Ethical Culture

CII guidance series

Developing a culture of personal responsibility in a regulated environment

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CII

List of abbreviations used in this paper

CII	Chartered Insurance Institute	**SIMR**	Senior Insurance Management Regime
FCA	Financial Conduct Authority	**SM&CR**	Senior Management and Certification Regime
NED	Non-Executive Director		
PRA	Prudential Regulation Authority	**SMF**	Senior Management Function
SIMF	Senior Insurance Management Function	**TCF**	Treating Customers Fairly

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This is one of a series of guidance documents prepared by the Chartered Insurance Institute. The guide has been fully revised and updated to reflect the new regulatory environment and the increased focus on individual accountability. The CII is grateful for Charles Cattell ACII, Chartered Insurance Practitioner, Partner of the Cattellyst Consultancy for updating this paper from its previous incarnation.

Disclaimer

2 Introduction

This paper is one in a series on ethical guidance produced by the Chartered Insurance Institute. With the culture and conduct of financial services organisations continuing to be a key focus of public and regulatory concerns, these papers are intended to provide a helping hand to individuals and firms across insurance and financial services.

Other papers in this series have looked at how to embed a culture of integrity within organisations and how the ethical side to culture supports professionalism, underpins trust and influences how firms handle the challenges of a changing business environment.

This paper considers how financial services regulation impacts on the development of an ethical culture and highlights pointers from within the regulation which can assist in securing ethical culture and behaviour. We have updated this guidance to take account of the changing conduct risk structure – in particular the move towards 'personal responsibility' and individual accountability as an integral part of regulation. In consequence, it seems appropriate to emphasise the significance of personal responsibility in the title. We concentrate primarily on the Senior Insurance Managers Regime (SIMR) rather than the Senior Managers & Certification Regime (SM&CR).

"The financial crisis and the conduct failures which subsequently came to light have had far reaching effects. They highlighted fundamental errors made by both firms and regulators. They identified deficiencies in the regulatory framework and structure. And they called into question some of the most fundamental aspects of fair dealing and integrity for which London's financial markets are known. And the response has been an unprecedented wave of legislative, regulatory and structural change and a deep, and critical, re-examination of the cultures, behaviours and incentives – of regulated and regulator – that created the conditions which allowed this to happen."

FCA: speech by Tracey McDermott
(22 October 2015)

There is increasing focus on culture and conduct within financial services businesses in regard to how both firms and individuals behave. This is partly due to the architecture of the current regulatory regime with the Financial Conduct Authority (FCA) and the Prudential Regulation Authority (PRA) bringing increased attention to their respective spheres of interest. The focus also results from continuing legislative and regulatory developments stemming from the work of the Parliamentary Commission on Banking Standards and the impact of the Solvency II Directive.

One effect of these changes is to bring enhanced requirements for senior managers and other key individuals. Initially these apply to dual-regulated firms (i.e those which are regulated by both the PRA and FCA) with effect from March 2016. These arrangements require both regulators to take a close interest in the way that firms and individuals behave. Whilst in the immediate future the requirements apply to certain firms (such as insurers), but not to others (such as brokers), much of what they contain reinforces what is already seen as good practice and as such are appropriate for wider application across all firms. Although the requirements for insurers are initially somewhat less onerous, HM Treasury intends to extend the full SM&CR for the banking sector to all regulated firms (including insurers, brokers and financial advisers) by 2018. Further details of the regimes are shown in Appendix 2.

"This expansion of the SM&CR to all financial services firms will enhance personal responsibility for senior managers as well as providing a more effective and proportionate means to raise standards of conduct of key staff more broadly, supported by robust enforcement powers for the regulators."

HM Treasury paper on Senior Managers and Certification Regime
(October 2015)

Destinations under SIMR and SM&CR

Senior manager functions	• All Executive Directors, and holders of Key Functions become subject to SIMR/SM&CR senior management provisions
Non-executive directors	• Chairs of board and committees become subject to SIMR/SM&CR senior management provisions • Other NEDs exempted (apart from relevant Conduct Rules)
Other Approved Persons	• SIMR: Current Approved Persons regime continues • SM&CR: Certification replaces Approved Persons regime
Other staff	• SIMR: No change • SM&CR: Conduct Rules apply

SIMR and SM&CR compared

SIMR	SM&CR
Prior approval required	Prior approval required
Scope of Responsibilities, consolidated on Governance Map	Statement of Responsibilities, consolidated on Management Responsibilities Map
Annual review of “fit and proper” status	Annual review of “fit and proper” status
Conduct Rules apply to senior staff	Conduct Rules apply
	Statutory duty to prevent regulatory breaches
	Criminal sanction for reckless misconduct

4 Ethics and regulations

What is meant by ethical culture in a regulatory context?

The demand for insurance and financial services stems from the fundamental need for protection against loss. This protection takes many forms. It includes, amongst other things, protection against accidental loss (general insurance), protection against the risk of being unable to look after one's dependants (life assurance), provision against the uncertainties of later life (retirement planning, pensions and annuities), security of assets and access to capital (banking) and stewardship of savings (asset management).

This range of protection and the certainty it brings enables people to offset risks in their personal and business lives. As a consequence of this security, the industry facilitates commerce, stimulates economic activity and creates wealth for the community at large with all the consequent benefits this brings. These are some of the best possible reasons for the existence of a thriving financial services industry.

However, there is a potential downside. These self-same activities carry with them temptations for inappropriate behaviour, particularly on the part of individuals from within the industry who should have their clients' best interests at heart and in whom customers place their trust. Such inappropriate behaviour may include taking shortcuts which may put the customer at risk, undertaking activities which are particularly beneficial to the "professionals" concerned (such as giving advice which increases the remuneration paid to those individuals), insider dealing and the misuse of client money or fraudulent or other criminal acts.

These risks are exacerbated because the relationship between financial services professionals and their clients is asymmetric, in that those working within the industry have a much greater understanding than their clients of financial issues in general and the products and services being offered in particular. This is especially the case in relation to retail customers.

So to secure order and fair treatment, and to protect against the risks of such abuses taking place, rules and regulations are created – and regulators to oversee their application. Whilst the nature of the regulatory regime is determined by legislation, the detailed design of the regulation is delegated to the regulatory authorities.

The attraction and benefit of regulatory rules is that they offer certainty, by defining (in more or less detail) absolute minimum standards. These then form a minimum level (or threshold) of performance and any regulated firm or individual who fails to meet these standards is deemed to have breached the regulatory requirements. This may in turn lead to regulatory action, ranging from closer supervision, through the requirement for a "Skilled Persons Report" to formal enforcement and sanction in the more extreme cases. By this token, any behaviour which exceeds the threshold standard could be seen to meet the regulatory requirement and therefore deemed to be compliant.

This is fine as far as it goes. However, matters are never quite so straightforward. Although firms need and seek regulatory certainty, this is not always easy to deliver. In many situations some element of judgement has to be applied to determine what is reasonable in the circumstances. This erodes the clarity which might otherwise exist about the regulatory threshold. A similar lack of absolute clarity also applies in those instances where a regulator sets out requirements at a higher level in the form of principles, rather than detailed and prescriptive rules. None the less, even though the perimeter may become blurred in places, the concept remains that a regulatory minimum standard is established below which no firm or professional is permitted to fall.

However, when considered from an ethical perspective the limitations of this approach are clear. The intent behind creating an ethical business culture is to aim to do the right thing all the time, as a matter of course. This approach may well lead to performance which exceeds prescribed regulatory thresholds, because doing the right thing calls for firms and the individuals within them to rise above the achievement of the minimum permitted standard and instead adhere to the full spirit and intent of the regulation.

In the past there have been siren voices which have encouraged the industry to do no more than meet the regulatory threshold standard, on the premise that, if the regulatory requirements are met, then why should you go further? This view became received wisdom during the boom years because the approach proved to be very profitable – at least for some in the short term. However, as we well know from all that has happened since, this model is fatally flawed. The combination of the banking crisis and the various subsequent scandals has seriously undermined confidence and trust in financial services generally. This confidence is now being rebuilt, but this is a slow process and the framework within which it is taking place has to go beyond mere compliance with minimum standards. The core value must be the aim of doing the right thing, not because it is obligatory, but more importantly because it is the right thing to do. Because this also happens to be the best approach for our clients and customers, it is also the way to build successful and sustainable businesses.

> Real markets don't just happen. They depend on the quality of the market infrastructure. That means hard infrastructure, the plumbing of markets that determines the mechanics of markets; and soft infrastructure, like standards and codes that define how market participants should behave.

