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Culture, Supervision and Enforcement in Bank Regulation

The primary interest of this subject is that at first glance these issues appear to have nothing to do with each other. However, this is because people - and especially lawyers - tend to look at the world with Austinian eyes, in that they divide norms using a binary distinction of “laws” and “not-laws”. In this oversimplified world, supervision is the inspection of compliance with “laws”, and enforcement is triggered only by breach of “law”. Since “culture” is by definition a “non-law”, supervision and enforcement can have nothing to do with it.

This world-view is to some extent embedded within organisations. A good working definition of culture within an organisation would be “the behavioural constraint which exists beyond formal rules”. If a bank employee does something which contravenes a directly applicable formal rule, he will probably be noticed by the supervisor (since supervision can be defined as the job of noticing such things), and if this happens he will almost certainly find himself the subject of enforcement action by the regulator. Conversely, a breach of the "culture" of an
institution by definition cannot be made the subject of formal enforcement action in the absence of formal rules.

There are two aspects of this distinction which are more complex than they first appear. One involves an element of time-inconsistency. One way of looking at culture is that it is the art of arranging a firm so that it does not do today that which will be prohibited and prosecuted tomorrow. A firm cannot know what exactly will be prosecuted tomorrow. However it can know the sorts of things which are done today, but which would, if the regulator knew that they were being done today, attract immediate censure (The “immediate” in this test is important - mores change over time, as do accepted practices. However the fact that changing mores cannot be easily anticipated is not the same as saying that that attitudes to currently unprohibited activities cannot be anticipated).

Rules and culture

The starting point here is that the casual assumption that there is a clear distinction between "rules" and "culture" is highly misleading. In many respects this is a reflection of the discussion which bedevils so much of jurisprudence, in that it is a form of the discussion “what is law”, or, more accurately, "when do informal norms become formal rules?". This is of interest to lawyers, but can be irrelevant in practice. If a particular employee of a particular institution is firmly of the view that if he does X he will be sacked, it matters not a jot whether X is prohibited by formal law or informal consensus within the bank. The issue here is akin to the debate as to whether the rules of the football league are “law” within the formal definition of a legal system. This is of interest to jurists, but irrelevant to footballers. If what you seek to change is the behaviour of groups of people, formal “law” is simply one tool (and not usually a particularly effective tool) to achieve that aim.

The one area where this debate is, however, of considerable importance is when viewed from the perspective of the enforcer himself. From the perspective of banks and other financial market participants it has never been more true that law is not what the rulebook says, but what the policeman does. However, when this is approached by the policeman himself, the answer to the question as to what he should do is a difficult one to answer. Financial regulatory authorities, like other public authorities, think of themselves a bound by Hartian secondary rules – they should only enforce those norms which have been through a process of endorsement by the legislator which results in their being regarded as “law”. This position has the merit of being in accordance with law, jurisprudence, and the traditions of individual freedom and constrained authority which form the basis of English Law. However, the consequence for those authorities of the adoption of this position has been sustained criticism over an extended period of time for having a “box-ticking” approach to their regulatory briefs; enforcing minor rules related to technical performance of functions without considering the “bigger picture” of the overall conduct of the industry as a whole. Few authorities accept that this criticism is entirely justified, but even fewer assert that it is entirely unjustified. Thus, in the same way that banks find themselves under pressure to enhance the non-legal norms within their organisations, regulators find themselves under pressure to find ways of enforcing those non-legal norms.

At this point we set foot into jurisprudence. An enormous amount of academic effort has gone into answering the question “what is law?”, and the most familiar manifestation if this is to be found in the question of whether there is any real difference between “law” and regulation”. Classical (Austinian) jurisprudence operates on the basis that law is simply that which the system designates as such – thus a law is a law if it is enacted by a lawmaking
body, and if it is not it is not. This yields a formal distinction between law and regulation which is accurate but useless – law is that which is made by legislatures, regulation is that which is made by regulators. However the real issue in the law versus regulation debate is as to whether regulation is somehow different in kind from law – is somehow “less” than law. In some respects this is clearly true – law applies to people generally; regulation generally applies to a subset of any population, and whereas law is intended to produce equity between parties, regulation is intended to place the regulated person at the service of (i.e. in an inferior position to) others. Finally, the sanctions which may be imposed in respect of a breach of a regulation are likely to be prosecuted by a different authority in front of a different tribunal with a different (and lesser) range of penalties from those which would be imposed in respect of a breach of the ordinary law of the land.

