



Treasury Committee

Oral evidence: [Fair and Effective Markets Review](#), HC 828

Wednesday 19 November 2014

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Members present: Mr Andrew Tyrie (Chair); Mark Garnier, Mr Andrew Love, Jesse Norman, Mr David Ruffley, John Thurso.

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Examination of Witnesses

Witnesses: **Dr Nemat Shafik**, Deputy Governor, Markets and Banking, Bank of England, and **Elizabeth Corley**, Chair of the Fair and Effective Markets Review Market Practitioner Panel, gave evidence.

Q1 Chair: Thank you very much for coming to give evidence this afternoon on the Fair and Effective Markets Review. Of course, when it comes to Forex, some would argue that the Bank of England has something of a mote in its own eye. Lord Grabiner has now reported and the Committee has taken a decision to return to that issue at another time, and we do not intend to say anything about that or to ask you anything about that this afternoon. If you have something that you particularly want to put on the record about it, we will not stop you but we are not going to pursue it.

Can I begin by asking you about the governance and conduct of the review you are conducting? Who is in charge of this thing?

Dr Shafik: The review has three co-chairs, myself, Charles Roxburgh from the Treasury and—

Chair: But who is running it? Who is in the lead?

Dr Shafik: To be candid with you, the team is a balanced team of staff from the Treasury, the Bank of England and the FCA. We have met as co-chairs collectively every time we have reviewed every step of the process, so I can honestly tell you it is a joint effort.

Q2 Chair: All of you is the answer. We have some bad experience on this Committee, and indeed Parliament does, with the tripartite agreement. That was—

Dr Shafik: A joint effort; a three-legged stool.

Chair: —a three-legged stool and it turned out that it fell over, and you are not giving us any confidence here.

Dr Shafik: This three-legged stool is quite solid because we are meeting very regularly and communicating very regularly.

Chair: That is a step up on the tripartite at least.

Dr Shafik: You might say that. On top of that, we have invested in terms of our own staff working side by side together daily.

Q3 Chair: This is something we want to keep under review and it might become a source of concern. Like any partnership in business, people march off bravely together confident that everything is going to be fine without having clarity about who is running the show. Then after a while problems occasionally emerge.

The review emphasises the value of voluntary codes at a number of places. Indeed your speeches have said as much. Is that still your view, post Forex?

Dr Shafik: The review takes a nuanced view on voluntary codes.

Chair: Have you changed your view since Forex?

Dr Shafik: No. The view in the document says that codes have problems because they have lacked teeth. In fact there is quite a nice box in the document—box 11—which talks about the weaknesses of voluntary codes, particularly the fact that there are not very strong enforcement mechanisms. We identify several options, including certification, contractual methods, oversight bodies and regulation, as ways that we would consider looking at to give codes more teeth.

Q4 Chair: These transactions are not directly regulated through the market but indirectly regulated through the players in the market already, are they not? That is the firms.

Dr Shafik: The codes. Sorry, can you—

Chair: The firms are regulated, even though the market itself is not regulated.

Dr Shafik: Many of the firms in the foreign exchange market are regulated, although there are many actors in the market who are not regulated as well.

Q5 Chair: Therefore, you have quite a role through the leverage that provides.

Dr Shafik: Yes. In fact, if you look at the enforcement cases from last week, the FCA was able to prosecute those cases on the basis of the FCA's 11 principles, in particular principle 3. That was a sufficient regulatory basis to conduct those enforcement cases.

Q6 Chair: You have held the firms responsible, and the firms have been heavily fined through the FCA as well. What the public want to know is the extent to which the traders themselves will be held individually accountable for their misconduct. To what extent are you going to be able to clawback some of these fines in malus, that is, in deferred bonus foregone, deferred remuneration foregone, from that couple of dozen people? Is it a couple of dozen? How many people are we talking about here roughly?

Dr Shafik: The actual number of people involved in the cases is on that order of magnitude. The actual number of people who would ultimately be held accountable to it we do not know yet. The decision about malus and holding back remuneration will ultimately be the responsibility of the firms, and many of them have already announced that they are in the process. Some of them have dismissed the individuals involved, and some of them have announced their own internal investigations to identify accountability up the chain for neglect of risk management that resulted in these abuses.

Q7 Chair: Yes, but you have a big interest in making sure that the individuals are made responsible, because it is by inculcating individual responsibility you will make the market safer, won't you?

Dr Shafik: Absolutely.

Chair: It is the systemic risk aspect, particularly, that the Bank of England should be concerned about. Because it is the size of the fines and, indeed, the instability in the markets that can eventually carry systemic risk.

Dr Shafik: That is absolutely right. I would also add that the FCA itself and the SFO, as you know, are opening up cases around individual accountability, and so that process is also unfolding over the coming months.

Q8 Chair: Can you tell us a bit more than "it is unfolding in the coming months"? What confidence can you give us that these individuals are going to be held personally responsible through loss of remuneration?

Dr Shafik: As I said, the first line of accountability for holding the individuals to account sits with the companies and their own remuneration committees on their boards. They will be making decisions—presumably, in the next month or two—about remuneration as well as malus in cases.

Q9 Chair: But you have a strong view, don't you?

Dr Shafik: Yes.

Chair: So your view will be they should be held as accountable as it is possible to do. Is that correct?

Dr Shafik: I would certainly say that we will look at their remuneration proposals when we get them in January. They have these powers now and we would expect to see them use this power to clawback or use malus in egregious cases, and I think these are clearly

egregious cases of misconduct. One would hope to see that the remuneration committees in these firms would use the powers that they have to hold these individuals to account.

Q10 Chair: Are you going to be pressing for the maximum possible malus in these cases, in the cases where there has clearly been misconduct?

Dr Shafik: I should say that the Fair and Effective Markets Review will not have a direct role in that. We are looking forward in terms of policy changes but the PRA, in its role of reviewing the remuneration decisions of regulated firms, will certainly be doing that.

Chair: When I say “you” I am talking about the Bank.

Dr Shafik: Me as deputy, yes. In that case, yes, we will be looking at how they handle these cases.

Q11 Chair: Are you going to try to get at the bonus pools?

Dr Shafik: Again, the firms have to decide where these penalties are going to come from. There are banks that have taken the burden of recent fines from their bonus pools. There are several cases that have done that. That sends a very strong signal, particularly when it is the bonus pools of the bits of the business that have been responsible for the misconduct. Again, that is going to be a decision for the institutions and for their remuneration committees but we will be reviewing those decisions.

Q12 Chair: The problem with getting at general bonus pools is that a lot of people who have done nothing wrong—maybe not even working in the same country—end up being hit.

Dr Shafik: That is exactly right.

Chair: So what we need to inculcate here—I just want to make sure that you are agreeing—is individual responsibility. That was the central theme of the work that was done by the Banking Commissioner; individuals need to be held accountable and responsible directly and to know that they have skin in the game.

