

Ethics in Banking and Finance

Exploring the law and regulation which underpins ethical behaviours of firms and individuals operating in the financial services sector.



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Foreword from UK Finance

The role of business beyond generating profits for, and paying dividends to, the providers of its capital is under increasing scrutiny. How those profits and dividends are generated, and the extent to which other stakeholders such as customers, work colleagues and the communities in which the business operates also benefit, or are at least not prejudiced, are regarded increasingly as important metrics of performance. For banking and finance, this broader scrutiny is particularly acute as one of the lessons learnt from the financial crisis is that businesses will be judged not only in terms of the products and services they offer, but also by the way in which they are provided.

Within banking and finance, as much regulatory attention is now paid to expectations around conduct as to prudential regulation – as reflected in the post-crisis creation in the UK of the FCA in addition to the PRA. While both are concerned with the safety and soundness of the financial system, they have quite distinct perspectives as reflected in their statutory obligations.

More general company law and corporate governance requirements, as overseen by BEIS and the FRC, each bring responsibilities for directors in the way in which they manage their organisations. While some of this is on a “comply or explain” basis, market and societal expectations around these should not be underestimated.

Businesses are then subject to a wide variety of obligations on the part of other government departments and agencies, not least the Home Office and HM Revenue and Customs.

Businesses must also consider market-based guidance and codes of practice, often developed with official endorsement but not necessarily with statutory underpinning, as market-based guidance can have judgements and relevance tests embedded of a type not always suited to statute or formal regulation.

Within our outward-looking financial services industry, we must also consider a wealth of material generated by international bodies that, whether or not translated into national law or regulation, can be said to be authoritative or instructive.

In approaching this resource, we have set out neither to produce a compendium, nor to duplicate, let alone interpret, the work of others. No one would thank us if we had. Instead, we have set our sights on profiling issues relevant when considering organisational ethics based around leadership, governance, systems and controls, employees, customers and other stakeholders. Prepared more as an online resource, the notes that follow are intended to profile issues that can be said to be of ethical relevance, in the process bringing together key sources and reference documents.

In addition to thanking our partners at Linklaters on the preparation of this resource, our thanks to Clare Woodman, Head of EMEA and CEO, Morgan Stanley & Co. International, and UK Finance Board member, for her guidance on the development of this resource, together with her colleagues David Best and Rosanna Ruff.

Stephen Jones

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Foreword from Linklaters LLP

Operating according to ethical values, and being able to demonstrate how governance, strategy and decision making has been informed by ethical principles, is an issue which is squarely in the spotlight. Firms do not operate in a vacuum and their licence to operate depends on customers and stakeholders (including, importantly, regulators) being satisfied with their business approach. Building trust through an ethical framework and responsible business outlook is critical to sustainable success as well as to avoiding costly crises.

As lawyers, we are neither philosophers nor behavioural scientists and so authoring a paper on the issue of ethics in banking and finance might be regarded as straying outside our area of expertise. However, as legal professionals we have seen at close hand the challenges which gave rise to, and which have flowed from, the financial crisis as well as the slew of regulatory change and reform which has sought (among other things) to strengthen and restore trust in the banking and financial system. Across our advisory, assurance and contentious practices, we have been at the forefront of advising on issues pertaining to conduct, culture and ethics and have seen how momentum has built and is shaping the approach of firms, regulators and industry organisations to matters of this kind. In addition, there is a large volume of law, regulation and guidance which seemed to us to be directly relevant to ethical business practices and behaviours; in drawing this material together we felt we could usefully contribute to the debate about what constitutes ethics in banking and finance and how this can be measured in practice.

While engendering trust through an ethical business approach demands an organisational mindset which is focused on achieving the right outcome, irrespective of legal or regulatory demands, complying with the rules and requirements which have been designed to deliver such outcomes is mandatory. Legal, regulatory and societal expectations have been steadily increasing over recent years and a heretofore unseen volume of material now exists to help guide firms in the area of culture, conduct and ethics. Our work with Boards has highlighted the need for a resource which enables a firm to more easily engage with the many and varied sources of those requirements and evaluate whether it is living up to these expectations and the values it has set for itself.

As a business, we recognise that our mindset is critical to achieving our strategy. Our approach is to put clients at the heart of all we do, recruiting and developing exceptional people and empowering them to do and think differently. We are proud of our long heritage and cherish our values, holding each other to account and doing our best to ensure that all our interactions reflect the DNA of our firm.

It is for these reasons that we feel a particular affinity with the issue of ethics in banking and finance and we have been delighted to partner with UK Finance in the preparation of this resource.

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Introduction

Culture, conduct and ethics are words which have come to pepper the regulatory lexicon. The importance of these intangible concepts and “getting it right” has been clearly communicated, and myriad speeches and initiatives in the financial services sector focus on these themes.

However, while the FCA has proffered a definition of “culture” and commented extensively on poor conduct through decision notices and its guidance on the individual Conduct Rules (among other things), ethics has been the subject of comparatively little description or definition, typically being considered in more philosophical or moral terms. As the references to ethical custom and business increase, it is worthwhile exploring how ethics interacts with conduct and culture in banking and finance, and what firms must consider in order to ensure they continue meeting expectations.

The Institute of Business Ethics describes business ethics as *“the application of ethical values, such as integrity, fairness, respect and openness, to business behaviour. [It] is about how an organisation does its business and how individuals carry out their roles”*. Andrew Bailey, Chief Executive Officer of the FCA, has meanwhile described ethics in terms of trust and integrity, commenting that trustworthiness demands good intentions and honesty as well as knowledge and skills.

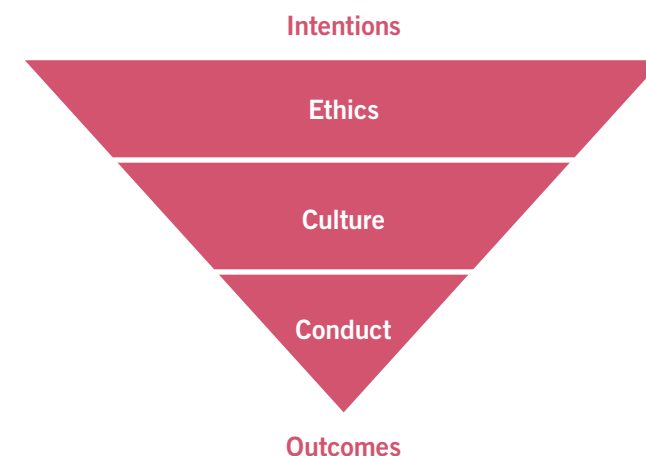
A sound ethical framework is something which can lay the foundations for, and strengthen, both the culture and conduct of an organisation. Ethical principles can inform both strategic decisions and day-to-day interactions. Having and embedding a set of core values and principles which dictate how an organisation should operate can influence both the *“habitual*

behaviours and mindsets that characterise an organisation” (how the FCA defines culture) and, in turn, the decisions, actions and inactions of individuals and groups (conduct).

However, while it may be interesting to consider ethics in the abstract, whether or not an institution does operate in a way which is informed by those core values and principles needs to be examined by reference to its culture and conduct on a day-to-day basis. For this reason, this resource does not consider the subject of ethics in a vacuum.

The FCA has been clear that there should be no “one size fits all” culture and, as a regulator, does not prescribe what an individual firm’s culture should be. That must be right; each business is unique, with its own history, values and purpose, which in turn will shape its culture. As a factor which contributes to the development and sustainability of a firm’s culture, there is likewise no single definition of “what good looks like” when it comes to ethics. What must be assessed in context, taking into account the nature of a firm’s business, its customers and its counterparties.

This resource does not purport to dictate how firms should define their values or operate their businesses. However, lawmakers, regulators and society have defined certain minimum expectations and standards of behaviour from the perspective of customer and business outcomes. These are sometimes framed or described (whether explicitly or implicitly) as issues of trust, integrity or honesty; concepts which have a distinct ethical underpin. Firms and individuals operating in the sector must be conscious and mindful of these standards and expectations and consider both whether



they are satisfying the letter and spirit of the rules and/or guidance and whether the values and principles which they have set for themselves are effective in directing and delivering the firm's desired outcomes.

In the decade since the 2008 global financial crisis, there has been significant governmental, regulatory and stakeholder attention on culture and conduct in the financial services industry, with multiple high-profile initiatives (at both the UK and international level) designed to improve culture and drive up standards of conduct.

Such changes have been complemented by developments in the UK corporate governance arena; a focus on long-termism and requirements for companies to report more broadly on stakeholder interests and the factors which may impact the value and sustainability of their business has stepped up pressure on firms to show that they are making a positive contribution to society, and there has been an increase in more general industry and societal expectations around issues such as climate, human rights and gender diversity.

The result of this is that a wealth of materials relevant to culture, conduct and ethics has been published since the crisis, with new material generated regularly and from a wide variety of sources. Navigating the landscape of (among other things) rules, guidance, industry papers, speeches, supervisory practice, and lessons learnt from enforcement notices is a monumental task, but one that must be undertaken in order for firms to successfully and responsibly operate their businesses.

This resource is designed to synthesise the many information points which exist, and empower Boards, NEDs and Senior Managers who are examining how their organisation conducts its business, and how individuals carry out their roles, to ask challenging questions and check that relevant minimum standards and their own ethical expectations are being met. We have structured our commentary around four themes which seem to us to be particularly relevant, namely a firm's approach to:

- > leadership, governance, systems and controls;
- > its workforce;
- > its customers and conduct of business; and
- > other relevant stakeholders, including shareholders, regulators and the wider community.

Supplementing our commentary are references and links to the most relevant legal requirements and sources of regulation, together with certain guides, speeches, enforcement notices and industry standards which we think helpful to consider when examining issues of ethics, conduct or culture. While, the issues and sources that we profile are not exhaustive, and will inevitably evolve, in our view they form the key components of the legal and regulatory baseline.

Although principally designed for Boards, NEDs and Senior Managers in banking organisations, we hope this resource will provide a useful reference point for all those working in and advising firms in the UK financial services sector. Further, we hope it makes a small but helpful contribution to the broader debate on what really constitutes *ethics in banking and finance*.

“

Prior to the financial crisis, the culture towards the public interest and ethical custom were essentially permissive, to the point of anything goes. In financial services, it was evident in the advocacy of light touch regulation, the view that left to themselves firms would succeed; and to paraphrase, just as a rising tide lifts all boats, so the whole public interest would benefit. It didn't work out that way, and in the wake of the crisis we have had to change the approach to regulation in the public interest.”

Andrew Bailey

Chief Executive Officer, FCA (October 2018)

Introduction

Key sources

- > COCON Conduct Rules
- > Speech by Andrew Bailey, Trust and ethics – a regulator's perspective (October 2018)
- > Financial Stability Board, Strengthening Governance Frameworks to Mitigate Misconduct Risk: A Toolkit for Firms and Supervisors (April 2018)
- > FCA Discussion Paper 18/2 Transforming Culture in Financial Services (March 2018)
- > Speech by Jonathan Davidson, Culture and conduct – extending the accountability regime (September 2017)
- > Institute of Business Ethics: Living Up to Our Values – Developing Ethical Assurance (Understanding Ethical Assurance) (December 2006)



Leadership, governance,
systems and controls



Leadership, governance, systems and controls

Introduction

Leadership, governance, systems and controls have long been seen as important for business success. As the famous business management consultant Peter Drucker reportedly said, “*culture eats strategy for breakfast.*” However, a decade on from the financial crisis, focus has turned from profitability to sustainability and it is recognised that a firm’s approach to leadership, governance and systems and controls is vital to the development of a good conduct culture. In this section we consider the key pillars which underpin a firm’s organisational approach and control structure, considering relevant legal and regulatory obligations and how these pillars can further ethical objectives and contribute to good outcomes.



Leadership,
governance, systems
and controls

Governance

- > Business model/purpose/values and strategy
- > Boards and Committees
- > Ethics and culture programmes

Leadership, responsibility and accountability

- > Tone from the top
- > The “leadership cascade”

Risk management and control framework

- > First line of defence
- > Second line of defence
- > Third line of defence



Leadership, governance, systems and controls

Governance

Legislation and regulatory guidance at both the EU and UK level is designed to ensure that Boards have the right composition and can clearly articulate, challenge and lead by example when it comes to, the ethical and cultural objectives of the firm. Individuals are required to dedicate sufficient time to the leadership of the firm and the collective Board must have not only sufficient knowledge and experience of the business but also a diversity of perspective, with a view to facilitating sound decision-making within the firm. Requirements and regulatory expectations exist in relation to NED appointments but also in relation to diversity more generally, with the EBA/ESMA Guidelines on Suitability requiring credit institutions/investment firms to implement a diversity policy and for significant institutions to include a quantitative target in relation to gender.

The PRA meanwhile expects a Board to articulate and maintain a culture of risk awareness and ethical behaviour for the entire organisation to follow in pursuit of its business goals, with its business strategy being supported by a clear and measurable statement of risk appetite. The need to collectively consider ethics, strategy and risk appetite also comes through more firmly in the revised UK Corporate Governance Code, where (amongst other things) the FRC asks Boards to create a culture which aligns company values with purpose and business strategy.

Thus, when it comes to considering the furtherance of an ethical business model, the firm's purpose and values must be clearly defined. Governance is not just about processes and decision-making; where it is successful it is aligned to the business model and values which the firm has set for itself. It follows that, if the underlying purpose of the business is, for example, to generate short-term profits without due regard to ethical business behaviour, governance, systems and controls which purport to embed and ensure an ethical approach will be largely meaningless.

A well-written code of ethics can provide a useful framework against which culture and conduct can be assessed. Such a framework will be important, given the expectations on Boards and Senior Managers to demonstrate ethical and cultural leadership (see further at **Leadership, responsibility and accountability**), and the FCA's view that culture can be "*managed*" even if it cannot be "*measured*". The rise in recent years of internal programmes focusing on culture, conduct and ethics has been helpful in raising awareness of the regulatory agenda but firms must look for qualitative and quantitative indicators of success, and use their programmes to understand drivers of behaviour and decision-making within their organisations if they are ultimately to be successful.

Potential sources of management information which could help a Board explore whether its culture and conduct reflect its underlying ethical values include:

- > the frequency and nature of customer complaints;
- > the output of workshops or focus groups with customers or employees;
- > employee feedback surveys;
- > appraisal/exit interviews;
- > analysis of whistleblowing hotlines and other "speak up" channels;
- > employee self-certification in respect of policies and procedures;
- > data from fit and proper processes;
- > observations undertaken by Senior Managers or risk functions; and
- > Board self-evaluation



Leadership, governance, systems and controls

Governance

It will also be important for Boards and Senior Managers to reflect and consider how their own approach and governance processes embed the ethical principles which have been agreed and demonstrate principled and effective leadership. This should include not only the way in which decisions are made and communicated, but also a consideration of the people and perspectives represented on the Board and relevant committees, to foster a culture of challenge and diversity of perspective (see further at [Attraction, selection and recruitment](#) and [Workplace environment \(Diversity & inclusion\)](#)). The role of the Chair is typically seen as “pivotal in setting expectations of a company’s culture, values and behaviours” and firms may therefore find it useful to consider how NEDs can be employed to help focus on ethical and cultural issues and ensure such matters remain “front of mind” in the Boardroom context.

Firms may find it useful to refer to the Banking Standards Board’s assessment criteria (replicated below) when evaluating the values and principles which they have set to help guide their organisational conduct and culture:





Leadership, governance, systems and controls

Governance

Questions for Firms

When considering how governance structures further ethical objectives and contribute to good outcomes, a firm may find it helpful to consider:

- > When was the last time the Board reviewed the organisation's core principles and values with a view to assessing whether they are aligned to business strategy and cascaded through the business?
- > How do those guiding principles take into account the current and potential ethical issues faced by the business and the risks which are relevant to its operations on a day-to-day basis?
- > To what extent has the organisation engaged with stakeholders such as employees and the wider community in developing such guiding principles?
- > Have the arrangements in place for stakeholder engagement been reviewed in light of recently enhanced governance requirements?
- > How does the organisation seek and obtain comfort that the guiding principles are understood and adhered to throughout the organisation?
- > What management information does the Board receive in relation to ethics, conduct and culture?
- > How does the Board keep ethical principles at "front of mind" when making its decisions?





Leadership, governance, systems and controls

Leadership, responsibility and accountability

The FCA is clear that a firm's leadership will shape the culture of the organisation and this is recognised more broadly, e.g. by the BCBS in its guidelines on corporate governance principles for banks and the FSB which lists senior managers who articulate a clear cultural vision as its first recommended "tool" for mitigating cultural drivers of misconduct.

The introduction of the SMCR and, in particular, the Senior Manager Conduct Rules, the statutory duty of responsibility and prescribed responsibility relating to culture, was designed to encourage an environment of personal responsibility where leaders both role model the desired culture of the firm and impress the value of responsible business and good conduct on more junior members of staff. Where senior individuals have not acted as "culture carriers" and have been unable to demonstrate the high standards of integrity and probity expected by the FCA, regulatory enforcement action has been taken against those individuals, resulting in fines being imposed and (in the most serious cases) individuals being banned from working in the financial services industry.

But while "tone from the top" is critical, senior managers are not the only influence on a firm's culture, and the risks associated with a "permafrost layer" of middle managers and junior employees has often been discussed in FCA speeches and papers. The SMCR makes senior managers clearly accountable for ensuring that all individuals working within their areas of responsibility meet appropriate standards of conduct and competence, and the shift to "in house" fitness and propriety assessments pursuant to the Certification Regime means that firms must more frequently and critically assess conduct across a broad population of staff.

If a firm's ethical objectives are to be embedded and contribute to the conduct and culture of the organisation, there will need to be "buy in" to the firm's approach (see further at [Governance](#)) and an understanding that staff at all levels are responsible for delivering on the firm's ethical commitments. Individuals should be held to account for "living the values of the firm" and contributing to an environment which promotes integrity, fair treatment of customers and compliance with regulatory requirements (among other things), with the Board seeking reassurance about both the "tone from the top" and "echo from the bottom".



