



# Regulatory Update: Conduct

19 June 2019



DUFF & PHELPS

# Agenda

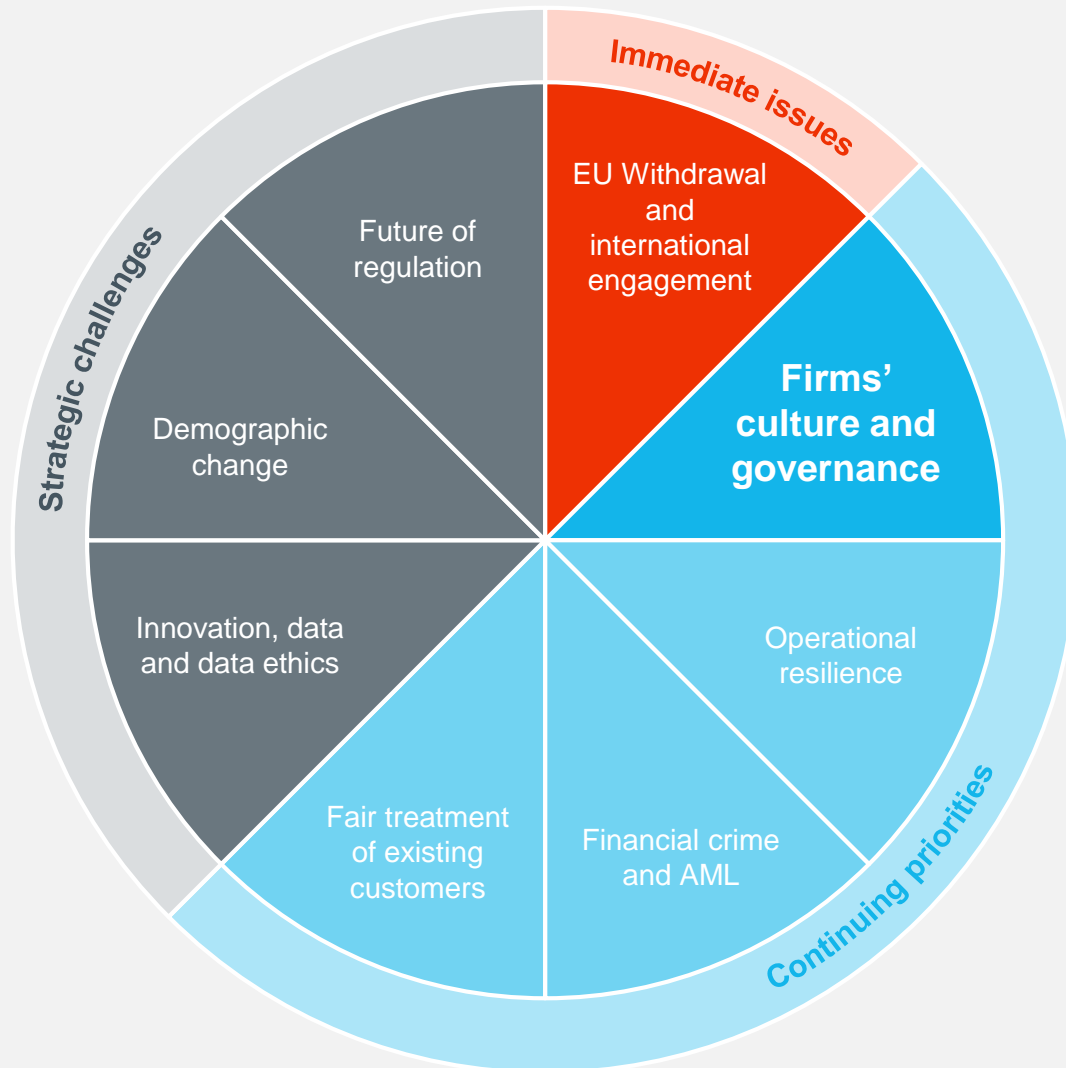


1. The FCA's continued focus on conduct
2. The FCA's 5 Conduct Questions Programme – latest findings
3. Speak-up and whistleblowing
4. FCA points to consider

*“Culture in financial services is widely accepted as a key root cause of the major conduct failings that have occurred within the industry in recent history, and we expect firms to foster healthy cultures which support the spirit of regulation in preventing harm to consumers and markets.”*

Megan Butler  
Executive Director of Supervision – Investment, Wholesale and Specialists Division  
and member of the Executive Committee  
Financial Conduct Authority, 2018

# FCA Business Plan 2019/20



One of the FCA's cross-sector priorities in 2019/20 is a continuing focus on firms' culture and governance, including accountability and conduct.

