

Monitoring Misconduct: Maintaining and  
Developing Banking Standards

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# Banking misconduct, improving governance and transparency, building public trust, implementing reforms, managing risk

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Check Against Delivery  
Seul le texte prononcé fait foi  
Es gilt das gesprochene Wort

## Introduction

It is a great pleasure to be speaking at the City's Business School, albeit virtually, and on the important topic of bank conduct, or misconduct. The European Banking Authority (EBA) was set up in 2011 as a response to the 2008 global financial crisis. Whilst we have focused very much on strengthening the prudential framework, we have an important and complementary role with regards to conduct and the protection of EU citizens, which manifests itself in both a direct and an indirect way.

The EBA founding Regulation recognises that consumer detriment can impact financial stability and I note that the only sub structure with an explicit mandate in this area when the EBA was created was a standing committee on consumer protection and financial innovation. The EBA Regulation also makes a direct link between market integrity and conduct issues, such as institutions' failure to prevent financial crime, which is addressed through the EBA new mandate to lead coordinate and monitor Anti Money Laundering and Countering the Financing of Terrorism (AML/CFT) across the EU. Moreover, the EBA is mandated to support various EU Directives and Regulations aimed at mitigating issues for consumers arising from the misconduct of financial institutions. Payments and

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mortgage credit are just some examples that have led to significant EBA work to avoid consumer detriment. These mandates point to our direct interest in mitigating the risks of misconduct to protect the well-being of EU citizens in their interactions with financial institutions and to protect society as a whole.

Equally important is the indirect obligation that falls to the EBA to monitor and address conduct risks through its prudential and financial stability mandates.

One, straight forward way, of understanding this is to look at the costs of misconduct in recent years. Studies vary depending on how costs are measured. I am aware that you probably have more granular numbers amongst the City's Business faculty, as the Conduct Cost Project now sits in the City's Business Centre for Banking Research and also that your latest analysis suggests that in aggregate, between January 2008 and December 2018, the 20 international banks included in your sample, have paid conduct costs in excess of GBP 377 billion. Other studies also point to similar orders of magnitude. As an example, recent ECB analysis suggests that, overall, costs have been in the magnitude of USD 350 billion. Therefore, I feel I don't need to convince you that misconduct costs hit profits and the capital that prudential regulators want to ensure is available to absorb losses arising from banks' main activities, such as lending into the real economy.

There are also more subtle reasons for prudential regulators to be concerned by misconduct, beyond the short-term financial impact of redress and other conduct costs. Trust in the reliability of the financial system is crucial for its proper functioning and is a prerequisite to contributing to the economy as a whole. In this context, effective structures and sound internal governance arrangements are fundamental if financial institutions and systems are to operate well. Similarly, financial crime misconduct undermines trust in the entire system and causes societal harm in a number of ways from tax evasion to terrorist financing. More generally, societal expectations and associated public scrutiny, are growing on all corporations including financial institutions. This is reflected in the acceptance that corporations, including banks, have responsibility to multiple stakeholders beyond shareholders, including their customers, staff and society. We have seen such a shift widely, but perhaps most dramatically evidenced, when the US Business Roundtable redefined the purpose of a corporation in 2019<sup>1</sup>.

Our direct and indirect conduct mandates are mutually reinforcing and are accompanied by the EBA existing conduct tools, which I will describe below. Yet the scale of the misconduct issues of recent years, and growing societal pressure, combine with changes in the nature of conduct related issues in a time of digital acceleration to increase the challenges in tackling misconduct. That means we need to consider how to develop our toolkits further and, where needed, combine those tools, also harnessing emerging themes such as Fintech and ESG, to really make a change.

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<sup>1</sup> <https://www.businessroundtable.org/business-roundtable-redefines-the-purpose-of-a-corporation-to-promote-an-economy-that-serves-all-americans>



## Context

I am aware that this audience has access to many examples of misconduct and insights into the associated drivers and costs. I strongly encourage ongoing research in this area to help us better learn lessons and contribute to the growing body of literature. Well known examples include the litigation and redress costs associated with Payment Protection Insurance (PPI) mis-selling, or fines and other measures associated with financial crime misconduct, concerns about the sale of bank debt instruments to retail clients and the rising prevalence of online fraud. But I do not wish to dwell on past cases today. Instead, I believe we should look at the future, using our knowledge of shifts we are seeing today to reflect on where potential issues of conduct will arise. To that end, allow me to identify two hot spot areas that I am concerned about and believe we should be building our defences against now.

