

WORKING GROUP ON
GOVERNANCE FRAMEWORKS
WORKSTREAM 3: INDUSTRY
ASSOCIATIONS

7 October 2016

**Stocktake of Efforts to Strengthen Governance Frameworks to
Mitigate Misconduct Risk**

Questionnaire for Industry Associations

Overview

The FSB Chair's February 2015 letter¹ to the G20 Finance Ministers and Central Bank Governors stated that the FSB will coordinate efforts to address emerging vulnerabilities from misconduct, noting that its scale in some financial institutions has risen to a level that has the potential to create systemic risks and undermine trust in financial institutions and markets. The implications of such misconduct can be far-reaching, contributing to financial exclusion, and limiting the potential of finance to serve real economies and foster global economic growth. The use of fines and sanctions acts as a deterrent to misconduct but preventative approaches that can mitigate the risk of misconduct through improved market organisation, structure and behaviour of market actors are also needed.

In May 2015 the FSB agreed to a workplan on measures to reduce misconduct risk,² covering: (1) examining whether reforms to incentives, for instance, to governance and compensation structures, are having sufficient effect on reducing misconduct; (2) examining whether steps are needed to improve global standards of conduct in the fixed income, commodities and currency (FICC) markets; and (3) coordinating reforms to major financial benchmarks.³ Collectively, these efforts aim to strengthen the resilience of the financial system by raising expectations for, as well as awareness of, good practice standards of behaviour and conduct across markets and market participants.

Ethical conduct, and compliance with both the letter and spirit of applicable laws and regulations, are critical to public trust and confidence in the financial system. Misconduct is also relevant to prudential oversight as it can potentially affect the safety and soundness of a

¹ See FSB, *Financial Reforms – Finishing the Post-Crisis Agenda and Moving Forward*, February 2015 (<http://www.fsb.org/wp-content/uploads/FSB-Chair-letter-to-G20-February-2015.pdf>).

² See FSB, *Measures to reduce misconduct risk: progress report*, November 2015 (<http://www.fsb.org/wp-content/uploads/Misconduct-risk-progress-report.pdf>).

³ The original FSB workplan on misconduct also included examining the extent of potential withdrawal from correspondent banking and possible steps to address this issue. The FSB has established a Correspondent Banking Coordination Group to take forward the four-point action plan on correspondent banking published in November 2015 (<http://www.fsb.org/wp-content/uploads/Correspondent-banking-report-to-G20-Summit.pdf>). As this work has broader financial inclusion goals, it is now being taken forward separately from the misconduct workplan, with its own progress reports to be published in August and December 2016.

particular financial institution and result in financial and reputational costs to that firm, as well as, depending on the dimension of the firm, systemic risk.⁴ Particularly severe patterns of misconduct can damage the efficient functioning of financial markets and may raise prudential concerns about broader risk management, governance and compensation practices. Furthermore, the erosion of trust in financial institutions and markets may pose even more far-reaching challenges for the financial system.⁵

As part of the work plan, in May 2016 the FSB established a Working Group on Governance Frameworks (WGGF), chaired by Jeremy Rudin, Superintendent of the Office of the Superintendent of Financial Institutions (OSFI), to explore the use of governance frameworks to mitigate misconduct risk with a view to potentially developing a supervisory toolkit or guidelines, taking into account the work of the standard setting bodies.

To launch this effort, the WGGF held a two-day meeting in June 2016. The first day provided an opportunity for national authorities to exchange information about supervisory practices in assessing governance frameworks, strengthening individual accountability and non-financial incentives, and enforcement powers. On the second day, the WGGF engaged with industry participants (e.g. directors, chief risk officers, business line leaders, heads of compliance) to explore efforts underway at banks and bank holding companies, insurers and asset managers to address conduct and culture issues. The discussions highlighted a broad range of practices that could be used to strengthen governance frameworks to reduce misconduct by both industry and national authorities.

At the July 2016 FSB Plenary meeting, members agreed it would be useful for the WGGF to take stock of efforts underway on governance frameworks to mitigate misconduct risk. The concept of “governance frameworks” is relatively broad. The WGGF has provided a working definition (see below) but is aware that this may not be consistent with definitions used by international bodies, national authorities, industry associations and firms. Thus, one of the goals of the stocktake is to review how “misconduct” and “governance frameworks” have been defined by international bodies, national authorities, industry associations and firms, and the scope of work that they have undertaken to address those areas. The WGGF will gather information and will seek to avoid overlap with existing workstreams with the aim of presenting a comprehensive landscape on governance frameworks and misconduct risk and identifying potential gaps.

