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## Protecting whistle-blowers in the UK financial industry

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### Abstract:

The author aims to investigate the current status of legal protection of whistle-blowers. She will focus on the treatment of the ex-Head of Regulatory Risk at HBOS prior to the financial crisis of 2007. The author then reviews the whistle-blowing policies and Codes of Conduct of five UK banks and compares them with the policies in the health industry.

The paper first utilises the black letter law approach to review the current status of legal protection to whistle-blowers. The author then undertakes empirical research into the whistle-blowing policies and Codes of Conduct of five major UK banks. She also adopts a comparative socio-legal analysis, studying the law in both the US and UK.

Whistle-blowers play an important role in increasing transparency and informing regulators to stay ahead of malpractice. Legislation alone cannot protect whistle-blowers fully. Corporate governance measures and a tripartite gatekeeping model between the regulator, Chief Risk Officer and auditors are required to give whistle-blowers more protection.

This paper will have policy implications for practitioners and policy makers on national and international dimensions. Whistle-blowing in the financial industry has been neglected in the major corporate governance and banking regulation reports. The author combines empirical research with her own model of tripartite gatekeeping to protect whistle-blowers in the financial world. This paper is thus original and valuable to both academics and practitioners.

Keywords: Banks, corporate governance, gatekeepers, Public Interest Disclosure Act, risk management, whistle-blowing

Article type: Research and empirical paper

### Section 1: Introduction

Financial stability is vital to both developed and developing countries. The financial crisis of 2007-2009 has revealed both regulatory and corporate governance problems within financial institutions in the United Kingdom. The Walker (Walker, 2009) and Turner (Turner, 2009) Reviews of 2009 concluded that excessive leverage, inadequate liquidity and reckless risk-taking contributed to the financial crisis. The Independent Commission on Banking's report of 2011 (Vickers, 2011b) recommended retail ring-fencing to reduce systemic risks. Whilst governments at the national, European and international levels are working towards better regulation and corporate governance,

one important area has been neglected—the protection of whistle-blowers, especially in the financial industry. The financial industry is notoriously opaque due to complex financial products and services (Acharya et al., 2009, Claessens et al., 2010). To increase transparency and accountability, protection to whistle-blowers must be enhanced. The corporate governance paradigm has shifted from the traditional reliance on shareholders and boards of directors to ‘gatekeepers’ in analysing control of companies (Rapp, 2010). Recently, scholars have realised the important role played by whistle-blowers in corporate governance. Rapp et al (Rapp, 2010) state that whistle-blowers have earlier and better information about the most heinous type of corporate fraud since whistle-blowers are usually insiders. Fisher et al (Fisher et al., 2000) opine that whistle-blowing is a useful deterrent and encourages whistle-blowing in the financial industry. Now is the time to address this area.

This paper will first examine the legislation on whistle-blowing and its problems in the UK. The Public Interest Disclosure Act 1998 (PIDA) protects, but does not encourage whistle-blowing. The PIDA does not require employers to put in place organisational whistle blowing policies. According to the 2009 report by Public Concern at Work (an independent authority on whistle-blowing), only 38% of employers have a whistle-blowing policy in place. The author will focus on whistle-blowing in the financial industry. This is illustrated by a study into the whistle-blowing policies of the five banks in the UK and an interview with Paul Moore. The author has interviewed Paul Moore, the ex-Head of Group Regulatory Risk at HBOS, who has been labelled as a whistle-blower. His revelations are very important towards reforming the financial landscape. The author will then compare the whistle-blowing policies in the financial industry with those of the health industry. Several recent high profile NHS whistle-blowers received detrimental treatment and it is worth examining these two industries in detail.

The rest of the paper is structured as follows: section 2 sets out the protection given to whistle-blowers in the UK. Section 3 explains the methodology used in this paper. Section 4 deals with whistle-blowers in the UK financial industry. Section 5 is a critical analysis of the whistle-blowing policy of the five major UK banks. This will be compared with the whistle-blowing policies of NHS Foundation Trusts. Section 6 sets out the author’s model given to risk managers in the financial industry. Finally, section 7 concludes.

## Section 2: UK Law on whistle-blowing

Current UK law provides inadequate protection to whistle-blowers. Whistle-blowers who disclose non-confidential information are seen to be breaching the common law implied duty of good faith and fidelity. (Lewis, 2001) Traditionally, employees act as agents of their principals, their employers. If they complain about their corporation either internally or externally, they are perceived as disloyal and deviant. (Larmer, 1992) Larmer stated that this is a very narrow approach to employment law and governance. At the other end of the spectrum, Duska argued that employees do not owe a prima facie duty of loyalty to their employers. Therefore, whistle-blowing does not have to be justified on moral grounds. (Duska, 1985) The author believes that Duska’s submission is too extreme. Employees have to consider their employers’ interests although they are not under a duty to act in the latter’s interests under the common law implied duty of good faith and fidelity. The common law implied duty applies to all employees. Hierarchy within an organisation does not influence the common law duty. On the other hand, the equitable principle of fiduciary duties applies only to senior employees and professionals who act on behalf of their clients. Fiduciaries

must act in the best interests of their clients, in good faith and must not make a profit. Loyalty is thus required from the fiduciaries. Although the equitable principle and the common law duty have merged in some ways, as seen in the case of *Neary v Dean of Westminster* (1999) opine that the two are different. The equitable principle is one-sided since the fiduciary owes an absolute duty to his/her employer or client. With the common law duty, the employee has to take into account of the employer's interests but does not owe a duty to act in the latter's interests. Therefore, the equitable principle of fiduciary duties imposes a higher burden on employees. It will be seen in section 3 that Moore, the ex- Head of Group Regulatory Risk at HBOS, owes an equitable principle to their employers but his disclosure of HBOS's excessive risk strategy and breach of FSA rules were not welcomed by his employers. Moore also alleged that several directors of HBOS breached their fiduciary duties when he blew the whistle. The equitable principle failed to protect Moore.

