

CURRENT IMPLICATIONS OF GLOBAL FINREG

Presented by Clark Hill and The Mizen Group
10 November 2020

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PRESENTERS

Sam Saarsteiner, Partner, Clark Hill

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Paul McCarthy, CTO, The Mizen Group

John Hern, CEO, Clark Hill

Moderated by Tom Lyons, CEO, The Currency

AGENDA

Introduction

Tom Lyons, CEO, The Currency

Program

Fitness & Probity

Sam Saarsteiner, Partner, Clark Hill

SEAR (Senior Executive Accountability Regime)

Peter Oakes, Consultant, Clark Hill

Culture & Behaviours

Paul McCarthy, CTO, The Mizen Group

Question and Answer Session

Moderated by Tom Lyons, CEO, The Currency

Closing Remarks

John Hern, CEO, Clark Hill

FINANCIAL REGULATION: FITNESS & PROBITY

Sam Saarsteiner, Partner, Clark Hill

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AMBITIOUS 12 MINUTE LESSON PLAN....

- What is Fitness & Probity?
- Does it apply to me?
- What are the standards expected of me?
- What can the Central Bank of Ireland do?
- What's the worst that can happen to me or my firm?
- How can I mitigate this risk?

WHAT IS FITNESS & PROBITY?

- Abbreviation warning:

*A regime operated by the Central Bank of Ireland ("CBI") to ensure that persons in Controlled Functions ("CF's") and Pre-approved Controlled Functions ("PCF's") in Regulated Financial Services Providers ("RFSPs") are **fit** and **proper**.*

- CBI objectives: Regulation, Supervision and Enforcement
- Falls within the umbrella of "Conduct Risk"
- Protection of consumers, integrity of financial services market and broader economy



WHAT IS IT NOT?

- ~~Merely a compliance matter~~
- ~~A check-box exercise~~
- ~~To be under-estimated~~
- ~~Optional~~

BEDTIME READING....

- **Central Bank Reform Act 2010 (the “Act”)** – note: majority focuses on powers of investigation and sanctions
- Central Bank Reform Act 2010 (Sections 20 and 22) Regulations, 2011 (S.I. No. 437 of 2011) – the primary regulations
- Central Bank Reform Act 2010 (Sections 20 and 22) (Amendment) Regulations 2011 (S.I. No. 615 of 2011)
- Central Bank Reform Act 2010 (Procedures Governing the **Conduct of Investigations**) Regulations, 2012
- **Central Bank (Supervision And Enforcement) Act 2013**
- Central Bank Reform Act 2010 (Sections 20 and 22) (Amendment) Regulations 2014 (S.I. No. 394 of 2014)
- Central Bank Reform Act 2010 (Sections 20 and 22) (Amendment) Regulations 2015 (S.I. No. 545 of 2015)
- Central Bank (Supervision and Enforcement) Act 2013 (Section 48 (1))
Minimum Competency Regulations 2017
- Central Bank Reform Act 2010 (Sections 20 and 22) (Amendment) Regulations 2020 (S.I. No. 410 of 2020)

STANDARDS & GUIDANCE

- CBI Fitness and Probity Standards 2014
 - Issued under Section 50 of the Act
 - Definitions focus on relevant functions and the applicable standards; the definition of fitness and probity is therefore intentionally absent
- Minimum Competency Code 2017 – broken down by industry and roles
- 2018 Guidance on F&P Standards; FAQs

WHAT IS EXPECTED OF ME? (1/2)

1. To Be Competent & Capable

- Professional or other relevant qualifications and capability
- Competence and skills (through training or experience) – see MCC 2017
- (If applicable) Competence and proficiency in a previous or similar role
- Sound knowledge of the business of the RFSP as a whole
- Understanding of the regulatory and legal environment appropriate to the function
- Avoidance of conflicts

2. To Act Honestly and Ethically

- Negligence, deceitful or discreditable business or professional practice
- Links with prior CBI record – (e.g. prohibition, refusal, restriction or suspension)
- Complaints to CBI, FSO or similar
- “Fitness to Practice” investigations by professional bodies
- Prior employment / engagement history, whether or not remunerated
- Disqualification/restriction from acting as a director
- Conviction of relevant offences
- Lack of candour or lack of cooperation with CBI

3. To Be Financially Sound

- Financial prudence
- Payment defaults
- Judgments & bankruptcy (whether discharged or not)
- Director of an entity the subject of any form of insolvency

Transparency – common thread - all information to CBI to be candid, truthful, full, fair and accurate and not misleading

WHAT IS EXPECTED OF ME? (2/2)

- Black and white v. principles based rules
- Per MCC 2017: "*Letter and Spirit...*"
- "Dear CEO" letter of 8th April 2019 (Derville Rowland – DG Financial Conduct)
 - Reminder of firms' obligations – ss.21 & 23 of the Act
 - S.21 of the Act – CF roles – firm as gatekeeper for CF roles
 - S.23 of the Act – PCFs - firm to apply
 - Ongoing internal Due Diligence
 - E.g. dismissing for fraud but not reporting to CBI
- F&P applies to CFs and PCFs even when carried on outside the State
- The CBI expects at least one CF or PCF per RFSP



WHAT ARE THE RELEVANT POWERS OF THE CBI?

