Dynamic change in uncertain times: Balancing opportunity and risk- Remarks by Derville Rowland, Deputy Governor Consumer and Investor Protection

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Dynamic change in uncertain times: Balancing opportunity and risk - Remarks by Derville Rowland Deputy Governor, Consumer and Investor Protection at the Association for Financial Markets in Europe (AFME) 7th Annual European Compliance and Legal Conference.

It's a pleasure to be with you today and my thanks to AFME for the invitation.

As a barrister by training and a regulator by profession, the theme of this year's conference – "managing legal and regulatory challenges in an ever-changing world" – strikes very close to my heart.

It was the American law professor Grant Gilmore who said: "Law is not static but dynamic. It changes as society changes, both forever in an equilibrium precarious and unstable."[i]

As it is brought into being through law-making, the same can be said for financial regulation. It too evolves - in ways subtle and striking – with the times.

But, it's the latter part of Gilmore's quote – when he speaks of the precarious and unstable equilibrium - that feels especially pertinent right now.

The tectonic plates shifted massively in recent years, and continue to do so. The pandemic, and all that entailed. The Russian invasion of Ukraine, reigniting war on our continent. The acceleration of the devastating effects of climate change. The human suffering, the societal impact, and the economic consequences.

In Jackson Hole last month, Christine Lagarde outlined how we are facing a deepening geopolitical divide and a global economy that is fragmenting into competing blocs. This is being accompanied by rising levels of protectionism as countries align with new strategic goals.[ii]

This is coupled with an inflationary shock, the end of quantitative easing and "low for long", and a new era of elevated volatility, higher bank funding and credit risk, and associated vulnerabilities for markets, businesses and consumers.

For good measure, add the fact that the financial system is changing at pace, both propelled and disrupted by continuing innovation in a tech sector now entering the age of AI.

Our world is increasingly complex, feels increasingly unpredictable, and yet – as regulators and industry professionals alike – it behoves us to respond.

Not just to stay up – but, in so far as possible, to stay ahead.

So how do we manage that?

The answer is by being dynamic ourselves – in evolving our markets, our organisations, our services, our standards. But such dynamism must, necessarily, balance the desire for speed with the need for caution. Seizing the opportunity while mitigating the risk for both the system overall and for consumers and investors within it.

To put it another way, it is about a renewal - without impairing resilience – of the financial system itself, and of the frameworks to protect consumers and investors.

To illustrate, I'll set out the Central Bank's view of how firms should handle such change across a number of related areas – investor protection, governance and accountability, and countering the risk of financial crime.

First, a little bit about the Central Bank of Ireland

A broad, deep and integrated mandate

Our mission is to serve the public interest by maintaining monetary and financial stability while ensuring that the financial system operates in the best interests of consumers and the wider economy.

Unusually among our EU peers – where it is more common to have standalone agencies for specific functions - the Central Bank has a number of broad, deep and interconnected responsibilities.

We are part of Europe's monetary and banking unions, of course, as well as being a regulatory, supervisory, resolution and anti-money-laundering (AML) authority. We are also responsible for Ireland's payment system and for the provision of its currency.

Our integrated mandate covers the maintenance of price and financial stability through monetary policy and other measures, the safety and soundness of individual firms through supervision at a European and national level, and the protection of consumers and investors through a mix of rules, supervisory effort and targeted enforcement.

Our integrated structure provides key benefits by enabling us to ensure that consumers and investors are holistically protected – as we have a cross-sector understanding and oversight of system level, firm level and individual level risks.

We believe regulation must be forward-looking, joined up, proportionate, predictable, and agile. Our work at home and abroad is grounded on this approach.

Of course, strategic transformation must have a clear purpose – and the Central Bank of Ireland (ourselves part way through our own transformation programme) and AFME share common ground in that respect.

As your chairperson, Thalia Chryssikou, put it in AFME's 2023 annual review, the objective is a "diversified and resilient financial system where banks and capital markets work in tandem to support Europe's real economy. Now more than ever, there also continues to be an important role for banks and capital markets in allocating capital to help finance the sustainable and digital transition of the economy and to help companies transition their businesses."[iii]

From a regulator's perspective, these are important aims. Put simply, we want to see that the potential benefits of innovation for consumers, investors, businesses and society are realised, while the risks are effectively managed.

Our objective is a resilient and trustworthy financial system, which sustainably serves the needs of the economy and its customers, in which firms and individuals adhere to a culture of fairness and high standards.

There are many component parts to delivery of that objective – but central to it are well-run, well-managed firms that instinctively understand the need to find that balance between opportunity and risk - firms that pursue dynamic change without being cavalier about the best interests of their clients and customers.

