



BERMUDA MONETARY AUTHORITY

CONSULTATION PAPER

PROPOSAL FOR A CONDUCT OF BUSINESS REGULATORY REGIME

DECEMBER 2020

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The Authority welcomes any views on the content of this paper, as well as any relevant matters in relation to the Authority’s conduct of business objective. Comments should be sent to the Authority, addressed to conduct@bma.bm, no later than 15 February 2021.

I. INTRODUCTION

1. In the ongoing development of Bermuda's financial services regulatory framework, the Bermuda Monetary Authority (Authority) has undertaken to examine its oversight of the financial services industry in order to stay aligned with international best practices. As a part of its multi-year corporate strategy, the Authority intends to establish a conduct of business regulatory regime in order to enhance protection for customers of financial services businesses in Bermuda.
2. The Authority has taken a customer-centric approach to designing this regime by taking into account how the actions of financial institutions impact customers. The goal of the proposed regime is to promote the fair and equitable treatment of financial services customers in Bermuda. Therefore, the Authority deems it reasonable to hold its regulated financial institutions accountable as to the manner in which they treat their customers.
3. As such, in its 2020 Business Plan, the Authority committed to exploring the development of a conduct of business regime for regulated financial services. In August of this year, the Authority published a Discussion Paper (DP) to solicit feedback from stakeholders (both financial institutions and individual customers) on the potential focus for such a regime in Bermuda.
4. The DP outlined international standards for conduct of business supervision, with a focus on consumer protection and national approaches to conduct regulation. Most importantly, the DP's core proposal was to regulate the conduct of financial services entities using a principles-based approach. This was encapsulated by the six high-level principles, which endorsed the following:
 - a. Fair and equitable treatment of customers
 - b. Responsible business practices
 - c. Disclosure and transparency
 - d. Protection of customer assets against loss, fraud and misuse
 - e. Dispute resolution mechanisms
 - f. Financial education and awareness for retail customers
5. The DP sought stakeholders' feedback on both the content of the paper's proposals through a set of discussion questions, and the experiences of customers when engaging with financial institutions through a survey.
6. The Authority found that stakeholders were generally supportive of the proposed expansion of the Authority's remit to supervise the conduct of its licensees for the protection of their customers. Moreover, the majority of respondents agreed with the scope of the above high-level principles and believed that they were sufficient to achieve the Authority's objective.
7. Based in part on the responses to the DP, the Authority has drafted a proposal for a comprehensive framework to regulate the conduct of financial services for the protection of customers.

8. This Consultation Paper (CP) sets out the proposal to regulate the conduct of business of Authority-regulated entities, including:
 - i. A more detailed explanation of the high-level principles for good conduct
 - ii. The scope of application of the conduct requirements

II. THE CONDUCT REGULATORY REGIME

9. The Authority is of the view that the conduct regime must be risked-based and pragmatic. Specifically, it should not create an undue regulatory burden on the financial services industry. As such, the principles-based approach is intended to achieve this goal by flexibly expanding the Authority's regulatory toolkit in line with its international peers and standard-setting bodies.
10. Thus far, the Authority's primary remit has focused on prudential regulation and supervision of financial services. However, the Authority notes that there are elements of licensee conduct that are currently regulated and supervised under the existing Regulatory Acts¹, sector-specific codes of practice and codes of conduct, and other guidance. The existing prudential regime contributes to the protection of customers by ensuring that licensees act with integrity and skill; deal fairly; make the appropriate disclosures to customers; mitigate the risks of conflicts of interest; have complaints handling systems; and adequately safeguard customer assets.
11. With this in mind, the introduction of the new principles-based conduct regime is intended to build upon existing conduct requirements to create fairer outcomes for customers as they engage with the financial services marketplace. The principles are intended to be complementary to these existing elements in order to comprehensively deliver on the customer protection objective.
12. It is the Authority's ultimate aim that the regime would be proportionate to the nature, scale, complexity and current conduct of Bermuda's financial services industry. In designing this regime, the Authority sought to undertake an approach that addresses the needs of customers according to their respective financial acumen and sophistication. In this way, the Authority acknowledges the necessity for the flexible application of the conduct principles and underpinning requirements in order to adequately protect the most vulnerable customers.

