

Symposium of the CFA Institute

Corporate conduct: How has culture changed? What is the role of regulation?

FSMA

AUTORITEIT
VOOR FINANCIËLE
DIENSTEN
EN MARKTEN

AUTORITÉ
DES SERVICES
ET MARCHÉS
FINANCIERS



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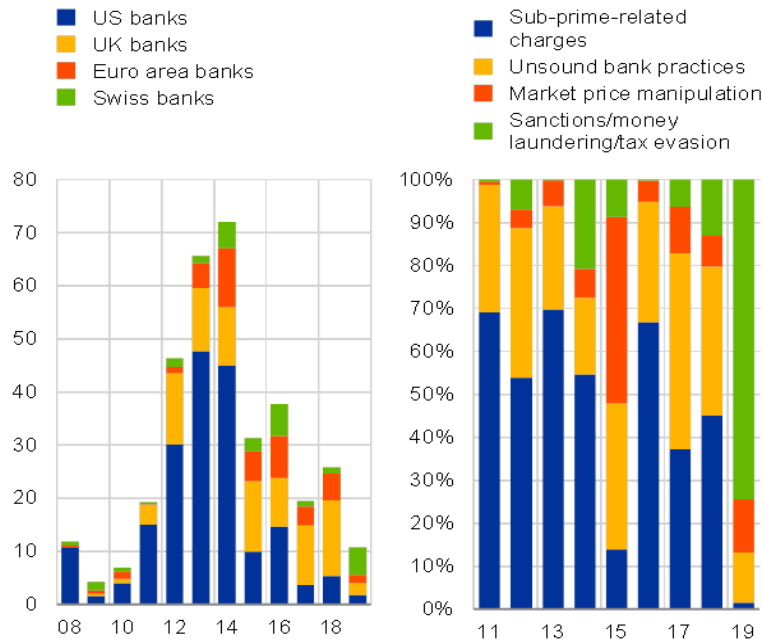
1. Culture, behaviour and misconduct (1/2)

- Culture, behaviour and misconduct are narrowly linked
- Why does it matter?
 - Widespread misconduct in the financial sector
 - Leads to mistrust
 - Weakens the ability of markets to allocate capital to the real economy
 - Has a social, economic and reputational cost
 - May give rise to systemic risks
- Costs?
 - “Past misconduct by banks has weighed on global bank profitability and equity positions over the last decade, with the related costs amounting to over USD 350 billion or 15% of total bank equity” (ECB, Financial Stability Review, November 2019)

1. Culture, behaviour and misconduct (2/2)

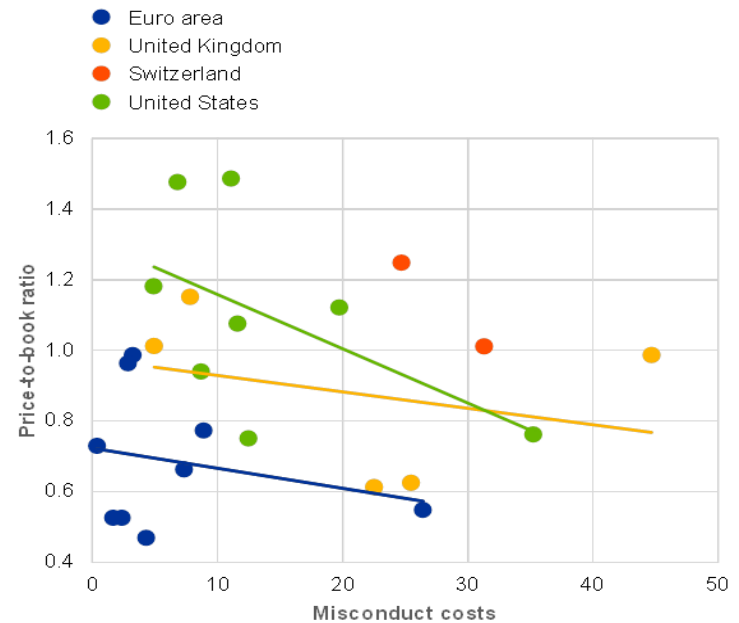
Global banks' misconduct costs by geographical area and type of misconduct since the global financial crisis

(Q1 2008-Q3 2019, USD billions, percentage of total)



Global banks' cumulative misconduct costs relative to total equity and average price-to-book ratios for 2008-19

(2008-19, percentage of average total equity, ratio)



