

Salz Review

An Independent Review of Barclays' Business Practices

April 2013

Salz Review

An Independent Review of Barclays' Business Practices

April 2013

Disclaimer

This Report has been prepared by Anthony Salz with Russell Collins acting as Deputy Reviewer (the Salz Review). The Review was set up by Barclays as an independent review reporting to a non-executive committee of Barclays. The views, findings and recommendations included in this Report are entirely those of the Salz Review. Barclays will consider and decide for itself whether, and if so how, to act on the views, findings and recommendations contained in this Report.

The Review's Terms of Reference and the approach to the Review are described in Appendix A. The views, findings and recommendations are based on the Salz Review's assessment of the documents provided by Barclays or others in response to requests and information gained from interviews. The Salz Review has not conducted a forensic investigation or an audit of the information made available to it. In some cases restrictions were placed on the Salz Review's access to documents or documents were redacted by Barclays, in each case for legal reasons. The Salz Review has generally assumed the veracity of information provided.

Other individuals considering the same information could form a different assessment of it. Similarly, the Salz Review might have formed a different assessment had it considered other information. Accordingly, the findings of the Salz Review should not be treated as determinative of any fact, nor of the performance of, or compliance with, any legal or regulatory obligation.

The Report is not for the purpose of guiding or influencing the conduct or decisions of any person other than Barclays, including any investment or other financial decisions. Accordingly, it must not be relied upon for that purpose. In this respect and generally, Anthony Salz and Russell Collins accept no legal responsibility or liability for the contents of, or any omissions from, the Report.

This Report is published at the request of Barclays PLC, consistent with the Terms of Reference.

Sir Michael Rake
Chairman, Business Practices Review
Committee
Barclays PLC
1 Churchill Place
E14 5HP

4, Lombard Street
London, EC3V 9HD

3 April 2013

Dear Sir Michael,

I am pleased to present to you my Report on Barclays' business practices.

This Review, in which I have been ably assisted by Russell Collins, sets out a number of recommendations. As contemplated in our Terms of Reference, we have developed these recommendations from conclusions we reached as to why, in a number of specific instances, Barclays' behaviours fell below the standards it expected.

Reports like this one inevitably concentrate on what went wrong, in order to find a better way forward. Accordingly they tend to read critically and negatively. We have sought to be balanced, but are mindful that some of this will be lost if our comments are taken and used out of context. Two points are worth making here. First, the problems faced by Barclays are to some extent industry problems – though Barclays should take no comfort from this. More importantly, despite the problems, there are many really good things about Barclays – not least that the overwhelming majority of its people are focused on doing their best for its customers, as reflected in the tens of millions of successful interactions every day.

Since I was appointed to carry out the Review, there have been a number of significant changes, including the appointments of Sir David Walker as Chairman and of Antony Jenkins as Group Chief Executive. Together, you have already started the work to restore trust in Barclays. Our recommendations should not be taken to suggest otherwise. They reflect the position when we started our work last summer. We believe they should provide a valuable road map for the future.

Barclays is a leading UK institution, with significant global businesses. The public rightly has high expectations. The changes envisaged in this Review will take time to have their effect. I welcome the start you have made.

Yours sincerely,

Anthony Salz

Anthony Salz

Contents

1.	Introduction to the Review	2
2.	Overview and Recommendations	4
3.	The Importance of Banks and the Roots of a Crisis.....	20
4.	Barclays' Evolution.....	28
5.	The Struggle for Survival through the Financial Crisis	39
6.	Conduct Matters	52
7.	Regulatory and Tax Matters	68
8.	Culture.....	76
9.	Board Governance	98
10.	People.....	120
11.	Pay.....	130
12.	Management Oversight and Risk Management	150
13.	Conclusion.....	163
14.	Appendices	165
	Appendix A – About the Review	166
	Appendix B – What is Culture and How Can it Go Wrong?	177
	Appendix C – Complaints Statistics	196
	Appendix D – Business Practices: Lessons from other Industries	198
	Appendix E – Barclays Timelines: Overall and Main non-UK Geographies.....	201
	Appendix F – Barclays' Governance Structure at Group Level.....	209
	Appendix G – Barclays' Employees	211
	Appendix H – Barclays' Financial Evolution	212
	Appendix I – Selected Bank Financial Ratios	222
	Appendix J – Variability in Risk Weighted Assets Calculations	225
	Appendix K – Correspondence between Lord Turner and Marcus Agius	226
	Appendix L – Glossary	231

1. Introduction to the Review

- 1.1 The Board of Barclays PLC (Barclays or the Group) announced in July 2012 that it had commissioned this independent external Review of its business practices and had appointed me to lead it. The Review's mandate is to determine how Barclays can rebuild trust and develop business practices which make it a leader, not only among its banking peers, but also among multinational corporates more generally. I take this as a commitment by Barclays not to be satisfied with following industry and regulatory standards if there are other higher standards that are attainable and meet the interests of its various stakeholder groups. Indeed, I regard this as entirely appropriate given Barclays' position as a leading UK financial institution. Nevertheless I recognise that the extent to which Barclays is able to implement some of our recommendations depends on how the industry as a whole responds to the challenges it faces. It is in the interests of all its stakeholders that Barclays is successful and is able to compete effectively in each of its markets.
- 1.2 I have reported to a sub-committee of Non-Executive Directors (NEDs) of Barclays' Board (the 'Sub-Committee'). The Sub-Committee is chaired by Sir Michael Rake, Deputy Chairman and Senior Independent Director, and comprises Sir David Walker, David Booth and Sir John Sunderland. The Terms of Reference for the Review appear within Appendix A.
- 1.3 With the agreement of Barclays, I appointed Russell Collins as my deputy for the Review. I appointed The Boston Consulting Group (BCG) and Herbert Smith Freehills (HSF) to assist us. In this report I will tend to refer to the joint views of myself and Russell Collins by using the word 'we'.
- 1.4 The Review was commissioned as an independent assessment of Barclays' values, principles and standards of operation. We have considered Barclays' Board governance, organisation and operating model, as well as its culture, people management and pay arrangements, and its risk and control systems.
- 1.5 As part of our work, we considered a number of significant 'events' which appear to have materially affected Barclays' reputation. Our purpose was not to prove or disprove any allegations surrounding those events. Our brief asked us to understand whether the events pointed to a gap between Barclays' articulated values and the way the bank operated in practice, and to recommend actions to reduce the likelihood of similar events occurring in the future. The Review was not intended to be a forensic investigation or audit of either the bank's activities or the events.
- 1.6 Appendix A sets out the approach we took to the Review, including consideration of the views expressed by more than 600 interviewees drawn from current and former members of the Barclays Board, senior management, other employees, customers, shareholders and other interested parties, in the UK, US, Africa, Spain, Hong Kong and Singapore.
- 1.7 On 9 August 2012, Barclays announced the appointment of Sir David Walker as Chairman of the Board, effective from 1 November 2012. Antony Jenkins was

appointed Group Chief Executive from 30 August 2012. Both Sir David Walker and Antony Jenkins confirmed that the Review and its independence were important to them.

- 1.8 Our recommendations are based on the business practices and culture prevailing in the autumn of 2012. On 17 January 2013, Antony Jenkins announced the launch of new Group-wide values. On 12 February 2013, he announced changes to the scope of Barclays' business. Antony Jenkins and the Barclays Board have rightly pressed ahead with making changes rather than waiting for our recommendations. As a result, a fair number of our suggestions have already been identified by Barclays and are in the process of being implemented.
- 1.9 We also make a number of observations relating to the regulation of banks, informed by our Review of Barclays.

Structure of this Report

- 1.10 Our report is structured as follows:
- **Section 2** provides an Overview of the key themes we develop in the report and lists our Recommendations;
 - **Section 3** outlines the role of banks and their importance to the economy. It also addresses the roots of the financial crisis;
 - **Section 4** sets out some key events in the history of Barclays, focusing primarily on its growth over the last two decades;
 - **Section 5** examines Barclays' struggle for survival as an independent bank, in the face of the financial crisis;
 - **Sections 6 and 7** look at events that have damaged Barclays' reputation, including the bank's relationship with UK regulators and the UK tax authorities, and the lessons to be learnt;
 - **Section 8** analyses the culture of Barclays and how the Group can change to restore trust;
 - **Sections 9 to 12** set out the Review's detailed findings, observations and recommendations on Board Governance, People, Pay, and Management Oversight and Risk Management;
 - **Section 13** sets out the Review's conclusions;
 - The Appendices in **Section 14** provide further information, including a glossary of terms and abbreviations¹ used in this report.

¹ See Appendix L.

2. Overview and Recommendations

- 2.1 Banks matter. They hold a unique position in our society. Their smooth functioning is essential for people, businesses, governments and many other organisations. They play a vital role in modern economies, underpinning productive activity and encouraging growth and development. They move, lend, invest and protect money for customers and clients. And in any developed economy, they represent a substantial sector, employing large numbers of staff. This is particularly true in the UK where financial services is a bigger industry than in most other countries.
- 2.2 Banks also play a central role in supporting the global economy by facilitating international trade and helping to manage risk. As a result, the largest banks operate in many regions and countries, making them globally significant in world affairs. This global reach brings challenges. Banks' importance to the stability of our economic environment puts them under intense scrutiny wherever they operate.
- 2.3 Barclays is the second largest UK bank with assets of £1.5 trillion, around 140,000 employees, and around 60 million customers and clients worldwide.² It is classified as a global systemically important bank and is one of the largest investment banks in the world.

Trust and Reputation

- 2.4 A bank's licence to operate is built on the trust of customers and of other stakeholders, such as its staff, regulators and the public as a whole. Trust is built from experience of reasonable expectations being fulfilled – a confidence that an organisation will behave fairly. Successful banks acquire a reputation for being trustworthy. This can take decades to build. Yet it can be destroyed quickly and, in global organisations, by events almost anywhere in the world. Some companies have greater reputational resilience than others. They get the benefit of the doubt when things go wrong – partly because of the far greater number of things that go right and partly because of the way they respond to problems. Public opinion also tends to be more generous to those organisations that seem to be trying to do the right thing, or that have an appreciable social purpose.
- 2.5 In our Terms of Reference, Barclays observed that trust in banks has been “decimated and needs to be rebuilt”. Over the last two or three decades, deregulation, globalisation, unprecedented prosperity and the availability of relatively cheap funding have been closely followed by an extended period of economic and financial turmoil. The public has been encouraged by politicians, regulators and the media to see the banks as having a significant responsibility for the financial crisis and the ensuing economic ills. This has been a cause of the loss of public confidence. In the UK, the government rescues of Royal Bank of Scotland (RBS) and Lloyds Banking Group (LBG) – along with the more general injection of liquidity into the financial system – have encouraged the public to see the major banks through the

² As of end 2012; source: Barclays, *Annual Report 2012*, March 2013.

same lens. The implicit and explicit government support of banks and the systemic risks they pose to financial stability make them semi-public institutions. As a result, politicians and the public believe they have the right to insist on changes. Banks need to set the highest standards to meet expectations.

- 2.6 The public disapproval of banks generally has been exacerbated by the series of high-profile occurrences that reflected poor behaviour by some bankers – including alleged mis-selling of products, such as PPI, to some customers; attempting to manipulate LIBOR,³ a key interest rate; and failing to comply with government sanctions. The public has been understandably shocked by some of the revelations. It takes them as confirming the view that some banks and bankers have lost any sense of social responsibility and are only out for themselves.
- 2.7 In this context, Barclays' behaviours have elicited significant criticism. Its business practices have been roundly questioned by regulators, politicians, the media and the wider public. Barclays' reputational vulnerability was amplified by its large investment bank, which it has successfully built over the past 15 years, and by having a high-profile investment banker as Group Chief Executive. Investment banks, with their complex products, financial trading activities and high bonuses, have been particularly blamed for the financial crisis.
- 2.8 For the employees at Barclays this has been a difficult time. Our meetings with them and a survey we conducted made clear that the overwhelming majority are focused on the bank's customers and doing their best for them. They are as disappointed as anyone by some of the behaviours.
- 2.9 In the face of this intense scrutiny and criticism, Barclays decided to set up this Review, tasking us to make recommendations as to how Barclays can rebuild trust and develop business practices which will help make it a leader among its banking peers and multinational corporates more generally.⁴
- 2.10 Our Review focuses on Barclays and the challenges it faces in achieving its objectives. However, while banks are not all the same and very different business models are adopted by different institutions, we recognise that some of the challenges facing Barclays and addressed here are industry challenges. We also recognise that Barclays is subject to real competitive pressures and will wish to set the changes to which it is committed in the context of building long-term value for its shareholders.

The Need for Change

- 2.11 In the years prior to the crisis in 2008, Barclays pursued a bold growth strategy which we describe in Section 4. About ten years ago, its ambition was to become a top-five global bank, with one third of Group profits coming from investment banking and two thirds from global retail and commercial banking (including Barclaycard). The

³ London InterBank Offered Rate, a benchmark interest rate at which banks can borrow funds from other banks in the London interbank market.

⁴ An analysis of the lessons Barclays can learn from other high-risk industries is set out in Appendix D.

strategy also envisaged the bank having more international scale. The investment bank planned to double in size in four years and it exceeded these plans. In addition, the retail and commercial bank expanded rapidly in Spain, India, Russia and elsewhere. By 2008 the bank's growth had resulted in leverage (ratio of assets to equity) of 43, higher than the other UK banks. With the acquisition of parts of Lehman Brothers in September 2008, the investment bank grew to represent rather more than half of Barclays' profits and three-quarters of its assets.

- 2.12 Barclays arguably achieved overall much of what it set out to do. It came through the last five years of financial crisis as an independent, profitable bank. It has become one of the UK's largest global banks, with businesses in Spain, Africa, the US and many other countries. Most of its customers have remained loyal despite recent events and Barclays has continued to attract talented staff to work for it.

- 2.13 However, it is our view that this rapid journey, from a primarily domestic retail bank to a global universal bank twenty or so years later, gave rise to cultural and other growth challenges. The result of this growth was that Barclays became complex to manage, tending to develop silos with different values and cultures. Despite some attempts to establish Group-wide values, the culture that emerged tended to favour transactions over relationships, the short term over sustainability, and financial over other business purposes. To some extent these characteristics were reflected in the broader business environment. But the overriding purpose at Barclays in the lead up to the crisis and beyond was expressed in terms of increases in revenues and profits, return on equity and competitive position. The drift in standards was manifest in the events that set the context for this Review. Barclays was not alone – many of its problems were also experienced by other major banks. But Barclays can take no comfort from this. Indeed, we believe that generally banks took too much comfort from some business practices being standard in the industry.

- 2.14 It is understandable, and in many respects necessary, that since the start of the financial crisis, there has been an explosion in new regulation and in the intrusiveness of regulators. However, regulation alone cannot address the fundamental underlying causes that led to the business practices which are in the spotlight – the cultural shortcomings we found. Barclays and all its stakeholders need to recognise that restoring its reputation requires transformational change to create a bank that must feel very different from when we started our Review: an organisation that feels different – to staff, customers, regulators, shareholders and the public at large, with a positive resilient culture that will sustain it as a modern, open and globally influential financial institution.

Barclays Culture

- 2.15 We believe that the business practices for which Barclays has rightly been criticised were shaped predominantly by its cultures, which rested on uncertain foundations. There was no sense of common purpose in a group that had grown and diversified significantly in less than two decades. And across the whole bank, there were no clearly articulated and understood shared values – so there could hardly be much consensus among employees as to what the values were and what should guide

everyday behaviours. And as a result there was no consistency to the development of a desired culture.

- 2.16 However, culture exists regardless. If left to its own devices, it shapes itself, with the inherent risk that behaviours will not be those desired. Employees will work out for themselves what is valued by the leaders to whom they report. The developing cultures across Barclays were still less consistent as a result of a highly decentralised business model, that tended to give rise to silos. This left a cultural ambiguity at the heart of the bank.
- 2.17 Successfully navigating the financial crisis and all its challenges may have combined to amplify some particular cultural characteristics. The struggle for survival, independent of government, dominated its activities. This led to a 'backs against the wall' mentality and a strong drive to win, "winning" being an evident part of the investment bank's culture. The management team and the Board had to work hard to pass the regulator's capital stress tests. Many suspected that they would fail. The crisis also offered a special opportunity to have a truly credible US investment banking capability. And so Barclays acquired parts of Lehman Brothers in the US. This added a significant integration challenge.
- 2.18 The institutional cleverness, taken with its edginess and a strong desire to win (particularly in the investment bank), made Barclays a difficult organisation for stakeholders to engage with, especially where those stakeholders were themselves dealing with unprecedented issues. It stretched relationships with regulators and resulted in them and the market questioning some of Barclays' financial information, especially its valuations of illiquid assets, and its control systems. Barclays was sometimes perceived as being within the letter of the law but not within its spirit.
- 2.19 Other characteristics added to the risk of less than ideal outcomes. There was an over-emphasis on short-term financial performance, reinforced by remuneration systems that tended to reward revenue generation rather than serving the interests of customers and clients. There was also in some parts of the Group a sense that senior management did not want to hear bad news and that employees should be capable of solving problems. This contributed to a reluctance to escalate issues of concern.
- 2.20 Transforming the culture will require a new sense of purpose beyond the need to perform financially. It will require establishing shared values, supported by a code of conduct, that create a foundation for improving behaviours while accommodating the particular characteristics of the bank's different businesses. It will require a public commitment, with clear milestones and regular reporting on progress. It will require Barclays to listen to stakeholders, serve its customers and clients well get on with the work to implement its plans and stay out of trouble. The complexity of Barclays' businesses makes this a particular challenge for its leaders. It will take time before it is clear that sustainable change is being achieved.

Leadership and Governance

- 2.21 The responsibility for leading this transformation must lie with the Board and the Group Chief Executive it has appointed. The system of Board governance at Barclays at the start of the crisis was in some respects ahead of its peer group. For example, Barclays was one of the first banks to establish a separate Board Risk Committee, and did so before this was recommended by the Walker Review.⁵ And it had a well-established risk appetite which set overall limits to protect the bank.
- 2.22 The board sets the tone from the top of the organisation, and must carry ultimate responsibility for its values, culture and business practices. With the benefit of hindsight, we believe that the Barclays Board did not give sufficient attention to this area. We also believe the Board found it difficult at times to penetrate into what was a large, complex organisation. It was significantly stretched in coping with the many issues that arose in the financial crisis – the Board met on 30 occasions in 2008 (at times by conference call) and 27 times in 2009 – and many of the events that have raised questions about culture and business practices only clearly emerged after the beginning of the financial crisis.
- 2.23 One of the principal roles of the Board is to provide challenge to management. Whether it is successful is influenced by a number of factors, including the composition of the Board, the skills of the Chairman, Board members' understanding of the Group's businesses, the time they have to give, the openness of the executive directors and the information available to the Board. Barclays has made progress in improving the specialist financial experience on the Board, as well as its diversity, but there is more to be done. It is hardly surprising that it underestimated the time it needed from non-executive directors since the beginning of the financial crisis. And we found some disquiet among Board members over the quality of the information provided to them.
- 2.24 We discuss Board governance in Section 9 and have made recommendations that reflect the importance of improving Board oversight and effectiveness, succession planning and the dynamics of the senior leadership team.

People and Pay

- 2.25 The role of human resources (HR), and the design and operation of the ways in which the bank managed and developed its people, did less than we would have wished to underpin desirable behaviours. The HR function was accorded insufficient status to stand up to the business units on a variety of people issues, including pay. This undermined any efforts to promote correlation of pay to broader behaviours than those driving individual financial performance. This mattered, because pay was seen as the primary tool to shape behaviour. The lack of serious attention to the consequences of individual behaviours was also reflected in insufficient attention being given to personal development and leadership skills (as opposed to technical

⁵ Sir David Walker, *A Review of Corporate Governance in UK Banks and other Financial Industry Entities – Final Recommendations*, 26 November 2009; all references to the 'Walker Review' are from the *Financial Recommendations*, except when indicated otherwise.

training). And there was too much emphasis on financial performance in recruiting, performance evaluation and promotion, with insufficient focus on values and behaviours.

- 2.26 The HR role needs to be strengthened, as does the general approach to people and performance management, in order to ensure that Barclays gets the very best out of its undoubtedly clever and highly motivated people, and that the people themselves benefit from a broader approach to the recognition of their work.
- 2.27 Our recommendations on the important issues relating to pay are set out in Section 11. We should point out that very many Barclays' staff are paid moderately and have minimal or moderate bonus incentives. It is unfortunate that the high bonus awards to a relatively small group of people indiscriminately impact the public perceptions of all bankers and bank employees in general.
- 2.28 Having said that, Barclays has struggled to deal with pay in a way that reflects a reasonable balance between the interests of shareholders on one hand, and those of executives and employees on the other. The structuring of pay was typically focused on revenues and not on other aspects of performance. Encouraging the maximisation of short-term revenues carried risks of unsatisfactory behaviour, with significant and adverse reputational consequences for the bank. The principal issues we have identified include high bonus awards in the investment bank which were incapable of justification to many stakeholders – especially since the beginning of the crisis; actions that maximised current year bonuses rather than consideration of sustainable profitability; and, in the retail bank and Barclaycard, sales incentives that risked products being sold to customers whether or not suitable for them. Overall, the pay structures gave the message to staff that the bank valued revenue over customer service.
- 2.29 Most but not all of the pay issues concern the investment bank. To some extent, they reflect the inevitable consequences of determinedly building that business – by hiring the best talent in a highly competitive international market (and during a bubble period) – into one of the leading investment banks in the world. The levels of pay (except at the most senior levels) were generally a response to the market. Nevertheless, based on our interviews, we could not avoid concluding that pay contributed significantly to a sense among a few that they were somehow unaffected by the ordinary rules. A few investment bankers seemed to lose a sense of proportion and humility.
- 2.30 We concluded that the reputational problems for Barclays stem in part from the perception that, at least in the UK, some bankers have appeared oblivious to reality. In the eyes of many stakeholders, despite the banks' role in the financial crisis (and the consequent recession), despite billions of pounds of liquidity support from taxpayers, many senior bankers seemed still to be arguing that they deserved their pre-crisis levels of pay (levels that were in any circumstances incomprehensible to the general public). The press reports of bonus numbers made it appear as though bankers in general were overpaid in the boom years and largely avoided sharing in austerity.

- 2.31 Barclays has responded to the public, political and regulatory concerns by trying to manage down total employee compensation as a proportion of adjusted profit before tax and adjusted net operating income, by deferring certain bonus payments and by applying claw-back or malus. If Barclays is to achieve a material improvement in its reputation, it will need to continue to make changes to its top levels of pay so as to reflect talent and contribution more realistically, and in ways that mean something to the general public. Barclays' success depends on hiring and keeping good people – and this requires that it pays them fairly. Its ability to lead change in compensation practices materially ahead of its competitors will necessarily be constrained if it is to avoid risking damage to its businesses. But we also feel that there is more that it can do over time to emphasise forms of recognition for performance other than pay.

Other Issues

- 2.32 To facilitate trust, the bank must improve its openness and transparency. This will require a fundamental change. It is not just about internal management information and published financial information. It is an attitude. It will take time to change mindsets and will need to be led clearly from the top. It involves two-way communications, both internally with all staff, management and the Board, and externally with all stakeholders – including, importantly, regulators. It involves better listening.
- 2.33 In our review of risk oversight and analysis, we found that, with some exceptions, credit and market risk had generally been well overseen but that, in relative terms, less attention had been paid to operational, conduct and reputational risk until recently. The decentralised business model had tended to contribute to weak central controls over business units and lessened the independence and effectiveness of some of the control functions, notably Compliance. And in some of the business units the 'front office' was not clear about its responsibilities as the first line of defence in the risk and control framework. The strategy underlying the aggregate risk appetite resulted in some inconsistencies across the Group. In the context of bold international expansion, this may have contributed to quite significant credit losses being incurred by the retail and commercial bank.
- 2.34 Fundamental change is also needed in Barclays' relationships with key stakeholders. This includes moving from a confrontational approach with regulators to one that is more open and cooperative. While the Barclays Board and senior management emphasised the importance of compliance with regulations and of regulatory relationships, we found that regulators in the UK had concerns about an approach that at times was aggressive and overly clever. It is also important that Barclays appreciates changes in public expectations. There are increasing demands from regulators, politicians and the wider public that banks of the standing of Barclays comply with the spirit and not just the letter of the law.

Moving Forward

- 2.35 The new senior management has acknowledged the need for change. As Antony Jenkins said in his note to all staff on 17 January 2013: "There might be some who

don't feel they can fully buy into an approach which so squarely links performance to the upholding of our values. My message to those people is simple: Barclays is not the place for you. The rules have changed. You won't feel comfortable at Barclays and, to be frank, we won't feel comfortable with you as colleagues."

- 2.36 Sir David Walker and Antony Jenkins acknowledge that there were gaps between Barclays' publicly articulated values and its business practices. They accept that Barclays took some decisions which were based on short-term considerations and were not always in the interests of its customers. As Antony Jenkins said in the 2012 Annual Report: "For the past 30 years, banking has been progressively too aggressive, too focused on the short term, too disconnected from the needs of our customers and clients, and wider society and we lost our way."
- 2.37 Antony Jenkins has launched the Transform Programme to address many of the issues we have explored. He has articulated the following values for Barclays: respect, integrity, service, excellence, and stewardship.⁶ And, while the bank's externally articulated objectives still include a financial focus to deliver a return on equity in excess of the 11.5% cost of capital, it is underpinned by a broader statement of purpose: 'Helping people achieve their ambitions – in the right way'.⁷
- 2.38 This is a good start. To address the trust issues and restore its reputation, we suggest that Barclays should communicate openly and transparently how, and to what extent, it will implement our recommendations. The values of the bank must be explained to, and understood by, employees and potential recruits, and consistently translated into everyday behaviour. The bank should set out clear plans for achieving cultural change and monitor and report publicly on progress with implementation. And it must learn from mistakes, paying close attention to staff and customer feedback. All of this will take time, and demand focused commitment by all levels of the bank's leadership in a period when the external environment and regulation continue to change.
- 2.39 There is a paradox in all this. In their efforts to change, banks could uncover more of the legacy problems that have dogged the industry since the start of the financial crisis. Despite being the first to settle regulators' investigations into its role in the attempted LIBOR manipulation and despite recognition of its cooperation in these investigations, Barclays seemingly suffered more reputational damage than its competitors. It would be unfortunate if this were to result generally in less cooperation and greater reluctance to settle issues arising from past problems. Accordingly, if in the change process Barclays discovers and brings to light past unsatisfactory behaviours, we hope that it will not be punished unnecessarily for its efforts and that recognition will be given to the challenges of achieving the transformational change on which Barclays has embarked.

⁶ Barclays' website: <http://group.barclays.com/transform/values>.

⁷ *Ibid.*

Recommendations

Introduction

- 2.40 Our recommendations are based on the business practices and culture prevailing prior to autumn 2012. On 17 January 2013, Antony Jenkins announced the launch of new Group-wide values. On 12 February 2012, he announced changes to the scope of Barclays' business. Antony Jenkins and the Barclays Board have rightly pressed ahead with making changes rather than waiting for our recommendations. As a result, some of our suggestions will already be in the process of being implemented.

1: Regulatory and business standards

Barclays should take a leading role in contributing to an effective regulatory system. It should ensure that it applies appropriate regulatory and business standards across all its businesses, complying with the spirit as well as the letter of prevailing regulation and law. It should work with regulators in a way that is consistently open, clear and transparent. It should reinforce these objectives through its performance management and reward systems.

The Chairman should seek, and respond to, feedback from its major regulators and appropriate public authorities.

2: Setting high standards

The Board and senior leadership, as custodians of Barclays' reputation, should promote and safeguard the trust in which it is held. They should state clearly Barclays' purpose and report regularly on how it is fulfilling that purpose. They should promote standards that support Barclays' ambition to be seen as a leader in business practices among its peer institutions and multi-national corporates generally. The senior leadership team should be responsible for demonstrating and promoting these high standards. This should be reflected in their annual evaluations and variable compensation.

In communicating internally and externally, Barclays should be as open and transparent as possible, aspiring to provide relevant, clear and meaningful information.

3: Customers

In pursuit of its goal of being a leader among its peer institutions, Barclays should develop an understanding across its businesses of how to meet its customers' needs and expectations while also meeting its own commercial objectives and those of its shareholders. It should seek to learn from customer feedback, and publish the measures by which it would judge performance in resolving complaints. Barclays should report periodically on progress against these measures by publishing the data both internally and externally so as to reinforce the seriousness Barclays places on continuous improvement.

4: Bringing the values to life

Barclays should institute learning programmes which actively encourage frequent discussion of its chosen values among all staff, focusing on understanding potential conflicts and how to address them. These discussions should be tailored so as to be relevant to the work of individual staff members. To make Barclays' commitment tangible to staff, senior management should lead and attend as many of these sessions as is practical.

5: Monitoring progress

Barclays should set clear targets against which to assess progress on embedding the values necessary to build a strong ethical culture. Progress against these targets should be measured through employee, customer and other stakeholder surveys and should be reported regularly to the Group Executive Committee (ExCo) and Board for discussion. Barclays should also communicate its progress more broadly as part of its commitment to greater openness and to support its efforts to rebuild public trust.

6: Code of conduct

Barclays should maintain and publish a global code of conduct, based on the bank's statement of purpose and values, outlining the high standards of conduct expected of all employees. This code should be regularly updated and provide clear guidance to employees about how the bank's standards can be applied on a day-to-day basis. Employees should attest to their compliance with this code annually.

7: Board experience

Barclays should include among its Non-Executive Directors a sufficient number with directly relevant banking expertise. This will help the Board to challenge effectively the performance of management, to satisfy itself that risk management systems are robust, and to test business practices. It is essential that the Board includes appropriate diversity of experience, without causing it to be excessively large.

8: Non-Executive Directors

Barclays should regularly consider the time commitments realistically expected for Non-Executive Directors, especially Chairmen of Board committees, and reflect its conclusions in its updated Charters of Expectations and in the Non-Executives' letters of appointment.

Barclays should maintain and put into action a plan for Non-Executive Directors over a period of time to engage with each major business and geography, including occasional attendance at appropriate business committees. This should be supplemented with detailed sessions on particular specialist topics.

9: Board information

Barclays should define options and implement arrangements to improve the quality, timeliness and level of detail of its Board information and allow flexibility to meet the demands of individual Board members.

Board papers should be prepared specifically for the Board and include analysis and insight to help guide debate.

10: Cohesive executive team

The Group Chief Executive should be responsible for building a cohesive senior executive team which actively contributes to decision making through open debate and challenge. This should be reflected in his performance reviews and in the performance reviews of the senior executive team. The Board should regularly review the effectiveness of the senior executive team.

11: Group Chief Executive succession

The Board should agree periodically the criteria and personal characteristics required for the role of Group Chief Executive as part of its succession planning. The framework for succession planning should include the long-term development of future leaders, Board exposure to potential internal candidates, thorough consideration of external candidates and assessment of alignment with Barclays' culture and values.

12: Board coordination

The Board should ensure that there is effective coordination and collaboration between it and its principal Board committees, and between it and the subsidiary boards of those of its major Group businesses which are subject to their own regulatory requirements. In particular, it should consider holding joint meetings of Board committees.

13: Board Committee for conduct, reputational and operational risk

The Board should make clear which committees have primary oversight of conduct, reputational and operational risks across the Group. The terms of reference should make clear where the primary responsibilities lie for different aspects of operational risk, and where oversight of all financial and non-financial risks comes together.

The terms of reference of these committees should also require a timely review of significant internal incidents, as well as of industry developments with high potential to impact Barclays' reputation.

14: Board effectiveness

The Board must be actively engaged in the process of improving its own effectiveness, including through regular and rigorous evaluations. The Board should report openly on the evaluation process, set forward-looking objectives for improvement and explain progress against these objectives.

15: Shareholder interaction

The Board should design, adopt and publish from time to time a communications policy for promoting effective and open communication with shareholders and encouraging their participation in general meetings. In its shareholder reports, Barclays should provide complete, relevant, balanced, accessible and understandable information about the Group, its performance, risks and prospects, with an emphasis on the quality and candour of information rather than its quantity. In particular, its annual report should include not only information as to its financial performance but also a prominent report on the successes and challenges in fulfilling its stated purpose.

16: Strengthening Human Resources

To support a strong and effective HR function, the Group Head of HR should normally sit on the Group Executive Committee. This will make it easier for HR both to provide necessary challenge to business leadership and to encourage prioritisation of consistent Group-wide approaches to the Group's people and their development. The Board should also consider making the appointment and removal of the Group Head of HR subject to approval of the Board Corporate Governance and Nominations Committee or another major Board committee.

17: Employee engagement

Barclays should maintain a clear policy statement as to how it fulfils its purpose with respect to its employees. This should include the emphasis it places on training and personal development, promoting an environment of continuous learning, and non-financial forms of recognition for performance.

18: Improving the performance management process

To ensure a strong and consistent relationship between performance management and key HR decisions such as pay, promotion and personal development, Barclays should ensure these decisions are based on transparent and measurable objectives, clearly linked to its purpose and values. Barclays should provide guidance to managers on how best to give feedback based on applying common standards across the Group. Managers should be trained to deliver clear and honest messages during individual performance evaluations, as well as during promotion and compensation discussions. This should also form part of the manager's own evaluation.

Barclays should require regular internal assurance of the effectiveness of performance management outcomes.

19: Recruiting and induction

In all recruiting, but particularly for senior managers, Barclays should look beyond a candidate's financial performance, and include a rigorous assessment of their fit with Barclays' values and culture. Barclays should supplement this with induction programmes that reinforce the values and standards to which the bank is committed.

20: Developing Barclays' future leaders

Barclays should clearly identify its pool of current and potential leaders and strengthen the leadership development programmes in which they participate. These programmes should be Group-wide and embrace all business units and functions, aiding current and future leaders to develop well-balanced skills. To strengthen the role leadership development plays in creating a cohesive Group, Barclays should carefully manage mobility across divisions, functions and geographies, investing in programmes to develop well-rounded future leaders through structured rotations across the Group.

Leadership promotion should include direct evidence of adherence to the values and standards and the encouragement of others to live them.

21: Pay principles

The Board, aware of the reputational and behavioural implications of pay, should align pay to levels that reasonably reflect individual talent and the contributions that individuals make, aiming to link pay to the long-term success of the institution.

Approaches to pay across the bank should be based on common underlying principles and be aligned with both the Group's values and the level of risk to which it is exposed. Individual pay should systematically reflect individual adherence to values and standards.

Barclays' approach to reward should be much more broadly based than pay, recognising the role of non-financial incentives wherever possible.

22: Retail incentives

Barclays should avoid retail sales incentives which may encourage behaviours that conflict with meeting customer needs. It should ensure that indirect sales-based targets (such as internal league tables) do not take the place of sales incentives in such a way as to encourage prioritising sales over customer needs. Retail incentives should, where practicable, be based on a balanced scorecard covering overall behaviours as well as customer satisfaction.

23: Discretionary pay

The size of the variable pool should aim to reflect, so far as practicable, the full range of risks. Significant bonuses should only be paid in the case of strong performance across all dimensions of a balanced scorecard which appropriately weights risk, values, and other non-financial elements.

Barclays should aim to be transparent as to its discretionary bonus process, including how bonuses correlate with performance ratings based on the balanced scorecard.

Barclays should combine bonus deferrals and malus adjustments to align reward with risk and prudent behaviour. It should apply malus consistently and systematically – while reinforcing efforts to get bonus decisions right first time.

24: Long-term awards

Long-term award structures should be simple and transparent, reflect financial performance adjusted for risk, be linked to Group not individual business unit performance, and apply to a small group of the most senior executives. The Remuneration Committee should give careful consideration to 'value at award' to ensure that it does not distort pay awards and disclosures. The Board should agree and apply principles for making adjustments for circumstances not anticipated at award.

25: Control functions' incentives

The design of incentive schemes for the control functions should avoid potential conflicts of interest, such as an interest in business unit profitability; this may require a higher proportion of fixed remuneration. Barclays should develop specific performance measures related to successful achievement of the control functions' objectives and these should form a significant element of any incentive arrangements.

26: Control functions' review of compensation

Barclays should ensure that all its control functions have meaningful and direct input into compensation decisions, making this input available to the relevant Board committees.

27: Board's role in compensation oversight

Barclays Remuneration Committee should establish, and the Board validate, clear remuneration principles and a robust framework to assess the impact of pay arrangements on culture and all elements of risk management. These should be reviewed regularly. From time to time, the Remuneration Committee should require internal assurance of the remuneration process, including the implementation of the remuneration principles.

The Committee's terms of reference should require it to be satisfied that there have been rigorous reviews of remuneration proposals relating to high earners. Barclays should have a bias towards open disclosure of the most important characteristics of its compensation system design and application.

The Remuneration Committee should work closely with other Board Risk Committees and also take advice from its own compensation advisers who should be appropriately independent of management.

28: Risk culture and control framework

To develop a consistently strong risk culture, Barclays should communicate clear statements as to its Group risk appetite for all types of risk; embed adherence to Group risk appetite into all business units; reinforce limits with strong management action for breaches; and embed risk and compliance criteria in performance evaluations, and in remuneration and promotion decisions.

Barclays should review its control framework and ensure that it covers all risk types and clearly articulates roles and responsibilities across the three lines of defence. The business (front-office) responsibility for risk should be reinforced. Barclays should endeavour to embed the framework consistently in all its businesses.

29: Conduct, reputational and operational risk

Barclays should ensure its conduct, reputational and operational risk framework includes the articulation of a tangible risk appetite statement and mechanisms to ensure that conduct, reputational and operational risk are fully factored into business decisions and governance.

30: Issue escalation

Barclays should foster a culture where employees feel that escalating issues is safe and valued.

Barclays should maintain robust arrangements for raising concerns (“whistle-blowing”) which are perceived to protect those raising them and to lead to actions being taken to address the underlying culture and values issues. There should be regular reports to the Board which are detailed enough for the Board to form insights as to the culture and behaviours within the organisation.

31: Learning from mistakes

Barclays should maintain effective processes for learning from its mistakes. It should endeavour to understand and address underlying root causes of issues so as to be able to apply lessons learned more broadly. Investigations should be carried out following a consistent Group-wide methodology.

32: Control functions' independence and influence

To improve the independence, capability and business engagement of control functions in overseeing all risk types, Barclays should promote the authority and influence of the control functions, including Risk, Compliance, Legal, Finance and, in this regard, HR with the primary reporting lines to the Group-level functions.

Barclays should ensure it constantly reinforces the compliance culture throughout the bank and should consider making the appointment and removal of the Group Head of Compliance subject to approval of the most appropriate Board committee.

33: Internal Audit

Barclays' Internal Audit should ensure the effectiveness of its audits in each of the businesses to identify control issues, prioritising high-risk entities. This will be aided by developing specialist internal audit teams able to deal effectively with the bank's more complex business units.

The Internal Audit Charter should be updated and periodically reviewed to ensure that it covers all aspects of governance, control and risk culture, as the business and external environment evolves.

34: Implementation

Barclays should publish the steps it intends to take to implement the recommendations in this Review and publicly report progress on implementation at regular intervals, with such internal and external assurance as the Board considers appropriate.

3. The Importance of Banks and the Roots of a Crisis

- 3.1 Banks play a vital role in modern economies. They provide payment systems which allow money to be transferred between people, businesses and other organisations without having to be physically moved. They make possible the transactions involved in commerce, trade and investment, allowing strangers to do business with each other even if far apart geographically. They ensure that savings can be used for productive activity, rather than remaining under the mattress or stored up in valuable but unproductive objects. And they help in ensuring that risks of economic activity are borne by those better equipped to bear them. In fulfilling such functions, they lower the costs of everyday products and services to the benefit of households and businesses, and encourage economic growth and development.
- 3.2 The importance of banks is reflected in the range of the customers they serve, from the general public and small businesses to sophisticated corporations and investors. Their services are essential in the operations of the markets that raise capital for long-term purposes, organise foreign exchange and provide sophisticated financial products that help consumers and businesses plan for the future. And they undertake tasks on behalf of regulators and governments, including making markets in government debt, supporting enforcement of sanctions by freezing accounts or blocking payments, performing money laundering checks and submitting information for the management of the economy.
- 3.3 In considering the role banks play in society and some of the specific instances of alleged mis-selling, we noted that various surveys (see Exhibit 1) have shown that quite large numbers of people have a tenuous understanding of their own finances and are not well prepared for making good choices of banking products.⁸ The UK Government has launched several initiatives to improve financial capability with so far disappointing results. This is important context when considering how far the principle of caveat emptor should apply to the consumer market or whether there should be some fiduciary obligation on banks to offer suitable products.

Exhibit 1. Financial Literacy in the UK

In March 2006, the Financial Services Authority (FSA) surveyed more than 5,300 individuals in order to create a comprehensive picture of UK residents' financial capability.⁹

Among other things, the FSA assessed whether UK customers possessed and understood enough information before buying financial products. It concluded that relatively few people demonstrated behaviours that would be considered financially capable – such as never running out of money at the end of the month, or keeping up with their financial commitments. Even among those who had bought financial products, approximately one third were clearly not very capable of choosing them. The under-30s and over-70s were highlighted as the most vulnerable groups.

⁸ FSA, *Financial Capability in the UK: Establishing a Baseline*, March 2006; Scottish Widows, *Scottish Widows UK Protection Report 2012*, 2012.

⁹ FSA, *Financial Capability in the UK: Establishing a Baseline*, March 2006.

The survey identified several concerns, including:

- *Poor product selection:* Customers who had bought financial products over the previous five years had largely relied on product information and/or advice from friends (42% of respondents). Only 21% had conducted an active search for the best buy or consulted an appropriate professional adviser. Overall, the FSA estimated that more than four million people had bought their most complex financial product without considering any other option at all;
- *Lack of awareness of risks:* Only 40% of equity ISA owners were aware that the cash value of their investment was directly affected by stock market performance, while 15% of cash ISA owners wrongly thought it was;
- *Weak financial 'literacy':* 7% of current account users were unable to read the final balance from a bank statement, while 49% of people with savings accounts could not estimate the current interest rate level;
- *Failure to plan ahead:* for retirement, an unexpected expense or a drop in income.

In July 2012 a Scottish Widows survey showed that 59% of households could only survive for up to six months if they lost their main income.¹⁰ And a 2012 Panelbase survey¹¹ found that 43% of seven-to-sixteen-year-olds worried about money and 12% had borrowed money they could not afford to repay.

To deal with the issue of financial illiteracy, the Government announced the creation of the Simple Financial Products Steering Group in October 2011, whose goal is to create a suite of simply designed financial products that would meet consumers' basic needs.¹²

This Group pointed out that given the volatile nature of the global economy, the sharp drop in household incomes for 2010-11 and uncertain employment patterns, "having financial provision and protection for today's needs and the unexpected, is even more of a necessity." They identified three main areas of change:

- Simple Financial Products need to be clearly identifiable with an easily recognisable badge;
- The language in product literature needs to be significantly simplified and standardised;
- Complicated products have a role to play, but there should also be a suite of Simple Financial Products that are low maintenance and designed to meet essential basic needs and no more.¹³

In February 2013, the Department for Education proposed that financial education become compulsory in school curricula from September 2014. Separately, Barclays runs a number of programmes designed to strengthen financial capability, with approximately 745,000 people reached through this work in 2011. One such programme is Barclays Money Skills which helps vulnerable people in the UK build their financial skills, knowledge and confidence.¹⁴

¹⁰ Scottish Widows, *Scottish Widows UK Protection Report 2012*, 2012.

¹¹ Conducted by the Personal Finance Education Group (pfeg) and the National Children's Bureau, 11 September 2012.

¹² HM Treasury, *Sergeant Review Interim Report*, July 2012.

¹³ HM Treasury, *Sergeant Review of Simple Financial Products: Final Report*, March 2013.

¹⁴ Barclays, *2011 Citizenship Report*, 26 April 2012.

- 3.4 The special role banks play in our society is reinforced by both the explicit and implicit support they receive from government. This means that it is incumbent on them to worry about public legitimacy. Their leaders face two particular challenges: money is fundamentally important to our way of life; and banks must provide services which often have long-term consequences for customers (such as mortgages or protection products). Consumer groups in particular would prefer to see banks take on an advisory and (probably) a fiduciary role, with a duty to help customers understand how they can increase wealth and achieve their long-term dreams – while also protecting us from the risk of losing what we have. Yet in most instances banks operate as principals rather than advisers and exist as commercial organisations to deliver value to shareholders.

Industry observation A: Caveat emptor and regulatory intervention

There is a difficult balance between responsibilities for the sale of financial products resting with customers and with banks, and as regards the extent of regulatory intervention. The new powers for the Financial Conduct Authority (FCA) to intervene in relation to financial products, including to ban specific products, are intended to avoid a repeat of the mass mis-selling scandals of recent years and, as such, are a positive development. However, if used inappropriately, this approach risks removing responsibility altogether from consumers for their own financial decisions. Ultimately, the need for the regulator to invoke these powers may in part depend on levels of consumer financial capability as well as on product design and sales processes. However, if the balance of risks and responsibilities between banks and consumers is not clearly set out by regulators, there is further potential for consumers to fail to understand their own responsibilities for their financial decisions. Clarity on the respective responsibilities of all parties to financial transactions would help reduce misunderstandings and future conflict. We would suggest that this is one of the early priorities of the new FCA.

- 3.5 The financial services industry is clearly important to the UK economy. In 2011, it represented 10% of GDP compared to 8% in the US, 5% in both Japan and France, and 4% in Germany.¹⁵ It employed one million people in the UK, of which UK banks themselves directly employed more than 400,000.¹⁶ And in the 2011-12 tax year, the financial services sector provided 12% of total UK tax receipts.¹⁷
- 3.6 The public debate has swung markedly towards sharp criticism of banks as institutions. Certainly, some bankers behaved inappropriately or exercised poor judgment. However, banks as institutions are essential to the smooth running of our economy and as an aid to our economic prosperity, and we should distinguish the importance of the institutions from the behaviours of some individuals. Part of the issue is that the public has little sympathy with some of the cultural shortcomings which they believe led banks to present significant systemic risks. Rightly so.

¹⁵ TheCityUK, *Key Facts About UK Financial and Professional Services*, January 2013.

¹⁶ TheCityUK, *Key Facts About UK Financial and Professional Services*, January 2013; and the Independent Commission on Banking, *Interim Report*, April 2011.

¹⁷ TheCityUK, *Key Facts About UK Financial and Professional Services*, January 2013.

We believe that banks were not alone in experiencing such shortcomings but, in their case, the examples were sometimes extreme and caused significant adverse effects economically.

Legal and Regulatory Requirements

- 3.7 Given the special position banks have in society and the potential risks they represent should things go wrong, politicians, regulators and central banks have developed a series of legal and regulatory requirements. Some of these are to help minimise the economic risks to financial stability that banks inherently pose. Bank capital, liquidity, and leverage levels are closely monitored. Banks are also subject to extensive reporting, governance and financial and market conduct rules. These rules impose obligations around standards, treatment of customers, and the suitability of products and sales processes. Collectively, they create significant complexity and cost for banks.
- 3.8 The approach to financial regulation changes from time to time. For example, deregulation in the UK in October 1986, through what was known as Big Bang, allowed the banks (including retail banks) to increase their securities market activities by taking on securities broking and market-making activities. Now there are proposals to change this. Investment banking activities are considered too risky not to be separated to some degree from retail activities. This is the case even though in the UK the banking problems from 2007 onwards started with Northern Rock, and later affected HBOS and Bradford & Bingley, none of which had investment banking activities. However, the Government has had to guarantee the deposits of customers and bail out some of the biggest banks because of systemic implications if they failed. The implicit guarantee for banks regarded as 'too big to fail' is argued to have made some banks insensitive to the risks they were taking on.
- 3.9 The Independent Commission on Banking has proposed that a bank's retail activities be ring-fenced from other bank activities, and the Treasury (in response to the Parliamentary Commission on Banking Standards) is considering 'electrifying'¹⁸ that ring fence with the threat of full separation for banks which attempt to breach it. In the US the repeal of part of the US Glass-Steagall Act in 1999 allowed the integration of investment and retail banks. This deregulation is now being revised by enormously complicated rules under the US Dodd-Frank Act. This includes the 'Volcker Rule', prohibiting banks from, among other things, engaging in proprietary trading.

¹⁸ The Financial Services (Banking Reform) Bill 2012-13 was proposed to give effect to the recommendations of the Independent Commission on Banking (ICB) chaired by Sir John Vickers. The bill proposed ring-fencing the 'core' retail activities of large universal banks in order to protect depositors and ensure business continuity. The Parliamentary Commission on Banking Standards was charged with reviewing the legislation, and welcomed the creation of a ring-fence. However, it went a step further and recommended the ring-fence be 'electrified' in order to be effective. The proposed electrification would give regulators the ability to force the total separation of a bank's retail and investment banking businesses, if the ring-fence were tested too vigorously. On 4 February 2013, the same day the bill was formally introduced in Parliament, Chancellor George Osborne publicly announced his support for an electrified ring-fence.

- 3.10 Internationally, the Basel Committee on Banking Supervision agreed new regulatory standards on bank capital in 2010 and 2011 (Basel III).¹⁹ There have also been reviews of banks' corporate governance, including by the Organisation for Economic Cooperation and Development, the Financial Stability Board, the Basel Committee, the Group of Thirty and – for the UK Government – Sir David Walker. Most recently, the European Parliament has proposed capping bankers' bonuses to 100% of annual salary or 200% if shareholders agree. This may result in upward pressure on fixed pay levels (which would make it harder for banks to reduce costs when business experiences a downturn). And there are many more new rules and regulations, in each case as a response to the perceived causes of past problems. While these should reduce the systemic risks, we all know it will not eliminate financial crises from history. The next one will reflect different issues.
- 3.11 The UK Government's reform of regulation includes the creation of a Financial Policy Committee at the Bank of England, the Prudential Regulation Authority (PRA) and the Financial Conduct Authority (FCA). The PRA stated in October 2012 that its "goal is to ensure that the public can put their trust in a stable and safe financial system".²⁰ In the context of our Review, we note that in its first business plan, published on 25 March 2013, the FCA stated: "Our job is to require, through regulation, that such a change takes place in the culture of financial firms so they learn the lessons from the past to prevent errors being repeated. We will do this by creating an environment supportive of good conduct but where the incentives and opportunities for bad behaviour are low and the potential costs are high."²¹
- 3.12 Alongside these and other regulatory responses to the financial crisis, there is increasing rigour of oversight, an increased range of potential breaches of rules and increased costs of compliance.
- 3.13 Universal banks are complex organisations. With so much regulation and focus on controls and compliance, they become even more so. For example, Barclays had approximately 1,500 Compliance staff in 2012, up from 600 in 2008.²² And regulators have also increased their resources, reflecting criticisms of their role in the crisis.
- 3.14 Some argue that the significant increase in the volume of regulation carries with it a potential danger. There is a risk that bankers, and others, in following a large number of detailed rules, may lose the ability to make good judgments to fit circumstances not specifically covered by rules. Absence of rules may suggest that it is permissible to proceed. Given the impossibility of anticipating every eventuality, this could serve to increase both risk and undesirable behaviours. It is a theme of this Review that rules need to be supplemented by a clear set of values that are understood through discussion and application, and that develop into a culture which tends to ensure good rather than bad behaviours.

¹⁹ See Appendix H.

²⁰ Bank of England, *Prudential Regulation Authority's Approach to Banking Supervision*, October 2012.

²¹ Financial Conduct Authority, *Business Plan 2013/14*, 25 March 2013.

²² Source: Barclays internal data.

The Roots of the Crisis Facing Banks

- 3.15 Although many will see the context for this Review as being the events since the beginning of the financial crisis, as well as the period leading up to it, the cultural challenges faced by banks today have their roots spreading back well over 20 years and can be linked, from a UK perspective, to the 'Big Bang' deregulation of the financial services industry in 1986. Deregulation was a catalyst for growth in the financial services sector and attracted significant investment from foreign financial institutions to the City of London. It broke down the barriers between different types of financial institution, bringing together large listed companies with smaller specialised businesses to create 'one-stop shops' for financial services. It brought to the UK the customs, skills and energies of Wall Street. Many of the smaller firms swept up in this process of consolidation had previously been run as partnerships. Their leaders tended to exhibit a sense of ownership natural to their positions as owners. And their liability for losses tended to make them sensitive to risk. Today some argue that the sense of ownership has remained for senior executives of banks without the same sharing of risk.
- 3.16 For 20 years across much of the Western world, the combination of deregulation, massive increases in liquidity and shrinking interest rates drove a search for higher yield – which came at the cost of higher risk. Leverage ratios increased while lending standards decreased. Simultaneous changes in accounting rules did little to cool things down.²³ And the use of derivatives expanded rapidly.²⁴
- 3.17 As asset prices rose, the banks came under pressure from shareholders and analysts to maximise returns and to make efficient use of their balance sheets. This was far from just a UK phenomenon in an increasingly globalised world. It was conveniently summed up by Chuck Prince, Chairman and Chief Executive of Citigroup in his now famous comment: "When the music stops, in terms of liquidity, things will be complicated. But as long as the music is playing, you've got to get up and dance. We're still dancing."²⁵ That was in July 2007. Things quickly unravelled once confidence in the markets faltered when assumptions about continuing house price growth proved wrong. As banks realised that the vast quantities of sophisticated investments they had created were not worth anything like their face value, they lost confidence in the creditworthiness of other banks with the result that they were reluctant to do business with one another. In terms of liquidity, the music was stopping.
- 3.18 Across Europe and the US, some banks – large and small – failed while others needed considerable support to continue operating. Many of the banks which experienced the greatest difficulties seem to us to have suffered from a combination of control and risk management failures, exacerbated by cultures favouring aggressive growth, and often compounded by governance weaknesses. Underpinning these

²³ The changes permitted, or even required, 'fair values' to be used to value assets and prohibited loan-loss provisions, unless the losses had been incurred.

²⁴ The Bank for International Settlements (BIS) reported that use of over-the-counter (OTC) derivatives grew 32% per annum over the three years from 2004 to 2007; see: BIS, *Triennial and regular OTC Derivatives Market Statistics*, November 2010.

²⁵ Financial Times, "Citigroup Chief stays bullish on buy-outs", 9 July 2007.

failings was a hubris born of (as it turned out) misplaced confidence that financial markets had irreversibly changed in ways that somehow made banks and economies more robust.

- 3.19 In the UK, it was Northern Rock, the former building society, that was first hit by a wider crisis of confidence that led to the country's first bank run in 140 years.²⁶ Initially supported with government funding, it was nationalised in 2008. Lloyds TSB's acquisition of HBOS was announced in September 2008 following funding problems at HBOS, with the new combination titled Lloyds Banking Group (LBG). RBS and LBG received Government equity support and were partially nationalised in October 2008. Barclays was determined to maintain its independence and so avoided taking any direct government investment. HSBC and Standard Chartered were apparently less badly impacted by the crisis.

- 3.20 While many must share responsibility for the financial crisis, the banks have attracted a significant share of the blame. The poor public perception of banks is unsurprising given the attacks from politicians. In February 2013, George Osborne, Chancellor of the Exchequer, said in relation to the crisis: "Irresponsible behaviour was rewarded, failure was bailed out, and the innocent – people who have nothing whatsoever to do with the banks – suffered."²⁷ In June 2012, Alistair Darling, his predecessor as Chancellor, said in relation to the involvement of Barclays' traders in the LIBOR scandal: "Quite clearly, there was a culture here that tolerated – if it didn't encourage – this sort of behaviour."²⁸

- 3.21 With the first UK recession since 1991, criticism was often focused on pay. Despite the economic pain that was being suffered in many Western economies, politicians and the media focused attention on bankers' pay, asserting that they continued to be paid handsomely, largely avoiding the consequences of their actions.

- 3.22 The leaders of many financial services organisations accepted that their institutions needed to change, and that in prioritising the growth of their businesses they had lost sight of some of the values that were important to their purpose. However, there was no sense that the leaders of financial services institutions were acting with enough determination or urgency. Various press reports suggested that the banks did not really 'get it'.

- 3.23 For Barclays, it took a crisis for the problems to gain real urgency. The particular event that caused this crisis and led to this Review was the announcement in June 2012 of a settlement by Barclays with regulators that included fines of £290 million in relation to the alleged manipulation of LIBOR. Prior to this settlement, most people probably knew little about LIBOR. It caught the attention of the media, politicians and the public – and so became a real crisis – because of emails that were made public and seemed to confirm a pervasive, much-caricatured, unethical, greedy and selfish behaviour on the trading floors of investment banks. These were shocking exchanges. It was clear from the beginning that Barclays was not the only bank involved in attempted LIBOR manipulations. Indeed larger fines for RBS and

²⁶ The Economist, "The Bank that Failed", 20 September 2007.

²⁷ Rt Hon George Osborne MP, HM Treasury, *On the Reform of Banking*, 4 February 2013.

²⁸ Daily Telegraph, "Barclays culture 'encouraged' abuse, says Alistair Darling", 28 June 2012.

UBS have since been announced. Nevertheless, the announcement of Barclays' settlement resulted first in the resignation of Marcus Agius, and then led to the resignations of Bob Diamond and Jerry del Missier.

- 3.24 Many of the people to whom we spoke over the course of the Review saw the erosion of public support for banks as an industry-wide problem. However, the LIBOR settlement put Barclays in the spotlight and some of the issues we have considered are specific to Barclays and not industry issues. The extreme public and political reactions that followed LIBOR have presented Barclays with an opportunity to confront the change required to make a sustainable difference.
- 3.25 We welcome the programme upon which Antony Jenkins has embarked. The challenge for Barclays – as indeed for many other banks – is how to embed the positive changes internally which will take time, while convincing a sceptical public impatient to see tangible progress. It will also be difficult to persuade the public of change while a number of historical regulatory and legal issues are still being dealt with.

4. Barclays' Evolution

- 4.1 Barclays today is the second largest UK bank²⁹ and is classified by the Financial Stability Board as one of the 28 banks around the world which are so large that they are systemically important globally.³⁰ As we interviewed Barclays' current and former management and directors, we were struck by the number of references to the history of the bank and how, as Barclays grew away from its family origins, it failed to develop a strong culture that could have avoided some unacceptable business practices. In this section we outline how the bank has evolved, and its considerable growth in recent years.

Early Years

- 4.2 Barclays' roots lie in retail banking in London. Founded as goldsmith bankers in 1690 by John Freame, a Quaker, and Thomas Gould, it is said to have initially attracted deposits because of the Quaker reputation for integrity. In 1728, the bank moved into Lombard Street in the heart of the City of London where its head office remained and the sign of the 'black eagle' could be seen until the move to Canary Wharf in 2005. In 1736 James Barclay, the son-in-law of John Freame, became a partner.
- 4.3 In 1896, Barclays grew significantly through the amalgamation of 20 regional banks and became a joint stock bank under the single name. The combined bank listed on the London Stock Exchange in 1902, and by 1925 had become one of the UK's five largest banks.
- 4.4 Between 1925 and 1986, Barclays expanded in the UK and overseas – most notably through mergers with the National Bank of South Africa and the Colonial and Anglo-Egyptian Banks. In 1966 it launched Barclaycard, the UK's first credit card, and in 1985, followed Midland Bank in abolishing transaction charges, unless overdrawn, for retail customers ('free-if-in-credit banking'). In 1986, Barclays announced that it would sell its investment in South Africa following anti-apartheid protests.
- 4.5 As a bank originally dominated by family interests, Barclays had developed a culture in its early years that was described to us as reflecting its non-conformist origins, but also somewhat based on patronage rather than being meritocratic. However, it was a bank where people knew how and where decisions were made and on what basis – whether these were described as family values or simply how things had always been done. Most of the power resided in the regions. As the bank grew and the external environment changed, the family-based culture was eroded and something of a vacuum seems to have developed, with individual businesses developing their own ways of doing things. This transition may account for the lack of clearly defined and consistently communicated values.

²⁹ Measured by assets.

³⁰ Financial Stability Board, *Update of Group of Global Systemically Important Banks*, 1 November 2012.

Big Bang and the 1990s

- 4.6 By the time of Big Bang, Barclays had 110,000 employees³¹ and it sought to take advantage of the deregulation in wholesale markets. In 1986 it bought the stockbroker de Zoete & Bevan and stockjobber Wedd Durlacher to create Barclays de Zoete Wedd (BZW).
- 4.7 In common with other banks, Barclays incurred significant losses during the UK economic downturn of the early 1990s, setting aside more than £4 billion in retail and commercial credit losses in 1991 and 1992. Interviewees told us that Barclays learned major lessons from this period, resolving to build more robust credit risk systems. Andrew Buxton, a descendant of one of the bank's founders, became Group Chief Executive in April 1992, and Group Chief Executive and Chairman in 1993.
- 4.8 There followed a period of retrenchment until economic conditions improved from the mid-1990s. During 1994, Martin Taylor became Barclays' Group Chief Executive, bringing non-banking experience from the textile industry and a perspective which was described to us as that of an outsider. He was the first Group Chief Executive with no connections with the founding families of the bank.
- 4.9 In 1995, Barclays was one of the first banks to set up an internet website, a precursor to online banking. In that year, Barclays also created Barclays Global Investors (BGI) when it merged its BZW Investment Management unit with fund manager Wells Fargo Nikko Investment Advisors, purchased for approximately \$440 million. BGI, headquartered in San Francisco, was allowed to run as an autonomous, standalone division of Barclays.
- 4.10 Bob Diamond joined Barclays from Credit Suisse First Boston in 1996. A year later, after suffering continuing losses in BZW, the bank abandoned BZW's equities and M&A advisory businesses. The retained fixed income business was renamed Barclays Capital, and Bob Diamond was appointed its Chief Executive. Barclays Capital got off to an inauspicious start in 1998, incurring significant losses on Russian bonds and on its exposure to Long-Term Capital Management. There followed an internal debate on the bank's footprint in investment banking, not the first or last time this has been the subject of debate in Barclays.
- 4.11 Martin Taylor left in November 1998. After his intended successor withdrew for health reasons, the Chairman Sir Peter Middleton took over as interim Group Chief Executive. Matthew Barrett, an experienced banker having previously run a Canadian bank, was appointed Group Chief Executive in October 1999.

2000 to 2007

- 4.12 By 2000, Barclays was the fourth largest UK bank – behind Lloyds, RBS and HSBC – with 1,718 branches. In that year, the bank acquired the recently demutualised

³¹ Barclays, *1986 Annual Report*, March 1987, p. 34.

Woolwich for £5.4 billion, adding the 402 branches of the second largest UK building society.³²

- 4.13 In the same year, an equity-based ownership plan was introduced at BGI for key BGI employees. Some executives of Barclays Capital were also included in the scheme – including Bob Diamond after he was appointed Executive Chairman of BGI (while still Chief Executive of Barclays Capital). BGI subsequently grew dramatically, with profit before tax increasing from £59 million in 2000 to £734 million in 2007.
- 4.14 Barclays also returned to international expansion, including the acquisition in 2003 of Banco Zaragozano, a Spanish bank, for £800 million to combine with Barclays own operations there and create Spain's sixth largest commercial bank with 526 branches. We were told this was an attempt to create a second home market. And Barclays re-entered the South African market when in May 2005 it acquired a 54% majority stake in Absa for \$4.5 billion in order to expand in emerging markets.
- 4.15 Meanwhile, the investment bank, Barclays Capital, continued to grow in size, launching the 'Alpha Plan' in 2003, with the aim of closing the gap with key competitors and more than doubling revenues in four years. This was prepared in line with Group practice for all expenditure, whereby investments had to be self-financing. The investment bank's focus on fixed income was still narrow compared with many of its competitors. But it then developed its fixed income business into Euros and expanded into commodities and equity derivatives. Throughout this period, Structured Capital Markets (SCM), a tax-led transaction-structuring business, was a significant contributor to its profits, although little information about this business was given publicly.
- 4.16 In September 2004, Matthew Barrett replaced Sir Peter Middleton as Group Chairman and John Varley was appointed Group Chief Executive. John Varley was married to a descendant of a Quaker family whose bank became part of Barclays in 1902. He had joined Barclays in 1982 and had worked in various divisions: BZW, where he became Deputy Chief Executive of the equity division in 1991; the asset management division, as Chairman in 1995; and the retail bank where he was appointed Chief Executive in 1998. In June 1998, he had become Group Finance Director and joined the Board, rising to Deputy Group Chief Executive at the start of 2004 and Group Chief Executive in September of that year.
- 4.17 In August 2006, Matthew Barrett was succeeded as Chairman by Marcus Agius, a former advisory investment banker from Lazard. Marcus Agius and John Varley then led the bank through the financial crisis until Bob Diamond became Group Chief Executive on 1 January 2011. Prior to this, Bob Diamond, who had been a candidate for Group Chief Executive in 2004, had continued to oversee Barclays' investment banking operations, becoming President in June 2005 and taking on Group-wide roles for talent and brand from 2006.

³² BBC News, "Barclays buys rival Woolwich", 11 August 2000.

- 4.18 Frits Seegers, who had worked at Citigroup, was appointed in June 2006 to run Barclays Global Retail and Commercial Banking (GRCB) businesses. There followed international acquisitions by GRCB such as Expobank in Russia for £373 million and a small bank in Indonesia. This was accompanied by rapid organic growth plans for countries such as Pakistan and India, as well as parts of Africa, Spain and Portugal, as part of the bank's "stated strategy of increasing its exposure over time to emerging markets with good growth characteristics".³³
- 4.19 Building on John Varley's Top 5 ambition,³⁴ Barclays had for some time hoped to agree a merger with ABN AMRO, announcing a proposed deal in March 2007.³⁵ It withdrew in October that year in the face of determined competition from RBS.

2008 and the Global Financial Crisis Onwards

- 4.20 Following the onset of the global financial crisis, Barclays keenly avoided direct equity investment from the UK Government believing that maintaining its independence from Government was in the best interests of its shareholders. It also believed that independence would enable it to take advantage of opportunities that would arise in the crisis. With the challenges of falling asset prices and confidence, problems of market liquidity and regulatory concern over the size of capital cushions to cope with potential stress scenarios, retaining its independence required considerable ingenuity and single-mindedness.
- 4.21 During interviews we were told that at times the executive management and Board of Barclays felt under siege, not only from the volatile markets but also from its stakeholders. The FSA and the Treasury naturally questioned whether Barclays could continue to operate without Government help following the Government's rescue of RBS and subsequently LBG. In the markets there were questions over many banks' asset valuations and Barclays was subject to particular scrutiny.
- 4.22 Barclays first raised an additional £4.5 billion of capital in July 2008 (which we describe in more detail in Section 5). After the collapse of Lehman Brothers in September 2008, Barclays committed to obtain additional funds from private investors, and to sell BGI, a transaction subsequently completed with BlackRock for \$13.5 billion (£8.2 billion). At this point BGI had \$1.5 trillion in assets, and the deal generated a net gain for Barclays of \$8.8 billion. More than half the proceeds were in shares, giving Barclays 19.9% shares in BlackRock. This deal triggered the exercise of outstanding options in the BGI employee incentive plan.

³³ Barclays, "Barclays to acquire Russian bank Expobank", press release, 3 March 2008; see: <http://group.barclays.com/about-barclays/news/press-release-item/navigation-1329924296988?releaseID=1323>.

³⁴ See for example Barclays' *Equality and Diversity Review 2005*, which refers to "our ambition of becoming a top-five global bank", p. 3; available from Barclays.com at http://www.personal.barclays.co.uk/PFS/A/Content/Files/ED_review_FINAL_VERSION_OCT.pdf. In a message to Barclays staff, John Varley said: "You've heard me say before that I want Barclays to be a top five bank. I measure that not by stock market size but by capability. In other words, the test is: are we seen by our customers and clients as one of the best (i.e. Top 5) in each of the markets or segments or product areas in which we compete? The answer to that is yes."

³⁵ Barclays, "Barclays and ABN AMRO Announce Outline of Preliminary Discussions", press release, 20 March 2007.

- 4.23 Barclays passed the FSA's capital stress tests in March 2009, and declined both asset insurance from the Government through the Asset Protection Scheme³⁶ and Government equity capital funding. But, in common with other banks, it accessed the Bank of England's special liquidity scheme, the European Central Bank's funding facilities and those of certain other central banks, such as the Federal Reserve in the USA.
- 4.24 The crisis did indeed bring a unique opportunity to Barclays. The US Government, somewhat to the surprise of observers, decided not to support Lehman Brothers which therefore went into bankruptcy in September 2008.³⁷ Barclays had initially tried to acquire the whole of Lehman but was unable to agree on specific guarantees from the authorities. In late September 2008, however, Barclays acquired parts of Lehman,³⁸ providing the investment bank with a significant US business in M&A advisory and equities to add to its existing strengths in fixed income, currencies and commodities, and saving several thousand jobs.³⁹ Even before the Lehman acquisition, the investment bank had become the largest part of Barclays, accounting for 31% of Barclays' revenues in 2007.
- 4.25 While the focus in the crisis was primarily on the investment bank, Barclays experienced financial losses in GRCB in several countries where it had expanded. Of particular note was the Spanish business where low-cost Group funding had enabled the treasury operations in Spain to finance asset growth of 18% a year between 2003 and 2007. This was concentrated in property and construction, both hit badly in the financial crisis. Barclays eventually booked impairments of almost £900 million against its Spanish Corporate loan book in 2010 and £480 million in 2011.

Barclays Today

- 4.26 The growth in Barclays' operations and its many acquisitions have transformed the Group in size and scope over the last two decades. Between 1993 and 2012, Barclays' total revenues, excluding own credit,⁴⁰ grew at a compound annual growth rate (CAGR) of 8% from £7 billion to £29 billion.⁴¹ Up until 2005, Barclays' largest businesses were the UK Retail Bank and the Corporate Bank, but thereafter it was the investment bank, Barclays Capital, which contributed the highest share of income apart from during the crisis year of 2008.

³⁶ Asset Protection Scheme announced by HM Treasury in January 2009.