If regulation is "less" than law, then it seems a fortiori that culture is less even than regulation. We shall examine this conclusion.

Consider a hypothetical bank. As a hypothetical employee of that hypothetical bank, how shall we order our conduct? The first point is that the majority of our concerns are in fact driven by the law of the land. The regulatory system supplies glosses to the basic dictates of law – don’t lie, don’t cheat, don’t steal – but we obey these laws not because we are employees of a regulated institution, but because we are citizens of the state. Over and above the law of the land is the regulatory system. The essence of bank regulation is the idea of the protected, regulated monopoly. In the same way that the state seeks to prevent people from holding themselves out as doctors or lawyers unless they are properly qualified, it does the same with Banks. This sort of arrangement has a classic quid-pro-quo character to it – participants are collectively given a monopoly backed by state power, and in exchange they agree to be subject to rules over and above those set out in the ordinary law. Thus – at its simplest – a banker who sells a financial product to a retail customer is required to do a number of things – determine that the product is suitable for the buyer, give full disclosure, provide follow-up information – which would not be required from a salesman selling a second-hand car. These standards are set out in the regulatory system, which can be viewed as applying a set of standards which are not applicable to the world as a whole, and compliance with which is the price of being permitted to participate in the protected monopoly.

This would seem to support the idea that regulation is somehow “less” than the law. However the issue with which we are currently concerned is not the classification of obligations, but the effect on behaviour of the existence of those obligations. The reason that this is significant is that inherent in the argument that regulation is “less” than law is the idea that it therefore has a lesser impact on conduct – that people will be more careful to obey legal than regulatory sanctions. If this were true, it would necessarily also follow that culture would be "less" again, since it stands even lower in the hierarchy of norms than regulation. Using this formal approach, we could conclude that culture is therefore irrelevant to a rules-based approach to behavioural modification.

Consider a football cup-final match. The players are playing according to the rules of the Football Association. Everyone in the ground is, at the same time, subject to the laws of the land. Let us say that the rules of the football association prohibit a particular type of tackle, which at common law would not constitute the offence of assault. If a policeman present at the match sees a tackle of this kind on the field, he will not run onto the pitch and arrest the player concerned – however, the referee will award a penalty which may well lose the match for the team to which the tackling player belongs. One of the things that we can be
reasonably certain of is that, from the point of view of the player at the time of the tackle, the rules of the Football Association will occupy a much larger slice of his attention than the criminal law. Playing football is what he is there to do, it is the sole aim of his career (and possibly of his life to date), and his success or otherwise in that aim will determine his future. In his mind, although the rules of the FA may be "less" than the law of the land, they are in practice the primary (and possibly the sole) determinant of his behaviour. If we flex our example slightly, and imagine that instead of a tackle which contravenes the rules of the FA but complies with the law of the land, the footballer performs a tackle which contravenes both the rules of the FA and the laws of the land. In the mind of the footballer, the only material consideration is likely to be the fact that he has contravened the rules of the FA and possibly given away a penalty.

What follows from this is that it is not possible to determine the impact of rules on behaviour by examining the formal nature of the rules themselves. What matters in any given circumstance is the classical calculation which applies to all prohibitions, both legal and non-legal (we can call these “norms”). This the deterrence algorithm, usually expressed as $a\% \times b\% \times c$, where $a\%$ is the likelihood of the breach of the norm being noticed, $b\%$ the likelihood of that breach being sanctioned, $c$ is the potential severity of the resulting sanction. The product of these three is the extent to which a person is likely to be deterred from a breach of the particular norm. The nature of the norm which is being breached is simply not relevant to the analysis.