- 1) The first relates to the treatment of customers during the pandemic, especially as they engage with banks on adjusting the payment schedules through loan moratoria. The EBA identified relevant moratoria criteria and clarified that moratoria loans should not automatically be reclassified for prudential purposes and, therefore, should not automatically impact consumers' credit rating. However, these agreements are happening fast, and on such a wide scale that I have been worried about ensuring that all consumers know what they are getting into and are treated fairly. That is why we supported our "prudential" work on moratoria with a call for fair and transparent treatment of customers<sup>2</sup> and worked with the EU Commission in supporting financial institutions and consumer groups to identify a set of best practices in terms of customer treatment<sup>3</sup>. Once the moratoria runs out, it will be imperative there is full transparency and fair treatment of consumers both for existing and new loans. Banks need to assure good governance and risk management and adherence to our Guidelines on non-performing exposures (NPE), as well as those on loan origination, recently issued.
- 2) The second relates to the rapid acceleration of the digitalisation agenda during the pandemic. This is indeed an acceleration of an existing trend but, almost overnight, customers across the EU have turned to digital financial services and cashless payments, often contactless. Of course, this offers high potential benefits to consumers in terms of cost and convenience. But we need to be on guard in several areas including:
  - a) **access to financial services.** Whilst digitalisation offers benefits, we must be cognisant of consumers who cannot or choose not to use technology for their financial services.

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[https://eba.europa.eu/sites/default/documents/files/document\\_library/News%20and%20Press/Press%20Room/Press%20Releases/2020/EBA%20provides%20clarity%20to%20banks%20and%20consumers%20on%20the%20application%20of%20the%20prudential%20framework%20in%20light%20of%20COVID-19%20measures/Statement%20on%20consumer%20protection%20and%20payments%20in%20the%20COVID19%20crisis.pdf](https://eba.europa.eu/sites/default/documents/files/document_library/News%20and%20Press/Press%20Room/Press%20Releases/2020/EBA%20provides%20clarity%20to%20banks%20and%20consumers%20on%20the%20application%20of%20the%20prudential%20framework%20in%20light%20of%20COVID-19%20measures/Statement%20on%20consumer%20protection%20and%20payments%20in%20the%20COVID19%20crisis.pdf)

<sup>3</sup> [https://ec.europa.eu/commission/presscorner/detail/en/ip\\_20\\_1281](https://ec.europa.eu/commission/presscorner/detail/en/ip_20_1281)



It will be important that in our embrace of the technology whole groups of individuals are not left behind.

- b) **increase in online fraud.** Our observations are naturally anecdotal at present but the Council of Europe has identified specific increases in fraud in relation to medical equipment, economic relief measures, and public procurement contracts<sup>4</sup>, also with implications for AML/CFT risk. Moreover, it worries me that the data used to power fraud detection engines may not be keeping up with the new trends, which also means that old data sets may not be well flagging the emerging range of fraudulent activity online.
- c) **consumers' understanding of online transaction risks and new products not keeping up with the pace of change.** The key onus is on banks for proper oversight and governance and transparency but we also need to properly equip consumers. In a rather prescient move, in December of last year, we at the EBA produced a handy guide for consumers, which was translated into all EU official languages, outlining ways to stay safe when choosing online banking services.<sup>5</sup>
- d) **increased focus on cyber security and digital operational resilience is key to protect consumers and their data.** That is why we have identified information and communications technology (ICT) risk management and digital operational resilience as a priority during the crisis<sup>6</sup> and expect work in this space to pick up, also as the EU Commission launches its Digital Finance Strategy

## Existing tools

Let me now turn to the tools at the EBA's disposal, primarily the legal instruments in which we have articulated requirements in order to mitigate conduct risks and strengthen governance and risk management. Allow me to start with the tools related to our indirect mandate and which focus on general governance and risk culture of credit institutions. I will then explain our retail conduct tools towards consumers, and AML conduct. And I will finish with a short comment on financial education.