- Sections 24-46 of the 2010 Act
- Authorisations - suspension / prohibition / refusal – keys to the club
- Investigation
- Compel production of documents
- Compel attendance at interviews
- Conduct on-site inspections (including without notice if warrant in place)
- Administrative Sanctions Procedure
- To be broadened and refocused - SEAR

WHAT'S THE WORST THAT CAN HAPPEN?

- Caution / reprimand
- Suspension/revocation of authorisations
- Prohibitions
- Disqualification from managing a regulated firm for a specified period
- Fine of up to €1m (individuals) or €10m or 10% of turnover if higher (RFSPs)
- Refusal of appointment – appealable to IFSAT
- CBI Policy of publishing outcomes

EXAMPLES OF ENFORCEMENT OUTCOMES

- 10 years prohibition (July 2020 – misleading answers, failure to cooperate with investigation);
- 2 Years (September 2019 – employment history)
- Indefinite period (February 2019 – misappropriation of client funds)
- Indefinite period (August 2018 – credit union prize draw)
- **Burns** (FCA – UK) - non-disclosure of conflict of interest
 - banned from acting as a NED for any RFSP
 - issued with a £20k fine

HOW DO I PROTECT MYSELF AND MY FIRM?

- Know thyself
- Be proactive
- Regular and relevant training
- Documenting your processes
- Practical steps to aid internal DD, e.g. Employment contracts to oblige notification to firm if judgment awarded against CF/PCF holder
- Make it part of the DNA of the firm
- Evolve your mindset

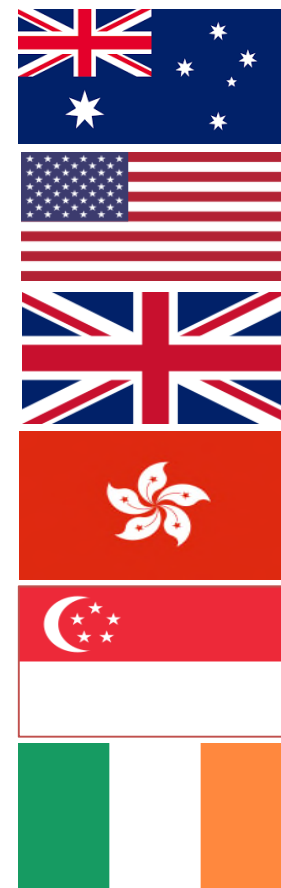
SEAR (SENIOR EXECUTIVE ACCOUNTABILITY REGIME)

Peter Oakes, Consultant, Clark Hill

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FINSERV EXECUTIVE ACCOUNTABILITY: EXAMPLES

- **Banking Executive Accountability Regime** - Australia
- **Rule 504** - USA (NY AML Regulations)
- **Senior Managers & Certification Regime** - United Kingdom
- **Manager in Charge Regime & Management Accountability Initiative** - Hong Kong
- **Guidelines on Individual Accountability and Conduct** - Singapore
- ***Senior Executive Accountability Regime*** - Ireland



CENTRAL BANK OF IRELAND'S 'CASE FOR S.E.A.R.' (PACKAGE OF MEASURES)

1. Five clear and enforceable conduct standards to apply to all staff in all regulated firms
2. Senior Executive Accountability Regime (SEAR) to ensure clearer responsibility and accountability
3. Further enhancements to the current Fitness & Probity (F&P) regime
4. Unified enforcement process

- Source - <https://www.centralbank.ie/news/article/speech-senior-executive-accountability-regime-derville-rowland-22-oct-2019>