# Firms' culture and governance

## The FCA's key priorities and activities

### KEY PRIORITIES

Focusing on measures to reduce potential harm to consumers or markets:

- Promote and embed healthy cultures in firms, focusing on four drivers of behavior: purpose, leadership, reward and managing people, and governance
- Review firms' remuneration arrangements to identify if they are encouraging staff to act in undesirable ways
- Expand SMCR to all FCA-authorized firms, and holding individuals to account under SMCR

### KEY ACTIVITIES



Supporting culture transformation



Exploring the role of 'purpose' in creating healthy cultures



Evaluating firm's remuneration practices



Extending SMCR to all FCA authorised firms



Establishing the Directory

# Code of Conduct Rules

All individual employees of SMCR in-scope firms must:

1. Act with **integrity**.
2. Act with **due skill, care** and **diligence**.
3. Be **open and co-operative** with the FCA, the PRA and other regulators.
4. Pay due regard to the **interests of customers** and **treat them fairly**.
5. Observe **proper standards** of **market conduct**.

Furthermore, senior managers must:

1. Take **reasonable steps** to ensure that the business of the firm for which you are responsible is **controlled effectively**.
2. Take reasonable steps to ensure that the business of the firm for which you are responsible **complies** with the relevant requirements and standards of the regulatory system.
3. Take reasonable steps to ensure that any **delegation of your responsibilities** is to an **appropriate person** and that you **oversee** the discharge of the delegated responsibility effectively.
4. **Disclose appropriately any information** of which the FCA or PRA would reasonably expect notice.

# Conduct Risk Framework Components



# The FCA's 5 Conduct Questions Programme

## ABOUT THE PROGRAMME

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- Introduced (2015) to help wholesale banks' improve conduct risk management and drive cultural change
- In 2018, rolled out the programme more widely into other sectors of wholesale financial markets
- Industry feedback / practice benchmark reports published in 2017, 2018 and 2019 – the content of which is relevant for all financial services firms
- Good progress and embedding has been made, however not in some cases

## 2019 FCA REPORT

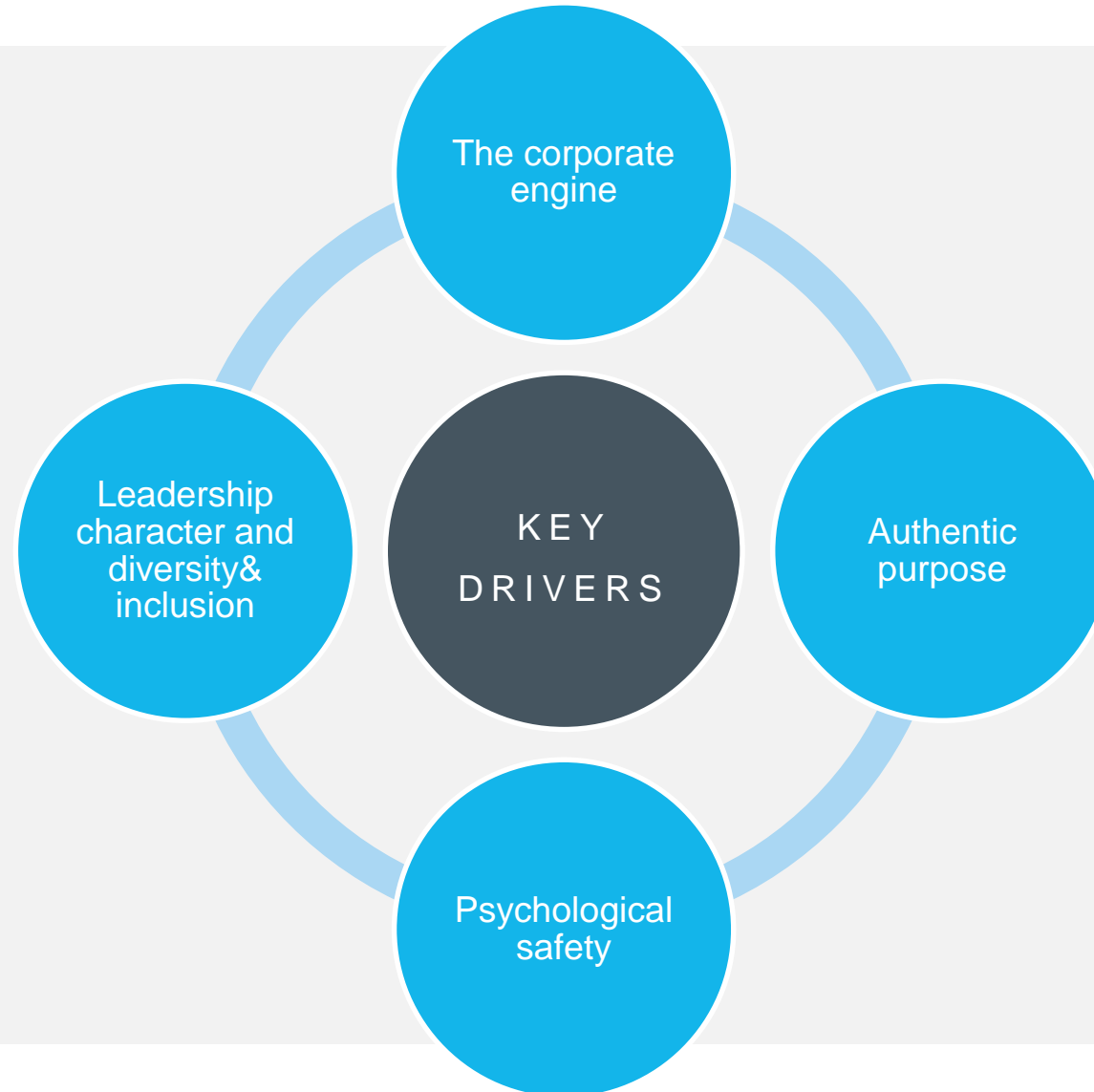
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The FCA released its 'Progress and challenges' report on the 5 Conduct Questions. Key message include:

