



Note on the FSB Progress Report to G20 Leaders on Reducing Misconduct Risks

This document responds to the mandate received by the FSB from G20 Leaders at the 2016 Hangzhou Summit for the FSB to report to the 2017 Hamburg Summit on authorities' work to address misconduct risks in their respective jurisdictions.

The FSB had already agreed a work plan in May 2015 to address this issue through a series of measures focused on the following aspects:

- a) Examining the effect of the reforms to compensation and salary incentives on reducing misconduct risk and whether additional measures are needed.
- b) Examining whether steps are needed to improve global standards of conduct in the fixed income, commodities and currency markets.
- c) Examining coordinating reforms to major financial benchmarks.

The overall objective is to reduce the opportunities for misconduct and strengthen the ability to contain the associated risks.

The FSB report provides an overview of the measures taken by the FSB and other international bodies to reduce misconduct risk and strengthen trust in the financial system and of the planned future steps to be taken.

1. Measures to strengthen financial institution governance

The management boards of financial institutions are responsible for establishing effective governance and compensation frameworks to promote an internal culture of the firm conducive to proper conduct. The FSB published in May 2017 a stock-take of efforts made by international bodies, national authorities, industry associations and firms. Drawing on these findings, the FSB considered the need to identify a toolkit for supervisors and firms to help strengthen financial institutions' governance, with special attention paid to the following areas:

- Responsibility mapping
- Addressing information gaps and due diligence in employment of individuals with a history of misconduct
- Use of governance frameworks to address cultural risk factors that drive misconduct

The FSB plans to finalise its work in early 2018 and assess the need to develop additional measures and perform new work.

In parallel, the FSB, in collaboration with standard-setting bodies, has initiated a public consultation on Supplementary Guidance to the FSB Compensation Principles and Standards regarding the use of

compensation tools to address misconduct (this Guidance is expected to be completed by the end of 2017).

This Guidance underlines the need to bear in mind subdued or negative financial performance of the firm when calculating the firm's variable compensation, with the use of malus or clawback arrangements.

It also recognises the existence of costs for firms and their customers not only by inappropriate risk-taking but also by misconduct that can result in harm to institutions and companies and impair trust in the financial system more generally.

The document examines the link between compensation practices and misconduct with the aim of identifying the specificities of the financial sector, the diversity of financial institutions and the differences in regulatory frameworks and supervisory mandates across jurisdictions and sectors.

The recommendations on better practice supplementing the compensation principles and standards of the FSB contained in the Guidance are as follows:

- (i) The full range of responsibility, from senior management to the front line
- (ii) The integration of non-financial considerations
- (iii) The alignment of compensation incentives to a longer time frame
- (iv) The use of transparent, consistent and fair compensation policies and procedures
- (v) The framing of supervisory expectations that supervisors should, within the scope of their authority, monitor and assess the effectiveness of firms' compensation policies and procedures in managing misconduct risk

2. Actions directed at authorities' capacity to address misconduct risk

Within this area, we can highlight: a) the IOSCO report on market conduct regulation on wholesale markets and b) the work of the FSB on assisting in enhancing authorities' monitoring capacity through recommendations for consistent national reporting and data collection on the use of compensation tools in instances of misconduct.

a) The IOSCO report, published in June 2017, sets out how market regulators prevent, identify and sanction misconduct in wholesale markets. The aim of the report is twofold: firstly, to raise a broader awareness of the tools and approaches that IOSCO members use to regulate conduct and practices in wholesale markets and, secondly, to highlight examples of market conduct tools and approaches that have proved to be particularly effective.

The tools identified in this report include mechanisms to share information to track "bad apples"; surveillance and data analysis to identify suspicious trades; tools to ensure individual responsibility and accountability; protection of whistleblowers; requirements to manage conflicts of interest; firms' self-assessment to identify own gaps and weaknesses; and tools to address increased automation (high-frequency trading and direct electronic access).

b) With regard to data collection for improving monitoring and reporting on the use of compensation tools, the FSB will publish a series of recommendations for consistent national reporting and data collection by national supervisors by the end of 2017. The recommendations will take into account the requirements of existing national laws and will focus on establishing the frequency with which supervisors should collect relevant data and information in this area, the types of tools deployed (both ex ante and ex post), the reasons for their use and the variable compensation subject to any specific tool applied. These recommendations will be subject to public consultation.

3. Actions aimed at improving market structures and practices

a.- Actions to enhance the robustness of market structures

In this section, we can highlight the reforms to major interest-rate benchmark setting to reduce manipulation risk. Following the FSB's report published in 2014 containing two sets of recommendations relating to benchmarks (strengthening the major benchmarks by anchoring them to a greater number of transactions and identifying alternative near risk-free rates), the FSB has continued working with benchmark administrators to implement and monitor these recommendations. In October 2017, the FSB will publish a report on progress made so far.

For its part, in July 2013 IOSCO released its Principles for Financial Benchmarks aimed at benchmark administrators and submitters. In December 2016, IOSCO published its Guidance on Statements of Compliance with the IOSCO Principles for Financial Benchmarks, which was supplemented with the Second Review of the Implementation of IOSCO's Principles for Financial Benchmarks. Following the meeting of the FSB's Official Sector Steering Group planned for October 2017, IOSCO will issue a public statement with the aim of increasing awareness of the dynamic risks of these benchmarks and the need to monitor such risks and conduct contingency planning.

b.- Actions to enhance conduct standards and adherence in foreign exchange markets

The Global Code of Conduct for Foreign Exchange Markets, published in May 2017, establishes a series of good practices aimed at establishing a fair, liquid and open global foreign exchange market to allow participants to confidently and effectively transact at competitive prices that reflect available market information. The Code aims to supplement local laws and contains 55 principles covering various areas (ethics, governance, execution and client order handling, handling confidential information, risk management and compliance, confirmation of settlement, electronic trading, algorithmic trading and prime brokerage) and is aimed at a wide range of market participants.

The Code will be updated by a new Global Foreign Exchange Committee, comprising public and private sector representatives from 16 international foreign exchange trading centres. This Committee seeks to promote collaboration and communication among local foreign exchange committees and other jurisdictions.

Link: [Reducing misconduct risks in the financial sector: Progress report to G20 Leaders](#)