In theory, the scope of the common law implied duty of good faith and fidelity is wide. Hepple believes that this duty imposes a duty to respect the employee's human rights. (Hepple, 1998) Employees should feel free to express any concerns about illegal, immoral or wrongful practice. In the case of *Heinisch v Germany*, (2011) the European Court of Human Rights have found that where a whistle-blower is dismissed, this could amount to a breach of the right to freedom of expression under Art 10 European Convention of Human Rights unless it was "prescribed by law, pursues a legitimate aim and is necessary in a democratic society for achievement of such an aim" and in particular, whether the interference was a proportionate response to the aim pursued. Here, it was held that Mrs Heinrich disclosed information of public interest; she acted in good faith; she had not knowingly reported false information and that she tried disclosing internally but management did not indicate when a solution will be available. This protects whistle-blowers' freedom of expression but does little to protect their employment status.

In relation to disclosing confidential information, employees can use the 'public interest' defence. This defence is however weak in practice, as demonstrated in cases such as *Initial Services v Putterill* (1968), *Lion Laboratories v Evans* (1985) and *Re a Company's Application* (1989). These cases demonstrated that the 'public interest' defence has been construed narrowly by the Courts. Only disclosure to a regulatory body in *Re a Company's Application* enabled an employee to whistle blow in the public interest. Employees of the National Health Service (NHS) face a difficult choice of whether their duty to maintain patient confidentiality should prevail over their wider professional obligations under their employment contracts and codes of conduct. The Courts have not set out clear guidelines as to whether professional obligations will prevail over their contractual duties. (Cripps, 1995)

Under section 43 of the Public Interest Disclosure Act 1998 (PIDA), employees appear to be better protected than under case law. The preamble states that the PIDA is 'An Act to protect individuals who make certain disclosures of information in the public interest; to allow such individuals to bring action in respect of victimisation; and for connected purposes.' Employees are protected if they inform on their employer where there is an issue of legitimate public concern. As long as the employees make a 'qualifying disclosure' under section 43B(1) PIDA in good faith (section 43D) and satisfy the conditions in section 43G, they should be protected. For the purpose of section 43B(1)(b) of PIDA, it was held in *Babula v Waltham Forest College* (2007) that the whistle-blower's reasonable belief is significant, not whether or not the belief turned out to be wrong. The use of the word "likely" did not mean that the whistle-blower had to be correct. Although the PIDA provides a

framework where internal disclosures within the organisation are protected, wider disclosures to external parties are more difficult. The principle of 'protected disclosure' is more difficult to fulfil. In *Goode v Marks and Spencer Plc.* (2009), the employee's communication to *The Times* did not qualify as 'protected disclosure' since his external disclosure was dissimilar to the internal one. However, the PDA will protect employees in exceptionally serious circumstances who disclose confidential information externally to the media. (2005) The case of *Holbrook v Queen Mary Sidcup NHS Trust* (2006) suggests that the whistle-blower should raise his/her concerns internally first before contacting the media.

Unlimited compensation for unfair dismissal of a whistle-blower under section 8 of the PDA should act as a deterrent for employers. Unfortunately, dismissals do take place. Peter Hamilton, the barrister who acted for Paul Moore, explained that: 'I don't suppose any legislation could prevent an employer firing someone, subject to the right to compensation, but once you've lost your job because you've been a whistle-blower it's very difficult to be reemployed and I'm not sure there's a realistic answer to that problem.' (Laver, 2011) The employer is often in a stronger position due to resources and power. Once employees are dismissed for whistle-blowing, it is very difficult for them to find new jobs. They are often seen as outcasts. Therefore, changes must be made to the law and governance to protect whistle-blowers better. After all, an empirical study by Jos et al. (Jos et al., 1989) reports that when asked "if you knew the results of your whistle-blowing before you attempted to report these incidents, would you have done what you did?" an overwhelming majority (81%) of fired whistle-blowers have answered affirmatively. When such a high percentage of whistle-blowers are prepared to act selflessly, it is only just and fair that greater protection is given to them. Before the author discusses her proposals in protecting whistle-blowers, she will discuss her methodology used in the next section.

### Section 3: Methodology

This paper covers employment law and corporate governance. The author believes that sole reliance on black letter law to protect whistle-blowers in the financial industry is inadequate. As seen in the previous section, there are weaknesses in both case law and legislation in protecting whistle-blowers. PDA has been criticised for not protecting independent contractors and volunteers. It does not protect expatriate workers of UK companies based abroad unless they have strong ties with British employment law.(Lowe, 2012) It does little to encourage whistleblowing and does not provide financial incentives. It does not include vicarious liability which means that employers will not be liable when a whistle-blower is subjected to bullying or harassment for making a qualified disclosure.(James, 2012) Under PDA, lawyers are not protected from whistleblowing if they breach legal professional privilege. Looking ahead, the new Enterprise and Regulatory Reform Bill in the UK does little to improve the protection given to whistle-blowers. Under section 15 of this Bill, a whistle-blower will only be protected for qualifying disclosures which are in the 'public interest'. This is judged by both subjective and objective standards since the Employment Tribunal will examine the qualifying disclosure from the worker's reasonable belief. Cathy James, Chief Executive of Public Concern at Work, said that the new Bill will 'result in a field day for lawyers and that this is a missed opportunity for addressing problems which have arisen in the legal protection for whistle-blowers'.(James, 2012) She added that: 'if the public interest test is to be inserted into the legislation as proposed, then it should replace the good faith test in the legislation as a countervailing measure to ensure that the legislation continues to strike the right balance between the public interest, the

interests of workers raising concerns and the interests of employers.’ (James, 2012) The Bill is currently in the final stages of the House of Lords, so further amendments may be made. In light of these issues, the author adopts a comparative socio-legal approach to this paper, incorporating the dynamic changes of recent events and the law into her paper. The financial crisis of 2007 is a recent phenomenon and had a severe impact on the markets in both the US and UK. A comparative analysis is undertaken to compare and contrast the law on whistle-blowing. She will then extend the ‘gatekeeper’ theory in corporate governance to whistle-blowers in the financial industry with the aim of improving accountability in financial institutions.