III. PROPOSAL TO EXPAND THE AUTHORITY'S MANDATE TO REGULATE CONDUCT OF BUSINESS

13. In order to widen its strategic focus as a regulator, the Authority proposes to expand its statutory remit to protect customers and promote the fair treatment of financial services customers under section 3 of the Bermuda Monetary Authority Act 1969 (BMA Act), by inserting the following wording:

to promote the protection of customers using products and services provided by financial institutions through the oversight of the conduct of business by financial institutions.

¹ Insurance Act 1978, Banks and Deposit Companies Act 1999, Trusts (Regulation of Trust Business) Act 2001, Investment Business Act 2003, Investment Funds Act 2006, Corporate Service Provider Business Act 2012, Money Service Business 2016, Digital Asset Business Act 2018, Fund Administration Provider Business Act 2019.

Principles for Good Conduct of Business

14. The Authority proposes to implement the following the high-level principles:

1. The firm must ensure fair and equitable treatment of its customers

Integrity and fair dealing

15. The firm must ensure that it always conducts business in a manner that is:

- a. Honest
- b. Fair
- c. Professional
- d. In accordance with the best interests of the customer

16. The directors, senior management and employees of the firm must ensure that business is transacted in a manner that is free of self-dealing.

Conflicts of interest

17. The firm must seek to identify and avoid conflicts of interest between itself and its customers, and between customers, where such action is within its control. The firm must exercise care such that it does not unfairly place its own interests over the interests of its customers.

2. The firm must have continuing regard for the interests of its customers in the conduct of its business

Corporate values and ethics

18. In order to establish and promote a culture of integrity, including the fair treatment of customers, the firm must establish and implement a code of conduct or code of ethics, which defines acceptable and unacceptable behaviours and outlines penalties for non-compliance.

Due care and diligence

19. As the firm conducts business and fulfils its obligations to the customer, it must consider the impact of their communication and interactions, or the lack thereof, on the customer. The firm must address the fair treatment of customers throughout the stages of the product life cycle and the duration of the provision of services.

Staff competence

20. All employees must be sufficiently qualified and experienced to discharge their duties properly.

21. The firm must provide the necessary training to employees relative to their business function. Specifically, the firm must ensure that the relevant front-line staff are trained to provide guidance on products and services and to promptly and effectively deal with customer queries, complaints and disputes.

Product governance

22. The firm must have policies and procedures that address the process for review and approval of new products, activities, processes and systems, and material changes to existing products.

Suitability

23. Where the firm is responsible for providing advice or exercising discretion for, or in relation to, customers, it must seek from the customer such information about their circumstances and objectives as may be appropriate with regard to the services to be provided.
24. The firm must assess the relevant features of products and services against the customer's information to determine the product's or service's suitability before it is recommended or invested in.

Vulnerable customers

25. A firm must establish and implement policies and procedures to identify and afford reasonable care to a vulnerable customer.
26. Broadly, a vulnerable customer is a natural person who:
 - a. Has the capacity to make his or her own decisions but who, because of individual circumstances, may require assistance to do so (for example, hearing impaired or visually impaired persons); and/or
 - b. Has limited capacity to make his or her own decisions, and who requires assistance to do so (for example, persons with intellectual disabilities or who suffers from a mental health condition)

Cancelling a service or transferring service providers

27. Firms should not unduly, except as required by law, limit the customer's ability to cancel or transfer a product or service to another provider on the customer's reasonable notice.

Conduct risk framework

28. Conduct risk must be integrated in the firm's risk management framework. The risk management function must define, assess and measure the firm's exposure to conduct risks.
29. The board has ultimate responsibility for managing the firm's conduct risk. The board may delegate functions to others, where appropriate, whilst maintaining oversight and responsibility.

