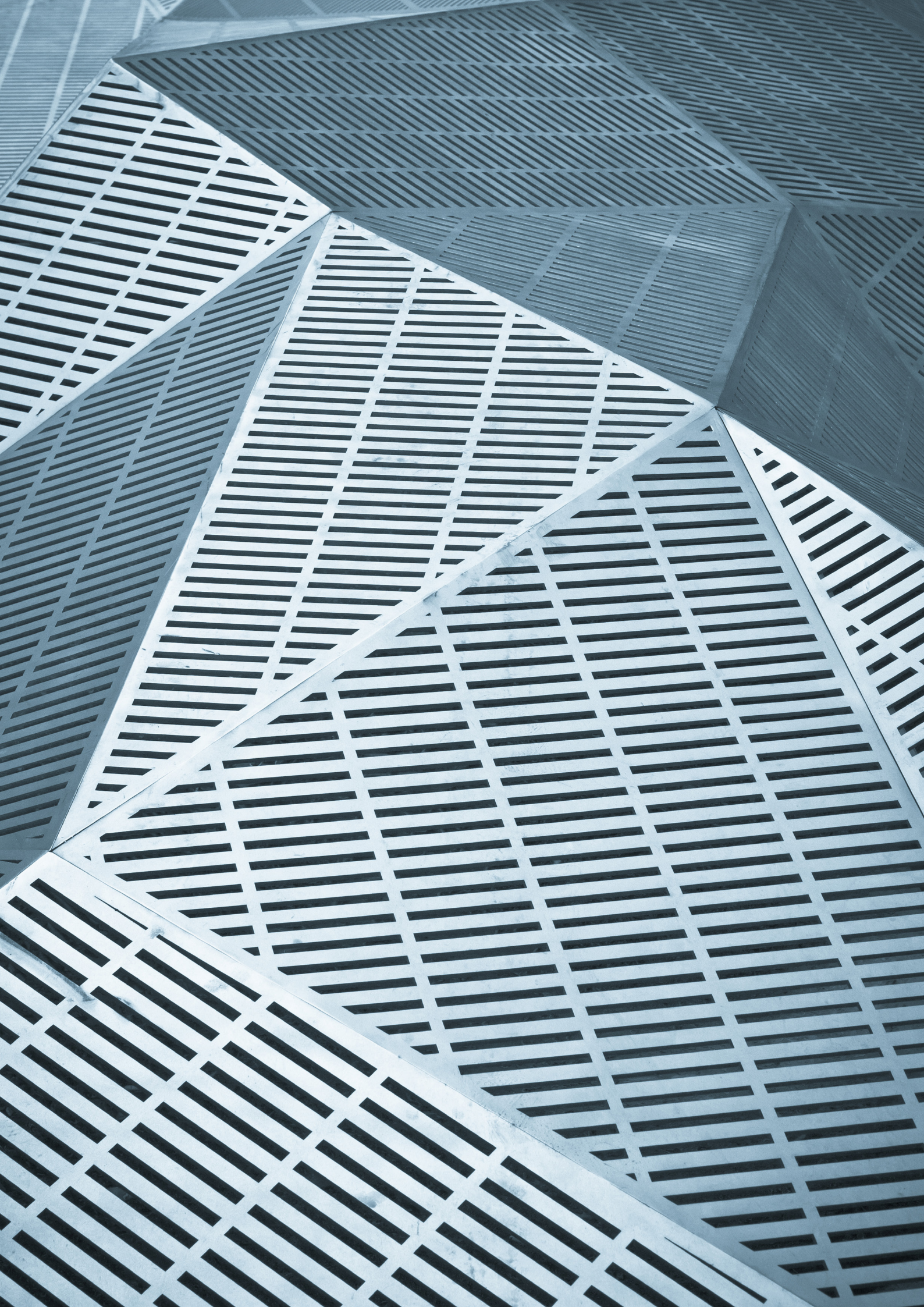


C L I F F O R D
C H A N C E

>THOUGHT
LEADERSHIP>

**CULTURE AND ETHICS IN
FINANCIAL INSTITUTIONS:
WHAT ARE THE EXPECTATIONS?**





➤ CULTURE AND ETHICS IN FINANCIAL INSTITUTIONS: WHAT ARE THE EXPECTATIONS?