It may be argued that this is an oversimplification, in that it matters who does the noticing - if an external person notes that an individual has contravened an internal norm, no consequences will follow from that. However, this is not in fact correct. Culture not only gives rise to internal expectations (that is, expectations of co-workers and management) but also external expectations (that is, expectations of clients, customers and the general public). Consider, for example, a large oil exploration company. There will be a long list of regulators with formal statutory powers over it. There will also be a long list of non-statutory entities with a significant interest in what it is doing – consider Greenpeace as an example of the latter. Greenpeace is in no way a formal regulator – its determinations have no legal force, and breach of its determinations formally leads to no legal consequences. However, it is clearly true as a matter of fact that organisations of this kind can, if not placated, have a very significant commercial impact on the activities of the firms with which they are concerned, and exactly the same calculation – likelihood of objection, likelihood of a campaign of action and the economic consequences of that campaign – must be approached in broadly the same way that the expectations of a formally constituted regulator would be.

The point of all this is that an employee of a bank generally will not regard himself as subject to a number of different levels of rules arranged in a formal hierarchy, but to a series of norms whose origin is likely to be largely irrelevant to the extent to which he regards them as binding. This collection of norms is made up of the law of the land, the provisions of the relevant regulator, and the informal codes and accepted behaviours which prevail in the institution in which he works. These last are clearly not formal legislative codes. However, in the same way that the football player in the cup final is likely to be significantly more interested in the rules of the FA than the Criminal Justice Acts, in practice the bank employee is likely to be significantly more interested in what is expected of him by the informal code of the institution in which he operates than in either law or regulation as it technically applies to him.
When considering such codes, however, we have to reconsider the operation of the deterrence algorithm. The first two elements are probably the same as for any other estimation, but it is the third – the extent of the potential enforcement action – which is interesting in this context. There are a number of ways in which institutions respond to breaches of the internal code of behaviour, but none of these are likely to involve formal sanction (modern employment law pretty much ensures that dismissal for breach of an informal internal code of expectations is impossible without the payment of very substantial compensation). However, it is equally clear that this is not a useful paradigm - in real life, employees do not spend any very significant amount of their working time debating the risk of dismissal. The aim of employees is generally recognition and reward within the institutional structure of their firm of choice. In this context “sanction” is most likely to mean promotion withheld, a bonus less than that of contemporaries, or even simple fall in esteem within the organisation. These “sanctions” sound almost trivial compared with those which are available to regulators or civil authorities. However, in many respects they are the equivalent of conceding the penalty in the cup-final in terms of their ability to motivate and ensure compliance.

Culture and Principles

It is impossible in a discussion of this kind not to consider the usefulness or otherwise of “principles based regulation”. This may at first glance seem surprising. Principles based regulation itself has fallen into bad odour in the post-crisis environment, with many regulators pointing to the UK FSAs “product recall” of its former focus on principles as evidence that principles based regulation was simply a polite name for light touch - which in turn was merely a polite name for inadequate - regulation.

This is, however, oversimplistic. It is true that the FCA was unusual amongst its international comparators in articulating a set of principles as the basis of its regulatory approach. However, as Julia Black has pointed out\(^1\), it is important not to confuse a formal adherence to published principles with the activity of principles-based regulation. On examination, most regulatory systems will be found, to one degree or another, to be based on a principles rather than a purely literalistic approach to rules enforcement. As Black says, the question of whether a regime is a principles based regime is entirely independent of the presence of formal principles in the written rulebook. If the question is rephrased as one as to whether the regulator can be said to operate on the basis of identifiable principles which underlie its formal rules, then most if not all regulators would claim to be principles-based using this definition.

What, then, do we mean by principles based regulation, and how do we identify it? It is important to emphasise at this point that principles based regulation does not mean a regulatory requirement to have principles. Principles based regulation has been described as an outcomes-based approach, where the regulator specifies the outcome to be achieved and leaves it to the firm concerned to achieve that required outcome.