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<sup>4</sup> [https://rm.coe.int/moneyval-2020-18rev-covid19/16809f66c3?utm\\_source=POLITICO.EU&utm\\_campaign=36c35ddbae-EMAIL\\_CAMPAIGN\\_2020\\_09\\_03\\_05\\_00&utm\\_medium=email&utm\\_term=0\\_10959edeb5-36c35ddbae-189826957](https://rm.coe.int/moneyval-2020-18rev-covid19/16809f66c3?utm_source=POLITICO.EU&utm_campaign=36c35ddbae-EMAIL_CAMPAIGN_2020_09_03_05_00&utm_medium=email&utm_term=0_10959edeb5-36c35ddbae-189826957)

<sup>5</sup> <https://eba.europa.eu/eba-raises-awareness-key-steps-consumers-should-consider-when-choosing-online-or-mobile-banking>

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[https://eba.europa.eu/sites/default/documents/files/document\\_library/News%20and%20Press/Press%20Room/Press%20Releases/2020/EBA%20Provides%20further%20guidance%20on%20the%20use%20of%20flexibility%20in%20relation%20to%20COVID-19%20and%20Calls%20for%20heightened%20attention%20to%20risks/882754/EBA%20statement%20on%20additional%20supervisory%20measures%20in%20the%20COVID-19%20pandemic.pdf](https://eba.europa.eu/sites/default/documents/files/document_library/News%20and%20Press/Press%20Room/Press%20Releases/2020/EBA%20Provides%20further%20guidance%20on%20the%20use%20of%20flexibility%20in%20relation%20to%20COVID-19%20and%20Calls%20for%20heightened%20attention%20to%20risks/882754/EBA%20statement%20on%20additional%20supervisory%20measures%20in%20the%20COVID-19%20pandemic.pdf)



## Governance and risk culture

Since the financial crisis in 2007, internal governance issues have received increased attention from various international bodies, regulators and supervisors. A lot has been done and institutions have made progress in their governance, risk culture and risk management framework. However, room for improvement remains. Some examples include: the fight against money laundering; the prevention of tax fraud such as via dividend arbitrage schemes; IT security threats, including the risk to customers that make more and more use of online distribution channels, and risks to the operational continuity of institutions in the context of an increasing concentration of outsourcing arrangements at a few large service providers.

To start with, a strong risk culture is essential to establishing appropriate structures and avoiding misconduct and should include at least:

- **tone from the top:** the management body is responsible for setting and communicating the institution's core values and expectations. The top management should lead by example and monitor and adjust the risk culture of the credit institution as needed;
- **accountability:** relevant staff at all levels should know and understand the core values of the credit institution and, to the extent necessary for their role, its risk appetite and risk capacity;
- **effective communication and challenge:** a culture of open communication, democratic management styles that allow for effective challenge in which decision making processes stimulate a constructive critical attitude within the organisation;
- **incentives:** appropriate incentives, including clear performance criteria for bonuses and consequences for misconduct play a key role in aligning behaviour of staff with the institution's risk profile and its long-term interest.

The EBA supports the development of institutions' good governance, risk culture and risk management through various sets of Guidelines on governance arrangements. These Guidelines highlight good practices including the establishment of clear organisational structure with well-defined, transparent and consistent lines of responsibility; the duties and responsibilities of the management body; effective processes to identify, manage, monitor and report the risks they are or might be exposed to; adequate internal control mechanisms, including sound administration and accounting procedures; and remuneration policies and practices that are consistent with and promote sound and effective risk management.

We are also working on operational resilience in the context of an increased use of outsourcing providers in third countries.