Bank of England: speech by Mark Carney (11 November 2015)

So far we have focused on problems which can arise from within organisations in the industry. However, we should remember that financial services are built on relationships and it is not only regulated firms and the people employed within them who may behave inappropriately. Not all our clients and customers necessarily act ethically either, especially in times of financial challenge. This exposure to moral hazard can create particular difficulties in maintaining relationships, especially where the need to protect the business from attempts at fraud by the few can result in the implementation of arrangements which may be seen to be obstructive and unhelpful to the many. Although the notion of utmost good faith may be a thing of the past, encouraging ethical behaviour on the part of clients and consumers must also be a long term goal.

Compliance as a by-product of doing the right thing (essential vs desirable)

If we are intending to do the right thing because it is the right thing to do, it is helpful to examine regulatory compliance from this perspective. Rather than focusing on the prescribed requirements, what if the primary objective is taken to be securing an ethical business culture? If that is to be the case, how does this impact on regulatory obligations?

There is an immediate attraction in taking this stance, because in seeking to do the right thing, an ethical culture will almost always secure a high degree of regulatory compliance as an automatic by-product. This is certainly true in the realm of principles and high-level rules; it will also go a long way towards ensuring compliance with more detailed rules and guidance. Remember, however, that regulatory guidance is intended to help with achieving compliance with the rules, rather than indicating best practice.

There is a fundamental advantage in this approach since much regulation has been conceived in an attempt to secure fair treatment for clients and customers. So committing to an ethical culture will bring the firm much closer to meeting the spirit and intent of the regulation. In the past this intent has often been promulgated by the regulator in speeches and other pronouncements. It has also tended to feature as part of the consultation process which prefaces changes to the Handbook, even though these aims have not always found their way explicitly into the final version of the rules.

In the past regulators have frequently exhorted firms to do the right thing and have encouraged firms to behave in an ethical way. Yet this has always tended to lie within the realm of good practice. The regulator could only go so far and if firms or individuals were intent on behaving improperly, the scope for effective regulatory enforcement action was constrained by the explicit standards contained within the Handbook.

The need to restore confidence in the industry and rebuild trust has called for a different approach – a different style of regulation.

> So the first task for the industry in rebuilding the trust of the public is thinking about the outcome we are trying to achieve, not trying to define whether conduct falls strictly within or outside some precise rule.

FCA: speech by Tracey McDermott (2 December 2015)

6 Ethics and regulations continued

Style and focus of conduct regulation – going beyond the tick box

The two regulators (the PRA and the FCA) both have an interest in ensuring that industry behaves ethically and with integrity, although they approach this for different purposes and from different perspectives which reflect their respective remits and objectives.

The FCA has been established with the aim of making markets work well to get consumers a fair deal, whilst the PRA is charged with securing the safety and soundness of the firms it regulates.

To deliver its strategic objective of ensuring that the relevant markets function well, the FCA seeks to:

- secure an appropriate degree of protection for consumers,
- protect and enhance the integrity of the UK financial system, and
- promote effective competition in the interests of consumers.

In endeavouring to deliver these regulatory objectives, the FCA has sought to serve the market better than previous regulators by acting more swiftly and by intervening earlier and more intelligently so as to avoid crises further down the line.

This judgement-based and forward looking approach is also applied by the PRA in its objectives of promoting the safety and soundness of the firms it authorises and (specifically for insurers) to contribute to securing of an appropriate degree of protection for those who are or may become policyholders.

> Most importantly, market participants are being made accountable for their actions. Misconduct will be met with genuine penalties. By holding individuals accountable, authorities are ending the Age of Irresponsibility.

Bank of England: speech by Mark Carney
(11 November 2015)

The FCA talks about a vision of successful, competitive markets in which there is a clear distinction between the best firms, products and services which continue and thrive, whilst the worst performing firms exit the market for good. Consequently, it is challenging firms to go beyond just verifying that products are compliant and tick every legal box. Instead it is seeking assurances that the outcomes are good, that the market is competitive and that the fair treatment of consumers is an inherent element both in the design of financial services products themselves and of the culture of all the firms involved in their creation, distribution and administration.

> It is increasingly evident that culture and conduct are two sides of the same coin. Good conduct relies on cultural change and can't happen without it

FCA: speech by Tracey McDermott
(24 July 2015)

In support of this the FCA has set out its expectations of firms' ethical culture and behaviour, increasingly in terms of conduct risk. The FCA is looking to work with the industry on solutions to rebuild reputation and embed cultural change.

Although the regulators have no prescriptive framework to regulate the ethical culture of a firm, we can expect these issues to be subject to increasing scrutiny and to become fully integrated into the regulators' supervisory approach. To that end, the requirements for senior managers do place specific responsibility for leading the development of the firm's culture on both the Chairman and Chief Executive. More generally, firms which are found to be falling short in terms of culture or conduct can expect to receive increased regulatory attention. The challenge for many firms, particularly small firms, is to understand and anticipate what the regulator expects to see in terms of better culture and how firms can demonstrate in regulatory terms that they are doing the 'right thing' for their customers.

Implications of a risk-based and judgement-led regulatory environment

In seeking to understand the basis of FCA's approach, it is helpful to be aware of the Principles of Good Regulation which FCA is required to consider in carrying out its work.

Principles of good regulation	
Efficiency and economy	The regulator should be efficient and economical in its use of resources.
Proportionality	The burdens or restrictions imposed on a person or activity should be proportionate to the benefits expected as a result.
Sustainable growth	The regulator should secure a desire for sustainable growth in the economy of the UK.
Consumer responsibility	Consumers should take responsibility for their decisions.
Senior management responsibility	Senior management should be held responsible for their firm's activities and for ensuring that its business complies with regulatory requirements.
Recognising the differences in the businesses carried on by different regulated persons	The regulator should act in a way that recognises differences in the nature and objectives of regulated businesses.
Openness and disclosure	The regulator should publish relevant market information about regulated persons to reinforce market discipline and improve consumers' knowledge with regulatory requirements.
Transparency	The regulator should exercise its functions as transparently as possible, providing appropriate information on regulatory decisions and being open and accessible.

These Principles call for the FCA to adopt a risk-based approach to regulation with greatest regulatory attention being paid to areas which are most likely to go wrong, cause most detriment if they do, or cause most damage to those least able to fend for themselves. In particular, these Principles encourage the regulator to focus on breakdowns in fair dealing and to hold senior management to account when this happens.

In response to these Principles, the regulator has established a framework which seeks to address risk in terms of impact and probability, with firms categorised according to the extent to which the firm in question poses risks to regulatory objectives. This categorisation effectively dictates the nature and closeness of the relationship which the firm can expect to experience with the FCA. As a result, smaller firms which present fewer risks are overseen through a process of market based thematic work alongside programmes of communication, engagement and education activity, rather than by dedicated supervisors. In consequence smaller firms are likely to have less direct contact with the regulator. Nonetheless, the combination of the review of firms' business models and the information supplied through routine compliance reporting enables the regulator to take a view about each firm's business practices.

The risk-based approach to regulation reflects the impracticalities of attempting to create detailed rules to cover every situation in which firms may find themselves. Instead, a more general sense of direction needs to be provided to give firms some clarity of regulatory expectation where no detailed rules exist. For businesses regulated by the FCA alone, this is delivered through two mutually supportive sets of requirements which have been created, one for firms and the other for key individuals, or Approved Persons.

FCA Principles for businesses

1. Integrity
2. Skill, care and diligence
3. Management and control
4. Financial prudence
5. Market conduct
6. Customers' interests
7. Communications with clients
8. Conflicts of interest
9. Customers: relationships of trust
10. Clients' assets
11. Relations with regulators

Approved Persons Statements of Principle

1. Act with integrity
2. Act with due skill, care and diligence
3. Observe proper standards of market conduct
4. Deal with the regulators in an open and cooperative way and disclose information appropriately
5. Ensure that the business is organised so that it can be controlled effectively
6. Exercise due skill, care and diligence in managing the business
7. Take reasonable steps to ensure that the business complies with regulatory requirements and standards.

Dual-regulated firms are required to comply also with PRA's Fundamental Rules, which are intended to set the overall context in which the firms operate.