In the wake of the financial crisis, culture and ethics have emerged as key themes for regulators, enforcement authorities and courts as they seek to promote systemic change. As the Clifford Chance Global investigations team celebrates its 10th anniversary, we see senior individuals being increasingly held to account and the calls for criminalisation of both institutions and individuals spreading around the globe. Here, Clifford Chance experts consider the current environment and how businesses and management should react.

Another regulatory enforcement action or speech from a regulator, another reference to the words “culture” and “ethics”. That these words have now become firmly entrenched in the global regulatory lexicon is a visible sign of how the world has moved on post-crisis. Politicians and policymakers appear to have taken away two key messages from the global financial crash, namely that markets cannot be trusted to regulate themselves, and that without significant cultural change, financial institutions cannot be trusted by the regulators charged with their oversight.

Carlos Conceicao, a contentious regulatory partner at Clifford Chance and former head of the Financial Services Authority’s Enforcement Wholesale Group, says: “There has been a breakdown in trust that permeates throughout the financial services industry. There is a lack of trust between the regulator and regulated, public and the regulator, between the public and regulated firms, and finally, between politicians and both regulators and the regulated. None of this is conducive to healthy regulation.”

The consequences of this are manifold, most notably the wholesale structural regulatory reform that is underway worldwide, increasingly intrusive

supervision, more aggressive enforcement, and demands for personal accountability. There was limited personal accountability for the sins linked to the financial crisis, but there is a strong regulatory desire for that to change. The theme of personal accountability for senior management is seen as being closely linked to the systemic question of culture and ethics, as those individuals are tasked with setting the “tone from the top” as setters of the corporate culture.

Matthew Newick, head of litigation and dispute resolution for Asia Pacific with Clifford Chance in Hong Kong, says, “for me, culture is largely about encouraging behaviour and decisions that focus on the long term health of the business, not just short term performance. That means far-sighted incentive structures, tough decisions on ethically challenged rainmakers, tangible recognition of staff that do the right thing, looking after your customers, and having the courage to say no to profitable business.”



“ There has been a breakdown in trust that permeates throughout the financial services industry.”

Carlos Conceicao, Clifford Chance, London

The global perspective:

United States

Much of this structural reform has been driven by the United States and Europe, more than Asia Pacific, but it is a global phenomenon. In the United States, the key enforcement agencies of the Securities and Exchange Commission (SEC), the Department of Justice and the Treasury Department's Financial Crimes Enforcement Network have all recently set out guidelines for banks on how they should establish a culture of compliance.

Chris Morvillo, a white-collar crime partner in Clifford Chance New York, says: "In the past year this has really become a hot topic in the US, from the very top of law enforcement. Regulators are becoming increasingly focused on the question of corporate culture and are looking for organisations to demonstrate that they are taking culture and ethics seriously."

In October 2014, Leslie Caldwell, Assistant Attorney General for the Criminal Division of the DOJ, set out 10 hallmarks of a good compliance programme.

What should companies do to create and maintain an effective culture of compliance?

Uphold a tone from the top	Set up clearly articulated compliance policies
Engage in periodic risk-based assessment	Maintain independent oversight of programme
Devote resources to training and guidance	Establish effective internal reporting
Institute swift investigation measures	Practice even-handed enforcement and discipline
Expect third-party partners to be compliant	Continue monitoring and testing

Likewise Andrew Ceresney, SEC Director of the Division of Enforcement, highlighted four questions that institutions should be asking

themselves to assess their commitment to compliance and correspondingly reduce their exposure to an SEC enforcement action.

Four questions banks should be asking, and answering yes

- Are legal and compliance personnel included in critical meetings?
- Are their views typically sought and followed?
- Do legal and compliance officers report to the CEO and have significant visibility with the board?
- Are the legal and compliance departments viewed as an important partner in the business, and not simply as support functions or a cost centre?



“ In the past six months this has really become a hot topic in the US, from the very top of law enforcement. Regulators are becoming increasingly focused on the question of corporate culture and are looking for organisations to demonstrate that they are taking culture and ethics seriously.”