In addition, supervisors monitor and supervise banks' governance, risk culture and management through the supervisory review and evaluation process (SREP). With its SREP Guidelines, the EBA provided a common framework for those assessments. In their assessment of internal governance, prudential supervisors assess if the institution has an appropriate and transparent corporate



structure that is 'fit for purpose'. They should also verify if the institution has a sound risk culture that is comprehensive and proportionate to the level and nature of the risks inherent within the institution and which should guard against potential misconduct. Similarly, the forward-looking business model analysis should identify undue risk-taking, including potential pressure for misconduct to meet ambitious growth targets.

## **Retail conduct**

Turning to retail conduct, that is the conduct of firms towards consumers, we have assessed the detriment arising to consumers from the past misconduct of firms and issued a number of technical standards and guidelines as a result. For example, our Guidelines on product oversight and governance prompt senior management of credit institutions to consider conduct-related issues when developing and distributing new products, whilst our standards on the security of payment services straddle the challenge of promoting enhanced security whilst simultaneously facilitating competition and innovation, both to the benefit of EU consumers.

The EBA is also working with national authorities to ensure that, at a national level, they supervise the requirements we have developed in a way that is effective and ensures consistently high outcomes for consumers. We are doing this in relation to the product oversight and governance Guidelines of 2015 as well as the complaints handling Guidelines we issued in 2014 and will soon be revising EBA Guidelines on the remuneration of sales staff that we issued in 2016. We will also assess how we can make best use of a new power we received on 1 January 2020, which is to coordinate national mystery shopping activities. This is potentially a very effective way to assess the conduct of financial institutions.

## **AML conduct**

Effective AML/CFT conduct means that financial institutions must conduct themselves in a way that prevents money laundering and terrorist financing. This goes beyond box ticking as they should rather seek to embed a culture in which financial crime is not acceptable, regardless of profits. To that end, the EBA has developed a range of important requirements including our Guidelines on risk-based AML/CFT supervision, which set out how authorities should carry out an effective risk-based approach to AML/CFT and assess risk, including the integrity of senior management. Our guidelines on AML/CFT risk factors, on the other hand, are addressed to financial institutions to equip them to make informed and proportionate decisions on the effective management of ML/TF risk associated with individual business relationships.

Moreover, on 1 January this year, the EBA received an enhanced legal mandate to lead, coordinate and monitor the EU's efforts in fighting financial crime across the financial sector. This involves further work, which has a conduct element, for example, the creation of a central AML/CFT database with information from national authorities on weaknesses they identify in governance arrangements or fitness and propriety issues of individual institutions. We can ensure this



information is shared with relevant authorities and it will also inform our own approach and priorities to help reduce financial crime misconduct across the EU. Finally we have just published our views on strengthening the existing legal framework on AML/CFT in the EU to improve AML conduct in the EU's financial sector, and what we consider the most efficient and effective set-up for a single EU supervisor on AML, which is a proposal currently being discussed in Brussels.

## Financial Education

Allow me briefly to mention financial education. Financial education and financial literacy are by no means a substitute for the conduct requirements that I have just presented. Instead, they usefully complement such requirements. This is because financial education and literacy give consumers the knowledge and skills needed to understand their legal rights and obligations as well as the features, risks and opportunities of using financial products and services. Education and literacy make it possible that the aims of conduct and transparency requirements imposed on financial institutions can actually materialise. The EBA coordinates this work and, at times, finds EU solutions, such as information sheet on digital transactions I mentioned earlier.

## EBA developments to strengthen conduct tools

Let me now turn to our ongoing work to strengthen our toolkit in relation to conduct. In particular, I would like to discuss how we can integrate and combine our various tools to really push change, whether it be on traditional issues such as preventing AML risks, or how the emerging themes of Fintech and ESG can be harnessed to prevent misconduct. I have in mind a particular example, which is the EBA Guidelines on loan origination. These were issued this year and cover prudential requirements whilst also capturing our consumer protection, ESG and AML objectives and I see this combination approach being continued going forward. Of course, in this we need to be mindful of the differing responsibilities of prudential supervisors, AML/CFT supervisors and conduct supervisors. Still, there are touchpoints between the different supervisory roles. To maximise the synergies between the various supervisory activities, it is important our regulatory products are consistent and integrated, where needed, so that the findings from the different supervisory activities inform each other to allow for a truly integrated supervision of institutions.