PRA Fundamental Rules

1. A firm must conduct its business with integrity
2. A firm must conduct its business with due skill, care and diligence
3. A firm must act in a prudent manner
4. A firm must at all times maintain adequate financial resources
5. A firm must have effective risk strategies and risk management systems
6. A firm must organise and control its affairs responsibly and effectively
7. A firm must deal with its regulators in an open and cooperative way and must disclose to the PRA appropriately anything relating to the firm of which the PRA would reasonably expect notice
8. A firm must prepare for resolution so, if the need arises, it can be resolved in an orderly manner with a minimum disruption of critical services.

The increasing focus on individual accountability has resulted in the new Senior Insurance Managers Regime (SIMR) being implemented from March 2016 for major insurers subject to Solvency II (with arrangements for large and small non-Solvency II insurers modified proportionately). Those falling within the scope of this regime will be subject to Conduct Rules (set by FCA) and Conduct Standards (set by PRA) instead of the Approved Persons regime.

These Rules and Standards enhance the current Approved Persons Code. There are separate individual requirements and requirements for those in senior positions. Whilst the Rules and Standards overlap, there are certain requirements which reflect the respective concerns of both regulators. Although these requirements are obligatory for anyone falling within their scope, it is recommended that the requirements are also taken into account when assessing the ongoing fit and proper status of anyone effectively running the business or performing a key function.

FCA Rule	PRA Standard	SIMR Conduct Rule/Standard
1	3.1	You must act with integrity
2	3.2	You must act with due skill, care and diligence
3	3.3	You must be open and cooperative with the FCA, the PRA and other regulators
4	-	You must pay due regard to the interests of customers and treat them fairly
5	-	You must observe proper standards of market conduct
SC1	3.4	You must take reasonable steps to ensure that the business of the firm for which you are responsible is controlled effectively
SC2	3.5	You must take reasonable steps to ensure that the business of the firm for which you are responsible complies with the relevant requirements and standards of the regulatory system
SC3	3.6	You must take reasonable steps to ensure that any delegation of your responsibilities is to an appropriate person and that you oversee the discharge of the delegated responsibility effectively
SC4	3.7	You must disclose appropriately any information of which the FCA or PRA would reasonably expect notice
-	3.8	When exercising your responsibilities, you must pay due regard to the interests of current and potential future policyholders in ensuring the provision by the firm of an appropriate degree of protection for their insured benefits.

These high level requirements call for, amongst other things, both firms and individuals to act with integrity, apply skill and care in their conduct and to treat customers fairly. It is challenging to present such concepts in narrow "do's and don'ts" format, which is perhaps why the Approved Persons requirements are currently presented in the form of a Code of Practice and the new Rules and Standards are supported by comprehensive guidance. Such Codes and guidance lend themselves to interpretation from an ethical perspective. Essentially firms are encouraged to adopt an ethical approach and individuals are encouraged to behave in an ethical fashion, without prescribing in detail how such outcomes should be achieved. This style of approach forms a core component of most risk-based regulatory regimes and is essential if cost-effective and proportionate regulation is to be delivered.

Relying too heavily on high level principles alone carries risks for regulators. Indeed, a commitment to "principle-based regulation" led to the light-touch regulatory approach during the height of the boom, which is seen by some commentators as one of the factors which contributed to the poor regulatory response to the financial crisis. Principles can make it challenging to determine the boundary of what is or is not acceptable and consequently to determine precisely what is and is not compliant. This is critical if a minimum level of compliance is being sought; its significance fades if the intent is to behave ethically. So whilst principles with their inherent flexibility can be very helpful to encourage those firms and individuals inclined to do the right thing, that same flexibility makes enforcement more difficult for regulators seeking to take action against the incalcitrant or those determined to behave less honourably.

> "The challenge for policy makers is that rules are generally easier to work around than principles. But the question for boards must be whether the value of a loophole is worth pushing the boundaries of acceptable behaviour."

FCA: speech by Tracey McDermott
(2 December 2015)

One of the advantages of principles is that they allow for a more holistic view of what constitutes good practice to be taken by regulators and the community they regulate. The FCA and PRA seek to take advantage of this by adopting a forward-looking “judgement-based” pre-emptive approach, with a focus on understanding firms’ business models and strategies. This approach may be evident when firms (irrespective of size) seek initial authorisation. It may also lead to greater challenge subsequently about the reasons for business decisions which have been taken, the extent to which the needs of clients and customers have been taken into account and the proposed future direction of the business. No doubt these challenges will be addressed primarily at senior management, both individually and collectively, for this is where ultimate accountability rests. This is of course in accordance with the Principles of Good Regulation, which promote sustainable growth and call for senior management to be held responsible for their firm’s activities and for ensuring that the business complies with regulatory requirements.

As the regulators move forward with the aim to serve the market better by acting more swiftly and by intervening earlier and more intelligently to avoid crises down the line, so we can anticipate that firms will be increasingly challenged to demonstrate that they are behaving ethically and displaying an ethical culture. In parallel, the rule requirements will continue to provide the regulatory underpin for those who are disinclined to meet the expected norms of good practice.

> “But I also see another role for us….. constantly challenging the industry to do better and pushing them to go further and faster in the quest for change. And we should be in no doubt that these methods – the push for higher than required voluntary standards - can be a very effective tool.”

FCA: speech by Tracey McDermott
(22 October 2015)

Demonstrating a commitment to high standards – CII Corporate Chartered status

One way a firm can show intent to regulators that they have committed voluntarily to higher standards is by achieving Corporate Chartered status.

The rationale for Chartered status for firms is the desire to help the insurance and financial advice disciplines to improve standards of knowledge and behaviour and, in turn, levels of professionalism.

This is achieved by firms adopting a framework that encourages and supports them as they strive to raise standards of capability and ethical practice.

Achieving corporate Chartered status demonstrates a commitment to an overall standard of excellence and professionalism, and evidences that commitment to customers, partners and employees.

CORPORATE CII CHARTERED

Key points from this section

1. Seeking to do the right thing and focusing on securing an ethical business culture will almost always secure a high degree of regulatory compliance as an automatic by-product.
2. The ethical culture and behaviour of firms and individuals is increasingly being considered in terms of conduct risk. Regulators are seeking to work with the industry on solutions to rebuild reputation and embed cultural change.
3. The Principles, Fundamental Rules and Conduct Rules are designed to give some clarity of regulatory expectation in the absence of more detailed rules.
4. The increasing focus on individual accountability has resulted in the new Senior Insurance Managers Regime (SIMR) being implemented from March 2016 for insurers.
5. We anticipate that firms and individuals will be increasingly challenged to demonstrate that they are behaving ethically and displaying an ethical culture.

12 Culture, ethics and regulating the firm

Using the Principles and Fundamental Rules to support the development of an ethical culture

Although FCA's Principles for Businesses and PRA's Fundamental Rules were created as part of the foundations of the regulatory regime, these requirements can also be used as a basis to examine the ethical culture of the firm and to consider how the firm manages and mitigates conduct risk. They also provide firms with a framework in which to consider how individuals may be held accountable for their actions. Here are the most relevant Principles and Fundamental Rules:

FCA Principle	PRA Fundamental Rule	
1	1	A firm must conduct its business with integrity
2	2	A firm must conduct its business with due skill, care and diligence
	3	A firm must act in a prudent manner
3		A firm must take reasonable care to organise and control its affairs responsibly and effectively with adequate risk management systems
	5	A firm must have effective risk strategies and risk management systems
	6	A firm must organise and control its affairs responsibly and effectively
6		A firm must pay due regard to the interests of its customers and treat them fairly
7		A firm must pay due regard to the information needs of its clients, and communicate information to them in a way which is clear, fair and not misleading
8		A firm must manage conflicts of interest fairly, both between itself and its customers and between a customer and another client
9		A firm must take reasonable care to ensure the suitability of its advice and discretionary decisions for any customer who is entitled to rely upon its judgement.

Taking these from an ethical perspective, a firm seeking to meet these requirements is likely to ensure that it:

- treats all its customers (and potential customers) fairly
- ensures it understands and responds to the precise needs of its customers
- makes sure that the services it provides for customers are suitable and meet their needs
- keeps customers fully informed about the services being provided
- reviews the performance of its staff to ensure that they are performing routinely to the required standard
- takes criticism and complaints seriously, resolving problems and learning from them to prevent repetition.

If you would like to check how well your firm is doing against the Principles for Businesses and the Fundamental Rules, please Appendix 1 at the end of this paper.

> "Good rules and standards describe the expectations and set the boundaries. But they're not like the rules of a board game: they don't determine the moves made by every player. Alone they cannot create the environment in which good governance, regulatory compliance and fair process magically appear – more is needed."

