bank spread itself too thinly, putting its fingers in too many pies and thus becoming less effective. It also raises question on whether this unprecedented level of diversification was truly in the best interests of the bank and its shareholders. Prior to this new initiative, Barclays had only five operational divisions namely Barclays Capital, Barclays Global Investors, Barclays Wealth Management, UK Banking and International Retail and Commercial Banking. Within this framework, as at 2010 it had only about twenty-three subsidiaries world-wide.[728]

Not too surprising, as at 31st December 2015, out of the 564 businesses, fifty-two of the wholly owned subsidiaries were in the process of liquidation while in the first quarter of 2016 forty-six of the wholly owned companies were already sold. Similarly, seventeen of the 288 joint venture companies were undergoing a liquidation process.[729] It is also not too surprising that the Chairman and the Group Chief Executive Officer, under whose tenure of office this initiative took place were allowed to go.

With all the de-merger, divestment and restructuring taking place, income generation capacity of the bank continued to deteriorate steadily from 2013 to 2018 as can be observed from Table 6 column 2. International private banking businesses were sold other than those that were in the UK, Monaco and Geneva. Investment banking

[724] Barclays Plc 'Annual Report and Financial Accounts' (2017, p.3)
[725] Barclays 'Annual Report and Financial Accounts' (2018, p.2)
[726] Op. Cit., I. Moosa, 2010, (n. 61).
[727] Barclays, 'Annual Report and Financial Accounts' (2014, p.2)
[728] Barclays Plc, 'Annual Report and Financial Accounts' (2010, p.130)
[729] Barclays Plc, 'Annual Report and Financial Accounts' (2015, p. 341 – 347)

withdrew from nine countries using the proceeds to boast capital requirements[730] and also Barclays sold their significant level of interest in Barclays Africa Group Ltd, to enable Barclays to take Barclays Africa Group out of the consolidated accounts.[731] This move was partly to enable the bank to meet their Common Equity Tier 1 Ratio.

Scaling down operations and walking away from most businesses built over the years around the world was a significant issue that affected Barclays Bank and by extension the economy. Although Barclays did not provide statistics on the proportion of its income that came from nations outside the UK, RBS declared that in the year ended 2006, they earned 42% of their income from abroad.[732]

Similarly, PBT suffered a similar fate, crashing from £5.1 billion in 2013 to £3.5 billion in 2018, which was a reduction of 31%. Assets had reduced from £2.1 trillion in 2008 to almost half at £1.1 trillion in 2018.

In the Chairman's report in 2016, John McFarlane commented that shareholders' equity had increased from £36.6 billion in 2008 to £58.4 billion, up by 60%. He concluded that although the group had grown smaller, it has become safer, more focused, better capitalised, less leveraged and very liquid.[733] This is what is seen as a desirable position that a healthy bank should be in. This outcome is what the regulators would want to see across the banking sector.

McFarlane was not being dishonest or trying to paint an inaccurate picture when he said the Group had become smaller, safer, more focused, less leveraged, better capitalised and highly liquid, with the customers at the centre of the business.

The context in which he gave the report was that of a steward giving a report about his stewardship as to how he had made the most of an adverse situation he would rather did not happen. He was paid to make things work for the benefit of the shareholders, regardless of the economic environment and the challenges he was faced with, and not to complain about the law and regulations imposed on the sector.

Although McFarlane said progress had been made in the sense that the bank had become compliant with the new regulations, the problem remains that the company

[730] Ibid (2015, p.2)
[731] Ibid (2016, p.3)
[732] Royal Bank of Scotland, 'Annual Report and Financial Accounts'(2006)
[733] Barclays Plc, 'Annual Report and Financial Accounts' (2016, p.3)

was still unable to generate sufficient bottom-line profit that yielded returns above the cost of capital. Dividend per share and pay-out ratio remained static and very low, varying from 2.5p – 6.5p over a period of 11 years from 2009 to 2018, as opposed to the 34p dividend paid when the bank was making a health profit (see column 9 of table 6).

In 2015, Barclays complained about what they termed a disproportionate fine and the incalculable damaging consequences to the society.[734] To worsen the situation for the bank, in the course of 2014, there was a penalty of £1.5 billion regarding misconduct matters and another £1.3 billion for remediation on mis-sold PPI[735] in addition to £4 billion litigation expenses in 2015 which further eroded Barclays' profit.[736]

Barclays paid a total sum of £15.1 billion in litigation costs, £2.4 billion as bank levies, incurred £10.1 billion losses from the sale of their non-core business (which grew to £12 billion[737] in 2018), they suffered £2.5 billion losses as a result of selling their interest in the Africa arm of the business, totalling the sum of £34.8 billion.[738] In addition to this is a separate £17 billion costs on legacy issues relating to the operation in America.[739] Altogether these amounted to about £49 billion losses by 2018 (Excluding £2.4 billion bank levy).

With this at the background, it is hardly surprising why Barclays floundered under intense pressure barely able to meet the cost of capital and was only able to deliver less than desirable dividends to shareholders.

McFarlane admitted that the fines levied against the bank were justified on the basis of the contribution of Barclays to the global financial crisis. He pointed out that the bank was working hard to address conduct issues.

For example, the then Chairman of Barclays Group pointed out that a fine of £50 million is the equivalent of a reduction of employees by 1000, the closing down of one hundred regional branches and forgoing the capacity to lend £500 million to

[734] Barclays Plc, 'Annual Report and Financial Accounts' (2015, p.3)
[735] Barclays Plc, 'Annual Report and Financial Accounts' (2014, p.15)
[736] Barclays Plc, 'Annual Report and Financial Accounts' (2015, p.4)
[737] Barclays Plc, 'Annual Report and Financial Accounts' (2018, p. 2)
[738] Barclays Plc, 'Annual Report and Financial Accounts' (2017, p.2)
[739] Barclays Plc, 'Annual Report and Financial Accounts' (2018, p. 2)

customers.[740] As indicated in the previous paragraphs, the fines and remediation payments were in billions of pounds. It could be argued that the pain and the impact of the enormous fines on the banks affected would be a deterrent to the bankers, giving them a strong warning that any untoward behaviour in the future will not be visited with just a slap on the wrist. Such strong warnings may curb the excesses of bankers in the future.

4.13 Contributions to the Operating Income Before Tax by the Investment Banking Division of Barclays Group

In general, this section examines the annual contributions from the investment banking division of the bank to the common purse in Barclays Group in order to emphasise the division's relative importance and over reliance on the investment banking's contribution to the income generation in Barclays over a period of fifteen years.

Table 7: Contributions of the Investment Banking to the Profit Before Tax Relative to other Divisions: Barclays Group

Year	Profit Before Tax £ million	Contributions of Investment Banking to The PBT £ million	Contributions Of all others To the PBT £ million	% Contributions Of Investment Banking	% Contributions Of all other Divisions
2004	4,580	1,020	3,560	22%	78%
2005	5,280	1,272	4,008	24%	76%
2006	7,136	2,216	4,920	31%	69%
2007	7,076	2,335	4,741	33%	67%
2008	6,077	1,302	4,775	21%	79%
2009	4,585	2,464	2,121	**54%**	46%
2010	6,079	4,780	1,299	**79%**	21%
2011	5,879	2,965	2,914	**51%**	49%
2012	7,048	4,063	2,985	**58%**	42%
2013	5,167	2,523	2,644	49%	51%

[740] Barclays Plc, 'Annual Report and Financial Accounts' (2015, p.3)

2014	5,502	1,377	4,125	25%	75%
2015	5,403	1,611	3,792	30%	70%
2016	3,230	2,650	580	**82%**	18%
2017	3,166	2,056	1,110	**65%**	35%
2018	3,494	2,593	901	**74%**	26%

It should be noted that this aspect of the evaluation suffers from one crucial disadvantage in the sense that there are no available statistics to let us know pound for pound in weighted averages the amount invested in each division which generated the amount contributed to the common purse. Such statistics would for example enable us to say with pinpoint accuracy that £1,000 invested in the Investment Banking Division generated **'x'** value while the same £1,000 invested in the other divisions generated **'y'** value.

Notwithstanding this gap, the available statistics underscore the capacity of the investment banking division's ability to generate income. **Table 7** indicates that over the period of fifteen years under review, investment banking division contributed more than 50% to the PBT in seven years. Out of those seven years, on three occasions, in 2010, 2016 and 2018, the investment banking division contributed more than 70% to the PBT. This very brief summary underscores the strong importance of the investment division to the profitability of Barclays. With the removal of the core banking arm of the bank arising from the ring-fencing policy, the contention is that the synergy that had hitherto existed would be dissipated and predictably the level of profitability in Barclays after this separation is more likely than not to be adversely affected.

In 2006, Barclays declared that,

> "The group provides banking services to its associates, joint ventures and the group pension funds…providing loans, overdrafts, interest and non-interest-bearing deposit and current accounts to these entities as well as other services.[741]

There is a range of intra bank services that a ring-fenced member in a group may provide to members within the group such as provision of current account, deposit account agency services provided to members within the group. However, exposure

[741] Barclays Annual Accounts p. 218

by the ring-fenced bank to other members of the group is not allowed. This is a cardinal principle about the ring-fencing policy.

Drawing on the provisions under s.142 D (2) Banking Reform Act 2013 Part 9 B (Ring-fenced banks excluded activities), the Guidance Consultation paper 15/5 at paragraph 1.6 reiterates the policy on intra dealing activities within a group. Ring-fenced banks are generally not allowed to deal in investments as principal or engage in commodity trading and are prohibited from being exposed to financial institutions, branches (within the group) and subsidiaries outside the EEA.

The idea behind this is to prevent situations where exposure by a ring-fenced bank to a member of the group results in the inability of the ring-fenced bank to continue in business should the group member exposed to goes into insolvency. In the same way, the non-ring-fenced bank cannot rely on the ring-fenced bank for support should the mainstream Non -Ring- Fenced bank runs into financial difficulty.

What this researcher proposes is a situation where only the riskier elements of investment banking such as proprietary trading, the type that ruined Baring Capital and brought considerable losses to Union Bank of Switzerland that should have been removed from the mainstream bank while the other part should have been properly supervised and allowed to continue to operate the relatively safe investment and corporate banking services. That way, the big UK banks would have remained competitive with their European counterparts.

4.14 Insurance Services Contributions to the Operating Profit Before Tax

Prior to the 2007 – 2009 global financial crisis, being a universal bank allowed Barclays to engage in the provision of insurance services as a part of its other financial services provisions. This remained the case until 2008 when the bank closed some of its Life Assurance businesses with a disposal profit of £326 million.[742]

Notwithstanding, Barclays still works in collaboration with other insurance companies as commissioned agents, intermediaries acting as introducers. For example, Barclays

[742] Barclays Plc, 'Annual Report and Financial Accounts' (2008, p. 17)

works with Legal & General regarding provision of insurance for mortgage holders, Allianz Insurance Plc and Simply Business in respect of business insurance, Gresham Insurance Company Ltd does Homes Insurance, Aviva Insurance and RAC provide travel pack and breakdown covers.[743]

The statistics available for insurance contributions to the PBT are only for four years from 2005 to 2008.

For the period in which statistics are available, the average annual contribution to the PBT was over half a billion pounds.[744] Given that the insurance arm of the company is a 'service' based operation with its income mainly derived from earned insurance premiums and commissions, huge investment in capital and assets are not a requirement for its success because the service for example does not need huge office space to operate nor an overly large number of employees. The bank had the benefit of using frontline staff in their local branches to sell insurance services as an add-on work to the core banking business. Thus, contributions to PBT which reached over half a billion pounds annually for this auxiliary service can reasonably be considered a highly profitable business.

4.15 Wealth Management's Contributions to the Operating Profit Before Tax

In Barclays, Wealth Management services is a niche market which afforded the bank the opportunity to provide private and investment management services to very wealthy individuals and corporate bodies. This service operated through a few dedicated branch offices and subsidiaries of Barclays in the UK and oversees.[745]

In 2015 accounts, it was disclosed that international private banking businesses other than those in the UK region, Monaco and Geneva, others were disposed with the sum realised from the sale used to boost capital requirements. Meanwhile Barclays continued to provide this lucrative service, in the few selected places listed above.

743 https://www.barclays.co.uk/insurance/travel-insurance/
744 Please see Table 6 column 13
745 Barclays Plc, 'Annual Report and Financial Accounts' (2008, p. 155)

We have the benefit of access to ten years statistics on the contributions of the Wealth Management division to the PBT from 2004 – 2013.[746] From 2014 there was a restructuring which led to merging the Wealth Management division with other division of the bank thus, there was no separate rendition of statistics on the Wealth Management division from that time forward.

4.16 Findings and Conclusions Regarding Barclays Group in the Light of the Aim of the Study

(i) Barclays bank was founded about 330 years ago. Over time, it grew into a vast and highly successful universal bank with a global spread that extended to over fifty countries, having about 160,000 employees serving 48 million customers worldwide.[747]

(ii) Following the adoption of trade liberalisation model in the late 1970s by the Margaret Thatcher's government, Barclays operated within the universal banking model which initially benefited the bank but then the bank went out of control which led to disastrous outcomes. The bank grew phenomenally with assets in excess of £2 trillion but which was later found to be the result of over inflated derivative assets.[748]

(iii) The global financial crisis affected Barclays as huge losses were incurred due to exposure to the subprime credit market especially through its acquisition of Lehman Brothers' businesses in the USA. This resulted in demurrages on the derivative accounts and consequently led to high impairment provisions made against these high-risk assets of the bank. Barclays struggled to keep up with the acceptable liquidity requirement in six out of the fifteen years evaluated.[749]

In other to resolve the acute liquidity problem and meet the new regulatory requirements, Barclays sought for alternative means of dealing with the issues. The bank avoided taking a government bailout package but instead took a £6.1 billion loan from Qatar.[750] Although this led to the bank being taken to the court on an

[746] Please see Table 6 column 14
[747] Please see page 221.
[748] Please see pages 223; 237 – 238.
[749] Please see pages 237 – 240.
[750] Please see page 114; 225 - 226

allegation of obtaining unlawful assistance from a foreign government, the charges were dismissed at both the Crown Court and the High Court.[751]

In addition to Barclays' quest to meet the new capital and liquidity requirements imposed by the new regulatory changes embedded in Basel III, Barclays had to dispose of Barclays Global Investors, Absa Group in South Africa, and other non-core banking businesses in Europe and America.[752]

(iv) Barclays planned to be ring-fencing compliant by the first quarter of 2018 which the bank succeeded in doing.[753]

(v) Under Basel III and the Capital Requirements Directive Regulations (CRD3), which requires banks to hold more buffer capital against market risks, Barclays complied with the directive by 31st December 2011. However, due to several scandals that emerged in the business operations of Barclays including LIBOR manipulation, mis-sold insurance products and other irregularities found in its investment arm of the banking operation, the management decided it was time to shut down substantial part of its non-core banking services.[754]

(vi) The global divestment took place when the economy was only just recovering from recession. A pertinent question is whether Barclays got the best value available for the businesses sold at that period and whether the bank could have received more for its assets if the bank had the opportunity to differ sale of the asset to a more auspicious time. Barclays incurred losses of about £12 billion from the sale of its non-core assets.[755]

(vii) Part of the consequences of low-level profitability was that from 2013 Barclays only managed to sustain a modest profit and had modest dividends pay outs to shareholders with the worst-case situation in 2017 when the bank was unable to make any dividend payment whatsoever.[756] As well, another fallout of this poor performance was that the level of profit made did not meet the cost of capital.[757] Worse still, if shareholders are not getting returns on their investment that is

[751] Please see pages 225 - 226.
[752] Please see page 236.
[753] Please see page 243.
[754] Please see page 241
[755] Please see page 245.
[756] Please See page 228 Table 6
[757] Barclays (2016, p.3) Annual Report and Financial Accounts

competitive enough with the income from alternative investment outlets elsewhere, not only would there be a shift in the number of people willing to hold to their shareholding in Barclays, this may also create some difficulties in the future when attempting to raise new capital from the stock market arising from poor dividends pay-out.[758]

(viii) Based on income level and distributable profit, it could be argued that Barclays has not fully returned to its status in the pre-crisis period, when earnings per share was 71.9p and dividend per share was 31.0p as opposed to 2018 when earnings per share was 9.4p and dividend per share remained at 6.5p.[759]

(ix) On a positive note, as at April 2018 Barclays had fully restructured and became compliant with the ring-fencing policy. The enormous restructuring costs are unlikely to be repeated. Hopefully, issues about huge fines, huge litigation expenses and costs on mis-sold PPI would also be put behind the bank so that it can have a new beginning free from the shackles of the past and so that in no distant future the bank may hopefully be able to generate sufficient profit margin which will yield returns that are above the cost of capital.

(x) **Table 7** on page 247 - 248 indicates that over the period of the fifteen years under review, the investment banking division contributed more than 50% to the PBT in seven years. Out of these seven years, on three occasions in 2010, 2016 and 2018 the investment banking division contributed more than 70% to the PBT.[760] With the removal of the core deposit accounts of the bank arising from the ring-fencing policy, the contention is that the synergy that had hitherto existed would be dissipated and predictably, the level of profitability in Barclays after this restructuring is more likely than not to be adversely affected.

(xi) Provision of insurance services as an auxiliary work of the bank was hugely successful and profitable to Barclays because this secondary service provision worked well by using its existing wide branch network and front desk staff of the bank to sell insurance services to vast numbers of existing bank customers.[761]

[758] Please page 246.
[759] Please see page 228 Table 6
[760] Please see page 247 - 248
[761] Please see page 228

In the light of the foregoing statements and the aim of the study, the analysis of the data extracted from the Annual Reports and Financial Accounts of Barclays led to the hard conclusion that huge losses were sustained through sale of non-core financial assets at a period when the economy was just recovering from recession. Barclays was also hit with huge fines for breach of conduct which eroded the profits of the company.

Section C: Standard Chartered Bank (Group Accounts)

4.17 Introduction

At the planning stages of this study, SCB was not part of the banks earmarked as a case study. The original plan was to examine some of the biggest global systematically important banks in the UK that are most likely to be affected by the ring-fencing policy and whose risks of possible collapse could pose significant harm to the economy more than others. These are banks with assets that are over a trillion pounds and whose possible collapse could seriously affect the real economy, such as availability of credits, and on a massive scale, jeopardising employment security.

However, in the course of a review, it was considered expedient to also include a mid-range bank with total assets below a trillion pounds. That was how SCB came into focus. However, during the course of evaluating the accounts of SCB, it was discovered that though the bank is a UK bank and its total core deposits far exceeded the £25 billion minimum threshold at which point the bank should ordinarily fall within the ambit of the ring-fencing policy, it escaped because most of its core banking customers that the ring-fencing policy primarily seeks to protect are outside of Europe.

Strategically, SCB does not operate branch banking in the UK, but they kept the hub of their investment banking operations in London. Traditionally, for upward of 150 years their commercial banking operations remained mainly in Asia, China, Taiwan, the Middle East, South Korea, and in some African countries including South Africa, Ghana, and Nigeria.

Nevertheless, whilst SCB was not directly affected by the ring-fencing policy, on a very positive note, the accounts of SCB presented a unique opportunity to compare and contrast its results with other UK banks within the case studies group in this study that had to be ring-fencing policy compliant by 1st January 2019.

These are the circumstances under which SCB retained its status as one of the case studies that is well deserving of inclusion in this study.

4.18 Standard Chartered Bank Plc: Historical Background and Basic Statistics

Standard Charted Bank is a Public Limited Liability Company registered in England under registration number 966425, having its Group Headquarters at 1, Basinghall Avenue London, EC2V 5DD, United Kingdom. SCB is listed on the London, Hong Kong Exchanges,[762] and as well as the Bombay and National Exchange in India.[763] In the period leading to the global financial crisis, by market capitalisation Standard Chartered Bank ranked among the top 25 companies in the FTSE100 index.[764]

The origin of Standard Chartered Bank dates way back to 1853 when a Royal Charter was granted to one of its founders, a Scotsman named James Wilson. He proceeded to open pioneering branches of the bank in Shanghai, Mumbai and Kolkata in 1858 and over the next decade opened other branches in Hong Kong and Singapore.[765] About that same period, a different bank, Standard Bank of British South Africa was founded in 1862 by another Scotsman, John Paterson, who was also granted a Royal Charter in 1853, which led to his establishing the first branch of the bank in Cape province, South Africa in 1862.[766] Eventually, the two separate banks merged in 1969, with the adopted name Standard Chartered Bank.

Right from their inception, both banks focused their banking operations outside the UK, having found a strong foothold in Asia Pacific countries such as Hong Kong, Singapore, Malaysia, Korea and in other places around the world including China, India, the Middle East and in Africa. Even today, that still reflects the current geographical spread of their business operations, with less than 20% of their operating income coming from Europe and the Americas. [[767]][[768]]

The Statutory Auditors for the bank are KPMG Audit Plc, London, Chartered Accountants, 15 Canada Square, London E14 5GL.[769] The financial accounting year starts from 1st January to 31st December annually. The accounts are denominated in US dollars. Apart from regulators in the countries around the world where they

[762] Standard Chartered Bank, 'Annual Report and Financial Accounts' 2007, p. 164
[763] Standard Chartered Bank 'Annual Report and Financial Accounts' 2012, p. 1
[764] Standard Chartered Bank 'Annual Report and Financial Accounts' 2008, p. 4
[765] https://www.theguardian.com/business/2012/aug/07/standard-chartered-short-history
[766] Ibid. (The Guardian)
[767] Standard Chartered Bank 'Annual Report and Financial Accounts' 2018
[768] Standard Chartered Bank 'Annual Report and Financial Accounts' 2008, p. 4.
[769] Standard Chartered Bank 'Annual Report and Financial Accounts' 2018, p. 235

operate, the Group's lead regulators are Prudential Regulatory Authority (PRA) and Financial Conduct Authority (FCA) in the UK.[770]

Following enhanced regulatory requirements in the banking sector in the aftermath of the global financial crisis of 2007 - 2009, a more onerous burden was imposed on the independent external auditors to among other requirements provide a more comprehensive report in their audit concerning wide ranging issues, including a specific report on the financial statement, the accounting report standards used, liquidity and insolvency risks, loans impairment provision, valuation of complex or illiquid financial instruments, an estimate of future profitability and the scope of the audit. There was no adverse report from the auditors in the accounts for the period evaluated.

4.19 The Size, Markets and Business Model of Standard Chartered Bank Over Time

With about 160 years of experience in some of the world's most dynamic markets in the Middle East, Asia and Africa, Standard Chartered Bank, an international banking group operates a universal banking model across about 1,700 branches in sixty eight markets, relying on both organic growth by ploughing back part of its profit into the business and also exploiting the benefits of mergers and acquisitions.[771] For example, in 1999 SCB acquired 75% majority interest in Narkornthon Bank in Thailand. In the year 2000 it purchased Grindlays in India. In 2004, in conjunction with a consortium partner PT Astra, the bank took a controlling interest in Bank Permata, Indonesia. SCB also purchased Korea First Bank in 2005. [772] In 2006, it merged with Union Bank in Pakistan. In 2007, it took controlling interest in the Taiwanese bank, Hsinchu International Bank, and in that same year SCB acquired Pembroke and Harrison Lovegrove and American Express Bank.[773]

In addition to their increased appetite for mergers and acquisitions of commercial banks, SCB also formed strategic alliances with non-core banking institutions like

[770] Standard Chartered Bank 'Annual Report and Financial Accounts' 2017, p. 68
[771] Standard Chartered Bank 'Annual Report and Financial Accounts' 2012, p. 1
[772] Standard Chartered Bank 'Annual Report and Financial Accounts' 2005, p. 5
[773] Standard Chartered Bank 'Annual Report and Financial Accounts' 2007, p. 6

Fleming Family & Partners Ltd (FF&P), a leading wealth management services provider, and acquired interest in Travelex a non-bank foreign exchange specialist.[774]

As demonstrated from all these, the period leading to the global financial crisis was a time of exponential growth for SCB, with ever increasing growth in their primary markets, including in China, Thailand, Indonesia, South Korea, Pakistan, India, Taiwan, Malaysia, Nigeria, Ghana, South Africa and in the United Arab Emirates. They have maintained a presence for about 160 years in some of these countries.

Although in terms of size, SCB was not in the same category as HSBC, RBS and Barclays, they had an impressive success story for the period under review. The four banks, SCB, RBS, HSBC and Barclays operated similar growth and operational strategies. The four banks operated a universal banking model and they all had very extensive international outreach. Unlike RBS and Barclays, HSBC and SCB focused more on markets outside Europe and America.

At the peak of their success in 2014, SCB held assets of about US$726 billion and employed about 90,000 people around the world against just US$147 billion assets they had in 2005.[775] This phenomenal growth in the space of ten years was partly due to their universal banking model, acquisitions and mergers strategies and they only kept a minimal share in the turbulent American markets so that when there was financial crisis in the American markets, the bank was one of the least affected banks.