- Good conduct and culture is increasingly recognised as a competitive advantage
- Framing conduct as an integral part of corporate goals has a positive impact on effective implementation
- Non-financial misconduct needs much more attention from staff at all levels, with Speak-up and Whistleblowing reflecting an unhealthy degree of non-financial misbehaviour



# The FCA's four key drivers of conduct behaviour



# The FCA's 5 Conduct Questions



## Identifying conduct risk

1. What proactive steps do you take as a firm to identify the conduct risks inherent within your business?



## Staff engagement and empowerment

2. How do you encourage the individuals who work in front, middle, back office, control and support functions to feel and be responsible for managing the conduct of their business?



## Supportive infrastructure

3. What support (broadly defined) does the firm put in place to enable those who work for it to improve the conduct of their business or function?



## Board oversight

4. How does the Board and ExCo (or appropriate senior management) gain oversight of the conduct of business within their firm and, equally importantly, how does the Board or ExCo consider the conduct implications of the strategic decisions that they make?



## Horizon scanning

5. Has the firm assessed whether there are any other activities that it undertakes that could undermine strategies put in place to improve conduct?

# Question 1: FCA Findings

*What proactive steps do you take as a firm to identify the conduct risks inherent within your business?*

## GOOD PRACTICE

- Defining conduct risk as a separate category
- Identify risks through both regular top down, bottom up approaches
- Widening the working scope of conduct risk
- Action to reduce the conduct risk challenges from staff using smartphones and social media
- Assessing the impact and harm of potential events from the customer's point of view
- Training that incorporates newly identified risks or crystallised risk, with grey area scenarios
- Interweaving conduct topics with business discussions

## POOR PRACTICE

- Lack of forward-looking proactive efforts and reliance on a largely top-down approach to identify risks
- Lack of investment to take action on risks identified
- Support services and second line of defence units not conferring with each other
- Firms approaching conduct risk in a diffused way
- Not discussing firm conduct separately from individual conduct

# Question 2: FCA Findings

*How do you encourage the individuals who work in front, middle, back office, control and support functions to feel and be responsible for managing the conduct of their business?*

## GOOD PRACTICE

- 'Tone from Above'
- Holding CEO-led town hall sessions on conduct
- Planning some sessions so that junior staff and their line manager don't attend together
- Open two-way communication with staff to openly share mistakes made by the firm and discuss ways to ensure they don't happen again
- Clear links between conduct and behaviour with performance assessment and remuneration