#### Section 4: Whistle-blowers in the UK finance sector

Fisher et al (Fisher et al., 2000) opine that whistle-blowing is a useful deterrent and encourages whistle-blowing in the financial industry. They submit that whistle-blowers help regulate the financial sector, since revealing wrongdoings will have a disinfectant effect and encourage adherence to regulation. Paul Moore, ex-Head of Group Regulatory Risk at HBOS between 2002-2004, knew as early as 2003/4 that ‘the bank was going too fast (and told them), had a cultural indisposition to challenge (and told them) and was a serious risk to financial stability and consumer protection (and told them).’ (Moore, 2009a) He added that HBOS did not minute the fact that he warned them of their speed of expansion. Moore was made redundant by Sir James Crosby, the then CEO of HBOS. Moore brought a claim for unfair dismissal under the whistle-blowing provisions of the PIDA. Moore received a ‘fair compensation’ from HBOS (Moore, 2009a). He was subject to a gagging order by HBOS but he believed that public interest prevailed, so he breached the gagging order when he gave evidence to the House of Commons Treasury Committee under the protection of parliamentary privilege.

Moore said that he was not trying to find a scapegoat when he decided to give evidence at the House of Commons Treasury Select Committee (Moore, 2009a). He was interested in looking forward, in learning from past failures. Moore’s evidence was very revealing. It shows that HBOS had little regard for risk management. After Moore was made redundant, he was replaced by a sales manager who had never been a risk manager before. The CEO personally made that appointment and against the wishes of the other directors. Moore questioned whether the CEO has breached his fiduciary duties as a result of this personal appointment. Secondly, the FSA raised red flags in 2004 that key sectors of the HBOS group posed “medium or high” risks to maintaining market confidence and protecting customers. Thirdly, risk management conflicted with other areas of the business. Risk management’s concerns were not recorded in board minutes. Moore was strongly reprimanded for ‘tabling at a Group Audit Committee meeting the full version of a critical report by my department making it clear that the systems and controls, risk management and compliance were inadequate in the Halifax to control its “over-eager” sales culture’(Moore, 2009a). Fourthly, corporate governance practice was poor at HBOS. There was little encouragement for challenging board decisions. One of the non-executive directors at HBOS admitted to Moore that he had no idea what the role of the Chairman of the Retail Risk Control Committee entails. Despite being an excellent businessman, this non-executive director was a close friend of Andy Hornby, the CEO who replaced Sir James Crosby. This personal relationship forged a boardroom culture of rubber-stamping rather than scrutiny.

Finally, there was a fear culture in HBOS where ‘...there were many more people in internal control functions, non-executive positions, auditors, regulators who did realise that the Emperor was naked

but knew if they spoke up they would be labelled “trouble makers” and “spoil sports” and would put themselves at personal risk.’(Moore, 2009b) The irony is that Moore was the ex-Head of Group Regulatory Risk. It was part of his job to oversee the systems and controls, risk compliance and management of HBOS. It was his duty to warn the board of HBOS if the bank was taking excessive risk or lending too aggressively. When he did warn them, he was ignored, reprimanded and ultimately dismissed. The common law implied duty of good faith and fidelity; equitable principle of fiduciary duties; PIDA and corporate governance all failed to give Moore adequate protection.

In Moore’s opinion, ‘further development of whistle-blowing rules to make sure that those who raise legitimate issues are not just “bought off” with shareholders’ money....the case should be reviewed by the regulator and action taken if necessary to ensure those responsible cannot get away scot-free’ (Moore, 2009a) is required to improve protection for whistle-blowers. Two points need to be addressed. First, whistle-blowers should be able to raise legitimate concerns with the assurance that they will be seriously addressed. Whistle-blowers are employees, insiders and stakeholders of the organisation concerned. They often have vested interests for the organisation to do well. Understandably, there are sometimes issues raised by whistle-blowers which are of a trivial nature or that the information is unreliable (Fisher et al., 2000). Nevertheless, risk managers in banks such as Moore have a duty to raise concerns regarding risk management and internal controls. He is only fulfilling his job, legal and equitable duties to bring the attention of such matters to senior management. Organisations should implement whistle-blowing policies at work and include a clause in employment contracts that the policy will be implemented when employees raise legitimate concerns. If the employer fails to follow the whistle-blowing policy, it will be a breach of contract. Employees will thus be able to bring a wrongful dismissal claim in addition to unfair dismissal. The ACAS Code on disciplinary and grievance procedures is considered as best practice to adopt. Although it is not statutory authority, failure to follow the Code may result in an uplift of up to 25% when the Court or tribunal awards compensation to the employee. It is proposed that there should be an ACAS Code on whistle-blowing and the uplift of 25% should be followed to protect whistle-blowers. This would also assure whistle-blowers that their issues are taken seriously.