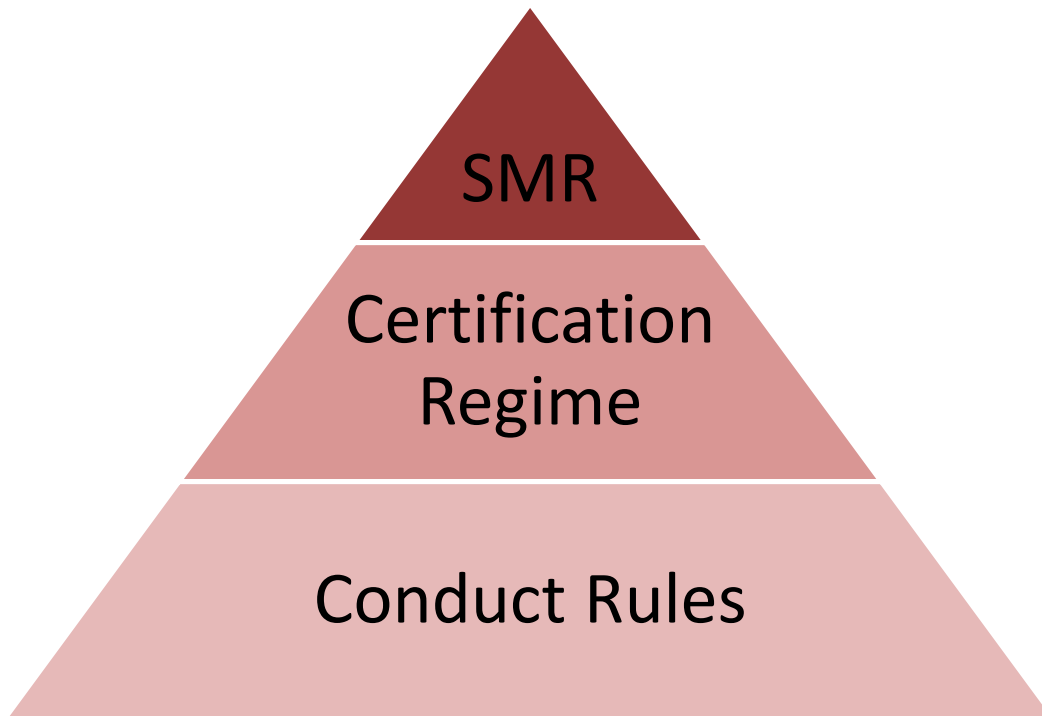


Banc Ceannais na hÉirean
Central Bank of Ireland

Eurosystem

IRISH PROPOSAL: COMMON THEMES WITH UK REGIME

3 key parts to the UK Senior Managers & Certification Regime:

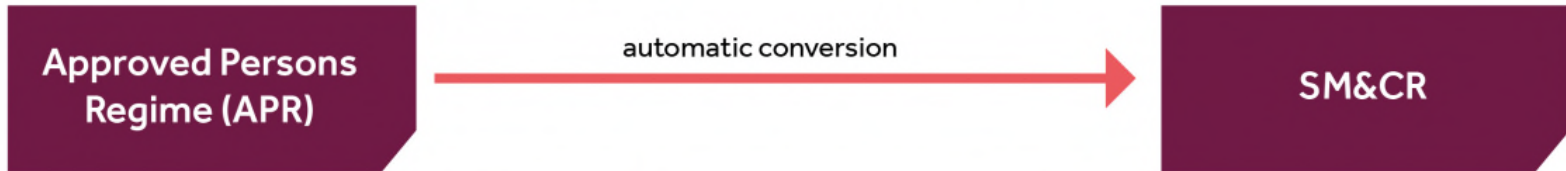


1. SMR: accountability and responsibility at top level
2. Certification Regime: Material Risk Takers
3. Conduct Rules: People at #1, #2 & all UK staff

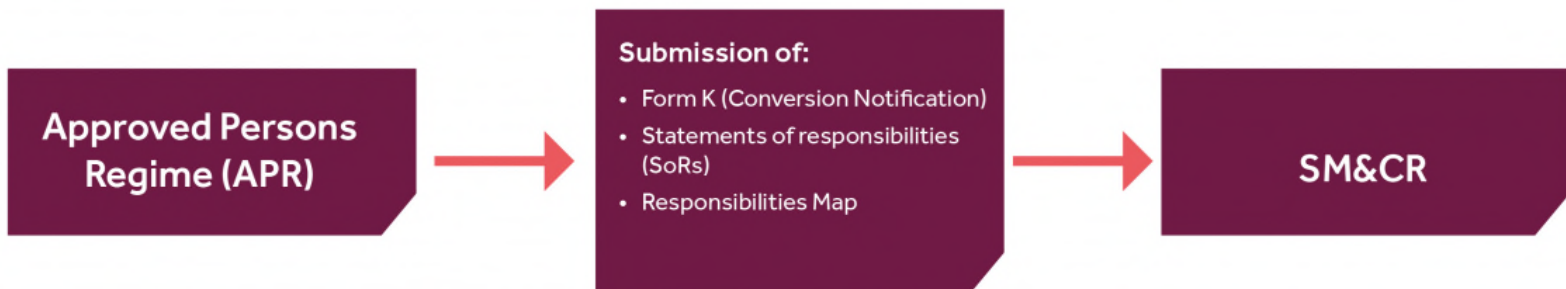
UK TRANSITION FROM APR TO SMR

An example for Ireland's transition from PCF to SEAR?

