The Corlytics Barometer
Conduct: 2018

CORLYTICS
Determine Regulatory Risk Impacts
# Table of contents

FOREWORD 3  
EXECUTIVE SUMMARY 4  
DISCLOSURE 6  
PERSONAL LIABILITY 8  
CONTROL FAILURES 13  
INDICATORS OF A SOUND RISK CULTURE 15  
REGIONAL VARIATIONS 16  
INTERNATIONAL FOCUS ON MISCONDUCT 19  
TOOLS FOR FIRMS MITIGATING CULTURAL DRIVERS OF MISCONDUCT 20  
IMPACT OF NON-FINANCIAL PENALTIES 23  
SECTORS MOST FREQUENTLY FINED FOR MISCONDUCT 25  
INCENTIVES & COMPENSATION 28  
CONCLUSION 32  
DATA 33  
METHODOLOGY 37  
CONTACT US 38
Corlytics is proud to have received a Regtech award for the second year in a row from A Team Group as the best solution for managing conduct risk. Firms across the financial services sector face a huge challenge in not only implementing cultural and conduct changes but in measuring their culture and conduct risk and being able to demonstrate that to regulators, shareholders and customers. Corlytics’ deep analytics of regulatory risk is helping firms address that challenge.

A snapshot of our data drawn from millions of regulatory data points is provided in this report. It is intended to help firms, and specifically senior managers, focus their valuable resources on the areas of greatest potential exposure to misconduct.

We hope you find it useful.

John Byrne, CEO Corlytics
June 2018
Regulators and policy makers around the world remain focused on conduct or misconduct risk. The Financial Stability Board (which operates under the aegis of the G20) has a supranational mandate to focus on misconduct driven by its sheer persistence in the marketplace. Post crisis instances of misconduct have ranged from conspiracies to manipulate markets to widespread retail mis-selling with penalties including multi-billion dollar fines. As just one measure of misconduct, Mark Carney, governor of the Bank of England, said in March 2017 that "Global banks’ misconduct costs have now reached $320 billion – capital that could otherwise have supported up to $5 trillion of lending to households and businesses."

Specifically, misconduct may further indicate that firms are unable to ensure their employees adhere to other standards, including those for sound risk management. Repeated and severe misconduct has implications for the financial system and has potential linkage to financial stability issues. The approach to managing and mitigating conduct risk is evolving. The link has been made between conduct risk and compensation structures and there is a growing swell of regulatory change to increase the personal liability of senior managers in order to drive consistently better behaviours in firms.

To manage conduct risk senior managers need relevant high-quality data, which can be used to inform and develop their own business-specific approach.

---

"... we hope to discourage misconduct before it takes root. And in a world of finite resources, it is imperative that enforcement actions advance goals of specific and general deterrence. One of the primary ways we do that is with a focus on identifying and charging culpable individuals. Bad actors undermine the hard-earned trust essential to the health and stability of our capital markets. I view individual accountability as perhaps the most effective general deterrent tool in our arsenal, because it can have a broad effect on corporate culture in a way that immeasurably benefits individual investors, preventing misconduct before it starts."

Steven Peikin, Co-Director, Division of Enforcement at the U.S. Securities and Exchange Commission (SEC). Keynote address to the UJA Federation, New York. (May 2018)
Executive summary

Analysis of Corlytics data covering the misconduct elements in enforcement actions published by key regulators from around the world has highlighted some key trends and takeaways for senior managers, including:

1. **Disclosures and communication is the major root cause** of misconduct penalties, accounting for 40 percent of the number of fines levied by regulators and three quarters (77 percent) of the total dollar amount of fines levied over the last six years. Implementation of major regulatory reform ranging from GDPR to MiFID II/R heightens the focus even further. Transparency is a key global regulatory theme requiring senior manager attention to ensure appropriate disclosure to both investors and customers.

2. **On average, at least one individual has been fined for misconduct every week for the last six years.** This is set to increase substantially as individual accountability regimes are rolled out around the world.

3. **The top three control failures** resulting in the largest monetary penalties in the last two years are underwriting and securitisation processes, compliance monitoring and oversight together with third party oversight. In fourth place is recordkeeping which is likely to feature more prominently in future as senior managers strive to evidence the discharge of their personal accountability and the new data privacy and protection requirements take effect.

4. **There are distinct regional variations** in the supervisory approach towards senior manager misconduct. The US imposes the largest fines in terms of monetary value. In contrast Australia has imposed the greatest number of fines against individuals over the last six years, even before the new Banking Executive Accountability Regime and results of the Royal Commission into misconduct take effect.

5. **The international focus on misconduct will remain high** on boards’ and regulators’ agendas. The FSB’s 2018 toolkit to mitigate misconduct risk has set the future benchmark for both firms and supervisors in seeking to raise standards and strengthen governance frameworks in the financial services sector.

6. **One in three of the non-financial penalties imposed for misconduct include an element of remedial action and redress.** In addition to the often-significant operational impact of an enforcement action including the need for substantial senior manager involvement, in the last couple of years redress and restitution costs have added an additional third to the overall financial cost of misconduct penalties.

7. **The top three sectors most frequently fined for misconduct** over the last six years are wealth management, retail lending and mortgage lending, reflecting the global regulatory focus on the need for consistently good customer outcomes.

8. **Regulators around the world will expect greater use of incentives and compensation practices in addressing future misconduct risk.** It has become a boardroom priority with the FSB making clear that accountability for misconduct lies, first and foremost, with board of directors.
Disclosure

Disclosures and communication is the major root cause of misconduct penalties, accounting for 40 percent of the number of fines levied by regulators and three quarters (77 percent) of the total dollar amount of fines levied over the last six years. Implementation of major regulatory reform ranging from GDPR to MiFID II/R heightens the focus even further. Transparency is a key global regulatory theme requiring senior manager attention to ensure appropriate disclosure to both investors and customers. Regulators around the world are seeking consistently good customer outcomes and a key part of that focus and effort is in seeking to ensure that financial services firms disclose all appropriate information to customers and investors alike. In Europe the disclosure and transpar-
Disclosure

highlighted in the case of the Home Capital Group (HCG) in Canada. In August 2017 HCG and three of its most senior executives reached a settlement with the Ontario Securities Commission (OSC) with regard to the company’s failure to comply with its continuous disclosure obligations, including making misleading statements to its investors.