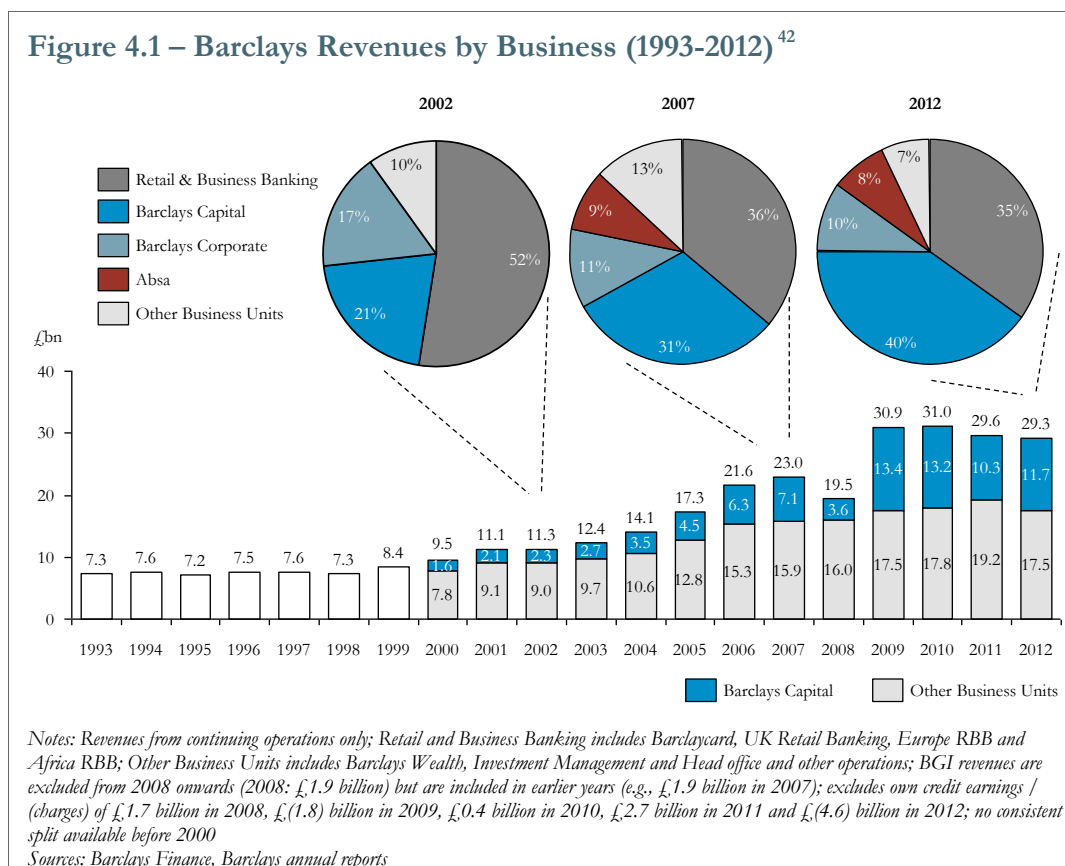
³⁷ On 15 September 2008, Lehman Brothers Holdings Inc. filed a petition in the US Bankruptcy Court in New York seeking relief under Chapter 11.

³⁸ On 17 September 2008, Barclays announced the intention to acquire trading assets with an estimated value of £40 billion and trading liabilities of £38 billion for a cash consideration of £0.14 billion; Barclays would also acquire the New York headquarters and two data centres. A revised version of the deal was approved on 20 September 2008 and the acquisition was completed on 22 September 2008.

³⁹ Source: Barclays HR.

⁴⁰ See Appendix H.

⁴¹ See Appendix H; According to Barclays' 2012 *Annual Report*: "The carrying amount of issued notes that are designated under the IAS 39 fair value option is adjusted to reflect the effect of changes in own credit spreads. The resulting gain or loss is recognised in the income statement [as own credit adjustments]. For funded instruments such as issued notes, mid-level credit spreads on Barclays issued bonds are the basis for this adjustment." If own credit is included, the CAGR is 7%.

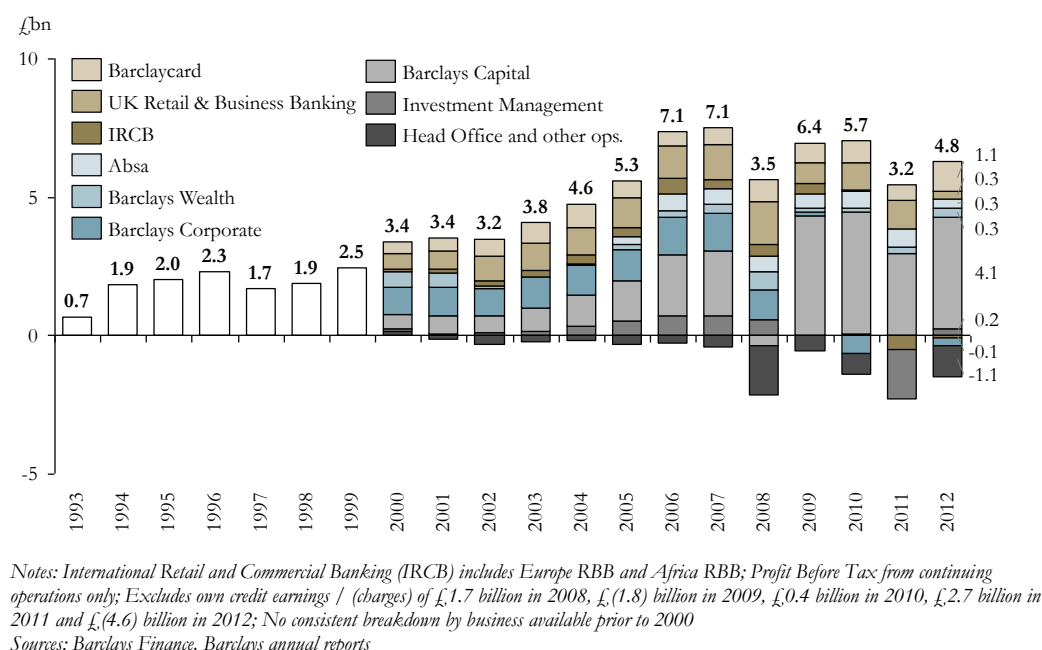


4.27 Between 1993 and 2012, Barclays' profits before tax excluding own credit grew at a CAGR of 11% although this reduces to 5% if the period starts in 1994.⁴³ However, profits fell back from their 2007 peak during the financial crisis: in 2008, for example, the Group experienced credit market losses and impairments of £8 billion, while Barclays Capital's income fell 27%. Despite this, and excluding any head-office charges and own credit, the contribution of Barclays Capital to Group profits before tax increased significantly from 15% in 2000, to over 75% in the period from 2009 to 2012, although this contribution is dependent on how capital and costs are allocated to business units (see Appendix H). It should also be pointed out that the overall and comparative results are materially impacted by the accounting treatment of own credit which reflects changes in the value of the bank's debt.

⁴² Excluding own credit.

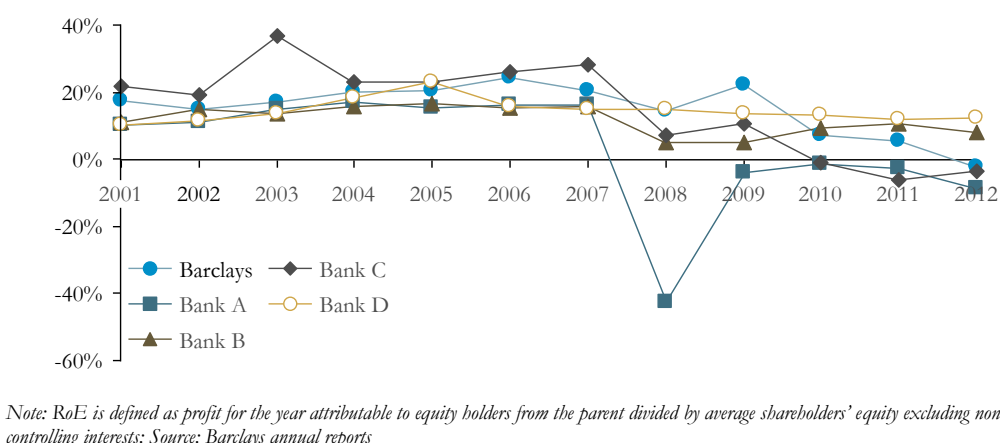
⁴³ See Appendix H.

Figure 4.2 – Barclays' Profit Before Tax by Business (1993-2012)⁴⁴



4.28 Over the 10-year period from 2002 to 2011, Barclays' statutory Return on Equity⁴⁵ was 15% on average, although it has been declining since 2009, becoming negative for the first time in 2012. Barclays has been disclosing an 'adjusted' post-tax return on equity since 2011, amounting to 6.8% in 2010, 6.6% in 2011 and 7.8% in 2012 (see Appendix H).⁴⁶

Figure 4.3 – Major UK Banks' Statutory Return on Equity (2001-2012)



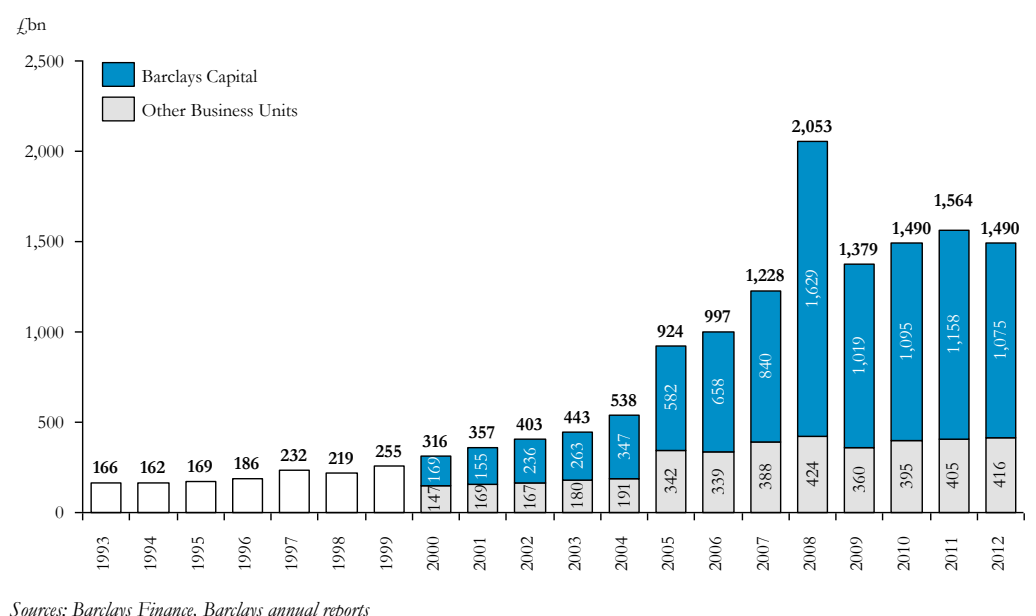
⁴⁴ Excluding own credit; See Appendix H for a breakdown of adjusted Profit Before Tax, which also excludes provisions for alleged PPI and interest swaps mis-selling.

⁴⁵ RoE is calculated as profit after tax attributable to equity holders in the parent divided by average shareholders' equity excluding non-controlling interests.

⁴⁶ Adjusted return on equity excludes the impact of own credit charge (£4,579 million in 2012), gain on disposal of strategic investment in Blackrock (£227 million in 2012), impairment of investment in BlackRock (nil in 2012), provision for PPI redress (£1,600 million in 2012), provision for interest rate hedging products redress (£850 million in 2012), goodwill impairment (nil in 2012), profit and loss on disposals of subsidiaries, associates and joint ventures (nil in 2012).

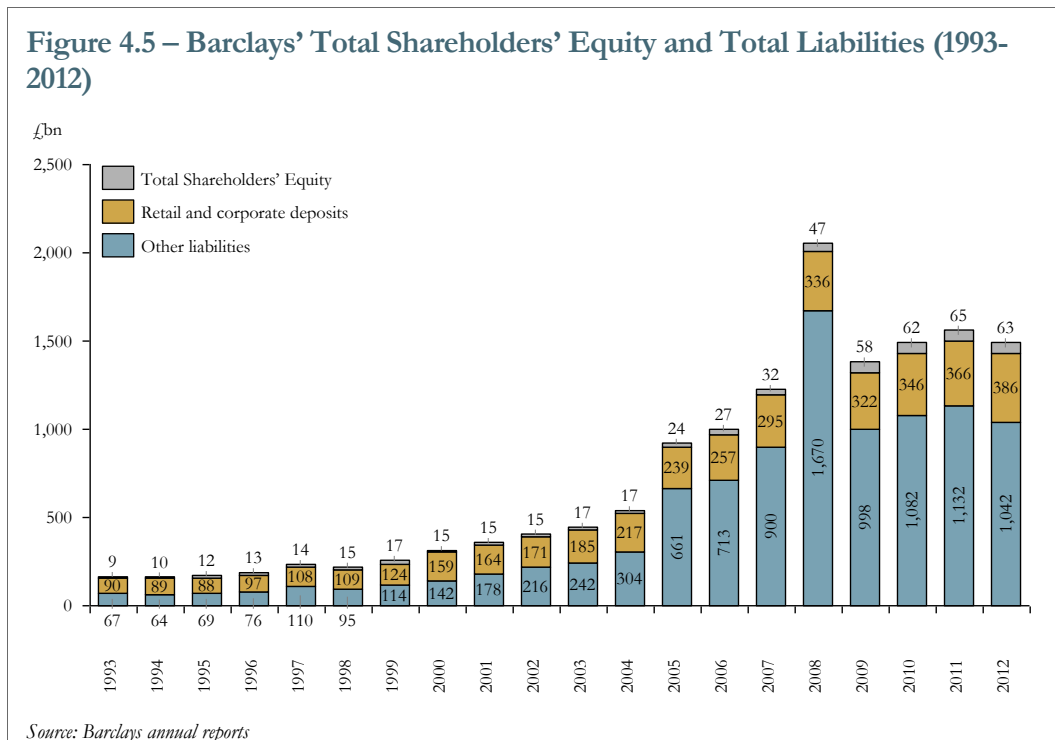
- 4.29 Barclays' assets have grown even faster than both revenues and profits at a CAGR of 12% between 1993 and 2012,⁴⁷ reaching more than £2 trillion in 2008 before falling to £1.5 trillion in 2012. The acquisition of a majority stake in Absa contributed to an increase of 80% in 2005. From 2008 onwards between 70% and 80% of Barclays' assets were in the investment bank.

Figure 4.4 – Barclays' Assets by Business (1993-2012)



- 4.30 Barclays' shareholder equity had been steadily rising between 1995 and 2007. Total shareholders' equity was £32 billion in 2007 immediately before the financial crisis; it increased to £58 billion by 2009 and was £63 billion at the end of 2012. The bank's regulatory capital has also increased (see Appendix H) with Barclays' Core Tier 1 ratio increasing from 4.7% in 2007 to 10.9% in 2012 and its Tier 1 ratio increasing from 7.6% to 13.3% (see Appendix H). Separately, although retail and corporate deposits (customer accounts) funding has increased in value from £159 billion in 2000 to £386 billion in 2012, its share of Barclays total funding dropped from 50% in 2000 to 26% in 2005 and has fluctuated between 16% and 26% since.

⁴⁷ The rate is 9% when adjusting for inflation.



- 4.31 The ratio of a bank's share price to its book value per share indicates the value shareholders ascribe to the bank compared to the value of its net assets. If the ratio is below one, shareholders are applying a discount. For Barclays, the ratio at the end of 2011, for example, was 0.33, which was lower than major international banks with similar business mixes.⁴⁸ At the end of 2012 this had improved to 0.51, reflecting recent improvements in the rating of Barclays.⁴⁹
- 4.32 The growth in Barclays' headcount, at a CAGR of 2% over 20 years, is significantly lower than the rate of growth in revenues, profits and assets. The distribution of staff is also different to the scale of the businesses, with a lower proportion in the investment bank (just under 20% of employees during 2012). In fact, employee numbers gradually reduced in the decade from 1993 to 2003 from 98,000 to 73,000 as automation and cost reduction programmes were implemented. Employee numbers then increased substantially in both 2005 and 2008 following the acquisitions of Absa and Lehman respectively. But headcount subsequently dropped, driven by the tougher economic environment. Employee numbers totalled almost 144,000 in 2012, of which 59,000 were in the UK, 11,000 in the US and 45,000 in Africa – i.e., 59% of employees are employed outside the UK (see Appendix G).
- 4.33 One consequence of the rapid growth and expansion into new activities has been the constantly changing shape of Barclays as a Group, which some interviewees suggested was often related to the dynamics of the senior team. Exhibit 2 illustrates the repeated reorganisation of the bank's structure accompanied by frequent changes

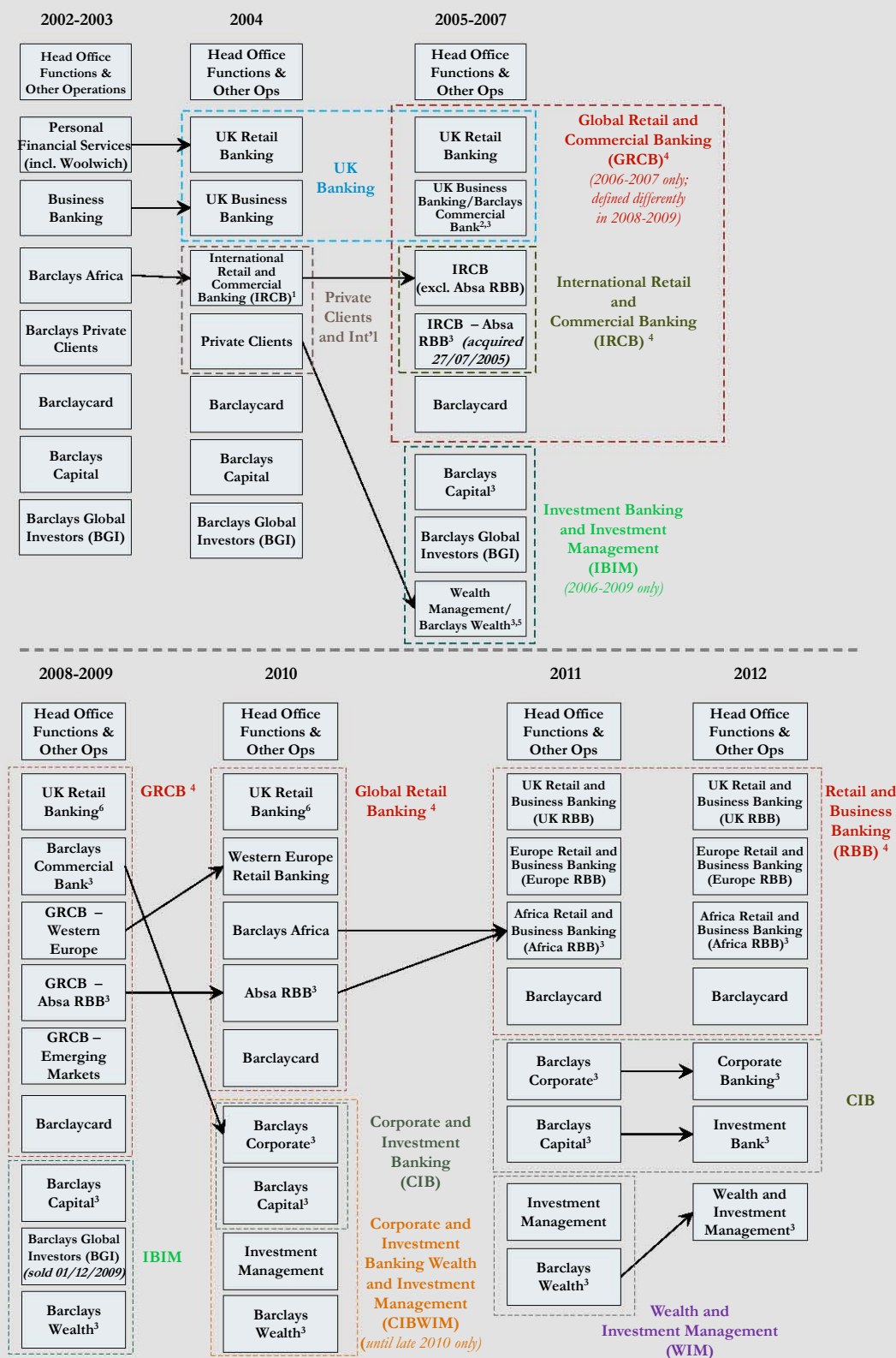
⁴⁸ For example, price-to-book ratio at the end of 2011 was 0.66 for Credit Suisse, 0.72 for UBS and 0.82 for HSBC.

⁴⁹ See Appendix I.

in the names and scope of the business units which have provided an additional challenge to management.⁵⁰ While most companies reorganise from time to time, it is inherently difficult to develop robust governance and control structures in organisations that undergo frequent structural change, as different operating models require different enablers (e.g., management information flows between Group Centre and business units), which require time to be put in place.

⁵⁰ Notes to Exhibit 2 (following page): This chart has been prepared by the Salz Review as an illustrative schematic view of the primary business units, it does not represent all the organisational units or reallocation of business unit between clusters; 1. IRCB in 2004 included Spain, Portugal, France, Italy, the Caribbean, Africa & the Middle East; 2. UK Business Banking in 2005-06; Barclays Commercial Bank in 2007; 3. Absa businesses besides Absa RBB (i.e., Absa Corporate, Absa Capital and Absa Wealth) had reporting lines separate from each of: Absa RBB (2005-07), GRCB Absa (2008-09), Absa (2010), and Africa RBB, (2011-12); each of Absa Corporate, Absa Capital and Absa Wealth had dual reporting lines; they reported into the CEO of Absa; additionally, Absa Corporate reported into UK Business Banking / Barclays Commercial Bank (2005-07), Barclays Commercial Bank (2008-09), Barclays Corporate (2010-11), and Corporate Banking (2012); Absa Capital also reported into Barclays Capital (2005-11), and Investment Bank (2012); Absa Wealth also reported into Wealth Management / Barclays Wealth (2005-07), Barclays Wealth (2008-11), and Wealth and Investment Management (2012); 4. Although not represented on the charts above, none of Absa Corporate, Absa Capital, nor Absa Wealth comprised part of any of International Retail and Commercial Bank (IRCB) (2005-07), Global Retail and Commercial Banking (GRCB) (2006-09), Global Retail Banking (2010), or Retail and Business Banking (2012); 5. Wealth Management in 2005; Barclays Wealth in 2006-07; 6. UK Retail Banking in 2008-10 includes Business Banking (i.e., SME banking).

Exhibit 2. Evolutions of Barclays' primary Business Units and Clusters



See footnote on previous page for detailed explanation
Sources: Barclays Annual Reports 2002-2011, Barclays Results Announcement 31 December 2012, and conversation with Barclays Strategy, 21 March 2013

5. The Struggle for Survival through the Financial Crisis

- 5.1 By autumn 2007, leverage had built up to dangerous levels in the financial system globally. Banks became reluctant to lend to each other and liquidity dried up, leading to sharp falls in the value of many types of assets. The financial crisis led to a collapse of consumer and business confidence and a recession. Regulators in the UK and elsewhere increased the capital and liquidity requirements for banks to take account of possible stress conditions and intensified their supervision.
- 5.2 The first sign of the financial crisis was the collapse of the US sub-prime mortgage market which left banks exposed to fast-growing losses on the complex securities created to finance such mortgages. It became difficult to value those illiquid assets which were held widely by many financial organisations, including the banks. This caused uncertainty around the recognition of losses, which would reduce capital – and with new capital hard to raise, the uncertainty caused them serious difficulties.
- 5.3 In the turmoil, intensity and unpredictability of the financial crisis, most banks – and Barclays was no exception – were struggling to survive. Barclays was determined to remain independent. Among other things, it believed that independence would allow it to take advantage of opportunities that would arise during the crisis – a belief justified by the September 2008 Lehman transaction.
- 5.4 Regulators took a close interest in the Barclays balance sheet because of the importance of the investment bank to its business. And Barclays was highly leveraged: its leverage at the end of 2008 was 43, higher than the other UK banks (RBS's leverage was 30 at the time), but lower than Deutsche Bank and UBS.⁵¹ As was the case with a number of banks, leverage levels were not immediately apparent from its published information because of complex, off-balance sheet securitisations and derivatives.
- 5.5 Following the collapse of Lehman Brothers, the UK government (and other governments around the world), in order to prevent a collapse of the financial system and with a view to restoring confidence, were anxious to support banks by providing sufficient capital to sustain their businesses through the crisis.
- 5.6 In October 2008 Barclays came under particular scrutiny. Around the time that Government support was given to RBS and LBG, Barclays had to convince the Treasury and regulators that it was strong enough to survive independently. It persuaded the authorities that it was, subject to a plan to improve its capital position. It also passed the regulatory stress tests in 2009 and 2011.

Illiquid Securities

- 5.7 Barclays' investment bank had expanded its US structured credit business quite rapidly before the crisis, most importantly through the acquisition of HomeEq

⁵¹ See Appendix I for UK banks' leverage evolution; care must be taken when comparing leverage ratios between financial institutions in different jurisdictions, as rules for netting assets and liabilities may differ.

Servicing and EquiFirst Corporation in 2006 and 2007 respectively, and subsequently had credit market exposure to US residential mortgages amounting to £15.3 billion at the end of 2007.⁵²

- 5.8 Barclays' impairment charges and other provisions increased substantially during the crisis, increasing over 336% from a total of £7.7 billion in the five-year period from 2002 to 2006, to £25.8 billion between 2007 and 2011 (including all credit losses across the Group). Barclays also disclosed in its annual reports the extent of its credit market exposures to illiquid securities, reporting £38 billion in 2007, rising to £42 billion in 2008 before being reduced to £9 billion in 2012. This exposure has consistently represented a small share of Barclays' total assets (under 2%) but the bank recorded impairment charges of £4.2 billion against these assets between 2007 and 2009.⁵³
- 5.9 There were, however, concerns in the market about the models banks were using to determine the carrying value of assets. In particular, questions were being asked about Barclays' valuation of its illiquid assets. Commentators were particularly concerned about the use of a variety of models which Barclays had developed to value these assets. In accordance with applicable accounting standards, those in the so-called 'banking book' being held to maturity were carried at cost less impairment. Those in the 'trading book' intended for sale were carried at fair value. There was great uncertainty about fair values given the scarcity of transactions at the time and fears that some of the securities were effectively worthless. The FSA some time later commented that it saw Barclays' valuations of some positions as "clearly at the aggressive end of the acceptable spectrum."⁵⁴
- 5.10 In January 2009, Barclays took the highly unusual step of issuing a public statement by the Group Chief Executive and Chairman announcing that it did not need to raise any further capital: "We have decided to communicate now with employees, customers, clients, and shareholders in this open letter in order to address the principal causes of concern which we are hearing. Writing in this way ahead of the release of results is unusual, of course, but the turn of events is also unusual. Our starting point is that Barclays has £36 billion of committed equity capital and reserves; we are well funded, and we are profitable."⁵⁵
- 5.11 During our interviews, we were repeatedly told by Barclays' management that the later realisation of credit market exposures at or above their valuations vindicated those valuations, even though they had been criticised at the time. We consider the intense focus on Barclays' valuation and accounting reflected not only attitudes resulting from the growth of its investment bank but also a view that Barclays was somehow failing to tell the whole story, an impression which management was unable to correct at the time.

⁵² Source: Barclays, 2007 Annual Report, March 2008, p. 67.

⁵³ Details of which are: £0.8 billion in 2007, £1.8 billion in 2008, and £1.7 billion in 2009; in addition, the bank made fair value write-downs in the same period of £12.9 billion: £2.2 billion in 2007, £6.3 billion in 2008 and £4.4 billion in 2009.

⁵⁴ Lord Turner, Chairman of the FSA, Letter to Marcus Agius dated 10 April 2012; see Appendix K.

⁵⁵ Open letter from Marcus Agius and John Varley, 26 January 2009; available on: <http://group.barclays.com/Satellite>.

Capital Raising

- 5.12 As the crisis continued, concerns over the solvency and liquidity of UK banks grew and Barclays committed to raise capital privately.⁵⁶ In July 2008, Barclays raised approximately £4.5 billion through the issue of 1,603 million shares. Existing shareholders were given the opportunity to subscribe for all but 169 million of the shares on a *pro rata* basis and subscribed to 19% of shares available to them. The remaining shares were allocated to investors, including Sumitomo Mitsui Banking Corporation, Qatar Investment Authority, Challenger, China Development Bank and Temasek.
- 5.13 On 17 September 2008, Barclays announced its agreement to purchase, subject to regulatory approval, the US investment-banking and trading divisions of Lehman Brothers that had filed for bankruptcy. This was closely followed, on 18 September 2008, with a successful placing of 226 million shares which raised approximately £700 million in order to give Barclays the capital necessary for the Lehman acquisition.
- 5.14 The financial crisis intensified in October 2008, leading the UK Government to inject £37 billion into RBS and LBG. Meanwhile, the Lehman acquisition in the previous month meant that scrutiny of the bank's capital levels remained high. Due to what were termed the "extraordinary market conditions", the government announced on 8 October 2008 that it "intended to ... make available new capital to UK banks and building societies" and the Bank of England would ensure the banking system had access to sufficient liquidity. On 13 October 2008 Barclays announced that: "... Barclays has been in detailed discussions with the UK FSA and HM Treasury. Given the strength of Barclays' well diversified business and the existing capital base, the Board expects that the additional capital will be raised from investors without calling on the Government funding which has been offered to UK banks. Accordingly, a plan has been agreed with and approved by the FSA In the event that any of the proposed capital issuances do not proceed, Barclays, along with the other UK banks, would be eligible to have access to the capital facilities announced by the UK Government on 8 October 2008. The UK Government has also confirmed that Barclays is eligible to use the extended facilities with the Bank of England and the UK Government guarantee of term unsecured issuance which have been made available to UK Banks."⁵⁷ This was an existential moment for Barclays. The Board decided that it was in the interests of shareholders not to take up the Government's offer of new capital, which would inevitably come with constraints relating to dividends, operational flexibility and executive compensation.
- 5.15 Our understanding is that Barclays agreed with the FSA to raise this additional capital by early the following summer, forego the 2008 final dividend, reduce costs and risk-weighted assets (RWAs), and raise funds by disposing of certain assets such as BGI. This series of actions at arguably the height of the crisis required rapid action by senior management.

⁵⁶ See Appendix H for information on capital ratios and requirements.

⁵⁷ See Barclays Form 6-K, SEC filing, 14 October 2008.

- 5.16 Barclays publicly explained on 13 October 2008 that it had identified the need “to raise new external capital as part of its overall plan to achieve the new higher capital targets set by the UK FSA for all UK banks”. John Varley stated that the “... capital raising provides certainty and speed of execution”.⁵⁸ Barclays therefore launched a further round of capital raising to ensure that it would remain independent. Approximately £7.1 billion was raised in October and November 2008 through the issue of £3 billion of warrants and an issue of £4.1 billion of mandatorily convertible notes. £1.25 billion of the mandatorily convertible notes were offered to existing and other institutional shareholders by way of a limited placing. The investors for this were Qatari interests, through Qatar Holding LLC and Challenger Universal Limited, together with the ruling family of Abu Dhabi. However, existing shareholders were not offered full pre-emption rights in this capital raising, which Barclays said would have required a period of market risk exposure of up to two months. The Board believed this represented “a risk that is unacceptable to shareholders at this time”.⁵⁹ In addition, Barclays said that “there was considerable uncertainty relating to the capacity of current shareholders to subscribe for the total amount of capital required”.⁶⁰
- 5.17 Barclays gave significant consideration to a rights issue or open offer (both of which provided pre-emption to existing shareholders). They considered neither to be viable given the need to raise capital quickly, the size of the capital raising, the uncertainty about take up by existing shareholders (informed by market testing) and the requirements of the new investors whose capital was judged necessary for certain minimum levels of investment. Barclays may not have fully anticipated the degree of shareholder concern for the structure, having had preliminary discussions with the Association of British Insurers (ABI) and the National Association of Pension Funds that did not indicate major concerns. In addition, Barclays may have considered that existing shareholders' concerns would be reduced by the tranche of Mandatorily Convertible Notes made available to them.
- 5.18 Nevertheless, the decision was poorly received by some shareholders, whose approval of the capital raising was required by a special resolution, given the size of the non-pre-emptive issue. The ABI gave the fundraising an ‘amber’ rating, which press reports at the time suggested was an indication of concerns over corporate governance and meant that shareholders should take their own decision on the vote to approve the capital raising. Research, Recommendations and Electronic Voting, a corporate governance advisory body, recommended that shareholders abstain from voting. Barclays offered various concessions to shareholders, including making £500 million of Reserve Capital Instruments available to existing institutional investors and promising to structure any new capital raisings for the following two years to give its then shareholders full rights of participation. The capital raising was approved by special resolution on 24 November 2008. Qatar Holding's stake in Barclays rose to 12.7% as a result of the capital raising, and it remains one of the bank's largest shareholders despite the sale of £1.37 billion of shares and warrants in

⁵⁸ Barclays, “Barclays Announces Capital Raising”, press release, 31 October 2008.

⁵⁹ *Ibid.*

⁶⁰ Barclays, “Chairman's Letter to Shareholders”, announcement, 7 November 2008.

October 2009 and a further sale of warrants worth around £750 million in November 2012.

- 5.19 While investors might have preferred to have had the opportunity to participate in a pre-emptive offer, we see no basis now to criticise the conclusion of Barclays' management and the Board that, with capital needed to be raised urgently and considerable uncertainty in the markets, a full pre-emptive offer carried a significant risk of failure which it was in the bank's interest to avoid. It is easy to forget the urgency when looking back now, but the October/November capital raising took place at a unique time of unpredictability and insecurity for the market and Barclays' ability to avoid a UK government equity investment was far from inevitable. The Board's doubts about the likely strength of support for a fully pre-emptive offer seem to us legitimate given the poor level of shareholder take-up of the open offer in July 2008 and of offerings of other banks around that time. However, given the level of investor dissatisfaction at the decision, there must be a question whether Barclays could have communicated more effectively with existing shareholders as to its rationale for the structure of the capital raising which it adopted. In the event, the relevant shareholder resolutions were passed by over 85% of those voting.
- 5.20 Barclays disclosed that the "commissions, fees and expenses" for the October/November 2008 capital raising amounted to £300 million, payable primarily to Qatar Holding, Challenger and HH Sheikh Mansour bin Zayed Al Nahyan, a member of the Abu Dhabi royal family, all of whom subscribed to the capital raising.⁶¹
- 5.21 Barclays' most recent public statements refer to:
- Investigations by the FSA and Serious Fraud Office in connection with certain commercial agreements between Barclays and Qatari interests and whether these may have related to Barclays capital raisings in June and November 2008;
 - An investigation by the US Department of Justice and US Securities and Exchange Commission into whether the Group's relationships with third parties who assist Barclays to win or retain business are compliant with the US Foreign Corrupt Practices Act.⁶²
- 5.22 In view of the continuing investigations into these capital raisings, we have not considered issues concerning the sufficiency of disclosure or the commercial arrangements.

Stress Tests

- 5.23 In early 2009 the FSA mandated a stress test to assess the resilience of the banking industry's capital base in the event of a severe economic downturn. Given the concerns about Barclays' valuation of its assets, there was strong market sentiment that Barclays could fail the test. This was a crucial moment in Barclays' struggle to

⁶¹ Barclays, "Barclays announces Capital Raising", press release, 31 October 2008.

⁶² Barclays, *2012 Annual Report*, March 2013.

remain independent, and a close call involving extensive debate with FSA officials. Nonetheless, the bank announced on 27 March 2009 that it had passed the stress test. Interviewees told us that this was seen as a significant milestone for Barclays, reaffirming its determination to avoid any Government ownership.

- 5.24 Barclays also passed a subsequent 2011 stress test mandated by the European Banking Authority.⁶³ However, Lord Turner, Chairman of the FSA, expressed concerns regarding Barclays' stress test presentation during this process. In a letter to Marcus Agius in April 2012 (see Appendix K), he described it as "confusing and potentially misleading". He added that it "appeared to be an attempt to leave FSA senior management with the impression that Barclays would be above the then intended 10% ... threshold, whereas Barclays was actually at 9.8%. ... Given that the eventually chosen 'pass mark' was 9%, this did not turn out to be of crucial importance. But it nevertheless left our senior management with an impression that Barclays were seeking to 'spin' its messages in an unhelpful fashion."⁶⁴
- 5.25 Barclays' management maintains that the exchange reflected a misunderstanding caused by the rapid turnaround the regulators required and the way in which communication between the two parties took place. Management said that they were surprised at the regulatory response, given that they had received limited questions during the submission time. We understand that these questions related primarily to matters such as the different treatment of minority interest reserves, which could have affected the outcome. With the benefit of hindsight, we consider that Barclays was insufficiently sensitive as to the impact of its handling of the stress tests on its relationships with the FSA and quite possibly other public authorities and politicians.

Risk Transfers

- 5.26 At the height of the financial crisis, when capital was scarce, the FSA learnt from market participants that a number of banks were creating Tranche Protection Trades, synthetic securitisation transactions that would reduce their capital requirements.⁶⁵ The transactions had unclear economic purpose and had the effect of reducing the capital in the overall system without reducing the risk. Barclays took part in a number of these transactions.
- 5.27 On 24 July 2009, Jon Pain, the FSA's Managing Director of Supervision, told the banking industry that the FSA believed that such transactions should not be used to reduce capital requirements where little or no economic risk is transferred.⁶⁶ He recommended firms to follow a substance over form approach and reminded them that they should discuss with the FSA any securitisations, or other credit protection arrangements, which were material or had complex features. A few months later he added: "If firms have reason to believe that the FSA may have an interest in

⁶³ European Banking Authority, *2011 EU-wide Stress Test – Aggregate Report*, 15 July 2011.

⁶⁴ Letter from Lord Turner, Chairman of the FSA, to Marcus Agius, Chairman of Barclays, 10 April 2012; www.publications.parliament.uk.

⁶⁵ For example, by delaying recognising losses by buying protection from another bank that nominally takes on the risk.

⁶⁶ FSA, *FSA letter to industry on synthetic securitisation transactions*, July 2009.

understanding a transaction, this should be disclosed to us prior to completion. Firms should also disclose to the FSA any existing transaction with such features.”⁶⁷

- 5.28 Having reviewed the transactions entered into by Barclays, the FSA determined that they were not explicitly prohibited by the rules in place. However, it amended the rules in 2010 and Barclays was required to unwind certain transactions. We consider these transactions to be examples of Barclays' inventiveness in designing new approaches to alleviate some of their regulatory challenges, but – in so doing – of being insensitive to the spirit of the capital rules. Barclays' approach would have been improved if it had discussed these transactions with the FSA in advance.

Protium Off-Balance Sheet Structure⁶⁸

- 5.29 Following market pressures and questions over the valuation of its assets, Barclays sold a selection of assets in September 2009 to an off-balance sheet vehicle called Protium, a transaction designed to achieve both financial reporting and regulatory capital benefits. Many of our interviewees referred to Protium. We go into it in some detail because to many it exemplified Barclays' corporate character at the time.
- 5.30 Protium was a complex transaction, designed by SCM. The assets being considered for the Protium transaction were recorded by Barclays in the part of its balance sheet which it fair valued (its trading book). Barclays explained when announcing the transaction that it ensured that Barclays' specialist team (approximately 45 employees of Barclays) would be available, and appropriately incentivised, to manage the assets. Barclays stressed that there was a real risk that this team, which was important to Barclays in realising the maximum value for the assets, would otherwise leave.
- 5.31 In formulating the Protium proposal Barclays also considered the potential accounting volatility in its financial statements related to the illiquid sub-prime assets. The valuation was uncertain, depending on a variety of factors, such as the projected cash flows from the underlying assets. In addition, there were concerns about the so-called 'jump to default risk'⁶⁹ associated with the monoline credit insurance wrapper on some of the underlying assets. If the monoline insurer defaulted, Barclays would have to recognise a lower current market value under the rules relating to fair-value accounting.
- 5.32 The bank's expectation in undertaking the Protium transaction was that Barclays' accounts would reflect the Protium assets as having been sold and replaced by the loan made by Barclays for the acquisition and that this loan would be less volatile under the valuation rules than the underlying assets, potentially with benefits to the calculation of Barclays' capital requirements.

⁶⁷ FSA, *FSA letter to industry on tranche protection trades*, February 2010.

⁶⁸ Protium is a complex structure which is difficult to summarise in simple, non-technical terms; this section provides such a simplified description and should not be taken as a full and precise account of the legal and commercial responsibilities.

⁶⁹ 'Jump to default' is a phrase used when a credit defaults suddenly before the market has had time to factor its increased default risk into current spreads; credit wrapping involves the provision of a financial guarantee to the obligations of the underlying issuer. In the event of a default in payment of principal and interest by an issuer, the monoline promises to make funds available in the amount of the interest or principal due.

- 5.33 The assets sold to Protium were valued at a total of \$12.3 billion (£7.6 billion). They comprised \$8.2 billion in structured credit assets insured by monolines, \$2.3 billion in other residential mortgage backed securities or asset backed securities and \$1.8 billion of residential mortgage assets. Barclays stated that Protium was to be run by C12 Capital Management, an independent asset management company. C12 was comprised of the 'specialist team' (of 45 individuals) and was ultimately owned by a subset of this team. C12 would receive an annual performance-based management fee expected to be \$40 million. Barclays provided a 10-year \$12.6 billion (£7.7 billion) loan to Protium to fund the purchase of the Protium assets. Barclays indicated that Protium was owned by 'limited partners', comprising two hedge funds plus C12. The 'limited partners' put in an investment of \$450 million which was designed to earn a return of 7% per annum over 10 years and with the principal repaid over the first five years (equivalent return of 18.1% *per annum*). There was also a small amount of equity contributed by one of the hedge funds and a member of the specialist team. We understand from interviewees that the residual cash flows would ultimately go to these equity holders.
- 5.34 Barclays explained the objectives of the Protium transaction as follows:
- To mitigate the risk that the management team with the required expertise would leave;
 - To enable the costs of asset management to be defrayed by enabling the team to take on the management of third party assets, which Barclays did not want to do;
 - To deliver more stable risk-adjusted returns;
 - To reduce the bank's exposure to volatile fair value accounting movements on legacy credit market assets;
 - To remove potential external pressures, if the assets were retained, to dispose of the assets at lower values in future.
- 5.35 Before implementing the transaction, Barclays subjected Protium to various reviews. The structure was developed and initially approved in Barclays Capital in June 2009. Subsequently, management discussed it with the Board Finance Committee and at a main Board meeting in August. The Board was told that the FSA was approaching the proposal cautiously and discussions with the FSA were continuing.
- 5.36 The management and Board spent considerable time reviewing the transaction. The Board Finance Committee considered the accounting and reputational risks and noted the importance of discussing Protium with the FSA. As was their usual practice, Barclays consulted their external auditors, PricewaterhouseCoopers LLP, who concurred with the accounting treatment. The bank also consulted their brokers and other financial advisers. Management referred in their Board reports to the view that Protium would provide a positive message to the market on Barclays' management of risk, noting that it was necessary to give a clear and transparent description publicly.
- 5.37 Recollections differ as to whether, and how strongly, concerns about the complexity and appropriateness of the Protium structure were expressed by senior FSA

management. Interviewees from Barclays' management and Board told us that the FSA discussions had focused on the treatment of risk-weighted assets for capital purposes and the accounting treatment and that the FSA indicated that it did not object to the transaction. However, the FSA did reserve its position on how the transaction would be treated for regulatory capital purposes. FSA executives told us that there were conversations with Barclays conveying the FSA's view that Protium was a complex transaction with which they were very uncomfortable.

5.38 In a meeting on 14 September 2009, the Board Finance Committee⁷⁰ was informed by the management that:

“The FSA had found it difficult to get comfortable with the proposal. They were concerned that it would set a precedent and that the market would have difficulty in understanding the transaction. They had now confirmed that they [the FSA] would not object, subject to certain mitigants:

- That the assets would continue to be consolidated for Regulatory Capital purposes;
- That the Loan to Protium would be rated;
- That Barclays will disclose in future financial statements the valuation of the loan and the performance of the underlying cash flows;
- The FSA will suggest amendments to the RNS.”⁷¹

5.39 On 16 September 2009, Barclays wrote to the FSA summarising its plans before the transaction was announced later that day. We understand there was no written reply. Barclays understood that while the FSA had reservations regarding the complexity of the transaction, it reserved its position on its capital treatment but did not object to the transaction. We think it is likely that the FSA took the view that it was not appropriate for the FSA, in the circumstances, either to approve or to disapprove the transaction. It nevertheless had the responsibility to decide how the transaction would be treated for capital purposes.

5.40 In developing the Protium proposal, Barclays initially seemed to expect that the regulatory capital treatment would be favourable. After further consideration, it thought that it would be neutral – consistent with the previously followed risk-weighted assets treatment of those assets on the balance sheet. However, the regulatory capital conditions subsequently imposed by the FSA were more onerous and confirmed to Barclays by the FSA in June 2010. This may have been in part because the FSA took a more conservative view of the size of the risk.

5.41 We reviewed the extensive disclosures made by Barclays about Protium, noting that these provided considerable detail, but did not include quantification of the residual value which would go to investors following any repayment of the loan to Barclays.

5.42 After the announcement of the Protium transaction, some commentators expressed concerns regarding its underlying purpose. For example, Credit Suisse analysts

⁷⁰ Barclays company secretariat, Minutes of the Board Finance Committee meeting, 14 September 2009.

⁷¹ RNS is the regulatory news service used for stock exchange announcements.

described it as “a little strange”, noting that the Bank appeared to be giving up the prospective benefit from a subsequent rise in the asset values from the carrying values ascribed at transaction date.⁷² The analyst Ian Gordon said: “It's being presented as providing a more stable, certain outturn, but you could argue they are giving away the upside but not really being sheltered from much of the downside.”⁷³

- 5.43 After internal reviews, including by the Board Finance Committee, Barclays made in its 2010 results a £532 million impairment provision against the Protium loan and it announced this on 15 February 2011.⁷⁴ Barclays' 2010 accounts stated that regulators were continuing to review the transaction, and that the “on-going review ... includes consideration of the non-consolidation of Protium”.⁷⁵ We understand that during the course of 2010 and into 2011, Barclays had been questioned about the Protium structure accounting by the Financial Reporting Review Panel (FRRP; part of the Financial Reporting Council) in the UK and the Securities and Exchange Commission in the US as financial reporting regulators. The FRRP took the view that Barclays' accounting treatment was not appropriate and that the bank should have continued to consolidate the assets relating to Protium in the 2009 and 2010 accounts. Following the impairment charge, the effect of non-consolidation ceased to be material and the FRRP closed their enquiry.
- 5.44 The Securities and Exchange Commission (SEC) concluded in March 2011 that they “were unable to concur with [Barclays'] conclusion that the non-consolidation of Protium is appropriate”. However, given that the effects of not consolidating Protium were not material, the SEC had “no additional comments at the present time.”⁷⁶ Accordingly, Barclays was not required to restate its accounts.
- 5.45 Barclays reconsidered the economics of the loan based on the FSA capital treatment. After various discussions during the first quarter, in April 2011 Barclays negotiated a restructuring of the transaction with the other parties and took back £6 billion in Protium assets on to the Barclays balance sheet.
- 5.46 The restructuring involved Barclays paying an \$83 million break fee based on accrued performance management fees to C12, the Protium management company. It also agreed to buy out unidentified third-party investors for \$270 million and to invest \$750m into another C12 credit fund called Helix. The Financial Times reported that: “Analysts said the Protium affair had damaged Barclays' reputation.”⁷⁷
- 5.47 It should also be noted that in the same financial year as the Protium transaction Barclays was working on a second similar but less complex transaction. We understand that when the FSA was approached regarding this proposed transaction, a number of concerns were raised and Barclays did not pursue it.

⁷² Guardian, “Barclays sells \$12 billion of risky assets”, 16 September 2009.

⁷³ Analyst at Exane BNP Paribas.

⁷⁴ Barclays' 2010 *Annual Report* states that “following a reassessment of the expected realisation period, the loan is carried at an amount equivalent to the fair value of the underlying collateral, resulting in an impairment of £532m”.

⁷⁵ Barclays, 2010 *Annual Report*, March 2011, p. 115.

⁷⁶ SEC, 22 March 2011 Letter to Barclays; <http://www.sec.gov/Archives/edgar/data/312069/000000000011017550/filename1.pdf>.

⁷⁷ Financial Times, “Barclays buys back £6bn Protium assets”, 27 April 2011.

- 5.48 Subsequently, Barclays reclassified to its banking book the assets which were to be the subject of this second transaction. In doing so, Barclays achieved one of its objectives to reduce their volatility for accounting purposes by making them subject only to impairment charges, in line with the permissible accounting treatment at the time. The total assets reclassified were of a slightly higher value than the Protium assets, and contained Collateralised Loan Obligations against which the Group held credit protection with monoline counterparties.⁷⁸ In the press, comparisons were made between the Protium transaction and the reclassification. For example, in an article headlined “Barclays’ Protium Deal is all that’s wrong in the City”, the Telegraph reported that: “Senior Barclays sources ... conceded that the bank could have achieved exactly the same thing by ‘reclassifying’ the ... [Protium] ... assets – as it did with the ... [other]... assets two months later. The Institute of Chartered Accountants in England & Wales confirmed there was nothing stopping it switching the assets from its trading to its banking book. In other words, Barclays did not need to set up Protium. A simpler and cheaper asset reclassification would have done the trick.”⁷⁹
- 5.49 This raises the question why this reclassification was not adopted as an alternative to the Protium structure. We accept that Barclays viewed Protium as offering the advantage of securing necessary specialist expertise to manage the assets, but it would seem to us that their incentivisation could have been achieved in other ways.
- 5.50 In the Treasury Committee hearings following the 2012 announcement of the LIBOR fine, the FSA described Protium as an example of aggressive management actions. Moreover, according to press reports at the time of the hearings, the FSA’s Andrew Bailey had told Barclays’ Board in February 2012 that Protium was “pushing the envelope too far”.⁸⁰ FSA Chairman Lord Turner wrote to Marcus Agius, the then Chairman of Barclays, on 10 April 2012⁸¹ about “a pattern of behaviour over the past few years in which Barclays often seems to be seeking to gain advantage from the use of complex structures or through arguing for regulatory approaches which are at the aggressive end of interpretation of the relevant rules and regulations”. Protium was cited as an example which was “within the accounting rules” but was “perceived by many external commentators as a convoluted attempt to portray a favourable accounting result”.⁸²
- 5.51 Barclays interviewees pointed to the subsequent realisation of the Protium assets. As at 31 December 2012 the carrying value of the assets had been reduced to \$1.9 billion with net losses incurred of only \$308 million. This, they told us, represented a relatively favourable result for shareholders and confirmed the reasonableness of their views on the asset values in late 2008.

⁷⁸ Barclays, *2009 Annual Report*, March 2010, p. 303; note that the relevant accounting standards had different rules relating to the on-balance sheet assets and related derivatives.

⁷⁹ Telegraph, “Barclays’ Protium Deal is all that’s wrong in the City”, 28 April 2011; www.telegraph.co.uk/finance/newsbysector/banksandfinance/8478780/Barclays-Protium-Deal-is-all-thats-wrong-in-the-City.html.

⁸⁰ The Times, “Regulator warned Barclays of Failings”, 6 July 2012.

⁸¹ See Appendix K.

⁸² FSA letter, dated 10 April 2012, disclosed to the Treasury Select Committee; see <http://www.parliament.uk/documents/commons-committees/treasury/10April2012.pdf>.

- 5.52 It is clear to us that Protium damaged Barclays' reputation in the eyes of its regulators and the market. We consider that Protium serves as an illustration of:
- The very significant financial pressures Barclays experienced during the financial crisis and its desire to reassure the market on its management of risk;
 - A complex transaction which Barclays believed complied with the rules but some stakeholders questioned as being inconsistent with their spirit;
 - Communication misunderstandings between Barclays and the FSA;
 - A mis-judgment by Barclays management and the Board as to the potential damage to the bank's reputation in taking an approach which, as it turned out, tended to confirm sceptical attitudes to Barclays assets and their valuations;
 - The inclination to use unusual incentive arrangements to reward and secure important expertise.

Models to Calculate Capital

- 5.53 Banks can calculate the amount of capital they are required to hold under the Basel II rules by using either their own models or standardised approaches prescribed by local regulators (with any specific modification approved).⁸³ Since the models differ between banks and the regulatory approaches differ by country, it is recognised that there can be significant variations in the resulting risk asset weights.⁸⁴
- 5.54 In a letter from Lord Turner to Marcus Agius on 10 April 2012, the FSA⁸⁵ wrote that, during the 2008 discussions on capital requirements, "Barclays was not fully transparent ... about the RWA⁸⁶ impacts of a proposed extension of model approaches".⁸⁷
- 5.55 We understand that this relates to discussions between the FSA and Barclays, following the Lehman acquisition in 2008, concerning the approach to be used to calculate regulatory capital requirements for the US entity when producing Group consolidated capital requirements. At the time of the acquisition, regulations allowed UK banks to use local standardised approaches for assets in foreign entities for capital purposes. However, this changed in 2011 when, like regulators in other EU countries, the FSA began requiring banks to use its rules for these assets.
- 5.56 Barclays' interviewees told us that the FSA is continuing to review the systems and calculations Barclays uses in the standardised (non-modelled) approaches following the concerns expressed above about risk-weighted assets.
- 5.57 We consider this to illustrate how stretched Barclays' systems and operational processes were by the Lehman transaction, combined with business growth and changes in the regulatory environment. We are aware that it is common for banks to

⁸³ The standardised approaches are sometimes referred to as non-modelled approaches.

⁸⁴ See Appendix J.

⁸⁵ See Appendix K.

⁸⁶ A financial institution's Risk-Weighted Assets (RWA) represent the base minimum amount of capital required; it is computed as a percentage of the financial institution's assets, weighted by risk; see Appendix J.

⁸⁷ Treasury Select Committee, *Fixing LIBOR: Some preliminary findings – Appendix*, 9 August 2012.

make use of complex models to determine capital but this seems to have been another area that contributed to some strain in the relationship between Barclays and the FSA.

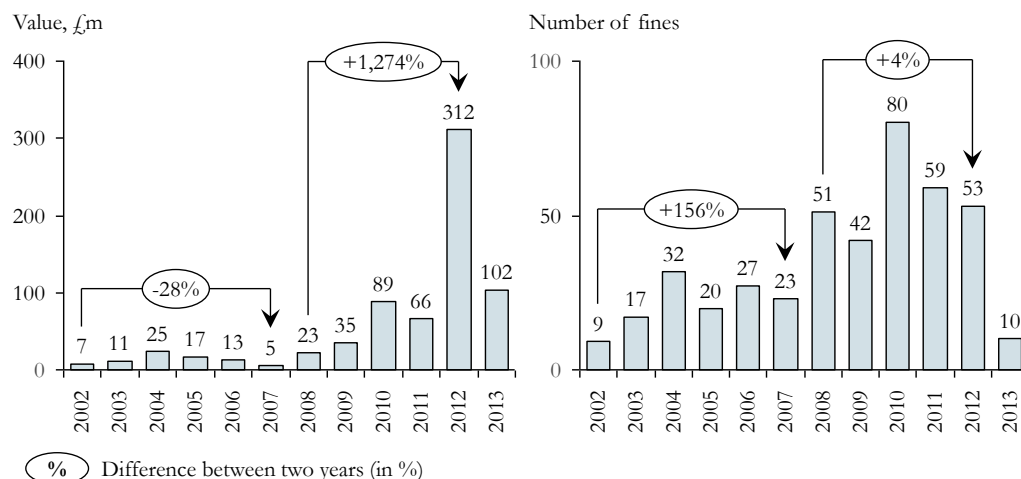
6. Conduct Matters

- 6.1 Our Terms of Reference require us to frame our recommendations around an analysis of past events where the bank's conduct had a negative impact on its reputation. Most of these events began well before the 2008 financial crisis but only came to a head after the crisis began. Some are still subject to regulatory investigation, while others such as LIBOR involve legal actions. Some have already resulted in financial penalties. Others such as PPI have resulted in continuing compensation payments to customers. In all cases there has been damage to Barclays' reputation and we have sought to understand the reasons for the inappropriate conduct. This Review is, however, not a forensic investigation into these events and we have not examined those areas which are subject to continuing investigations or legal actions.
- 6.2 In this section, we begin by looking at the increasing attention paid by UK regulators to conduct matters, and the increasing scale of the penalties imposed for conduct failures by the UK and US regulators. We then analyse the specific events in the following groups:
- Regulatory penalties for conduct failures;
 - Sanctions;
 - Products and advice;
 - Operational failures;
 - Treatment of customers;
 - Inappropriate behaviour – the LIBOR scandal.

Regulatory Penalties for Conduct Failures

- 6.3 In the UK, the FSA has made enforcement actions backed by financial penalties a key plank of its approach to regulation since it was set up in December 2001 under the Financial Services and Markets Act 2000. The total value of fines imposed by the FSA on all financial services businesses between 2002 and 2008 fluctuated in a fairly narrow band of £5 million to £25 million a year. But in 2009, the quantum of fines began to increase substantially, reaching £89 million in 2010 and £312 million in 2012 – despite a much smaller increase in the number of fines (see Figure 6.1).

Figure 6.1 – Values and Number of FSA Fines Imposed by the FSA, per annum (2002-March 2013)



Note: 2013 data is as of 11 March
Source: FSA website: www.fsa.gov.uk

- 6.4 Between 2009 and 2011, Barclays paid a total of £11.3 million in three fines imposed by the FSA, not materially different from the amounts paid by other UK banks, whereas it had not been subject to an FSA fine prior to 2009 (see Figure 6.2). In June 2012, however, it was fined £59.5 million by the FSA for its role in the LIBOR scandal. The investigation of LIBOR continues, but the FSA has since fined UBS £160 million in December 2012 and RBS £87.5 million in February 2013.

Figure 6.2 – Barclays' UK Fines

Date	Event	Failure	Fine amount (£)
19 August 2009	Transaction reporting	For failing to provide accurate transaction reports to the FSA and for serious weaknesses in systems and controls in transaction reporting	2,450,000
18 January 2011	Aviva Bonds	For failures in relation to the sale of two funds	7,700,000
26 January 2011	Client Assets sourcebook (CASS)	For failing to protect and segregate client money	1,127,559
27 June 2012	LIBOR	For misconduct relating to the LIBOR and EURIBOR	59,500,000
Total			70,777,559

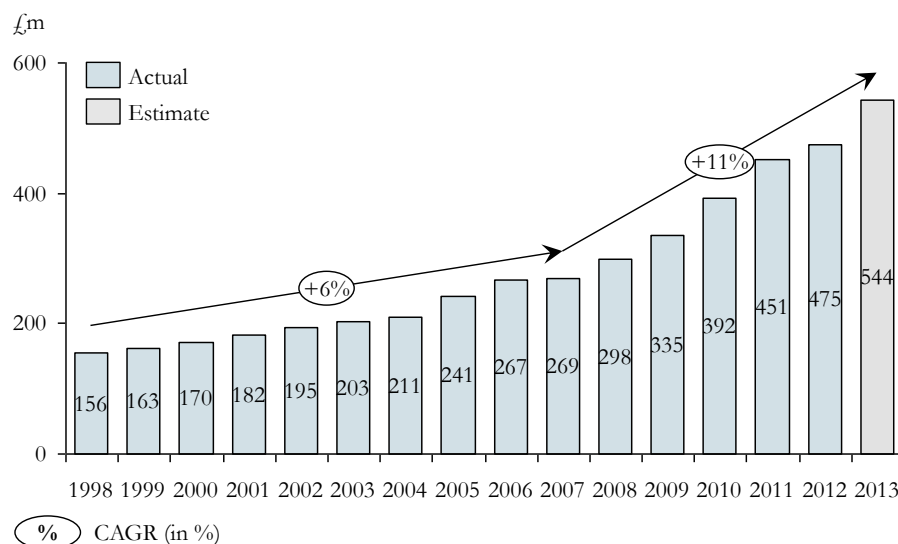
Source: FSA

- 6.5 In the US, there are several financial regulators and they tend to impose fines much more frequently than their UK counterparts – even allowing for the fact that the US is a larger market. For instance, between 2005 and 2011, the Financial Industry

Regulatory Authority, a securities regulator, imposed approximately twenty times as many fines as the FSA. Similarly, financial institutions face significantly higher regulatory fines and settlements in the US than in the UK. For example, for its role in the LIBOR scandal, Barclays was fined \$200 million by the Commodity Futures Trading Commission (CFTC) and \$160 million by the US Department of Justice (against £59.5 million by the FSA). RBS's equivalent fines in February 2013 were \$325 million by the CFTC, and \$150 million by the US Department of Justice (DoJ).

- 6.6 The quantum of fines also seems to be increasing in the US. In the second half of 2012, Standard Chartered incurred a civil penalty charge of \$340 million and a forfeiture of \$100 million to the New York Department of Financial Services for transactions with Iranian clients. HSBC was fined \$1.9 billion by the DoJ, the Office of the Comptroller of the Currency (OCC) and the Federal Reserve after allegations of money laundering through the US by Mexican drug cartels and certain other transactions with sanctioned countries.
- 6.7 UBS has been fined a total of \$1.2 billion by the DoJ and the CFTC for its part in the LIBOR events, as well as being ordered to pay a disgorgement of profits of CHF59 million to the Swiss Financial Market Supervisory Authority (FINMA).⁸⁸
- 6.8 The UK and US regulatory environments have become much more challenging for all banks. And in addition to the cost of fines, banks face substantially increased compliance costs of their own in their efforts to ensure their operations do not breach the various regulatory rules. The most obvious cost relates to the need for banks to employ more compliance staff.⁸⁹ The costs for regulators have also increased (see Figure 6.3 on the FSA budget).

Figure 6.3 – FSA (and predecessors) Budget Evolution (1998-2013)



Notes: Care is needed with these figures due to increases in the scope of the FSA's activities during the period; 2013 represents the budgeted costs
Source: Financial Services Practitioner Panel, FSA annual reports and business plans

⁸⁸ FINMA, "LIBOR: FINMA concludes proceedings against UBS and orders disgorgement of profits", press release, 19 December 2012.

⁸⁹ See Section 3 for Barclays' compliance staff numbers.

Sanctions

- 6.9 Barclays, like other banks, has experienced problems in complying with sanctions aimed at restricting the financial dealings of individuals or organisations which governments believe may be involved in terrorist, narcotics or other criminal activities. The sanctions rules, which relate to customer account openings and payments, are complex and apply to a huge number of transactions undertaken by banks. In the US, they cover countries and a list of “specially designated nationals” containing thousands of entries of individuals’ names and aliases.
- 6.10 In August 2010 Barclays agreed to pay almost \$300 million to the DoJ and New York District Attorney’s Office and \$176 million to the Office of Foreign Assets Control (OFAC) for breaches of US Sanctions. The settlement related to Barclays’ handling of \$500 million in money transfers from banks in US-sanctioned countries including Cuba, Iran, Sudan, Libya and Burma between 1995 and 2006. Barclays was alleged to have removed details from payments to hide the identity of these recipients. Under the terms of the settlement, Barclays agreed to implement specific conditions, including new training and compliance programmes, in return for the dismissal of the sanctions charges – which happened in December 2012 when a US federal judge agreed that Barclays had met the conditions.
- 6.11 Sanctions violations, especially relating to US rules, are an industry-wide issue. Since 2010, LBG has incurred sanctions-related costs of \$350 million, Credit Suisse \$536 million, RBS (via ABN AMRO) \$500 million, ING \$619 million and Standard Chartered \$327 million. In the UK, the FSA fined RBS £5.6 million in 2010 for failing to have adequate systems and controls to prevent breaches of UK financial sanctions.
- 6.12 There is no doubt that compliance with sanctions requirements is an extremely complex undertaking for global banks such as Barclays. Since the requirements stipulate that banks should be able to screen individual transactions, banks require sophisticated IT monitoring systems capable of monitoring huge numbers of transactions every day.
- 6.13 Despite the practical challenges, we have concluded that Barclays’ sanctions breaches suggest inadequate operational level computer systems, processes and training. They also suggest that there may have been an underinvestment in monitoring compliance, risk and other control processes as legal and regulatory requirements have intensified and the business has become more complex. However, we note that Barclays has now increased their management focus on the importance of compliance with sanctions requirements and also restructured these processes since the incidents occurred.

Products and Advice

- 6.14 Concerns have grown in recent years about financial services organisations selling inappropriate products to customers, particularly individuals and small businesses with limited understanding of more complex financial matters. Regulators have

imposed fines for mis-selling and required the payment of compensation to customers running into hundreds of millions or even billions of pounds in total. In this sub-section, we look at the instances where Barclays is alleged to have mis-sold products or given unsuitable advice.

Payment Protection Insurance

- 6.15 Payment Protection Insurance (PPI) policies are designed to provide help for borrowers to repay loans if they lose their income for a period. They are potentially a valuable product for customers, and Barclays, like other banks, has been selling PPI or equivalent products for around 30 years. In the UK it became common practice for banks to package the cost of PPI in the interest rate quoted to the customer.
- 6.16 However, a number of concerns became apparent which led to accusations of mis-selling of PPI. These included:
- High-pressure sales tactics such as giving borrowers the impression that they had to buy PPI to get a loan;
 - Legal exclusions which meant claims could not be made in some cases such as back pain and stress, common causes of absence from work;
 - The sale of PPI policies to customers who were self-employed and not eligible to claim;
 - The sale of policies to people with no income to protect;
 - Requirements for customers to opt out of the product rather than opt in – which in some cases meant that they were unaware that they had taken out a PPI policy;
 - Single-premium policies which did not refund part of the premium if the loan was repaid early.
- 6.17 In 2009, the FSA estimated that PPI mis-selling may have affected around three million people in the UK since the 1990s.⁹⁰ Barclays was one of the banks identified.
- 6.18 The businesses in Barclays selling the most PPI products were the Retail Bank, Barclaycard and FirstPlus (acquired with Woolwich in 2000). There are several indicators that PPI was an important and profitable part of Barclays' retail banking and credit card businesses. For example, PPI comprised between 32% and 42% of Barclays' UK retail and business bank pre-tax profit between 2001 and 2005, when almost 70% of borrowers taking some loan products also bought a policy. Indeed the penetration rate of PPI sales was a key performance indicator used by Barclays. Gross premiums from Barclays PPI sales exceeded £400 million *per annum* between 2003 and 2008, falling to £346 million in 2009, £264 million in 2010, and less than £200 million *per annum* thereafter (mainly due to the fact that Barclays was still collecting premiums for regular premium policies taken out in previous years). The cost of meeting claims on Barclays PPI policies has been under 25% of gross premiums in every year since 2002. Overall, between 2002 and 2012, Barclays' total

⁹⁰ Guardian, "Three million in the queue for compensation over PPI mis-selling", 10 August 2012; based on: FSA, *FSA confirms measures to reform PPI market and protect consumers*, August 2010.

revenues from PPI, net of claims and provisions for alleged mis-selling, amounted to an estimated £940 million.⁹¹

- 6.19 We reviewed the consideration given at various times by Barclays' senior management to potential problems from the sale of PPI. In 1996 Barclays moved the underwriting of PPI business in-house, using insurance subsidiaries set up in Ireland where the tax rate was lower. On 2 October 1996, the Group Executive Committee was told that Barclays was "the largest British vendor of PPI", that "the business was particularly profitable because of the way it was managed", and that there were plans to "offer PPI to different customers and product groups". A separate paper noted a risk that: "Regulation (particularly commission disclosure) and scrutiny by such bodies as the Office of Fair Trading (OFT) are likely in the mid-term. They would expose Barclays in particular to both profit and reputational risk".
- 6.20 Later, in August 2005, the Group Executive Committee again reviewed PPI. In May 2005, it had noted that Barclays had the highest market share of all banks, claims were running at under 15% of premiums in 2005 but could go above 30% in a recession, and that the PPI business was "highly profitable" at £400 million per annum. The Group Executive Committee noted that there were potential concerns relating to the fairness of single premium policies, policies sold where customers could not make claims and sales practices that were "not customer friendly" or "high pressure". A "doomsday" scenario was identified whereby PPI profits fell to £100 million *per annum* by 2008, but the likely scenario taking into account regulatory concerns was that it remained at £450 million per annum.
- 6.21 We enquired about the role played by sales incentives. We were told that there were schemes designed to encourage staff to sell PPI. One example we noted was that in 2009 a sales person would earn two and a half times more commission for selling a loan with PPI compared to a loan without PPI.
- 6.22 Like many other banks, Barclays responded to PPI concerns by redesigning its single premium product. However, it continued to sell single-premium PPI policies until January 2009, as did several banks. Some stopped earlier – for example HSBC stated that it "stopped selling PPI in its branches in December 2007 and throughout the rest of its business in 2008."⁹² In January 2009, when the FSA indicated that single premium PPI was the most problematic, there was a discussion at the Barclays Brand and Reputation Committee. Our understanding is that management put forward a proposal for the single premium offering to be revised to be compliant but the Board Committee rejected this proposal, preferring that this product be withdrawn.
- 6.23 In response to the regulatory concerns about PPI and the increasing level of complaints, the British Bankers' Association (BBA), representing the major banks (including Barclays), brought a legal challenge against the FSA and the Financial Ombudsman Service (FOS), in January 2011, regarding the assessment and redress of PPI complaints. The courts decided in favour of the FSA and FOS. As a result the banks had to review past PPI sales even when customers had not complained. The

⁹¹ Sources: Barclays Finance and Barclays annual reports.

⁹² HSBC, *What is PPI*, HSBC website, 'Contact us' section on Payment Protection Insurance; <http://www.hsbc.co.uk/1/2/contact-us/payment-protection-insurance>.

banks then made the decision to provide for alleged PPI mis-selling claims. Barclays announced in May 2011 that it would not appeal the court decision.

6.24 We accept that PPI was intrinsically a valuable product for some customers and that the instances of alleged mis-selling were an industry-wide problem. But we believe Barclays might have taken too much comfort from this and from the regulatory involvement with the issues – and as a result was slow to address control failures. We consider that:

- Given the level of customer complaints from 2005 to 2008, there should have been more scrutiny of customer suitability;
- The high profitability of PPI should have raised questions as to whether this was consistent with Barclays' obligations to customers;
- Barclays was slow to deal with the emerging regulatory concerns;
- Barclays' PPI sales force incentive schemes aggressively pushed sales, potentially at the expense of customer suitability, until the schemes were changed in recent years;
- Controls over the selling process could have been stronger – certain business units were particularly aggressive, most notably FirstPlus (which ceased making new loans in 2008), but also the retail bank and Barclaycard;⁹³
- The culture of the bank had developed into one which at times valued meeting financial targets more than meeting customer needs.

Industry observation B: Retrospective interpretations

The industry has been vocal in asserting that regulators and others involved in redress have sometimes developed and adapted their approach over time to specific conduct issues, ultimately relating to the settlement of customer claims, to the material disadvantage of the banks. We are not in a position to judge whether this is a fair viewpoint. On occasions any such change in approach will no doubt be justified by new information available to the regulators or be a reaction to how the banks have themselves handled an issue. Effective regulation, at its best, is based on mutual trust and respect. For this, it will be important that, wherever possible, banks fully understand how the regulators intend to approach issues and how any rules will be applied. Certainty is impossible and consistency on the part of the regulator will, in turn, depend upon the industry applying regulation in line with its spirit. This will, of course, be assisted by the efforts of the banks to apply the highest standards of customer care.

SME Derivatives

6.25 In June 2012, the FSA found that there were serious failings in the way interest rate hedging products had been sold by Barclays, among other banks, to small and medium-sized enterprises (SMEs) and required the banks to provide redress where mis-selling had occurred. These derivatives sales had started around 2001, via a joint

⁹³ Telegraph, "Barclays stops loans at FirstPlus", 8 July 2008.

venture between the investment bank and the Retail and Business Banking known as the Retail Sales Group. A high level of complaints emerged in 2008, when interest rates fell to historically low levels. Complaints frequently related to the high cost of the break clause which, in a lower interest rate environment, could be up to 20% of the notional value of the loan.