A sole focus on 'tone from the top' has gradually given way to a more complex, multi-system approach to influencing culture and behaviour. While there remains an important role for senior leaders, influence happens at all levels of an organisation. ”

FCA Discussion Paper DP 18/2:

Transforming Culture in Financial Services (March 2018)

Case Study – Morgan Stanley

Morgan Stanley annually hosts ~1,000 mandatory "Culture Conversations" across its' global organisation, engaging all employees in an interactive dialogue around opaque ethics based topics such as appropriate conduct, behaviour and decision making that can often sit outside of explicit rule-sets. Sessions are led by Managing Directors and provide a unique opportunity for live engagement and feedback, anchored to the firm's Core Values.



Leadership, governance, systems and controls

Leadership, responsibility and accountability

Questions for Firms

When considering how leadership, responsibility and accountability of individuals further ethical objectives and contribute to good outcomes, a firm may find it helpful to consider:

- > How do Senior Managers sponsor and show commitment for initiatives which are designed to promote the firm's ethical values, responsible business and regulatory compliance?
- > How does the firm ensure there is consistency between the messages which are disseminated throughout the firm and the decisions which are taken by Senior Managers?
- > What communication strategies are in place to ensure that Senior Managers' messages about ethics, culture and compliance are conveyed effectively across the firm?
- > Would Senior Managers benefit from any training to help develop cultural leadership skills?
- > How do Senior Managers create a safe environment for discussion and escalation of issues, including where mistakes have been made?
- > Are staff rewarded based on their commitment to the values of the firm?
- > How do job descriptions set out the firm's expectations of an individual in relation to ethics, conduct and culture?
- > How do fitness and propriety, appraisal and remuneration processes take account of ethical, conduct and culture issues, particularly compared to other performance measures?





Leadership, governance, systems and controls

Risk management and control framework

Firms subject to CRDIV and MiFID II are required to establish independent Compliance and Internal Audit functions as part of their framework of systems and controls and, in the UK context, the so-called “three lines of defence” model is almost universally adopted as the structure through which organisations consider and assure themselves on risk-management issues. While the SMCR requires each Senior Manager to be clear about the responsibilities and accountability which they have in relation to their function (with such clarity also being recommended by the FSB), FCA supervisory activity has emphasised the importance of the first line taking responsibility for business decisions and conduct of business, together with any resulting risk or cultural impacts. The expectation that Compliance and Internal Audit teams are growing both in sophistication and stature within a firm has meanwhile been communicated through thematic work and commentary in the context of enforcement notices.

As a result of increased regulatory focus on the three lines of defence model, we have seen a trend towards a “1.5 line of defence”, where in business risk teams are located alongside business functions and work hand in hand to provide a risk and quality assurance role. The emergence of a “2.5 line of defence” which separates testing groups focused on

assurance and monitoring activity (and which are sometimes aligned to, or combined with, Operational Risk teams) from Compliance’s advisory/challenge function has also been observed. These developments potentially provide a useful structure within which firms can embed and seek assurance as to the operation of their business, in comparison to the ethical principles and values which underpin their strategy and risk appetite (see further at [Governance](#)). However, care must also be taken, for example, to preserve an appropriately independent Compliance function and ensure front-line business teams continue to feel responsible and accountable for the risks associated with their activities.

If the three lines of defence model is to contribute to the embedding and monitoring of ethical values within an organisation, it will first be important to empower the business (i.e. the first line) to consider ethical principles (i.e. “should we” rather than “can we” questions) within their business approach. This may require firms to review how business performance is measured and evaluated and the training which is given to staff. How staff are incentivised to carry out their role is also likely to contribute to such empowerment (see further at [Training, qualifications and suitability](#) and [Performance management and progression](#)).

“

The growing sophistication and stature of the first line of defence is, in my view, an unqualified improvement in corporate governance – especially at financial firms.”

Michael Held

Executive Vice President of the Legal Group,
Federal Reserve Bank of New York



Leadership, governance, systems and controls

Risk management and control framework

Where Compliance's role is to advise and challenge the business to help guide it to business decisions which take into account internal policy (including ethical) drivers, additional training may also be needed to equip Compliance personnel with the knowledge and skills to hold the business to account. More generally, and consistent with broader observations regarding the effectiveness of the second line of defence, firms will need to ensure that senior management promotes the importance of second line teams and their status within the firm, if they are to help an organisation deliver on its ethical ambitions.

Internal audit, as the third line of defence, meanwhile are relied upon to exercise professional objectivity in their review of internal processes, systems and controls. However, their focus should not only be on testing and reporting on the control framework; firms should also encourage a more proactive and holistic approach which supports the Board in evaluating and managing key risks to the business. This may include an evaluation of the firm's culture, confirmation that key conduct risks are understood and integrated within the firm's strategic planning and that the internal control environment is aligned to relevant policies, codes and initiatives.





Leadership, governance, systems and controls

Risk management and control framework

Questions for Firms

When considering how risk management and control issues can further ethical objectives and contribute to good outcomes, a firm may find it helpful to consider:

- > How is profitability rewarded within the business?
- > How does the firm communicate to staff operating within the first line of defence that it is their responsibility to operate their business in accordance with the firm's ethical code?
- > Do job descriptions for staff make reference to ethics and ethical responsibilities?
- > What barriers might exist to business teams prioritising ethics when it comes to business selection, product design or customer service?
- > What is the internal standing and cultural view of teams operating within the second line of defence?
- > Do the forums in which business decisions are made contain adequate and appropriate control function representation?
- > What is the mandate for internal audit?
- > Do internal audit teams have the skills, capabilities and resources to perform a more holistic review role?
- > What management information is provided to the Board by teams operating within the second and third lines of defence?





Leadership, governance, systems and controls

Key sources

Governance

Legislation:

- > [CRD IV](#) (in particular Article 88 (Governance arrangements) and Article 91 (Management body))
- > [MiFID II](#) (in particular Article 9 (Management body))

Regulation:

- > [SYSC Senior Management Arrangements, Systems and Controls](#) (in particular [SYSC 4](#) (General organisational requirements) and [SYSC 24](#) (SMCR: Allocation of prescribed responsibilities))
- > [EBA/ESMA Guidelines on Suitability Assessment for Management Body Members and Key Function Holders](#) (March 2018)

Other Sources:

- > [Speech by Andrew Bailey, Trust and ethics – a regulator's perspective](#) (October 2018)
- > [PRA Supervisory Statement 5/16 on Corporate governance: Board responsibilities](#) (July 2018)
- > [Financial Reporting Council, Guidance on Board Effectiveness](#) (July 2018)

- > [FCA Final Notice, Canara Bank](#) (June 2018) (in relation to Canara's senior management's failure to establish a rigorous approach to systems and controls for addressing AML and financial crime risks and as a result Canara Bank failing to embed a culture of compliance)
- > [Financial Stability Board, Strengthening Governance Frameworks to Mitigate Misconduct Risk: A Toolkit for Firms and Supervisors](#) (April 2018)
- > [FCA Press Release, FCA bans former Co-operative Bank Chair, Paul Flowers, from the financial services industry](#) (March 2018) (in relation to his failure to lead by example and meet the FCA's requirements for integrity and probity)
- > [FCA Approach to Supervision](#) (March 2018)
- > [FCA Discussion Paper 18/2 Transforming Culture in Financial Services](#) (March 2018)
- > [BSB Statement of Principle: Strengthening professionalism](#) (March 2018)
- > [Institute of Business Ethics Board Briefing, Culture indicators: understanding corporate behaviour](#) (March 2018)
- > [Financial Reporting Council, UK Corporate Governance Code](#) (2018)

- > [Speech by Jonathan Davidson, Culture and conduct – extending the accountability regime](#) (September 2017)
- > [City of London, The Business of Trust Campaign](#) (2017)
- > [FCA Final Notice, Sonali Bank \(UK\) Limited \(October 2016\)](#) and [FCA Decision Notice, Mohammad Ataur Rahman Prodhan](#) (May 2018) (in relation to the Board and senior management failing to embed a culture of compliance throughout the firm and failing to provide adequate oversight to the MLRO department)
- > [Financial Reporting Council, Report on Corporate Culture and the Role of Boards](#) (July 2016)
- > [Basel Committee on Banking Standards, Corporate governance principles for banks](#) (July 2015)
- > [Institute of Business Ethics: Living Up to Our Values – Developing Ethical Assurance](#) (December 2006)
- > [Banking Standards Board, Overview of the BSB Assessment](#)
- > [FCA's 5 Conduct Questions Programme](#)
- > [The Good Corporation, Business Ethics Standard](#)
- > [The Good Corporation, Measuring Ethical Culture](#)



Leadership, governance, systems and controls

Key sources

Leadership, responsibility and accountability

Legislation:

- > **Financial Services and Markets Act 2000** (in particular section 64A (Rules of conduct) and sections 66A and 66B (Misconduct))

Regulation:

- > **COCON Code of Conduct** (in particular **COCON 2** (Individual conduct rules) and **COCON 4** (Specific guidance on individual conduct rules));
- > **SYSC Senior Management Arrangements, Systems and Controls** (in particular **SYSC 24** (SMCR: Allocation of prescribed responsibilities), **SYSC 26** (SMCR: Overall responsibility) and **SYSC 27** (SMCR: Certification regime))

Other Sources:

- > **Video, banking leaders' experience of adopting the SMCR** (February 2019)
- > Speech by Christopher Woolard, **Opening up and speaking out: diversity in financial services and the challenge to be met** (December 2018)

- > **Letter from Megan Butler to the Women and Equalities Committee on Sexual Harassment in the Workplace** (September 2018)
- > **Financial Stability Board, Strengthening Governance Frameworks to Mitigate Misconduct Risk: A Toolkit for Firms and Supervisors** (April 2018)
- > **FCA Discussion Paper 18/2 Transforming Culture in Financial Services** (March 2018)
- > **Institute of Business Ethics** Board Briefing, **Culture indicators: understanding corporate behaviour** (March 2018)
- > **FCA Occasional Paper No 24 Behaviour and Compliance in Organisations** (December 2016)
- > Speech by Jonathan Davidson, **Getting culture and conduct right – the role of the regulator** (July 2016)
- > **PRA Final Notices for Keith Alderson and Barry Tootell** (January 2016) (in relation to a breach of APER Principle 6 and being knowingly concerned in The Co-operative Bank plc's breach of Principle 3)
- > **FCA Final Notice, Barclays Bank** (May 2015) (in relation to Principle 3 and the failure to embed the correct values and cultures in the firm's FX business)

- > **FCA Final Notice, Bank of Beirut (UK) Ltd** (March 2015) (in relation to the Bank of Beirut failing to demonstrate the culture and level of cooperation expected by the FCA in relation to anti-money laundering systems and controls).
- > **FCA Final Notices, Clare, Halpin and Bowyer** (November 2014) (in relation to oversight responsibilities and the development of a culture whereby profit generation was prioritised over treating customers fairly)
- > **FSA Final Notice, Cummings** (September 2012) (in relation to a breach of APER Principle 6, being knowingly concerned in a breach of Principle 3 by HBOS and weaknesses in culture, including the incentivisation of revenue over risk)
- > **Institute of Business Ethics: Living Up to Our Values – Developing Ethical Assurance** (December 2006)
- > **FCA Final Notice, Kraft** (in relation to a breach of APER Principles 6 and 7 in relation to compliance failures in relation to LIBOR misconduct) and **Caplin** (breach of APER Principle 7 for presiding over a firm where the compliance culture was "extremely weak")



Leadership, governance, systems and controls

Key sources

Risk management and control framework

Legislation:

- > **MiFID Org Regulation** (in particular Article 22 (Compliance), Article 23 (Risk management) and Article 24 (Internal Audit))

Regulation:

- > **COCON Code of Conduct** (in particular **COCON 2** (Individual conduct rules) and **COCON 4** (Specific guidance on individual conduct rules));
- > **SYSC Senior Management Arrangements, Systems and Controls** (in particular **SYSC 6** (Compliance, internal audit and financial crime), **SYSC 7** (Risk control), **SYSC 21** (Risk control: additional guidance))
- > **SUP Supervision** (in particular **SUP10C** (FCA Senior Managers Regime))

Other Sources:

- > **Financial Stability Board, Strengthening Governance Frameworks to Mitigate Misconduct Risk: A Toolkit for Firms and Supervisors** (April 2018)
- > Speech by Michael Held, Federal Reserve Bank of New York at the 1LoD Summit: **The evolving first line of defense** (April 2018)
- > FCA review of **The compliance function in wholesale banks** (November 2017)
- > **FCA Final Notice, Sonali Bank (UK) Limited and Steven Smith** (October 2016) (in relation to the board and senior management failing to embed a culture of compliance throughout the firm and failing to provide adequate oversight to the MLRO department which was under-resourced)
- > **PRA Final Notice, Co-Operative Bank PLC** (August 2015) (in relation to breaches of Principles 3 and 11 and, in particular, an inadequate control framework and culture of prioritising the short-term financial position of the firm at the cost of prudent and sustainable actions for the longer-term)
- > **ESMA: Guidelines on certain aspects of the MiFID compliance function requirements** (September 2012)

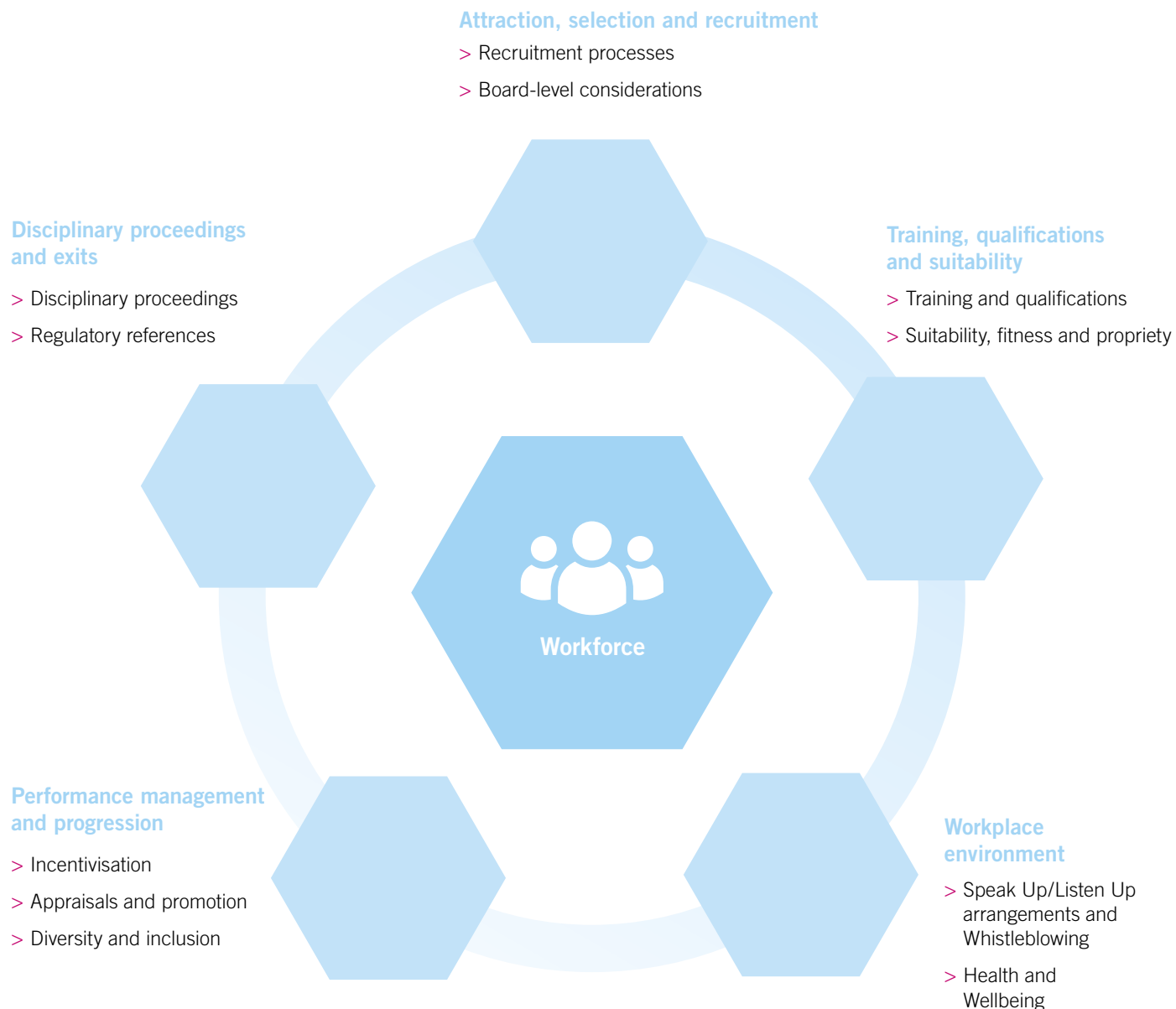
- > **Institute of Business Ethics: Living Up to Our Values – Developing Ethical Assurance** (Understanding Ethical Assurance) (December 2006)
- > FCA's **5 Conduct Questions Programme**
- > **FCA Final Notices in relation to Kraft** (in relation to a breach of APER Principles 6 and 7 in relation to compliance failures in relation to LIBOR misconduct) and **Caplin** (breach of APER Principle 7 for presiding over a firm where the compliance culture was “extremely weak”)



Workforce

Workforce Introduction

One of the most critical challenges for firms is ensuring that its workforce understand, are supported and incentivised to behave in accordance with, a firm's ethical values and principles, so that they contribute to a positive, healthy culture. In this section, we examine the main stages of an employee's lifecycle and experience within an organisation, considering relevant legal and regulatory obligations and how a firm's approach to its workforce can further ethical objectives and contribute to good outcomes. While we refer to "employees" throughout this resource, it is important that firms consider their approach in relation to all individuals within its workforce (i.e. consultants, contractors and temporary workers) regardless of their legal employment status.