Individuals at Core and Limited Scope firms will be automatically converted from APR functions to corresponding Senior Management Functions wherever possible (see Chapter 4 for more information).



Individuals at Enhanced firms will be converted from APR functions to Senior Management Functions subject to the submissions of a conversion notification and accompanying documentation.



DOESN'T MATTER WHAT YOU KNOW, ONLY WHAT YOU CAN PROVE (1/2)

- Examples of three Central Bank of Ireland enforcement actions and fines for lapses in implementation of existing fitness & probity regime:
 - Stockbroking - €200,000
 - Credit Union - €155,000
 - Asset Management - €433,000 (other failures re safeguarding of assets)

Source - <https://www.centralbank.ie>

DOESN'T MATTER WHAT YOU KNOW, ONLY WHAT YOU CAN PROVE (2/2)

- Failure (cumulative by the three firms) to:
 - Introduce adequate systems or procedures to ensure compliance with its obligations under section 21 of the 2010 Act
 - Take reasonable steps to satisfy itself that its CFs and PCFs complied with the Standards
 - Ensure that an employee, performing a role that might expose the Firm to financial, consumer or regulatory risk, was fit for that role
 - Introduce adequate systems or controls to ensure full compliance with its F&P obligations
 - Take all reasonable steps to carry out adequate F&P due diligence on individuals performing CFs
 - Ensure that certain employees and an outsourced internal audit service provider complied with and agreed to abide by the F&P Standards

LESSON FROM HISTORY?

- Likelihood of Central Bank of Ireland adopting a similar approach to assertive supervision and enforcement for SEAR as that of F&P
- Areas to focus upon:
 - identification of persons and functions likely to fall under new regime
 - pathway to adequate systems and procedures to ensure compliance with proposed obligations under SEAR
 - take all reasonable steps to carry out adequate due diligence on individuals falling within SEAR
 - take reasonable steps to satisfy yourself that Senior Executives (and Board) will be able to comply with enforceable conduct standards
 - roles that might expose your firm to financial, consumer or regulatory risk: are staff 'fit for the role' [*what the UK refers to as 'significant harm functions & their managers'*]
 - take all reasonable steps to carry out adequate F&P due diligence on individuals performing a Senior Executive function

PERSONAL ACCOUNTABILITY: NOT LIMITED FINANCIAL SERVICES MISCONDUCT



The screenshot shows the top of the FCA website. On the left is the FCA logo with the text 'FINANCIAL CONDUCT AUTHORITY'. To the right is a search bar. Below these are four navigation buttons: 'About us', 'Firms', 'Markets', and 'Consumers'. A dark red breadcrumb trail reads 'Home / News / FCA bans three individuals from working in the financial services industry for non-financial misconduct'. The main heading is 'FCA bans three individuals from working in the financial services industry for non-financial misconduct'. Below the heading, it says 'Press Releases | First published: 05/11/2020 | Last updated: 05/11/2020'. A thick dark red horizontal line separates the header from the main text. The main text reads: 'The Financial Conduct Authority (FCA) has prohibited Russell David Jameson, Mark Horsey, and Frank Cochran from working in the financial services industry following findings that they are not fit and proper. Each of them had been convicted of serious non-financial indictable offences while working in the financial services industry.'

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Source: <https://www.fca.org.uk/news/press-releases/fca-bans-three-individuals-working-financial-services-industry-non-financial-misconduct>

SEAR, F&P AND CULTURE: HAND-IN-HAND

"Lack of diversity at senior management and board level is a leading indicator of heightened behaviour and culture risks."

Ed Sibley, Deputy Governor Central Bank of Ireland

Source: Speech 25 October 2018 (Central Bank of Ireland)



"Culture defines the soft rules that people play by. But there are more tangible rules as well – and this is where regulators and supervisors come in."