FCA: speech by Mark Steward (11 November 2015)

Corporate and internal governance

Central to the ethical conduct of firms is their approach to corporate governance. In the UK, the obligations relating to corporate governance are set out in the UK Corporate Governance Code, produced by the Financial Reporting Council, which spreads best boardroom practice across the listed sector. The financial services regulators have always reinforced the application of the Code to authorised firms. The PRA has further fine-tuned its expectations and has highlighted a number of aspects. Amongst others, these include culture, strategy and remuneration, all of which have particular relevance in promoting and securing ethical behaviour by the individuals within firms.

Non-Executive Directors

A core element within Corporate Governance is the role that Non-Executive Directors (NEDs) play in holding the Executive to account through constructive challenge and through helping to develop proposals on strategy. NEDs are expected to scrutinise the performance of management and to satisfy themselves that the systems of risk management are robust and defensible.

The regulators view the NEDs as a key component in a firm's control framework, because of the influence they can bring to bear on the executives and on the quality of board decisions.

Under the new Senior Insurance Management Regime all non-executives who chair either the main board or any of its committees will hold Senior Insurance Management Functions (SIMFs). Other NEDs without these responsibilities will not be subject to the requirements of SIMR, apart from obligations to comply with relevant Conduct Rules and Standards.

Whistleblowing

Aside from a firm's formal reporting and communication channels, it is important that individuals who suspect wrongdoing can report this appropriately (i.e. whistleblow). Both the regulators have their own whistleblowing functions to whom anyone can report their concerns. It is a matter of fact that the most frequently recorded issue reported by whistleblowers to FCA is the negative culture in their firms.[1]

Firms themselves are also expected to have appropriate arrangements in place to enable individuals to whistleblow internally without running the risk of being treated unfairly as a consequence. Under rule changes which come into effect in 2016, Solvency II insurers are obliged to appoint a NED as a "Whistleblowers' Champion" and to implement arrangements which can handle all types of disclosure from all types of person. These include providing relevant training for all staff (including the regulators' whistleblowing services), providing a report to the board on whistleblowing at least annually and notifying the regulators if the firm loses an employment tribunal with a whistleblower.

Although the rules will apply to Solvency II insurers, other firms are expected to use these requirements as a template for good practice.

Ethics, fairness and conduct risk

Although ethics are not regulated as such, regulators are very much concerned with the mitigation of conduct risk. This can be defined as the risk that a firm's actions (or the actions of its staff) ultimately result in poor customer or client outcomes and/or damage to the integrity of the UK financial services industry. The regulators seek to ensure that firms and those who work for them behave appropriately at all times. This expectation applies equally to both wholesale and retail activity. It is cautionary to remember that should a conduct risk crystallise and not be addressed, the situation can escalate quite rapidly to a point at which significant damage can be done to the brand, which may also lead to a wider loss of trust. As past enforcement actions testify, the costs of redress, remediation and the restoration of brand value frequently far outweigh any financial penalty which may be levied.

A core element in securing ethical behaviour and minimising conduct risk is by ensuring the fair treatment of customers. This notion has always lain at the heart of the regulatory framework and is incorporated in Principle 6 of FCA's Principles for Businesses. The focus on fairness is a central theme in the regulation of conduct risk and the FCA has confirmed that the six Consumer Outcomes for Treating Customers Fairly (TCF) remain core to what it expects of firms.

The six TCF outcomes

- **Outcome 1:** Consumers can be confident that they are dealing with firms where the fair treatment of customers is central to the corporate culture.
- **Outcome 2:** Products and services marketed and sold in the retail market are designed to meet the needs of identified consumer groups and are targeted accordingly.
- **Outcome 3:** Consumers are provided with clear information and are kept appropriately informed before, during and after the point of sale.
- **Outcome 4:** Where consumers receive advice, the advice is suitable and takes account of their circumstances.
- **Outcome 5:** Consumers are provided with products that perform as firms have led them to expect, and the associated service is of an acceptable standard and as they have been led to expect.
- **Outcome 6**: Consumers do not face unreasonable post-sale barriers imposed by firms to change product, switch provider, submit a claim or make a complaint.

1 FCA: How we handle disclosures from whistleblowers (February 2015)

Whilst TCF was originally conceived in a retail context, its underlying precepts apply across all markets as ways of mitigating conduct risk. There is recognition that the fair treatment of customers may well be impacted significantly by the activities of firms elsewhere in the market, even if they do not interact directly with retail customers themselves. The risk of unfairness may arise through the complexities of retail distribution arrangements. It may also come about as a result of risks being transmitted from wholesale markets where the use of products developed in that context may end up being used to satisfy the needs of retail consumers. Furthermore, FCA has acknowledged that not only may different kinds of retail consumers have different levels of expertise and sophistication, but also that asymmetries exist in the relationships between firms and their clients within the wholesale markets. FCA supervises conduct in wholesale markets also, taking a particular interest in regard to risks to market integrity or where wholesale market costs or risks may be borne ultimately by retail customers.

> “Good conduct is not about preventing innovation or growth. To the contrary I would argue that it is essential to allow innovation and growth.”

FCA: speech by Tracey McDermott (24 July 2015)

As part of the TCF initiative, a culture framework was created which remains relevant to the supervision of culture and governance. The framework contains six ‘key drivers’, which have been found to have a significant influence on behaviour in firms. The drivers are illustrated in terms of indicators of good and poor practice.

Drivers for a TCF culture

- Leadership
- Strategy and business model
- Decision making and challenge
- Controls
- Recruitment, training and competence
- Recognition, rewards and incentives.

This behaviour-focused framework lends itself to being used as a touchstone to examine how far your firm has secured an ethical culture within the regulatory context. By way of example, here are some key questions for you to consider:

- How do you instil the notion of the fair treatment to your staff and ensure that this is integral to the way your firm carries out its business?
- How do you manage and control your business and measure performance and service standards?
- How can you be sure you provide your customers with clear information and suitable advice in all your dealings with them?
- How do you ensure you deal with complaints fairly and that lessons are learned from any adverse feedback to ensure you avoid similar problems in future?
- How do you ensure your recruitment and reward structures complement and support your firm’s values?
- How do you educate and train your staff to ensure that your customers always receive a fair deal?

If you would like to check how well your firm is doing in securing an ethical culture you may find it useful to explore each of the drivers in more depth. To do this, please refer to Appendix 1 at the end of this paper.

Regulation of business models

The FCA takes a close and continuing interest in firms' business models and strategies, including a consideration of the firms' competitive position. This approach links analysis of the business model with analysis of the firm's culture. A key reason for monitoring a firm's business model is to ensure its sustainability, in order that the firm in question will be able to weather bad times and continue to provide the service which customer has been promised and expects for as long as this is required. The FCA also seeks to satisfy itself that firms are in a position to exit from the market in an orderly way if they wish to do so, without causing detriment to customers or market instability.

The focus on conduct and associated risks also embraces product supervision, so as to secure fair treatment for the consumer at each stage of the product life-cycle. This is to ensure that the outcomes of product design, governance, sales effectiveness and post-sales handling are in line with consumer expectations. Fair treatment also includes the appropriate management and mitigation of any related conflicts of interest.