Process

Respondents are kindly requested to provide a response to this survey, covering all workstreams that have worked, or plan to do work, on governance frameworks to mitigate misconduct risk at firms, referring to our working definitions. Annex A provides a list of

⁴ The ECB recently estimated that cumulative legal costs (including damages, fines, settlements and litigation costs) at a sample of 26 global banks headquartered in the United States, the United Kingdom, Switzerland and the euro area have reached almost USD 275 bn between 2008 and mid-2016. In the case of European banks, provisions for legal costs amounted to USD 160 bn in between 2008 and 2015, equal to almost half of their net income over the period (<https://www.ecb.europa.eu/pub/pdf/other/sfcfinancialstabilityreview201605.en.pdf>).

⁵ See for example Dudley W.C. *Enhancing Financial Stability by Improving Culture in the Financial Services Industry*, October 2014 (<http://www.bis.org/review/r141021c.htm>).

industry associations that will be asked to complete the survey.

Respondents are asked to send the completed survey to the FSB Secretariat (Grace.Sone@fsb.org and Jason.George@fsb.org) by 11 November 2016, and to provide contact person(s) to facilitate any follow-up consultations with the working group.

Stocktake report

The stocktake report will include the list of surveyed industry associations but it will not include any information on particular characteristics or practices that could identify an individual association unless that information is already in the public domain, e.g. disclosed by the association in its annual report or website. The report could include tables that summarise, in aggregated form, the information collected from associations, including peer-group comparisons.

Based on the findings from this stocktaking exercise, the WGGF will determine whether a second phase of work is warranted and what such work might entail, including whether the development of a supervisory toolkit or guidance is needed. A draft report, including potential recommendations for the second phase of work, will be prepared by the WGGF for discussion by the FSB Steering Committee and FSB Plenary, with publication expected by April 2017.

Definitions

To help facilitate a response to this survey, the following definitions have been provided as a guide in thinking about what work may be relevant for inclusion. The definitions provided may be different from the meanings usually attached to these words by participants and are not intended to imply that the meanings used are definitive.

Governance framework: The range of methods and techniques by which a firm is directed and overseen by those who have ultimate responsibility for the affairs of the firm (e.g. directors, executive management). These could include, but are not limited to: corporate governance structures (i.e. boards and board-level committees and management committees); risk governance framework; individual accountability; strategy setting, business planning and budgeting; internal reporting and management information; system of internal controls (risk management, compliance, and audit); financial and non-financial incentives; people management (including recruitment, training and competence, performance management and staff promotions); and promulgation of corporate culture and values (e.g. “tone at the top”, risk culture, escalation and whistleblowing mechanisms).

Misconduct: Misconduct, for purposes of this questionnaire, means conduct that falls short of expected standards, including legal, professional and ethical standards. The FSB is focussed on misconduct at a level that could undermine confidence in the financial system.

Questionnaire

<i>Name of industry association</i>	The Association for Financial Markets in Europe (AFME)
<i>Association's mandate</i>	AFME is the voice of Europe's wholesale financial markets. We represent the leading global and European banks and other significant capital market players. We focus on a wide range of market, business and prudential issues and offer a pan-European perspective.
<i>Composition of membership (e.g. banks, insurers, investment firms, etc.)</i>	AFME consists of 76 full members operating in the financial industry across Asia, Europe, and the Americas (http://www.afme.eu/Membership/AFMEFullMembers/), as well as a number of associate members operating in ancillary industries.

1. Please describe your organisation's efforts to mitigate misconduct risk in firms and in relation to ensuring high standards of corporate governance across the industry. This could include, for example, your role in representation/co-ordination of members' engagement in national and international policy development, publication of any industry standards or best practice research, roundtables with members to discuss the root causes of misconduct, or any other initiatives undertaken by your organisation. For each initiative or policy/research document, please complete the table in Annex B.

Response:

AFME works to support the efforts of regulators and the industry to help continue the improvement of levels of culture and conduct across the industry. AFME has recently worked with the UK regulators on the implementation of the Senior Managers and Certification Regime. AFME staff and members have contributed to the work of the Fair and Effective Markets Review and the FICC Markets Standards Board.

If the role of your organisation in relation to governance frameworks to mitigate misconduct risk at firms is not considered significant, then please do not complete the rest of the questionnaire.

2. For purposes of this survey, the WGGF has provided some definitions for ‘governance framework’ and ‘misconduct’. If available, please provide the definitions for these terms, as well as for ‘conduct’, used by your organisation. In addition, please describe the three features of a governance framework (building on your definition or the one provided by the WGGF) considered most important by your organisation in mitigating misconduct risk at firms, and explain why.