Chris Morvillo, Clifford Chance, New York



The United Kingdom

Meanwhile in the UK we have seen the creation of a new regulatory regime for senior bankers as recommended by the Parliamentary Commission on Banking Standards. The new Senior Managers Regime makes it easier for regulators to apportion blame to senior individuals by more clearly assigning roles and responsibilities, and thus making it easier to take disciplinary action against them. This in turn has implications for bank governance structures.

And, just as in the US, there is a culture of change across the UK criminal authorities too. The Serious Fraud Office, under director David Green QC, has increasingly made ethical business conduct an area of focus. Judith Seddon, a partner specialising in white-collar crime and regulatory enforcement at Clifford Chance in London, says: “The message coming out of the SFO is that there is a moral imperative for companies to change their culture, to do the right thing, and to demonstrate that they are serious about behaving ethically.”

The UK Bribery Act, which came into force in 2011, was a critical step in a shift towards a new culture of high ethical standards in conducting business, in the UK and overseas, and brought with it concepts such as ‘tone from the top’, the importance of policies and procedures and proper training to establish and foster a culture across an organisation where bribery is never acceptable. Since then the drive to bring corporations and senior management within the reach of criminal prosecutors has increased.

This drive has comprised both carrot and stick initiatives.



The message coming out of the SFO is that there is a moral imperative for companies to change their culture, to do the right thing, and to demonstrate that they are serious about behaving ethically.”

Judith Seddon, Clifford Chance, London

As for the carrot, in February of last year Deferred Prosecution Agreements (DPAs) were introduced to allow prosecutors to delay criminal charges against organisations in return for compliance with a range of conditions, such as the payment of a fine or an agreement to comply with monitoring for a set period of time. DPAs introduce a new incentive for corporates to ensure a good compliance culture, because that is a factor taken into account when a prosecutor decides whether to prosecute or to offer a DPA at the outset.

Then, the stick: in October 2014 new sentencing guidelines were put in place to deal with corporate offenders in cases of fraud, bribery and money laundering. These allow for the application of a multiplier of up to 400% to the financial “harm” caused by the offending; the greater the culpability, the higher the multiplier. Evidence of “a culture of wilful disregard” for the commission of offences, and no effort to put effective systems in place, are factors that indicate high culpability.

Ms Seddon says: “The SFO does not just have corporates in its sights. It is also very keen to secure heads on poles. As such there is a focus by prosecutors on senior management and not just middle-ranking officials.”

Asia Pacific

Around the rest of the world, culture and ethics are also moving up the agenda. In Hong Kong the Securities & Futures Commission (SFC) has begun to concentrate on culture, reflecting UK and US approaches but also developing its own. The Hong Kong Monetary Authority, the Australian Securities and Investment Commission and the Singapore Monetary Authority have all, as of the second half of 2014, begun dedicating column-inches to the issue of culture. Despite coming to the subject later than the UK and US, culture has moved swiftly up the agenda.

In July last year James Shipton, the SFC's Executive Director of Intermediaries, gave a speech promising to put 'ethics', 'integrity' and 'professionalism' back in the spotlight in the Hong Kong market, saying the SFC would increasingly look beyond systems and procedures in search of a supporting culture, along with business models that put those control priorities at the heart of a business strategy.

Like the FCA and Federal Reserve, he said the tone from the top would become a key element for regulators looking to see the human element of supervision taken seriously, while also pointing to the tone from the middle, and the key part to be played by frontline management.

Matthew Newick observes that "enforcement action in Asia Pacific now often talks about misconduct in terms of culture, with regulators talking about seeking evidence of a compliance culture. But this is not yet

pan-Asian – it is a big topic now in Hong Kong, Singapore and Australia, but the enforcement discussion does not focus so much on culture in Japan, Korea, Malaysia and other Southeast Asian jurisdictions."

The rest of Europe

Across Europe the systems and controls that a corporate has in place, and the adequacy of its compliance culture, are relevant to decisions as to whether or not to prosecute, and may act as an aggravating or mitigating factor in any prosecution. In some European jurisdictions a corporate can avoid criminal liability altogether by proving the offence was not the result of defective systems and controls.

Mr Conceicao says: "When you survey the landscape of European regulators, we are seeing some regulators leading and others following. Some wouldn't necessarily use the phrase "cultural change", but we can see from what they are doing that that is what they are trying to effect."