Andrea Enria, Chair of the Supervisory Board of the ECB

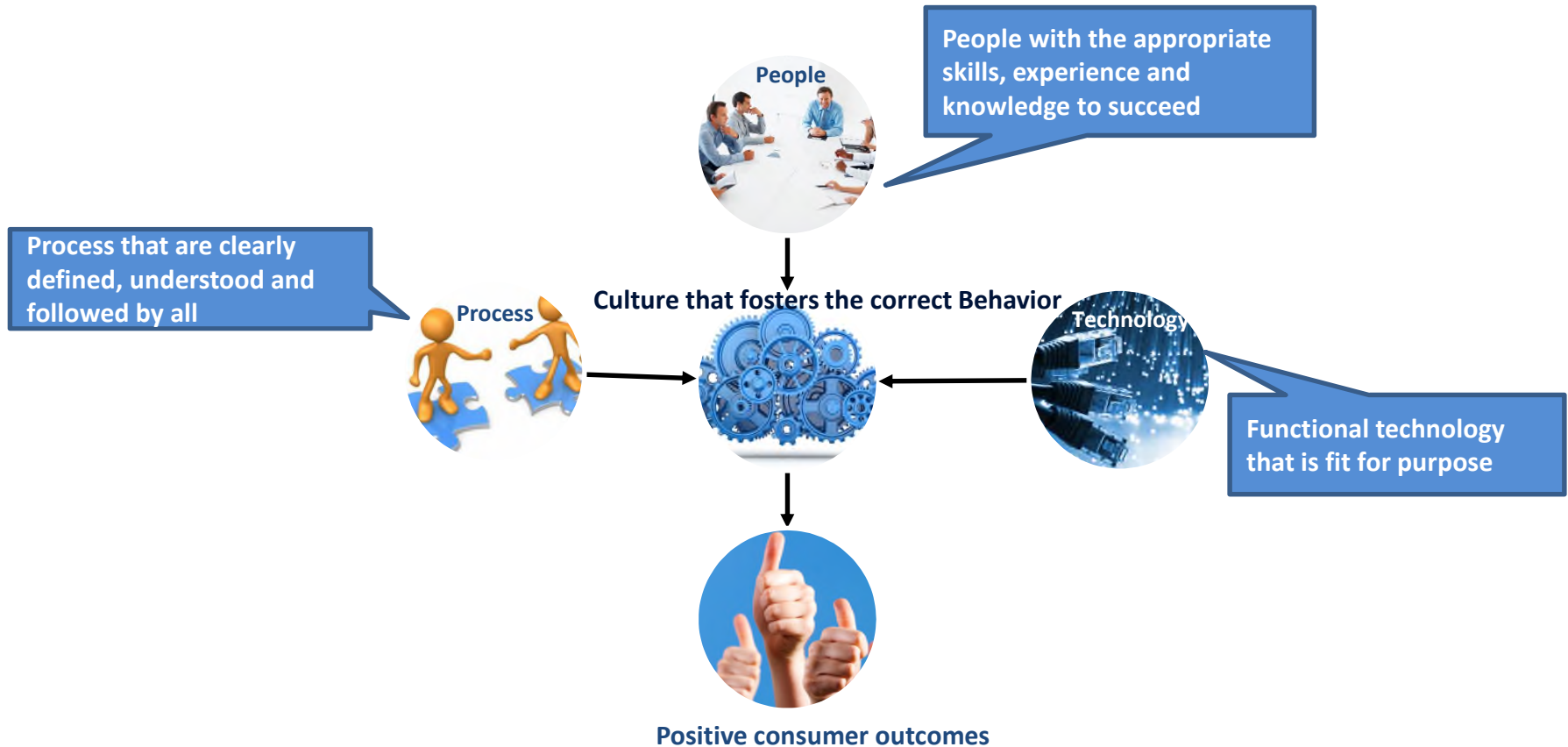
Source: White Paper Impact of Culture and Conduct on Compliance (The Mizen Group) 15 September 2020

CONDUCT CULTURE

Paul McCarthy, CTO, The Mizen Group

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ROLE OF CULTURE



WHAT IS CULTURE?

| Questions | Answers |
|---|---|
| Colloquially, how do we describe culture? | <ul style="list-style-type: none">• The way we do things• Social glue• Unique environment becomes “correct” way |
| Is there such a thing as a “right” culture? | <ul style="list-style-type: none">• No “one size fits all”• Foster cultures to support spirit and letter of the law• Underlying ethical base |
| Why isn’t culture a regulatory requirement? | <ul style="list-style-type: none">• Difficult to mandate the culture of an institution• Ways to make expectations known• Know it when they see it |