Dr Shafik: I completely agree with you. From some of the research that has been done on what deters misconduct, it is clear that individual accountability—particularly, criminal sanctions—is the most powerful inducement to better behaviour.

Q13 Chair: Have you had intercessions, or have you had it put to you, that if we in the UK press this that some of these markets might migrate?

Dr Shafik: We have had that argument made to us. We have talked with lots of people who operate in these markets. We have met with over 100 firms already who are participants in these markets.

Q14 Chair: What credibility do you attach to what you have been hearing?

Dr Shafik: I do not attach much credibility to that view, because these markets have two sides, and people who are on—let’s say—the buy side of the foreign exchange market will not be eager to move to venues where they feel that there is misconduct going on. So enhancing the credibility of FICC markets in the UK ultimately will be to our comparative advantage.

Q15 Chair: That was also a conclusion of the Banking Commission. One last issue that I think is worth checking out: to what extent are you ensuring that the new rules you have put in place, through certification and through the senior managers regime, are going to reflect the lessons learned from the Forex?

Dr Shafik: As you know, we have just finished the consultation process on the new senior managers and certification regime. Under the EBA’s definition, in terms of the people who are potential meaningful risk takers, there is a set of quite elaborate criteria that determines who is covered by this regime.

Chair: It all sounds a bit prescriptive to me.

Dr Shafik: The EBA’s formula is rather formulaic. Having said that, our view is that it is up to firms to make judgments about who, in addition to the people who would be captured by this formula, should be included as being risk takers.

Chair: So then it becomes a floor because that may catch people who should not be caught.

Dr Shafik: Exactly. It is a minimum. The question about whether traders—for example, in the foreign exchange market—would be covered by it would be captured by that potential wider definition. Some of the people involved, for example, in the cases that have been reported recently, were not very senior in the organisation and might not be captured if you simply looked at seniority and other things. The events of last week point clearly that they were significant risk takers and could certainly put their own institutions at risk.

Q16 Chair: This is all very technical but, for those who are following these things outside this room, the material risk-taking definition, which derives from the EU legislation, is also the definition that is going to trigger whether under their remuneration code their pay will be required to fit “subject to deferral”. Is that correct?

Dr Shafik: That is correct.

Q17 Chair: So it is absolutely vital that we make sure we get the right people into this category, if we want to change behaviour on Forex markets or in other trading floors, correct?

Dr Shafik: That is correct.

Q18 Chair: Would you agree that anybody who is taking risks that are capable of doing serious harm to customers, to the firm or to markets, on those trading floors, should be subject to deferral or certainly capable of being subject to deferral? Are you agreeing with that?

Dr Shafik: In principle, yes. The practicality of that is something that we ask in the consultation documents. One of the things that we ask is: how could the senior managers and certification regime be extended to cover FICC markets? Some of these firms are not regulated as you asked at the beginning of your questions, and so there is a question about extending the reach of that regulatory regime beyond regulated institutions. That is a question we ask in the consultation document.

I might also add that there is another type of certification that we ask about in the consultation document, which is more around professional qualification and certification on conduct issues. That is similar to what the US has in terms of Series 7 exams, where people have to sit an exam to enter the profession and renew it regularly, to make sure they are up to date with standards in that profession, and could potentially have their certification revoked if they are found guilty of misconduct. So in the consultation document we also ask whether we should look at that kind of professional certification regime in these markets to improve standards.

Q19 Chair: It is not one consultation document. It is two. We have two sets of proposals knocking around in that: paper one by the PRA and one by the FCA, haven't we?

Dr Shafik: Yes, and then you have this third one here, which looks particularly at the FICC market issues.

Q20 Chair: We have to find a way of ironing out those differences in an intelligent way.

Dr Shafik: Yes, although it is important to remember that they have different objectives. The PRA of course are more concerned about prudential and the FCA on conduct.

Q21 Jesse Norman: Dr Shafik, some people have suggested that the correct approach to this kind of regulation is that there should be no responsibility gap inside a financial institution. That is to say, it should be clear for any activity which individual person is responsible and, when they do not bear responsibility within that area, where it has been delegated, so that it is perfectly clear who to praise if things go well and who not to praise if things go badly. Is that a view you share?

Dr Shafik: We certainly agree that accountability should be clear in these markets so, yes, I will agree with that.

Jesse Norman: It was not intended as a trick question. It seems a pretty common-sense idea.

Dr Shafik: Yes, I cannot disagree with that.

Jesse Norman: It is not always easy to implement but, nevertheless, a principle should be clear.

Dr Shafik: Yes.

Q22 Jesse Norman: That is helpful, thanks. Picking up on the Chairman's question about bonus pools, when we had James Leigh-Pemberton here from UKFI I asked him whether the banks were being run in the interests of their shareholders to which his answer was, "Increasingly yes". I am not sure that is true, but it certainly points to the fact that they have not been run in the interests of their shareholders in the past. Is this an area where you would be prepared to give personal leadership to make sure that there is proper allocation of responsibility, and that encouragement is given to these financial institutions to make sure that those who are responsible pay through their own bonuses rather than it being allowed to get lost in a general morass?

Dr Shafik: As my colleague Jon Cunliffe mentioned in a recent speech, if you look at what has happened to return on equity in the banks of late it has fallen considerably. The burden of that fall has been borne by equity rather than pay, and pay bills have not fallen significantly in recent years. Frankly that is not something that the Bank of England, with its mandate for monitoring financial stability, has a lever on. Ultimately it is something that shareholders of banks themselves will have to take up with the management of their institutions.

Q23 Jesse Norman: That is not quite true, is it, because, when you have a situation where people can game the system by moving from one institution to another, you have essentially an economically suboptimal system. Therefore, there is a case for Government intervention to tax or regulate the industry in a way that applies to all market participants and does not allow that kind of gaming behaviour. We know that bonus pools distort market practitioner activity in a way that is threatening to stability, so it is actually a responsibility for banks.

Dr Shafik: Yes. But that is why I think the deferral regime is quite a powerful way of tying people to their institution, and also tying them to the consequences of their own investment and financial decisions. So I think that regulation will be quite powerful for better aligning the interests that—

Q24 Jesse Norman: You would acknowledge that the Bank has a responsibility from a financial stability standpoint, to make sure that these bonuses are appropriately allocated and paid?

Dr Shafik: Yes. We do not have a view on the level of pay or how much bonuses should be. We do have a view on whether the way they are paid contributes to stability from a prudential point of view.

Jesse Norman: Yes and whether there is leakage in a way that would allow—

Dr Shafik: Exactly. The extent to which bonuses are aligned with the interests of equity, but also debt holders in the institutions, and also the extent to which bonuses are aligned with conduct, those will be good for financial stability.

