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# Regulatory News Alert

## FSB's toolkit to mitigate misconduct

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### Financial Stability Board releases a toolkit for firms and supervisors to mitigate misconduct risk

Within its work plan aimed at developing measures to reduce misconduct risks in the marketplace, on 20 April the Financial Stability Board (FSB) published a toolkit for firms and supervisors with suggested ways on how best to mitigate it. The **FSB paper forms part of a wider initiative to reduce misconduct risks** in the financial sector (i.e. BCBS 239) and promote incentives for good behavior, following a series of high-profile misconduct cases that came to light in recent years. The FSB identified several areas for further investigation with the aim to prepare a **toolkit for supervisors and financial undertakings** in these areas.

The toolkit is designed to help firms and national authorities to strengthen their governance frameworks to tackle the causes and consequences of misconduct. The FSB emphasizes that the toolkit is not a recommendation or guidance and instead offers a set of options based on FSB members' shared experience. The FSB stated that the toolkit will continue to evolve as the industry participants and supervisors learn from their experiences.

It currently identifies 19 tools that firms and supervisors could use to address the three overarching issues identified by FSB as part of its earlier work on misconduct: mitigating cultural drivers of misconduct, strengthening individual responsibility and accountability, and addressing the "rolling bad apples" phenomenon.

**The proposed tools for firms**

1) *Mitigating cultural drivers of misconduct*. The FSB proposes measures to be taken by firms' senior leadership. To develop and communicate misconduct reducing strategies effectively, the FSB suggests that a firm's leadership could:
   a) articulate a clear cultural vision to guide the right behavior;
   b) identify significant cultural drivers of misconduct by reviewing a broad set of information using multidisciplinary techniques and
   c) take actions to shift behavioral norms to mitigate cultural drivers of misconduct attitudes.

2) *Strengthening individual responsibility and accountability.* In order to promote accountability and transparency, firms could:
   a) identify and clearly assign key responsibilities, including for mitigation of misconduct risks;

b) hold individuals accountable for their actions, e.g. through a firm's internal processes, including employee contracts and
c) assess the suitability of individuals holding key responsibilities (the FSB states that firms could undertake assessments of the suitability of individuals who have been assigned key responsibilities, including integrity, professional competency, etc.)

3) *Addressing the 'rolling bad apples' phenomenon*. This refers to individuals who engage in misconduct but are able to obtain subsequent employment elsewhere, without disclosing their earlier misbehavior. With this in mind firms could:
    a) communicate conduct expectations early and consistently in the recruitment processes;
    b) enhance interviewing techniques to consider a candidate's behavioral competency and conduct history as well as their potential for adhering to the firm's values. The FSB suggests that this could be accomplished by asking particular questions or even by conducting a separate interview focused entirely on behavioral and conduct matters;
    c) take into account multiple sources of information before hiring;
    d) regularly re-assess employee conduct and renew background checks and
    e) conduct exit reviews and maintain appropriate records on their former employees, without prejudice to applicable legal requirements.

**The proposed tools for supervisors**

1) *Mitigating cultural drivers of misconduct*. To effectively supervise firms' misconduct mitigation strategies supervisors could:
    a) build a **supervision programme** focused on culture to reduce misconduct;
    b) use a risk-based approach to prioritize review of firms with significant cultural drivers of misconduct;
    c) use a broad range of information and techniques to assess cultural misconduct drivers and
    d) engage firms' leadership regarding observations on culture and misconduct.

2) *Strengthening individual responsibility and accountability*. In addition to the tools listed under this category for firms (see above), the FSB suggested some supervisor-specific actions:
    a) develop and monitor a "responsibility and accountability" framework and
    b) co-ordinate with other authorities: approaches applied by one authority may have consequences for approaches that other authorities are considering. National authorities could engage and coordinate with those authorities to understand their approaches to individual accountability.

The Toolkit does not prescribe a precise form for the "responsibility and accountability" framework, and instead suggests a variety of options, which regulators might use to implement such a framework (including, for example, a responsibilities map). However, it seems likely that the inclusion of such a framework by the FSB will lead to the implementation of more senior management accountability regimes globally, following the lead set by countries like the UK and Australia.

3) *Addressing the 'rolling bad apples' phenomenon.* In order to address this issue, national authorities could:
    a) supervise firms' practices for screening prospective employees and monitoring current ones and
    b) promote compliance with legal or regulatory rules regarding conduct-related information about applicable employees, where these exist. The FSB suggests that 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.

Importantly, the FSB has noted that such measures should aim to provide protection against the legal risks (such as breach of employment and / or privacy laws), which often deter meaningful information sharing between financial institutions about employees who have been terminated for misconduct, contributing to the "bad apple" phenomenon.

Apart from the proposed tools for firms and supervisors, the toolkit also includes:

- Standards and codes of behavior, such as the FX Global code, and reforms to benchmark-setting practices
- Toolkit of measures related to wholesale market conduct, based on national approaches
- Guidance on compensation practices in addressing misconduct

## How can Deloitte help?

Deloitte can help your institution assess its compliance to principles and international standards, as well as perform regulatory health checks globally or dedicated to specific regulations, for example with its D.Ready MIFID II service.

Deloitte can also help you address the implementation of these principles and optimize your firm strategy to mitigate misconduct risks.

We are here to help you stay on top of the regulatory curve with our Kaleidoscope Regulatory Watch service.

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