- 6.26 Following press articles and complaints, the FSA launched a review into SME derivatives in 2012. The regulator found that Barclays, among other banks, had sales rewards and incentives schemes that could have exacerbated the risk of poor sales practice.⁹⁴ Moreover, in early 2013 the FSA reported that more than 90% of the interest-rate derivatives in their sample did not comply with at least one regulatory requirement.⁹⁵ While some clients may have understood the derivative arrangements, others did not and relied on the advice of their relationship manager. Some clients may have felt they had no choice if they wanted the loan. It is also likely that few had foreseen, when they took out protection against increases in interest rates, that there would be an unprecedented period of low rates – with costs they had not anticipated. This is very much a current issue for Barclays. For its year-end 2012 accounts, it announced £450 million for SME compensation during 2012 and a further £400 million in February 2013 (total £850 million). In addition, the bank is currently undertaking an SME sales review.
- 6.27 It seems to us that Barclays should take care to ensure that complex derivatives products manufactured in the investment bank and sold to less sophisticated customers in the retail bank are properly understood by whoever oversees the sale to the Barclays customer. We noted that, since the experience on these cases, Barclays has increased its attention to customer needs by improving its sales processes to ensure that risk is appropriately explained, especially when dealing with small businesses. In addition, some pay arrangements for staff are being reviewed to encourage employees to give due consideration to customer suitability. Again, we consider it likely that the issues arising from the sales of derivatives to SMEs could have been reduced if the culture within the bank had placed higher priority on meeting the needs of customers.

Investment Funds

- 6.28 Barclays misclassified two fund products developed by a fund management affiliate of Aviva which it sold to customers between 2006 and 2008. The products were:
- A so-called Global Cautious Income Fund, which should have been labelled as a risky investment;
 - A Global Balanced Income Fund, which was also more risky than described.
- 6.29 Aviva itself rated the funds as four out of five on a risk scale, with five being high-risk.⁹⁶ However, using an accelerated classification process, Barclays incorrectly

⁹⁴ FSA, “FSA agrees settlement with four banks over interest-rate hedging products” (FSA/PN/071/2012), press release, 29 June 2012.

⁹⁵ Source: FSA, “FSA confirms start of full review of interest-rate swap mis-selling” (FSA/PN/010/2013), press release, 31 January 2013.

⁹⁶ Aviva later reclassified the Cautious Income Fund to three out of five – i.e., medium risk.

classified the two funds in July 2007 as appropriate for risk-averse investors and in August began selling accordingly. Concerns were raised within Barclays in November 2007 over whether the risk categorisation of the funds was accurate, and the rating was changed in December 2007. By then, more than 12,000 customers had invested almost £700 million in the two funds. In late 2008, Barclays stopped selling both funds. By 1 April 2009, the value of the Global Balanced Income Fund had fallen by 48% over the previous 12 months, and the Global Cautious Income Fund by 29%.⁹⁷

- 6.30 In January 2011, the FSA fined Barclays £7.7 million for “failing to take reasonable care to ensure the suitability of its advice” with respect to the Aviva funds. Underlying failures were identified in training materials, sales briefs, product brochures, monitoring of sales and lack of action after compliance had identified potentially unsuitable sales. However, the FSA said that Barclays had not “deliberately or recklessly contravened regulatory requirements” and had been open and co-operative during its investigation. The FSA estimated that Barclays would have to pay over £60 million in compensation to investors. Since then, Barclays has modified the sales and advice process, as well as increasing training for advisers.⁹⁸
- 6.31 There was a similar incident in Spain in 2009 when the Comisión Nacional del Mercado de Valores (CNMV), as part of a review of financial market activities in a number of Spanish financial institutions, found deficiencies in Barclays’ product classification process. Following action to deal with the issues, CNMV fined Barclays €600,000 in December 2012 for under-rating the risk in €16.5 million of bonds sold between January and March of 2008. The regulatory rules in Spain are different from those in the UK. We consider this breach is mainly a matter of product design, combined with a failure to classify it correctly for risk purposes.

Operational Failures

- 6.32 Regulators also require financial services organisations to operate in ways that protect clients’ money and help monitor transactions so that they can be reviewed subsequently. Barclays has twice been fined for failure to observe such regulations, apparently as a result of underinvestment in its systems and processes.

Client Money Segregation

- 6.33 Financial institutions must protect customers’ assets by segregating them from their own. When Lehman Brothers collapsed in September 2008, and customers were unable to withdraw their deposits, its failure to segregate client money from its own was widely publicised. As a result, regulators intensified their focus on segregation arrangements.
- 6.34 In 2009, Barclays identified a failure to segregate client money and launched an internal review to identify the cause and resolve the issue. The FSA considered this to have been a “serious breach” though “not deliberate”. In January 2011, it fined Barclays Capital £1.12 million for “failing to protect and segregate on an intra-day

⁹⁷ Source: Bloomberg data.

⁹⁸ FSA, “Final Notice to Barclays”, 14 January 2011.

basis client money held in sterling money market deposits". This had happened for over eight years, between 1 December 2001 and 29 December 2009. Such client monies were segregated overnight but not on an intra-day basis. The average daily amount of client money involved increased from £6 million in 2002 to £387 million in 2009. The highest amount held in the account and at risk at any one time was £752 million.⁹⁹

- 6.35 Other firms have been fined by the FSA for client money segregation matters – for instance, JP Morgan (£33.3 million in June 2010).¹⁰⁰ We consider that the Barclays breach was allowed to continue for too long, but was eventually corrected quickly. The bank appears to have prioritised business growth over ensuring that the underlying operational systems and processes were adequate to protect its customers' interests.

Transaction Reporting

- 6.36 In order to detect and investigate suspected market abuse such as insider trading and market manipulation, the FSA requires firms to submit data of reportable transactions by close of business on the day after a trade is executed. While reviewing a suspected incident of market abuse by a third party, the FSA discovered discrepancies in Barclays' data, which during a subsequent review of the bank's transaction reporting arrangements revealed that it did not have adequate systems and controls to satisfy the transaction reporting requirements. Over a two-year period, 57.5 million transactions across all asset classes had been inaccurately reported, including 17 million transactions where no report had been submitted.
- 6.37 The FSA consequently fined Barclays Capital Securities Ltd (the subsidiary in which the breaches occurred) and Barclays Bank PLC (the parent company) £2.45 million in August 2009,¹⁰¹ the largest of the six fines the FSA has imposed for failures to provide accurate transaction reports and for serious weaknesses in systems and controls in transaction reporting. The FSA remarked that "complete and accurate transaction reports are an essential component of the FSA's market monitoring work. Barclays' reporting failures could have a damaging impact on our ability to detect and investigate suspected market abuse. The penalty imposed on Barclays is significantly higher than previous penalties imposed for transaction reporting errors. This reflects the serious nature of Barclays' breaches and is a warning to other firms that the FSA will not tolerate inadequate systems and controls."¹⁰²
- 6.38 We consider that this is another example of inadequate systems and controls in a core area of the bank's business. Causes could include under-investment in relevant IT systems and inappropriate reliance on manual intervention.

⁹⁹ FSA, "FSA levies £1.12m fine on Barclays Capital for client money breaches" (FSA/PN/014/2011), 26 January 2011.

¹⁰⁰ FSA, "FSA levies largest ever fine of £33.32m on J.P.Morgan Securities Ltd for client money breaches" (FSA/PN/089/2010), 3 June 2010.

¹⁰¹ FSA, "FSA fines Barclays £2.45m for failures in transaction reporting" (FSA/PN/117/2009), 8 September 2009.

¹⁰² *Ibid.*

Treatment of Customers

- 6.39 We consider below particular challenges that Barclays has faced in balancing the need to treat customers and clients fairly with other (e.g., financial) objectives. These are examples of conflicts that will arise from time to time in ordinary dealings with customers. One relates to the retail bank, and the other to the investment bank.

Charges for Credit Cards and Overdrafts

- 6.40 The charges levied on customers for exceeding credit card limits and for unauthorised overdrafts on their current accounts have led to customer complaints, media campaigns, regulatory, OFT and government intervention, and legal battles involving the UK's largest banks.
- 6.41 At the heart of the problem is the sense that these charges are often high to enable banks to recoup the costs of not charging for other services: credit card users mostly pay no fees if they clear their outstanding balances promptly; and personal current accounts are free if in credit, as is the use of ATMs. There is therefore potentially an element of cross-subsidy involved with some charges, which raises challenging fairness issues for the banks.
- 6.42 The first issue relates to credit card fees. The OFT, following a detailed review, declared in 2006 that "credit card default charges have generally been set at a significantly higher level than is legally fair". The OFT estimated that this had involved unlawful penalty charges in excess of £300 million a year and said that, if default charges exceeded £12, it would "presume that they are unfair".¹⁰³ Accordingly, card issuers reviewed their charges, and Barclaycard, along with other issuers, reduced their charges to £12. Prior to 2006, Barclaycard had charged £20 to £24 per month.
- 6.43 In addition, the UK Government reached agreement with the industry in January 2011 on changes which included paying off the most expensive debt first and allowing customers to decline increases in their credit limit or even to reduce it.
- 6.44 As a major UK card issuer, the cost of making these changes for Barclaycard was significant. Barclays also received customer complaints regarding credit card fees and charges and prior to 2012, compensating some customers. In 2012, Barclays calculated a cost-based justification of its £12 card default fee and does not expect to have to meet fee complaints in future.
- 6.45 We have also considered the much publicised issue of UK current account charges. In its report into the UK current account market (published in 2008), the OFT concluded that "the ... market is not working well for consumers. A combination of complexity and lack of transparency means that consumers and competition are focused almost exclusively on more visible fees, and not on the less visible elements

¹⁰³ Office of Fair Trading (OFT), "Current credit card default charges unfair" (68/06), press release, 5 April 2006.

such as insufficient funds charges and forgone interest – despite the fact that these make up the vast bulk of banks' revenues.”¹⁰⁴

- 6.46 In parallel to reviewing the competitiveness of the UK current account market, the OFT brought a test case to the High Court to establish the fairness of unauthorised overdraft charges. The lawsuit commenced in 2007, and involved seven banks and one building society, including Barclays. While initial rulings went against the banks (commentators described them as “potentially excessive or unfair, but not illegal”), the Supreme Court ultimately upheld the banks' appeal in 2009.¹⁰⁵
- 6.47 While the detail of the legal proceeding is not considered by this Review, the process prompted the banks to consider their positions with respect to fees and charges in the current account market. In advance of the victory in the Supreme Court, Barclays withdrew its unauthorised overdraft offering and improved the transparency of authorised overdraft charges.
- 6.48 The OFT continues to make statements on the Current Account market. As recently as January 2013, the OFT continued to claim that banks had not made costs clearer, and it would therefore consider whether to refer the industry to the Competition Commission in 2015.¹⁰⁶
- 6.49 We were told that Barclays' management believe the bank's credit card and overdraft charges are in line with other providers. As we have said elsewhere in the Review, we consider that the bank should take no comfort from this. There was a significant longstanding issue of a lack of transparency in the explanation of overdraft charges to customers. And implicit cross-subsidies, in part caused by the continuation of ‘free-if-in-credit banking’ in the UK, made it difficult to demonstrate consistently fair consumer outcomes.
- 6.50 These are examples where senior management could have taken a leadership role in focusing on fair outcomes for customers. Failure to resolve these charging issues quickly seems to have been a missed opportunity for all banks to show that they prioritise treating their customers fairly where there is a conflict between customers' interests and their own.

Del Monte Conflict of Interest

- 6.51 In October 2011, Barclays and Del Monte Corporation agreed to pay approximately \$90 million to shareholders to settle a lawsuit related to the 2010 sale of Del Monte to a group of investors. Barclays paid \$24 million to shareholders and Del Monte paid \$66 million.¹⁰⁷ Barclays denied all allegations of wrongdoing with respect to the settlement and was not a party to the litigation. The case related to a leveraged buy-out by a consortium led by private equity investor KKR. Barclays Capital advised Del Monte.

¹⁰⁴ OFT, *Personal Current Accounts in the UK: An OFT Market Study*, 16 July 2008.

¹⁰⁵ Tim Edmonds, Parliamentary Research Briefing, *Retail Banking: Overdraft and Credit Card Charges*, 1 June 2011.

¹⁰⁶ The Times, “Banks must make costs clearer or else, OFT warns”, 26 January, 2011.

¹⁰⁷ Chancery Court of Delaware, *In re Del Monte Foods Company Shareholders Litigation*, February 2011 and June 2011 filings; see also: Del Monte SEC filing 333-107830-05.

- 6.52 The lawsuit alleged that Barclays Capital had a conflict of interest while advising Del Monte on the sale that may have resulted in Del Monte receiving a lower sale price. Investors claimed that Barclays Capital intentionally limited the number of potential Del Monte buyers and, despite confidentiality agreements, steered the group together to increase chances that Barclays would provide the financing. The practice of a bank advising on a deal also providing the financing, called staple financing, was reasonably common at that time. A prearranged financing package could help the seller complete a sale quickly and the buyer to know that financing is available. Banks would earn fees from both sides of a potential merger by advising the seller and financing the buyer.
- 6.53 Barclays told us that it has since stopped the practice of providing staple financing. The settlement and associated publicity also led at least eight other banks to review their own policies on financing buy-outs when they also have a role advising sellers.¹⁰⁸
- 6.54 We accept that investment banks have historically had to navigate a number of inherent conflicts of interest, given that they will often have present or historical connections on both the sell and buy sides of deals. How conflicts of interest are best managed in particular circumstances depends on the precise circumstances. We consider, however, that the practice of staple financing did carry a risk of a perception that the interests of Barclays Capital's clients could have been affected by the bank's involvement in financing the deal. This provides another example of where reliance on apparent industry practice is not necessarily a satisfactory answer to a particular ethical issue. It may well be that what is said to be a standard practice is only appropriate in specific circumstances, or subject to specific conditions, and that there is a danger that these limitations are not fully understood as the practice develops. An ideal culture would value curiosity and enquiry in circumstances where on the face of it there is an ethical issue.

Inappropriate Behaviour – LIBOR and EURIBOR

- 6.55 The LIBOR and EURIBOR index rate-setting issues that emerged publicly in June 2012 led to fines for Barclays, which was the first bank publicly to settle the regulatory complaints. Due to continuing investigations into potential criminal actions, the scope of our review of these events excluded all matters subject to legal privilege.
- 6.56 At the heart of the matter were submissions of figures for the rates paid on inter-bank transactions used in the calculation of the LIBOR and EURIBOR rates widely used in financial transactions. These submissions took place at least as far back as January 2005 and continued until July 2008. Barclays' employees and employees at certain other banks were involved.
- 6.57 On 27 June 2012, the FSA said that "Barclays' misconduct was serious, widespread, and extended over a number of years" and that the bank's breaches included:

¹⁰⁸ Bloomberg, "Barclays Leads LBO Financing Retreat After Del Monte Slap", 14 September 2011.

- “Making submissions which formed part of the LIBOR and EURIBOR setting process that took into account requests from Barclays’ interest rate derivatives traders. These traders were motivated by profit and sought to benefit Barclays’ trading positions;
- Seeking to influence the EURIBOR submissions of other banks contributing to the rate setting process; and
- Reducing its LIBOR submissions during the financial crisis as a result of senior management concerns over negative media comment.”¹⁰⁹

6.58 The FSA found that Barclays had “failed to have adequate systems and controls in place relating to its LIBOR and EURIBOR submissions processes until June 2010 and failed to review its systems and controls at a number of appropriate points”.¹¹⁰ The FSA also found that LIBOR concerns had been escalated to Barclays Compliance in the investment bank, but they had not been addressed effectively. The FSA acknowledged that Barclays co-operated fully with the regulatory investigation.¹¹¹

6.59 Marcus Agius, then Chairman of Barclays, said: “The Board takes the issues underlying today’s announcement extremely seriously and views them with the utmost regret. Since these issues were identified, the Authorities acknowledge that Barclays management has co-operated fully with their investigations and taken, and continues to take, prompt and decisive action to correct them.”¹¹²

6.60 Although Barclays was the first bank to be fined for significant failings in relations to LIBOR submissions, a number of other banks were also under investigation.¹¹³ UBS and RBS have recently paid £940 million and £390 million respectively in fines and penalties for issues related to the attempted manipulation of LIBOR.¹¹⁴

6.61 Unlike most of the other events considered in this section so far, LIBOR concerns the investment bank and raises questions as to whether behaviours might be more commonplace on trading floors. We consider that these LIBOR events suggest there were:

- Cultural deficiencies on the trading floor; indicative of a failure to embed clear ethical values in this part of the Group;
- Ineffective front office supervision and controls, furthered by the lack of separation or ethical walls between the trading teams and those submitting data to the LIBOR and EURIBOR compilers;
- Flaws in the relevant functional controls so that breaches on the trading floor were neither discovered nor dealt with on a timely basis – recognising that until the problem was discovered, it had not been seen as presenting any material risk;

¹⁰⁹ FSA, “Barclays fined £59.5 million for significant failings in relation to LIBOR and EURIBOR” (FSA/PN/070/2012), press release, 27 June 2012.

¹¹⁰ *Ibid.*

¹¹¹ *Ibid.*

¹¹² Barclays, “Barclays Bank PLC Settlement with Authorities”, press release, 27 June 2012.

¹¹³ CNN Money, “Nine more banks under scrutiny in LIBOR investigations”, 26 October 2012.

¹¹⁴ BBC news, “LIBOR scandal: RBS issued £390m fine”, 6 February 2013.

- Performance targets and bonus arrangements for traders which encouraged behaviours to make profits for the bank and for themselves and which may have led some to ignore the ethical or legal issues or the reputational impact on the bank.

- 6.62 The FSA also considered LIBOR rate submissions between September 2008 and May 2009, amid concerns that they had been adjusted on the instruction of Barclays' senior management to make the bank appear healthier at the peak of the financial crisis. We draw no conclusions in relation to these issues, other than that there appear to have been significant failures of communication, internally and with the authorities, regarding the bank's rate submissions.
- 6.63 We have not been able to assess whether the behaviour illustrated by the much publicised LIBOR emails reflects a particular trading culture that could extend into other parts of the investment bank. With current levels of scepticism, the public is likely to suspect that the problem extends elsewhere. It will be important that Barclays seriously addresses this possibility and fully investigates other areas where similar issues might have occurred.
- 6.64 Barclays cooperated with the regulatory enquiries and was given credit by the regulators for this. We have been told that Barclays was generally good at responding to particular issues identified by regulators – but less good at identifying and dealing with the wider implications of those issues. As Barclays discovered the LIBOR problem, we believe that it could have moved more quickly to learn any wider lessons and to review whether there were pricing or trading issues elsewhere across the bank.
- 6.65 A number of banks, including Barclays, had raised concerns about the setting of LIBOR. In the press notice relating to the FSA's own internal audit report (in March 2013) into the LIBOR submissions issue, it noted that "the information received should have been better managed" by the FSA and "taking the information cumulatively the likelihood that lowballing was occurring should have been considered". The information included some from Barclays.¹¹⁵

Looking Forward

- 6.66 As Barclays, on the back of the Transform Programme, works to improve its values and culture, and the effectiveness of its systems and controls, it is quite possible that further historic conduct issues will be discovered. This brings with it the paradox that current improvements could uncover legacy issues which further damage Barclays' reputation. We consider this to be an inevitable part of the change process and Barclays should be quick to handle issues, and not be put off by the specific response to its early settlement of the LIBOR regulatory actions.
- 6.67 Interest-only mortgages are an example of the present predicament that banks face under which long-established products are subsequently reviewed and challenged for their suitability. The FSA has stated that interest-only mortgages can still be sold

¹¹⁵ Source: FSA internal audit report, 5 March 2013.

“if the borrower can show that they have a credible repayment strategy.”¹¹⁶ These mortgages offer lower regular payments by customers who are required to repay the capital in its entirety at maturity. Flat or declining house prices in recent years, coupled with low-returns on savings, reduce a customer’s room for manoeuvre and leave banks with less cover in cases of default. On the other hand, many of these mortgages will have been taken out at a time of rising property prices, when it would have seemed a reasonable assumption to borrowers that they would be able to remortgage on maturity, and when joining the property ladder was preferable to paying rents for many years with no prospect of building equity. Banks (and regulators) should avoid this being a new opportunity for claims management companies. Instead, Barclays and its peers should consider how most helpfully to respond to the issues now faced by their customers whose mortgages are coming to maturity. This is an opportunity for Barclays to show that its actions are consistent with its purpose – “Helping people achieve their ambitions, in the right way.”¹¹⁷

- 6.68 Banks also face a number of legacy issues in the global wholesale markets. In the US, for instance, the Federal Energy Regulatory Commission (FERC)¹¹⁸ is looking into alleged manipulation of the US energy markets. This illustrates an issue about the development of regulation. Over time, regulation applies broadly agreed standards to new markets or asset classes. Until that point, there is a possibility that those trading in such markets or asset classes will have an opportunity to take advantage of the relative lack of such regulation. Banks should take care to consider the application of the spirit of regulation to these trading opportunities ahead of the precise regulation, having due regard to public expectations and to the reputational implications.

Industry observation C: Legacy

As banks take actions to restore trust, there is a risk that their task will be made more difficult by the emergence of historical issues that crystallise and become public in the future. This is, to some extent, inevitable. The regulators may have an opportunity to recognise the historic nature of these issues and so help the rehabilitation process.

¹¹⁶ FSA, “FSA confirms new rules that will hard-wire common sense into the mortgage market” (FSA/PN/098/2012), 25 October 2012.

¹¹⁷ Barclays’ website: <http://group.barclays.com/transform/values>.

¹¹⁸ Bloomberg website, 29 January 2013; see www.bloomberg.com.

7. Regulatory and Tax Matters

- 7.1 As noted earlier, banks play a vital role in modern economies and in the well-being of individuals and businesses. The biggest banks are of great importance to society as employers and taxpayers. They also carry significant risk such that politicians, central banks and regulators have developed a series of legal and regulatory requirements for them. Complying with these requirements and engaging with the regulators and other public bodies are essential responsibilities for banks and their managements. Failure to do so can inflict reputational damage on a bank and undermine public trust in it.
- 7.2 The Barclays Board and senior management have rightly emphasised the importance they put on compliance with regulations and in regulatory relationships.¹¹⁹ However, various regulators have expressed concerns about the bank's historical engagement with them. Likewise, Barclays says that it goes to great lengths to comply with tax legislation, and to maintain an open relationship with Her Majesty's Revenue and Customs (HMRC). However, some of the tax avoidance schemes that Barclays has promoted are now seen as aggressive and not in accordance with the spirit of the relevant tax legislation.
- 7.3 In this section, we examine Barclays' engagement with the regulators and the tax authorities.

Regulatory Engagement

- 7.4 Successfully managing various stakeholders and balancing their priorities is critical for all organisations. For banks, regulators are a vitally important stakeholder: they set the rules, supervise prudential financial strength and business conduct, challenge, and ultimately approve a bank's licence to operate. A poor regulatory relationship can result in onerous challenges for management including withdrawal of a banking licence, increased capital and liquidity requirements, financial penalties, mandatory remediation exercises, restrictions on activities and, as was the case for Barclays, the departure of senior executives and Board members.
- 7.5 The FSA Handbook contains eleven principles for regulated firms (see Exhibit 3). Principle 11 states: "A firm must deal with its regulators in an open and cooperative way, and must disclose to the FSA appropriately anything relating to the firm of which the FSA would reasonably expect notice."¹²⁰
- 7.6 An important element of fostering a positive and cooperative relationship with regulators is therefore open communication and transparency. Some communications from regulators will always need interpretation and some of their approaches should rightly be challenged. But banks must listen carefully and not interpret regulatory requests and feedback too narrowly. Both the Chairman and

¹¹⁹ For example, after its settlement with the US authorities on 18 August 2010: "Barclays is committed to the highest levels of integrity and regulatory compliance across all of its operations"; Barclays, "Barclays Bank PLC settlement with US Authorities", press release, 18 August 2010.

¹²⁰ FSA, *The FSA Principles for Businesses*; see: <http://fsahandbook.info/FSA/html/handbook/PRIN/2/1>.

Group Chief Executive have an important role to play in building strong relationships with the regulators. They are key contacts for the most senior regulators and set the tone for the rest of the organisation. Based on input from interviewees, we believe that the Chairmen and Group Chief Executives over our Review period recognised the importance of regulation and engaged in regular dialogue with regulators, although inevitably the style of the Group Chief Executive varied and so did the nature of the regulatory discussions.

Exhibit 3. FSA Principles for Businesses

The Financial Services Authority has established 11 'Principles for Businesses', which are included in the FSA Handbook. The principles are the following:

1. Integrity: A firm must conduct its business with integrity;
2. Skill, care and diligence: A firm must conduct its business with due skill, care and diligence;
3. Management and control: A firm must take reasonable care to organise and control its affairs responsibly and effectively, with adequate risk management systems;
4. Financial prudence: A firm must maintain adequate financial resources;
5. Market conduct: A firm must observe proper standards of market conduct;
6. Customers' interests: A firm must pay due regard to the interests of its customers and treat them fairly;
7. Communications with clients: A firm must pay due regard to the information needs of its clients, and communicate information to them in a way which is clear, fair and not misleading;
8. Conflicts of interest: A firm must manage conflicts of interest fairly, both between itself and its customers and between a customer and another client;
9. Customers – relationships of trust: A firm must take reasonable care to ensure the suitability of its advice and discretionary decisions for any customer who is entitled to rely upon its judgment;
10. Clients' assets: A firm must arrange adequate protection for clients' assets when it is responsible for them;
11. Relations with regulators: A firm must deal with its regulators in an open and cooperative way, and must disclose to the FSA appropriately anything relating to the firm of which the FSA would reasonably expect notice.

7.7 In 2009, Barclays also established a new Regulatory Relations role, working alongside, but not reporting to, Compliance. The purpose of this role was to improve communication with regulators and strengthen relationships. It did improve the bank's focus on the needs of the regulator, but also – unhelpfully – divided responsibilities between the new role and the Group Head of Compliance. In December 2012, Barclays created a new role of Head of Compliance, Government and Regulatory Relations reporting directly to the Group Chief Executive.

7.8 It is inevitable that most regulated firms will at times feel the need to challenge their regulator – sometimes robustly – on specific matters. However, we observed a tendency for Barclays to test the interpretation of rules and regulations rather more

strongly than we would have expected. Occasionally this resulted in Barclays positioning itself within the letter of the regulations but with little sensitivity for the regulators' views as to the spirit of those regulations. Protium is an example of this. Others are (as outlined in Section 5) the modelling approaches used in calculating capital, and the significant risk transfers which Barclays, along with other banks, engaged in for the purpose of arbitraging capital rules to reduce capital requirements. These, and the broader question of meeting capital requirements, led to some intense debates with the FSA on the acceptability of calculations, assumptions and transactions. There was a lot at stake for Barclays but the relationship seems to have suffered, with less trust and mutual respect than is desirable.

- 7.9 In some cases, Barclays' approach to the management of regulatory compliance processes also strained relationships with the regulators. Barclays told us that when a problem was identified, it was good at fixing that particular problem. Interviewees told us that it was less adept at addressing the underlying causes or seeing that the specific issues required a more comprehensive solution. These concerns intensified as the regulatory environment became more intrusive in response to the financial crisis and as Barclays businesses grew and became more complex. Barclays seems to have found it difficult at times to moderate its approach.
- 7.10 We acknowledge that regulations have become complex and challenging for banks, made more so by the political and regulatory response to the financial crisis. There is a risk that at times the resources available to large universal banks on matters that have a bearing on these complex regulatory determinations significantly outweigh the resources available to the FSA, although these have been increased in the past five years. The approach by a technically expert and well-supported Barclays team, focusing on the letter of the law when presenting or discussing specific matters may, however, have created a significant risk of mistrust on the part of the regulatory team. We believe a culture developed within Barclays, quite possibly derived originally from the investment bank, which came across to some as being 'clever' or what some people have termed 'too clever by half', even arrogant and aggressive. Barclays was viewed by some as pushing the envelope to the limits. This was a view expressed at times by financial regulators, at least in the UK. It is also true that some shareholders and public bodies shared the same perspective.

Industry observation D: Open collaboration

Leading UK financial institutions have a stake in the high quality and international reputation of UK regulation and in the effect of regulation on the resilience of counterparties and the system as a whole. While challenge is appropriate, such institutions have a critical role to play in supporting the effectiveness of regulation. This should include regular engagement by the Chairmen and Chief Executives of the banks with the leadership of the PRA and the FCA, as well as with other public authorities with an interest in regulation. It should include consideration of ideas to assist both regulators and the banks improve mutual understanding.

One example would be for banks to recognise the value to bankers, as part of their careers, of spending time (probably for around two years to be valuable)

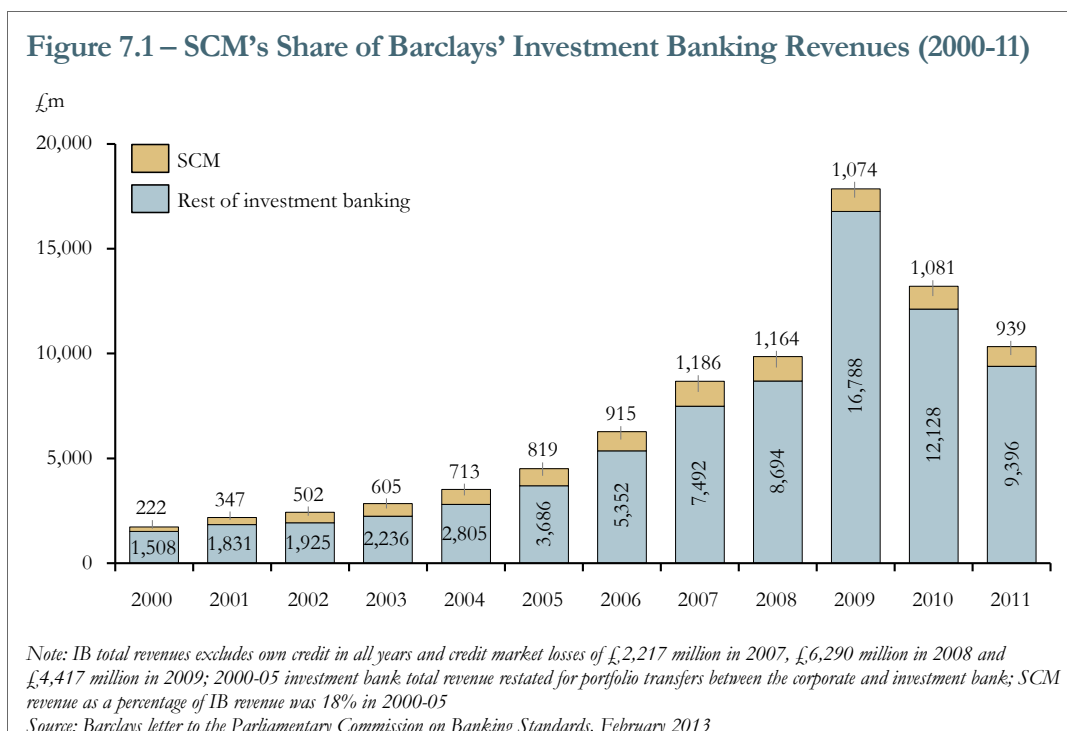
working in a regulator, and vice versa. We see no reason why conflict and confidentiality issues should not be capable of resolution as this is a common practice in some other jurisdictions.

Collaboration between regulators and banks might also encourage candour and support for the values which regulators and the public wish to see banks uphold. This, in turn, depends on regulators having regard, in enforcing breaches, to the risk of driving a culture of defensiveness within banks and a more legalistic response. Honest mistakes in complex organisations of thousands of people are inevitable. Banks will find it harder to establish open cultures if such mistakes are perceived as being treated in the same way as serious breaches of duties or rules.

Relationship with HMRC

- 7.11 Barclays may have underestimated the reputational effect of its dealings with the tax authorities, which have been another source of damage to the bank's reputation. Financial institutions have increasingly come under media and public pressure since the financial crisis over their tax optimisation strategies. In March 2009, the Guardian published details of certain Barclays' tax structuring schemes. We set out details of Barclays' corporation tax charges in Appendix H. Barclays represents that the tax structure was voluntarily and fully disclosed to HMRC though there was no statutory obligation to do so.¹²¹
- 7.12 Historically, some banks have been actively involved in structuring financial transactions to gain tax, financial reporting or regulatory capital benefits. Often these activities were run as part of, or as add-ons to, fixed income or equities businesses. At Barclays, the SCM business was run as a free-standing operation, primarily based in London, but also replicated in the US following the Lehman acquisition. It undertook transactions in many countries for financially-sophisticated corporates and financial institutions. In addition to its client-facing business, SCM provided tax advice and structures to Barclays itself to help the bank manage its own tax and regulatory position efficiently.
- 7.13 Barclays provided limited information in its published accounts about SCM as the business grew, and it did not present its results separately. Overall, while there are some accounting assumptions necessary in allocating costs to SCM's separate business, SCM (with around 100 employees) has clearly been a large and profitable part of the investment bank, making a particularly high contribution in the early years of the investment bank. Its profitability helped support the development of other areas of the investment bank.

¹²¹ The Guardian, "Revenue Investigates Barclays tax mole claims", 16 March 2009.



- 7.14 There is no suggestion that Barclays illegally evaded tax or put forward such schemes to clients. Interviewees told us that SCM adopted a policy of transparency with HMRC. Its practice was to disclose to HMRC, on an annual basis, details about the structured transactions so that HMRC could evaluate them. However, we note that HMRC had introduced a disclosure requirement from August 2004 concerning employment or financial products, widened in 2006 to all income tax, corporation tax and capital gains taxes. A tax arrangement had to be disclosed if it “will, or might be expected to, enable any person to obtain a tax advantage”.¹²²
- 7.15 In interviews, senior management stressed that Barclays put in place rigorous internal review processes, involving senior individuals, to approve tax transactions to ensure they were in compliance with relevant legislation and Barclays’ policies. SCM also obtained external legal advice in support of the legal effect of transactions.
- 7.16 Nonetheless, SCM operated in an inherently risky business dependent on the interpretation of the relevant tax legislation. Barclays tended to negotiate an annual settlement of its tax liabilities with HMRC. From 2006, under its ‘Litigation and Settlement Strategy’, HMRC took a view as to whether to challenge tax-based transactions on the basis of its judgment as to their legal effectiveness for tax purposes.¹²³ This made it inappropriate to settle the tax liability on an overall negotiated basis and Barclays has found it more difficult to settle outstanding tax issues since then.

¹²² HMRC, *Disclosure of Tax Avoidance Schemes*, August 2004.

¹²³ Dave Hartnett, “Exclusive: Litigation and Settlement Strategy Relaunched”, *Tax Journal*, 14 July 2011; <http://www.taxjournal.com/tj/articles/litigation-and-settlement-strategy-relaunched-28812>.

- 7.17 Practice was further changed by the 2009 *Code of Practice for Taxation for Banks* which said: “The Government expects that banking groups, their subsidiaries and their branches operating in the UK will comply with the spirit, as well as the letter, of tax law, discerning and following the intentions of Parliament”.¹²⁴ Barclays, like all of the other top 15 banks in the UK,¹²⁵ adopted this Code.
- 7.18 HM Treasury announced on 27 February 2012¹²⁶ that it had taken steps to close two “highly abusive” and “aggressive” tax avoidance schemes, which would ensure payment of over £500 million in corporation tax.¹²⁷ We understand that SCM designed such schemes for Barclays. The first scheme sought “to ensure that the commercial profit arising to the bank from a buyback of its own debt” was not subject to corporation tax. HM Treasury’s action was implemented retroactively. The second involved Authorised Investment Funds (AIFs) and aimed “to convert non-taxable income into an amount carrying a repayable tax credit in an attempt to secure ‘repayment’ from the Exchequer of tax that [had] not been paid.”¹²⁸
- 7.19 Before entering into these schemes Barclays obtained “strong legal guidance, as well as information on market practice in this area from professional advisers, which together helped inform (its) conclusion that the transaction was compliant with the Tax Code.”¹²⁹ Barclays had also “voluntarily and proactively disclosed” the schemes to HMRC “in line with (its) long-standing practice of full transparency”.¹³⁰ However, HMRC said it had “not been able to identify any arrangements” suggesting this was market practice and would challenge any that came to light. At the Treasury Select Committee, Andrew Tyrie said: “had (HMRC) been consulted in advance of the bank’s transactions they could have made the position clear.”¹³¹
- 7.20 John Whiting, policy director at the Chartered Institute of Taxation was cited in the Sunday Times as saying: “It is difficult to define what is acceptable tax planning and what is tax avoidance. The banks have all signed an agreement saying they won’t engage in tax avoidance, but nobody has said where the lines are drawn.”¹³²
- 7.21 In entering into these schemes, Barclays “failed to sense a prevailing mood against tax avoidance” – according to an executive at a rival cited in The Sunday Times, it

¹²⁴ HMRC, *Code of Practice on Taxation for Banks*, December 2009.

¹²⁵ HM Treasury, “Top 15 banks sign Code of Practice”, press notice, 30 November 2010: http://www.hm-treasury.gov.uk/press_66_10.htm.

¹²⁶ HM Treasury, “Government action halts banking tax avoidance schemes”, press notice, 27 February 2012: http://www.hm-treasury.gov.uk/press_15_02.htm.

¹²⁷ Ultimately enacted as legislation through the 2012 UK Finance Act.

¹²⁸ HM Treasury, “Government action halts banking tax avoidance schemes”, press notice, 27 February 2012; http://www.hm-treasury.gov.uk/press_15_02.htm.

¹²⁹ Letter from Bob Diamond to Andrew Tyrie MP, Chairman of the Treasury Select Committee, dated 1 June 2012; <http://www.parliament.uk/documents/commons-committees/treasury/Letter-from-Chief-Executive-of-Barclays.pdf>.

¹³⁰ Letter from Bob Diamond to Andrew Tyrie MP, Treasury Select Committee, dated 15 May 2012; <http://www.parliament.uk/documents/commons-committees/treasury/Letter-from-Chief-Executive-of-Barclays.pdf>.

¹³¹ Letter from Andrew Tyrie MP, Chairman of the Treasury Select Committee, to Bob Diamond dated 1 June 2012: <http://www.parliament.uk/documents/commons-committees/treasury/Letter%20from%20Chancellor%20re%20tax%20and%20barclays.pdf>.

¹³² Sunday Times, “Barclays licks wounds as ministers show no mercy; The bank has failed to sense a prevailing mood against tax avoidance”, 4 March 2012.

failed “to realise what was acceptable before is no longer acceptable”.¹³³ We consider that this is another example of Barclays’ failure to assess adequately the reputational damage of its actions, inclining to rationalise its behaviour on technical arguments rather than reaching a broader judgment of reasonable public expectations. In doing so it further eroded trust in Barclays.

- 7.22 In the second half of 2012, the investment bank undertook a review, known internally as Project Mango, to assess the reputational risks involved in its various business lines as well as their profitability. In February 2013, Barclays published its tax principles for conducting business which has an impact on clients’ and Barclays’ tax.¹³⁴ We regard this as a good example of improved openness. Barclays announced that, while continuing tax planning for clients and on its own account within its publicly defined tax principles, it would “close the SCM business unit”.¹³⁵ We understand most of the SCM employees are to move to other businesses in the investment bank.
- 7.23 In our view, if Barclays is to restore its reputation and rebuild trust, it needs to consider much more thoroughly the reputational impact of businesses and transactions in which it is engaged, such as SCM – not just whether individual transactions are commercially viable and in compliance with the law, but also taking account of the cumulative impact of such transactions, as well as their impact on stakeholders’ views of Barclays. The executives and Barclays Board should reflect these considerations in reviewing the bank’s risk appetite.
- 7.24 The Barclays Board should closely monitor the bank’s relationships with regulators and other public authorities, particularly any feedback from them on transactions and businesses the bank engages in. Barclays appears to have been insensitive to changing political and public expectations around tax and to the UK regulators’ expectations on openness and compliance with the spirit of the rules. In the view of many, this reflected a failure more generally to recognise its responsibility, as a major UK institution, to show leadership.

Recommendation 1: Regulatory and business standards

Barclays should take a leading role in contributing to an effective regulatory system. It should ensure that it applies appropriate regulatory and business standards across all its businesses, complying with the spirit as well as the letter of prevailing regulation and law. It should work with regulators in a way that is consistently open, clear and transparent. It should reinforce these objectives through its performance management and reward systems.

The Chairman should seek, and respond to, feedback from its major regulators and appropriate public authorities.

¹³³ *Ibid.*

¹³⁴ See Barclays Strategic Review presentation, 12 February 2013.

¹³⁵ Barclays, “Becoming the Go-To Bank”, *Barclays Strategic Review*, Antony Jenkins presentation to investors, 12 February 2013.

Industry observation E: Clarity of message

At times there has been confusion between some bankers and regulators as to the precise message that the regulators are sending. Clarity of message is more complicated in times of financial stress when there are interactions at many levels and the matters being discussed are sensitive. These relationships, however, are not helped by such misunderstandings. In saying this, we are not making any assessment of where any communication fault lies, but rather that regulators should seek to be as clear as possible in their messaging and banks should listen carefully and seek clarification where any message is unclear.

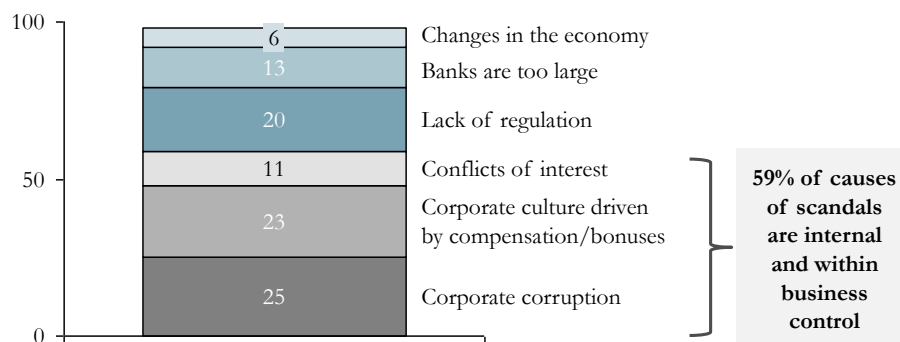
8. Culture

- 8.1 Trust is a fundamental requirement for any successful organisation. Yet survey data show a persistent and debilitating scepticism among customers, investors and other stakeholders in the trustworthiness of the business world.¹³⁶
- 8.2 Banks in particular are built on trust. After all, they look after our money. Banking requires that we have trust and confidence that our bank is not taking undue risk. Building an organisation's reputation for trustworthiness takes time and is founded on a robust ethical culture supported by leaders, systems and policies designed to foster and reinforce employee trustworthiness. In industries that are associated with risk and risk-taking, the work that must be done to establish and sustain trust is greater. Barclays' work on culture and values comes at a time when trust in banking and bankers is at an all-time low. Trust comes from an expectation that what is said will be delivered. Trust is also strongly related to fairness. Studies show that the experience of unfairness quickly erodes trust.¹³⁷
- 8.3 Data from the Edelman 2013 Global Trust Barometer shows that at 50%, trust in banks and financial services, is lower than for all other business sectors. In the UK, the level of trust in banks is a startling 22% in 2013. The Global Trust Barometer measures trust through surveys of over 31,000 people in 26 countries. The survey also asked respondents to explain the biggest causes of the recent scandals in banking. 59% of responses linked the issues to organisational culture – i.e., conflicts of interest, corporate corruption, and the consequences of bonuses and compensation (see Figure 8.1).¹³⁸ Compensation is heavily weighted in public judgment because of the perception of fair value and the challenge of justifying compensation levels (particularly in investment banking) in terms that most people can relate to (see Section 11).

Figure 8.1 – Perception of the Causes of Banking Scandals

“What do you think is the biggest cause of these scandals?”

(%, Question asked of respondents familiar with recent banking/financial services scandals)



Note: Segments in source data do not sum up to 100% due to rounding
Source: 2013 Edelman Trust Barometer

¹³⁶ Edelman, 2013 Edelman Trust Barometer, January 2013.

¹³⁷ Roderick Kramer, *Rethinking Trust*, 2009.

¹³⁸ Edelman, 2013 Edelman Trust Barometer, January 2013.

- 8.4 Worryingly, trust in banking has also been eroded amongst bankers themselves. 24% of all respondents to a 2012 survey of 500 financial services professionals in the US and the UK believed that, in order to succeed, financial services professionals may need to engage in unethical or illegal conduct.¹³⁹ A similar number purported to have first-hand knowledge of wrongdoing in their workplace. The extent of the challenge was underlined by the preliminary findings from a 2013 multi-country study of banks by Deloitte which seeks to understand senior bankers perspectives on the challenge of culture and cultural change in banking. This study has identified that 70% of senior bankers believe that there are significant cultural problems across the industry and 78% believe the industry would benefit from cultural change.¹⁴⁰

Cultural Challenge Facing Banks

- 8.5 Senior British bankers have acknowledged that problems with organisational culture contributed to the financial crisis and to the erosion of public trust and confidence in banks:
- In October 2010, Marcus Agius, then Chairman of Barclays, stated: “The leaders of our industry must collectively procure a visible and substantive change in the culture of our institutions ... so as fundamentally to convince the world once again that they are businesses which can be relied on”;¹⁴¹
 - In October 2012, Stephen Hester, Chief Executive of RBS, said: “Banks must undergo wholesale change in their culture and refocus their behaviour on meeting the needs of customers to restore trust in the industry”;¹⁴²
 - In October 2012, Sir David Walker, now Chairman of Barclays, said: “Mistrust and the perception of inadequate standards have led to a crisis of confidence and it is severe. (...) We must not recoil from the shock waves, rather embrace the current reality and deliver the cultural change”;¹⁴³
 - In November 2012, Douglas Flint, Chairman of HSBC, said (when talking about the banks having come to terms with ring-fencing): “I think we have lost the right to self-determination... It doesn't really matter whether any of us think it [the new rules] will be our optimal choice as I think we have lost the right to determine ourselves what we think the optimal choice is. We can work with this, and I think the transparency would be good.”¹⁴⁴

¹³⁹ Labaton Sucharow, *United States & United Kingdom Financial Services Industry Survey*, July 2012; <http://labaton.com/en/about/press/upload/US-UK-Financial-Services-Industry-Survey.pdf>.

¹⁴⁰ Deloitte LLP, *Culture in Banking Survey*, 2013. Deloitte refers to Deloitte LLP, the UK member firm of Deloitte Touche Tohmatsu Limited (“DTTL”), a UK private company limited by guarantee, whose member firms are legally separate and independent entities. Please see www.deloitte.co.uk/about for a detailed description of the legal structure of DTTL and its member firms.

¹⁴¹ Financial Times, “Bad actions stick, the archbishop tells city”, 4 October 2010.

¹⁴² Reuters, “CEO says banks need culture change to regain trust”, 1 October 2012.

¹⁴³ Alison Gill, “A Boardroom Conversation with Sir David Walker”, 1 October 2012; <http://www.bvalco.com/a-boardroom-conversation-with-sir-david-walker-1-october-2012.htm>.

¹⁴⁴ Oral evidence given by Douglas Flint to the Parliamentary Commission on Banking Standards, 5 November 2012.

- 8.6 How did leading bankers reach these sobering conclusions? The answer seems to lie partly in the fact that the crisis (and other events covered by this report) highlighted in the public eye the imbalance between high pay (at least for some), high risk, and treatment of customers and other stakeholder interests. It has become increasingly apparent that the UK public also considers its major banks to be semi-public institutions. The crisis seemed to reveal levels of carelessness relating to capital adequacy, concentration of risk and unsustainable funding models. This carelessness was possibly encouraged by the Government who were content to allow the misplaced optimism that a new economic paradigm was evolving. The idea that leaders of some banks somehow allowed their organisations to 'forget' these fundamental principles and to pay disproportionate rewards, based on a share of unsustainable profits, led to a conclusion that leaders, tone from the top and culture went awry. Bank leaders became identified with driving profit and shareholder return rather than promoting a clear sense of purpose, instilling good values, and doing the right thing for the customer and the long-term good of the organisation. Banks became synonymous with flawed business practices.
- 8.7 Appropriate business practices are always important, but disproportionately so in higher-risk industries where key business concerns transcend growth, profitability and competitive advantage. In such industries, management focus on developing business practices which emphasise the importance of never compromising safety or of managing risk in a way which avoids catastrophic loss. Banking certainly falls into the latter.
- 8.8 When culture compromises business practices, severe reputational risks can ensue – as the Ford Motor Company experienced in the late 1970s. In 1977, a magazine article¹⁴⁵, citing a 1973 Ford internal cost-benefit analysis, claimed that the Ford Pinto's structural design was dangerous for passengers and that Ford believed it would be cheaper to pay off lawsuits resulting from damage and injuries than to recall vehicles for repair. This caused huge damage to Ford's reputation, with Ford ultimately directed to recall the Pinto in 1978 for safety failures.¹⁴⁶
- 8.9 The lessons from other high-risk industries include fostering a culture where: leadership and operational discipline is focused on areas of highest risk; speaking up and working collaboratively with regulators and with other stakeholders is encouraged; and risks and the appropriateness of business practices are continually evaluated. Industries which have encountered trouble, or which actively look for potential trouble and collaborate in working to avoid it, offer some useful lessons for banks. Appendix D summarises what other industries have done to create the right cultural context, and describes how these lessons can apply to banks.
- 8.10 Culture is experienced socially and intellectually. It is the experience which distinguishes being a customer or employee of one organisation from being a customer or employee of another. Values are the foundation of culture. They represent the core of what is important – the shared principles by which individuals and groups in organisations make choices. They help people to determine that which

¹⁴⁵ Mother Jones, *Pinto Madness*, September/October 1977 issue.

¹⁴⁶ See Appendix D for further details of this case.

is right and wrong. Business practices are shaped by values. Appendix B provides a more general discussion of what culture is, why it matters and how it can go wrong.

- 8.11 Appendix B also discusses some of the research pointing to the importance of an organisation having a clear sense of purpose. Groups of people require (in a socio-psychological sense) that sense of purpose (what they are there to do). In this way, purpose is a foundation of culture. Culture then gets determined by the way the group shares and acts upon its collective sense of purpose. The research also shows that cultures defined by overly commercial and competitive features, with little regard for other elements, lead to poor outcomes. It is inherent in most people to seek purpose beyond the purely commercial. In many successful organisations, this purpose is expressed around their promise to customers and their role in society at large. In our view, Barclays did not, until recently, have a clear statement of a common purpose across its businesses. It rather emphasised growth and financial success. The closest the Group came to having a single vision was the strategy adopted by Group Chief Executive, John Varley, where he articulated the bank's goal to become a 'Top 5' bank – not necessarily in overall size, but in terms of the capability and global competitive position of each of the businesses in which Barclays competed. While this was a galvanising force, the stated aim was growth and improvement of competitive position.

Recommendation 2: Setting high standards

The Board and senior leadership, as custodians of Barclays' reputation, should promote and safeguard the trust in which it is held. They should state clearly Barclays' purpose and report regularly on how it is fulfilling that purpose. They should promote standards that support Barclays' ambition to be seen as a leader in business practices among its peer institutions and multi-national corporates generally. The senior leadership team should be responsible for demonstrating and promoting these high standards. This should be reflected in their annual evaluations and variable compensation.

In communicating internally and externally, Barclays should be as open and transparent as possible, aspiring to provide relevant, clear and meaningful information.

- 8.12 Over the period studied by the Review, the push for growth in the investment bank and Wealth, coupled with the need to increase returns in Retail, seems to have replaced the Group's sense of purpose and its customer focus. Perhaps unsurprisingly, this appears to have intensified as the Group fought to maintain its independence in the aftermath of the financial crisis.

Culture and Values at Barclays

- 8.13 Values drive everyday behaviour, helping to define what is normal and acceptable, explaining how things ought to be (for example, staff ought to put customers first). Values provide a framework through which the natural and often difficult conflicts that arise in people's day-to-day work can be resolved. But they will not always

provide the answers. Organisations need to create an environment where employees feel it is safe to resolve the frequent differences that arise. For example, on a daily basis, retail bank staff can face the dilemma of determining which deposit product best meets customer needs given the frequency with which interest rates and conditions can change.

- 8.14 In our review we found that the Group did not define, embed and reinforce a common set of values by which it would act. In 2005, John Varley launched the Group's five Guiding Principles – 'customer focus', 'winning together', 'best people', 'pioneering' and 'trusted' – demonstrating intent to oversee the Group through one set of values. In 2007 they were embedded in a refreshed Group Statement on Corporate Conduct and Ethics. However, over time, even the statement of these principles was lost. Most companies communicate their values; what distinguishes them is not typically the precise words but rather the way in which values become pervasive, reinforced through formal and informal processes, and demonstrably evident in leaders' attitudes, behaviours and decision making.
- 8.15 There were separate and inconsistent attempts to promote values in separate businesses. Seemingly, until Bob Diamond launched his 'One Barclays' initiative, the Group lacked a sense of the importance and role played by values in shaping a single organisation and its culture. They certainly did not prioritise it.
- 8.16 We should also note that there is a significant challenge to instilling shared values in a universal bank like Barclays. Cultural compatibility is difficult to achieve across businesses which may attract very different employee profiles, and where the business model and objectives are different. It takes a great deal of finesse to translate the same common values into credible expectations of a trading floor and of a retail branch network. This task is made harder when, as at Barclays, rapid growth (which propelled it from a family bank to a leading universal bank), multiple reorganisations and extensive external hiring (particularly in the investment bank) create a less stable cultural base.
- 8.17 Our interviews and survey data confirm that the entire Group Guiding Principles had not percolated into the consciousness of the Group. Employees of all ranks were often unaware of the Guiding Principles. If they were aware, they could cite only one or two of them – often without much authority. They also told us that they were not a regular feature of induction processes, were rarely discussed as part of how they should work in practice, and were not embedded in training or performance management processes.
- 8.18 Our review of the performance evaluation documentation revealed little emphasis on culture and values. Where present, there was little evidence of how the performance evaluation process used values effectively as a means to drive behaviour. For example, in the investment bank, although 'integrity' was specified to be a key value, the performance evaluation parameters used to determine integrity (even in relative terms) were ill-defined. The crux to embedding values is as much about the zero-tolerance for value breaches as it is about determining what good looks like. Some of the failures to report and escalate poor behaviours relating to the LIBOR issues demonstrate quite how loosely certain values were applied.

- 8.19 Different leaders across the Group took significantly different approaches to launching and embedding values. With a few notable exceptions (mostly in RBB from 2009 onwards), values and cultural initiatives tended to be promulgated rather more passively (e.g., Barclays intranet) than through more interactive methods, reinforced throughout an employee's career.
- 8.20 In the absence of a common purpose, shared culture and a set of values reinforced from the top, we found that Barclays' divisional leaders devised their own values frameworks – perhaps unsurprising given the bank's decentralised model. Indeed, in March 2012, the Barclays Brand & Marketing team identified a significant number of different values and behaviours spread across the Group and its businesses. These are laid out in Figure 8.2.

Figure 8.2 – Values and Behaviours Identified by Barclays, March 2012

<i>(Number of mentions)</i>	Barclays Group	Investment Bank	Corporate Banking	Wealth	Retail and Business Bank (EU)	UK Retail & Business Bank	Barclay-card	Absa
Winning together (6)	Winning together	Be one firm	Teamwork	Winning together		Work together	Working together	
Customer / client focus (5)	Customer & client focus	Client focus	Client focus	Client focus	Customers' world			
Forward thinking (5)	Pioneering			Pioneering	Thinking bold		Thinking ahead	Initiative
Responsible (5)	Trusted		Integrity	Trusted		Own it	Taking ownership	
Best people (4)	Best people	Invest in talent	Meritocracy	Best people				
Execute flawlessly (2)		Execute flawlessly	Execution					
Resourcefulness (2)						Think smart		Resourcefulness
Build to last (1)		Build to last						
Unique (1)					Unique			
Keep it simple (1)						Keep it simple		
Energy (1)						100% energy		
Loving success (1)							Loving success	
Courage (1)								Courage

- 8.21 These separate attempts in different business units to define values – some of which seemed to be intentionally distinctive from those conveyed by the Group – were attributable to, and encouraged by, different sub-cultures. Employees therefore were likely to make their own decisions about values, based on what seemed to be

important to their business unit head – or even the individual leaders to whom they reported. This apparently contributed to focusing employees on loyalty to the business unit leaders (or their own boss) rather than to the Group.

- 8.22 The strongest sub-cultures were in the investment bank and Barclaycard. The investment bank promoted a small number of shared values powerfully conveyed by the attitudes and behaviours of its leaders and through its promotion reviews and compensation system. Most notably, these values were centred on commercial drive and winning. Barclaycard also built a strong identity, even to the extent of creating a different working environment and allowing a different dress code at the Group's Canary Wharf headquarters.
- 8.23 Winning and commercial drive are not necessarily wrong as values for a commercial organisation, especially if, as the investment bank tried to stress, they are intended to promote teamwork. Winning also extended to a keen interest in Barclays' position on industry league tables. However, we found that, particularly in the investment bank (but also in the retail bank sales force), the interpretation and implementation of 'winning' went beyond the simply competitive. It was sometimes underpinned by what appeared to have been an 'at all costs' attitude. This was insufficiently tempered by permission to decide that it was better sometimes to compromise and move on. This may have led to a tendency to argue at times for the letter rather than the spirit of the law. Winning at all costs comes at a price: collateral issues of rivalry, arrogance, selfishness and a lack of humility and generosity. It is dangerous to over-generalise about one culture, especially in a large global business with an overtly decentralised model. However, the evidence of highly competitive and overtly revenue-driven behaviours led us to question how far and how deep these behaviours had travelled.
- 8.24 In the investment bank, for example, we concluded that the drive to win contributed to the pursuit of some of the SCM deals and some of the actions that impacted the relationships with regulators. Barclays seems to have been more willing than its peers to challenge outsiders and less willing to cede ground. The FSA has publicly made clear that Barclays was on the aggressive end of interpretation. The consequences were that some of the actions were not entirely grounded on foundations which most people would consider reasonable, although it should be acknowledged that much of this occurred in the context of Barclays struggling to survive during the financial crisis as an independent bank. But in similar ways, not driven by the crisis, some retail bank sellers would pursue the sale of PPI, emphasising the meeting of targets and success rather than the satisfaction of customers.
- 8.25 If winning was a stated value, then 'cleverness' was an unstated – but equally strong – one. They were somewhat related. Barclays undoubtedly hired clever people. For the investment bank, this was the key to its success. Cleverness manifested itself in the way the team clearly built a very successful business on the back of a well thought-through strategy. But the cleverness showed through in other ways described elsewhere in this report: the tendency to take robust positions with regulators, to determine its position by the letter rather than the spirit of the rules, and in the 'edgy' way it pushed its own business agenda. Winning through intellectual power and single-mindedness was key to the investment bank's considerable success, both in

building revenue through effective competition and in avoiding some – though not all – of the mistakes that others made.

- 8.26 As we observe throughout this report, Barclays has not always been as open and clear as it could have been. Openness is a value which goes directly to the heart of relationships with all stakeholders, for example: providing clarity about product suitability and pricing for customers; resisting ambiguity and applying high standards of disclosure to shareholder communication; promoting cooperative and straightforward discourse with regulators; and encouraging staff to raise concerns with no need to fear the consequences.
- 8.27 It seemed to us that some of these cultural characteristics combined in an attitude which came to represent Barclays in the eyes of the external audience. This attitude may have been reinforced by the challenges of navigating the financial crisis. This may have caused Barclays to focus internally, and somewhat defensively, rather than listen fully to legitimate external views and respond to them.
- 8.28 The vast majority of Barclays' employees want to act with integrity. They want to exhibit behaviours consistent with the standards the public would expect of it as a major financial institution. This was reflected in our many discussions with staff, customers and counterparties, by the e-mails to our Review website, as well as in Barclays' Employee Opinion Surveys and both ours and Barclays' customer research. Many employees told us directly about their sadness, disbelief and anger with what has gone wrong in terms of the much publicised poor behaviours. Some spoke of their frustration with management for not listening to their concerns about the way culture was evolving. They also spoke of their determination to restore trust and rebuild an organisation in which they and their customers can feel proud. This is important, but will be achieved only if the Group, throughout all levels of leadership, consistently strengthens its efforts to define, embed and reinforce a sustainable culture suited to a modern, major financial institution.
- 8.29 We have been grateful for the willingness of many Barclays employees to help us with the Review. At the same time, we experienced directly some signs of the organisational reluctance to be open. For example, it was generally left to us to ask the right questions and identify the right documents. This seemed to be representative of an organisational defensiveness, where some more junior members of staff had been given limited authority to apply their own judgment. We suspected that the caution was perhaps a habit left over from 'fighting' to remain independent through a long crisis with many challenges, combined perhaps with a feeling that the bank was continually under attack: from virtually all sides on the quantum of pay and bonuses; from regulators (in the UK especially on stress tests but also on conduct issues); from customers claiming for alleged mis-selling; from shareholders on the clarity of its asset valuations and its pay arrangements; from the Government for not making sufficient credit available to small businesses; and from a media happy to report all of this on both its business and front pages. We hope that a clearer set of values, well discussed and understood, will help to develop a confidence in the exercise of judgment around these values and an attitude of openness based on this confidence.

- 8.30 We conclude that it would benefit the Group significantly to regain and rebuild its sense of purpose, to develop a clear understanding of the values needed to support employees in delivering on this purpose and to design the business practices that will ensure that these benefit customers, shareholders and ultimately society at large.

Customer Complaints as a Window into Culture

- 8.31 The way banks deal with complaints and client feedback reflects their approach to customers and clients. It is one of the most powerful external manifestations of an organisation's culture. Barclays' track record has been poor, although it has recently instituted significant improvements.¹⁴⁷

Exhibit 4. Complaints and Feedback Management

Organisations that care about clients listen carefully to feedback and handle complaints efficiently, effectively and openly. This requires a belief that complaints and feedback management matters, clear management commitment, dedicated resources and efficient processes.

Barclays Group's historical complaints record has been as bad as or worse than that of most other main UK banks in terms of the absolute numbers of 'FSA-reportable' complaints made against it. PPI complaints¹⁴⁸ contributed significantly to an overall 39% increase in the total number of complaints over the previous two years. However, aside from these complaints, Barclays Group's 'banking' category¹⁴⁹ complaints record has in fact been improving. This amounts to a 55% reduction in banking category complaints per 1,000 accounts in the second half of 2012 compared to the first half of 2010.

While the number of non-PPI complaints made against Barclays Group has fallen, some of our interviewees related that, historically, Barclays had a poor attitude towards complaints handling in some parts of the organisation. We consider that this is likely to reflect Barclays' tendency to be challenging or defensive when dealing with outsiders, which we observed in this Review. We believe the causes underlying this are relevant to our Review of business practices.

Customers said that Barclays acts slowly throughout the complaints handling process; that there are shortfalls and delays in identifying the most significant issues. Interviewees told us, and we observed more generally, that Barclays was not always quick to recognise recurring patterns and deal with them diligently. This is reflected in the high number of banking complaints that remain unresolved eight weeks after being raised,¹⁵⁰ as well as in the limited change in the top-20 complaints categories since 2008.¹⁵¹ More importantly, we observed insufficient urgency and failure to reach

¹⁴⁷ See Appendix C for further details.

¹⁴⁸ And other "General Insurance and Pure Protection" category complaints, namely: critical illness, income protection, other general insurance and other pure protection complaints:
<http://www.fsa.gov.uk/static/pubs/complaints/firm-level-complaints-data-2012-h1.xls>.

¹⁴⁹ Banking category of complaints comprises complaints about credit cards, current accounts, savings (including cash ISAs) and other banking and unregulated loans, according to FSA H1 2012 firm-level complaints data: <http://www.fsa.gov.uk/static/pubs/complaints/firm-level-complaints-data-2012-h1.xls>.

¹⁵⁰ 9% in H1 2010, which improved over time but jumped to 29% in H2 2012: according to FSA complaints data, the same on Barclays' website and Salz Review analysis.

¹⁵¹ Source: Barclays.

resolution on issues specifically focused around helping customers. Barclays assessed their own progress in Treating Customers Fairly (TCF)¹⁵² issues and a third of the TCF issues in the second quarter of 2012 had been live for over a year.

Barclays is also seen to take a consistently over-defensive stance towards complaints. In the second half of 2012, 57% of Barclays complaints in total (77% of PPI complaints) referred to the Financial Ombudsman Service (FOS) were settled in favour of the customer. Between the first half of 2010 and 2012, the number of new Barclays' cases reported to the FOS increased nearly fourfold.

With an experienced leadership team focusing on the issues, it is clear that Barclays has recently given more attention to handling retail complaints:

"... we believe complaints give us an opportunity to listen to and better understand the needs of our customers. We use this feedback to learn from the experience, continually improve our processes and prevent issues from reoccurring. We believe complaint handling is not just about principles and processes, but about resolving the root cause of customer concerns and stopping complaints from occurring in the first place."¹⁵³

Other initiatives are also helping to reduce the number of complaints, including reinforcement of teams in charge of handling complaints, re-designing incentives to focus on customer satisfaction, regular 'client care calls' by management, better customer discussion documents and enhanced contact centre information tools. The challenge is to ensure that these statements and initiatives are fully applied in practice.

Most corporate and institutional clients talked of the positive attitude of their dedicated relationship managers, whom they see as open to their complaints and effective in dealing with them. This is reinforced by new initiatives taking place within the corporate bank, including the implementation of quarterly compliance reviews to drive policy adherence as well as more analysis of (and learning from) root causes to identify, correct and prevent complaints.

Recommendation 3: Customers

In pursuit of its goal of being a leader among its peer institutions, Barclays should develop an understanding across its businesses of how to meet its customers' needs and expectations while also meeting its own commercial objectives and those of its shareholders. It should seek to learn from customer feedback, and publish the measures by which it would judge performance in resolving complaints. Barclays should report periodically on progress against these measures by publishing the data both internally and externally so as to reinforce the seriousness Barclays places on continuous improvement.

¹⁵² TCF aims to help customers fully understand the features, benefits, risks and costs of the financial products they buy, as well as minimise the sale of unsuitable products by encouraging best practice before, during and after the sale.

¹⁵³ Barclays Citizenship Strategy, UK complaints data: <http://group.barclays.com/about-barclays/citizenship/uk-complaints-data>.

Culture and Leadership by Business

- 8.32 There has been much speculation about the extent to which the investment bank dominated, and influenced the culture and behaviours of the retail bank. Our analysis concluded that, although there was some truth in this speculation, attempts to influence the retail bank were generally resisted. Decentralisation, the lack of mobility between the different businesses, as well as the launches of inconsistent values and cultural initiatives in each of the different businesses, led to a sense of cultural difference and cultural distance between the divisions rather than a sense of one culture with one clear sense of purpose and one set of values. Nevertheless, it does seem clear that some behaviours and values became increasingly common – commercial performance at the expense of a more balanced perspective perhaps being the most significant.
- 8.33 Although we did not find much evidence of the investment bank influencing the culture of the rest of the Group, we did find some examples:
- Between 2005 and 2011, internal movements into the Group Centre (Executive Committee and Group functions) predominantly comprised leaders from the investment bank and wealth management;
 - Because these leaders had been with the Group longer than many senior leaders in the retail bank or Group functions, they typically seemed to have more influence in decision making at Group level;
 - There was a programme of re-assigning clients from the Corporate Bank to the investment bank which (at least at the time) encouraged internal competition about ownership of clients.
- 8.34 In any group, the role models are important. At Barclays, the compensation system, promotions, and senior recruits all pointed in one direction. Financial contribution was paramount. In both the retail bank and the investment bank, the success stories were largely attached to strong personalities, successful sellers and revenue earners and individuals who demonstrated cleverness and an ability to win. We now turn to some of the individual business units.

Barclays Capital, the Corporate Bank, and Wealth

- 8.35 The investment bank grew fast over a relatively short period of time (indeed, until 2001, Barclays' Business Bank generated more revenue than the investment bank). The investment bank had a distinct, tightknit and consistent leadership team and operated as a relatively independent business within Barclays. We identified three (partly overlapping) phases with distinct characteristics: the 'edgy underdog' of the early years (1999-2003), with a narrowly focused business model; the rapid organic growth phase (2003 to 2007); and the financial crisis years (which included the 2008 acquisition of Lehman) to 2012 by which time it had become a leading global investment bank. In just over a decade, the weight of Barclays' business model has moved from one based on relatively simple consumer products to one whose revenue depends increasingly on far more complex investment banking.

- 8.36 Compared with other parts of Barclays, the investment bank lacked history. So its leaders had an opportunity to define their own cultural context. The investment bankers tended to regard the retail bank as slow, indecisive and un-commercial. In contrast, the investment banking characteristics were hard-working, fast, competitive and well rewarded for success. So despite being part of the Group and benefiting from a lower cost of funds supported by a single credit rating, and retail inflows, the investment bank tended not to recognise the relevance of Group and was never likely to adopt its culture.
- 8.37 Nor was it likely to adopt the culture of Barclays' Corporate Bank (or its Business Bank) which, while quite distinctive and emphasising integrity, was described by a number of interviewees as being relatively conservative, hierarchical and slow-moving – perhaps reflecting an emphasis on tenure and loyalty over performance.
- 8.38 The culture in Barclays Capital was influenced from its inception by its need to hire people to build the business. And Barclays did build, almost from scratch, a world-class investment bank – which no other UK bank had achieved in the same period of time. The mantra was to hire the best people – and as a challenger, Barclays Capital often had to pay a premium. This reinforced a tendency to apply disproportionate value to personal commercial performance as well as to assume that simply increasing compensation would resolve issues at senior levels. While compensation overall was broadly in line with peers, compensation for the 'group of 70' most highly-paid executives¹⁵⁴ was consistently and significantly above the peer group median (see Section 11). The stable, close-knit leadership team brought continuity, experience and a common understanding. We were also told that this made it hard for others to inject challenge.
- 8.39 The Lehman acquisition instantly increased the size and complexity of the investment bank leadership challenge. Lehman had a distinct culture and the combined organisation triggered issues of size and complexity. Running this larger organisation undoubtedly demanded more emphasis on formal systems and processes. But many of our interviewees told us that while some members of Barclays Capital's top team inspired and valued loyalty, the team disliked bad news. This all combined to create an environment in which leaders were rarely effectively tested or challenged, contributing to a sense of ambiguity about what was considered right and wrong.
- 8.40 We also heard evidence of human resources leaders who lacked authority to impose policies and exert sufficient authority to influence how the business was led (see Section 10). Reluctance by staff to escalate issues, coupled with an expectation that employees needed to show that they could resolve problems themselves, rather than look to others to do so, created a culture that lacked openness. Given these dynamics, we did not find it surprising that some in Barclays Capital failed initially to

¹⁵⁴ For the purposes of the report we defined this group as including Executive Committee members in Group, RBB, WIM and CIB; IB employees earning more than £5m; and any employees in RBB, WIM and CB who are one of the top ten highest earners in their business unit but are not on the Executive Committee. This group received the most scrutiny from the Board Remuneration Committee, and the number of executives varied slightly year on year.

escalate LIBOR issues within the investment bank and to the Group-level executives outside it. It is difficult to balance encouraging initiative, creating a culture of openness as to mistakes and enforcing a zero-tolerance approach to breaches. But that balance is critical in an investment bank.

