Financial Product Governance and Culture

Annex C: Literature Review

July 2021

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Table of acronyms and abbreviations

Acronym and abbreviation	Definition
ASIC	Australian Securities and Investments Commission
BCB	Central Bank of Brazil
CGAP	Consultative Group to Assist the Poor
CMN	Conselho Monetário Nacional (National Monetary Council Brazil)
EBA	European Banking Authority
FCA	Financial Conduct Authority (United Kingdom)
FinCoNet	International Financial Consumer Protection Organisation
G20	Group of Twenty
G30	Group of Thirty
HKMA	Hong Kong Monetary Authority
MiFID	Markets in Financial Instruments Directive
NPAP	new product approval policy
OECD	Organisation for Economic Co-operation and Development
SBS	Superintendence of Banks, Insurers and Private Pension Funds (Peru)
SMCR	Senior Managers and Certification Regime
SC6	Standing Committee 6
STHCC	short-term high-cost credit
Task Force	G20/OECD Task Force on Financial Consumer Protection

Glossary

Term	Definition
Banking deposit products	Amount of money placed into a bank account. The account holder has the right to withdraw the deposited funds, as set forth in the terms and conditions governing the account agreement.
Banking products	For the purposes of this literature review, consumer credit products, payment products and banking deposit products.
Consumers	Individuals acting for personal, domestic or household purposes, not business or professional purposes.
Consumer credit	Credit provided to individuals for personal, domestic or household purposes, not business or professional purposes. This includes both secured credit (such as mortgage loans and personal loans) and unsecured credit (such as personal loans, lines of credit, credit cards, overdraft facilities and payday lending).
Distributor	A person or entity who offers and/or sells the product to consumers. This includes intermediaries and business units of financial product providers that are not involved in designing the product but are responsible for bringing the product to the market.
Financial product governance	The procedures and controls in place to design, approve, market and manage retail financial products through their life cycle to ensure that they meet, at any time, the interests and objectives of consumers and the relevant regulatory requirements.
Financial product governance requirements	The legal/regulatory and/or supervisory requirements on an entity to implement financial product governance.
Financial product provider	An organisation that offers financial products to consumers.
Financial product intervention power	A power enabling a regulator/supervisor to intervene in the design, sale and/or distribution of a financial product including power(s) to approve a financial product, require modifications or require a financial product to be suspended or withdrawn from sale.
Firm	For the purposes of this literature review, a financial services firm (including a financial, credit or banking institution).
Guidelines	Instructions issued by a supervisory authority to be adopted by financial institutions according to existing legislation and regulation.
Jurisdiction	The territory over which the respondent's authority is exercised.

Payment products	Instruments, banking processes or services which enable the transfer of funds from a payer to a payee.
Product governance	For the purposes of this literature review, governance of financial products.
Product life cycle	A number of stages products go through from research, design, manufacture and distribution/sales and ultimately to the product's decline or removal from the market.
Supervisor	For the purposes of this literature review, a supervisory authority.
Supervisory approaches and practices	Instruments, procedures and devices used by supervisors to ensure that the supervised entities comply with the applicable regulation and best practices (for example reporting of information, complaints handling, on-site inspections and mystery shopping). The same tool can be implemented and used differently, according to each supervisory authority's practice.
Target market	Group of end consumers for whom the product is designed.

Executive summary

This literature review has been prepared to support work conducted by FinCoNet Standing Committee 6 (SC6), in collaboration with the G20/OECD Task Force on Financial Consumer Protection, on financial product governance and the impact of organisational culture within the financial services industry. It outlines why organisational culture is important, as well as some of the approaches to product governance adopted since the global financial crisis.

This literature review is a companion publication, and Annex C, to the Report on Financial Product Governance and Culture. [www.finconet.org/Financial-Product-Governance-Culture.pdf]

Organisational culture

Culture in financial firms was well-researched in the decade following the global financial crisis. This review draws on several reports globally to outline the impact organisational culture can have on consumer outcomes. Although there is evidence that culture has been changing in a positive way, there are still many challenges that must be addressed. This review also identifies that cultural change is a never-ending journey and that achieving a positive culture but failing to maintain it will quickly result in a relapse to previous negative behaviours.

Importance and effect of culture in the financial services industry

Culture within financial services firms directly affects the behaviour of a firm and the outcome for consumers. This makes culture an important consideration for regulators and supervisors when thinking about financial product governance. Particularly since the global financial crisis, culture has become increasingly important for the financial services industry. Research has shown that public trust in financial services firms can be affected by culture, and it also affects the economic and social viability of banking institutions. However, this importance is not just for the entities themselves but also for the whole market. As the global financial crisis showed, culture can affect the worldwide economy if it is not maintained by financial institutions who bear the burden of ensuring their culture is positive.

How to change culture

Culture is accepted as a 'dependent variable' which, due to its abstract nature, cannot be changed on its own. Instead, financial services firms must change many factors and behaviours which lead into good culture supporting a consumer-centric outcome. The main factors discussed in this review are:

- product governance;
- remuneration and work environment;
- risk management and culture; and
- tone from the top.

Drivers of financial product regulation

The global financial crisis played a large part in the push to increase financial product governance. The crisis exemplified the shortcomings of the regulation and governance of the financial services industry at that time. It also encouraged regulatory bodies to examine imperfections in the market including information asymmetry and behavioural distortions.

Developments in financial product regulation

A number of jurisdictions have introduced obligations for manufacturers and distributors of financial products, moving away from reliance on mere disclosure obligations. Most jurisdictions surveyed by SC6 have also seen product intervention powers implemented to reinforce proactive measure to protect consumers. Recent developments in the following jurisdictions are examined in detail:

- Australia;
- Brazil;
- European Union;
- Hong Kong;
- New Zealand;
- United Kingdom; and
- United States.

1. Introduction

FinCoNet established Standing Committee 6 (SC6) to examine globally financial product governance and culture in relation to banking products, in collaboration with the G20/OECD Task Force on Financial Consumer Protection. In examining these topics, SC6 considered consumer harms, policy and supervisory approaches, challenges for regulators and supervisory authorities, and the impact of organisational culture on product governance within the financial services industry.

The purpose of this literature review is to inform the SC6 work looking at encouraging consumer-centric cultural norms within financial services firms along with good practices for regulating and supervising product governance. The review summarises existing research on product governance and how this is affected by organisational culture, particularly in terms of the design and distribution of financial products. The focus of this review is on banking products, specifically consumer credit, payments products and banking deposit products.

A wide range of sources was collated to comprehensively outline the existing knowledge on culture and product governance. Sources include reports from national regulatory bodies, journal articles and other relevant literature.

This literature review is a companion publication, and Annex C, to the Report on Financial Product Governance and Culture. [www.finconet.org/Financial-Product-Governance-Culture.pdf]

1.1 Research questions

This review of the literature on culture and product governance in the financial services industry was informed by six overarching research questions:

- What are the drivers and what is the effect of culture in the financial services industry?
- How can organisational culture improve and who is responsible for changing it?
- What are the drivers of product governance?
- What is the current state of product governance internationally?
- What are some recent developments in product governance and what challenges are these developments aiming to address?
- What are the current challenges for product governance?

These questions informed the structure of this review.

1.2 Structure of this review

This literature review has five chapters. Chapter 2 focuses on organisational culture in the financial services industry. First it defines ‘organisational culture’. Then it discusses the culture within financial services firms, how it can be changed, and who should be responsible for doing so. The drivers of organisational culture and its importance for the industry are also examined.

Chapter 3 discusses product governance. It first defines 'financial product governance'. Then it discusses the drivers of the recent increase in financial product regulation, drawing on economic events and advances in behavioural economics. This chapter also examines current challenges for product governance and the strategies used to address them.

Chapter 4 presents case studies from five jurisdictions to highlight the extent of recent developments in product governance and discuss the effects that have been observed. Chapter 5 provides broad observations on the key points outlined in Chapters 2, 3 and 4.

2. Culture in financial services firms

One of the major regulatory changes to follow the global financial crisis was a focus on the culture of firms and the financial services industry as a whole.[1] In the last decade, it has become impossible to argue that cultural norms are 'not capable of exerting a profound influence on human *and organisational* behaviour'.[2] This focus has been, and continues to be, met with a range of challenges stemming from the abstract nature of culture. One of these challenges is attempting to define 'good culture'.

For the purposes of this review we define 'good culture' as a strong 'consumer outcome focused' or 'consumer-centric' culture.[3] This definition is a good starting point from which to discuss how culture affects the outcomes of firms, how product governance should deal with cultural problems and the recent developments in this area.

This discussion of culture includes:

- definitions of culture;
- the drivers and indicators of culture;
- the importance and effect of culture for financial product regulation;
- reasons to change culture;
- who is responsible for cultural change; and
- how to change culture.

2.1. Defining culture

A standard definition of 'culture' has been elusive. The term 'culture' has been described as 'one of the most complicated words in the English language'.[4] Organisational culture, to quote Andrew Bailey,[5] is both 'everywhere and nowhere'.[6] A wide range of factors can

[1] Centre for Regulatory Strategy, *Culture in financial services: Scrutiny by the regulator, in principle and in practice*, Deloitte, 2018, p. 17.

[2] D Awrey, W Blair and D Kershaw, *Between law and markets: Is there a role for culture and ethics in financial regulation?* (14/2012), working paper, London School of Economics Law Society and Economy, 2012, p. 16.

[3] International Financial Consumer Protection Organisation, FinCoNet SC6 Financial Product Governance and Culture Draft Project Plan, June 2018, p. 3. This definition of 'good' culture is similar to that given in Financial Markets Authority and Reserve Bank of New Zealand, *Bank conduct and culture: Findings from an FMA and RBNZ review of conduct and culture in New Zealand retail banks*, report, November 2018, p. 9.

[4] R Williams, *Keywords: A vocabulary of culture and society*, Oxford University Press, 1976, p. 76.

[5] Andrew Bailey served as Chief Executive Officer (CEO) of the Financial Conduct Authority (FCA) from 1 July 2016 until taking up the role of Governor of the Bank of England on 16 March 2020.

[6] 'Culture in financial institutions: It's everywhere and nowhere', speech by CEO of the FCA, Andrew Bailey, Hong Kong Monetary Authority (HKMA) Annual Conference for Independent Non-Executive Directors, Hong Kong, 16 March 2017.

affect organisational culture, but no one external factor can be called 'culture' and therefore 'culture' cannot by itself be adjusted.[7] Instead, it requires the changing of external factors, much like a dependent variable in a scientific experiment. Despite these challenges, regulatory authorities, along with academics, have attempted to give meaning to the term.

Most definitions of organisational culture focus on the shared values and norms present within an organisation.[8] For instance, the Australian Prudential Regulation Authority defines 'culture' as:

> a system of shared values and norms that shape behaviours and mindsets within an institution.[9]

A similar definition of 'corporate culture' was adopted by De Nederlandsche Bank.[10] Commissioner Kenneth Hayne in Australia's Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry (Financial Services Royal Commission) adopted this definition[11] but omitted the reference to 'a system'. He did so to acknowledge that 'culture is observed and described, not created apart from, or imposed on, the entity'.[12]

Australia enacted a legislative definition of 'corporate culture' in section 12.3(6) of the *Criminal Code Act 1995*. 'Corporate culture' is there defined as 'an attitude, policy, rule, course of conduct, or practice existing within the body corporate generally or in the part of the body corporate in which the relevant activities took place'.[13] This definition is broad, encompassing both abstract concepts, such as attitudes, and more material considerations, such as rules and policies. While this definition is not as helpful in defining culture for the purposes of this review, it allows us to see the potential causes of culture norms.

While some mention of shared values and norms is present in most definitions of organisational culture, another common theme is the influence of these values and norms on the behaviour of members of the firm. In Canada, the Autorité des marchés financiers defines 'corporate culture' as:

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[7] 'The importance of corporate culture', speech by Australian Securities and Investments Commission (ASIC) Chairman, Greg Medcraft, International Table Luncheon, Melbourne, 8 December 2016.

[8] See, eg, 'The importance of culture to improving conduct within the financial industry', speech by ASIC Commissioner, Greg Tanzer, 3rd Thomson Reuters' Australian Regulatory Summit, Sydney, 27 May 2015.

[9] Australian Prudential Regulation Authority, *Prudential inquiry into the Commonwealth Bank of Australia*, April 2018, p. 81.

[10] '[E]mployee behaviour [is] based on a range of norms, these norms being determined by the overall national culture on the one hand and by the specific attitudes of the company, the shared values, on the other': L Schuster, *Banking cultures of the world*, Knapp, 1996.

[11] Commonwealth of Australia, *Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry*, final report, February 2019, vol. 1, p. 375.