Source: ECB, Financial Stability Review, November 2019

Notes: Left panel: Misconduct costs comprise damages, fines, settlements and litigation costs above USD 1 million for a sample of 26 global banks headquartered in the United States (8), the United Kingdom (5), Switzerland (2) and the euro area (11). Sub-prime-related charges cover misconduct costs related to the issuance, structuring, marketing and sale of residential mortgage-backed securities and collateralised debt obligations, and to the underwriting, origination and servicing of mortgage loans. Unsound bank practices include the mis-selling of payment protection insurance, disclosure, reporting and compliance failures, as well as investment advice failings. Market price manipulation comprises fraudulent behaviour in interest rate, foreign exchange, swap, gold and silver price fixing. Sanctions, money laundering and tax evasion reflect the failure to comply with international sanctions, anti-money laundering failures and banks' involvement in or assistance of tax evasion.

2. What has changed? (1/3)

- What has changed (in summary)
 - Information
 - Conduct
 - Product
 - Convergence

2. What has changed? (2/3)



information

- More balanced marketing materials across products
- Focus on cost/return
- Clear explanation of specific risks



conduct

- MiFID : growing awareness*



product regulation

- Simplification of product offering without impact on possible return

* the Belgian independent Ombudsman in financial matters observed a significant decrease in the number of complaints regarding transactions in financial instruments over the last 10 years

2. What has changed? (3/3)

=> More convergence

legislation

- enhanced use of single rule books and guidelines

interpretation

- ESMA IPISC and FISC
- EIOPA committee on consumer protection and financial innovation
- ...

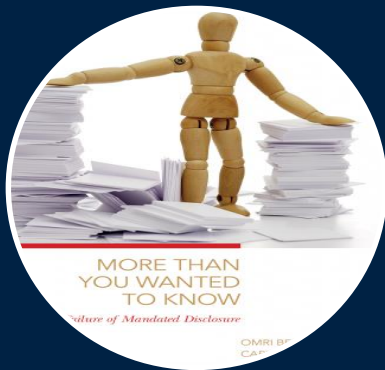
Supervision
enforcement

- ESMA and EIOPA networks/platforms
- Peer reviews, reporting on measures
- Product intervention powers

3. EU and Belgian framework (1/2)

- Regulation and supervisory practices played a major role in the changes highlighted
 - new regulations (for example, PRIIPs)
 - amended regulations (for example, MiFID II)
 - new powers (for example, product intervention)
 - new initiatives (for example regarding financial education)

3. EU and Belgian framework (2/2)



Information

Prospectus,
UCITSV, PRIIPS,
MiFID II, IDD

‘RD Pub’

‘RD Life’

Front page
warnings

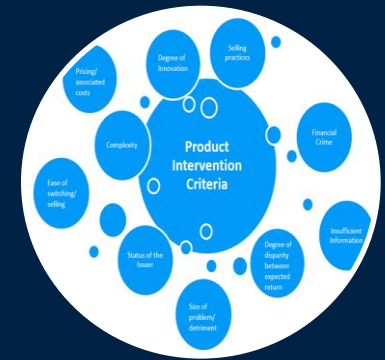


Conduct

MiFID II, IDD

Centralised
inspection
capacity

Mystery shopping



Product regulation

UCITS V, AIFMD,
PRIIPS, MiFID II,
MiFIR

‘Moratorium’

Bannings

Financial education

4. Enhancing risk culture with regards to conduct of business rules

- 4.1 « Multi-tool » approach
- 4.2 A two-steps approach
- 4.3 Prevention
- 4.4 Reaction

3.1 “Multi-tool” approach

- While ex-post fines are essential to punish misconduct, which in turn can help to enhance culture, a **preventive approach** is also required
- A **multi-angle approach** seems needed to enhance culture, behaviour and avoid misconduct
 - At international level
 - Prudential supervision of corporate governance within banks and investment firms
 - Enhancing risk culture with regards to conduct of business rules
- In the context of this multi-angle approach, a « multi-tool » approach should probably be used. Tools?
 - Prevention (foreseeability of FSMA’s actions and expectations, for example)
 - Supervision
 - Sanctions (fines, other measures)
 - Remedial actions

