Are Financial Institutions: in Asia Ready for the Culture and Conduct Revolution?

Natalie Curtis, Partner in Singapore at law firm Herbert Smith Freehills, gave an insightful, detailed and thought-provoking presentation on why regulators are increasingly focused on senior management and individual accountability. She highlighted the latest developments in senior management/individual accountability and conduct regimes globally and advised delegates attending the Hubbis Compliance in Asian Wealth Management Forum in Singapore to start preparing for the Monetary Authority of Singapore's forthcoming Individual Accountability and Conduct Regime.

ARMED WITH A DETAILED AND USER-FRIENDLY PDF PRESENTATION, Curtis began by explaining that as a Partner in her law firm's financial services regulatory practice, she has been working closely with financial intermediaries to prepare them for the what she termed the "culture and conduct revolution". The background, of course, dates back to the GFC and the systemic failings and risks at that time, but she noted that very few individuals were held to account, largely because of difficulties in assessing the opaque reporting and responsibility structures.

"But there was a clear recognition then that something needed to be done," Curtis explained. "And what this means is the authorities wanted to work out a way to incentivise and change behaviour because while it was all very well to impose sanctions and fines on organisations, at the end of the day, that would not necessarily change behaviour."

The UK as a prime mover

The UK then came up with the Senior Managers Certification Regime - SMCR - which was quickly followed by Hong Kong

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Manager-in-Charge (MIC) regime, while in Australia there is the Banking Executive Accountability Regime (BEAR). And soon to roll out is the Singapore regime, which will be based on the MAS' proposed Guidelines on Individual Accountability and Conduct (IAC Guidelines), the consultation for which emerged in April 2018 and the final version due out soon.

The global scene

Curtis then briefly reviewed some of the latest developments globally, such as the latest situation in New Zealand, Malaysia, Ireland and other jurisdictions, noting that all have similar objectives in that they aim to change behaviour and mitigate misconduct risk. "Many of the regimes are centring on fitness and properness and enhancing the requirements around that, but some are also looking to increase their regulator's powers of enforcement so that they can take action against individuals for transgressions of individuals, that distinguish from any possible misconduct by the organisation itself," she commented.

She zoomed in on the UK's SMCR regime, which was extended on the 9th of December and now covers all Financial Services and Markets Act (FSMA) authorised firms. "With SMCR in place for more than three years now," Curtis noted, "they have conducted studies into the effects, and there is a robust agreement that the regime had brought about a meaningful change in behaviour in the industry, with benefits in the clarification of the roles and responsibilities of senior managers."

Taking effect

Moreover, she noted that there have been significant changes in the approach taken to decision making within most organisations, including in respect of considering relative risks and involving relevant control functions and decisions. Additionally, there is clear evidence of governance improvements more broadly, including the tightening of committee structures, terms of reference and membership.

Moving on to enforcement relating to SMCR, Curtis then highlighted that the regime is designed to deter and change behaviour, but so far while there might be investigations brewing, there are only a few cases of enforcement. Nevertheless, she noted that as of December 2nd, 2019, the FCA had 377 open inquiries into individuals, with 15 concerning high-level managers according to information obtained via a Freedom of Information Act request.

No action without reflection

In Hong Kong, the regulators have said that before they look at senior managers, there really has to be cogent evidence of genuine misconduct and lack of oversight. "They and others do in fact appreciate that being in the frame of an investigation is obviously something that is very distressing and can be career-ending or at least career-limiting, so they tell us that they do take that seriously," Curtis remarked.

Regarding the Singapore IAC guidelines, Curtis said that she had been expecting them earlier, but they remain in the pipeline. "The MAS," she reported, "has taken a slightly different approach, coming up with five accountability and conduct outcomes that financial institutions are expected to work towards. We see the MAS has looked very closely at the other regimes, to then choose what they want as both differences and similarities." Curtis briefed the audience on those five outcomes.

The 5 MAS outcomes

Outcome 1 relates to clearly identifying senior managers who have responsibility for the management and conduct of functions that are core to the financial institution's operations.

Outcome 2 requires the financial institution to ensure that the senior managers are indeed fit and proper for their roles and held responsible for the actions of their staff and the conduct of the business under their purview.

Outcome 3 covers the financial institution's governance framework and requires it to be supportive of and conducive to senior managers' performance of their roles and responsibilities. The financial institution must also assess if their overall management structure and reporting relationships are clear, transparent and fit for purpose.

Outcome 4 relates to whether material risk personnel are fit and proper for their roles, and subject to effective risk governance as well as the appropriate standards of conduct and incentive structure within the financial institution.

And Outcome 5 requires the financial institution to have a framework that promotes and sustains the desired conduct among all employees.

Implications galore

Commenting on this approach, Curtis told delegates that Outcome 4 is probably causing the most concern amongst financial institutions because there isn't a lot of clarity in relation to who are material risk personnel.

The fifth outcome, she remarked, is the requirement to make sure that expected standards of conduct are communicated. "This," she explained, "demonstrates that it is not just a regime for senior managers, but broadens the expectations to require that everybody involved will take responsibility and everyone will understand what is expected of them."