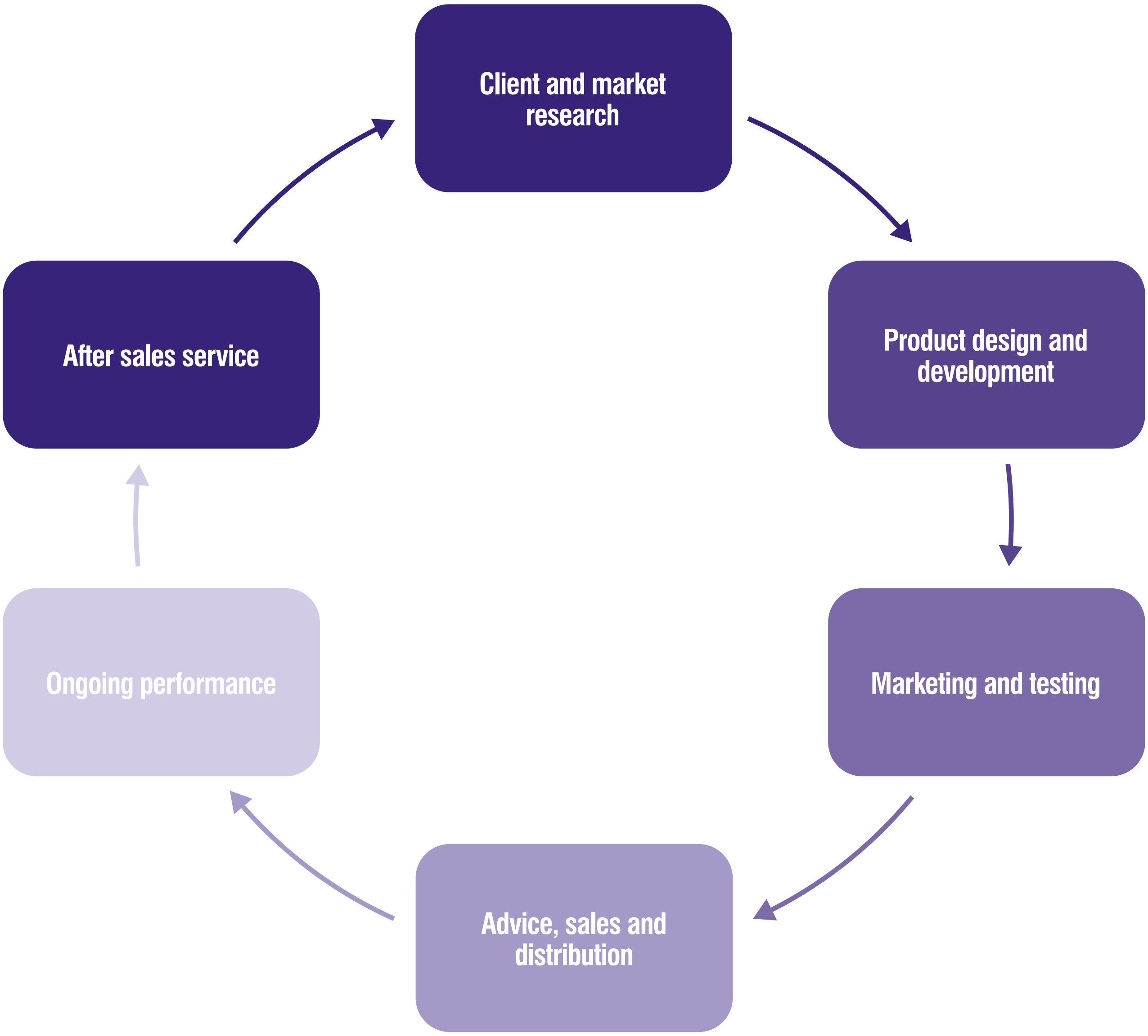
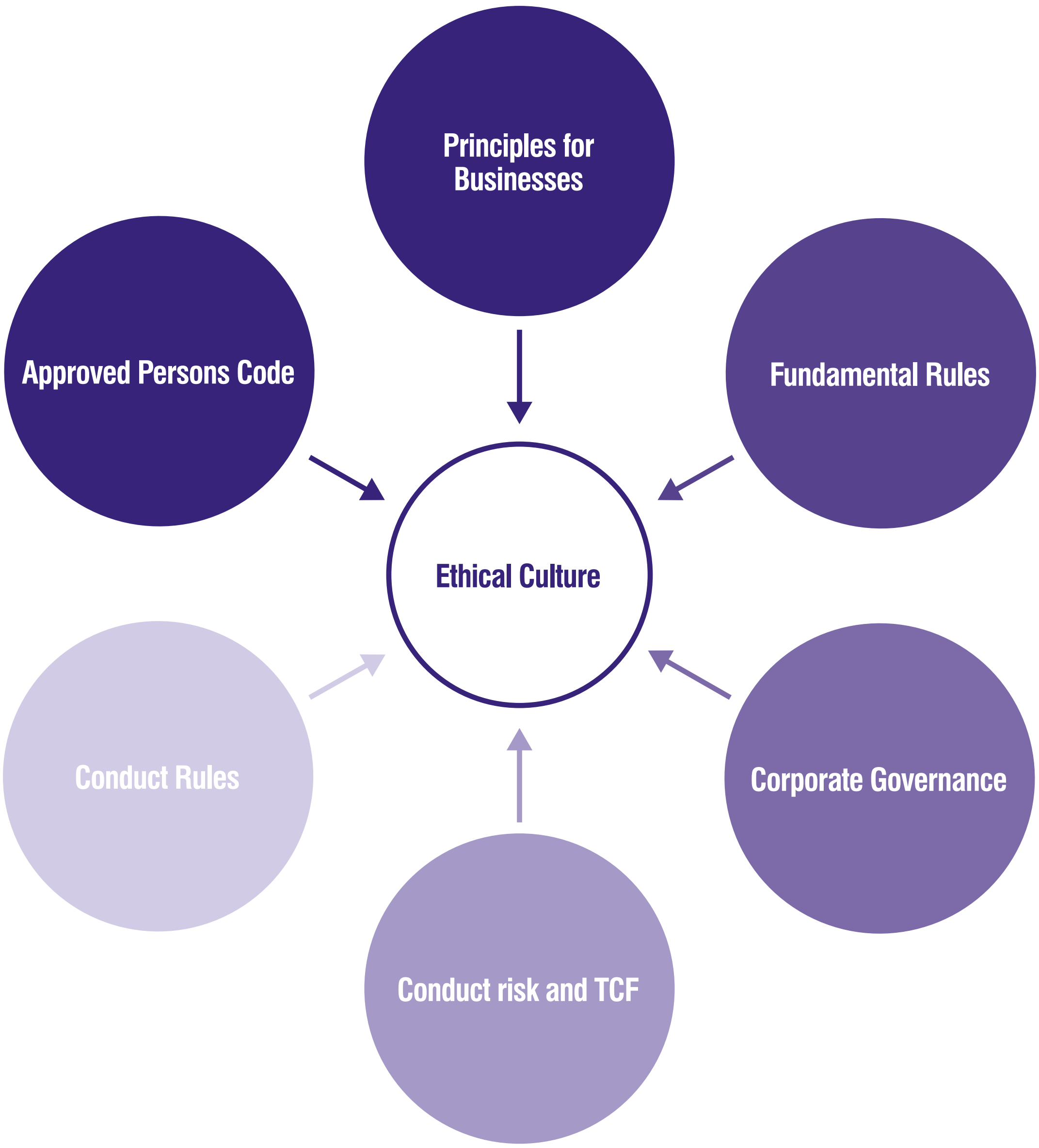


Diagram of the product life-cycle

A related aspect of conduct risk which needs to be taken into account is the effectiveness of the arrangements which are in place to avoid the firm or its other customers being exposed to the actions of higher-risk individuals who may seek to defraud the firm or to launder money.

The Threshold Conditions are used by the regulators to analyse a firm's business model at the time that the firm seeks authorisation to conduct business. At this stage the firm's entire business model (including unregulated business) is assessed to ensure that the overall business is suitable, there are no fundamentally uncompetitive aspects and it will not put consumers at risk. Firms which seek to behave ethically in all that they do are in a strong position to meet these regulatory expectations.

As can be seen from the diagram below, there are a number of arrows within the regulatory quiver all of which aim to encourage the industry to do the right thing. The regulator can select a variety of routes to ensure its views are communicated and understood. The surest way for firms to secure compliance across all the various strands is to focus on operating ethically as a matter of everyday practice. In the same way that you have to focus on certain key issues in managing your business successfully, so focusing on building an ethical culture and approach will simplify many compliance issues.



Regulatory drivers for fostering an ethical corporate culture

Regulation, culture and internal controls

Control arrangements need to be in place in every business to ensure that the firm meets its obligations under the regulatory regime. Compliance, along with Risk and Internal Audit, form the core control functions which need to exist in some form within every firm, though the degree of sophistication of each of these inevitably differs depending on the business model and size of the firm in question. For compliance purposes, the control functions provide the infrastructure for monitoring the performance of the firm and its staff against the various regulatory and other requirements.

However, an effective control infrastructure alone is unlikely to be sufficient to ensure that an ethical culture is secured and ethical behaviour takes place as matter of routine. Ethical considerations need to lie at the heart of the business. The following questions may help you identify how far you are meeting this aspiration:

- How can you demonstrate that your firm's business model is robust, centred on the needs of your clients and that all risks associated with it have been identified?
- How can you demonstrate that the way you have determined the risk appetite and strategy of the firm is most advantageous from the perspective of your customers?
- How can you demonstrate that your firm's management arrangements and controls are appropriate to deliver the business model?
- How can you show that your firm's recruitment, talent management and succession arrangements are designed to secure ethical behaviour and reinforce an ethical culture?
- How can you show that your firm's remuneration and reward arrangements are designed to secure ethical behaviour and reinforce the ethical culture?