As part of its settlement with the OSC, HCG has undertaken to pay CAN$10 million for the benefit of investors and agreed that no legal fees or expenses will be deducted. The firm also agreed to conduct a review of its continuous disclosure practices and deliver a report to its board and to OSC staff within one year. The company also agreed to pay CAN$500,000 in costs.

The former chief executive will pay an administrative penalty of CAN$1 million and will be prohibited from becoming or acting as an officer or director of a reporting issuer for four years. The other two senior individuals will pay an administrative penalty of CAN$500,000 and will be prohibited from becoming or acting as an officer or director of a reporting issuer for two years.

As Huston Loke, Director of Corporate Finance at the OSC made crystal clear “Disclosure requirements are a cornerstone of our investor protection regime and are essential to fair and efficient markets. When companies or their management fail to comply, we will take action.”

On average, at least one individual in the financial services industry has been fined for misconduct every week for the last six years. This is set to increase substantially as individual accountability regimes are rolled out around the world.

In order to address persistent misconduct by financial services firms, regulators around the world are looking to increase senior manager accountability and liability to seek to drive better risk-aware behaviours. The UK introduced its Senior Manager and Certification Regime for banks in 2016, it will be rolled out to insurers in December 2018 and all other financial services firms in, most likely, 2019. Even though it is in its relative infancy the UK regime, which has as its core the requirement for senior managers to identify precisely what they have oversight of (‘responsibility maps’), has been deemed a success and is being used as the model for similar regimes in other jurisdictions.

Two of the more recent countries to announce policy moves towards a UK style senior manager accountability regime are Singapore and Ireland.

“Clear accountability and proper conduct are important elements of good governance and sound business practice. Persistent misconduct and a lack of individual accountability by persons in charge will erode public confidence in our Financial Institutions (FIs). We expect the boards and senior management of FIs to instill a strong culture of responsibility and ethical conduct.”

Mr Ong Chong Tee, Deputy Managing Director (Financial Supervision), Monetary Authority of Singapore, April 2018
In April 2018 the Monetary Authority of Singapore (MAS) proposed guidelines to strengthen individual accountability of senior managers and raise standards of conduct in financial institutions (FIs). The guidelines are a key part of MAS’ broader efforts to foster a culture of ethical behaviour and responsible risk-taking in the financial industry. The proposed guidelines set out MAS’ supervisory expectations of boards and senior management with respect to individual conduct and behaviours. They are not designed to be prescriptive. It is ultimately the responsibility of each FI to hold its senior managers accountable for their actions and ensure proper conduct amongst their employees.

The guidelines reinforce FIs’ responsibilities in three key areas:

- Promote individual accountability of senior managers - FIs should identify senior managers who are responsible for core management functions and clearly specify their individual accountabilities. FIs should ensure that senior managers are fit and proper for their roles and hold them responsible for the actions of their staff and the conduct of the business under their purview. The FI’s management structure and reporting relationships should be clear and transparent.

- Strengthen oversight of employees in material risk functions - FIs should identify employees who have the authority to make decisions or conduct activities that can significantly impact the FI’s safety and soundness, or cause harm to a significant segment of the FI’s customers or other stakeholders. FIs should ensure that such employees are fit and proper and are subject to an appropriate incentive structure and effective risk governance.

- Embed standards of proper conduct among all employees - FIs should have in place a framework that promotes and sustains the desired conduct among employees. The conduct framework should articulate the standards of conduct expected of all employees and be effectively communicated and enforced throughout the organisation. Policies and processes should be implemented to ensure regular monitoring and reporting of conduct issues to the board and senior management. There should also be appropriate incentive systems and effective feedback channels, such as whistle-blowing mechanisms, in place.

The guidelines are designed to provide FIs with the operational flexibility to determine the most appropriate ways to achieve the desired outcomes of proper accountability and conduct. The MAS has made clear that it intends to monitor FIs’ progress in implementing the guidelines through its regular supervisory engagements. The consultation closed in May 2018.
In line with regulators around the world, the Central Bank of Ireland (CBOI) has been driving forward a suite of changes to seek to eradicate misconduct and the associated customer detriment. In January 2018 the CBOI responded to the Law Reform Commission’s Issues Paper on Regulatory Enforcement and Corporate Offences. The CBOI’s response set the updated the policy agenda for future regulatory reform together with some specific observations on criminal powers, individual responsibility for regulatory breaches and reckless decision-making informed by recent enforcement actions.

The CBOI has used its experience to respond to the issues paper, specifically the standardisation of regulatory powers, the use of civil financial sanctions, the coordination of regulators and jurisdiction for regulatory appeals. The response included a number of recommendations including:

- Governance requirements around board-level awareness of ethical and cultural issues (Including the establishment of a board standards sub-committee and a clearly defined role for internal audit in the review of culture).

- Providing feedback on what we see on inspections to build awareness in firms of the impact of, for example, their incentives policies.

- Requiring an increase in the formality of individual accountability at leadership level.”

Source: “Transforming Culture in Regulated Financial Services in Ireland” Martin Moloney, Special Advisor, Central Bank of Ireland, May 2018
Ireland

- That reform strengthening the accountability of senior personnel in regulated entities be adopted. Such reform would permit the CBOI to require senior managers to submit a statement of responsibilities that clearly states the matters for which they are responsible and accountable. These requirements would assist in assigning responsibility to individuals in a regulatory context and decrease the ability of individuals to claim that the culpability for wrongdoing lay outside their sphere of responsibility.