## POOR PRACTICE

- Promotion of the importance of the firm's conduct messages without explanation of what those messages are
- Issues being escalated too rapidly and bypassing key individuals
- Undermining conduct objectives by not ensuring senior managers attend open session Conduct Risk Forum meetings
- The proportionality of the rewards or penalties for conduct are inconsistent

# Question 3: FCA Findings

*What support (broadly defined) does the firm put in place to enable those who work for it to improve the conduct of their business or function?*

## GOOD PRACTICE

- Framing risk appetite statements as a series of expectations of staff and developing metrics
- Positive framing of key initiatives, and reframing initiatives to focus more on rewarding efforts
- Changing 'zero tolerance for conduct risk' culture as 'zero tolerance for unmanaged conduct risk'
- Looking beyond the firm's own boundaries
- Ignoring if a client mistreats a staff member
- Introducing a reverse mentoring programme, an internal conduct risk survey, and specific communications around disciplinary outcomes
- Shifting beyond gender-based diversity
- Providing staff with specific tools and training on how to 'speak up' and ensuring that individuals feel psychological safe
- New training models including 'grey area' scenarios

## POOR PRACTICE

- Governance structure with weighty, complex, centrally-led committees and programme management infrastructure
- Insufficient conduct risk training or inadequate follow-on support for Non-Executive Directors
- Responsibility for design and organisation of firm-wide conduct events sit with Compliance and Risk so they can't actively participate

# Question 4: FCA Findings

*How does the Board and ExCo (or appropriate senior management) gain oversight of the conduct of business within their firm and, equally importantly, how does the Board or ExCo consider the conduct implications of the strategic decisions that they make?*

## GOOD PRACTICE

- Greater investment in MI design and use of data
- People management data growing in depth and scope
- More focused and streamlined processes to collate and aggregate perceived risks
- Clear evidence that conduct risk is a component of the review of strategic business initiatives
- Evidence of challenge of new product approvals
- Better use of customer feedback, so while not a complaint, can alert firms to potential problems

## POOR PRACTICE

- Key risk indicators continue to be inwardly focused on misbehaviour, rule breaches or policy compliance
- Not ensuring sufficient steps have been taken toward actually embedding conduct

# Question 5: FCA Findings

*Has the firm assessed whether there are any other activities that it undertakes that could undermine strategies put in place to improve conduct?*

## GOOD PRACTICE

- Horizon-scanning formally included within strategic business planning, with a formal tipping point analysis for growing risks
- New working groups being established to specifically address conduct issues from new or evolving products or other business initiatives
- Senior and middle-level executives actively participating in industry-wide initiatives
- Oversight of outsourced activities

## POOR PRACTICE

- Horizon-scanning not including new conduct risks
- Not including any business representatives in periodic horizon-scanning
- Insufficient attention being given by firms to Question 5 as a whole, with activity in this area under developed