In this context, looking forward, our guidelines on internal governance will build up the link between governance and combating money laundering and terrorist financing by clarifying that identifying, managing and mitigating ML/TF risk is part of sound internal governance arrangements and credit institutions' risk management framework. At the same time, the framework regarding loans to members of the management body and related parties will be further specified as those loans may constitute a specific source of actual or potential conflict of interest.

In addition, and as a reflection of the increased focus on social issues, we will be providing new guidance on gender-neutral remuneration policies to ensure that institutions take all necessary measures to avoid discrimination and guarantee equal opportunities to staff of all genders.



Similarly, we will be working to combine conduct-related issues into the SREP to raise awareness among prudential supervisors that weaknesses in the internal governance and controls framework can be exploited for money laundering or terrorist financing purposes. In the business model analysis for example, a financially successful business model can at the same time give rise to increased money laundering or terrorist financing risks due to the type of services offered or the distribution channels that are used. The process for withdrawal of prudential authorisations as a result of serious AML/CFT breaches is also in development. We are also currently implementing a 10-point action plan, published earlier this year, that spans prudential and AML/CFT requirements to enhance prudential and anti-money laundering requirements in relation to tax misconduct and specifically so-called dividend arbitrage trading schemes, or “Cum-Ex/Cum-Cum”.

### **Emerging themes: FinTech and ESG**

Regulators also face a number of emerging sector wide themes, which pose new conduct-related risks but also offer opportunities to further strengthen the existing conduct toolkit. Notably, technology, or Fintech, and the importance of Environment Social and Governance (ESG) factors both of which the EBA has a broad set of mandates on.

I started by noting that the rapid digital acceleration we have lived through in 2020 is a vital consideration when considering future conduct. Increasing digitisation of the EU financial sector raises opportunities and risks for consumers. As banking becomes ever increasingly digital, we will need to ensure that the concept of technological neutrality is embedded in everything we do and in so doing that our approach is customer centric.

On this let me be clear: in accordance with the principle of technological neutrality consumers should always benefit from the same – high – standards of protection when accessing financial services through digital means as through more traditional intermediation channels. As an example, disclosures of pre-contractual and contractual information must effectively convey the risks of a financial product or service regardless of access channel.

Similarly, as AI applications for credit scoring and roboadvice become more prevalent, we will ensure our approach is consumer centric to guard against the risk of unfair bias and ensure explainability is built into the models. As set out in the EBA report on Big Data and advanced analytics, the solution entails a strong and consistent framework for oversight and regulation to ensure the ethical (and secure) use of data and the avoidance of bias.

On the ESG front, our work is currently focused on climate change but social factors have taken greater prominence in 2020 for a variety of reasons, including a focus on workers treatment during the pandemic and the importance of demonstrating a commitment to diversity in the workforce and the supply chain. This brings with it the very real risk of green and social washing, which will be a point of potential misconduct risk going forward. We will need to use our ESG toolkit to address these risks, in conjunction with other tools, whether that be ensuring that our classifications and definitions are practical and adhered to, or the regime for verifiers is robust. Still, the key



intersection of our ESG work and our conduct work starts with the potential for enhanced transparency around institutions' stated strategy on ESG issues, and this will inevitably shine a light on their approach to conduct.

## Conclusion

Conduct matters for the EBA, both because of our immediate direct responsibilities towards EU citizens and because of our indirect prudential mandate. We have done a lot but we can do better, especially as conduct risks change, with the acceleration of digitalisation and as the public appetite for banks to demonstrate good conduct is growing.

We have a wide range of tools, which we will use going forward in conjunction with the other EU supervisory authorities, ESMA and EIOPA. But importantly the EBA has an opportunity to combine our tools and ensure conduct-related aspects are integrated into all our work where it counts. Our experience of combining consumer issues into loan origination guidelines, our efforts to integrate AML considerations into broader governance guidelines, the importance of consumer centric Fintech regulation and the visibility that ESG considerations will provide, mean that we should expect regulators and supervisors to be looking harder at conduct going forward, and I expect a positive response from regulated institutions.