Workforce

Attraction, selection and recruitment

A key aspect of the legislative framework is the Equality Act 2010, which makes it unlawful for discrimination to take place at any stage in the recruitment process. Meanwhile, the FCA requires firms to assess whether candidates for Senior Manager and Certification roles are “fit and proper” and to ensure that employees have the requisite skills, knowledge and expertise to discharge their regulatory responsibilities (see further at [Training, qualifications and suitability](#)). It has further identified diversity as a “*key supervisory issue*”, asserting that a healthier culture can be created, and risks associated with “group-think” mitigated, by the selection and retention of a diverse workforce (see further at [Workplace environment \(Diversity and inclusion\)](#)).

CRD IV and MiFID II meanwhile restrict candidates who can be appointed to the Board of a relevant firm to those with sufficient time to dedicate to leadership (the FCA rules restrict the number of directorships an individual can take on) and require an institution to look for diversity in terms of age, gender, geographic provenance, and education and professional background. The PRA is also clear that “*to be effective a board needs to include individuals with a mix of skills and experience that are up to date and cover the major business areas in order to make informed decisions and provide effective oversight of risks*”. Too great a focus on technical competence for Board appointments may lead to a significantly reduced pool of potential candidates and

increased the risk of group-think. There will accordingly be an important role for a firm’s nomination committee (or the Board more generally) in succession planning and evaluating the characteristics which are valued and/or particularly required in a new appointment.

These requirements reflect the understanding that organisations are shaped by the people who work there. A firm’s culture and approach, its decisions, choices and priorities, will reflect the beliefs, values and biases of the people it employs. It is therefore imperative that a firm’s approach to attracting potential candidates, together with its selection and hiring processes operate to promote the recruitment of staff who will positively contribute to the firm’s ethical ambitions. Such mindset should be adopted both in relation to “new to firm” hires and internal promotion processes, where the corollary of ignoring ethics and personal conduct may be to instil within the broader workforce a sense that management values attributes such as profitability or business success over and above good conduct (see further at [Performance management and progression](#)).

Individuals, especially younger generations, are increasingly considering a firm’s culture as a key factor when seeking new roles. In order to attract candidates who place importance on ethical values, a firm will need to demonstrate this is a priority for them.



Firms with monocultures are significantly more likely to have governance-related issues. ”

Speech by Megan Butler

Director of Supervision – Investment,
Wholesale and Specialists, FCA (March 2018)

Workforce

Attraction, selection and recruitment

Questions for Firms

When considering how the attraction, selection and recruitment of employees can further ethical objectives and contribute to good outcomes, a firm may find it helpful to consider:

- > How does the firm communicate its values and guiding principles to the wider community so as to attract candidates with a compatible mindset?
- > How does the firm define the skills and attributes that it is looking for in candidates?
- > How does the firm ensure balanced/diverse shortlists?
- > How does the firm select and train its interview panels?
- > How does the recruitment process enable the firm to assess a candidate's ethical outlook?
- > What questions and/or techniques could be used to test and identify indicators of good behaviour in candidates?
- > How much weight does a firm place on the information given in a regulatory reference when it comes to ethical, conduct and culture issues?
- > How does the recruitment process take into account previous personal conduct as compared to past business performance?
- > How do recruitment statistics (e.g. diversity) measure up to the firm's stated goals?
- > What recruitment agencies does the firm use and are they aligned with its policies and values?



Workforce

Training, qualifications and suitability

The requirement for a firm to employ personnel with the necessary skills, knowledge and expertise to discharge the responsibilities allocated to them is enshrined in the FCA Handbook. The TC Sourcebook supplements this rule in relation to retail activities, defining “competence” to include achieving a good standard of ethical behaviour. Among other things, TC defines qualification requirements, specifies how a firm should assess and review training needs, how competence should be assessed on an ongoing basis and sets out requirements in terms of continuing professional development.

Firms who are not subject to TC must nevertheless ensure that their staff have the appropriate skills and qualifications to undertake their role, with MiFID investment firms needing to ensure that the MiFID II knowledge and competency requirements and the associated ESMA Guidelines are embedded within their internal procedures.

Knowledge and competency requirements are supplemented by the FCA's rules in FIT, which require a firm to assess at least annually that its Senior Managers and Certification staff have the honesty, integrity and reputation, competence and capability and financial soundness to undertake their role (“fitness and propriety”). As part of the SMCR, one or more Senior Managers will be responsible for ensuring such fitness and propriety assessments are appropriately undertaken and, within banks, one or more Senior Managers must also take on the prescribed responsibility for overseeing the firm's policies

and procedures for the induction, training and professional development of senior management and members of the firm's governing body.

The importance of embedding individual accountability and ensuring that individuals at all levels are suitable to undertake their role and contribute to an appropriate culture, has been at the forefront of the UK regulatory agenda for a number of years. Effective training is key to promoting a positive culture within firms and the FCA has recommended steps which a firm can take to develop good practice. Firms must ensure that employees across all levels of an organisation understand the Conduct Rules which apply to them and how specific rules and internal policies are relevant to their work. Training further provides an opportunity for the Board to cascade the firm's strategy, its ethical outlook and make clear what it expects of its employees.

Without an effective programme of training and qualifications (including continuous professional development), firms increase the risk of ethical mis-steps and/or regulatory breaches occurring within their organisation. If the organisational and ethical culture of the firm is not clearly and frequently communicated to the workforce (see further at [Governance](#)), it is unlikely to be consistently considered and reflected in decision-making and staff are less likely to feel empowered to identify potential issues and escalate them to senior management (see further at [Workplace environment \(Whistleblowing and “speak up” arrangements\)](#)).



Management within firms can influence their culture through their tone, through the training they give to staff and by setting out their expectations of their staff. ”

FCA Occasional Paper 24

“Behaviour and Compliance in Organisations”
(December 2016)

The FCA recommends the following as good practice:

- > have an annual training plan;
- > encourage advisers to obtain qualifications and improve their knowledge and skills;
- > discuss complex cases in recorded training events;
- > use a variety of training and assessment methods for developing competence, such as: mock exams; product/market training; or practical training;
- > ensure appropriate examinations are taken; and
- > regularly evaluate the effectiveness of training. (FCA Training and competence webpage)

Workforce

Training, qualifications and suitability

Questions for Firms

When considering how training, qualifications and suitability assessments can further ethical objectives and contribute to good outcomes, a firm may find it helpful to consider:

- > How does the firm encourage staff at all levels to develop relevant skills and progress their careers?
- > What forms of training are offered or required within the firm?
- > What value does the firm place on training relating to its values and 'soft' skills rather than technical capabilities?
- > How are ethical considerations incorporated within training and development programmes?
- > How do representatives of senior management emphasise the importance of and encourage attendance at training?
- > How does the firm measure the effectiveness of its training and development programmes?
- > How are training needs taken into account on an ongoing basis?
- > To what extent are job descriptions in place throughout the institution and how are they reviewed and updated?
- > What pieces of information does a firm take into account as part of its annual fitness and propriety assessments?
- > For staff who are not in Senior Manager or Certified roles, how and when are suitability and conduct assessed on an ongoing basis?



Workforce

Workplace environment

Whistleblowing and “speak up” / “listen up” arrangements:

Firms are required to have put in place appropriate internal procedures to handle disclosures that a whistleblower might make in relation to reportable concerns. This is wider than simply “protected disclosures” under the Employment Rights Act 1996 and includes rule or internal policy breaches, or any other behaviour that harms or is likely to harm the reputation or financial wellbeing of the firm. SYSC 18 in the FCA Handbook sets out specific obligations for banks and financial services firms, including those derived from various pieces of EU legislation, while the Public Interest Disclosure Act 1998 affords protection to employees and certain other staff who raise concerns in the public interest. Privacy, anonymity and data protection regulations may also be relevant to the information which an organisation holds and/or is able to communicate with whistleblowers or “respondents”.

It is well recognised that workers can help prevent or mitigate misconduct or other dysfunctional behaviour that could impact on customers, the market or the broader financial system by proactively voicing their concerns regarding the internal arrangements of an organisation. Fostering a culture in which staff are able to speak up when they see wrongdoing and, importantly, are listened to when they do is therefore critical in the financial services industry. Increased regulatory focus on good governance and corporate responsibility, coupled with

recent regulatory enforcement action, highlight the importance of firms testing, and ensuring the adequacy and effectiveness of, their internal whistleblowing processes and procedures.

It is important that a firm’s whistleblowing processes and procedures involve input from, and engagement with, all levels within the organisation. Banks are required to appoint a director or Senior Manager as its “whistleblowers’ champion” but other firms should also consider how internal sponsorship and profiling of their arrangements might engender trust and confidence within the employee population. It is important that there is a clear understanding of what whistleblowing is and the support that is available from both within and external to the firm. Further, firms need to demonstrate that concerns are listened to and appropriate action is taken to address issues that are raised.

However, consideration should extend beyond traditional whistleblowing arrangements as, in practice, many instances of regulatory or compliance failings will not result from “wrongdoing” but from human error or a weakness in processes or systems. Formal reporting channels may not be as well suited to escalation and discussion of these events and firms must therefore consider more broadly whether their culture encourages workers to speak openly about mistakes and concerns and creates a safe space to do so.

In an environment where Senior Managers are individually accountable for failings within their business areas, there should be a common interest in unearthing problems so that these can be dealt with. However, without so-called “psychological safety” (a shared belief that the team is safe for interpersonal risk taking) the ability for individuals to escalate mistakes or errors of judgement, and for the management of a firm to process and learn from them is diminished. Where trust is low or staff fear negative personal consequences, human nature is such that an ethical desire to speak up can be overridden by the “safer course” of saying nothing.

Case Study – ‘Speak up’

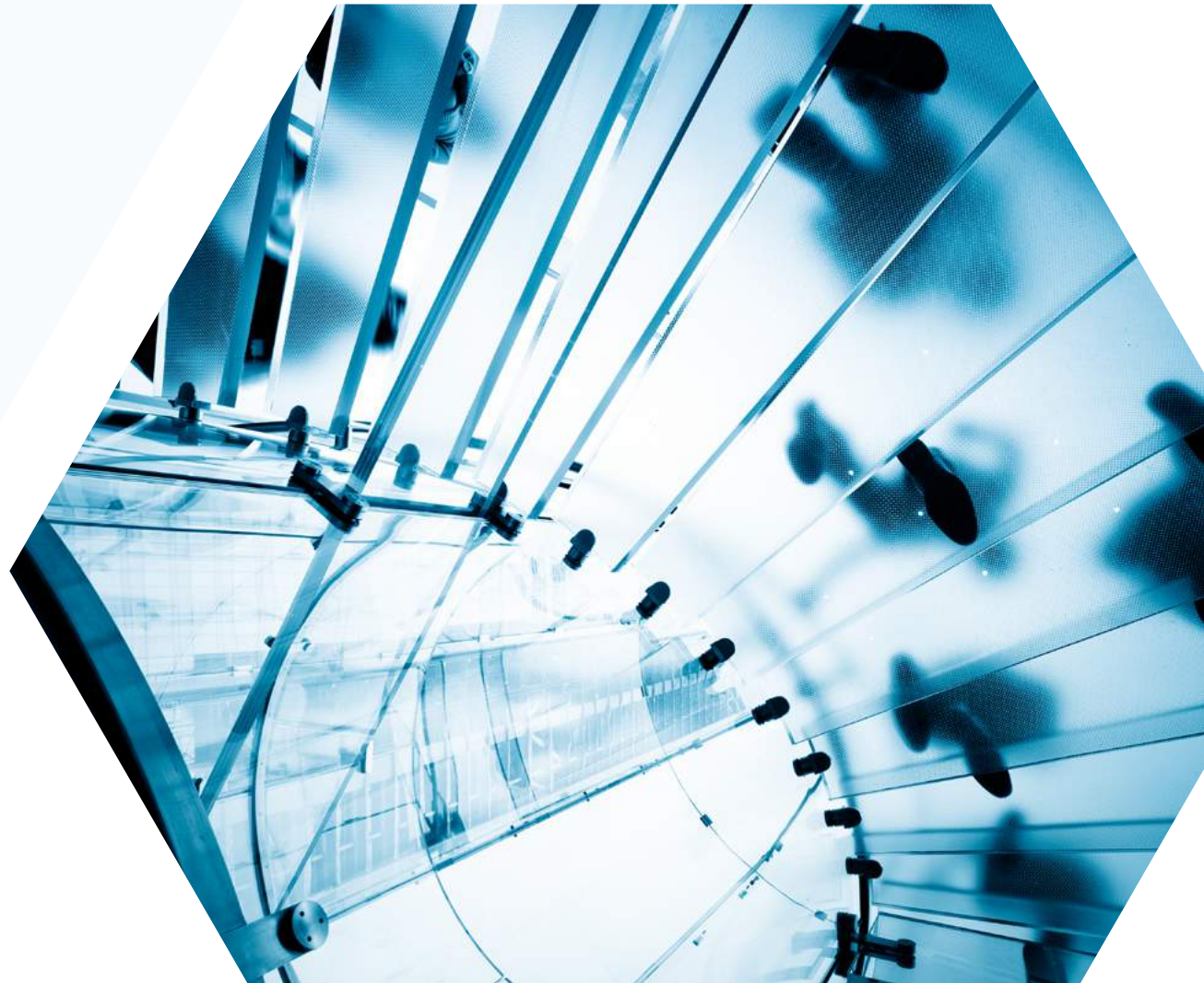
Lessons can be learned from the aviation sector, where regulation requires accidents and incidents to be reported and in addition for organisations to implement “just culture” principles. “Just culture” means a culture in which persons are not punished for actions, omission or decisions taken by them that are commensurate with their experience and training, but in which wilful violations and destructive acts are not tolerated. The sole objective of reporting is the prevention of accidents and incidents and not to attribute blame or liability and raising concerns has now become ‘normalised’ in the industry.

Workforce Workplace environment

Questions for Firms

When considering how whistleblowing and “speak up”/“listen up” arrangements can further ethical objectives and contribute to good outcomes, a firm may find it helpful to consider:

- > How does the firm seek to build trust with employees?
- > What barriers, challenges or practical limitations might exist within the organisation with respect to “speak up” policies and procedures?
- > What arrangements has the firm put in place to encourage employees to “speak up”?
- > What training does the firm put in place to help managers respond to concerns?
- > How (where possible) does a firm make its responses to “speak up” incidents visible?
- > How does the firm analyse and use whistleblowing and “speak up” data?
- > What management information is provided to the Board?



Workforce

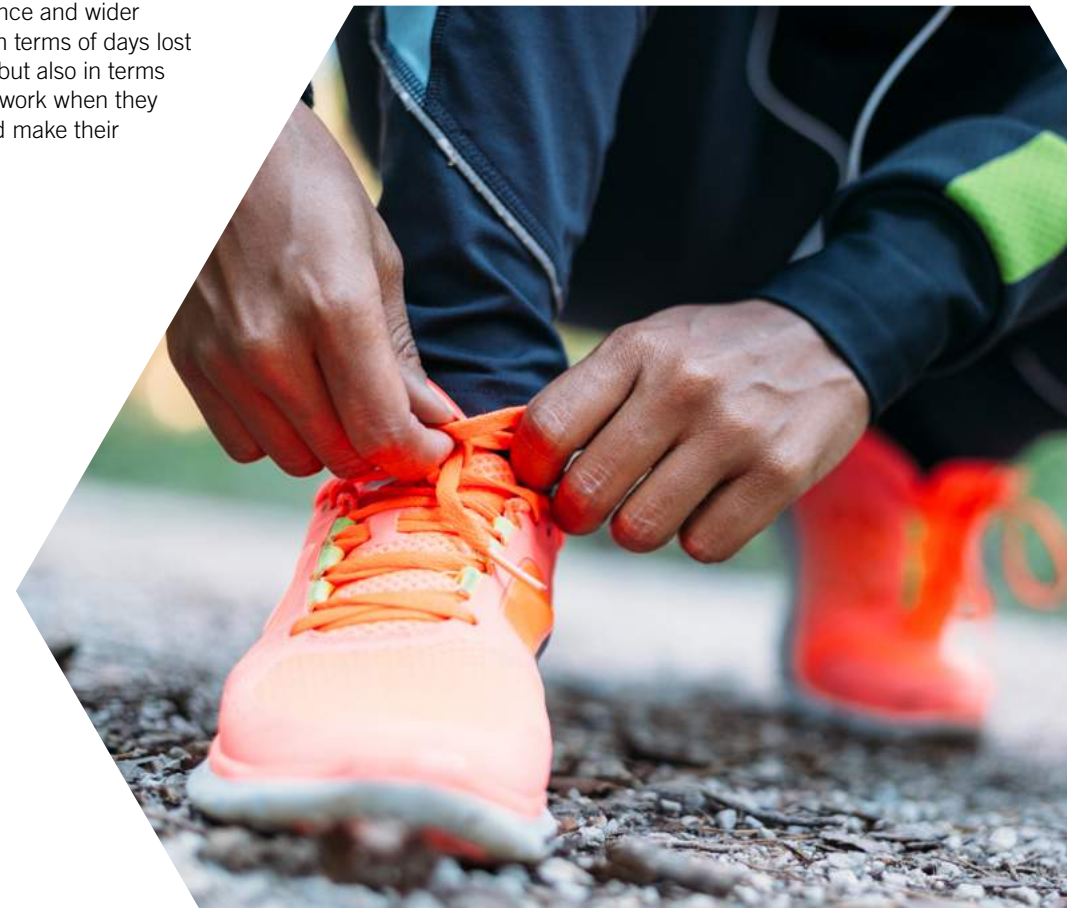
Workplace environment

Health and wellbeing: An individual's employment has the potential to have a significant impact (both positive and negative) on their physical and mental health. The Banking Standard Board's Annual Review stated that *"in 2017, 26% of people felt that working in their organisation was having a negative impact on their health and wellbeing"*. As well as creating an environment where employees with existing health conditions are supported, firms should also ensure that they have practices in place which prevent health problems being caused by an individual's working environment.