# Speak-up and whistleblowing

## Improving trends observed by the FCA

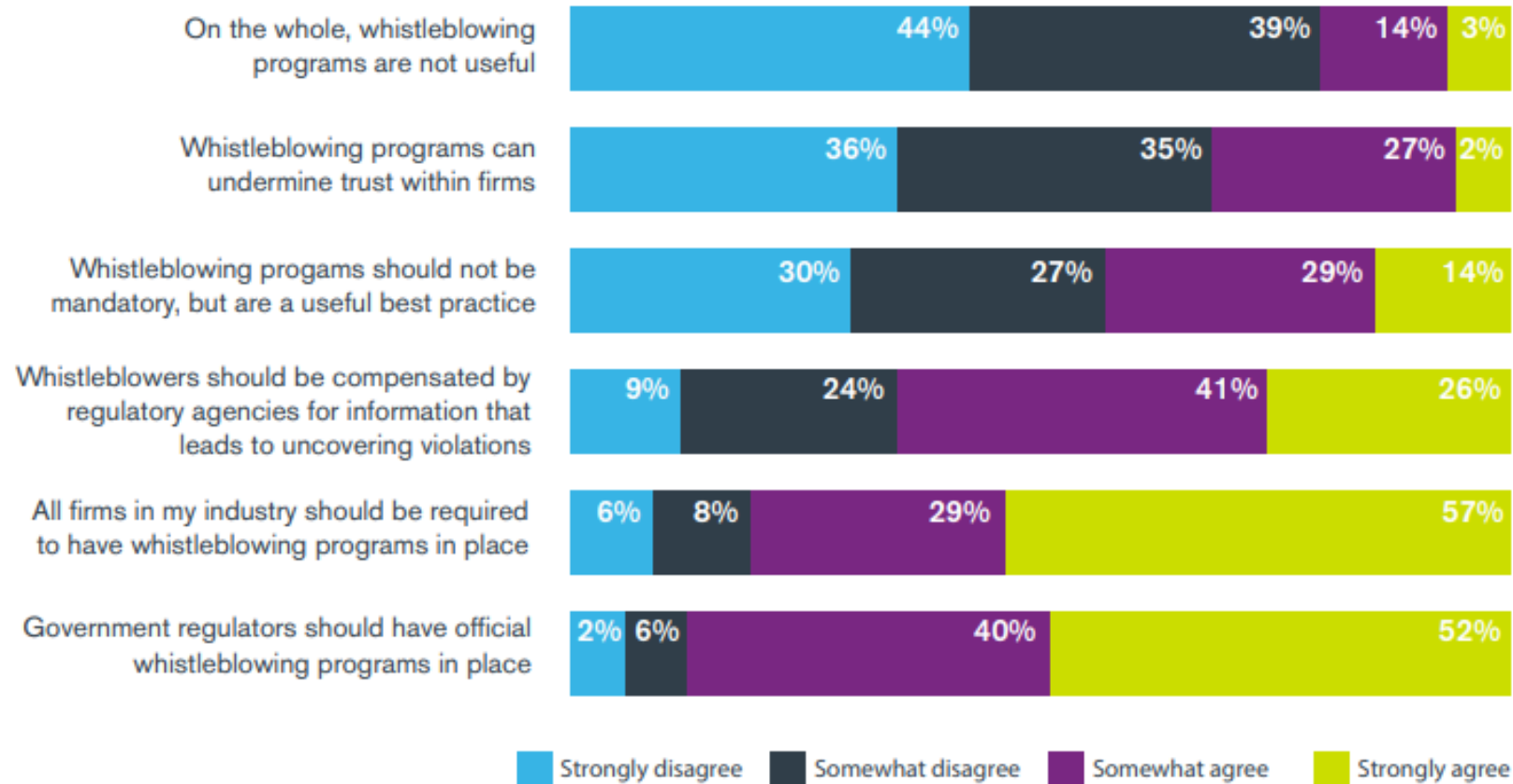
- Speak-up: “Willingness and opportunities for staff to challenge and discuss issues as normal day to day activity, including escalating issues where needed”
- General observation is that firms have effective policies and procedures in place
- However, embedding the change in mindset continues to present challenges
- On whistleblowing, there is still lingering fear and reluctance to report however a greater than usual number of cases were being reported
- An organisation’s culture drives whether they will either ‘speak up’ or whistleblow