More should be done in corporate governance to protect whistle-blowers who are risk managers. Directors who have been reckless in their risk strategy should be held responsible when the organisation suffers losses, which are then passed onto taxpayers in the case of banks. Accountability must be seen to be done. So far in the financial crisis of 2007, only three directors have been held accountable. David Baker (former chief executive) and Richard Baclay (former managing credit director) of Northern Rock were fined and banned by the FSA for hiding debt. David was fined £504,000 and is banned from taking new roles at regulated financial institutions. Richard is fined £140,000 and cannot hold any senior roles at Northern Rock again. Peter Cummings, former director at HBOS, has been fined £500,000 and banned from working in the city for life. This is the most severe penalty imposed on bank executives for their actions in the financial crisis. Tracey McDermott, Director of enforcement and financial crime at the FSA, said that: “Despite being aware of the weaknesses in his division and growing problems in the economy, Cummings presided over a culture of aggressive growth without the controls in place to manage the risks associated with that strategy. Instead of reacting to the worsening environment, he raised his targets as other banks pulled out of the same markets.”(Russell, 2012 )

Moore's second suggestion is that the FSA should have more resources so that they can recruit the best people. The FSA's ARROW visit in 2003 identified the key risks. Moore believed that 'the operational staff at the FSA had done a good job on the ARROW visit they had conducted and that they almost certainly had identified the key risks at the bank at that stage in its development'. (Moore, 2010) Moore's submission is that the senior staff failed to act upon the red flags. Peter Hamilton, barrister acting for Moore, recommended that whistle-blowers should have the right to raise concerns with the FSA before raising them internally. He also states that the parliamentary ombudsman should have power and jurisdiction to deal with whistle-blowers' concerns and appeals. (Laver, 2011) It is important that risk managers in banks are able to work closely with FSA staff, so that any problems can be dealt with openly, honestly and efficiently. The author will compare the position of whistle-blowers in the UK financial and health industries before making recommendations.

## Section 5: Whistle-blowing policies in the financial industry and health industry

As part of this paper, the author did empirical research and reviewed the whistle-blowing policies of five UK banks between 2004-2011: Northern Rock; The Royal Bank of Scotland; Lloyds Banking Group; Barclays and HSBC. Northern Rock was included in the study because it was the first bank in the UK to experience financial difficulties during the financial crisis of 2007. The author has also studied the whistle-blowing policy of the regulator, the Financial Services Authority. Whistle-blowing is protected by statutes, namely the Public Interest Disclosure Act. Under the UK Corporate Governance Code, companies listed in the UK are obliged to have whistle blowing arrangements or explain why they do not. Corporate governance plays an important role when it comes to regulate human behaviour. Therefore, Codes of Conduct and internal whistle-blowing policies should provide detailed information to protect employees who may want to blow the whistle. These Codes and policies should also be incorporated into the employee's contract to protect employees.

It is unfortunate that the five UK banks do not have comprehensive whistle-blowing policies. The Royal Bank of Scotland has the most comprehensive whistle-blowing policy. This is found in the RBS Code of Conduct 2011:

'We want to know about any internal behaviour or questionable business practices you feel may be unethical without fear of victimisation, discrimination, dismissal or detriment.

Concerns can be raised by using the Group's Whistle-blowing service, Right Call - an independent, free, confidential telephone helpline and web service. Right Call aims to reduce the Group's risk, potential losses, and possible reputational damage by providing an impartial service. Both phone calls and web reports are managed confidentially by an independent specialist offering a range of language options.

A unique reference number is provided after each call. Those who raise concerns can review their report on the Right Call website by using their reference code and respond to any additional questions relating to their concern. For further information refer to the Group Policy Framework Whistle-blowing Policy Standard. If Right Call is not available, refer to your Divisional/Local Regulatory Risk team for details of how to raise any concerns.'(The Royal Bank of Scotland Plc, 2011)



It is encouraging to see that employees are reassured that they will not be victimised, ostracised, discriminated or dismissed if they blow the whistle. Right Call is an independent service, which should reduce the employee's fear of discussing the matter internally. RBS have certainly made improvements in protecting whistle-blowers. They did not have a whistle-blowing policy between 2004-2010. It would be helpful however, for employees to have access to the Group Policy Framework Whistle-blowing Policy Standard mentioned in the Code of Conduct.

Northern Rock has a generic and broad statement about their whistle-blowing policy in 2011: 'As part of its remit, it [the Audit Committee] oversaw anti-money laundering and whistle-blowing procedures'.(Northern Rock Plc, 2011) On its website, the duties of the Audit Committee include 'reviewing the procedures operated by the compliance function for handling allegations from whistle-blowers and, upon request, review a log of all complaints'. There is a paragraph in Northern Rock's 2004 Annual Report stating that 'the company reviewed its obligations under public interest disclosure, strengthening the policy to protect staff in the event of whistle-blowing'.(Northern Rock Plc, 2004) Northern Rock do not have a Code of Conduct and there is nothing on whistle-blowing between 2005-2007. It is only in 2009 that the bank started to include general statements about their whistle-blowing procedure.

In Lloyds TSB's annual report of 2007, Lloyds mentioned that they have 'a whistle-blowing policy setting out the procedure by which people can raise, in any confidence, any matters of concern. A whistle-blowing line enables employees to raise any concerns and for such matters to be independently investigated'.(Lloyds Banking Group, 2007) There was nothing on whistle-blowing between 2008-2009. In 2010 and 2011, the Lloyds stated in their annual report that they had reviewed the group's whistle-blowing procedures and incidents. Lloyds have a Code of Conduct but whistle-blowing is not mentioned. HBOS do not have any information on whistle-blowing in their annual reports 2004-2011. They do not have a Code of Conduct. Barclays and HSBC are similar in that they do not have information on whistle-blowing in their annual reports 2004-2011. They have a Code of Conduct/Ethics respectively but whistle-blowing is not mentioned. These three banks are not transparent or helpful to employees who wish to raise a concern. Particularly worrying is Lloyds Banking Group in light of Paul Moore's experience. It would be helpful if the bank can provide a more thorough policy on whistle-blowing. Barclays have announced in mid-September 2012 that they are keen to see a professional body for bankers who will strike off rogue bankers at all levels.(Knight, 2012) This professional body will be part of the Financial Conduct Authority (FCA). The Financial Services Authority (FSA) will be replaced by the FCA and the Prudential Regulation Authority in 2013. The current proposal states that the professional body would be independent but funded by the major banks. The creation of a professional body and Code of Conduct will make bankers more aware of their duties. The increased enforcement role of the FCA will hopefully act as a deterrent to rogue traders. However, the FCA must practise what they preach and take enforcement action where necessary. One of the weaknesses of the FSA is that it rarely fined or banned senior executives. The author also believes that there will not be a level playing field when only the major banks fund the professional body. There is a danger that the smaller banks and building societies will not be treated on parity as they do not fund the professional body. The author proposes that each banker will need to hold a valid practising certificate, to be renewed every year with a fee. This fee will contribute towards funding the FCA. The annual renewal will also be an annual check on bankers' ability to carry on practising. Currently, the FSA encourage bank employees to discuss issues internally first then use the FSA Whistle-blowing Helpline if they wish. As