This raises the question as to why, if regulators regard these principles as being rules, they do not all formally incorporate the into their rule books. The answer to this is that even for those regulators who do incorporate principles in their rule books, those principles are not really

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\(^1\) *The Rise and Fall of Principles Based Regulation*, LSE law, society and economy working paper 17/2010
“rules”. The problem, of course, is that rules at this level of generality do not pass the Hart/Raz test of being law at all, for the same reason that “be good” would not constitute an effective criminal statute. Thus, for example the FCA principle that firms should “treat customers fairly” is not, as it stands, a rule. The FCA has given a great deal of guidance as to what this principle means in certain specific situations, and firms have been fined for breaches of that guidance. However, although the formal justification of the sanction is breach of the principle, in practice it is the guidance, not the principle, which constitutes the rule.

This example illustrates the difficulty of complying with principles. It is easy for commentators to say that it should be clear to firms whether their activities amount to treating customers fairly or not. The problem, however, is that there is no single common standard for what is “fair”, and treatment which may be accepted by one customer as fair may be regarded by another as grossly exploitative. It is generally for this reason that when firms are exposed to regulatory sanctions, the justification for the sanction is by reference to breaches of identifiable specific rules rather than of principles alone.

The conclusion from this seems to be that principles perform much the same functions for regulators that culture forms for firms - a statement of a specific set of aspirations which exist alongside, but in some senses above, the specific rules which explicitly govern day to day interactions. It might, indeed, be not unfair to describe principles as a statement of the regulators’ culture, in the sense of an articulation of the outcomes which the rules should seek to achieve. However, it is quite clear that regulators themselves would not accept this - or rather, would not agree that this was the only purpose of the principles. Principles, they would say, should be goals for the regulated as well as the regulator, and if the regulated are not seeking to deliver outcomes which satisfy the principles of the regulator then they are delinquent in their duty.

We can consider the obligation to deliver outcomes compatible with the underlying principles as a separate regulatory obligation which is distinct from the obligation to comply with the specific rules set out in the rule books. Considered on this basis, then the issue becomes one of how firms are to achieve this aim. One way of looking at the problem would be to say that the firm has one tool - compliance - to ensure that detailed rules are adhered to, and another - culture - to ensure that principles are taken into account in the way in which the business is conducted. A critic might say that a structure of this kind has ceased to constitute principles-based regulation, and become two separate forms of regulation - principles based and rule-based - which are applied interchangeable to the regulated firm according to which gets the best regulatory outcome. This is almost certainly correct.

Conduct and outcomes

One of the worst problems with discussions of conduct is generally a lack of specificity – that is, the idea that conduct – and indeed people – can be simply and easily divided into "good" and "bad". The most extreme manifestation of this can be seen in those accounts of the 2007-8 financial crash which argue, in effect, that those who structured sub-prime mortgage securitisations must have been dishonest because, five years later, people who worked in an entirely different part of a different bank were prosecuted for manipulating LIBOR. It is clearly true that a successful regulatory action against any institution on the basis of dishonest conduct within that institution will have a detrimental impact on the perception of the institution as a whole, and by implication of all those who work for it. However, outside the media, perception is not reality, and the fact that something has gone badly wrong within a
part of an organisation tells us nothing useful about the way in which other parts of the same institution are managed. It is clearly true that institutions have cultures, but this is probably not what is meant here.

It is helpful in this regard to examine what "bad" culture looks like. In the FCA/PRA report on the failure of HBOS, probably the most spectacular of the UK bank failures during the crisis, a great deal of the blame of the failure is laid at the door of the culture within the institution. The (devastating) finding was that "The ineffectiveness of HBOS’s risk management framework was a consequence of a culture within the firm that prioritised growth aspirations over the consideration of risk. HBOS’s weak risk culture was evident at all levels of the firm, with the Board-approved emphasis on growth setting the tone for the rest of the organisation."

This is important for a number of reasons. One is that it rings true – the underestimation of risk in pursuit of gain is a universal element of the human conditions, and although it is true that management structures within firms should be constructed primarily to rein in this tendency, it is not at all surprising that they are not invariably successful in this regard.