[774] Standard Chartered Bank 'Annual Report and Financial Accounts' 2005, p. 15
[775] Standard Chartered Bank 'Annual Report and Financial Accounts' 2014

4.20 Table 8 – Tabulated Data Extracted from the Annual Reports and Consolidated Financial Accounts of the Standard Chartered Group From 2004 to 2018 (Financial Year Ending on 31st December Annually)

Year	Operating Income US$ (b)	Operating Profit Before Tax US$ (b)	Total Asset US$ (b)	Impairment Charges US$ (b)	Branches	Employees **000**	Earnings Per Share **(Cent)**	Dividend Per Share **(Cent)**	Total Deposit US$ (b)	Total Loan US$ (b)	Income from Wholesale Banking **£ (b)**	Contribution Insurance US$ (000)	Income from Wealth Management US$ (000)
1	2	3	4	5	6	7	8	9	10	11	12	13	14
2004	5.4	2.3	147.1	0.3			129.6c	57.50c	100.2	88.7	1.2	-	0.9
2005	6.9	2.7	215.0	0.4	1,200	44	148.5c	64.00c	138.8	133.5	1.4	-	1.4
2006	8.6	3.2	266.0	0.6	1,400	59	169.0c	71.04c	173.6	159.0	1.8	-	1.9
2007	11.0	4.0	329.2	0.8	1,600	70	201.1c	79.35c	205.6	189.6	5.2	-	2.6
2008	14.0	4.8	435.0	1.8	1,600	74	202.4c	61.62c	265.9	220.8	7.5	-	2.8
2009	15.1	5.1	436.7	2.1	1,600	77	167.9c	66.03c	289.7	249.2	9.3	-	2.2
2010	16.0	6.1	516.5	1.0	1,700	85	196.3c	69.15c	335.5	292.4	10.0	-	1.1
2011	17.6	6.8	599.0	1.0	1,500	87	200.8c	76.00c	378.0	329.7	10.8	-	1.3
2012	19.0	6.9	636.5	1.4	1,700	89	199.7c	84.00c	414.1	352.3	11.8	-	1.3
2013	18.8	6.0	674.4	2.7	1,600	87	164.4c	86.00c	424.6	374.4	11.5	-	1.3
2014	18.3	4.2	725.9	2.9	1,200	90	102.2c	86.00c	459.7	368.6	6.0	-	1.7
2015	15.3	(1.5)	640.5	5.5	-	84	(91.9c)	13.70c	388.2	321.9	5.3	-	1.7
2016	14.0	0.4	646.7	3.0	-	87	(14.5c)	Nil	408.7	325.3	6.5	-	0.5
2017	14.4	2.4	663.5	1.7	-	86	23.5c	11.00c	401.5	306.2	6.5	-	0.5
2018	14.8	2.5	688.8	0.8	-	85	18.7c	21.00c	420.7	318.0	6.9	-	0.5

4.21 Constituents of Table 8

Table 8 above contains the tabulated data regarding the financial summaries extracted from the Annual Reports and Financial Accounts of SCB over a period of 15 years starting from 2004 to 2018.

The first three years' accounts from 2004 to 2006 represent the years immediately preceding the global financial crisis. Remarkably, SCB continued to perform creditably well through the crisis period until 2015, when for the first time they had a negative OPBT. By the year 2017 – 2018, they started picking up momentum again, returning to making a modest OPBT.

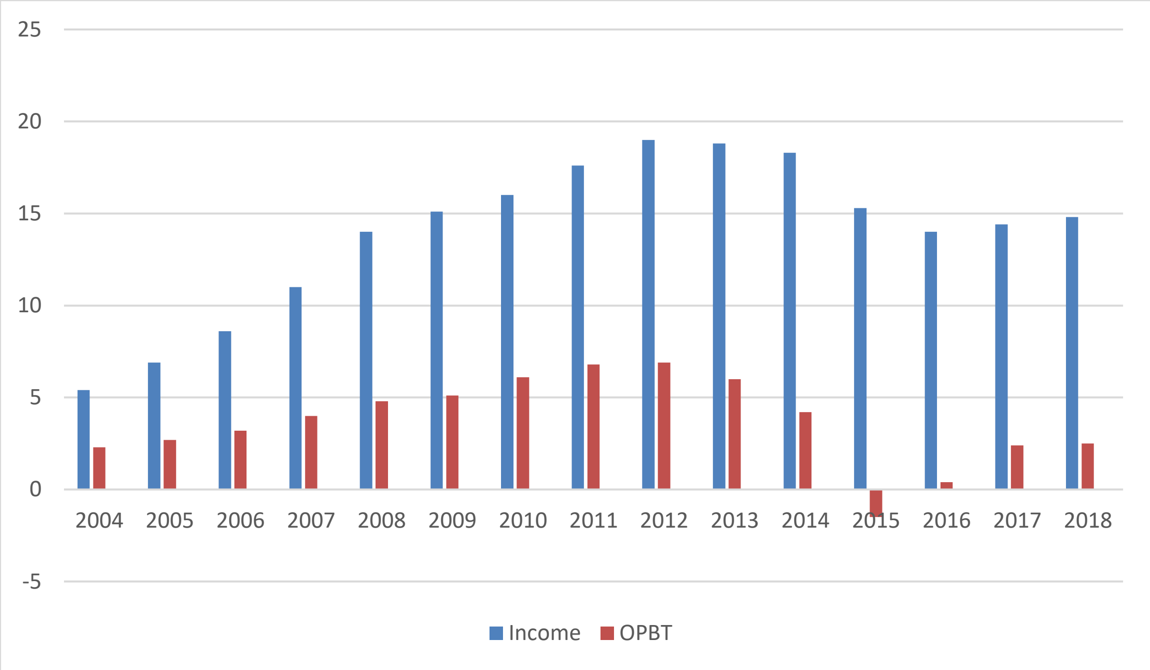
Appendix 3 at the back of this report contains page reference numbers indicating the pages in the Annual Reports and Financial Accounts where the financial summaries were extracted.

The Table comprises fourteen vertical columns with self-explanatory headings indicating the variables contained in each column. The horizontal rows are the values of Key Performance Indicators (KPI) recorded on annual basis.

Figures 18 – 25 below are graphical presentations of the variables on Table 8 in chart forms to illustrate visually the relationships between the variables indicated on the headings of each chart. Beneath each chart is a summary at a glance of the results generated from the chart.

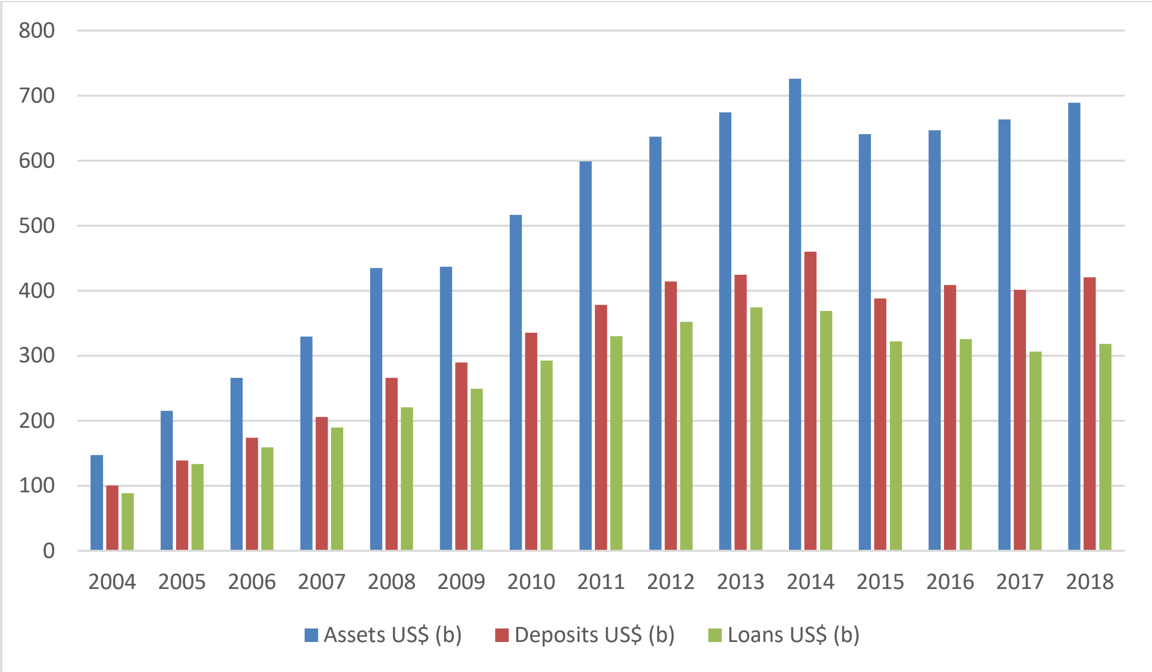
The scales in both 'X' and 'Y' axes of each chart are presented in Appendices 18 to 25 at the back of this report.

Figure 18 SCB Group: The Relationship Between Income and Operating Profit Before Tax 2004 – 2018



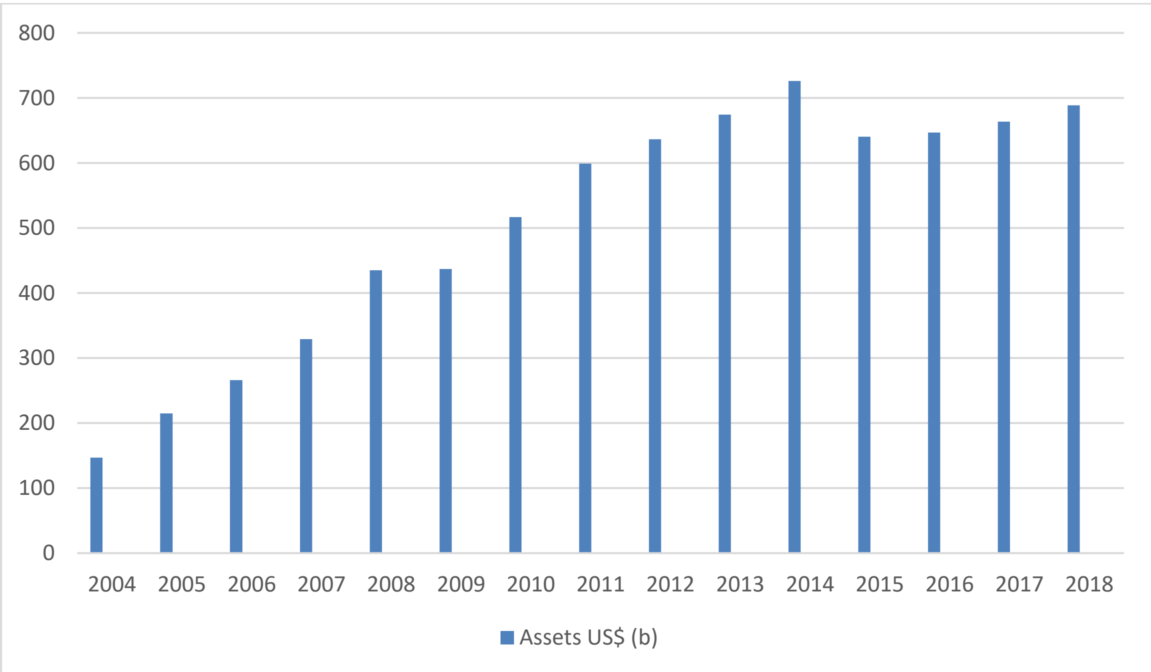
The Chart indicates nine unbroken years of growth in income which peaked at US$19 billion in 2012. In 2013 and 2014 there were dips in the operating income of about US$200 million in 2013, and a slide of US$500 million in 2014. Thereafter, there was a huge fall in the income by US$3 billion in 2015 and so also, the impairment charges increased from $2.9 billion in 2014 to $5.5 billion. Income only started to pick up gradually in 2017 and 2018. Correspondingly, OPBT maintained unbroken growth for nine years from 2004 – 2012. The bank suffered a negative OPBT in 2015 following a decline of US$3 billion in its operating income and a sharp increase in the impairment charges as mentioned earlier. The bank went back to making modest positive OPBT from 2016 to 2018.

Figure 19 SCB Group: The Relationship Between Assets, Deposits and Loans 2004 – 2018 US$ (b)



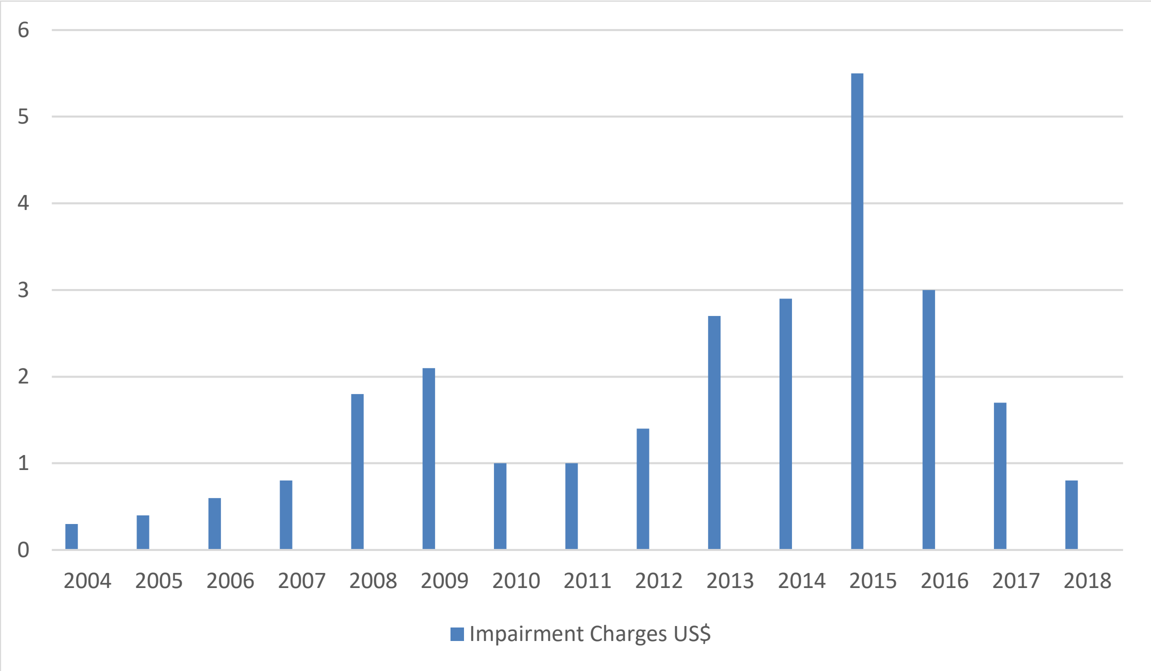
Except in 2015 when the total assets fell from $726 billion to $641 billion in 2015, the bank maintained fairly consistent growth in the total assets employed having quadrupled from about $147 billion in 2004 to $689 billion in 2018. In the same vein, from 2008 to 2018 the deposits had a good margin above the aggregate loans indicating that the bank maintained a healthy liquidity ratio.

Figure: 20 SCB Trend of Growth/Decline in the Total Assets For 2004 – 2018 US$



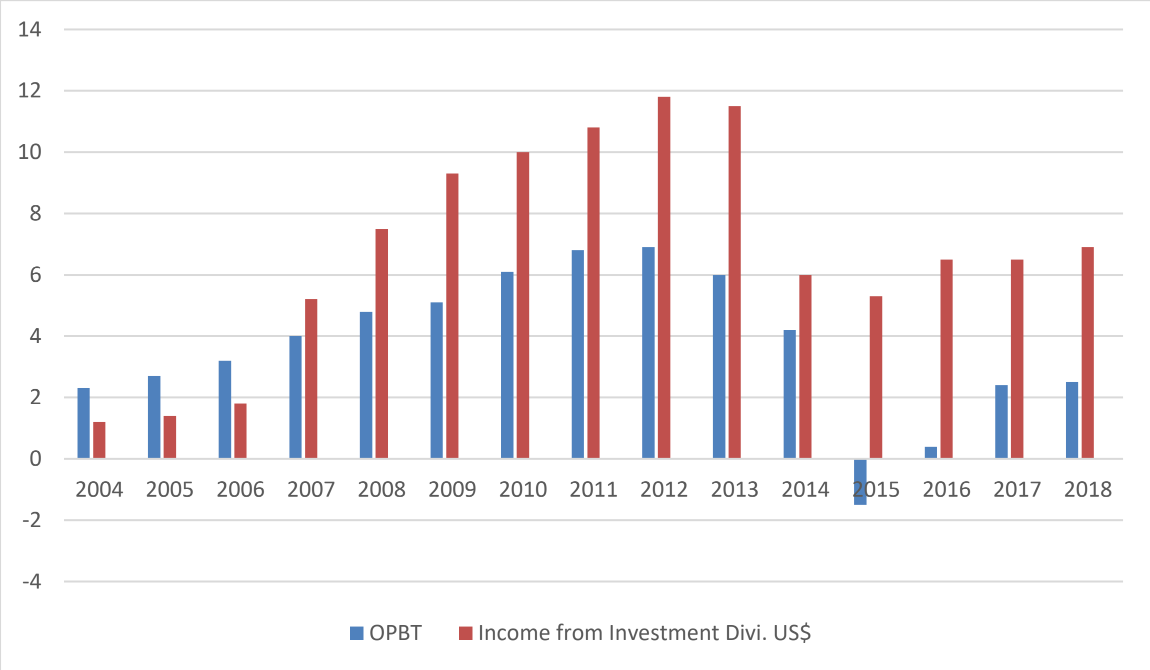
This chart relates to the total assets held by SCB from 2004 – 2018 standing by itself. It shows consistent growth from 2004 to 2014 and then a dip which started to pick up from 2017.

Figure: 21 SCB Trend of Growth/Decline in Impairment Charges 2004 – 2018 US$ (b)



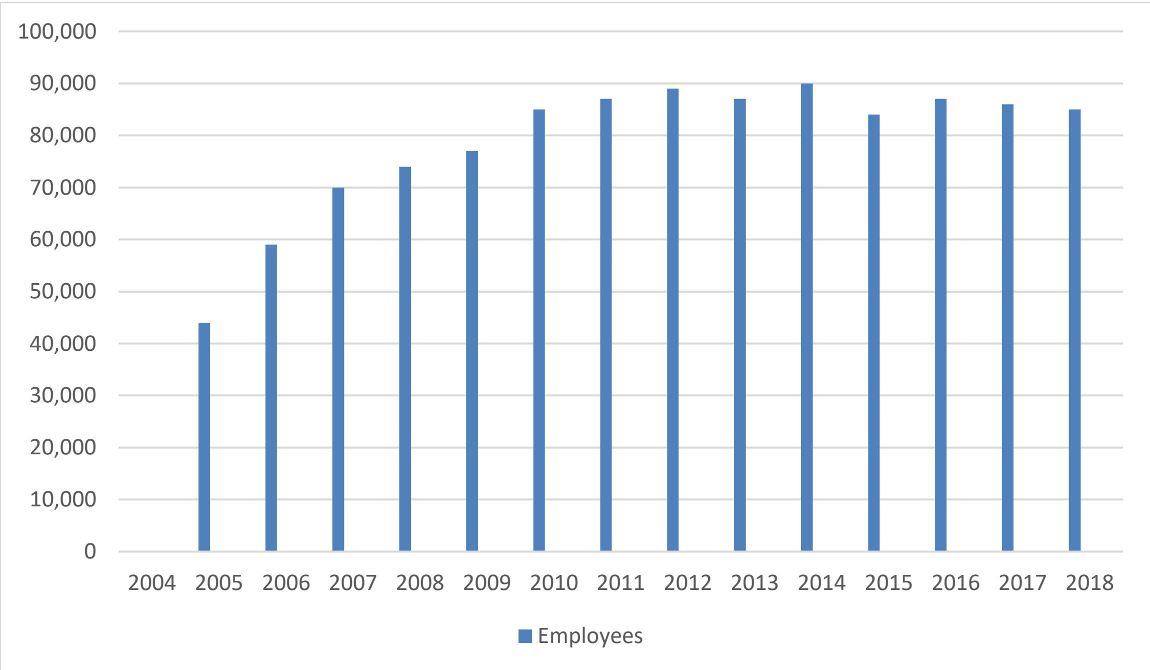
This chart indicates a very sharp increase in the impairment charges which in 2015 amounted to $5.5 billion. This helps us to understand why SCB went into negative OPBT particularly in 2015. Impairment charges is a provision made against credit risks such as weakened recoverable loans and advances. It is also a proportion of the profit set aside against losses arising from diminished value of financial assets of the bank (this is different to provisions made for depreciation of buildings and machinery). As it was on this occasion, the impairment charges related to depreciation in the local currencies against dollar. Viewed against the backdrop of a reduction of US$ 3 billion in the operating income in that same year helps us to understand why SCB OPBT ended up in a negative OPBT of US$ 1.5 billion in 2015.

Fig. 22 SCB Group: The Proportion of Contribution of Investment Banking Division to the Operating Profit Before Tax 2004 - 2018



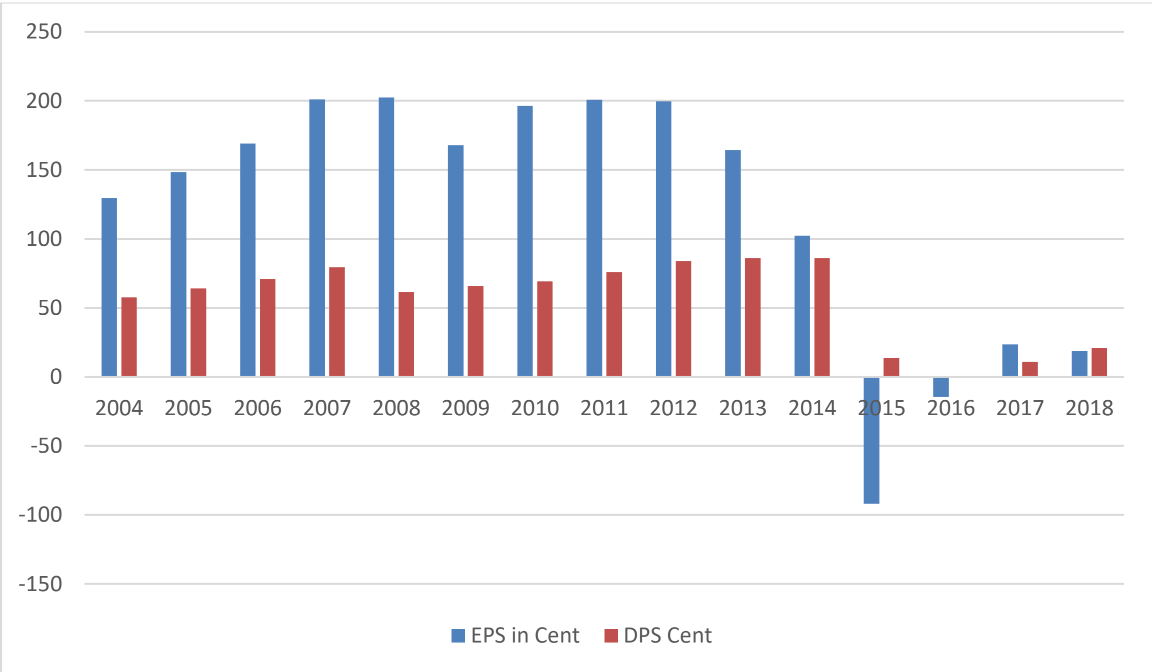
This chart implies that from 2007 – 2018 income from the investment division accounted for most of the income generated by SCB. SCB was heavily dependent on income from investment division. Income from that division peaked in 2009 to 2013 when income was: 2009 - $9.3 billion, 2010 - $10 billion, 2011 - $10.8 billion, 2012 - $11.8 billion and 2013 - $11.5 billion.

Figure 23 SCB Group: Employee Profile 2005 – 2018



The chart is a reflection of growth/decline in the staff profile of SCB on the data available from 2005 – 2018. SCB had 44,000 staff members in 2005. The number of staff peaked at 90,000 in 2014. As reflected in the downward slide in income and OPBT from 2015, number of staff also went down marginally to 85,000 employees. In general terms, there was stability in the staff numerical strength over the 15 years under review.

Figure 24 SCB Group: Trend of Growth/Decline in Earnings per Share and Divided Per Share 2004 - 2018



Considering the global financial crisis that affected most financial institutions in 2007 - 2009, the consistent growth in the EPS and commensurate level of dividends paid by the bank from 2004 to 2014 is indeed remarkable. In 2015 and 2016 there was a downturn for the bank, but they started to pick up again from 2017.

Figure 25 SCB Group: Trend of Growth/Decline in Income from Wealth Management 2004 – 2018 US$ (b)

The undulating movement in the income earned from wealth management is a response to increase/decrease growth in revenue for the period under review. SCB earned US$ 2.8 billion from this arm of its operations in 2008 which was its highest within the period under review. Thereafter, there was a sharp decline by $600 million in the income in 2009 having earned US$2.2 billion. There was a further downward trend coming to US$1.1 billion in 2010. The second wave in the movement of income witnessed a very slight increase in income increasing to US$ 1.3 billion in 2011. Thereafter, there was a slight upsurge to US$1.7 billion in 2014. In 2015 – 2018 income from wealth management crashed to all time low in the sum of US$0.5 billion for each of these years.

4.22 Analysis and Interpretation of the Extracted Information Collated from the Annual Financial Accounts of Standard Chartered Bank Plc in Light of the Aim and Objectives of the Study

The trend in the level of income generated by a business is an important performance indicator that enables assessors to see whether the business is gaining or losing its hold on the market share. More importantly, this performance marker enables managers to assess whether assets are being effectively deployed to generate sufficient income that meets the bank's budgeted income level and whether costs are justified by the level of income being generated by the business.[776]

Column (2) is the record of the annual operating income. From 2005 to 2012, remarkably, SCB maintained an eight unbroken record of increase in income starting with $5.4 billion in 2004 which increased to $19 billion by 2012. The increase in income is considered commensurate with the level of increase in the operating assets.