- The extension of the period for which individuals can be suspended from senior positions in regulated firms as part of the fitness and probity regime.

- That the legislative framework be strengthened to include a criminal offence of egregious recklessness by those in charge of financial firms that fail.

- The embedding of certain core common standards within a legislative framework. These standards would be used to guide regulated entities, and the individuals who exercise influence and authority over them, as to what is expected of them. Core standards can sit alongside prescriptive rules, and can be enforced where entities or individuals fall below them. Such core standards could include the requirement on entities and individuals that they conduct themselves with honesty and integrity, possess the competence and capability to conduct their business properly and cooperate with relevant regulatory authorities.

The CBOI ‘strongly recommends’ that reforms to assign responsibility to senior personnel should be adopted and that such reforms ‘should be modeled on the Senior Managers and Certification Regime in the UK’. The CBOI noted that the FCA has found the new
Ireland

approach 'effective' and that 'great benefit has been found in other jurisdictions in relation to the adoption of this policy'.

Such a reform would permit the CBOI to require every senior manager to present a statement of responsibilities that clearly states the matters for which they are responsible and accountable. Firms could be obliged to provide maps setting out the responsibilities of their senior managers, and their management and governance arrangements. As already stated it is believed that these requirements would assist in assigning responsibility to individuals in a regulatory context and decrease the ability of individuals to claim that the responsibility for wrongdoing lay outside their sphere of responsibility.

While the timescale has not been set, the direction of travel appears to be relatively clear with the CBOI seeking changes in particular to how it can oversee the (in)actions and activities of senior managers with the aim of driving better, compliant and risk aware behaviors.
The top three control failures resulting in the largest monetary penalties in the last two years are
1. underwriting and securitisation processes
2. compliance monitoring and oversight together with
3. third party oversight.

In fourth place is recordkeeping which is likely to feature more prominently in future as senior managers strive to evidence the discharge of their personal accountability and the new data privacy and protection requirements take effect.

For the purposes of the report ‘underwriting and securitisation’ is defined as the underwriting, registration and/or the issuance of securities, as well as compliance with the terms of issuance and maintenance of ownership records’. Senior managers are on notice of their obligations to robustly and consistently comply with all relevant conduct of business obligations associated with underwriting and securitisation processes, compliance monitoring and oversight and third party oversight.

A key thread throughout all the top three control failures is the need for skilled senior managers to be able to competently oversee all aspects of the business activity. This includes approving policies, procedures and processes, ensuring appropriate resources and using constructive challenge to consider all reports and management information received.

Looking to the future firms need to assess all aspects of record keeping. In the past there has been a danger that record keeping has been something of a poor relation in terms of investment when compared to other areas. However high quality record keeping should be considered as a core competency for firms. There is little value investing in a compliant process if the firm or individual is then not able to evidence that compliance.

Other control failings highlighted which may be indicators of areas of future regulatory interest are those of staff training and competency and conflicts of interest. Staff training and competency can be seen as aligned to the increase in personal accountability and liability as well as the need to refresh skill sets in line with,
Control failures

in particular, the evolution of fintech and regtech. Conflicts of interest has fluctuated as a regulatory priority. It is an area where global regulatory expectations are clear that a firm must be able to identify and manage any and all conflicts arising with its customer base. Just one example of a policy change which may well put conflicts of interest back in a future regulatory spotlight is MiFID II/R which came into effect for all investment activities in the EU from January 2018. On conflicts of interest some of the specific detail is set out in the MiFID II (Organisational Requirements and Operating Conditions for Investment Firms) Regulation (2017/565). In a nutshell the improvements to the existing framework include a number of additional safeguards:

- By creating an explicit requirement for conflicts of interest policies to be reviewed at least annually.

- By making it clear that disclosure of a conflict, as a means (or alternative) to managing it, should be an option of last resort.

Any disclosure made must be specific and enable the client to make an informed decision as to whether to carry on with the service/investment offered, and

- an additional requirement to consider conflicts caused by inducements and incentives

Top 10 Control failures between 2016 - (Q1) 2018

- UNDERWRITING & SECURITIZATION: 63%
- COMPLIANCE MONITORING & OVERSIGHT: 17%
- THIRD PARTY OVERSIGHT: 4%
- RECORD KEEPING: 3.2%
- LOAN SERVICING: 3%
- INTERNAL AUDIT: 2.6%
- SUPERVISION OF RELEVANT PERSONS: 2%
- RISK MANAGEMENT: 2%
- STAFF TRAINING & COMPETENCY: 1.6%
- CONFLICT OF INTEREST MANAGEMENT: 1.3%
Indicators of a sound risk culture

**Tone from the top**

**Leading by example:**
- Integrity
- Open exchange of views encouraged
- Decision making not dominated by one individual
- Senior management subject to same expectations as other staff

**Assessing espoused values:**
- Board ensure tone from the “middle” and further down consistent with tone from the top
- Board and senior management assess that risk appetite framework and business strategy is clearly understood and embraced

**Ensuring common understanding and awareness of risk:**
- Risk appetite, strategy, risk management effectively aligned and embedded in decision making and ops at all levels
- Board and senior management have clear views on most risky business lines - risk/return balance
- Board and senior management monitor how promptly and effectively issues raised are addressed by management

**Learning from past experiences:**
- Root cause analysis of deficiencies conducted
- Assessment and communication of lessons learned from past events (failures and successes) seen as opportunity to enhance risk culture

**Accountability**

**Ownership of risk:**
- Clear expectations set re: monitoring/reporting or risk
- Information-sharing mechanisms in place on emerging risks, etc
- All held accountable where their actions do not align with core values, risk appetite and culture