This, in our view, very much starts with culture.

Culture, capital markets and investor protection

Effective culture is essential for any organisation seeking to navigate change efficiently and well.

Definitions vary, but for me, culture is the shared values and norms that shape behaviours and mind-sets within a firm – the "unwritten rules" or the "way things are done around here".

As Frank Elderson noted, culture is not only "the invisible hand that nudges employees towards either prudent risk management or reckless behaviour. It is the undercurrent that determines whether compliance considerations are seen as mere adornments or as important guiding principles. A healthy culture can spur innovation, nurture customer relationships and foster employee loyalty. But an imprudent culture can propel institutions towards crises that reverberate through financial history."[iv]

Culture is a matter for each individual firm and we want to promote and incentivise positive values and behaviours – resulting in well-run firms, good outcomes for consumers and positive contributions to wider society.

One indicator of an effective culture is demonstrated by a commitment to diversity and inclusion throughout a firm's organisation, including at board level – and by "diversity" here I mean not just gender diversity but also other factors like ethnicity, socio-economic status and also diversity of thought. Why? To prevent group-think. To guard against overconfidence. And to promote internal challenge[v]. If that wasn't enough incentive, there is evidence that diverse organisations have better bottom lines, so the economic case has also been made out[vi].

We want to see deeper capital markets, because of its potential economic and social benefits for citizens and our economies.

The case for deeper, more liquid capital markets is overwhelming – CMU, as a spur to economic growth, as a bedrock for the green and digital transitions, as a pathway to increased prosperity for European citizens.

It will surprise nobody when I stress our view that retail investors should remain at the core of the project. The end goal should be enhancing access to products with a rewarding risk-return profile, and transparent pricing and cost structures, to support consumers to build diversified portfolios. A culture that truly serves the needs of investors will prosper.

The Commission's Retail Investment Strategy represents a further step towards creating a horizontal regime at EU level for retail financial products. The strategy strikes at the core of manufacturing and distribution of financial products, and the provision of advice to retail investors, with key proposals around value for money, clients' best interests and improved and more standardised transparency, particularly on costs.

It also provides greater certainty on what is expected from firms' marketing communications, which is particularly relevant in a digital age.

We, of course, recognise the risk that deeper capital markets will raise the risk of misconduct, mis-selling and instances of poor investor outcomes. A core part of our job is to anticipate and plan for that.

On ESG, we welcome firms that are ambitious on tackling the sustainable finance agenda and supporting the transition to net zero - well-run firms with sustainable business models and effective cultures who do the right thing by their clients and customers, and who do well in return.

Because most transformative change is not a binary good or bad proposition. The opportunities and risks in every transformation must be weighed and balanced.

The IAF – balanced and proportionate

Which brings me to one of the signature ways in which we, the Central Bank, are evolving our policy frameworks to protect consumers and investors – and seeking to be balanced and proportionate in doing so.

Most of you will be familiar with the UK Senior Managers' Regime, Australia's Banking Executive Accountability Regime or Hong Kong's Manager-in-Charge Regime.

Our Report on the Behaviour and Culture of the Irish Retail Banks in 2018 identified concerns related to poor governance, weak structures of accountability within firms and a lack of consumer-focused cultures.

This was more than just a national concern. The Irish financial system serves not only the Irish but also the European and global economies.

In response to those findings, and learning from best practice in other jurisdictions, we are introducing an Individual Accountability Framework (IAF) in Ireland, which will include a Senior Executive Accountability Regime (SEAR) as well as Conduct Standards for all staff.

The primary purpose of the IAF is to promote sound governance throughout the regulated financial services sector.

I won't labour on the detail here – we have a dedicated landing page on our website for further information - and the IAF was discussed at a panel earlier today – but I want just to capture how we think about the IAF in the context of firms.[vii]

I emphasise again that most firms and individuals aspire to high standards – it is important to give that acknowledgement. That is why we have said that the majority of firms and staff will see nothing to fear in the IAF - because they already adhere to the principles. Nevertheless, the minority who do not aspire to such high standards cause reputational issues for the sector as a whole, and pose a risk to consumers, investors and wider society.

Hence, the IAF, with a view to driving improved governance and accountability across the sector. The framework is built on proportionality, predictability and reasonable expectations. Our approach to implementation also embeds these features. For example, we conducted a broad consultation - the outcome of which we will soon publish - and we are phasing the implementation of the package to balance the need for timely application with the readiness work required by firms.

And its arc will bend, I hope, towards mutually beneficial outcomes.