a prescribed person under the Public Interest Disclosure Act, the FSA is an alternative source for employees. Employees working in the financial sector should feel safe to report any concerns internally and externally. This is particularly so given that banks have a wide stakeholder interests, especially after the government bail-out of Lloyds Banking Group, RBS and Northern Rock. Financial institutions have only started to include whistle-blowing policies recently. As seen above, the policies tend to be brief and generic, with the exception of RBS.

In comparison, NHS Foundation Trust whistle-blowing policies tend to be more draconian and punitive in style. The Government expects public bodies to have a policy in place and the whistle blowing schemes in local authorities and NHS bodies in England are assessed regularly as part of their external audit and review. O'Dowd & Hayes carried out a study into the whistle-blowing policies of 122 NHS Foundation Trusts. Their results show that 118 out of 122 Foundation Trusts had differing approaches to whistle-blowing. 22 out of 118 Foundation Trusts do not specify what constitutes a 'concern' for employees. 23 trusts said that they will not protect an employee's confidentiality if latter raises a concern and 106 trusts have included a provision on sanctions if the employees raised a false or malicious concern.(O'Dowd and Hayes, 2010) Barnsley Hospital NHS Foundation Trust says staff can report concerns externally, but there is potential disciplinary action if they go outside unjustifiably. Their policy document mentions the word 'disciplinary' 21 times.(Lakhani, 2012) This is very worrying since whistle-blowers should be protected and not punished. Whistle-blowers should not be perceived as bad, troublesome or difficult. Unfortunately, a recent NHS employee, Kay Sheldon was removed as a non-executive director of the Care Quality Commission, the NHS regulator. At a public inquiry into the failings of the Care Quality Commission, she expressed concerns about poor governance, leadership and accountability. Moreover, the inspections system was unsafe. Kay suffered from depression for 26 years. The Chair of the Care Quality Commission sought a report from an occupational health doctor, who was not a psychiatrist. He declared that Kay Sheldon was suffering from paranoid schizophrenia.(Lakhani, 2012) Kay expressed that: 'They [the Care Quality Commission] were trying to discredit me as either mad or bad, as mentally ill or troublemaker-it's shocking the lengths they were willing to go to in order to get me out.'(Lakhani, 2012) Kay Sheldon was eventually allowed to remain on the board after negotiation with the Department of Health and her lawyer.

To the NHS, patient safety is of paramount importance. Whistle-blowers face a dilemma when they wish to blow the whistle about patient safety but they also have a duty to uphold patient confidentiality. Just as solicitors act in the best interests of clients except where the instructions are illegal, doctors and NHS workers should act in the best interests of patients. The case of Gary Walker shows that even when a NHS employee raises a concern about patient safety, he was dismissed and was imposed a gagging clause. In Gary Walker's case, the gagging clause was 15 pages long.(Lakhani, 2012) Although it is void to use gagging clauses for exposing issues of public interest, Gary Walker's case was settled by a compromise agreement. A year later, the Care Quality Commission made a full investigation into the trust which Gary Walker worked for. The Care Quality Commission found that Gary's concerns were justified and demanded the trust to make urgent improvements, otherwise the trust will be closed down. Paul Moore, the ex-Head of Group Regulatory Risk at HBOS warned his manager before the financial crisis the HBOS were taking too many risks and that risk management was poor. He was subject to a gagging order by HBOS but he believed that public interest prevailed, so he breached the gagging order when he gave evidence to the House of Commons Treasury Committee under the protection of parliamentary privilege. Paul's evidence has been useful to the

public because up till his appearance before the House of Commons Treasury Committee, little was known about the bank's practice. In financial institutions, Chief Risk Officers only have one interest—that of the bank. They do not have direct contact with clients. Most employees in investment banks do not have direct contact with clients. The shift from 'relationship banking' to 'sales banking' over the past 20 years has diluted the client's interest further. To protect employees in the financial industry, it is very important that banks have well-drafted whistle-blowing policies. They should reassure whistle-blowers that their concerns are taken seriously, that they are treated in confidence and that they will not suffer detriment, harassed, victimised or dismissed because of their acts. Strengthening protection of whistle-blowers through legislation is not ideal because it will only widen inequality further. The less advantaged will not be as well protected as the well-informed, more affluent claimants.(Feintuck and Keenan, 1998) Further, it is difficult to legislate what types of disclosure is protected since professional discretion must be taken into account.