As mentioned previously under paragraph 4.20, in 2005, SCB acquired interest in other financial institutions including Korea First Bank, Union Bank in Pakistan and Taiwan (2006)[777], Hsinchu International Bank and formed alliances with non-banking financial institutions such as Fleming Family & Partners Ltd and Travelex. These acquisitions and alliances may have helped to boost the revenue of SCB as their operating income more than doubled by 2007 when it reached $11 billion. In addition, during that period Asia region including China, had widely diversified economies and there was high degree of insulation, resilience due to stronger domestic demand and strong policy response to market challenges at the time.[778]

The bank witnessed accelerated growth in this period with staff strength more than doubled, reaching almost sixty thousand by 2006. In five years from 2001 to 2006, SCB reported that the number of customers grew from about 7 million to over 14 million and the number of branches increased to over 1,400 from just 550 branches in 2001.[779] What all this meant for SCB was an impressive growth in operating income which climaxed at $19 in 2012. Although from 2012 to 2014 revenue dipped to $18.3 billion, it is remarkable that SCB had such sustained growth throughout the

[776] Op. Cit. E. McLaney and P. Atrill 2016, p. 70, (n .697).
[777] Standard Chartered Bank 'Annual Report and Financial Accounts' 2006, p. 6
[778] Standard Chartered Bank 'Annual Report and Financial Accounts' 2007, p. 9
[779] Standard Chartered Bank, 'Annual Report and Financial Accounts' 2006, p. 9

global recession period that, it appears that the recession hardly touched SCB. According to SCB, the reason for their resilience during the global financial crisis was because of their disciplined approach to risk taking and that they had very limited exposure to direct and indirect Asset-Backed Securities (ABS), including Collateralised Debt Obligations (CDO) which at the time amounted to only $6 billion.[780]

Part of the strategy that enabled SCB to thrive during the inclement global financial crisis was that the bank kept a very close tab on the basics of banking – costs, capital, operational risks and liquidity.[781]

However, from 2015 to 2018, their revenue suffered a significant reversal of fortune as their revenue dwindled to $14 billion in 2015. By 2018 they had made a slight recovery as operating income started a turnaround, making $14.8 billion.

Operating Profit Before Tax followed the same pattern as Operating Income. OPBT maintained an unbroken record of consistent growth for a straight eight-year period from 2004 to 2012. The OPBT almost doubled from $2.3 billion earned in 2004 to $4 billion in 2007. This continued to increase modestly between 2008 through to 2012 when the bank made the highest OPBT of $6.9 billion. Thereafter, OPBT reduced to $6 billion in 2013 and worst of all, SCB had a negative OPBT of $1.5 billion in 2015 having had the worst level of fall in their revenue by $3 billion in the same year, 2015. Thus, the reasons behind the OPBT loss of $1.5 billion are understandable. Foremost, there was a drop of $3 billion in the revenue. Secondly, a settlement agreement was reached with the US authorities over sanctions for breaches relating to compliance on regulatory issues. This amounted to $667 million, a dent in the profit of SCB.[782] SCB was faced with other civil monetary penalties of $5.2 billion [[783]][[784]]. Worst of all, the impairment losses on loans and advances and other credit provisions increased phenomenally from $2.9 billion in 2014 to $5.5 billion in 2015. The reason for the very high impairment losses was due to some irrecoverable loans, and a drastic fall in the value of local currencies against the dollar in Asia and Africa, their main markets. [785] The situation was worsened by stricter regulation, low interest rates, subdued world trade and trade tension between America and China

780 Standard Chartered Bank, 'Annual Report and Financial Accounts' 2007, p. 11
781 Standard Chartered Bank, 'Annual Report and Financial Accounts' 2008, p. 9
782 Standard Chartered Bank, 'Annual Report and Financial Accounts' 2012, p. 8
783 Standard Chartered Bank, 'Annual Report and Financial Accounts' 2014, p. 3
784 Standard Chartered Bank, 'Annual Report and Financial Accounts' 2018, p. 9 & 305
785 Standard Chartered Bank, 'Annual Report and Financial Accounts' 2012, p. 9

which impacted on market confidence.[786] Notwithstanding, SCB returned to making profit in 2016 and began to pick up modestly as the OPBT increased from $0.4 billion in 2016 to $2.4 billion in 2017 and $2.5 billion in 2018.

Column 4 shows that total assets in 2004 stood at $147 billion but over the next ten years the assets grew to $729.9 billion due to both organic and extensive mergers, acquisitions and strategic alliances mainly in Asian markets, but also in America as previously mentioned. From 2015, the assets value witnessed some decline, reduced to $640.5 billion. In 2016 it started to pick up reaching $646.7 billion and ultimately attained $688.8 billion in 2018. As explained previously, the worsened economic environment in Asia, SCB primary market, coupled with unfavourable movement in exchange rates significantly affected the performance of the bank from 2013 to 2018.

Column 5, relating to impairment charges, this is a contingent provision set aside annually from OPBT to defray potential losses that may arise due to nonperforming accounts or irrecoverable loans, advances and losses arising from diminution in the value of financial assets (Not physical assets such as land, building and equipment). Impairment provision is contingent in the sense that, a loan classified as irrecoverable may eventually be recovered, so, the provision made for impairment regarding that account would be added back to the profit of the bank when a previously bad debt is recovered. As a matter of prudency and good practice, banks are encouraged to make generous provisions for losses that may arise from their business which entails giving loans and advances to customers. The proportion of the amount provided would usually be based on the degree of riskiness of their exposure in respect to loans and advances to customers.[787]

In the case of SCB, the sum provided as impairment charges from 2004 to 2007 were, $0.3 billion, $0.4 billion, $0.6 billion, and $0.8 billion for each of the years. This researcher is unable to ascertain the adequacy of this level of provision at that time given that the impairment charges was not growing at the same pace as the total assets. There is no explanation given by SCB in the financial accounts for this seemingly low provisions. Similarly, from 2008 to 2014, the impairment provisions for nonperforming accounts, which ranged between $1 billion and $2.9 billion, are

[786] Standard Chartered Bank 'Annual Report and Financial Accounts' 2018, p. 4
[787] Op. Cit., Bank of International Settlement, 2017, (n. 355).

also considered to be very modest bearing in mind that the assets of the bank had grown exponentially over the years. Be that as it may, if over time the impairment provisions were inadequate, SCB had only deferred the 'doomsday' until 2015 when the bank had to cough up $5.5 billion as impairment charges.

The significantly high impairment provision may well be due to the intervention of bank supervisors in line with the requirements under Basel III. As explained in chapter 2, under Basel I and II banks were given the discretion to use an internal model to determine how they wanted to determine the Risk Weighted Averages of their loan profile.[788] But after the global financial crisis 2007 - 2009 it was discovered that some banks were not entirely honest in the grading of the quality of their assets. Thereupon, under Basel III reforms, banks' supervisors were given powers to look closely at the methodology engaged and powers to require banks to provide 'buffers' to cover risks, as they may determine.[789] This could have been what happened to SCB in 2015 but we are not certain about that.

What is known however, is that as a direct consequence of the relatively huge impairment provision of $5.5 billion in 2015, the bank for the first time in the years under review sustained operating losses before tax to the sum of $1.5 billion.

Column 6 is related to the number of branches and outlets from which SCB operated. In 2003 SCB made a note that they had only 450 branches. In 2005 following strategic mergers and acquisitions, their network of branches increased to 1,200.[790] From then the network of branches continued to increase until it peaked at 1,700 in 2010 and 2012. By 2014 the branches had reduced to 1,200. Following that, no further statistics were provided as to whether the branches increased or decreased. Understandably, with the increase in the impact of technology, the importance of an increasing or diminishing number of branches reduced.

Column 7 is concerned with the number of staff engaged by the Group. SCB employment profile hit 90,000 in 2014 from about 44,000 in 2005. These were people employed in over 50 countries around their highly diversified markets.[791] In view of the SCB strategy of keeping its investment banking arm mainly in the UK

[788] Please see page 113
[789] Please see pages 113.
[790] Standard Chartered Bank, 'Annual Report and Financial Accounts' 2005, p. 5
[791] Standard Chartered Bank, 'Annual Report and Financial Accounts' 2007, p. 1

while branch banking was kept elsewhere, the staff complement in the UK was only about 2,000 people.

Columns 8 and 9 are related to EPS and DPS. Over the period of eleven years from 2004 – 2014 SCB maintained an unbroken record of profit making. Except for 2016 the bank continued to pay a generous dividend to equity shareholders, ranging from 0.11 cents in 2017 to 0.86 cents in 2013 and 2014. The average DPS for the years under review was in the region of about 60 cents yearly.

Columns 10 and 11 relate to total deposits and loans. The key issue in relationship to these two variables is a consideration over whether or not aggregate loans exceeded total deposits. This is about the liquidity risk, whether there are concerns about SCB's ability to meet the demands of its customers. It should be borne in mind that the representative figures for each year is the sum total of loans and deposits for just one day in the year, the 31st December annually. What that means is that there may have been instances in the course of the year when the ratio of the aggregate deposits to loans may not necessarily be as impressive. That would be difficult to say based on the figures presented in the annual reports and accounts for the years under review.

However, based on the statistics in column 10 and 11, for the fifteen years under review, the aggregate deposit figures in each year exceeded the loan figures by very comfortable margins. For example, in 2008 to 2011, the deposits exceeded loans by an average of $50 billion. In 2012 to 2016, the deposits exceeded loans by an average of $70 billion. In 2017 and 2018 the average figure with which the deposits exceeded loans was almost $100 billion. These figures give the impression of a well-resourced and a bank with good level of liquidity.

Column 12 is the extract of income from the investment banking division of SCB from 2004 to 2018. Starting with a contribution of $1.2 billion in 2004 and $1.4 billion in the subsequent year, but by 2009 the contribution from this arm of SCB significantly rose to $9.3 billion. This was after the strategic mergers, takeovers, acquisitions, and alliances with other financial institutions which SCB engaged in to grow itself especially in the period 2005 leading to 2009 as pointed out earlier in the review. In 2010 to 2013, the contributions from the investment banking arm of the bank was even better, with over $10 billion annual contributions from the division, until 2014 when as it were the bubble ruptured, leading to about 50% reduction in the sums contributed by the division. The reason provided for the slump in the general performance of SCB from 2013 onward was linked with the inclement market conditions in Asia generally at that time and the depreciation in the value of the local currencies within SCB main markets against the USA dollar.

Column 13 indicates a nil return as SCB appears not to have engaged in insurance business in its portfolio or that they were not reported separately.

Column 14 relates to income derived from wealth management services provided to wealthy private customers. This is a niche market that SCB made a significant inroad into, having grown from a revenue earning capacity of a little less than a billion dollars in 2004 to an earning capacity of $2.8 billion in 2008. In 2013 SCB had $58 billion in Assets Under Management (AUM) from high net worth individuals which generated income of $1.3 billion.[792] The plan then was to increase the AUM to $300 billion by 2020. As with other segments of SCB, the private banking sector income generating capacity went down from $1.7 billion in 2015 to a mere $0.5 billion from 2016 to 2018.

4.23 Findings and Conclusions Regarding Standard Chartered Bank Group in the Light of the Aim of the Study

(i) SCB is a UK registered bank regulated by the PRA and FSA and regulatory authorities in other countries where they are hosted. The bank has a long history, having its roots linked to two Scottish pioneers who were licensed to operate financial institutions as far back as in 1850s and 1860s.[793]

(ii) SCB is a universal bank listed on the London Stock Exchange, Hong Kong Stock Exchange, and Bombay National Stock Exchange in India. Notwithstanding that the core deposits of the bank are more than £25 billion pounds, SCB is not directly affected by the ring-fencing policy.[794] This is because the bank was outside the scope of the ring-fencing policy on the account that the core banking customers of the bank that the ring-fencing policy seeks to protect are based outside Europe.

[792] Standard Chartered Bank 'Annual Report and Financial Accounts', 2013, p. 9
[793] Please see page 256
[794] Please see page 256

Thus, other than a requirement to comply with the law and banking regulations in the UK, the bank was not directly affected by the need to prepare for compliance with the ring-fencing policy.[795]

(iii) Although the bank is a registered UK bank, the bank derives between 80 - 90% of its income from overseas in Asia, China, Africa, and the Middle East where most of its consumer banking services have been provided over the last 150 years plus. [796][797]

(iv) Strategically, SCB coordinates its investment banking services from the UK.[798]

(v) Generally, in all the areas of the statistics made available in relation to the Key Performance Indicators (with the exception of impairment charges of $5.5 billion recorded in 2015), SCB performed creditably well. The operating income grew consistently from only $5.4 billion in 2004 to $19 billion in 2012 but dropped sharply by $3 billion in 2015.[799]

(vi) SCB maintained an unbroken stretch of growth in its OPBT between 2004 – 2012 which climaxed at $6.9 billion. Similarly, earnings per share peaked at about $2.02 per ordinary share of the company. The strong earning capacity of the company gave room to SCB to pay a generous average DPS of about $0.69 to its ordinary shareholders between 2007 – 2009 in the midst of the chaos of the global financial crisis in 2007 – 2009. From 2010 to 2014, DPS reached $0.86.[800]

(vii) Similarly, SCB had a very comfortable liquidity ratio such that deposits/loan ratios in 2004 was 1.14:1 and in 2018 it was 1.32:1. As pointed out previously, the difference between aggregate deposits was about $100 billion above total loan in 2017 and 2018.[801]

In conclusion, this researcher wants to point out a remarkable presence of regulatory arbitrage in the circumstances of SCB as discussed below.

[795] Please see page 255
[796] Standard Chartered Bank 'Annual Report and Financial Accounts' 2006, pages 4 & 5
[797] Standard Chartered Bank 'Annual Report and Financial Accounts' 2008, page 4
[798] Please see page 255
[799] Please see Table 8 page 259
[800] Please see Table 8, page 259
[801] Please see page 259

For example, economic arbitrage is a situation that arises where a trader exploits price differences on the same instruments so that while selling an overpriced security, he simultaneously buys the under-priced security.[802] That trader later reaps a huge profit by ultimately selling the under-priced security at a much higher price. Arbitrage is not illegal, nor does it amount to breaking any rules.

SCB coordinates its investment banking activities from the UK while its core banking customers are spread in other jurisdictions. The bank is listed on the London Stock Exchange and in other places such as Hong Kong and India.[803] Thus, the bank has the advantages of carrying out its investment banking businesses in the UK with enhanced capacity to raise much needed finance in the UK (with the exclusion of deposits from consumer banking customers) thereby using London as a corridor to funnel pounds sterling to fund its operations in Asia, China, the Middle East and African markets. It could also go the other way round so that access to funding in those other markets could also be channelled through to London to fund wholesale banking in the UK, without the strenuous burden of the need to be ring-fencing compliant at home as other competitors in the UK market are compelled to do.

The question may then be, "Why couldn't other universal banks like Barclays and RBS use foreign deposits to subsidise their investment banking activities?"

The circumstances of SCB were very different to Barclays and RBS in a number of ways in the years under evaluation.

SCB was well resourced with very attractive balance sheets. Unlike Barclays and RBS that were hardly able to break even during the global financial crisis, SCB scaled through the crisis almost effortlessly. With such credential, SCB would naturally be the 'darling' of financiers and underwriters whether in Europe, America or in Asia having few difficulties assuming they wanted to raise more funds.

Secondly, SCB had the appearance of a well-managed and a stable bank unlike Barclays and RBS that were floundering for upward of ten years. The same reasons why Barclays and RBS struggled to raise funds in the UK would also be the obstacles they would meet elsewhere whether in Europe, America or in Asia because they

[802] Op. Cit., G. Arnold, 2005, p. 720, n. 25)
[803] Please see page 255

would be presenting the same set of financial records analysed in this thesis to potential lenders wherever they go. The potential financiers and underwriters would as well see the holes and difficulties in their accounts and may not want to throw good money after bad business.

Thirdly, it is not the case that RBS and Barclays cannot use funding from elsewhere to support their operations here in the UK. Afterall that was what Barclays did by accessing £6.1 billion from Qatar through private arrangement as discussed under Section B.

The argument is that apart from the fact that Barclays and RBS had loads of difficulties already discussed, compliance with the ring-fencing policy would even make things worse for Barclays and RBS when compared with SCB and other European Banks that are not obliged to be ring-fencing compliant.

The evidence of the inherent advantages to SCB is that, while in the face of the global financial crisis in 2007 – 2009 other banks in the same market in the UK were struggling to remain afloat (RBS was hardly able to break even in 10 years and Barclays could only pay little to nothing as dividend) SCB was growing. In the case of SCB for 10 years during and after the global financial crisis, SCB was thriving, declaring an unbroken eight years' record of increasing profits and comfortably paying an increasing level of dividends from 2004 - 2014.

Making profits and paying increasing levels of dividend year in year out is not a problem in itself, it only raises questions about whether there was a level playing field. While RBS and Barclays were subjected to the UK's stringent rules including the ring-fencing policy, SCB was not subjected to the ring-fencing policy. Whilst RBS and Barclays had to dispose their assets for one reason or the other as previously discussed, SCB did not need to because of its impressive all - round performance.

Assuming that SCB was faced with criticisms in line with the issues highlighted, SCB might argue that as regards regulation arbitrage, even if it were true, the bank did nothing wrong. SCB has always had its businesses spread round the world in more than 150 years from its inception.[804] In any event, even if SCB were found to have benefited from regulatory arbitrage, the bank did not do anything illegal.

SCB could also defend their unbroken impressive profitability record from 2004 – 2014 on the basis that, unlike their competitors that were exposed to toxic collateralised assets in excess of £100 billion in some instances, SCB's extent of exposure to such assets was only limited to $6 billion.[805] As SCB did not share in the excruciating burden of collateralised toxic assets when compared with other banks that did, it should not be seen as out of the ordinary that SCB was making record profits while their competitors were struggling.

As well, in regard to the $5.5 billion impairment charges that stood out of the lot in 2015, SCB could defend it as a one-off issue that arose as a result of depreciation in the currencies of their local markets against the US dollar, which is nothing unusual.

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[804] Please see page 255 - 256

[805] Standard Chartered Bank, 'Annual Report and Financial Accounts' 2007, p. 11

Section D: HSBC Holdings Plc (Group Accounts)

4. 24 HSBC Plc: Historical Background, Size and the Corporate Services Provided by the Bank

HSBC Holdings Plc is currently the largest amongst the UK banks. As of 2018, HSBC was the 7th in rank amidst the largest banks in the world.[806]

The abbreviation HSBC stands for "Hongkong and Shanghai Banking Corporation". Although the bank has a long history dating far back to 1865 when it was established in Hong Kong and where it then had its headquarters, HSBC was only incorporated in England on 1st January 1959 under the UK Companies Act.[807] At registration the bank was issued with company registration number 617987. The Group Headquarters which was formerly located at 1 Queen's Road in the City of Victoria at the Central district in Hong Kong was relocated to the UK in 1993 following the merger and acquisition of Midland Bank Plc.[808] The headquarters is currently sited at number 8, Canada Square London, E14 5HQ.[809]

The idea behind the establishment of HSBC started in 1864 while a Scottish Merchant Seaman called Thomas Sutherland was sailing along the coast of South China. He sensed a growing need for the presence of a bank that could cater for the needs of the rapidly growing international trade between Europe and Asian countries especial at the ports of Hong Kong, Shanghai and Japan. Thus inspired, with the support of well-established business communities across his social network in Hong Kong, Sutherland soon floated a corporation with an initial capital consisting of 20,000 ordinary shares at HKD250 each, which sold out promptly.[810]

The first branch of the bank was established in Hong Kong on 3rd March 1865 while another soon followed in Shanghai in the April of the same year. A branch of the bank was also opened in London in July 1865. Then, the London branch was more of an outstation branch planted primarily to assist with the recruitment and training

[806] Please see Table 3 page 149
[807] HSBC, Annual Accounts, 2017, p. 270
[808] HSBC, Annual Accounts, 2008, p. 458
[809] HSBC, Annual Accounts, 2018, p. 318
[810] https://www.hsbc.com/who-we-are/our-history

of staff in London and to facilitate procurement of foreign exchange needed for trading between Europe and Asia.[811]

The point is that, at inception, HSBC was primarily founded to provide international banking services in Asia, providing financial services to support export of variety of goods to Europe including silk and tea from China, sugar from the Philippines and jute and cotton from India.[812] In a short time, the bank became very successful in their business such that at the start of the 20th century, the bank had expanded to sixteen countries and had strong resources enough to support infrastructural development in its primary place of birth in Asia. This included providing developmental loans to national governments to finance capital projects such as railway in some of the Asian countries.[813]

Although HSBC's far-reaching tentacles now extend globally, in keeping with the vision of the pioneer of the bank, a larger proportion of the bank's businesses are still located in Asia. HSBC operates a universal banking model with global businesses that are providing wide ranging financial services segmented along four main divisions including (i) Retail banking and wealth management (ii) Commercial banking (iii) Global banking and market (iv) Global private banking.[814]

To enable readers to have a feel of the enormous size of HSBC in a more recent history and as well to appreciate the magnitude of the scale of the global operations of the bank, the following statistics are made available. At the peak of its success, HSBC had about US$ 2.7 trillion in assets,[815] over 310,000 employees,[816] about 221,000 shareholders spread across 127 countries and territories around the world.[817] HSBC was listed on the Bermuda, London, New York, Hong Kong and Paris stock exchanges. Prior to the global financial crisis, HSBC operated from a network of branches in about 10,000 locations that span across almost 100 countries in five regions in the world including Hong Kong, the rest of Asia pacific, North America, Latin America and Europe.[818] Also, before the global financial crisis, the bank served

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811 Ibid.
812 Ibid.
813 Ibid.
814 HSBC Annual Accounts, 2016, p. 3
815 HSBC Annual Accounts, 2012, p. 374.
816 HSBC Annual Accounts, 2006, p. 265.
817 HSBC Annual Accounts, 2010, the introductory page.
818 HSBC Annual Accounts, 2006, the introductory page

over 128 million customers worldwide,[819] which has now drastically reduced to about 39 million customers following a programme of demerger, de-risking and sale of several non-core banking businesses especially in the North and Latin American countries.[820]

Importantly too, the above stated statistics vis – a – vis the far-reaching potential consequences of the failure of such a mammoth size bank to the local and international banking system could understandably be a matter of deep concern to the public, the banking sector regulators and policy makers leading to supporting the argument for the ring-fencing policy adopted in the UK.

Just as RBS ran into difficulties by acquiring ABN Ambro and Barclays had its own share of the trouble buying part of the businesses of Lehman Brothers, so also HSBC suffered losses during the global financial crisis because of its involvement in the sub-prime housing market through its merger with Household Finance Corporation, which HSBC acquired in 2003.

On a positive note, the processes of restructuring that took place in HSBC in the period leading to 2019 inspired by policy measures taken to mitigate the effect of a possible failure in the banking sector has arguably provided a bit of a relief on the risk factor of a failure occurring in HSBC banking group just as it is in other banking groups too. However, an important difference in the sales of HSBC non-core businesses is that (except where there were losses such as in the case of Household Finance Corporation), the proceeds of sales mostly remained in the business which made the total assets to remain almost unchanged unlike RBS and Barclays that the substantial part of the realised gains from the sale of their assets went into cutting losses. Thus, while the non-core businesses were sold in Barclays and RBS, the total value of assets were declining rather than increasing.

The summary of how HSBC faired in the 15 years from 2004 to 2018 under review, the regulatory environment under which the bank operated in the aftermath of the global financial crisis, the threat that the bank may still pose to the world economy and issues identified in the HSBC financial records in those 15 years spanning the period of the global financial crisis and about ten years thereafter are part of the subjects discussed in Section D.

[819] HSBC Annual Accounts, 2007, the introductory page
[820] HSBC Annual Accounts, 2018, p. 2.

HSBC is primarily regulated and supervised by FCA and PRA (Departments in the Bank of England). This is in addition to the Federal Reserve Board in the USA and the Hong Kong Monetary Authorities. In 2008, HSBC reported having regulatory relationships that covered about 540 supervisory agencies including central banks in jurisdictions across the world where they have offices, branches or subsidiaries.[821] The areas that these regulatory activities covered include lending practices, matters concerning financial stability, capital adequacy, transparency in financial market dealings and depositors' protection among many other areas. According to HSBC, the estimated costs of these regulatory and supervisory relationships to the bank was about US$635 million in 2005 lone.[822]

The financial year of the bank starts on the 1st of January and ends on the 31st December annually. For the period under review, reporting currency was USA dollars.

As reported in the literature review in chapter 2, paragraph 2.16 under "Accounting Standards", the contributions of accounting reporting scandals in the failed USA based energy company Enron and the events that led to the collapse of BCCI have led to more scrutiny being paid to the quality of the auditing standards adopted by banks' auditors in the UK and in fact, globally.