**Escalation process:**
- Process in place to support risk management and clear consequences for noncompliance
- Assessments done to ensure employees are aware
- Mechanisms in place for employees to elevate and report concerns
- Clear whistleblowing policy that is followed in practice

**Clear consequences:**
- Consequences are clearly established, articulated and applied
- Breaches in internal policies, procedures and risk limits, as well as nonadherence to internal codes of conduct, are understood to have a potential impact on an individual’s compensation and responsibilities, can affect career progression and, depending on severity may result in termination

**Effective communications & challenge**

**Open to alternate views:**
- Alternate views or questions from individuals and groups are encouraged, valued and respected and occur in practice
- A culture of open communication and collaboration is constantly promoted to ensure that each employee’s view is valued and the institution works together to strengthen risk-related decision making

**Stature of control functions:**
- Risk management, internal audit, compliance share the same stature as the business lines, actively participate in committees and are proactively involved in all relevant risk decisions and activities
- Controls functions operate independently, have appropriate direct access to the board and senior management
- Controls functions, including their representatives, have sufficient stature not only to act as advisors, but to effectively exert control tasks with respect to the institution’s risk culture

**Talent development:**
- Understanding key risks, essential elements of risk management and the institution’s culture is considered a critical skill set for senior employees and reflected in their development plans
- Job rotation between control functions and business lines is considered a way to facilitate a virtuous cycle for bringing business knowledge to the control functions and introducing risk awareness to the decision-making process of the business line
- Training programs are available for all staff to develop risk management competencies and the elements supporting a sound risk culture, including effective challenge and open communication

**Incentives**

**Renumeration and performance:**
- Renumeration and performance metrics consistently support and drive the desired risk-tasking behaviours, risk appetite and risk culture - encourage employees to act in the interest of the greater good of the company, rather than for themselves or their business line
- Annual performance reviews, objective-setting and processes are linked to promoting the institution’s desired core values and behaviours as well as compliance with policies and procedures
- Incentive compensation programs systematically include individual and group adherence to the financial institution’s core values and risk culture, including treatment of customers, cooperation with internal control functions and supervisors, respect of risk limits and alignment between performance and risk

**Source:** Financial Stability Board, Guidance on Supervisory Interaction with Financial Institutions on Risk Culture April 2014

© Corlytics 2018 | Corlytics Barometer - Conduct 2018
Regional variations

There are distinct regional variations in the supervisory approach towards senior manager misconduct. The US imposes the largest fines in terms of monetary value. In contrast Australia has imposed the greatest number of fines against individuals over the last six years, even before the new Banking Executive Accountability Regime and results of the Royal Commission take effect. It ought to be stating the obvious but senior managers and their firms need to understand all regulatory obligations which apply to their business activities. Despite the role of supranational policy making bodies such as the Financial Stability Board and Basel, individual regulators vary in their policy approach and supervision from jurisdiction to jurisdiction.

Over the last six years Australia was seen to have imposed the largest number of fines on individuals for misconduct. This is unlikely to diminish in the near future as the regulatory landscape in Australia is under critical scrutiny.

Widespread and persistent misconduct concerns led to the Royal Commission into misconduct in the banking, superannuation and financial services industry being established on December 14, 2017. The Commission will submit an interim report no later than September 30, 2018, and will provide a final report by February 1, 2019.1

Australia had already made substantive moves with regard to senior manager accountability with the Banking Executive Accountability Regime (BEAR) which will come into effect in July 2018. The new regime has many of the hallmarks of the UK senior managers regime and requires the registration of senior managers with APRA and introduces the need for responsibility mapping of roles and responsibilities. BEAR covers executives who have management or oversight functions as prescribed under the legislation or who otherwise have significant influence over all, or a material part of, the bank’s operation. The requirements also expressly cover non-executive directors.

BEAR will fundamentally extend APRA’s ability to fine banks for misconduct, and to remove and disqualified the firms’ board members and senior managers. APRA will also have stronger powers to review and adjust remuneration policies when it sees inappropriate outcomes.


"Our regulatory system was not designed as a police state, and this is deliberate. Instead, our system was designed on the premise that participants should also do their part to ensure the system operates appropriately. I think ‘professionalism’ is a good description of the role that is expected of participants.”

Speech by James Shipton, Chair of the Australian Securities & Investments Commission (ASIC), April 2018
Regional variations

In May 2018 APRA Chairman Wayne Byres’ gave a speech entitled ‘Beyond the BEAR Necessities’. In his speech, Mr Byres discussed accountability in the financial sector and the implementation of the new Banking Executive Accountability Regime (BEAR). Mr Byres’ comments included:

The BEAR provides an important new framework for promoting stronger accountability in the banking sector, but more than the BEAR alone is needed. Financial institutions need to think beyond the necessities of BEAR if they wish to truly demonstrate accountability.

The financial sector provides products which are, in many cases, not optional to consume, difficult to understand, and of great importance to an individual’s overall financial well-being, now and into the future. That combination of compulsion, opacity and materiality generates, as a quid pro quo, a heightened expectation that financial institutions will exhibit high standards of behaviour in the way they operate.

APRA … has an interest in failings in governance, culture and accountability that indicate a lax attitude to risk-taking, which might ultimately impact the soundness of the financial institution itself (and thereby jeopardise the interests of depositors, policyholders and superannuation fund members).

In many authorised deposit taking institutions, there is often collective responsibility for various aspects of its business: for any given process or product, there are often hand-offs of responsibility (including, at times, to external partners and suppliers). But this creates the risk of collective responsibility leading to no individual accountability. Clarity of accountability – the foundation of the BEAR – goes to the heart of a strong risk culture.