One suggestion to improve protection for whistle-blowers via corporate governance methods is to improve the internal complaints procedure so that managers can deal with the concern at the first instance.(McHale, 1995) McHale however, acknowledged that in practice, reliance on internal procedures is insufficient. When one person in senior management undermines the whistle-blower, then procedure falls apart. Introducing financial incentives under the federal False Claims Act to whistle-blowers has not increased the number of claims in the US. As seen above in section 2, most whistle-blowers in both the US and UK are not driven by financial awards. In most cases, whistle-blowers blew the whistle on grounds of altruism rather than financial gain. In the US, whistle-blowers in Oregon can obtain up to \$250 if this is an amount greater than the potential damages in a retaliation claim for whistle-blowing. (McHale, 1995) Research has revealed that there is little evidence of abuse since whistle-blowers are not protected without assistance. Further, those who make disclosures are more likely to be young people and those with low self-esteem.(McHale, 1995)

#### Section 6: An alternative model: Whistle-blowers as gatekeepers?

In the US, some nurses act as patient advocates to highlight the breach of patients' rights. Free speech is safeguarded as a right in the US Constitution. In New Jersey for example, patients are informed of their rights by receiving a Charter of Rights as a matter of law. There is also a designated member of staff to deal with grievances.(McHale, 1995) There are two difficulties with the use of patient advocates. First, patient advocates are employees themselves so their independence can be questioned. Secondly, one cannot expect too much from patient advocates. Their roles are limited to considering grievances only. There is a gradual move in the UK towards establishing patient advocates in the NHS. The success of such patient advocates will depend on the acceptance by stakeholders in the health industry. They will however, act as a useful link between patients and health care provider.

In the financial industry, a bank manager and a customer will have a clear client relationship. However, modern banking has shifted to selling products rather than acting in the client's best interest. The CEO of Lloyds Banking Group, Antonia Horta-Osorio, said that banks have been "complacent, non-customer-focused and inefficient" in recent years.(Knight, 2012) Further, there is no standardised Code of Conduct for bankers. Each bank has its own Code of Conduct. The first step to protect whistle-blowers should be incorporation of the proposed FCA's standardised Code of Conduct and whistle-blowing policies into employees' contracts. Secondly, the concept of patient

advocates is unlikely to work in the financial industry due to the focus on products in modern banking. Therefore, the author wishes to propose the alternative model of whistle-blowers acting as gatekeepers.

The 'gatekeeper' theory was first advocated by Professor Kraakman in 1986. (Kraakman, 1986) In Professor Kraakman's view, third parties such as accountants, auditors and lawyers can play a useful monitoring and enforcement role in corporate governance. They can 'disrupt misconduct' of employers by withholding their cooperation. Professor Kraakman further suggested in his footnotes that there can be a duty of whistle-blowing on the gatekeeper's part on the wrongdoer. (Kraakman, 1986) The financial crisis of 2007-2009 provides an example of how accountants and lawyers failed in their roles as gatekeepers. Lehman Brothers International Europe utilised an accounting device called Repo 105 which masked the size of Lehman Brothers' balance sheet. There was pressure for investment banks such as Lehman Brothers to reduce their leverage at the end of 2007. Even if Repo 105 was not lethal, it was certainly poisonous. Lehman Brothers had been abusing it as far back as 2001, using repurchase agreements to finance assets but, unlike with typical repo transactions, treating them for accounting purposes as sold. This enabled Lehman Brothers to cover up its true leverage, making it seem lower than it actually was. Lehman Brothers International Europe took the lead role in Repo 105 transactions. This is because Lehman Brothers (the parent company) had difficulty complying with SFAS 140, the US accounting rules. They could not obtain true sale transactions, which meant that assets could not go off-balance. The leverage ratio was thus not reduced. In the UK, Linklaters, a London based law firm was able to obtain true sale status for Lehman Brothers International Europe. Anton Valukas states in his report: "Although the Linklaters's letter was written for the exclusive benefit of Lehman Brothers International Europe, a significant volume of Lehman's Repo 105 transactions was executed for the benefit and using the securities of one or more US-based Lehman entities" (Valukas, 2010). It is important to note that there is no evidence that Linklaters acted illegally. Regulatory arbitrage succeeded here due to differences in international financial regulations and standards. This lacuna in accounting and financial regulation must be addressed immediately. Accountants and lawyers must co-operate to stop regulatory arbitrage.

Professor Coffee adopted a narrower definition of 'gatekeeper' to mean a 'reputational intermediary who provides verification or certification services to investors.' (Coffee, 2004a) Auditors and credit rating agencies are examples of gatekeepers. Through behavioural economics, Professor Coffee proved that reputation alone could not guarantee gatekeepers from fulfilling their duties. (Coffee, 2004a) In Professor Coffee's opinion, 'to some degree, gatekeepers will be followed even when they are not trusted, because it is expected that they will influence the market'. (Coffee, 2004a) Since reputation alone would not prevent corporate scandals, scholars have shifted their attention to other incentives. Professor Coffee recommended a form of strict liability for gatekeepers, although lawyers are excluded. This is because 'auditors are better at discovering fraud than attorneys'. (Coffee, 2004b) Strict liability is too harsh and the fault-based system was ineffective. Professor Coffee therefore recommends that gatekeepers should act like insurers and their liability is capped based on a multiple of the gatekeeper's revenues. Professor Partnoy (Partnoy, 2004) agrees that insuring is sensible but differs in that he caps the gatekeeper's liability through a contract between the corporation and the gatekeepers. The most notable difference between Professors Coffee and Partnoy is that under Professor Coffee's theory, a gatekeeper can be held liable even though the corporation is not (Coffee, 2004b).