Regarding HSBC, for the period under review, the accounts in 2004 – 2014 were audited by KPMG Audit Plc while from 2015 – 2018, PricewaterhouseCoopers LL P, Chartered Accountants and Statutory Auditors based in London took over as the principal reporting auditors. Among many other areas of importance, the report of their audits includes (i) Risk assessment of the bank at a global level which separately covered individual legal entities within the group and the parent company itself (ii) Auditor's fieldwork was reported to have stretched over widespread locations. The auditors also stated that they assessed operational processes that are critical to the financial reporting of HSBC (iii) The auditors also claimed to have carried out assessment of the methodology engaged to determine the fair value of financial assets and measurements of capital adequacy and liquidity ratios adopted by HSBC. [823] The point being emphasised is that it is increasingly recognised that effective auditing that is deep and far reaching are *sine qua non* to the ongoing

[821] HSBC Annual Accounts, 2008, p. 188.
[822] HSBC Annual Accounts, 2005, p. 13.
[823] HSBC Annual Accounts, 2018, p. 213

efforts and processes needed to keep the banking sector safe. In 2017, HSBC reported auditor's fee of US$129.7 million which served to demonstrate the extent and the value of the works carried out by the auditors.[824]

Overall, there were no adverse reports given by the auditors for the years under review.

The followed paragraphs deal with presentation of the data extracted from the accounts of HSBC for the period 2004 – 2018 in tables, graphs and it concluded with analysis of the data.

[824] HSBC Annual Accounts, 2017, p. 129

Table 9 – Tabulated Data Extracted from the Annual Reports and Consolidated Financial Accounts of HSBC Group From 2004 to 2018 (Financial Year Ending on 31st December Annually)

Year 1	Total Income US$ (b) 2	Operating Profit Before Tax US$ (b) 3	Total Assets US$ (b) 4	Impairment Charges US$ (b) 5	Branches 6	Employees 000 7	Earnings Per Share (Cent) 8	Dividend Per Share (Cent) 9	Total Deposit US$ (b) 10	Total Loan US$ (b) 11	Investment Banking US$ (b) 12	Contribution Insurance US$ (b) 13	Global Private Banking US$ (000) 14
2004	51	19	1,280	6		253	1.18c	0.63c	777	816	5	1	1
2005	58	21	1,502	8		284	1.36c	0.69c	809	866	5	1	1
2006	65	22	1,861	11	10,000	312	1.40c	0.76c	997	1,053	7	1	1
2007	79	24	2,354	17	10,000	322	1.65c	0.87c	1,228	1,219	6	0.5	2
2008	82	9	2,527	25	9,500	325	0.47c	0.93c	1,245	1,087	3	4	1
2009	66	7	2,364	26	9,500	310	0.34c	0.34c	1,284	1,076	10	(2)	1
2010	68	19	2,455	14		307	0.73c	0.36c	1,338	1,167	10	(0.6)	1
2011	72	22	2,556	12	7,200	288	0.92c	0.39c	1,367	1,121	7	2	1
2012	68	21	2,693	8	6,600	270	0.74c	0.45c	1,447	1,150	9	(1)	1
2013	65	23	2,671	6	6,300	235	0.84c	0.49c	1,612	1,292	9	(2)	0.1
2014	61	19	2,634	4	6,100	258	0.69c	0.50c	1,428	1,087	6	(1)	1
2015	60	19	2,410	4	4,700	255	0.65c	0.51c	1,344	1,015	8	(1)	0.3
2016	48	7	2,375	3	-	235	0.07c	0.51c	1,332	950	6	(2)	0.3
2017	51	17	2,522	2	3,900	229	0.48c	0.51c	1,434	1,053	6	(3)	0.3
2018	54	20	2,558	2	-	235	0.63c	0.51c	1,419	1,054	6	1	0.3

4.25 Constituents of Table 9

Table 9 comprises tabulated financial data extracted from the annual reports and financial accounts of HSBC for a period of 15 years starting from 2004 – 2018. The table contains fourteen vertical columns with self-explanatory headings regarding some key economic performance indicators obtained on annual basis for the fifteen years under review.

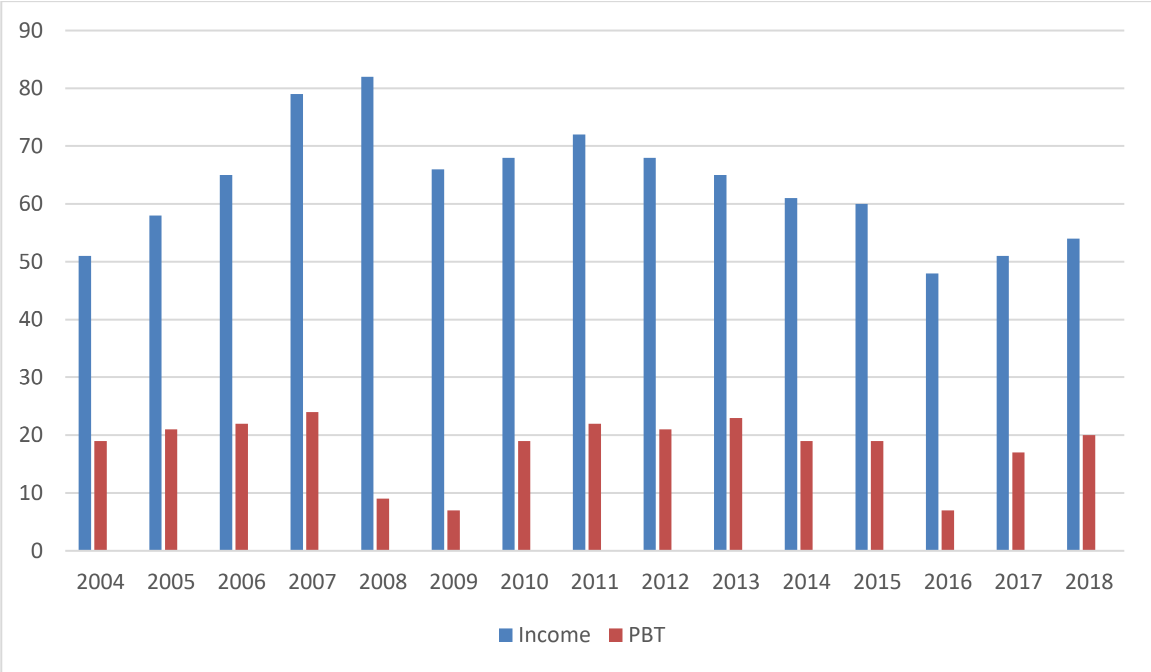
The first 3 years, 2004 – 2006 is the period that preceded the global financial crisis. Going by the accounting records of HSBC, the bank generally performed credibly well in those three years including 2007 when the crisis began. Although HSBC struggled considerably in 2008, 2009 and 2016, the bank came out of the general economic doldrum unaided by government's bailout packages and successfully managed to pay dividends throughout the 15 years under review. A more detail analysis of the performance of the bank is given in the next paragraph, 4.26.

Appendix 4 at the back of this report provides the page numbers within the annual reports and financial accounts wherein the financial data were extracted.

Figures 26 – 30 are presentations of the data in chart forms to illustrate at a glance the relationships between the data. The visual presentation assisted in understanding the basis of the bank's performance, how well the bank performed in some areas of its business activities and the extent to which the bank did not perform so well in other areas and why that may have been the case.

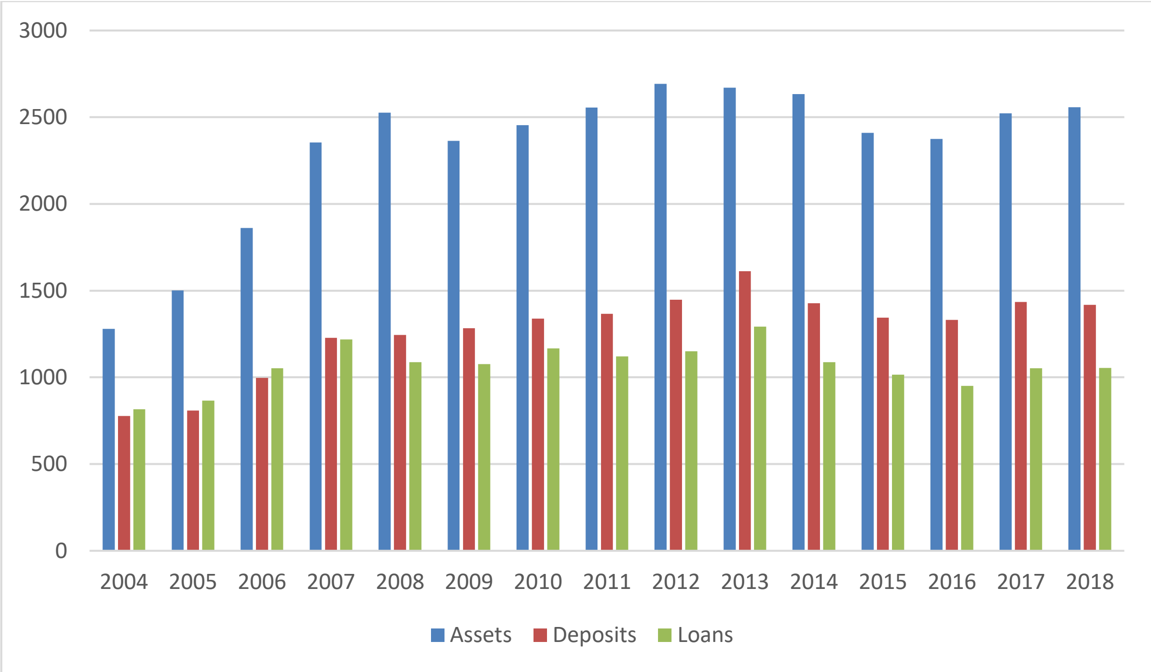
The scale and the variables contained in both X and Y axes of each chart are presented in a separate Appendices 26 – 30 stated at the back of this report.

Figure 26 HSBC Group: The Relationship Between Operating Income and PBT 2004 – 2018 US$ billion



The chart indicates growth in the operating income of HSBC from 2004 to 2008 when their income constantly increased annually from US$51 billion in 2004 to $82 in 2008. Thereafter, from 2009 – 2015 the annual operating income ranged between $60 billion and $72 billion. The operating income nose-dived sharply in 2016 when the bank had $48 billion income as opposed to the $60 billion made in the previous year, 2015. The reason for this dismal performance was due to the losses incurred in the North American market where HSBC lost $7 billion and in Brazil market where the bank sustained a loss of about $1 billion. As well, operating profit before tax ranged between $24 billion in 2007 and $7 in 2009 and 20016. The poor performance in the 2008 and 2009 had its roots with the defunct sub-prime lenders, Household Finance Corporation acquired by HSBC in 2003. Losses from this outfit cost HSBC about $50 billion. Part of the underlying difficulties at the height of the global financial crisis resulted in impairment charges of $25 and $26 billion charged on the accounts in 2008 and 2009. This was also exacerbated by a written down goodwill in 2009. In addition to all these are (i) scaled down operations by disposing non-core banking assets which considerably brought down its global number of clients from 128 million down to 39 million in 2018. (ii) Reduced interest rate and, (iii) depreciation in Asia countries' currencies against US dollars.

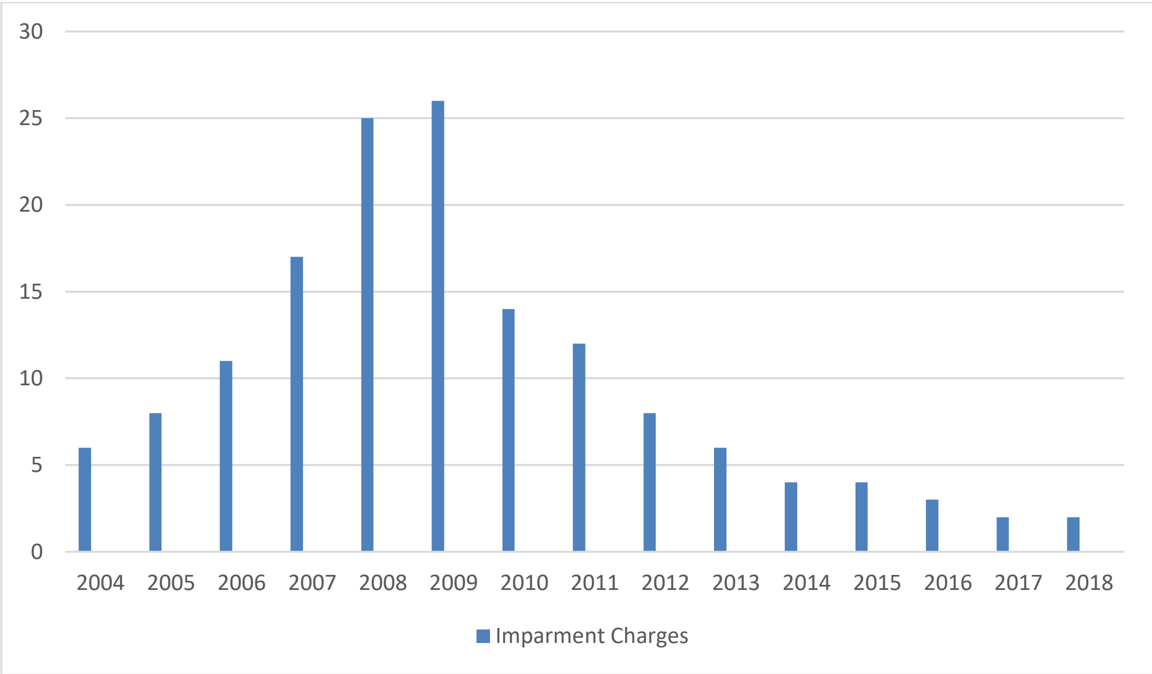
Figure 27, HSBC Group: The Relationship Between Assets, Deposits and Loans 2004 – 2018 US$ billion '000



Remarkably, HSBC doubled its total assets in the course of the 15 years under review such that its assets grew from $1.3 trillion in 2004 to $2.6 trillion by 2018. As well, except between 2004 to 2006 when the aggregate loans slightly exceeded deposits, HSBC was firmly in control of its liquidity position from 2009 – 2018. HSBC had excess deposits of between $200 - $400 billion above the total loans annually throughout that period.

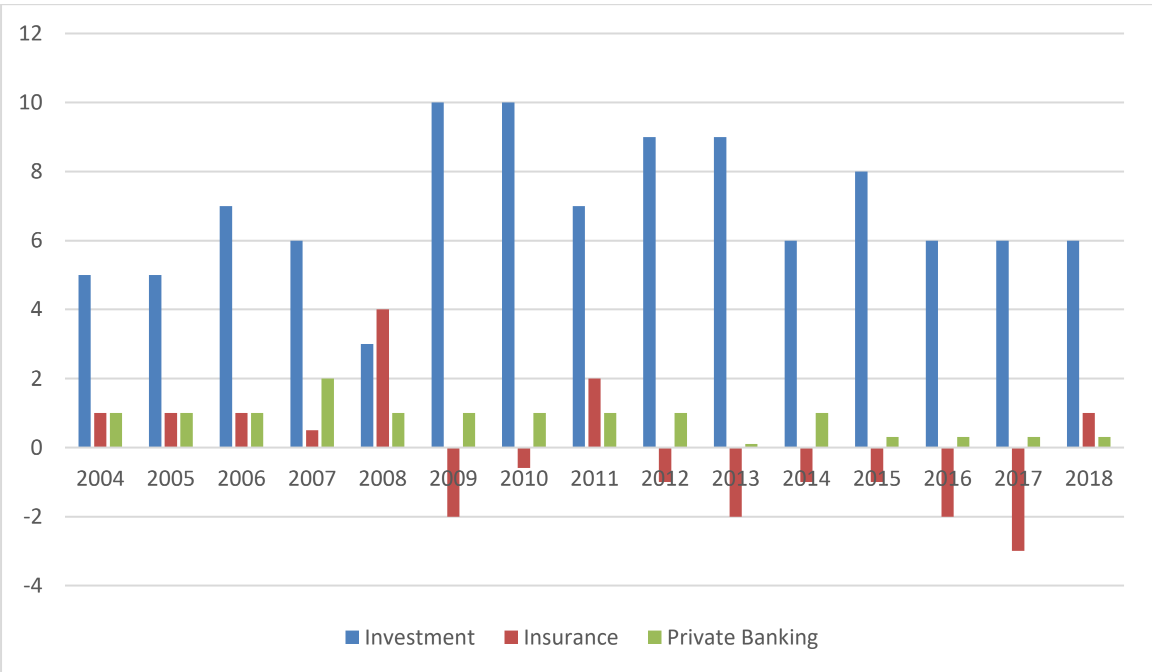
The significance of the huge deposits which is far more than loans and advances is that HSBC was in good liquidity position. Depending on where this excess liquidity is stationed whether in the ring-fenced bank or non-ring-fenced bank, HSBC has good capacity to support larger customers. Either way, generally, HSBC is still in far better position to support its large customers. The constraints of the ring-fencing policy would be minimal on HSBC unlike RBS and Barclays.

Figure 28, HSBC Group: Trend of Growth/Decline in Impairment Charges 2004 – 2018 US$ billion



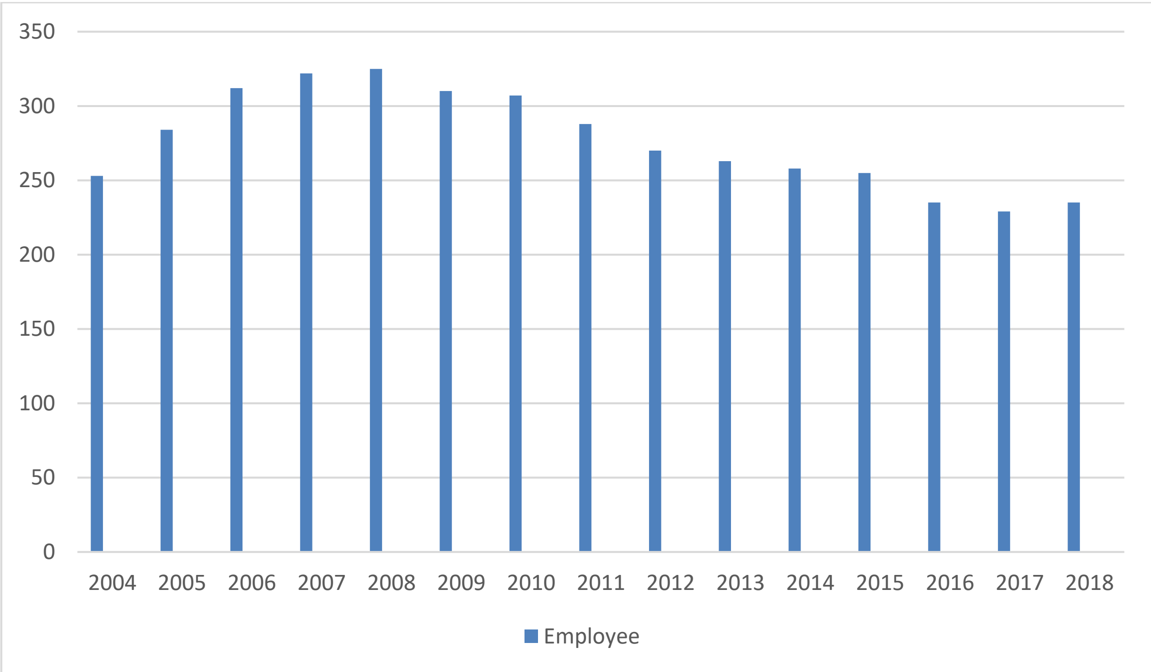
Impairment charges rose sharply in 2008 and 2009. This was due to revaluation of derivatives in 2008 and written down goodwill in 2009.

Figure 29, HSBC Group: The Proportion of Contributions to PBT from Investment Banking Division, Insurance Business and Private Banking 2004 – 2018 US$ billion



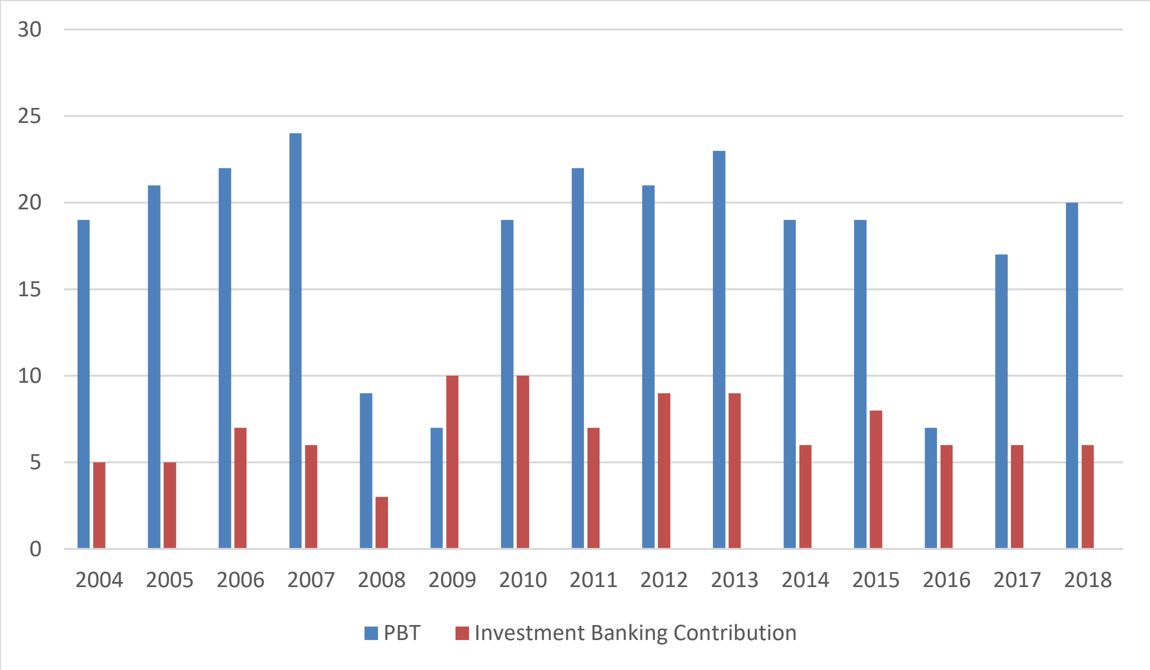
The investment banking division of HSBC made some considerable contributions of $10 billion each in 2009 and 2010 and thereafter remained fairly stable in its contributions to the PBT. The strength of HSBC lied with its retail banking business. Generally, the insurance business was the weakest as it consistently made losses for eight of the 15 years evaluated. Private banking division also only made very modest contributions to the PBT. That division stagnated for four years running from 2013 to 2018.

Figure 30, HSBC Group: Employee Profile 2004 – 2018



At the highest level in 2008, HSBC had about 325,000 employees which reduced to about 229,000 in 2017. Notwithstanding that the physical network of branches and office locations climbed down from 10,000 to about 3,900 and customers numbers reduced from 128 million to about 39 million, commendably, the least number of staff HSBC had in the fifteen years under evaluation was 229,000 employees in 2017. This started picking up again reaching 235,000 in 2018.

Figure 31, HSBC Group: Investment Banking Contributions to the Profit Before Tax 2004 – 2018 US$'000 billion



Although investment banking made significant contributions towards the profit before tax, generally the contributions were not predominant.

4.26 Analysis and Interpretation of the Extracted Financial Data Collated from the Annual Accounts of HSBC Group

2004 – 2006

This was the period before the dawn of the global financial crisis. The bank reported a setback brought about by losses incurred from their earlier purchase of Household Finance Corporation, a sub-prime mortgage business acquired in the USA which slowed down their growth in 2006.[825] As well, the liquidity position of the bank in the period 2004 – 2006 was below acceptable standards as aggregate loans exceeded total deposits throughout that period. The impairment charges increased from $6 billion in 2004 to $11 billion in 2006. That is almost double the amount charged in 2004. The increase can be associated with envisaged losses from their investment in sub-prime mortgages as mentioned earlier and the fact that the assets grew substantially from $1.3 trillion in 2004 to $1.9 trillion in 2006. While the bank had an appearance of having a growing income and growing assets, there

[825] HSBC, Annual Accounts, 2006, p. 8

are noticeable degree of underlying difficulty as the profit before tax was not growing at the same pace as the assets. This was part of the slowing down in the earning powers of the assets due to weakened assets quality, low interest rate and regulatory pressure to boost both capital and liquidity requirements.

Apart from these occurrences, generally, the bank maintained a steady growth rate in their income, and they had a consistent growth in their operating profit before tax even if it was only marginal. On the positive side, the bank was still making profits and they were able to declare dividends to shareholders. In 2004 to 2006 they declared dividends of 0.63 cents, 0.69 cents and 0.76 cents respectively. Above all, HSBC aimed to retain up to 60% of their profits in the business which was very helpful to the company in subsequent years to support its Common Equity Tier 1.

2007 – 2009

This was a period of unprecedented upheaval in the banking sector, credit crunch and general slowdown in the global economy which brought many financial institutions down on their knees and some including RBS had to be bailed out at a great cost to the national government.

The economic climate of that period amplified the weaknesses in the financial position of HSBC. HSBC carried the burden of their misadventure relating to buying HFC into the heat of the global financial crisis in 2007 - 2009. It was a venture that HSBC regretted very much because of the string of losses over time estimated to be in the region of $50 billion. In 2009, reflecting over the losses, S. K Green the then Group Chairman said,

"*With the benefits of hindsight, this is an acquisition we wish we had not undertaken.*"[826]

Income reached its peak in the period 2007 and 2009 when the bank had income of $79 billion, $82 billion and $66 billion respectively with total assets for the same period climbing to $2.4 trillion, $2.5 trillion and $2.4 trillion which generated declared profits before tax of $24 billion, $9 billion and $7 billion.