[12] Commonwealth of Australia, *Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry*, final report, February 2019, vol. 1, p. 375 footnote 158.

[13] *Criminal Code Act 1995* section 12.3(6).

> the common values and standards that define a business and influence its mindset, conduct and the actions of all its staff.[14]

The reference of this effect is also included in the definition of 'corporate culture' given by Professor Martin Staniland as:

> the belief that can guide staff in knowing what to do and what not to do, including practices, values and assumptions about their work.[15]

A different approach was taken by the Hong Kong Monetary Authority (HKMA) when implementing its bank culture reform.[16] Instead of directly defining 'corporate culture', HKMA identified three pillars which banks should give particular attention to when promoting sound bank culture. These pillars are governance, incentive systems and assessment and feedback mechanisms[17] (discussed in section 0).

These definitions demonstrate that regulators and academics agree that organisational culture in the financial services industry directly affects the behaviour of employees. Therefore, some commentators argue that it is not regulators who should be taking steps to improve the culture of the industry, but rather the industry and the firms themselves (discussed in section 0).

2.2 Drivers of organisational culture

The three main drivers discussed in this section are remuneration, risk management and the tone from the top. The fourth, governance, is discussed throughout the examination of the other three. Each is considered in the context of the financial services industry to evaluate (in section 0) what specific actions are needed for the financial services industry to improve organisational culture.

Defining and monitoring the drivers of culture in the financial services industry is especially important for two reasons. First, knowing and monitoring the drivers within a firm gives the firm the ability to change its culture, however long that process may take. Second, the drivers of cultural change are unlike cultural norms themselves and therefore 'can and should be measured'.[18] They offer tangible evidence regarding the culture in financial firms.

This is not to say that the drivers selected are the only influences on culture or are the only ways to measure culture. For example, Robert Simons' risk exposure calculator uses nine key indicators to calculate the risk exposure of a firm. These indicators are:

- pressures for performance;
- rate of expansion;

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[14] Autorité des marchés financiers, *Governance guideline*, July 2016, p. 5.

[15] M Staniland, *What is a political economy? A study of social theory and underdevelopment*, Yale University Press, 1985.

[16] HKMA, *Bank culture reform* (B1/15C; B9/146C), circular, 2 March 2017.

[17] Ibid.

[18] Group of Thirty, *Banking conduct and culture: A permanent mindset change*, report, November 2018, pp. xii–xiii.

- staff inexperience;
- rewards for entrepreneurial risk-taking;
- executive resistance to bad news;
- level of internal competition;
- transaction complexity and velocity;
- gaps in diagnostic performance measures; and
- degree of decentralised decision-making.[19]

Examination of the drivers of culture reveals that regulation and supervision alone cannot change the culture within a firm or industry.[20] Instead, supervisors and regulators encourage certain processes and behaviour in the industry in order to mould the appropriate culture.[21]

Remuneration and work environment

Remuneration structures are an important driver of firm culture. Employee behaviours are influenced by the remuneration employees can achieve and how they can achieve it. In particular, the structure of remuneration (in this case including other rewards such as promotion opportunities and monetary raises) can signal to employees what the organisation expects of them.[22] For example, a sales-first oriented firm will signal to its employees that priority should be given to sales rather than the consumer's financial wellbeing. This is a countervailing norm – a norm that counteracts the structures that financial institutions put in place to promote good culture. David Miller has categorised these as 'norms of self-interest' promoted by the incentive structures of firms.[23]

In its review of bank retail sales practices, the Financial Consumer Agency of Canada found that rewards that are centred on success can encourage behaviour that breaches market conduct obligations.[24] This is not a unique finding. For instance, Australia's Financial Services Royal Commission took aim at several industry sectors – including mortgage

[19] R Simons, 'How risky is your company?', *Harvard Business Review*, May–June 1999.

[20] 'Enhancing financial stability by improving culture in the financial services industry', speech by President and Chief Executive Officer of the Federal Reserve Bank, William C Dudley, Workshop on Reforming Culture and Behaviour in the Financial Services Industry, New York, 20 October 2014.

[21] Group of Thirty, *Banking conduct and culture: A permanent mindset change*, report, November 2018, p. 23.

[22] D Awrey and D Kershaw, 'Toward a more ethical culture in finance' in N Morris and D Vines, *Capital failure: Rebuilding trust in financial services*, Oxford University Press, 2016, p. 285.

[23] D Miller, 'The norm of self-interest', *American Psychologist*, vol. 54(12), 2000.

[24] Financial Consumer Agency of Canada, *Domestic bank retail sales practices review*, 20 March 2018, p. 5.

brokers[25] and retail banks[26] – for focusing on sales to the detriment of consumers' best interests. Further, in 2014 an Australian Senate committee revealed that financial planners had targeted low-risk-investment clients and misled them into making high-risk investments with the knowledge of Commonwealth Bank of Australia management. In return for their activity, the planners were given higher bonuses and secure employment.[27] Similar behaviour was observed at the National Australia Bank.[28] Such behaviour is a good indicator that the culture of a firm is focused on self-interest rather than prioritising the consumer's interests.

Remuneration structures can also be used to promote a consumer-centric culture – something that several regulators have observed. Assuming some level of transparency, the patterns of hiring, firing, promoting and demoting staff, and similar factors, can signal to employees what the organisation's values are.[29] To this end, New Zealand's Financial Markets Authority outlined factors that affect risks associated with sales-based remuneration structures. Factors that decreased risks included:

- risk and behaviour gateways;
- caps on the number of salespeople who can receive 'variable pay';
- clawbacks;
- deferrals;
- decelerators; and
- non-sales measures.[30]

The Authority also identified factors which can increase the risks of inappropriate behaviour stemming from sales-based remuneration or branch performance measures (each factor can either increase or decrease risk, depending on how it is designed:

- manager incentives (incentives to managers who may then pressure their staff);
- manager discretion in performance ratings; and
- competitions and performance management.[31]

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[25] Commonwealth of Australia, *Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry*, final report, February 2019, vol. 2, pp. 60–83.

[26] Commonwealth of Australia, *Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry*, final report, February 2019, vol. 2, pp. 51–60.

[27] Senate Economics References Committee, *The performance of the Australian Securities and Investments Commission*, final report, 26 June 2014, p. 183.

[28] ASIC, *ASIC commences civil penalty proceedings against NAB for BBSW conduct*, media release 16-183, 7 June 2016.

[29] 'Good compliance, not mere compliance', speech by Governor of the Federal Reserve Board, Daniel Tarullo, Federal Reserve Bank of New York Conference 'Reforming Culture and Behaviour in the Financial Services Industry', New York, 20 October 2014.

[30] Financial Markets Authority, *Bank incentive structures*, November 2018, pp. 10–11.

[31] Financial Markets Authority, *Bank incentive structures*, November 2018, pp. 12–13.

This review finds that the structure of remuneration has been one of the most examined drivers of cultural change over the past decade. Sales-based remuneration has fallen out of favour with regulators and the reports detailed above show the negative effect that remuneration structure can have.

Risk management and risk culture

'Risk culture' is defined as the impact of organisational culture on risk management within that organisation.[32] More specifically, it is:

> the norms and traditions of behaviour of individuals and of groups within an organisation that determine the way in which they identify, understand, discuss, and act on the risks the organisation confronts and the risks it takes.[33]

In a similar vein, risk culture is defined by the German Federal Financial Supervisory Authority in the annotations to its *Minimum requirements for risk management* based on para. 25a of the *German Banking Act*:

> [R]isk culture refers in general to the manner in which the institution's staff (should) deal with risks in the course of their duties.[34]

There is some interplay between risk management and other cultural influences. For instance, if the remuneration and incentive packages in a firm are based on sales, an employee of that firm may be more likely to recommend a riskier product to a customer than they otherwise would be. The way that a firm deals with the risk of inappropriate behaviour also acts as a signal to employees, as do the hiring and firing practices of firms. Therefore, risk management – and signalling to employees that risks are taken seriously – is an important step to creating and maintaining good culture.

Tone from the top

Through their actions, senior management within a firm convey the level of acceptable behaviour expected from their employees.[35] This effect is sometimes called 'tone from the top'. The tone from the top is especially important in creating an ethical corporate culture because '[if] you don't have tone from the top … people will just bypass [behavioural expectations] and work around them'.[36] As in the example of the interplay between risk management and hiring and firing practices, this driver does not operate in a vacuum.

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[32] Australian Prudential Regulation Authority, *Risk culture*, information paper, October 2016, p. 7.

[33] International Institute of Finance, *Reform in the financial services industry: Strengthening practices for a more stable system*, report, 2009.

[34] Federal Financial Supervisory Authority, *Annex 1: Annotated text of the Minimum requirements for risk management*, *27 October 2017*, p. 10.

[35] Basel Committee on Banking Supervision, *Principles for enhancing corporate governance*, consultative document, 15 June 2010, [26].

[36] C Ford and D Hess, 'Corporate monitorships and new governance regulation: In theory, in practice, and in context', *Law & Policy*, vol. 33, 2000, p. 523.

Taking the example discussed in the previous section, a firm policy that incentivises sales and encourages socially excessive risk-taking would be seen as 'bad tone from the top'.[37]

While culture itself cannot be forced into or onto firms or industries, the actions and attitudes of senior managers can be moulded in order to promote good culture. For example, in the United Kingdom the Senior Managers and Certification Regime (SMCR), which replaced the Approved Persons Regime, places responsibility on senior managers to foster a positive culture throughout their firm.[38] Along with this, the United Kingdom has the Treating Customers Fairly initiative which places the onus on senior management to promote a positive corporate culture.[39]

Under these frameworks, senior management must consider how to best assess culture and governance. Other reports have made it clear that senior management will often pay less attention to their own behaviour than to the behaviour of their employees.[40] However, Martin Wheatley noted it would be a tall order to ask bank boards on their own to reform the culture of their entire bank.[41] Instead senior management must, through their actions, set a standard which should be reflected by their employees.

Senior managers have two foundational responsibilities to change and reinforce good culture. The first is making it clear to their employees that regulatory objectives are important; the second is showing that violating those objectives will result in disciplinary measures.[42]

This top-down approach is not universally accepted. For instance, Mark Yallop, during an interview, was presented with a finding that 13% of bankers in the United Kingdom felt they had to 'flex' their ethical standards to get ahead.[43] Yallop replied that this demonstrated the importance of a bottom-up approach to culture and ethics:

> Yes, there has to be messaging from the board and CEO, and the actions of the CEO have to be consistent with that message, but if you've got 22 year olds starting out in finance straight out of university, they don't arrive with a clear map of how to behave.

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[37] S Omarova, 'Ethical finance as a systemic challenge: Risk, culture, and structure', *Cornell Journal of Law & Public Policy*, vol. 27, 2018, p. 811.

[38] *Culture in financial services – A regulator's perspective*, speech by Deputy Governor of Prudential Regulation and Chief Executive Officer of the Prudential Regulation Authority at the Bank of England, Andrew Bailey, City Week 2016 Conference, London, 9 May 2016.

[39] Financial Services Authority, *Treating customers fairly – Towards fair outcomes for consumers*, report, July 2006, p. 6 [1.13].

[40] De Nederlandsche Bank, *Leading by example: Behaviour in the board rooms of financial institutions*, 2013.

[41] *Debating trust and confidence in banking*, speech by Chief Executive of the FCA, Martin Wheatley, ResPublica Vocational Banking event, London, 28 May 2015.

[42] D Awrey, W Blair and D Kershaw, *Between law and markets: Is there a role for culture and ethics in financial regulation?* (14/2012), working paper, London School of Economics Law Society and Economy, 2012, p. 23.

[43] M Yallop, 'Conduct and culture Q&A', *International Financial Law Review*, vol. 36, July/August 2017, p. 43.

> They need to be given examples, and training needs to become more sophisticated and develop their career paths.[44]

While it is true that in all industries, including financial services, new employees need to be made aware of their obligations and ethical responsibilities, this alone is not the most effective way to effect organisational change. Instead, it is only part of the wider push by financial service firms to form a more consumer centric culture and regain the trust of the public.

2.3 Importance and effect of culture for financial product regulation

Culture within financial services firms directly affects the behaviour of firms and the outcomes for consumers. This makes culture an important consideration for regulators and supervisors when thinking about financial product governance. Behavioural issues in the financial services industry can cause significant loss to consumers and investors. This in turn can lead to more widespread economic problems,[45] a prominent example being the global financial crisis.