As a minimum, firms should comply with their obligations under the Equality Act 2010 not to discriminate against those with disabilities and to make reasonable adjustments. However, firms should consider taking a wider and more proactive approach to ensure they support staff in relation to all aspects of health and wellbeing. Providing training on resilience could, for example, prevent an employee from developing a more serious mental health condition.

While firms should prioritise employee wellbeing issues because it is the right thing to do, it should also be noted that it can also have a significant impact on the firm's business. Higher levels of employee wellbeing can result in improved customer service, lower employee turnover, improvements in individual performance and wider productivity and reduced costs, e.g. in terms of days lost to sick leave and long-term absence but also in terms of presenteeism, where people go to work when they shouldn't and are less productive and make their condition worse.

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Workforce Workplace environment

Questions for Firms

When considering how its approach to health and wellbeing issues can further ethical objectives and contribute to good outcomes, a firm may find it helpful to consider:

- > What policies and training does the firm have in place to support the mental health of your employees?
- > Does the firm offer any benefits or initiatives to promote physical wellbeing, such as gym memberships and health checks?
- > How does the firm ensure that employees have a healthy work life balance?
- > How does the firm monitor employee health and wellbeing?



Workforce

Performance management and progression

Incentives, promotion and appraisals: Regulatory remuneration rules, encapsulated in SYSC and the Material Risk Takers Regulation (among other sources), were introduced to counteract well-publicised concerns that, in the lead-up to the financial crisis, banks and other financial institutions prioritised short-term returns above the longer-term interests of customers. The deferral, malus and clawback rules are accordingly designed to ensure a greater alignment between risk and individual reward, discourage excessive risk-taking and short-termism, and encourage more effective risk management. Their aim is to support positive behaviours and develop a strong conduct culture within firms. However, in addition to these specific remuneration requirements, the FCA and PRA have observed that incentives may extend beyond the issue of executive pay and are consequently encouraging firms to take a broader perspective when considering the factors and levers which contribute to good conduct and culture.

Any firm seeking to evaluate the drivers of business and customer outcomes must examine its people-related practices, including incentives and the overall approach to staff remuneration. As regards remuneration, firms take different views on whether they should reward staff for exemplary conduct and culture, with some positively rewarding it through financial remuneration and others treating it as expected and therefore only applying penalties where staff fall short of the expected standards.

Whichever philosophy is adopted, it is critical that firms acknowledge the potential effect that remuneration and other incentives can have on staff behaviour. Getting this wrong may put pressure on employees to act in a way which enhances the risk of negative conduct and gives rise to a risk of customer harm (see further at [Approach to new customers](#)). The FCA has made a point of commenting on high-risk incentive scheme features in its enforcement notices, e.g. calling out bonus schemes and promotion processes which were explicitly linked to the delivery of sales targets.

The elements of performance which attract praise and status (and conversely sanction) within an organisation are critical to the furtherance of good conduct and culture. If employees observe individuals being rewarded and promoted despite poor conduct, this message will undermine (and could even outweigh) the positive steps which are taken to communicate and educate staff on the importance of ethical values (see further at [Governance](#) and [Training, qualifications and suitability](#) and [Disciplinary proceedings and exits](#)). As firms find themselves under increasing regulatory pressure to make performance adjustments for individuals in relation to management failings (as distinct from misconduct), one can further see how remuneration decisions can be used to reinforce principles of individual accountability and to position an individual's role within the greater context of the firm and its responsibilities as a whole.

“

The PRA expects the culture to be embedded with the use of appropriate incentives, including but not limited to remuneration, to encourage, and where necessary require, the behaviours the board wishes to see, and for this to be actively overseen by the board. ”

Supervisory Statement SS5/16: Corporate governance: board responsibilities (as updated in July 2018 and applicable from December 2018)

The FCA has stated that, when assessing conduct risk, a number of firms have developed or introduced “scorecards” of linked metrics. These include those linked to promoting the firm's desired culture, strategy, values, reputation, quality of client relationships, stakeholder engagement and people.

These firms believed this approach meant they were more able to measure performance against conduct objectives, and reward and incentive incremental improvements in behaviours and conduct.

(FCA, Industry Feedback on 5 Conduct Questions Programme, 2016)

Workforce

Performance management and progression

Questions for Firms

When considering how incentives, promotion and appraisal processes can further ethical objectives and contribute to good outcomes, a firm may find it helpful to consider:

- > How does the firm incorporate or take account of its ethical values and standards in its objective setting, appraisal and promotion processes?
- > How is feedback from control functions and 360° feedback on conduct and behaviour factored into appraisals and remuneration decisions?
- > To what extent are assessments based both on “how” individuals perform and “what” they achieve?
- > How are an individual's conduct and cultural characteristics assessed in the context of promotion decisions?
- > To what extent is the organisation transparent to an individual, or the broader workforce, about circumstances where staff have been held back from promotion due to conduct issues?
- > How does the firm undertake quality assurance in relation to objective setting, appraisals and remuneration decisions to ensure consistent standards and approaches are taken across the firm?



Workforce

Performance management and progression

Diversity and inclusion: The Equality Act 2010 prevents discrimination based on age, gender, marital status, pregnancy/ maternity, disability, race, religion or belief, sex or sexual orientation. More positively, from a financial services regulatory perspective, diversity and inclusion has been championed by the FCA as important to facilitate independent opinions, avoid “group-think”, promote critical challenge and facilitate sound decision-making. CRD IV, MiFID II and the associated EBA/ ESMA Guidelines require in-scope firms to implement a diversity policy in relation to Board positions, with “significant” firms being expected to set participation targets for the underrepresented gender and specify the timeframe within which they aim to meet those targets (see further at [Attraction, selection and recruitment](#)). In order to facilitate a suitably diverse pool of candidates for these roles, firms are encouraged to implement a diversity policy for the broader employee population.

Legislation also now requires employers of more than 250 employees to carry out mandatory gender pay gap reporting, and the government is currently consulting on the introduction of ethnicity pay reporting.

D&I is often described as an issue of moral conscience, and any firm seeking to adopt an ethical business approach will want to ensure that its employees are able to progress and succeed, irrespective of their identity or inherent characteristics. Beyond its clear link to ethical principles, however, it is also important from a more general commercial and reputational perspective.

With respect to gender diversity, increased focus has resulted in over 300 financial services organisations signing up to the HM Treasury Women in Finance Charter, which aims to accelerate the pace at which women are better represented in senior management positions. Signatories pledge to promote gender diversity in various tangible ways, including by tasking a member of the senior leadership team to be accountable for gender diversity inclusion, setting internal gender diversity targets for senior management positions, publishing progress against such targets on an annual basis and ensuring that senior management remuneration is linked to delivery against such targets.

Meanwhile, the FCA's high-profile campaign, encapsulated in speeches and public statements by Megan Butler and Christopher Woolard (among others), focuses not only on gender diversity but also the need for firms to incorporate varied life experiences within their business to help avoid the risk of an echo chamber. D&I features firmly in the regulator's Supervisory outlook, with comments such as: “how a firm approaches diversity and inclusion tells us a lot about its culture”, showing the clear link which the FCA is drawing between D&I and customer and business outcomes.

“

A culture that pursues diversity and equal opportunities is I think one that will have much wider benefits for an organisation. It suggests a culture that is open-minded, tolerant, aspiring to improve and considerate. When I look back at the cultures that I have seen where things have gone wrong, those are not descriptive terms that I would employ.”

Andrew Bailey

Chief Executive Officer, FCA (March 2018)

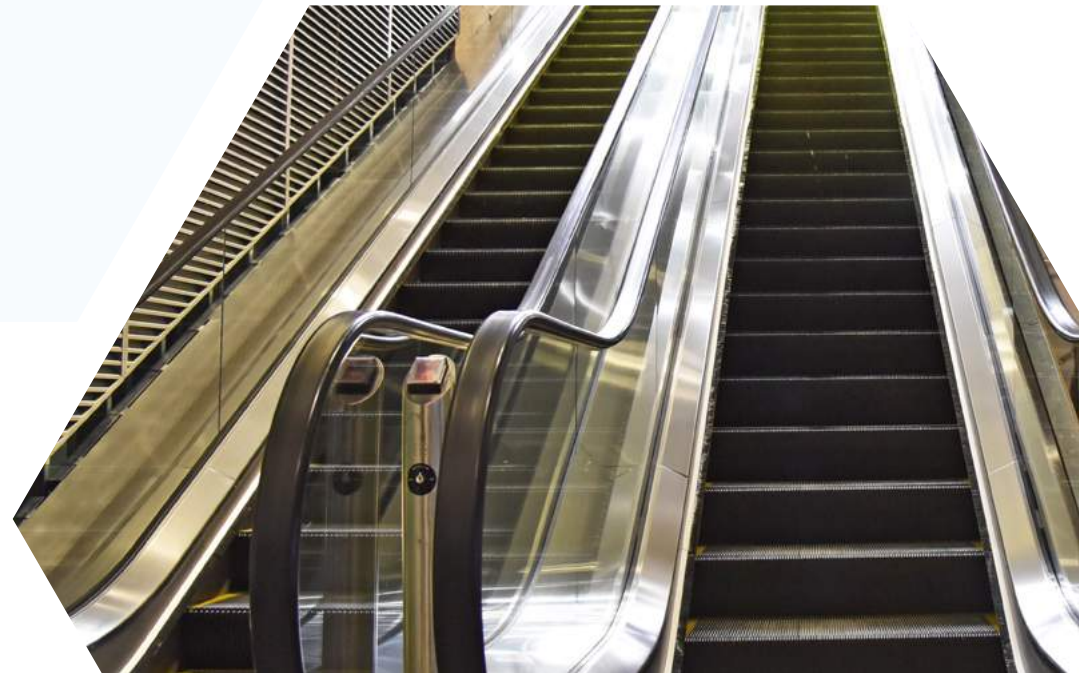
Workforce

Performance management and progression

Questions for Firms

When considering how D&I can further ethical objectives and contribute to good outcomes, a firm may find it helpful to consider:

- > How do recruitment processes contribute to the firm's D&I ambitions? (see further at Attraction, selection and recruitment)
- > Do the firm's recruitment statistics match the firm's ambitions for D&I and align with its ethical values and principles?
- > How are the firm's D&I expectations reflected in policies and processes within the firm, including e.g. disciplinary processes?
- > How does the firm promote a working environment which is inclusive and supportive of employees with a range of characteristics and backgrounds?
- > How does the firm track progression of individuals within the organisation?
- > To the extent particular groups are not progressing, or are progressing slower than others, does the firm understand why?
- > How are equal pay and the gender/ethnicity pay gap considered within the firm?
- > What management information in relation to D&I is provided to the Board?



Disciplinary proceedings and exits

Disciplinary proceedings: Where there has been a failure by employees to comply with the firm's expectations regarding conduct, culture and values, it is important that this is addressed. The FCA has made clear that personal conduct, as well as customer related activity must be taken seriously, commenting e.g. that: *"the way firms handle non-financial misconduct, including allegations of sexual misconduct, is potentially relevant to our assessment of that firm, in the same way that their handling of insider dealing, market manipulation or any other misconduct is."*

While it may be appropriate to deal with 'lower level' behavioural concerns informally, firms must consider whether it is appropriate to initiate formal disciplinary proceedings in circumstances where individuals (in particular those at a senior level) fall short of the required standards. Failing to hold staff to account for poor conduct significantly detracts from any other messages which the firm sends with the intention of promoting the importance of good conduct and culture (see further at [Performance management and progression](#)).

Regulatory References: Meanwhile, the regulatory reference regime, as set out in SYSC 22, aims to prevent individuals who have committed misconduct or regulatory breaches from moving to a new firm which is unaware of their previous history ("the rolling bad apple"). As such, firms are required to take reasonable steps to obtain regulatory references when appointing an employee to either a certification, senior management function or director position. According to the FCA, *"References are a key tool in allowing firms to share relevant information on individuals to support their assessment of potential new recruits as fit and proper"*.

Firms subject to the SMCR (which from December 2019 will be nearly all UK financial services firms) must disclose any disciplinary action (as defined in s.64C FSMA) taken which relates to a breach of the Conduct Rules and if they have previously concluded that the individual was not fit and proper to perform a function. Further, firms are required to disclose any other information which they reasonably consider to be relevant to the hiring firm's assessment of the fitness and propriety of the candidate.

Complying with the regulatory reference requirements must be positioned in the context of the duty of fairness which a firm owes to both its former employee and the hiring firm. This will inform how a reference is written and prepared and broader ethical considerations may come into play alongside the legal ones.

For example, when an individual has left a firm following an allegation in relation to his/her conduct, but prior to an investigation being carried out or disciplinary findings being made, a firm will need to consider matters such as whether an investigation should be commenced notwithstanding the individual's departure, the extent to which the former employee should be invited to participate in or be informed about an investigation into past conduct, and how the outcome of any post-exit investigation should be presented within a reference.

In addition, a firm's view of which matters contribute to an individual's fitness and propriety, and therefore the circumstances in which disclosure may need to be made, is likely to be informed by its inherent ethical values and the culture which it seeks to promote. There will accordingly be an express link between the values and principles which underpin and guide a firm's behaviour (see further at [Governance](#)) and the practicalities of the regulatory reference regime.

Workforce

Disciplinary proceedings and exits

Questions for Firms

When considering how its approach to disciplinary proceedings and employee exits can further ethical objectives and contribute to good outcomes, a firm may find it helpful to consider:

- > How does the firm assess whether disciplinary action is warranted?
- > How does the firm ensure consistency of outcome?
- > How are issues of non-financial misconduct dealt with in firm policies and procedures?
- > What is the firm's approach to investigating issues of personal misconduct?
- > How would the firm approach a culture/conduct allegation which relates to an ex-employee?
- > What does the firm define as serious misconduct for the purposes of the regulatory reference regime?
- > How does the firm define the matters which would be relevant to an assessment of fitness and propriety and which therefore need to be disclosed within a regulatory reference?
- > What approach does the firm take to managed exits and/or settlement discussions?
- > Does the firm conduct exit interviews and do these include a question about the workplace environment and/or the culture of the firm?
- > How does the firm achieve an appropriate handover of responsibilities and salient information from an outgoing employee to residual or new members of the team?



Workforce

Key Sources

Attraction, selection and recruitment

Legislation:

- > CRD IV (in particular Article 88 (Governance arrangements) and Article 91 (Management body))
- > MiFID II (in particular Article 9 (Management body))
- > Equality Act 2010
- > Financial Services and Markets Act 2000 (in particular section 60A (Vetting of candidates) and section 63F (Issuing of certificates))

Regulation:

- > SYSC Senior Management Arrangements, Systems and Controls (in particular SYSC 4 (General organisational requirements), SYSC 5 (Employees, agents and other relevant persons) and SYSC 22 (Regulatory references));
- > FIT Fit and Proper test for Employees and Senior Personnel (in particular FIT 2 (Main assessment criteria));
- > TC Training and Competence (in particular TC 2 (Competence))

Other Sources:

- > PRA Supervisory Statement 5/16 on Corporate governance: Board responsibilities (July 2018)
- > Speech by Megan Butler, Women in finance: keeping up the pressure for progress (March 2018)
- > FCA Discussion Paper 18/2 Transforming Culture in Financial Services (March 2018)
- > FCA Insight: Creating and sustaining cultures of compliance (December 2016)
- > FCA Occasional Paper No 24: Behaviour and compliance in organisations (December 2016)
- > FCA Good practice on recruiting, training and supervising staff

Training, qualifications and suitability

Legislation:

- > CRD IV (in particular Article 88 (Governance arrangements), Article 91 (Management body), Article 121 (Qualification of directors))
- > MiFID II (in particular Article 16 (Organisational requirements) and Article 25 (Assessment of suitability and appropriateness and reporting to clients))
- > Financial Services and Markets Act 2000 (in particular s60A (Vetting of candidates) and 63F (Issuing of certificates))

Regulation:

- > Principles for Business (in particular Principle 3 (Management and control))
- > FIT Fit and Proper test for Employees and Senior Personnel (in particular FIT 2 (Main assessment criteria))
- > TC Training and Competence (in particular TC 2 (Competence))
- > SYSC Senior Management Arrangements Systems and Controls (in particular SYSC 5 (Employees, agents and other persons) and SYSC 27 (SMCR: Certification regime))
- > COCON Code of Conduct (in particular COCON 2 (Individual conduct rules))

Workforce

Key Sources

Other Sources:

- > FCA Final Notice: [Tesco Personal Finance plc](#) (October 2018) (in relation to a breach of Principle 2 and training deficiencies in relation to fraud risk controls and the invocation of crisis management procedures)
- > ESMA Guidelines for the Assessment of Knowledge and Competence (January 2017)
- > FCA webpage on [training and competence](#)
- > FCA Good practice on [recruiting, training and supervising staff](#)
- > Banking Standards Board [Statement of Good Practice 1: Certification Regime \(Fitness and Propriety Assessment Principles\)](#) and [Supporting Guidance](#)

Workplace Environment

Legislation:

- > [Employment Rights Act 1996](#)
- > [Public Interest Disclosure Act 1998](#)
- > [EU General Data Protection Regulation](#)
- > [Data Protection Act 2018](#)

Regulation:

- > [Principles for Business](#) (in particular Principle 1 (Integrity))
- > [SYSC Senior Management Arrangements Systems and Controls](#) (in particular [SYSC 18](#) (Whistleblowing))
- > [COCON Code of Conduct](#) (in particular [COCON 2](#) (Individual conduct rules))

Other Sources:

- > Banking Standards Board, [Employee Wellbeing – Why does it Matter?](#) (October 2018)
- > FCA Insight, [Psychological safety: the secret to effective teams](#) (May 2018)
- > [Final Notice: James Staley](#) (May 2018) (in relation ICR 2 and his response to a whistleblowing complaint)
- > [FCA Discussion Paper 18/2 Transforming Culture in Financial Services](#) (March 2018)
- > [Banking Standards Board Annual Review 2017/2018](#)
- > [Thriving at Work – The Stevenson / Farmer review of mental health and employers](#) (October 2017)