For the most part the terms culture and ethics are not concepts used by the German regulators, but where compliance incidents take place involving board members of firms, regulators are taking a tough approach.



“ Enforcement action in Asia Pacific now often talks about misconduct in terms of culture.”

Matthew Newick, Clifford Chance, Hong Kong



The criminal and civil courts in Germany are looking even more closely at top management and at how the legal and compliance infrastructure affects behaviour.”

Heiner Hugger, Clifford Chance, Frankfurt

Heiner Hugger is a Clifford Chance partner in Frankfurt advising on investigations. He says: “The criminal and civil courts in Germany are looking even more closely at top management and at how the legal and compliance infrastructure affects behaviour. We have enforcement cases where top managers and in-house lawyers have come under fire for how they handled compliance cases and related civil and criminal litigation.”

There are also calls for the strengthening of the concept of voluntary disclosure in Germany – a practice much more common in the US and UK – with many compliance officers arguing the compliance levels in banks and major corporates can only be strengthened with the encouragement of self-reporting, internal investigations and disclosure.

In France, the discussion around culture and ethics has been somewhat limited, with regulators and prosecutors still more inclined on using the stick rather than the carrot to influence behaviour in institutions. There is a history of mistrust between the enforcement authorities (whether the regulator or the prosecutor) and the regulated, which pre-dates the financial crisis, and a competition between the Financial Markets Authority (AMF) and the French financial prosecution authority (Parquet national

financier) when investigations and enforcement proceedings do take place, which often results in costly parallel processes.

Again, there is no real incentive for institutions to self-report instances of wrongdoing when they don't have to, and Clifford Chance partner Thomas Baudesson in Paris says: “With very few exceptions, self-reporting is something that does not really exist in France, and whistle-blowing is not culturally welcome although recent laws are now protecting whistle-blowers. In France, financial institutions and corporates have put in place compliance programmes but we haven't really got to the stage where the regulators and prosecutors value the fact that a culture of ethics and compliance is critical.”

In Italy, a law creating liability for corporate entities for crimes committed by their employees was first introduced in 2001, leading to an



In France, financial institutions and corporates have put in place compliance programmes but we haven't really got to the stage where the regulators and prosecutors value the fact that a culture of ethics and compliance is critical.”

Thomas Baudesson, Clifford Chance, Paris



“ Case law is going towards a more substantive approach, focused on the culture of a company.”

Antonio Golino, Clifford Chance, Milan

explosion of systems and controls that were not always backed up by substance. A more substantive approach is now following: “The courts have looked at compliance from a systems and controls perspective,” says Antonio Golino, a partner in Clifford Chance’s regulatory enforcement team in Milan. “The reality was nobody looked sufficiently at the substance of those in the past, but now case law is going towards a more substantive approach, focused on the culture of a company,” he says.

The impact on individuals

When it comes to the way in which individuals are treated by their employers when instances of wrongdoing arise, there is an uneven playing field globally, with US employers entitled to fire at will and Europeans much more beholden to due process, a right of appeal, notice periods and so on.

Alistair Woodland, a Clifford Chance employment partner, says: “There are also widely disparate bases on which you can take action against employees. In France, for example, it is very difficult to take action if you have known about the misconduct in question for a number of months previously.”

Remuneration policies have come under scrutiny as regulators have sought to influence institutional culture and ethics post-crisis.

Across Europe there is now a common set of rules for the remuneration of financial services executives through the Capital Requirements Directives, although these rules have been implemented differently in different jurisdictions and have certainly had a bigger impact in the City of London than in other markets.

Recently the Prudential Regulation Authority’s Remuneration Code in the UK has introduced a power of clawback, to allow for the repayment of remuneration after it has been awarded, in certain circumstances.

There is a mismatch between the way in which regulators like to impose behavioural standards on individuals and businesses, and the way in which employees and the courts look to receive that guidance. “Regulators like generic rules, saying employees must act with integrity for example, because financial services firms are



“ Regulators like generic rules, saying employees must act with integrity for example, because financial services firms are so complex.”