Q25 Jesse Norman: That is very interesting. Do you see the Bank of England's job—from a standards perspective and the institutions that sit under it—as being about maintaining what you might call “the morals of the marketplace”, or do you think they ought to be setting a higher standard for people to aspire to?

Dr Shafik: We have spent a lot of time in the consultation document defining what we mean by “fair and effective markets”, and we have seven criteria. I will not take you through all of them, but we consulted with philosophers, with economists, with a lot of very thoughtful people to come to an understanding of that. Markets that are open, where there is transparency, where people can transact at fair prices and where people compete on the basis of merit, all of those are aspects of the kind of marketplace we want to see, not just for moral grounds but also for stability grounds.

Q26 Jesse Norman: Let me put the question slightly differently, which is: do you believe in general standards should be within a spectrum at the higher end or at the lower end?

Dr Shafik: In general, we like high standards.

Q27 Jesse Norman: Again, that being the case, do you think there is a case for the Bank itself to be subject to the Senior Persons Regime or its equivalent?

Dr Shafik: In terms of bonuses, is that what you are referring to?

Jesse Norman: In terms of the capacity for people to be brought within legal purview if they have failed to do their job, to discharge those responsibilities that we have agreed sit properly allocated to them, and in terms of the avoidance of a gap in accountability or responsibility.

Dr Shafik: Yes. The staff at the Bank of England are subject to the very same laws that everyone else in the country is subject to. So if they do anything inappropriate, illegal and so on they would be treated no differently.

Jesse Norman: It would be difficult in a way, because the FCA would then be investigating the Bank. I do not know how that would quite work.

Dr Shafik: If that were necessary, that would be necessary. I do not see where that would be a—

Q28 Jesse Norman: All right. That is very helpful and interesting. My final question, could I ask Ms Corley about the practice in your own institution, and whether you share the view, which we have been discussing, that there should be accountability over bonus allocation in order to stop the situation where a few bad apples poison the whole barrel

and then everyone else has to pay the price when bonuses are deducted? That must be terribly corrupting to morale as well as to performance in your institution.

Elizabeth Corley: Thank you for the question, Mr Norman. Good afternoon, Chairman. Speaking for our own organisation, we are subject to regulation in Germany. We are incorporated in Germany, where we already have malus and clawback regimes in place for senior risk takers, so I am subject to that already.

In addition to that, we have the Alternative Investment Fund Managers Directive, which is coming through and being implemented from next year, which requires risk takers to be designated. Those risk takers have to be subject not just to incentives but to long-term goals, so that we know we are working over a multiple year period in terms of achievement of performance.

We routinely defer compensation and the amount of deferral rises with the level of pay, so that the higher paid you are the more gets deferred. The principle of deferral has been there for over 10 years. The amount of deferral has been steadily increasing. We are a global organisation, so typically we find that in Europe levels of deferral are higher than in America and in Asia where you tend to find more of a cash alternative. Nevertheless, as a global organisation, we apply global standards so we do apply those deferral tables globally.

In terms of the deferral itself, it is in two parts and this is a recent innovation over the last two years. Half of it goes into a three-year plan that rises with a sustainable profitability over the three years. The other half of it is invested in investment funds alongside our clients, so we are investing in our own funds so we have alignment with client interest. Does that fully answer your question?

Q29 Jesse Norman: That is very helpful. A final supplementary, which is: if you came across a situation in which people in your organisation were taking levels of risk, or perhaps guilty of market communication in some way, what statutory or regulatory requirements are there that would apply to those people? In other words, can we be sure that that kind of activity would not occur within your organisation lawfully?

Elizabeth Corley: First of all, the whole point of designating risk takers under the Alternative Investment Funds Management Directive is that there are sanctions that can be applied, and that will mean that—

Jesse Norman: Even to junior employees who are operating under someone else's balance sheet?

Elizabeth Corley: If they are designated as risk takers.

Jesse Norman: That does not really address the point I was making.

Elizabeth Corley: I will come back to your second point, but let me talk about what is regulated and what is not regulated. In terms of the regulatory piece, typically those will be more senior—although we have interpreted it to look at risk takers irrespective of grade—and they would be subject to review. Maybe a moment on how we actually define the bonus pool and pay people, and then I will come back to the directly unregulated.

We have compensation committees. The compensation committees are structured, such that there are independent representatives there and an independent secretariat to record the findings of the compensation committee. That escalates up to our overall board. There is full transparency. The board can come down as far as they want in the detail and it is all minuted independently. We receive a report from compliance and we receive a report from risk, in every compensation committee meeting where bonuses are being discussed and compensation is being discussed. Those reports are two-fold. One is: generally, is there any reason we should be concerned about the bonus pool? So is there a risk factor, which is not an individual but it is about the pool? Secondly, is there any specific individual we are about to discuss, irrespective of whether they are regulated or not, for which we should be aware of risk or compliance issues?

Jesse Norman: If you could bear one tiny supplementary?

Chair: One quick question and one quick reply.

Q30 Jesse Norman: To be clear, someone who was not a designated risk taker, who was junior but who was in fact taking a fair bit of risk or a lot of risk, which can sometimes happen?

Elizabeth Corley: It could be behavioural. It might not be risk. It might be cultural, behavioural. It would be anything where we would decide that there was a behavioural reason that they should not receive their full compensation.

Q31 Jesse Norman: You could go back and you could claw that back up to three years after?

Elizabeth Corley: We are talking about the bonus allocation.

Jesse Norman: The allocation?

Elizabeth Corley: This is the allocation.

Jesse Norman: Right. Then if something is subsequently discovered—

Elizabeth Corley: In terms of clawback, clawback is only able under the regulated regime.

Q32 Jesse Norman: So you cannot exercise clawback against these junior risk-taking types we are worried about?

Elizabeth Corley: If they were not designated, no, not currently.

Jesse Norman: That is interesting. That is the point I wanted to get to.

Chair: There is deferral over there and there is clawback over there.

Jesse Norman: There is a gap though, Chairman—which I think is worth highlighting—that Ms Corley has mentioned. Thank you.

Chair: That has been helpful.

Q33 Mr Ruffley: Dr Shafik, good afternoon. The Conduct Cost Project estimates that the number of SICC related conduct fines doubled between 2012 and 2013, an increase of five times since 2010. Would you say that is mainly because there is more misconduct in those markets, or would you say it is mainly because the regulator is doing a better job in investigating and punishing? Which is it?

Dr Shafik: I think the scale of the fines partly reflects the scale of these markets and how they have grown over time, so I think that is part of the scale effect in terms of the quantity. We have had technological changes that have made it possible for regulators to use different ways to find misconduct, so the existence of these chatrooms and email traffic that could be used as a way to capture misconduct, which might not have been as possible in the past. Implicit in your question is: have things got worse? Attempts to manipulate financial markets are maybe the second oldest profession. It has been around for a very, very long time.

