Bringing the code of conduct to life

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In this article I hope to show some examples of what the new code of conduct might mean when it comes into effect for the Financial Services industry and to bring it to life for the people and institutions that it will apply to.

I will start with a look at some dictionary definitions of both ‘Conduct’ and ‘Culture’.

Conduct has several different definitions but there are probably two that we are most interested in.

1st Definition:

“The manner in which a person behaves, especially in a particular place or situation”

Synonyms: behaviour, way of behaving, performance, actions, acts, activities, deeds, habits, practices, manners

Example: “the townspeople regularly complained about the students’ conduct”

2nd Definition:

“the manner in which an organisation or activity is managed or directed”

Synonyms: management, managing, running, direction, control, controlling, overseeing, supervision, regulation, leadership, administration, organisation, coordination, guidance;

Example: “the conduct of the elections”

A brief glance at the definitions and particularly the ‘synonyms’ indicates the breadth and scope of ‘conduct’ within a Financial Services organisation, and makes clear some of the links between ‘conduct’ as we might interpret it and ‘culture’, which has its own set of potentially complex and nebulous implications.

Culture can be defined as “The beliefs, customs, practices and social behaviour of a particular group of people”

One conclusion is that a firm’s ‘Culture’ is a key factor in determining the ‘Conduct’ of its staff.

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Certainly, both words are enjoying a significant share of media coverage, regulator attention and industry profile.

In the detail of the Conduct Rules part of the new Individual Accountability Regime (IAR), the rules as they are currently drafted are:

First tier: all staff (excluding auxiliary staff)

1. You must act with integrity.
2. You must act with due skill, care and diligence.
3. You must be open and cooperative with the FCA, the PRA and other regulators.
4. You must pay due regard to the interests of customers and treat them fairly.
5. You must observe proper standards of market conduct.

Second tier: requirements for Senior Managers only

6. You must take reasonable steps to ensure that the business of the firm for which you are responsible is controlled effectively.
7. You must 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.

8. You must take reasonable steps to ensure that any delegation of your responsibilities is to an appropriate person and that you oversee this effectively.
9. You must disclose appropriately any information of which the FCA or PRA would reasonably expect notice.

It is material to note that these rules are still only 'draft', although I think it is unlikely that there will be any significant changes when the final rules are published.

Both FCA and PRA are due to publish their final rules covering most elements of the IAR by 'Spring / Summer 2015'. I think we can now forget 'Spring' but I guess 'Summer' could mean any time between now and end of August? To date, I have been unable to achieve any more clarity from either regulator about the likely date of the next round – we are all waiting and all in the same boat.

However, there are some things we do know.

Namely that the final version of these new Conduct Rules will apply to both Senior Managers and Certified Persons with effect from 7th March 2016. Which means that, by then, all Senior Managers and all Certified Staff must have been specifically trained in how these Conduct Rules apply to them, in their particular role. Firms then have until 7th March 2017 to issue the first Certificates to their Certified Staff and to roll out the Conduct Rules training and obligations to all except ancillary staff.

In the latest publications from the regulators they commented that despite feedback concerns about the potential cost implications of these Conduct Rules, *"a wide scope is critical to improving accountability and awareness of conduct issues all the way through firms, and for promoting the right culture, governance and conduct, in support of our consumer protection and market integrity objectives."*

Although FCA did add that they *"recognise the importance of ensuring that the new rules can be implemented proportionately."* And that they would *"look further at the reporting requirements that fall on firms, in regard to potential breaches of the new rules, and consider how they should be applied in practice."*

This feedback is important because it suggest very strongly that the rules and their scope are unlikely to change much but that perhaps the breach reporting obligations may ease.

One area we may hope to receive more guidance on relates to 'materiality'. Currently, there is no material threshold for notification of suspected Conduct Breaches. I suspect that it is appropriate for there to be a threshold but that the regulators will suggest that Firms define it for themselves – only reporting suspected beaches which they determine 'material', hopefully with some guidance from regulators. We will have to wait and see.

Returning to the link between the terms 'culture' and 'conduct', both have their roots in the betterment and refinement of individuals and personal behaviour. Both influence the way individuals act and therefore

collectively, the way the Firm behaves and interacts with customers and other participants in the markets. Both are therefore very much at the heart of what the regulators are trying to change through their focus on Individual Accountability, organisation governance and risk management.