Alistair Woodland, Clifford Chance, London

so complex they are never going to be able to identify every circumstance that may arise and tell people what to do,” says Mr Woodland. “But from the employee perspective, they want clear rules. Employment tribunals in the UK want to know whether an employee was clearly shown that they weren’t allowed to do something, and if an employer can’t demonstrate that, it is very hard to take action.”

Mr Conceicao says: “Beyond the obvious focus by enforcement agencies on bringing senior executives to account for failing to instil the correct ‘tone from the top,’ some regulators have also turned the spotlight on ‘tone from the middle,’ focusing on middle management as those whose behaviours and examples are most likely to have an impact on frontline staff.” In an employment law scenario it is much more difficult to hold middle management accountable, however, as a result of blurring lines of responsibility and supervision.

The focus on culture and ethics has implications for lawyers and compliance professionals, who are now being seen as “stewards of the franchise”. Regulators and enforcement agencies have highlighted the need for legal and compliance personnel to be included in critical meetings and to have a strong voice at board level. Indeed treating legal and compliance departments as fully fledged partners in the business with the right to say “no”, rather than just as support functions,

is one way of illustrating a commitment to cultural change.

Meanwhile Hong Kong’s SFC has committed to increasingly communicating with the management of financial institutions directly, rather than through the legal and compliance functions, to push those in authority to embed the correct culture in to the firm.

The Financial Stability Board consultation paper on risk culture published at end of last year, refers to one indicator of a sound risk culture being evidence of a culture of “effective challenge” or a culture that is open to dissent. And one of the elements of such a culture is one where legal and control functions have sufficient stature to act not just as advisers (i.e. deal facilitators) but to exert control over the firm’s risk culture.

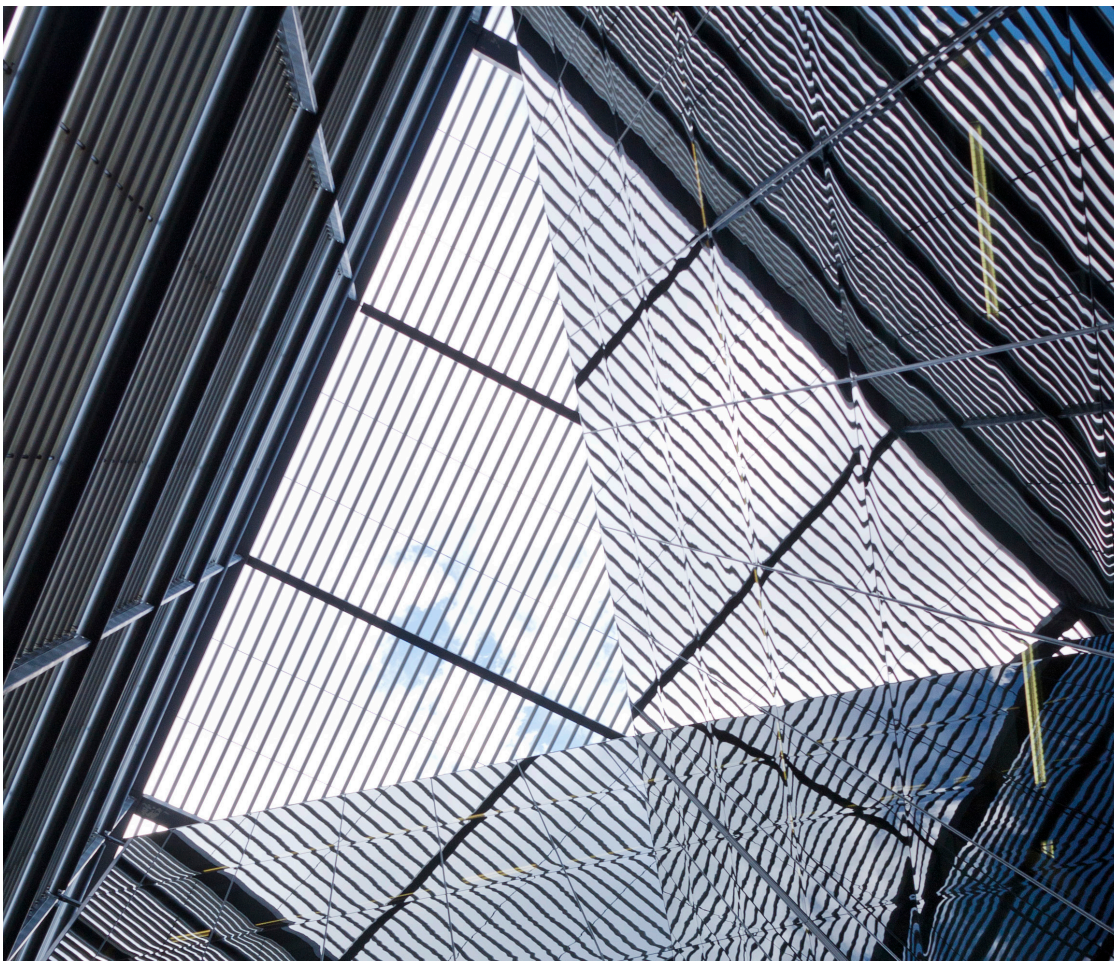
Mr Conceicao concludes: “The idea of cultural change has significant implications for Legal and Compliance. The traditional role of Legal has been as a facilitator, looking purely at whether behaviour is within the law. For Compliance, it has been about monitoring