Mr Ruffley: They resemble the first profession very much as well.

Dr Shafik: I did not say that, but it has been around for a very, very, very long time. The scale of it has changed and our ability to detect it has changed. Also in this case, with the foreign exchange cases, I think the FCA took a different approach to the enforcement cases. Clearly they could do a better job than I could of describing how they did it, but they had the firms collect a lot of the data. They moved much more quickly than in the past.

Q34 Mr Ruffley: Sure. We have identified three things: one is the greater size of the market, secondly, regulators getting better because they have better technology among other things, and thirdly, there is probably more misconduct going on. Would you say there is probably more misconduct going on?

Dr Shafik: I honestly cannot answer that. I do not have the data to tell you that for sure.

Q35 Mr Ruffley: There is a fourth possible explanation for this rise in fines, which is that the regulators are interpreting misconduct more broadly. Would you say that is part of the story for this five-fold increase in fines since 2000?

Dr Shafik: I do not think so if you look at these cases. As part of this review, one of the things we did was to look at all of the published misconduct cases in the UK in the last 20 years. If you look at the causes, that is where we get this six-part framework, which is part of this review that looks at the different causes. The technology may have changed. The financial instruments being used may have changed but the underlying causes for misconduct have—

Mr Ruffley: Misconduct is misconduct and there has not been—

Dr Shafik: Misconduct is deceiving your clients, sharing information inappropriately, manipulating benchmarks, conflicts of interest.

Q36 Mr Ruffley: Sure. Would you say that poor practice misconduct has been overlooked historically by regulators because they felt that market participants were sophisticated, is that an issue?

Dr Shafik: I would say that in the FICC markets there was a view, embodied in the term caveat emptor, that, “These are sophisticated market players that can look after themselves, so we do not need regulators worrying about babysitting these markets”. I think there was also a perception that, “These markets are of such a scale, and there are so many participants, that competitive forces will weed out problems”. I think that—based on the cases that have been found in the last few weeks—that view has to be questioned.

Q37 Mr Ruffley: You have talked in the past tense about caveat emptor, sophisticated investors being one of the reasons maybe why regulators were not as assiduous as they are now. When and how do you think that has changed?

Dr Shafik: I think LIBOR was a wakeup call, but the fact that these markets underpin so much of our economy was another important reason, and the fact that we have to think about competition. Competition in these markets is a complicated thing to think about. If you look at the foreign exchange market, the six largest players control about 60% of foreign exchange trading in spot FX. If you use conventional measures of competition, industry concentration ratios, Herfindahl indices, that kind of thing, it does not come out as particularly uncompetitive. The point is that with competition you can have market power in many ways. You can be a very large share of the market. You can have informational advantages or you can have collusion at the bottom of the market, like we saw in these recent FX cases. So market power may exist, and manipulation may exist, even when markets at a superficial level look very large and seem to have many players in them.

Q38 Mr Ruffley: A final question for you, Ms Corley. The answer to this is not human nature, if you can give me an answer other than human nature. Why are markets not as fair and as effective as they could be?

Elizabeth Corley: If we look at the capital markets and the FICC markets, which I think is the subject here—

Mr Ruffley: Take the FICC markets.

Elizabeth Corley: There is no doubt that the scale of these markets grew exponentially in the last 10 to 15 years. As we saw globalisation of trade we saw more counterparty dealing with emerging markets. Suddenly we found that the perimeter of these markets was expanding substantially. At the same time if we go back—and this is a personal philosophy—before the global financial crisis, there was an expectation that these markets would self-correct and would self-govern to a degree.

Mr Ruffley: Because smaller?

Elizabeth Corley: I do not think it was because they were smaller. I think it was because they were largely professional counterparty markets where there was a common interest in ensuring stability, security and effectiveness. The global financial crisis generally was a

wakeup call that globalisation needed to keep pace with global regulation, and the FSB's activities subsequent to that are clearly a catch-up on probably more than a decade of very rapid evolution and growth. I think in part we are in that catch-up period and the FSB's agenda, which we are still seeing rolling through, is catch up for globalisation of global capital markets including FICC.

The second issue, which is post financial crisis—which makes this more important and more relevant for the global economy and for individual outcomes—is that, because we now rely less on bank lending and bank balance sheets to finance growth across wholesale SME and retail, therefore clearly the effectiveness and the accessibility of these markets becomes as important as the traditional lending markets. Again, we are in a period of catch-up, policy catch-up, regulatory and institutional catch-up, which is healthy to sustain global growth. The extent to which we are now seeing forward looking agendas in this regulatory environment is to be welcomed, and should underpin the further globalisation in a secure and effective way for future generations. We owe it to those future generations, frankly.

Q39 Mr Ruffley: Do you have confidence, for instance, in the Chinese regulators, the Indian regulators?

Elizabeth Corley: I do not have any specific insight into those regulators to give you an authoritative answer. What I would say is encouraging is that we see an FSB agenda and a determination to tackle this globally. I think there is to a certain degree an important role for the United Kingdom, given that the substantial proportion of our markets are taking place here. We can look into this market activity. We can offer ideas, not just for the United Kingdom but also for the wider Europe and also for the FSB, IOSCO and the Basel Agenda, which is why I welcome this review.

Mr Ruffley: Thank you.

Q40 Chair: Just on the caveat emptor and sophisticated investor point and all that, and whether competition can drive out malpractice, this was clearly a major attempt that we have seen to rig markets. Did it succeed?

Elizabeth Corley: Are you asking me, Chairman?

Chair: I was, but if you want to pass the—

Elizabeth Corley: No, I am happy to. I was not sure which way it was going. I can talk only as a practitioner rather than as a regulator or supervisor.

Chair: Yes, but you will have read the—

Elizabeth Corley: So my insight is what I read in the newspapers and read from this Committee.

Chair: And what you have had fed back to you by your fellow members of the practitioner panel.

Elizabeth Corley: I think clearly the scale of collusion and the way in which it continued, long after the financial crisis, is something that practitioners are disappointed in and regret deeply.

Q41 Chair: Yes, I understand that. My question was: did anybody get ripped off?

Elizabeth Corley: That is a great question, and I think it is a difficult one. I notice that last week in the press comments from Tracey McDermott she was asked that question: what is the scale of the loss? She said it was impossible to calculate. I think that is the challenge. From our perspective, if you asked us, we do not use FX hugely. The only time we use it is if a client wants us to protect a forward position on foreign exchange or something like that. It would be very, very difficult to calculate actual loss.

Q42 Chair: But I am asking you, even if you could not calculate it, are you confident that there have been some losses out there?

Elizabeth Corley: I cannot answer that question. I just do not have insight.

Chair: So may be zero.

Elizabeth Corley: Frankly, I think the biggest loss is in confidence and trustworthiness of the market.