- > [ACCA Report: effective speak up arrangements for whistle-blowers](#) (May 2016) and associated recommendations for directors and managers
- > [UK Government Code of Practice for employers](#) (2015)
- > The Whistleblowing Commission, [Report on the effectiveness of existing arrangements for workplace whistleblowing in the UK](#) (November 2013)

Performance management and progression

Legislation:

- > [Material Risk Takers Regulation](#)
- > [CRD IV](#) (in particular Article 92 (Remunerations policies), Article 94 (Variable elements of remuneration) and Article 95 (Remuneration Committee))
- > [MiFID II](#) (in particular Recital 77 and Article 24 (General principles and information to clients))
- > [Equality Act 2010](#)
- > [EHRC Employment Statutory Code of Practice](#) (September 2015)
- > [The Equality Act 2010 \(Gender Pay Gap Information\) Regulations 2017](#)

Workforce

Key Sources

Regulation:

- > SYSC Senior Management Arrangements Systems and Controls (in particular SYSC 19A to F (Remuneration Codes)) and PRA Remuneration rules
- > PRA Supervisory Statement SS5/16, Corporate governance: board responsibilities

Other Sources:

- > BEIS Consultation: Ethnicity Pay Reporting (January 2019)
- > Speech by Christopher Woolard, *Opening up and speaking out: diversity in financial services and the challenge to be met* (December 2018)
- > Letter from Megan Butler to the Women and Equalities Committee on Sexual Harassment in the Workplace (September 2018)
- > FCA Discussion Paper 18/2 Transforming Culture in Financial Services (March 2018)
- > Finalised Guidance 18/2: Staff incentives, remuneration and performance management in consumer credit firms (March 2018)
- > EBA/ESMA Guidelines on the assessment of the suitability of members of the management body and key function holders (March 2018)
- > Speech by Megan Butler, *Women in finance: keeping up the pressure for progress* (March 2018)

- > McKinsey Report, *Delivering through Diversity* (January 2018)
- > Hampton-Alexander Review: Improving gender balance in FTSE Leadership (November 2017)
- > The Parker Review Committee: A Report into the Ethnic Diversity of UK Boards (October 2017)
- > FCA Occasional Paper No 24 Behaviour and Compliance in Organisations (December 2016)
- > Final Notice Swinton Group Limited (July 2013) (in relation to sales incentive schemes which were designed to increase sales without having due regard to the interests of customers)
- > Final Notice Lloyds TSB Bank plc and Bank of Scotland plc (December 2013) (in relation to remuneration schemes and their impact on the sales culture of a firm)
- > Final Notice Alliance & Leicester (October 2008) (in relation to Principles 3, 6, 7 and 9 and the risk that the firm's remuneration structure increased the risk of unsuitable PPI sales)
- > FCA's 5 Conduct Questions Programme
- > HM Treasury Women in Finance Charter

Disciplinary proceedings and exits

Legislation:

- > Financial Services and Markets Act 2000 (in particular section 64C (Disciplinary action))

Regulation:

- > SYSC Senior Management Arrangements Systems and Controls (in particular SYSC 22 (Regulatory references))
- > COCON Code of Conduct

Other Sources:

- > Banking Standards Board Consultation on Good Practice Guidance on Regulatory References (January 2019)
- > Letter from Megan Butler to the Women and Equalities Committee on Sexual Harassment in the Workplace (September 2018)
- > FCA Policy Statement 16/22 (Strengthening accountability in banking and insurance: regulatory references final rules) (September 2016)



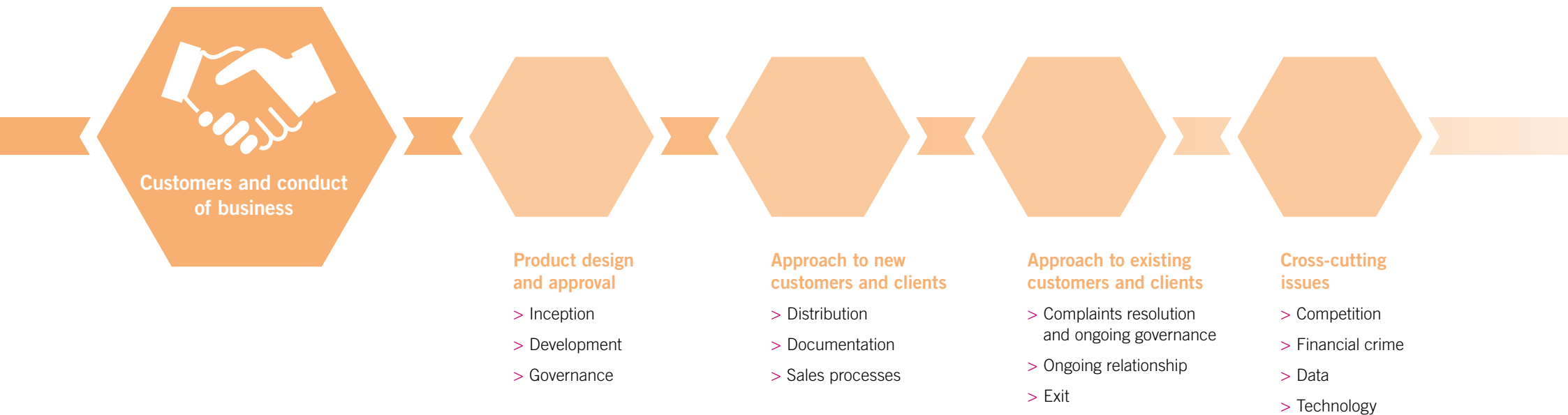
Customers and
conduct of business



Customers and conduct of business

Introduction

Without customers, banks and financial services institutions would not exist. Building and maintaining a relationship of trust and confidence, through a firm's approach to its customers and its conduct of business is critical to business success as well as a firm's more general standing in the market. Unsurprisingly, this is an area where a significant volume of law and regulation exists to inform or *dictate* the approach a firm must take in relation to its customers. In this section we explore some of these obligations by reference to the stages of a typical customer lifecycle and consider how a firm's approach to these stages can further ethical objectives and contribute to good outcomes.





Customers and conduct of business

Product design and approval

Together with the overarching Principles for Business/Fundamental Rules, firms must consider more detailed rules and regulations when designing and developing a new product or service. Conduct of business rules mean that firms must consider potential conflicts of interest, and product governance obligations introduced under MiFID II require manufacturers of financial instruments to identify the target market and ensure that products are designed to meet the needs of such clients. Firms must also consider the distribution strategy in respect of such financial instruments, taking reasonable steps to ensure that only those clients or customers for whom an instrument has been designed will be approached in any sales activity, and operate a review and approval process for new or significant proposed amendments to relevant products.

The underlying objectives of the MiFID II rules reflect the more general supervisory outcome which the FCA seeks in relation to retail customers, namely that customer need should be inherent to internal product design and approval processes and considered alongside business strategy and risk appetite. Consideration of pricing, privacy and data protection issues (among others) is also expected of firms at the product design and approval stage (see further at [Cross-cutting issues \(Competition\)](#) and [\(Data\)](#)), with a clear regulatory expectation that any commercial terms must be consistent with overriding TCF principles.

In recent years, the FCA has increasingly engaged with behavioural economics to inform its policy and supervisory approach, with certain observations being particularly relevant to a firm's consideration of its ethical business practice (as well as its regulatory compliance). For example, reflections on behavioural biases should encourage firms to consider whether certain features of a product could play on a potential customer's emotional bias. In the particular circumstances, firms should then consider whether it is right for the firm to promote a product in a way which takes advantage of the ways in which individuals make decisions or if certain safeguards/mitigating factors should be introduced. Social factors such as desire to achieve financial inclusion and focus on protecting vulnerable customers (see further at [Approach to new customers](#)) should also be considered both from a cultural and regulatory perspective.

A further example of how a firm's ethical values may factor into business planning and service offerings include the potential impact of bundling, and whether certain products would be more suited to a customer segment if they were unbundled or capable of being unbundled.

The judgement of when price discrimination is fair is not always straightforward. The FCA has proposed six evidential questions that it will consider when assessing pricing fairness:

- > Who is harmed by price discrimination?
- > How much are these individuals harmed?
- > How significant is the pool of people harmed?
- > How are firms price discriminating?
- > Is the product/service essential?
- > Would society view the price discrimination as egregious/socially unfair?

(FCA Discussion Paper DP 18/19: Fair Pricing in Financial Services, October 2018)



Customers and conduct of business

Product design and approval

Depending upon the product or service in question, organisations may also wish to consider voluntary market standards relating to product and service design and subsequent delivery. Such issues are not limited to the retail banking environment and various voluntary codes and statements have been published with a view to enhancing standards of behaviour across the market. These include standards issued by the Lending Standards Board in relation to personal and business banking customers, the FICC Markets Standards Board in relation to wholesale markets activity, the Global FX Code which sets out a common set of guidelines for good practice in the FX market, and the UK Finance Standards Framework in relation to invoice finance and asset-based lending.

It is important for firms to remember that the internal teams responsible for product design, development and approval may be distant from the customer or counterparty for which the product/service is intended. Firms will therefore need to ensure that employees undertaking these activities have an adequate and appropriate understanding of how their work has a real-world impact. It may also be appropriate to consider whether structures can be put in place to remind individuals of the potential ethical challenges or decision points which arise in relation to product design and approval. Training and messaging from senior management (see further at **Leadership, responsibility and accountability** and **Training, qualifications and suitability**) will be important for embedding the firm's values and guiding principles in the product design and approval process and may encourage employees to regard their work as more than simply “numbers on a screen” and acknowledge the importance of a well-functioning finance sector for the wider economy.

Case Study – The RBS YES check

“The YES check is a simple tool that asks five questions to guide the thinking behind our decisions and actions. Our customers expect each of us to exercise good judgement and to do the right thing. We use our values to help us think through decisions and make sure we do the right thing. When in doubt, we use the YES check for guidance:

- > Does what I am doing keep our customers and the bank safe and secure?
- > Would customers and colleagues say I am acting with integrity?
- > Am I happy with how this would be perceived on the outside
- > Is what I am doing meeting the standards of conduct required?
- > In 5 years' time would others see this as a good way to work?”



Customers and conduct of business

Product design and approval

Questions for Firms

When considering how product design and approval can further ethical objectives and contribute to good outcomes, a firm may find it helpful to consider:

- > How does the firm consider the benefits of a particular product/service for the intended customer segment?
- > What steps have been taken to ensure that a new product/service is inclusive by design?
- > Has account been taken of any relevant market-based standards, codes or guidance?
- > Has sufficient consideration been given from a vulnerable customer perspective?
- > Do longer-term products incorporate an appropriate level of in-built flexibility that can adapt to the changing circumstances in which a customer might find themselves?
- > How is the proponent of a new product/service asked to describe the risks and benefits of the product/services in the context of product approval documentation and/or governance processes?
- > How do the results of market testing play into governance and decision-making?
- > How are behavioural biases or influences on customer decision-making considered as part of the product design process?
- > How are decisions about pricing made?
- > What management information about product design and approval is escalated to the Board?
- > How many times has the firm decided not to pursue a product or strategy because it is not considered the right thing to do?
- > What is the organisation's approach to product following approval and launch?





Customers and conduct of business

Approach to new customers and clients

A large volume of rules and regulations dictate how a firm should engage with its customers and clients as it carries out its regulated activities; these take the form of both overarching Principles and high-level rules as well as more prescriptive obligations which may derive from either/both EU and UK domestic law.

For example, requirements for client-facing information and documentation to contain minimum terms and be fair, clear and not misleading form an essential component of multiple EU regimes (e.g. MiFID II and PRIIPs) as well as the UK financial promotions regime; and legislation such as the Consumer Rights Act 2015 and Unfair Terms in Consumer Regulations 1999 provide additional grounds for the FCA to consider the fairness of contract terms and commercial practices. In many instances, firms have an obligation to take all reasonable steps to achieve the best possible results for their clients, while suitability and appropriateness rules are designed to ensure that adequate consideration has been given to customer circumstances and their investment objectives, knowledge and risk appetite.

Since the FCA's principal focus is on the regulated activities which a firm undertakes, an interesting question for firms to consider is the extent to which they require the conduct of their unregulated business to adhere to similar standards as their regulated business lines. Commenting in the wake

of the FX scandal (see further at [Cross-cutting issues \(Competition\)](#)) the FCA was clear that neither it nor market users should accept lower standards of behaviour or conduct than in regulated markets; the volume of fines levied in this context demonstrates the appetite of regulators to enforce in circumstances where firms are seen to pay insufficient regard to the interests of its clients, even where the instruments in question fell strictly outside the regulatory perimeter.

Another area for firms to consider when comparing their business practices to their fundamental guiding principles is the disclosure of information which may not strictly be required under the regulatory regime but which, in the circumstances, may be seen as reasonable to disclose. In particular, firms may wish to think whether there are aspects of a product/service which the intended customer would not know to ask about. This should include letting customers know all of the communication channels and accessibility options available to them but may also extend to the commercial basis on which the product is offered. In this regard, the recent case of *Plevin v Paragon Finance*, in which the Supreme Court found that significant undisclosed commissions in the context of PPI rendered the borrower's relationship with the lender "unfair" provides further stimulus for firms to consider the potential implications of non-disclosure of commercial terms/arrangements.





Customers and conduct of business

Approach to new customers and clients

When it comes to client/customer interaction, whether directly or through a distribution network, the nature of the product or service which is being marketed should inform the sales strategy. In general, the more complex a product, the more explanation customers will ordinarily require and, therefore, the greater the amount of training needed for sales staff.

This may be particularly relevant in the case of business banking given that the complexity of corporate and commercial lending products and services can vary significantly according to the funding profile or risks they are designed to embrace. Firms will also need to consider whether their remuneration structures reward behaviour which involves good outcomes for customers (see further at [Performance management and progression](#)) and take care that cross-selling does not become mis-selling (as was seen e.g. in the context of PPI) and that the needs of particular customer segments are taken into account.

The issue and treatment of vulnerable customers merits particular attention in the context of a resource on ethics. While most consumer protection legislation is underpinned by the notion of the average or typical consumer and what they might expect, understand or how they might behave, vulnerable customers may be significantly less able to represent their own interests, and more likely to suffer harm than the average consumer. The FCA defines a vulnerable customer as someone who, due to their personal circumstances, is especially susceptible to detriment, particularly when a firm is not acting with appropriate levels of care. Firms seeking to embed an ethical approach within their offering of products and services should therefore take steps to develop an effective vulnerability strategy which ensure good outcomes for the customer, in keeping with the design. This will additionally stand firms in good stead from a regulatory perspective as the FCA's continued focus on this customer segment is soon expected to bring additional guidance to inform their supervisory and enforcement approach.



Removing the fear, enabling difficult conversations: many staff may feel awkward or scared of having conversations around issues such as mental or other forms of illness, stressful situations and dealing with customers who may be distressed. Therefore they may not feel able to encourage customers to disclose vulnerabilities. Removing as much of this fear as possible via increased understanding, clear guidance on how to respond, role play, listening to sample calls are all ways that this can be achieved. ”

Practitioners' Pack

FCA Occasional Paper 8: Consumer Vulnerability,
Appendix 4 (February 2015)



Customers and conduct of business

Approach to new customers and clients

Questions for Firms

When considering how its approach to new customers and clients furthers ethical objectives and contributes to good outcomes, a firm may find it helpful to consider:

- > How does the firm determine what standards should apply to the conduct of business which is not subject to specific rules or guidance or which falls outside the regulatory perimeter?
- > How does the firm use a “customer lens” to review the information and documentation associated with its products and services?
- > How does the firm consider and approach what should be disclosed in product documentation?
- > Does the firm ever make disclosure above what is required by law and regulation?
- > What is the firm's approach to vulnerable customers?
- > To what extent has the firm adopted and embedded voluntary codes or standards to inform its practices?
- > What management information do senior management and the Board receive in relation to the firm's sales processes and practices?
- > To what extent are metrics such as sales volumes or penetration rates considered as potential indicators of poor conduct?





Customers and conduct of business

Approach to existing customers and clients

The plethora of rules and regulations which apply upon inception of a customer or client relationship typically continue through the lifespan of the product or service, but firms must additionally consider those elements of the legislative and regulatory framework which are specific to the ongoing servicing and treatment of customers. Among others, rules in DISP govern the investigation and resolution of customer complaints and FCA enforcement notices have highlighted the need for firms to conduct and learn from root cause analysis exercises to improve their product offering and sales processes on an ongoing basis.

Treatment of existing customers is named in the FCA's 2018/19 Business Plan as a cross-sector priority, with the clarity of information that is provided to customers about the products and services which they are invested in, their performance and applicable charges, being of particular focus. When considering if business outcomes align to underlying ethical intentions, firms should consider the practical implications of "treating customers fairly" and what good disclosure looks like from a customer perspective (see further

at [Approach to new customers and clients](#)). This might include considering how a customer might use information which is provided/otherwise in the possession of the firm, e.g. to determine whether to switch products or provider or decide if an "add-on" product is suitable for them.

The FCA's mandatory renewal disclosure rules for insurers illustrate how, in some areas, the FCA has amplified its general Principles for Business to direct firms to take action in relation to ongoing relationships. In this context, the requirement to clearly disclose the previous year's premium at renewal was introduced in order to make it easy for consumers to compare pricing, and supplementary guidance encourages firms to review the language used in their renewal notices to check that they are not discouraging customers from shopping around.

Balancing the inherent commercial objective of a firm to retain its customers, while considering their best interests and facilitating exits in appropriate circumstances, can present challenges for firms. Ensuring that product features and/or internal firm processes do not make it unduly difficult



Switching between platforms can be difficult. Consumers who would benefit from switching can find it difficult to do so: The switching process for investors is complex and time consuming. Almost half of consumers who have not switched nor considered switching platform are happy as they are. But we found that 7% of consumers have tried to switch at some point but failed mainly because of the time involved, the complexity of the process and exit fees. We are not concerned about the rate of switching per se, what matters is the ability to switch - consumers should have the option even if they choose not to use it. ”

FCA Investment Platforms Market Study
(Interim Report) (July 2018)



Customers and conduct of business

Approach to existing customers and clients

for customers to exit and/or switch to another provider is imperative from the regulatory perspective and the FCA's thematic review of the closed-book life insurance sector and recent investment platforms market study (following which a ban on exit fees is being contemplated) demonstrate the current regulatory scrutiny in this area (see also at [Cross-cutting issues \(Competition\)](#)).