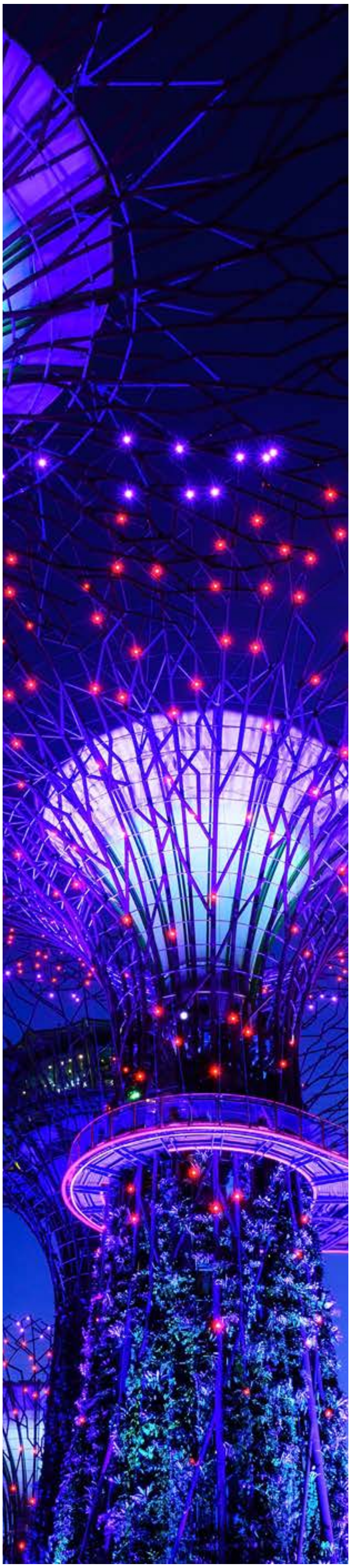
Don't procrastinate

Curtis then advised the financial institutions present not to wait before acting on the IAC Guidelines, as they will be issued in their final form before not too long. "Implementation of some of these requirements will likely take longer than expected," she commented, "and you may find yourself in a situation where you have to have difficult conversations with people."

She therefore proposed that the first step is identifying the senior managers with the day to day responsibility of the core management function. "Assess exactly who is actually the decision-maker," she said, "and while some decisions maybe then escalated to someone even more senior, perhaps at a regional level, this is actually about the day to day management, very important to bear in mind."

A holistic perspective

Curtis also advised financial institutions to prepare for the fit and proper requirements. "Under the IAC Guidelines," she explained, "it is clear that all of the senior managers of core management functions will need to be assessed to be fit and proper. Some of those senior managers will already be



subject to a regulatory fit and proper assessment. However, for other such as the Head of HR or Head of Compliance, you will need to then think about what criteria are to be used, what types of qualifications are required for such roles. You need therefore to come up with a framework, carry out the assessments and record them, and then also refresh them when there is a material change. In short, get on to this sooner rather than later."

She also pointed to material risk personnel, individuals who have the authority to make decisions or conduct activities that can significantly impact the financial institution's safety and soundness, or cause harm to a significant segment of the firm's customers or stakeholders.

"There is something similar in the certification part of the UK's SMCR regime where the FCA has specified 8 functions which is considers to be "significant harm functions," she noted, "but because the IAC Guidelines will cover most of the financial services industry, it is more difficult for MAS to be quite so specific and granular as to who would fall into the bucket of material risk personnel under the IAC Guidelines."

MAS, Curtis added, has said that financial institutions therefore need to take a qualitative and a quantitative approach to identifying material risk personnel.

Know your organisation

In implementing the IAC Guidelines, financial institutions need to "identify their core management functions, and make sure a senior manager is identified and allocated responsibility for each core management function."

She also pointed to the importance of establishing standards of conduct. "You might have this already, perhaps gathering dust in a drawer," she remarked, "but this needs to be refreshed and the standards of conduct communicated throughout the financial institution, so build that into your training programmes, your onboarding programmes, and make sure that then everybody is aware of what the expectations are. The entire organisation is part of the regime."

Communication essential

Curtis closed the insightful and thought-provoking talk by adding that from an HR perspective, communication about what this regime means is very important. "You will need to speak to senior managers who perhaps have not been in the target sights of the regulators previously, and you will have to explain to them that they could be held personally responsible not only for their own actions, but for the actions of the employees that they oversee," she said.

"Of course," she added, "that worries people, and often leads to questions on remuneration, compensation in the event of problems, insurance, and so forth. But it is also important to reinforce to these people that actually this is not changing their roles and responsibilities currently. It is, in fact, providing some clarity and transparency around that. It is also vital to make sure that your contracts and job descriptions are consistent."

Her final word was that MAS' IAC Guidelines will be far-reaching, but will offer a 12-month transition period, which Curtis says reflects that there will be rather a lot of work to implement this regime. "The takeaway I want to reiterate today is to start now; it will take longer than you expect, be prepared to have some difficult conversations, and make sure you communicate broadly what this means not just to the senior managers, but throughout your firms." ■