Professor Coffee's explanation on the exclusion of lawyer is interesting. In the UK, lawyers are often protected by legal professional privilege. Legal professional privilege protects communications between clients and lawyers. It belongs to the client and aims to protect the client. The duty owed to clients sits above the lawyer's duty to disclose unless the lawyer is used, knowingly or unknowingly, to commit or cover up a crime or serious fraud, then he can disclose what he knows. Whilst individuals who make 'qualified disclosures' under PDA are protected from victimisation, lawyers are not due to the legal professional privilege. Therefore, if a lawyer suspects his client is involved in fraud or money laundering activities, he is not protected under PDA. He is however, protected under the Proceeds of Crime Act 2002 and terrorism legislation since he has a statutory duty to report such activities. Therefore, only in limited circumstances would a UK lawyer make disclosures. Strict liability on lawyers applies only in exceptional cases. In-house lawyers give legal advice to their client organisation and they are also part of the internal investigation if an employee raises a concern. They only act for one client, unlike lawyers in private practice. It is therefore understandable that there is little incentive to blow the whistle in such an environment. The case of *Akzo Nobel Chemicals Limited and Akros Chemicals Limited v Commission of the European Communities (C-550/07)* stated that in-house counsels are not protected by legal professional privilege. This is because they are not 'independent lawyers' since they have employment contracts with their clients. In-house counsels are thus protected by PDA if they make disclosures. Whether they will is doubtful since their loyalty lies with one client only.

In the US, legal professional privilege is more limited than in the UK. The 'crime-fraud' exception to legal professional privilege means that attorneys are not protected if they wish to disclose a crime or fraud. They are not under a duty to do so. Further, whistle-blowing protection differs from state to state. In Minnesota, there is a 'job duties exception' for whistle-blowers. In the case of *Brian Kidwell*, an in-house counsel for Sybaritic Incorporation, was held to be merely performing his duties when he sent an email to an external source regarding the company's alleged concealment of documents. The Minnesota Supreme Court held that Kidwell was not whistle-blowing and that his dismissal is justified because he breached his fiduciary duties by sending the email to an external source. The Court did allow exceptions to this so that an employee would be protected if he makes the report outside his usual channels or if the report went beyond the remit of his job description. This is unsatisfactory for attorneys since they receive little protection and have little incentive for blowing the whistle. Other professionals will be even more vulnerable without legal professional privilege or protection under the relevant whistle-blowing legislation. A range of protective mechanisms are required to protect whistle-blowers.

Section 922 of the Dodd-Frank Wall Street Reform and Consumer Protection Act encourages whistle-blowers to provide information since they are financially rewarded. Further, whistle-blowers are protected from retaliation by employers. As seen earlier, not all whistle-blowers are motivated by money. Moreover, Fisher et al (Fisher et al., 2000) casted doubt over the relationship between the use of financial incentives and the quality of information received. This is particularly so because whistle-blowing is an 'intrinsically personal activity' and altruistic.(Fisher et al., 2000) Protection from retaliation by employers is better since many whistle-blowers are protected from discrimination. The author however, believes that this does not safeguard the whistle-blower's job. Dismissal is the ultimate sanction for whistle-blowers even though it is automatically unfair under UK law. Other channels must be used to protect whistle-blowers. The Sarbanes-Oxley Act 2002 ('the 2002 Act') gives protection to US whistle-blowers through corporate governance recommendation;

civil and criminal channels. First, the 2002 Act requires all public companies to establish independent audit committees. Internal complaints procedures should deal with employees' complaints in a confidential manner. Secondly, new ethical standards are set up for attorneys so that they know when they are required to blow the whistle on their clients. Thirdly, an honest whistle-blower who reports to a law enforcement officer will be protected from retaliation under the 2002 Act. Finally, by virtue of clause 3b of the 2002 Act, the Securities Exchange Commission can enforce every clause of the 2002 Act and impose criminal sanctions for breaching it. (Kohn, 2012) In the UK, the Corporate Governance Code 2010 requires at least three independent non-executive directors on the audit committee of FTSE 350 companies. The Walker Review has proposed more independence within the risk committee, which will be discussed below. Auditors are better equipped to detect fraud or financial malpractice, especially in the financial industry. Building on Kraakman and Coffee's theories on gatekeeping, the author suggests that the regulator, Chief Risk Officers and the auditors should work together as gatekeepers. This would give better protection for employees in the financial industry. Public Concern at Work, a UK charity which helps whistle-blowers, said that: 'Regulators should promote the role of and protection for employees blowing the whistle internally, to them as regulators and beyond as a means to encourage and help responsible employers to (a) establish effective internal compliance systems and (b) adopt open and constructive relationships with them as regulators.' The financial regulator should have an open, honest and transparent relationship with the Chief Risk Officer so that they discuss any potential matter in confidence before the Chief Risk Officer mentions it internally. This should be set out as best practice in a code of practice for the regulator. The Chief Risk Officer and the regulator should act as joint gatekeepers.

For this to work well, the regulator should eliminate the notion of regulatory capture. Regulatory capture, also known as the 'grabbing hand' by Shleifer and Vishny (Shleifer and Vishny, 1998), is used by the regulator or regulatees to promote their private interests, rather than the public interest. (Kroszner and Strahan, 2001) Politics and banking are inextricably linked. Barth et al (Barth et al., 2006) enunciated succinctly that 'banking supervisory and regulatory policies are selected by those in power for the benefit of a narrow set of society, subject to the constraints of prevailing political institutions'. Whilst it is inevitable that politicians will play a role in shaping banking regulatory policies, it is far from desirable that the government, via the regulator, pursues its own interests rather than the public interest. In light of the vast amounts of taxpayers' money required in rescuing certain banks, public interest must prevail after the financial crisis of 2007.

With the public interest in mind, the author builds on the idea of Tricker (Tricker, 2011). Tricker's main argument is that external auditors should report to the regulator, not shareholders. Following the financial crisis, there has been a paradigm shift to stakeholder sustainability. Tricker explained that: 'if a company wants limited liability it must meet societies' expectations and play by their rules. Limited liability is a privilege not a right: what society gives it can take away. Power in society should be exercised through its legislators not by companies through their directors.' (Tricker, 2011) Auditors will be appointed by regulator and they will report to regulator. The state should protect the various stakeholders' interests. The regulator will work closely with shareholders, where they will hire, fire or reappoint the auditors at the general meeting. (Tricker, 2011) The author would modify Tricker's suggestion so that institutional investors should work closely with the regulator since institutional investors have more time and resources than the individual shareholder to participate in such activities.