Similar challenges may come into play when considering customer wellbeing and financial circumstances. For example, in the context of its 2014 credit card market study, the FCA observed that customers had persistent levels of credit card debt, but firms had limited incentives to assist. In this instance, a series of remedies was put in place, with firms required to take steps to help customers avoid getting into debt, and ultimately offer forbearance if debt could not be repaid within a reasonable time period. Firms considering whether their approach exemplifies their organisational aims should more generally consider what proactive steps they take to identify stress points or disadvantages which arise for customers and what they might do in order to enhance the customer experience.

Once a product or service has been launched, ongoing monitoring should be undertaken to enable firms to learn more about the customer experience, with the results flowing through to internal governance fora so that trends or issues can be analysed. For example, products with high penetration rates across multiple client segments could be indicative of pressurised or unsuitable sales, which may result in poor outcomes for certain groups. Other factors or data that could be relevant to consider include unusually high profitability/margins and customer complaints data. Where any issues are identified, governance processes should enable the firm to effect changes in relation to existing customers (as appropriate) and potentially reassess the factors considered as part of the product design and development stage.





Customers and conduct of business

Approach to existing customers and clients

Questions for Firms

When considering how its approach to existing customers and clients further ethical objectives and contribute to good outcomes, a firm may find it helpful to consider:

- > How does the firm's strategy and governance framework contribute to the fair treatment of existing customers?
- > How does the firm communicate with existing customers to ensure they are able to make informed decisions at key points in a product's lifecycle?
- > What is the firm's approach to longstanding customers?
- > How does the firm approach pricing and to what extent is cross-subsidisation actively considered within governance?
- > What data does the firm collect in relation to its current customer base and how is it measured and monitored in order to spot potential issues arising?
- > How does data emanating from the firm's complaints handling processes contribute to root cause analysis and feed into governance forums?
- > How is the firm incentivised to help customers, and consider their interests, in circumstances of financial stress or other instances of vulnerability?





Customers and conduct of business

Cross-cutting issues

Competition: The basic purpose of competition law is to ensure the fair operation of markets for goods and services. The FCA is one of the few financial regulators in the world with a core objective to promote competition, and outlines its duty as considering the impact that all its activities have on competition, including those activities that are mainly about consumer protection or market integrity. Its objective is to promote competition in the interests of consumers, not just for its own sake. A key element of focus for the FCA is ensuring that businesses do not collude with each other at the consumer's expense. The FCA issued its first formal decision under its competition enforcement powers in February 2019 and other enforcement action has been taken e.g. in the context of the FX scandal, where firms have inappropriately shared information in a way that could disadvantage clients and the market.

In focusing on identifying actual or potential harm and the fairness of markets for customers, the FCA is looking at factors such as market concentration, price discrimination, integrated supply chains and barriers to entry or switching. Firms must likewise be alive to these issues. Such indicators are not always associated with rule breaches but are potentially aligned to issues of integrity and how a firm defines its purpose and guiding principles.

Helping consumers get the information they need, empowering consumers to assess the best choice for them and helping consumers to act on their decisions are all areas that the FCA is looking to deliver on through its competition agenda. It is taking real steps to achieve this (e.g. through the requirements for retail banks and building societies to publish standardised, comparable information about personal and small business current account services). The largest providers are now required to publish independent service quality results and make the data available across multiple channels. Firms who expressly consider these issues in the context of their business planning and product development (see further at [Product design and approval](#)) should be well placed to contribute to the promotion of effective competition.



When competition works well, consumers are empowered as well as informed. They can make sense of the information they receive and can take their business elsewhere if they are not happy. In turn, firms strive to win custom on the basis of service, quality, price and innovation. This helps generate better outcomes for consumers. Markets are open to entry and innovation, and successful, innovative firms thrive, while unsuccessful firms change or exit.



FCA

Promoting Competition Webpage



Customers and conduct of business

Cross-cutting issues

Financial crime: A significant volume of law and regulation exists in relation to the prevention of financial crime, with sources including the EU Money Laundering Directives and associated UK regulations, the Criminal Finances Act 2017, Proceeds of Crime Act 2002, Terrorism Act 2000, Bribery Act 2010 and civil and criminal market abuse regimes all contributing to firms' obligations in this area. These are supplemented by numerous pieces of industry guidance, including the guidelines published by JMLSG, and additional high-level rules and principles directed at governance and senior management accountability. However, continuing political pressure (in light of matters such as terrorist financing, the introduction of cryptocurrencies and rise in new technologies) means that further focus and developments are expected in this area, for example through the entry into force of MLD V and VI.

The extent of law and regulation which exists means that many ethical considerations in the financial crime arena have been codified (e.g. bribery and obligations to notify suspicions about other market participants' conduct through the suspicious transaction and order reporting regime). However, against the backdrop of increased regulatory and supervisory focus and the increased cost of compliance, questions nevertheless arise which may require a firm to consider the consistency of its approach with the ethical values and principles it has set for itself.

An example is "de-risking", whereby customers perceived to present a higher money-laundering risk are "de-banked". De-risking, while potentially safeguarding AML compliance on the one hand, has the potential to disproportionately impact smaller businesses along with certain sectors/areas of business such as money services, charities and FinTech. The FCA has accordingly made a commitment to work with banks to lessen the damaging effects of de-risking without constraining banks' commercial freedom.

A further example of ethical decision-making which is underpinned by the financial crime agenda and (in this case) the inducements rules is a firm's approach to gifts and entertainment. Determining the quantum and type of gifts and entertainment which a firm permits its employees to give/receive in relation to their business activities should be consistent with its values and guiding principles as well as safeguarding against risks that the firm and/or its counterparty/client could be improperly influenced or used as a conduit for financial crime.

Case Study –Standard Chartered Bank

Standard Chartered Bank has adopted a "de-risking through education" approach. It continues to provide correspondent banking services in conjunction with running "Correspondent Banking Academies" which aim to educate its clients in financial crime compliance standards. These involve not only Standard Chartered Bank staff but also representatives of the public sector and other organisations such as FATF, the UN and others. Standard Chartered Bank runs similar courses for NGOs, as charities are often excluded from the financial sector particularly when operating in difficult locations because of financial crime compliance concerns.



Customers and conduct of business

Cross-cutting issues

Technology: All modern financial services are underpinned by information technology systems, and failure or misuse of those systems can cause significant harm to customers and society more generally. Governmental and regulatory focus in this area continues to grow at both the domestic and EU level, as can be seen from (among other things) the specific rules addressing algorithmic trading which were introduced by MiFID II and MAR. Such reforms are complemented by the SMCR's individual accountability regime (in particular the SMF24 Chief Operations role and the Algorithmic Trading Certification Function) as well as the FCA's Statement on Big Data and recent Select Committee reports on algorithms in decision-making and AI.

However, the challenge from new and disruptive technology is constant. It can provide significant benefits, such as greater efficiency and new and improved services to customers but can also have significant downsides. A firm's approach to new technology should go beyond narrow operational and regulatory considerations and consider broader ethical factors.

For example, an increasing number of firms are using AI to help automate their business. It has real potential for good but raises a number of risks: most notably because these systems' behaviour is typically learnt not programmed and so operates in a "black box". This raises questions such as: how can a firm ensure it is not taking discriminatory decisions? And, is it appropriate to delegate certain types of decisions to a computer?

Equally, there is a growing role for robo or hybrid robo-human advice, which has many potential benefits, including allowing many more customers to access that advice and reducing the risk of human error. However, ad-hoc human failure might be replaced with systematic errors and biases, a particular concern if decisions are taking place in a black box.

The impact of new technology can also have a broader effect on society. For example, the move from banking in-branch to banking online can create barriers to those trying to access financial services, particularly customers who are less confident about the use of technology. The use of data can also lead to financial exclusion or disadvantage (see further at [Cross-cutting issues \(Data\)](#)). It is important for firms to

Case Study – AI at Microsoft

Microsoft has issued a set of AI Principles to ensure its work is built on ethical foundations. There are four key principles:

- > Fairness: AI must maximise efficiencies without destroying dignity and guard against bias.
- > Accountability: AI must have algorithmic accountability.
- > Transparency: AI must be transparent.
- > Ethics: AI must assist humanity and be designed for intelligent privacy.

These are supported by five design principles:

- > Humans are the heroes: People first, technology second. Design experiences that augment and unlock human potential.
- > Know the context: Context defines meaning. Design for where and how people work, play and live.
- > Balance EQ and IQ: Design experiences that bridge emotional and cognitive intelligence.
- > Evolve over time: Design for adaptation. Tailor experiences for how people use technology.
- > Honor societal values: Design to respect differences and celebrate a diversity of experiences.



Customers and conduct of business

Cross-cutting issues

consider these issues when creating new products and setting their digital strategy (see further at [Product design and approval](#) and [Approach to new customers and clients](#)). There may also be impacts on a firm's workforce, including the extent to which employees have the right skills and training to adapt to changes in their working environment and, in the longer term, potential workforce disruption/displacement.

Firms should consequently consider factoring new technology into their risk management framework and taking appropriate operational measures to test and supervise new technologies. Some firms may want to go further and adopt a code of practice on the use of AI and other new technology, supported by specific ethics committees (which governance models are commonly used in the tech sector).

Data: Underpinning many advances in technology, and business models more generally, is data. That data might either be analysed to obtain new insights, underpin decision-making or train artificially intelligent systems. Data is a regulatory hot topic as well as a matter of reputational importance, and how an institution uses, controls and protects the information it holds must be considered in the context of other legal and ethical obligations including duties of confidence and confidentiality owed to employees, customers and counterparties. The GDPR marked the biggest shake

up to European privacy laws in 20 years, with implications for both information control and security. The GDPR sets out a comprehensive regulatory framework including not only broad requirements to ensure data is used “fairly” but also obligations to carry out impact assessments on new processing that creates risks to individual privacy.

Separately the FCA has carried out a thematic review and issued multiple MarketWatch publications and enforcement notices, focusing on the use and control of confidential and inside information within financial services firms. This continues to be an issue of Supervisory importance and the FCA's upcoming 'Approach to Market Integrity' document can be expected to emphasise the criticality of control arrangements within firms.

Regulatory focus on operational resilience and cyber security is meanwhile at an all-time high, with the FCA having completed a cyber review across the asset management and wholesale banking sectors in December 2018, concluding that “*most [Boards and Management Committees] continue to have limited familiarity with the specific cyber risks their organisations face*”. Other regulatory authorities including the PRA and EBA are consistent in warning that potential cyber and data security breaches present one of the main challenges for the banking sector.



Advances in data science have already brought huge benefits to society, such as smarter ways of detecting financial crime and market abuse, cheaper and faster transactions and greater access to affordable financial advice and guidance. The UK FinTech industry is world leading and bursting with new ideas. But there is no room for complacency. ”

Charles Randell

Chair of the FCA and PSR (July 2018)



Customers and conduct of business

Cross-cutting issues

Recent and rapid advances in data collection and storage capabilities have exponentially increased firms' ability to create and hold data in relation to their customer base. The ability to use technology to analyse customer behaviour and demand for products has the potential to benefit customers (e.g. auto-enrolment for pensions and Open Banking initiatives) and/or to enhance customer service through better and more targeted product design. However, firms must be careful that the capacity to undertake more targeted sales initiatives and product reviews does not exploit inherent customer biases in a negative way or result in excessive risk segmentation or price discrimination. Firms should consider potential opportunities to use their data for customer advantage, e.g. internal communication for the benefit of vulnerable customers (see further at [Product design and approval](#) and [Approach to new customers and clients](#)). Information control meanwhile remains an ethically important topic with firms needing to ensure that their "need to know" processes effectively safeguard sensitive information and that the firm and individuals operating within it are unable to exploit data for their own benefit.

The Centre for Data Ethics & Innovation has recently been set up by the Government to encourage beneficial data technology innovation and may help firms navigate new ethical issues that emerge.





Customers and conduct of business

Cross-cutting issues

Questions for Firms

When considering how its approach to cross-cutting issues such as competition, anti-money laundering, technology and data can further ethical objectives and contribute to good outcomes, a firm may find it helpful to consider:

- > How are decisions made to balance the interests of the firm and the interests of customers or counterparties?
- > How do new product approval processes take into account potential competition impacts, e.g. pricing and barriers to entry?
- > How does the firm monitor whether the way in which it conducts its business gives rise to any potential competition concerns?
- > What analysis is made of information in the public domain on the service quality of personal and business current accounts, or other products and services?
- > What action has been taken to guard against potential customer detriment including through accidental unfair bias due to poor data quality or algorithm design?
- > How does the firm ensure that the policies and procedures which apply to its staff, and business decisions which are taken in relation to customers or counterparties, reflect the underlying ethical values and principles of the organisation?
- > How confident is the Board in relation to its information control arrangements?
- > How knowledgeable is the Board of potential cyber risks which could impact customers and the way in which the firm conducts its business?
- > How are technological developments evaluated in relation to their potential impact on customers or conduct of business?
- > Has the firm's governance and risk management frameworks adequately taken into account any use of AI and other new technology?
- > When did the firm last undertake a cybersecurity audit?





Customers and conduct of business

Key sources

Customers and conduct of business Product design and approval

Legislation:

- > Markets in Financial Instruments Regulation (600/2014/EU) and MiFID II Delegated Directive (2017/593/EU) (in particular those provisions relating to product governance including Articles 9 and 10 MiFID II Delegated Directive)

Regulation:

- > Principles for Business and Fundamental Rules (in particular Principle/Fundamental Rule 1 (Integrity), Principle/Fundamental Rules 2 (Due skill, care and diligence), Principle 6 (Customers' interests), Principle 8 (Conflicts));
- > SYSC Senior Management Arrangements, Systems and Controls (in particular SYSC 4 (General organisational requirements) and SYSC 10 (Conflicts of Interest));
- > COBS Conduct of Business Sourcebook (in particular COBS 2 (Conduct of Business) and equivalent provisions in MCOB Mortgages and Home Finance: Conduct of Business sourcebook, BCOBS Banking: Conduct of Business sourcebook and CONC Consumer Credit sourcebook
- > PROD Product Intervention and Product Governance Sourcebook (in particular PROD 3.2 (Manufacture of products))

Other Sources:

- > FCA Strategic Review of Retail Banking Business Models (December 2018)
- > FCA Discussion Paper 18/9 – Fair Pricing in Financial Services (October 2018);
- > FCA Thematic Review 18/4 and Dear CEO Letter on pricing in the general insurance sector (October 2018)
- > Open Banking Customer Experience Guidelines (September 2018)
- > FCA's Approach to Consumers document July 2018
- > FCA DP 18/5: Discussion paper on a duty of care and potential alternative approaches (July 2018)
- > FCA Research Note: Price discrimination in financial services (July 2018);
- > FCA Feedback Statement – Call for Input on Access to Insurance (June 2018)
- > FCA, Business Plan 2018/19 (in particular Sector priorities (Wholesale financial markets and Retail lending)) (April 2018)
- > FCA's Financial Lives Survey 2017
- > FCA FG 12/09 Retail Product Development and Governance – Structured Product Review (March 2017)
- > FCA Occasional Paper No 24 Behaviour and Compliance in Organisations (December 2016)
- > FCA Thematic Review 15/2 – Structured Products: Review of Product Development and Governance (March 2015)
- > FCA's Occasional Paper No 8 Consumer Vulnerability (February 2015)

- > FCA's Practitioners' Pack (accompanying OP No 8) (February 2015)
- > Final Notice: Credit Suisse International (June 2014) (relating to Principle 7 and the Cliquet Product)
- > Final Notice: Yorkshire Building Society (June 2014) (relating to Principle 7 and the Cliquet Product)
- > Final Notice: State Street Bank Europe Limited and State Street Global Markets International Limited (January 2014) (relating to Principles 3, 6, 7 and the operation of the UK transition management business)
- > FCA Occasional Paper No 1 Applying behavioural economics at the Financial Conduct Authority (April 2013)
- > RPPD The Responsibilities of Providers and Distributors for the Fair Treatment of Customers

Approach to new customers

Legislation:

- > MiFID II (in particular Article 24 (General principles and information to clients))
- > Packaged Retail and Insurance-based Investment Products Regulation (in particular Chapter II (Key Information Document))
- > Financial Services and Markets Act 2000 and Financial Services and Markets 2000 (Financial Promotion) Order 2005 (SI 2005/1529) (in particular section 21)
- > Consumer Rights Act 2015
- > Unfair Terms in Consumer Regulations 1999



Customers and conduct of business

Key sources

Regulation:

- > **Principles for Business** and **Fundamental Rules** (in particular Principle/Fundamental Rule 1 (Integrity), Principle/Fundamental Rule 2 (Due skill care and diligence), Principle 6 (Customers' interests), Principle 7 (Client communications), Principle 8 (Conflicts), Principle 9 (Suitability))
- > **COBS Conduct of Business Sourcebook** (in particular **COBS 4** (Communicating with clients), **COBS 6** (Information about the firm), **COBS 8** and **8A** (Client agreements), **COBS 9** and **9A** (Suitability), **COBS 10** and **10A** (Appropriateness), **COBS 11** (Dealing and managing) and *equivalent provisions* in **MCOB** (including **MCOB 2A** (MCD)), **BCOBS** (including **BCOBS 2A** (Optional additional products)) and **CONC** (including **CONC 4** (Pre-contractual requirements) and **CONC 5** (Responsible lending));
- > **PROD Product Intervention and Product Governance Sourcebook** (in particular **PROD 3.3** (Distribution of products))
- > **RPPD The Responsibilities of Providers and Distributors for the Fair Treatment of Customers**
- > **PERG Perimeter Guidance Manual** (in particular **PERG 8** (Financial promotion))
- > **UNFCOG The Unfair Contract Terms and Consumer Notices Regulatory Guide**.