However 'individual behaviour' is essentially intangible. Either because of the huge number of interactions that take place every day or even worse because future interactions haven't happened yet. It makes measuring and reporting on culture and conduct potentially very difficult.

So what can Firms do to provide assurance that they are on the right track and behaving appropriately?

The new 'conduct rules' sound like a good idea – they ought to provide a solid point of reference as guidance for staff faced with complex choices, or uncertain situations but there is a growing body of experience and evidence that 'value statements', like these new rules, fail to make an impact - staff simply don't find them useful guides in their day-to-day decision-making.

To create effective 'conduct' programmes managers need to be brave and be prepared to exercise judgement, this is after all what the regulator is going to do to assess your programme!

The FCA Business Plan 2015/16 sets out the risks they perceive and intend to focus on for this year and it is no surprise that it includes *"how poor culture and control continues to threaten market integrity"*. The detailed plan specifically refers to Individual Accountability as a key priority and goes on to state *"It is vital that firms, in wholesale and retail markets, ensure that cultural changes have been made to prevent poor conduct in future . . . We continue to address conduct issues arising from failures in firm culture and are committed to ensuring this momentum is not lost."*

In a speech given by Clive Adamson as far back as 2013, FCA suggested that they would *"draw conclusions about culture from what we observe about a firm – in other words, joining the dots rather than assessing culture directly . . . This includes assessing if the perceived customer-focused culture is supported by, for example, regular discussions on conduct at board level . . ."*

Under the IAR, Senior Managers will be personally responsible for Culture and Conduct within the Firm, for ensuring that appropriate behaviours become the norm and that appropriate outcomes are focused on.

However, the Senior Managers with these responsibilities will probably not be personally responsible for the business operations where most of the conduct risks occur or directly responsible for the staff who will give rise to them. Therefore these managers need to ensure that Management Information is available across the operation which does effectively monitor conduct and behaviours within each operational area and that the existing indicators which can be used to interpret and expose conduct issues actually help by being aligned and integrated with the management of the Conduct Rules regime.

New KPIs should be developed within Operations to monitor adherence to the new Conduct Rules and the related programmes of change. Firms should ask themselves what new metrics will they add to their governance regime to support the Conduct Rules programme and how will the required information be collected. Existing systems and processes across the operation may need to be enhanced to ensure that appropriate information can be reported holistically and by division, region, line of business etc. as required.

One large firm we are working with is adding new KPIs to people subject to Certification that will measure how well the Conduct Regime staff reporting to them are complying with the Conduct Rules. For example, are training and conduct workshops being attended and completed on time? Are people completing their personal declarations? How many breaches or suspected breaches are being recorded across operational areas? Performance against the new Conduct KPIs within their operations will form part of their annual Certification assessment.

Is this way, by being able to report against the Conduct Rules programme and the Certifications Regime holistically up to the responsible Senior Managers within the Senior Managers Regime key information is made available to the Board.

But critically, by being able to report all of the metrics operationally, across operational lines of responsibility, the firm's performance against the Conduct Rules and Cultural programmes can be owned by all of the management teams, within their areas and lines of responsibility and genuinely embedded in day to day activity and process monitoring.

Thereby breathing life into the new Conduct Rules.

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How do you manage conduct risk in your business?

In our experience this is not a simple question to answer, but in today's regulatory environment and ever more competitive market place, surely it is a question worth asking?

Perhaps consider the following;

Is your conduct risk model easy to define, distribute and evidence ?

Can you utilise your existing systems to provide a real dynamic view of individual risk ?

Is your T&C scheme forced to adopt a 'Sheep dip' supervision approach for all individuals ?

Are you satisfied with your file checking model, capacity and flexibility ?

Can you proactively identify trends, risks, issues and monitor their resolution ?

Have you got a 'joined up' approach to managing T&C, Business Quality, Risk and Customer Outcomes ?

We have delivered market leading solutions to these types of issues for our customers across the UK Financial Services market.

If cost effective conduct risk management across your business is important to you, why not talk to Redland to see if we can help?

If you would like an open discussion, on the needs of your organisation and how our Insight platform may be able to support your business, please call or visit **www.redland-solutions.co.uk**

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