> "One way of knowing when culture has failed is when things go wrong and get worse or just go wrong again. This may be worth some thought.
>
> - How quickly does it take for problems to escalate to the right person or group of persons for effective decision making or action?
> - How many problems linger in the inbox or the draft box or the bottom drawer beyond their easily fixable date?
> - How difficult is it to fix things once they are detected?"

FCA: speech by Mark Steward (11 November 2015)

Regulation and enforcement

Despite the best endeavours of all concerned, sometimes mistakes can happen or problems arise and the regulator decides to take disciplinary action. As is well known, firms which have been found to have breached regulatory requirements are likely to find themselves subject to enforcement action, as can individuals in certain circumstances. However hard a firm tries to secure an ethical culture and to encourage appropriate behaviour, it is always possible for something to go wrong. Whilst effective controls will go a long way towards preventing adverse events from crystallising, there is always the possibility that something or someone will escape the net.

Should firms find themselves subject to enforcement, there will be an immediate cost of fines and rectification. There will also be the need to manage the adverse publicity which will accompany any enforcement action and reprimand. This aspect is highly significant as any immediate costs are likely to be far outweighed by the damage the enforcement action and the surrounding publicity will cause to the firm's reputation and brand value. This can manifest itself in a number of ways, including the loss of clients and customers as well as increases in the cost of capital. Whilst the circumstances of each case will dictate the action which is taken, there is anecdotal evidence which indicates that firms which are recognised to have an ethical approach to business find it easier to recover from this type of set-back.

Key points from this section

1. The Principles and Fundamental Rules support the development of an ethical culture.
2. Central to the ethical conduct of firms is their approach to corporate governance. Culture, strategy and remuneration, all of which have particular relevance in promoting and securing ethical behaviour by individuals.
3. NEDs are key to a firm's control framework, because of the influence they can bring to bear on the executives and on the quality of board decisions.
4. It is important that individuals who suspect wrongdoing can report this appropriately (i.e. whistleblow).
5. A core element in securing ethical behaviour and minimising conduct risk is by ensuring the fair treatment of customers. Whilst TCF was originally conceived in a retail context, its underlying precepts apply across all markets as ways of mitigating conduct risk.
6. Regulators take a close and continuing interest in firms' business models and strategies, which includes analysis of the firms' culture.
7. An effective control infrastructure alone is unlikely to be sufficient to ensure that an ethical culture is secured and ethical behaviour takes place as matter of routine. Ethical considerations need to lie at the heart of the business.
8. However hard a firm tries to secure an ethical culture and to encourage appropriate behaviour, it is always possible for something to go wrong. Effective controls will go a long way towards preventing adverse events from crystallising.

The role of individuals in delivering the regulators' objectives and the broader public interest

Whilst the concept of culture applies to organisations, expectations about ethical behaviour are centred on individuals. The regulatory system identifies those individuals whose behaviour warrants the closest scrutiny. This has always been the aim of the framework of Controlled Functions and the provisions of the Approved Persons regime. These regulatory arrangements are now being enhanced by the Senior Insurance Management Regime (SIMR) and, in due course, will be replaced by the Senior Management and Certification Regime (SM&CR).

Under the Approved Persons regime, there are two categories of Approved Person: those in Significant Influence Functions who are involved in the governance and management of the firm at the most senior level and those in the Customer Function who are involved in giving advice or undertaking specific types of activity on behalf of customers. Under the SIMR, those responsible for governance occupy Senior Insurance Management Functions (SIMF). Under the SM&CR, other senior staff and those currently in the Customer Function are included in the group of roles which are subject to Certification.

As noted earlier, all Approved Persons are required to comply with the Statements of Principle, some of which apply to all Approved Persons and others which apply only to those in Significant Influence Functions (SIFs). These Statements of Principle are expanded in a Code of Practice. Although the topics addressed remain largely the same, under SIMR and SM&CR the evidential Approved Persons Code is replaced by Conduct Rules and supporting guidance.

> "….. the Government announced last week that – subject to agreement by Parliament – it plans to extend the Senior Managers regime to other firms across the industry. This is a further step in the right direction. There is no doubt that one regime will be better than many."

PRA: speech by Andrew Bailey
(22 October 2015)

> "Being a senior manager in finance now brings the responsibility and accountability that befits what the best in the industry have long recognised: finance is a true profession."

Bank of England: speech by Mark Carney
(11 November 2015)

The Code of Practice and the Conduct Rules raise ethical dimensions as well as providing important benchmarks against which to assess individual behaviour. However, the Code of Practice guidance to the Conduct Rules concentrates on examples of behaviour which would indicate that the requirements have not been attained.

Expectations of those who give advice

If you give advice or are otherwise approved in a Customer Function, here are some ethical issues raised by the Code of Practice which you might like to consider:

In dealing with clients and customers, **Statement of Principle 2** requires you to act with due skill, care and diligence.

So from an ethical standpoint:

- How can you demonstrate that you know your customers' needs and fully understand their attitude to risk?
- How can you demonstrate that all the recommendations made to your customers are suitable?
- How can you demonstrate that you understand the risk exposures of each transaction?
- How can you demonstrate that you have paid full regard to the interests of your customers and have put their interests first?

Expectations of senior managers

The regulators place responsibility for the conduct of firms firmly on the shoulders of senior managers. This is because the quality of governance and the tone set by the senior team will be reflected throughout the organisation. If an ethical culture is to be created, it is essential to secure an ethical approach and behaviour at the highest level. In consequence, directors and senior managers can expect to be subject to increasing levels of scrutiny, both on appointment and subsequently.

If you are a senior manager in a Significant Influence Function or in a Senior Insurance Management Function (SIMF), the Code of Practice or Conduct Rules raise some ethical issues which you might like to consider in relation to how you manage the business:

Statement of Principle 5/Conduct Rule SC1 requires you to ensure that the business is organised so that it can be controlled effectively and **Statement of Principle 6/ Conduct Rule 2** requires you to exercise due skill, care and diligence in managing the business, whilst **Conduct Rule SC3** requires you to oversee delegated responsibilities effectively.

> The simple principle that you can delegate tasks and work, but you cannot delegate responsibility for the safety and soundness and conduct of your firm must become embedded at all levels….

PRA: speech by Andrew Bailey
(22 October 2015)

So from an ethical standpoint:

- How can you demonstrate that the reporting lines and authorisation levels you implement are fully understood by all concerned?
- How can you demonstrate that you are aware of the skill and competence levels of the staff to whom you delegate?
- How can you demonstrate that decisions you reach about the competence of members of staff are not overshadowed by their individual financial performance?
- How can you demonstrate that you fully understand all the risk exposures inherent in the business?
- How can you demonstrate that you fully understand all the risk exposures before entering into new ventures?
- How can you demonstrate that you are confident about the suitability of individuals before delegating responsibilities to them?
- How can you demonstrate that you are kept fully informed about responsibilities which you have delegated and take all appropriate action in managing those delegated responsibilities?

Beyond the regulatory requirements, you may find it helpful to consider the following points in your drive to secure an ethical culture.

- How can you demonstrate that the aims and objectives of the senior team are centred on delivering ethical business practices?
- How can you demonstrate that ethical behaviour and values lie at the heart of all senior management activity?
- How can you demonstrate that senior management's attitude to risk seeks to minimise exposure for clients?
- How can you demonstrate that senior management address any conflicts of interest which arise in an appropriate manner?
- How can you demonstrate that senior management drive forward ethical values when leading and communicating with staff?

In the context of Individual Accountability, it is increasingly important to be able to evidence compliance, because designated SIMFs/SMFs have prescribed responsibilities (amongst other matters) to develop the firm's culture and to ensure that every person who performs a key function is fit and proper.

> The senior managers and certified persons regime is also not purely, or in my view even primarily, a tool of enforcement. Our job is always to apply forward-looking judgement to prevent problems occurring; and the new regime will ensure that the incentives on senior managers in the roles that they perform align with that approach.

PRA: speech by Andrew Bailey
(22 October 2015)

Expectations of those who manage teams

In securing ethical behaviour from all staff as a matter of routine, there are a number of aspects about the nature of the relationship that individual employees have with the firm and their colleagues which should be considered. These present potential risks to the delivery of ethical behaviour and should be borne in mind by anyone in managerial or supervisory roles who are responsible for others.