Chair: I understand that. That is a completely separate point.

Elizabeth Corley: I think that is unquantifiable and more important.

Q43 Chair: What I am concentrating on is whether in fact the sophistication of these markets, the large number of players, has to some degree protected customers from actual loss, even though they may feel much more cautious about using markets as a consequence of the revelation of the attempt to rip them off.

Elizabeth Corley: Yes. I think, where there are either expert counterparties or professional investors, a lot of what we do is organised to ensure best execution and good price outcomes for our customers. So not just our own organisation but many organisations acting on behalf of customers will have monitoring in place, to make sure that we can check the prices we are getting and we will be consistently going for best execution.

To our extent, I would hope that we are managing our internal controls and processes. What I cannot comment on is where people may be working unregulated or doing their own personal trading. There I do not know how they would satisfy themselves on price or execution.

Q44 Chair: Did the LIBOR riggers succeed?

Elizabeth Corley: In doing what, sorry Mr Chairman?

Chair: Did they succeed in making any money out of it, the LIBOR riggers?

Elizabeth Corley: I do not know. I do not have that insight.

Q45 Chair: Did you take a look at those judgments?

Elizabeth Corley: It is very hard for me to say who wins or loses in that, other than the market and confidence in the market.

Q46 Chair: I have had a view from regulators on this, so I am going to move on unless you have something you particularly want to add.

Dr Shafik: Just the FCA cases do show that the individuals involved did make profits and were able to move the markets by some considerable basis points during some of these fixed windows, so they succeeded in that sense as individuals. But trying to quantify a larger impact in terms of losses I think—as the FCA have said—is very, very difficult because you need to know who was trading at that moment. There are usually two sides on every trade; quantifying that would be quite difficult.

Q47 Chair: The individual actions: so where you cannot calculate the loss you can calculate the gain to the trader. That seems to be what you are saying.

Dr Shafik: Exactly and there are quantifying amounts.

Q48 Chair: Have you done that and published that?

Dr Shafik: Yes. In the FCA cases you can see estimates of how much the traders made on particular transactions.

Chair: Unlike LIBOR?

Dr Shafik: Correct. It is in the £100,000 per trade; £50,000, that sort of magnitude.

Q49 Mr Love: Dr Shafik, can I turn to the market practitioner panel? Why did you choose to create such a panel and why have you given it such a central role in this process?

Dr Shafik: It has emerged as good practice in policy-making in these areas to have a set of market practitioners working alongside. If you look at some of the FSB's processes it is very common for them to have a set of market practitioners working alongside. It has three key roles in this process: first, to advise and provide information to the secretariat and the Fair and Effective Markets Review team on the operations of these markets, to provide insights, data analysis and so on.

Secondly, they have a role in providing formal feedback to the consultation questions in the documents. So they will provide a written input to the process reflecting a balance of views from a practitioners' panel that includes sell-side firms, buy-side firms, infrastructure providers and corporate users of these markets.

Their third role is hopefully to take forward some of the recommendations of the review process. I should say they do have a central role—you are quite right—and they will provide very valuable input, but they will not be the ones making the recommendations about policy. That will be the sole responsibility of me, my co-chairs and the very excellent secretary that we have assembled to work for us. We are ultimately accountable for the recommendations.

Q50 Mr Love: I want to come back to that final point you have made, but let me ask you about the composition: how did you decide the composition, and was it the central body that decided that it would be a steering committee and expert groups? How did that all come about?

Dr Shafik: Elizabeth Corley was chosen by the Chancellor and the Governor of the Bank of England before I joined. I was delighted she was chosen because of the depth of her experience in these markets. After that, she, I and the co-chairs, Martin Wheatley and Charles Roxburgh, had a set of conversations; we developed a set of criteria—and I think Elizabeth might speak to that process—that would guide what kinds of people and what skills we would need on the practitioners panel. Elizabeth, do you want to say something about that?

Elizabeth Corley: Yes. May I, Mr Love? I can perhaps take you through or would you like—

Dr Shafik: I am happy to answer that.

Q51 Mr Love: Perhaps I could add to that and ask you what your main aim is, as the chair? You can do that alongside responding to the second question.

Elizabeth Corley: I will indeed. Thank you, Mr Love.

Essentially, when I was asked whether I would chair this Market Practitioner Panel, first of all, I tried to ascertain what its purpose was. Dr Shafik has just explained that, so I will not repeat it. Having thought about that purpose, I took a step back and thought, “What is the one thing this panel can add that many other people won’t because there will be many, many responses to the consultation document?” Lots of people were responding. The one conclusion we came to was that this can be a cross-sectoral panel. It is a place where you can get all the different interests of the wholesale market together: the corporate treasurers, for example; the people actually raising debt; the investors; a hedge fund; market infrastructure; the sales side; plus some independents, including those previously involved in regulation.

So what I did was come up with some criteria for those categories and then thought about the seniority of the panel, and concluded that for this to be of any use at all it had to be a senior panel. There is no point bringing people in who would not be able to talk, even though they are talking in an individual capacity, with a degree of seniority and experience.

Then the third thing was, clearly the United Kingdom is a very important global financial market. Therefore we needed to think about the nationalities of the institutions, their

locations, and to get diversity of membership by background. All those factors came together and produced not a long list but a long list of options, which I then shared with the principals supporting this from which we then defined the panel. How did we come up with those names? There are a manageable number of people that one can really chair in a meeting and much more than about 20 it gets rather difficult. We had to not get everybody into the panel, simply for workable numbers, and it ended up at 20.

In terms of my role and responsibility, I think my responsibility is to make sure that we have an effective panel, which can act as a sounding board and a contributor, that we can come up with ideas as well as be open about the issues we think there are in the markets, to try to identify where there is cross-sectoral agreement—across the whole sector because that might help policy-makers to consider that—but also where there are disagreements and why those disagreements exist because, again, we can try to get some substance around those disagreements. This is a hugely important consultation and I would anticipate that the review team will get a lot of feedback, including ours. So I hoped this was one area where we would try to get some of this cross-sectoral insight from an international perspective from senior individuals to be able to contribute.

Q52 Mr Love: I will come back to that but, Dr Shafik, the panel has been set up as an independent panel. Almost all—in fact I suspect all—of the participants will be market participants. How do we ensure that they act in an independent manner? As Ms Corley has already said, they will be going for very senior people who will act independently but how do we ensure that we are confident that they are acting independently?

Dr Shafik: I think the fact that they represent a wide array of interests is very important. It is not just sell-side firms who will have a particular perspective and a particular axe to grind. The fact that it has very balanced representation will enhance independence quite a bit. The other thing I should say is they will not be the only voice that we hear; we already know many, many parties who are planning to submit responses to the consultation document. We will get independent views from elsewhere as well.