Organisational complexity and diffused responsibility have been at the heart of many of the issues that have damaged the standing of the banking industry in recent years. … To the extent that BEAR provides a catalyst to untangle that complexity and provide clear accountability for putting things right, it can only be a good thing.
Regional variations

Total financial penalties for misconduct by regulatory body against individuals 2012 – (Q1) 2018
International focus on misconduct

The international focus on misconduct will remain high on boards’ and regulators’ agendas. The FSB’s 2018 toolkit has set the future benchmark for both firms and supervisors in seeking to raise standards and strengthen governance frameworks in the financial services sector.

In April 2018, the FSB published a ‘toolkit’ for both firms and supervisors with the aim of strengthening governance frameworks to mitigate misconduct risk. The toolkit builds on the May 2017 FSB ‘stocktake’ of efforts to strengthen governance frameworks to mitigate misconduct risks. In the stocktake and other work, the FSB has sought to analyse the underlying cause of the continuing misconduct given addressing misconduct risk is inherent to the core mission of financial services regulators.

Mitigating misconduct risk requires a multifaceted approach. The toolkit identifies 19 tools that firms and supervisors could use to address three overarching issues identified by the FSB as part of its earlier work on misconduct, namely:

Mitigating cultural drivers of misconduct – including tools to effectively develop and communicate strategies for reducing misconduct in firms and for authorities to effectively supervise such approaches.

Strengthening individual responsibility and accountability – including tools that seek to identify key responsibilities and functions in a firm and assign them to individuals to promote accountability and increase transparency.

Addressing the “rolling bad apples” phenomenon – including tools to improve interview processes and onboarding of new employees and for regular updates to background checks to avoid hiring individuals with a history of misconduct.

19 tools for firms mitigating cultural drivers of misconduct

For firms mitigating cultural drivers of misconduct

1. Senior leadership of the firm articulate desired cultural features that mitigate the risk of misconduct.

2. Identify significant cultural drivers of misconduct by reviewing a broad set of information and using multidisciplinary techniques.

3. Act to shift behavioural norms to mitigate cultural drivers of misconduct. Senior leadership could take actions to shift attitudes and behaviours within the firm toward its cultural vision and to reinforce the governance frameworks designed to mitigate misconduct risk. Actions could be selected with reference to the most significant cultural drivers of misconduct identified by the firm (tool 2) and based on the firm’s operations.

For national authorities mitigating cultural drivers of misconduct

4. Build a supervisory programme focused on culture to mitigate the risk of misconduct.

5. Use a risk-based approach to prioritise for review the firms or groups of firms that display significant cultural drivers of misconduct. A risk-based approach to reviews could prioritise firms according to a comparative assessment of the cultural drivers of misconduct risk present within each firm. The depth of review could depend upon both the size and complexity of a firm or groups of firms under review, as well as the authority’s own resources and the magnitude of misconduct.

6. Use a broad range of information and techniques to assess the cultural drivers of misconduct at firms.

7. Engage firms’ leadership with respect to observations on culture and misconduct.

For firms strengthening individual responsibility and accountability

8. Identify key responsibilities, including mitigation of the risk of misconduct, and assign them. Identifying key responsibilities and clearly assigning them to the holders of various positions within a firm promotes individual accountability and increases transparency both within a firm and to relevant stakeholders. The identification and assignment of key responsibilities may be achieved through legislative or regulatory requirements, firm driven decisions on their preferred structure, or both.

9. Hold individuals accountable.

© Corlytics 2018 | Corlytics Barometer - Conduct 2018
19 tools for firms mitigating cultural drivers of misconduct

Assess the suitability of individuals assigned key responsibilities.

For national authorities strengthening individual responsibility and accountability

Develop and monitor a responsibility and accountability framework.

Coordinate with other authorities. Supervisory techniques that aim to strengthen individual accountability through clearly assigned responsibilities could be deployed by more than one authority in the same jurisdiction. Approaches applied by one authority may have consequences for approaches that other authorities are considering. As such, national authorities could engage and coordinate with those authorities to understand their approaches to individual accountability.

For firms addressing the rolling bad apples phenomenon

Communicate conduct expectations early and consistently in recruitment and hiring processes.

Enhance interviewing techniques.

Leverage multiple sources of available information before hiring.

Reassess employee conduct regularly.

For national authorities addressing the rolling bad apples phenomenon

Conduct “exit reviews”.

Supervise firms’ practices for screening prospective employees and monitoring current employees.

Promote compliance with legal or regulatory requirements regarding conduct-related information about applicable employees, where these exist. Authorities could provide methods for firms to exchange meaningful information on employees. This could include promoting consistent and more comprehensive information in databases of financial services professionals, where they exist.
The toolkit is not only a comprehensive set of suggestions, recommendations and options but also a landmark publication which sets the benchmark for the consideration and management of governance, culture and (mis)conduct risk in financial services firms. The toolkit is not guidance and not all elements will be relevant to all firms but it does set the international policy approach to seek to prevent and mitigate misconduct.

$61,122,710,986

The total fine amount for enforcement involving misconduct since 2012 from top 15 global regulators
Impact of non-financial penalties

One in three of the non-financial penalties imposed for misconduct include an element of remedial action and redress. In addition to the often-significant operational impact of an enforcement action including the need for substantial senior manager involvement, in the last couple of years redress and restitution costs have added an additional third to the overall financial cost of misconduct penalties.

As part of their approach to tackling misconduct, regulators have sought increasingly creative means of sanctioning firms and individuals in order to be seen to have a credible deterrent approach to all enforcement action taken. It is a universal regulatory expectation that firms learn from the mistakes of others. Firms need to assess the detail of all relevant enforcement actions and consider whether the same issues have or could arise in their own business.