In response to these problems, a number of countries are developing or have developed instruments to improve the culture of the industry. For instance, Australia has adopted legislation dealing with conflicted remuneration[46] and product design and distribution.[47] In the United Kingdom, similar product intervention powers have been in place for almost a decade.[48]

These regulatory advances show that while there has been debate over the meaning of 'culture', there has been no such debate over the importance of firm culture in financial regulation.[49] As mentioned at the outset of this chapter, it is almost impossible today to argue that the norms that surround an individual, and in turn their organisation, do not exercise a 'profound influence'.[50] This has proven especially true in the financial services sector. Discussing the importance of 'culture' in this context, Andrew Bailey said:

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[44] Ibid.

[45] A Wardrop, D Wishart and M McMahon, 'Regulating financial institution culture: Reforming the regulatory toolkit', *Journal of Banking & Finance Law & Practice*, vol. 27, 2016, p. 171.

[46] Financial Sector Reform (Hayne Royal Commission Response – Protecting Consumers (2019 Measures)) Bill 2019.

[47] *Treasury Laws Amendment (Design and Distribution Obligations and Product Intervention Powers) Act 2019*; *Corporations Act 2001*, Pt 7.8A.

[48] *Financial Services Act 2012* (UK) s. 137A(1).

[49] *Culture in financial services – A regulator's perspective*, speech by Deputy Governor of Prudential Regulation and CEO of the Prudential Regulation Authority at the Bank of England, Andrew Bailey, City Week 2016 Conference, London, 9 May 2016.

[50] D Awrey, W Blair and D Kershaw, *Between law and markets: Is there a role for culture and ethics in financial regulation?* (14/2012), working paper, London School of Economics Law Society and Economy, 2012, p. 16.

> My assessment of recent history is that there has not been a case of major prudential or conduct failing in a firm which did not have among its root causes a failure of culture as manifested in governance, remuneration, risk management or tone from the top.[51]

This sentiment has been echoed on numerous occasions by commissions examining financial products. For instance, the Financial Services Royal Commission found in 2019 that 'failings of organisational culture, governance arrangements and remuneration systems, lie at the heart of much of the misconduct examined in the Commission'.[52] Five years earlier, speaking about the final report of the Financial System Inquiry (Murray Report), David Murray noted that there was a requirement for 'improved firm culture along with stronger obligations in some areas, especially in product manufacture and distribution'.[53]

Taking a more scientific view of the effects of organisational culture in the financial services industry, research conducted in 2014 by Alain Cohn, Ernst Fehr and Michel André Maréchal suggested that 'the prevailing business culture in the banking industry weakens and undermines the honesty norm, implying that measures to re-establish an honest culture are very important'.[54] This quasi-experiment built on earlier findings that participants in the financial services industry (specifically bankers) are not more dishonest than other workers to a statistically significant degree.[55] Therefore, culture is an important part of financial stability, and of ensuring that the public does (and should) trust the financial services industry.

Trust

It is also important to look at culture as a way to achieve positive outcomes. Not only is poor culture a foundation of major failings in the industry, but good culture is essential for good governance.[56] Good culture is the foundation of trust in financial institutions and, in turn, trust is the foundation of an effective financial system.[57] This relationship was described by the Group of Thirty (G30) in the 2015 research report, *Conduct and culture: A call for sustained and comprehensive reform*:

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[51] *Culture in financial services – A regulator's perspective*, speech by Deputy Governor of Prudential Regulation and CEO of the Prudential Regulation Authority at the Bank of England, Andrew Bailey, City Week 2016 Conference, London, 9 May 2016.

[52] Commonwealth of Australia, *Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry*, final report, February 2019, vol. 1, p. 412.

[53] *Supporting Australia's economic growth – Release of the final report of the Financial System Inquiry*, speech by AO Chairman of the Financial Services Inquiry, David Murray, Committee for Economic Development of Australia, 8 December 2014.

[54] A Cohn, E Fehr and M Maréchal, 'Business culture and dishonesty in the banking industry', *Nature*, vol. 516, 2014, p. 86.

[55] Ibid.

[56] Basel Committee on Banking Supervision, *Principles for enhancing corporate governance*, consultative document, 15 June 2010, [29].

[57] Group of Thirty, *Banking conduct and culture: A permanent mindset change*, report, November 2018, p. 18.

> We define culture as the mechanism that delivers the values and behaviours that shape conduct and contributes to creating trust in banks and a positive reputation for banks among key stakeholders, both internal and external.[58]

While this definition of culture is not broadly used, it draws attention to the fact that the culture (including the perceived culture) of the financial services industry plays a role in the trust consumers and investors have in the industry. Banking was one of the most trusted industries in the 2000s.[59] This trust was severely damaged after the global financial crisis. The need to rebuild that trust has been recognised by regulators[60] and industry alike.[61] However, it is suggested that cultural change alone will not be enough to rebuild that trust. This cultural change must also be substantive and visible to potential consumers and investors to accomplish this goal.[62]

Finally, it is important to note that the cultural and ethical problems facing the financial services industry are not unique. These problems can be seen in a variety of industries. However, as William C Dudley, then President of the New York Federal Reserve Bank, observed, they are particularly damaging to financial firms:

> Financial firms exist, in part, to benefit the public, not simply their shareholders, employees and corporate clients. Unless the financial industry can rebuild the public trust, it cannot effectively perform its essential functions. For this reason alone, the industry must do much better.[63]

Therefore, while trust and acceptable culture are important for many industries, the financial services industry is unusually susceptible to the failings of public confidence. Trust and acceptable culture are necessary for banking to be a viable and substantiable industry, both socially and economically.[64] Therefore culture – including its changes and,

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[58] Group of Thirty, *Conduct and culture: A call for sustained and comprehensive reform*, report, July 2015, p. 17.

[59] Group of Thirty, *Banking conduct and culture: A permanent mindset change*, report, November 2018, p. 18.

[60] *Enhancing financial stability by improving culture in the financial services industry*, speech by President and CEO of the Federal Reserve Bank, William C Dudley, Workshop on reforming culture and behaviour in the financial services industry, New York, 20 October 2014; Stephen Hester quoted in M Scuffham, 'RBS CEO says banks need culture change to regain trust', *Reuters*, 2 October 2012 ("Banks must undergo a wholesale change in their culture and refocus their behaviour on meeting the needs of customers to restore trust in the industry").

[61] Marcus Agius quoted in M Murphy, 'Bad actions stick, archbishop tells City', *Financial Times*, 5 October 2010 ("the leaders of industry must collectively procure a visible and substantive change in the culture of our institutions, so as fundamentally to convince the world once again that they are businesses which can be relied on").

[62] Marcus Agius quoted in M Murphy, 'Bad actions stick, archbishop tells City', *Financial Times*, 5 October 2010.

[63] *Enhancing financial stability by improving culture in the financial services industry*, speech by President and CEO of the Federal Reserve Bank, William C Dudley, Workshop on reforming culture and behaviour in the financial services industry, New York, 20 October 2014.

[64] Group of Thirty, *Banking conduct and culture: A permanent mindset change*, report, November 2018, p. v.

perhaps more importantly, the visibility of those changes – has been a focus of financial services regulators and the financial services industry itself.[65]

2.4 Reasons to improve culture in the financial services industry

Before delving into who is responsible for changing the culture within the financial services industry this review will first turn its attention to why there may be a need for cultural change. The current culture and why it needs to change are examined in this section through the use of recent examples.

Financial Services Royal Commission

One of the most recent examinations of culture comes from the Financial Services Royal Commission in Australia. Commissioner Hayne, discussing the challenges facing the financial services industry, stated:

> [C]ulture, governance and remuneration. … Each [of those words] can provoke serious debate about definition. But there is no other vocabulary available to discuss issues that lie at the centre of what has happened in Australia's financial services entities and with which this Report must deal.[66]

The industry behaviour described during the Royal Commission hearings was enough for the Commission to conclude that culture within the Australian financial services industry required widespread change and continuous monitoring. A result of assessing examples of industry culture, recommendation 5.6 of the final report attempts to force financial services firms to assess their culture, identify any problems with that culture, deal with those problems and determine whether these changes have been effective.[67]

G30 banking conduct and culture report

In 2018 the G30 took a more holistic view of culture within the global financial services industry. In its report on banking culture and conduct, the G30 noted that both geographic location and the effort of firms had caused some differences between jurisdictions in how much cultural norms had shifted worldwide.[68]

The G30 report found that many banks had taken steps to improve their culture since the global financial crisis. These steps included reviewing remuneration structures and adding behavioural and cultural indicators to performance scorecards,[69] implementing a code of conduct, changing processes, and increasing the accountability of senior members of banks.

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[65] Marcus Agius quoted in M Murphy, 'Bad actions stick, archbishop tells City', *Financial Times*, 5 October 2010.

[66] Commonwealth of Australia, *Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry*, final report, February 2019, vol. 1, p. 334.

[67] Commonwealth of Australia, *Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry*, final report, February 2019, vol. 1, p. 392.

[68] Group of Thirty, *Banking conduct and culture: A permanent mindset change*, report, November 2018, p. 30.

[69] Group of Thirty, *Banking conduct and culture: A permanent mindset change*, report, November 2018, p. xii.

This increasing focus on culture coincided with an increase in consumers' trust in banks from 2015 to 2018.[70]

Central Bank of Ireland report

The July 2018 report *Behaviour and culture of the Irish retail banks* was completed by the Central Bank of Ireland in collaboration with De Nederlandsche Bank.[71] While the report focused on the behaviour of senior management, it offers a valuable examination of the culture within that sector of the financial services industry.

The positive observations of the report included that the five banks subject to the review had taken steps to move towards a more consumer-centred culture, both in terms of board decision-making and structural decisions and processes.[72] However, the critical observations were that industry is still developing this culture, with the term "customer centric" often being used but not lived.[73]

Other cultural norms identified as potentially problematic in the report were an overly optimistic attitude after coming out of the global financial crisis and the continuing preference of short-term interests over the interests of consumers.[74]

HKMA circulars

The HKMA has focused on promoting reform of banking culture in recent years. This focus has come in light of continuing misconduct in the banking sector identified by the HKMA, both domestically and worldwide.[75] Two circulars – one released in 2017[76] and one and 2018[77] (collectively 'the Circulars') – show two steps that the HKMA has taken in order to help reform banking culture.

2017 – Bank culture reform circular

The first circular, released in March 2017, identified three pillars of sound banking culture: governance (referring to, in part, 'tone from the top), incentive systems, and assessment and feedback mechanisms.[78] These three pillars, either individually or in combination, had

[70] Group of Thirty, *Banking conduct and culture: A permanent mindset change*, report, November 2018, p. 3.

[71] Central Bank of Ireland, *Behaviour and culture of the Irish retail banks*, report, July 2018.

[72] Central Bank of Ireland, *Behaviour and culture of the Irish retail banks*, report, July 2018, p. 20.

[73] Central Bank of Ireland, *Behaviour and culture of the Irish retail banks*, report, July 2018, pp. 20–21.

[74] Central Bank of Ireland, *Behaviour and culture of the Irish retail banks*, report, July 2018, p. 18.

[75] HKMA, *Bank culture reform* (B1/15C; B9/146C), circular, 2 March 2017, pp. 1–2.

[76] HKMA, *Bank culture reform* (B1/15C; B9/146C), circular, 2 March 2017.

[77] HKMA, *Supervision for bank culture* (B1/15C; B9/195C), circular, 19 December 2018.

[78] HKMA, *Bank culture reform* (B1/15C; B9/146C), circular, 2 March 2017.

been identified by the HKMA as often being related to the root cause of major conduct incidents in the banking sector.[79]

The practice guide in annex 1 of the circular gave examples of practices within each pillar that could be implemented by banks for promoting sound bank culture. The examples included:

- using conduct summary sheets supplemental to a code of conduct, tailored to the day-to-day activities of employees;[80]
- giving adequate consideration to non-sales-related performance indicators, such as relationships with customers;[81] and
- drawing on staff feedback (of variable types) to improve the culture of the bank.[82]

In light of the 2017 circular, some banks had already begun implementing measures to positively influence their culture before the second circular was released. One such bank hosted a workshop by its board members to discuss with its staff the top 10 'grey area' scenarios that had been suggested by staff prior to the workshop.[83] Therefore, these measures had begun to shift culture positively by identifying practices that banks could implement.

2018 – Supervision for bank culture circular

The second circular,[84] published in December 2018, built on the three pillars by outlining three measures the HKMA would use to gauge the progress of bank culture reform and provide further guidance to the industry where necessary. The measures were: self-assessment of authorised institutions, focus reviews conducted by the HKMA, and discussions with senior management and board members about banking culture. The self-assessment questions were included as an annex to the 2018 circular. Bank staff were asked questions such as:

- Does your institution have any effective mechanisms in place for ensuring that your institution's desired culture is understood and shared by all levels of staff?
- Do the incentive systems of your institution avoid incentivising short-term business performance at the expense of the interests of customers and the safety and soundness of your institution?
- Does your institution develop appropriate tools to monitor adherence of individual business units and relevant staff to your institution's culture and behaviour standards?