Q53 Mr Love: Let me ask Ms Corley, you are the chair of this body and you have the responsibility to ensure it is independent and objective, how will you go about that as chair?

Elizabeth Corley: It is exactly the right question, Mr Love, because essentially we are market practitioners; we are a Markets Practitioner Panel and the clue is in the name. Therefore, by definition, we are in the markets. While we will strive to be as independent as we can—and my role as chairman is to make sure that it does not become a vehicle, a Trojan horse for vested interests, that is one of my roles—nevertheless, we will be in the markets as practitioners. I think the strongest test will be that we will make our response to the consultation document public. It will be there for public scrutiny. I am absolutely convinced that the review team is strong minded and independent enough to ignore anything they believe is not an independent contribution to the debate. Having said that, I would seek to minimise or eliminate that wherever we can.

Q54 Mr Love: Let me move the argument slightly further, Dr Shafik. Part of the panel's job will be, and I quote here, "To refine and modify the review's proposals following market consultation". Some people have interpreted that as handing a great deal of power to this panel. How do you respond to that concern?

Dr Shafik: Their job will be to give us feedback but they will not be the ones shaping the final recommendations. That is our responsibility as the review team.

Q55 Mr Love: How will you exercise that responsibility? They are coming to you and saying, "You're the experts. Inform us as to whether we are getting it right or wrong". How will you ensure that you do that in an objective and independent manner?

Elizabeth Corley: All we can do is give advice as independently as we can. We are dealing with expert counterparties in terms of the review team. We are dealing with the Treasury, the FCA and the Bank, all of whom have deeper insights, frankly, into the overall market than we do. We have insights into particular pieces of the practice. We will definitely strive to do that. As I say, if ever I felt that we were veering away from that I would declare that to the review team.

That is partly why we have structured such a balanced steering committee. You do not have people of like mind on that steering committee; you have very different interests. The one shared interest—and why everybody was willing to sign up—is they want to see the trustworthiness of these markets improved, but they do not necessarily agree on the policy measures or others that should be taken. So I think there is a lot of internal dynamic within that panel. I wish I could somehow explain it to you, but there are a lot of differences of opinion as to what the root causes might be and what the policy responses should be. Ultimately, though, we are only one voice and there will be many other voices talking about what the policy response should be.

Q56 Mr Love: But a particularly authoritative voice, if I may say so. The terms of reference are peppered with guidance and assistance. Some people have interpreted that as there not being the level of expertise in the Bank and the FCA and the other organisations that are taking this forward. How would you respond to that?

Dr Shafik: We have a review team, almost half of which have direct market experience themselves. That is an important part of the process. We are also consulting very widely, not just with the Markets Participant Panel, but with people in the markets outside; with a variety of academic experts who study these markets very carefully, as well as regulators around the world and policy-makers around the world. In addition to the Markets Participant Panel we have met with 100 firms already. There is quite a lot of input from a variety of sources. It is very clear to me that the review team will be very independent minded.

Q57 Mr Love: Are you confident that you understand the day-to-day operations and the cultures and the variety, a very diverse variety? You already mentioned that is the reason for the size of the panel. Does that expertise exist in the Bank and the regulators, and the

Treasury for that matter, to ensure that no one is pulling the wool over your eyes, if I can put it crudely?

Dr Shafik: No, I understand. We have quite a broad array of expertise in the review team. We have brought in senior people who were in the markets but have left the markets who have deep knowledge of many of these markets. We have the capacity to get expertise in when we need it in particular areas if we want that. We have the knowledge either in the team or have the capacity to get additional expertise should we need it.

Q58 Mr Love: Perhaps I can ask you, how will you ensure that someone working, or an expert in a particularly obtuse market area, does not pull the wool over the panel?

Elizabeth Corley: The framing of the consultation document questions is one of the best safeguards, frankly. They are very searching and deep questions. They will stimulate very thoughtful and sometimes technical but quite deep answers. It is going to be very difficult to game those answers, quite honestly, because of the way in which the consultation document has been structured. Certainly, none of the members of the Markets Practitioner Panel would put their name to something which they felt had been gamed.

Dr Shafik: If I may share an anecdote: in the last meeting I had with the Markets Practitioner Panel, where they had seen a consultation document, they said, “This document is long and complicated and that is good because it shows you understand these markets”. I am going to take that semi-insult as a compliment.

Q59 Chair: If you are offering advice only in a capacity of complete independence and disinterested commercially but at the same time seeking to build trust in the market, who is doing the lobbying?

Elizabeth Corley: That is particularly why I think you will get a lot of responses to the consultation document. There will be many, many individual corporate responses and also industry association responses to this.

Chair: Which will differ from what the panel is proposing?

Elizabeth Corley: I do not know. We will not be privy to those until they are public.

Chair: That is a very helpful and interesting answer.

Q60 Mr Love: Let me ask: some of the people who are sitting on the panel will be answering the consultation document independently. Somebody verifying that what they are saying independently is the same as they are saying at the panel?

Elizabeth Corley: We may find that the consolidated view coming out of the Markets Practitioner Panel differs from the individual views of members and participants of that panel; that could well happen. We have an independent market practitioner secretariat supported by pro bono consultancy and legal advice. They will also be helping us in scripting those answers and making sure that there is some verification and authentication on those answers.

Q61 Mark Garnier: Elizabeth Corley, can I address most of my questions to you but please do jump in, Dr Shafik, if you feel like it.

In its 2014 risk outlook the Financial Conduct Authority looks at certain conflicts of interest as being built into the financial sector's structured process and management. How do you resolve that? Do we have to break firms up or are the internal controls sufficient?

Elizabeth Corley: I think that goes to the heart of the effectiveness and fairness of markets, Mr Garnier, and it is the great question. Either firms or their boards must be able to demonstrate that they can adequately manage conflicts of interest or they have to eliminate them or you have to question the structure of the firm. Those are the three ways of dealing with conflicts of interest.

From a personal perspective, I do not think there is a one-size-fits-all answer but, clearly, one has to be able adequately to demonstrate that those conflicts are being managed because they are inherent in firms, even with very single purpose.

Q62 Mark Garnier: Do you think people believe that they are being managed properly? Do you think that the reputation of the City is at risk because there could be a perception—either fairly or unfairly—that conflicts of interest are not being managed properly?

Elizabeth Corley: Certainly if one reads the media and if one reads public opinion surveys, the wider question of the trustworthiness is in doubt. If part of the reason people do not trust is because they believe the conflicts of interest are not being adequately managed, there could be others that are around incentives as we heard earlier—potential collusion—but managing conflicts of interest adequately, or eliminating them where it is possible, is undoubtedly one of the key things that has to be done for fair and effective markets. I could not agree more.