The second point, however, is that when we describe this culture as being defective, we are not thereby passing a value-judgement of any form as to the extent to which what was done was "evil" or "wrong". The individuals concerned might be accused of putting their own interests before those of others – for example, in order to gain short-term bonuses whilst leaving the payers of those bonuses (the shareholders) exposed to long term risks. However, what is notable about the report is the extent to which this does not appear to have been the case. The foundation of HBOS's underrecognition of risk appears to have been an entirely understandable ambition on the part of its senior managers to grow their business, win market share and demonstrate to others the superiority of themselves and their organisation. The idea that there is no reason to worry because, when the day of reckoning comes, “I will be gone, you will be gone” is entirely absent from these findings. What this demonstrates is, inter alia, the almost complete separation between “morally culpable” and “harmful” in this context. A culture can be so harmful as to be toxic, both to the entity and to the wider economy, without any individual within it doing anything, or holding any view, which should attract moral obloquy.

When we consider the HBOS example and ask the question “what should have been done”?, it is quite clear that the response should have been to create an atmosphere within which there was greater concern with risk, and less with apparent commercial success. It is also entirely clear that this is something which, in order to be effective, should permeate the organisation from the top down.

However, when we consider what role regulation might have played in the development of such a culture, we do not come to any particularly useful conclusion. As regards corporate governance, there is nothing easier than prescribing procedures, and regulators have created mountains of paper doing this. However, as is made clear in the HBOS report, the corporate governance procedures within HBOS were, on paper, excellent – indeed the "three lines of defence" model operated by HBOS was, on paper at least, a sophisticated and effective process. The problems lay less in the processes, and more in the approaches maintained by those participating in those processes.
It is fair to say, in conclusion, that supervisors now acknowledge that merely looking at formal processes is not, of itself, a particularly effective way of monitoring management, and seek to watch the process in action rather than merely examining the processes in isolation.

Enforcement policy

The primary question to be addressed here is whether enforcement per se has any role at all to play as a policy instrument in driving cultural change. In principle, the answer would seem to be that it does not. Enforcement policy, by definition, is focused on actual breaches of the existing rules. To the extent that the objective of those focussed on culture are to drive improvements which go beyond the existing rules, the two might appear to be at complete cross-purposes.

Enforcement decisions are the basis of any regulator’s interaction with the regulated community. Brutally, a regulator needs to be believed to be capable of effective, targeted action having a significant impact on the recipient before it will be effective in imposing its requirements on the regulated community. It is not true that enforcement is regulation, but it is true that without enforcement regulation is not regulation.

This takes us to the question of how the decision to commence enforcement action is taken. It is not the case that any regulator will automatically commence enforcement proceedings wherever there has been a demonstrable breach of the rules. All enforcement decisions are made using a two-stage process. The first stage involves an assessment of the evidence collected by the enforcement authority and an assessment of the likelihood of succeeding in enforcement proceedings. If this is not likely, then the proceedings are abandoned. However, even if there is enough evidence to secure a successful outcome, there is a further assessment to be made as to whether bringing enforcement action in the particular case is in line with the public policy objectives of the regulator.

There are a large number of policy issues which a regulator may consider in bringing enforcement action. However one of the clearest is that the enforcement action itself is intended to have an impact not only on the person engaged in the activity but also on others. This objective is neatly summarised in the FCAs enforcement guide

“The FCA will aim to change the behaviour of the person who is the subject of its action, to deter future non-compliance by others, to eliminate any financial gain or benefit from non-compliance, and where appropriate, to remedy the harm caused by the non-compliance.” [FCA Enforcement Guide 2.2(4).]

This makes clear that enforcement action is not simply aimed at the person on the receiving end of that action. This is made even clearer slightly further on

The FCA does not have a set of enforcement priorities that are distinct from the priorities of the FCA as a whole. Rather, the FCA consciously uses the enforcement tool to deliver its overall strategic priorities. The areas and issues which the FCA as an organisation regards as priorities at any particular time are therefore key in
determining at a strategic level how enforcement resource should be allocated. FCA priorities will influence the use of resources in its supervisory work and as such, make it more likely that the FCA will identify possible breaches in these priority areas. Further, should evidence emerge of potential breaches, these areas are more likely to be supported by enforcement action than non-priority areas.