Where firms and individuals adopt and demonstrate a mature approach to enhanced responsibility for customer and client outcomes, we can focus more on outcomes-based supervisory engagement, underpinned by clarity as to accountabilities.

From the international experience, we believe the IAF will not just assist the Central Bank in our mission as regulator - but assist firms in achieving their objectives too, with the longer-term outcome of a more trusted financial services sector, which is in everybody's interest.

Caring about the integrity of the system

Central to successful implementation of the IAF – and driving a permanent uplift in governance standards – is the need for firms to take real ownership of the framework. This will make the fundamental difference. If firms embed the framework properly, it should ideally result in fewer serious issues in the sector over time – and, from our perspective, less need for enforcement actions.

I mention this because I think there is a strong parallel with the final area I wish to touch upon – that of the importance of the integrity of the financial system and the role we all must play. Protecting the integrity of the financial system from abuse by criminals is essential to ensure that it works in the best interests of consumers, investors and the economy.

As an open economy, with a global financial centre, we must ensure the highest standards apply to prevent the Irish and International financial system being used for illicit purposes. The continued growth of financial services that delivers for our economy and our people, depends on maintaining this reputation for high standards.

As an integrated regulator supervising all sectors for anti-money laundering and countering terrorist financing purposes, we see both the opportunities and the risks associated with digitalisation and innovation. For example, new KYC technology can bring about greater and more efficient transparency around customers and business relationships.

However, new and quicker ways of accessing financial services and products that also increase anonymity present greater risks of abuse of the system. For example, the anonymity offered by crypto was a haven for criminal enterprise for a sustained period. The pace of some Fintech firms, if there is a focus on growth over all else, with risks and controls being considered secondary, increases the vulnerability of the system to abuse. And I'm not sure we have capacity to fully imagine what risks AI may pose.

As Europol's executive director Catherine De Bolle noted last month, "organised crime has built a parallel global criminal economy around money laundering, illicit financial transfers and corruption. With modern technology, they have diversified their modi operandi to evade detection."[viii]

From a regulatory perspective, the EU Commission's AML Action Plan signals an overdue and welcome move towards a more coordinated and cross-border focus on AML/CFT. A single-rulebook and a single European AML supervisor that counters fragmentation with more harmonised approaches across the EU, are crucial steps that need to be expedited.

From the perspective of the individual firm – even for entities of significant size - the scale of the challenge can seem daunting. But again, well-run, well-managed firms that consider the risks specific to their business, and have robust risk management frameworks to mitigate those risks will – and must - rise to the challenge.

Here, the emphasis must be on a rigorous risk based approach to AML/CFT, on robust frameworks and control systems, and on agile mind-sets to assess data in new ways and adapt to ever-changing threats.   Innovation and technology is a friend to mastering this challenge.

Conclusion:

So, to conclude on an optimistic note, I leave with you with words from the great stoic philosopher Marcus Aurelius who said:

"Never let the future disturb you. You will meet it, if you have to, with the same weapons of reason which today arm you against the present"[ix].

We have to live with the uncertainty the future holds, and back ourselves to plot and plan our way through it.

That means meeting the changes in the world around us with reason - yes - but we must also meet them with agility and dynamism – balancing risk and opportunity in the process. Given what's at stake, it is a worthwhile and necessary pursuit, I hope you will agree.

Thank you.

[i] Gilmore, G. "Legal Realism: Its Cause and Cure" (1961), Yale Law Journal, Volume 70 No 7.

[ii] "Policymaking in an age of shifts and breaks." Speech by Christine Lagarde, President of the ECB, at the annual Economic Policy Symposium "Structural Shifts in the Global Economy" organised by Federal Reserve Bank of Kansas City in Jackson Hole, 25 August 2023.

[iii] See AFME, "Remaining resilient in turbulent times – steps taken towards competitive capital markets." Annual Review 2023.

[iv] ‘Treading softly yet boldly: how culture drives risk in banks and what supervisors can do about it’ Speech by Frank Elderson, Member of the Executive Board of the ECB and Vice-Chair of the Supervisory Board of the ECB, at the 10th Conference on the Banking Union organised by Freshfields Bruckhaus Deringer, the Institute for Law and Finance at Goethe University and the Center for Financial Studies Frankfurt am Main, 19 September 2023

[v] See my address to the 'Women in Leadership' Conference here

[vi] See Christiansen, H., Lin, H., Pereira J., Topalova, P. and Turk, R. (2016) ‘Gender Diversity in Senior Positions and Firm Performance: Evidence from Europe.’ IMF Working Paper, WP/16/50.

[vii] See Individual Accountability Framework

[viii] See: Europol - The other side of the coin

[ix] Aurelius, M. (2002). The Meditations. Random House