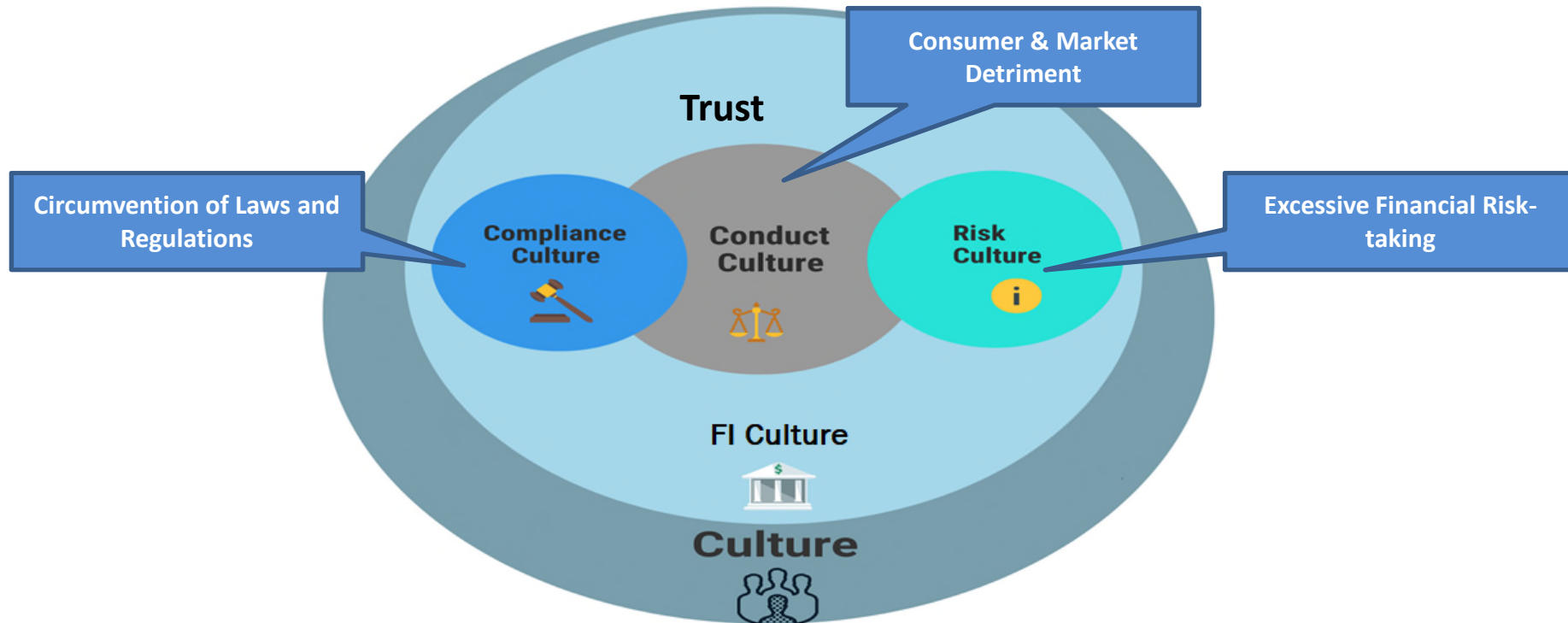
BUSINESS CULTURES?

Norms of business in different countries/regions are subtly understood and mostly honored

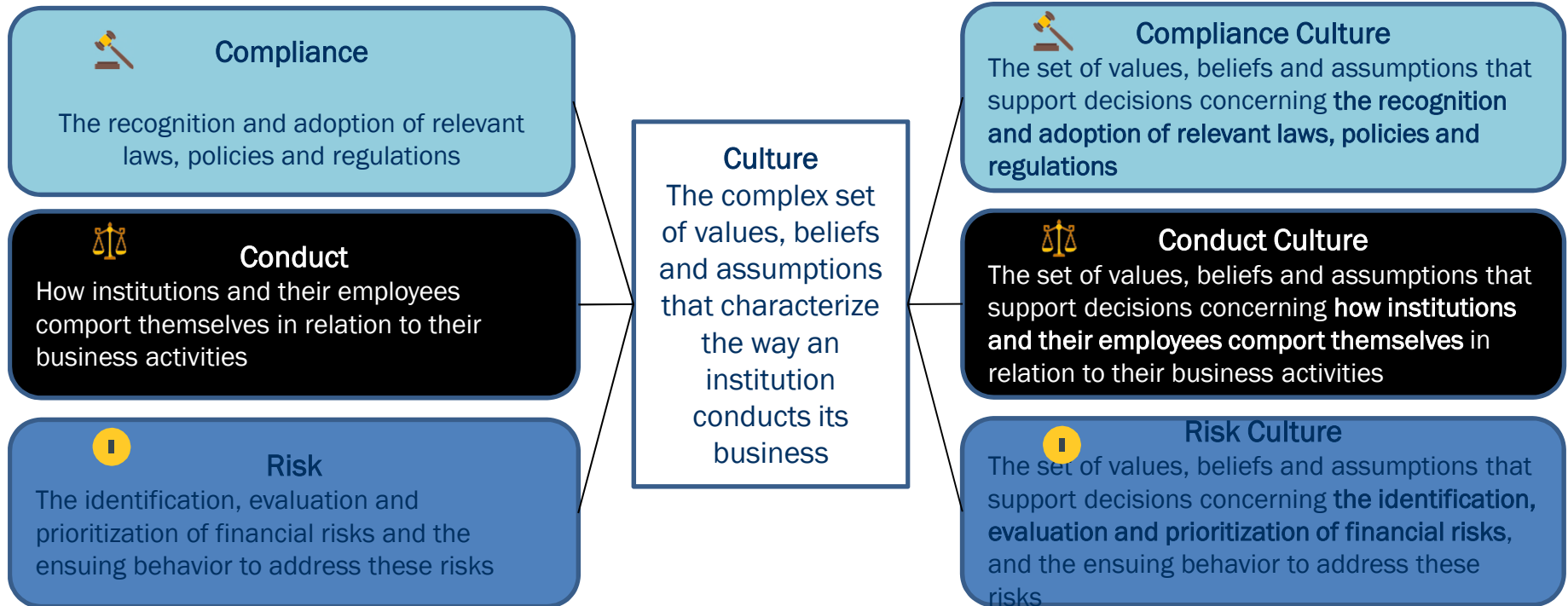
| | |
|----------------------|--|
| China | <ul style="list-style-type: none">• Guanxi is at the heart of business enterprise, with ties of family, community, and trust |
| Middle East | <ul style="list-style-type: none">• Key attributes: relationship and trust |
| Anglo-Irish/Maritime | <ul style="list-style-type: none">• My word is my bond, also supported by business, relationship, trust |
| United States | <ul style="list-style-type: none">• Historically, business inherited Anglo-Irish trust model• To distinguish itself, US is focused on rules and regulations |