[Guide 2.6]

This does make clear that enforcement is a communication tool.

Enforcement authorities can clearly bring enforcement actions in respect of breaches of rules. However, there are two problems with using enforcement action per se to affect behaviour outside the rules. The first is that behaviour is, by definition, a matter of human conduct. Put simply, a firm cannot have a behaviour – it is only the individuals who compose that firm who can behave. However, in general the regulatory system applies to regulated entities, and the regulated entity in these cases is the firm, not the individuals. This is, of course, an oversimplification, in that regulators have jurisdiction over the individuals who comprise the firm. However this jurisdiction is limited by the fact that it tends to arise only where the firm itself has breached rules. The issues with bringing enforcement actions against individuals are well-known- where the individual is clearly culpable then action is straightforward, but where the individual is a manager or employee, in general enforcement is only likely to be practical where actual wrongdoing can be shown on the part of that person. Actual wrongdoing in this case can be inferred from inaction – for example, a failure to establish system to address a known problem, or a failure to act on information received which might have indicated breaches of the rules – or from active encouragement of another person to breach rules.

All of this may be regarded as a long-winded way of saying that regulatory enforcement cannot lie for breach of non-regulatory rules. However, the world is a more complicated place than that, and it is interesting to consider an example of a situation - the UK PPI mis-selling case - where a regulator succeeded in doing exactly that.

The facts of the PPI situation are contentious even now, but a short summary might run roughly as follows. It is common practice amongst banks of all descriptions to provide their customers with a mixture of credit and services, and it is generally found upon inspection that the profit in the relationship comes through the price of the services - indeed, in corporate relationships it is by no means unusual to find loans priced at below the cost to the bank of the financing concerned, such loans being provided on this basis in order that the relationship arising from the provision of the loan may be sued for the sale of other services. This approach was deployed by UK retail banks as regards the retail lending market in the UK, in the retail market, with apparently underpriced loans being offered in association with apparently overpriced insurance. There was nothing particularly difficult to understand about the insurance being offered, there was no doubt that the pricing of the insurance was clear and transparent, in that the price to be aid was clearly disclosed, and it was common ground that the sales concerned were in accordance with the rules governing sales of insurance which were in force at the time. However, the financial terms on which the insurance was sold yielded an extraordinarily high profit to the person selling it - in *Plevin v Paragon Finance*\(^2\), Lord Sumption held that the mere economic terms of the contract alone (a commission equal

\(^2\) [2014] UKSC 61
to 71% of the sale price was paid) made it per se unfair, although he indicated without deciding that the disclosure of this fact might have cured the unfairness.

The position, in a nutshell was therefore that the outcomes for most PPI customers were held to have been unfair, although no actual rule had been broken in the course of their sale.

Pausing here for a second, it may be noted that a good part of the problem in practice seems to have arisen from the fact that the regulations surrounding the sale of insurance products of this type at the relevant time were based on the assumption that the investor had a responsibility to look after his own interests, and in particular, when he was clearly informed what he was getting and what price he was paying for it, that the responsibility for the decision would then become his own. The various commentaries on the incident seem to agree that any thinking customer should have been able to see immediately that what was being offered was substantially overpriced, and although it was suggested that in some cases buyers of the product were either coerced or deceived into buying it, this was not the case with the majority of buyers. This fact pattern raises some very difficult issues for regulators as to what their role in such cases is actually supposed to be and, in particular, what level (if any) of responsibility for their own decisions should retail customers be expected to take. That’s having been said, it is not in dispute that by 2010 a very large number of these policies had been sold; many distributors and banks had been significantly enriched thereby; and many customers had suffered detriment.