Foremost, HSBC had a sudden expansion on the balances on its derivative accounts during this period which contributed to the increase in the asset growth. For example, in 2006 the balance on the derivative account was only $104 billion but by 2008 it had risen to $495

[826] HSBC, Annual Report and Financial Accounts, 2008, p. 9.

billion but revalued downward to $251 billion in 2009. [[827]][[828]] HSBC reported that these financial instruments increased in value on the account of upward review of the price of the financial instruments not necessarily because there were any changes in the notional value of the underlying contracts.[829] In the following accounting period the value had to be written down to reflect the reality of the then prevailing market conditions.[830]

Although a peak of $82 billion in the operating income was significantly high in the period, they were vastly eroded by impairment charges which also peaked at $26 billion. HSBC reported that part of the reasons for the increase in the impairment charges was due to increase in credit card balances and a rise in bankruptcies in Hong Kong.[831] Similarly, housing price depreciation restricted refinancing options for customers coupled with job losses in the labour market.[832] In addition to that, HSBC reported that they had business challenges in their North America market where they sustained a loss of $7 billion and in Brazil where they had a loss of over $1 billion.[833] At the same time, the economic climate in Europe at home affected HSBC's performance just as it affected other banks in the UK.

HSBC kept afloat through refocused operation in the emerging markets such as in South Korea, Vietnam, Malaysia, Brazil and India. The bank benefited from the economic boom in China and also gained as a result of increase in oil prices for five consecutive years in the Middle East.[834] In addition, HSBC sold some of its matured investments during this period including sale of 20% of its investments in Yantai City Commercial Bank in China.[835]

On a good note, HSBC gained control over the liquidity status of the bank in the period 2007 – 2009 without any need for a recourse to the government for a bailout. In addition, right in the heat of the global financial crisis, HSBC paid its highest dividends of 0.93 cents in 2008 meanwhile Tier 1 Capital under Basel II was consistently gaining strength as it increased from $91 billion in 2007 [836] to $95 billion and $122 billion in 2008 and 2009 respectively.[837]

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[827] HSBC Accounts 2007, p. 334
[828] HSBC Accounts 2009, p. 355
[829] HSBC Accounts 2008, p. 40
[830] HSBC Accounts 2008, p. 10.
[831] HSBC Accounts 2007, p. 61
[832] HSBC Accounts, 2008, p. 34
[833] HSBC Accounts 2007, p. 6
[834] HSBC Accounts, 2007, p. 8
[835] HSBC Accounts, 2007, p. 7
[836] HSBC Accounts 2007, p. 288
[837] HSBC Accounts 2009, p. 290

Notably, customers deposits increased substantially from $997 billion in 2006 to $1.3 trillion. The reason given for the over $300 billion increase was due to inflow from customers who withdrew from volatile investments and brought such proceeds to HSBC attracted by the strength and stability of the bank.[838]

2010 - 2013

The period 2010 – 2013 was the time of regulatory reforms. It was a period of uncertainty. Then there were international collaborations, consultations with stakeholders, deliberations, and determination on what should be the appropriate regulatory response to the global financial crisis. It was the period that the Financial Services (Banking Reform) Act 2013 was conceived. This was also the period that the UK government proceeded with a plan to impose levies on the UK banks to further stabilise the banking sector. In addition to all these was the impact of fines, redress to customers for past misdeeds and issues around tightening of Common Equity Tier 1, all of which had significant impact in boosting confidence in the banking sector but as well had cost implications to the banks.

Regarding HSBC, the year 2010/2011 marked a time of changes in the management of the bank. It was the time of the incoming new administration of D J Flint, the new Group Chairman, Stuart Gulliver the new Chief Executive Officer and the exit of the bank's former Chairman Stephen Green and Michael Geoghegan the former Chief Executive Officer of the bank. Both retired key officers navigated the affairs of the bank throughout the period of the global financial crisis. At the time of their retirement, they had put in 28 and 37 years' service respectively into the service of the bank including the period in which they led the bank.[839]

The years 2010 to 2013, witnessed a fairly stable financial performance for HSBC after the difficulties the bank had in between 2007 – 2009. Operating income, profit before tax and total asset remained fairly stable. HSBC had its highest asset level of $2.7 trillion in 2012. Although with much higher assets, the bank started to make as much profits as it did in the pre-global financial crisis era. Notwithstanding the increased asset level, the impairment charges also came down drastically to $6 billion in 2013 as opposed to $26 billion in 2009.

[838] HSBC Accounts 2008, p. 41.
[839] HSBC Accounts, 2010, p. 4

A contributory factor to the improvement witnessed on the account of HSBC was the benefit of higher trade volumes in Asia markets. As reported by the bank, Asia contributed the largest proportion to the operating profit before tax.[840] Asset level grew to its highest level through controlled disposal of 16 non-strategic investments which also yielded further profits that enabled the bank to pay more dividends and to boost the Core Tier 1 capital in the period.[841]

Although the bank paid a levy of $571 million in 2012, the negative impact on the profit of the bank was almost negligible in view of the bank's huge size and large-scale operation. The bank reported that the levy of $571 million was equivalent to $0.03 per ordinary share which would have been available for distribution as dividends or used to increase the capital for the year if it was not set aside for the levy.[842]

The deposit base increased substantially from $1.3 trillion in 2009 to $1.6 trillion in 2013, a difference of $300 billion. While RBS and Barclays were shrinking in size, HSBC was growing and attracting deposits on a large scale. HSBC attributed their success in this regard to the fact that they focused more on the Asian market that did not face as much upheaval as it was in Europe and America. As well, deposal of their non-core banking businesses was not under any compulsion as was the case with both RBS and Barclays. For example, when HSBC could not get a good offer for the divestment in Turkey, they stopped the sale and rather invested more to increase the marketability of the planned asset disposal.

2014 - 2018

Operational performance in the period between 2014 – 2018 was not particularly attractive for HSBC. With the exception of the impairment charges which went down to $2 billion apiece in 2017 and 2018 (the lowest ever for the period under review), most of the key statistics went down. Operating income went to all time low at $48 billion in 2016. Correspondingly, operating profit also came down to $7 billion in 2016 but started picking up again from 2017 and 2018 when operating profit increased to $17 billion and $20 billion respectively. Assets climbed down from $2.7 trillion in 2013 to $2.4 trillion. There was reduction in the deposit accounts but not so dramatic as in the other key areas. Loans and overdrafts reduced considerably from $1.3 trillion in 2013 to $950 billion in 2016. This

[840] HSBC, Accounts 2010, p. 7
[841] HSBC, Accounts, 2012, p. 7
[842] HSBC Account, 2012, p. 5

started to pick up marginally to $1 trillion in 2017 and 2018. The reduction of about $300 billion between 2013 and 2016 could only have resulted in lower revenue generation.

So, in addition to the poor interest rate generally, and the decline in the mortgage market, HSBC also faced the decline in its main Asian markets which was at a period of trade war between China and America during the tenure in office of President Donald Trump. In addition to that was the deterioration in the Asian currencies against the US dollars. In 2014, HSBC faced fines, settlements, and customers' redress in the total sum of £3.7 billion for uncovered past misdeeds which could not have come at a worse period for HSBC.[843]

To compound matters for HSBC, they suffered losses in some of their operations in Europe and in the Latin America in that period. Part of the losses in Europe related to a written off of a substantial historical goodwill.[844] The new auditors, PWC picked up issues with HSBC over an historical goodwill account that stood at $15.5 billion some of which related to acquisition of Safra Republic Holdings purchased in 1999. The auditors were of the view that a review on this account balance was long overdue. That led to writing off $800 million on the account related to Europe.[845]

4.27 Conclusions

The HSBC faced almost the same trajectory as SCB in the period under review. This is not surprising given that both banks had similar main markets in Asia.

In the cases of RBS and Barclays, they faced the worst period of their operations during the global financial crisis and immediately thereafter but started to recover gradually from 2017 and 2018. On the other hand, SCB and HSBC scaled through the heat of the period of the global financial crisis relatively well but faced general decline in their performance at exactly the same time from 2014 mainly due to weakened Asian currencies depreciation against dollars and slowdown in the economy in Asia at that time due to the tension between the US and China.

HSBC was also embroiled in the same reputation damaging ethical issues as were found to be the case in RBS and Barclays. This included matters such as interest rate manipulation scandal, facilitation of tax evasion schemes, money laundry allegations, surreptitious

[843] HSBC Accounts, 2014, p.
[844] HSBC Accounts 2016, p 7.
[845] HSBC Accounts 2016, p. 179

inflation of the value of their derivative accounts, regulation compliance failure, proliferation of merger and acquisition deals (not necessarily a bad business to do in themselves but too often they end up having crippling bad deals) and were found complicit in matters related to mis-sold products that warranted customers' redress and huge fines.[846] Alongside with RBS and Barclays, HSBC was also considered vulnerable to failing and as such classified as a high risk Global Systemically Important Bank more so that the bank operated from multiple jurisdictions.

Despite some of the similarities with RBS and Barclays, HSBC stood out in some respects. In keeping with the vision of the founder, HSBC's businesses were mainly focused on China, its place of birth and also in emerging markets in Asia. This policy largely insulated the bank from some of the effects of the global financial crisis that mainly affected America and Europe.

In the case of HSBC, there was stability in the tenure of office of its leadership. The top executives in the bank were mainly 'home grown' hands that were familiar with their markets and organisation's culture.

The spread of the businesses of HSBC were well diversified but at the same time strategically focused on developing large volume of personal banking. This was unlike RBS and Barclays that were over reliant on investment banking. For example, as of 2005, the income generation profile of the four strategic divisions in HSBC were as follow:

Personal Financial Services	$9.9 billion
Commercial Banking	$4.9 billion
Corporate Investment Banking	$5.0 billion
Private Banking/Wealth Management	$0.9 billion
Total	$20.7 billion

The all-round performance of HSBC over the period under review demonstrated that big banks could be managed safely with or without application of the ring-fencing policy. HSBC scaled through the global financial crisis without the need to request for government bail-out.

[846] HSBC Accounts 2014, p. 5

Chapter 5

Comparative Evaluation of the Performance of the Four Case Studies

5.1 Introduction

The study evaluated the desirability or otherwise of the ring-fencing policy as a suitable regulatory measure in response to the global financial crisis (GFC) in the circumstances of the Global Systemically Important Banks (GSI-Bs) in the UK.[847]

Through evaluation of the financial accounts of the case studies from 2004 to 2018, the study aimed to determine the varied long-term impacts of the GFC on the performance of four of the largest UK banks chosen as case studies. Lest we forget too quickly, the study lays out some of the direct consequences and costs of the downward journey of these banks and the difficult road back to recovery as a lesson on record for the future.

Following the evaluation of the accounts of the case studies and in light of the aim of the study stated, this chapter evaluates the shared characteristics among the case studies, the Royal Bank of Scotland, Barclays Bank, Standard Chartered Bank and HSBC Holdings Plc. This section stresses how skilful integration of different facets of the business operations management in one bank and the robustness of the implementation strategies adopted in the bank can enable that bank to excel above others, and, as well, how a deficiency in those management capabilities can make an appreciable difference between the success and failure among the banks under study.[848]

Underscoring the contingency management theorists' approach, the chapter also emphasises how the availability of management talents in any of the banks can aid the bank to manage change effectively during an unpredictable season and acutely turbulent market environment, ultimately leading to a better performance than other

[847] Please see page 3.
[848] N. Slack, et al., 'Operations Management 3rd Ed.' Pearson Education, 2001, p. 151

organisations faced with similar circumstances as was the case during the financial crisis. [849][850]

Also, this chapter contrasts the differences in the circumstances of each of the banks, identifying distinctive characteristics that differentiate each of the banks in the case studies. Such differences include the dominant markets that each of the banks was exposed to and the different levels of credit risk exposure to the subprime financial instruments in the period leading to the crisis. Another example includes the impact the restrictions imposed on RBS had on its performance due to the bank obtaining bailout support from the UK government.

As well, the chapter evaluates how these differences helped or became a burden in the process of responding to the regulatory changes and other non-regulatory market environmental factors that the banks were confronted with during and in the aftermath of the financial crisis in 2007 – 2009. This served as the background to understanding why HSBC thrived during and in the aftermath of the global financial crisis. It also facilitates understanding on how the performance of SCB, a bank that was excluded from needing to be ring-fencing compliant was remarkably better when compared with the performance of the two other banks, RBS and Barclays that struggled on for almost ten years after the financial crisis.

5.2 Similarities in the Circumstances of the Case Studies: People, Objectives, Structure and Business Models

Mullins made the point that there may be manifest cultural differences in different types of organisations, but at least there are three basic factors that are common in most organisations, which include people, objectives, and structure.[851] Typically, organisations employ people who are organised or structured in ways to efficiently implement the organisation's strategic business plan with the objective of making profits.

Arguably, this principle is applicable to the four banks that formed the case studies. Part of the critical differences between the banks would be about how each of the

[849] B. Burnes, 'Managing Change 4th Ed' (Pearson Education, 2004)
[850] P. Drucker, 'Managing in Turbulent Times' (Routledge, 2011)
[851] Op. Cit., L. Mullins, Prentice-Hall, 2016, (n. 46).

organisations configured processes, systems, styles of management, methods of operation and the behaviour of the members of the organisation in order to achieve their objectives.[852] The interactions of these factors within each of these banks can either make or break the organisation.

In addition, referring to behaviour of complex organisations in a turbulent period and management practice, Ansoff states the importance of engaging with the basic SWOT analysis model in strategic business planning, decision making and problem-solving processes in business organisations. [853][854]

- S represents Strengths, identification of inherent competitive advantages that exist within the organisation including skills, abilities, and activities that the organisation does very well,
- W stands for Weaknesses – these are disadvantages, success factors that are lacking or not in a sufficient quantity within the organisation,
- O is concerned with external Opportunities – positive chances or business openings that the organisation can take advantage of, and
- T represents external Threats which are factors such as changes in regulation and undiversifiable market conditions that negatively impact on the success of the organisation as was the case when the banks were exposed to harsh market conditions brought about by the global financial crisis.[855]

Working with the two-grid matrix in the SWOT model can help organisations to identify ways to make the most out of the advantages that they have while realistically seeking ways of reducing to the barest minimum external threats that may expose the banks to potential failure while at same time finding a way to improve on critical success factors that are lacking or insufficient in the organisation.

It is arguable that the impact of the financial crisis, and the regulatory changes that came with it on each of the banks and their responses to them largely depended on the different circumstances of each bank and the capabilities of the leadership steering the affairs of each of the banks. An example is the case of Standard Chartered Bank which hardly changed their leadership team over the period under

[852] ibid
[853] H. Ansoff, 'Business Strategy' (Penguin, 1969)
[854] M. Abdi, et al., 'SWOT Methodology: A State-of-the-art Review for the Past, a Framework for the Future'(2011) 1 (24 – 48) Journal of Business Economics and Management.
[855] P. Drucker, 'Managing for Results' (Butterwort-Heinemann, 1994)

review. John Peace was the chairman of the bank for eight years from 2008 – 2015. Through the turbulent period, Peter Sands remained the CEO for nine years from 2006 to 2014. The same situation was applicable to HSBC as the bank had its key leadership team unchanged for a long time. More often, HSBC appointed 'home grown' chief executives from within the organisation. These were long standing employees that understood their markets and the culture of the organisation. RBS and Barclays witnessed changes in leadership frequently. Barclays' case was the worst in terms of frequency of changes in the leadership team. From 2005 to 2018 they had five chairmen and four CEOs. The most recent change was in 2019.[856]

In the SWOT analytic model, the interaction of processes, and the availability of managerial capabilities in an organisation do not assume simplification of the challenges involved in managing a complex multinational universal banking group. What it does, however, is to firstly emphasise the important differences that having capable hands at the helm of affairs can make in the management of huge conglomerate banks during uncertain and turbulent periods such as the banking sector faced between 2007 to 2018.[857]

Secondly, they point out how failed business strategies can bring an organisation to its knees, as was the case with RBS when the bank in consortium with other banks made the strategic decision to purchase ABS Ambro in 2007 and ended up with losses of about £40 billion in 2008.[858] Another example, in 2013 under the leadership of David Walker, the Chairman, and the Group Chief Executive, Anthony Jenkins, Barclays floated 564 wholly owned subsidiaries and 288 joint venture companies in order to run the non-core businesses of the bank.[859] That business model failed. In the end, the bank incurred total losses of £12 billion in the disposal of this classified non-core business arm of Barclays.[860] Both the Chairman and the Group CEO who promoted the model were relieved of their posts.

Thirdly, and very importantly, it is also meant to reiterate the fact that other than regulatory changes that created additional burdens on the banks evaluated, there

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[856] Barclays Plc 'Barclays Announces Leadership Changes' (2019)
[857] T. Chermack, and B. Kasshanna, 'The Use and Misuse of SWOT Analysis and Implications for HRD Professionals' (2007) Vol. 10 (4) 383 – 399 Human Resources Development International.
[858] RBS 'Annual Report and financial Accounts' (2008)
[859] Barclays Plc 'Annual Report and Financial Accounts' (2015, p. 341 – 347
[860] Barclays 'Annual Report and Financial Accounts' (2018, p .2)

were endemic managerial issues in both RBS and Barclays as highlighted in the previous paragraph.

The four banks that formed the case studies are reputable UK registered banks and are long established financial institutions that have been operating in the banking business for centuries. In the case of RBS, the bank has been around for almost three hundred years. Barclays is well over three hundred years old and SCB started about one hundred and sixty years ago while HSBC started in 1865, slightly over 150 years ago.

Apart from the influence of the regulatory and supervisory guidance emanating from the collaborative efforts of international governments spearheaded by the Basel Committee on Banking Supervision, the four banks in the case studies are supervised in the UK by the Financial Conduct Authority and the Prudential Regulation Authority. They are also subject to the various regulatory and supervisory authorities of host countries where they operate their businesses around the world.

A common characteristic among these foremost UK banks is that they are all outgoing, huge financial institutions having extensive geographical spread in their fields of business operations as demonstrated in the sections allocated to each of the banks in Chapter 4 Sections A, B, C and D.[861] Their business tentacles are in almost identical markets across the globe, especially in Asia, the Middle East, Africa, America and in Europe except that HSBC and SCB concentrated their businesses in Asia more than other parts of the world where they operated.

So also, they shared the same universal banking model. All of them grew their businesses organically and through acquisitions, mergers and affiliations with other financial institutions. The universal banking model enabled them to undertake diverse financial services across wholesale and consumer banking products and services.[862] They all operated extensive branch banking with their headquarters in the UK, providing wide-ranging services including personalised banking services to individual customers, commercial banking to small and medium size customers, and tailored specialist services to large corporate organisations and institutional customers. SCB is slightly different in the sense that the bank maintains its

[861] Please see pages A – 197, B – 221, C – 255, D – 277.
[862] Type of services rendered RBS, see page 199 - 201, Barclays see page 221 - 223, SCB see page 257 - 258 and HSBC page 278 – 280.

investment banking hub in the UK whilst most of its retail banking customers are outside Europe. RBS' major markets are in Europe and America whilst HSBC has its market spread across the world but mostly domiciled in Asia.

As of November 2019, three of the banks (Barclays, SCB and HSBC) were rated as global systemically important banks in the sense that each had significantly huge assets and re operating in multiple jurisdictions, such that should any of these banks fail, their collapse could potentially trigger a global financial crisis.[863]

To put the size of these banks into context, at its peak in 2007, just before the global financial crisis, RBS's number of branches reached 2,278[864] and the numerical strength of its customer's base clocked about 44 million in 53 countries across the globe.[865] In 2008, total assets amounted to £2.4 billion and at RBS's height, the number of employees was over 226,000. Earnings Per Share at its highest was £1.94 and the highest dividend paid was 0.77 p per ordinary share.

Similarly, at Barclay's zenith in 2008, the bank's asset was £2.1 trillion.[866] At that time, it had about 160,000[867] employees globally with 1,733 branches across the UK as of 2009[868] while it served about 48 million customers globally.[869]

In the case of Standard Chartered Bank, at their peak they had total assets of about US$726 billion with 90,000 employees spread across diverse regions of the world including Asia, the Middle East, Africa, America, and Europe.

At HSBC's peak in 2012, the bank's assets clocked $2.7 trillion. Deposits peaked at $1.6 trillion, they had 325, 000 employees in 2006 and about 10,000 service outlets.

As the core deposits of each of the four banks were above the minimum threshold of £25 billion pounds, from 2013 to 2018 all these banks should ordinarily have been subjected to preparation to be ring-fencing compliant by 1st January 2019. However, in view of the fact that SCB had negligible core banking customers in Europe, the ring-fencing policy was not applicable to SCB.

[863] Op. Cit., Financial Stability Board, 2019, (n. 28)
[864] The Royal Bank of Scotland, 'Annual Report and Accounts' (2007, p. 15)
[865] Ibid (2007, p.11)
[866] Barclays Plc, 'Annual Report and Financial Accounts', (2008, p.205)
[867] Ibid (2008, p.23)
[868] Barclays Plc, 'Annual Report and Financial Accounts' (2009, p.4)
[869] Barclays Plc, 'Annual Report and Financial Accounts', (2008, p.4)

5.3 The Differences in the Circumstances of the Four Case Study Banks: RBS, Barclays, SCB and HSBC

Despite the significant similarities between the four banks mentioned in the previous paragraph, there were differences in the fortune of each of the banks. The impact of the global financial crisis on each of the banks and their ability to respond to the crisis was influenced by their individual circumstances and their investment choices in the immediate period leading to the financial crisis. For example, the level of involvement and exposure to the derivative markets, subprime securitised Collateral Debt Obligation (CDO) in the period leading to the global financial crisis varied substantially. The worst affected in this regard were RBS through the bank's purchase of ABN Ambro and Barclays through its purchase of failed Lehman Brothers.[870]

5.4 The Royal Bank of Scotland

Although before the global financial crisis began RBS had cumulative underlying problems regarding managerial issues, poor assets' quality, inadequate capital and liquidity issues and problems with its compulsive aggression towards mergers and acquisitions, the full impact of these ailments in the bank started to come out to the surface at the beginning of the global financial crisis when RBS could no longer access immediate supply of funds from the wholesale financial market to meet its cash requirements.

The burden of the liquidity crunch went into overdrive in 2008.[871] As pointed out in Section B of chapter 4 under the analysis of RBS, this was when the impact of the toxic assets acquired from the Netherland Bank, ABS Amro, started to crystallise and the need to urgently seek bailout dawned on the bank, the regulatory authorities and the government.[872] It was also at that point in 2008 that the book of accounts started to witness a significant stress level. As may be observed on Table 5, there

[870] Please see page 209 and 237
[871] Please see page 212
[872] Please see page 206

was liquidity problem emerging as the total deposits was £898 billion compared to loans of £1.013 trillion.[873]

Impairment charges skyrocketed from about £2 billion in 2006 and 2007 to £8 billion in 2008. In that year, RBS made a previously unmatched operating loss of £40.7 billion.[874]

Given the perilous liquidity position of RBS at that time, the bank as it were had its back against the wall as there was no opportunity to seek assistance from other banks. The availability of interbank assistance had frozen because of the dislocation in the market then. The catastrophic tactical mistake RBS management made was that, in conjunction with other partners they had then only purchased ABS Amro for about $100 billion in cash.[875]

If the successful bid for ABS Amro was paid for in cash and shares, just maybe the story about RBS may have been very different especially if the cash spent to buy ABS Amro was in hand to deal with immediate needs and RBS did not have to take government funded bailout. It may also be argued that there were more than enough long-term underlying issues in RBS before the crisis began which were enough to still keep RBS in the difficulty it found itself in. These include the poor quality of its assets, a general loss of confidence in the bank due to past misdeeds, the free fall in the share price of the bank which went down from £18 to 0.67 p over the years, inadequate equity capital, poor liquidity, huge nonperforming assets, growing accumulated losses and the burden of the fines, penalties and huge litigation costs that the bank faced due to its past misdeeds .[876] Part of the consequences for RBS was that for almost ten years they were unable to break even, unable to earn income to meet the cost of capital, and they were unable to pay dividends. Some of the consequences are that it would be extremely difficult for RBS to raise fresh funds in the capital market. In the circumstances of RBS, the bank is likely to be under more pressure with additional costs of implementation of the ring-fencing policy when compared with other competitors as explained in the body of the thesis.

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[873] Please see page 203
[874] Please Table 5, page 203
[875] Please see page 212.
[876]Please see pages 212.