Other Sources:

- > **Dear CEO Letter on financial promotions** (January 2019)
- > **FCA Technical Report: The fair treatment of existing interest-only mortgage customers** (January 2018)
- > **FCA Occasional Paper No 26: From advert to action: behavioural insights into the advertising of financial products** (April 2017)
- > **FCA Occasional Paper No 22: Price discrimination and cross-subsidy in financial services** (September 2016)
- > **Thematic Review 16/2 Fair treatment of long-standing customers in the life insurance sector** (March 2016)
- > **Final Notice: PDHL (March 2016)** (in relation to various systems and controls failings, notably deficiencies in the identification and treatment of vulnerable customers)
- > **Final Notice: Lloyds Bank plc, Bank of Scotland plc and Black Horse Limited (June 2015)** (in relation to Principle 6 and PPI complaints handling)
- > **FCA's Occasional Paper No 8 Consumer Vulnerability** (February 2015);
- > **FCA's Practitioners' Pack** (accompanying OP No 8) (February 2015);
- > Supreme Court's judgment in **Plevin v Paragon Personal Finance Limited**;
- > **Final Notice: Stonebridge International Insurance Limited (August 2014)** (relating to Principles 3, 6 and the telephone sales of various insurance products via intermediary firms)
- > **Final Notice: Credit Suisse International and Yorkshire**

- Building Society** (June 2014) (relating to Principle 7 and the Cliquet Product)
- > **Final notice: Santander UK plc (March 2014)** (relating to Principles 7, 9 and the provision of investment advice / assessments to ensure continued suitability of investment products for retail customers)
- > **Final Notice: State Street Bank Europe Limited and State Street Global Markets International Limited (January 2014)** (in relation to Principles 3, 6 and 7 and a deliberate strategy to charge clients substantial mark-ups on certain transitions, in addition to the agreed management fee or commission)
- > **Final Notice: Swinton Group Limited (July 2013)** (relating to Principles 3, 6 and 7 and adequacy of information at point of sale and monitoring to identify poor compliance)



Customers and conduct of business

Key sources

Approach to existing customers

Regulation:

- > **Principles for Business** and **Fundamental Rules** (in particular Principle/Fundamental Rule 1 (Integrity), Principle/Fundamental Rule 2 (Due skill care and diligence), Principle 3/Fundamental Rule 5 (Risk management systems), Principle 6 (Customers' interests), Principle 7 (Client communications), Principle 8 (Conflicts), Principle 9 (Suitability))
- > **COBS Conduct of Business Sourcebook** (in particular **COBS 4** (Communicating with clients), **COBS 6** (Information about the firm), **COBS 15** (Cancellation), **COBS 16** and **16A** (Reporting information to clients)) and equivalent provisions in **MCOB** (including **MCOB 2A** (MCD) and **13** (Arrears, payment shortfalls and repossessions)), **BCOBS** (including **BCOBS 2A** (Optional additional products), **BCOBS 5** (Post sale) and **BCOBS 6** (Cancellation)) and **CONC**
- > **DISP Dispute Resolution: Complaints** (in particular **DISP 1** (Treating Customers Fairly), **DISP App 1** (Mortgage Endowment Complaints) and **DISP App 3** (PPI complaints))

Other Sources:

- > **FCA Business Plan 2018/19** (in particular Cross-Sector Priority on Treatment of existing customers)
- > **Final Notice: Santander UK plc (December 2018)** (in relation to breaches of Principles 3, 6 and 11 related to governance, unfair treatment of customers, failing to act on information appropriately and failing to be open and co-operative in the retail banking sector)

- > **Final Notice: Liberty Mutual Insurance Europe SE (October 2018)** (in relation to Principles 3 and 6, SYSC, ICOBS and DISP related to complaints-handling, culture/governance and unfair treatment of customers in the general insurance and protection sector)
- > **FCA Investment Platforms Market Study, Interim Report** (July 2018)
- > **FCA Policy Statement 18/4 Credit card market study: persistent debt and earlier intervention** (February 2018)
- > **FCA webpage on Transparency in insurance renewals** (March 2017)
- > **FCA Occasional Paper No 22: Price discrimination and cross-subsidy in financial services** (September 2016)
- > **FCA Thematic Review 16/2: Fair treatment of long-standing customers in the life insurance sector** (March 2016) and associated FCA Statement
- > **Final Notice: Lloyds Bank plc, Bank of Scotland plc and Black Horse Limited (June 2015)** (in relation to Principle 6 and PPI complaints handling)
- > **Final Notice: Clydesdale Bank (April 2015)** (in relation to Principle 6 and PPI complaints handling)
- > **Final Notice: Yorkshire Building Society (October 2014)** (in relation to Principles 3, 6 and the handling of mortgage customers in payment difficulties or arrears)

Cross-cutting issues

Legislation:

- > **EU General Data Protection Regulation**
- > **Data Protection Act 2018**
- > **Competition Act 1998**
- > **Market Abuse Regulation**
- > **Criminal Justice Act 1993**
- > **Financial Services Act 2012**
- > **Proceeds of Crime Act 2002**
- > **Money Laundering, Terrorist Financing and Transfer of Funds (Information on the Payer) Regulations 2017**
- > **Terrorism Act 2000**
- > **Bribery Act 2010**

Regulation:

- > **Principles for Business** and **Fundamental Rules** (in particular Principle/Fundamental Rule 1 (integrity), Principle/Fundamental Rule 2 (Due skill, care and diligence), Principle 6 (Treating customers fairly))
- > **SYSC Senior Management Arrangements, Systems and Controls** (in particular **SYSC 6** (Compliance, internal audit and financial crime) and **SYSC 4** (General organisational requirements))
- > **FCTR Financial Crime Thematic Reviews**

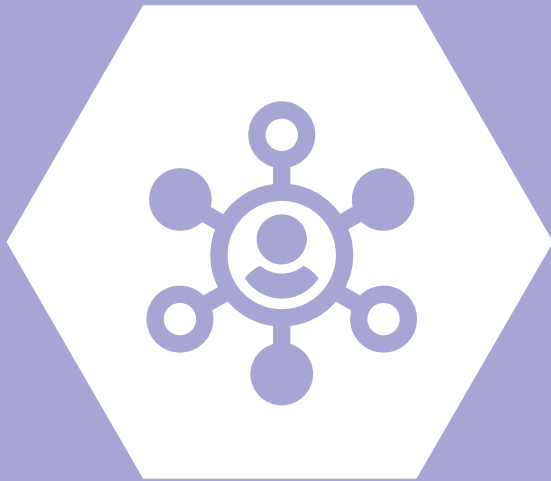


Customers and conduct of business

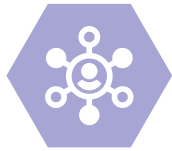
Key sources

Other Sources:

- > Speech by Julia Hoggett, [Market Abuse requires a dynamic response to a changing risk profile](#) (February 2019)
- > [FCA Business Plan 2018/19](#)
- > BCBS report [Cyber-resilience: range of practices](#) (December 2018)
- > [FCA Market Watch 58](#) (December 2018)
- > Linklaters' Report: [Ethical, safe, lawful: a toolkit for artificial intelligence projects](#) (November 2018)
- > Department for Digital, Culture, Media & Sport, [Consultation outcome: Centre for Data Ethics and Innovation](#) (November 2018)
- > [FCA Final Notice: Tesco Personal Finance plc](#) (October 2018) (in relation to Principle 2 and the failure to protect customers from foreseeable cyber risk)
- > Speech by UK Finance Chair Bob Wigley (October 2018)
- > [FCA Approach to Competition](#) (October 2018)
- > [FCA Market Watch 56](#) (September 2018)
- > Speech by Charles Randall, [How can we ensure that Big Data does not make us prisoners of technology?](#) (July 2018)
- > Bank of England, PRA, FCA Discussion Paper 1/18: [Building the UK financial sector's operational resilience](#) (July 2018)
- > [FCA Final Notice: Canara Bank](#) (June 2018) (in relation to Principle 3 and financial crime and money laundering failures)
- > Speech by Christopher Woolard, [A helping hand for the invisible hand: the FCA's approach to competition and innovation](#) (June 2018)
- > [FCA Final Notice: Interactive Brokers \(UK\) Limited](#) (January 2018) (in relation to breaches of Principle 3 and SUP 15.10.2R relating to poor market abuse controls and failure to report suspicious client transactions)
- > [FCA Anti-money laundering Annual Report 2017/18](#);
- > [FCA Policy Statement 17/26: Information about current accounts](#) (December 2017)
- > [Joint Money Laundering Steering Group Guidance](#) (December 2017)
- > Speech by Julia Hoggett, [Effective compliance with the Market Abuse Regulation – a state of mind](#) (November 2017)
- > Speech by Mark Steward, [A Better View](#) (September 2017)
- > FCA webpage on [promoting competition](#)
- > [FCA Feedback Statement on Big Data Call for Input](#) (September 2016)
- > [FCA-commissioned study: "Drivers & Impacts of Derisking"](#) (2016); [FCA Research into the issue of de-risking](#) (2016);
- > [FCA statement on de-risking](#) (2016);
- > FCA webpage on [cyber resilience](#) (with links to publications and guidance from the FCA and the National Cyber Security Centre on cyber security and cyber resilience)
- > [FCA Market Studies](#) webpage
- > [Joint Money Laundering Intelligence Taskforce](#)

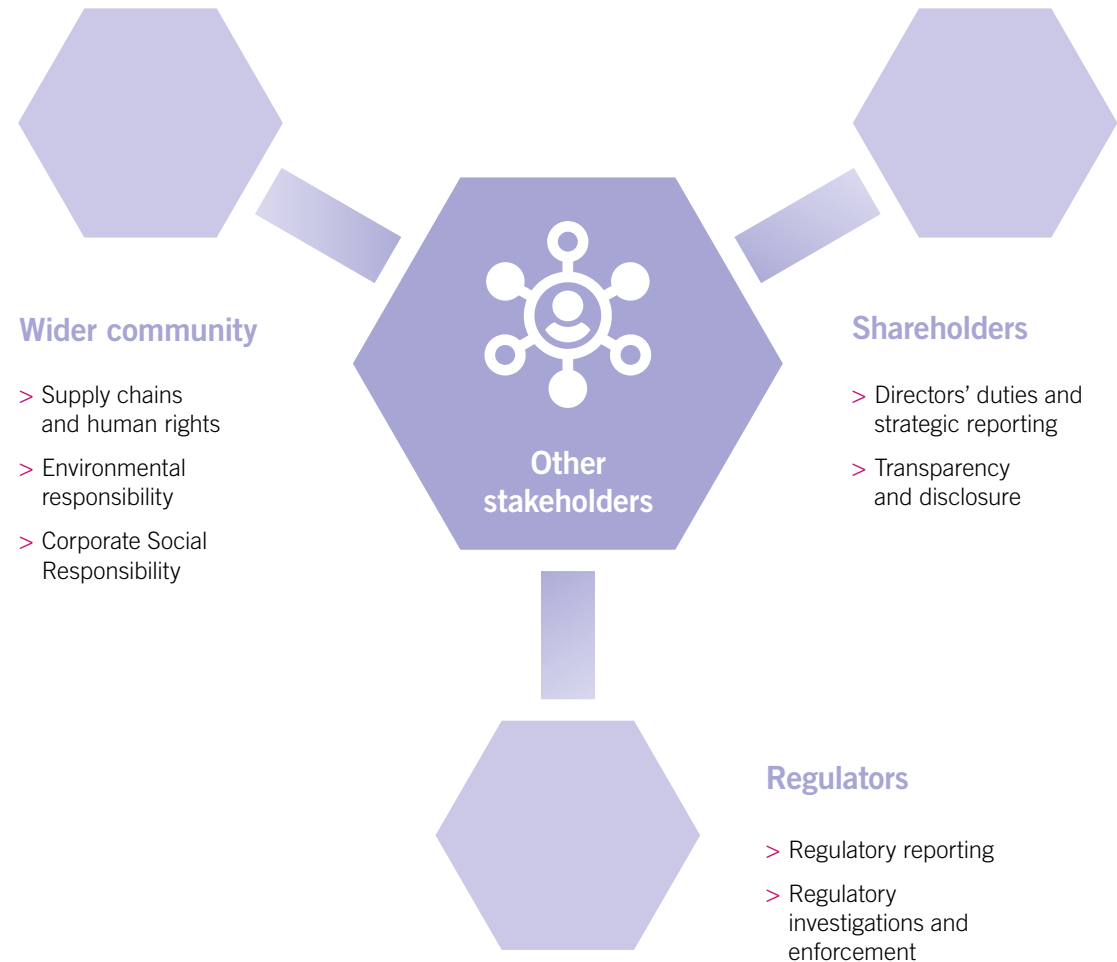


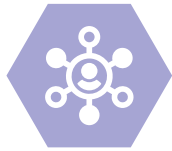
Other stakeholders



Other stakeholders Introduction

Our final theme considers the wider relationships and context within which a firm must undertake its business. Multiple stakeholders have an interest in the activities or affairs of a firm and can be influenced or affected by the way in which the firm manages itself and conducts its business activities. We have chosen shareholders, regulators and the wider community to profile further salient sources of law and regulation which inform the outcomes a firm should achieve, and which have a connection to the underlying ethical principles which will inform the decisions of firms operating in this sector.





Other stakeholders

Shareholders

Directors' duties and strategic reporting: The decisions of directors can have long-term and far-reaching consequences for the firm's shareholders, among others. Directors of UK companies owe fiduciary and other duties the company, with the CA 2006 having codified a number of ethical principles.

Of particular relevance in this context is the duty to promote the success of the company for the benefit of its members under section 172 CA 2006. In doing so, directors are required to have regard to a broad range of factors, including the long-term consequences of decisions, employees' interests, suppliers, customers, the community, the environment and the company's reputation for high standards of business conduct. The section 172 duty encapsulates the concept of "enlightened shareholder value", which asserts that a corporate's social responsibility and safeguarding of stakeholders' interests are critical to long term value creation. This idea is emphasised in recent revisions of the FRC's UK Corporate Governance Code, associated Guidance on Board Effectiveness and Guidance on the Strategic Report, as well as the new Wates Corporate Governance Principles for large private companies.

These duties are accompanied by disclosure requirements in the company's annual strategic report, whose purpose is to facilitate shareholder stewardship by providing information to enable shareholders to assess how the directors have fulfilled their section 172 duty.

The last decade has seen a considerable growth in specific items of information which are mandated by policy makers with the intention of encouraging responsible behaviour towards stakeholders in a way that is not focused purely on financial performance (see further at Wider community).

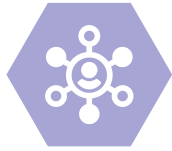
These disclosures aim to make companies behave in a more ethical way and with a greater sense of social responsibility – both by focusing the minds of directors on the issues that they must report on, and by empowering shareholders and other stakeholders to better compare and critique the actions of companies they are interested in.

Examples include the non-financial information statement, under the EU Non-Financial Reporting Directive, which requires listed companies and certain other banks and insurance companies to provide information on their policies and impacts in relation to the environment, social matters, human rights and anti-bribery and corruption. Additional reporting requirements were introduced by the UK government in 2018, under which listed companies and some unlisted companies must state in their annual reports how the directors took account of the factors set out in section 172 CA 2006 in performing their duty under that section. Further specific details required include information about employee engagement; how the directors have had regard to the interests of employees and the need to foster the company's business relationships with suppliers, customers and others; and the effect of those considerations on directors' decisions.

These requirements make it important for boards to consider the practical steps they need to take to address risks, engage with the company's stakeholders and be able to demonstrate the fulfilment of their fiduciary duties.

While it can be difficult to balance proportionate oversight and monitoring at Board level with decision-making, a combination of training, appropriate management information, oversight of a firm's policies and procedures and stakeholder engagement will help directors embed the relevant factors within their decision making and, more generally, set a foundation against which the organisation's ethical approach can be both articulated and tested.





Other stakeholders

Shareholders

Transparency and disclosure: The importance of safeguarding shareholders' interests, by assisting them to make fully informed decisions, is critical. The FCA has said that *"the life blood of all well-functioning markets is the timely dissemination of information"* and the UK Listing Regime and MAR (among others) impose governance, disclosure and transparency requirements which further the market integrity objective for publicly traded companies. They also give shareholders additional opportunity for information and engagement on matters such as directors' pay, and substantial or related party transactions.

In addition to compliance with specific rules which require timely and accurate disclosure, the regulators rely on listed companies to be open and cooperative with them and there have been numerous instances of enforcement action where companies have fallen below expected standards.

Such rules exemplify a key element of the post-crisis regulatory agenda, which has been to promote a culture of openness and honesty (see further at [Regulators](#)). Boards will also need to equip themselves with the relevant information and tools to ensure they can maintain a satisfactory dialogue with shareholders based on a mutual understanding of the company's objectives, values and principles (see further at [Governance](#)). To gain the trust of, and foster a strong relationship with its shareholders, a firm must ultimately promote a culture of openness and honesty and demonstrate an ethical approach to its business.

Linklaters





Other stakeholders

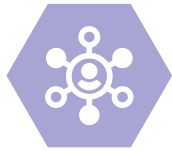
Shareholders

Questions for Firms

When considering how a firm's obligations to its shareholders can further ethical objectives and contribute to good outcomes, a firm may find it helpful to consider:

- > How does the firm engage with its shareholders?
- > What issues have the firm's shareholders communicated as being particularly important?
- > How does the firm ensure that it makes accurate, timely and appropriate disclosures?
- > How does the Board oversee ethics and engagement with employees and stakeholders for the purposes of strategic reporting?
- > How can the firm demonstrate to its shareholders that it manages its business in accordance with its ethical code?