- 8.41 When revenue leads directly to pay, with insufficient consideration of other measures of success such as safeguarding reputation or respect for others, it is an enormous challenge to prevent a cultural drift toward a sense of entitlement. It is difficult for employees to give up that which they have been led to expect.
- 8.42 The culture of Barclays Wealth up until 2006 was described as staid and in need of rejuvenation. In turning this around, its culture developed to be more like the investment bank than the retail bank. A Cultural Audit Report of Barclays Wealth Americas, which subsequently attracted media attention,¹⁵⁵ suggested an environment in which ambitious growth, financial incentives and revenue targets undermined support functions and led to a culture that was hostile to Compliance. A cultural change programme is now underway to address the issues.

Retail and Business Banking (RBB) and Barclaycard

- 8.43 The retail bank has a more diverse leadership history than the investment bank. Before 2005, RBB's culture was characterised by an emphasis on strong relationships between bankers and customers. From around 2005, we observed that the leadership of the retail and commercial bank felt that they were being challenged to improve performance. In 2007, Frits Seegers was appointed to run GRCB. He drove its international expansion, some felt with insufficient focus on risks and controls. There was a material shift from client focus to one that valued scale and financial performance. Employees felt unable to question the new growth targets – which contributed to poor financial and acquisition decisions. Employees attribute this to a 'culture of fear' (particularly, it seemed a fear of not achieving targets) as well as to weak central oversight.
- 8.44 Thereafter, the retail bank under the leadership of Antony Jenkins sought to renew its focus on customer relationships, with the business starting to focus on quality (rather than quantity) of business and to learn from recent mistakes. Employees directed us to numerous cultural initiatives in RBB, including implementation of upward feedback for all team leaders, introduction of employee opinion surveys and a cross-RBB customer complaints forum. Project LiMME (Lives Made Much Easier, introduced in 2010) demonstrates this sharper focus on developing a customer-centric business. It attempted, through the eyes of employees, to identify what could be done to deliver improvements. In March 2012, RBB's own employee interviews revealed a number of concerns – some more widely shared than others. A few broad themes did emerge, which illustrate some of the challenges the Group will face as it seeks to implement change:
- Employees believed there was little collaboration at the level of the Group Executive Committee;

¹⁵⁵ Daily Mail, "Exposed: The regime of fear inside Barclays – and how the boss lied and shredded the evidence", 20 January 2013.

- Employees felt they were treated as commodities, with no sense of long-term belonging;
- While leaders cared about customers, they did not care about employees;
- Employees felt over-managed by risk-management considerations and unable to make their own judgments about what was right and wrong; and
- Employees felt overwhelmed with initiatives ('4 Cs', 'Think Big', '5 Priorities', '13 x 13 relentless focus on simplification').

- 8.45 Barclaycard and the retail bank operate as different businesses (two websites, different call centres with little collaboration, and different dress code and work environment at Barclays' Canary Wharf head office). In the early 2000s, Barclaycard pursued a growth strategy – but failed to pay adequate attention to its controls. The incentive programmes and revenue targets of the time focused attention on, for example, the sale of PPI, together with the way in which charges for late payments and for borrowing over the limit were applied. These seem to have contributed to a culture in which making money was placed ahead of customer satisfaction. Decreasing profitability and a change in leadership precipitated a turnaround programme and heightened Barclaycard's emphasis on addressing cultural and behavioural weaknesses. The business introduced the 4Cs (customer, colleague, citizenship and company) and four behaviours (thinking ahead, taking ownership, working together and loving success).
- 8.46 Today, Barclaycard is seen within the Group as having a distinct culture which is more dynamic, innovative and collaborative, and which is supported by a management which is clear on expected behaviours. These expectations have led to customer satisfaction scores and employee behaviour playing a greater role in the Barclaycard performance appraisal process and remuneration than in the past. We also heard that there is more emphasis on the whole leadership team working collaboratively together than elsewhere in the Group. Perhaps perversely, the pride expressed in the distinctiveness of Barclaycard's culture may make it more of a challenge to align Barclaycard to the new purpose and values launched through the Transform Programme, than some of the other businesses. On the other hand, the Barclaycard experience shows the benefits of building a culture based on clearly understood values.
- 8.47 Barclaycard Employee Opinion Survey results are relatively better than the rest of the Group. They score highly on the ability of employees to challenge traditional ways of doing things, effective line management and a strong culture of cooperation.

Absa and Barclays Africa

- 8.48 Absa is run as a separate business with its own Board of Directors. This reflects both the degree of Barclays' ownership and the interests of minority shareholders. Interviewees offered different characterisations of the culture of Barclays' African operations. This is understandable given its diverse geographic and business reach. However, some common themes emerged, including an over-reliance on personal relationships, a strong sense of hierarchy, a lack of diversity, and too much deference to authority – characterised by some unwillingness to flag emerging issues early or

vigorously enough. Internal surveys indicate progress on these fronts, but only slowly. For example, junior employees still do not feel empowered to create change. Our interviews indicated that senior management recognise that this is not a sustainable model in a rapidly growing and changing region. Rather like Spain (described below) the African businesses are yet to develop strong cultural links to the rest of the Group. Interviewees observed that increasing Group mobility would help in this regard. Indeed, the same points hold true within the Africa businesses themselves.

- 8.49 We also found that cultural differences between Absa's investment bank and retail banking operation mirrored to some extent the relationship between Barclays' investment bank and retail bank. There is a pan-African plan in progress to change the business culture and operating model of Barclays Africa. This will be a considerable challenge as the management team works to integrate the separate businesses across the continent.

Spain

- 8.50 The culture in the Spanish bank reflected the culture of large banks in Spain. The decentralised business model and lack of a notable influence from the Group meant that the Spanish bank largely retained its own culture and felt like a home-market competitor. Through our interviews we saw a largely hierarchical culture but also a culture in which teamwork, consensus and avoidance of confrontation are valued. More recently, Barclays has commenced initiatives to build an Iberian umbrella to share good practices between Portugal and Spain.

Group Central Functions

- 8.51 The culture of the Group central functions was described by many from the business units as highly expert but typically slow to respond and overly internally focused. Our interviewees both from within Group and outside told us that sometimes the Group functions lacked collective influence and were kept at arms-length by the businesses, particularly by the investment bank. We concluded that this insularity was likely caused, in part, by the decentralised structure. Our interviewees told us that understanding the reporting lines was difficult and exacerbated these tendencies. Some functions worked more closely with the businesses than others – for example Credit Risk.

Board Management and Oversight of Culture

- 8.52 A board has an important role to play in protecting the culture of its institution by overseeing how effectively management promotes and embeds its stated values. So the board must consider the tone it sets; and it should dedicate sufficient board and board committee time to discussing how values are being implemented internally and to assessing how the culture is developing and its impact on behaviours.
- 8.53 Some interviewees observed, and our analysis of Barclays Board and Board committee minutes confirms, that the Barclays Board did not spend much time

discussing the culture, values and business practices developing in the Group – except in relation to the Lehman acquisition, when it was concerned with the challenges of cultural and organisational integration. We concluded that some of the more qualitative information that could have alerted the Board to fundamental indications of cultural issues was not discussed. For example, reports to the Board from the Employee Opinion Surveys showed an increasingly positive picture. Most of the time, the Board was given aggregated scores which showed that employee satisfaction was increasing year-on-year across the Group. But the Board reports did not consistently include granular data indicating, for example, wide-ranging concerns about escalating ethical issues.

- 8.54 Until recently, there was also no explicit agreement at the level of the Board about the target culture and how it might operate as a key driver of Barclays' reputation. Since the beginning of the financial crisis this is likely to have been in part because the Board agenda was dominated by the large number of difficult issues faced by the industry in general and by Barclays in particular.

Restoring Trust in Barclays

- 8.55 When Bob Diamond became Group Chief Executive, he promoted the concept of 'One Barclays'. In addition to seeking to address cost overruns and to centralise the functions, he promoted the importance of citizenship. Antony Jenkins was asked to lead the citizenship work.
- 8.56 Those initial efforts to address citizenship have continued, and we now see an increased leadership focus on, and interest in, understanding and harnessing the importance of values and culture. On 17 January 2013, Barclays' Chief Executive, Antony Jenkins, sent a memo to all 140,000 staff requesting that they sign up to a new ethical code of conduct. In this launch, he admitted that the bank had "a tendency at times, manifest in all parts of the bank, to pursue short-term profits at the expense of the values and reputation of the organisation." He added: "We must never again be in a position of rewarding people for making the bank money in a way which is unethical or inconsistent with our values."¹⁵⁶ Good decisions are made in the context of society's values, expectations and needs.¹⁵⁷
- 8.57 Values need to be embedded in the way a bank engages with the wider community. Barclays' community support activities are extensive, but there seems to be little awareness of them in some parts of Barclays. In 2012, Barclays invested a total of £64.5 million in communities around the world, focused on building the enterprise, financial and life skills of the next generation. In addition, 68,000 Barclays' employees – around half its workforce – supported community activity through volunteering, matched fundraising and regular payroll giving.¹⁵⁸ Indeed, the 2012 Employee Opinion Survey showed that 83% of employees overall are proud of the contribution Barclays makes to the community and society, although less so in Europe RBB, the

¹⁵⁶ Internal memo as quoted by Margot Patrick in the Wall Street Journal, "Barclays tells staff to uphold values or leave", 17 January 2013.

¹⁵⁷ Blueprint for Better Business, *A Framework to Guide Decision Making*, 2013.

¹⁵⁸ Barclays, *2012 Annual Report*, March 2013, p. 31; Barclays, *2011 Citizenship Report*, pp. 59-62.

investment bank and Wealth and Investment Management. Community activities were mentioned infrequently in our interviews with senior management. Barclays could do more to develop a common appreciation of these initiatives, to help embed its values and develop a recognition across Barclays that these community investments are valued by Barclays leadership and considered critical to success.

- 8.58 Changing culture in a large, diverse organisation is a significant task. We were cautioned repeatedly in our interviews with business leaders who have undertaken such transformations that embedding a resilient and values-led culture in a complex organisation takes time and is not easy. Our own survey identified high levels of scepticism among employees. Nearly 70% of those polled said that they did not believe that their leadership lived and breathed Barclays' values – although 70% also believed that their leaders were committed to change. Part of the cultural challenge to the industry might be addressed by coordinated efforts to reinforce the professional standards in the banking industry.

Exhibit 5. Professional Standards in Banking

One mechanism a bank could employ to promote appropriate standards or encourage desired behaviours has been well aired: the establishment of an organisation to encourage ethical requirements, professional qualifications and continuing professional development among staff. Barclays itself made a similar proposal in its August 2012 submission to the Parliamentary Commission on Banking Standards, including the suggestion for a code of conduct for bankers. Such a code could then be reinforced through a bank's own HR practices.

There are, of course, several existing industry bodies offering qualifications and training courses relevant to bank employees. For instance, the Chartered Institute for Securities & Investments offers judgment-based training courses using role-specific dilemmas which individuals may face at work.

We are attracted to the potential for instilling professional standards in the banking industry to rebuild a sense of a vocation or profession among bankers, and even collaboration in some areas, such as financial literacy. There are important questions to resolve, such as whether to include some self-regulation and associated disciplinary processes, how to oversee conduct, how to create a standard curriculum and whether to administer any exams. Possibly, unlike the legal, accounting or medical professions, a unitary banking body might struggle to create a curriculum which covers the full scope of a universal bank's activities. Nonetheless, a single overarching code of conduct should be capable of applying across all activities.

We believe that any future professional body would benefit from a number of attributes. To achieve registration, bankers should need to meet certain qualification requirements. These should encompass both technical skills and behavioural components in order to ensure that training addresses both content and judgment. There would need to be an overarching, principles-based code of conduct which applies to both individuals and member firms. The issue of disciplinary authority against either individuals or firms who fail to adhere to the code of conduct is more complex. Primary responsibility for conduct would rest with the member firm. Where a regulator is involved, it will be difficult for the new body to act quickly and independently of the firm and the regulator. Nevertheless, the new body would need to be able to take action against members who failed to meet its standards. Continuing

professional development would reinforce both skills and behavioural components of training.

A new industry body would seem to require the support of the Bank of England and regulators. We also see a benefit in such a body of bringing together those working in the industry, to encourage the sense that they are part of a community, constituted by the vocation or profession, with responsibilities for the industry and not just the bank for which the individual is working.

We would encourage this debate to ensure that banks are appropriately focused on how best to support change in their business practices.

'Transform Programme' and Changing Barclays' Culture

- 8.59 Restoring external trust requires Barclays to change behaviours. For this to happen, the bank needs to address its deep-rooted cultural challenges. As part of the Transform Programme, Antony Jenkins has launched an initiative to re-define Barclays' purpose and values in order to implement its goal of becoming the 'Go-To' bank. Believing that a distinctive culture must be underpinned by a common purpose and a clearly articulated set of values, Barclays' senior management has defined the common purpose as "helping people achieve their ambitions – in the right way".¹⁵⁹ And it has developed a set of Group-wide values which it says are essential in delivering strong, sustainable returns.
- 8.60 The five values which Barclays will seek to embed throughout the bank are:
1. **Respect:** We respect and value those we work with, and the contribution they make;
 2. **Integrity:** We act fairly, ethically and openly in all we do;
 3. **Service:** We put our clients and customers at the centre of what we do;
 4. **Excellence:** We use our energy, skills and resources to deliver the best, sustainable results;
 5. **Stewardship:** We are passionate about leaving things better than we found them.
- 8.61 A detailed plan has been developed to embed these values in the organisation. The plan includes the support of 1,500 values champions whose job is to facilitate discussion and exploration of the values and their implementation with all their colleagues.
- 8.62 Changing behaviours is difficult. It is easier to induct and immerse new recruits than it is to change the practices of years. For the values roll-out to work, it is important that it is both bank-wide and that all employees can relate it to their everyday work and any interactions with customers. For this reason, the bank will need to make greater efforts to engage employees in areas of the business where there is less sense

¹⁵⁹ Barclays' website: <http://group.barclays.com/transform/values>.

that the activities are undertaken for a customer or a client. Making the discussions of values and ethical dilemmas resonate is essential to the success of embedding the values in the organisation.

- 8.63 Creating a distinctive culture requires a process which is disciplined, thoughtful and persistent – one in which actions will speak louder than words. A detailed road map is needed to ensure that the values set by management are reflected in the organisation's business practices. It is their day-to-day experiences that enable people to orient themselves and their attitudes and behaviours around the cultural norms, through informal dialogue, and observing how leaders behave, as well as more formally through training, development, recognition and reward and disciplinary procedures.

Recommendation 4: Bringing the values to life

Barclays should institute learning programmes which actively encourage frequent discussion of its chosen values among all staff, focusing on understanding potential conflicts and how to address them. These discussions should be tailored so as to be relevant to the work of individual staff members. To make Barclays' commitment tangible to staff, senior management should lead and attend as many of these sessions as is practical.

- 8.64 Key challenges for Barclays will include:
- Ensuring that, where leaders are faced with the inevitable conflicts of doing business, their decisions demonstrate consistency with the values;
 - Responding to evidence of unethical practices appropriately – promoting open learning from 'near misses', celebrating things which go well and imposing clear, consistent disciplinary action on those who breach the code of conduct;
 - Establishing and applying consistently a performance appraisal system using a balanced scorecard approach which places real weight on behaviours that reflect values as well as achieving financial targets;
 - Linking promotion, bonuses and other incentives explicitly and clearly to the results of such an appraisal system;
 - Providing induction for new employees which explains the bank's purposes and values, and how those shape business practices;
 - Training leaders so that they understand group dynamics, effective group decision-making and engaging with employees;
 - Developing formal and informal systems to encourage discussion of how values are implemented in practice, and when to escalate difficulties to managers – to encourage open debate and review of ethical and organisational dilemmas;
 - Commissioning regular reviews of business practices to ensure that progress is being made and identifying areas for further improvement;

- Measuring progress with tools which include regular audits of customer, leadership, employee and stakeholder opinions.

Recommendation 5: Monitoring progress

Barclays should set clear targets against which to assess progress on embedding the values necessary to build a strong ethical culture. Progress against these targets should be measured through employee, customer and other stakeholder surveys and should be reported regularly to the Group ExCo and Board for discussion. Barclays should also communicate its progress more broadly as part of its commitment to greater openness and to support its efforts to rebuild public trust.

- 8.65 We want to draw particular attention to the importance of monitoring. The Board should consider establishing a programme of assurance to enable it to assess the extent to which the organisation is living up to its values. The Board and senior management should receive regular reports on progress, breaches of values and the code of conduct, and the use employees make of the escalation and whistleblowing procedures. Indeed, throughout this report we have emphasised the usefulness of seeking internal or external assurance or validation of important people, pay and governance processes. Combining this assurance with appropriate public communications of the results will contribute to Barclays' ability to restore trust.
- 8.66 Success will require the values to be supported by a revised code of conduct and reinforced by a common approach to professional standards. The values must be evident in internal and external communications – and customers, too, should be clear what behaviours they can expect from Barclays.
- 8.67 It is common for companies to set out their own standards of conduct in codes which govern their business practices. In banks, these can get overwhelmed by the detailed rules which necessarily apply to the conduct of the myriad of specific transactions which banks undertake. We believe that Barclays would find it helpful to prepare a code which collects in one place the standards to which it wishes to hold itself accountable in the conduct of its business and by which it wishes to be judged by customers, regulators and the public more broadly.
- 8.68 For such a code to be effective, it must be a living document, owned and developed by those to whom it will then apply. We would expect a code of conduct to:
- Be owned by the Board and the bank's leadership;
 - Describe in simple language the high standards of behaviour expected of all those who work for Barclays and how such standards can contribute to Barclays' success;
 - Clearly reflect the bank's purpose, vision and values;
 - Reinforce the obligation of staff to speak out; not just when things go wrong, but also to promote things which go well;

- Clearly explain both the benefits of complying with, and the consequences for breaching, the high standards;
- Commit to assurance, reporting and review in a way which supports implementation of the code.

8.69 In preparing the code, Barclays may find it helpful to:

- Consider issues which may cause concern for its staff, customers and others with whom it deals;
- Explain to whom staff should address concerns;
- Understand external standards and good practice;
- Distinguish between “must do” and aspiration;
- Explicitly address potential conflicts of interest: one way of doing this is to prepare representative questions and answers to relevant day-to-day dilemmas.

8.70 Whether part of the code of conduct, or as part of documentation to support it, we would expect Barclays to consider defining its expectations of senior management and the reinforcing role to be played by its people management and compensation approaches. Importantly, Barclays should be clear about how its code of conduct will be implemented and embedded into the organisation’s culture and business practices.

Recommendation 6: Code of conduct

Barclays should maintain and publish a global code of conduct, based on the bank’s statement of purpose and values, outlining the high standards of conduct expected of all employees. This code should be regularly updated and provide clear guidance to employees about how the bank’s standards can be applied on a day-to-day basis. Employees should attest to their compliance with this code annually.

8.71 We looked at the Lord George Principles for Good Business Conduct, developed by The Worshipful Company of International Bankers, and approved and circulated to all of its members in 2005. We found the principles to be relevant and compelling to the Review and would suggest that they be reflected in this code of conduct.

Exhibit 6. The Lord George Principles for Good Business Conduct

Introduction

The core purpose of international financial service providers is to promote global economic and social welfare by aggregating financial resources, converting them into specific services and products and delivering them in accordance with the mandates of their clients, customers and counterparties. Both the public good and the personal interest that stands behind this purpose and the capacity of providers to fulfil their mandates on a competitive, efficient and cost-effective basis can be substantially impaired, even frustrated, by dishonesty or by a lack of professional integrity, transparency and accountability. Accordingly, financial service firms and their officers and employees have both a collective and an individual commercial interest in the

maintenance of high standards of behaviour and of their professional reputation.

These objectives cannot be attained, however, through mere compliance with rules and regulations. Whether the prevailing regulatory environment is prescriptive or principles-based, the interpretation and observation of such rules and regulations, if it is to be meaningful, and if it is to ensure confidence at all levels, must itself be underpinned by behaviour that is rooted in trust, honesty and integrity.

The principles set out below are founded upon and reflect the essential business values which are necessary to meet these objectives and, at the same time, support the function of regulatory compliance.

Principles

1. To act honestly and fairly at all times when dealing with clients, customers and counterparties and to be a good steward of their interests, taking into account the nature of the business relationship with each of them, the nature of the service to be provided to them and the individual mandates given by them.
2. To act with integrity in fulfilling the responsibilities of your appointment and seek to avoid any acts or omissions or business practices which damage the reputation of your organisation and the financial services industry.
3. To observe applicable law, regulations and professional conduct standards when carrying out financial service activities and to interpret and apply them according to principles rooted in trust, honesty and integrity.
4. To observe the standards of market integrity, good practice and conduct required by or expected of participants in markets when engaged in any form of market dealings.
5. To be alert to and manage fairly and effectively and to the best of your ability any relevant conflict of interest.
6. To attain and actively manage a level of professional competence appropriate to your responsibilities, to commit to continued learning to ensure the currency of your knowledge, skills and expertise and to promote the development of others.
7. To decline any engagement for which you are not competent unless you have access to such advice and assistance as will enable you to carry out the work competently.
8. To strive to uphold the highest personal and professional standards.

Observance of the eight principles above is wholly compatible with comparable notions of good behaviour which may be expected or mandated by applicable law or financial or other regulations or by the membership requirements of any relevant professional association or by any other applicable code of good conduct.

9. Board Governance

Board Governance and Business Practices

- 9.1 “The purpose of corporate governance is to facilitate effective, entrepreneurial and prudent management that can deliver the long-term success of the company. ... Corporate governance is therefore about what the board of a company does... and is to be distinguished from the day to day operational management of the company by full-time executives.”¹⁶⁰
- 9.2 “The board’s role is to provide entrepreneurial leadership of the company within a framework of prudent and effective controls which enables risk to be assessed and managed. The board should set the company’s strategic aims, ensure that the necessary financial and human resources are in place for the company to meet its objectives and review management performance. The board should set the company’s values and standards and ensure that its obligations to its shareholders and others are understood and met.”¹⁶¹
- 9.3 Bank boards have additional responsibilities compared to those of other organisations, primarily reflecting the risks associated with banking, the systemic consequences of bank failure and regulatory requirements attempting to address these and other risks, including protecting customers. More broadly, bank boards need to be concerned that their banks enjoy high levels of public trust and confidence.
- 9.4 Bank boards have attracted criticism for what went wrong in their banks in the financial crisis, especially boards of banks that had to be rescued. As a recent Financial Stability Board (FSB) report noted: “The crisis highlighted that many boards had directors with little financial industry experience and limited understanding of the rapidly increasing complexity of the institutions they were leading. Too often, directors were unable to dedicate sufficient time to understand the firm’s business model and too deferential to senior management.”¹⁶² Barclays did not fail and we believe that, among other things, this reflects some strong engagement from its directors, who took a series of significant decisions in order to avoid having to take direct support from the Government. But it came very close – having to work hard, under considerable pressure, to persuade regulators that it was strong enough to survive without Government support. There are therefore lessons to be learned for the future, from looking back at Board governance and how it might have impacted business practices. It is not, however, within our scope to comment on the Group business strategy.
- 9.5 As we noted earlier, public trust in banks is at an all-time low.¹⁶³ Research suggests trust in bank employees may be more resilient than trust in banks overall.¹⁶⁴ Nevertheless

¹⁶⁰ Financial Reporting Council, *The UK Corporate Governance Code*, September 2012, p. 1.

¹⁶¹ *Ibid.*, p. 8.

¹⁶² Financial Stability Board, *Thematic Review of Risk Governance*, February 2013, p. 1.

¹⁶³ Which?, “Banks fail to learn lessons”, 2012.

¹⁶⁴ Edelman, *Trust Barometer*, 2013.

Andrew Bailey, then Managing Director of the Prudential Business Unit of the FSA¹⁶⁵, has suggested that “if ... there is a fundamental breakdown in trust, then the boards of these institutions have to recognise that trust has got to be got back and they have to think very hard about how they do that.”¹⁶⁶ The level of expectation placed on bank boards, particularly in terms of what can be accomplished by non-executive directors, is extremely high – perhaps unrealistically so.

- 9.6 The Barclays Board has explicitly recognised the need for change. Antony Jenkins announced the bank’s new purpose and values in January 2013, acknowledging that “unless we operate to the highest standards and our stakeholders trust us to behave with integrity, no business – and certainly no financial institution – can continue to be successful”.¹⁶⁷
- 9.7 It will be unhelpful if the ever-increasing expectations of bank board governance – driven by reviews, regulators, parliamentary enquiries and the media – deter those with the competencies and experience from offering to join bank boards.
- 9.8 Given the systemic importance of major banks, attracting the strongest and best qualified people to non-executive roles should be a concern to us all. Improving this may well require a change in attitudes, from broad acceptance of the limitations and realities of the non-executive role to improved collaboration between bank boards and regulators. Bank boards need experts on the banks’ specialist banking activities and they would also benefit from expertise in other important aspects of their business such as technology and retailing. Proposals currently under consideration to increase sanctions available against bank directors, over and above those generally applicable to directors, may deter candidates who do not at the outset understand specialist and complex banking areas and so find it difficult to assess the risks.¹⁶⁸
- 9.9 We have considered both the design and the effectiveness of governance at Barclays, concentrating on those areas where, in our judgment, change may have a meaningful impact on the Group’s future success in improving its business practices. In reviewing the written records of Board meetings, we found it difficult to gauge the extent of challenge and debate although minutes have provided a professional record of the major issues and decisions. Our conclusions therefore have been influenced by views expressed to us in interviews and may not necessarily represent the views of all Board members.

¹⁶⁵ As of 1 April 2013, Deputy Governor for Prudential Regulation at the Bank of England, and Chief Executive of the Prudential Regulatory Authority.

¹⁶⁶ Comments made on 28 June 2012, quoted widely in the press e.g., <http://www.ft.com/cms/s/0/fb6e8350-c1e0-11e1-b76a-00144feabdc0.html>.

¹⁶⁷ Antony Jenkins, Email to Barclays staff, 17 January 2013 – widely quoted and reproduced in full in the New York Times: <http://dealbook.nytimes.com/2013/01/17/new-barclays-chief-tells-staff-accept-changes-or-leave/>.

¹⁶⁸ “[T]he crisis highlighted the important role that individuals – especially bank directors – play in the key decisions taken by banks – decisions which can have far-reaching consequences not just for the institution concerned or its customers but for Government, taxpayers and the wider economy. This wider impact of financial difficulties at banks makes them different from other companies and potentially justifies treating the directors and senior management of banks differently from those in other types of companies.” HM Treasury, *Sanctions for the Directors of Failed Banks*, July 2012.

Board Governance at Barclays

- 9.10 In some respects Barclays has been ahead of its peers in designing its Board governance framework.¹⁶⁹ For example, it established a separate Board Risk Committee more than 10 years ago, before most other banks and well before this was recommended by the Walker Review. It also conducted externally facilitated board evaluations annually (rather than every three years as contemplated in the UK Corporate Governance Code). It publishes its entire Corporate Governance Framework on its website – including Charters of Expectations for Board members, and Terms of Reference for all Board committees.
- 9.11 In addition, the Board made improvements to its governance design when issues were identified. For example, in 2010 it added a target that 50% of non-executive directors should have “banking and/or financial”¹⁷⁰ experience, reflecting a period where this had not been the case. In 2011 it set a target for 20% of the Board to be women by the end of 2013 (rising to 25% by 2015). Also in November 2011, after Marcus Agius had acknowledged the need for cultural change, it added to the Board’s Role and Responsibilities the statement that: “The Board, in order to be effective, should demonstrate ethical leadership and promote the company’s collective vision of the company’s purpose, values, culture and behaviours.”¹⁷¹
- 9.12 Board committees play a crucial role in the effectiveness of Board governance and their role in banks has increased significantly in recent years. Committees allow non-executive directors to examine issues in more depth and with greater efficiency than at the full Board level. In 2012 the Barclays’ Board had six main board sub-committees: a Corporate Governance and Nominations Committee, an Audit Committee, a Risk Committee, a Remuneration Committee, a Finance Committee and a Citizenship Committee¹⁷² – each chaired by the Chairman or a non-executive director.¹⁷³
- 9.13 Barclays’ Board is supported by the Barclays Corporate Secretariat. This comprises a total team of 27, of which 7 work primarily on agendas, papers, minutes and actions from the Board and committees and the writing of annual reports. The others deal primarily with the formalities of the many companies in the Barclays Group.
- 9.14 We do not conclude that the events which resulted in reputational and financial damage to the bank necessarily reflected poor Board governance. Good governance is demonstrated by decisions being arrived at after an open debate among a group of people who together have the necessary skills, experience and information. “Good governance increases the probability that good decisions will be made”,¹⁷⁴ but it does

¹⁶⁹ See Appendix F.

¹⁷⁰ Barclays Corporate Secretariat, “Corporate Governance in Barclays”, July 2012: <http://group.barclays.com/about-barclays/about-us#corporate-governance/>.

¹⁷¹ Papers presented to Barclays Board Corporate Governance & Nominations Committee, on 2 November 2011.

¹⁷² Recently renamed Board Conduct, Reputation and Operational Risk Committee.

¹⁷³ The Finance Committee exists to approve specific decisions (e.g., M&A transactions), as authorised by the Board in each case.

¹⁷⁴ FSA, “Delivering effective corporate governance: the financial regulator’s role”, speech by Hector Sants, 24 April 2012.

not make it certain that all decisions will be good ones. The following are some of the issues that we considered relevant to our Review:

- The Board's composition and organisation for the effective challenge of management;
- The time expectations made of non-executives;
- The information available for effective oversight and decision making;
- Board oversight of the executive team;
- The approach to succession planning;
- The operation of subsidiary boards;
- The approach to culture and values that existed in the Group and their effect on business practices;
- The oversight of pay decisions;
- The oversight of operational, reputational and conduct risk;
- The approach to Board evaluations and improving the Board's effectiveness;
- Engagement with external stakeholders, especially with shareholders, and the openness of communications.

Each is explored in more detail in this section, except for the Board's role in the governance of remuneration, which is considered in Section 11.

- 9.15 Since 2007, the demands on the Board have increased substantially. For much of that time it was a period of intense crisis and, for almost everyone, unprecedented uncertainty. For Barclays there was a particular focus, through this crisis, on retaining its independence from Government control. Given the investment bank's exposures, this was a considerable challenge. There were many positives in the performance of the Barclays Board in the way it coped with this challenge, and successfully steered an independent course to become one of the leading universal banks in the world today. Approximately 40 other banks in Europe required direct state aid (including – in the UK – LBG, RBS and Northern Rock). The number, complexity and intensity of the challenges Barclays faced in this period need to be borne in mind in judging the Board's effectiveness.
- 9.16 In January 2012 Marcus Agius reported to the Board that a review by the FSA supervisors of the governance of the Board and its Risk and Audit Committees found that both the design and effectiveness were satisfactory. In the FSA's detailed review there were suggestions as to how to improve the Board's understanding of, and engagement with, the investment bank. In addition, it was noted that the Board meetings were short whereas the information packs were long. Other observations included the risk that Board members tended to look to one non-executive as a recognised expert on a technical area to provide comfort. This was regarded as important by the FSA as it continued to view Barclays as one of the most challenging firms in both its regulatory as well as its accounting approaches. Finally, there was a need to give operational and reputational risks appropriate profile and attention.

Foundations of Challenge

- 9.17 A role of the board is to provide 'challenge' to the actions of management. Sir David Walker explained this to the Parliamentary Commission on Banking Standards as the combination of the quality of individuals and their interaction: "The test is not only the quality of the individuals but the board dynamic – what happens in the boardroom – and if you don't have the right dynamic, however good the people are, you won't have the right challenge."¹⁷⁵ In addition to the quality of people and as contributors to the board dynamic, we would add the overall composition of the board and their understanding as a group of the bank's businesses, the time non-executives have to give, the openness of the executive directors and the information available to the board.
- 9.18 We make reference a number of times in this section to the Walker Review. This made recommendations for the corporate governance in UK banks. It was published in 2009 in response to the banking crisis. We draw on it because it is the most comprehensive review of this nature since the crisis with a focus on UK-based banks such as Barclays, rather than because of Sir David Walker's position as Chairman of Barclays. In some areas our Review suggests developments on Sir David Walker's suggestions, based on the evidence gathered in our Review.
- 9.19 The Walker Review outlined how the "principal deficiencies in [bank] boards related much more to patterns of behaviour than to organisation".¹⁷⁶ It went on to explain that: "The pressure for conformity on boards can be strong, generating corresponding difficulty for an individual board member who wishes to challenge group thinking. Such challenge on substantive policy issues can be seen as disruptive, non-collegial and even as disloyal. Yet, without it, there can be an illusion of unanimity in a board, with silence assumed to be acquiescence (...) Critically relevant to success of the challenge process in any well-functioning board will be the demeanour and capability of the CEO, who is unlikely to be in the role without having displayed qualities of competence and toughness which are not dependably tolerant of challenge. Even a strong and established CEO may have a degree of concern, if not resentment, that challenge from the NEDs is unproductively time-consuming, adding little or no value, and might intrude on or constrain the ability of the executive team to implement the agreed strategy. Equally, however, the greater the entrenchment of the CEO, perhaps partly on the basis of excellent past performance and longevity in the role, the greater is likely to be the risk of CEO hubris or arrogance and, in consequence, the greater the importance (and, quite likely, difficulty) of NED challenge. Achieving an appropriate balance among potentially conflicting concerns is frequently the most difficult part of the overall functioning of the board."¹⁷⁷
- 9.20 Responsibility clearly rests with the Chairman for sorting this out, including the engagement with the Chief Executive. He or she has to develop the atmosphere in

¹⁷⁵ Parliamentary Commission on Banking Standards, *Corrected transcript of oral evidence*, 5 February 2013, p. 4.

¹⁷⁶ Sir David Walker, *A Review of Corporate Governance in UK Banks and other Financial Industry Entities – Final Recommendations*, 26 November 2009, p. 12; all references to the 'Walker Review' are from the *Financial Recommendations*, except when indicated otherwise.

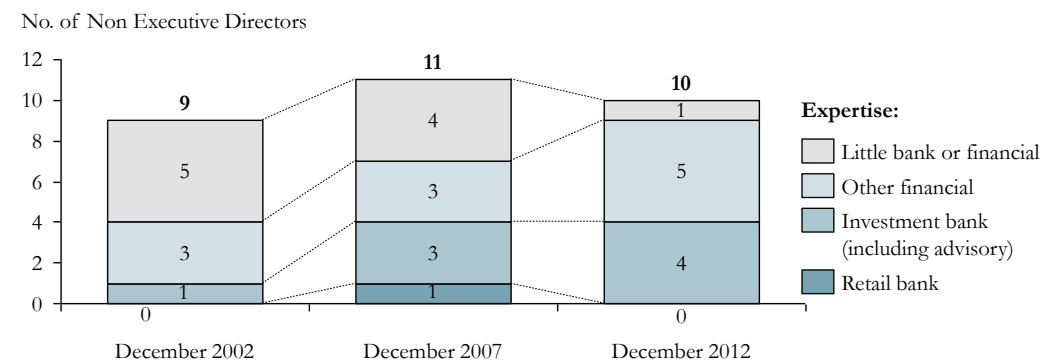
¹⁷⁷ Sir David Walker, *A Review of Corporate Governance in UK Banks*, pp. 53-4.

which different views are seen as constructive and are encouraged (even if sometimes mistaken), where disciplined but rigorous challenge on significant issues is regarded as acceptable. The culture and style of the board is a core continuing responsibility of the Chairman, supported by the Senior Independent Director or the Deputy Chairman.

- 9.21 Some of our interviewees told us that the challenge process was not as effective as they would have liked. Most were complimentary that the Board remained level-headed during times of pressure and that people were able to raise their concerns one way or another.
- 9.22 Board members at other companies mentioned the importance of reserving board time for free-form discussion of key issues, to understand emerging or future risks (sometimes referred to as 'horizon scanning') across the Group as a whole. Barclays did have informal sessions, for example over dinner the night before their normal scheduled Board meetings. Nevertheless, some suggested that it would help to have time at the end of the agenda, sometimes without executives, to discuss how a particular meeting had gone while still fresh in directors' minds. There are practical problems with having these discussions at the end of meetings, but if this time is not planned into the timetable, there is a risk that such discussions will be crowded out by what is seen as urgent.
- 9.23 We agree with the Walker Review in acknowledging that "while a majority of NEDs should be expected to bring materially relevant financial experience (...), there will still be scope and need for diversity in skillsets and different types of skillset and experience (...). A [bank] board should not be over-specialised and should be able to draw on a broad range of skills and experience. These generic skills should ideally include perspective, insight and confidence in distinguishing between major issues for the board and important but lesser issues that, if unchecked, can crowd out and distract from board focus on the larger issues; a readiness where necessary to challenge the executive and other NEDs in debates on major issues where a strategic proposition from the executive or emerging conventional wisdom may require close scrutiny; and experience relevant to assessing the performance of the CEO and senior executive team."¹⁷⁸
- 9.24 The chart below (see Figure 9.1) shows the extent of banking and/or financial experience among Barclays' non-executives at five-year intervals from 2002 to 2012. It illustrates that Barclays has now exceeded its 50% target for non-executive directors with banking and/or financial experience. Ideally, this group should also reflect Barclays' particular activities. We regard first-hand experience of senior positions in bank risk or compliance functions or in regulation as particularly useful, as well as experience of some of the more complex investment banking businesses. We also believe that diversity of experience, and gender diversity, are essential to avoid 'groupthink'. It is disappointing that only one of five female non-executives between 2002 and 2012 has completed two terms as a director.

¹⁷⁸ *Ibid.*, p. 45.

Figure 9.1 – Banking and Financial Expertise of Barclays NEDs (2002-12)



Notes: CFO roles, and NED roles at financial institutions included in Other Financial (e.g., Woolwich NEDs)

Recommendation 7: Board experience

Barclays should include among its Non-Executive Directors a sufficient number with directly relevant banking expertise. This will help the Board to challenge effectively the performance of management, to satisfy itself that risk management systems are robust, and to test business practices. It is essential that the Board includes appropriate diversity of experience, without causing it to be excessively large.

- 9.25 It is for the Chairman to ensure that all directors have the opportunity to make a contribution to matters coming before the Board and for individual directors to invest time in developing their familiarity with the Group businesses. All non-executives should take time, outside the formal induction process, to visit operations and develop experience of senior executives. This will be especially important for those directors who have a particular contribution to make to Board discussions through non-financial services experience (such as in retail or technology) but who have less familiarity with aspects of Barclays business.
- 9.26 We consider it important that non-executives invest time in getting to know the members of the Group ExCo and some tiers of management below Group ExCo level. This brings multiple benefits. Among other things, it gives the opportunity to:
- Develop views on how effectively management ‘lives’ the bank’s values;
 - Assess the quality of people in various important roles and to evaluate the operation of ExCo;
 - Assess the quality of control functions and their independence; and
 - Assess the quality of the management of the risks that the Group runs.

In addition, this should give the Board more opportunity to engage on staff and customer satisfaction issues in particular business units.

- 9.27 Greater non-executive engagement at a business unit level should also improve the Board's ability to take a longer-term view of senior executive succession, building a picture of the potential of candidates one or two tiers below the Chief Executive level.
- 9.28 Barclays' directors did recognise the importance of investing time outside Board meetings to develop their understanding of the businesses and the people. However, the demands placed on Board time will have made this difficult to accommodate.
- 9.29 Barclays has a continuing training programme for non-executives which, since 2010, has included detailed sessions on specific specialist topics, for instance, derivatives, risk-weighted assets, long-term incentive plans and conduct and operational risk. These continuing initiatives are important in assisting non-executives' understanding of key issues so that they can participate confidently in Board discussions.
- 9.30 We have considered examples of Board challenge in areas that have given rise to concern. This has been with the benefit of hindsight and, more importantly, without having been there at the time. Our judgments are therefore more illustrative of issues than definitive. There is a common view that Barclays' management were at times inclined to focus too narrowly on whether a proposed action met the applicable rules, without exploring wider implications such as how that decision might look to shareholders, customers, regulators and the public. In some cases this has resulted in reputational damage – and a loss of 'reputational resilience'. The Protium transaction is an example of a decision where considerable care was taken, including by members of the Board, as to compliance with relevant accounting rules. This was not a straightforward decision and much non-executive time was given to it, including as to reputational aspects. Nevertheless, with hindsight, the Board did not anticipate the degree of adverse reaction and scepticism that resulted, taking undue reassurance from the absence of regulatory objection, which was itself quite nuanced.
- 9.31 It also seems to us that at times the Board might have given greater challenge to management assurances, for example that issues were 'industry issues' or known to the regulators. Such assurances were no doubt given in good faith – but they did not always turn out to be a reasonable basis for not taking more urgent action. This would seem to be the case on PPI, which, although both an industry problem and known to regulators, seems to have taken too long to be fully confronted.
- 9.32 Another test of the Board's effectiveness is how management responds to Board guidance. In one instance we reviewed, involving a serious breach of a limit in the investment bank, Board members thought they had sent a clear message to management that the seriousness of the matter required disciplinary consequences. In the event, the Board's expectations were not fully met, although the Board did initiate a process to check that there were no similar problems with limit adherence elsewhere.

Time Expectations

- 9.33 It is essential that non-executive directors' expectations of the time they are required to spend are realistic. Otherwise there are risks that they will be unable to find the

time to give to particular decisions or to more general oversight. Barclays' own Board evaluations in recent years concluded that the contribution of non-executive directors was uneven. We believe it is inevitable, in a business as complicated as Barclays, that a disproportionately heavy responsibility is carried by the chairs of the major Board committees. This almost inevitably leads to the *de facto* establishment of two tiers of non-executive Board members, with those who are less involved in the detail being less able to provide effective challenge, especially if they have not themselves had extensive experience in the relevant businesses. It is important that these differences are openly discussed in the Board and acknowledgment given to the ways in which different non-executives can make a contribution that is valued by their colleagues.

- 9.34 Some committee chairs have estimated that they spent 100 days *per annum* or more on Barclays' matters during the financial crisis. It is commendable that they managed to find the time against the much lower levels indicated when they agreed to the roles. The Board met on 30 occasions in 2008, at times by conference call, and 27 times in 2009.¹⁷⁹ Those are only the numbers of Board meetings – and take no account of preparation time, committee meetings or other time outside meetings. We are wary of prescribing a minimum or target number of days for all non-executive directors, partly because of the importance of achieving a balanced board and not unnecessarily excluding candidates who could make an important contribution with less time. Barclays' minimum commitment of 20 days per annum reflects this idea. The Walker Review in its interim (but not final) version proposed a time commitment of 30 to 36 days per annum for all non-executive directors on a major bank board.¹⁸⁰ This has been the level of expectation reflected in Barclays' letters of appointment. Given the increasing regulatory requirements and expectations it is doubtful whether even this is sufficient for universal bank boards today. In normal circumstances we see minimum time commitments for non-executive directors trending towards 45 to 50 days a year, and considerably more than this (probably in the region of 80 to 100 days) for key committee chairs. In times of crisis, this will inevitably increase.
- 9.35 In order to achieve the required balance on a board, with a range of expertise and diversity, it may be necessary to agree variations in time commitments among non-executives. We question how easy it is in most cases for a serving chief executive of another major business to give the necessary priority to the needs of a bank like Barclays. We do, however, recognise the value to the Board, and to the Group Chief Executive, of having this experience on the Board (for example through a recently retired Chief Executive).
- 9.36 We consider that in a business as complex as Barclays it will take most incoming non-executives some time to gain real understanding of the businesses so as to be confident about when and what to challenge, although this will vary according to experience. We would like to see most non-executives serve at least two terms of three years.

¹⁷⁹ Barclays annual reports, 2008 and 2009.

¹⁸⁰ Sir David Walker, *A Review of Corporate Governance in UK Banks and other financial industry entities – Interim Report*, July 2012, p. 10.

- 9.37 Non-executive pay also needs to reflect a realistic assessment of the time required (including travel time and time for induction and deepening familiarity with Group businesses).

Recommendation 8: Non-Executive Directors

Barclays should regularly consider the time commitments realistically expected for Non-Executive Directors, especially Chairmen of Board committees, and reflect its conclusions in its updated Charters of Expectations and in the Non-Executives' letters of appointment.

Barclays should maintain and put into action a plan for Non-Executive Directors over a period of time to engage with each major business and geography, including occasional attendance at appropriate business committees. This should be supplemented with detailed sessions on particular specialist topics.

Board Information

- 9.38 All boards need to receive the appropriate high quality information to perform their roles well. Good governance and decision making is impossible without it. The oversight of this is clearly the responsibility of the Chairman.¹⁸¹ It is difficult to achieve the right balance in board papers and information, between only high-level summaries and excessive data. It will also be difficult to reconcile the different expectations of different board members. This tends, we believe, to be a perennial problem for all boards.
- 9.39 Since the financial crisis, Barclays Board papers have increased in length, making some issues seem ever more complex. The annual Barclays Board evaluations, including most recently in 2012, confirmed our discussions with past and present Board members that the quality, timeliness and level of detail of information provided for Board meetings, were a continuing concern. It was suggested that papers needed to focus more on delivering analysis and insight to help guide debate rather than simply data for information.
- 9.40 Board members told us they would have preferred papers from management to include less advocacy (supporting one point of view) and more explanation of options in a balanced and even handed manner, accepting that a recommendation would be appropriate. In addition, there was a desire for more information on emerging themes. In the case of the growth period of Barclays Capital (the 'Alpha Plan' years of 2004 to 2007), many Board members commented that insufficiently detailed information was provided concerning individual businesses within the investment bank. This apparently improved over time in response to requests but it made it difficult for Board members to understand the different parts of the investment banking business and their significance. Examples include the role of SCM, the extent of proprietary trading, the expansion of structured credit in the

¹⁸¹ "The chairman is responsible for ensuring that the directors receive accurate, timely and clear information", *UK Corporate Governance Code*, Financial Reporting Council, September 2012, p. 9.

run-up to the financial crisis, and the validity of asset valuations and models. Similarly, more information about GRCB's international expansion would have assisted the Board in assessing the risks such expansion presented.

- 9.41 We found some instances where important qualitative information had seemingly not been discussed by the Board. Specifically, more information on the annual Employee Opinion Surveys could have alerted the Board to cultural issues. The Board reports gave too much emphasis to the positive aspects of such surveys, including the high employee engagement scores. For example, as far as we can tell, in 2011 the Board and Board Remuneration Committee did not spend significant time discussing the reluctance in some areas to escalate issues and what this might have said about the culture in areas of the bank.
- 9.42 Ideally, Board papers should be specially commissioned and prepared for the particular perspective of the Board, including a relevant summary of the issues. A larger team with a range of skills might be able to support the Company Secretary in, for example, arranging the review of papers with executives before they are submitted to the Board, and liaising with group function heads to facilitate more balanced papers. Others have experimented with size limits for individual papers, more concise summaries, feedback processes and greater use of technology.

Recommendation 9: Board information

Barclays should define options and implement arrangements to improve the quality, timeliness and level of detail of its Board information and allow flexibility to meet the demands of individual Board members.

Board papers should be prepared specifically for the Board and include analysis and insight to help guide debate.

Board Oversight of the Executive Team

- 9.43 It is worth emphasising, as Sir David Walker did in the Walker Review, that “the most important factor in ensuring long-term corporate success, whether in a [bank], or a non-financial business, is a highly effective executive team that is not dominated by a single voice; where open challenge and debate occurs; and yet the executive team is cohesive and collectively strong. If there is a weak executive team, even the most robust corporate governance procedures and effective independent directors are unlikely to be able to protect the company”.¹⁸²
- 9.44 It is accordingly an important aspect of a board's responsibilities, led by the chairman, to assess the effectiveness and resilience of the executive team as a whole, including the leaders of the control functions, and to be satisfied that there are suitable balances to any weaknesses it identifies. This should include consideration of their behaviours as well as their performance outcomes.

¹⁸² Sir David Walker, *A Review of Corporate Governance in UK Banks*, p. 35.

- 9.45 In our view, for much of the period under review, the Barclays executive team included strong leaders but was not cohesive as a whole, relying heavily on individual accountability for 'cluster' or business unit performance and not enough on collective responsibility for the success of the Group as a whole.
- 9.46 The Barclays Group Chief Executive chairs the Group ExCo, which has a wide-ranging remit to "assist the Barclays Chief Executive in carrying out his duties, and act on issues of Barclays wide concern".¹⁸³ The decision-making power vests in the Chief Executive, not in the ExCo. We consider that, however it is constituted, its role for the success of the Group as a whole should be made clear. The executive team should challenge and debate Group issues. Similar considerations apply to the ExCos at business unit level in the Group.
- 9.47 As at 31 December 2003, the Group ExCo comprised 11 people including the Chief Risk Officer (CRO), Chief Operating Officer (COO) and Chief Administrative Officer (CAO), together with business unit leaders. A year later this had reduced to seven, with the departure from the committee of the CRO and CAO and two business unit leaders.
- 9.48 For a key period in the run-up to and during the financial crisis (2006 to 2009), the membership of ExCo was kept relatively small (four to six people), at times including only John Varley as the Group Chief Executive, the Chief Finance Officer and the two 'cluster' Chief Executives. At that time, ExCo had no direct representation from smaller business units, or from functions such as Group Risk, Compliance, Legal or HR. The cluster arrangement was based on a decentralised system of accountability with a powerful leader for each of the 'clusters'. While intended by John Varley to avoid silos, it did not develop a cohesive team at the top of the organisation or lead to the right kind of debate and challenge – members had little incentive to challenge each other. Leaders of particular business units may be reluctant to challenge and debate the plans of other business units, to avoid provoking such challenge and debate in relation to their own. We would suggest that a bigger ExCo, led on a cohesive basis with sufficient debate and challenge across the businesses, would have led in this period to a materially better sense of teamwork across the Group, better integration of the Group Centre with the business units, and stronger engagement of the control functions. If so, this might well have improved decision making.
- 9.49 When Frits Seegers left Barclays in November 2009, John Varley broadened ExCo's membership to add five leaders of businesses: Antony Jenkins running Global Retail Banking; Jerry del Missier and Rich Ricci as Co-Chief Executives of Corporate and Investment Banking; Tom Kalaris, Chief Executive of Barclays Wealth; and Absa Chief Executive Maria Ramos. From the control functions, he added Mark Harding as Group General Counsel (also responsible for Compliance), Robert Le Blanc as Group CRO and Cathy Turner as Group HR Director. Interviewees have remarked that the wider membership of 11 people from November 2009 was more effective. Antony Jenkins has since gone further in adding to ExCo Ashok Vaswani as Chief Executive of UK Retail & Business Banking, and Valerie Soranno-Keating as CEO

¹⁸³ Group Executive Committee Terms of Reference.

of Barclaycard, in addition to Sir Hector Sants as Head of Compliance, and Shaygan Kheradpir as Chief Operations and Technology Officer.

- 9.50 Particular consideration should be paid to ensuring that the CRO and Head of Compliance have the status among senior leaders so that their views are adequately taken into account. The primary responsibility for this must rest with the Group Chief Executive. The presence of control function leaders in the Group ExCo and in similar ExCos at business unit level will typically help to achieve a wider focus from all participants. The ExCo Chairmen at business unit level have an important role in ensuring that their ExCo is a meaningful part of the Group governance structure, with responsibilities for the overall Group's success. The Chairman's role in leading an ExCo should be reflected in his performance review and, as regards the Group ExCo, the Barclays Board should extend the annual Board evaluations to cover its oversight of the Group ExCo's effectiveness.
- 9.51 In making these suggestions we are less concerned about the formal governance framework for the executive team. Some organisations prefer an ExCo with collective decision rights; others, including the Barclays Group ExCo, reserve decision making for the Chief Executive. Some Chief Executives may prefer to have different groups of executives for Group Centre issues than for operational business issues. What matters is that the leadership group, and the Chief Executive in particular, is truly open to challenge and debate, that the right people are included in those debates, and that the team develops consistency in the management of the Group.

Recommendation 10: Cohesive executive team

The Group Chief Executive should be responsible for building a cohesive senior executive team which actively contributes to decision making through open debate and challenge. This should be reflected in his performance reviews and in the performance reviews of the senior executive team. The Board should regularly review the effectiveness of the senior executive team.

Group Chief Executive Succession Planning

- 9.52 The board has a primary role in choosing the chief executive. For as long as it has confidence in that chief executive and his team, it will tend to support him, while challenging particular proposals and regularly reviewing performance. Getting the appointment of the chief executive right is therefore very important, and so is the board's process of developing succession plans in advance of any appointment. Done well, succession processes identify the skills and capabilities needed for the success of the organisation well ahead of a possible appointment, enable long-term development of future leaders internally and identify possible candidates externally at an early stage. For a universal bank like Barclays, it involves choosing the best person available in the world.
- 9.53 In making its choice of Group Chief Executive, the Barclays Board should be mindful not just of the quality of candidates as individuals and their track records,

but also of the candidates' abilities to function effectively in the bank's governance system, to develop a relationship with the Chairman and non-executives, and to lead the senior executive team cohesively. It is also crucial that the Board assesses personal compatibility with, and ability to demonstrate, Barclays' values. On the basis that no candidate meets every criterion fully, the Board should also identify how it would handle particular shortcomings to avoid potential adverse impact. Once an appointment has been made, the Chairman, with help from the Board, should regularly re-evaluate how the assessments are working out and be prepared to take action to adjust the approach. An open working relationship between the Chairman and Chief Executive is particularly important in ensuring that the arrangements are properly put into effect.

- 9.54 We have considered only the Group Chief Executive appointments of John Varley in 2004 and Bob Diamond in 2010. The process that led to the appointment of John Varley was lengthy, involved a total of five internal candidates and attracted publicity that heightened its significance for all concerned. Interviewees told us that this caused unfortunate rivalries. There was little attempt to consider external candidates. When it came to choosing John Varley's successor in 2010, the memories of the earlier process may have contributed to a desire to take an approach that was less drawn-out and less public. Again there seemed not to be an extensive consideration of external candidates. This was apparently a conscious decision based on the particular circumstances, including the need for secrecy, and Board views as to the strength of the internal candidate.
- 9.55 It is clear that the Barclays Board took its responsibilities for the 2010 selection process seriously and diligently. It seems that considerable weight was given, in identifying the ideal successor, to the size of the investment bank and the consequent need for a candidate with the competencies to manage it. This may have led quite quickly to the Board deciding that Bob Diamond was the best internal candidate. When the focus turned to weighing him against a short list of external candidates, it was decided that only one should be interviewed. We feel that more time should have been invested in considering external candidates but accept that the Board gave consideration to this. In our view, establishing the criteria at an earlier stage (including, after the Lehman acquisition, the need for investment banking credibility) would have allowed greater opportunity for the Board to broaden the experience of leaders and identify high-quality external candidates. Nevertheless, Bob Diamond's considerable success in building the investment bank clearly made him a very credible candidate.
- 9.56 With hindsight, in particular the public response to the LIBOR announcement and the resignations that followed, it is possible that too much weight was given to Bob Diamond's considerable achievements in building a leading investment bank (as well as BGI) and not enough to the different challenges of leading a UK institution such as Barclays, with an important retail customer base, and in an environment of low public trust and enhanced scrutiny. It is doubtful, also, whether at the time the Board had focused on the scale of the task to achieve the cultural change that is now identified as needed.

- 9.57 Some boards treat succession planning, including the development of potential leaders, more systematically than was apparent in the two Barclays cases we looked at. For example, they will see reports on a significant number of senior managers and devote more time to a discussion of a number of managers with top-level potential. “Assessment reports are like finance reports, providing granularity about performance, what has been achieved and how. Information can be gleaned about personality preferences (likes to do), ability (can do), behaviour (how it is done), motivation (will do) and red flags (de-railers).”¹⁸⁴

Recommendation 11: Group Chief Executive succession

The Board should agree periodically the criteria and personal characteristics required for the role of Group Chief Executive as part of its succession planning. The framework for succession planning should include the long-term development of future leaders, Board exposure to potential internal candidates, thorough consideration of external candidates and assessment of alignment with Barclays' culture and values.

Operation of Subsidiary Boards

- 9.58 We have considered formalising non-executive participation (drawn from existing Barclays' non-executive directors or others) on some subsidiary boards or on key governance, risk and audit committees covering geographies or businesses. Historically, many banks have done this only where laws or regulators require it and the corporate structure makes it appropriate. From a governance viewpoint, there are advantages and disadvantages in such an approach, as well as legal considerations around the responsibilities of directors. Significant advantages of adding non-executives who are not on the Group Board to a subsidiary board (such as one designed to cover the investment bank) would be to share some of the workload and to give a more specific non-executive focus to a complex part of the Group. The assumption would be that the workload at Group level would be reduced by a degree of reliance on the subsidiary level oversight. If the structure achieved better understanding of a complex area, improved oversight would be achieved overall. On the other hand, it may be difficult for Group non-executives, having regard to their own responsibilities, not to duplicate much of the work done at subsidiary board level especially if, as would be likely, the subsidiary represented an important part of the business and there was a risk of issues falling between the two. And issues such as culture, standards and values are Group issues that require an understanding of the behaviours across the whole Group. For example, the Barclays Wealth business is a relatively small part of the Group taken as a whole but is nevertheless significant to Barclays' reputation. And there would need to be occasions when all the non-executives met together – not least to assure some consistency of approach. At present where such boards and board committees exist at subsidiary level, for example in South Africa, there is insufficient linkage with Barclays Board non-executives, although there are arrangements for issues to be raised to Group level through management reporting lines.

¹⁸⁴ Sir David Walker, *A Review of Corporate Governance in UK Banks*, p. 141.

- 9.59 Some form of subsidiary Board governance is likely to be required by law in the UK in the future. The Financial Services (Banking Reform) Bill as currently proposed would impose a requirement for independent non-executive directors on the board (or equivalent management bodies) of ring-fenced banks, and the ring-fenced subsidiary bank will have to be “able to take decisions independently of other members of its group”.¹⁸⁵ The exact structure of the ring-fence is being left to secondary legislation. Accordingly, the industry awaits further clarification on how ring-fenced governance will be implemented in practice. We believe it is essential that issues of Board responsibility at Group and subsidiary ring-fence level, such as described in the previous paragraph, be clarified. This includes the legal responsibilities of the various directors. Without clarification, there may be concerns about conflicts, such as to the inconsistent accountability of subsidiary directors on the one hand to the parent as its owner, and on the other for the ring-fence. The implications of ring-fencing for the Group's overall operating model are considered briefly in Section 12.

Culture and Values

- 9.60 The Group of Thirty has highlighted certain values – including honesty, integrity, independence of thought, openness/transparency and the courage to speak out and act – as the ‘bedrock values’ of corporate governance. They go on to argue that: “It is for the board of directors to articulate and senior executives to promote a culture that embeds these values from the top to the bottom of the entity.... Well-functioning boards set, promulgate, and embed these values, commonly in the form of a code, so that directors, senior executives and all other employees in an entity are fully aware of the standards of behaviour that are expected of them.”¹⁸⁶
- 9.61 A board oversees how effectively management promotes and embeds its stated values. So the board must consider the tone it sets; and it should dedicate sufficient board and board committee time both to discuss how well culture and values are being implemented internally and how they are being received externally.
- 9.62 Some interviewees observed, and our analysis of relevant minutes confirms, that the Barclays Board did not give as much attention to the culture, values and business practices developing in the Group as, with the benefit of hindsight, these matters are now recognised to deserve. An exception to this was consideration given at the time of the Lehman transaction and afterwards to the challenges of integrating different cultures.
- 9.63 Bob Diamond, when he became Group Chief Executive, set about building a more integrated Group with a stronger accountability to the Group Centre, under the heading ‘One Barclays’. A One Barclays presentation, prepared in 2011, supported the benefits of a Group-wide culture and mind-set. In November 2011, the Board's responsibilities were altered to include promotion of the Group's purpose, values, cultures and behaviours, presumably as a response to the reputational issues that

¹⁸⁵ Financial Service (Banking Reform) Bill 2012-13, pp. 7-8; <http://www.publications.parliament.uk/pa/bills/cbill/2012-2013/0130/2013130.pdf>.

¹⁸⁶ Group of Thirty, *Towards Effective Governance of Financial Institutions*, 2012, p. 25.

Marcus Agius had identified in 2010 or before. But it was the LIBOR crisis in 2012 that gave this subject real priority and urgency.

Risk Oversight

- 9.64 The division of responsibilities and the coordination of activity between the Barclays Board and its Board committees requires clarity. As a starting point, the Board itself must develop clear agreement on the Group's risk appetite given how fundamental this is to the bank's business. It must also be clear as to the allocation of risk oversight between the Risk, Audit and Citizenship¹⁸⁷ Committees, and also on their input to the Remuneration Committee.
- 9.65 We have two primary concerns regarding the way in which the Barclays Board oversaw risk in recent years. Each may have contributed to problems:
- There was no clear home for Board oversight of operational risk, including the increasingly important category of conduct risk, although it came within the formal remit of the Board Risk Committee;
 - Reputational risk was not prioritised in the framework of Board decision making, and lacked formal Board oversight until 2011.
- 9.66 Setting the Group's risk appetite for operational risk and monitoring its position against that appetite was primarily the responsibility of the Board Risk Committee. Barclays' 2009 Annual Report¹⁸⁸ explained that "the Board Risk Committee focuses on risks taken deliberately and overtly, such as credit, market, capital and liquidity risk, rather than the risks of simply doing business, such as operational risk." We have the sense that operational risk was something of an orphan, perhaps because the risk appetite was less easily capable of being quantified numerically and managed. Events like LIBOR, non-compliance with sanctions and various mis-selling allegations, as well as integration, IT and systems issues related to the growth of the investment bank, demonstrate that financial and reputational damage from operational failures can be no less severe than that arising from credit and market risk.
- 9.67 We are not aware of responsibility for oversight of operational risk being explicitly passed to any other committee, although we were told that, as is customary, the Board Audit Committee had the responsibility to review internal controls including the way in which any control failures affected operational risk. We discuss operational risk more generally in a Section 12.
- 9.68 We have seen instances where the reputational impact of events or actions was greater than anticipated. This suggests to us that there needs to be clear responsibility for oversight of reputational risk at Board level. This was given to the Citizenship Committee in 2011 but the Committee met only three times over 2011 and 2012. It was therefore not well placed to influence the general flow of decisions that could have involved reputational issues. Before 2011, the Group operated a Brand & Reputation Committee which, though primarily a management committee, was

¹⁸⁷ Recently renamed Board Conduct, Reputation and Operational Risk Committee.

¹⁸⁸ Barclays, *2009 Annual Report*, March 2010, p. 166.

chaired by the Group Chairman with other non-executive representation. Its minutes went to Group ExCo and it was not formally constituted as a committee of the Board.

- 9.69 Barclays has recently announced a new Board Conduct, Reputation and Operational Risk Committee (CROR Committee) which will take over the responsibilities of the Citizenship Committee, and have oversight responsibility for these three areas of risk. The inclusion of conduct risk is a welcome step given the increasing regulatory focus in this area, and the importance of conduct risk as an indicator of other types of losses – e.g., poor documentation may hinder recoverability of bad loans. The CROR Committee should also provide greater clarity over the governance of risks associated with information systems and technology – risks that fall broadly under operational risk and deserve particular attention.
- 9.70 Barclays has taken steps to ensure that there is necessary coordination between Board committees, including some joint membership, sharing of papers and minutes and meetings involving the chairmen of the different committees. This includes the establishment of the Board Enterprise-Wide Risk Committee, made up of the Board Chairman and the Chairmen of the Board Risk, Audit and CROR Committees. We welcome this development.

Recommendation 12: Board coordination

The Board should ensure that there is effective coordination and collaboration between it and its principal Board committees, and between it and the subsidiary boards of those of its major Group businesses which are subject to their own regulatory requirements. In particular, it should consider holding joint meetings of Board committees.

Recommendation 13: Board Committee for conduct, reputational and operational risk

The Board should make clear which committees have primary oversight of conduct, reputational and operational risks across the Group. The terms of reference should make clear where the primary responsibilities lie for different aspects of operational risk, and where oversight of all financial and non-financial risks comes together.

The terms of reference of these committees should also require a timely review of significant internal incidents, as well as of industry developments with high potential to impact Barclays' reputation.

Board Evaluations

- 9.71 There is increasing acceptance of the value of externally facilitated board evaluations as a component of best practice in corporate governance. The Walker Review considered imposing an annual requirement for such a review, before finally recommending external facilitation at least every three years – a recommendation

which was included in the UK Corporate Governance Code from 2010 onwards. The Code also requires that the annual report discloses “how performance evaluation of the board, its committees and its individual directors has been conducted”.¹⁸⁹

- 9.72 The purpose of any board evaluation should be to assist the board and individual directors in their process of continuing improvement and change through an open discussion. Recent Barclays' Board evaluations were criticised by Sir David Walker before the Parliamentary Commission on Banking Standards as “not good enough” and lacking “tough external facilitation”.¹⁹⁰ We consider that the impact of a board evaluation will be determined by the quality of internal engagement in the process, the quality of dialogue about the findings and the commitment to follow-up actions. This should be led by the Chairman and, given Sir David Walker's comments, no doubt the rigour of the evaluations will change considerably. High-quality external facilitation is an important aid to Board engagement, but it is not a substitute for that engagement.
- 9.73 The Board evaluations at Barclays since 2004 highlighted many issues for change, suggesting a good level of engagement. We found that they were focused on the quantitative outputs of surveys of members of the Board, examining changes in scores year-on-year, as well as individual interviews. The evaluations did not include observation of actual meetings, and did not separately evaluate information available to the Board or Board committees. The follow-on work tended to be delegated to the Corporate Secretariat without active ownership by the Board. Action plans recently appeared to have limited impact. For example, one of the lowest rated scores was given to the Group's compensation strategy in nearly every evaluation but, difficult as the issue may have been, it did not lead to steps which materially improved the score. However, it should not be forgotten that the financial crisis imposed exceptional burdens on the Board and would have taken much of its attention.
- 9.74 The ABI has commended Barclays' reporting of its evaluation process. Recently, it has recommended that companies go further in their disclosure of board evaluations: “Companies should explain the performance evaluation process and disclose any significant recommendations and the changes or improvements that the board has committed to following the review. We expect the outcomes of these evaluations to be different year-on-year.”¹⁹¹ Barclays has followed the ABI's recommendations detailing actions taken in respect of the prior year's evaluation and describing themes for the coming year. We would encourage as much specificity as reasonably possible on the action plan so as to provide clarity when reporting on progress. Care will need to be taken to avoid non-executives feeling that they cannot be open and candid in the evaluation processes.
- 9.75 We consider board evaluations to be one element in a process where the board takes time to consider explicitly its own workings and effectiveness, and the changes required to improve them. Some companies, building on their board evaluation

¹⁸⁹ Financial Reporting Council, *UK Corporate Governance Code*, 2012, p. 15.

¹⁹⁰ Parliamentary Commission on Banking Standards, *Corrected Transcript of Oral Evidence*, HC606-xxxii, 5 February 2013.

¹⁹¹ Association of British Insurers, *Report on Board Effectiveness*, December 2012.

outcomes, have agreed and published an overall set of board objectives in meaningful detail. This improves the accountability of the board for its effectiveness, enabling shareholders to judge what it considers important and how well it succeeds in achieving the objectives. We suggest that Barclays considers this.

Recommendation 14: Board effectiveness

The Board must be actively engaged in the process of improving its own effectiveness, including through regular and rigorous evaluations. The Board should report openly on the evaluation process, set forward-looking objectives for improvement and explain progress against these objectives.

Engagement with Shareholders

- 9.76 Our discussions with shareholders suggest that some feel their concerns have not always been listened to by the Barclays Board. Some told us, for example, that they had raised concerns about executive pay and Board oversight well before the 2012 Annual General Meeting (AGM). There is no doubt that Barclays was faced with some difficult issues, including the bonus for the Group Chief Executive and certain tax equalisation matters. Not resolving shareholder concerns appears to have led to significant votes against both the Remuneration Report and the reappointment of the Remuneration Committee Chairman. We suggest that, overseen by the Chairman, there should be more discussion and openness over a course of time to avoid this sort of stand-off. This, of course, requires engagement by shareholders as well as by Barclays. HSBC's annual reports feature an extended description of the methodology and judgments behind variable pay awards for executive directors, supported by quantitative disclosures. Openness should in principle provide a better basis for annual discussions with shareholders on remuneration.¹⁹²
- 9.77 Many shareholders also raised concerns about Barclays' financial information which they regarded as difficult to understand, even by the standards of an industry beset by complexity in its disclosures. Many commentators have expressed opinions similar to Andrew Bailey who, on the point of the risk-weighting system, recently said: "We need a lot more transparency to the outside world... I talk a lot to investors and the analyst community... and they do not understand it and they have lost confidence in it... Do not just dump data into the world: please have meaningful, sensible disclosure."¹⁹³ A recent publication by the European Banking Authority also found significant variations in the way a sample of banks calculate Risk Weighted Assets (RWAs) – only half of which could be explained by objective factors like asset mix (see also Appendix J).¹⁹⁴

¹⁹² HSBC Holdings plc, 2012 *Annual Report*, March 2013, pp. 347-367.

¹⁹³ House of Commons Treasury Committee, *Bank of England November 2012 Financial Stability Report*, Oral and written evidence, 14 February 2013, ev 10; <http://www.publications.parliament.uk/pa/cm201213/cmselect/cmtreasy/873/873.pdf>.

¹⁹⁴ European Banking Authority, Interim *results of the EBA Review of the Consistency of Risk-Weighted Assets*, February 2013; see also Appendix J.

