'Changing individual behaviour and culture in financial services' - Speech by Director General, Financial Conduct Derville Rowland

09 March 2022 Speech

Speech delivered at the UCD Sutherland School of Law & Eversheds Sutherland book launch

Introduction

I am pleased to be here at the launch of "New Accountability in Financial Services: Changing Individual Behaviour and Culture". I wish to congratulate the authors, Joe McGrath and Ciaran Walker, on their timely and welcome contribution to this important area.

It is said that everyone has a book in them and happily this one deals with matters close to my heart.

Regulation is continually evolving. Success in a changing and competitive world requires that it evolves steadily and well to respond to a changing environment to deliver positive outcomes for consumers, for businesses, and for the economy.

Most firms aspire to high standards. Nevertheless, those who don't cause reputational issues for the sector as a whole, and pose a risk to consumers, investors and wider society.

Poor governance, lack of consumer-focused cultures, and weak structures of accountability within firms were among the issues we set out in our Report on the Behaviour and Culture of the Irish Retail Banks.[1]

The Central Bank proposed the introduction of an enhanced Individual Accountability Framework (IAF) to address the serious issues we had identified in the regulated financial services sector.[2]

In explaining why, let me first say that financial regulation generally is about supporting positive outcomes.

It is there of course to prevent abusive behaviour by financial firms and to avoid crises and instability. More broadly, however, financial regulation is there to ensure that the financial system operates in a manner that supports the effective and sustainable functioning of the economy, so that households, firms and individuals can avail of the services they require.

So we very much welcome well-run firms with sustainable business models and effective cultures who do the right thing by their customers and do well in return.

We see the IAF in that context – a tool that delivers better outcomes not solely for consumers and investors, but for businesses themselves.

A tool to help firms strengthen their internal processes, foster better decision making and to ensure that all firms and all staff know what is expected of them.

A tool to ensure that senior leaders in particular are crystal-clear about their responsibilities and can therefore better manage their businesses which will ultimately deliver better outcomes for customers.

A tool that drives an uplift in governance across the board.

And there is evidence for same. In 2020, the Prudential Regulation Authority conducted an evaluation of the UK Senior Managers Regime.[3]

Most senior managers (94%) who participated in the survey observed that the regime brought about positive changes to behaviours, while 83% of firms said it had changed their working practices for the better.

So we believe the IAF will not just assist the Central Bank in our mission as regulator - but assist firms in achieving their objectives too with the longer term outcome of a more trusted financial services sector, which is in everybody's interest.

Today, I'd like to give some further insight into why that is the case.

Trust, culture and the social licence

The Central Bank serves the public interest by safeguarding monetary and financial stability and by working to ensure that the financial system operates in the best interests of consumers and the wider economy.

In line with *Our Strategy 2022-2026*[4], we are an open, engaged and future-focused regulator, seeking to anticipate and support innovation in financial services and understand, anticipate and adapt to the far-reaching changes taking place within the industry.

Within that, the objective of financial regulation is a resilient and trustworthy financial system, which sustainably serves the needs of the economy and its customers, in which firms and individuals adhere to a culture of fairness and high standards. We regulate more than 10,000 firms and entities providing financial services in Ireland and overseas.

In an open market economy, it is important that people and companies have the right – legal and practical - to take up new economic activities and provide services.

However, as the then Governor of the Bank of England, Mark Carney noted, markets are not ends in themselves, but must serve the interests of end-users.[5] As such, they need to retain the consent of society to be allowed to operate, innovate and grow. Otherwise, their social licence can and will be called into question.

Notwithstanding the desire of most firms to do right by their customers, misconduct in financial services is, as the authors note, "pervasive" and a global issue.[6] Given that misconduct can cause consumer detriment and, indeed, threaten the safety of financial institutions, regulators are increasingly focusing on how firms manage conduct risk. Hence the increasing focus on effective culture and governance, which drive behaviour and, ultimately, customer and investor outcomes.

The various separate aspects of the IAF complement each other to achieve the ultimate goals of better outcomes for consumers and a more sustainable financial system by driving higher standards of behaviour for individuals in financial services firms.

They are in line with best international practice, and will provide a proportionate and predictable framework to help the financial sector fulfil its role of supporting the economy and serving the best interests of consumers and other users of financial services.

Core components of the IAF

As has been said, "good organisational culture is about more than avoiding good people doing bad things; it is about equipping and enabling good people to do ever better things".[7] This is the route to better outcomes for businesses as well as those who rely on their services – and thus a very powerful incentive for firms.

Firms need to be effectively managed and organised, individuals need to be clear what they are responsible for, and both need to be accountable if they fall short of expected standards. It is essential to be clear on roles and responsibilities in firms, particularly large and complex institutions where things can and do go wrong through systems, error and individual conduct. In an increasingly technological and rapidly changing world, the need for effective governance underpinned by strong ethical culture and robust systems of delivery, which incorporate trust components, is essential.