5.5 Barclays Group

At a face value of the book of accounts, in 2006, just before the financial crisis began, Barclays had an outstanding performance with 37% increase in the Operating Profit Before Tax.[877]

Just as RBS, Barclays also made offers in the proposed acquisition of ABN Ambro but they had to walk away from the deal because, while Barclays made a share-based offer, RBS in a consortium with others made a cash-based offer, which was accepted.[878]

Although not as much as RBS, Barclays was also badly hit by securitisation and subprime debit issues. Dealing with this burden threw open other difficulties that the bank had to contend with. Foremost, although income generation increased from £23 billion in 2008 to £29 billion in 2009, costs were escalating. Impairment charges were growing at a galloping rate having increased from £5 billion to £8 billion in 2009. Secondly, liquidity was under tremendous strain as deposits stood at £399 billion against loans which were far ahead at £461 billion. It was not until 2011 before Barclays started to have a grip over the poor liquidity problem.[879]

Thirdly, on the account of the deteriorated liquidity position, the cash strapped bank made a desperate bid to seek help from the Qatar government. That move helped with a cash booster of £6.1 billion.[880] Although Barclays was taken to the court by the UK Serious Fraud Office in 2017 and by UK Antifraud Office in 2018 for seeking assistance from a foreign government and for providing assistance to purchase own shares,[881] the bank got away lightly, unlike RBS that took the UK government bailout at very unfavourable terms, leading to the forced sale of many of its branches, including some non-core banking arms of the bank both locally and overseas.[882]

Unlike RBS, Barclays kept making some profits and continued to pay dividends to its shareholders even if it was only a modest one.[883]

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[877] Table 6 Column 3 page 228
[878] Barclays Plc (2007, p.7) Annual Report and Financial Account
[879] Table 6, page 228
[880] Please see page 225 - 226
[881] Ibid.
[882] See pages 214.
[883] See Table 6, Page 228.

In addition to these difficulties was the need to be compliant with regulatory changes including Basel III, reviewed capital requirements and the ring-fencing policy.

5.6 Standard Chartered Bank

The period leading to the global financial crisis was a time of exponential growth for SCB, with ever increasing expansion in their primary markets in China, Thailand, Indonesia, South Korea, Pakistan, India, Taiwan, Malaysia, Nigeria, Ghana, South Africa and in the United Arab Emirates.[884] They have maintained a presence for about 160 years in some of these countries.[885]

Although SCB was also affected by the burden associated with Asset Backed Securities, in relative terms their case was very mild when compared with RBS and Barclays described earlier.

SCB had total ABS exposure of $5.9 billion in 2007, $3.3 billion in 2008 and $2.7 billion in 2009 as opposed to hundreds of billions that others had.[886] Throughout the period of the global financial crisis in 2007 – 2009 and the ensuing recession period, remarkably SCB continued to flourish all round. As indicated on Table 8, for nine years in a row, 2004 – 2012, total income and Operating Profit Before Tax continued to grow steadily.[887] Income rose from $5.4 billion in 2004 to $19 billion in 2012. Similarly, OPBT increased from $2.3 billion in 2004 to $6.9 billion in 2012. Thus, SCB maintained a fairly consistent growth in dividend pay-out ratio.[888] Just like HSBC, SCB was not under pressure to sell off any of its businesses neither did they have a massive reduction in staff levels, as did the other two banks.[889] Throughout the fifteen years under review, SCB had no liquidity problem. Except in 2015 and 2016 when their performance dipped due to difficulties that arose in the Asian markets and a one-off comparatively high impairment charges of $5.5 billion in 2015, otherwise SCB was a success story.[890]

[884] See page 257 - 258, Table 8, Page 259
[885] See page 257 - 258.
[886] SCB Accounts 2007, p. 54, 2008, p. 57, 2009, p. 61
[887] See Table 8, page 259
[888] Ibid (Table 8) Page 259
[889] Ibid (Table 8) page 259
[890] Ibid.

The most likely factors that contributed to the SCB success story include their very low exposure to subprime assets, stability in the leadership of the bank and the strategic advantages that accrued from keeping the hub of their very lucrative investment banking division in the UK.[891] Thus, SCB was insulated from the strict regulatory regime in the UK and the need to be ring-fencing compliant because their retail banking customers were mostly outside Europe and generally, SCB was well resourced.[892]

5.7 HSBC

HSBC was also involved in similar reputation damaging ethical issues as were found in the cases of RBS and Barclays. HSBC was accused of facilitating tax evasion schemes in their Switzerland private banking business, they were involved in the interest rate manipulating scandal, they were indicted over matters relating to money laundry, they fell short on regulation compliance and as well they were found complicit in matters relating to mis-sold financial products. As such, HSBC also faced the consequences of breaches in conduct matters which led to huge fines and penalties.

Just as SCB, HSBC's dominant markets were in Asia especially in China. Although China where HSBC maintained a dominant presence was not as badly affected as Europe during the global financial crisis in 2007 – 2009, the account evaluation revealed that HSBC was to some extent adversely affected by the global financial crisis through its businesses in Europe, America and in Latin America especially in Brazil.

HSBC suffered losses during the global financial crisis because of its involvement in the sub-prime housing market through its merger with Household Finance Corporation, which HSBC acquired in 2003.[893]

Except for 2004 – 2006 when total loans slightly exceeded deposits as indicated below, for the remaining twelve years deposits always exceeded loans as of the balance sheet dates. In 2004 deposit accounts amounted to $777 billion while

[891] Please see page 255. In relative terms, SCB had the least exposure to subprime securities
[892] Please see page 258
[893] Please see page 279

aggregate loan accounts amounted to $816, in 2005 deposit accounts was $809 billion whereas loans amounted to $866 billion and in 2006 while deposit was $997 billion loan was $1 trillion.[894]

Contributions from insurance division of the bank is not impressive as it made overall losses in 8 years out of the 15 years under review. As well, contribution from the private banking division was only marginal. Although the investment banking division generated relatively sizeable portion to the PBT at a range of $5 billion to $10 billion annually, HSBC's main strength was in the provision of core banking services and corporate banking. Another key strength of HSBC was their leadership team. They safely navigated the affairs of the bank through the crisis period hitch free and throughout the 15 years under review. The bank made profits and thus able to declare generous dividends and ploughed back retained earnings which annually improved their Core Tier 1 Capital.

Notwithstanding the issues enumerated, in general, HSBC faired very well when compared with RBS and Barclays. Throughout the period under review, the bank was self-sufficient as it did not require any bailout from the UK government or from any other external support.

The all-round performance of HSBC over the period under review demonstrated that big banks could be managed safely with or without the application of the ring-fencing policy. Given that HSBC is well resourced, the impact of the ring-fencing policy on the bank may be minimal.

Annually, the equity capital progressively increased through retained profit and funds generated from sale of non-core financial assets.

5.8 Conclusions

(i) This chapter makes the point that at a turbulent period as was the case during and in the immediate period after the 2007 – 2009 global financial crisis, managing change in conglomerate universal banks in response to regulatory and non-regulatory market environments required talented leadership firmly holding the helm of affairs and an abundance of competent middle level managers across the board to

[894] Please, see page 282

navigate through such a challenging period.[895] Availability or lack of such skilful hands and the role they played deserves mentioning, even if ascertaining the extent of the presence of these critical success factors in the banks evaluated is outside the scope of this study.

(ii) Analysis of SCB financial accounts in chapter 4 Section D and evaluation of the unique circumstances of the bank in this chapter led to a conclusion that, comparatively, SCB stood in a better position to weather the storm during the global financial crisis and in the period of the recession that followed than did RBS and Barclays primarily because, SCB's exposure to subprime assets was relatively low.[896] Also, very importantly, as their retail banking customers were outside Europe, SCB was not faced with the burden to be ring-fencing compliant.[897] In the same vein, HSBC also thrived successfully during and after the crisis as the bank was well resourced, their operations were largely domiciled in Asia where the effects of the global financial crisis was less pronounced. As well, the bank had the benefit of good and successful leaders.

(iii) The cumulative effects of inadequate equity capital and liquidity ratio, low interest rate, ineffective management, low interest rate, exposure to high level of subprime assets, the upward review of the composition of capital requirements under Basel III, large-scale divestment during an inclement recession period and the need to be compliant with conditionalities attached to taking government bailout placed considerable pressure on RBS. These led to low profitability, low return on investment, inability to cover cost of capital, large scale reduction in the number of employees and diminished influence globally.[898] Similarly, Barclays suffered from poor leadership, low interest rate, weak assets, huge consequences for breaches of rules and over bloated asset levels which in the end were written down.

[895] Please, see page 298
[896] Please See page 305
[897] See page 258
[898] See page 203 Table 5 RSB; Page 228 Table 6 Barclays and SCB page 259 Table 8

Chapter 6: Findings and Conclusions

6.1 Introduction

The study evaluated the desirability or otherwise of the ring-fencing policy as a suitable regulatory measure in response to the global financial crisis (GFC) particularly in the circumstances of the Global Systemically Important Banks (GSI-Bs) in the UK.[899]

Through evaluation of the financial accounts of the case studies from 2004 to 2018, the study aimed to determine the varied long-term impacts of the GFC on the performance of four of the largest UK banks chosen as case studies. Lest we forget too quickly, the study lays out some of the direct consequences and costs of the downward journey of these banks since 2004 to 2018 and the difficult road back to recovery as a lesson on record for the future.[900]

In light of these aims and objectives of the study stated above and also found in chapter 1, page 3 – 4 and page 10 – 11, this chapter is concerned with presenting a summary of the findings and conclusions drawn on each of the following,

(i) the varied long-term impacts of the GFC on the performance of four of the largest UK banks in the UK chosen as case studies, the downward journey of each of these banks since 2004 to 2018 and their difficult route to recovery,

(ii) the desirability or otherwise of the ring-fencing policy as a suitable regulatory measure in response to the global financial crisis (GFC) particularly in the circumstances of the Global Systemically Important Banks (GSI-Bs) in the UK,

(iii) the appropriateness of the ring-fencing policy as a measure that is capable of deterring financial crises in the future,

(iv) some of the commonly accepted general causes of the GFC found in the literature, it paints the picture of the burden that the negligence of bankers

[899] Please see page 3
[900] Please see page 4

brought upon themselves, an estimate of the extent of the losses brought upon the global financial system, the hardship created for businesses, individuals, equity owners in the banks that were hit hardest, and employees that lost out during the GFC,

(v) although mergers and acquisitions, deficiencies in leadership performance and inadequate internal control mechanisms were not specific part of the issues under consideration at the beginning of the study, these factors emerged in the course of the study as very significant factors among the problems that some of the case studies had which could have permanently ruined at least two of the banks in the case studies, and finally

(vi) the chapter makes recommendations on the ways forward into the future.

6.2 The Varied Long-term Impacts of the GFC on RBS, Barclays, SCB, HSBC and the Undulating Trips of these Case Studies to Recovery from 2004 to 2018

This section graphically presents how the global financial crisis affected each of the banks in the case studies differently, their downward journeys and the route to their turnaround through 2004 – 2018.

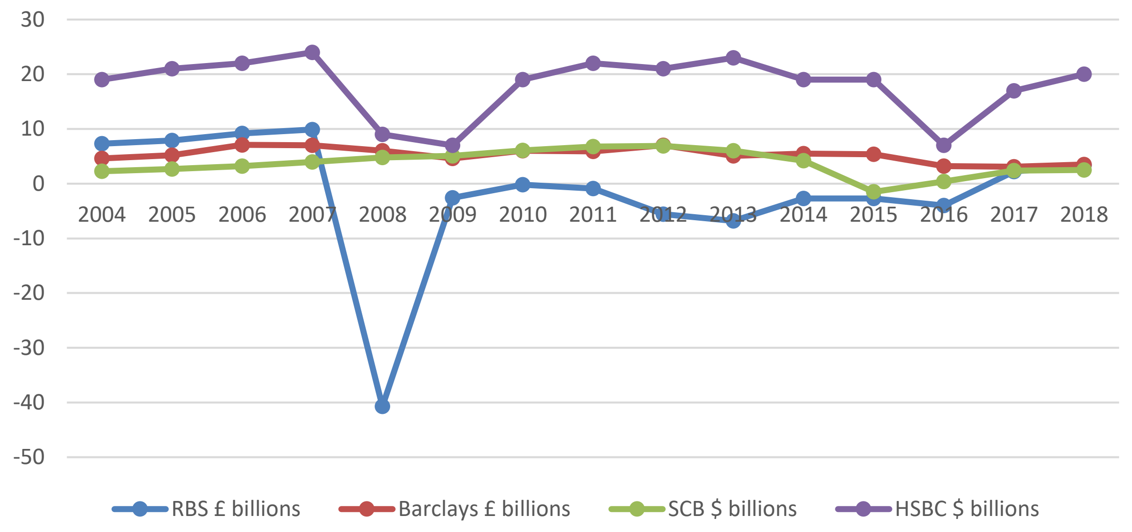

Fig. 32: The Varied Impacts of GFC on the Case Studies and their Difficult Recovery Trips Through 2004 to 2018

The variables on the 'Y' axis of the graph are the annual Operating Profit Before Tax measured in billions for each of the banks in the case studies, while the horizontal axis is the time frame from 2004 – 2018. In the case of RBS and Barclays, the unit of measurement of their performance is £ sterling while for SCB and HSBC it is in US$.

The graph above indicates undulating movements of the individual bank during their varied journeys through 2004 – 2018. This should not be confused with comparison of the banks' profitability against each other. That is not the aim of the graph because each of the banks operated with different asset levels and their level of operations were measured differently in terms of the currency units.

The graph demonstrates how RBS went deep down at minus £40 billion OPBT in 2008 and for several years between 2008 – 2016 operated below the water level having had negative OPBT until 2017 when the bank had a turnaround with positive OPBT of £2.2 billion and £3.4 billion in 2018.[901] In the case of Barclays, though the bank operated at a positive OPBT throughout the entire journey from 2004 – 2018, the bank only barely broke-even due to huge impairment charges, losses from the sale of non-core assets, pressure from the need to meet enhanced capital and liquidity requirements and huge regulatory fines due to regulatory infringements

[901] Please see page 203 Table 5 column 3, OPBT

which resulted in the Barclays only being able to pay lacklustre DPS ranging from 2.5p to 6.5p from 2009 – 2018 as opposed to 34p paid in 2007.[902] HSBC also felt the negative impact of the crisis in the sense that their OPBT was $24 billion in 2007, but it drastically fell to $9 billion and $7 billion in 2008 and 2009 respectively. Notwithstanding, throughout the period under review, the bank did not for once have any negative OPBT.[903] SCB dipped into negative OPBT once in 2015.[904]

The most remarkable point about the graph is that, for all the banks, 2017 was the turning point. This was when they all started to return to increasing upon their annual OPBT. At that point as well, impairment charges came back to the pre-crisis era and even lower. The question now is whether the darkest part of the night is over for the banks and whether they have started to match forward into the dawn of a new era. Only time will tell.

6.3 The Desirability or Otherwise of the Ring-fencing Policy as a Suitable Regulatory Measure in Response to the Global Financial Crisis in the UK

For example, Goodhart accepts that the ring-fencing policy would most likely support stability in the banking sector as any case of dislocation arising in the non-ring-fenced banks are unlikely to cause disruptions to the continuation of payment and retail banking services in the ring-fenced banks.[905] The ring-fencing policy would also make it less likely for any need to provide expensive government funded bailouts to rescue non-ring-fenced banks should they run into difficulties out of their own making.[906]

However, it is suggested that, except the ring-fencing policy in the banking sector is rescinded or amended so that only the risky investment banking arms in the non-ring-fenced banks are removed, some of the likely long-term damaging impacts on the banking sector and to the UK economy highlighted in the study include:

(1) The UK banks would be at a disadvantage competing with other banks at international level more especially huge universal banks in other countries

[902] Please see page 228 Table 6
[903] Please see page 282 Table 9 Column 3
[904] Please see page 259 Table 8 Column 3
[905] Op. Cit., C. Goodhart, 2012, (n. 44)
[906] Ibid.

where their laws are less restrictive, and they do not favour implementation of the ring-fencing policy as it is in the UK.[907]

Part of the challenges that the UK banks would then face is that they are obligated to abide by the internationally agreed banking regulations just like other global systemically important banks elsewhere, but in addition, the UK banks would at a higher cost need to comply with the ring – fencing policy whereas those other banks are not required to do so.

(2) Due to the breaking up of synergy in the huge and well-resourced universal banks in the UK as a result of the remover of cheap bdepositors' funds from the non-ring-fenced banks to the ring-fenced bank, it is contended that though both classes of banks have the capacity to lend, the ability of the restructured banks to support the needs of the biggest multinational corporate customers as individual unit would be considerably diminished.[908]

(3) Part of the consequences would be the additional cost to huge conglomerate customers in dire need of huge capital outlay, but which would now face the additional difficulties involved in searching for multiple sources of finance instead of dealing with just one or relatively fewer banks where complications arising from perfecting security against loans and advances can be minimised[909]

(4) The ring-fencing policy is likely to cause reduction in the performance of the non-ring-fenced banks in situations where the cheap core deposits are no longer available to subsidise loans and advances including huge, accumulated mortgage portfolio that are only generating low interest income due to the prevalent low interest rate orchestrated by the global financial crisis. It is appreciated that the bankers have the discretion to choose the side of the fence where they want the loan assets to be whether within the ring-fenced bank or the non-ring-fenced bank.[910]

[907] Please see pages 137 - 138
[908] The point about synergy was extensively discussed in pages, 143, 152, 248 and 253 for example
[909] Please see pages 218 - 220
[910] Please see page 219, second to the last paragraph.

(5) As well, this researcher contends that the financial sector encompasses banking, the stock market, pension funds, insurance, credit card service providers etc. These subsectors have a symbiotic relationship, depending on one another. The point is that although the ring-fenced banks have the capacity to provide both corporate and retail banking services and can provide allowed services to the banks within the group, by separating banks along ring-fenced and non-ring-fenced bank, the ring-fencing policy limits the support that comes from the ring-fenced banks to the entire financial system. This is because restrictions are placed on the ring-fenced banks regarding providing facilities to other financial institutions, branches, and subsidiaries outside the EEA.[911] The effect is that should the non-ring-fenced bank runs into financial difficulties they cannot depend on the ring-fenced bank to provide the non-ring-fenced bank with financial assistance.

The above enumerated issues led to the suggestion that the policy makers should consider a review of the ring-fencing policy in the best interest of the economy especially following the huge restructuring in the banks that has de-risked and improved stability in the banking sector so far. As well, in the past ten years after the GFC there have been considerable number of policy measures already evaluated in Chapter 2, literature review that are designed to mitigate the risks of possible failure in the banking sector especially relating to improved capital and liquidity adequacy, better supervisory regime in addition to the considerable restructuring through demergers and substantial divestment from non-core assets.[912]

6.4 Suitability or otherwise of the Ring-fencing Policy as a Measure that is Capable of Deterring Financial Crises in the Future

The suitability or otherwise of the ring-fencing policy in response to the global financial crisis is a significant part of the thrust of the study which was discussed in the body of the thesis in chapter 1 and 2. The conclusion is that the general idea that gave birth to the ring-fencing policy has some potential benefits but as well, the study highlighted the significant drawbacks of the policy including its potential to

[911] Op. Cit., Ring-fencing Guidance para. 1.6 (n. 34), Please see pages 9 & 18
[912] Please see pages 212 & 279.

make the GSI-Bs in the UK to be less competitive when compared with their peers elsewhere as enumerated in the previous paragraph 6.3.

Goodhart agreed that the ring-fencing policy will limit the probable contingent liability that the UK taxpayers may likely face in the event of another global financial crisis.[913]

Indeed, the ring-fencing policy has its appeals and benefits, but the question is, "at what cost?"

In July 2013 the UK government came up with the estimated costs of the ring-fencing policy stated as follows:

- Direct private costs to UK banks - about £1.7 billion - £4.4 billion annually
- Indirect cost on GDP about £0.4 billion - £1.9 billion annually
- Reduction in tax receipt about £150 million - £690 million annually
- The assumed benefits of adopting the ring-fencing policy stated in the document are (i) greater financial stability (ii) reduction on the likelihood of government providing bailout as crises become less frequent and severe (iii) reduction in implicit subsidies to the huge banks and reducing probability of future crises by 15% which would generate annual benefit of £7.1 billion.[914]

One side of the argument is that if the ring-fencing policy is able to keep in abeyance financial crisis, then the cost is probably worth it because it would be far lower than the costs of a rescue package where there is a situation that requires bailout after a possible financial crisis.[915]

On the other hand, Campbell and Moffatt's contention is that, given the improvement in the prudential regulation since 2009 after the crisis and the ongoing efforts directed towards recovery and resolution efforts in the banks which arguably have led to significant improvement in the stability of the banks, they do not see how the enormous cost of ring-fencing can be justified.[916]

Arguably, the regulatory and supervisory environment has improved considerably since the GFC. So also, there has been considerable recovery from losses incurred

[913] Op. Cit., C. Goodhart, 2012, (n. 44).
[914] Ibid.
[915] Op. Cit., C. Hofmann, 2017, (n. 26).
[916] Op. Cit., Campbell and Moffatt 2019, (n. 53).

from the nonperforming assets over the past 10 years. There has been huge divestment from risky investments in Barclays and RBS. Hopefully, the issue around mis-sold products and regulatory fines have been put behind these banks. With all these developments, hopefully in no distance future the regulators may wish to consider easing regulatory burden imposed on the UK banks regarding the ring-fencing policy.

6.5 The Commonly Accepted Causes of the Global Financial Crisis in 2007 - 2009

As discussed on page 45 to 46, among several factors attributed as the causes of the financial crisis are: failings arising from the inadequate cross border and unified international financial regulation, products and services that escaped boundary of regulation and supervision, poor banking supervision,[917] securitisation of sub-prime mortgage assets, poor lending practices, failings in the administration/governance of financial institutions, general laxity in internal control mechanisms,[918] behavioural issues relating to corporate culture where there are tensions in power dynamics and internal politics, external socio-economic pressure leading to financial institutions intentionally circumventing rules[919] and less than acceptable standards of the activities of credit rating agencies.[920]

Other than the spill over of the causes of the crisis that emanated in America, in the particular circumstances of the UK, the trigger of the crisis was loss of confidence in the banks and a reaction to the chain of events that started with the short-term money market freeze which prevented banks in dire need of liquidity from accessing funds from the wholesale money market.[921] What compounded the problem for these banks included poor liquidity position, inadequate capital and underlying weaknesses in assets/nonperforming loans. The underlying issue was the precarious liquidity position of these distressed banks, their inadequate operating capital, poor management decisions, weak assets, disproportionate nonperforming loan accounts and on top of that, in December 2007 to February 2008 major investment banks

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[917] Op. cit., Arora, A. 2010, (n. 18)
[918] Op. cit., R. Grosse, 2012, (n. 146)
[919] Op. Cit., S. Ashby, 2009, (n. 147)
[920] Op. cit., G. Baber, 2013 (n. 16).
[921] Op. Cit., Financial Services Authority, 2011, pp 314 – 315, (n. 149)

owned up that their structural credit assets were overstated and needed to be written downs.[922] Understandably, this led to credibility issue and doubts about what to believe about bankers who prior to the GFC were paying themselves obscene bonuses and at a time, Hudson thought that bankers cannot be relied on to file honest reports that may likely damage their business interest.[923]

6.6 Some of the Dire Consequences of the Global Financial Crisis in 2007 – 2008 to Different Classes of People and Organisations

Some of the dire consequences of the fallouts precipitated by the GFC to the bankers themselves include loss of credibility and personal disgrace faced by some principal bank officials that lost their jobs in the process including Fred Goodwin who did not only lose his job as the CEO of RBS but also had an additional embarrassment of having his knighthood annulled.[924] Bob Diamond and Marcus Agius the erstwhile CEO and Chairman of Barclays as discussed in the body of the thesis also were relieved of their posts.[925]

Globally, incalculable huge losses were sustained including examples of twenty-four of some of the most industrialised nations in the world whose financial system's stock market capitalisation fell substantially as depicted on Table 1, pages 47 & 48. For example, the USA was assessed to have lost $1.2 trillion in their banking system market capitalisation, the UK lost $551 billion, Japan lost $402 and France lost $275 billion.[926]

Also, there was unquantifiable level of hardship caused to businesses in the UK out of which some went into liquidation. The equity owners in RBS and Barclays had their investment reduced in value as painted in the analysis of their accounts of the banks in chapter 4. In the case of RBS for ten years from 2008 2017 they were not paid dividends.[927] RBS' share which was £4 in 2000 rose £18 just before the crisis but went crashing to only 67p.[928] In the case of Barclays, though the shareholders

[922] Ibid.
[923] Op. Cit., A. Hudson, 2013, (n. 14), Please see page 103.
[924] Please see pages 153, 215 - 217
[925] Please see page 242.
[926] Please see Table 1 on page 47 – 48.
[927] Please see Table 5, page 203 column 9
[928] Please see discussion on pages 215 – 216.

received some dividends, they were pittances. In Barclays, from 2009 – 2018 DPS ranged from 2.5p to 6.5p as opposed to 34p paid out to shareholders in 2007.[929]

Worst of all is the burden shared by ordinary bank workers that lost their jobs in RBS and Barclays. By the time the dust settled, RBS which their employees peaked at 226,000 came down to 65,000 while in Barclays the total employees' level that reached 156,000 globally came down to 84,000.[930]

All this goes to show the importance of the financial system to the public generally and why it is in everyone's interest to safeguard the banking sector as far as possible.

6.7 Some Other Problems in the Banking Sector that Emerged in the Course of the Study but Which Were Not Part of the Original Aims of the Study

This section deals with issues that arose in the course of the study which can potentially contribute to instability in the banking sector, and which needs specific attention of bankers, regulators and banks' supervisors.