- 9.78 Improved transparency in the disclosure of RWAs, as well as the performance of individual units within the investment banking business, were regularly among the top reporting priorities identified during our conversations with Barclays shareholders. Given the past level of narrative and quantitative disclosure on the investment bank, it is not surprising that many shareholders felt unable to take a view on the underlying quality of investment bank earnings.
- 9.79 The answer is not simply additional disclosure. Indeed Barclays, in line with other major UK lenders, provided the extra information set out in the British Bankers Association Code for Financial Disclosure. We suggest that the following are all important to good communications: (a) enhancing the quality of narrative disclosure, (b) offering a balanced, candid assessment of performance and prospects, and (c) integrating the explanation of risks more fully with overall strategy, objectives and results. And, reflecting the Group Chief Executive's identification of Barclays' purpose, we suggest that the annual report should be framed in the context of that purpose and report on the successes and challenges in fulfilling it.
- 9.80 There are examples where Barclays has set a standard for openness. For example, Barclays' Audit Committee disclosure since 2009 has included a substantive discussion of specific issues, actions and conclusions drawn. More still is expected in this area following the Financial Reporting Council (FRC)'s new Guidance on Audit Committees released in 2012.
- 9.81 Barclays' major institutional shareholders are a diverse group, with differing levels of interest when it comes to matters of corporate governance. *The Kay Review of UK Equity Markets* emphasises the choice shareholders have between exit (the sale of shares) and voice (the exchange of views with the company) as a means of communicating concerns to management of a company (and the bias towards exit in markets today).¹⁹⁵ Many of the Barclays' shareholders we interviewed were passive funds investing in line with an index and therefore had no exit option for their Barclays shares – and accordingly had every incentive to maintain a high quality dialogue with Barclays. On the other hand Barclays' overseas shareholders tend to engage less on governance matters.
- 9.82 We have noted that Antony Jenkins and Sir David Walker have demonstrated their willingness to listen to shareholders' concerns and engage with them constructively. The reaction to this among shareholders we interviewed was extremely positive. Barclays must ensure that listening to shareholders is not a one-off effort, but part of a long-term strategy to improve transparency and build confidence and trust. While much of the engagement will be led by the Executive Directors, it should be overseen by the Chairman, assisted by the Senior Independent Director.
- 9.83 Several leading FTSE 100 businesses schedule annual 'governance days' where the Chairman and Board Committee Chairmen meet with their company's top 30 shareholders. One financial institution has included major institutional shareholders in a working party to redesign its remuneration architecture. Another bank publishes its Shareholder Communications Policy, explicitly linked to corporate values, which

¹⁹⁵ John Kay, *The Kay Review of UK Equity Markets and Long-term Decision Making*, July 2012, p.10.

sets out what shareholders can expect in terms of open communication and access to management. In its annual report, Barclays does describe its interactions with its shareholders. Adding transparency more explicitly, while linking this to its values, and setting out principles for responsible two-way communication with shareholders and other stakeholders, may improve the mutual understanding of sensitive matters such as pay. Such a plan is a requirement of corporate governance codes in some jurisdictions outside the UK.¹⁹⁶

Recommendation 15: Shareholder interaction

The Board should design, adopt and publish from time to time a communications policy for promoting effective and open communication with shareholders and encouraging their participation in general meetings. In its shareholder reports, Barclays should provide complete, relevant, balanced, accessible and understandable information about the Group, its performance, risks and prospects, with an emphasis on the quality and candour of information rather than its quantity. In particular, its annual report should include not only information as to its financial performance but also a prominent report on the successes and challenges in fulfilling its stated purpose.

¹⁹⁶ Australian Securities Exchange Corporate Governance Council, *Corporate Governance Principles and Recommendations*, 2010, p. 11; and Institute of Directors in South Africa, *King Code of Governance for South Africa*, 2009, p. 48.

10. People

- 10.1 People are, of course, the human capital of a bank – the key to its success. Competitive advantage comes, at least in part, from the way in which a bank is able to deploy the talent it has and help its people to achieve their full potential. In all the talk of treating customers fairly, risk-weighted assets, capital ratios, operational risk, control frameworks and the like, we cannot lose sight of the fact that it is people who determine how customers should be served, what risk ought to be taken, and which actions are right (or wrong).
- 10.2 Barclays undoubtedly recruited many capable people. As we have pointed out elsewhere in this report, they performed better than many of their peers during some very demanding times once the financial crisis hit. The investment bank grew into a world leading investment bank in around 10 years, from almost a standing start, attracting new employees to Barclays because of the cleverness – and some argued – the edginess of its people. Barclaycard, too, is a business which appears to have built its success on the capability of its employees relative to its peers. But as this report also seeks to make clear, there were occasions when the high standards to which Barclays aspired were not met. And when this was the case it was usually because individuals or groups of individuals made unfortunate choices. Barclays' purpose ("Helping people achieve their ambitions – in the right way") applies to Barclays' employees as well as to its customers and other stakeholders. So, if people and their ambitions are at the heart of the bank, the role of the HR function and the strength of the people management processes and tools are critically important.

The Role of HR

- 10.3 A strong HR function owns and drives the processes which underpin ethical business practices. It has a key role in supporting the Chief Executive and the Board in the achievement of strategy. At Barclays, HR at times appears to have been seen more as an administrative function required to satisfy business needs. Although Bob Diamond, on becoming President, also took on responsibility for Group Talent, the heads of HR were typically on neither the Group nor divisional Executive Committees. HR appears accordingly to have found it difficult to exercise an appropriate level of challenge to the businesses on some people-related issues. Heads of HR were not given the authority to push sufficiently for the heads of business units to reflect desired behaviours in a variety of matters, such as promotion decisions, performance reviews, or remuneration. Given the decentralised model, it was especially difficult for the Group Head of HR to have appropriate influence within the investment bank.
- 10.4 We are also of the view that HR should continue to develop at the Group level; sharing good practice across businesses, developing strong Group-wide initiatives, and rotating HR staff across businesses. A focus should be placed on investment in HR systems, as a historical lack of investment has increased the difficulty in driving and monitoring HR practice.

Recommendation 16: Strengthening Human Resources

To support a strong and effective HR function, the Group Head of HR should normally sit on the Group Executive Committee. This will make it easier for HR both to provide necessary challenge to business leadership and to encourage prioritisation of consistent Group-wide approaches to the Group's people and their development. The Board should also consider making the appointment and removal of the Group Head of HR subject to approval of the Board Corporate Governance and Nominations Committee or another major Board committee.

Barclays' Approach to People Management

- 10.5 People management – the organisational tools of recruitment, training and development, performance management, promotion, disciplinary decisions and termination – plays a critical role in shaping the workforce and its behaviour. Although the public are particularly exercised by the effect of compensation on behaviour in banking, we believe that people management also plays a major role: explicitly in communicating desired behaviours, and implicitly in sending powerful signals of what really matters.
- 10.6 At Barclays, pay was emphasised above any other aspect of people management (see Section 11). In addition, rather than being seen as a means of driving culture, people management was considered predominantly as a tool to increase business performance. Moreover, the people management processes seemed to us to be loosely linked, resulting in different, and sometimes conflicting, messages.
- 10.7 Barclays now has the imperative and opportunity to develop a new, more powerful, form of employee engagement which places greater focus on non-monetary factors (such as recognition) and less emphasis on compensation. The continually difficult business environment, including dampened pay levels and low industry growth rates, make this shift a necessary one for all financial institutions. Early adoption will not be easy, but may develop loyalty and prove to be an important competitive advantage over time.
- 10.8 As the rest of this section illustrates, some of the shortcomings in Barclays' business practices can, at least in part, be attributed to shortcomings in the workings of its people management processes. So we believe that any approach to people management must comprehensively and systematically reinforce organisational culture if Barclays is truly to embed its values within its workforce. This should include opportunities for employees to express their views and ideas to the bank's leadership.

Recommendation 17: Employee engagement

Barclays should maintain a clear policy statement as to how it fulfils its purpose with respect to its employees. This should include the emphasis it places on training and personal development, promoting an environment of continuous learning, and non-financial forms of recognition for performance.

Performance Development

- 10.9 Performance development is Barclays' formal process of reviewing employees' performance and providing guidance for their professional development. The annual performance review is the cornerstone of the performance development process. Individuals are assessed by their manager according to a set of pre-agreed objectives within a framework provided by business unit HR. Objectives may be both quantitative (e.g., sales performance) and qualitative (e.g., teamwork). Employees also write a self-assessment. The performance development system over the period covered by this Review was taken seriously but did not achieve the objective of supporting the development of appropriate business practices.
- 10.10 Although we would expect some variation in the approach to performance development across different business units, we found there was a lack of a common Group-wide framework until 2012. Each business unit's use of a different set of performance criteria resulted in an inconsistent emphasis on the importance of demonstrating the correct behaviours. The investment bank used a number of different performance development approaches; the common feature seems to have been a heavy focus on financial measures with limited behavioural assessment.
- 10.11 In many cases managers were required to define for themselves the specific performance indicators against which to judge employees, including behavioural factors, and then to determine what constituted above or below average behaviour. In our review of a small sample of completed performance development forms, we found a heavy emphasis on financial or sales-oriented performance objectives. Customer service and teamwork were mentioned infrequently.
- 10.12 Both of these issues are due to be addressed on a Group-wide basis through the Transform Programme. We understand that a new performance management system will be implemented. It will combine a balanced scorecard of performance objectives (the 'what') with a compulsory assessment of behaviours (the 'how') and a more detailed definition of how to determine overall performance development ratings based on the two. We believe these changes should greatly strengthen performance management and drive a broader understanding among employees of what strong performance entails – so long as the weightings are appropriate and the non-commercial factors are appropriately evaluated.
- 10.13 We recognise that the effectiveness of the performance development process will depend on the diligence, discretion, competence and judgment of the manager responsible, and on all staff believing in its importance. During the course of the

Review, we identified issues which indicate that performance assessment was not very effective. For example, a number of employees appear not to have been set clear objectives at the beginning of the year. Across business units, the performance development system was skewed towards placing staff of all seniorities in the top performance bands – approximately 90% of RBB employees (in 2011) and 97% of the investment bank's employees (in 2010) were placed in the top two of four bands.¹⁹⁷ These numbers partly reflect the fact that the investment bank made a point of acting quickly on what it saw as under-performance. There was also limited training for managers on how to conduct performance reviews effectively, including a lack of clear and specific guidance for managers on how to assess their staff. An effective performance development process will inevitably trigger performance improvement plans for some employees. We would expect Barclays to apply ever greater diligence in this area. Addressing these issues will be critical to ensuring the successful and consistent use of the new balanced scorecard across the whole Group.

- 10.14 To address the issue of grade inflation, Barclays has over time placed increasing emphasis on 'target distribution' – whereby managers are "encouraged strongly" to allocate ratings for the individuals they are evaluating into a pre-specified distribution, so that the lowest grades have to be used. Staff members responding to our survey were noticeably unenthusiastic about this recent emphasis. Forced distributions can have a positive impact in requiring managers to identify poorly performing staff, but care should be taken when applying this approach to small teams.
- 10.15 While 79% of employees in the UK retail bank found their performance reviews helped them improve their job performance, employees elsewhere in the bank were far less positive. Many employees said to us that their managers placed limited weight on performance objectives other than their financial targets, causing employees to believe that performance reviews are not linked effectively enough to either compensation decisions or promotions. Additionally, performance development was rarely used as a tool to drive continuous professional development through training and other actions; managers infrequently gave explicit references to concrete actions their reports should take to continue their development. The inconsistency between messages sent by the performance development process and other elements of people management limits its effectiveness in reinforcing behaviours.

¹⁹⁷ From 2011, the investment bank followed a new grading approach. For 2011, only 6% of its employees were graded as having not fully met expectations. This figure reached 11% for 2012. For RBB in 2012, the equivalent number was 12%.

Recommendation 18: Improving the performance management process

To ensure a strong and consistent relationship between performance management and key HR decisions such as pay, promotion and personal development, Barclays should ensure these decisions are based on transparent and measurable objectives, clearly linked to its purpose and values. Barclays should provide guidance to managers on how best to give feedback based on applying common standards across the Group. Managers should be trained to deliver clear and honest messages during individual performance evaluations, as well as during promotion and compensation discussions. This should also form part of the manager's own evaluation.

Barclays should require regular internal assurance of the effectiveness of performance management outcomes.

Recruitment and Induction

- 10.16 We believe that Barclays' approach to recruiting senior talent had an important knock-on effect in influencing its business practices. Recruiting for positions at director level and above followed the 'Topgrading®' approach (see Exhibit 7). For managing directors, this process involved more than ten hours of interviews, with separate sessions to test key competencies such as: business skills, commercial effectiveness, control environment, management and leadership capability, technical skills, and personal and interpersonal skills. While the process was highly structured, one employee pointed to a flaw: "There is no comparison of aspirational profile with values and behaviours.... The bank is not 'intentional' when it comes to hiring."
- 10.17 We noted a number of ways in which the adoption of the Topgrading approach may have influenced people practices at Barclays. For example, the Topgrading book suggests that senior management should drive recruitment processes and not HR.¹⁹⁸ There is a clear articulation that HR lacks the "line authority and political clout" to maintain the 'A player' standard in the organisation, with little consideration of the consequences of a weak HR function. The book is also clear that if Topgrading is successful, 'A player' performance is the company standard. Perhaps this explains to some degree why the persistent skew in Barclays' performance development system towards 'A' ratings was tolerated until recently.

Exhibit 7. Topgrading® and its Use at Barclays

'Topgrading' is an approach to recruitment, training and talent management articulated by Brad Smart in the book *Topgrading: how leading companies win by hiring, coaching and keeping the best people* (2005).

The approach is based on the premise that the best teams and companies are composed of the best people, the 'A players'; these are defined as the top 10% of individuals available for a given role in an organisation. Filling the organisation with A players and eliminating those without the potential to become A players is the key to success.

¹⁹⁸ Brad Smart, *Topgrading: how leading companies win by hiring, coaching and keeping the best people*, 2005.

According to the Topgrading approach, the main purpose of the recruitment process is to identify the A players and avoid B and C players. The interview process must be comprehensive and exhaustive on the basis that understanding a candidate's past performance and motivators is the best guide to predicting their future performance. The Topgrading book sets out a comprehensive framework for the recruitment process, which can involve 10 or more hours of interviews for each candidate. This resource-intensive approach is justified by the cost to the organisation of mistakenly hiring B or C players.

Barclays senior recruitment process, which was referred to internally as Topgrading, was heavily based on the approach documented in the book, using the same terminology and the two main types of interview technique: competency-based interviews and an extensive chronological interview to understand career history and aspirations. Although the approach was most closely associated with the investment bank, it was also used in the retail bank as early as 2005, as noted in a case study in the second edition of the Topgrading book. The recruitment process for less senior employees shared some features with the Topgrading approach, such as competency-based interviews, although these are quite commonly used and not a distinctive feature. Topgrading has now been discontinued at Barclays.

- 10.18 Assessment of personal values forms only a limited part of the Topgrading assessment process, and perhaps did not receive sufficient emphasis. Our review of a small sample of feedback forms from recruitment interviews indicates that they were often biased towards commercial effectiveness. In interviews that should have tested personal and interpersonal skills – which includes the focus on values – we found evidence of greater (and at times exclusive) focus on previous financial performance. It is apparent from some of our interviews that this recruitment process resulted in some senior hires who were unduly focused on financial success and may have valued little beyond this. This approach then filtered down through the organisation. Indeed our own survey indicated that less than 15% of employees believe that Barclays' values are communicated during interviews and the recruitment process. On the other hand, we were also told that some senior hires joined Barclays to be part of a growing, dynamic team.
- 10.19 Topgrading has now been discontinued at Barclays. In its place, Barclays uses a recruitment process that follows a structured, multi-interviewer interview programme aligned to a competency-based framework.
- 10.20 Except for entry-level staff, induction programmes appear to be neither consistent nor rigorous. This is particularly the case for those in senior roles. Rather, the content of the induction appears to be primarily driven by individual managers, with limited introduction to Barclays' purpose, values and culture. Induction training is an important opportunity to explain the firm's values and expected behaviours to all employees. For senior employees, who become role models in the organisation, this is of paramount importance.
- 10.21 Induction provides an opportunity for employees to explore and make sense of an organisation's culture and values. This is an important first step in helping new recruits to identify ways to adapt. Along with key promotion points, induction

represents the most effective point of intervention in building awareness of culture and values. Better use should be made of the opportunity.

Recommendation 19: Recruiting and induction

In all recruiting, but particularly for senior managers, Barclays should look beyond a candidate's financial performance, and include a rigorous assessment of their fit with Barclays' values and culture. Barclays should supplement this with induction programmes that reinforce the values and standards to which the bank is committed.

Promotion

- 10.22 The bank considered that it was a meritocratic organisation. In many ways it was, although some elements underlying career advancement show that this principle was not consistently applied.

- 10.23 In the UK retail branch network, the performance management process appears to have been used to encourage staff to think about their careers and which development opportunities are required if they are to take the next step. Some front-line staff join the bank as cashiers, and progress relatively quickly along different paths. Many of the retail bank branch staff with whom we spoke believed their career path could lead to other parts of the bank, including roles in head office, Barclaycard, Business Banking, Corporate and Wealth. However, promotion decisions themselves appear to be more influenced by sales rankings than formal appraisals, a signal with obvious consequences for staff behaviour.

- 10.24 Elsewhere, our interviews with employees have indicated a less consistent emphasis on career development. Employees consider promotion processes to be insufficiently transparent and not directly linked to performance management processes. For example, within the investment bank, employees believe promotion at junior levels is primarily driven by tenure. As they become more senior, they see 'political' connections as increasingly important. Perceived promotion criteria for these cohorts do little to support desired behaviours.

- 10.25 In conjunction with the industry move towards greater emphasis on professional standards, there may be a case for aligning promotion decisions with professional development milestones. Promotion for certain client-facing roles may in future require membership of a chartered industry body (or similar organisation) from a pre-approved list. This would reinforce a sense of banking being vocational, carrying a commitment to continuing professional development for those seeking to advance through the organisation. Membership of a professional body alone is, in any case, no substitute for high personal and institutional standards. As the experience of many existing professional bodies can attest, members do, on occasion, fall short of expected behavioural standards. Irrespective of membership of a professional body, Barclays should consider adopting the continuous professional education approach that is a requirement of many of them. Barclays should also ensure that its staff have

a diversity of experience, for example time spent working for a regulator or in a different division or country.

Developing Barclays' Future Leaders

- 10.26 Whether home-grown or recruited externally, leaders set the tone which drives or condones business practices. During the period covered by this Review, leadership development was inconsistently implemented and possibly under-regarded. The bank appears to have had neither a Group-wide view of what 'leadership' was nor a Group-wide understanding of who were the various leadership cohorts. Unsurprisingly therefore it does not offer a systematic or coherent leadership development programme across the Group. Instead it is fragmented, with individual business units offering a variety of programmes, which differ significantly by seniority, scope and resources. Some interviewees mentioned that this reflected amongst the highest level of management a historic lack of interest in development programmes for themselves.
- 10.27 We were told that the bank had limited programmes in place to understand the dynamics and improve the effectiveness of its leadership teams. Developing further capability in this area should be a priority given the importance of strong leadership teams in driving cultural change and demonstrating effective behaviours to staff, especially across an organisation of the scale and complexity of Barclays.
- 10.28 Barclays has during 2012 recognised the need for a stronger and more coherent leadership development programme and is creating a Group-wide framework and leadership development programme, the details of which are yet to be confirmed. We are supportive of these moves, as an increased emphasis on leadership and leadership development would be helpful in encouraging individuals to consider more carefully the responsibilities that are inherent in taking on a leadership role. Focusing on a cadre of leaders will emphasise the collective and distributed responsibility of the group of leaders.
- 10.29 Over the period under review, we noted that Barclays' senior managers have tended to follow career paths within a single business unit or a closely related business unit. This constrains efforts to build and reinforce a common culture, spread good practice, and break down silos across the bank. What mobility we did observe was primarily limited to transfers from the investment bank, mostly into the Group Centre or Group functions.
- 10.30 Our review of career paths at other leading companies with complex, global operations (both within financial services and in other industries) indicates a greater level of executive rotation between businesses than at Barclays. Some have programmes promoting mobility from an early stage in the careers of potential high fliers. There is clearly an advantage in those who are promoted to senior Group positions in the bank having an understanding of different business divisions and different geographies.

Recommendation 20: Developing Barclays' future leaders

Barclays should clearly identify its pool of current and potential leaders and strengthen the leadership development programmes in which they participate. These programmes should be Group-wide and embrace all business units and functions, aiding current and future leaders to develop well-balanced skills. To strengthen the role leadership development plays in creating a cohesive Group, Barclays should carefully manage mobility across divisions, functions and geographies, investing in programmes to develop well-rounded future leaders through structured rotations across the Group.

Leadership promotion should include direct evidence of adherence to the values and standards and the encouragement of others to live them.

Training

- 10.31 We found inconsistent levels of staff participation in, and satisfaction with, Barclays' training. UK RBB appears to have some strong training programmes in place, and many staff members are required to complete a minimum number of training hours each year. UK RBB training is well attended and staff satisfaction is high. In other areas of the bank a wide range of training is available. However, there are fewer and less defined training programmes. In these businesses training is less formalised, generally not mandatory, and primarily relies on individual initiative (except for required compliance training and those on graduate schemes). Barclays' internal employee survey supports this; less than 60% of staff in Wealth, the investment bank and Europe RBB believe they have sufficient training opportunities available.¹⁹⁹ In several areas of the investment bank, over 50% of staff complete no training beyond that required for regulatory compliance, diversity or health and safety.²⁰⁰ In general, training concentrates mostly on technical skills, with limited emphasis placed on behaviours and values.
- 10.32 The investment bank's own recent diagnosis concluded that few training and development programmes explicitly addressed conduct; that leadership education programmes with the heaviest conduct components were not delivered to all employees; that conduct and values programmes were mostly elective; that mandatory courses were either delivered electronically or in large groups; that management information systems to measure training participation and effectiveness were not robust enough; and that there was no firm-wide mentoring programme.
- 10.33 This inconsistent commitment primarily reflects the different emphasis given to training and development by some of the bank's senior leaders. Senior managers to whom we spoke rarely cited training and development – even when discussing people management. We concluded that this 'tone from the top' sent an important signal about the priority managers and staff should give to training – evidenced by the tenuous link between training and other people management processes (for example, it appears that performance reviews rarely led to training

¹⁹⁹ Barclays' 2012 Employee Opinion Survey.

²⁰⁰ Not including staff on a formal graduate programme.

recommendations). Outside the retail branch networks, there is not a widespread requirement for a minimum number of training or development hours to be completed each year. Indeed in our survey of employees, staff recognised a significant gap between the level of importance staff assigned to continuous professional development and the priority given to it today.

- 10.34 A significant proportion of training is offered remotely (e-learning) and often is fairly generic in terms of content. While there are clear efficiencies in promoting training online (for reasons of cost, time and managing compliance), we believe much more emphasis should be given to the benefits of training in groups. This is particularly important given the need to spend more time discussing Barclays' values and how best to make them real for staff and customers. Our own survey indicates that very few employees consider that training is used as a significant tool for communicating values today. Many of the cultural and change management experts with whom we consulted argued passionately for far more regular staff discussion about how to translate values into action. This is most important in the investment bank and in the senior cohorts – possibly the groups most cynical about so engaging.
- 10.35 More broadly, Barclays could do more to build a learning organisation. We have already commented on the bank's mixed success in learning from specific events and applying those lessons more broadly. Successful learning organisations encourage mentorship, regularly reflect on where things go wrong (as well as on what works well), and have leaders who set an example of inquiry and curiosity. The meaningfulness of employee reflections is significantly increased through regular discussions of real dilemmas which the businesses can face in the course of their day-to-day operations.
- 10.36 Through the Transform Programme Barclays has announced its firm intention to measure not only what people deliver, but how they deliver it. As it works to embed this, Barclays should identify clearly what competencies it wants in staff and ensure that training programmes develop these competencies in a comprehensive and systematic way across the bank.

11. Pay

- 11.1 Because the business of banking is so associated with money, and because (for some) the pay of some bankers has come to represent an allegory of bigger issues, pay in banking stimulates heated debate. Employees come to work for many reasons. But monetary reward is one of them and employees who work hard, serving customers and their employer well, are entitled to expect to be fairly rewarded for their talent and effort. Of course, pay is not everything. Personal recognition, affiliation, friendship, the opportunity to offer a valuable service, stimulation and challenge all play a role.
- 11.2 This is true even in the often criticised investment bank – which Barclays successfully built over a short period of time, taking advantage of the inherent mobility of the investment banking workforce. Barclays paid much to achieve this, but pay alone would not have attracted people to what was – at least at the outset – a less well-positioned competitor. Recruits were also attracted among other things by the prospect of being involved in building a new, edgy business. Nevertheless, pay matters as much to Barclays staff as it does to anyone else. It is more difficult however, in investment banking, to be clear about what is fair when the common view is that the global market for investment bankers is not a reasonable indicator. What also matters organisationally is how the pay lever is used to support desired behaviours.

Approaches to Pay

- 11.3 Many observers believe – as do many of our interviewees – that the banking industry has treated pay as the primary, and sometimes only, tool to motivate employees and influence their behaviours. Given that bonuses and incentive payments continue to represent a material portion of that pay, the structure of bank pay plays an important role in shaping a bank's culture. Indeed, many people choose to enter banking, especially investment banking, for the potential to earn above average levels of pay, probably realising that they will have to work hard for it.
- 11.4 Employees learn to adjust their behaviours as they experience the response to those behaviours. If there are no other significant forms of recognition for good performance, bonuses for achieving financial outcomes will be seen as the major organisational response employees experience. Financial outcomes then become what employees believe the organisation values. Incentive pay systems can be effective in sending signals about what an organisation values, but studies show that the motivational effects of pay, especially for complex tasks, can be overstated.²⁰¹
- 11.5 Barclays' staff emphasised to us that individual financial contribution was the overriding determinant of discretionary bonuses. Retail branch staff participated in incentive schemes formulaically linking their pay to their individual sales. And for senior executives, the highest rewards were available to those participating in long-

²⁰¹ See Appendix B.

term incentive plans, which until very recently used only financial measures of performance.

- 11.6 Outside Barclays, we observed with interest alternative approaches to pay which tended not to emphasise financial reward as the primary motivator of employee behaviour. Some companies emphasise collective achievement through a firm-wide profit share scheme; others pay bonuses only for exceptional performance. These pay models serve to reinforce – as well as being products of – their companies' distinctive cultures. They explicitly value the performance of the team over the individual, they tend to balance better the long term objectives of the company, and they amplify the message that higher pay is not the only form of reward. Personal responsibility and a sense of purpose can produce superior results and a better alignment to stated values than purely financial incentives. Taken in the round, these examples capture the approach to rewards that we would favour for Barclays over the long term (see Appendix B for further discussion).

Exhibit 8. Examples of Other Pay Models

Common wisdom is that companies perform better by offering staff a financial incentive for their performance. However, not only has a significant body of academic research cast doubt on that assumption, but many leading companies have succeeded while being far less reliant on pay as a performance lever. Prominent examples of alternative models include:

- Employee profit share schemes at UK department store John Lewis and European banking group Handelsbanken;²⁰²
- Absence of individual incentives for retail staff at Apple, which nonetheless achieves the highest sales per retail square foot in the world;²⁰³
- Absence of individual incentives for staff at Southwest Airlines, which is consistently the cost, productivity and customer service leader in its industry;²⁰⁴
- Elimination of individual sales goals at GlaxoSmithKline in the United States and replacement by assessment of three factors: sales competency, customer evaluation, and overall business unit performance.²⁰⁵

- 11.7 Because it is difficult to understand fully the subtleties of the behaviours they generate, it is hard to use incentive schemes alone to drive appropriate behaviours. Incentives tend to cause employees to focus narrowly on the outcomes directly rewarded by the scheme (or what employees believe will be rewarded) – as the alleged mis-selling of PPI demonstrates. So it may be possible to use incentives to drive sales of retail bank products; but it is far harder to design incentives which encourage the sellers at the same time to consider whether the product is suitable.
- 11.8 As a universal bank embracing many different businesses, Barclays' approach to pay must reflect the fact that the skills, attributes and market pay rates of staff in

²⁰² See www.johnlewispartnership.co.uk; Jeremy Hope and Steve Player, *Beyond Performance Management*, 2012.

²⁰³ The New York Times, "Apple's Retail Army, Long on Loyalty but Short on Pay", 23 June 2012.

²⁰⁴ Hope and Player, *Beyond Performance Management*.

²⁰⁵ GlaxoSmithKline, "GlaxoSmithKline implements next phase of new incentive compensation program for US sales representatives", press release, 5 July 2011.

different businesses are inevitably very different. Nonetheless, it is essential that Barclays' pay arrangements are designed and evaluated with sufficient regard for how they align with the Group's values, what behaviour they incentivise, and how adjustments can be made not just for bad behaviour but also for losses or costs incurred in the future. Although we would have hoped to find some common principles, we could find no evidence – for the period addressed by our review – of a consistently implemented Group-wide 'philosophy' and approach to pay.

- 11.9 At the heart of any consistent philosophy and approach to pay, we would expect balance in the way that the burden of risk is shared between employees and shareholders. We would expect careful consideration of the appropriate sharing in the fortunes of the entire institution – both in good times and in bad. And we would expect under-performance not to be rewarded.
- 11.10 The essence of a bank is to take risk. The first call on earnings should therefore be to maintain an appropriate capital base to support the risks taken. As the Financial Stability Board observed, significant financial institutions should ensure that total variable compensation does not limit their ability to strengthen their capital base.²⁰⁶ Pay should then reflect risks taken, properly aligning the consequences of risk so that employees only benefit if shareholders do too. Despite the sophistication of accounting standards, the complexity of some bank businesses means that the financial accounts will not be able to reflect all risks at a given point in time. This makes it difficult to reflect risk fully in compensation decisions.
- 11.11 The Financial Stability Forum (FSF) observed in 2009 that “as a practical matter, most financial institutions have viewed compensation systems as being unrelated to risk management and risk governance”. The FSF illustrates this by pointing out that “two employees who generate the same short-run profit but take different amounts of risk on behalf of their firm should not be treated the same by the compensation system. In general, both quantitative measures and human judgment should play a role in determining risk adjustments.”²⁰⁷ Barclays appears to have made limited use of risk metrics and risk input in key compensation decisions. In our view, risk considerations should be embedded throughout the compensation system. Compensation outcomes should be symmetric with risk outcomes to the extent possible. The FSF observed that some of the “greatest barriers to progress towards the principle that compensation must be adjusted for risk are:
- Determining and implementing the proper mix of executive judgment and quantitative risk measures;
 - The difficulty of incorporating types of risk for which measurement is at early stages such as liquidity or reputation risk. The difficulty is not a reason to ignore such risks;
 - The difficulty of safeguarding the fairness of risk adjustments;

²⁰⁶ Financial Stability Board, *FSB Principles for Sound Compensation Practices – Implementation Standards*, 2009.

²⁰⁷ Financial Stability Forum, *FSF Principles for Sound Compensation Practices*, 2009; www.financialstabilityboard.org/publications/r_0904b.pdf.

- The danger that quantitative measures will be distorted by self-interested employees.²⁰⁸

11.12 Broadly speaking, we feel that the pay structures in banks have tended in the past to be too complicated, too easily gamed, too narrowly and too short-term focused, and too often resulting in overly generous pay-outs. And these payouts have tended inadequately to reflect risks, a genuine assessment of an individual's contribution or a fair allocation between employees and shareholders. It is also true, in the context of a competitive global industry, that it is particularly challenging to change radically the structure of compensation. Such change will take time.

Pay Levels Overall

- 11.13 Bank pay helped drive the financial crisis. Multiple surveys find that over 80% of market participants believe that compensation played a role in promoting the accumulation of risks that led to the current crisis.²⁰⁹ High short-term profits resulted in generous payments to employees. This encouraged increased leverage and amplified risk-taking, which left firms less able to absorb large losses as risks materialised and severely threatened the global financial system.
- 11.14 Since the financial crisis hit, there has been increasing and significant public, political and regulatory frustration – and anger – with pay in the banking industry, particularly in investment banks. This has been driven largely by an increasingly popular (and populist) view that bankers enjoy the upside but insufficiently participate in the downside. Across the industry bonuses may have been reduced, but the reduction did not appear to have been proportionate to either reductions in profitability and shareholder value or significant state financial support for the banking system.
- 11.15 There is therefore, for many, a significant disconnect between the quantum of pay awarded to some bankers and the long-term value they generate. This has contributed to significant reputational damage for banks and a decline in public trust of 'bankers'. Barclays has been a target for the discontent – even though many of Barclays' employees are modestly paid. Outside the investment bank the average bonus was £4,800 in 2012. The pay of the relatively few influences attitudes towards an entire industry
- 11.16 In addition to reputational issues, elevated pay levels inevitably distort culture, tending to attract people who measure their personal success principally on compensation. Our Review indicates that this was the case in the investment bank, with many interviewees reporting a sense of an entitlement culture.
- 11.17 Few industries (if any) make it so easy to link apparent personal financial contribution directly to revenue generation. Some interviewees pointed out that, with

²⁰⁸ Financial Stability Forum, *FSF Principles for Sound Compensation Practices*, 2009; www.financialstabilityboard.org/publications/r_0904b.pdf.

²⁰⁹ Noted by the Financial Stability Forum in *Principles for Sound Compensation Practices*, which refers to: FSF, *Enhancing Market and Institutional Resilience*, April 2008; Institute of International Finance, *Principles of Conduct and Best Practice Recommendations*, July 2008; and The Group of Thirty, *Financial Reform: A Framework for Financial Stability*, January 2009; see: www.financialstabilityboard.org/publications/r_0904b.pdf.

the enormous growth in investment bank top-line revenue, the 'commission' mind-set (whereby a small percentage of a large number gets allocated to the producer) leads to very high pay awards. It had become difficult, they said, to determine what the appropriate share should be. So while there might be an intellectual case for paying exceptional performers handsomely (the so-called 'stars' or 'rain-makers'), there seems to be little logic for the inflationary trickle down to less exceptional colleagues. One interviewee observed that the scandal of banker pay was less that of the star performer, but of the mediocre banker who, under the umbrella of a star and benefiting from the franchise of a top investment bank, received disproportionate reward simply for being there.

- 11.18 Total compensation at Barclays was over £10 billion in 2010 and 2011, and £9.8 billion in 2012. Of this £3.5 billion was paid out as incentive pay in 2010, £2.6 billion in 2011 and £2.4 billion in 2012. Total compensation has come down since pre-crisis levels, most notably in the investment bank where average salary plus bonus per employee in 2012 was down 30% over 2007 (having been higher than 2007 in three of the four succeeding years). On average, in both the investment and retail banks, compensation levels for most roles in Barclays have been in line with peers. The exception to this is the Group's 70 or so most senior or highly-paid executives.²¹⁰
- 11.19 Compensation for the 'group of 70' was consistently and significantly above the median compared to peer banks. For example, in 2010 average pay to these executives was overall 35% more than the market benchmark for their positions. This level has come down over the past two years. In 2011 average pay for these executives was 17% more than the market.²¹¹ Pay in excess of benchmarks was in large part caused by several senior staff transferring from the investment bank to different, less well-paid roles, without adjustment in pay to reflect the 'going rate' for the new position. It is likely that these movements themselves had a ripple effect on other packages – with the result that in different parts of the bank Barclays was paying different rates for the same job – including paying well over the going rate for some positions. We recognise that moving individuals around the Group may result in those individuals receiving above-market compensation for a particular role for a period of time, but the knock-on effects seem inappropriate. In general we are supportive of increased mobility of senior executives across the Group (see Recommendation 20). Having substantially the same rates for essentially similar jobs will assist mobility.
- 11.20 One of the difficulties surrounding the debate about bankers' pay is that there is no shared view of how to divide the pie between owners and employees – particularly given the difficulty of distinguishing individual contribution from the umbrella value of the franchise.

²¹⁰ For the purposes of the report we defined this group as including Executive Committee members in Group, RBB, WIM and CIB; IB employees earning more than £5m; and any employees in RBB, WIM and CB who are one of the top ten highest earners in their business unit but are not on the Executive Committee. This group received the most scrutiny from the Board Remuneration Committee, and the number of executives varied slightly year on year.

²¹¹ Benchmark data for 2012 was not yet available to make a similar comparison for the most recent financial year.

- 11.21 We identified two particular compensation arrangements which seemed to us to be inconsistent with normal practice and met with some public criticism. The granting of options in BGI to senior Barclays Capital executives went through appropriate governance processes. While it is common for executives in asset management to enjoy shadow equity schemes, there was some criticism of Barclays extending BGI equity to executives who were primarily employed elsewhere in the Group. Others pragmatically respond that BGI was an exceptional success story of value creation for the Group and that this would not have happened without the talents of the executives concerned. A second example relates to the compensation arrangements for the specialist team involved with the Protium transaction. In that case the arrangements were justified in terms of the considerable value to the Group in having specialist skills available to manage the portfolio of Barclays' assets at a time when asset values were key to Barclays' survival.
- 11.22 More broadly, during 2010 and 2011 approximately £6 billion in total was paid out to staff in incentive pay at a time when total shareholder return was down 34% and dividend payments totalled only £2.7 billion.²¹² Many of Barclays' peers pursued a similar approach, although not all. For example, during the same period dividends paid by Société Générale, HSBC and Standard Chartered were significantly higher than total incentive payments,²¹³ although we recognise that their business mix is different.
- 11.23 In the absence of any regulatory or accounting requirement to treat bonus payments to employees in the same way as dividend payments to shareholders, Barclays might wish to consider how best to achieve some cash symmetry for shareholders. It could be helpful for the Board to go beyond an agreed ratio of total compensation to net income and agree with shareholders in advance the dimensions of a scorecard on which to decide the ratio between capital requirements, dividend payout and bonuses. This approach could perhaps be built into the statement of future remuneration policy that new UK regulation will likely require companies to agree with shareholders every three years.²¹⁴
- 11.24 Given the prevailing state of the market for jobs in investment banks and the extent of reputational damage and public anger, we believe that the current environment presents a unique opportunity to make significant changes to the way remuneration policy is developed and applied across the financial services industry. In saying this, we are mindful that Barclays competes in a global market for talent and this provides some real constraints in meeting UK public expectations on bank pay. Many employees care principally about pay relativities. While their primary point of comparison will be with their peers internally, they will likely be aware of the comparisons within the wider community in which they see themselves. So in New York, for example, Barclays competes for talent with New York banks locally.

²¹² Incentive pay stated is the income statement charge for total incentive awards (Total incentive awards granted, less deferred bonuses awarded, add current year charges for deferred bonuses from previous years, and add 'other' incentives). Source: Barclays, *2012 Annual Report*, March 2013. See Page 235 (Consolidated Cashflow). Dividends paid to equity holders of the parent company were £1.2 billion for the same time period – see appendix H.

²¹³ Société Générale, HSBC and Standard Chartered annual reports.

²¹⁴ Department for Business Innovation and Skills, *Proposals for Improved Transparency of Executive Remuneration*; June 2012.

- 11.25 As Barclays continues to take action on pay levels, it must develop a clear understanding of what it wants to reward staff for. This could include:
- Implementing a more robust process for determining individual value creation beyond that attributable to the franchise benefits of being part of Barclays;
 - Significantly increasing the weight given to staff behaviours and contributions to the bank's purpose; and
 - Assessing the true sustainable value contributed by individuals and teams – as far as possible, fully adjusted for all forms of risk.

Recommendation 21: Pay principles

The Board, aware of the reputational and behavioural implications of pay, should align pay to levels that reasonably reflect individual talent and the contributions that individuals make, aiming to link pay to the long-term success of the institution.

Approaches to pay across the bank should be based on common underlying principles and be aligned with both the Group's values and the level of risk to which it is exposed. Individual pay should systematically reflect individual adherence to values and standards.

Barclays' approach to reward should be much more broadly based than pay, recognising the role of non-financial incentives wherever possible.

Fixed versus Variable Compensation

- 11.26 An important issue faced by parts of the banking industry is the ratio of variable to fixed compensation. High levels of variable compensation have long been popular within investment banking because they enable compensation to be tied to the significant volatility of markets and income – and so be reduced if profitability falls. However, over a period of consistent growth a pattern has developed for variable components of salary to be consistently high and linked to individual revenue performance rather than the profitability of the organisation.
- 11.27 The FSF asserts that “compensation systems should link the size of the bonus pool to the overall performance of the firm”.²¹⁵ However, there is a danger that the size of variable compensation pools is driven too much from a ‘bottom up’ perspective with limited linkage to the overall success of the firm. Successful business areas demand financial recognition of their performance even if the firm or industry as a whole has performed badly. At the same time, poorly performing (even loss making) areas may not accept zero – and rather argue for a degree of variable remuneration to reflect individual performance and to support staff retention. Such an approach serves to reduce the true variability of incentive pay.
- 11.28 Across the investment banking industry generally, and Barclays in particular, compensation has been much more variable upward in response to good

²¹⁵ Financial Stability Forum, *FSF Principles for Sound Compensation Practices*, 2009; www.financialstabilityboard.org/publications/r_0904b.pdf.

performance than downward in response to poor performance. Consequently, compensation at the investment bank as a percentage of pre-compensation profit before tax increased from 51% to 62% between 2009 and 2011, dropping to 53% in 2012, and compensation as a percentage of net income increased from 41% to 47%, dropping to 41% again in 2012.²¹⁶

11.29 At Barclays, fixed pay as a proportion of total compensation has changed significantly, increasing on average from 65% in 2010 to 76% in 2012 across the Group. This shift has been even more pronounced in the investment bank where average fixed pay has risen from 25% in 2007 to 59% in 2012, and from 6% in 2007 to 32% in 2012 for managing directors only, reflecting both absolute increases in fixed pay and significant reductions in average bonus.

11.30 EU legislation, currently being finalised, on the ratio of variable to fixed compensation in banks is likely to reinforce this – particularly in the UK where, according to a recent Towers Watson estimate, 89% of those likely to be impacted work.²¹⁷ The proposal is to cap bonuses at 100% of salary (200% with shareholder approval).²¹⁸ At the time of writing it is unclear how these regulations will be formulated, especially given the complexity of the issue (e.g., how non-cash elements should be considered, and to which staff the legislation should apply). Nonetheless it is likely that it will result in further increases in fixed pay to offset the cap, reducing bank flexibility with respect to its cost base and arguably therefore increasing risk. Additional potentially unintended consequences include less opportunity to reduce pay for under-performance and a lower proportion of pay being available for malus. It is also possible that, in order to maintain their competitiveness with US and Asian banks, European banks will look for ways to lessen the adverse impact of the restrictions on their US and Asian businesses – which may have the unfortunate collateral effect of reinforcing the public view that some banks always try to game the system.

11.31 We now look at Barclays' three main incentive schemes:

- Formulaic retail schemes, which apply to customer facing staff ineligible for discretionary bonuses (approximately 38,000 staff in 2012);
- Discretionary bonus schemes, which apply to all other staff (approximately 106,000 staff in 2012);
- Long-Term Incentive Plans, which have historically applied to a group of approximately 200 senior executives, and from 2013 only apply to Executive Directors and members of the Group Executive Committee.

²¹⁶ Both PBT and net income are calculated excluding own credit.

²¹⁷ Towers Watson, "Update on CRD IV – Remuneration", 28 February 2013; see: www.towerswatson.com/DownloadMedia.

²¹⁸ Recently agreed EU proposals under the EU Capital Requirements Directive IV (CRD IV) which are expected to be approved by EU member states and the European Parliament plenary in mid-April 2013. January 2014 has been suggested as the date for implementation.

Retail Incentive Schemes

- 11.32 Many retail staff participate in branch network incentive schemes.²¹⁹ These employees are not eligible for a discretionary bonus. For them, incentives comprise a relatively small (approximately 11% for UK Personal Bankers in 2012) portion of total compensation, although a few staff achieved relatively high bonuses in relation to salary. Research shows that even incentives of relatively small magnitude impact employees' behaviour – good and bad.
- 11.33 Prior to 2007, the Barclays UK RBB sales force worked under a discretionary bonus scheme where points were allocated for each type of product sold. After 2007, the scheme linked bonuses formulaically to individual sales performance, with different incentive payments for each product sold; for example, as we noted earlier in the report, loans sold with PPI had an incentive value of two and a half times that of a loan without PPI. Over time, additional customer service elements were added, although a number of sales focused features remained in place through 2012 – most notably an “accelerator”²²⁰ feature that disproportionately increased the value of incentive payments as an individual sold more.
- 11.34 There has been much debate on the moral hazards of basing the incentives of a retail bank sales force on achieving sales volumes thereby underemphasising customer needs and suitability. We have concluded that the sales focus of the incentive schemes in place at UK RBB and Barclaycard were likely to have contributed to alleged mis-selling of certain products, such as PPI. Incentive schemes signal what matters to management – and so how staff should behave in order to be regarded as successful.
- 11.35 A new retail incentive scheme was introduced by Barclays in the UK in December 2012.²²¹ It is focused on customer satisfaction, with no direct link to sales. This move is intended by management to put Barclays ahead of many peers in encouraging greater customer focus. Importantly it also puts significantly greater emphasis on collective efforts; customer satisfaction is measured at a branch and area level – there are no individual key performance indicators (KPIs). This is an encouraging step in reinforcing appropriate behaviours in the branch network.
- 11.36 The new incentive scheme may need to evolve further still. Currently it is not well aligned to the bank's people management tools. For example, performance objectives are not well reflected in pay structures (the objectives are based on five dimensions²²² but incentives are based only on customer service). Sales incentives may have gone, but it appears that sales targets still exist at both a branch and individual level (either formally or informally). Such contradictions need addressing. If staff see sales targets (such as internal branch league tables) to be important, removing sales-based incentive pay may not succeed in changing individual behaviour. Narrowly defined

²¹⁹ Some staff in contact centres also participated in sales incentive schemes.

²²⁰ The ‘Accelerator’ in Barclays’ retail incentive schemes resulted in commission payments per product sold increasing as an individual’s sales increased during a month.

²²¹ Europe and Africa retail branch networks continue to have incentive schemes which are sales focused, both in language and content, with customer service comprising a smaller part of the incentive formula.

²²² The 4 Cs: ‘customer’, ‘colleague’, ‘citizenship’ and ‘company’; in addition to a further ‘control’ objective.

incentive schemes (such as ones focused on customer satisfaction) can work. But narrowing such schemes serves to make them too blunt. Incentive schemes should consider overall behaviours and be linked with performance management, and offer non-financial forms of recognition as well as financial rewards. Changes to Barclays' incentive scheme to date appear still to rely on pay as the primary driver of behaviours, even if this is now measured by customer satisfaction not sales.

- 11.37 Individuals need to understand how their performance is regarded. Therefore, where an incentive scheme focuses exclusively on collective behaviour, management will need to give close attention to how individual performance is assessed and how appropriately it is recognised. Good collective metrics must not hide poor individual behaviours.
- 11.38 Bonuses typically reflect an individual or a team reward for a job well done. A collective profit share ties reward to the performance of an enterprise overall. With the new Barclays emphasis on team rewards, we are drawn to the notion that – at least in part – bonuses paid to retail employees might reflect the economic outcomes of a larger team and, ultimately, the retail bank or even the whole Group.²²³ In terms of building a common culture and pride in the institution, there would seem to be advantages in employees sharing in the successes and the disappointments of the enterprise as a whole. This philosophy could be applied more broadly across the bank but we recognise this is something for the future.

Recommendation 22: Retail incentives

Barclays should avoid retail sales incentives which may encourage behaviours that conflict with meeting customer needs. It should ensure that indirect sales-based targets (such as internal league tables) do not take the place of sales incentives in such a way as to encourage prioritising sales over customer needs. Retail incentives should, where practicable, be based on a balanced scorecard covering overall behaviours as well as customer satisfaction.

Discretionary Bonus Arrangements

- 11.39 The majority of staff across Barclays are eligible to receive incentives in the form of a discretionary bonus. The bonus is a financial reward to individuals based on short-term (annual) performance, not formulaically linked to any KPIs and with very high levels of discretion given to line managers to decide individual awards. For many staff, especially in the investment bank, the discretionary bonus forms a very significant part of their compensation. The average investment bank bonus was 70% of base salary in 2012 and approximately 135% of base salary in 2011. These figures are significantly higher for senior employees, with the average managing director bonus at 350% of base salary in 2011 and 210% in 2012 – rising to many multiples of salary for the most senior bankers. Typically, base salaries for the managing director population fall in the range of £150,000 to £300,000.

²²³ Any consideration of profitability at a business unit level should be put in a Group context which would significantly reduce incentive pay-outs in instances where that business had been profitable but the overall Group had not.

- 11.40 Managers told us that, in practice, bonus allocations were determined by individual financial performance. This was largely because there appeared to be no explicit criteria for bonus decisions: they were truly 'discretionary.' This view was reflected in our interviews with Barclays' employees and in our survey of Barclays' staff. Only 41% of respondents (and only 32% of respondents from the investment bank) agreed that pay is clearly tied to performance. It seemed to us that a number of managers appreciated the opacity; it enabled them to avoid having difficult conversations with staff about relative and absolute performance.
- 11.41 Bonus decisions also appear to have been highly dependent on the judgment of individual line managers. We were told that this created a culture which encouraged individuals to follow their manager – resulting in complex dynamics around loyalty and willingness to offer challenge. While relying on judgment can be appropriate, it requires careful calibrations across managers, clear and role-specific guidelines on how to make appropriate decisions, and significant support for managers to ensure they perform this role effectively. It also serves to give individual managers significant power.
- 11.42 Even where a balanced scorecard was used, for example in the Wealth business, in practice the awards still remained overly linked to financial performance with adherence to the right values consistently under-weighted. In our survey of employees only 35% of staff agreed that the right behaviours are rewarded.
- 11.43 We are encouraged by proposals emerging from the Transform Programme. We understand Barclays intends to improve its discretionary bonus arrangements by emphasising desired behaviours through the introduction of a balanced scorecard and behavioural assessment for all employees. Specificity around the elements underpinning bonus decisions should improve the transparency of the process. Although Barclays plans to base individual discretionary bonus decisions on the new scorecard and behavioural assessment, it must work hard to articulate clearly the link between the holistic assessment of performance and rewards. It will be challenging to train line managers to make nuanced, rigorous and consistent judgments on behaviours (see Section 10). We are encouraged by the bank's intention to audit how well the scorecard is implemented.
- 11.44 In order better to align employees' interests with those of shareholders, banks increasingly pay part of discretionary bonuses in shares and some are imposing significant minimum holding periods. In 2011, Barclays paid around 40% of the investment bank bonus pool in shares (approximately 25% in 2010). It is far from clear how differently cash or share awards affect behaviour. Greater employee share ownership seems desirable and may help to increase sensitivity to risk – important given the intent to align more closely the long-term interests of the employee with those of the bank. Yet many staff will consider that they have limited ability to influence the share price and are already sufficiently exposed to the company. They will therefore discount the value of share awards (more so where required holding periods are longer). Moreover, shareholders are sensitive to the risk that share awards result in over-emphasis on short-term performance to drive the share price.

- 11.45 If paying bonuses in shares is a first step to better aligning employee and shareholder interests, then the use of deferral is a way to improve risk sharing. Barclays has followed the industry in its increasing use of bonus deferral. Bonuses over £65,000 in financial year 2012 are subject to a graduated level of deferral and will be paid out over the following three years subject to continued service and malus.²²⁴ 100% of bonuses paid to managing directors in the investment bank have been deferred. Increased deferral enables Barclays to claw back bonuses more easily as risks crystallise. But deferring bonuses for longer periods leads to many recipients discounting their value to reflect the possibility they will not be paid. As a result, they are likely to have less impact on encouraging particular behaviours.²²⁵ Ideally the deferral period should reflect the degree of risk in the relevant business activity, with greater and longer deferrals where there is a significant risk that the accounting basis for the award could be shown to be inaccurate. The effectiveness of deferral as a means of adjusting pay retrospectively will be greater where the consequences of individual performance can be tracked over time and malus can be applied to the awards before they vest.
- 11.46 There has been significant industry commentary about bonuses being subject to claw back or malus. These terms are often confused and misused. In general use, clawback requires an employee to pay back an amount already received under a cash or share incentive scheme. This is difficult to apply both legally and practically. Malus, in contrast, is used to reduce the employee's unvested deferred cash or share incentive award. In either case (subject to the terms of the arrangements), the cause can be: because a risk crystallises as a result of which performance was inaccurately measured at award, because the employee is in breach of his employment contract, or because historic issues come to light. Although strictly different, malus and clawback are ways of seeking redress either through recovery of what has already been paid or by reducing the value of what is being held as a deferral. For this reason, we will use them interchangeably – as, so we were told, Barclays does.²²⁶
- 11.47 In the FSA's Remuneration Code, Principle 12(h)²²⁷ requires the largest financial institutions to reduce deferred remuneration where there is evidence of employee misbehaviour or material error; where the firm or business unit suffers a material financial downturn; or where there is material failure in risk management.
- 11.48 Banks' 'accounts' are complex and necessarily reflect a financial position at a given point of time, with judgments made as to the valuation of assets and the prudent provisioning at that point. Inevitably, these valuations and provisions will prove to be wrong to some degree. Results also include items that will seem to have little to do with employee performance, such as 'own credit.' In determining the size and structure of the variable compensation pool, good practice requires a bank to consider current and potential risks, the cost and quantity of capital required to

²²⁴ Code staff deferral is a minimum of 40% for bonuses less than £500,000 and 60% for bonuses of more than £500,000.

²²⁵ See for example: PricewaterhouseCoopers, "If executive pay is broken, making it more complex is not the answer", *The Psychology of Incentives Study*, March 2011; <http://www.pwc.co.uk/human-resource-services/publications>.

²²⁶ For informal discussion purposes; formal legal distinctions are used when required.

²²⁷ FSA, Policy Statement 10/20: Revising the Remuneration Code – Feedback on CP10/19 and final rules, 2010; www.fsa.gov.uk/pubs/policy/ps10_20.pdf.

support those risks, as well as the timings associated with the revenue streams on which the pool is based. Sir Win Bischoff recently observed: "We need a return to proper forward loss provisioning. People should be paid based on realised profits, not mark to market."²²⁸ The starting point for a remuneration committee in any given year is therefore to determine the appropriate risk-adjusted profit number that should form the basis for calculating the compensation pool.

- 11.49 Given the difficulty of reflecting risk fully at the time of bonus awards, we consider the idea of malus to be a useful tool in compensation arrangements. Malus seems in the past to have required a material event to occur, internal investigations and public admissions of failure. This created asymmetry between the burden of proof required to award a bonus and that necessary to cancel it. It is not obvious why this should be the case where payment of the relevant bonus has been deferred. But new remuneration contracts may be required to widen the ability of banks to apply malus. We are encouraged by the firmer stance Barclays appears now to be taking on malus for the financial year 2012: clawing back £300 million of unvested deferred and long-term incentive awards, and applying malus on the basis of risk adjustments, not just for misconduct.

Recommendation 23: Discretionary pay

The size of the variable pool should aim to reflect, so far as practicable, the full range of risks. Significant bonuses should only be paid in the case of strong performance across all dimensions of a balanced scorecard which appropriately weights risk, values, and other non-financial elements.

Barclays should aim to be transparent as to its discretionary bonus process, including how bonuses correlate with performance ratings based on the balanced scorecard.

Barclays should combine bonus deferrals and malus adjustments to align reward with risk and prudent behaviour. It should apply malus consistently and systematically – while reinforcing efforts to get bonus decisions right first time.

Long-term Incentives

- 11.50 For a group of around 200 executives, compensation has historically been structured differently from the rest of the bank.²²⁹ In addition to a fixed annual salary and discretionary annual bonus, these executives received an annual Long-Term Incentive Plan (LTIP) award. Each year, new LTIP pools were defined, with each eligible member being given an award bounded by a target range, and subject to a predetermined maximum cap. The actual payout to employees was then linked to criteria relating to business and individual performance over a defined period – typically three years. Maximum payouts have tended to be several times larger than annual salary, ranging from an average of three times salary in the retail bank to an average of eight times salary in the investment bank. In 2011 only seven executives

²²⁸ Financial News, "Sir Win Bischoff calls for accounting reform", 13 March 2013.

²²⁹ A much broader Group LTIP (The Performance Share Plan) applying to nearly 1500 employees was discontinued after the awards made in 2007.

participated in an LTIP based on Group-wide performance. The majority of executives participated in individual business LTIPs, based on divisional financial performance.

- 11.51 We found that Barclays' LTIPs suffered a number of design issues. In particular, other than for the Group LTIP, the link to divisional performance (such as the performance of the investment bank) would not necessarily be reflected in equivalent value to shareholders based on their interests in the Group as a whole. As one might expect, this also did not necessarily help to embed Group-wide thinking and behaviour. While the outcome of the schemes was highly variable (in some years some individual business schemes paid out nothing), many interviewees suggested that some KPIs were too easily achievable and were insufficiently effective in promoting long-term value creation. The target payouts were linked to achievements against medium-term plan, with the size of the potential pool at the discretion of the Remuneration Committee. With hindsight it appears that certain of Barclays' LTIPs were overly generous. This was particularly the case in the investment bank, where Barclays Capital's LTIPs between 2002 and 2009 paid out an average of £170 million each year to a changing group of approximately 60 people (in addition to salary and bonus.)
- 11.52 There is a significant difference between the likely value assigned to these long-term awards when first awarded and the actual payouts commencing three years later at the conclusion of the performance period. Long-term incentive awards were given a value at award of approximately 20% of the target maximum which an individual could achieve. Between 2002 and 2009 the Barclays Capital LTIPs paid out approximately 80% of the total possible maximum. This does not appear to have been completely unexpected. In 2004 Barclays' remuneration advisers showed that, if Barclays Capital delivered its expected financial projections, then the LTIP would pay out at close to maximum. And in 2007 analysis from an external adviser suggested that, on different assumptions, the value at award figure could be over three times higher at 67.5%. In future, the Remuneration Committee should give careful consideration to 'value at award' to ensure that it does not distort pay awards and disclosures.
- 11.53 The Kay Review (2012)²³⁰, spoke of the need better to align senior executives' rewards with long-term value creation by paying performance incentives mostly in the form of company shares. It argues for long retention periods. Up until the end of 2012, half of Barclays' investment bank LTIP awards were paid out in cash immediately at the conclusion of the three-year performance period.²³¹ The other half was paid in shares at the same time, with executives only required to retain the shares for a twelve-month period after they vested.²³² Even after Barclays increased the 2013 vesting period to two years, it remains shorter than that of some of its peers: Deutsche Bank's deferred portion (minimum 60%) of LTIPs vests over four and a half years; Goldman Sachs requires their managing directors to retain 25% of all

²³⁰ John Kay, *The Kay Review of UK Equity Markets and Long-Term Decision Making*, 2012.

²³¹ In other words, the cash component of an award made at the start of 2009 would be available for pay out in cash by early 2012

²³² Barclays Group LTIP pays out 100% in shares, with 50% vesting immediately and 50% subject to a one year retention period.

awarded stock until retirement; while HSBC – with only a one-year performance period – applies a five-year vesting period and a requirement to hold shares net of tax until the participant retires.²³³

- 11.54 In terms of the measures of performance, Barclays' business level LTIPs have been based primarily on a single business performance metric: variously return on risk-weighted assets (RoRWA), economic profit (EP) and return on regulatory capital (RoRC). Any other adjustments (e.g., for behaviours) were entirely discretionary. The exceptions to this (since 2011) are the RBB, Wealth and Group LTIPs. There are practical difficulties with any individual metric, however. For example, with RoRWA, the true extent of the risk involved is often not evident for a number of years. Therefore we believe it important that any long-term incentives embrace a small number of financial and non-financial measures, making adjustments for broader behaviours as well as for the risks taken by the business, including conduct, reputational and operational risks.
- 11.55 Barclays has announced some changes to its LTIPs through the Transform Programme. We are encouraged by a number of these changes. From 2013 the relevant business reference point will be Group-wide, the bank will introduce a more balanced set of measures, and LTIPs will only be awarded to the Executive Directors and members of the Group Executive Committee. However, we remain concerned about the complexity of LTIPs; like any target based scheme they are susceptible to a focus on particular targets which may not be sufficiently aligned with the building of sustainable success. We hope that this will be taken into account by Barclays as it conducts a more fundamental review of its LTIPs during the year ahead. At a minimum, the scheme arrangements should allow the Remuneration Committee to have the discretion to adjust award if they feel that payouts are inappropriate or excessive relative to what was intended. We also note that the industry is increasingly moving away from LTIPs, towards simpler and more transparent grants of equity.

Recommendation 24: Long-term awards

Long-term award structures should be simple and transparent, reflect financial performance adjusted for risk, be linked to Group not individual business unit performance, and apply to a small group of the most senior executives. The Remuneration Committee should give careful consideration to 'value at award' to ensure that it does not distort pay awards and disclosures. The Board should agree and apply principles for making adjustments for circumstances not anticipated at award.

Control Function Pay

- 11.56 The independence of the functions responsible for the risk and control environment (Risk, Compliance and Legal) is critical for the success of the business. However, for Barclays employees in these functions – especially senior people – the variable

²³³ Only a few senior executives at Goldman Sachs receive long-term incentive awards, but all bonuses paid out to managing directors are subject to this requirement.

component of pay was significant and dependent on the performance of the business. It appears that their performance assessment and variable remuneration decisions were largely determined by their front-office counterparts. This reflected the fact that the primary reporting lines for some functions were to business unit chief executives. Under certain circumstances, this could be construed as a conflict of interest, although we should note that the Group Centre functions also provided input to these decisions, with their influence varying by function. Given the role of HR and Finance, many of the same considerations should apply to these functions too.

- 11.57 Barclays has recognised the disadvantages of the current structure and is now changing the dual reporting lines for control functions so that the hard line is to Group functions (see Section 12).

Recommendation 25: Control functions' incentives

The design of incentive schemes for the control functions should avoid potential conflicts of interest, such as an interest in business unit profitability; this may require a higher proportion of fixed remuneration. Barclays should develop specific performance measures related to successful achievement of the control functions' objectives and these should form a significant element of any incentive arrangements.

Remuneration Governance

- 11.58 Remuneration governance is primarily overseen by the Board Remuneration Committee. In line with good practice, the overarching purpose of the Committee is to develop and oversee an overall remuneration policy and philosophy that is aligned with Barclays' long-term business strategy, objectives, risk appetite and values. The Remuneration Committee must be given all the information necessary to exercise rigorous and independent judgment on the operation of the compensation system. This will include appropriate market benchmarks, analyses of discretionary pay relative to profitability, the correlation of discretionary pay to performance evaluation grades, application of malus and adjustments made for risk. This will assist the Committee in determining how well the compensation system delivers appropriate pay outcomes, motivates appropriate employee behaviour, improves the wider culture in the bank, influences the firm's current and future financial condition, and impacts its level of risk. It needs the power to make discretionary adjustments as it feels appropriate. This focus on strategic principles has not been evident at times and Barclays has often been slow to identify undesirable outcomes and to change the compensation system accordingly.
- 11.59 The governance of pay is particularly challenging; according to the Barclays Board evaluations, compensation strategy has been one of the top concerns for the Board for the last four years. Remuneration issues in a bank are particularly complex and quite unlike any other industry in having a very large number of extremely well-paid employees, significant regulatory requirements and important risk issues. Indeed, when remuneration committees were first established, they were designed to set the

structure and policy of compensation and to oversee the pay of the company's executive directors (broadly similar to executive committee members today given the significant decrease in the number of executive directors since the early 1990s).²³⁴ It was assumed that these few senior leaders would be the highest paid individuals, which is not necessarily the case in large banks.

- 11.60 From our discussions with management and Board members, it seems likely that information submitted to Barclays Remuneration Committee relating to individual compensation awards may have been difficult to navigate. For example, it appears that prior to 2011 the Remuneration Committee was not given, in an easily digestible form, details of each component of the total compensation to be paid out to individual senior executives.
- 11.61 Our Review found that at times the Remuneration Committee may have concluded that its role was to focus more on regulatory requirements and the size of the overall bonus pool, than the detailed oversight of individual compensation (other than for key senior individuals). While the Remuneration Committee spent an appropriate amount of time discussing the pay of the Executive Directors, whose remuneration was publicly disclosed, it may have been impractical for the Committee to devote similar attention to the relatively large number of other staff receiving significant compensation – in 2010, 728 staff received over £1 million; 428 did so in 2012. Given the number of highly-paid employees at Barclays, the bank has already given its Board Remuneration Committee a broader mandate than many other large companies. Nevertheless, the difficulty of addressing such large cohorts leads us to conclude that large banks may need a special approach to remuneration.
- 11.62 It is essential that bank remuneration committees have substantial expertise available to them, particularly on risk-measurement given the complexity of the topic and the important link between pay and risk outcomes. Such expertise can be drawn from within a bank's own control functions, through effective collaboration with the board risk committees and from careful recruitment of non-executive directors selected to sit on the remuneration committee. From our review, it appears that Barclays did not utilise these areas of expertise as fully as it could have done. For example while the Chairman of the Board Risk Committee did join the Remuneration Committee in 2012, the Remuneration Committee did not typically hold any joint meetings with the Risk Committee or meet with the Chief Risk Officer without management being present – common practice in some of Barclays' peers.²³⁵ The Group Chief Executive was always present (except for discussion regarding his own remuneration).
- 11.63 These issues could be addressed to some extent by creating small control function committees (including HR) to review pay at the business unit level, before it reaches the Board Remuneration Committee. Such an approach would help to safeguard the integrity of the control function input and limit the pressure a particular individual might feel in challenging business unit management.

²³⁴ See: Adrian Cadbury, *The Cadbury Report on the financial aspects of Corporate Governance*, 1992, paragraph 4.42; the report is available at www.ecgi.org/codes/documents/cadbury.pdf.

²³⁵ See, for example, Lloyds Banking Group Remuneration Committee Terms of Reference; www.lloydsbankinggroup.com/about_us/corporate_governance/remuneration_committee.asp.

- 11.64 It is essential that shareholders, the Board and the Remuneration Committee all have confidence in the way in which management and the control functions operate the remuneration process. As such, it might be useful for the Remuneration Committee from time to time to commission an audit of the remuneration process, including the implementation of the remuneration principles and the integrity of the underlying performance management process. This will also provide some comfort that discretion has been applied on a consistent basis.

Recommendation 26: Control functions' review of compensation

Barclays should ensure that all its control functions have meaningful and direct input into compensation decisions, making this input available to the relevant Board committees.

- 11.65 Bank management typically have strong views on compensation. They often see it as a key strategic lever – particularly in investment banks. Therefore the difficulty of the remuneration committee's role will vary according to the chief executive's attitude to pay. In Barclays' case, there were times when the strong views of senior executives may have made it more difficult for some Board members to address compensation issues to their satisfaction. Problems are likely to arise whenever particular individuals become apparently indispensable to the performance of the business. A remuneration committee plays an important role in reviewing such cases and challenging such arguments when made – but there are limits to its ability to second guess an executive team and the senior HR executive on the risks of losing people who are key to the business. Nevertheless, it is important that the Chairman and his colleagues are able to challenge executive management and to rely on the senior HR executives to have provided robust and well-considered advice to management.
- 11.66 Given the importance of compensation in banks as a strategic lever, it is desirable that the Board as a whole is involved in critical decisions on remuneration, especially where there are reputational issues.
- 11.67 From our interviews it appears that a number of shareholders have felt they have been insufficiently consulted on remuneration issues. And, as we observed earlier, more engagement with shareholders would also be useful. Shareholder communication will be an important responsibility of the Remuneration Committee Chairman.
- 11.68 We would also observe that, although the bank engaged remuneration consultants to advise the Remuneration Committee, the practice of targeting top-quartile pay (to attract top-quartile performers) is inherently inflationary. Too much emphasis may have been placed on market benchmarks as a primary source of data rather than clear measures of objective performance. We would prefer that the Remuneration Committee has a genuinely independent remuneration adviser, with no role or prospect of a role for the bank's management. This would be required by its terms of reference. However, the point was made to us that this would discourage leading remuneration consulting firms from taking on such roles (or exclude them from doing so). If the adviser is not fully independent but the Remuneration Committee

considers its particular expertise to outweigh the lack of independence, Barclays should disclose publicly a summary of all the services provided by the remuneration adviser and the process by which the appointment was made. And the Remuneration Committee should also confirm publicly that it is satisfied that the adviser has provided objective and independent advice to the Committee.

- 11.69 The Board Remuneration Committee has a critical role to play in leading Barclays' response to the remuneration issues the bank has faced. In doing so it should ensure that Barclays' remuneration practices comply with not only the letter but also the spirit of the Financial Stability Forum's Principles for Sound Compensation Practices – as embraced by the FSA in its Remuneration Code.
- 11.70 We believe that, in view of its sensitivity, Barclays should aim to be open in its approach to describing pay. Prior to 2012, Barclays had not apparently adopted such an approach, particularly for its senior executives and its highly paid investment bankers. In particular, we would have preferred to see greater clarity about the actual payouts made under LTIPs. We are encouraged, however, by Barclays recent more transparent approach to reporting remuneration; for example, disclosing the number of employees in a series of pay bands and adopting a year early many aspects of proposed UK regulation on directors' remuneration reporting.²³⁶

Recommendation 27: Board's role in compensation oversight

Barclays Remuneration Committee should establish, and the Board validate, clear remuneration principles and a robust framework to assess the impact of pay arrangements on culture and all elements of risk management. These should be reviewed regularly. From time to time, the Remuneration Committee should require internal assurance of the remuneration process, including the implementation of the remuneration principles.

The Committee's terms of reference should require it to be satisfied that there have been rigorous reviews of remuneration proposals relating to high earners. Barclays should have a bias towards open disclosure of the most important characteristics of its compensation system design and application.

The Remuneration Committee should work closely with other Board Risk Committees and also take advice from its own compensation advisers who should be appropriately independent of management.

- 11.71 Bankers' pay excites significant public emotion. We have tried to point out certain issues with the way pay structures at Barclays were designed and operated. But for pay structures and pay processes to work effectively, it is critical that they be part of a much larger armoury of people management processes. Training, development, mentoring, coaching, evaluating, providing honest feedback, imposing performance improvement plans and disciplining are just some of the tools at Barclays' disposal. As we discussed in Section 10, such tools matter a great deal in embedding the right

²³⁶ Department for Business Innovation & Skills, *Draft Statutory Instrument on Directors' Remuneration: the Large and Medium-sized Companies and Groups (Accounts and Reports) (Amendment) Regulations 2013*, 11 March 2013.

values and encouraging the right behaviours. And only a strong HR function, with sufficient standing in the organisation, can help Barclays achieve that. A strong HR function is also critical to the appropriate design and operation of a robust compensation system. In Section 10 we recommended that Barclays identifies ways to strengthen the effectiveness of the HR function and to see that it provides necessary challenge to business leadership, for example by ensuring the Group Head of HR is on the Group Executive Committee and by making the appointment and removal of the Group Head of HR subject to approval of the Board Corporate Governance and Nominations Committee or another major Board committee.

12. Management Oversight and Risk Management

- 12.1 What uniquely distinguishes banks from other companies is their role in risk transfer and risk management. As Walter Wriston famously said: "... managing risk ... is the business of banking."²³⁷

The Three Lines of Defence Model

- 12.2 For any bank, the business practices associated with risk management and management oversight are critical. Banks use a 'Three Lines of Defence model' as the standard approach for the design and implementation of risk and control frameworks. The 'first line' is the business management. They are fully responsible for ensuring that a risk and control environment is established as part of day-to-day operations. The 'second line' comprises the control functions such as Risk, Compliance, Legal, and the non-advisory parts of Finance and HR. These functions collectively provide oversight of the control environment by setting frameworks and establishing, implementing and enforcing policies and procedures. The 'third line' is Internal Audit as the independent provider of assurance.
- 12.3 While the concept is straightforward, its implementation is more difficult in complex global organisations. All the more so where the operating model is relatively decentralised, as at Barclays. Such decentralised organisations can blur the distinction between the first and second lines of defence, since control functions exist (and often report) within business units. Where control functions feel greater affinity to the business unit they are supposed to control, they can lose the degree of independence they need to perform their roles effectively.
- 12.4 The 'operating model' – how authority is delegated, the degree of decentralisation, how the bank's various businesses are managed, how decisions are made, and the role of the Group Centre at Barclays – is critical to the management oversight of risk. There have been periodic shifts in the level of decision making at the Group Centre but, for most of the past 10 to 15 years, there has been considerable delegation of authority.²³⁸
- 12.5 After John Varley became Group Chief Executive in 2004, he increased delegation, setting up two powerful business clusters. He described in 2007 how he "decentralised operations so that many more decisions are made locally".²³⁹ Each cluster had a Chief Executive who was, as John Varley put it in the 2006 Annual Report, "the single point of strategic direction and control" for the businesses in that cluster. The underlying philosophy of this operating model, for the most part, was one of 'devolution' with the Group Centre providing strategic leadership,

²³⁷ Attributed to Walter Wriston, ex-CEO and Chairman of CitiCorp by the Economist in 1993 ("Survey of International Bankers: A comedy of errors" April 1993) though other sources also attribute the quote to John Pierpoint Morgan.