That is why we recommended that the enhanced Individual Accountability Framework consist of:

- Conduct Standards;
- A Senior Executive Accountability Regime (SEAR);
- Enhancements to the current Fitness & Probity (F&P) Regime; and
- A strengthened enforcement process.

The proposed conduct standards will apply to all sectors, across the thousands of firms and entities we currently regulate. The standards comprise common conduct standards for individuals carrying out controlled functions (CFs), additional conduct standards for senior executives, and the important standards for businesses themselves.

The conduct standards set out the behaviour expected of firms and their staff, including obligations to conduct themselves with honesty and integrity, to act with due skill, care and diligence, and in the interest of consumers.

We consider these to be the basic standards that should underpin the provision of financial services and the relationships of trust that are central in this area. We also believe they are the standards to which most firms and individuals already hold themselves.

The additional conduct standards will be applied to senior executives and require them to meet a standard of reasonable care in how they manage their respective areas of the business.

The initial scope of SEAR will include credit institutions, certain insurance undertakings and investment firms amounting to approximately 150 firms. It will require in-scope firms to set out clearly and comprehensively where responsibility and decision-making lie in order to ensure transparency. Firms will be required to provide a Statement of Responsibilities for each Senior Executive Function which clearly sets out their role and responsibilities, in addition to a Management Responsibilities Map for the firm documenting key management and governance arrangements.

We expect that implementation of SEAR will support senior management in implementing an effective governance framework by identifying how risks are being managed and any gaps which may arise. This has been the experience in the UK whereby the Senior Manager and Certification Regime has been credited by firms as providing a sound framework for enhancing governance.

The Fitness and Probity[8] framework will be enhanced by including a requirement for firms to certify on an annual basis that individuals exercising a controlled function remain fit and proper. The introduction of a positive duty on firms to certify each controlled function strengthens the focus on the responsibility of firms for the conduct of their staff and their corporate culture.

Finally, the Central Bank's primary enforcement process, the Administrative Sanctions Procedure[9], will be enhanced to enable us to take direct enforcement action against individuals without first needing to establish wrongdoing by their firm.

The need for firms to own their own cultures

Which brings us to the role of the firms themselves.

The authors note the commonality between the UK, Australian and Irish frameworks, namely that their aim is to "establish a culture of individual accountability, particularly at a more senior level, for (mis)conduct within financial services firms, and thereby lead to improvements in ethical culture in this industry".[10]

Culture, here, is the operative word. And a useful way for firms to think about culture is through the prism of trust.

As the moral philosopher Professor Onora O'Neill points out, firms often speak about the need to increase trust, when what they should actually focus on is increasing *trustworthiness*.

In other words, be what you want your customers to see. Professor O'Neill identifies the three key elements of trustworthiness as competence, honesty and reliability.[11]

Competence is a matter of bringing the relevant skills to each task—and where the tasks are multiple and complex, the skills will be many and demanding.

Honesty is a matter of saying only what is intended, and of doing what is undertaken.

Reliability is a matter of achieving competence and honesty not just on special occasions, but with boring regularity.

It is globally recognised that culture is a matter for each individual firm in the first instance and that regulators cannot prescribe culture for individual firms. That is the role of the boards and senior leadership teams.

It is up to those leaders to define a set of values and guidelines for desired behaviour and to lead by example with regular re-enforcement to ensure the culture is actively shared.

Research in behavioural ethics has shown that people are likely to follow the culture within an organisation if there is significant peer pressure to do so. This again emphasises the need for organisations to promote effective cultures. However focussing solely on the organisation is not sufficient to achieve cultural change, which requires looking at the broader landscape which must include professional industry bodies.

All participants in the financial services industry, including key legal and accountancy advisors, must play their part in the cultural transformation.

Given that the purpose of regulation is to safeguard stability and protect consumers, the Central Bank expects the conscientious professional to advise firms to comply not only with the letter of the rules, but also with the spirit.

The role of sanctions

In the book the authors state that sanctioning powers are "no silver bullet". But their core point is in line with the Central Bank's perspective, namely that the law alone cannot compel cultural change.

"… Organisations and business leaders must accept more responsibility in pursuing pro-social purposes and raising professional standards on an industry-basis."[12]

It is important, in that context, to emphasise two points.

Firstly, the Central Bank does not view enforcement in isolation. The imposition of sanctions plays a role in addressing issues, punishing wrongdoing, and deterring future misconduct. Enforcement is thus a critical component of our high-quality regulatory framework underpinning effective gatekeeping and intrusive supervision, and we deploy it in a targeted, proportionate way to support our supervisory strategies.

We have a broad range of powers, and we escalate as appropriate depending on the scale and gravity of an issue. We most commonly use our soft powers of education, persuasion and similar to promote compliance. Further up the scale – and less frequently used – are our "hard powers". These involve increasing degrees of intrusion into firms' business and coercion of their actions. At the peak are the most coercive measures, such as administrative sanctions, criminal punishment including fines, and licence revocations. We use those powers sparingly, albeit without hesitation where warranted.