If the matter cannot be resolved with the regulator or it requires the management's attention, the Chief Risk Officer has a power of veto on the board of directors. This proposal goes further than the Walker Review. According to the Walker Review, (Walker, 2009) the Chief Risk Officer is accountable to the Board Risk Committee, a committee to be made up primarily of non-executive directors. The Chief Risk Officer should be independent from the business units and enable objectivity to be preserved. He reports to the Chief Executive Officer and/or the Chief Financial Officer. The Basle Committee's consultation paper on corporate governance stipulates that senior executives such as the Chief Operations Office or Chief Financial Officer, should not also act as Chief Risk Officer or equivalent. (Basle Committee for Banking Supervision, 2009) The Chief Risk Officer needs to attend board meetings regularly to ensure that the board of directors are aware of the risk profile. It is here that the Chief Risk Officer should have a power of veto if he disagrees with the rest of the board. With the power of veto, the Chief Risk Officer can challenge the board's strategy with some ammunition. Empowerment of the Chief Risk Officer by the board is essential to secure a sound relationship. The Walker Review (Walker, 2009) and the Basle Committee paper on corporate governance (Basle, 2009) both recommend that the Chief Risk Officer should not be removed without approval of the board. The author's alternative model of corporate governance shown in diagram 1 is radical but it is only with the above changes in corporate governance that better protection can be given to whistle-blowers. The advantage of this model is that it would eliminate the 'performance/conformance' and 'independence' paradoxes'. (Tricker, 2011) The main criticism of unitary boards is that strategy and performance are integrated, where directors are responsible for both setting out the aims and ensuring that they are achieved. The solution to this is encouraging non-executive directors to sit on the board of directors. Non-executive directors are perceived as independent, objective and impartial. The paradox is that the more independent a director is, the less he knows about the company (Tricker, 2011). Having the Chief Risk Officer on the board of directors would bring expertise to the board. He should not be a non-executive director since he is an employee of the company thus compromising his independence. His presence and the power of veto should encourage him to report his concerns. More transparency in banks should thus follow.

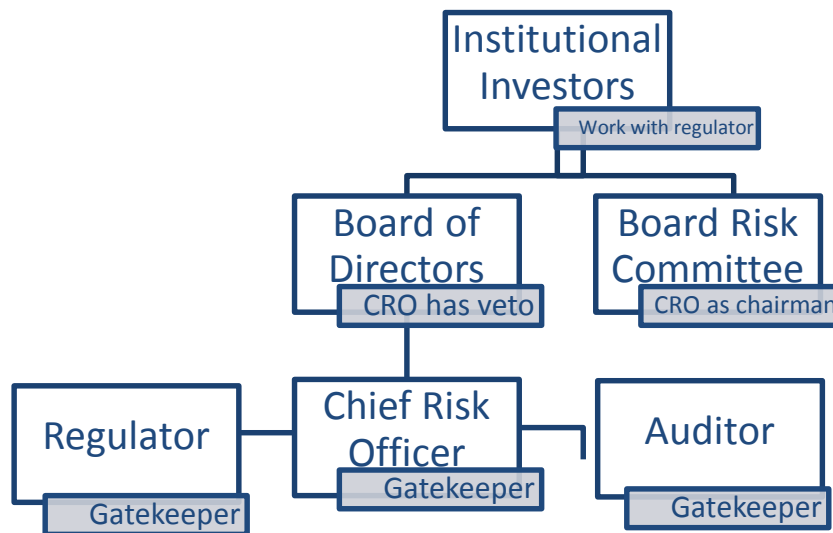


Diagram 1: Alternative model of corporate governance

## Section 7: Conclusion

Whistle-blowing is a personal and altruistic option chosen by a few workers. They do not want their concerns to be ignored, ostracised or lose their jobs. Whistle-blowing is not an enforcement tool for regulation but it can be a useful deterrent. Current UK law is inadequate in protecting whistle-blowers, especially case law. Whistle-blowers who blow the whistle are seen to be breaching the common law duty of implied faith and duty. They are labelled as trouble-makers. The case of *Heinisch v Germany* offers some glimmer of hope since the European Court of Human Rights have found that where a whistle-blower is dismissed, this could amount to a breach of the right to freedom of expression under Art 10 ECHR unless it was “prescribed by law, pursues a legitimate aim and is necessary in a democratic society for achievement of such an aim”. Although this decision is encouraging, the whistle-blower is not protected from dismissal. The Public Interest Disclosure Act 1998 aims to offer more protection to employees in relation to external disclosures, especially those of a public interest. The author then reviewed how both case law and the Public Interest Disclosure Act 1998 failed to protect Paul Moore, ex-Head of Group Regulatory Risk at HBOS. Having reviewed the whistle-blowing policies in give UK banks and compared the position with the health industry, the author proposes the following steps to improve protection for whistle-blowers in the financial industry. First, financial organisations need to incorporate standardised whistle-blowing policies into their workplace and into employee’s contracts. This would ensure that employee’s legitimate concerns are taken seriously and give employees protection from wrongful dismissal if the policy is not followed. Secondly, the Financial Conduct Authority should work with an independent professional regulatory body for bankers and develop a standardised Code of Conduct for bankers. They should also be prepared to take enforcement action against rogue bankers. Thirdly, to ensure that there is Chief Risk Officers should be able to raise concerns with the regulator freely and openly. They should act together as ‘gatekeepers’. Further, Chief Risk Officers will have a power of veto and



sit on the board of directors and act as the chairman of Board Risk Committee. Institutional investors should work with the regulator to ensure that wider stakeholders' interests are taken into account and actioned.

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