Q63 Mark Garnier: Part of the problem is also that there is a perception that you have this huge amount of information within certain big organisations. For example, in looking at a prime broker, they could obviously be handling huge amounts of equity transactions, which in turn have huge amounts of foreign currency transactions that go with it, which are on the settlement date of the equity transaction. That firm could also have within it a foreign exchange dealer. The perception would be that the foreign exchange dealers would be having, potentially, three days' advance warning of orders coming through. While I have no doubt that those firms will have to demonstrate to regulators that they are managing these Chinese walls within these departments quite effectively, nonetheless it is going to be incredibly difficult for people not to start levelling accusations that some of these firms are taking advantage of this information asymmetry in order to advantage themselves.

Elizabeth Corley: The challenge with information is, on the one hand—in particular in FICC markets—it is necessary to have effective markets. On the other hand, clearly, if you have a concentration of information across functions, one has to be able to manage those conflicts; there is no doubt about that. That is why part of the consultation document is talking about surveillance and governance, and particularly surveillance. For confidence in

markets to be resilient, you have to be able to demonstrate there is adequate surveillance. You are quite right; a desk might well be dealing with three or four different pieces of information at any one point. Some of that is very legitimate; some of it might actually help that desk provide a better price for a customer but then some of it might be used to hedge a position within the company for risk management purposes that are required for prudential reasons. So you have multiple reasons on that same desk for looking at that information.

The only ability to do that is through very sophisticated surveillance; front-line accountability; the first line of defence, so-called, which is management accountability, which gets us back to this question of how do you get the responsibilities allocated. That is exactly the focus for the future of these markets—how do you balance that?

Q64 Mark Garnier: Are firms too big?

Elizabeth Corley: It is impossible for me to comment on that. There is a natural tendency towards scale, which is mentioned in this paper, because information does enable you to set more appropriate prices. That is part of the challenge. So some of these markets do lend themselves to scale—not all markets do—but some of these do.

Q65 Mark Garnier: The FCA already has power to take action against certain firms that fail to manage these conflicts of interest. We have seen record breaking fines coming up recently, in terms of where people have failed to do that. Yet the threat of enforcement does not seem to be enough to do it—as evidenced by the recent FX and LIBOR scandals—and who knows what other scandal could be bubbling below the surface, which we have yet to discover, in the next few weeks, months or years. Why is this threat of enforcement apparently not pushing people away from straying into these unpleasant areas?

Elizabeth Corley: Maybe I could give a response as an investor and shareholder and then ask Dr Shafik to come into it as a regulator. Clearly, from an investor point of view, we see these fines levied as either putting a strain on bank capital, ultimately, or requiring capital raising or preventing an appropriate dividend and return to the underlying investors and owners of these shares. For many years, particularly in Europe, we have been very cautious on banking stocks because we anticipated significant potential regulatory interventions, which would reduce the value of these stocks to underlying investors. The other side of that was also—

Q66 Mark Garnier: Sorry, just to come into that as an investor: so you own a bank, the foreign exchange dealer screws up and you get fined as the investor or, indeed, as the pension—

Elizabeth Corley: Ultimately it is the pension fund owner or the individual mutual fund owner, if their investment manager has invested in that bank, who will not get the dividend that year, potentially, or will get a reduced level of equity.

Mark Garnier: So the fine is absolutely going to the wrong place.

Elizabeth Corley: Which is why I think this consultation, which is talking about how you translate enforcement action through the bank to the individuals who are responsible for the misdemeanours, is exactly right.

The other side of why banking stocks are undervalued and below book value at the moment is because of the asset quality review. As we see asset quality review work through and the quality of balance sheets and lending—which has been a subject, I know, of this Committee in the past—as that improves, that dead weight on bank stocks should reduce. Therefore the focus will grow on brand, quality of reputation, management of conflicts of interest, the ability to pay a dividend and the ability to establish a sustainable return on equity. Probably over time the impact of these future fines will grow as asset quality normalises.

Dr Shafik: If I may add, I would be very surprised if boards of the banks that have been fined this week are not paying a lot of attention to this issue.

Mark Garnier: Fingers crossed.

Dr Shafik: Yes. I would be very surprised if there were not consequences for remuneration. I would be very surprised if there were not much bigger investments in compliance, training of staff and getting to grips with some of the governance issues in some of these firms. I think the fines do have a very important signalling and deterrent effect. Having said that, there is also something very powerful about criminal sanctions. The fact that the review—as one of its very first acts within a month of being formed—proposed bringing seven additional benchmarks under the regulatory perimeter, so that if anyone is caught manipulating those seven key benchmarks in the future they will be subjected to criminal sanctions, is also a very powerful signal.

Mark Garnier: Did either of you look when we had the LIBOR fines, in particular with RBS specifically? Sir Philip Hampton came in front of us and we were asking him specifically about this at the time of the LIBOR fines. He made a comment—I think the LIBOR fine was about £350 million, and it was about the beginning of last year if I remember rightly—that that money was going to be taken out of the bonus pool, which would be the current year's bonus pool. Being a cynical ex-investment banker myself, inevitably there was a semi-question in my mind that, although the intention was to have a £300 million bonus pool for RBS, all they would simply do is just increase it to £650 million or £700 million in anticipation of the fine and then just dock it. Elizabeth Corley, do you think I am being far too cynical or do you think some of these banks may just game this type of thing?

Elizabeth Corley: I do not have any special insight and you probably have more than I do, as you say, having worked in some of the banks and institutions. I think the cynicism is yours and I cannot challenge it.

I would say though, in terms of remuneration policy, one of the things that have again improved since the global financial crisis is the extent to which shareholders can vote on overall remuneration policy. There is a significant degree of engagement on that. In terms of the individual bonus pools and the way they are allocated, I do not have transparency on that.

Q67 Mark Garnier: I have one problem with everything about the reference to shareholders, particularly when you come to the big banks, and that is that equity capital is, what, 8%, 10% or something of the capital that a bank uses. So any of these big banks are going to go out and get equity capital but, apart from the annual general meeting, the requirement from the talk to the shareholders on any practical sense is pretty minimal. Where they need to be talking to people is the bondholders because those are being refreshed on a fairly regular basis; they are going to have fairly intense conversations when they are trying to raise capital in terms of debt capital in the bond market. That is greater in terms of the amount of cash than it is in the equity market. As I say, it matures on a cycle that means that Sir Philip Hampton—just to pick a name out of a hat—is going back to PIMCO on a fairly regular basis asking for money.

PIMCO, or indeed any other bondholder, as a non-equity shareholder, as a debt holder, in theory has very limited rights in terms of what they can call, but in any practical sense it is the bondholders who have far, far more influence over what happens within these institutions than any equity holder. Discuss.

Elizabeth Corley: I am not sure how much time we have for that type of PhD question. Maybe very briefly, you are absolutely right that the capital structures of many large financial institutions have changed significantly, yet the responsibilities for ownership lie with the equity shareholders, so that is the point at which the rubber hits the road.