Equally where issues are found, root cause analysis should be part of the work undertaken to ensure that all elements of any possible conduct of business breach has been found and remediated.
Impact of non-financial penalties

Regulators are using a wide range of measures to punish misconduct with the top five non-financial penalties imposed on firms over the last six years being:

1. Remedial action/redress
2. Cease and desist
3. Censure
4. Market ban
5. Injunction

It was an old rule of thumb that whatever the size of financial penalty imposed that it costs the firm ten times that amount to implement all associated remedial action. For firms and their senior managers, particularly with the overlay of enhanced personal liability, it is now more than ever worth investing in a robust approach to conduct of business compliance. Regulators will not only impose a fine for breaches but will not hesitate to impose additional sanctions in the form of redress and restitution as well as other remedial measures.
The top three sectors most frequently fined for misconduct over the last six years are wealth management, retail lending and mortgage lending, reflecting the global regulatory focus on the need for consistently good customer outcomes.

The next three most frequently fined areas are securities issuing and corporate trust, card services and sales & trading – commodities again reflecting the global regulatory focus on treating customers fairly to ensure consistently good customer outcomes.

The persistent concerns regarding wealth management services have driven further work and policy initiatives by regulators. In 2017 the FCA published a series of documents including its final report\(^1\) on the asset management market study and set out a package of remedies to address the concerns identified. Overall the FCA found that price competition was weak in a number of areas of the industry. Despite a large number of firms operating in the market the FCA found evidence of sustained, high profits over a number of years. It also found that investors are not always clear what the objectives of funds are, and fund performance is not always reported against an appropriate benchmark. Finally, the FCA found concerns about the way the investment consultant market operates.

---

Top three sectors most frequently fined for misconduct

The package of proposed remedies is being consulted on in 2018 and consists of

• measures to give protection to investors who are less able to find better value

• measures to drive competitive pressure on asset managers

• proposals to improve the effectiveness of intermediaries

The overall package of remedies is designed to bring together a consistent and coherent framework of interventions. The FCA has made a point of the conduct of business aspects of asset and wealth management and has recognised that some investors are not well placed to find better value. Because of this, it is strengthening the duty on asset managers to act in the best interests of investors and seeking to provide greater protection for investors. The remedies package also seeks to enable those investors who are able, to exert greater competitive pressure on asset managers. It will increase the transparency of costs so that those seeking information can get it. There is also work towards providing greater clarity of fund objectives and performance reporting. Finally, the package seeks to improve how effective intermediaries are for both retail and institutional investors.

Firms in the UK and elsewhere will find increasing regulatory interest in the ‘how’ customers are treated and will need to prioritise embedding strong culture and conduct risk measures throughout its business.
Frequency of financial penalties for misconduct by service line 2012 - (Q1) 2018

- 1. Wealth management services
- 2. Lending retail
- 3. Mortgage lending
- 4. Securities issuing & corporate trust
- 5. Card services
- 6. Sales & trading - commodities
- 7. Insurance - general liability
- 8. Asset management
- 9. Sales & trading - currency & FX
- 10. Insurance advisory & brokerage
- 11. Sales & trading
- 12. Savings & deposits - retail
- 13. Fund admin & accounting
- 14. Custody & safekeeping
- 15. Sales & trading - fixed income
Incentives and compensation

Regulators around the world will expect greater use of incentives and compensation practices in addressing future misconduct risk. It has become a boardroom priority with the FSB making clear that accountability for misconduct lies, first and foremost, with board of directors.

In May 2018 the FSB published a consultation on recommendations for consistent national reporting of data on the use of compensation tools to address misconduct risk. The consultation builds on numerous other FSB work regarding misconduct risk including the final supplementary guidance to the FSB principles and standards on sound compensation practices regarding the use of compensation tools to address misconduct risk published in March 2018. The original principles for sound compensation practices were published in April 2009 and the associated implementation standards in September 2009.

The FSB has focused on the need for the regular collection and evaluation of appropriate and consistent data to enable firms and supervisors to assess the effectiveness of compensation programs and to highlight potential areas of weakness. In the first instance the recommendations are aimed at the supervision of significant financial institutions but may well be applied more universally by regulators.

Incentives and compensation

Equally the recommendations are not intended to be prescriptive, but instead suggest certain categories of data that may be useful for supervisors when interacting with firms on misconduct risk. Specifically the FSB believes the recommendations will be useful in furthering a number of important FSB objectives, including development of comparative baselines, supporting accountability for adverse outcomes and identifying areas of weakness or emerging risks that could usefully be addressed through compensation and performance management processes. The use of compensation and performance management mechanisms should not only address misconduct - preventatively and when it occurs - but should also help to promote good conduct.

The proposed data set is designed to help firms and supervisors answer a number of important questions. These include whether governance and risk management processes surrounding compensation:

- appropriately include conduct considerations in the design of their compensation and incentive systems, including the setting of individual goals, ex ante performance measurement mechanisms and ex post compensation adjustments;

- support the effective use of compensation tools - in combination with other performance management tools such as training, promotion and disciplinary systems - to help promote good conduct or to remediate individual conduct that is not in line with the firm’s expectations, including holding individuals accountable for any misconduct that occurs;

- promote wider risk management goals, including for conduct issues, consistent with the firm’s strategy and risk tolerance; and

- support the effective identification of emerging misconduct risks and where appropriate, review use of incentive systems and compensation decisions in response to conduct incidents to ensure alignment of incentives, risk and reward.
Incentives and compensation

The detail of the ‘core’ data set proposed is divided into two parts – the first considers in part A the compensation frameworks to address misconduct risk and their governance and the second, in part B, the compensation actions taken in the event of misconduct. The core data set is supported by additional information which is designed to provide supervisors with additional context and may be useful in particular in case of supervisory deep dives or horizontal reviews on compensation and misconduct risk.

The FSB is recommending that supervisors carry out an initial, comprehensive data gathering of the core data set for significant financial institutions, and then receive updates no less frequently than once a year. Since frameworks, policies and procedures do not usually change frequently, at least not in a material way, the updates on the information in part A related to the firms’ policies and procedures generally should include only material changes or new elements that became relevant.