# Attitudes Towards Whistleblowing

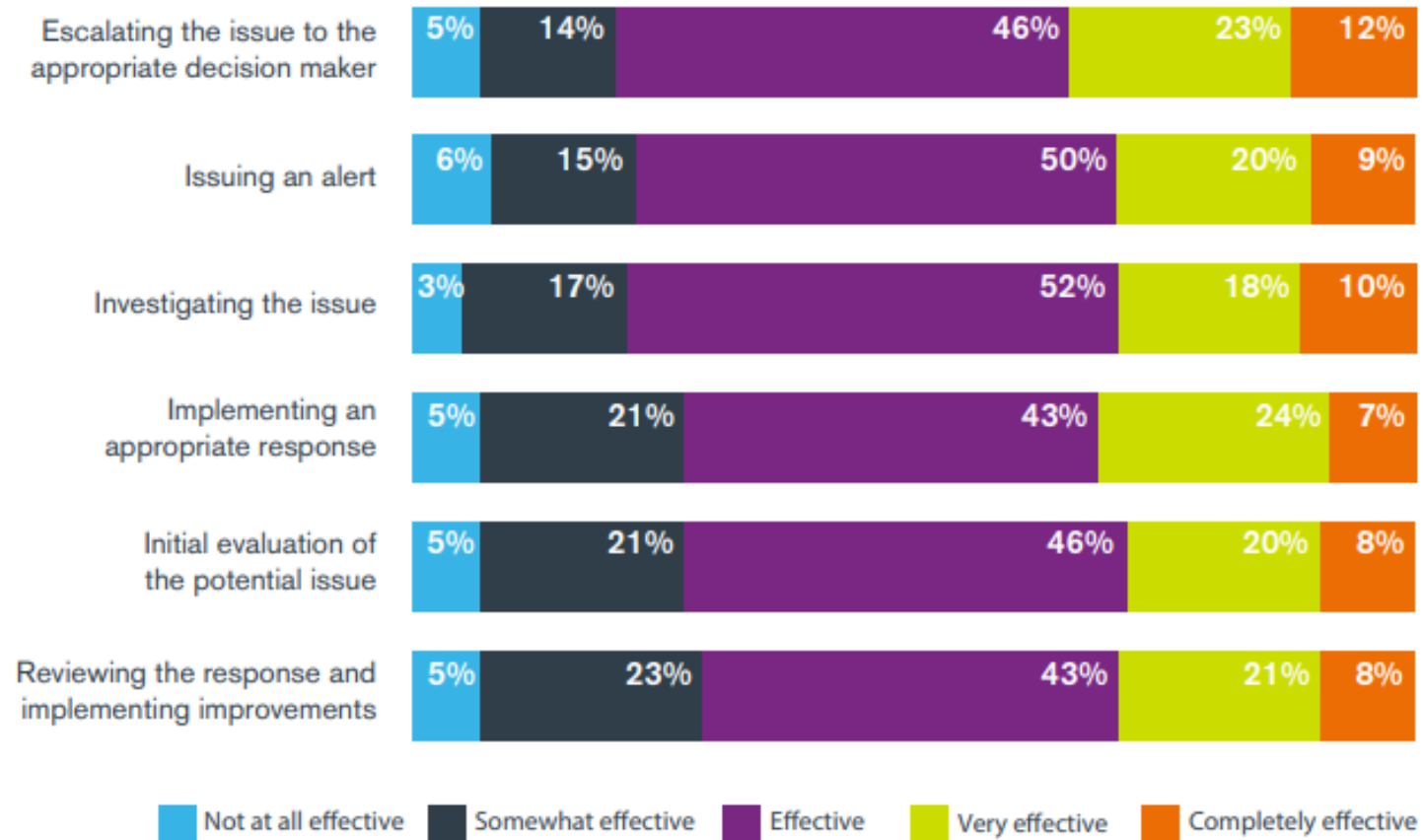
Duff & Phelps' Global Regulatory Outlook 2019



The most extensive whistleblowing programme will be ineffective if employees do not sense that it has the support of the firm's senior leadership.

# Effectiveness of Whistleblowing

Duff & Phelps' Global Regulatory Outlook 2019



Organisations implementing whistleblowing programmes for the first time are often surprised by the number of alerts that are generated.

# Non-Financial Misconduct

All staff must consider this matter

- Not tolerating misconduct is indicative of a healthy culture
- If conduct gives rise to failures or harm, the FCA will take an interest:
  - The proactive steps the firm has taken
  - The policies and procedures in place and used by the firm
  - The training provided by the firm and whether it needs to be refreshed
- Be mindful of providing support to both the complainant and the person being investigated; an independent third party is one option here to
- Managing expectations throughout the process
- Quick yet robust resolution is needed
- Firms should be proportionate in their response



# FCA Points to Consider

Questions that the FCA may ask Boards and Executive Management, and that the Board and Executive Management might choose to ask of their own firms include:

1. Are conduct and related programmes suitably framed against your firm's purpose and longer-term competitiveness and sustainability?
2. Do your conduct and related programmes include sufficient efforts to strengthen and support good behaviour rather than just reduce or eliminate bad behaviour?
3. Is there an adequate bottom-up exercise to identify and help prioritise conduct risks throughout your whole firm?
4. Do you have strategic HR programmes that focus adequately on developing the individual human skills that underpin conduct and culture change in line with the ambitions of the firm for itself and its staff?
5. In the shorter term, do your business managers and each of your lines of defence sufficiently recognise the variability and changing mix of conduct risks across your firm, and act on this?
6. In the longer term, does your firm adequately capture insights from bottom-up exercises, training programmes and crystallised events at an organisational level, such as in your overall corporate strategy, policy and updated training?
7. Looking at the evolving use of technology and digitisation, are you giving enough consideration to conduct risks that can arise as a result?
8. Are you and management doing enough to address non-financial misconduct and personal misbehaviour?

# Questions?



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