²³⁸ "Since I joined Barclays in 1996, it has been run on a relatively decentralised basis", Bob Diamond Speech to UBS Global Financial Services Conference, May 2012.

²³⁹ "Barclays' Global Acceleration", *strategy+business*, May 2007; <http://www.strategy-business.com/article/07216?pg=all>.

establishing accountabilities, key financial and operating metrics, and reviewing performance of the businesses – with the businesses then fully accountable in implementing the plans.²⁴⁰

- 12.6 On becoming Group Chief Executive in 2011, Bob Diamond launched his 'One Barclays' programme, which set out to consolidate more activity in the Group Centre – initially around HR and Treasury – to increase efficiency and to forge more of an overall group identity.
- 12.7 Before Bob Diamond started to reverse the policy of decentralisation, the autonomy given to business units was most apparent in the investment bank, BGI and Barclaycard. These businesses had their own executive committees and, to a large extent, their own control functions. In particular, Barclays Capital (and before it was sold, BGI even more so) was quite separate from the rest of the Group. It had its own name, branding and premises, as well as many of its own systems and processes – including its own general ledger, front and middle office systems, approval processes, and email and calendar system.
- 12.8 A decentralised operating model has some advantages: increased accountability of business leaders and faster-decision making closer to the customers. A number of interviewees argued that, to be successful, the investment bank had to be run separately. Otherwise it risked being slowed down by the less agile decision-making process and more staid culture elsewhere in the bank.
- 12.9 We consider that a decentralised model presents additional challenges to the Group Centre of a universal bank such as Barclays – both in ensuring that it has sufficient understanding of the risks taken at a business unit level and in driving behaviours based on the Group's common values and standards. Without close day-to-day involvement in business unit operations, the Group Centre will tend to place more reliance on individual relationships between the Group Chief Executive and business unit chief executives and between Group Centre function heads and their business unit equivalents.
- 12.10 US regulatory plans for a holding company²⁴¹ and the UK ring-fencing requirements of the Financial Services (Banking Reform) Bill will require Barclays to alter its operating model. The UK's current proposals require the ring-fenced retail subsidiary bank to be "able to take decisions independently of other members of its group".²⁴² The Parliamentary Commission on Banking Standards has recommended separate risk management and governance for the ring-fenced bank.²⁴³ Barclays will need to give careful consideration to the mechanisms required to ensure that subsidiary

²⁴⁰ Internal Barclays documents relating to the 2007 restructuring project.

²⁴¹ The Federal Reserve Board have proposed rules that would require foreign banking organisations with a significant US presence to create an intermediate holding company over the US subsidiaries to help enhance supervision and regulation of these operations; see: Board of Governors of the Federal Reserve System, press release, 14 December, 2012; <http://www.federalreserve.gov/newsevents/press/bcreg/20121214a.htm>.

²⁴² Financial Services (Banking Reform) Bill 2012-13, p. 7; <http://www.publications.parliament.uk/pa/bills/cbill/2012-2013/0130/2013130.pdf>.

²⁴³ Parliamentary Commission on Banking Standards, *Second Report*, 11 March 2013.

business practices remain consistent with the Group's risk appetite, standards, and values, and that matters of importance do not fall between the cracks.

- 12.11 Management indicated to us that they recognise the need to build on the existing strengths in some aspects of the bank's risk management and management oversight to ensure it is consistently robust across all risk types and businesses. Under the Transform Programme, a comprehensive review of the control framework is already underway. Our Review suggests this should focus on ensuring the framework covers all risk types and articulates responsibilities; improving management of operational, conduct and reputational risk; reinforcing the risk culture and business ownership of risk and embedding the risk appetite; and strengthening the control functions.

First Line of Defence – Business Ownership of Risk

- 12.12 In all large complex organisations, whether centralised or decentralised, an effective internal control environment provides assurance to senior management and the Board that business practices are as intended, including maintaining risk levels within pre-approved limits, and adhering to applicable laws and regulations.
- 12.13 Barclays' internal control environment is implicitly rather than explicitly based on a 'three lines of defence' model. In our view, however, it categorises the main risks, provides a reasonably common language of risk terminology, assigns accountability for risks, and defines the process for managing the control environment. Two particular components are the Group Internal Control & Assurance Framework (GICAF) and the Principal Risks Policy (PRP).
- 12.14 GICAF sets out the requirements to identify, measure, assess, analyse, report and manage the risks faced by the business. If there are issues with the control of these risks or with compliance with regulations Governance and Control Committees (G&CCs) govern an escalation and management process. The G&CCs include business and control representatives from the relevant business or region as well as an independent member from another business or Group.
- 12.15 The PRP outlines the process for the management of the Principal Risks. Prior to 2011 Barclays classified credit, market, and funding risks as its Principal Risks. Operational risk was added in 2012, followed by conduct and reputational risks in early 2013. Each Principal Risk is sub-divided into several Key Risks and all are assigned an owner responsible for ensuring that an appropriate risk control framework and a risk appetite to manage the risk are in place. Risk owners must also provide semi-annual attestation regarding the effective discharge of responsibility for the Key Risk. Key Risk owners are responsible for ensuring that independent checks (which Barclays calls 'conformance testing') are done in each business to verify the effective operation of controls.

12.16 The Principal Risks are defined by Barclays as follows:²⁴⁴

- **Credit risk** is the suffering of financial loss should any customers, clients or market counterparties fail to fulfil their contractual obligations;
- **Market risk** is the reduction to earnings or capital due to the volatility of any trading book positions or an inability to hedge the banking book balance sheet;
- **Funding risk** is the failure to maintain necessary capital ratios to support business activity and meet regulatory requirements and the failure to meet liquidity obligations;
- **Operational risk** is the direct or indirect impacts resulting from human factors, inadequate or failed internal processes and systems, or external events;
- **Conduct risk** is detriment to the bank, customers, clients or counterparties because of inappropriate execution of business activities;
- **Reputation risk** is damage to the brand arising from any association, action or inaction which is perceived by stakeholders to be inappropriate or unethical.

Credit, Market and Funding Risk

12.17 Credit, Market and Funding risk are essential components of risk management in all banks and were severely tested in the financial crisis.

12.18 Barclays' performance through the crisis would suggest that its efforts in this area were reasonably effective. In particular, we have noted market leading practices including early development of a formal risk appetite process for financial risks, the establishment of Group-wide 'Mandate and Scales' limits and in the development of credit portfolio analytics. Joint sign-off between market and credit risk and integrated daily Value at Risk (VaR) production, stress testing and reporting process were also good practices.

12.19 This picture was confirmed by interviewees from both the front office and the risk function. Notwithstanding this generally positive picture, we observed instances of limit excesses or particular risk concentrations:

- The front office has sometimes exceeded limits. This is particularly important because, in addition to its execution of client transactions, Barclays has historically operated some proprietary trading or principal trading businesses which required close supervision given the risks being taken;
- Losses in the US structured credit business suggest that the business did not fully assess the risk taken on (although the market volatility was unusually high);
- The real estate portfolio in certain business units, for example in Spain, became overly concentrated in property and construction.

²⁴⁴ See: Barclays, *Annual Report 2012*, March 2013, pp. 28, 116, and 187-9.

- 12.20 We consider that the Group-wide management and Board Risk Committee oversight of these risks would be improved if the management information provided included a more granular assessment of risk against appetite to identify divergence.

Recommendation 28: Risk culture and control framework

To develop a consistently strong risk culture, Barclays should communicate clear statements as to its Group risk appetite for all types of risk; embed adherence to Group risk appetite into all business units; reinforce limits with strong management action for breaches; and embed risk and compliance criteria in performance evaluations, and in remuneration and promotion decisions.

Barclays should review its control framework and ensure that it covers all risk types and clearly articulates roles and responsibilities across the three lines of defence. The business (front office) responsibility for risk should be reinforced. Barclays should endeavour to embed the framework consistently in all its businesses.

Conduct and Operational Risk

- 12.21 Conduct and operational risk management in the banking industry are less mature than credit and market risk management. While Barclays has not had a formal conduct risk framework, it has had an operational risk framework for some time and has developed its capability to quantify operational risk losses and capital.
- 12.22 Following the incidents described in Section 6, in June 2012 Barclays enhanced its product approval process, with approvals required at various points in the product development process. It required a product risk assessment considering control environment reliability, intended customer outcomes and internal capabilities. In addition, Barclays introduced a product review process to review continually the suitability of existing products.
- 12.23 Both internal control and regulatory compliance concerns suggest, however, that conduct and operational risk have not been managed as the framework intended.
- The extent of control and compliance issues in the investment bank following the Lehman acquisition suggests that management may not have adequately prioritised operational risk matters in the integration plan.
 - Barclays has complex systems which have not been integrated and necessitate manual intervention, including in critical areas such as risk-weighted asset calculations, client money segregation and transaction reporting.
 - Operational indicators for risks, which are difficult to quantify, are less well developed, reducing the effectiveness of key management and Board Committees.
- 12.24 As we noted in Section 6, there were also several crystallised conduct risk matters:
- Barclays' fine for attempted LIBOR manipulation in the investment bank;

- In the retail and commercial banks, Barclays booked provisions for alleged PPI and SME derivatives mis-selling;
- In Wealth Management, Barclays' fines in respect of Aviva bonds;
- Across the Group, Barclays' fine for a failure to comply with US sanctions and transaction reporting.

- 12.25 Senior management told us that they personally had a zero tolerance towards non-compliance. However, the compliance culture did not uniformly reflect across the Group the view that compliance was everybody's responsibility. Many interviewees suggested that a number of business leaders and front line staff did not view regulatory compliance as central to their own role. Some also felt the relationship between the business and the Compliance function was adversarial rather than collegiate, with Compliance seen as an obstacle to overcome in doing business. These issues have been recognised by Barclays. For example, the investment bank has launched a programme to improve the compliance culture, including overhauling the compliance manual and principles.
- 12.26 These problems may have been caused, in part, by an inconsistent implementation of operational risk policies. In some businesses, Risk Control Assessments (RCAs), were viewed by the businesses as a 'box ticking' exercise and the responsibility of the Operational Risk function.
- 12.27 We also found it difficult to see how the various management committees charged with operations and operational risk came together to oversee these risks. In reviewing both management risk committee and Board Risk Committee presentations, it was not clear that all operational risk losses were evaluated both quantitatively and qualitatively against Group risk appetite and linked to subsequent management action, for example in internal controls. We also suspect that this made it less straightforward for the Board Risk and Audit Committees to exercise their oversight of operational risk (see Section 9).

Reputational Risk

- 12.28 The management of reputational risk is complicated by the fact that reputational damage is often the result of other risk events. Given the fallout from the financial crisis, the low levels of trust in banks, and heightened scrutiny on business conduct, reputational risk has become a critical issue.
- 12.29 Historically, Barclays articulated its approach to reputational risk as making clear that individuals were responsible for the impact of their decisions and that certain decisions had to be reviewed by business-specific transaction committees, which considered the reputational impact in their assessment of a transaction. Barclays would have benefited from a more comprehensive reputational risk framework given its business mix. This might, for example, have led to an earlier discussion as to whether the scale of the SCM business needed to be moderated in response to changing public views as to the acceptability of tax structuring.

- 12.30 Barclays has recently revised its reputational risk framework to help it consider more consistently and systematically the impact of business decisions on its reputation. The framework defines roles and responsibilities for managing reputational risk for all businesses and functions, including the newly formed Citizenship team. The framework also defines a governance structure for raising and escalating reputational risk issues from Reputation Councils to the new Board Conduct, Reputational and Operational Risk Committee. The Reputation Councils conduct regular reviews of the effective operation of the reputational risk framework. This effort is being reinforced by a reputation management initiative to embed better capabilities in the businesses to identify, mitigate and manage reputational risks.
- 12.31 Barclays has also conducted a business line review within the investment bank. Reputational impact was one of three criteria used to determine which businesses to exit or significantly modify.
- 12.32 Barclays has begun to elevate reputational risk by classifying it as a Principal Risk and trying to build it more into its decision making. Ultimately, it is how its staff and leadership behave, coupled with effective governance, which will determine its success in rebuilding its reputation.

Recommendation 29: Conduct, reputational and operational risk

Barclays should ensure its conduct, reputational and operational risk framework includes the articulation of a tangible risk appetite statement and mechanisms to ensure that conduct, reputational and operational risk are fully factored into business decisions and governance.

The First and Second Lines of Defence: Risk Culture and Learning

- 12.33 We now look at three aspects of a control environment that matter for both the first and second lines of defence.

Risk Culture

- 12.34 Strengthening the risk management culture requires embedding a risk appetite framework, while clarifying the roles and responsibilities of the first and second lines in the control frameworks.
- 12.35 We did not find it easy to discern who is responsible for each aspect of the daily management of risks and the associated controls. This is important if performance management is to reinforce accountability for risk. The personal development objectives we reviewed show that qualitative risk management and control environment objectives were included in individual performance appraisals. However, we have observed that these objectives were somewhat undifferentiated across cohorts and job roles. In addition, risk and control themes were rarely mentioned in the actual performance assessments and were typically not explicitly weighted in the overall performance grade. Overall, it was hard to determine what

impact operational risk and control environment matters have had on performance ratings, promotion prospects and remuneration.

- 12.36 Induction and professional development training programmes certainly existed – including some mandatory compliance training across roles and businesses. However, feedback from interviewees on their effectiveness was mixed.

Issue Escalation

- 12.37 Barclays has designed a comprehensive framework for escalating risk and control issues, monitoring the progress of remediation plans and closing resolved issues. These issues are discussed at the G&CCs. While some interviewees have praised these committees as effective tools to improve the control environment, others have criticised the level of real debate and challenge.
- 12.38 It appears that Barclays can be effective at addressing issues once they are identified. For example, in the FSA final notice for failing to segregate client money in the investment bank, the FSA notes that the issue was resolved promptly.²⁴⁵ But many interviewees cited a tendency to resolve issues narrowly by “fixing them” rather than by addressing the root cause or applying the learning from one experience more broadly across the Group.
- 12.39 Organisations need to have other safety valves for staff to report potential problems. Barclays has a whistleblowing policy, called ‘Raising Concerns’²⁴⁶ and recently initiated an awareness campaign titled ‘Speak up for our reputation’. This reminded staff of their responsibility to raise concerns.²⁴⁷ We have not conducted a general review of whistleblowing, but those matters initiated and raised with us during the Review were addressed appropriately.
- 12.40 A culture where staff are reluctant to raise issues can lead to the problems becoming more difficult to manage. A desire to report solutions rather than problems is understandable, but for some critical issues it is imperative that relevant senior management are notified as quickly as possible. Our review of various limit breaches suggests that this has not always been the case. After a limit breach in the investment bank, the most senior business leader was only informed after several days. In that instance, by the time he was informed, the exposure had been reduced and a plan was in place to reverse the breach. In that case, we also felt that the decision taken by management on the relevant employee’s accountability and pay, following a discussion at the Board Audit Committee, did not sufficiently reinforce the vital importance of limits.
- 12.41 There is also evidence from Barclays’ internal Employee Opinion Survey of a cultural unwillingness to escalate issues. A significant proportion of employees in the investment bank, for example, said that they were “reluctant to report problems to management”, and that they did not feel able to “report unethical behaviour without

²⁴⁵ FSA Final Notice Ref: 124431, dated 24 January 2011.

²⁴⁶ The number of concerns raised under this policy was 179 in a recent six-month period; see Semi-Annual Compliance Report to GGCC, March 2012, whistleblowing extract.

²⁴⁷ Updated Whistleblowing policy, dated 21 December 2012.

fear of reprisal". This is not isolated to the investment bank – as our own staff survey showed.

Recommendation 30: Issue escalation

Barclays should foster a culture where employees feel that escalating issues is safe and valued.

Barclays should maintain robust arrangements for raising concerns (whistleblowing) which are perceived to protect those raising them and to lead to actions being taken to address the underlying culture and values issues. There should be regular reports to the Board which are detailed enough for the Board to form insights as to the culture and behaviours within the organisation.

Learning from Experience

- 12.42 We enquired as to whether Barclays' risk culture encouraged learning from experience. Following the LIBOR event, Barclays initiated a review of all of its business activity involving benchmark rates or indices. Lessons learned studies were also conducted after other loss events, such as the credit losses in Spain and a major trading limit breach. However, it is not evident that they were carried out consistently, promptly or following the same approach.

Recommendation 31: Learning from mistakes

Barclays should maintain effective processes for learning from its mistakes. It should endeavour to understand and address underlying root causes of issues so as to be able to apply lessons learned more broadly. Investigations should be carried out following a consistent Group-wide methodology.

Risk Disclosures

- 12.43 Barclays has significantly enhanced its risk disclosure in its annual reports since the financial crisis. This is an important part of the bank's communication with stakeholders. Industry practice on audit and risk disclosures are also evolving to ensure they provide transparency into risks and audit issues raised. Recent examples of new disclosure standards which should be considered by Barclays include the *Enhancing the Risk Disclosures of Banks* report by the Financial Stability Board's Enhanced Disclosure Task Force and consultation papers on *Audit Disclosures* by the Financial Reporting Council.

The Second Line of Defence – Control Functions

- 12.44 Several second line of defence functions collaborate to design and operationalise the internal control environment. As defined by Barclays, these include:
- **Risk:** The role of the Risk function is “to deliver appropriately effective and efficient risk management and control that is consistent with Barclays’ strategy, through providing risk management capability including independent and appropriate challenge at every level, from a single transaction to an aggregate portfolio view, while ensuring ‘no surprises’”,²⁴⁸
 - **Legal:** The primary role of the Legal function is “to protect and create value for Barclays by managing legal risks and advancing opportunities”,²⁴⁹
 - **Compliance:** The Compliance function is “responsible for oversight of regulatory activities undertaken by Barclays and its remit is to support Barclays in complying with financial services legislation”,²⁵⁰
 - **Finance:** The Finance function “operates as a strategic business partner, ... supports decision making, providing accurate relevant and timely financial information and analytics to internal and external stakeholders; acts as an independent control function, consistently challenging the status quo and holding the business and the finance function to a high standard of integrity and transparency”,²⁵¹
 - **Human Resources:** The purpose of the HR function is to “be the strategic partner of choice to the business providing advice on all aspects of the people agenda – supporting business leaders and colleagues to maximise performance, fulfil their individual and team’s potential and enable business outcomes”.²⁵²

Independence and Influence of Control Functions

- 12.45 Most of the control functions in the business units reported directly to the business unit management as their primary reporting line. While we acknowledge that this enabled the function to collaborate closely with the business, we consider such arrangements could compromise their ability to challenge the business. More recently, the functions’ reporting lines have changed and are now weighted more heavily towards Group functions. This process has stopped short of severing all reporting lines to the business. Some banks have gone further and insisted that the control functions report exclusively to the Group function heads, which Barclays has done for one function, Compliance (in January 2013). This is a question of balance – the right balance of proximity, knowledge of the business and independence should be determined by management and should be regularly reviewed, including by the relevant Board committees.

²⁴⁸ *One Barclays – Functional Model*, 14 November 2012.

²⁴⁹ Barclays Legal definition.

²⁵⁰ Barclays Compliance definition.

²⁵¹ Source: Barclays Group Finance.

²⁵² Barclays, OneHR Vision.

- 12.46 In order for control functions to have a strong enough voice to challenge businesses, they need to be sufficiently independent, understand the business, and be adequately represented at senior management forums. The number of control function personnel directly represented on Barclays' Group ExCo has changed – there were periods in the past when some were directly represented, but from 2005 to late 2009 Compliance, Risk and HR were not. Finance has always had a seat on ExCo. Barclays' General Counsel has had a seat since November 2009, representing the Legal and Compliance functions but Compliance did not have direct representation until January 2013. The Group Chief Risk Officer and the Group Head of HR also joined the Executive Committee in November 2009.
- 12.47 As we pointed out in Section 10, the control functions should play a significant role in people management processes, in particular performance management and remuneration. Barclays established policies and processes to ensure that the Group Risk function was able to provide input to the Remuneration Committee on Group and business unit performance. It also operated an annual process to identify areas of concern and communicate them to the HR teams in advance of the pay-round. This level of scrutiny seemed to apply mainly to the more senior management.
- 12.48 Having explicit methods to appraise individual behaviour and performance against risk and control objectives is also a key lever in ensuring that a control culture is encouraged within the businesses. We have seen personal development objectives for the Retail and Wealth and Investment Management business units that have included such metrics, including the introduction of a balanced scorecard with a clear risk element and a semi-annual opportunity for Risk and Compliance functions to provide input to performance reviews. However, this approach has not been consistently implemented across the Group.

Capability of the Control Functions

- 12.49 Effective control functions are built around sufficient people with the right skill sets and supported by effective data and IT systems. Interviewees have suggested that management of credit and market risk are reasonably resourced (with some exceptions). In contrast, they said that the operational and conduct risk functions were under-resourced at various times. This is partly because the number of experienced senior individuals with operational and conduct risk experience is lower across the industry than for credit and market risk; and partly because the roles have developed more recently. Interviewees told us that these issues are being addressed but the talent pool will remain challenging for the next few years.
- 12.50 Interviewees suggested that many parts of the bank's systems and IT had received large amounts of investment. In some cases, we heard specifically that the control function infrastructures were built before a new business was allowed to start operating. Conversely, in the period following the Lehman acquisition, numerous control and compliance issues have been identified, some of which we believe were linked to business growth, out-dated systems or a failure to integrate systems.

Compliance

- 12.51 Barclays' recent conduct issues have raised particular questions about Compliance. Barclays has grown the Compliance staff from approximately 600 at the end of 2008 to 1,500 at the end of 2012.²⁵³ This increase has reflected, to some extent, moving roles from the business units into Compliance. Barclays also developed compliance policies at both the Group and the business unit levels with guidance on required behaviours and consequences of non-compliance. The Compliance function's responsibilities have increased, adding resources to support the expanded scope. We are aware that Barclays is currently reviewing the remit of Compliance in the light of the changes to the bank's operational risk framework.
- 12.52 We consider it important that Compliance is given sufficient authority within the organisation. Having the Group Head of Compliance on the ExCo helps this. It also helps consideration of compliance issues among senior management in an intensifying regulatory environment. Barclays is seeking to make Compliance more forward looking. Barclays has recently separated the reporting lines of Compliance so as to make it distinct from Legal so that, from 2013, it is a control function in its own right. Compliance is now reporting to the Group Chief Executive, rather than the General Counsel, and is represented on ExCo.
- 12.53 Since compliance functions have significant controlling responsibilities as well as their advising responsibilities, maintaining their independence is particularly important to the effective execution of their mandate and the escalation of matters from the business units to the Group Head of Compliance. Accordingly, their remuneration arrangements need to be structured so as to avoid conflicts between their incentives and their independence.

Recommendation 32: Control functions' independence and influence

To improve the independence, capability and business engagement of control functions in overseeing all risk types, Barclays should promote the authority and influence of the control functions, including Risk, Compliance, Legal, Finance and, in this regard, HR with the primary reporting lines to the Group-level functions.

Barclays should ensure it constantly reinforces the compliance culture throughout the bank and should consider making the appointment and removal of the Group Head of Compliance subject to approval of the most appropriate Board committee.

The Third Line of Defence – Internal Audit

- 12.54 The operation of the control environment needs to be further supported by a strong, independent internal audit function as the 'third line of defence' – that is able to assure the quality and effectiveness of the controls.

²⁵³ Source: Barclays Risk and Compliance, headcount and turnover data; full-time employees.

- 12.55 Barclays' Internal Audit Charter defines the objective of Barclays Internal Audit as being to "provide independent, reliable, valued, insightful and timely assurance to the Board and Executive Management over the effectiveness of governance, risk management and control over current and evolving risks, in the context of the current and expected business environment."²⁵⁴ The staffing of the Internal Audit function increased from 157 in 2003 to 611 in 2012. The function also increased its independence. Since 2003, the Chief Internal Auditor (CIA) has reported functionally to the Chairman of the Board Audit Committee and only administratively to the Group Chief Executive. Business unit audit teams have reported to the Group CIA since 2004.
- 12.56 In 2009, Barclays Internal Audit was reviewed by an external assessor. The review concluded that it was an industry-leading function which complied with relevant codes and standards, and met the expectations of management, the Board and other stakeholders.
- 12.57 However, some interviewees felt that the methodologies and metrics followed had resulted in some governance and control issues not being identified early enough by Internal Audit. Barclays has recently identified the need for certain changes, including more rotation of business unit auditors, greater audit focus on the investment bank to reflect its growth, a reduced number of auditable entities, and improved ways of reporting issues.
- 12.58 Across the industry banks and professional bodies have been reviewing the remit of the internal audit functions to improve their ability to influence the effectiveness of governance, risk management and internal controls. A recent consultation document by the Chartered Institute of Internal Auditors has proposed that the scope and priorities of the audit function include the risk and control culture of the organisation and the risks of poor customer outcomes, giving rise to conduct or reputational risk.²⁵⁵ We support these recommendations as a practical way to reinforce sound business practices.

Recommendation 33: Internal Audit

Barclays' Internal Audit should ensure the effectiveness of its audits in each of the businesses to identify control issues, prioritising high-risk entities. This will be aided by developing specialist internal audit teams able to deal effectively with the bank's more complex business units.

The Internal Audit Charter should be updated and periodically reviewed to ensure that it covers all aspects of governance, control and risk culture, as the business and external environment evolves.

²⁵⁴ Barclays Internal Audit Charter, 25 July 2012.

²⁵⁵ Chartered Institute of Internal Auditors, *Effective Internal Audit in the Financial Services Sector*, 11 February 2013.

13. Conclusion

This independent Review was commissioned over eight months ago. Our terms of reference were specific yet broad. Our role has been essentially to review Barclays' business practices and to make forward looking recommendations to assist Barclays as it seeks to rebuild trust and reputation.

As contemplated in the Terms of Reference, we have considered past events, primarily to understand the gaps between Barclays' behaviours and the standards it expected. From these, we have developed the recommendations – focused on improving Barclays' business practices. The Terms of Reference did not ask us to determine the truth or otherwise of allegations surrounding the events, or to pass judgment on the shape of the business or the strategic decisions which were taken.

Inevitably readers of this Review will be tempted to focus on the evidence of past failings. However, it is also important to put these in context. This is the story of a proud British bank that has achieved much. Despite its turbulent recent history, it is today a globally competitive and diverse business that has emerged from the crisis, somewhat against the odds, as one of the world's pre-eminent universal banks. But this has been achieved at a cost.

Barclays responded to the changes in the City of London in the 1980s by taking on the international banks. Early in this century, after a few false starts, it began successfully to grow its investment bank. Aiming to be one of the global leaders, it pushed for growth, taking advantage of seemingly endless liquidity and rising asset prices. And the applicable Basel capital rules permitted it to add assets with significant leverage. Investors came to expect short term success and rising returns on equity.

For UK customers, the banks' focus on growth was accompanied by cost efficiencies, experienced through branch closures, a proliferation of call centres, centralisation of credit decisions and the expansion of online banking. There was a gradual depersonalisation of the customer experience.

The investment bank's success was based on recruiting clever, competitive people. Its 'edginess' attracted them, as did the promise of high pay, the opportunity to be part of building something and the deeply entrenched commitment to winning.

Short-term success fed into the pay, bonuses and LTIPs of the senior executives and those who made the money, especially in the investment bank. At a time of growth for almost everyone, the cracks were not noticed by Barclays, by the other banks or, to a significant extent, by the regulators. Without being aware of it, Barclays allowed a drift in its cultures.

When the financial crisis broke, all this changed. The disproportionate sharing of risk between employees and shareholders became apparent. Barclays continued to serve many customers and clients well. But serious shortcomings had developed: the absence of a common purpose or set of values; cultural inconsistencies across the

Group; insufficiently strong controls; and a performance system that reflected financial performance at the expense of other behaviours and failed to focus sufficiently on the development of its people. These shortcomings led to significant conduct problems involving breaches of regulation, investigations and litigation, with reputational damage and the loss of public trust. These problems were not confined to any one part of the bank. And Barclays was by no means alone. The public tend to see this as an industry problem. But Barclays must not take comfort from this.

Barclays survived the financial crisis as an independent institution, but it was close. The fight to survive seems to have accentuated the clever and competitive characteristics into something rather closer to aggressive and defensive. But it did survive, helped by having learned from lessons of past crises and essentially better risk judgments than some of its competitors.

Today is a new world for bankers and banks and they are coming to realise it. The exceptional pre-crisis years for bank growth and profitability led some bankers to feel an entitlement to a share of success. Today the economic climate is very different. Barclays needs to take the opportunity to re-establish a clear purpose, common values and a more open and customer-focused culture. It needs to reassess the effectiveness of its governance arrangements, control and risk frameworks and how it incentivises its people. Its leaders need to focus on earning the loyalty of its customers, clients and employees and the trust of its regulators. And the Board needs to re-calibrate the importance of its role in society and the value it offers shareholders. The task is clearly far from straightforward.

The Barclays of today is committed to change and has set out a five-year programme. Its current leaders have started the process of embedding awareness of what a large, evolving, global bank needs – and does not need – if it is to sustain itself over the long term. It was a lack of self-awareness that contributed to the deeply disappointing chapter in Barclays long and proud story. If short-term financial returns and employee rewards are ever too dominant in the bank's culture, problems will result. We believe the recommendations in this Review provide a framework for Barclays to address the failings we have identified and a roadmap to help it restore trust and its reputation.

It will require perseverance and consistency at all levels of leadership.

And it will take time.

Recommendation 34: Implementation

Barclays should publish the steps it intends to take to implement the recommendations in this Review and publicly report progress on implementation at regular intervals, with such internal and external assurance as the Board considers appropriate.

14. Appendices

Contents

Appendix A – About the Review166

Appendix B – What is Culture and How Can it Go Wrong?177

Appendix C – Complaints Statistics196

Appendix D – Business Practices: Lessons from other Industries198

Appendix E – Barclays’ Timelines: Overall and Main non-UK Geographies.....201

Appendix F – Barclays’ Governance Structure at Group Level.....209

Appendix G – Barclays’ Employees211

Appendix H – Barclays’ Financial Evolution212

Appendix I – Selected Bank Financial Ratios222

Appendix J – Variability in Risk Weighted Assets Calculations225

Appendix K – Correspondence between Lord Turner and Marcus Agius226

Appendix L – Glossary231

Appendix A – About the Review

Press Releases

Barclays' press release announcing the Review – 2 July 2012²⁵⁶

Barclays today announces the resignation of its Chairman, Marcus Agius. The search for a successor both from within the existing Board members and from outside will be led by Sir John Sunderland and will commence today. Mr Agius will remain in post until an orderly succession is assured and Sir Michael Rake has been appointed Deputy Chairman.

Commenting, Marcus Agius said, "It has been my privilege to serve as Barclays Chairman for the past six years. This has been a period of unprecedented stress and turmoil for the banking industry in particular and for the wider world economy in general. Barclays has been well served by an excellent executive team – led, first by John Varley, and now by Bob Diamond – which has worked constructively with a strong and supportive Board of directors. Barclays has remained resilient throughout the crisis, and has worked hard to ensure that today it is a strong, well-capitalised and profitable business.

But last week's events – evidencing as they do unacceptable standards of behaviour within the bank – have dealt a devastating blow to Barclays' reputation. As Chairman, I am the ultimate guardian of the bank's reputation. Accordingly, the buck stops with me and I must acknowledge responsibility by standing aside.

The Board has also agreed to launch an audit of our business practices.

This audit will be led by an independent third party reporting to Sir Michael Rake and a panel of Non-Executive Directors.

It will have three objectives:

- To undertake a root and branch review of all of the past practices that have been revealed as flawed since the credit crisis started and identify implications for our business practices and culture going forward;
- To publish a public report of its findings; and
- To produce a new, mandatory code of conduct that will be applied across Barclays.

This exercise will be part of a broader programme of activity intended to restore Barclays reputation and we will establish a zero tolerance policy for any actions that harm the reputation of the bank.

I am truly sorry that our customers, clients, employees and shareholders have been let down. Barclays is full of hard working, talented individuals whose integrity is not in question.

It goes without saying that Barclays will continue to have my wholehearted support in the future.

²⁵⁶ www.newsroom.barclays.com/Press-releases/Board-changes-905.aspx.

*Barclays' press release announcing appointment of Anthony Salz – 24 July 2012*²⁵⁷

On 2 July, Barclays announced that it would establish an independent review of its business practices, reporting to Deputy Chairman, Sir Michael Rake, and a sub-committee of the Barclays Board. Barclays today announces that Anthony Salz has agreed to lead that review.

The global review will assess the bank's current values, principles and standards of operation and determine to what extent those need to change; test how well current decision-making processes incorporate the bank's values, standards and principles and outline any changes required; and determine whether or not the appropriate training, development, incentives and disciplinary processes are in place. The review's findings and recommendations will be published, based on evidence gathered through extensive engagement with all of the bank's stakeholders and a thorough review of all pertinent documentary evidence. Any interested party is encouraged to provide input to the review by submitting a perspective or evidence via queries@salzreview.com.

Mr Salz will direct the review as he deems appropriate. He will have the support of a senior, independent individual to act as his deputy, as well as a team of staff from a professional services firm. Barclays will fill both of those support roles in direct consultation with Mr Salz.

Barclays Board and Executive Committee will consider the review's recommendations carefully, with the intention of implementing them in full. Shortly after the conclusion of the review, Barclays will publish an account of how it intends to implement its recommendations.

Commenting on his appointment, Mr Salz said:

"Barclays has a real opportunity to use the events of the past weeks to drive a change in its values and practices, and I look forward to hearing views on the changes that should be made. I very much hope that this review will significantly assist Barclays in rebuilding trust and reaffirming its position as one of our leading institutions."

Sir Michael Rake, Deputy Chairman, said:

"Anthony Salz is the ideal individual to lead this review given his standing and experience. He has the full support of the Barclays Board, and we will ensure that he has whatever resources necessary at his disposal to make it thorough and far-reaching. We expect this work to contribute significantly to the broader change that we intend to bring about to the way in which Barclays operates."

²⁵⁷ www.newsroom.barclays.com/Press-releases/Anthony-Salz-to-lead-independent-business-practices-review-915.aspx.

Terms of Reference for the Review

Context

The culture of the banking industry overall, and that of Barclays within it, needs to evolve. A number of events during and after the financial crisis demonstrated that banks need to revisit fundamentally the basis on which they operate, and how they add value to society. Trust has been decimated and needs to be rebuilt.

Barclays acknowledged that need some time ago and has begun to put in place changes in the way in which it operates consistent with that need. However, recent events indicate clearly that Barclays, like other big UK banks, needs to redouble its efforts. That task may seem more daunting today than ever, but Barclays remains committed to it. As an institution, Barclays must move further and faster to demonstrate that banks, and those who work for them, consistently operate to the highest standards of probity, integrity and honesty. This requires clear evidence, not assertion.

Culture is generally defined as “the instinctive behaviours and beliefs characteristic of a particular group”. Changing a culture, therefore, requires at least three things:

- Affirming the key values and operative beliefs that guide the behaviour of everyone in an organisation – these are deep-seated and tend not to change without direct intervention.
- Ensuring that the actual behaviours of those who represent the organisation are consistent with those values (and are so regarded by those who come in contact with the bank); and
- Ensuring that vital reinforcing mechanisms, such as visible leadership examples, formal and informal systems and processes, policies and rewards, are aligned with those values, operative beliefs and behaviours.

The burden of proof required to demonstrate change in culture is now much higher. The Barclays Board is conducting this review (the Review) of Barclays business practices to assist in the bank's efforts to rebuild trust by making it a leader in businesses practices among not only its peer institutions, but also multinational corporates generally. The Review is independent, reporting to Sir Michael Rake and a sub-committee of Non-Executive Directors (the Committee) including David Booth; Alison Carnwath; and Sir John Sunderland. Anthony Salz has agreed to lead the Review (the Reviewer) in a personal capacity.

Barclays Board and Executive Committee will consider the review's recommendations carefully, with the intention of implementing them in full. Barclays will publish an account of how it specifically intends to implement them a short time after the conclusion of the Review. The broader work at Barclays oriented at changing the bank's culture will be particularly informed by the Review's recommendations.

The Programme of Work

Given the nature of what banks do, customers and clients must be at the heart of everything that Barclays does and, therefore, at the heart of the bank's values. The nature of what Barclays does also gives rise to responsibilities to counterparties. These responsibilities include the indirect impact the bank has through its activities, including through its role in promoting and protecting the integrity of the public and private markets in which it participates.

To rebuild trust, Barclays must start with an open and honest assessment of the bank's current values, principles and standards of operation; determine to what extent they need to change; test how well decision-making processes currently incorporate those values, principles and standards, and outline how those processes need to change; and determine whether or not the appropriate training, development, incentives and disciplinary processes are in place to reinforce them.

The Review will analyse past events that have had a particularly negative impact on the bank's reputation. The purpose is not to determine the truth or otherwise of any allegations surrounding those events. The analysis in those areas will rather focus on understanding whether there was a gap between the bank's articulated values and behaviours and the way in which the bank operated in practice and to identify if there are actions that need to be taken to reduce the likelihood of similarly negative events occurring in the future. The Review will also analyse current practices to understand how current behaviours and reinforcing mechanisms fit with the bank's stated values and operative beliefs. It is not, though, an investigation or audit of those activities.

The Reviewer will undertake extensive, independent analysis to build a fact base; identify priority areas for change; develop a set of recommendations for change; and prepare and publish, after consultation with the Committee, a report (the Report) on the findings and recommendations of the Review. The scope of the Review's recommendations will be global and span all businesses within Barclays without exception.

One of the principal recommendations in the Report will concern changes to the mandatory code of conduct (the Code) that is applied across Barclays. The Code should establish clear standards of behaviour, in plain language; provide the framework for a zero-tolerance policy regarding compliance with the Code; and be flexible to evolve with stakeholder expectations. The Report will also include recommendations for improvements to key policies and procedures to make them more consistent with the Code, and mechanisms to create assurance for the Board and the Executive Committee that the Code has been implemented.

The Report may make any further recommendations as the Reviewer deems relevant to Barclays based on the evidence studied and conclusions drawn.

Approach to the Review

The Reviewer will ultimately have the responsibility for agreeing how the Review will progress with the Committee. It is anticipated that the work plan will have six streams of work:

1. Create familiarity with Barclays principal business segments, including the key competitors and historical, contemporary and prospective challenges within each segment;
2. Conduct detailed review of past events identified as having caused material reputational damage for Barclays and the industry, with particular emphasis on events since the start of the financial crisis;
3. Review Barclays current global values, principles and standards;
4. Analyse key policies and procedures to identify potential weaknesses in reinforcing mechanisms;
5. Develop new global, mandatory code of conduct and recommendations for its implementation and on-going assurance; and
6. Prepare a public report on findings and recommendations.

With respect to the fourth work stream, the Reviewer has discretion to identify the policies and procedures to test through the Review. Those may include some or all of: customer, client and counterparty focus; market integrity requirements; conflicts of interest; product and pricing suitability; reputational risk management; governance standards, including internal controls; leadership behaviours; whistleblowing; induction, training and assurance; performance management and development; and incentives.

The Review will be evidence-based. Any conclusions drawn and recommendations set out in the Report will be linked directly back to analysis completed during the Review. To build that evidence, the Review will rely on access to a wide range of stakeholders (including, for example, customers, clients, shareholders, regulators, government officials, staff (current and former) and other interested parties) and any internal and external data (including relevant papers, reports, minutes, etc.) pertinent to the scope of the Review, subject only to legal privilege. Barclays will ensure that any current or former staff involved in the process receive full indemnity and are able to provide input on a non-attributable basis, so that they may participate without any fear of potential consequences. To facilitate broad input into the Review, any interested stakeholder will be able to submit a perspective or evidence via: SalzReview@barclays.com. The bank will conduct any bespoke customer and client research required by the Reviewer. It will also arrange any interviews required by the Reviewer.

According to specifications agreed with the Reviewer, the bank will fund the external Review team. It is anticipated that will include the support of a senior, independent individual to act as deputy reviewer and an appropriately sized team from a well-regarded professional services firm (or firms) with skills and experience appropriate to a review of this nature. Both will be selected in consultation with the Reviewer. Barclays will also make available appropriate internal staff to support the Review.

Expected Timeline

The Review is expected to publish its Report in the spring of 2013, in advance of Barclays 2013 Annual General Meeting.

The Review Team

Anthony Salz, Reviewer

Anthony Salz is Executive Vice Chairman of Rothschild. Mr Salz joined Rothschild in 2006, after more than 30 years as a corporate lawyer with the international firm Freshfields Bruckhaus Deringer, the last 10 years as the senior partner.

Among various roles, Mr Salz is a Trustee of the Tate Foundation, the Eden Project, the Paul Hamlyn Foundation, the Scott Trust, Reprieve and the Royal Opera House. He was for some years a member of Business in the Community's Business Action on Homelessness Executive Forum and a member of its Education Leadership team. He was Vice Chairman of the BBC Board of Governors between 2004 and 2006 and the lead Non-Executive member of the Board of the Department for Education from 2010 to December 2012. He chaired the Independent Commission on Youth Crime and Antisocial Behaviour in England and Wales, which reported in 2010. He also chaired two review groups on press self-regulation on behalf of the Media Standards Trust (on which Board he sits), which published reports and recommendations in 2009 and in June 2012.

Russell Collins, Deputy Reviewer

Russell Collins is a qualified chartered accountant with over 30 years of audit, governance and regulatory advisory experience in the financial services sector.

He was, until 31 May 2012, a Vice Chairman of Deloitte LLP, the UK professional services firm, and a member of both its Global Financial Services Management Board and its Centre for Regulatory Strategy. Previously, Russell had been Managing Partner for Financial Services for Deloitte in the UK and in Europe, Middle East and Africa for 10 years.

Russell was a member of the FSA's Financial Services Practitioner Panel for six years and was its Chairman in 2011-12. He was one of the accountants to the inquiry by the Board of Banking Supervision of the Bank of England into the collapse of Barings. More recently he advised the FSA as it developed some aspects of its more intensive regulatory environment following the financial crisis.

Russell has previously been a member of the Institute of Chartered Accountants in England and Wales' (ICAEW) Financial Services and Banking sub-committees, and has represented the ICAEW on the European Banks' Working Party.

Support Provided to the Review

Throughout the review, advice was provided by:

- The Boston Consulting Group, a leading global management consulting firm – for analytical support and consulting advice;
- Herbert Smith Freehills LLP, one of the world's leading law firms – for legal advice.

The Reviewers are also grateful for the support provided by:

- Alison Gill, co-founder and CEO of Crelos Ltd., a consulting firm specialising in organisational development and change, executive coaching and facilitation – for advice on culture;
- John Willman, Editorial Consultant, formerly Specialist Adviser to the Parliamentary Commission on Banking Standards, and formerly UK Business Editor for The Financial Times – for editorial services;
- Citigate Dewe Rogerson Ltd – for public relations advice; and
- Katherine Webb, executive assistant to the Review Team.

Costs

From the outset, Barclays and Anthony Salz recognised that the scale and complexity of Barclays' businesses, together with the scope of work envisaged in the Terms of Reference, required extensive expert support for the Review.

This included “the support of a senior independent individual to act as deputy reviewer, and an appropriately sized team from a well-recognised professional services firm.” Accordingly, Russell Collins was appointed as Deputy Reviewer and The Boston Consulting Group were retained, both with the approval of Barclays.

In addition, because the Review's Terms of Reference required it to look into issues which were subject to regulation or other investigation, Barclays suggested and it was agreed that the Review should have its own independent legal advisers. Herbert Smith Freehills were accordingly retained by the Review and they participated closely in the interview process.

The estimated costs of the Review total £13.7m including VAT (which banks in the UK cannot reclaim), made up of the following categories of expense:

- Report leadership, consulting, media, PR and report writing services – £11.9m. These include fees paid to Rothschild for the time of Anthony Salz in his role as Reviewer of £1.5m (exclusive of VAT). Anthony Salz is Executive Vice Chairman of Rothschild and has continued to be employed by Rothschild during the period of the Review;
- Herbert Smith Freehills' fees and expenses for legal advice to the Review – £0.7m;
- Leasing of office space and IT equipment (in London) – £1.0m;
- Other costs including customer research, travel, printing – £0.1m.

In addition to the £13.7m above, £1.1m in legal fees for Herbert Smith Freehills were incurred to support the interview process. Barclays provided temporary office space in New York.

In addition, Barclays retained Boies, Schiller & Flexner as its own legal advisers.

Approach to the Review

Internal and External Data

In compiling this report, we conducted independent analysis of both internal data supplied to us by Barclays, as well as external data. Internal data included a selection of: Barclays' Board, Board committees, and executive management committee minutes; management papers and reports; policies; governance and control frameworks; employee surveys; aggregate remuneration and performance management data; and management communications. External data included annual reports; regulatory requirements and guidelines; industry reports, books and database analysis; and UK House of Commons Treasury Committee papers.

The views, findings and recommendations set out in this report are based solely on the Salz Review's assessment of the documents and information considered by it during the course of the Review. The Review requested that Barclays provide it with relevant documents for those matters which were in the scope of the Review, including those relating to specific regulatory events. The Review has not, however, conducted a forensic investigation or audit of the documents and information made available to it. In some cases restrictions were placed on the Review's access to documents or documents were redacted by Barclays, in each case for legal reasons. Accordingly, while the Review has sought to identify a reasonable selection of documents, it may not have reviewed all materials relevant to specific events. Likewise, the Review has been to some extent dependent on what it has been told in interviews and has assumed the veracity of information provided to it at interviews, unless there was any reason to think otherwise.

As the purpose of the Review has not been to conduct a forensic analysis, other individuals considering the same information or documents could form a different assessment of it. Similarly, the Salz Review might have formed a different assessment of the matters under consideration were it to have reviewed or considered other documents or information.

We are grateful to those people in Barclays who provided us with this information.

Interview Programme

Over the course of the Review process, we conducted over 600 interviews with key Barclays and industry stakeholders:

- Barclays' employees and Board members (current and former);
- Investors in Barclays;
- Clients and customers of Barclays;
- Regulatory and government bodies engaging with Barclays;
- Barclays' professional advisers;
- Board members and executives from Barclays' competitors; and
- Other organisations and interested parties.

We are extremely grateful to everyone who gave up their time to meet with us, send their ideas and provide us with input.

Barclays' Employees and Board Members

Approximately half of our interviews were conducted with current and former Barclays' employees and Board members. We interviewed all current and several former members of the Group Executive Committee, a number of their direct reports, and a sample of less senior employees at the bank, including some working in branches and on the trading floors. Our interviewees included a sample of employees across Barclays' Group Centre, business units, functions and geographies, such as:

- Business units: UK, Europe and Africa Retail and Business Banking, Barclaycard, Investment Bank, Corporate Banking and Wealth and Investment Management;
- Functions: Finance, Tax, Treasury, Human Resources, Legal, Compliance, Risk, Strategy, Corporate Affairs, Brand & Marketing and Internal Audit;
- Geographies: United Kingdom (London and other regions), United States, Spain, Portugal, Africa, Singapore and Hong Kong.

We also interviewed all current Board members as well as almost all Executive and Non-Executive Directors who have served on the Board since 2002.

Investors in Barclays

We invited to interview a sample of Barclays' shareholders (with at least 0.10% ownership as of August 2012), based in various geographies. We interviewed more than 10 who agreed to take up our invitation.

Clients and Customers of Barclays

We carried a programme of interviews with Barclays' clients. We chose our interview sample to capture client views across geographies, business segments, size and strength of relationship. Overall, we conducted approximately 140 interviews across institutional clients of the Investment Bank and Corporate Banking, Wealth, and SME Business Banking. Additionally, we commissioned focus groups with over 50 UK Retail Banking and Barclaycard customers.

Regulatory and Government Bodies engaging with Barclays

We met with or spoke to approximately 40 representatives from regulatory and government bodies. We met with financial services and financial reporting regulatory and government organisations in the UK, including tax authorities, and practitioner and consumer bodies. We were not permitted under US law to meet with regulators in the US – with one exception – nor could we review US regulatory correspondence. We had discussions with certain regulators in Spain and South Africa.

Professional Advisers

We spoke with around 25 professional advisers of both Barclays and other financial institutions such as:

- Auditors and tax specialists;
- Brokers;

- Lawyers;
- Human resource and remuneration specialists; and
- Other consultants.

Other Organisations and Interested Parties

Additionally, we met with approximately 65 individuals and representatives of organisations which expressed an interest in our Review, or who we thought may be able to offer perspectives relevant to our scope. This included (amongst others):

- Current and former senior executives and board members from both financial services firms and large non-financial corporations;
- Research analysts;
- Rating agencies;
- Consumer groups;
- Financial services, banking industry and other professional bodies;
- Employee unions; and
- Professors and academic researchers.

Round Tables

The Review team held four round-table discussions in January and February 2013 in order to benefit from informed debates, with senior representatives from industry, government and NGOs, on the key topics under consideration. These discussions were held on a confidential basis. While these sessions were chaired by the Review team, they were hosted and moderated by representatives from professional services firms, to whom the Review is most grateful:

- Governance and Board effectiveness, hosted by Deloitte;
- Risk management, hosted by Ernst & Young;
- People management, hosted by JCA Group; and
- Culture and cultural change, hosted by McKinsey & Company.

Messages to Review's Electronic Mailbox

We considered perspectives and evidence from over 200 interested parties who contacted us through the Review website. We also conducted selected confidential interviews with some of these individuals.

Salz Review Staff Survey

To engage with and obtain insights from the broadest possible set of Barclays employees, the Salz Review conducted its own confidential online staff survey in January 2013 regarding:

- Overall engagement with Barclays;
- Leadership and tone from the top;
- Stated values and how they were put into action;

- Issue escalation and consequences of unethical behaviour;
- Mechanisms to support or reinforce behaviours;
- Questions related to demographics and role at Barclays; and
- Other matters that respondent employees wished to raise to the Review's attention.

The Barclays Communications team helped publicise the survey throughout the bank. However, the survey itself was conducted independently of Barclays and respondents were advised of this.

Over 9,100 responses were received from across business lines, roles, seniorities, tenures, locations, ages and genders. A roughly even number of responses came before and after Antony Jenkins' announcement of Barclays' new purpose and values on 17 January 2013. Almost all post-announcement respondents were aware of the new purpose and values. We are most grateful to all the Barclays staff who completed the survey.

Appendix B – What is Culture and How Can it Go Wrong?

Introduction

In the body of this report we looked at the culture of Barclays and what we believe needs to change. We commissioned this appendix to provide greater context – beyond that of Barclays – of what culture is, why it matters, and how it can go wrong. The appendix draws more broadly on the body of research addressing cultural issues. We hope it provides useful background.

The financial crisis of 2008 has rocked trust and confidence in the industry at all levels of society, including many of those who work within the industry itself. ‘Culture’ has been mooted by many as a root cause of the damage done²⁵⁸ and a programme of cultural change has been proposed as the course of action to aid recovery.

The culture of banks, it is said, drove the wrong behaviours. The sector lost sight of its sense of purpose and lost sight of the values that are needed to run a successful global financial system. Leaders built banks that pursued profit at the expense of all else, failing to see the systemic risks and forgetting the fundamental principles of the profession of banking.²⁵⁹

Leaders need a sense of purpose and integrity to redefine banking and restore trust with customers and employees. These leaders need to be people who see themselves and others as people first (not just employees or customers) and who recognise that creating organisations with ‘good’ cultures isn’t a project or a short-term focus – rather it is the leaders’ work. Work that requires a good grasp of people, culture and organisational development, as well as business, strategy and structure; the latter without the former is inadequate.

‘Culture’ and cultural change have become somewhat of buzz words amongst those faced with delivering change in banking. The reality of course is that changing culture should not be a goal. The goal should be to change the tangible things about what the service does for customers and how people will do their work; gradually, this will change the culture. Fundamentally changing how we work (beliefs, behaviours, structures and systems) is the more challenging part and takes time.

Culture, Sub-culture and Leadership

Anthropologist Redfield²⁶⁰ defined culture as “shared understandings made manifest in act and artefact”. In an organisational context we might understand culture as the practices and values, where practices are the acts or the way things are done and values are artefacts which are human concepts and are the judgments about the way things should be done.

²⁵⁸ For example, Hector Sants, Chief Executive of the FSA, Sir David Walker, Chairman of Barclays and Marcus Agius, former Chairman of Barclays.

²⁵⁹ Banking Standards Committee: *Evidence from Douglas Flint, Chairman of HSBC PLC.*

²⁶⁰ Robert Redfield, *Introduction to Bronislaw Malinowski, Magic, science and religion*, 1948.

'Culture' is a human construct that applies to collective activity. It is the social and unwritten rules with regard to how people in groups interact; the collective habits. Culture is built through interactions between people in groups. Cultural studies have their roots in understanding how to help people who have different societal origins interact to get things done. Early anthropologists recognised that while some differences between people from different cultures were observable and describable, these differences were rarely sufficient to really know how work gets done. Understanding culture is a way of smoothing out how people in groups can get work done while feeling socially at ease in the group.

Culture is best understood by thinking of the levels at which culture can be experienced. National (macro-cultures), organisational cultures and, other sub-cultures such as industry (or professional) cultures are evident and prominent in our lives. Of these cultural levels, national cultures are the most studied and readily understood. Most people still live their lives in a single national culture, and as part of that culture they develop shared patterns of thinking, responding to and interpreting the stimuli that they encounter. These patterns become hardwired such that ways of interacting are guided by basic, unwritten, unspoken assumptions generated through years of shared social interaction and learning.

National cultures are prominent and enduring such that comparisons of organisations based in the same country of origin have been shown consistently to share fundamental underlying value systems which are deeply rooted in the history and evolution of the nation. The national cultural identities are more evident and consistent as driving forces than industry-wide or organisational-specific cultures.

In the model of global universal banking, the question arises whether it is possible to have one organisational culture given that employees have such widely varying national cultures in an organisation offering such different services (retail, corporate, investment banking)?

Research efforts have doubled over the last three decades to find ways to define notable differences between national cultures in the hope that it might help us to understand how to predict the challenges we might face when bringing together those who have different cultural origins. The GLOBE Study is one of the most comprehensive studies of culture to date.²⁶¹ GLOBE studied culture in 62 societies and in three global industries (financial services, telecommunications and food), seeking to answer questions such as:

- Do global industries have identifiable cultures that supersede national cultures?
- Do different national cultures recognise and require different leadership styles?
- Is it possible to reliably define national cultures in a way which helps define different interventions that might help to bring two organisations from different country origins together?

The research identified nine cultural dimensions by which national cultures can be reliably compared (see Figure B.1) and seven positive attributes of good leadership that stood the test across all 62 societies:

- Integrity – good leaders can be trusted;
- Generosity – good leaders are helpful;

²⁶¹ Robert J. House et al., *Leadership, Culture and Organisations: The GLOBE Study of 62 Societies*, 2004.

- Fairness – good leaders are just and equitable;
- Diplomatic – good leaders handle conflict well;
- Decisiveness – good leaders make sound and timely judgments;
- Competence – good leaders contribute to the company performance;
- Vision – good leaders articulate a desirable future.

They also identified eight universally undesirable attributes in leaders, including being ruthless, a loner, egocentric and dictatorial. Other attributes were more culturally contingent, for example respondents from different countries reacted differently to 'being ambitious'.

Their findings suggest that there are culturally shared conceptions of leadership whereby people in different cultures share common observations and values concerning that which constitutes effective and ineffective leadership. For example, in some cultures, leadership is romanticised and leaders are given exceptional status and power; in others, for example in cultures like the Netherlands, leadership is something to be suspicious of. The Dutch, it seems, recognise that leadership carries with it an opportunity to abuse power. However, Values-Based Charismatic Leadership (encompassing the seven positive universal attributes of good leadership) is generally reported across cultures to contribute to effective leadership.

Figure B.1 – Global Cultural Dimensions ²⁶²

Power distance:	The degree to which members expect power to be distributed equally
Uncertainty avoidance:	The extent to which a collective relies on social norms, rules and procedures to alleviate unpredictability of future events
Humane orientation:	The degree to which a collective encourages and rewards individuals for being fair, altruistic, generous, caring and kind to others
Collectivism I (Institutional):	The degree to which organisation or society practices encourage and reward collective distribution of resources
Collectivism II (In-group):	The degree to which individuals express pride, loyalty and cohesiveness in their organisations
Assertiveness:	The degree to which individuals are assertive, confrontational and aggressive in their relationships with others
Gender equalitarianism:	The degree to which a collective minimises gender inequality
Future orientation:	The extent to which individuals engage in future-oriented behaviours in such a way which delays gratification and encourages planning and future investment
Performance orientation:	The degree to which a collective encourages and rewards group members for performance improvement and excellence

Most of us spend a significant proportion of our lives in organisations, most notably schools, universities and work organisations. 'Organisational culture' is a term that can be used to differentiate the experience of being a member, an employee, a customer or a

²⁶² Based on House et al., *Leadership, Culture and Organisations*, 2004.

supplier of one organisation from another. According to culture expert Geert Hofstede, organisational cultures differ mainly at the level of practices (symbols, heroes and rituals) and as such they are more superficial and more easily learned and unlearned than the values that form the core of national cultures.²⁶³ A key challenge for leaders is to build cultures in which values are embedded, stand the test of time and can challenge and shape (the sometimes competing) deeply engrained national cultural values.

Researchers from across the globe agree that leaders and leadership behaviour play a significant role in defining and sustaining organisational culture. Leading researcher, Edgar Schein, estimates the impact of leadership on organisational culture to be considerable, although variable, dependent upon the stage of development of the organisation. Leaders as entrepreneurs are the main early architects of culture, but once cultures are formed, they influence what type of leadership is possible and, if culture becomes dysfunctional (as a whole or in part), the leader's job is to speed up cultural change.²⁶⁴ This belief is supported by evidence from GLOBE. Given that the average tenure for CEOs is decreasing, it is vital that leaders not only understand their role in cultural creation, maintenance and reinforcement, but also that they become skilled as cultural engineers.

Entering a profession (or industry) comes with the expectation of holding certain values and convictions and of learning new skills. As shared experiences and learning underpin cultural development, it is unsurprising that professions contribute to, and are often found to be, a mediating factor in the development of organisational cultures. Professions that have demanding learning and continued professional development criteria typically develop stronger cultures than those that do not. Reputation and success in these professions are strong stabilising influences. Professions, and to some extent industries, have language, symbols, rituals and heroes that signify the culture of the profession. Associating with a particular profession sets an expectation to abide by certain rules of interaction. Professions and industry bodies, when they do their job well, act as a mediator and culture carrier, promoting the best behaviours and controlling the worst. Professional cultures are typically experienced as sub-cultures within an organisation. So in a Universal Global Bank it would be natural to expect different cultures amongst those trained as investment bankers versus those that have learnt their trade in the Retail Bank.

Schein argued that in any organisation there are a minimum of three sub-cultures at play: an executive sub-culture, an operator sub-culture and an engineering/design/professional sub-culture. Each sub-culture demonstrates distinctive patterns of interaction. For an overarching organisational culture to function effectively, it must align sub-cultures through overarching organisational values that help manage the natural tensions that arise.

Perhaps the most notable influence in developing an over-arching organisational culture lies with how people progress from being a leader of a business unit to executive leadership of the organisation as a whole. Because cultural patterns are enduring, if insufficient attention is paid to the transition to the executive function, professional sub-culture beliefs and behaviours are likely to be carried into the new role. Transition implies new shared learning; learning the role of the executive and establishing appropriate models of executive leadership are vital in order that sub-cultures are not able to exceed that for which they were designed.

²⁶³ Geert Hofstede, <http://www.geerthofstede.nl/culture>.

²⁶⁴ Edgar Schein, *Organisational Culture and Leadership*, 2006.

Culture is Experienced

Understanding culture comes with the challenge that people typically have difficulty describing culture. We are conditioned to internalise and experience culture, not to speak about it. Conversations about culture have a tendency quickly to become nebulous. No matter how hard one tries to articulate what a culture is or is not, words rarely seem enough. Culture cannot really be understood without being immersed in it. This can pose a problem for executives who are used to studying phenomena at arm's length through survey data and analytical reports.

Observations and stories shared about culture typically take the form of descriptions of cultural signifiers such as signals and symbols, stories of what our cultural heroes have achieved and how they did it, and explanations of rituals and why they matter to an organisation and its members. These explanations give some clues to culture, but they are the 'observable' artefacts (see Figure B.2) of culture, which do not expose the basic underlying assumptions and value systems by which decisions are made. To get under the skin of culture requires subjective and shared experiences. For example, working with others to achieve a task or working through an organisational dilemma to experience how values are prioritised and judgments are made. It also requires the skill of 'listening with the third ear'²⁶⁵, a term coined by psychoanalyst Manfred Kets de Vries to describe the ability to listen for, and to make sense of and interpret, the emotional and intellectual experience of interactions between people.

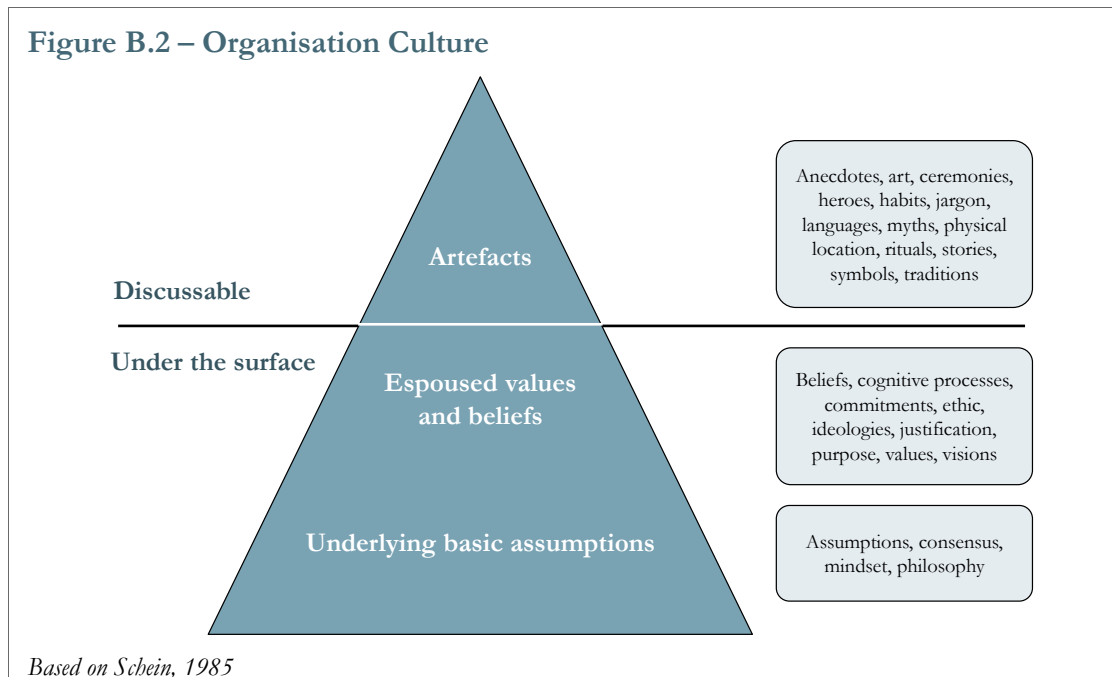
Culture needs to be explored through shared experiences, made visible and tangible through discussion about those experiences. Social validation is the process by which espoused values and beliefs become shared foundations of a culture. For example, if a manager's response to a downturn in sales is to bring people together and to invest in creative thinking and innovation, a belief develops that innovation and creativity will resolve a downturn in sales. If the investment in innovation and creativity works, over time they will become shared values and ultimately shared basic assumptions (see Figure B.2). Only by experiencing and surfacing the basic assumptions can an organisational culture be truly understood.²⁶⁶

Technology today plays an important mediating role in social validation. Online and physical communities have a different architectural base, but at the social level there are still people interacting with people. People can be as upset by a comment on Facebook as by a comment in a conversation. Social-technical systems arise when cognitive and social interactions are mediated by information technology.

The capacity of the social-technical system to mediate social norms is increasingly becoming an important inhibitor or enabler of culture. Traders, for example, send millions of dollars to foreigners they have never seen, for goods they have never touched, to arrive at unknown times. Social-technical systems can generate enormous productivity; but for this to occur, system design must reflect cognitive and social needs. System usability drops when the system design contradicts the user's cognitive needs. Social-technical design is a whole new paradigm for cultural engineers.

²⁶⁵ Manfred Kets de Vries, *Are you feeling mad, bad, sad or glad?*, INSEAD Faculty Working Paper 2007.

²⁶⁶ Edgar Schein, *Organisational Culture and Leadership*, 2006.



At the root of culture are basic assumptions: every set of behaviours incorporates a view about the way that the world works. Assumptions give comfort: that these views mean we do not have to experiment or doubt. We can just act. Comfort is habit: over time the assumptions disappear and become ‘the way we do things around here’. Habits become institutionalised: a set of routines, procedures and rules which define us and give us identity. Technology plays a role in this. Identity is defended: everyone defends their identity.

Culture creates stability, is reassuring and feels safe. Culture is a space where individuals can feel at home, a place where their identity can reside and makes sense. Paradoxically, a good culture needs to be challenged by its adherents to ensure that the assumptions upon which it is based are still suited to the environment in which the organisation exists. Additionally, those who join organisations need to decide consciously whether they can align and fit to the values of the organisation they join.

Culture and Financial Services

It is dangerous to make sweeping judgments about the culture of a whole sector in which there are multiple types of businesses – ranging from insurance to investment banks – and in which multiple subcultures will exist. However the analysis of the cultural challenge facing the whole sector would be meaningless without an attempt to understand some of the history, artefacts, beliefs and basic underlying assumptions which underpin our financial services sector and have led to the challenges faced today.

A comparison of the description of financial services in the 1970s and 1980s by former regulator Brian Quinn, and the description of the last two decades of the 20th century provided by financial historian Philip Augar provides a compelling starting point. Quinn describes the early years as “stable and clubby...in which risk taking was minimal and

unnecessary....and banks lent to customers with whom they had established relationships.” In this environment he explains that “movements of staff round the City were rare and even frowned upon...and the Bank of England wielded enormous power.”²⁶⁷

Contrast this with the “chasing alpha decades” described by Augar, who explains that “alpha was shorthand in the City for supercharged profit.” During this period “the City attained enormous wealth and power...using sophisticated methods of financial engineering to offer limitless credit to consumers (largely unknown to the lender) eager to buy homes, cars and retail goods using borrowed money.”²⁶⁸

During these phases many of the artefacts and symbols of banking remained the same; banks have typically been associated with imposing buildings, a prestigious career, attractive to (mostly) males with an interest in numbers and high financial reward.

Geographically, the square mile of ‘the City’ in EC2 denoted the financial services industry, but over time the physical presence spread to regional centres, Mayfair and Canary Wharf. The size of the geographic footprint and the speed at which the buildings went up were symbolic of its significant contribution to, and influence on, the UK economy.

With regard to the underlying beliefs and basic assumptions which were at the root of the culture of banks, interview data from thirty chairmen, chief executives and senior regulators of some of the UK’s largest banks²⁶⁹ offers some clues:

- **Money:** In banks, money seems to convey different things: “In business, money is lifeblood; people in business know its power and importance. In the City, money is an end in itself. There is a dislocation in the amount of money earned and effort”. There seemed to be an unspoken basic assumption that money is a defence against unpredictability: the more money, the less susceptible to risk. “Since the crisis we have to reorient our thinking. Going for the last million and thinking about the quality of life and the lives of our customers has to be balanced. Levels of remuneration are not the only things which matter in life.”
- **Regulation and the discipline of self-control:** Regulation, regulators and the market are safety devices designed to stop the system failing. “Bankers believe the market is failsafe. The market isn’t failsafe it is designed to fail. Bankers have an infinite capacity for self-delusion”....”The industry was in ‘silent complicity’; we knew it could not go on...many allowed themselves to feel reassured because the regulators approved of the model of banks not needing much capital....none of them said ‘stop!’”
- **Numbers and technology not humans and human judgment:** “We got too focused on analytics not management....In the past supervisors came to see us and looked us in the eye...in turn we looked our customers in the eye. We made informal and subjective judgments about whether what customers said stacked up and the regulators did the same with us. We all became obsessed with the quality of numbers and algorithms; we stopped being human beings.” Technology replaced

²⁶⁷ Brian Quinn, *Renew respect for the Head*, 2012; <http://www.bvalco.com/brian-quinn-renew-respect-for-the-head.htm>.

²⁶⁸ Philip Augar, *Reckless: The rise and fall of the City*, 2009.

²⁶⁹ See: Alison Gill and Mannie Sher, “Inside the minds of the money minders”, in *Towards A Socioanalysis of Money, Finance and Capitalism*, 2011, for quotes in following paragraphs.

humans and created a distance between banker and customer and banker and regulator, giving a sense of independence from normal subjective interactions.

Culturally, financial service organisations were led by those whose basic assumptions were founded on money as the goal; numbers as the answers, and technology as the intermediary. The implications of replacing people with technology, judgment with money, and leadership with those skilled only in money making went unrecognised. Understanding how technology and mathematical judgments impact the social context is a daunting task, but the alternative, as we have seen, is not an option. Currently there is a social-technical gap.²⁷⁰

The study identified that the behaviours that drove culture presented a paradox to leaders of financial services. On the one hand, they recognised and associated numerical competence, regulatory lenience and the pace of business transaction as positive underlying reasons for their success. On the other hand, they realised that these cultural norms may have played a far greater role in the crisis than they were able to comprehend. The role of leadership in understanding and engineering the systemic cultural forces was missing. Those who benefited the most probably still have the most to unlearn and relearn if change is to be achieved.

Culture and Value Creation

Organisation culture is often talked about as a soft concept. In financial services particularly, culture has not been on the radar as a profit driver. However, there is increasingly a body of research which indicates the impact of culture on profitability. Research by Heskett (2011)²⁷¹ indicates that 'culturally unremarkable; competitors suffer a 20-30% drop in performance.

Heskett's research claims to establish cause-and-effect relationships that are crucial to shaping effective cultures, and demonstrates how to calculate culture's economic value through 'Four Rs': referrals, retention, returns to labour, and relationships. The 'Four Rs' can be measured by combining the organisation's employee engagement metrics, customer loyalty metrics and brand loyalty metrics. Companies who intentionally managed their cultures effectively outperformed similar companies that did not.

Other researchers have similarly identified culture as a key contributor to corporate performance. In 2006, Sackman and Stiftung conducted a detailed analysis of the culture of six companies: The BMW Group, Deutsche Lufthansa, Grundfos, Henkel, Hilti and Novo Nordisk. They concluded that "the corporate culture that distinguishes each of them today has, on the one hand contributed to their success and, on the other hand, placed them in a strong position as they face challenges to come."²⁷²

Culture has also been studied empirically as to its role in corporate failure. Joel Bankan's *The Corporation*²⁷³ is a meta-study of corporate failure. His basic hypothesis is that corporate

²⁷⁰ Brian Whitworth, *Socio-Technical Systems*, 2006.