On the other hand, the information in part B on concrete compensation actions taken in response to misconduct generally should be updated annually.

The consultation on compensation data has several ramifications for firms. The first is to re-emphasize the FSB’s focus on the link between compensation and misconduct. The FSB believes that persistent misconduct may further indicate that firms are unable to get their employees to adhere to other standards, including those for sound risk management. Repeated and severe misconduct has implications for the financial system and has potential linkage to financial stability issues.

Firms, particularly those deemed to be significant, need to review the proposed data set in detail and ensure that they would be able to produce the required information on a regular and repeatable basis. Firms should also be prepared to discuss the precise detail of the data required with all relevant supervisors.

As the FSB has put it, it is not a one-size-fits all approach but the aim remains for globally consistent data to be gathered enabling deeper analysis and comparison.
Conclusion

Conduct of business concerns and specifically the costs of persistent misconduct remain key regulatory priorities. Regulators are tackling the issues arising through a variety of means including policy changes to enhance the potential for personal liability when a breach occurs. Firms need to stay ahead of the regulatory curve by using high quality relevant data to not only analyse the key regulatory risks, lessons and priorities from past enforcement actions and key regulatory publications but to also act as a guide to where to prioritise resources and focus for future risk management.

In an increasingly data driven and technologically enabled world senior managers that do not make use of relevant data and analytics will not only find conduct of business issues increasingly challenging but may well be asked by their regulators why they have not deployed appropriate solutions to aid both compliance and evidence of compliant activities.
**Conduct of business obligations 2012 - (Q1) 2018**

### Disclosures and communications

Disclosures and communication is the major root cause of misconduct penalties, accounting for 40 percent of the number of fines levied by regulators and three quarters (77 percent) of the total dollar amount of fines levied over the last six years.

- **40%** No. of enforcement notices involving disclosure
- **77%** Total fine amount involving disclosure

### Individuals

On average, at least one individual has been fined for misconduct every week for the last six years.

### Control failures

Top 3 control failures resulting in the largest monetary penalties in the last two years:

1. Underwriting & securitisation processes
2. Compliance monitoring oversight
3. Third party oversight

### Remedial action and redress

One in three of the non-financial penalties imposed for misconduct include an element of remedial action and redress. In addition to the often-significant operational impact of an enforcement action including the need for substantial senior manager involvement, in the last couple of years redress and restitution costs have added an additional third to the overall financial cost of misconduct penalties.

### Service lines

The top three sectors most frequently fined for misconduct over the last six years are wealth management, retail lending and mortgage lending.

---

© Corlytics 2018 | Corlytics Barometer - Conduct 2018
## Data

### Enforcement for misconduct by regulator to firms 2012 - (Q1) 2018

<table>
<thead>
<tr>
<th>Regulator</th>
<th>Fine amounts</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. US FHFA</td>
<td>$28,569,574,211</td>
</tr>
<tr>
<td>2. US Fannie Mae</td>
<td>$14,423,500,000</td>
</tr>
<tr>
<td>3. US OCC</td>
<td>$9,448,546,421</td>
</tr>
<tr>
<td>4. US Freddie Mac</td>
<td>$2,355,000,000</td>
</tr>
<tr>
<td>5. US OCC</td>
<td>$5,851,154</td>
</tr>
<tr>
<td>6. US NYDFS</td>
<td>$1,471,085</td>
</tr>
<tr>
<td>7. AUS ASIC</td>
<td>$122,370</td>
</tr>
<tr>
<td>8. HK SFC</td>
<td>$219,365</td>
</tr>
<tr>
<td>9. Singapore MAS</td>
<td>$11,850</td>
</tr>
</tbody>
</table>

### Enforcement for misconduct by regulator to individuals 2012 - (Q1) 2018

<table>
<thead>
<tr>
<th>Regulator</th>
<th>Fine amounts</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. US CFTC</td>
<td>$126,023,256</td>
</tr>
<tr>
<td>2. UK FCA</td>
<td>$106,804,154</td>
</tr>
<tr>
<td>3. US OCC</td>
<td>$5,851,154</td>
</tr>
<tr>
<td>4. US NYDFS</td>
<td>$1,471,085</td>
</tr>
<tr>
<td>5. AUS ASIC</td>
<td>$777,486</td>
</tr>
<tr>
<td>6. HK SFC</td>
<td>$219,365</td>
</tr>
<tr>
<td>7. Singapore MAS</td>
<td>$122,370</td>
</tr>
<tr>
<td>8. UK PRA</td>
<td>$20,283</td>
</tr>
<tr>
<td>9. US FED</td>
<td>$20,003</td>
</tr>
</tbody>
</table>

© Corlytics 2018 | Corlytics Barometer - Conduct 2018
### Top 10 - Control failures 2016 - (Q1) 2018

<table>
<thead>
<tr>
<th>Control</th>
<th>Fine Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Underwriting &amp; securitisation</td>
<td>$2,067,649,802</td>
</tr>
<tr>
<td>2. Compliance monitoring &amp; oversight</td>
<td>$560,058,626</td>
</tr>
<tr>
<td>3. Thirdparty oversight</td>
<td>$122,984,012</td>
</tr>
<tr>
<td>4. Record keeping</td>
<td>$105,107,975</td>
</tr>
<tr>
<td>5. Loan servicing</td>
<td>$99,006,354</td>
</tr>
<tr>
<td>6. Internal audit</td>
<td>$87,908,108</td>
</tr>
<tr>
<td>7. Supervision of relevant persons</td>
<td>$58,873,730</td>
</tr>
<tr>
<td>8. Risk management</td>
<td>$58,488,003</td>
</tr>
<tr>
<td>9. Staff training &amp; competency</td>
<td>$52,937,984</td>
</tr>
<tr>
<td>10. Conflict of interest management</td>
<td>$44,468,352</td>
</tr>
</tbody>
</table>