Ask yourself:

- What are the values and ethical attitudes of individual team members?
- How do these fit in with the attitudes of peers and colleagues?
- What motivates each individual?
- What recognition, rewards and incentives does each individual receive? How do these underpin ethical behaviour? Are there any perverse elements in these arrangements which could encourage unethical behaviour?
- What risks are there of any individual becoming demotivated?
- How is each individual's performance monitored and managed?
- What learning and development has been provided in the past and what is planned for the future? How does this reinforce ethical behaviour?

The Conduct Rules formalise this managerial good practice by requiring all those who manage and supervise others to act with skill, care and diligence in their management role.

As the managers and their teams are a part of the larger organisation, so firms and those within them are part of a larger universe. Individual members of staff do not operate in a vacuum. They are subject to pressures and expectations from others around them, both internally and those who are external to the organisation. In seeking to secure an ethical culture it is helpful to examine the following environmental issues and consider the potential impacts of them on members of your team:

- Expectations of peers and colleagues
- Expectations of shareholders and other stakeholders
- Parent group policies
- Practices and expectations of business partners
- Market practice and competitor behaviour
- Expectations of clients and customers.

Making new senior appointments

Firms are expected to carry out appropriate due diligence as part of the process of making senior appointments to ensure that candidates meet the "Fit and Proper" requirements.

Here is a checklist of items raised by the "Fit and Proper" requirements which address ethical considerations:

- Are there any issues for concern on the candidate's cv?
- Does the recruitment process include examination of evidence of candidates' ethical values and past behaviour? What information can be obtained from previous employers in the form of regulatory references?
- Is the recruit in good standing as a member of a professional body (such as CII) which requires its members to comply with a code of ethics?
- Have the candidate's skills been analysed and anything which might have a bearing on the individual's behaviour and performance been captured in a learning and development plan?
- Have you considered the impact the candidate is likely to make on the culture of the firm and the behaviour of the existing senior team?
- Are the role's responsibilities and reporting lines clear on the Role Specification and the Organisation Chart?

Under SIMR, this last bullet point regarding the Role Specification and Organisation Chart becomes a regulatory obligation in the form of the Scope of Responsibilities and Governance Map required for SIMF roles. A similar, but more detailed approach is required for the SM&CR.

22 Behaviour, ethics and regulating individuals continued

Governance Maps

For insurers, the Governance Map is a comprehensive single document about the firm, which must be kept up-to-date, and which must contain the following information:

- A list of the firm's key Senior Insurance Management Functions (SIMF);
- The names of persons holding SIMFs who effectively run the firm or who are responsible for other key functions;
- A summary of the significant responsibilities allocated to each SIMF, including any prescribed responsibilities;
- If responsibilities are shared or divided between individual SIMFs, details of how the responsibilities are shared or divided;
- The reporting lines and lines of responsibilities for each SIMF;
- Where the firm is part of a group, how the firm's management and governance arrangements fit with those of the group, and details of the reporting lines and lines of responsibility of SIMFs to persons who are employees, or committees, of other group members.

The Governance Map has to be updated at least quarterly and the regulators notified as and when any significant change is made to it.

Key points from this section

1. Whilst the concept of culture applies to the organisation, expectations about ethical behaviour are centred on individuals.
2. There is particular focus on the behaviour of those in direct contact with customers and those responsible for the conduct of firms.
3. The quality of governance and the tone set by the senior team are key determinants in securing an ethical culture. In consequence, directors and senior managers can expect their approach and behaviour be subject to increasing levels of scrutiny, both on appointment and subsequently.
4. In the context of Individual Accountability, designated SIMFs have responsibilities for the culture of the firm.
5. The potential risks to the delivery of ethical behaviour arising from individuals' relationships with the firm and their colleagues should be borne in mind by anyone in a managerial or supervisory role.
6. It is essential to be able to evidence that every person who performs a key function is fit and proper. The assessment of "Fit and Proper" requirements includes addressing ethical considerations.

What the future holds

At the time of publication (February 2016), the introduction of the SIMR was imminent and the extension of the SM&CR to all authorised firms had only been recently announced. A number of matters of detail in both regimes had only just been confirmed. As the new arrangements bed in during the months ahead, what is seen as good practice will no doubt become clearer, both in terms of the SIMR and also the application of the SM&CR within the banking sector.

The overall need to address the reputational damage caused to the sector by the scandals of the past decade remains clear. Legislators, regulators and the industry itself all have a vested interest in rebuilding trust with clients, customers and the general public, to support the economic well-being of the UK and to demonstrate the broader value of financial services to society.

As one strand in meeting these aims, it is quite clear that the behaviours of firms and the individuals within them are going to be exposed to ever-increasing scrutiny. Regulators can create systems which can seek to hold individuals and organisations responsible for their actions. However, it is much better when the firms themselves take proactive responsibility for identifying and managing conduct risks and securing an ethical culture.

Individuals can make their own personal contribution to this by setting out to do the right thing as a matter of course. Those who are members of a professional body and consequently commit to adhering to codes of conduct and aspiring to the expectations of their various professions have a further part to play as role models in this new environment, as do the professional bodies themselves in helping to encourage and guide their members.

> “Before you can explain the value and utility of what you do to others, you must be able to explain the same thing to your own staff and colleagues.”

FCA: speech by Tracey McDermott (22 October 2015)

24 Appendix 1 – Checklists

The checklists in this appendix are intended to help readers to conduct some self-analysis and challenge their own performance and that of their firms. The answers can be used to identify gaps and create an action plan to help to secure a robust culture and to mitigate conduct risk.

Principles for businesses and fundamental rules

To check how well you are doing against the FCA's Principles for Businesses and PRA's Fundamental Rules, here are some questions to ask yourself about your firm:

FCA Principle	PRA Fundamental Rule	
1	1	*A firm must conduct its business with integrity.* In seeking to secure an ethical culture: • How can your firm demonstrate that it always seeks to put the principles of ethical and fair dealing into practice? • How can your firm show that it does the right thing for its clients and customers as a matter of course?
2	2	*A firm must conduct its business with due skill, care and diligence.*
	3	*A firm must act in a prudent manner.* In seeking to secure an ethical culture: • How can your firm demonstrate that it always takes proper care when acting for its clients? • How does your firm ensure your clients are not disadvantaged if something does go wrong?
3		*A firm must take reasonable care to organise and control its affairs responsibly and effectively with adequate risk management systems.*
	5	A *firm* must have effective risk strategies and risk management systems.
	6	A *firm* must organise and control its affairs responsibly and effectively. In seeking to secure an ethical culture: • How can you show that your firm's managerial arrangements deliver your intended business model and meet your ethical ambitions? • How can you show that your risk management arrangements are sufficiently robust to protect the interests of your clients? • How can you show that your firm's managerial arrangements have taken account of the ethical risks faced by your firm?

FCA Principle	PRA Fundamental Rule	
6		*A firm must pay due regard to the interests of its customers and treat them fairly.* In seeking to secure an ethical culture: • How can you show that you always put the interests of your customers first? • How can you show that the fair treatment of customers lies at the heart of your firm's business model and is the basis for the way you go about conducting business as usual?
7		*A firm must pay due regard to the information needs of its clients, and communicate information to them in a way which is clear, fair and not misleading.* In seeking to secure an ethical culture: • How can you show that you fully understand the information needs of all your clients? • How can you verify that your clients understand the various communications they receive from you?
8		*A firm must manage conflicts of interest fairly, both between itself and its customers and between a customer and another client* In seeking to secure an ethical culture: • How can your firm demonstrate that it always seeks to identify and manage fairly potential conflicts of interest? • How can your firm demonstrate that it manages and resolves fairly any conflicts of interest which do arise?
9		*A firm must take reasonable care to ensure the suitability of its advice and discretionary decisions for any customer who is entitled to rely upon its judgement.* In seeking to secure an ethical culture: • How can your firm demonstrate the suitability of the advice it offers and the services it provides to all its clients? • How can your firm show that it fully understands the needs of its individual customers?

Drivers of Ethical Culture

To secure an ethical culture you may find it useful to consider the following issues raised by the drivers in the TCF culture framework:

Leadership

- What steps have you taken to ensure that the fair and ethical treatment of customers is central to the behaviour and values of everyone in your firm?
- How do ensure that all messages about the fair and ethical treatment of customers are communicated and understood by everyone in the firm?
- How do you demonstrate your personal commitment to the fair and ethical treatment of customers in your own actions and behaviour?