²⁷¹ James L. Heskett, *The Culture Cycle*, 2011.

²⁷² Sonya Sackman and Bertlesman Stiftung, *Corporate Culture and Leadership Behaviour*, 2006.

²⁷³ Joel Bankan, *The Corporation: The Pathological Pursuit of Profit and Power*, 2005.

cultures defined by overly commercial and competitive features at the expense of all else are at the root of major corporate failure. Other research by Corporate Philosopher, Roger Steare²⁷⁴, supports this hypothesis, pointing to cultures which lack the ethic of 'care'. In such cultures, research shows an increase in fear-driven compliant behaviour at the expense of doing the right thing. Steare argues that the modern corporation is a relic of feudal thinking in which power ultimately derives from wealth. His research points to evidence that these pseudo-democratic organisations are prone to cultural dysfunction, with profit pursued at the expense of a higher order purpose. This, he concludes, is a root cause of corporate failure.

Regulators have also pointed the finger at culture, describing unacceptable culture as a root cause of the recent financial crisis.²⁷⁵ Regulators need healthy bank cultures to enable them to do their work effectively. They can never have sufficient resources to monitor every bit of the banks' work, so culture is the crux to ensuring that organisations comply not just with the law but with the spirit too. Markets rely on rules and laws, but those rules and laws in turn depend on truth and trust.²⁷⁶ Better cultures should require less regulation, fewer laws and fewer regulators.

Culture takes time to create, is enduring and resistant to change and is almost impossible to copy. It is this which can make culture an organisation's most valuable (or value depreciating) asset. For employees, culture can be a key component of the decision to stay with one organisation instead of seeking work in another. It is the social glue that delivers discretionary effort at work, and it is this which makes culture a valuable construct.

How Groups Carry Culture

To truly understand how culture is created through shared learning, it is necessary to understand the basics of groups and how group norms are created through the processes of group formation and shared learning. There are basic socio-psychological forces that operate in all of us (need to achieve, need for affiliation/relationships and need for influence).²⁷⁷ These are the raw materials around which people organise to accomplish tasks and to create viable, socially comfortable organised groups to which members feel aligned.

Groups typically develop in stages. Each stage requires the group to solve the questions of purpose (what are we here to do); member identity (why am I/we part of this group and how do we fit together); mechanisms of influence (what is my role); and how to manage both feelings of frustration and caring through the norms of authority and intimacy (how do we get things done and what does it feel like to be part of this group). Norms are developed as these questions are answered. Values and associated behaviours and patterns of interaction that work for the group, helping the group accomplish its tasks, gradually over time become cultural assumptions. The stages that a group progresses through are not exactly linear, but do typically follow a pattern, resolving matters of purpose, authority and intimacy in this order.

²⁷⁴ www.MoralDNA.org.

²⁷⁵ Hector Sants speech, "Do regulators have a role to play in judging culture and ethics?", 17 July 2010.

²⁷⁶ Charles Handy, *What's a Business For?*, 2002.

²⁷⁷ David C. McClelland, *Human Motivation*, 1987.

For example, imagine a group who come together for the first time. The nominated leader of the group typically reminds the group what they are there to achieve and may propose that each group member introduce themselves as a way to get started. In response to this request, another group member may suggest an alternative or an addition – for example suggesting that group members say a bit about their reason for attending. If the group accepts this suggestion, a norm is established that it is permissible to question the authority of the leader with a suggested alternative. Whether the group accepts or rejects a suggestion is important in terms of setting a precedent for matters of authority – whether leadership is shared or located in one individual. Once matters of authority are resolved, the group turns typically to norms around intimacy.

Turquet (1973) used the term 'fusion' to reflect the strong emotional need to feel comfortable and at ease within a group. The degree of intimacy in a group is a function of the intimacy needs of individual group members. Some members resolve conflicts by avoiding intimacy, others by seeking it and attempting to maintain harmony at all costs. Norms about intimacy evolve around incidents that involve aggression and/or affection/affiliation. For example, if member A attacks member B (emotionally or intellectually), it is what the group does after the attack that creates the norm. The group may ignore the attack and move on, or someone may suggest that attack is an inappropriate form of behaviour. Similarly, if there is a hostile interaction between two members, the manner in which the group handles the expression of feeling matters. If group members help to facilitate resolution, then norms get built that feelings can be expressed and worked through; if feelings are ignored and conflicts brushed aside, this pattern of interaction becomes the norm.

Cultural norms in groups are built through incidents and responses to them. Group members learn through their shared experiences the norms which are the most successful in helping the group to achieve a task (or lead to avoidance of failure). As groups mature, their cultural assumptions become stable and enduring. Challenging and changing group cultural norms, creates anxiety and instability. The quickest way for a group to become unproductive is to question its cultural assumptions because the challenge re-arouses the primary anxieties that the cultural norms dealt with when the group was formed.

Cultural norms are created and sustained by many interlocking elements which mutually reinforce. People rapidly come to know and spread cultural norms as the accepted and expected way to behave. Normal behaviour creates expectation – and from expectation derives trust. We trust those who are similar to us, those who we are closest to and those with whom we share common goals.²⁷⁸ Because of these key elements of how groups function, how behavioural norms and the bonds of trust are created, culture once created, is resistant to change. Cultural stability sustains organisational identity and provides an important sense of psychological security to organisational life.

Delivering Cultural Change

Paradoxically, the most important aspect of delivering cultural change is not to focus explicitly on changing the culture, but rather to focus on what the exact nature of the

²⁷⁸ Roderick Kramer, *Collective Trust within Organisations: Conceptual Foundations and Empirical Insights*, 2011.

change is (a problem that needs fixing), how it will be achieved, and how the existing culture will facilitate or resist the required change. This subtle and important difference is often misunderstood.

Change is by nature transformational; that is it requires unlearning of beliefs and behaviours and relearning of new beliefs and behaviours. There are numerous models that indicate that change typically takes place in stages and that different interventions are required at the different stages in order for real change to take place.

Lewin (1947) and later Schein and Bennis (1965) describe the change process as one that takes place in three stages:

- Stage 1: Unfreezing and creating the motivation to change;
- Stage 2: Learning new concepts and new meanings for old concepts, and new standards for judgment; and
- Stage 3: Internalising new concepts, meanings and standards.

Prochaska and Diclemente²⁷⁹ (1984) however, recommend a five-stage model of change. Their model was originally developed as a model of behavioural change for changing problem behaviours such as cessation of smoking. The model has more recently been applied to organisational contexts, recognising that cultural change requires significant shifts in behaviour:

- Stage 1: Pre-contemplation (Not Ready) in which people are not ready to change and typically struggle to believe the benefits of change. Interventions need to be targeted at educating them of the benefits of change and risks of not changing;
- Stage 2: Contemplation (Getting Ready). People can see the benefits of change and express willingness, but still see the challenge of the change as insurmountable.
- Stage 3: Preparation (Ready). People are ready to start taking action. They take small steps, for example, telling others that they want to change their behaviour and experimenting with small incremental changes;
- Stage 4: Action. People have changed their behaviour and need to work hard to keep moving ahead. These participants need to learn how to strengthen their commitments to change and to fight urges to slip back; and
- Stage 5: Maintenance (Reinforcing) People have changed their behaviour and must work on identifying situations that may tempt them to slip back —particularly stressful situations.

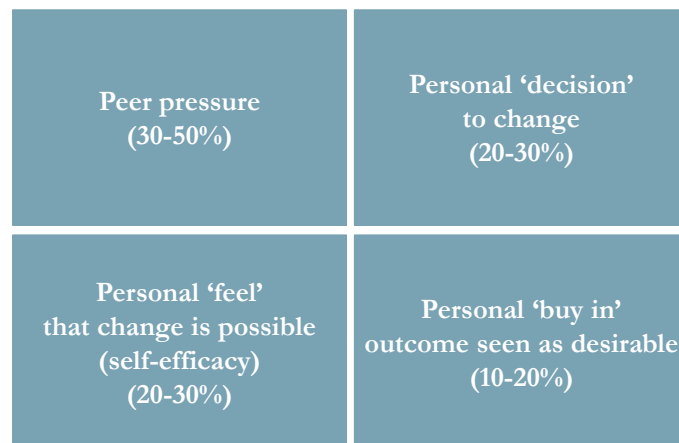
Kotter and Cohen²⁸⁰, on the other hand, describe a ten stage process. All models of change share some common factors. For example, people at different stages of the change process require different types of interventions; and inappropriately timed interventions can cause set-backs. Trying to teach new behaviours if the person has not yet decided to change is a

²⁷⁹ James Prochaska and Carlo DiClemente, *The Trans-theoretical Approach: Towards a Systematic Eclectic Framework*, 1984.

²⁸⁰ Jan Kotter and Dan Cohen, *The Heart of Change*, 2002.

waste of resource and is likely to lead to resistance to change. There are four key influences that have proportionately differential effects on encouraging change, of which peer pressure is the most influential (see Figure B.3). In a large networked organisation, the use of advocacy type interventions are possibly the most powerful drivers of change.

Figure B.3 – Factors that Influence Change²⁸¹



Finally, change brings with it a high degree of anxiety. This anxiety is typically associated with four factors: fear of loss of power or position, fear of incompetence (and loss of reward associated with previous competence), fear of loss of group membership; and fear of loss of identity. Schein describes these fears as learning anxieties. Creating psychological safety is vital to achieving change and Schein identifies that the majority of major change programmes fail because they do not pay sufficient attention to creating this psychological safety. Schein cites eight activities (see Figure B.4) required to ensure psychological safety, none of which can be missed. Delivering transformational change cannot be done without all eight factors in place.²⁸²

Figure B.4 – Eight Activities that are needed to Create Psychological Safety

1. A compelling vision
2. Formal training
3. Involvement of the learner
4. Informal training of relevant surrounding support groups and teams
5. Practice, coaches and feedback
6. Positive role models
7. Support groups in which issues and problems can be aired and shared
8. Systems and structures that are consistent with the new way of working

²⁸¹ Alison Gill, *The value of peer pressure in delivering cultural change*, working paper, 2009.

²⁸² Edgar Schein, *Organisational Culture and Leadership*, 2006.

The Leader's Role

Psychoanalyst Manfred Kets de Vrie²⁸³ identified that the key skills of leaders in shaping culture and delivering change are self-awareness and the ability to change personally at all levels, intellectually, emotionally and behaviourally. When leaders engage in personal learning and change, they signal to the organisation that transformation is safe and important to the future survival and success of the organisation. Actions speak louder than words. Humility and the ability to consciously reflect are required for leaders to succeed in leading transformational change. These are characteristics associated with helping oneself and others to grow.²⁸⁴

Growing and learning often involves failure and can be embarrassing. So leaders who can overcome their fears and broadcast their feelings as they work through the messy internal growth process will be viewed more favourably by their employees. Researchers, Owen and Heckman, found that those leaders who model how to be human rather than superhuman and legitimise 'becoming' rather than 'pretending', were considered more effective. You cannot fake humility. You either genuinely want to grow and develop, or you do not, and people pick up on this. Leaders who action their own change and growth signal to followers that learning, growth, mistakes, uncertainty and false starts are normal and expected in the workplace, and this produces organisations that constantly keep growing and improving.

Strategy and culture can be said to work hand in hand – two sides of the same coin – with strategy signified by the purpose (why we do what we do), mission, vision and objectives of the organisation (the what we do), and culture – signified by the values, behaviours and working practices (the how we do it). It is the leader's role to focus on both the strategic and cultural development of the organisation, weaving a system which enables the organisation to survive, grow and adapt to meet the needs of the environment in which it works. This work can only be done by leaders who are prepared to engage at a personal as well as systemic level. Changing the 'how we do things' is for most leaders where the risks lie.

The Role of Employees

Working with and for others is deeply engrained in our biological evolution. Through infancy, childhood and adulthood, we retain a propensity to work in groups and accept particular individuals to co-ordinate our efforts and take on leadership roles. However, what makes a good employee has generally been understudied and is typically understated in organisational life. Leadership, on the other hand, has been much studied and often over romanticised: Google gets about 120,000 hits when you type in 'followership' (or 'citizenship'), versus more like one million for 'leadership'. In fact we struggle, in an organisational sense, to even effectively label individuals who are not in leadership or managerial roles, calling them variously employees, colleagues, workers, team members, staff or even – most recently – citizens.

²⁸³ Manfred Kets de Vries, *The Leader on the Couch*, 2006.

²⁸⁴ Bradley Owens and David Heckman, *Modelling How to Grow: An Inductive Examination of Humble Leader Behaviours, Contingencies, and Outcomes*, 2012.

Being an effective employee is important, and the ability to be able to be an employee who can work effectively in groups has a number of benefits. These include safety, social reward and the ability to achieve more than one might alone. Research from CRESS (The Centre for Research in to Employment, Skills and Society) argues that the definition of performance at work has for too long been narrowly defined as the successful accomplishment of the duties and responsibilities of a given job, or task performance. Task performance is critical to the organisations technical core²⁸⁵ and is therefore critical to the success of the organisation. However, they argue that there are two other important dimensions for the performance of the organisation, namely the enactment of citizenship behaviours and the absence of withdrawal behaviours.²⁸⁶ Both of these are positively correlated with organisational success.

Citizenship behaviours²⁸⁷ are often referred to as extra-role behaviours that go beyond the task requirements of the job. They include supporting colleagues, contributing to ideas for improving the organisation and participating in organisation-wide initiatives. Withdrawal behaviours on the other hand have a negative impact on the functioning of the organisation.

Withdrawal behaviours²⁸⁸ include intention to leave and deviant types of behaviour such as consistently arriving late and leaving early, neglecting work, or abusing company property. Individuals who are emotionally engaged at work are more likely to demonstrate citizenship behaviours and less likely to demonstrate withdrawal behaviours. In summary, setting an organisation's purpose in a broader sense, and encouraging employees to contribute widely, has a positive impact on both individuals and the long term success of the organisation.

What it means to be a good employee has become somewhat confused of late, drowned in a milieu of employment law, the proliferation of a culture of individualism and a wave of interest in what organisations must do keep employees engaged. But, other than doing important tasks of work, employees have important roles to play. Being a good employee means: co-operating in teams to maximise resources and to drive productivity and contribution; building skills which are valuable to the organisation as a whole; exercising judgment about those we select as leaders to follow; voicing opinion about what works and does not work in the organisation; and being a good 'corporate citizen', supporting fellow employees, and fostering a social environment that is conducive to the accomplishment of work.

Yet, in modern, large organisations, few employees are properly involved. Research from the Kingston Consortium on Employee Engagement²⁸⁹ indicates that just 34% of employees are 'vocally involved' and have opportunities to voice their views. Interestingly, the vocally involved category of workers is the most engaged. This definition of engagement derives from the work of earlier theorists and commentators such as Kahn (1990), May et al (2004) and Schaufeli and Bakker (2004), all of whom regard engagement

²⁸⁵ W.C. Borman and S.J. Motowidlo, *Expanding the Criterion Domain to Include Elements of Contextual Performance*, 1993.

²⁸⁶ CIPD Research Insight, Emotional and Transactional Engagement – does it matter?, 2012.

²⁸⁷ K. Lee and A.J. Allen, *Organisational Citizenship Behaviour and Workplace Deviance: the Role of Affect and Cognitions*, 2002.

²⁸⁸ S.L. Robinson and R.J. Bennett, *A typology of Deviant Workplace Behaviours: a Multidimensional Scaling Study*, 1995.

²⁸⁹ Kingston Consortium Project on Employee Engagement, *Creating an Engaged Workforce*, 2010.

as a psychological state experienced by employees in relation to their work. In their report, they describe an engaged employee as someone who thinks hard about their work, feels positive when they do a good job, and discusses work-related matters with those around them. Engagement therefore has intellectual, emotional, social and behavioural dimensions.

Having a voice at work and exercising that voice points to a natural human need to be able to be in control of our own destiny. Intrinsic motivation for work comes from this.²⁹⁰ Exercising individual and – where necessary – collective voice is important in escalating issues of concerns about leaders and cultural norms that abuse the moral compass of the organisation. It is also important in selecting leaders who demonstrate the qualities of humility, care, and respect for others over those of self-interest and status building. In their book *Selected*²⁹¹ Vugt and Ahuja describe employee voice as one of the key STOPS (Strategies To Overcome the Powerful) for keeping over-bearing leaders in check. Functioning organisations need employees, not just those in leadership positions, to have and to exercise voice. Organisations in which the employee voice is silent have much to be concerned about. Silence signifies disengagement or, worse still, fear of becoming engaged.

The Role of Pay and Reward

Pay for performance has been around for a long time and it has become a truism in the business world that pay should be structured to encourage people to perform. However, there is a paradox in this in that there is over sixty years of academic research which highlights that extrinsic motivation (encouraging people to do something for a reward) is not as effective at improving performance as intrinsic motivation (a form of fulfilment people get from doing work). Put simply, there is a mismatch between what science knows and what business does.

There is a body of evidence which shows that extrinsic rewards, like bonus payments or contingent pay, dulls creativity, narrows focus and slows our capability to solve problems. Deci's famous 'Soma Cube Experiment'²⁹² required groups of people to work together to complete complex puzzles, some for reward others not. Deci played with multiple configurations of reward and multiple configurations of group. In each, the result is the same. The rewarded group consistently produced fewer solutions, were less engaged in the task, and were less socially engaged with their colleagues. The results are completely counter-intuitive. The conclusion is that when people are motivated intrinsically, they perform better and more consistently than when motivated extrinsically.

Deci's work has been supported by multiple other studies. In fact it seems that a new study is now published almost weekly. Most of these studies highlight that pay does not come top of the list of elements which encourage motivation and engagement at work. Feeling valued, having the opportunity to do interesting stimulating work, and opportunities for advancement supersede pay. Extrinsic rewards motivate for a short time, a bit like caffeine does, before the effect wears off. Extrinsic rewards are good for motivating people to do simple, rule based tasks for a short period of time, primarily because they narrow one's focus on to the immediate and the obvious.

²⁹⁰ Richard Ryan and Edward Deci, *Self-Determination Theory*, 1970.

²⁹¹ Mark Vugt and Anjana Ahuja, *Why some people lead, why others follow and why it matters*, selected, 2010.

²⁹² Edward L. Deci, *The effects of Contingent and Non-contingent Rewards and Controls on Intrinsic Motivation*, 1972.

There is a considerable body of research which points toward the role of nonfinancial rewards as key to motivation and performance at work. A survey of one thousand executives by McKinsey²⁹³ for example, highlights that non-cash rewards, such as praise from immediate managers, leadership attention (for example, one-on-one conversations), and a chance to lead projects or task forces, are even more effective motivators than the three highest-rated financial incentives: cash bonuses, increased base pay, and stock or stock options.

The secret to performance maintenance and engagement at work (and at home) is the human need to direct our own lives, to learn, to create new things, and to have engaging social relations with those that we work with. The role of culture is to create an environment in which this can happen. Reward and remuneration are powerful levers if used to best effect and with a clear understanding of where they sit in the hierarchy of needs.²⁹⁴

Avoiding Cultural Corruption

As humans we would like to think that morality is linked inherently to our individual personalities or values. However, a century's worth of research suggests it is not. Employees who are routinely dishonest at work are not dishonest at home; people who are courageous at home are not routinely courageous at work. Moral behaviour does not exhibit what researchers call cross-situational stability.²⁹⁵ Rather, it seems to be powerfully influenced by context and, in an organisational sense, this context is the culture and cultural norms.

Work by Lasch (1979)²⁹⁶ and Long (2008)²⁹⁷ points toward evidence that cultures which are highly individualistic, verging on narcissistic, create a collective dynamic which reinforces perverse behaviour through the process of turning a blind eye.²⁹⁸ In organisations such as financial services, which are highly people and knowledge centric, denial of knowledge is significant. There is a challenge about our relationship with knowledge, particularly in environments where control and control frameworks are knowledge that one might not want to know. "I know things, but they are of no use to me in terms of what I am trying to achieve". Instead, I value some constructed knowledge that I can rationalise as being 'better or a different lens through which to see the control framework to help me achieve my needs'. This is known as delusion and Mannie Sher, a researcher who has studied the group dynamics of turning a blind eye and its corrupting influence, suggests that this can often be seen at the start of group corruption.²⁹⁹ 'I/we know it is wrong but I/we can construct a rationale, logical framework which means that I/we can subvert my/our moral compass.' No-one in the group speaks out about the concerns of what might be right or wrong for fear of being seen to be disloyal. Rationale and logic is encouraged at the expense of that which we know/feel deep down to be right.

²⁹³ McKinsey, *Motivating People: Getting beyond Money*, 2009.

²⁹⁴ Daniel Pink, *Drive: The surprising truth about what motivates us*, 2011.

²⁹⁵ David Magnusson and Hakan Stattin, *Stability of Cross-Situational Patterns of Behaviour*, 1981.

²⁹⁶ Christopher Lasch, *The Culture of Narcissism: American Life in the Age of Diminishing Expectations*, 1979.

²⁹⁷ Susan Long, *The Perverse Organisation and its Deadly Sins*, 2008.

²⁹⁸ Paul Hoggett, *Partisans in an Uncertain World*, 1992.

²⁹⁹ Mannie Sher, *Managing Change*, 2012.

In the modern corporations, 'corruption' is a word typically associated with matters to do with crimes like bribery and health and safety breaches. Sher proposes a fuller definition encompassing the following:

- Turning away from what we know to be right;
- Exercising leadership in pursuit of an objective that has nothing to do with the specified task of work;
- The erosion of values and standards through noxious processes that have not been foreseen nor worked with until it is too late;
- Undermining the spirit of the law.³⁰⁰

Rationalised wishful thinking allows us to detach ourselves from the emotions that would normally signify risks. These emotions start with anxiety and can escalate to shame and then genuine guilt. In an absence of acknowledging these emotional states, we are in a semi-delusional state of mind (or a corrupt state of mind) in which, rather than admit responsibility, or learn from our mistakes, we create rational logical arguments which explain our actions.

Sher proposes that leadership plays an important role in collectivising the unconscious processes by which individuals coalesce into groups which operate as corrupted herds. The leader captures the allegiance of individuals to some particular ideal that is represented in ways that appears value-driven. In financial services organisations, this might be expressed as the profit motive in pursuit of delivering value to shareholders. It is the structural elements, as well as the apparent value-driven components, that enable individuals, who despite having their own moral compass, will follow leaders to destruction. "Corruption is about bending the means to achieve the end. The psychological dynamics of corruption are manifest in greed, arrogance, a sense of personal entitlement, the idea of personal loyalty as virtue and the inability to distinguish between organisational and personal ends."³⁰¹

Humans do have strong visceral reactions to both morally good and morally bad things. The unconscious makes the call. When we experience injustice, we react with fury; when we experience charity, we are warmed; when we experience prudence, we feel safe. We go through our days making instant moral judgments about the behaviour that we see around us. We call this 'moral intuition'. However, when surrounded by a context which clouds our intuition and encourages compliance behaviour instead of thinking and sound judgment, the majority of us are capable of doing that which might be considered morally wrong. This is partly because we all have deeply engrained, but often competing drives, some of which point towards co-operation and social conscience and some which are selfish drives. Selfish drives include to take what we can, to magnify our status, to appear superior to others, to exercise power over others, and to satisfy lusts. These drives are deeply rooted, are capable of warping our perception and can lead to behaviour that is morally wrong.

The emotional intelligence of groups and organisations can play an important role in helping individuals manage these competing drives. The basic emotions of anxiety, fear of

³⁰⁰ *Ibid.*

³⁰¹ David P. Levine, *The Corrupt Organisation*, 2005.

reprisal, shame, guilt, and fear of personal harm are vital feelings that help us to assess risk and, where necessary, prevent us taking risks and committing immoral acts. Emotional escalation is our brain's way of signalling the perceived intensity of risk. In an absence of acknowledging these emotional states, we are in a semi-delusional state of mind in which, rather than admit responsibility, or learn from our mistakes, we create rational logical arguments which explain our actions. Rationalised wishful thinking allows us to detach ourselves from the reality. Cultures which emphasise constant pleasure seeking without the balance of reality dampen our emotional antennae and increase the propensity for risk taking.

While we would prefer not to think it is the case, we all need to contain our propensity to be corrupted (in groups). In group life, corruption can readily, and often somewhat unconsciously, be systematised. However, if we acknowledge this, then we will be more readily able to identify it and contain it. When culture is corrupted there will be a misalignment between what we have learnt to expect and that which we experience. But to do anything about it, we first have to notice this at a fundamental level.

A culture which encourages exploration of ethical and moral dilemmas has a healthy respect for emotional expression. And a culture which encourages open challenge to decisions that contradict the values of the organisation is a healthy culture. Cultures in which corruption ensues typically are those in which we find denial or suppression of values, as well as ethical dilemmas.

In Conclusion

On the whole, when you work through the abundant literature on the crisis, it seems that bankers, regulators, shareholders and politicians now have a better grasp on the behavioural and cultural issues that they were once ignorant of, and blind to – and which contributed to the financial crisis. Now the work begins, with unlearning of old beliefs and behaviours and learning of new. This will be a journey that will take some time.

Leadership and decision making: Culture begins with the personal. Leaders must have a sense of purpose which goes beyond themselves and their own personal contribution. Personal integrity is universally recognised as an attribute required for effective leadership. It is a life long journey³⁰² and actions speak louder than words. Part of that learning must include developing better knowledge and understanding of people and how people interact in organisations to create culture. This learning needs to be more than an intellectual experience. Rather, it needs to be experienced personally and subjectively by reflecting on decisions and challenging behaviours. The decisions that we take, and the alignment of actions and words, are the windows into integrity. Change must start with the self; without self-awareness it is difficult to change.

Voice and shared experiences: Culture is created by shared interactions between people in groups. Culture is in the spaces between us, formed by how we choose to respond to incidents with regard to: purpose – the work we set out to do; authority – who we accept as leader(s) and how we want authority to be dispersed; intimacy – how we treat each other and want to be treated ourselves. At its very heart, it is a process of learning and trust.

³⁰² Roger Steare, *Culture and the Good Corporation*, 2013.

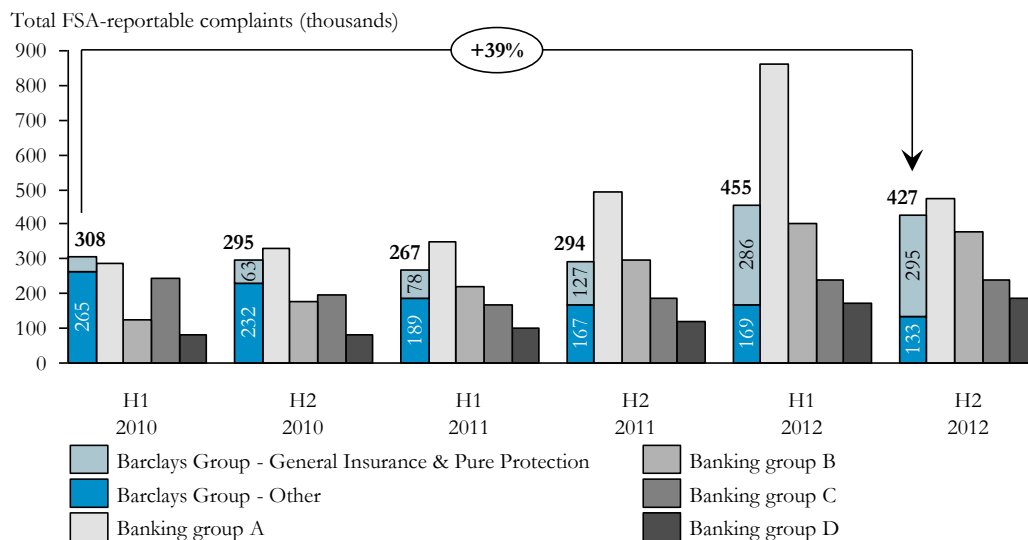
To develop newfound trust in our banks, customers need a better understanding of what they can expect from banks; employees need a better sense of what it means to be a good employee of a bank; leaders need a better sense of what both their customers and employees expect from them – and they need to be held to account. This will be a journey in which open dialogue and shared experience of continuous improvement will count more than pronouncements. Employees and customers must have a voice that is heard and leads to a new and better banking experience.

Alignment, learning and systemic reflection: Developing a global universal banking model which works will not be easy. The proposition involves uniting people with very different cultural and professional backgrounds around a common framework of values. At the heart of getting this right will be a culture that emphasises systematic induction, careful promotion, continuous personal and professional development and systematic review and reflection. When learning stagnates, the old constrains needed evolution. Induction, first promotion and on-going personal and professional development ensure cultural awareness and stability. Systematic and regular independent review ensures that stability is maintained, but necessary change is thoughtfully pursued.

In organisations, we systematise culture by the way that we share a collective sense of purpose; through how we develop new services; through how we develop people to do their work through socio-technical systems; through how we communicate our successes and our failures; through our systems of performance management and reward; and most notably, through the people that we chose to hire, promote and to fire. There is both power and danger in systems in that we can easily forget the purpose for which they were designed. Organisational culture needs to be reviewed and challenged by its adherents to ensure that the assumptions upon which it is based are still suited to the environment in which the organisation exists.

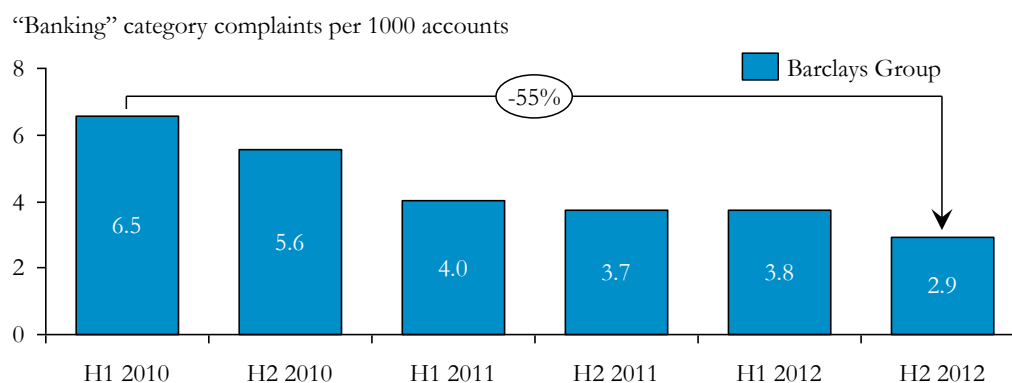
Appendix C – Complaints Statistics

Total FSA-reportable complaints of Barclays Group and other main UK banking groups, H1 2010-H2 2012



Note: Total complaints data comprises complaints in 5 categories (Banking; Home Finance; General Insurance & Pure Protection; Decumulation, Life and Pensions; Investments). We identify Barclays Group's General Insurance and Pure Protection complaints as a proxy for PPI complaints. In the case of a discrepancy between complaints data reported on the FSA website and another bank's website, we used the data reported on the FSA website
 Source: FSA complaints data, company websites, Salz Review analysis

Barclays Group "banking" category FSA-reportable complaints per 1000 accounts, H1 2010-H2 2012



Note: Data for Barclays Group, of which on average 97% of complaints reported are against Barclays Bank Plc. Complaints data falls into 5 categories (Banking; Home Finance; General Insurance and Pure Protection; Decumulation, Life and Pensions; and Investments) dominated by Banking and by General Insurance and Pure Protection. Figures for complaints per 1000 accounts are reported by individual complaints categories only, without overall figures. We use Banking as a proxy overall, as total complaints data is skewed by PPI complaints. Banking category refers to credit cards, current accounts, savings (including cash ISA) and other banking accounts and unregulated loans
 Source: FSA complaints data, company websites, Salz Review analysis

Total "New Cases" reported to the FOS, of Barclays Group and other main UK banking groups, H1 2010-H2 2012

Total complaints (thousands)



Note: Complaints data falls into six categories (banking and credit; mortgages and home finance; general insurance (excluding PPI); PPI; investments; and life & pensions and decumulation)

Source: FOS Complaints data for "New Cases" by business group H1 2010-H2 2012

Appendix D – Business Practices: Lessons from other Industries

Culture and values are important drivers of appropriate business practices, as are governance arrangements. However, other factors also play a role. These include legal and regulatory obligations, the economic and competitive environment, and the expectations expressed by key stakeholders such as shareholders and also by the media.

Appropriate business practices are always important, but disproportionately so in high-risk industries – where key business concerns transcend profitability, growth and competitive advantage. Personal safety or the prevention of catastrophic property or financial loss are paramount. Clearly, these risks differ, so care is needed in seeking to make comparisons. However, as a high-risk industry, the banking industry can draw some lessons from how other high-risk industries explicitly shape their business practices.

In the **chemical industry**, employees' personal safety is paramount. One company which has effectively managed this risk is DuPont.³⁰³ DuPont has refined its own safety methodology over 200 years of experience and has advised over a thousand clients worldwide on their own safety management.³⁰⁴ DuPont found that the level of leadership focus and operational discipline around safe practices are leading indicators for near misses and accidents. They set 'zero targets' for accidents and fostered a culture of individual responsibility and prevention rather than reaction. DuPont's total recordable injury rate averaged 0.67 recordable cases per 100 full-time workers in the US from 2008 and 2009. The industry average for the chemical industry was 2.7 in 2008, while the average for the manufacturing industry was 5.0 in the same year.³⁰⁵ The rate means that a typical DuPont employee was in 2008 working in an environment that was four times safer than the chemical industry average in the US.

In the **commercial aviation industry**,³⁰⁶ passenger safety is also paramount; there is zero tolerance for safety risk. To manage this risk, risk assessment has become an essential component of decision-making. This is helped, of course, by pilots having a personal stake in managing safety risks. To inform decision-making, the industry fosters a strong culture encouraging employees to speak up, without assigning blame, and ensures rigorous training, licensing and adherence to procedures. Risk management is improved through mechanisms for close co-operation, which allow competing airlines to share experience on technical and safety issues.

³⁰³ http://www2.dupont.com/Media_Center/en_SG/speeches/Wui_Poh_Speech.pdf; Hilde Janssens Business Development – DuPont Safety Resources deck: "Improving your business with safety management – EAGOSH – Nov 2002"; and <http://www.move-europe.it/file%20pdf/Paul%20Weber%20-%20WHP%20e%20Mental%20health.PDF>.

³⁰⁴ http://www2.dupont.com/Sustainable_Solutions/en_US/assets/downloads/DnA_USA_Brochure_06192012.pdf.

³⁰⁵ <http://c.ycdn.com/sites/www.naem.org/resource/resmgr/docs/casestudy-2011-dupont.pdf>.

³⁰⁶ Regarding the commercial aviation, wildfire fighting and pharmaceutical industries, see: World Economic Forum paper prepared in collaboration with The Boston Consulting Group, *Rethinking Risk Management in Financial Services: Practices from other Domains*, April 2010: <http://members.weforum.org/pdf/FinancialInstitutions/RethinkingRiskManagement.pdf>; and Martin, D., *Managing Risk in Extreme Environments*, London: Kogan Page, 2008.

Not all high-risk industries have zero tolerance for safety risk. **Wildfire fighters**, for example, must balance allowing wildfires for environmental renewal, while protecting human life and property. To achieve this balance, wildfire fighters first reduce unnecessary risks, by actively pre-empting wildfires through controlled burn offs. Continual risk evaluation process improvement is supported by feedback from fire analysts, training based on an historical experience base, and on-call experts. Finally, the industry culture empowers staff on site to make decisions, given their situational awareness.

Other high-risk industries must manage competing objectives and stakeholders' expectations. In the **pharmaceutical manufacturing industry**, the dominant concern is patient safety. Pharmaceutical companies must ensure product safety, observe extensive legal and regulatory requirements and manage the significant costs of research and development, but they must also foster invention and innovation. Stakeholders (employees, trial participants, patients, physicians, carers, regulators and the public) all have interests in ensuring the risks and business practices of the pharmaceutical industry are closely managed. Pharmaceutical companies manage risk by partnering closely with regulators (to ensure safety and obtain approvals) and closely controlling standardised manufacturing processes. They also foster a culture of fact-based decision-making, informed by sequential trials, and clear risk/benefit evaluations.

In some high-risk industries, striking a clear balance is hard. **Defence contractors**³⁰⁷ have many, sometimes competing objectives. These include: national security; maintaining a national defence capacity; commercial profit and economic benefit. The industry also seeks to manage a balance between private and public interest – with the ability of a country to defend itself cost effectively partly depending upon the contractor achieving significant exports. Defence contractors must also weigh the ethical, reputational, bribery, corruption, legal, commercial, confidentiality, political, and “through-life” risks of each contract. To manage the combination of risk and competing objectives, defence contractors put in place robust policies and procedures which are reinforced by regular internal and external audits. This helps ensure strict compliance with controls and identification of issues.

Companies need to consider not only physical or financial risks, but also reputational risks. In the **automobile industry** there have been periodic safety concerns. For example, the Ford Pinto was a popular subcompact car sold between 1971 and 1980. In 1977, a magazine article³⁰⁸ claimed the Pinto's structural design was dangerous for passengers. It cited a 1973 Ford internal cost-benefit analysis, which concluded that it would be cheaper to pay off lawsuits resulting from damage and injuries than to recall vehicles for repair. The article surmised that Ford had been aware of the Pinto security issues for a few years, but had decided not to act upon them. The memorandum quickly became known as the ‘Ford Pinto Memo’ and caused huge damage to Ford's reputation. However, Ford's senior management claimed that the memo's figures applied to the US car manufacturing industry as a whole, and that the memo was primarily used to petition the National Highway Traffic Safety Administration (NHTSA) to enhance road safety, by reconsidering low expected penalties from car accident lawsuits. Following the “Ford Pinto Memo” controversy, the NHTSA ultimately directed Ford to recall the Pinto in 1978 for safety failures. Nowadays,

³⁰⁷ See the report by The Rt Hon The Lord Woolf of Barnes and the Woolf Committee, “Business ethics, global companies and the defence industry – Ethical business conduct in BAE Systems PLC – the way forward”, May 2008; <http://ir.baesystems.com/investors/>.

³⁰⁸ Mark Dowie, *Pinto Madness*, Mother Jones, September/October 1977 issue.

the Ford Pinto Memo is still often referred to as an example of how exacerbated corporate focus on financial performance could take place at the expense of the customer and the company's reputation.

Reputational risks can also affect products across an industry, as much as individual companies within an industry. In the UK, numerous **supermarkets** have in early 2013 faced a scandal as a result of it being discovered that meat and meat products packaged as beef were in fact partly or significantly composed of horse meat, often provided by third party suppliers. Concerns were raised that, in their constant push to remain price-competitive and to drive down costs accordingly, supermarkets may have forced suppliers to compromise on quality and safety checks and processes, and that some type of contamination may have been a scandal waiting to happen. The National Beef Association accused retailers of "short-sighted, price-led purchasing tactics" and a "bullying culture".³⁰⁹ The scandal damaged consumers' trust in the industry, causing some to switch to vegetarian meals or to purchasing meat from their local butchers instead of from supermarkets. This scandal highlights that even products and common business practices across an industry can cause significant reputational damage to individual businesses within it.

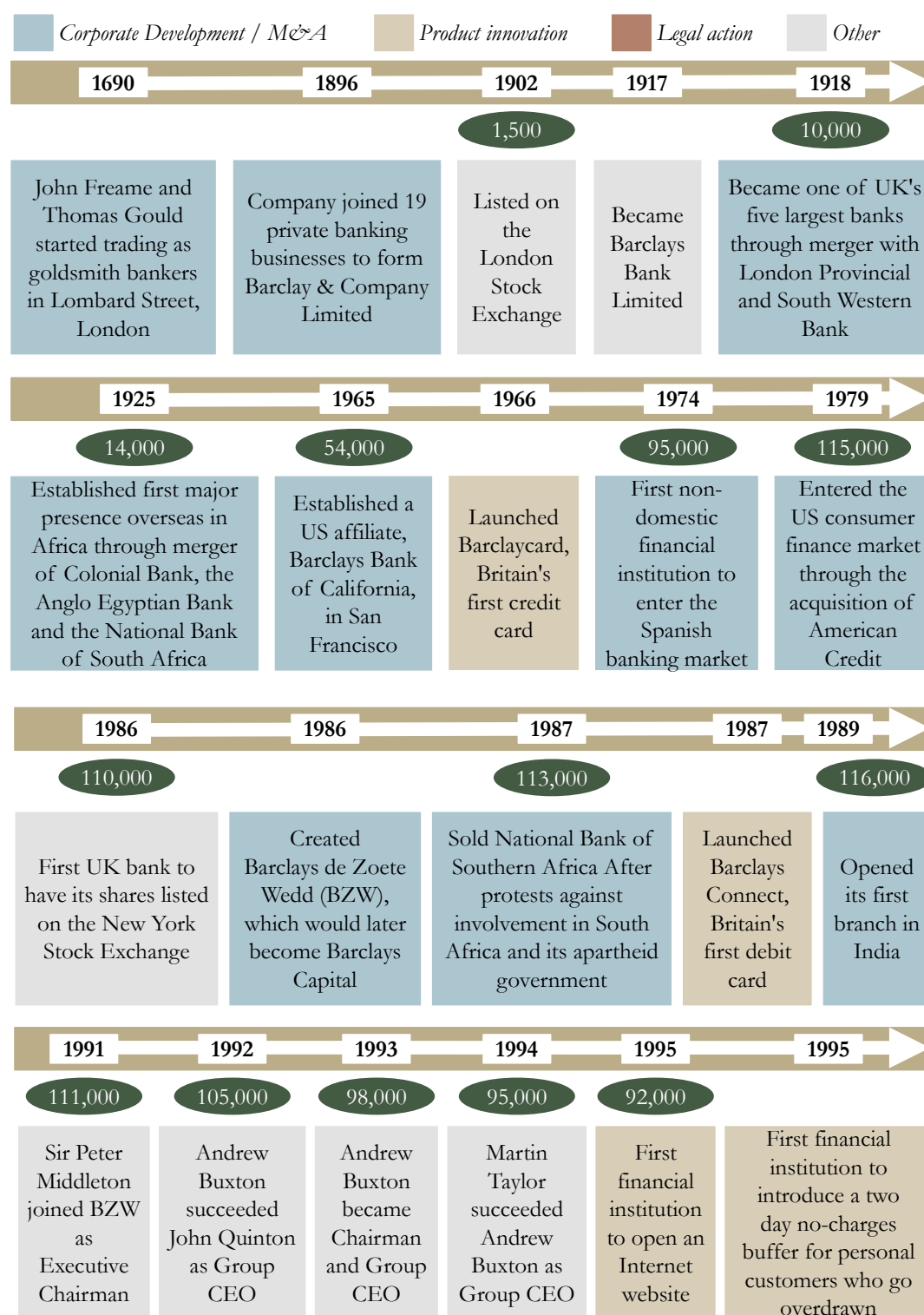
The level of planning required to manage risks also differs by industry. In the **nuclear industry**, although some key risks are not readily identifiable on a daily basis, nuclear plant employees have an acute understanding of the potential consequences of a serious incident. In order to signpost and manage these invisible risks, the industry puts in place visible frameworks and decision rules. The nuclear industry perceives the risks it faces as being severe enough to warrant placing a strong emphasis on stress-testing its risk management processes at both the individual and the organisational level.

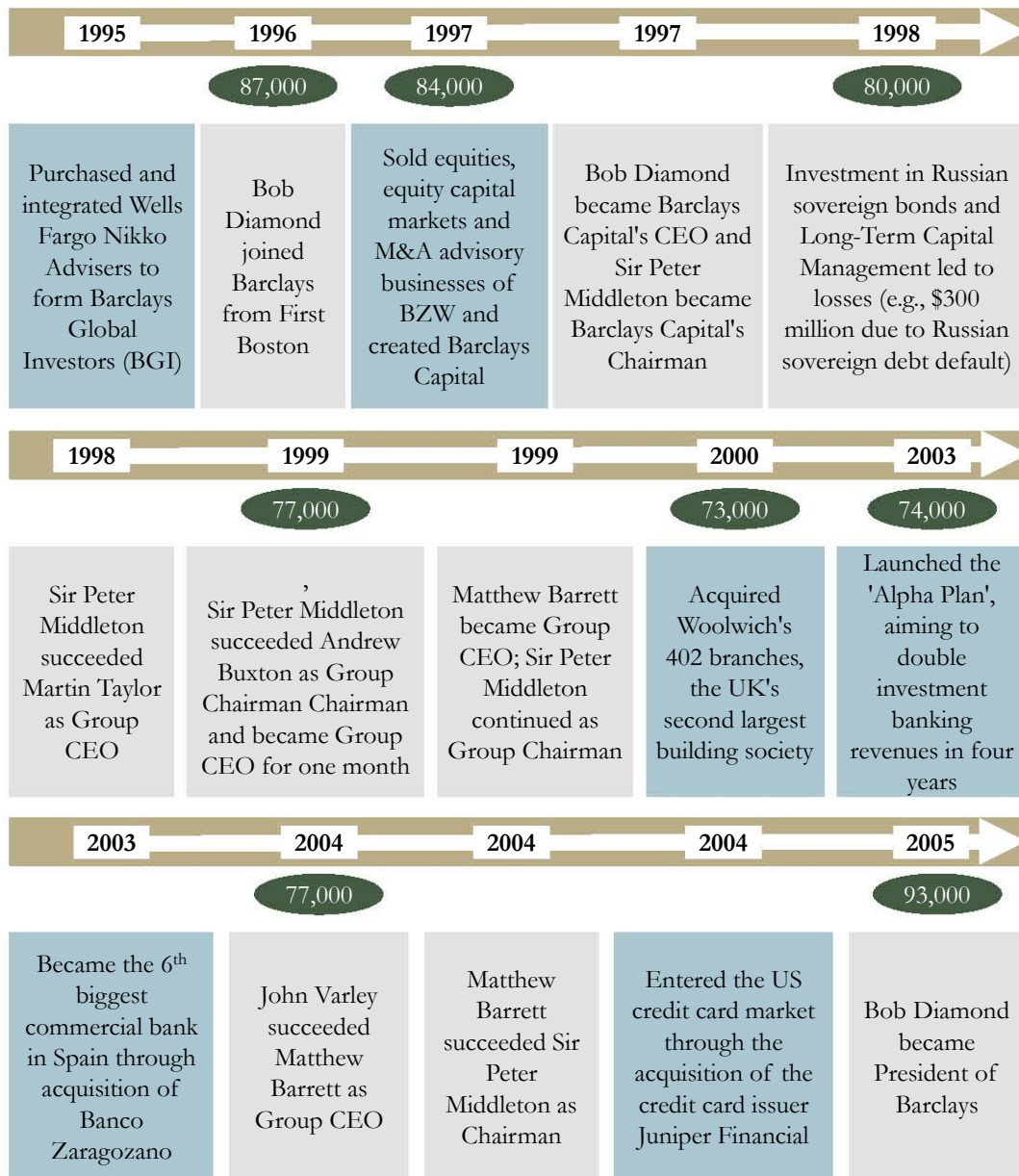
The **banking industry** can and should learn from the business practices of other high-risk industries, for example: focusing leadership and operational discipline on areas of highest risk; creating mechanisms for sharing risk-related data cross-industry; fostering a culture of speaking up; working collaboratively with regulators and with other stakeholders; continually evaluating risks and the appropriateness of business practices; maintaining a balanced view of the different risks faced; being vigilant about industry wide practices which may cause reputational and other risks; and focusing on managing not only individual or business-level risks, but also organisation-level and systemic industry risks. Industries which have encountered trouble, or which actively look for potential trouble and collaborate in working to avoid it, offer some useful lessons for banks.

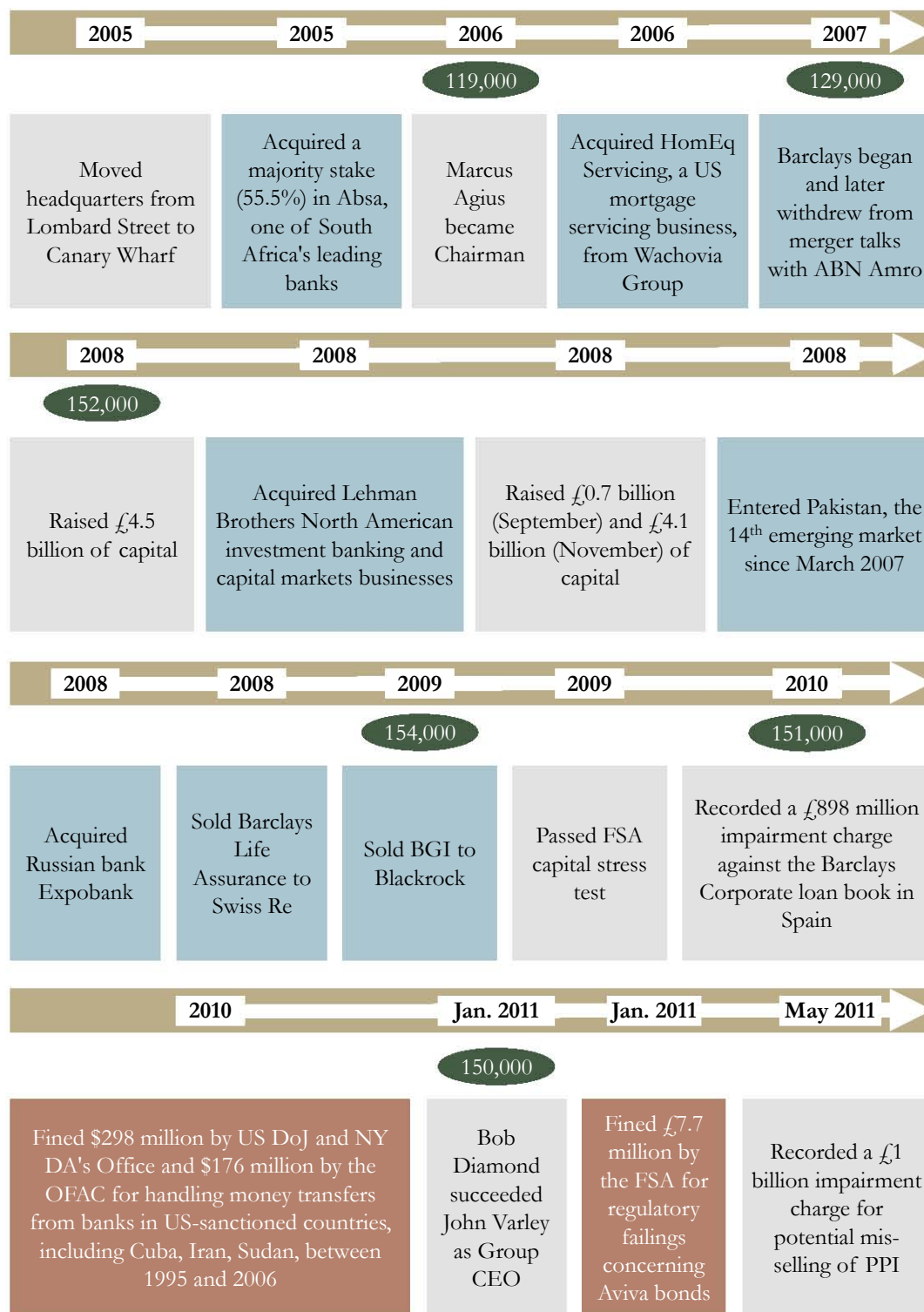
³⁰⁹ Ruddick, Graham, "Sainsbury's chief Justin King warns of 'new reality' after horse meat crisis", The Telegraph (online), 22 February 2013: <http://www.telegraph.co.uk/finance/newsbysector/retailandconsumer/9886724/Horse-meat-Sainsburys-chief-Justin-King-warns-of-new-reality-after-horse-meat-crisis.html>.

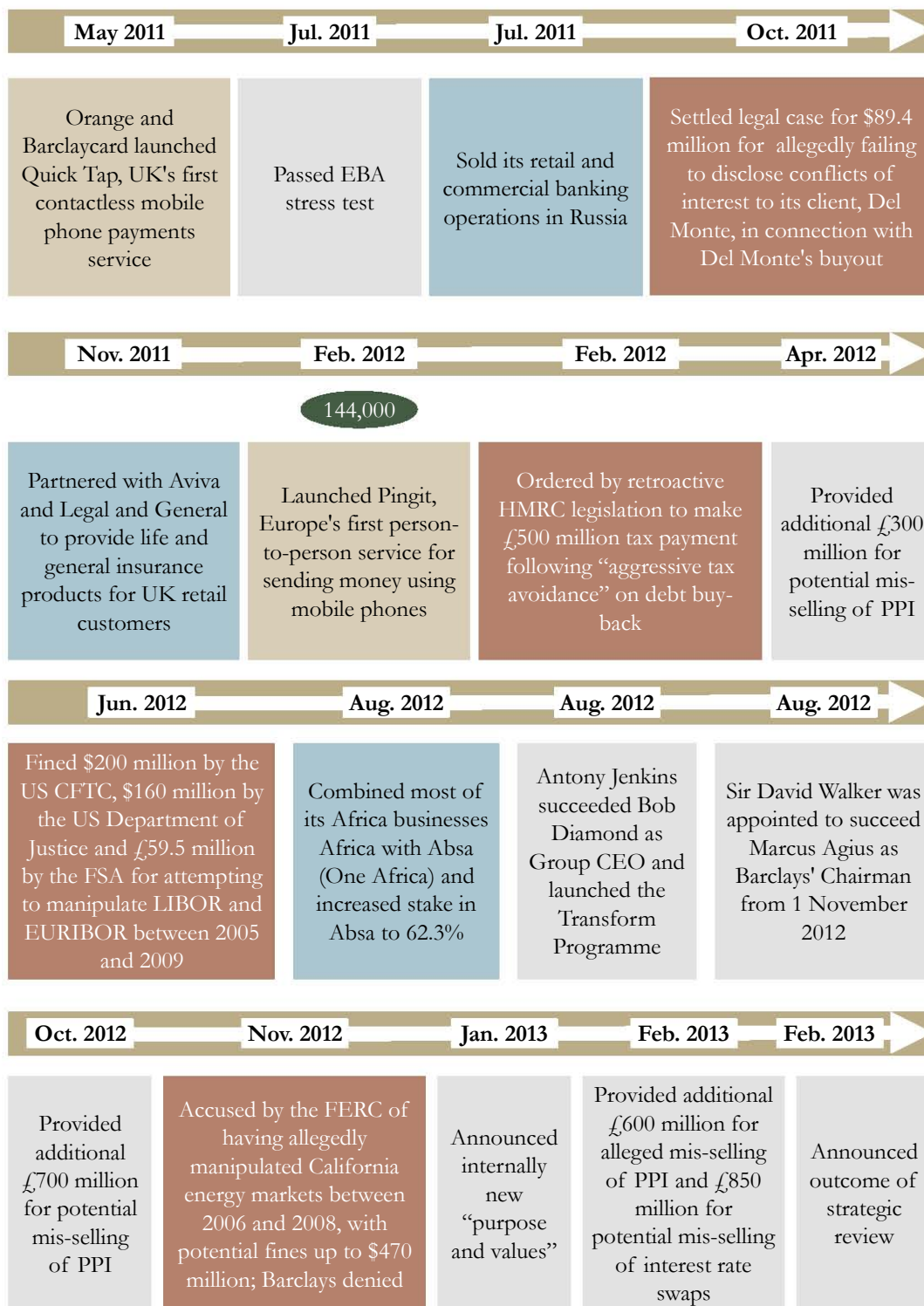
Appendix E – Barclays Timelines: Overall and Main non-UK Geographies

Barclays' Overall Timeline







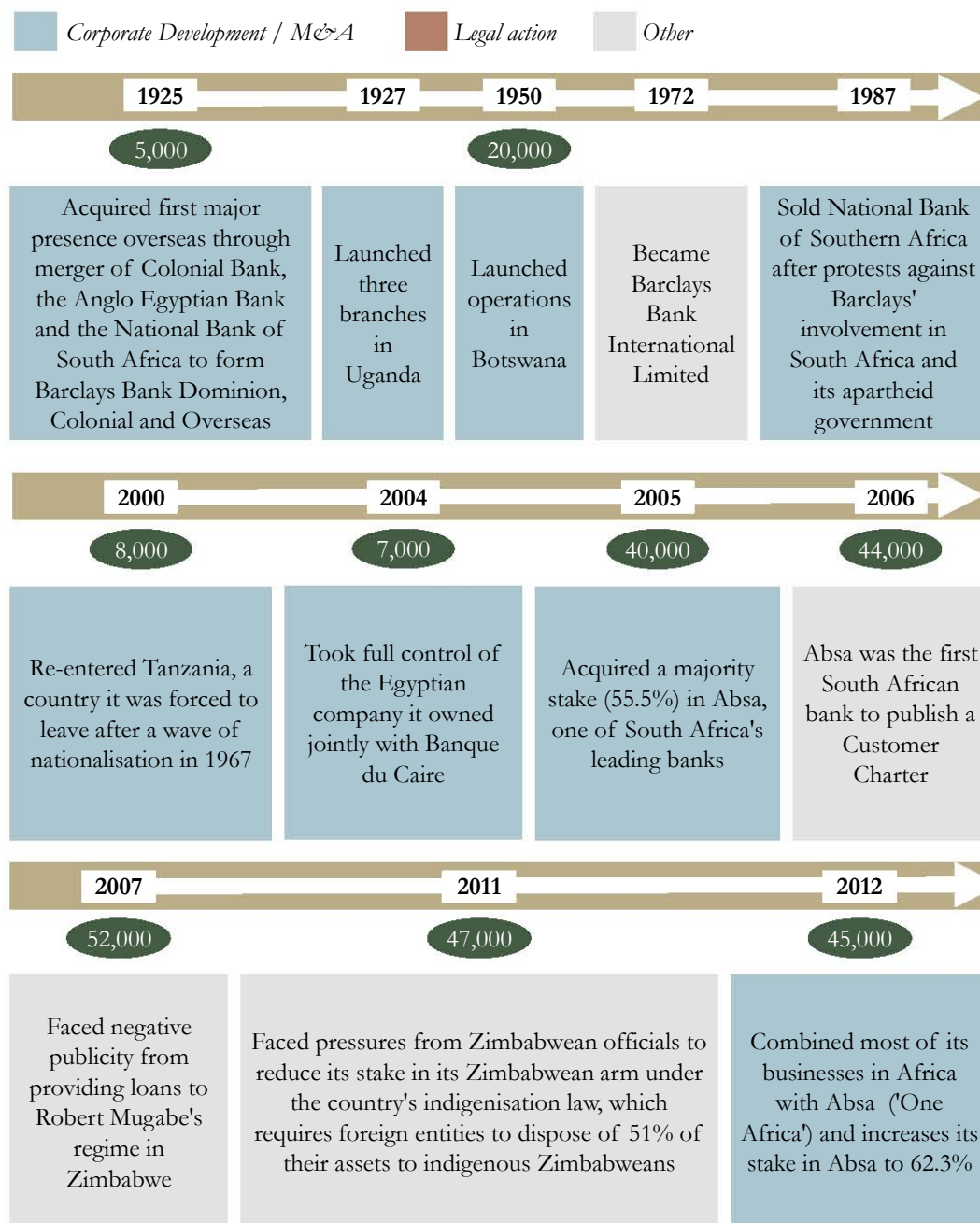


#

Total number of Barclays employees (yearly average)

Employee numbers from Barclays HR data. All yearly average number of employees, except 2012 (end of November), excluding agency and temporary staff.

Barclays' Africa Timeline

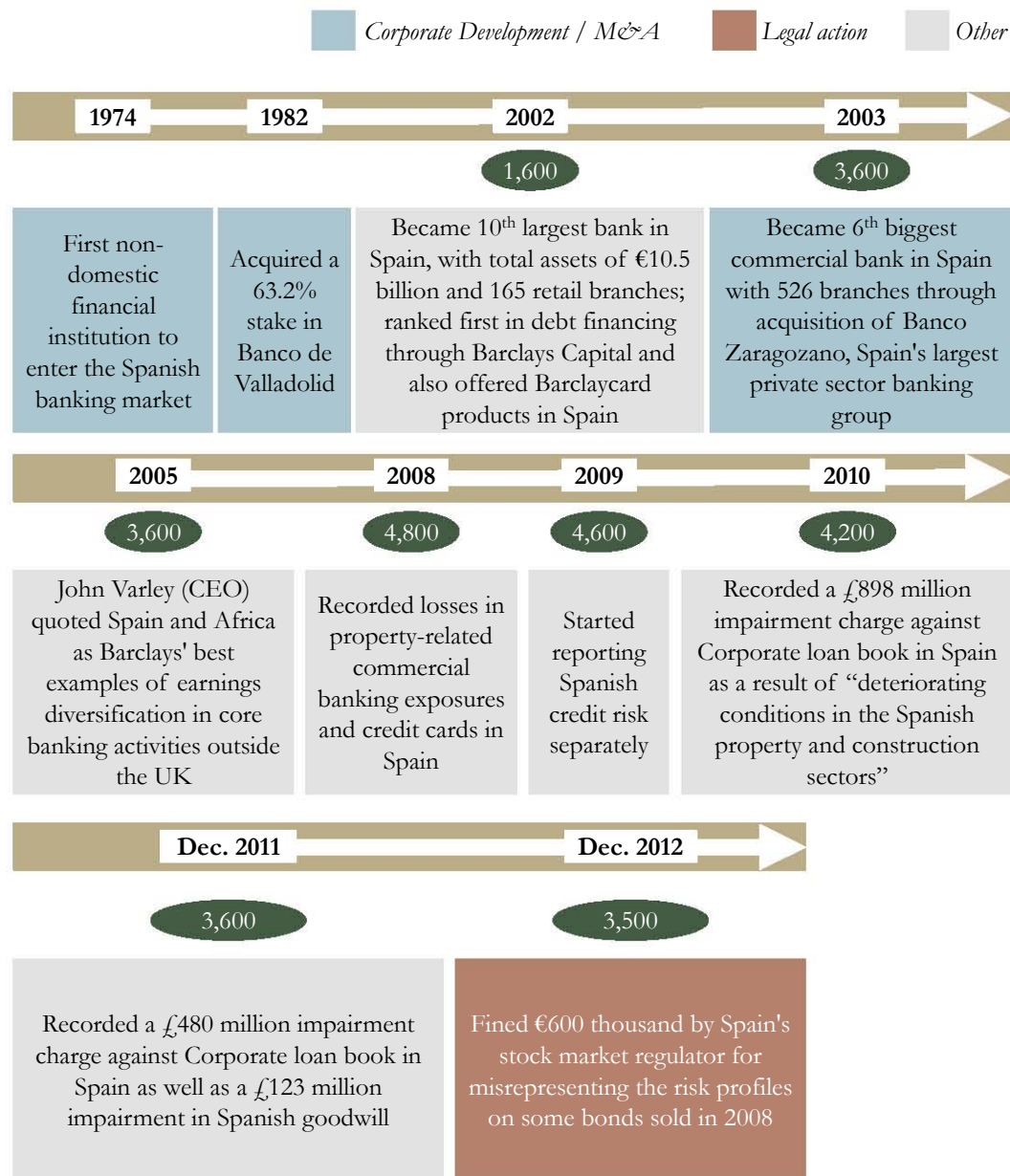


#

Number of Barclays FTEs in Africa

Employee numbers from Barclays HR data. All year-end FTE numbers, except 2012 (end of November); includes part-time staff; excludes interim and agency staff.

Barclays' Spain Timeline

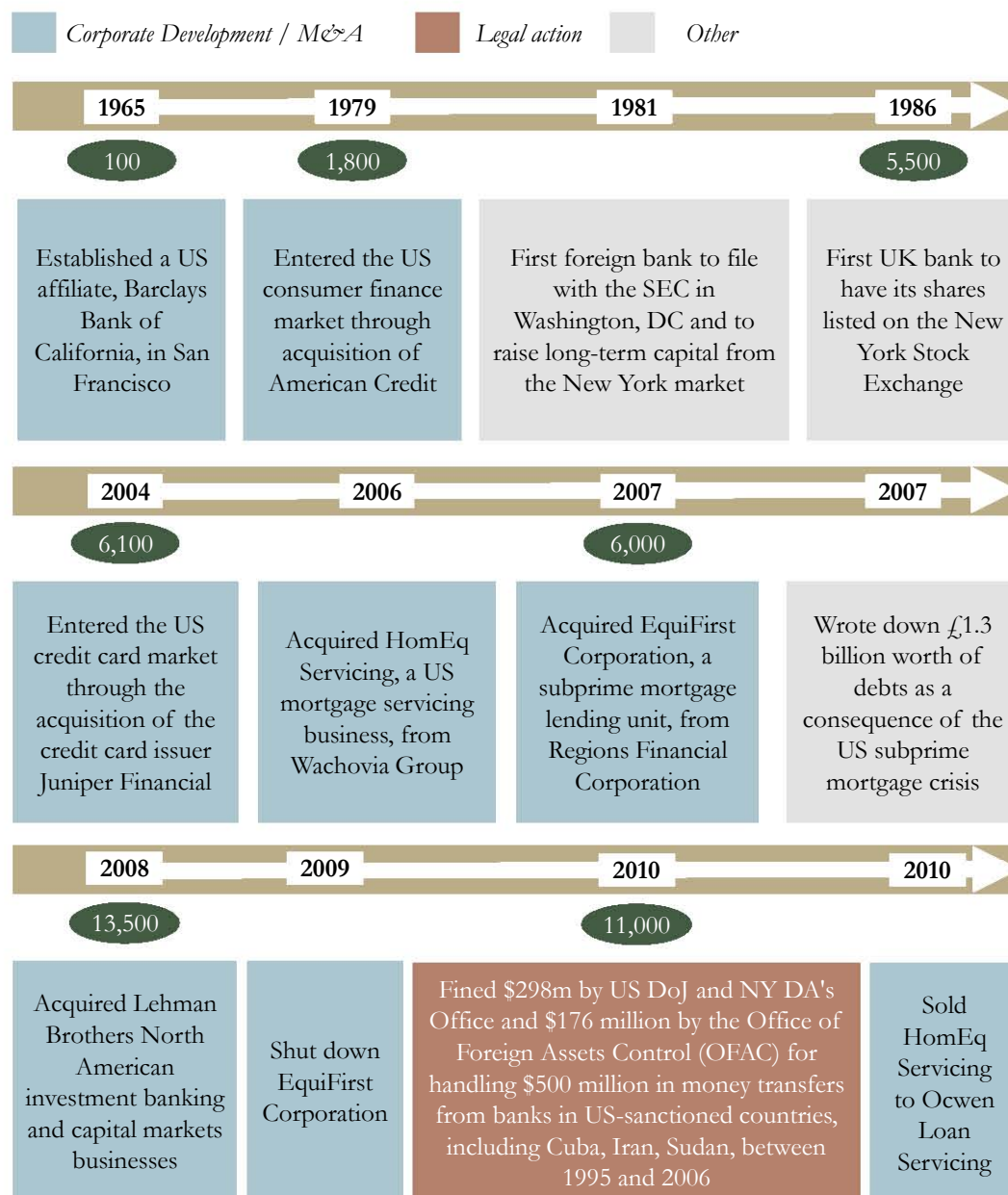


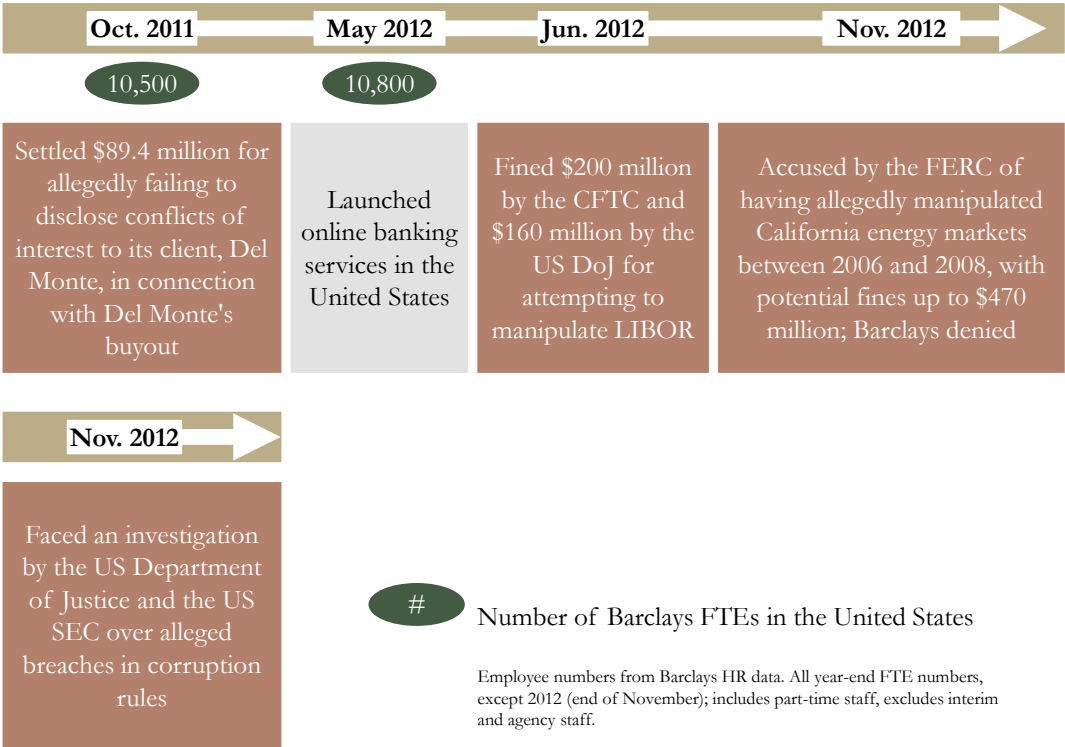
#

Number of Barclays FTEs in Spain

Employee numbers from Barclays HR data. All year-end FTE numbers, except 2012 (end of November). Includes part-time staff, excludes interim and agency staff.