3.2 A two-steps approach

- How to enhance risk culture with regards to conduct of business rules? => a two-steps approach
 - Prevention
 - Improve the understanding of the legal and regulatory requirements as well as of the supervisor's expectations
 - Tone at the top
 - Responsabilisation
 - Banning
 - Impact?
 - Reaction
 - Remedial action plans
 - Sanctions
 - Remedial actions
 - Examples

3.2 Prevention - Improve understanding (1/3)

- Several tools used
- Foreseeability of FSMA's actions and expectations
 - FSMA's work programmes
 - Published on the FSMA's website (see <https://www.fsma.be/fr/regles-de-conduite-mifid>, under 'MiFID-Toezichtsinstrumenten')
 - Presented to CEOs as well as to Compliance Officers
 - Standardized methodology
 - On-site visits announced in advance and explained

3.2 Prevention - Improve understanding (2/3)

- FSMA's Reports to firms
 - Audit's results are reported to the firm
 - Some figures regarding recent on-site visits (about conflicts of interest, suitability/appropriateness/execution-only and best execution):
 - Extensive coverage (87% of the sector in terms of services provided to retail clients)
 - 1850 persons met
 - 6930 files analyzed
 - 532 branches visited
 - 225 orders, 253 recommendations, 33 points for attention

3.2 Prevention - Improve understanding (3/3)

- **Mystery shopping**
 - Preparation of the field work by the FSMA
 - Further analysis of Mystery Shoppers results' done by the FSMA
 - **Communication**
 - Anonymous results are communicated at a press conference
 - Each regulated entity receives results regarding the firm
- **FSMA's findings and standpoints**
 - Anonymous observations
 - Helps firms to benchmark themselves with each other

3.2 Prevention - Tone at the top

- Tone at the top is crucial
- Therefore
 - FSMA's reports presented to CEO of the relevant firm as well as to the president of the Management Board (when the report includes orders)
 - Strong commitment is expected from the top to ensure firm's compliance with conduct of business rules (in certain way, this anticipates MiFID II: see following slide)

3.2 Prevention - Responsabilisation (1/3)

- Specific requirements in MiFID II:
 - The management body of an investment firm defines, oversees and is accountable for the implementation of the governance arrangements that ensure effective and prudent management of the firm, including (amongst others) the prevention of conflicts of interest, and in a manner that promotes integrity of the market and the interest of clients
 - Those arrangements shall also ensure that the management body defines, approves and oversees (amongst others) the organisation of the firm (taking into account all the requirements the firm has to comply with), a policy as to services, activities, products and operations offered or provided in accordance with the risk tolerance of the firm and the characteristics and needs of the clients, a remuneration policy aiming to encourage responsible business conduct, fair treatment of clients as well as avoiding conflicts of interest

3.2 Prevention - Responsabilisation (2/3)

- Specific requirements in MiFID II:
 - The management body shall monitor and periodically assess (amongst others) the effectiveness of the firm's governance arrangements and adequacy of the policies and take appropriate steps to address any deficiencies
 - Members of the management body shall have adequate access to information and documents which are needed to oversee and monitor management decision-making
- Besides tone at the top, in Belgium, specific role of the Compliance Officer

3.2 Prevention - Responsabilisation (3/3)

- Compliance Officer: **key function** with regards to conduct of business rules
- **Specific regime** for Compliance Officers
 - FSMA's Regulation of 27 October 2011 (Royal Decree of 12 March 2012)
 - Authorization procedure
 - Conditions regarding experience, knowledge (knowledge to be demonstrated through passing an exam; exceptions possible), insurance regarding legal protection, proper character
 - Periodic updating of knowledge
 - At this date, there are 145 authorized compliance officers :
 - 40 for credit institutions;
 - 62 for Insurance undertakings;
 - 36 for investments firms;
 - 7 for management companies of UCITS.