CULTURES WITHIN CULTURES?

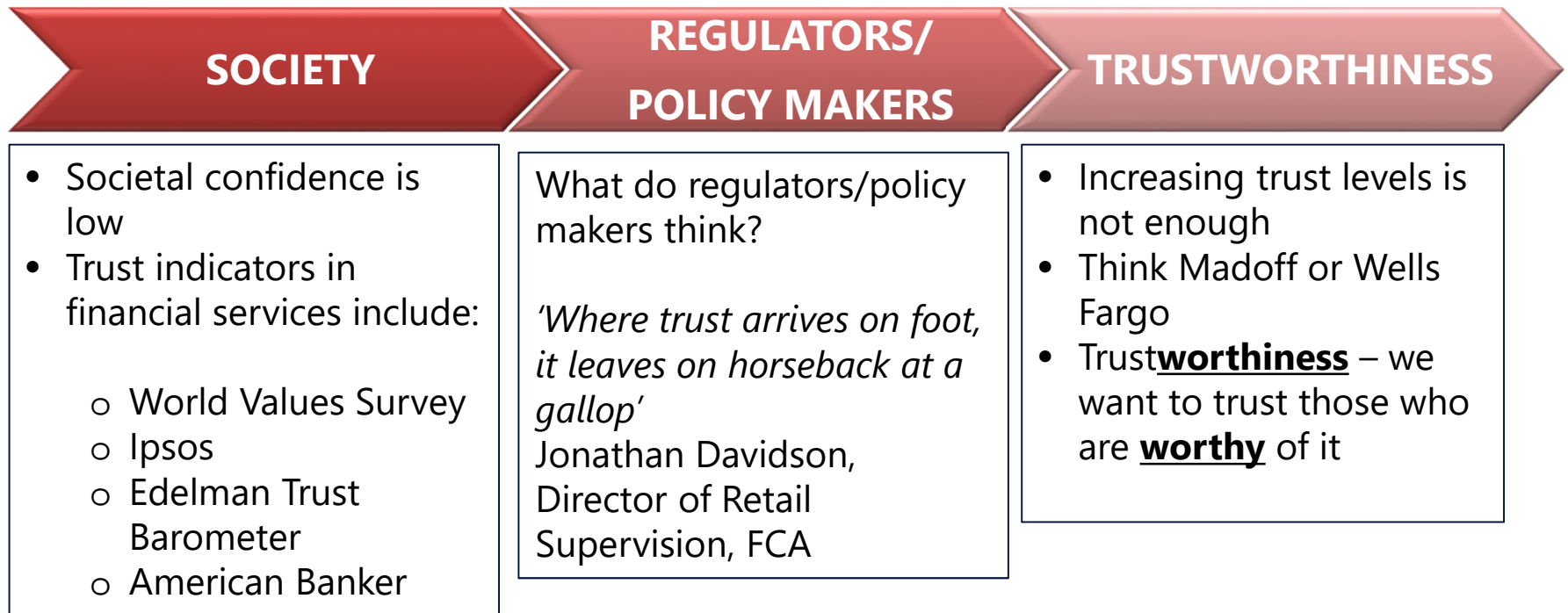


MIZEN DEFINITIONS



THE TRUST PARADOX

Customer perception: *We don't trust financial institutions but we need them*



Regulator perception: *Trust but verify*

ADDRESSING THE TRUST PARADOX

TRUSTWORTHINESS

- Trustworthiness:
 - Placing of trust intelligently
 - Worthy of trust
- Indicators:
 - Honesty
 - Reliability
 - Competence

WHAT IS NEEDED?