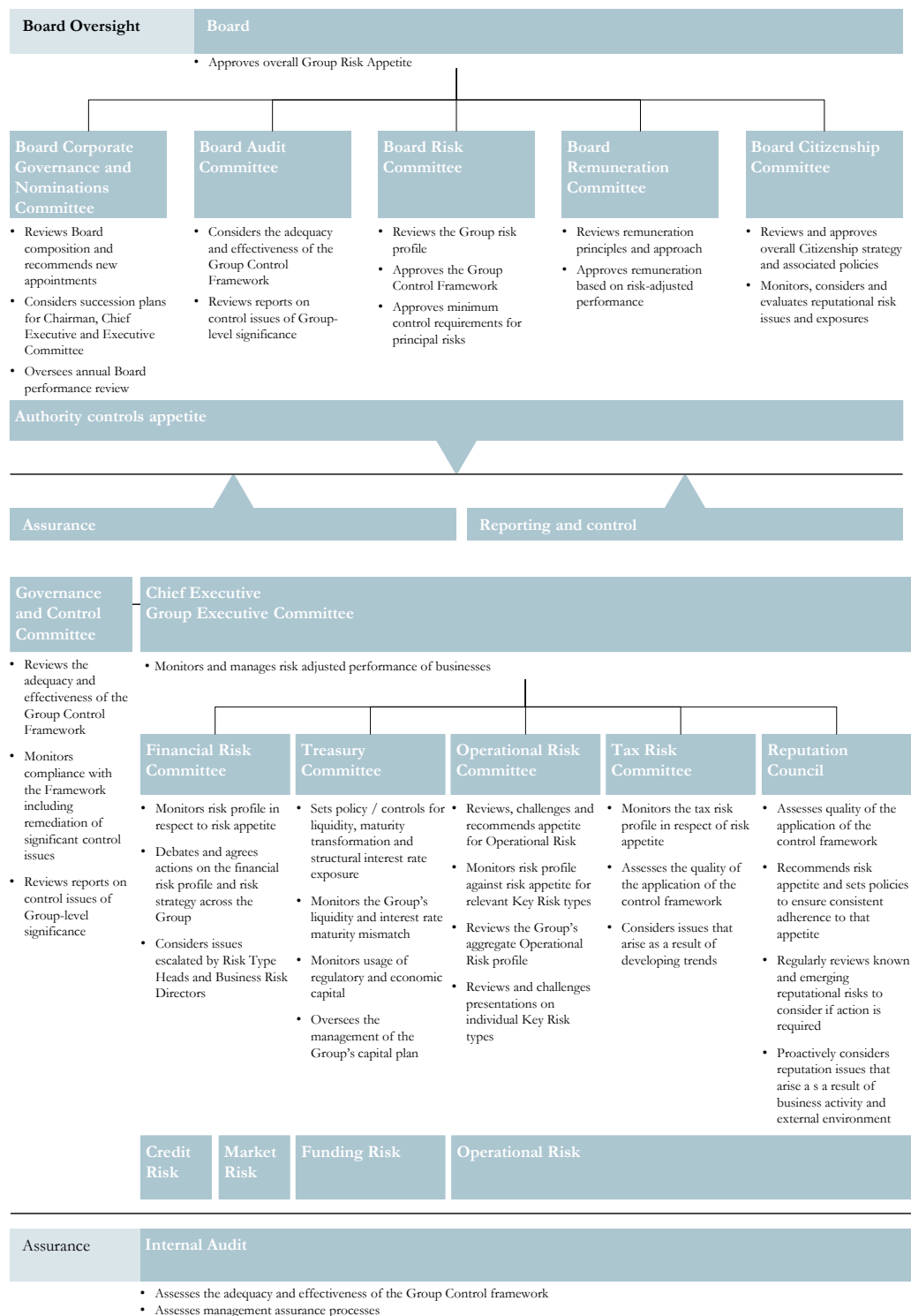
Barclays' US Timeline





Appendix F – Barclays' Governance Structure at Group Level

Below is a diagram of the governance structure of Barclays at Group level as at 31 December 2012.³¹⁰



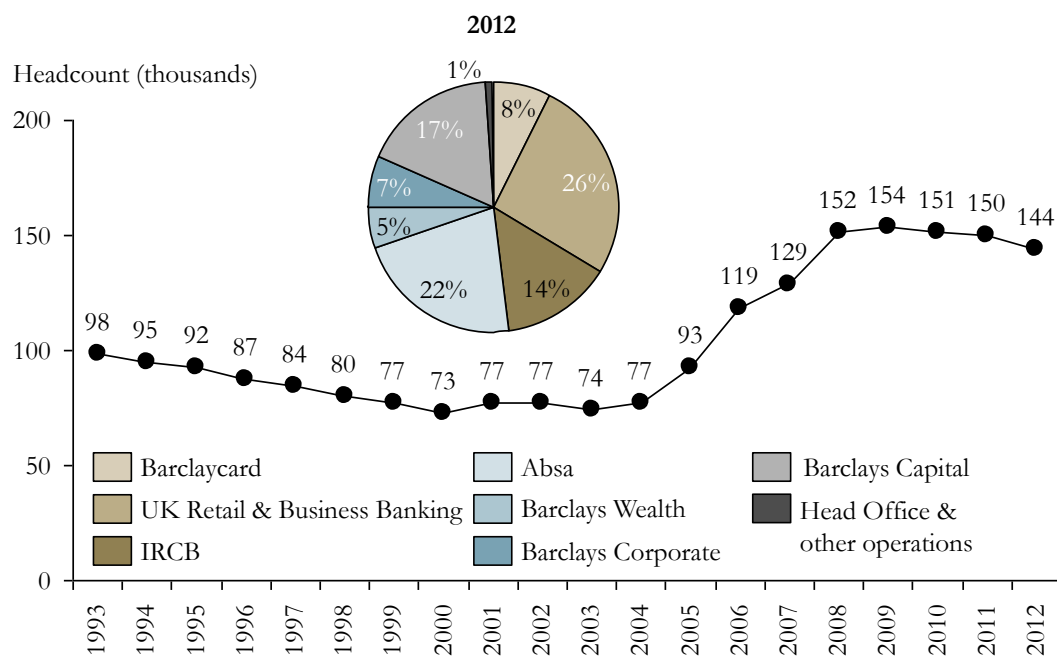
³¹⁰ Barclays, 2012 Annual Return, p. 315.

On 31 January 2013, Barclays renamed its Board Citizenship Committee the Board Conduct, Reputation and Operational Risk Committee, to have oversight of conduct risk, reputation risk and operational risk and to retain its responsibilities for oversight of Barclays' citizenship strategy. Barclays also renamed its Board Risk Committee the Board Financial Risk Committee, to have oversight of credit, market and funding matters. Finally, Barclays created a Board Enterprise Wide Risk Committee, to take an enterprise wide view of risk and controls, including reviewing and agreeing overall risk appetite and monitoring performance.³¹¹

³¹¹ Barclays, *2012 Annual Report*, pp. 27-29.

Appendix G – Barclays' Employees

Barclays' Average Headcount per year, 1993-2012



Notes: Average headcount number, including part-time staff, excluding temporary staff; Average for 2012 computed using nine monthly reports (January to August and November); Number of full-time equivalents as of end 2012 was 139,200; International Retail and Commercial Banking (IRCB) includes Europe RBB and Africa RBB; Barclays Capital includes Absa Capital and EquiFirst; No headcount allocated to Investment Management; Assumes headcount in RBB functions split 55% to UK RBB, 10% to Europe RBB, 5% to Africa RBB and 30% to Barclaycard

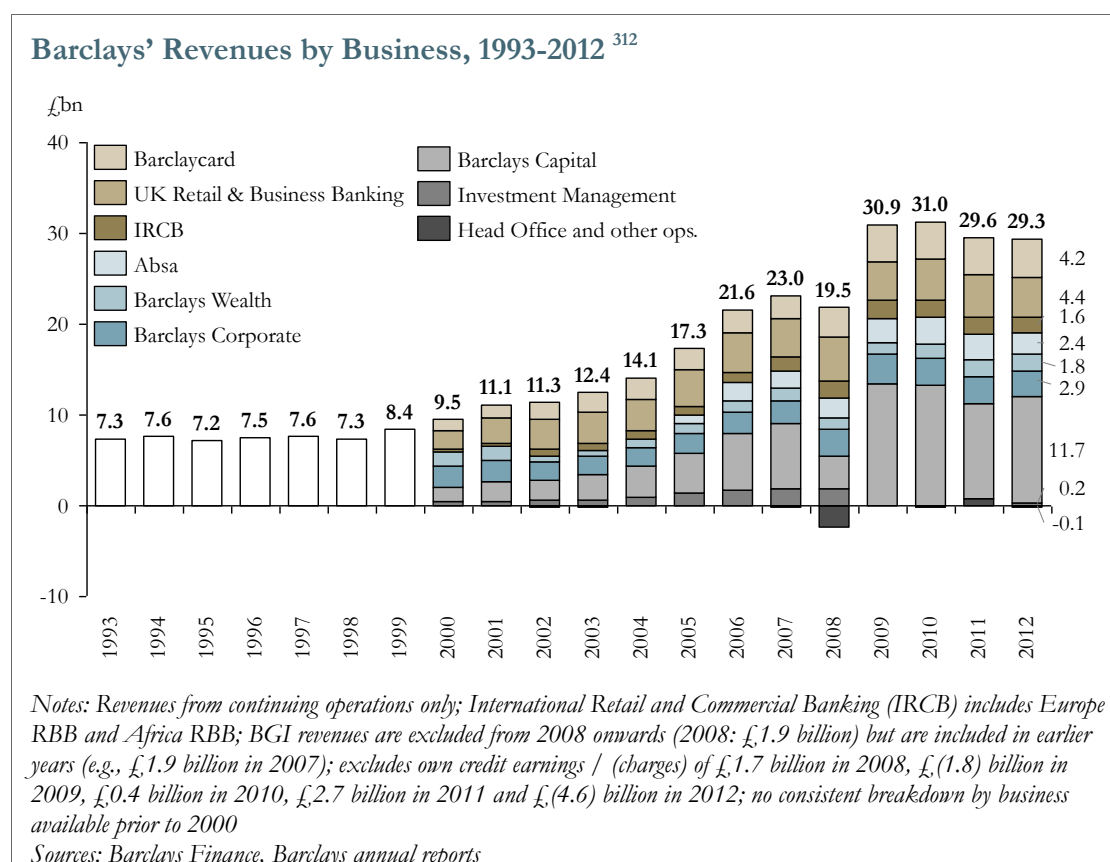
Sources: Barclays HR; Barclays annual reports

Appendix H – Barclays' Financial Evolution

This Appendix includes historical data on Barclays':

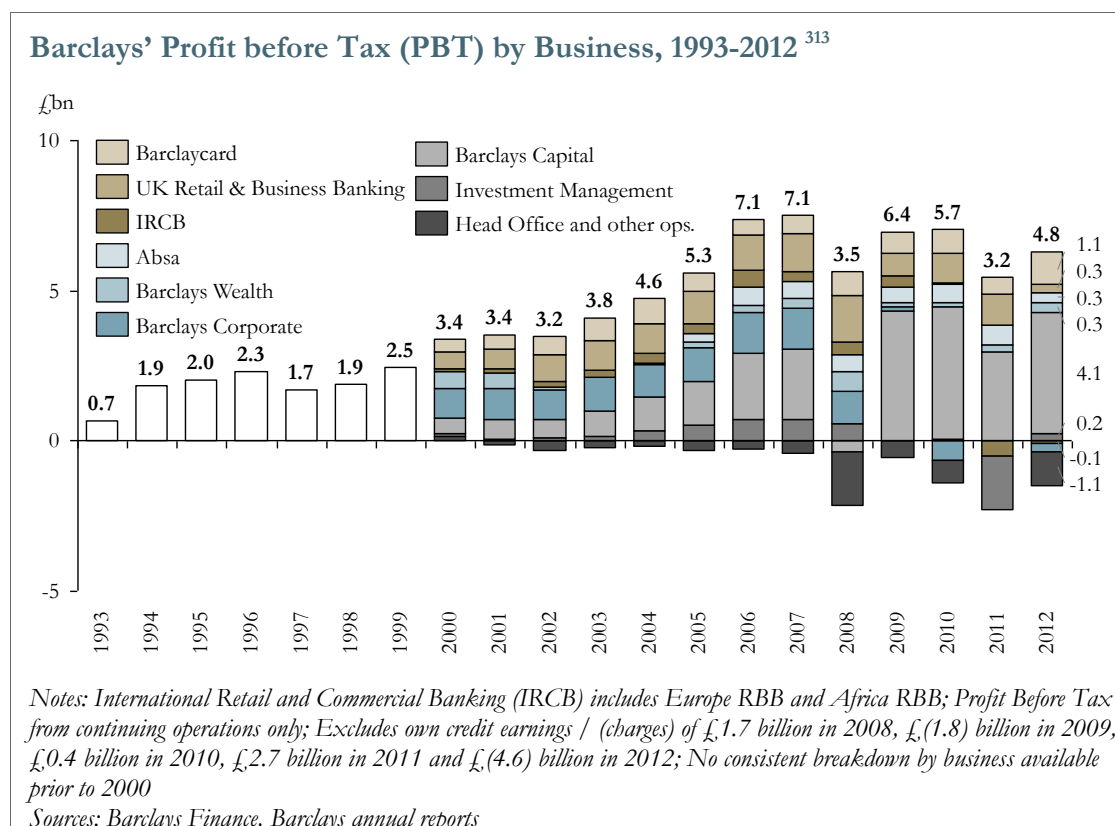
- Revenues by business;
- Profits by business;
- Assets by business;
- Equity and liabilities;
- Deposits and liabilities;
- Regulatory capital;
- Dividend payout ratio;
- Total shareholder return;
- Employee costs; and
- Corporation tax charged.

Revenues by Business



³¹² Excluding own credit.

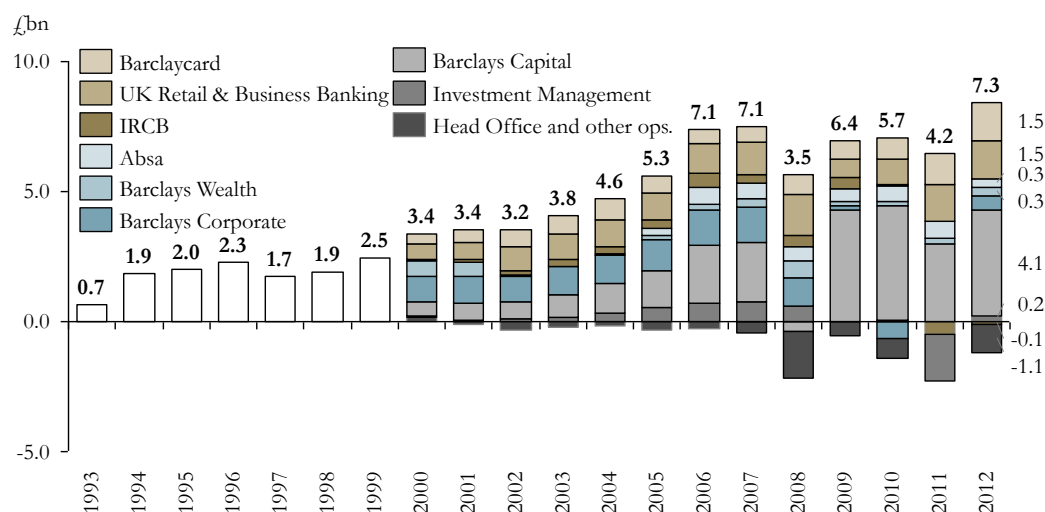
Profits



Caution is needed in analysing revenues, compensation, profit and return ratios at business unit level, as this requires broad, and sometimes bank-specific, assumptions dependent on the organisational structure and transfer pricing arrangements. This is affected, for example, by shared costs incurred at central level, such as group management and IT, or by funding costs, which can also be considered as 'shared', as all business units benefit from the same group-wide credit rating. Finally, revenues from clients or activities can be considered as 'shared' between business units when the product designer and the seller belong to different business units, or the success of one business unit depends on the existence of another.

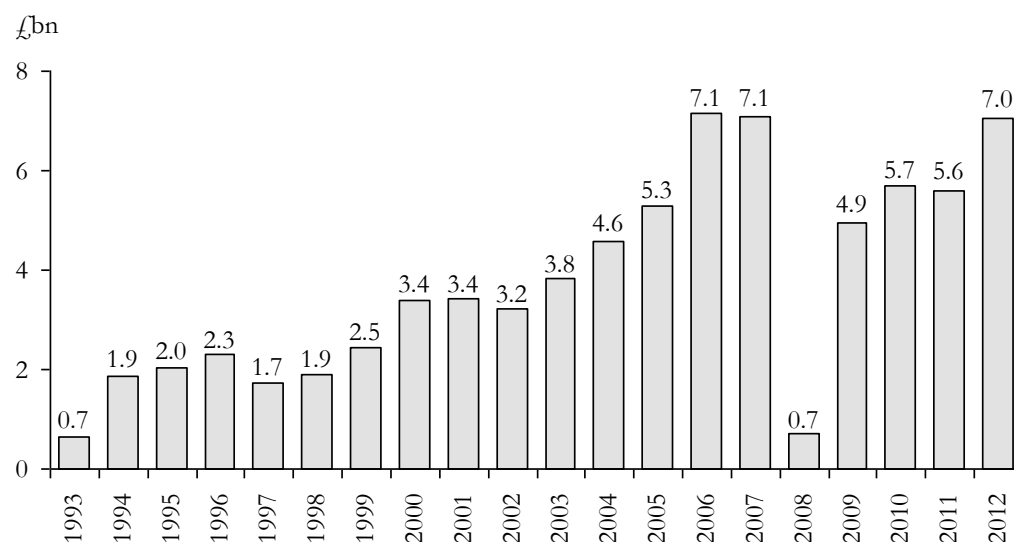
³¹³ Excluding own credit.

Barclays' PBT by Business, 1993-2012³¹⁴



Note: International Retail and Commercial Banking (IRCB) includes Europe RBB and Africa RBB
Sources: Barclays Finance, Barclays annual reports

Barclays' adjusted PBT, 1993-2012

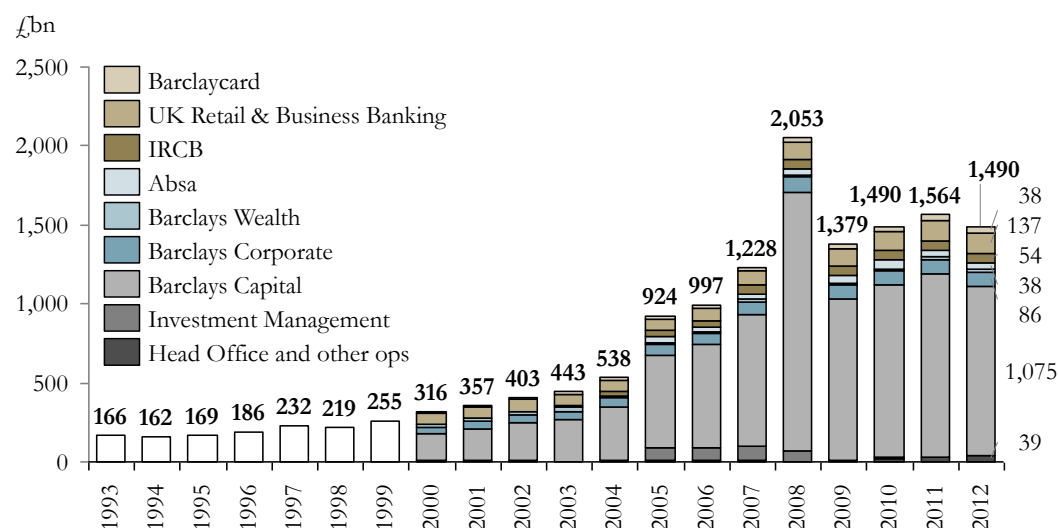


Notes: PBT from continuing operations only; Adjusted PBT excludes the impact of own credit, gains or losses on debt buy-backs, gains or losses on disposal and impairment of BlackRock investment, provision for PPI redress, provision for interest rate hedging product redress, goodwill impairment and gain or losses on acquisitions and disposals; Adjusted PBT is similar to PBT prior to 2008
Sources: Barclays Finance, Barclays annual reports

³¹⁴ Excluding own credit, PPI and SME derivatives redress provisions.

Assets by Business

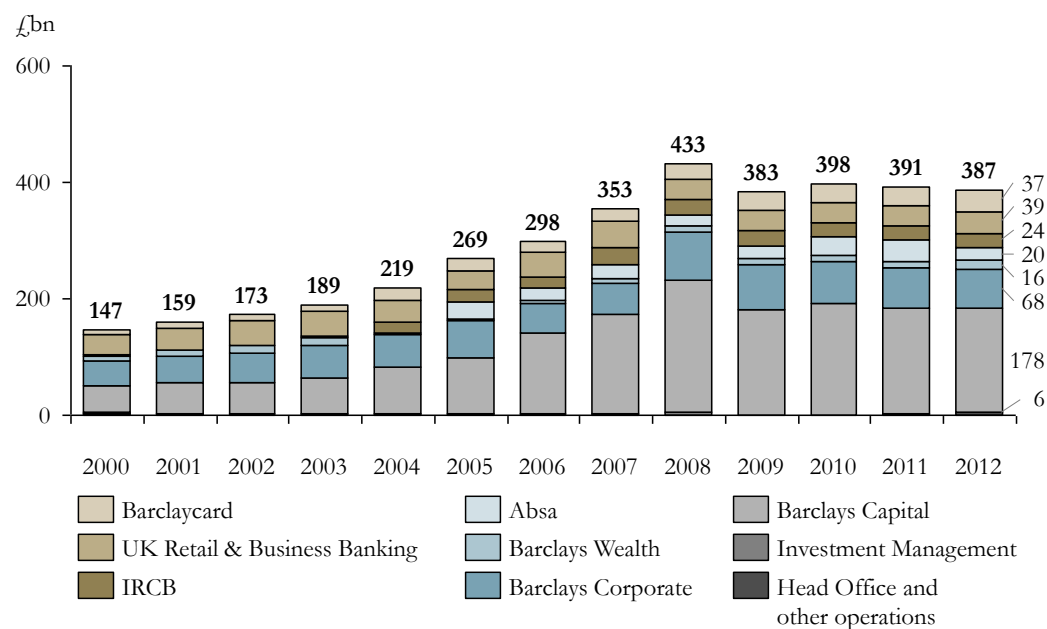
Barclays' assets by business, 1993 – 2012



Notes: International Retail and Commercial Banking (IRCB) includes Europe RBB and Africa RBB; No consistent breakdown by business available prior to 2000

Sources: Barclays Finance, annual reports

Barclays' risk-weighted assets by business, 2000 – 2012

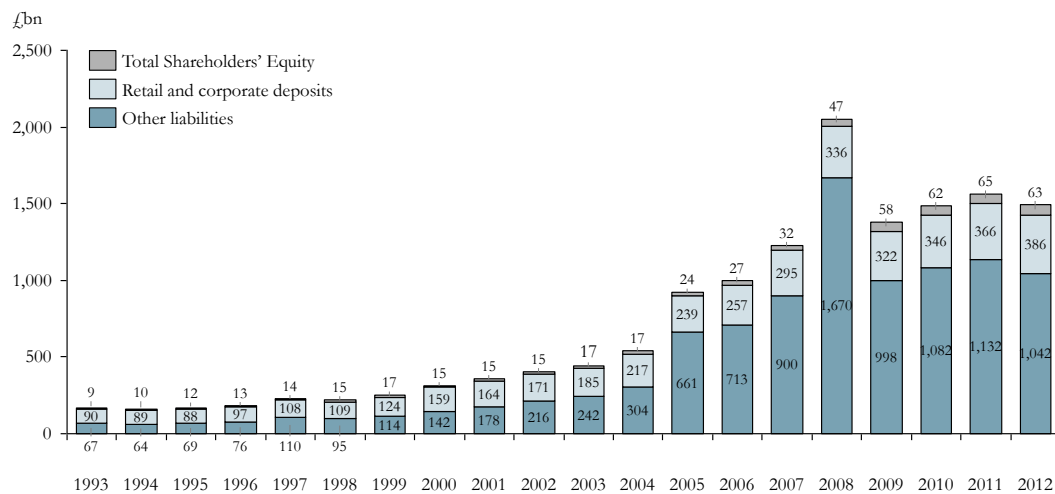


Note: International Retail and Commercial Banking (IRCB) includes Europe RBB and Africa RBB

Source: Barclays Finance

Equity and Liabilities

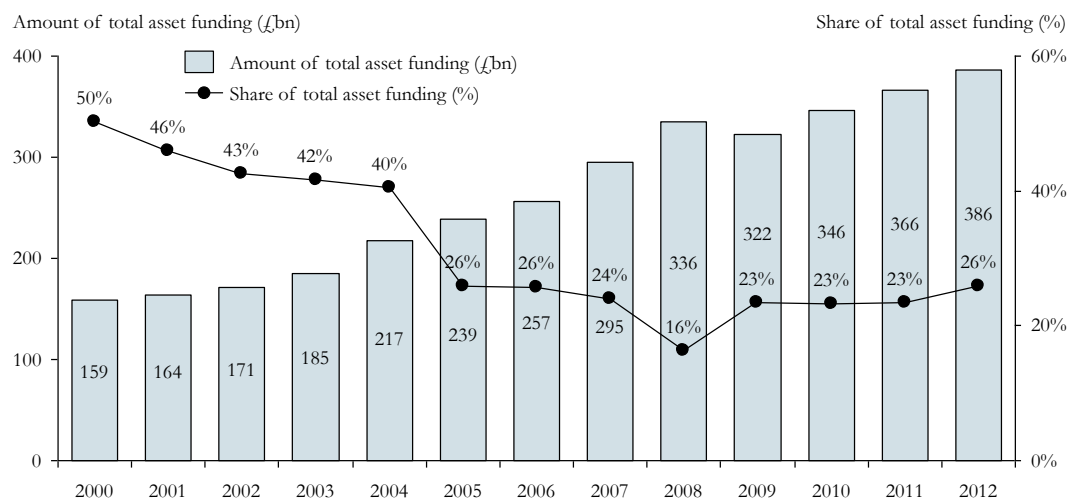
Barclays' total shareholders' equity and total liabilities, 1993 – 2012



Source: Barclays annual reports

Deposits and Liabilities

Barclays' liabilities attributable to customer accounts – Amount and share of total asset funding, 2000 – 2012



Note: Customer accounts include both retail and corporate customers

Source: Barclays annual reports

Regulatory Capital

Barclays' tier 1 regulatory capital ratio has varied over the last decade, from 8.2% in 2002, to 7.6% in 2007 and 13.3% in 2012. A significant restructuring of the balance sheet (increasing shareholders' equity and reducing the total balance sheet size) led to a significant increase in capital ratios in 2009.

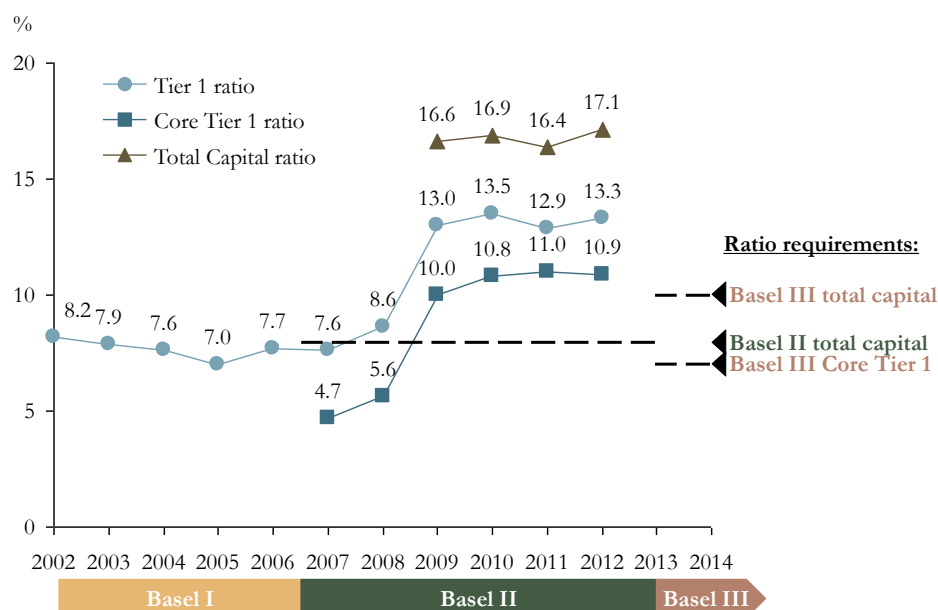
There has been considerable debate concerning bank regulatory capital ratios, which are recommended by the Bank for International Settlements or Basel Committee on Banking Supervision and implemented by national regulators. In the European Union, these are translated into Capital Requirements Directives.

Under the original Basel I Accord from 1988, banks were required to have a capital ratio (percentage of capital to risk weighted assets) of 8%, of which core capital (tier 1) had to be 4%. Assets were weighted according to relatively simple rules, such as 20% for OECD governments, 50% for residential mortgages and 100% for other assets. Tier 2 capital comprised certain reserves, hybrid capital investments and subordinated debt.

Basel II then required the capital ratio to be no lower than 8%, divided into two tiers, and required banks to have a minimum level of common equity (2%) and tier 1 capital (4%). It came into force at various dates. Basel II attempted to adjust risk weighted assets based on credit, market and operational risk. Banks could use, subject to regulatory consent, advanced measurements based on their own models or standardised (non-modelled) approaches. Basel II also mandated more disclosures.

Basel III, when fully implemented, will introduce a number of important changes to strengthen the quality and quantity of capital, including more capital for counterparty risk and derivatives, procyclicality and capital conservation buffers and other liquidity and funding ratios. Originally, it required an increase by 2015 in common equity from 2% to 4.5% (plus a capital buffer of 2.5% to total 7%), and tier 1 capital increased from 4% to 6% (plus other capital buffers). The minimum total capital ratio remained at 8% (plus capital buffers). The EU is currently working on Capital Requirement Directive IV to implement Basel III, plus changes to corporate governance and remuneration.

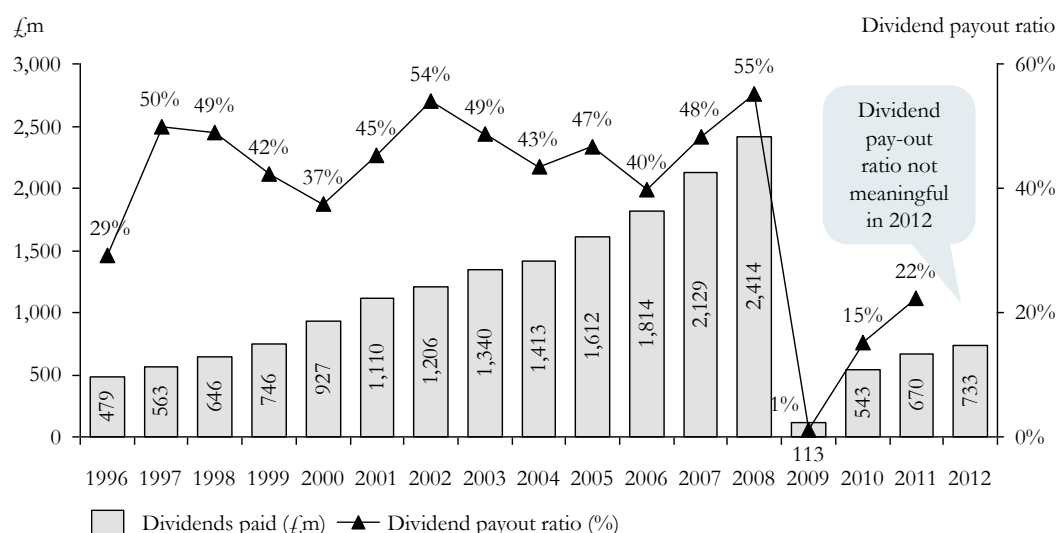
Barclays' capital ratios and illustrative requirements, 2002 – 2012



Note: For global systemically important banks, such as Barclays, an additional loss absorbency requirement, which could consist of either equity, non-equity capital or highest quality loss absorbing debt, will be phased in starting from 2016
Sources: HM Treasury, Banking reform: delivering stability and supporting a sustainable economy, 2012; Barclays annual reports

Dividend Payout Ratio

Barclays' dividends paid to equity holders of the parent company and payout ratio, 1996-2012

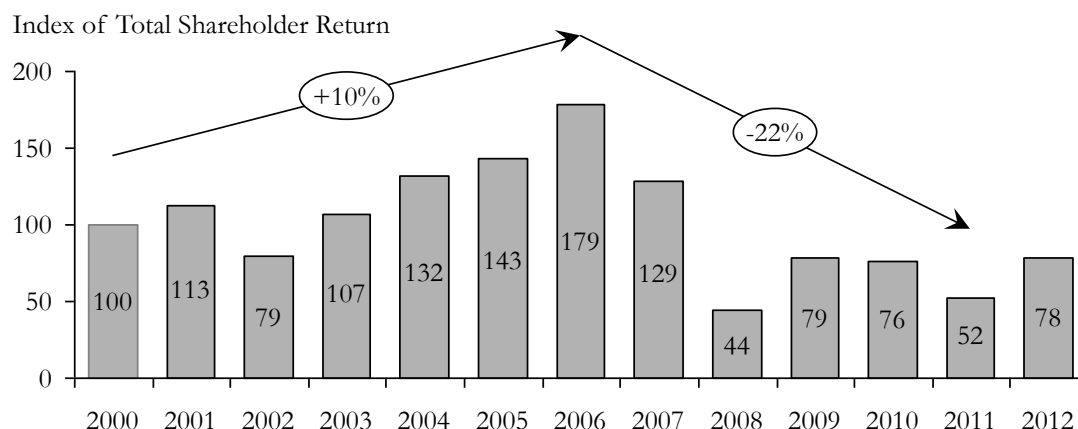


Notes: Payout ratio computed as dividends divided by profit for the year attributable to equity holders from the parent; Dividend payout ratio not meaningful in 2012 as profit for the year attributable to equity holders from the parent was negative; Dividends booked according to UK GAAP for years 1996 to 2003
Source: Barclays annual reports

Total Shareholder Return

Total Shareholder Return (TSR) is publicly used by Barclays as a way to measure value created for shareholders. Until 2006, Barclays created significant value for its shareholders: £100 invested in Barclays' shares at the end of 2000 would have been worth £179 at the end of 2006 as the sum of the share price at the time and accumulated dividends, representing a compound annual growth rate of 10%. Nonetheless, this has been reducing value since then, as the same shares would be only worth £78 at the end of 2012.

Index of Barclays' TSR, 2000 – 2012



Note: Index of TSR represents the year-end value (in £), as the sum of the share price at the time and accumulated dividends, of £100 invested in Barclays shares at the end of 2000

Source: Annual reports

Barclays' share price evolution, 2002 – 2013

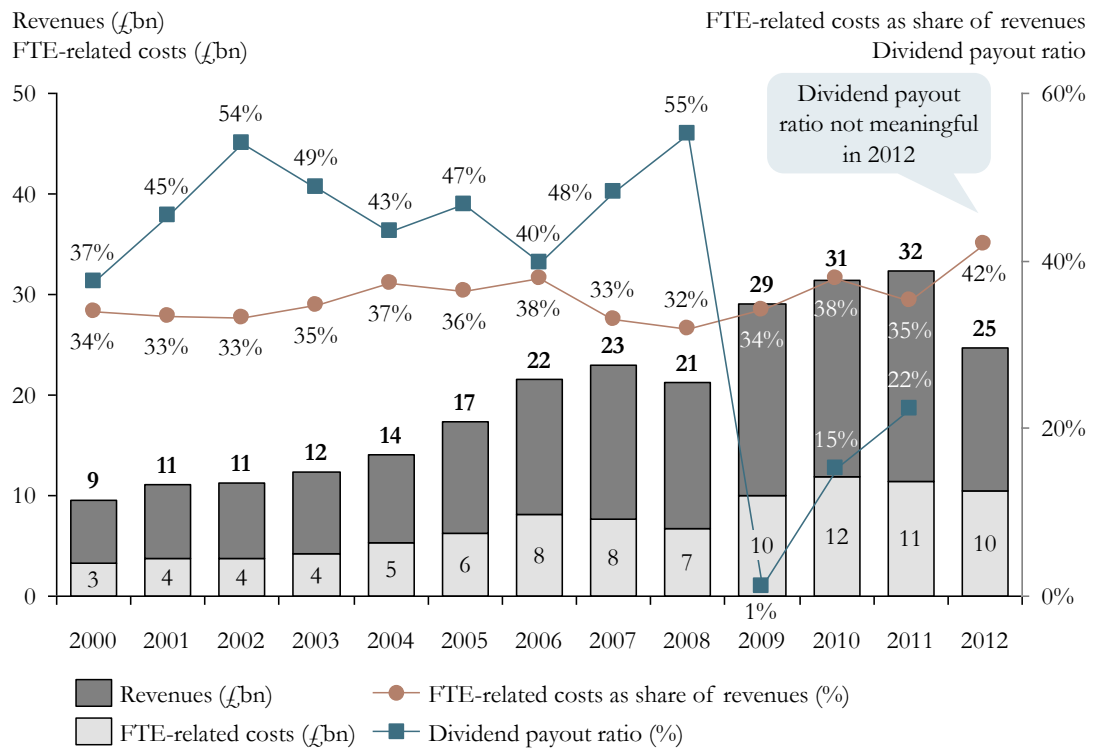


Note: Closing price per share; Latest date considered is 18 March 2013

Source: Bloomberg

Employee Costs

Revenues, FTE-related costs (total amount and shares of revenues) and dividend payout ratio, 2000 – 2012

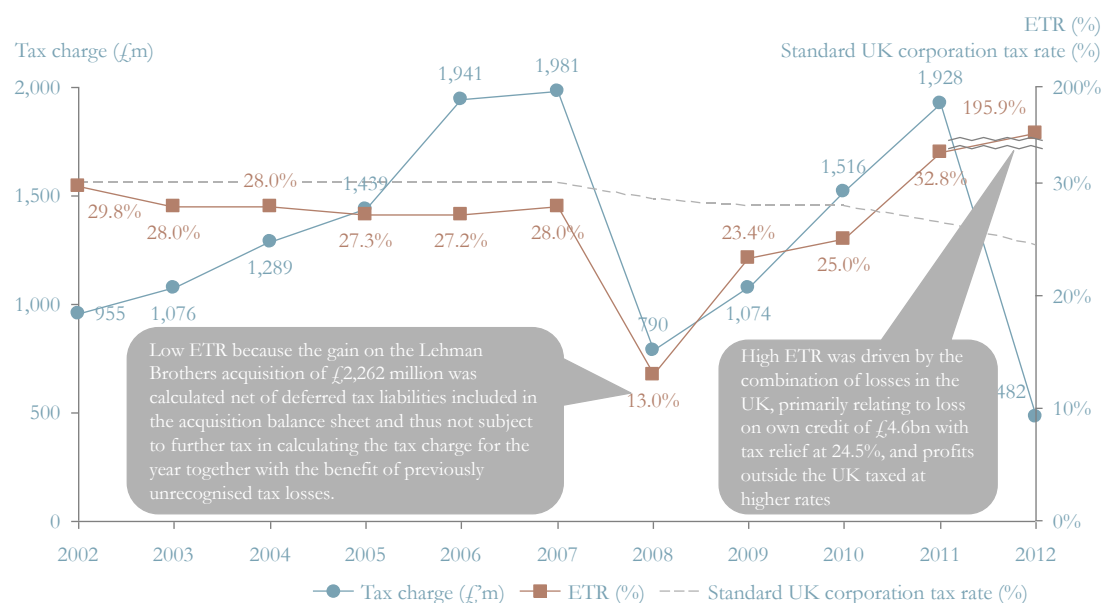


Notes: FTE-related costs include performance costs (bonuses), salaries, other share based payments, training, redundancy, recruitment, social security costs, post-retirement benefits and bank payroll tax; Payout ratio computed as dividends divided by net income available to common shareholders; 2012 pay-out ratio not meaningful in 2012 as net income available to common shareholders was negative; Dividends booked according to UK GAAP for years 2000 to 2003

Sources: Barclays Finance, Barclays annual reports

Corporation Tax Charge

Barclays' tax charge, effective tax rate (ETR) and standard UK corporation tax rate, 2002 – 2012



Notes: Effective corporation tax rate is defined as tax charged in profit & loss account divided by Profit Before Tax; Amounts exclude taxes included in PBT such as bank levy, bank payroll tax, irrecoverable VAT and employer's social security costs; Barclays' cash tax paid on income and profits globally was £1,458 million in 2010, £1,686 million in 2011 and £1,516 million in 2012, including UK corporation tax of £147 million in 2010, £296 million in 2011 and £82 million in 2012

Sources: Barclays annual reports, Barclays Finance

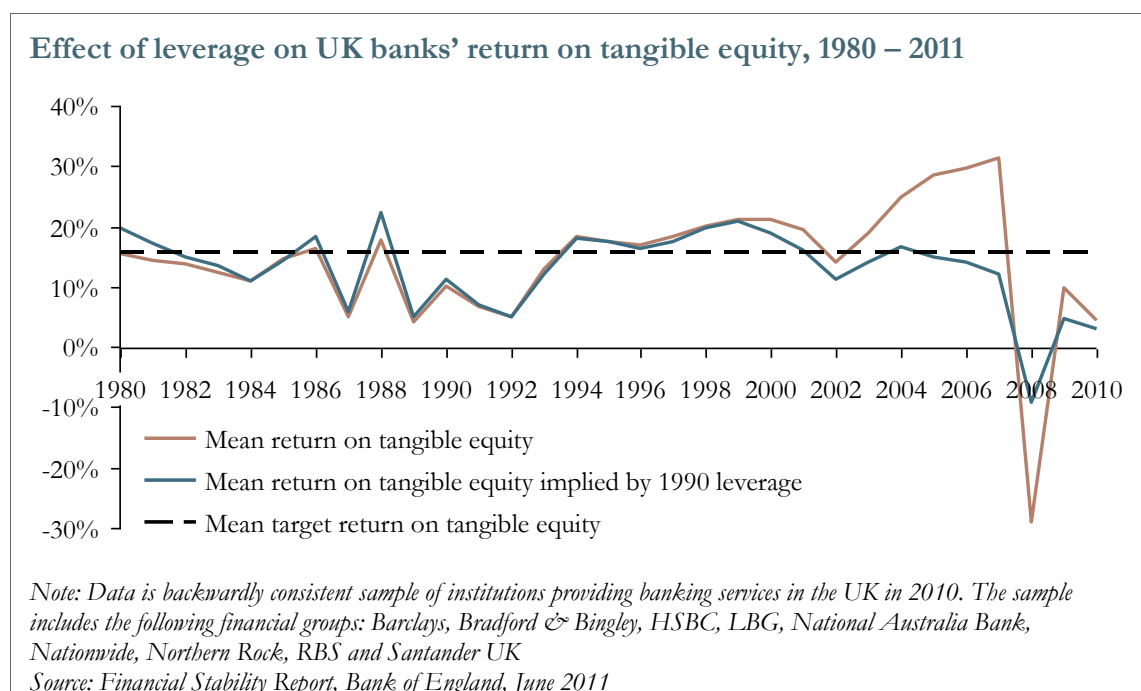
Appendix I – Selected Bank Financial Ratios

Leverage

'Leverage' is a capital ratio commonly used to compare banks' capital structure. Leverage is defined as the corporation's total assets (or sometimes risk weighted assets) divided by the amount of equity (or sometimes regulatory capital) used to support it.

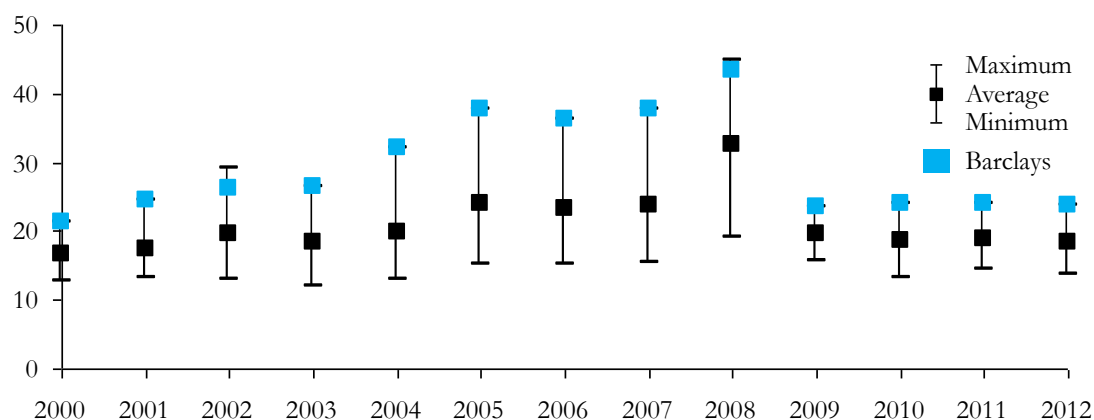
Over the decade to the financial crisis, banks have been inclined to increase their leverage. Commentators have argued that this occurred for a number of reasons, including taking advantage of rising asset prices to meet shareholders' rising return on equity expectations and also because Basel II capital rules permitted more leverage. A study from the Financial Stability Committee³¹⁵ indeed shows that, if the aggregate banks' leverage had been constant at the average 1990s level of around 25 times, banks would have achieved their new target levels of return on tangible equity (RoTE) in fewer than half of the past thirty years and not once since 2004. 'Excessive' banks' leverage, combined with increased wholesale funding, has often been quoted as one of the core root causes of the current financial crisis.

During this period covered by this Review, Barclays was one of the most highly leveraged UK banks. Its leverage rose from around 20 in 2000 to more than 37 in 2007, and this increased to 43 when the financial crisis hit in 2008, making it the most highly leveraged UK bank in those years. In 2012, Barclays' leverage fell back to 24, but was still the highest among the major UK banks.



³¹⁵ See: Bank of England, interim Financial Policy Committee, *Financial Stability Report*, June 2011, p. 36.

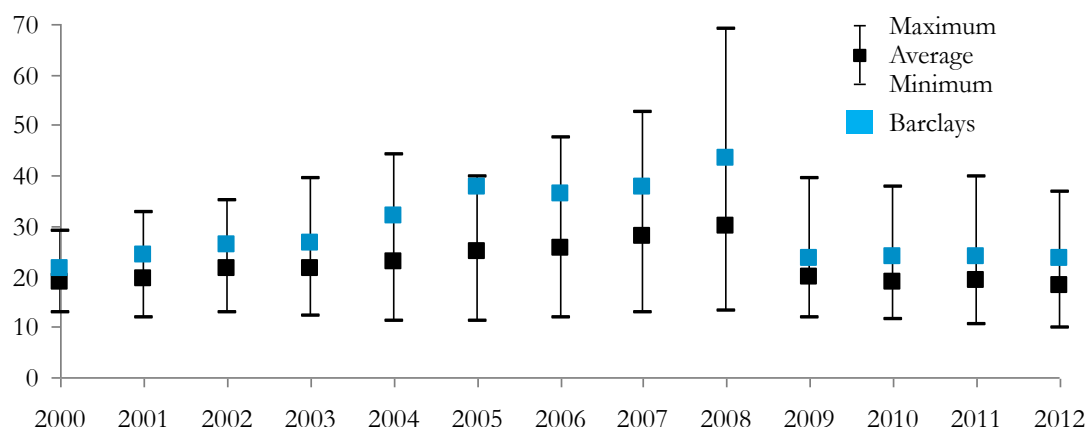
UK banks' leverage (assets / equity) evolution, 2000 – 2012



Note: Banks in sample are HSBC, Lloyds, Standard Chartered, RBS and Barclays

Source: Annual reports

UK and international banks' leverage (assets / equity) evolution, 2000 – 2012



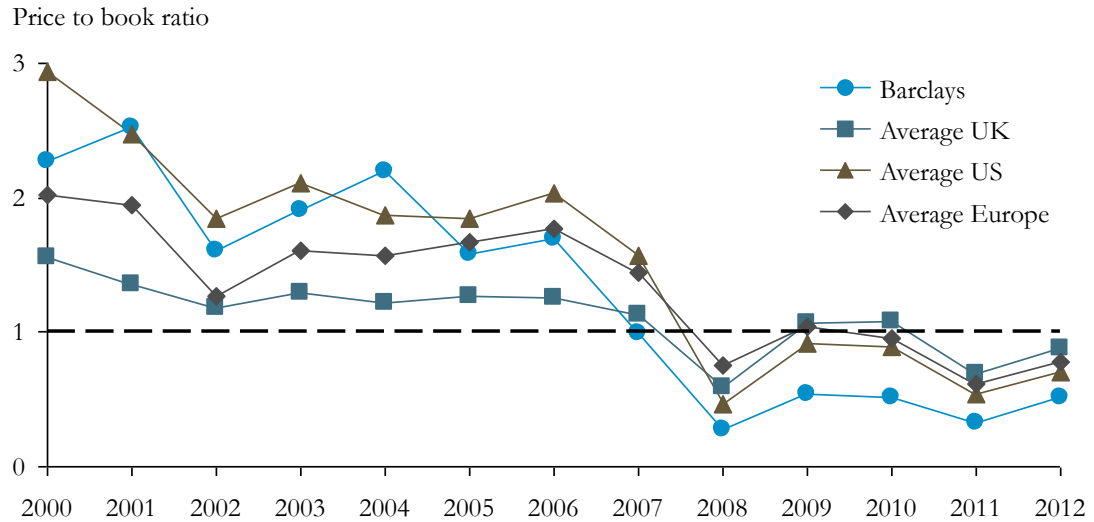
Note: Banks in sample are Citigroup, Goldman Sachs, JP Morgan, Morgan Stanley, RBS, Credit Suisse, Deutsche Bank, HSBC, Lloyds, Standard Chartered, UBS and Barclays. Care must be taken when comparing leverage ratios between financial institutions in different jurisdictions, as rules for netting assets and liabilities may differ

Source: Annual reports

Price to Book Ratio

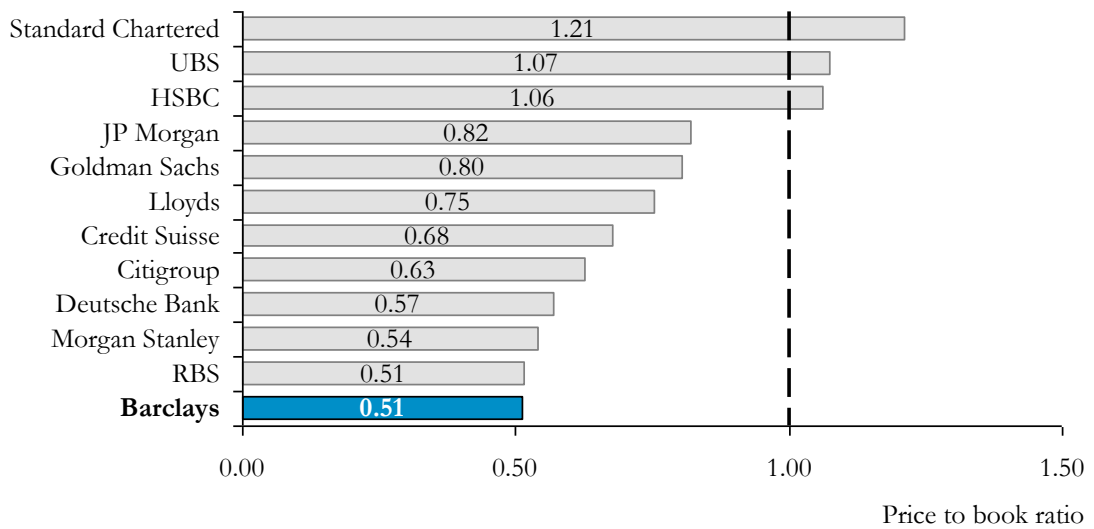
For banks, the ratio of market share price divided by the book value per share is often used as a measure of the value shareholders ascribe to the bank compared to the value of the net assets of the bank in its accounts. If the ratio is below one, then there is a discount being applied. Major financial institutions' price to book ratio dropped significantly between 2000 and 2008. Barclays' ratio has been below the vast majority of its peers' and has been less than 1 since 2008. At the end of 2012, Barclays' price to book ratio was 0.51, lower than all other major financial institutions considered.

Historical price to book ratios of major financial institutions by geographical area, 2000 – 2012



Notes: UK sample includes RBS, HSBC, Lloyds and Standard Chartered; US sample includes Citigroup, Goldman Sachs, JP Morgan and Morgan Stanley; European sample includes Credit Suisse, Deutsche Bank and UBS
Source: Annual reports

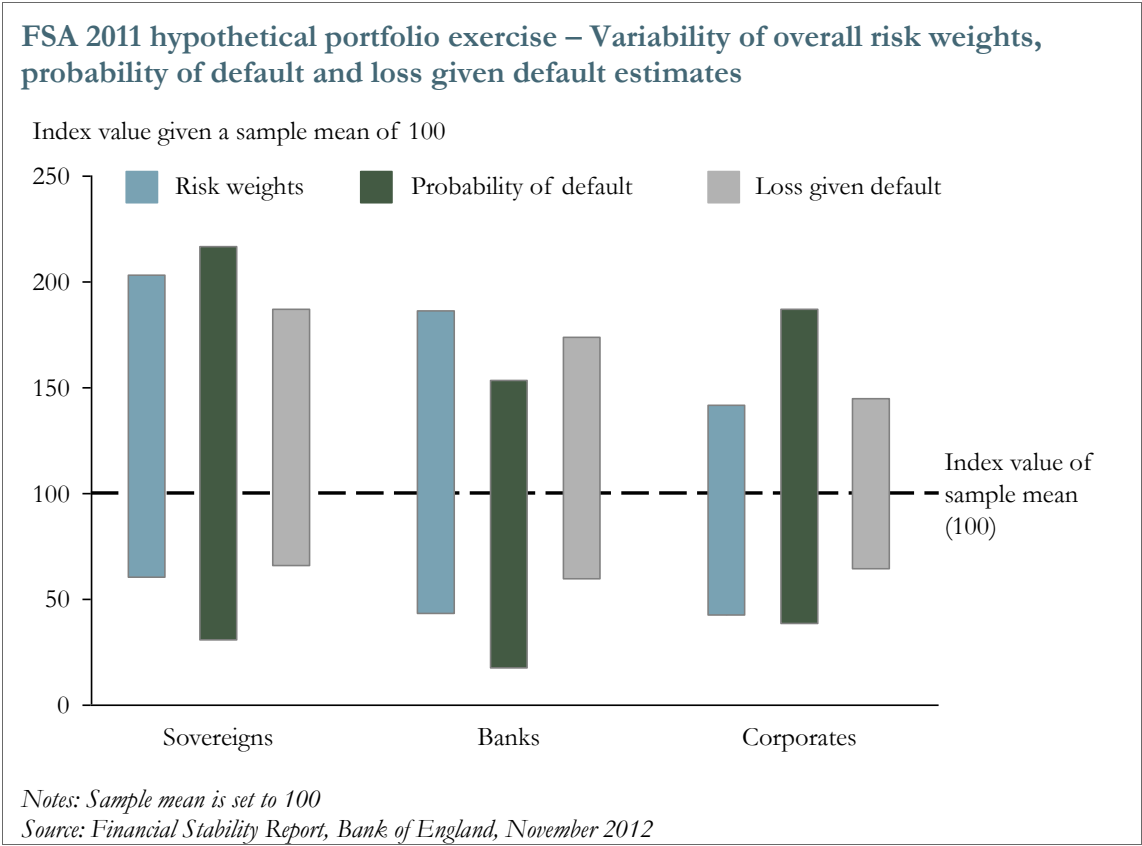
Price to book ratios of major financial institutions, 2012



Source: Annual reports


Appendix J – Variability in Risk Weighted Assets Calculations

Differences in RWA calculations can be explained either by differences in intrinsic portfolio risk and asset quality or by differences in banks’ internal models. To distinguish between those two factors, the FSA conducted over time multiple exercises in which banks applied their internal models to three hypothetical portfolios (respectively sovereigns, banks and corporates). The latest of these exercises was undertaken in 2011 and shows a high-level of variability in banks’ estimates for overall risk weights, probability of default and loss given default. For instance, for the same portfolio, estimated capital requirements for the most ‘prudent’ banks were more than three times higher than the most ‘aggressive’ banks. Consequently, the difference in risk weights translates into differences in capital ratio computations.



Appendix K – Correspondence between Lord Turner and Marcus Agius³¹⁶

Financial Services Authority



Marcus Agius
Chairman
Barclays Bank PLC
One Churchill Place
London
E14 5HP

10 April 2012

Our Ref: CW

Dear Marcus

As promised, this letter follows up our recent meeting and sets out FSA concerns relating to aspects of Barclays' approach to regulatory and other issues.

Obviously where we have specific areas of concern which merit it, our Supervisory Team will directly make those concerns known at the appropriate level, and require any appropriate action in response. The purpose of my meeting with you was therefore not to focus on any one specific issue which requires remedial action. Rather I wished to bring to your attention our concerns about the cumulative impression created by a pattern of behaviour over the last few years, in which Barclays often seems to be seeking to gain advantage through the use of complex structures, or through arguing for regulatory approaches which are at the aggressive end of interpretation of the relevant rules and regulations. Andrew Bailey also expressed these concerns at your Board meeting on 9th February.

The specific examples which I mentioned at our meeting included two examples which I accept are 'old news', but also four relating to recent events.

Old news

I cited two examples.

- The development of the Protium structure in 2009 which, although not delivering Barclays any regulatory capital advantage, and while within accounting rules, was perceived by many external commentators as a convoluted attempt to portray a favourable accounting result.
- The approach to the valuation of monoline CVA positions which became apparent in FSA analysis in early 2009, and which showed Barclays choosing valuations clearly at the aggressive end of the acceptable spectrum.

Financial Services Authority
 25 The Quadrant, Canary Wharf, London E14 5HS, United Kingdom
 Telephone: +44 (0)20 7066 1000 Fax: +44 (0)20 7066 1099
www.fsa.gov.uk

³¹⁶ Redactions were inserted by Barclays in the documents provided to the Treasury Select Committee.

More recent events

Examples I cited were:

- Our concern that in the run up to the latest year-end, Barclays was not fully transparent with us about the RWA impacts of a proposed extension of model approaches (AIRB and IMM) applied in Barclays Capital Inc. Ultimately, we felt that the need for us to unpick the real impact of these proposed changes caused unnecessary friction and burdened our internal processes.



- Protracted communication between ourselves and Barclays about your desire to move index hedges of own credit from the trading book to the banking book, with the impact of materially reducing RWAs. In this case, after the initial outcome was not resolved in Barclays' favour, our team felt that Barclays continued to argue for capital optimisation in a way which inefficiently used up our resource and goodwill.
- The confusing and potentially misleading impression created by Barclays' initial presentation of its position under the EBA stress tests, which appeared to be an attempt to leave FSA senior management with the impression that Barclays would be above the then intended 10% CTI threshold, whereas at the relevant date of September 2011 it was actually at 9.8%. In fact given that the eventually chosen 'pass mark' was 9%, this did not turn out to be of crucial importance. But it nevertheless left our senior management with an impression that Barclays were seeking to 'spin' its messages in an unhelpful fashion.

I also mentioned at our meeting the recent publicity in relation to Barclays UK tax management. I recognise that since adequate provisioning had been put in place, this was not a regulatory issue per se. But as I know you recognise, and whatever the extent of advice which Barclays received in advance, the net impact has clearly been unfavourable to the degree of external trust in Barclays' approach to issues such as tax, regulation and accounting.

Clearly these examples vary in both currency and importance. And it is of course acceptable for a bank to argue for a favourable approach on any one specific issue, even if the regulator does not immediately agree. But the cumulative effect of the examples set out above has been to leave us with an impression that Barclays has a tendency continually to seek advantage from complex structures or favourable regulatory interpretations. These concerns are sufficiently great that I felt it was appropriate to communicate them directly to you, and to urge you and the Board to encourage a tone of full co-operation and transparency between all levels of your Executive and the FSA.

I know from our conversation that you take these issues seriously.



Yours sincerely,
Adair

Adair Turner

Enc.



Marcus Agius
Chairman

Lord Turner
Chairman
Financial Services Authority
25 The North Colonnade
London
E14 5HS

18 April 2012

Dear David,

Thank you for your letter of 10 April, 2012.

It is a matter of regret for us that you have the concerns outlined in your letter. Barclays has invested significant effort and time in building and improving its relationship with the FSA. It is very important to us to have a strong, open, cooperative and transparent relationship with the FSA and with all of our regulators globally. The Board and I took note of Andrew Bailey's comments in our February meeting and, while he specifically excluded Bob Diamond and Chris Lucas from his comments, it was clear that "tone from the top" is one of the FSA's concerns. Our objective is and has always been to have a strong and mutually beneficial relationship with the FSA and you have my commitment that we will work harder in the future to procure this outcome.

Your letter notes six examples of areas of concern to the FSA and without wanting to prolong the debate on these, I do feel the need to make one or two comments in relation to these specific points.

- With regard to Protium, I believe this has been discussed exhaustively. As you know, we reconfirm that our objective at the time was to change the repayment profile and maximize shareholder value. As it turned out, this is exactly what occurred. As you note, this was done within accounting rules and with no regulatory capital advantage and with explicit FSA approval.
- The monoline CVA positions from 2009 represent a highly subjective area where we are and were aware of at least one other major European based bank which had valuations very similar to Barclays. As you note, these valuations were within the acceptable spectrum. Time and markets have proven these to be less aggressive than suggested.
- On the more recent experience of the run up to year-end, we recognise that we asked a lot of your team with regard to model approvals. These were waiver

2

requests which came about later than expected but they were necessary given the late changes to our capital guidance at year end via the FPC to FSA. A guideline of 10% was moved to 10.30% at the very end of the year and so the criticality of these model approvals was paramount for us. We greatly appreciate the time and effort contributed by your team to facilitate these reviews.



- The discussions surrounding the index hedges of own credit were protracted because we had very strongly held views. Of course, the FSA has the ability to set rules and we respect the outcome of those discussions.
- We believe the concern you mention regarding capital stress tests refers to two separate but parallel requests from last year to assess the effect of EBA capital definitions: 1) an FSA request to ascertain whether 10% CT1 could be achieved by mid-2012 using a constant balance sheet and Basel 2.5 for December 2011 and 2) an EBA stress test request to estimate CT1 for June 2011 assuming the early adoption of Basel 2.5. Although both requests were related, we thought we were clear where differences existed in our responses because of the slightly different requests. We did not intend to mislead in any way and we will ensure that we communicate more clearly in the future.

Finally with regard to the UK tax issue, we fully understand the potential damage to our reputation. On the other hand, as tested recently through a third party review, our tax procedures are robust and sound but no procedure can guard against retroactive tax law changes. We acknowledge that this is not a comfortable place for us to be. Despite our voluntary disclosure to HMRC of the transactions, they did not inform us of their intention to change the law.

I appreciate your taking the time to write. I can assure you that the points you have raised have my full attention as well as the Board's. We are committed to ensuring the full co-operation of all levels of our Executive when engaging with the FSA and we take these matters very seriously, particularly as they relate to the transparency and openness of our interactions.

Yours sincerely,
Marcus

Marcus Agius

Appendix L – Glossary

Term	Definition
ABI	Association of British Insurers
Absa	Barclays' South African business, majority owned by Barclays
Africa RBB	Barclays' Africa Retail and Business Banking, which includes the operations previously reported as Barclays Africa and Absa
Authorised Investment Funds	Collective investment schemes authorised and regulated by the FSA ³¹⁷
Barclays	Barclays PLC, including its wholly owned subsidiary, Barclays Bank PLC, and its subsidiaries
Barclays Capital	Former name of Barclays' investment bank
Basel Committee	Basel Committee on Banking Supervision
Basel I, Basel II and Basel III	Comprehensive sets of reform measures, developed by the Basel Committee on Banking Supervision, to strengthen the regulation, supervision and risk management of the banking sector ³¹⁸
BBA	British Bankers' Association (UK)
BGI	Barclays Global Investors, Barclays' former institutional asset management business
Big Bang	Deregulation of the UK financial markets on 27 October 1986
Board committees	Collectively, Barclays' Board Audit Committee; Board Conduct, Reputation and Operational Risk Committee; Board Corporate Governance and Nominations Committee; Board Remuneration Committee; Board Financial Risk Committee; and Board Enterprise Wide Risk Committee ³¹⁹
Businesses, business units or clusters	Currently Barclays' UK Retail and Business Banking (UK RBB), European Retail and Business Banking (Europe RBB), Africa Retail and Business Banking (Africa RBB), Barclaycard, Corporate Banking, Investment Bank and Wealth and Investment Management. These varied over time, as shown in Exhibit 2
BZW	Barclays de Zoete Wedd, Barclays' former investment banking business, substantially divested in 1998 except for the fixed income business which together became Barclays Capital

³¹⁷ www.hmrc.gov.uk/manuals/ctmanual/CTM48115.htm.

³¹⁸ www.bis.org/publ/bcbbsca.htm.

³¹⁹ <http://group.barclays.com/about-barclays/about-us/the-board-committees>

Term	Definition
CAGR	Compound Annual Growth Rate
Capital ratio	Percentage of a bank's capital to its risk weighted assets (RWAs). Common capital ratios include the Core Tier 1 Ratio, Tier 1 Ratio and Total Capital Ratio
CFO	Chief Financial Officer
CFTC	Commodity Futures Trading Commission (US)
Client money	"Client money" as defined in the FSA's Client Asset Sourcebook (CASS), the FSA's requirements relating to holding client assets and client money ³²⁰
Conduct Business Unit	A division of the FSA, responsible for: developing and operationalising the FCA
Conduct risk	Detriment to the bank, customers, clients or counterparties because of inappropriate execution of business activities ³²¹
Core Tier 1 ratio	A measure of a bank's financial strength, being the ratio of its core tier 1 capital (a bank's most liquid form of capital consisting primarily of common stock and retained earnings) to its total RWAs
Credit risk	The suffering of financial loss should any customers, clients or market counterparties fail to fulfil their contractual obligations ³²²
CRO	Chief Risk Officer
EBA	European Banking Authority
ETR	Effective tax rate
EURIBOR	Euro Interbank Offered Rate
Europe RBB	Europe Retail and Business Banking
ExCo	Executive Committee
FCA	Financial Conduct Authority (UK), the conduct authority in the UK from April 2013. One of two bodies being set up to replace the FSA, the other being the PRA
Financial risk	Barclays' credit risk, market risk and funding risk collectively ³²³
FINMA	Financial Market Supervisory Authority (Switzerland)

³²⁰ FSA Client Assets Sourcebook: <http://fsahandbook.info/FSA/html/handbook/CASS>.

³²¹ Barclays, *Annual Report 2012*, March 2013, p. 189.

³²² Barclays, *Annual Report 2012*, p. 116.

³²³ Barclays, *Annual Report 2012*, p. 29.

Term	Definition
FirstPlus	Former lending business operated by Barclays
FOS	Financial Ombudsman Service (UK)
FRRP	Financial Reporting Review Panel (UK)
FRC	Financial Reporting Council (UK)
FSA	Financial Services Authority (UK), to be replaced
FTE	Full-time equivalent
Funding risk	Failure to maintain necessary capital ratios to support business activity and meet regulatory requirements and the failure to meet liquidity obligations ³²⁴
GICAF	Barclays' Group Internal Control and Assurance Framework
GRCB	Global Retail and Commercial Banking business
Group	Barclays PLC, including its subsidiaries
Group Centre	Head office management and functional oversight across all businesses, including Group ExCo and the Group functions
Group Chief Executive	Chief Executive Officer of Barclays
Group ExCo	Barclays' Group-wide Executive Committee, which comprises part of the Group Centre. This includes the Group Chief Executive and heads of the businesses and functions, with the exception of the Head of Compliance, who reports in to Barclays' General Counsel, the head of the legal function
HMRC	Her Majesty's Revenue & Customs (UK)
HR	Human resources
IRCB	International Retail and Commercial Bank
Key Risk	Risks designated as such in Barclays' Principal Risks Policy
KPIs	Key performance indicators
Lehman	Lehman Brothers Holdings Inc., the North American investment banking and trading divisions of which, along with its New York headquarters building, were acquired by Barclays in 2008
LIBOR	London InterBank Offered Rate

³²⁴ Barclays, *Annual Report 2012*, p. 28.

Term	Definition
LTIP	Long-Term Incentive Plan
M&A	Mergers and acquisitions
Market risk	The reduction to earnings or capital due to the volatility of any trading book positions or an inability to hedge the banking book balance sheet ³²⁵
NED	Non-executive director
OECD	Organisation for Economic Co-operation and Development (International)
OFT	Office of Fair Trading (UK)
Operational risk	The direct or indirect impacts resulting from human factors, inadequate or failed internal processes and systems, or external events ³²⁶
PBT	Profit before tax
People management	A collective term used in this Report to refer to the core organisational tools of recruitment, training, performance management and promotion
Personal Banker	A branch-based role at Barclays, to identify retail customers' needs and to identify products and services that fit the customer
PPI	Payment Protection Insurance
PRA	Prudential Regulation Authority (UK), the prudential regulator in the UK from April 2013. One of two bodies being set up to replace the FSA, the other being the FCA
Principal Risk	Risks designated as such in Barclays' Principal Risks Policy
Principal Risks Policy	Barclays' risk management policy which defines and outlines the management of the risks that emerge in the execution of Barclays' business activities ³²⁷
Prudential Business Unit	A division of the FSA, responsible for financial services industry supervision and regulatory reform and developing and operationalising the PRA
RBB	Retail and Business Banking, Barclays' acronym
RBS	Royal Bank of Scotland plc

³²⁵ Barclays, *Annual Report 2012*, March 2013, p. 155.

³²⁶ Barclays, *Annual Report 2012*, March 2013, p. 187.

³²⁷ Barclays' Principal Risks Policy of December 2006, last revised December 2011.

Term	Definition
Reputational risk	Damage to the brand arising from any association, action or inaction which is perceived by stakeholders to be inappropriate or unethical ³²⁸
RoE	Return on equity
RoRWA	Return on risk weighted assets
RWA	Risk weighted assets
Sanctions	Domestic penalties applied by a country against other countries, including trade barriers and restrictions on financial transactions with or through sanctioned countries. They may be imposed for economic, political or social reasons
SCM	Barclays' structured capital markets business within the investment bank
SEC	Securities and Exchange Commission (US)
Single premium PPI	Type of PPI policy, in which the full cost of insurance is paid up-front and usually added to the total value of the loan, with interest charged on top ³²⁹
SME	Small and Medium Sized Enterprises
SME derivatives	Interest rate hedging products sold to SMEs
Stress test of the European Banking Authority	An assessment of the resilience of financial institutions to adverse market developments ³³⁰
Tax Code	HMRC Code of Practice on Taxation for Banks (UK)
TCF	Treating Customers Fairly, a 2006 retail regulatory initiative by the FSA, to ensure an efficient and effective market, thereby helping consumers to achieve a fair deal ³³¹
Tier 1 ratio	Ratio of a bank's tier 1 capital to its total RWAs, a measure of its financial strength
Total capital ratio	Ratio of a bank's total capital to its total RWAs, a measure of its financial strength
TSR	Total shareholder return

³²⁸ Barclays, *Annual Return 2012*, p. 188.

³²⁹ www.fsa.gov.uk.

³³⁰ EBA webpage, "EU-wide stress testing", www.eba.europa.eu/EU-wide-stress-testing.aspx; the results of which for Barclays are available at: www.eba.europa.eu/pdf/bank/GB090.pdf.

³³¹ www.fsa.gov.uk/doing/regulated/tcf.

Term	Definition
UK Corporate Governance Code	Code published by the Financial Reporting Council (UK), which sets out standards of good practice on board leadership and effectiveness, remuneration, accountability and relations with shareholders ³³²
UK RBB	UK Retail and Business Banking, Barclays' acronym

In the Review, we have for simplicity referred to the masculine gender, without any intended gender bias. Accordingly, references to the masculine gender should be taken to include the feminine.

³³² www.frc.org.uk/Our-Work/Codes-Standards/Corporate-governance/UK-Corporate-Governance-Code.aspx.