“Some regulators have also turned the spotlight on ‘tone from the middle,’ focusing on middle management as those whose behaviours and examples are most likely to have an impact on frontline staff.”

Carlos Conceicao, Clifford Chance, London

conduct to see whether it conforms with controls and regulatory requirements. A new culture means asking different questions and playing different roles. For Legal, it means not just asking “can we do it?”, but “should we

do it?” For Compliance, its role will involve assessing whether the front office are doing ‘the right thing’.”



CLIFFORD CHANCE CONTACTS



Thomas Baudesson
Partner, Paris
T: +33 144 055443
E: thomas.baudesson@cliffordchance.com



Carlos Conceicao
Partner, London
T: +44 20 7006 8281
E: carlos.conceicao@cliffordchance.com



Antonio Golino
Partner, Milan
T: +39 0280 6341
E: antonio.golino@cliffordchance.com



Heiner Hugger
Partner, Frankfurt
T: +4969 7199 283
E: heiner.hugger@cliffordchance.com



Chris Morvillo
Partner, New York
T: +1 212878 3437
E: chris.morvillo@cliffordchance.com



Matthew Newick
Partner, Hong Kong
T: +852 282 63459
E: matthew.newick@cliffordchance.com



Kelwin Nicholls
Partner, London
T: +44 20 7006 4879
E: kelwin.nicholls@cliffordchance.com



Judith Seddon
Partner, London
T: +44 20 7006 4820
E: judith.seddon@cliffordchance.com



Alistair Woodland
Partner, London
T: +44 20 7006 8936
E: alistair.woodland@cliffordchance.com

C L I F F O R D

C H A N C E

© Clifford Chance, March 2015

Clifford Chance LLP is a limited liability partnership registered in England and Wales under number OC323571.

Registered office: 10 Upper Bank Street, London, E14 5JJ.

We use the word 'partner' to refer to a member of Clifford Chance LLP, or an employee or consultant with equivalent standing and qualifications.

This publication does not necessarily deal with every important topic nor cover every aspect of the topics with which it deals. It is not designed to provide legal or other advice.

If you do not wish to receive further information from Clifford Chance about events or legal developments which we believe may be of interest to you, please either send an email to nomorecontact@cliffordchance.com or contact our database administrator by post at Clifford Chance LLP, 10 Upper Bank Street, Canary Wharf, London E14 5JJ.

www.cliffordchance.com

Abu Dhabi ■ Amsterdam ■ Bangkok ■ Barcelona ■ Beijing ■ Brussels ■ Bucharest ■ Casablanca ■ Doha ■ Dubai ■ Düsseldorf ■ Frankfurt ■ Hong Kong ■ Istanbul ■ Jakarta* ■ Kyiv ■ London ■ Luxembourg ■ Madrid ■ Milan ■ Moscow ■ Munich ■ New York ■ Paris ■ Perth ■ Prague ■ Riyadh ■ Rome ■ São Paulo ■ Seoul ■ Shanghai ■ Singapore ■ Sydney ■ Tokyo ■ Warsaw ■ Washington, D.C.

*Linda Widyati and Partners in association with Clifford Chance.

J201503060046774