- Actions of employees reflect the organization:
 - Are they confident enough to make good decisions?
 - Are they supported by the culture to be honest, reliable, competent?
 - Is the institution swimming in calm waters?

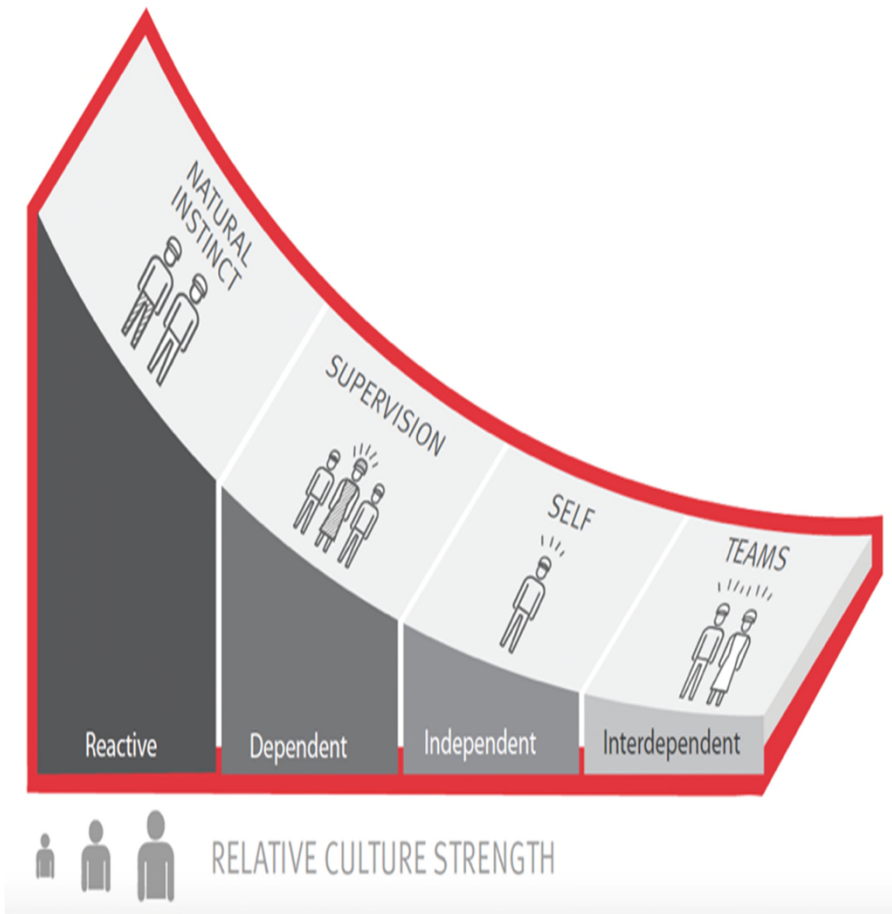
HOW TO OBTAIN IT?

- Perception based surveys
- Perceptions are *'the primary source of information for the supervision of behavior and culture'*
De Nederlandsche Bank

WHY MEASURE CULTURE?

- Regulatory expectations increasing
 - Putting in place supervisory frameworks as it relates to culture
- To understand the views of the employees across multiple dimensions
- Perform a deeper dive into root causes of the institution's culture
- Get beyond usual embedding factors
- If you can't measure it, you can't manage it

LEVERAGE PROVEN MEASUREMENT METHODOLOGY



- Dupont Bradley Curve: The stronger the organization's safety culture, the lower the injury rate
- Mizen corollary to the financial industry:
 - The stronger the compliance and conduct culture, the lower compliance breaches or behavioral misconduct
- Mizen products incorporate multidisciplinary research and requirements of regulators
 - Utilizing behavioral science, value theory, econometrics, philosophy and statistics
 - Identifies correlations between employee perceptions and outcomes

CONDUCT CULTURE MEASUREMENT: HOW IT WORKS?

Employee perceptions via an anonymized survey



Institution's metrics indicative of cultural outcomes



Rapid insight for healthy or unhealthy culture



Employee perceptions are correlated with quantitative measures utilizing advanced analytics

Scorecard
Anonymized Benchmark to peers

QUESTION & ANSWER SESSION

Moderated by Tom Lyons, CEO, The Currency

Please feel free to submit your questions through the Q&A box at the bottom of your screen.

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CLOSING REMARKS



John Hern, CEO, Clark Hill

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THANK YOU

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