Response:

<i>Definition</i>	AFME defines ‘culture’ as the values of an organisation and how these values are translated into every day actions; and ‘conduct’ as referring to the behaviour exhibited by personnel within firms that could directly cause problems to customer protection, market integrity and/or competition.
<i>Top 3 features of a governance framework, and please explain why</i>	These three features are not placed in order, as we think that is difficult to determine.
	1. Managing conduct risk: conduct should be a standing, key agenda item in all governance committees up to and including the highest level, not delegated to a separate committee.
	2. Individual accountability: individuals to reap the rewards of successful governance, and take responsibility for the failure of governance, in those areas for which they are responsible.
	3. People management: management to take responsibility for people at all stages during their work in the organisation, including recruitment, day to day management, training, remuneration.

3. Has your organisation conducted a survey or gathered information relating to addressing misconduct risks through governance frameworks? If so, please share the key outcomes of that work, its summary and/or the raw input. Please tell us what conditions you might have, if any, for sharing this information with the FSB. In addition, if you have filled out a survey or participated in information gathering in this area, please grant us access to your response(s) and tell us under what conditions we may use it.

Response:

<i>Motivation for the survey/information gathering</i>	AFME devised and ran on behalf of the International Council of Securities Associations (ICSA) an April, 2016 member survey on Culture and Conduct. ICSA members are trade associations, not individual firms. ICSA members were surveyed to share their views on both their initiatives and those underway in their jurisdictions. The survey was designed to establish the degree to which ICSA Members are focusing on culture and conduct issues, and their priorities. 12 out of 16 ICSA members responded.
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<i>Key findings</i>	<p>Key findings included:</p> <ul style="list-style-type: none"> - Members could readily identify regulators with responsibility for conduct, but less so culture - Members did not believe that initiatives on culture and conduct are likely to reduce capital requirements, but believe that that strong work on conduct could reduce the volume of new legislation - Most members viewed culture as a top ten issue, but were split on plans to increase resources in the area <p>As of the date of the survey, ICSA members focused mostly on codes of conduct/standard practices and awareness, but planned initiatives on training and qualifications, alignment of incentives, and regulatory references.</p>
<i>Conditions for usage</i>	None – ICSA has consented.

4. Please describe your organisation’s approach and strategy to discouraging misconduct at firms through governance frameworks, including any specific initiatives, and outline the reasons for your approach and for undertaking these initiatives, as well as their expected benefits, including:
- (a) policy initiatives (including but not limited to those relating to financial and non-financial incentives)⁶ implemented or planned such as rules, standards, procedures, codes of conduct, oaths etc.
 - (b) monitoring and review, surveys, reporting, etc.
 - (c) other schemes

Response:

<i>Approach/strategy</i>	As well as the work described in answers 1 and 3, we continue to engage on the topics of conduct and culture with regulators, academic bodies and organisations such as IOSCO and the Basel Committee on Banking Supervision, whose workshop on conduct we attended in August 2016
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⁶ Please indicate if you have previously responded to the FSB Compensation Monitoring Contact Group (CMCG) survey on financial incentives, and if so, then please only describe your work on non-financial incentives.

	<p>AFME regularly replies to consultation papers about conduct and culture. Further to that, AFME holds seminars and conferences to discuss these issues.</p> <p>AFME held a culture and ethics seminar entitled “The Future for Banking Professionals” in January 2016, in association with Freshfields. Also in January 2016, AFME hosted a teleconference among its members entitled “Culture and Ethics in Banking.”</p> <p>AFME staff regularly speak and publish on issues of conduct and culture. By way of example only, Simon Lewis, AFME’s CEO published an op-ed in City AM in December 2015 regarding cultural change in an organization. He also spoke at the Santander International Banking Conference in 2015 on a panel entitled, “Recovering Confidence: from heightened standards to a stronger culture.”</p>
<i>(a) Policy initiatives</i>	.
<i>(b) Monitoring and review</i>	
<i>(c) Other schemes</i>	

5. Please describe how your organisation’s initiatives to address misconduct risk in firms interact with those of national authorities or of firms.

Response:

As mentioned above, AFME staff take on speaking engagements on the topics of conduct and culture, regularly addressing member firms as well as public conferences on these subjects.

We also engage with regulators on the subject. We contributed closely, and we continue to contribute closely, to the work of the FCA and the PRA on the Senior Management and Certification Regime, and to the work of the UK Fair & Effective Markets Review.