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[79] *Bank culture reform – Our next steps*, speech by HKMA Executive Director, Alan Au, 1LoD Summit, Hong Kong, 16 January 2019.

[80] HKMA, *Bank culture reform* (B1/15C; B9/146C), circular, 2 March 2017, Annex p. 1.

[81] HKMA, *Bank culture reform* (B1/15C; B9/146C), circular, 2 March 2017, Annex p. 2.

[82] HKMA, *Bank culture reform* (B1/15C; B9/146C), circular, 2 March 2017, Annex p. 3.

[83] *Bank culture reform – Our next steps*, speech by HKMA Executive Director, Alan Au, 1LoD Summit, Hong Kong, 16 January 2019, [12].

[84] HKMA, *Supervision for bank culture* (B1/15C; B9/195C), circular, 19 December 2018.

The first round of self-assessment commenced in early 2019 and involved 30 authorised institutions selected by the HKMA. Following it review of the self-assessment submissions, HKMA's has published a circular[85] and full report.[86]

Current outcomes of the Circulars

Cultural changes take time and the relative recency of the Circulars means that their impact will not be fully understood for some time. Some initial findings, based on the results of the first self-assessment, were discussed by HKMA Executive Director Alan Au in January 2020

Au outlined some of the measures that banks had incorporated under the three pillars. On the governance pillar, all locally incorporated banks had board-level oversight of culture. While commending this, Au noted that this alone would not be sufficient to promote sound culture, if banks want their staff to understand and live up to their culture.[87] Several creative approaches to governance had been taken. For instance, one bank also created a series of videos combining conduct-related themes and Fung Shui,[88] while another bank had tailored its conduct summary sheets to each business function.[89]

The purpose of these non-conventional communication attempts is to promote cultural expectations in a way that is readily understandable by staff. Their positive reception indicates that firms should aim to tailor their cultural changes approaches not only to the organisation but also to the different limbs of that organisation.

Banks had also implemented mechanisms to address the two other pillars of sound culture. Banks had increasingly implemented both incentives and disincentives for staff based on their behaviour rather than sales.[90] Assessment and feedback mechanisms had also been increased; however, it is important for banks to assess the effectiveness of their culture enhancement efforts in driving cultural change.[91]

While these developments show that the process has begun to work and take effect Au believes that banks need to focus more attention on the common themes identified by the HKMA in the self-assessment exercise.[92] Au also identified more specific aspects of bank culture that still required the attention of the HKMA, including incentive systems in front

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[85] HKMA, *Report on Review of Self-assessments on Bank Culture* (B1/15C; B9/195C), circular, 22 May 2020.

[86] HKMA, *Report on Review of Self-assessments on Bank Culture*, report, 22 May 2020.

[87] *Our journey towards sound bank culture – Reflections and beyond*, speech by HKMA Executive Director, Alan Au, 1LoD Summit, Hong Kong, 14 January 2020, [11].

[88] *Our journey towards sound bank culture – Reflections and beyond*, speech by HKMA Executive Director, Alan Au, 1LoD Summit, Hong Kong, 14 January 2020, [13].

[89] *Our journey towards sound bank culture – Reflections and beyond*, speech by HKMA Executive Director, Alan Au, 1LoD Summit, Hong Kong, 14 January 2020, [14].

[90] *Our journey towards sound bank culture – Reflections and beyond*, speech by HKMA Executive Director, Alan Au, 1LoD Summit, Hong Kong, 14 January 2020, [15]–[16].

[91] *Our journey towards sound bank culture – Reflections and beyond*, speech by HKMA Executive Director, Alan Au, 1LoD Summit, Hong Kong, 14 January 2020, [17]–[18].

[92] *Our journey towards sound bank culture – Reflections and beyond*, speech by HKMA Executive Director, Alan Au, 1LoD Summit, Hong Kong, 14 January 2020, [31].

offices of retail banks.[93] While more work is needed, the HKMA's approach to promote bank culture reform by returning responsibility to banks to improve their culture is an interesting and promising case study on how to change culture in the banking sector.

FCA review of product governance in retail banking

In March 2018, the Financial Conduct Authority (FCA) released a review of product governance in small-to-medium banks. The review was aimed at assessing:

- how firms identify and respond to risks from both their customers' changing needs and external factors;
- whether firms' product governance frameworks provide sufficient challenge to their risk assessment assumptions; and
- how these product reviews identify potential customer harm, provide effective management information and use customer feedback.[94]

The review found that consumer-oriented frameworks were the most effective. This effectiveness was greater when the consumer focus continued across all financial products. The review also found that most senior management staff had a positive 'tone from the top'.[95]

While the review highlighted many positive trends in financial product governance in the United Kingdom, it also identified areas in need of improvement. These areas included:

- upholding record-keeping obligations;
- taking action on identified risks stemming from financial products;
- issuing clearer terms and conditions; and
- testing consumers for their understanding of the financial product.

2.5 Responsibility for promoting a consumer-focused culture

Culture is not a quality which lends itself easily to regulation. A regulator cannot ask a firm to display its culture norms. Therefore, it is argued that responsibility for changing negative cultures within financial services firms cannot fall to the regulator. Instead 'the primary responsibility for misconduct in the financial services industry lies with the entities concerned and with those who manage and control them: their boards and senior management'.[96] This was one of the five assumptions used by De Nederlandsche Bank in its examination of culture in financial institutions.[97]

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[93] *Our journey towards sound bank culture – Reflections and beyond*, speech by HKMA Executive Director, Alan Au, 1LoD Summit, Hong Kong, 14 January 2020, [28].

[94] See Retail banking: Product governance review on the FCA website.

[95] Ibid.

[96] Commonwealth of Australia, *Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry*, final report, vol. 1, p. 4.

[97] De Nederlandsche Bank, *Supervision of behaviour and culture: Foundations, practice and future developments*, report, 2015, p. 53.

In 2016 Andrew Bailey observed:

> Culture begins and lives, and I am afraid dies, at home with firms.[98]

The regulator has an assistive role, setting standards of behaviour that should be maintained,[99] and advising firms on how they may change their culture.[100] Therefore, the following analysis and the subject of organisational culture generally must be viewed in this context, with the responsibility for cultural change placed on firms and the industry.

The other important aspect to note was stated by former Chairman of the Australian Prudential Regulation Authority, John Laker:

> The task [of transforming culture] will evolve, not end – it's a journey, not a destination.[101]

2.6 Changing organisational culture

Once it is determined that the current culture of an organisation is not satisfactory, methods for changing it should be examined. Culture is not something that can be changed through one organisational shift or by changing a single external factor.[102] Rather, it requires shifts of different and multiple factors to be effective. These shifts also do not usually come from implementing a code of conduct alone.[103] This is because countervailing cultural norms may overpower these efforts.[104]

For instance, if a firm's code of conduct prioritises the consumer's best interests but the firm's remuneration structure is based on sales (value or quantity), this creates a conflict.[105] This conflict may, and likely will, result in an employee preferring the remuneration package to the best interests duty placed on them by the code of conduct.

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[98] *Culture in financial services – A regulator's perspective*, speech by Deputy Governor of Prudential Regulation and CEO of the Prudential Regulation Authority at the Bank of England, Andrew Bailey, City Week 2016 Conference, London, 9 May 2016.

[99] De Nederlandsche Bank, *Supervision of behaviour and culture: Foundations, practice and future developments*, report, 2015, p. 54.

[100] Compare De Nederlandsche Bank, *Supervision of behaviour and culture: Foundations, practice and future developments*, report, 2015, p. 54.

[101] T Boyd, '"Transforming culture is not a short-term project": John Laker', *Financial Review*, 18 June 2019.

[102] *Enhancing financial stability by improving culture in the financial services industry*, speech by President and CEO of the Federal Reserve Bank, William C Dudley, Workshop on reforming culture and behaviour in the financial services industry, New York, 20 October 2014.

[103] D Awrey, W Blair and D Kershaw, *Between law and markets: Is there a role for culture and ethics in financial regulation?* (14/2012), working paper, London School of Economics Law Society and Economy, 2012, p. 20.

[104] D Awrey, W Blair and D Kershaw, *Between law and markets: Is there a role for culture and ethics in financial regulation?* (14/2012), working paper, London School of Economics Law Society and Economy, 2012, p. 20.

[105] R David, D Awrey and W Blair, *Between law and markets: Is there a role for culture and ethics in financial regulation*, London School of Economics and Political Science, 5 October 2012, p. 39.

Another consideration when discussing how culture can be improved is the metrics that are used to judge this change. This is especially important because cultural change in financial services firms must not just happen; it also must be seen to have happened, for public confidence to be regained. This challenge has already arisen in the United Kingdom with the SMCR. A recent report by the FCA on the impact of the SMCR program indicated that '[f]irms have found it challenging to find appropriate ways of measuring culture'.[106] This problem is not unexpected, due to the abstract nature of 'culture'. Unlike other risks and controls, culture cannot be valued and governed by a mathematical model.[107] This is another challenge for the methodology used to change culture in the financial services industry.

There is also debate over how long it takes for cultural changes to become observable. The Financial Services Royal Commission heard a variety of answers to this question, ranging from 2 to 10 years depending on the commitment of the firm.[108] In the United Kingdom, firms have reported seeing changes in culture and behaviours[109] in the three years since the SMCR regime was introduced in 2016.[110] Whatever this time period is, it should be noted that culture is an ever-changing part of firms and, as such, the financial services industry faces an ongoing task of maintaining good culture.

[106] FCA, *Senior Managers and Certification Regime banking stocktake report*, August 2019.

[107] *Debating trust and confidence in banking*, speech by CEO of the FCA, Martin Wheatley, ResPublica Vocational Banking event, London, 28 May 2015.

[108] Commonwealth of Australia, *Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry*, final report, February 2019, vol. 2 p. 391.

[109] Note that what is deemed a change in culture may differ from firm to firm, and such changes may have only been gradual in nature.

[110] FCA, *Senior Managers and Certification Regime banking stocktake report*, August 2019.

3. Product governance and regulation

Consumer protection regulations for financial products have become increasingly common across the world. Regulation traditionally did not focus on product design and distribution.[111] Its focus was on regulating specific products, not financial products as a general class. This was particularly true of regulation focusing on the quality or 'merit' of a product.[112] Since the global financial crisis, this focus has shifted.[113] Increasingly, regulation is adopting a general approach to financial products, which includes the implementation of product intervention powers,[114] and regulatory coverage of product designers and distributors.

This chapter discusses:

- definitions of financial product governance, regulation and intervention;
- drivers of product regulation; and
- current challenges for product governance and regulation.

3.1 Defining product governance, regulation and intervention

Product governance has been defined as 'regulation that requires product issuers (and distributors) to perform oversight processes' on financial products throughout the product life cycle.[115] Phases of the life cycle referred to in this definition include:

- design of the product (including identification of the target market);
- monitoring of the product's market performance (and consequent adjustments to its distribution); and
- if necessary, use of product intervention powers on the product.[116]

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[111] R Thomas, 'Regulating financial product design in Australia: An analysis of the UK approach', *Journal of Banking & Finance Law & Practice*, vol. 28, 2017, p. 95.

[112] R Bollen, 'Quality and safety for financial services and products', *Journal of Banking & Finance Law & Practice*, vol. 26, 2015, p. 182.

[113] See, eg, Financial Services Authority, *Treating customers fairly after the point of sale*, discussion paper 7, July 2001, cited in R Thomas, 'Regulating financial product design in Australia: An analysis of the UK approach', *Journal of Banking & Finance Law & Practice*, vol. 28, 2017, p. 95.

[114] Out of 24 countries that responded to question 7 of the SC6 survey, 20 had product intervention powers and another (Australia) have since implemented such powers.

[115] R Thomas, 'Regulating financial product design in Australia: An analysis of the UK approach', *Journal of Banking & Finance Law & Practice*, vol. 28, 2017, p. 95.

[116] Australian Government Treasury, *Design and distribution obligations and product intervention power*, proposals paper, December 2016, p. 7.