Mark Garnier: But not very satisfactorily?

Elizabeth Corley: Again; for discussion.

Q68 Mark Garnier: Dr Shafik, you are being uncharacteristically unenthusiastic to jump in on this one. Let me give you an opportunity.

Dr Shafik: I would observe the empirical fact that equity holders have borne the brunt of the falling return on equity in banks; that they have not been as vocal about that, maybe, as you might expect. One would have hoped that they now have tools in terms of the CBS's recommendations on the senior managers and certification regime in order to exercise more discipline on pay, particularly in light of these cases.

Q69 Mark Garnier: Elizabeth Corley, you are an asset manager. You have a responsibility to the people who invest in your funds. How would you, in any practical sense, turn around to those people and say, "I held onto the shares because I wanted to have a vote on the remuneration package, despite the fact that I knew I should have sold them and thereby saved you a lot of money and done the right thing"? That is an incredibly simple conflict of interest where, as an investment manager, surely the answer is that every single time you are voting you are voting with your order in your shares?

Elizabeth Corley: I think that is ultimately why the banks' share prices are where they are. It is precisely the demand and supply through the equity markets that is showing up in terms of overall equity values. If a manager was very strongly convinced that that bank was a good long-term hold and yet the remuneration policy was inappropriate, as for any other corporate, they would vote on the remuneration policy. If, on the other hand, the view was that the risk for holding that equity was not being remunerated, either through

dividends or potential growth, you would ultimately sell the share because you would not go back to your customer and say, “I’m awfully sorry, I held onto it so I could vote on remuneration”. Exactly; you would not do that.

Q70 Mark Garnier: This is the biggest flaw in the whole business of shareholders getting involved in the management of the company. They simply, in any practical sense, will not do it.

Elizabeth Corley: There are those—and I think this another important thing to think about in terms of particularly the larger capitalisation equity markets—we have a significant growth in passive and ETF holders who are required to hold their stocks. They have an interest in seeing the overall value of stock markets go up; therefore probably the long-term interest for more passive ETFs is they cannot sell that stock. Indeed they do engage very actively—many of the larger ones—because they can see that they have a responsibility to do so on behalf of the asset owners.

Mark Garnier: These are ETFs that reflect—

Elizabeth Corley: All passive investors. Indices, exactly. They would have a FTSE 100 Index, for example. Exactly.

Mark Garnier: That is very interesting.

Q71 John Thurso: May I apologise for missing the beginning. I was chairing another Committee.

Can I follow up very briefly on the point that Mark Garnier has been exploring with you? I will perhaps come to you first, Dr Shafik. In a nutshell, do the regulators have sufficient powers—looking at recent Forex enforcement action—do they have sufficient tools in the locker to do the job?

Dr Shafik: In the case of Forex it is a complicated landscape because the spot for an exchange market is not regulated under current regulations. The FCA, however, was able to prosecute these cases under the rubric of the FCA 11 principles, so they found a vehicle to pursue these enforcement cases. The landscape is changing because we have the introduction of method 2, which will affect the way that clients are segmented and expand the regulatory perimeter and increase pre-imposed trade transparency. We also have the market abuse regime from the EU that is going to take effect in 2016. That will, again, expand the regulatory perimeter and expand rules around insider trading and market manipulation. There is also a set of changes on benchmark reform. Clearly, the seven additional benchmarks we have recommended come under regulatory scope and will again expand the regulatory perimeter somewhat. The perimeter has changed; the landscape is changing; regulators will have more powers in the future.

There is one blank spot, which is spot FX. In the consultation document we do ask that question: should we be doing something on spot FX or will these other changes that I have described—the regulation, for example, of the key foreign exchange benchmark, the WM Reuters 4pm London Fix—be sufficient to reduce the risk of the kind of misconduct that we have seen recently? That is an open question in the consultation document.

Q72 John Thurso: Clearly the perpetrators of the Forex swindle or scandal, or whatever it is, did not believe they were going to be caught. It seems they also did not believe that if they were caught, much would happen.

It is reported that the FCA have passed this on to the Serious Fraud Office and there is a real possibility of some criminal sanctions. First, is that a good model; and secondly, do you think it will have an impact on the possibility of other people in making them think twice?

Dr Shafik: Yes, I do think it is a good thing that these cases have been passed to the Serious Fraud Office and, yes, I do think so. In some of the research that has been done on deterrents, criminal sanctions are top of the list in terms of dissuading people from doing certain things. I think making them pay is further down the list in terms of impact.

Q73 John Thurso: A quick question, if I may, to you, Elizabeth. Do you, on the other side of the fence, feel that people in the market fear the FCA or the SFO more or is the combination something they will now fear in the future?

Elizabeth Corley: There is a lot of respect for the regulator, particularly within the new regime. The FCA really is a very present regulator in terms of conduct. That is probably the regulator we see more as investment managers but if I think about, more broadly, the practitioner panel and the banking then, yes, I think there is a lot of respect. The way this respect could become fear is that, hopefully if there is wrongdoing, they should be very afraid.

Q74 John Thurso: Following up on your last discussion with Mark about on how these things come to pass and who gets punished and whether it is the bank. There is a much wider problem—having sat on the Banking Commission—this is yet another example of something that has—

Chair: Four of the five.

John Thurso: Yes, four of the five years. But this is just yet another example and one is almost saying, “Hello, new dawn, new scandal”. It seems to be going on and on. Recent conversations with some senior bankers would indicate that there is a possibility there may be more. We just do not know that we have come to the end. There is plainly a major cultural problem within the way traders operate. To what extent is that problem because the people who manage traders are traders themselves and their reward is based on the aggregate reward of the individual traders? To what extent is changing that management model, where managers of traders are not rewarded for trading? Is that a key part of shifting the culture?

Elizabeth Corley: Listening to what the chairmen and chief executives of a number of banks are saying, it gets exactly to the heart of that, Mr Thurso. How do we get a more balanced score card approach to the way in which management and senior management are rewarded; how do we make it more long-term; and how do we make it more aligned with shareholder and client interest? That is very much at the heart of what people are thinking about in terms of their own governance, surveillance and goal-setting for the first line of defence. It is something that is referenced in this consultation. It is certainly

something we will be commenting on. Clearly, to have a single outcome that remunerates or does not remunerate somebody, and for that to be completely allied with the activity of the trading desk, puts the check and balance into a compliance function—into a second line of defence or surveillance—whereas we would all agree that the first line of defence has to be the first check and balance in these markets.

John Thurso: So strengthening that first line of defence?

Elizabeth Corley: Absolutely.

John Thurso: Thank you very much.

Chair: It has been extremely interesting this afternoon. I expect it is the first of a number of hearings we will be having on the work of the review. We are very grateful to both you for the evidence you have given this afternoon.