6. What are the top three issues relating to governance frameworks to mitigate misconduct risk at firms that would most benefit from improved international standards or guidance? Why do you think these would be beneficial? In your response, please also consider cases where differences in approach between countries reduce the effectiveness of governance frameworks in mitigating misconduct or lead to increased cost and complexity.

Response:

<i>Top 3 issues that would benefit from improved guidance, and why</i>	We believe that trying to ascribe a “top three” or similar approach is inappropriate. There are a range of issues (examples given below under question 8) which govern a firm’s culture and the conduct of its staff. That said, we do believe that harmonisation of approach among regulators does, as a generalisation, result in decreased cost and complexity in any area of regulation, including this one, and hence in better results.
	2.
	3.

7. Has your organisation conducted any quantitative or qualitative assessment to measure the impact of misconduct on the financial performance of firms or on the vulnerability of the financial sector in the region your members are based? If so, please mention the main results. Please also elaborate on the methodology which was used for this study.

Response:

<i>Impact assessment on financial performance</i>	<i>Main results:</i> No
	<i>Description of methodology:</i>
<i>Impact assessment on the vulnerability of the financial sector</i>	<i>Main results:</i>

	<i>Description of methodology:</i>
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8. In relation to the most significant misconduct events experienced by firms in the last eight years, please summarise what your organisation believes to be the most material root causes of these events. What were some of the lessons learnt? Did your organisation observe that these misconduct events triggered governance framework changes at firms?

Response:

<i>Principal root causes of recent misconduct events</i>	<p>We have not done any research which would enable us to answer this question with any degree of confidence.</p> <p>Many ideas have been put forward as to the causes of various events of misconduct. They include senior management engagement (“tone from the top”), culture of teams, remuneration policy and practice, attitude of regulators, personal liability of staff and management, effectiveness of whistleblowing policies and procedures, ability to obtain accurate references on employees, effectiveness of staff vetting and monitoring, employment law constraints on terminating staff for misconduct, data privacy law constraints on vetting and monitoring. There may be others.</p>
<i>Misconduct event</i>	
<i>Was the misconduct detected through the governance framework? If so, how?</i>	
<i>Were prevailing policies sufficient to address or deter the misconduct?</i>	

<i>Lessons learnt</i>	
<i>Any reforms in response to the misconduct event</i>	

Annex A: List of Industry Associations To Be Surveyed

American Bankers Association	German Derivatives Association
American Counsel of Life Insurers	German Insurance Association
Asia Securities Industry & Financial Markets Association	Global Federation of Insurance Associations
Asian Corporate Governance Association	Global Financial Markets Association
Association for Financial Markets in Europe	Institute of International Finance
Association of British Insurers	Insurance Bureau of Canada
Association of Foreign Banks	Insurance Council of Australia
Australian Bankers' Association	Insurance Europe
Australian Financial Markets Association	International Banking Federation
Banking Standards Board	International Capital Market Association
Brazilian Association of Financial Markets Institutions	International Corporate Governance Network
Brazilian Federation of Banks	Investment Adviser Association
British Bankers Association	Investment Association
Canadian Banker Association	Investment Company Institute
Chief Compliance Officers' Forum	Investment Industry Association of Canada
Deutsches Aktieninstitut (DAI)	Japanese Bankers Association
Dutch Banking Association	SIFMA Firm Culture Working Group
European Banking Federation	Spanish Banking Association
Geneva Association	The Clearing House
	UK FICC Markets Standards Board

Annex B: Initiatives and policy/research documents related to governance frameworks to mitigate misconduct risk

(a) what is the initiative/ policy document trying to achieve, i.e. the desired outcome	(b) which principles/ chapters/ sections address governance frameworks	(c) Method for keeping policy documents up-to-date	(d) whether an implementation assessment of the policy document has been conducted. If so, please share any high-level findings pertaining to implementation	(e) the types of financial institutions (e.g. banks, insurers, asset managers, financial holding companies, listed firms, internationally active, etc.) to which the policies are applicable	(f) At what level within an institution do the policies apply (i.e. board members, executive management, business line leaders, all staff, group-wide, entity level, etc.)	(g) whether there are certain positions/roles that are held to a higher standard relative to others within an organisation, e.g. those with fiduciary advisory roles	(h) Whether the policies specify a role for supervisors/regulators in ensuring their implementation, including cooperation with other national authorities both domestically and across borders
If relevant, name and link to policy document: <i>[insert name of document and the link]</i>							
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If relevant, name and link to policy document: <i>[insert name of document and the link]</i>							
If relevant, name and link to policy document: <i>[insert name of document and the link]</i>							

AFME Contact:

Will Dennis, Head of Compliance

+44 (0)20 3828 2683

Will.dennis@afme.eu