Strategy and business model

- Does your firm have a clear vision which places the fair and ethical treatment of customers at the heart of its business model?
- How can this be evidenced in the way strategic decisions are reached and implemented?
- How is the fair and ethical treatment of customers reflected in your firm's risk appetite?
- How is the fair and ethical treatment of customers reflected in your firm's outsourcing agreements (where these exist)?
- Does your firm revisit and reaffirm its vision?

Decision making and challenge

- How does decision making at all levels in your firm reflect the fair and ethical treatment of customers?
- In reaching decisions, how does your firm encourage constructive discussion and debate to ensure that customers achieve a fair deal?
- How does your firm use feedback from staff, customers and other sources to secure the fair and ethical treatment of customers?
- How can your firm show that the interests of customers are properly balanced against those of its other stakeholders?

Controls

- What controls exist to ensure that the fair and ethical treatment of customers is delivered?
- How can your firm demonstrate that its controls are integral to the way it manages risk?
- How is management information monitored and used to enhance the fair and ethical treatment of customers?

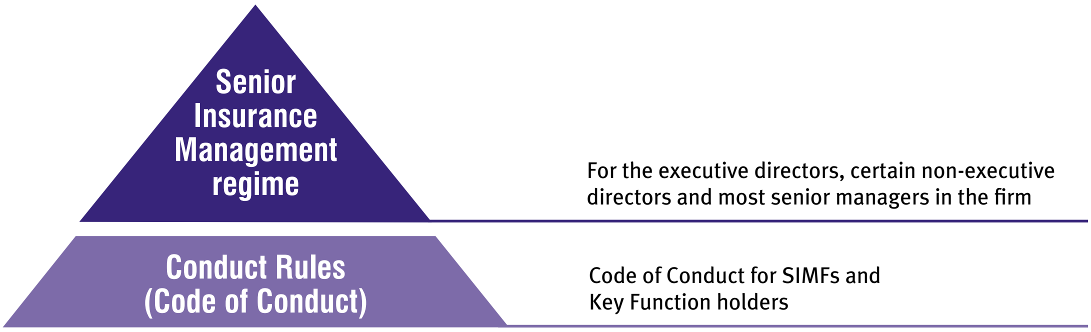
Recruitment, training and competence

- How are your firm's expectations about positive behaviours and attitudes towards the fair and ethical treatment of customers established and used in the selection of staff?
- How are the fair and ethical treatment of customers and the values of your firm integrated into the training and continuing development of all staff?
- How are the fair and ethical treatment of customers and the values of your firm reinforced by your performance management arrangements?
- How can your firm evidence that it recognises and supports desired behaviours, whilst identifying and addressing poor performance when this occurs?

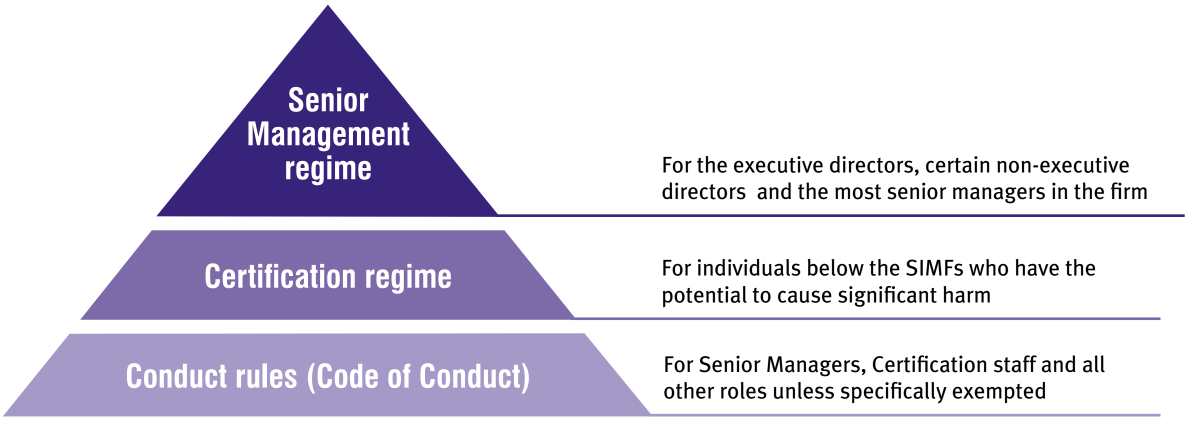
Recognition, rewards and incentives

- How can your firm show that all its reward structures and incentive schemes are transparent, recognise quality and support the fair treatment of customers?
- How can your firm demonstrate that its informal recognition of success reflects the fair and ethical treatment of customers?

Appendix 2 – Summary of the individual accountability regimes



Outline of the Senior Insurance Management Regime (SIMR) (from March 2016)



Outline of the Senior Management and Certification Regime (SM&CR) (from March 2016)

When and to whom the regimes apply

Type of Firm	Commencement Date	
	2016	2018
Insurerers (Solvency II firms)	SIMR applies with effect from 07 March	SIMR upgraded to SM&CR
Brokers and advisers	Approved Persons regime continues	SM&CR applies
Banks etc (Relevant Authorised Persons)	SM&CR applies with effect from 07 March	SM&CR continues
Other FCA regulated firms	Approved Persons regime continues	SM&CR applies

Notes

- The full SIMR regime applies to Solvency II insurers. Arrangements for large and small non-Solvency II insurers are modified proportionately.
- 2018 position subject to consultation.

Appendix 2 – Summary of the individual accountability regimes continued

Key features of the Senior Insurance Management Regime (SIMR)
1. The Senior Insurance Management Regime covers those in Senior Insurance Management Functions (SIMFs). These include Executive Directors, certain Non-Executive Directors and other holders of Key Functions
2. Provisions in the Senior Insurance Management Regime include: • The allocation of particular responsibilities to individual senior managers, shown in the firm's Governance Map and in individuals' Scope of Responsibilities documents • Vetting of fitness and propriety by the firm required prior to appointment • Approval from the relevant regulator prior to appointment • Approval may be subject to conditions or time limits • Annual review of continuing fitness and propriety (including competence for the role)
3. The Conduct Rules: • Apply to all individuals in Senior Insurance Management Functions and to all other staff who are Approved Persons • Relevant Conduct Rules apply to Non-Executive Directors who do not hold Senior Insurance Management Functions • Everyone covered is required to have generic awareness of the rules and specific understanding about the application of the rules in the context of their job roles • Breaches have to be reported to the regulators

Please note: This table represents a high level summary. Should you require further details visit the FCA and PRA websites (see below).

Useful links relating to the regulatory changes can be found here:

HM Treasury:

https://www.gov.uk/government/publications/senior-managers-and-certification-regime-extension-to-all-fsma-authorised-persons

FCA:

https://www.the-fca.org.uk/improving-individual-accountability

PRA:

http://www.bankofengland.co.uk/pra/Pages/supervision/strengtheningacc/default.aspx

The Senior Management and Certification Regime enhances the Senior Insurance Management Regime as follows:

1. Senior managers

    - The Governance Map and Scope of Responsibilities are replaced by a more detailed Management Responsibilities Map and more detailed Statements of Responsibility
    - Senior Managers are subject to a statutory duty of responsibility to prevent regulatory breaches
    - Reckless misconduct leading to the insolvency of a bank may result in criminal prosecution

2. The current arrangements for Approved Persons are replaced by the Certification regime

    - Everyone who is not in a Senior Management Function and who is a material risk taker or has the potential to pose significant harm is covered by Certification
    - Certification includes a wider group of individuals than the current Approved Persons regime, including all staff who manage Certification staff (unless they are in a Senior Management Function)
    - Provisions in the Certification Regime include:

        i. Vetting of fitness and propriety by the firm prior to appointment, but with no prior approval from the regulator

        ii. An annual review of continuing fitness and propriety (including competence for the role)

        iii. Continuing fitness and propriety confirmed through personal certificates issued by the firm

3. The Conduct Rules

    - Apply to all Certification staff in addition to those in Senior Management Functions
    - Certain Conduct Rules continue to apply to Non-Executive Directors who do not hold Senior Management Functions
    - Application of the Conduct Rules is also extended to all other staff engaged in regulated activity

CII links

SIMR, conduct rules, approved persons: a CII briefing **www.cii.co.uk/37798**

The information in this guide is accurate as of February 2016. The online version of this guide will be updated regularly. Follow the link to find out more: **www.cii.co.uk/39598**

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