This chapter discusses 'financial product regulation' as a whole.[117] Product regulation is used as a blanket term encompassing both:

- the obligations placed on designers and distributors of financial products (product governance); and
- the powers of regulators when those obligations have not been met (product intervention powers).[118]

The objectives of product regulation have been described by Federico Della Negra as follows:

> Some requirements, including key target market identification requirements, aim primarily to protect investors, thus reducing the need for recourse to alternative dispute resolution systems or the courts for compensation. Other requirements aim to ensure that adequate internal corporate processes and arrangements are in place. Lastly, a broader objective pursued by financial product governance obligations is to ensure orderly functioning and stability of financial markets to reduce the risk of creating a financial instrument that might create systemic risks.[119]

Further, one of the main aims of product governance is to protect consumers by promoting a consumer-centric culture in financial services firms.[120] Therefore, any assessment of the efficiency of product governance should be based on the outcomes they have achieved for consumers.

This approach does have its pitfalls. For instance, it is important to stress, as the Murray Report cautioned, that 'regulation cannot be expected to prevent all customer loss'.[121] Regulation is 'intended to reduce the risk of consumers being sold poor quality or unsuitable products' rather than reduce the standard risks found in financial markets.[122] That aim forms the basis of this review's discussion of the effectiveness of current product regulation.

3.2 Drivers of product governance

Financial product governance has historically focused on requirements of transparency and disclosure during product marketing. However, a new wave of governance has recently

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[117] R Thomas, 'Regulating financial product design in Australia: An analysis of the UK approach', *Journal of Banking & Finance Law & Practice*, vol. 28, 2017, p. 95.

[118] R Thomas, 'Regulating financial product design in Australia: An analysis of the UK approach', *Journal of Banking & Finance Law & Practice*, vol. 28, 2017, p. 95.

[119] F Della Negra, *MiFID II and private law: Enforcing EU Conduct of Business Rules*, Hart Publishing, 2019, p. 46.

[120] Consultative Group to Assist the Poor, Making Consumer Protection Regulation More Customer Centric, June 2020, p.8.

[121] *Supporting Australia's economic growth – Release of the final report of the Financial System Inquiry*, speech by AO Chairman of the Financial System Inquiry, David Murray, Committee for Economic Development of Australia, 8 December 2014.

[122] *Supporting Australia's economic growth – Release of the final report of the Financial System Inquiry*, speech by AO Chairman of the Financial System Inquiry, David Murray, Committee for Economic Development of Australia, 8 December 2014.

begun to find favour with legislators worldwide. This section discusses the drivers of this new wave of regulation, beginning with the global financial crisis and then discussing new research that questions the effectiveness of past product governance methods.

Global financial crisis

The literature, including academic articles and regulator releases, points to the 2007–09 global financial crisis as a turning point for attitudes towards product governance.[123] After the crisis, regulations and governance almost uniformly increased globally. For example, when discussing its new product intervention powers, the FCA wrote: 'We have learned from previous major product failures that earlier intervention can be more effective and efficient than waiting until the event'.[124]

Another example of more regulatory power being given in the wake of the global financial crisis is the *Dodd-Frank Wall Street Reform and Consumer Protection Act*[125] (discussed later in section 0), introduced in the United States.[126] However, the global financial crisis was only the catalyst for an increase in regulation. If it had been the only reason for this increase, regulation would not have continued to develop after the recovery from the crisis. Therefore, the continuation and expansion of product governance can also be explained by other, more consistent factors.

Market imperfections

While the global financial crisis acted as a wakeup call to the financial services industry, regulators and legislators worldwide, it also promoted closer examination of current practices, especially in relation to the disclosure and transparency obligations in place at the time. While transparency and disclosure are important parts of product governance, the crisis proved that they are not enough to protect consumers or the market as a whole.[127] Stronger measures are required.

The Murray Report found:

> The existing framework relies heavily on disclosure, financial advice and financial literacy. However, disclosure can be ineffective for a number of reasons, including consumer disengagement, complexity of documents and products, behavioural biases, misaligned interests and low financial literacy.[128]

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[123] See, eg, R Bollen, 'Quality and safety for financial services and products', *Journal of Banking & Finance Law & Practice*, vol. 26, 2015, p. 189; Financial Services Authority, *The FCA's use of temporary product intervention rules* (CP 12/35), consultation paper, December 2012, p. 8; CGAP, Making Consumer Protection Regulation More Customer Centric, 2020, p.4.

[124] Financial Services Authority, *The FCA's use of temporary product intervention rules* (CP 12/35), consultation paper, December 2012, p. 8.

[125] *Dodd-Frank Wall Street Reform and Consumer Protection Act* (2010) 12 USC 5301.

[126] Congressional Research Service, *The Dodd-Frank Wall Street Reform and Consumer Protection Act: Background and summary*, 21 April 2017, p. 1.

[127] L Velliscig, 'Season 3: Financial product governance – Rethinking retail customer protection in the EU insurance market', *Global Jurist*, vol. 18, 2017, [10.1515].

[128] Australian Government Treasury, *Financial System Inquiry*, final report, November 2014, p. 199.

Therefore, reform and a changed attitude to product governance were necessary to remedy the inadequacies of the previous approaches. The imperfections in the financial services market (market imperfections) identified in the Murray Report included information asymmetry due to the complexity of financial products, and behavioural distortions (or biases).[129]

The FCA paper *Economics for effective regulation* identified five categories of market imperfection:

- information asymmetries;
- market power;
- externalities;
- regulatory failure; and
- behavioural distortions.[130]

Market imperfections exist within a market when that market is not perfectly efficient. A perfectly efficient market delivers goods and services that meet the consumer's needs, and the highest consumer welfare possible. When a market is not perfectly efficient, consumers will suffer a loss of welfare.[131] Product governance aims to improve the welfare of consumers by reducing or remedying market imperfections.

As highlighted by the Murray Report, the two market imperfections that product governance attempts to remedy are information asymmetry and behavioural distortions.

Information asymmetry

Information asymmetry is the difference in knowledge (about the financial products) between those that design and distribute products and the consumer who buys a product. In theory, with all else being equal, welfare would be maximised if consumers of financial products knew all the characteristics of all products on the market.[132] This outcome is not possible in practice. However, minimising information asymmetry and its effect is a goal of product governance.

In the past, there have been attempts to combat this information asymmetry by placing disclosure obligations on product designers and distributors and by educating consumers. This has been criticised as a simplistic approach which 'can be ineffective for a number of reasons'.[133] The reasons for the limited effectiveness of disclosure were discussed in a joint report by the Australian Securities and Investments Commission (ASIC) and the Dutch

[129] Australian Government Treasury, *Financial System Inquiry*, final report, November 2014, p. 199.

[130] Z Iscenk, P Andrews, K Dambe and P Edmonds, *Economics for effective regulation*, occasional paper no. 13, FCA, March 2016, p. 5.

[131] Z Iscenk, P Andrews, K Dambe and P Edmonds, *Economics for effective regulation*, occasional paper no. 13, FCA, March 2016, p. 12.

[132] W van Caenegem, 'Striking a balance between protecting commercial reputation and promoting competition', *Australian Law Journal*, vol. 77, 2003, p. 602.

[133] Australian Government Treasury, *Financial System Inquiry*, final report, November 2014, p. 199.

Authority for the Financial Markets, *Disclosure: Why it shouldn't be the default*. The challenges to the effectiveness of disclosure include:

- disclosure cannot solve the underlying complexity of financial products;[134]
- consumers are unlikely to read the provided disclosure statement due to the lack of relevance, complexity or length of the document;
- a one-size-fits-all approach to disclosure does not work (people are different but disclosure statements do not recognise these differences); and
- disclosures can backfire, causing consumer harm that the disclosure was meant to prevent.[135]

In contrast, financial product regulation offers a more sophisticated approach to remedying information asymmetry. It works by motivating product designers to produce products that meet the needs of a specified target market and to choose appropriate distribution strategies for that market. In contrast to disclosure, which relies on consumer understanding, these obligations focus on active measures, placing responsibility on producers to actively ensure their products are safe for the consumers targeted.

This message is echoed by the FCA in its guidance on the design of structured financial products:

> It is clear that there can be considerable asymmetry between firms' and consumers' understanding of how structured financial products work … This reinforces how important it is for firms developing structured financial products to ensure the role(s) they perform supports the delivery of good outcomes for consumers.[136]

The requirement for product governance other than disclosure obligations, is especially effective when information asymmetry is combined with the second prevalent market imperfection: behavioural distortions. As mentioned in the Centre for International Finance and Regulation's submission to the Financial System Inquiry (which resulted in the Murray Report), reliance on disclosure alone is insufficient in protecting consumers, especially

[134] 'The effectiveness of different disclosure in helping consumers make "optimal" purchasing choices about home insurance was tested in an experiment conducted by Monash University. The experiment was conducted in a computer laboratory and the only information participants could base their decision on was a detailed Product Disclosure Statement (PDS) and/or a two-page key facts sheet. Key findings from a number of different experimental groups showed that: [1] only two fifths (41%) of participants provided with the "simple" key facts sheet selected the objectively best insurance product. They did no better than those provided with the longer PDS; [2] almost three fifths (59%) of participants provided with either the "simple" key facts sheet or longer PDS made suboptimal choices; and [3] within some experimental groups, up to 42% of participants chose the worst product on offer': ASIC and Dutch Authority for the Financial Markets, *Disclosure: Why it shouldn't be the default*, October 2014, p. 14. The research was reported in J Malbon and H Oppewal, '(In)effective disclosure: An experimental study of consumers purchasing home contents insurance', Financial Rights Legal Centre and Monash University, 2018.

[135] ASIC and Dutch Authority for the Financial Markets, *Disclosure: Why it shouldn't be the default*, October 2014.

[136] FCA, *Structured products: Thematic review of product development and governance* (TR 15/2), March 2015, p. 13.

when information asymmetry is combined with behavioural influences.[137] Further, the two can sometimes overlap. For example, in *Applying behavioural economics at the Financial Conduct Authority*, the FCA stated that information asymmetries could occur when a consumer who is presented with all the information on a product is unable to process that information due to their own biases.[138]

Behavioural distortions

As noted earlier in the discussion of market imperfections, if all consumers knew all the characteristics of all products in the market then theoretically welfare would be maximised. However, this welfare maximisation remains theoretical due to behavioural distortions. Behavioural distortions (which can simply be thought of as biases) mean that consumers with perfect (correct and complete) information will not always behave in their own best interests.[139] Dr Rhys Bollen acknowledged:

> Behavioural finance research shows excessive optimism, timing biases and over-confidence mean that even with adequate information many consumers are unlikely to make optimal decisions about financial products and services.[140]

An example of consumer overconfidence in relation to consumer credit lending was provided by the FCA in its consultation paper on temporary intervention rules:

> Competition that is focused on exploiting consumer biases or information asymmetries may harm consumers. For example, intense competition between banks for current account customers has focused on highly visible features, which exploited consumers' overconfidence that they would not go overdrawn and incur charges or other less visible fees.[141]

In summary, even when fully informed, consumers may make irrational decisions due to inconsistent judgments or reasoning.[142]

The FCA made several findings about potential consumer biases and other behavioural distortions:

- A lack of motivation to become informed is often exacerbated by the complexity of financial products.
- Consumers are generally poor intuitive statisticians and prone to errors.

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[137] Centre for International Finance and Regulation, *CIFR submission to the Financial System Inquiry*, submission, March 2015.

[138] K Erta, S Hunt, Z Iscenko and W Brambley, *Applying behavioural economics at the Financial Conduct Authority*, occasional paper no. 1, FCA, April 2013, p. 24.

[139] R Bollen, 'Bounded rationality in the sale and purchase of managed funds', *Macquarie Journal of Business Law*, vol. 9, 2012, p. 98.

[140] R Bollen, 'Quality and safety for financial services and products', *Journal of Banking & Finance Law & Practice*, vol. 26, 2015, p. 195.

[141] Financial Services Authority, *The FCA's use of temporary product intervention rules* (CP 12/35), consultation paper, December 2012, p. 9.

[142] R Thaler and C Sunstein, *Nudge: Improving decisions about health, wealth and happiness*, Yale University Press, 2008.

- Consumers are prone to preferencing short-term gain while neglecting long-term considerations.
- Consumers are influenced by the emotion of financial decisions.
- The infrequency of financial decisions makes it difficult for consumers to fully inform themselves.[143]

It may be for these reasons that, in the last decade, behavioural economics has attracted increased attention from policymakers.[144] There has been a consensus that certain features of financial products may lead to consumers and their decision-making process being taken advantage of.[145] Questionable practices include the use of numbers, framing devices and emotions in advertising.[146] Some of these have been curbed by the introduction of various obligations on product distributors. However, distributors' marketing methods are not the only cause of market imperfections by behavioural distortion.