### Top 15 - Service lines 2012 - (Q1) 2018

<table>
<thead>
<tr>
<th>Service lines</th>
<th>No. of fines</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Wealth management services</td>
<td>126</td>
</tr>
<tr>
<td>2. Lending - retail</td>
<td>58</td>
</tr>
<tr>
<td>3. Mortgage lending</td>
<td>48</td>
</tr>
<tr>
<td>4. Securities issuing &amp; corporate trust</td>
<td>35</td>
</tr>
<tr>
<td>5. Card services</td>
<td>28</td>
</tr>
<tr>
<td>6. Sales &amp; trading - commodities</td>
<td>27</td>
</tr>
<tr>
<td>7. Insurance - general liability</td>
<td>26</td>
</tr>
<tr>
<td>8. Asset management</td>
<td>26</td>
</tr>
<tr>
<td>9. Sales &amp; trading - currency &amp; FX</td>
<td>24</td>
</tr>
<tr>
<td>10. Insurance advisory &amp; brokerage</td>
<td>20</td>
</tr>
<tr>
<td>11. Sales &amp; trading</td>
<td>14</td>
</tr>
<tr>
<td>12. Savings &amp; deposits - retail</td>
<td>12</td>
</tr>
<tr>
<td>13. Fund admin &amp; accounting</td>
<td>6</td>
</tr>
<tr>
<td>14. Custody &amp; safekeeping</td>
<td>6</td>
</tr>
<tr>
<td>15. Sales &amp; trading - fixed income</td>
<td>5</td>
</tr>
</tbody>
</table>
## % Redress for total fine amounts for misconduct 2016 - (Q1) 2018

<table>
<thead>
<tr>
<th>Regulator</th>
<th>Redress amounts</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. US DOJ</td>
<td>$21,259,130,846</td>
</tr>
<tr>
<td>2. US FHFA</td>
<td>$5,500,000,000</td>
</tr>
<tr>
<td>3. US SEC</td>
<td>$1,168,967,216</td>
</tr>
<tr>
<td>3. US DOJ, HUD, CFPB &amp; 49 AGs</td>
<td>$470,000,000</td>
</tr>
<tr>
<td>4. UK FCA</td>
<td>$417,805,212</td>
</tr>
<tr>
<td>5. US FDIC</td>
<td>$302,293,917</td>
</tr>
<tr>
<td>6. US CFPB</td>
<td>$224,407,432</td>
</tr>
<tr>
<td>7. US FED</td>
<td>$189,506,899</td>
</tr>
<tr>
<td>8. US NYDFS</td>
<td>$108,683,419</td>
</tr>
<tr>
<td>9. US OCC</td>
<td>$99,984,844</td>
</tr>
<tr>
<td>10. AUSTRALIA ASIC</td>
<td>$60,503,875</td>
</tr>
<tr>
<td>11. HK SFC</td>
<td>$58,553,691</td>
</tr>
<tr>
<td>12. US CFTC</td>
<td>$19,983,746</td>
</tr>
<tr>
<td>13. UK PRA</td>
<td>$3,675,046</td>
</tr>
<tr>
<td>14. NETHERLANDS AFM</td>
<td>$3,656,647</td>
</tr>
<tr>
<td>15. CBOI</td>
<td>$3,308,130</td>
</tr>
<tr>
<td>16. US MSD</td>
<td>$1,825,924</td>
</tr>
</tbody>
</table>
Corlytics is the world leader in determining regulatory risk impact. Our forensic analysis and forecasting of global enforcement cases, business plans, speeches, thematic reviews, Dear CEO letters, and other regulatory notices sees Corlytics deliver 360-degree intelligence. Our team is made up of leading data scientists, seasoned technologists, proven banking risk practitioners and expert lawyers. We measure, calculate and predict regulatory out-comes and impact. Empowering you to make transformational, positive choices.

To highlight the key issues and trends Corlytics has undertaken specific analysis of the enforcement action taken regarding conduct of business breaches from select financial services regulators in the United States, Europe and Asia. Over two million data points were analysed for conduct of business elements in enforcement actions published between 2012 and Q1 2018, and for systemic issues between 2016 and Q1 2018 including those from:


**Europe:** UK Financial Conduct Authority (FCA) UK Prudential Regulation Authority (PRA), Ireland Central Bank of Ireland (CBOI)

**Asia:** Australian Securities and Investment Commission (ASIC) HK Securities and Futures Commission (HK SFC) Hong Kong Monetary Authority (HKMA) Monetary Authority of Singapore (MAS).

All fines were converted into US dollars at the date of the enforcement action. Fines include financial penalties, restitutions, disgorgements, and non-financial penalties mandated by regulators. It does not include class actions, or intercompany litigations.

---

**Conduct of business regulatory categories**

<table>
<thead>
<tr>
<th>Disclosure &amp; Communications to Clients</th>
<th>Arrears handling</th>
</tr>
</thead>
<tbody>
<tr>
<td>Unfair treatment</td>
<td>Client data/ privacy</td>
</tr>
<tr>
<td>Misselling &amp; suitability</td>
<td>Conflict of interest</td>
</tr>
<tr>
<td>Complaint handling</td>
<td>Customer authorisation</td>
</tr>
<tr>
<td>Overcharging</td>
<td>Client asset/ cash</td>
</tr>
<tr>
<td>Client order execution</td>
<td>Unfair contracts</td>
</tr>
</tbody>
</table>

**Our very special thanks to Selina Ji**
Contact us

Boston
+1 978 290 6710

Dublin
+353 1 9038761

London
+44 (0) 203 608 8962

New York
+1 718 218 4729

Sydney
+61 28 311 1600

www.corlytics.com
twitter.com/corlytics
linkedin.com/company/corlytics

insights@corlytics.com