Although mergers and acquisitions, deficiencies in leadership performance and inadequate internal control mechanisms were not specific part of the issues under consideration at the beginning of the study, these factors emerged in the course of the study as very significant factors among the problems that some of the case studies had which could have permanently ruined at least two of the banks in the case studies especially RBS and Barclays. Apart from these, the issues that led to the collapse of Barings Capital discussed under the literature review was inefficient internal control mechanism and the Union Bank of Switzerland also lost over $2 billion due to the same problem in their internal control systems.[931]

[929] Please see Table 6, page 228 column 9
[930] Please see Table 5 page 203 and Table 6 page 228.
[931] Please see pages 94 – 96

6.7.1 The Benefits of Mergers and Acquisitions and Potential Harms

Apart from growth cultivated through ploughing back part of the profits generated into the businesses, the evidence found in the study is that in more than a century, all the banks in the case studies adopted policies that promoted growth of their banks through mergers and acquisitions.[932] While in some cases, the policy was beneficial to the banks, but also it proved to be the undoing of RBS and Barclays. In the case of RBS, the purchase of Natwest in 2000 was highly successful and the deal brought Fred Godwin a former CEO into limelight whereas the purchase of ABN Amro among other factors nearly brought RBS into a ruin.[933]

The critics of deregulation policy often tend to point out that the abrogation of the Glass Stealgall Act 1933 may have been the primary cause of the catastrophe that the global financial crisis in 2007 – 2009 was.[934] The argument was that the repeal of the Act opened the lid that had previously restrained commercial banks from getting directly involved in risky investment banking.

A historical review of each of the case studies in Chapter 4, Sections A, B, C and D revealed that each of the banks under study had a long history of acquiring and taking over of other financial institutions dating back to over a hundred years. Over that period, the strategy of mergers aided the expansion of these banks.[935] However, in later years, say, in about 30 years since the adoption of deregulation policy and the repeal of the Glass Stealgall Act 1933, the commercial banks under study ventured into buying chains of financial institutions that are not core banking institutions including banks that were deeply enmeshed in investment banking, which came with it, ruinous sub-prime assets that almost crashed RBS that bought ABN Ambro, Barclays that bought part of Lehman Brothers businesses and HSBC that bought Household Finance Corporation as expounded in Chapter 4.[936]

On the one hand, some of the other mergers and acquisitions were generally beneficial to the banks. Mergers and acquisitions can have serious implications and constitute potential risks capable of bringing a bank down as demonstrated by the case studies. Given the huge potential risks associated with mergers and

[932] Please see for example RBS page 197 – 199 and Barclays, page 223
[933] Ibid.
[934] Please see page 135 – 136, M. Steger and R. Roy, 2010, line 448.
[935] Please see pages 199 for RBS, page 223 for Barclays and 257 – 258 for SCB
[936] Please see page 284.

acquisitions to the banking sector and its contributory role in the near collapse of some of the global systemically important banks in the UK during and in the aftermath of the global financial crisis in 2007 - 2009, the question is concerned with what the attitude of the policy makers should now be when designing the legal framework for the banking sector in order to keep these huge financial conglomerate banks in the UK safe from future catastrophe.

6.7.2 Given the Huge Contributions of Mergers and Acquisitions to the Near Collapse of Some of the Case Studies, "What has Been the Response of the Banking Regulators to M & A and Why?"

As demonstrated in the cases of RBS, Barclays, SCB and HSBC, notwithstanding the enormous potential hazards identified in M & A that can immensely contribute to the vulnerability of GSI-Bs when such deals go wrong, the equally huge accruable benefits of M & A cannot be ignored.

In the real world of business, there are variety of reasons why people and businesses generally want to dispose their assets. It could either be a voluntary disposal or sometimes, a seller may be under intense pressure to dispose their personal properties ranging from moveable chattels such as television, cooker, refrigerator, vehicle and real estate such as land and buildings. Depending on the reasons for selling, sometimes these valuable assets can come to the market at giveaway prices because the seller has a need for immediate cash. Investors can be on the lookout to take advantage of such opportunities. But as well, there could be hidden adverse features in the property that is on sale which may only come to light long after the purchase of a seemingly cheap article had gone through and worse of all, without a right of recourse to the seller after the deal has been finalised.

It is not in any way different in the financial sector. There are wide ranging reasons why a bank may want to take over another financial institution. A financial institution may want to take-over another organisation for reasons which may include an opportunity to cheaply buy a company that is under winding up order or in receivership, the desire to buy another company may be motivated by a wish to buy a cash rich organisation, a desire to extend market outreach across international boundaries, takeover may be induced by tax advantages that may accrue from the takeover, an opportunity may arise to buy a company with choice landed property that is of interest to the buyer, there may be a need to diversify into some desired business areas, and so many other reasons that could be advantageous to the predator company.[937] Growing a bank through mergers and acquisitions is nothing new. It is a popular means of stimulating growth as found in all the case studies.[938] In the past, it served the interest of the banks very well.[939]

The huge risks that may come with M&A includes the purchaser's inability to achieve desired level of integration and failure to realise full synergy among the constituents in a merger.[940] As well, when M&A becomes too frequent as was in the case studies, the combined risk increases and so are the uncertainties.[941] Part of the difficulties in M & A is that not all the underlying facts about the targeted financial institution may be known to the purchaser when considering whether to buy or not. The responsibility lies with the purchaser to exercise due diligence. This was what happened in the case of ABN Ambro purchased by RBS. RBS did not appreciate the extent of the poor quality of the assets when they bought ABN Ambro. Barclays and HSBC had exactly the same problem in their purchase of Lehman Brothers and HSBC in the case of their purchase of Household Finance Corporation in 2003.[942]

Abraham and Shrives contended that during the early stages when the acquiring organisation is expected to exercise due diligence, it is doubtful whether the acquiring managers are always entirely honest in their declaration of all potential risks identified which may hinder commitment to buying an organisation.[943]

This point may be very relevant in the circumstances of the case studies regarding the purchase of ABN Ambro by RBS, Lehman Brothers by Barclays and HFC by HSBC. The question is, in the process of exercising caution and due diligence prior to committing themselves to the mergers and acquisitions of the troubled banks,

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[937] Op. Cit., E. McLaney, 2016, p. 207, (n. 670).
[938] Y. Ahmed and T. Elshandidy, 'The Effect of Bidder Conservatism on M & A Decisions: Text -based Evidence from US 10 – K Fillings'. 46, 176 – 190, (2016) International Review of Financial Analysis.
[939] Please refer to line 933.
[940] C. Ott, 'The Risks of Mergers and Acquisitions: Analysing the Incentives for Risk, Reporting in Items 1A of 10 -K Fillings'. (2020) 106, 158 – 181, Journal of Business Research.
[941] Ibid.
[942] Please see pages 288 & 305.
[943] S. Abraham and P. Shrives, 'Improving the Relevance of Risk Factor Disclosure in Corporate Annual Reports'. (2014) 46 (1) 91 – 107.

whether the managers were entirely honest in giving due weight to all the risks identified or they simply did not see those risks and then ended up paying too much for the Dutch bank and in the same way with the other banks.

Similarly, Robert et al, contended that the motivation behind agitation to purchase another bank may relate to a high compensation usually paid to the CEO when such ventures are successful.[944] These authors also suggested that CEOs may be motivated by the desire to become personally famous and to acquire the "Too big to fail" status for their bank so as to reap the benefits of associated subsidies. [945]

The erstwhile CEO of RBS, Fred Goodwin, was accused of being too ambitious, in search of fame and that such drive led to his aggressive pursuit of mergers and acquisitions which eventually ended up in bringing the bank he led (RBS) into disrepute and ruin.[946]

In the Financial Services Authority's report relating to their enquiry into the causes of the failure at RBS which concluded in December 2011, the banking sector regulator identified M & A of ABN as a major contributory factor to the causes of the near collapse of the bank, but FSA did not propose to stop banks altogether from engaging in M & A. FSA made the point that RBS did not exercise necessary caution before taking on the immense risks associated with the cross-border acquisition neither did the management of RSB sufficiently engage the regulators to enable them to probe further into that purchase.[947] Even if RBS did, the FSA at that time did not see itself as responsible for providing a detailed assessment or to give approval for the purchase of ABN Amro.[948]

Following that event, whilst banks may still engage in M & A, significant deals would now be subjected to a more intrusive assessment by special supervisory focus group that would rigorously assess associated risks during the exercise of due diligence

[944] D. Robert, E. Douglas and M. Philips, 'Mergers and Acquisitions of Financial Institutions: A Review of the Post 2000 Literature' (2009) Vol 36 (23) 87 – 110. Journal of Financial Services Research.
[945] Ibid.
[946] Please see page 215.
[947] Op. Cit., Financial Services Authority, December 2011, p. 25 & p. 264, (n. 149)
[948] Ibid.

stage and the supervisors would now need to approve important M & A before the deal can be progressed by a supervised bank.[949]

Although the bank's management would still need to take responsibility for the decision to commit themselves to a M & A, the introduction of the back-up which involves independent assessment of risks associated with M & A in the ways suggested would in this researcher's view (i) eliminate subjective evaluation by CEOs who may be over optimistic about the value of the assets and risks attached to financial institutions that are prime targets of the predator company (ii) the involvement of independent assessors would provide safety measures by having another layer of assessors who have no emotional attachment and no specific benefits to gain or anything to lose whether acquisition of targeted financial institutions goes through or fails to go through (iii) as a consequence of the additional layer of independent assessors, banks can still enjoy the benefits that are available in M & A while safety measures are also improved. The alternative could have been a compulsory cessation of M & A in huge banks because of the enormous risks of failure that may be induced by M & A as it happened in RBS, Barclays and HSBC. In view of the advantages available in M & A, this researcher is of the view that it would not be economically prudent to dispense with M & A altogether.

Thus, the new supervisory approach which involves getting the permission of the bank supervisor for M & A to scale through would be a welcomed development as part of the strategies to keep huge banks in the UK that are global systemically important safe.

6.7.3 The Impact of Poor Management Decisions Which Often Led to Incessant Changes in Leadership

The importance of the quality of the leadership in a bank, the stability in office of the foremost leaders and a culture of planned succession cannot be over emphasised in relationship to success or failure of a bank.[950] One wrong appointment is all it takes to face the risk of collapse. Examples are found in the cases of Nick Leeson and

[949] Ibid.

[950] These issues were discussed in chapter 5, pages 295 & 296

Kawu Adoboli relating to Barings Capital and UBS.[951] In both cases, they were not part of the leadership team of their organisations just that they were given the powers to commit their banks on a huge scale, but they were not adequately supervised.

In recognition of this key issue, FSMA 2000 Part V and the Banking Reform Act 2013 took this matter into account under Part 4 of the Banking Reform Act which deals with the issues of regulating and vetting of those that are to take up senior management roles in the banking sector.[952] By involving supervisory agencies in scrutinising those that are to hold key roles in the bank, this researcher accepts that this necessary step will lead to ensuring that the most capable people are given the roles of gatekeepers on financial issues of grave consequences which are of concern to the public.

In the circumstances of the four case studies, HSBC and Standard Chartered Bank were more successful at leadership retention with average of about 8 – 9 years services as Chairmen/Chief Executive Officers. In most cases, these officers would have served for upward of about 20 – 25 years in their organisation so they are deeply familiar with the bank's market, ethos of the bank, their aspirations and organisation culture.[953]

In the case of RBS, although before the near collapse of RBS there was stability in the bank's leadership, in the period leading to the global financial crisis, those that had served in the capacity of the Chairmen and Chief Executive Officers had no prior training in banking and finance or other subjects that are related to banking and finance and neither did they have prior experience in leading a bank. For example, Sir George Matthewson who was the CEO from 1992 and became the Chairman from 2001 – 2006 was a Mathematician and Applied Physicist.[954] Similarly, Tom McKillop who served as the Chairman from 2006 – 2008 held a Ph D in Chemistry. It was after the global financial crisis that matters started to improve when Philip Hampton who holds an MBA and was previously an investment banker took over the leadership following the crisis while Stephen Hester, an Economist, Ross McEwan, a

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[951] Please see pages 94 – 95 regarding Nick Leeson and pages 95 – 96 regarding Adoboli.
[952] These Parts of the Banking Reform Act 2013 were discussed on pages 23 - 28, paragraphs 1.9 – 1.9.9
[953] Please see pages 294
[954] Royal Bank of Scotland, 'Annual Accounts', 2005, p.7

holder of an MBA from Harvard and Prof Howard Davies a seasoned professor of economics and central banking all had a stint in joining hands to revamp RBS.

Worst of all, in Barclays there were instances where Chairmen/CEOs served for just one year and others could only serve for 2 years. It is not difficult to figure out that each time a new leader is brought in, foremost such leaders would be faced with the difficult task of gaining the trust and cooperation of those he met on the ground and would be under additional challenge to meet the expectation of the shareholders who would naturally expect new leaders to bring into the bank new ideas and purposeful leadership in order to create a turn-around in an ailing bank under a turbulent economic environment. For example, in 2014 under the leadership of David Walker, the Chairman, and Anthony Jenkins the Group Chief Executive of Barclays went through what John McFarlane, the subsequent Chairman of Barclays described as one of the largest restructuring in history when the company floated almost 600 non-core banking subsidiaries to manage its non-core banking assets.[955] In the end, the project turned out to be a disaster for Barclays.[956]

The argument is that hunting for the right people to manage the affairs of a huge multinational banking corporation and a succession programme cannot be left to a game of chance or a matter of trial-and-error, as this area is an important critical success factor that has the potential to make or undo a bank. As such, this researcher opines that there should be a well-planned out policy that is subjected to periodic reviews if that does not exist already. For example, in 2010/2011 when there was a change in leadership at HSBC, a senior staff Vincent Cheng was about to retire after 33 years in service, but the bank management persuaded him to take up an advisory role to the incoming Group Chief Executive on regional matters, an area in which Vincent was considered to have considerable expertise.[957]

As pointed out previously, it is consoling to have the provisions under Part 4 of the Banking Reform Act 2013 wherein banks' supervisors are required by law to be involved in vetting responsible position holders before they can function in key positions in the bank. It is one thing to have such policy in place and a supporting

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[955] Barclays Plc 'Annual Report and Financial Accounts (2016, p. 2)
[956] Please see pages 243 – 245.
[957] HSBC, Annual Accounts, 2010, p. 4.

legislation to back it, but the most important part that should be of concern to all stakeholders is the processes on how such a policy would be implemented in practice.

6.7.4 Suggestions About Internal Control Mechanisms

Internal control mechanisms are part of the micro areas of management in huge banks that may easily escape proper scrutiny. The problem is not about a bank not having some sort of internal control systems in place. It would be highly unusual for a bank not to have any internal control systems in place.

The real issue has to do with the working, adequacy and effectiveness of the processes of the systems engaged in a bank whether it is fit for purpose, whether it is able to timeously discover anomalies and how issues identified are promptly resolved. It is suggested that this area of banking practice should be subjected to periodic evaluation and auditing. If necessary, external management consultants could be engaged in addition to auditor's annual review in this area of operation management.

For example, in the case of Adoboli of UBS cited earlier, he was given the sole responsibility to commit his bank up to a limit of $100 million. His case is an example of all that could possibly go wrong in an internal control system. In his case there was virtually no supervision by his managers and other members of his team were unaware of his dubious activities that went on for some years before he exposed himself. Although his trading limit was $100 million, at one point he exposed his employers to a potential loss of $12 billion.[958]

In any internal control environment in a bank of any size, it should never be possible for any single individual to have such enormous powers as to commit his/her bank to such extent. This is because, personal circumstances of individuals can change over time. So also, personal character can for some reasons deteriorate. For example, not many people are immune to exhaustion, depression and their consequences and

[958] Please see discussion of this on page 95 - 96.

more so different people handle these vicissitudes of life differently. Individuals can run into personal financial difficulties, family problems, divorce etc which in some cases can lead to gambling, developing bad drinking habit and so on as coping strategies. There are hosts of other operational risks that can lead to someone hiding important documents or even shredding documents. That is why the barest minimum of security measures in an internal control system should embrace a Dual Control Mechanism (DCM) at all levels of operation involving exposure of bank's assets to significant level of risks.

Thus, before the release of a substantial amount including the granting of loans and overdraft running up to $100 million or exposure of a bank to an amount in the region of $12 billion, the barest minimum would be a dual control of senior managers and where it reaches up to $12 billion such amount should gain the attention of the board. In any transaction involving a huge amount such as $100 million, a system is suggested in a way that at least two to three senior managers must authorise such significant amount before it can scale through. The disadvantage of this suggestion is that it may slow down processing time, but it has the potential advantage to avoid huge losses and reduce incidences of banks' failure as was the case in Adoboli and Nick Lesson.[959] It is indeed very surprising and a matter of deep concern if an individual can continue to act alone authorising significant payments for up to three years without any of the colleague knowing what he was doing and the person was not supervised.

Even if a bank has a very robust capital base and the liquidity are all impeachable, all those could disappear rapidly as it happened in the case of Nick Leeson at Barings Capital. It is unlikely that during the period that Nick ran down his employer's asset he ever woke up in the morning at any time and thought of checking what the level of the capital or liquidity was before he engaged in the activities that filtered away the bank's resources. That was possible because he had the capacity to work alone and did as he pleased without anyone having oversight on what he was doing. By the time his wrongdoing came to light it was too late. The point here is that an effective regulatory architecture must be holistic not just capital and liquidity adequacy alone, but it must among other factors embrace efficient supervision, perfectly working internal control mechanisms and quality leadership.

[959] Please see pages 95 -96

In any internal control environment in a bank of any size, it should never be possible for any single individual to have such enormous powers as to act solely and bring a bank into liquidation.

6.8 Justification of the Hypothesis Proposed at the Beginning of the Study

The hypothesis at the beginning of the study was, "Notwithstanding some benefits that may accrue from the ring-fencing policy, the banking sector and by extension the economy in the UK may likely face long term detriments arising from the implementation of the ring-fencing policy".[960]

The study came to a finding that indeed as suggested by Goodhart, application of the ring-fencing policy would most likely support stability in the banking sector as any case of dislocation arising in the non-ring-fenced banks are unlikely to cause disruptions to the continuation of payment and retail banking services in the ring-fenced banks.[961] The ring-fencing policy would also make it less likely for any need to provide expensive government funded bailouts to rescue non-ring-fenced banks should they run into difficulties out of their own making.[962]

However, it is suggested that, except the ring-fencing policy in the banking sector is rescinded or amended so that only the risky investment banking arms in the non-ring-fenced banks are removed, some of the likely long-term damaging impacts on the banking sector and to the UK economy highlighted in the study include the following:

(1) The UK banks would be at a disadvantage competing with other banks at international level more especially huge universal banks in other countries where their laws are less restrictive, and they do not favour implementation of the ring-fencing policy as it is in the UK.[963]

[960] Please see page 12.
[961] Op. Cit., C. Goodhart, 2012, (n. 44)
[962] Ibid.
[963] Please see pages 137 - 138

Part of the challenges that the UK banks would then face is that they are obligated to abide by the internationally agreed banking regulations just like other global systemically important banks elsewhere, but in addition, the UK banks would need to comply with the ring – fencing policy at additional costs whereas those other banks are not required to do so.

(2) Due to the breaking up of synergy in the huge and well-resourced universal banks in the UK as a result of the remover of cheap depositors' funds from the non-ring-fenced banks to the ring-fenced bank, it is contended that though both classes of banks have the capacity to lend, the ability of the restructured banks to support the needs of the biggest multinational corporate customers as individual unit would be considerably diminished.[964]

(3) Part of the consequences would be the additional cost to huge conglomerate customers in dire need of huge capital outlay, but which would now face the additional difficulties involved in searching for multiple sources of finance instead of dealing with just one or relatively fewer banks where complications arising from perfecting security against loans and advances can be minimised.[965]

(4) The ring-fencing policy is likely to cause reduction in the performance of the non-ring-fenced banks in situations where the cheap core deposits are no longer available to subsidise loans and advances including huge, accumulated mortgage portfolio that are only generating low interest income due to the prevalent low interest rate orchestrated by the global financial crisis. It is appreciated that the bankers have the discretion to choose the side of the fence where they want the loan assets to be whether within the ring-fenced bank or the non-ring-fenced bank.[966]

(5) As well, this researcher contends that the financial sector encompasses banking, the stock market, pension funds, insurance, credit card service providers etc. These subsectors have a symbiotic relationship, depending on one another. The point is that although the ring-fenced banks have the

[964] The point about synergy was extensively discussed in pages, 143, 152, 248 and 253 for example
[965] Please see pages 218 - 220
[966] Please see page 219, second to the last paragraph.

capacity to provide both corporate and retail banking services and can provide allowed services to the banks within the group, by separating banks along ring-fenced and non-ring-fenced bank, the ring-fencing policy limits the support that comes from the ring-fenced banks to the entire financial system. This is because restrictions are placed on the ring-fenced banks regarding providing facilities to other financial institutions, branches, and subsidiaries outside the EEA.[967] The effect is that should the non-ring-fenced bank runs into financial difficulties they cannot depend on the ring-fenced bank to provide the non-ring-fenced bank with financial assistance.

The above enumerated issues led to the suggestion that the policy makers should consider a review of the ring-fencing policy in the best interest of the economy especially following the huge restructuring in the banks that has de-risked and improved stability in the banking sector so far. As well, in the past ten years after the GFC, there have been considerable number of policy measures already evaluated in Chapter 2, literature review that are designed to mitigate the risks of possible failure in the banking sector especially regulations relating to improved capital and liquidity adequacy, better supervisory regime in addition to the considerable restructuring through demergers and substantial divestment from non-core assets.[968]

6.9 Recommendations on the Way Forward and Further Research

It is understood that it may still take some time to appreciate the full impact of the regulatory changes including the full effects of the ring-fencing policy on the UK banks and the economy.

This study suggests that a better approach could have been to use legislative powers to stop the banks from engaging in risky speculative investment trading while on application, licences could be given to qualified banks that are interested in incorporating a separate entity that could engage in speculative proprietary trading and derivative accounts should they wish to do so. In effect, it is the risky

[967] Op. Cit., Ring-fencing Guidance para. 1.6 (n. 34), Please see pages 9 & 18
[968] Please see pages 212 & 279.

investment elements that should be taken off the mainstream banks not the core deposit accounts.

That way, core depositors' accounts would be protected in the same way that the ring-fencing policy would do. The added advantages are that the cheap core deposits would then be available for the traditional corporate lending where huge multinational corporate customers' financial needs could be catered for. Also, the UK universal banks would have been able to retain their competitiveness in relationship with the other European counterparts that did not adopt the ring-fencing policy.

As well, following recovery from the recession and possible reduction in the scale of penalties imposed on banks, performance in the banking sector may take a new positive turn. It is therefore suggested that keeping in view the economic performance of the banking sector in the next five to ten years may aid policy makers in coming to a decision on whether to retain or repeal the ring-fencing policy in the banking sector.

In addition to the foregoing, this researcher would in summary suggest that the most diligent attention should be paid to the following as discussed in the body of the thesis:

(1) Keen attention to be paid to mergers and acquisitions in banks by supervisors to forestall issues that arose with the purchase of ABN Ambro by RBS and Lehman Brothers purchased by Barclays at costs considered too high for the value of those financial institutions and the high risks that came with them to RBS and Barclays.[969]

(2) Banks' supervisors should continue to demand for improvement in the quality of corporate governance of banks in order to ensure that only competent hands that are able to add value to the security of bank's assets are allowed to be appointed into the boards of banks and other positions of responsibility.[970]

[969] Please refer to page 199 for purchase of ABN Ambro and page 239 for Lehman Brothers
[970] Please refer to page 134

(3) Banks' supervisors should continue to demand for improvement in the quality of training and development of compliance officers in the banking sector.[971]

(4) Emphasis should be laid on the importance of empowerment of internal auditors so that outcomes of their audit which raises serious concerns should receive the direct attention of the board of the bank concerned and the bank's supervisors.[972]

(5) Supervisory agencies should see to it that banks follow policy of enhanced incentives and protection of whistle blowers in the banking sector as discussed in the body of the thesis.[973]

(6) As also discussed by Admati, diligent attention should be paid by banks' supervisors to ensure that banks under their supervision are compliant with capital and liquidity ratios requirements considered appropriate in the circumstances of each bank, based on their risk levels.[974]

(7) The principle of dual control mechanism expounded earlier should form part of the basic foundations in the management of internal control system.[975]

If other researchers pick up interest in this area of study and keep under watch performance in the banking sector for the next 5 – 10 years, the outcome of a collective research endeavour may hopefully spearhead policy change on ring-fencing in the future assuming that it is considered desirable to do so.

6.10 Contributions to Knowledge

For emphasis on the important contributions to knowledge derived from this study, this paragraph is a signpost to the section of this report that contains "Contributions to knowledge" in Chapter 1, Paragraph 1.11 at page 32 - 34. This is to avoid tedious re-copying of that section, kindly refer to the pages cited.