While marketing methods may influence consumers and cause behavioural distortions, the inbuilt biases of the human mind can also cause consumers to act irrationally. For instance, inertia or overconfidence bias may prevent consumers finding out which product is in their best interests. Having considered this fact, firms can further exploit this behavioural trait and lower the quality of their products. Situational monopolies can also arise due to consumers not looking for better products.[147] A financial product designed to exploit these traits may need additional regulatory intervention.[148]

Research also suggests that the increase in technology in the financial services industry will exacerbate existing behavioural traits.[149] The future importance of technology was also

[143] K Erta, S Hunt, Z Iscenko and W Brambley, *Applying behavioural economics at the Financial Conduct Authority*, occasional paper no. 1, FCA, April 2013, p. 16.

[144] A Lefevre and M Chapman, *Behavioural Economics and Financial Consumer Protection*, OECD Working Papers on Finance, Insurance and Private Pensions No42.

[145] P Adams and L Smart, *From advert to action: Behavioural insights into the advertising of financial products*, occasional paper no. 26, FCA, April 2017; K Erta, S Hunt, Z Iscenko and W Brambley, *Applying behavioural economics at the Financial Conduct Authority*, occasional paper no. 1, FCA, April 2013; R Mazer, K McKee and A Fiorillo, *Applying behavioral insights in consumer protection policy*, focus note no. 95, World Bank Group, June 2014.

[146] P Adams and L Smart, *From advert to action: Behavioural insights into the advertising of financial products*, occasional paper no. 26, FCA, April 2017.

[147] K Erta, S Hunt, Z Iscenko and W Brambley, *Applying behavioural economics at the Financial Conduct Authority*, occasional paper no. 1, FCA, April 2013. For explanation of the lowering of product quality due to information asymmetry, see G Akerlof, 'The Market for "Lemons": Quality uncertainty and the market mechanism', *The Quarterly Journal of Economics*, vol. 84(3), August 1970, p. 488.

[148] FCA, *Product intervention* (11/1), discussion paper, January 2011.

[149] D Kingsford Smith and M Nehme, *Product intervention powers: A legal, comparative and policy analysis*, UNSW Centre for Law, Markets and Regulation, 2015, p. 6.

noted in the Murray Report.[150] With rising use of big data[151] and machine learning,[152] the speed and reach of financial services provision will increase, making speedy and effective regulation of providers increasingly important.[153] These developments also increase the risk of behavioural exploitation by financial firms. These risks can be, at least in part, addressed through measures in the product governance process.[154]

3.3 Challenges for product governance

This section will discuss the challenges to financial product governance and the ways regulators and legislatures have attempted to meet them. The challenges discussed are:

- the lack of a standardised data format within the product governance sphere;
- poor culture in financial services firms; and
- the potential for stifling innovation in the financial services industry.

Lack of data standardisation

Standardisation of data within the global financial services industry has been an elusive goal. While not expressly discussed in this section, this challenge could be expanded to encompass the standardisation of terms within the broader financial services and regulatory space. Within the industry there exist many different data standards.[155] During the Frankfurt Group Technical Workshop on Data Standards Interoperability forum, 16 different data standards were identified in the financial services industry.[156] Despite

[150] Australian Government Treasury, *Financial System Inquiry*, final report, November 2014, pp. xix, 2.

[151] 'Big data is high-volume, high velocity and/or high variety information assets that demand cost-effective, innovative forms of information processing that enable enhanced insight, decision making, and process automation': Gartner, Information Technology Glossary, 'Big data'. This data can be used to reveal patterns and trends in the behaviour of consumers.

[152] 'Machine learning at its most basic is the practice of using algorithms to parse data, learn from it, and then make a determination or prediction about something in the world … [T]he machine is trained using large amounts of data and algorithms that give it the ability to learn how to perform the task': M Copeland, What's the difference between artificial intelligence, machine learning and deep learning? Nvidia, 29 July 2019.

[153] World Bank Group, *Product design and distribution: Emerging regulatory approaches for retail banking products*, discussion note, August 2019, p. 5.

[154] M Brenncke, 'The legal framework for financial advertising: Curbing behavioural exploitation', *European Business Organization Law Review*, vol. 19(4), 2018, p. 853.

[155] Frankfurt Group Technical Workshop on Data Standards Interoperability. Specifically, 16 data standards exist: 11 granular and five aggregated.

[156] *Overview of international experiences with data standards and identifiers applicable for big data analysis*, paper by M Piechocki, IFC–Bank Indonesia Satellite Seminar on 'Big Data' at the ISI Regional Statistics Conference, Bali, 21 March 2017, p. 5.

acknowledgement that the lack of data standards played a part in the magnitude of the global financial crisis,[157] this lack remains a challenge for the industry and regulators.

The financial services industry has lagged other industries in making and implementing blanket data standards.[158] This problem does not just affect manufacturers and distributors of financial products. Standardisation would also help regulators ensure that the financial product market is operating in an appropriate manner. This problem will inevitably increase with the growth of globalisation and international distribution of financial products in coming years.

Standardised data gives markets resilience and reduces the likelihood of information gaps by ensuring that quality data can be understood and compared throughout the market. It aims to prevent the occurrence of 'knowable unknowns' in the financial sector, especially in times of crisis.[159] During the global financial crisis, the Supervisory Capital Assessment program was one of the ways data was disseminated throughout the market in the United States. The program was described as 'one of the critical turning points in the financial crisis. It provided anxious investors with something they craved: credible information about prospective losses at banks.'[160]

Lack of data standardisation is a challenge that has in part been lessened in the European Union by the Markets in Financial Instruments Directive (MiFID II) (discussed in section 0). MiFID II requires distributors to collect data for the benefit of product manufacturers. This data includes the units and volumes of sales being made on specific products, along with feedback and expectations of customers. While this does help, it does not fix the problem of differing data standards, especially outside the European Union.

Poor culture

Culture within financial product manufacturers and distributors can render product governance ineffective if the organisational culture puts forth a countervailing norm for staff to follow. This means that regulators have a vested interest in ensuring that the culture within the financial services industry is an appropriate one. The problems caused by poor organisational culture were discussed in detail in Chapter 2.

Potential stifling of innovation

There are some concerns that increasing product governance will act to stifle innovation in the financial services industry.[161] Some see a likely endpoint of increasing governance

[157] Financial Stability Board, *The financial crisis and information gaps*, report, 29 October 2009, p. 4 ('the recent crisis has reaffirmed an old lesson – good data and good analysis are the lifeblood of effective surveillance and policy responses at both the national and international level').

[158] B Couillault, J Mizuguchi and M Reed, *Collective action: Toward solving a vexing problem to build a global infrastructure for financial information*, Office of Financial Research, 2 February 2017.

[159] R Berner and K Judge, 'The data standardization challenge' in D Arner and E Avgoukeas (eds), *Systematic risk in the financial sector*, Centre for International Governance Innovation, 2019, p. 2.

[160] *Stress testing banks – What have we learned?* speech by Chairman of the Board of Governors of the Federal Reserve System, Ben Bernanke, 'Maintaining Financial Stability: Holding a Tiger by the Tail' financial markets conference, Georgia, 8 April 2013, p. 1.

[161] See M W Muller, 'Does legal innovation cope with financial innovation? Product intervention powers in post-crisis EU financial markets regulation', *Edinburgh Student Law Review*, vol. 2, 2015,

obligations in something akin to the 'precautionary principle' taken by British courts – that is, allowing new technology to be prohibited if there are concerns about potential risks, without the need for scientific evidence.[162] This highlights the two likely outcomes in regulation. The law can be accused of being either too restrictive with its regulations or too late in putting those regulations in place.[163]

Interestingly, the concern about stifling innovation has been dismissed by some in relation to product intervention powers. For example, in its response to the suggestion that broadening governance could have the effect of stifling innovation, the FCA stated 'not all innovation is necessarily beneficial'.[164] The Murray Report also dismissed this effect, saying 'if the power is used effectively, it should not significantly affect innovation'.[165]

These attitudes demonstrate the effect of the shift in product governance since the global financial crisis. Reliance is being placed on the discretion of the regulator, rather than on set rules.[166] This is also demonstrated by the broad product intervention powers given to some regulators, along with other discretionary actions that can be taken.[167] The change allows regulation to adjust to the changing needs of industry (and consumers) but also increases the risk that innovation will be stifled by overuse of the power. So far, however, product intervention powers seem to have been used sparingly by regulators, meaning this concern has remained academic in nature.

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p. 130. (Muller uses the fable of the hedgehog and the hare to signify the relationship between financial product governance and financial markets. While financial product governance may 'win', it must ensure it does not kill the financial markets in the process.) There is also debate over whether this would be an entirely bad outcome: see A Palmer, 'In defense of financial innovation', *Foreign Affairs*, vol. 94(3), May/June 2015, pp. 67–68.

[162] R Thomas, 'Regulating financial product design in Australia: An analysis of the UK approach', *Journal of Banking & Finance Law & Practice*, vol. 28, 2017, p. 108.

[163] M W Muller, 'Does legal innovation cope with financial innovation? Product intervention powers in post-crisis EU financial markets regulation', *Edinburgh Student Law Review*, vol. 2, 2015, p. 130.

[164] Financial Services Authority, *The FCA's use of temporary product intervention rules* (CP 12/35), consultation paper, December 2012, p. 21.

[165] Australian Government Treasury, *Financial System Inquiry*, final report, November 2014, p. 210.

[166] P Schultz, 'The shifting foundations of financial regulation', *University of St. Thomas Journal of Law & Public Policy*, vol. 10, 2015-2016,, pp. 1–2.

[167] See, eg, systemically important financial institutions.

4. Product governance developments around the world

Policy makers around the world are developing frameworks for product governance to focus financial product design on consumer needs and to intervene when poor product design or distribution results in consumer harm. New product governance frameworks are being implemented in some jurisdictions and existing policy is being refined in others.

4.1 Australia

The Australian Government's Financial System Inquiry (Murry Report) made the recommendation that 'a targeted and principles-based financial product design and distribution obligation' be introduced. This obligation would require:

> financial product issuers and distributors to consider a range of factors when designing financial products and distribution strategies. In addition to commercial considerations, issuers and distributors should consider the type of consumer whose financial needs would be addressed by buying the financial product and the channel best suited to distributing the financial product.[168]

The report also identified that, since the global financial crisis, significant reforms had taken place globally to protect consumers and ensure that the outcomes a product is expected to deliver are aligned with the expectations of consumers throughout the product life cycle.[169]

As part of the its response to the Murray Report, in 2016 the Government released a paper proposing that issuers should be required to identify appropriate target markets for financial products.[170] The proposals paper examined similar laws relating to design and distribution obligations and product intervention powers in other jurisdictions.[171] Legislation implementing the product intervention power and the design and distribution obligations received assent in April 2019.[172]

The product intervention power allows ASIC to temporarily intervene to allow both individual and market-wide orders to be made. It is aimed at stopping 'consumer detriment' including a 'broad range of harm or damage that may flow from a product … including the product's features, defective disclosure, poor design, or inappropriate distribution'.[173]

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[168] Australian Government Treasury, *Financial System Inquiry*, final report, 7 December 2014, p. 198.

[169] Australian Government Treasury, *Design and distribution obligations and product intervention power*, proposals paper, December 2016, p. 3.

[170] Australian Government Treasury, *Design and distribution obligations and product intervention power*, proposals paper, December 2016, p. 5.

[171] Australian Government Treasury, *Design and distribution obligations and product intervention power*, proposals paper, December 2016, pp. 9–10.

[172] *Treasury Laws Amendment (Design and Distribution Obligations and Product Intervention Powers) Act 2019*.

[173] Treasury Laws Amendment (Design and Distribution Obligations and Product Intervention Powers) Bill 2019, revised explanatory memorandum, p. 50 [2.33].

Orders can be made for 18 months and only extended by declaration with approval from the Minister.[174]

ASIC's regulatory guide makes it clear that it will use this power to take a more proactive approach to regulation to stop significant or continuing detriment to consumers.[175] This aim echoes the remarks of the FCA that 'earlier intervention can be more effective and efficient than waiting until after the event'.[176]

In June 2019, ASIC consulted on its proposed use of the new product intervention power.[177] In September 2019 ASIC made an order banning a lending model found in the short-term credit sector.[178]

In December 2020, ASIC provided guidance on the design and distribution obligations ahead of implementation on 5 October 2021.[179] The obligations require effective product governance across the life cycle of financial products to ensure that consumers receive products that meet their likely objectives, financial situation and needs.[180] To achieve this the product issuer must identify the class of consumers that comprise the target market and any distribution conditions. Both issuers and distributors must take reasonable steps to ensure distribution is consistent with the target market determination. There are record keeping requirements and notification requirements should there be significant dealings that are not consistent with the target market determination.[181]

4.2 Brazil

Over time, the Central Bank of Brazil (BCB) and the National Monetary Council (CMN) have built an extensive regulatory framework that supports product governance using a product-specific or service-specific approach. Its strategy has been to avoid unnecessary risks and poor market practices such as unclear and non-transparent disclosure of prices and fees, limited understanding of contractual terms and conditions, customer over-indebtedness, financial exclusion, fraudulent practices, and unfair treatment.