3.2 Prevention - Banning

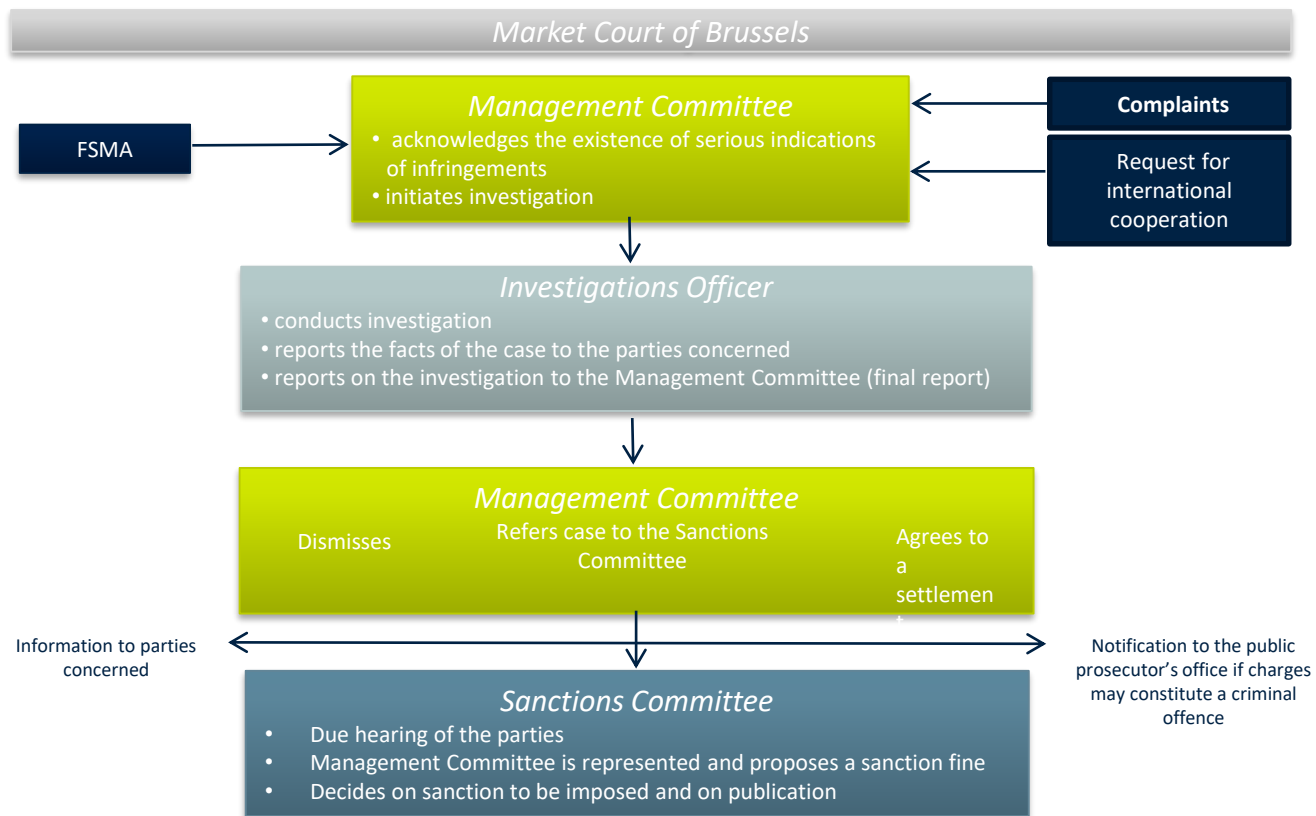
- In some situations, **ex-ante actions are needed to protect investors**
 - **Moratorium on the distribution of particularly complex structured products**
 - **FSMA's Regulations of 3 April 2014 on the ban on the distribution of certain financial products to retail clients (non-mainstream products) (Royal Decree of 24 April 2014)**
 - **FSMA's Regulation of 26 May 2016 governing the distribution of certain derivative financial instruments to consumers (Royal Decree of 26 July 2016)**

3.3 Reaction - Remedial action plan

- Remedial action plans
 - Each firm visited has adopted a remedial action plan (41 plans adopted with regards to conduct of business rules)
 - In some situations, the plan adopted implied heavy changes in the firm's procedures or business model
 - Remedial action plans need to be presented and discussed at the board level
 - Remedial action plan presented to the FSMA by the CEO
- Follow-up by the FSMA and interactions with firms
- Involvement of the CEO of the firm in the follow-up

3.3 Reaction - Sanctions

Overview of the process



3.3 Reaction - Remedial actions

- Besides sanctions, the FSMA has also, in the past, imposed **remedial actions** to firms

3.3 Reaction - Examples

- BNP Paribas Fortis SA (see <https://www.fsma.be/nl/admisancties>, 28.03.17)
 - Greek bonds advised to retail clients while being unsuitable for such clients
 - Compensation of relevant clients
- FSMA's action about IRS proposed to SMEs (see : <https://www.fsma.be/fr/regles-de-conduite-mifid>, under 'Constatations et positions dégagées à l'issue de plusieurs contrôles')

Q&A