[971] ibid
[972] Please refer to pages 106 & 134
[973] Please see pages 107 – 109 and page 134
[974] Op. Cit., A. R. Admati 2014, (n. 11).
[975] Please refer to pages 325 – 326

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Appendix 1 – The Royal Bank of Scotland Group: References to Page Numbers on the Annual Reports and the Financial Accounts

From 2004 -2018

	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017*	2018
Income	p.145	p.145	p.139	p.120	p.174	p.241	p.127	p.169	p.353	p.202	p.342	p.260	p.290	p.176	p.176
Operating Profit Before Tax	p.145	p.145	p.139	p.120	p.174	p.241	p.127	p.169	p.353	p.202	p.342	p.260	p.290	p.176	p.176
Total Assets	p.146	p.146	p.140	p.121	p.175	p.243	p.127	p.171	p.355	p.204	p.344	p.262	p.292	p.178	p.178
Impairment Charges	p.58	p.58	p.50	p.35	p.174	p.73	p.126	p.169	p.353	p.202	p.342	p.260	p.290	p.176	p.176
Number of Branches		p.11	p.19	p.15											
Number of Employees	p.81	p.81	p.40	p.3	p.149	p.262	p.120	p.163	p.346	p.196	p.4	p.87	p.117	p.188	p.188
Earnings Per Share	p.145	p.1	p.139	p.1	p.174	p.241								p.176	p.176
Dividend Per Share	p.145	p.1	p.139	p.1											p.176
Total Deposit	p.146	p.146	p.140	p.121	p.175	p.243	p.127	p.171	p.355	p.204	p.344	p.262	p.292	p.178	p.178
Total Loan	p.146	p.146	p.140	p.121	p.175	p.243	p.127	p.171	p.355	p.204	p.344	p.262	p.292	p.178	p.178
Contribution from Investment Banking	p.70	p.70	p.12	p.2	p.50	p.86	p.7	p.8	p.28	p.10					
Contribution from Insurance Division	p.38	p.38	p.31	p.12	p.17	p.36									
Contribution from Wealth Management	p.76	p.76	p.2	p.2	p.12	p.26	p.7	p.12	p.24	p.10					

Note

(i) The figures for the year ended December 2004 were extracted from the Annual Report and Financial Accounts for 2005, hence pages referred to are actually on the Group Financial Report and Annual Financial Accounts for the Year 2005

(ii) Statistics for 2017 was derived from 2018 Annual Report and Financial Accounts. This is because the Annual Report and Financial Accounts for 2017 was comprehensively redrafted such that operating loss before tax of £1,396 billion (p.81, 2017 Financial Accounts) became £2,239 billion (p.176, 2018 Financial Accounts) after the adjustments. Since this is considered to be a material adjustment in the accounts of the Group, hence this researcher opted to work with the adjusted figures.

(iii) From 2008 to 2017, the Group was in difficulty and mostly recorded losses and as such, there was no dividend paid from 2008 to 2017.

(iv) Due to divestment, the insurance arm of the Group was sold out as such, from 2009 contributions from that arm of the Group stopped. That situation similarly affected the investment arm of the Group. Due to restructuring, Wealth Management ceased to be reported separately having been merged with another department in the Group

Appendix 2 – Barclays Group: References to Page Numbers on the Annual Reports and the Financial Accounts from 2004 – 2018

	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Total Income	p.96	p.96	p.162	p.176	p.204	p.204	p.74	p.164	p.2	p.245	p.224	p.220	p.240	p.137	p.226
Operating Profit Before Tax	p.96	p.96	p.162	p.176	p.204	p.204	p.74	p.164	p.2	p.246	p.224	p.220	p.240	p.137	p.226
Total Assets	p.98	p.98	p.163	p.177	p.205	p.206	p.76	p.170	p.204	p.247	p.227	p.223	p.242	p.139	p.228
Impairment Charges	p.96	p.96	p.162	p.176	p.204	p.204	p.74	p.164	p.202	p.245	p.224	p.220	p.240	p.137	p.226
Number of Branches	p.4*	p.4*	p.4	p.24		p.4									
Number of Employees	p.109	p.109	p.49	p.2	p.23	p.5	p.29*	p.29	p.34	p.2	p.71	p.76	p.90*	p.90*	p.90
Earnings Per Share	p.96	p.96	p.10	p.176	p.204	p.204	p.164*	p.164	p.203	p.246	p.224	p.220	p.240	-	p.226
Dividend Per Share	p.96	p.96	p.10	p.2	p.2	p.204	p.164*	p.164	p.2	p.245	p.222	p.350	p.376	-	p.359
Total Deposit	p.98	p.98	p.12	p.177	p.205	p.206	p.76	p.170	p.204	p.247	p.227	p.223	p.242	p.139	p.228
Total Loan	p.98	p.98	p.12	p.177	p.205	p.206	p.76	p.170	p.204	p.247	p.227	p.223	p.242	p.139	p.228
Contribution from Investment Banking	p.114	p.114	p.4	p.3	p.5	p.3	p.9	p.173	p.207	p.249	p.229	p.225	p.234*	p.234*	p.234
Contribution from Insurance Division		p.183	p.183	p.183											
Contribution from Wealth Management	p.115	p.115	p.4	p.3	p.5	p.10*	p.10	p.173	p.207	p.249					

Note

(i) The figures for the year ended December 2004 were extracted from the Annual Report and Financial Accounts for 2005, hence pages referred to are actually on the Group Financial Report and Annual Financial Accounts for the Year 2005

(ii) The figures relating to contribution of insurance division for the 2005, 2006 and 2007 were extracted from the Annual Report and Financial Accounts for the 2007 p.183

(iii) EPS and DPS for 2010 found on page 164, 2011 Accounts

(iv) In 2012 audited adjusted figures were used relating to total income, Profit Before Tax and Earning Per Share since the difference in the amounts are substantial and can significantly impact on the analysis

(v) Number of employees stated as 119,300 as at 2016, 79,900 as at 2017 and 83,500 for 2018 were found on p. 90, 2018 Accounts

(vi) Contributions of investment banking for years 2016, 2017 and 2018 are found on p.234 of 2018 Accounts

(vii) The number of employees for 2010 was found in the Financial Accounts for 2011

(viii) Consequent to the bottom-line loss declared in 2017, there was no dividend paid hence there is no statistics for EPS and DPS in 2017

(ix) Number of branches for 2004, 2005 and 2006 were extracted from 2006 Annual report and financial accounts

(x) Profit Before Tax in 2009 was £4.6 billion for continuing operations while in addition to that was income £6.78 billion earned from discontinued operations

Appendix 3 – Standard Chartered Bank Group: References to Page Numbers on the Annual Reports and the Financial Accounts from 2004 – 2018

	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Income	p.64*	p.64	p.76	p.88	p.96	p.112	p.139	p.163	p.197	p.229	p.225	p.235	p.199	p.200	p.236
Operating Profit Before Tax	p.64*	p.64	p.76	p.88	p.96	p.112	p.139	p.163	p.197	p.229	p.225	p.235	p.199	p.200	p.236
Total Assets	p.65*	p.65	p.77	p.89	p.97	p.114	p.141	p.165	p.199	p.231	p.227	p.237	p.201	p.202	p.238
Impairment Charges	p.64*	p.64	p.76	p.88	p.96	p.112	p.139	p.163	p.197	p.229	p.225	p.235	p.199	p.200	p.236
Number of Branches		p.42	p.9	p.66	p.4	p.76	p.126	p.152	p.4	p.213	p.210				
Employees		p.42	p.1	p.3	p.2	p.1	p.39	p.2	p.3	p.3	p.23	p.1	p.315	p.217	p.7
Earnings Per Share	p.64*	p.64	p.76	p.88	p.96	p.112	p.139	p.163	p.197	p.229	p.225	p.235	p.199	p.200	p.236
Dividend Per Share	p.1*	p.1	p.1	p.3	p.2	p.1	p.4	p.2	p.2	p.2	p.2	p.5	p.5	p.5	p.30
Deposit	p.65*	p.65	p.77	p.89	p.97	p.114	p.141	p.165	p.199	p.231	p.227	p.237	p.201	p.202	p.238
Loan	p.65*	p.65	P.77	p.89	p.97	p.114	p.141	p.165	p.199	p.231	p.227	p.237	p.201	p.202	p.238
Contribution from Investment Banking	p.24*	p.24	p.31	p.5	p.5	p.1	p.1	p.2	p.2	p.2	p.2	p.3	p.2	p.2	p.2
Wealth Management	p.24	p.24	p.37*	p.37	P.25*	p.25	p.29	p.29	p.50*	p.50	p.37	p.3	p.2	p.2	p.2

Note:

(i) Information regarding 2004 Annual Accounts were extracted from 2005 Annual Financial Accounts
(ii) Operating Income from wealth management for 2012 was obtained from 2013 Annual Financial Accounts
(iii) Operating Income from wealth management for 2008 was obtained from p.25 of 2009 Annual Financial Accounts
(iv) Operating Income from wealth management for 2006 was obtained from p.37 of 2007 Annual Financial Accounts
(v) Operating Income from wealth management for 2004 was obtained from p.24 of 2005 Annual Financial Accounts

Appendix 4 – HSBC Group: References to Page Numbers on the Annual Reports and the Financial Accounts from 2004 – 2018

	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Total Income	p. 1	p. 1	p.294	p.337	p.333	p.66	p.238	p.279	p.372	p.417	p.335	p.337	p.184	p.176	p.214
Operating Profit Before Tax	p.236	p.236	p.294	p.337	p.333	p.353	p.238	p.279	p.372	p.417	p.335	p.337	p.2184	p.176	p.214
Total Assets	p.237	p.237	p.295	p.338	p.334	p.355	p.240	p.281	p.374	p.419	p.337	p.339	p.186	p.178	p.216
Impairment Charges	p.236	p.236	p.294	p.337	p.333	p.24	p.238	p.279	p.372	p.417	p.335	p.337	p.184	p.176	p.214
Number of Branches								p.1	p.1	p.1	p.1	p.5		p.2	
Number of Employees	p.10	p.10	p.265	P365	p.303	p.388	p.206	p.29	p.335	p.27	p.1	p.60	p.40	p.2	p.2
Earnings Per Share	p.236	p.236	p.294	p.337	p.2	p.2	p.238	p.279	p.2	p.417	p.335	p.337	p.184	p.176	p.214
Dividend Per Share	p.236	p.236	p.294	p.337	p.2	p.2	p.1	p.2	p.1	p.2	p.1	p.3	p.3	p.3-	p.3
Total Deposit	p.237	p.237	p.295	p.338	p.334	p.355	p.240	p.281	p.374	p.419	p.337	p.339	p.186	p.178	p.216
Total Loan	p.237	p.237	p.295	p.338	p.334	p.355	p.240	p.281	p.374	p.419	p.337	p.339	p.186	p.178	p.216
Contribution from Investment Banking	p.45	p.44	p.45	p.33	p.84	p.82	p.48	p.57	p.76	p.94	p.76	p.74	p.20*	p.20	p.20
Contribution from Insurance Division	p.236	p.236	p.294	p.337	p.333	p.82	p.48	p.57	p.76	p.94	p.76	p.74	p.21*	p.21	p.214
Private Banking	p.45	p.44	p.45	p.33	p.84	p.82	p.48	p.72*	p.72	p.72*	p.72	p.72	p.18*	p.18	p.21

Note to Appendix 4

(a) Data for the year 2004 were extracted from Annual accounts for year 2005

(i) Contribution from investment banking for 2016 was extracted from 2017 accounts at page 20

(ii) Contribution from insurance business for 2016 was extracted from 2017 accounts at page 21

(iii) Contribution from private banking for 2011 was extracted from 2012 accounts at page 72

(iv) Contribution for private banking for 2013 was extracted from 2014 accounts at page 72

Appendix 5 – Data for Figure 5: The Royal Bank of Scotland Group:

The Relationship Between Income and Operating Profit Before Tax 2004 - 2018

£ (b)

Year	Income	Profit Before Tax
2004	23.4	7.3
2005	25.9	7.9
2006	28	9.2
2007	31.1	9.9
2008	25.9	-40.7
2009	38.7	-2.6
2010	23.7	-0.2
2011	21.8	-0.9
2012	17.9	-5.6
2013	19.8	-6.8
2014	15.1	-2.7
2015	12.9	-2.7
2016	12.6	-4
2017	13.1	2.2
2018	13.4	3.4

Appendix 6 – Data for Figure 6: The Royal Bank of Scotland Group

The Relationship Between Assets, Deposits and Loans

2004 – 2018

£ (b)

Year	Assets	Deposits	Loans
2004	588	382	408
2005	777	453	488
2006	871	516	549
2007	1901	995	1049
2008	2402	898	1013
2009	1696	756	820
2010	1307	558	606
2011	1433	581	587
2012	1312	623	564
2013	1020	537	506
2014	1051	452	421
2015	815	408	364
2016	799	420	382
2017	738	392	322
2018	694	384	318

Appendix 7 – Data for Figure 7: The Royal Bank of Scotland Group

Trend of Growth and Decline in the Total Assets

2004 - 2018

£ (b)

Year	Total Assets
2004	588
2005	777
2006	871
2007	1901
2008	2402
2009	1696
2010	1307
2011	1433
2012	1312
2013	1020
2014	1051
2015	815
2016	799
2017	738
2018	694

Appendix 8 – Data for Figure 8: The Royal Bank of Scotland Group

The Contributions of Earnings from the Investment Banking to the Profit Before Tax 2004 – 2013 £ (b)

Year	Profit Before Tax	Earning from Investment Banking
2004	7.3	4.2
2005	7.9	5.2
2006	9.2	6.1
2007	9.9	5.6
2008	-40.7	-8.7
2009	-2.6	5.7
2010	-0.2	3.2
2011	-0.9	1.5
2012	-5.6	1.5
2013	-6.8	0.7
2014	-2.7	
2015	-2.7	
2016	-4	
2017	2.2	
2018	3.4	

Appendix 9 – Data for Fig. 9: The Royal Bank of Scotland Group

Impairment Charges 2004 – 2018 £ (b)

Year	Impairment Charges
2004	1.5
2005	1.7
2006	1.9
2007	2.1
2008	8
2009	14
2010	9.4
2011	7.2
2012	5.3
2013	8.4
2014	
2015	
2016	0.5
2017	0.5
2018	0.4

Appendix 10 – Data for Figure 10: The Royal Bank of Scotland Group

Trend of Growth and the Decline in the Employees' Profile 2005 – 2018

Year	Number of Employees
2004	-
2005	137000
2006	135000
2007	226400
2008	199800
2009	184500
2010	113600
2011	113700
2012	137200
2013	106100
2014	110027
2015	93659
2016	77900
2017	69700
2018	65400

Appendix 11 – Data on Fig. 11. Barclays Group: The Relationship Between Income and Operating Profit Before Tax From 2004 – 2018 £ (b)

Year	Income	Profit Before Tax
2004	14,108	4,580
2005	17,333	5,280
2006	21,595	7,136
2007	23,000	7,076
2008	23,115	6,077
2009	29,123	11,642
2010	31,450	6,079
2011	32,292	5,879
2012	29,043	7,048
2013	27,935	5,167
2014	25,288	5,502
2015	25,454	5,403
2016	21,451	3,230
2017	20,937	3,166
2018	21,136	3,494

Appendix 12 on Data for Fig. 12 Barclays Group: The Relationship Between Assets, Deposits and Loans From 2004 – 2018 £ (b)

Year	Assets	Deposits	Loans
2004	538,181	329,721	343,041
2005	924,357	316,152	300,001
2006	996,787	338,537	313,226
2007	1,227,361	385,535	385,518
2008	2,052,980	450,415	509,522
2009	1,378,929	398,875	461,359
2010	1,490,038	423,777	465,741
2011	1,563,527	458,117	479,380
2012	1,490,321	464,290	466,218
2013	1,312,267	482,736	468,264
2014	1,357,906	486,094	469,878
2015	1,120,012	465,322	440,566
2016	1,213,126	471,392	436,035
2017	1,129,343	467,332	401,762
2018	1,133,283	394,838	326,406

Appendix 13 – Data for Fig. 13 - Barclays Group: Trend of Growth/Decline in the Total Assets for 2004 – 2018 £ (b)

Year	Total Assets
2004	538,181
2005	924,357
2006	996,787
2007	1,227,361
2008	2,052,980
2009	1,378,929
2010	1,490,038
2011	1,563,527
2012	1,490,321
2013	1,312,267
2014	1,357,906
2015	1,120,012
2016	1,213,126
2017	1,129,343
2018	1,133,283

Appendix 14 – Data for Figure 14 - Barclays Group: Trend of Growth/Decline in Impairment Charges from 2004 – 2018 £ (b)

	Impairment Charges
2004	1.1
2005	1.6
2006	2.2
2007	2.8
2008	5.4
2009	8.1
2010	5.7
2011	5.6
2012	3.6
2013	3.1
2014	2.2
2015	2.1
2016	2.4
2017	2.3
2018	1.5

Appendix 15 – Data for Fig. 15 - Barclays Group: The Proportion of the Contributions of the Investment Banking to the Operating Profit Before Tax 2004 - 2018 £ (billion)

Year	PBT	Investment Banking
2004	4.6	1
2005	5.2	1.3
2006	7.1	2.2
2007	7	2.3
2008	6	1.3
2009	4.6	2.5
2010	6	4.8
2011	5.9	3
2012	7	4
2013	5.2	2.5
2014	5.5	1.4
2015	5.4	1.6
2016	3.2	2.7
2017	3.2	2
2018	3.5	2.6

Appendix 16 Data on Fig. 16 - Barclays Group: Trend of Growth/Decline in the Employees' Profile 2004 - 2018

Year	Employees
2004	82,700
2005	120,300
2006	131,700
2007	135,000
2008	156,300
2009	144,200
2010	147,500
2011	141,100
2012	139,200
2013	139,600
2014	132,200
2015	129,400
2016	119,300
2017	79,900
2018	83,500

Appendix 17 Data on Fig. 17 Barclays Group: Trend of Growth/Decline in Earnings Per Share and Dividend Per Share in Pence 2004 - 2018

Year	Earnings Per Share Pence	Dividend Per Share Pence
2004	0.51	0.24
2005	0.544	0.266
2006	0.719	0.31
2007	0.689	0.34
2008	0.593	0.115
2009	0.862	0.025
2010	0.304	0.055
2011	0.251	0.06
2012	0.345	0.065
2013	0.167	0.065
2014	0.173	0.065
2015	0.166	0.065
2016	0.104	0.03
2017		
2018	0.094	0.065

Appendix 18: Data for Figure 18 SCB Group: The Relationship Between Income and Operating Profit

Before Tax 2004 – 2018

Year	Income US$ (b)	OPBT US$ (b)
2004	5.4	2.3
2005	6.9	2.7
2006	8.6	3.2
2007	11	4
2008	14	4.8
2009	15.1	5.1
2010	16	6.1
2011	17.6	6.8
2012	19	6.9
2013	18.8	6
2014	18.3	4.2
2015	15.3	-1.5
2016	14	0.4
2017	14.4	2.4
2018	14.8	2.5

Appendix 19, Data for Figure 19 SCB Group: The Relationship Between Assets, Deposits and Loans 2004 - 2018

Year	Assets US$ (b)	Deposits US$ (b)	Loans US$ (b)
2004	147.1	100.2	88.7
2005	215	138.8	133.5
2006	266	173.6	159
2007	329.2	205.6	189.6
2008	435	265.9	220.8
2009	436.7	289.7	249.2
2010	516.5	335.5	292.4
2011	599	378	329.7
2012	636.5	414.1	352.3
2013	674.4	424.6	374.4
2014	725.9	459.7	368.6
2015	640.5	388.2	321.9
2016	646.7	408.7	325.3
2017	663.5	401.5	306.2
2018	688.8	420.7	318

Appendix 20, Fig. 20 SCB Group: Trend of Growth/Decline in the Total Assets Employed 2004 – 2018 US$ (b)

Year	Assets US$ (b)
2004	147
2005	215
2006	266
2007	329
2008	435
2009	436.7
2010	516.5
2011	599
2012	636.5
2013	674.4
2014	725.9
2015	640.5
2016	646.7
2017	663.5
2018	688.8

Appendix 21, Fig 21 SCB Group: Trend in Growth/Decline in Impairment Charges 2004 – 2018 US$ (b)

Year	Impairment Charges US$
2004	0.3
2005	0.4
2006	0.6
2007	0.8
2008	1.8
2009	2.1
2010	1
2011	1
2012	1.4
2013	2.7
2014	2.9
2015	5.5
2016	3
2017	1.7
2018	0.8

Appendix 22, Fig 22 SCB Group: The Proportion of Contributions of the Investment Division to the OPBT US$ 2004 – 2018

Year	OPBT US$	Income from Investment Division US$
2004	2.3	1.2
2005	2.7	1.4
2006	3.2	1.8
2007	4	5.2
2008	4.8	7.5
2009	5.1	9.3
2010	6.1	10
2011	6.8	10.8
2012	6.9	11.8
2013	6	11.5
2014	4.2	6
2015	-1.5	5.3
2016	0.4	6.5
2017	2.4	6.5
2018	2.5	6.9

Appendix 23, Fig 23 SCB Group: Employees' Profile

Year	Employees
2004	
2005	44,000
2006	59,000
2007	70,000
2008	74,000
2009	77,000
2010	85,000
2011	87,000
2012	89,000
2013	87,000
2014	90,000
2015	84,000
2016	87,000
2017	86,000
2018	85,000

Appendix 24, Fig. 24 SCB Group: Trend of Growth/Decline in Earnings Per Share and Divided Per Share 2004 - 2018

Year	EPS in Cent	DPS in Cent
2004	129.6	57.5
2005	148.5	64
2006	169	71.04
2007	201.1	79.35
2008	202.4	61.62
2009	167.9	66.03
2010	196.3	69.15
2011	200.8	76
2012	199.7	84
2013	164.4	86
2014	102.2	86
2015	-91.9	13.7
2016	-14.5	
2017	23.5	11
2018	18.7	21

Appendix 25, Fig. 25 SCB Group: Trend of Growth/Decline in Income from Wealth Management 2004 – 2018 US$ (b)

Year	Income from wealth Management US$ (b)
2004	*0.9*
2005	*1.4*
2006	*1.9*
2007	*2.6*
2008	*2.8*
2009	*2.2*
2010	*1.1*
2011	*1.3*
2012	*1.3*
2013	*1.3*
2014	*1.7*
2015	*1.7*
2016	*0.5*
2017	*0.5*
2018	*0.5*

Appendix 26 HSBC Group: The Relationship Between Operating Income and PBT 2004 – 2018 US$ billion

	Income	PBT
2004	51	19
2005	58	21
2006	65	22
2007	79	24
2008	82	9
2009	66	7
2010	68	19
2011	72	22
2012	68	21
2013	65	23
2014	61	19
2015	60	19
2016	48	7
2017	51	17
2018	54	20

Appendix 27, HSBC Group: The Relationship Between Assets, Deposits and Loans 2004 – 2018 US$ billion '000

	Assets	Deposits	Loans
2004	1280	777	816
2005	1502	809	866
2006	1861	997	1053
2007	2354	1228	1219
2008	2527	1245	1087
2009	2364	1284	1076
2010	2455	1338	1167
2011	2556	1367	1121
2012	2693	1447	1150
2013	2671	1612	1292
2014	2634	1428	1087
2015	2410	1344	1015
2016	2375	1332	950
2017	2522	1434	1053
2018	2558	1419	1054

Appendix 28, HSBC Group: Trend of Growth/Decline in Impairment Charges 2004 – 2018 US$ billion

	Impairment Charges
2004	6
2005	8
2006	11
2007	17
2008	25
2009	26
2010	14
2011	12
2012	8
2013	6
2014	4
2015	4
2016	3
2017	2
2018	2

Appendix 29, HSBC Group: Contributions to the PBT by Investment Banking, Insurance Business and Private Banking 2004 – 2018 US$ billion

	Investment	Insurance	Private Banking
2004	5	1	1
2005	5	1	1
2006	7	1	1
2007	6	0.5	2
2008	3	4	1
2009	10	-2	1
2010	10	-0.6	1
2011	7	2	1
2012	9	-1	1
2013	9	-2	0.1
2014	6	-1	1
2015	8	-1	0.3
2016	6	-2	0.3
2017	6	-3	0.3
2018	6	1	0.3

Appendix 30: Figure 30, HSBC Group: Employee Profile 2004 - 2018

	Employee
2004	253
2005	284
2006	312
2007	322
2008	325
2009	310
2010	307
2011	288
2012	270
2013	263
2014	258
2015	255
2016	235
2017	229
2018	235

Appendix 31, HSBC Group: Investment Banking Contributions to PBT 2004 – 2018

	PBT	Investment Banking Contribution
2004	19	5
2005	21	5
2006	22	7
2007	24	6
2008	9	3
2009	7	10
2010	19	10
2011	22	7
2012	21	9
2013	23	9
2014	19	6
2015	19	8
2016	7	6
2017	17	6
2018	20	6

Appendix 32, Fig 32 The Impacts of GFC on the Case Studies and their Difficult Recovery Trips Through 2004 – 2018

Time	RBS £ billions	Barclays £ billions	SCB $ billions	HSBC $ billions
2004	7.3	4.6	2.3	19
2005	7.9	5.2	2.7	21
2006	9.2	7.1	3.2	22
2007	9.9	7	4	24
2008	-40.7	6	4.8	9
2009	-2.6	4.6	5.1	7
2010	-0.2	6	6.1	19
2011	-0.9	5.9	6.8	22
2012	-5.6	7	6.9	21
2013	-6.8	5.1	6	23
2014	-2.7	5.5	4.2	19
2015	-2.7	5.4	-1.5	19
2016	-4	3.2	0.4	7
2017	2.2	3.1	2.4	17
2018	3.4	3.5	2.5	20