Recently, this strategy has been challenged by new products and services such as digital accounts, online and mobile payment solutions, and peer-to-peer lending. These products and their rapid adoption have increased the role of consumer protection. This has prompted changes to provide clearer standards with the aim of improving the regulatory environment for all financial products and services throughout their life cycle.

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[174] Treasury Laws Amendment (Design and Distribution Obligations and Product Intervention Powers) Bill 2019, revised explanatory memorandum, p. 57 [2.35].

[175] ASIC, *Product intervention power* (RG 272), regulatory guide, June 2020, [272.2].

[176] Financial Services Authority, *The FCA's use of temporary product intervention rules* (CP 12/35), consultation paper, December 2012.

[177] See ASIC, *Product intervention power* (CP 313), consultation paper, June 2019.

[178] ASIC, ASIC makes product intervention order banning short term lending model to protect consumers from predatory lending (19-250MR), media release, 12 September 2019.

[179] ASIC, *Design and Distribution Power* (RG 274), regulatory guide, December 2020.

[180] ASIC, *Design and Distribution Power* (RG 274), regulatory guide, December 2020, 274.6.

[181] ASIC, *Design and Distribution Power* (RG 274), regulatory guide, December 2020, 274.18.

Resolution 4,539 and product governance

The CMN enacted Resolution 4,539 in November 2016 to require financial industry compliance with principles of ethics, responsibility, transparency and diligence, fostering the convergence of interests between providers and consumers, and consolidating the Brazilian financial system's image of credibility, soundness and competence.[182]

The resolution promotes an organisational culture that encourages a cooperative and balanced relationship with customers, striving to treat them fairly and equitably throughout the relationship, which covers pre-contractual, contractual and post-contractual duties.[183] Fair and equitable treatment includes providing product information in a clear and precise manner.[184]

To achieve these objectives, firms must consolidate their guidelines, strategic objectives and organisational values and prepare an institutional customer relationship policy.

Regulation 4,539 is also intended to increase transparency and assist in assessing the suitability of products and services. It requires firms to establish target markets for products and services, taking into account their characteristics and level of complexity in the design, as well as the offering, recommendation, contracting or distribution of the products.

Resolution 4,539 is complemented by CMN Resolution 3,694 which requires firms to:

- ensure that the products and services they offer or recommend are adequate for the customer's needs, interests and objectives; [185] and
- provide the information necessary for consumers to make decisions, explicitly referring to rights, obligations, responsibilities, costs and charges, penalties, and risks.[186]

Resolution 4,539 and culture

Resolution 4,539 requires firms to establish institutional policies that follow their guidelines, objectives and core values, including any programs of goals and performance incentives for employees and third parties.[187]

A firm's policy must encompass all phases of the product life cycle and its mandatory disclosure; the firm must avoid an understanding gap between the sales department and the rest of the staff. The different areas of a firm, which often perform their activities independently, must start to communicate with one another and effectively absorb the entire policy, as a starting point to achieving a more balanced internal relationship to meet consumers' needs.

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[182] National Monetary Council, Resolution 4,539/16, art. 2.

[183] National Monetary Council, Resolution 4,539/16, art. 1(2).

[184] National Monetary Council, Resolution 4,539/16, art. 3.

[185] National Monetary Council, Resolution 3,694/09, art. 1, item I.

[186] National Monetary Council, Resolution 3,694/09, art. 3.

[187] National Monetary Council, Resolution 4,539/16, art. 5, item XIII.

Product governance supervision outcomes

Although neither Resolution 4,539 nor Resolution 3,694 expressly provides for product withdrawal. The BCB has occasionally prevented the sale of products based on a firm's failure to ensure that:

- products offered or recommended are suitable to the customer's needs, interests and objectives;
- customer relationships cover the pre-employment, contracting and post-employment phases;
- activities are conducted in compliance with principles of ethics, responsibility, transparency and diligence, fostering the convergence of interests and the consolidation of the institutional image of credibility, security and competence;
- information is provided to customers in a clear and accurate manner; and
- its routines and operational procedures comply with the firm's policy, including for the design, offer, recommendation, hiring or distribution of products or services.

Financial product governance further developments

BCB's product governance requirements do not regulate firms' internal product approval procedures. Nevertheless, firms normally discuss with BCB the details of new products or related initiatives. BCB's Conduct Supervision Department organises periodic meetings with senior executives from firms to encourage this practice.

As a result of this approach, systemically important financial institutions (serving 90% of domestic financial consumers) now evaluate the launch of new products based on the firm's policy pillars; they also review existing products in light of the same pillars. The Conduct Supervision Department requires firms to carry out these evaluations through their own launch and review committees in order to audit the documents issued by those committees.

4.3 European Union

EBA Guidelines

On 22 March 2016 the European Banking Authority (EBA) issued the *Guidelines on financial product oversight and governance arrangements for retail banking financial products* (EBA Guidelines).[188]

The EBA Guidelines emerged in a context where a very broad legal and regulatory framework was already implemented largely by sectorial Directives, establishing a set of duties within the scope of provision of pre-contractual and contractual information (such as, provision of information in a clear and transparent manner, duty of assistance, product adequacy) and during the lifetime of the contracts.

Supplementing the existing legal and regulatory framework, the EBA issued specific guidelines on product oversight and governance. These guidelines, in force from 3 January

[188] European Banking Authority, *Guidelines on product oversight and governance arrangements for retail banking products* (EBA/GL/2015/18), 22 March 2016.

2017, were adopted by many authorities in Europe,[189] who were then in charge of implementing the guidelines nationally.[190] The EBA Guidelines lay out the obligations to be placed on both manufacturers and distributors of financial products brought into the market after the implementation date along with existing products which have been significantly changed.[191]

The categories of product that fall within these obligations include:

- credit agreements relating to residential immovable property;
- most deposits;[192]
- electronic money;
- other forms of consumer credit; and
- other means of payment.

Manufacturer obligations

The aims for manufacturers of financial products under the EBA Guidelines are threefold:

- to 'ensure that the interests, objectives and characteristics of consumers are taken into account';[193]
- to avoid potential harm to the consumer;[194] and
- to minimise potential conflicts of interest that may arise due to the product.[195]

What the manufacturer must do to meet these expectations depends on the nature of the financial product being considered.[196]

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[189] Competent authorities are defined in European Parliament and Council, Regulation (EU) No 1093/2010 establishing a European Supervisory Authority (European Banking Authority), 24 November 2010, art. 4(2). At 9 February 2018, 32 out of 38 competent authorities had signalled they either currently complied or intended to comply with the EBA Guidelines: European Banking Authority, *Compliance table for Guidelines on product oversight and governance arrangements for retail banking product*, 9 February 2018.

[190] National transpositions of Directive 2014/65/EU on markets in financial instruments (MiFID2). The EBA Guidelines on POG concern core banking products and were not based on this directive. Guidelines on POG have also been issued by the European Securities and Markets Authority (ESMA) and the European Insurance and Occupational Pensions Authority (EIOPA)

[191] European Banking Authority, Guidelines on product oversight and governance arrangements for retail banking products (EBA/GL/2015/18), guidelines, 22 March 2016.

[192] The EBA Guidelines do not govern structured deposits which are instead covered by the requirements in the Markets in Financial Instruments Directive (MIFID II): see MiFID II art. 4(43).

[193] European Banking Authority, Guidelines on product oversight and governance arrangements for retail banking products (EBA/GL/2015/18), guidelines, 22 March 2016, p. 9 [1.1].

[194] Ibid.

[195] Ibid.

[196] European Banking Authority, Guidelines on product oversight and governance arrangements for retail banking products (EBA/GL/2015/18), guidelines, 22 March 2016, p. 9 [1.5].

The obligations placed on manufacturers by the EBA Guidelines are like other design and distribution obligations. Manufacturers are required to:

- identify suitable and non-suitable segments of the market for their product;[197]
- undertake product testing;[198]
- monitor the product while it is being distributed;[199]
- undertake any necessary remedial action if problems are identified with the product;[200]
- select appropriate distribution channels for the product; [201] and
- give appropriate information to distributors about the main characteristics of the product.

Distributor obligations

Like the obligations for manufacturers, the obligations for distributors under the EBA Guidelines do not differ substantially from other design and distribution obligations. These obligations are dependent on distributors establishing frameworks that are specific and proportionate to their role of distributing financial products to the market.

The specific requirements for distributors under the EBA Guidelines are:

- to have relevant knowledge of a product target market so that they can identify whether a customer fits within the target market;[202] and
- to disclose the main characteristics of a product including the risks associated with the product and the price to be paid.[203]

[197] European Banking Authority, Guidelines on product oversight and governance arrangements for retail banking products (EBA/GL/2015/18), guidelines, 22 March 2016, guideline 3.

[198] European Banking Authority, Guidelines on product oversight and governance arrangements for retail banking products (EBA/GL/2015/18), guidelines, 22 March 2016, guideline 4.

[199] European Banking Authority, Guidelines on product oversight and governance arrangements for retail banking products (EBA/GL/2015/18), guidelines, 22 March 2016, guideline 5.

[200] European Banking Authority, Guidelines on product oversight and governance arrangements for retail banking products (EBA/GL/2015/18), guidelines, 22 March 2016, guideline 6.

[201] European Banking Authority, Guidelines on product oversight and governance arrangements for retail banking products (EBA/GL/2015/18), guidelines, 22 March 2016, guideline 7.

[202] European Banking Authority, Guidelines on product oversight and governance arrangements for retail banking products (EBA/GL/2015/18), guidelines, 22 March 2016, guideline 11.

[203] European Banking Authority, Guidelines on product oversight and governance arrangements for retail banking products (EBA/GL/2015/18), guidelines, 22 March 2016, guideline 12.

Reports on implementation

The EBA has undertaken action to verify how the industry has implemented the EBA Guidelines, publishing the outcomes of this action in two reports. The first EBA report,[204] based on a survey of 30 credit institutions, showed that manufacturers have made welcome changes, particularly in terms of process and governance. However, in many cases, customer interests may not have received the same attention as the manufacturer's commercial interests and prudential concerns. The EBA's assessment also suggested that the industry may have different understandings of the Guidelines, and that further clarification may be warranted to ensure more convergence across Europe.[205] A number of good practices were identified, which firms can take into consideration when designing and implementing their product governance policies.

The second EBA report[206] was based on a larger sample of financial institutions (78 from 12 member states). The report identified ways for financial institutions to further strengthen the application of the EBA Guidelines. It did so by outlining good practices among the sample concerning:

- the scope of the EBA Guidelines and general governance;
- identifying the target market;
- product testing;
- product monitoring and remedial actions; and
- governance arrangements for distributors.

The report confirmed the conclusions reached in the first report – namely, that while the manufacturers surveyed had implemented internal processes for oversight of retail products, this was not necessarily done in a way that put the required focus on ensuring that consumers' needs are met. Despite the objectives of the EBA Guidelines – to enhance consumer protection and address the prudential risks arising from misconduct – institutions appeared to focus almost exclusively on the prudential requirements set out in the EBA *Guidelines on internal governance*[207] under the Capital Requirements Directive.[208] The good practices identified cover each aspect of the EBA Guidelines and include relevant examples.

The EBA Guidelines are not the only product governance instrument to be developed in the European Union after the financial crisis. The revised MiFID II also provided further governance and powers for regulatory bodies to implement.

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[204] European Banking Authority, *EBA report on the application of the Guidelines on product oversight and governance (POG) arrangements (EBA/GL/2015/18)*, report, July 2019.

[205] Ibid.

[206] European Banking Authority, *Second EBA report on the application of the Guidelines on product oversight and governance (POG) arrangements (EBA/GL/2015/18)* (EBA/REP/2020/28).

[207] European Banking Authority, Guidelines on internal governance (EBA/GL/2017/11), guidelines, 21 March 2018.

[208] European Parliament and Council, Directive 2013/36/EU on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms, 26 June 2013.

MiFID II

MiFID II[209] is a European legislative framework which has been in force since 3 January 2018 and which builds on the former Markets in Financial Instruments Directive.[210] The revised requirements include increased reporting obligations and new product governance requirements. The MiFID II obligations apply to both manufacturing and distribution sides of the financial product industry.

The new product governance and distribution rules – described negatively as 'meticulous' in one academic article[211] – aim to bring greater transparency to the industry. The overarching purpose of the revised MiFID obligations is to require firms to shape their conduct around the best interests of their clients.[212] Article 24(1) provides that a firm has the duty to:

> act honestly, fairly and professionally in accordance with the best interests of its clients and comply, in particular, with the principles set out in this Article and in Article 25.