The starting-point for the PPI discussions was the activity of the UK Financial Ombudsman. Now the operations of Ombudsmen are an interesting illustration of the limits of conventional analysis of the distinction between law and morality. An Ombudsman is generally established in respect of a particular industry, and exists to review complaints made by customers of the firms in that industry. However Ombudsmen are not judges, and are not constrained to operate within the law. In the UK, for example, it was decided in R (Heather Moor v Edgecombe) v FOS that an ombudsman may reach a decision in a case which is at variance with the ordinary common law, and indeed with all of the other materials which relate to the situation, provided that he is satisfied that the outcome is fair and reasonable.

In summary, the approach of the Ombudsman to PPI complainants was to say that all sales of PPI should be presumed to be unfair unless the institution concerned could prove that, at the point of sale, full disclosure had been made of the commission or profit levels, the sale would be treated as being unfair and the ombudsman would order compensation to be paid. The banks - who had in general made no such disclosure because there was at the time no rule requiring it - were understandably unhappy by this approach, and appealed to the courts to hold that what was being done should be stopped.

It is interesting to consider the number of different layers of "laws" which were present in this case.

- At the lowest level are the specific rules of the FCA relating to the sale of the products. It is common ground that these were not breached at any time.

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3 Although the Competition Commission report (Market Investigation into Payment Protection Insurance, 29 January 2009) into the PPI market concluded that there were very significant impediments to customers comparing different PPI policies, to some extent directly attributable to the behaviour of the sellers of PPI.

4 [2008] EWCA Civ 642
- next, there was guidance given by the FCA to the Ombudsman (in the form of an "open letter"). This was the document which specified further obligations on banks selling PPI products which went beyond those set out in the FCA rules. These were adopted by the FOS, to the extent that it began to award compensation against banks in a large number of cases where the banks themselves, having considered the situation, had determined (correctly) that there had been no breach of the rules

- finally, we have the FCA "principles for business" Prior to the case, it would have been agreed by all parties that (a) these principles applied to all of the activities of the firms concerned, (b) breach of them would have constituted a breach of rules in respect of which FCA could have taken enforcement action, but (c) breach of principles did not give rise to a civil law right of action in damages vested in the customer (or any third party).

The upshot of the decision is interesting. In effect, the reasoning of the court was that (a) an obligation could be derived from the principles which was not set out in the rules (in this case, an obligation to communicate more detail that was required in the rules), (b) it was therefore open to the ombudsman to regard failure to comply with such obligation as unfair and, (c) it was therefore proper for the ombudsman to require the bank concerned to compensate the customer for a breach of that obligation, despite the fact that the effect of this decision was in practice to treat the bank as if it had been subject to a regulatory obligation which did not exist (and had not been suggested) at the time when the activity concerned was engaged in.

This outcome can be summarised as a successful attempt by the regulator to impose a very significant economic penalty on the banking industry in respect of conduct which, at its simplest, was fully compliant with the formal rules as they existed at the time when the conduct was engaged in.

This example usefully brings together a number of the points set out above. First, there was no wrongdoing, in the sense of moral turpitude. Those who sold PPI insurance knew that it was overpriced, but they justified it as being sold in accordance with the rules, as being clearly described to customers, and as being optional (in the sense that no investor was ever - in theory - obliged to buy it). However, it is highly arguable that those involved would probably have admitted, if pressed, that viewed in isolation the economics of the individual transactions would be likely to be perceived by external observers as an extremely unattractive business, and not something which any regulator would have been able to defend in public as a legitimate business practice. In other words, the practice was something which the regulators could reasonably have expected the banks concerned to have thought carefully about in the context of their reputations generally. It is really this - the notion of looking at business which is legal (or at least not illegal) and asking whether there could be long-term detriments to the organisation as a whole arising out of doing that business - which constitutes a good culture in this regard. As the PPI case illustrates, the mere fact that something is legal is a useful starting point, but there is a further level of consideration which should be applied to any decision before it is concluded that it is something which can safely be done without risk of subsequent challenge. Finally, it illustrates that regulators can, given sufficient will, find ways directly to enforce behavioural norms which are not to be found in the rule book.