Other stakeholders Regulators

Principle 11/Fundamental Rule 7 underpins a firm's dealings with its regulator(s), the general principle being that a firm must be open and co-operative and disclose matters of which the regulators would expect notice. Specific rules and guidance in the FCA and PRA Handbooks articulate when particular issues *must* be notified but in most instances a firm will need to exercise judgement as to *whether* and *when* notification is required.

Compliance with this overarching obligation is a relevant factor in determining whether the firm satisfies the suitability threshold condition, and its importance cannot be overstated. The regulators have, on many occasions, severely criticised institutions who do not make disclosure on a timely basis or who provide inaccurate or misleading information.

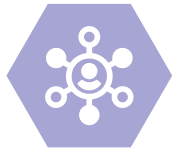
The FCA and PRA prefer to discharge their functions by working in an open and cooperative relationship with firms and will generally seek to obtain information in the context of that relationship. In this context it is inevitable that firms will encounter questions as to what, when and how much information should be disclosed to the regulator in the particular circumstances.

The relevance of ethics and what amounts to ethical decision-making in this context is complex. While firms must ensure their approach and dealings with the FCA and PRA comply with the overarching Principles for Business and Fundamental Rules, firms must also be mindful of considerations such as data protection, client confidentiality, and duties owed to its workforce, when determining the content and scope of regulatory disclosure.

Specifically in the investigation context, where an incident has occurred within a firm, regulators may seek to limit the extent of internal discussion and investigation which is undertaken due to a concern that the firm may “trample over the crime scene”. While genuine regulatory concern may arise in some instances, and a firm must always be careful and respectful that its actions do not prejudice a subsequent/parallel regulatory or criminal investigation, the firm's obligations to its stakeholders (including relevant members of the workforce), to understand the full facts and circumstances of an issue that is being investigated and to enable lessons to be learnt within the business, could mean it finds itself out of sync with the regulatory investigation team.

What is the “right decision” in terms of disclosure will inevitably be fact – and context-specific, with some analyses more straightforward than others. However, as the regulatory threshold for commencement of enforcement investigations has been lowered, consistent with Mark Steward's principle that investigations should be used as part of a “diagnostic process”, and the number of investigations into individuals (especially Senior Managers and Certified Persons) has increased, the balance of what and when to disclose will need to be struck ever more frequently.





Other stakeholders

Wider community

Supply chains, customer relationships and human rights:

In an increasingly globalised and inter-connected environment, business supply chains are more complex and there is an ever-growing expectation on the part of civil society for multinational corporations to demonstrate increased transparency and set standards of behaviour for those in their supply chain. Action by non-governmental organisations and a drive for change by internal and external stakeholders has culminated in a culture of heightened scrutiny which extends to elements of business outside the purely financial. This expectation is not limited to a firm's own offices and operations but also applies to how and who it engages with as part of the provision of financial services.

In regulatory terms this is being applied largely through reporting obligations. For example, the UK's Modern Slavery Act 2015 requires businesses to be transparent about what they are doing to tackle modern slavery, both within their own operations and those of their supply chains. This is reflective of a broader regulatory trend of increasingly stringent transparency requirements, linked to the societal expectation that it is no longer acceptable for businesses to operate purely with financial metrics in mind (see further at [Shareholders](#)). Businesses now need to be more engaged to preserve their "social licence to operate" and to be able to adapt to increased public expectations around business conduct.

In addition to being transparent about supply chain payments, firms owe obligations towards the wider community more generally in terms of responsible supply chain sourcing. The EU Anti-Corruption Report found that public procurement is particularly prone to corruption in EU Member States owing to deficient control mechanisms and risk management. As a result, anti-money laundering regulations now extend to modern slavery and firms are being encouraged to engage with Government working parties to improve identification of slavery and trafficking-related funds.

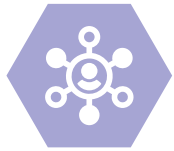
With ethics in mind, there is a need for firms to consider not only their arrangements in terms of procurement and supply chains but also their business relationships and the extent to which their customers or counterparties may be connected to sectors, geographies or industries which give rise to human rights concerns. In relation to business and human rights specifically, there has been a proliferation of "soft law" standards (including, among other things, the UNGPs) which impose on private enterprises responsibility to respect human rights and suggest that an institution's relationships contribute to potential human rights impacts.

Linklaters



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FINANCE





Other stakeholders

Wider community

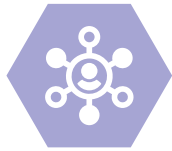
Inherent in the adoption of these human rights principles is the potential for a firm to be linked to the human rights impacts of its customers. Civil society groups have analysed the contribution or linkage of firms to particular projects or sectors that are associated with human rights impacts. Recent areas of attention have been relationships with palm oil suppliers and coal producers. Firms are reasonably well positioned to respond to regulatory requirements and soft law commitments insofar as their own assets and office operations are concerned; however, the extension of soft law into impacts arising out of activities supported by their primary business activities poses genuine challenges. These have so far been addressed most effectively where the financing is asset or project specific. For example, both export credit agencies and commercial financial institutions have developed a sophisticated approach to managing environmental and social risks in project financings with the Equator Principles and equivalent approaches.

As expectations grow, there are some broad principles that firms may wish to consider. Sustaining social and environmental commitments can be challenging and complex. There is a growing willingness to hold firms to the values they have publicly espoused, to translate this into regulation and to use a variety of regulatory, judicial and soft law complaint mechanisms to do so in addition to other protest action. While firms may wish to consider adherence to standards or guidelines which are consistent with the underlying values which they have set for themselves and the business objectives they wish to achieve, it will be important for firms to be thoughtful and confident about the public commitments they do make and to carefully consider any sustainability related regimes which are proposed to them.

Many firms in the financial sector have decided to become a signatory to or express public support for, e.g.

- > the OECD guidelines for Multinational Enterprises;
- > the UN Global Compact;
- > the UN Principles for Responsible Investment;
- > the Thun Principles;
- > the Global Sullivan principles; and/or
- > the Joint Money Laundering Intelligence Taskforce.

Firms should articulate precisely how they implement these guidelines and have systems and processes to implement, monitor and report upon their commitments.



Other stakeholders

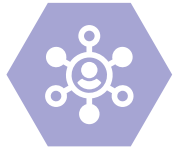
Wider community

Sustainable finance: The pressure on business to consider ESG issues has been growing steadily over the years. That pressure has focused sharply on the financial services sector recently as the transition to a lower carbon economy gathers pace and as policy makers acknowledge that ESG factors can be financially material considerations. Firms are increasingly required to comply with obligations under hard rules/regulations (such as company reporting requirements in relation to material risks to the business under CA 2006 (see further at [Shareholders](#))) and softer optional standards to which they have signed up (e.g. the Equator Principles).

A key environmental issue, the importance of which to businesses cannot be overstated, is climate change. Following the UNFCCC Agreement, an FSB-sponsored Taskforce was established on Climate-Related Financial Disclosures. Its recommendations have now been endorsed by a large number of financial services firms, including 23 Global Systemically Important Banks. New regulatory initiatives proposed in 2018/19 in the EU and UK draw on the TCFD to propose that analysis of ESG risks and opportunities be integrated in corporate governance, strategy, and risk management processes. There is a particular focus initially on how climate change is addressed by banks, insurers and investment managers.

Determining how best to satisfy regulatory and stakeholder expectations and contribute to achieving goals set by the UNFCCC Agreement is of course no easy balancing act and will require firms to make difficult decisions in light of regulatory and societal expectations and their own ethical values and principles. For example, correlating access to capital with moves towards decarbonisation may seem the best approach at a macro level from a pure climate policy perspective. However, firms, regulators and policy makers will need to consider how to take account of broader social, technological, economic and practical risks and constraints. Further, while the direction of travel is becoming clearer, time is needed to allow the financial services sector and corporates alike to accumulate the skillset and experience that will be required to consider these issues in detail.





Other stakeholders

Wider community

Corporate social responsibility: While not generally mandated by law or regulation, a firm's attitude to CSR is likely to be relevant to its culture and its more general attitude to the wider community. CSR is often considered as part of the broader environmental and diversity and inclusion agenda, with firms delivering on their ethical values and expressing their commitment in this area through various initiatives including:

- > Charitable giving/partners: Many firms invest in or have started charitable foundations in order to partner with and fund charities and other organisations. Going beyond a pure monetary investment, support may also extend to developmental support and strategic guidance in order to help an organisation grow and maintain its strength and sustainability; and
- > Pro bono: Using the firm's resources to help particular communities or markets, e.g. financing or investing for a positive impact; promoting equal opportunity through financial education and microfinance.

Still at a formative stage are the draft UN Principles for Responsible Banking, published for a six-month consultation period at the end of November 2018. In general, there is a growing expectation that greater thought is given to how, and the extent to which, CSR fits within and is aligned to core governance and values.



Firms are part of ... society, as such they have public interest duties. I think this lack of connection between firms and societal duties in terms of the responsibilities of firms is where the culture debate and practice subsequently went wrong. ”

Andrew Bailey

Chief Executive Office, FCA (March 2018)



Other stakeholders

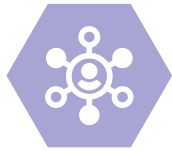
Wider community

Questions for Firms

When considering how its approach to the wider community can further ethical objectives and contribute to good outcomes, a firm may find it helpful to consider:

- > Whose responsibility is it to engage and/or interact with wider community interests?
- > How can the firm's impact on the wider community be measured and assessed?
- > To what extent does the firm engage with the wider community to seek feedback and/or understand issues or concerns?
- > How does the firm choose and approach its relationships with suppliers?
- > How does the firm consider complaints and feedback from creditors?
- > To what extent are human rights and climate considered and managed as risk issues?
- > How does the firm choose its partners and/or targets in the context of CSR?
- > How are ethics factored into governance processes and forums?





Other stakeholders

Key sources

Shareholders

Legislation:

- > **Companies Act 2006** (in particular sections 171 to 177 (Directors' duties) and sections 182-183 (conflicts))
- > **Financial Services and Markets Act 2000** (in particular s1B (The FCA's general duties), 2B (The PRA's general objective), and ss80-82 (Disclosure in listing particulars))
- > **Financial Services Act 2012** (in particular ss89-91 (Misleading statements/impressions))
- > **Market Abuse Regulation**

Regulation:

- > **COCON Code of Conduct** (in particular **COCON 2** (Individual conduct rules))
- > **LR Listing Rules** (in particular **LR 7** (Listing Principles) and **LR 9** (Continuing obligations))
- > **DTR Disclosure Guidance and Transparency Rules sourcebook** (in particular **DTR 1A** (Transparency), **DTR 2** (Disclosure and control of inside information), **DTR 4** (Periodic Financial Reporting))
- > **SUP Supervision** (including **SUP 3** (Auditors)) and **Auditors**

Other Sources:

- > Speech by Julia Hoggett, **Market Abuse requires a dynamic response to a changing risk profile** (February 2019)
- > **Wates Corporate Governance Principles for Large Private Companies** (December 2018)
- > **Financial Reporting Council, UK Corporate Governance Code** (July 2018)
- > **Financial Reporting Council, Guidance on Board Effectiveness** (July 2018)
- > **Financial Reporting Council, Guidance on the Strategic Report** (July 2018)
- > **FCA Final Notice: Tejoori Ltd** (December 2017) (in relation to Article 17 of MAR by failing to inform the public as soon as possible of inside information which directly concerned it)
- > **FCA Final Notice: Tesco plc and Tesco Stores Limited** (March 2017) (in relation to s118(7) FSMA and the announcement of information that gave a false or misleading impression in relation to Tesco plc shares and certain group company bonds)
- > **Financial Reporting Council, Report on Corporate Culture and the Role of Boards** (July 2016)
- > **FCA Final Notice: Cooperative Bank Plc** (August 2015) (in relation to Listing Rule 1 and the publishing of misleading information in the company's financial statements)

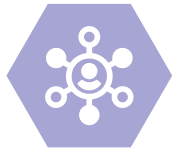
Regulators

Legislation:

- > **Financial Services and Markets Act 2000** (including sections 165-165A (Powers to require information); section 398 (Misleading the FCA or PRA) and Schedule 6 (Threshold conditions))

Regulation:

- > **Principles for Businesses and Fundamental Rules** (in particular Principle 11 / Fundamental Rules 7 (Relations with regulators))
- > **COCON Code of Conduct** (in particular **COCON 2** (Individual conduct rules))
- > **SYSC Senior Management Arrangements, Systems and Controls** (in particular **SYSC 4** (General organisational requirements))
- > **SUP Supervision** (including **SUP 15** (Notifications to the FCA))
- > **Notifications** (including Notification 2 (Notifications))
- > **EG Enforcement Guide**
- > **COND Threshold Conditions** (in particular **COND 2** (The threshold conditions))



Other stakeholders

Key sources

Other Sources:

- > FCA's Approach to Enforcement (2018)
- > PRA's Approach to Enforcement: statutory statements of policy and procedure (2018)
- > Speech by Mark Steward, A Better View (September 2017)
- > PRA Final Notice: The Bank of Tokyo Mitsubishi UFJ Limited and MUFG Securities EMEA plc (February 2017) (in relation to Fundamental Rules 6 and 7 and the failure to appropriately communicate information relating to a settlement with the New York Department of Financial Services)
- > FCA Final Notice: Deutsche Bank AG (April 2015) (in relation to Principles 5, 3 and 11 and the failure to disclose a BaFin commissioned report in the context of IBOR misconduct)
- > FCA Final Notice: Bank of Beirut (UK) Limited (March 2015) (in relation to Principle 11 and provision of misleading information to the FCA)
- > FSA Final Notice: Prudential Assurance Company Limited (March 2013) (in relation to Principle 11 and the failure to disclose a proposed substantial acquisition by a controlling entity to the FSA)

Wider community

Legislation:

- > Modern Slavery Act 2015
- > Money Laundering, Terrorist Financing and Transfer of Funds (Information on the Payer) Regulations 2017
- > Bribery Act 2010
- > Reporting on Payment Practices and Performance Regulations 2017
- > Non-Financial Reporting Directive 2014/95/EU (rules on disclosure of non-financial and diversity information by large companies)
- > Companies Act 2006 (in particular section 172 and section 414CA (non-financial information statement))

Other Sources:

- > UN Principles for Responsible Banking (November 2018)
- > PRA Consultation Paper 23/18: Enhancing banks' and insurers' approaches to managing the financial risks from climate change (October 2018)
- > FCA Discussion Paper 18/8: Climate change and green finance (October 2018)
- > Speech by Christopher Woolard, Going green: the FCA's developing approach (October 2018)
- > PRA: Transition in thinking: The impact of climate change on the UK banking sector (September 2018)
- > European Commission Action Plan: Financing Sustainable Growth (proposed regulations on climate/risks, specifically on mandatory climate disclosure (March 2018))

- > Speech by Andrew Bailey, Transforming culture in financial services (March 2018)
- > The 2015 UNFCCC Agreement
- > EU Anti-Corruption Report (February 2014)
- > European Commission EU Anti-Corruption Report (2014)
- > Equator Principles (June 2013)
- > UN Guiding Principles on Business and Human Rights (2011)
- > OECD Guidelines for Multinational Enterprises (2011)
- > UN Global Compact
- > UN Principles for Responsible Investment
- > The Thun Group Discussion Papers
- > Global Sullivan Principles
- > Joint Money Laundering Intelligence Taskforce



Definitions



Definitions

AI: Artificial intelligence

AML: Anti-money laundering

BCBS: The Basel Committee on Banking Supervision

BEIS: The Department for Business, Enterprise & Industrial Strategy

CA 2006: The Companies Act 2006

Certification: The regime prescribed by section 63E FSMA whereby persons performing significant harm functions prescribed by the FCA/PRA must be certified as “fit and proper” to perform their function

Conduct Rules: The Individual and Senior Manager Conduct Rules set out in the FCA’s Handbook and the PRA’s Rulebook

CRD IV: The Capital Requirements Directive IV (comprising Directive 2013/3/6EU and Regulation 575/2013/EU)

CSR: Corporate social responsibility

D&I: Diversity and inclusion

DTRs: The FCA’s Disclosure and Transparency Rules

EBA: The European Banking Authority

ESG: Environmental, social and governance

ESMA: The European Securities and Markets Authority

EU: European Union

FATF: The Financial Action Task Force

FCA: The Financial Conduct Authority

FIT: The FCA’s Fit and Proper test for Employees and Senior Personnel sourcebook

FRC: The Financial Reporting Council

FSB: The Financial Stability Board

FSMA: The Financial Services and Markets Act 2000

Fundamental Rules: The PRA’s Fundamental Rules

GDPR: The General Data Protection Regulation (Regulation 2016/679/EU)

JMLSG: The Joint Money Laundering Steering Group

Listing Rules: The FCA’s Listing Rules

MAR: The Market Abuse Regulation (Regulation 596/2014/EU)

MiFID II: The Markets in Financial Instruments Directive II (comprising Directive 2014/65/EU and Regulation 600/2014/EU)

MLD V and VI: The Fifth and Sixth Anti-Money Laundering Directives (Directive 2018/843/EU and Directive 2018/1673/EU)

NEDs: Non-executive directors

NGOs: Non-governmental organisations

PRA: The Prudential Regulation Authority

PRIPs: The Packaged Retail and Insurance-based Investment Products Regulation (Directive 1286/2014/EU)

Principles for Business: The FCA’s Principles for Business

Senior Managers: Persons approved by the PRA or FCA to perform a Senior Management Function

SMCR: The Senior Managers and Certification Regime

SMF: One of the PRA or FCA specified Senior Management Functions

SYSC: The FCA’s Senior Management Arrangements, Systems and Controls sourcebook

TC: The FCA’s Training and Competence sourcebook

TCF: Treating Customers Fairly

TCFD: The FSB-sponsored Task Force on Climate Related Financial Disclosures

UK: United Kingdom

UN: The United Nations

UNFCCC Agreement: The 2015 Paris UN Framework Convention on Climate Change

UNGPs: The UN Guiding Principles on Business and Human Rights



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