A breach of this duty, without any express rule-breaking, can still result in administrative[213] or private sanctions.[214] The duty also has a flow-on effect to other requirements within MiFID II,[215] including requirements regarding remuneration structures,[216] conflicts of interest[217] and conducting a suitability assessment before a transaction is entered into when providing an investment advice.[218] Along with these broader requirements, article 16(3) of MiFID II requires that a target market be specified for each financial product.

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[209] European Parliament and Council, Directive 2014/65/EU on markets in financial instruments, 15 May 2014.

[210] European Parliament and Council, Directive 2004/39/EC on markets in financial instruments, 21 April 2004 (repealed 12 June 2014).

[211] J Crabb, E Meager and B Yap, 'The right way: MiFID II has disoriented the investment research market. Will it find the correct path forward?', *International Financial Law Review*, vol. 36, p. 25.

[212] European Parliament and Council, Directive 2014/65/EU on markets in financial instruments, 15 May 2014, art. 24(1).

[213] European Parliament and Council, Directive 2014/65/EU on markets in financial instruments, 15 May 2014, art. 70(3)(a)(x).

[214] European Parliament and Council, Directive 2014/65/EU on markets in financial instruments, 15 May 2014, art. 69(2).

[215] L Enriques and M Gargantini, 'The expanding boundaries of MiFID's duty to act in the client's best interest: The Italian case', *Italian Law Journal*, vol. 3, 2017, p. 486.

[216] European Parliament and Council, Directive 2014/65/EU on markets in financial instruments, 15 May 2014, art. 24(10).

[217] European Parliament and Council, Directive 2014/65/EU on markets in financial instruments, 15 May 2014, art. 23.

[218] European Parliament and Council, Directive 2014/65/EU on markets in financial instruments, 15 May 2014, art. 25(2), (3).

4.4 New Zealand

In 2015, the *Credit Contracts and Consumer Finance Act 2003* was amended to include the lender responsibility principles. These principles require lenders to exercise the care, diligence and skill of a responsible lender during the credit lending process.[219]

In April 2019, more amendments were proposed through the Credit Contracts Legislation Amendment Bill.[220] The Bill aims to protect vulnerable consumers by introducing a cap on interest and fees of 100% of the loan principal, thereby preventing consumers falling into a 'spiral of debt'.[221] In the first reading speech for the amendment, the New Zealand Minister of Commerce and Consumer Affairs the Honourable Kris Faafoi, detailed three other protections the amendments would implement:

- tests for the minimum standards of suitability and affordability;
- obligations on lenders to verify details of consumers applying for loans; and
- record-keeping obligations on lenders to demonstrate that these tests have been satisfied and their fees are reasonable and cost-based.[222]

There will also be stronger penalties for lenders who break these laws,[223] including by lending to customers irresponsibly.[224] These obligations signal that New Zealand, like other countries discussed in this review, is continuing to increase its product governance to protect consumers and the integrity of the country's financial markets.

4.5 United Kingdom

Product governance in the United Kingdom pre-dates the global financial crisis. It began with the Treating Customers Fairly initiative of the Financial Services Authority,[225] published in 2001. From this initiative a range of guidance was developed, including six outcomes for firms to achieve,[226] and the development of a financial product life cycle to be used in subsequent regulation.[227]

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[219] *Credit Contracts and Consumer Finance Amendment Act 2014* (NZ) s. 9C(2)(a); see also Ministry of Business, Innovation and Employment (NZ), *Review of consumer credit regulation*, discussion paper, June 2018.

[220] Credit Contracts Legislation Amendment Bill (NZ).

[221] K Faafoi, Credit Contracts Legislation Amendment Bill – First Reading, 30 April 2019.

[222] Ibid.

[223] Ibid.

[224] Credit Contracts Legislation Amendment Bill (NZ) s. 36.

[225] The Financial Services Authority was abolished in 2012 by the *Financial Services Act 2012* (UK). Its former duties were taken over by the FCA and the Prudential Regulation Authority of the Bank of England.

[226] See Fair treatment of customers on the FCA website.

[227] FCA, *Treating customers fairly – Towards fair outcomes for consumers*, report, July 2006, p. 6 [1.13].

Since the global financial crisis, the FCA has been given new powers to regulate financial service industry. These include temporary product intervention orders[228] and permanent intervention orders.[229] These orders can be made against any regulated financial products.

Guidance on fair treatment of customers

On 1 April 2013, the FCA published a guide titled *The responsibilities of providers and distributors for the fair treatment of customers*. This document provides guidance on the obligation of a product issuer to 'pay due regard to the interests of its customers and treat them fairly'.[230] The guidance is intended to apply to 'all regulated firms involved in the supply of products or services to retail customers'.[231] This includes both designers and distributors of financial products.[232]

The responsibilities of designers include identifying target markets, stress-testing the products being offered, and ensuring that any information communicated to the consumer is 'clear, fair and not misleading'.[233] Information provided to distributors is also regulated and must be 'sufficient, appropriate and comprehensible'.[234]

The responsibilities of distributors relate to the effective management of risk and acting with due skill, care and diligence.[235] Distributors should also give customers adequate information and decide on their understanding of that information at the point of distribution.[236]

The FCA guidance has been the foundation for several thematic reviews of the financial services industry.[237]

Response to MiFID II

MiFID II (discussed in section 0) mirrored the guide on *The responsibilities of providers and distributors for the fair treatment of customers* in some ways while going further in others. The FCA amended the *FCA Handbook* to incorporate MiFID's changes into law in

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[228] *Financial Services and Markets Act 2000* (UK) s. 138N.

[229] *Financial Services and Markets Act 2000* (UK) s. 137D.

[230] See Fair treatment of customers on the FCA website.

[231] FCA, The responsibilities of providers and distributors for the fair treatment of customers (RPPD), guidance, 1 April 2013, p. 2 [1.7].

[232] FCA, The responsibilities of providers and distributors for the fair treatment of customers (RPPD), guidance, 1 April 2013, p. 2 [1.12].

[233] FCA, The responsibilities of providers and distributors for the fair treatment of customers (RPPD), guidance, 1 April 2013, p. 4 [1.17]

[234] FCA, The responsibilities of providers and distributors for the fair treatment of customers (RPPD), guidance, 1 April 2013, p. 4 [1.18(2)].

[235] FCA, The responsibilities of providers and distributors for the fair treatment of customers (RPPD), guidance, 1 April 2013, p. 5 [1.22].

[236] FCA, The responsibilities of providers and distributors for the fair treatment of customers (RPPD), guidance, 1 April 2013, p. 5 [1.23].

[237] See, eg, FCA, Review of the fair treatment of with-profits customers (TR 19/3), thematic review, 25 April 2019.

the United Kingdom. The changes were integrated into the *Financial intervention and financial product governance sourcebook*.[238]

The guidance identifies three results that flow from good financial product governance:

- financial products being offered meet the needs of one or more identifiable target market;
- these financial products are sold to clients in the target markets by appropriate distribution channels; and
- the financial products deliver appropriate client outcomes.[239]

Further, the requirements placed on the regulated industry members must be complied with in a way that is proportionate in the context of the financial product being examined and the proposed target market of that product.[240]

4.6 United States

Dodd-Frank Act

The *Dodd-Frank Wall Street Reform and Consumer Protection Act*[241] was introduced in response to the global financial crisis, which came in part from the collapse of the housing market in the United States. The purpose of the Act was to protect consumers entering into mortgage market transactions.[242] Specifically, product intervention powers were given to the Consumer Financial Protection Bureau to protect consumers from three dangers identified by the Federal Reserve Board: limited competition, limited transparency, and the complexity of financial products.[243] The latter two cause information asymmetries in the financial products market.

In the United States the power to intervene is limited to 'unfair, deceptive and abusive' conduct.[244] 'Abusive' conduct is defined as an act or practice which:

> (1) materially interferes with the ability of a consumer to understand a term or condition of a consumer financial product or service; or
>
> (2) takes unreasonable advantage of –
>
> (A) a lack of understanding on the part of the consumer of the material risks, costs, or conditions of the product or service;

[238] See FCA Handbook on the FCA website.

[239] FCA, Financial intervention and financial product governance sourcebook, FCA Handbook, February 2021, PROD 1.1.3.

[240] FCA, Financial intervention and financial product governance sourcebook, FCA Handbook, February 2021, PROD 3.1.2.

[241] *Dodd-Frank Wall Street Reform and Consumer Protection Act* (2010) 12 USC 5301.

[242] B Sabel and C Smith, *Mortgage lending practice after the Dodd-Frank Act*, Harvard Law School Forum on Corporate Governance and Financial Regulation.

[243] Truth in Lending, *Federal Register*, vol. 73, p. 44524-5.

[244] *Dodd-Frank Wall Street Reform and Consumer Protection Act* (US) 12 USC 5301, s. 1031.

(B) the inability of the consumer to protect the interests of the consumer in selecting or using a consumer financial product or service; or

(C) the reasonable reliance by the consumer on a covered person to act in the interests of the consumer.[245]

This power, while more general than the product intervention powers in Australia and the United Kingdom, is attempting to combat a similar problem. The purpose of these provisions is to limit the information asymmetry between consumers and product providers and/or to lessen the risk to the consumer, by the knowledge that breach of these provisions will allow the regulator to intervene.

[245] *Dodd-Frank Wall Street Reform and Consumer Protection Act* (US) 12 USC 5301, s. 1031(d).

5. Observations

This literature review has examined relevant research, commentary and other literature on the financial services industry, focusing on culture and product governance.

The global financial crisis was a key driver of the increase in product governance over the past decade. While there was some suggestion that the crisis would lead to a 'light touch' approach to financial regulation,[246] this has not been the case.[247] Another driver has been the need to limit market imperfections, including information asymmetry and behavioural distortions.

The increase in knowledge and awareness of information asymmetry and behavioural distortions is reflected in one of the largest changes in product regulation: the movement away from disclosure, and towards more proactive ways of eliminating the effect of information asymmetry. This shift encompasses the increasing prevalence of product intervention powers and of obligations placed on firms to tailor their products to specific target markets.

Broadly speaking, the current development of product governance is towards a more proactive regulatory approach. This has been supplemented by increasing the industry's responsibility to ensure the products they sell are safe and suitable for consumers. In part, this is due to the global financial crisis demonstrating that reactive methods of regulation can be ineffective.

The literature discusses three challenges for product governance at this time. These are:

- lack of data standardisation in the financial services industry;
- difficulties linked with poor culture within the industry; and
- achieving a balance between regulation and the stifling of financial product innovation.

There are currently efforts to address these challenges. For instance, industry continues to rein in cultural problems which were at the heart of the global financial crisis. Further, data standardisation is becoming an increasingly relevant topic of discussion in the financial governance space.

Of these three challenges, it seems that culture currently has the most influence on the state of the financial services industry. This comes from the nullifying effect that culture can have on financial regulation when organisational culture contradicts the aims of regulation.

While many have observed considerable cultural change since the global financial crisis, this change has been neither uniform nor industry wide. There are at least two reasons for this. First, the speed at which measures have been implemented have affected the changing culture in the industry. Second, because culture is constantly changing, the financial services industry will never fully complete its reform, even if the public trust lost during the crisis is regained.

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[246] See, eg, J Hacker and P Pierson, *Winner take all politics*, Simon & Schuster, 2010, Ch. 10.

[247] M Lodge and K Wegrich, 'Arguing about financial regulation: Comparing national discourses on the global financial crisis', *PS: Political Science & Politics*, vol. 44(3), October 2011, p. 726.

While there is a lack of consensus and clarity about the meaning of 'organisational culture', there is agreement about both the drivers and effects of different types of organisational culture. The drivers of culture include:

- the work environment, including the basis of a firm's remuneration structures;
- the risk culture within the organisation; and
- the behaviour of senior management (or 'tone from the top').

Culture can be likened to a dependant variable in science. Rather than being able to be adjusted on its own, cultural change requires the changing of independent variables which can be controlled, such as the work environment within an organisation.

Finally, the academic literature agrees that it is industry's responsibility to monitor and, where necessary, change its own culture. While regulators should also supervise the behaviours and norms that are indicative of industry culture, there is no way to prescribe good culture. Instead, people within these firms must change behaviours and incentives within the organisation to bring about a consumer-focused culture.

The literature also suggests that industry-driven change in culture has made some progress. While some firms lag, overall the industry has become more cognisant of culture since the global financial crisis. While this is positive, it should not be viewed as the end of the journey for the financial services industry.

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