Secondly, and building on that, the IAF is about encouraging the good, not just focusing solely on stopping the bad. While robust enforcement action will continue to underpin our powers, we would far rather that firms focus on preventing, identifying, and acting upon misconduct in the first place than on us punishing them after the fact.

And we believe the IAF can assist firms in that purpose.

Next steps and consultation

In terms of next steps, the Minister has already touched on these.

Subject to the legislative process, it can be expected that the Bill will be enacted into law during the course of the months ahead. The General Scheme provides the Central Bank with regulation-making powers in respect of the SEAR, the Conduct Standards and Certification on which we have been working in parallel to complete the new framework.

Once the Bill has been enacted, we will move quickly to consult and engage with key stakeholders on the operationalisation of the IAF. As an open and engaged regulator, this consultation will include draft regulations and accompanying guidance on these key components to ensure the proposed policy measures and guidance are clear, consistent, and pragmatic and to support firms in achieving an effective and consistent implementation of what is a significant step forward.

What firms should do now

I would strongly encourage firms to use this time to prepare to implement the IAF by understanding their obligations, assessing their current governance structures in order to identify who is responsible for what, and implement any necessary changes to their existing business model in order to ensure the requirements are properly embedded.

Firms should review their current Fitness and Probity processes to assess any enhancements required to meet the annual certification requirements and consider what training and monitoring will be required to embed the conduct standards as expected standards of behavior.

These steps, inclusive of observing the lessons learned in implementing similar frameworks in other jurisdictions, will help firms to assess gaps and identify the key changes needed on a timely basis.

Firms should also more broadly examine their internal culture and values as against the IAF principles and how these could be more meaningfully reflected in practice in the firm's business.

Consideration should be given to effective ways of engaging with staff, customers and other stakeholders to spread awareness of and embed standards and positive behaviours.

Education and training together with consistent internal and external messaging will play an important part in this.

The Bill must now make its way through the necessary legislative phases before the public consultation process. When implemented, the initial focus will be on embedding the IAF into our processes and watching to ensure firms embed it into theirs. As such, and rightly so, our task will be a supervisory one to begin with, not an enforcement one.

This is where firms taking real ownership of the IAF will make a major difference.

If firms do the work to embed the IAF properly – if they embrace its spirit rather than doing the least amount possible to comply – it should ideally result in fewer serious issues in the sector, meaning fewer enforcement actions, not more of them.

Conclusion

We consider that the IAF will be extremely valuable in setting firms up to deliver positive outcomes for consumers, for their businesses, and for the economy in an increasingly fast paced, complex and technological world and as such is an opportunity to be seized.

As Professor O'Neill has noted, citing Gillian Tett's work on silo effects, "shared culture is a powerful engine of coordination, and can also be faster, cheaper and more pleasant than a reliance on law, regulation and accountability."[13]

Thank you.

---

[1]See: https://www.centralbank.ie/publication/behaviour-and-culture-report

[2]In our response to the Law Reform Commission's Issues Paper on Regulatory Enforcement and Corporate Offences in January 2018, the Central Bank recommended a number of changes to the existing framework. We indicated that we supported reforms such as legislating for an offence of egregious recklessness, assigning responsibility to senior personnel, enhancing individual accountability, and introducing conduct standards that would set clear expectations as to behaviour and conduct in the financial sector. We built on those proposals in our July 2018 report to the Minister for Finance on the Behaviour and Culture of the Irish Retail Banks by recommending the introduction of the enhanced Individual Accountability Framework

[3]See: https://www.bankofengland.co.uk/-/media/boe/files/prudential-regulation/report/evaluation-of-smcr-2020.pdf?la=en&hash=151E78315E5C50E70A6B8B08AE3D5E93563D0168

[4]The Central Bank Strategy can be viewed here: https://www.centralbank.ie/publication/corporate-reports/strategic-plan

[5]See, for example, Carney, "Staying Connected", speech given to the Markets Forum 2018. Available here: https://www.bis.org/review/r180611d.pdf

[6]McGrath and Walker, "New Accountability in Financial Services: Changing Individual Behaviour and Culture" (2022, Cham, Switzerland: Palgrave Macmillan) at pg2.

[7]Allison Cottrell, CEO of the UK Financial Services Culture Board, Transforming Culture in Financial Services, FCA Discussion Paper.

[8]For more on the Fitness and Probity Regime, see: https://www.centralbank.ie/regulation/how-we-regulate/fitness-probity

[9]For more on the Administrative Sanctions Procedure, see: https://www.centralbank.ie/regulation/how-we-regulate/enforcement/administrative-sanctions-procedure

[10]McGrath and Walker at pg.3.

[11]See: www.newyorkfed.org/medialibrary/media/governance-and-culture-reform/ONeill-Culture-Workshop-Remarks-10202016.pdf

[12]McGrath and Walker at pg.110.

[13]See: https://www.thebritishacademy.ac.uk/documents/2563/Future-of-the-corporation-Trust-trustworthiness-transparency.pdf