



Regulatory Alert

Financial Services Regulatory Insight Center



May 2018

Financial Stability Board releases toolkit for mitigating misconduct risk

Key points

- The FSB outlines 19 tools, including a variety of formal and informal mechanisms and processes, that firms and supervisors can use to strengthen governance frameworks for misconduct.
- The tools are not guidance or recommendations of the FSB; firms and authorities may choose from among the tools based on their legislative, judicial, and regulatory frameworks.
- The tools are part of the FSB's workplan on measures to reduce misconduct risk, which also includes codes of behavior, market conduct, and guidance on compensation practices.

Summary

Financial services misconduct can impact not only consumers and markets, but the financial system as a whole. In response, the Financial Stability Board (FSB) announced in 2015 the launch of a workplan to reduce misconduct risk. Recently, the FSB published a "toolkit" for firms and supervisors offering a set of options for [*Strengthening Governance Frameworks to Mitigate Misconduct Risk*](#), completing one of the four "building blocks" of its misconduct workplan. The toolkit outlines nineteen (19) tools organized around three overarching issues: mitigating cultural drivers of misconduct, strengthening individual responsibility and accountability, and dealing with "rolling bad apples."

Mitigating cultural drivers of misconduct: The FSB highlights the role of culture in reducing incidents of misconduct and emphasizes that governance frameworks and culture mutually influence one another. Elements of culture that can influence governance frameworks include leadership, the decision-making process, and values and behavioral norms. The FSB identifies seven tools to mitigate potential drivers of misconduct.

For firms, the FSB emphasizes the role of senior leadership in transforming culture. This includes:

- Articulating the desired cultural aspects that mitigate misconduct risk (Tool 1)
- Identifying the cultural drivers of misconduct through review of a broad set of information with multidisciplinary analysis (Tool 2)
- Shifting behavioral norms to mitigate these cultural drivers. (Tool 3)

To assess culture, national authorities might consider:

- Building a supervisory program focused on culture (Tool 4)
- Using a risk-based approach to prioritize reviews of firms or groups of firms that display significant cultural drivers of misconduct (Tool 5)
- Using a range of quantitative and qualitative information and techniques to assess cultural drivers (Tool 6)
- Engaging in dialogue with leadership on related supervisory observations. (Tool 7)

Strengthening individual responsibility and accountability: Holding individuals accountable for their behavior has become increasingly important in response to rising fines and settlements. The FSB notes that emphasizing individual accountability can support



cultural change and encourages regulators to review the effectiveness of such firm-led approaches.

Tools related to individual responsibility and accountability for both firms and national authorities include:

- Identifying and assigning key responsibilities to specific individuals (Tool 8)
- Holding individuals accountable through internal processes and supervisory actions (Tool 9)
- Assessing the suitability, including integrity and professional competency, of individuals assigned to key responsibilities. (Tool 10)

National authorities may also consider:

- Developing and monitoring a firm's implementation of its responsibility and accountability framework (Tool 11)
- Coordinating with other authorities to understand their supervisory approaches to accountability. (Tool 12)

Addressing the "rolling bad apples" phenomenon: A "rolling bad apple" is an individual who changes firms, or changes roles within a firm, without disclosing previous misconduct or conduct that contravenes a firm's policies, norms, or values. The ability to change firms without a record of misconduct can reduce deterrence.

To address the "rolling bad apple" phenomenon, firms might consider:

- Communicating conduct expectations early and consistently in the recruitment and hiring processes (Tool 13)
- Enhancing interview techniques to consider a candidate's behavioral competency, conduct history, and potential adherence to firm values (Tool 14)
- Leveraging multiple sources of available information before hiring (Tool 15)
- Reassessing employee conduct regularly (Tool 16)
- Conducting "exit reviews" and maintaining appropriate records on former employees. (Tool 17)

National authorities might consider:

- Supervising firms' screening practices for prospective employees and monitoring practices for current employees (Tool 18)
- Promoting compliance with legal or regulatory requirements regarding conduct-related information about applicable employees. (Tool 19)

Closing Thoughts

The FSB stresses that the outlined tools do not constitute guidance and are not recommendations. Rather, the tools are based on the shared experiences and diversity of perspectives of FSB members. The FSB encourages firms and national authorities to choose those options that work within their jurisdictions, considering their legislative, judicial, and regulatory frameworks. Nonetheless, the FSB adds that the overarching issues mitigating cultural drivers of misconduct, strengthening individual responsibility and accountability, and dealing with "rolling bad apples," are interlinked and build upon each other to outline the critical elements needed to strengthen governance frameworks and mitigate misconduct.

The building blocks of the FSB's workplan to reduce misconduct risk consist of i) standards and codes of behavior, such as the FX Global code and reforms to benchmark-setting practices; ii) a toolkit of measure related to wholesale market conduct, based on national approaches; iii) guidance on compensation practices in addressing misconduct; and iv) a toolkit to strengthen governance frameworks by improving corporate culture, clarifying individual responsibility and accountability and preventing the movement of "bad apples" within or between firms. Publication of the toolkit completes the fourth building block.

For additional information on the FSB's toolkit, please contact [Deborah Bailey](#), [Homer Hill](#), or [Amy Matsuo](#).

Amy Matsuo

Principal and National Lead

Regulatory Insights

T: 919-664-7302

E: amatsuo@kpmg.com

Contributing authors:

Amy Matsuo, Principal and National Lead,
Regulatory Insights

Karen Staines, Director, Financial Services
Regulatory Insight Center

Phil MacFarlane, Associate Director, Financial
Services Regulatory Insight Center

kpmg.com/socialmedia



All information provided here is of a general nature and is not intended to address the circumstances of any particular individual or entity. Although we endeavor to provide accurate and timely information, there can be no guarantee that such information is accurate as of the date it is received or that it will continue to be accurate in the future. No one should act upon such information without appropriate professional advice after a thorough examination of the facts of the particular situation.

The KPMG name and logo are registered trademarks or trademarks of KPMG International.

© 2018 KPMG LLP, a Delaware limited liability partnership and the U.S. member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. All rights reserved. Printed in the U.S.A. NDPPS 592774