Outsourcing

30. The firm must ensure that outsourced activities comply with applicable legislation, codes and guidance governing the conduct of business. The firm must establish clear senior management responsibility and oversight for monitoring the providers of outsourced services and for reporting to the board.

3. The firm must ensure that communications with customers are fair, clear and not misleading

31. The firm must supply the customer, or the potential customer, with information that is adequate, up-to-date and material for decision-making purposes.
32. The firm must not disguise, omit, diminish or obscure material information, statements or warnings. The firm must consider whether omission of any relevant fact will result in the information being insufficient, unclear, unfair or misleading.
33. The firm must ensure that information is presented in a way that is likely to be understood by the customer. The firm must consider the impact of content and presentation of information by:
 - a. Positioning material information in a location such that it is obvious and apparent
 - b. Simplifying language where possible
 - c. Considering the accessibility of the communication channel
34. The firm must be able to demonstrate that information is supplied to customers with reasonable timeliness, in comprehensible form and through the appropriate channel.

Advertising and promotion

35. The firm must promote products and services in a manner that is clear, fair and not misleading. The firm must ensure that its advertisements:
 - a. Do not contain a statement, promise or forecast that is untrue, misleading or deceptive
 - b. Are not designed in such a way as to distort or conceal any relevant subject material
 - c. Are clearly recognisable as advertisements
 - d. Use clear and easy to understand language
 - e. Include a statement of the related risks

Sales practices

36. The firm must establish and comply with sales policies and procedures which prohibit and prevent misbehaviour such as mis-selling, misrepresentations, aggressive sales tactics and discrimination during the sales process.
37. Sales representatives must understand the products that they are selling and the risks that the products may pose to customers. To the best of their ability they must present products in a truthful manner. Firms should also ensure that their sales representatives are adequately trained to effectively deal with customers in a fair and transparent manner.

Disclosure prior to providing services

38. Adequate information should be provided so as to enable the customer to make a competent decision. Prior to the customer entering into a contract, the firm must ensure they effectively communicate:
 - a. The nature and level of benefits and risks to the customer in a fair and balanced way

- b. The obligations of the parties involved, including those for the firm, intermediaries and customers for the duration of the relationship
 - c. The duty of customers to disclose material information
39. The firm is required to demonstrate in writing that the customer has been made aware of any:
- a. Interest rates
 - b. Fees and charges, including commissions
 - c. Penalties associated with the use of a product or service
 - d. Any pre-sale or post-sale barriers to changing a product, service or financial institution

Terms of business

40. The firm must document its terms of business and provide each customer with a copy prior to any service being provided to that customer, except when it is impractical to do so, in which case the document must be provided at the earliest available opportunity.
41. The terms of business must include information on the actions or inactions of the customer which will lead to the termination of the business relationship by the firm.
42. Prior to the signing-off of an agreement, the appropriate customer service representative must explain the key terms and conditions to the customer on request or where deemed necessary based on the customer's circumstances.

Statements, reports and notices to the customer

43. The firm must provide the customer with periodic written statements of the:
- a. Value
 - b. Composition
 - c. Transactions or other fulfilment of the firm's obligations
 - d. Fees and charges (including commissions)
 - e. Dividends and interest earned in the relevant time period
- of each account, portfolio or policy. The frequency with which statements are provided should be commensurate with the type of product and customer. In general, statements need to be self-explanatory, comprehensive, objective and clear.
44. The firm must provide a customer with a closing statement when an agreement is terminated.
45. The firm must notify the customer, in writing, within a reasonable time of any material change, such as:
- a. Changes in fees, charges and interest rates
 - b. Material modification to products or services
 - c. Discontinuation of products and services; or

d. Contractual changes to agreements and terms and conditions

4. The firm must ensure the protection of the customer's assets against loss, fraud and misuse

46. Firms should have in place appropriate controls and protection mechanisms for the protection of customers' deposits, investments and other similar financial assets, including against fraud, misappropriation or other misuses, and against reasonably foreseeable losses, in accordance with the responsibility the firm has accepted.
47. Where the firm is in control, or is otherwise responsible for, monies or assets belonging to the customer, the firm must have adequate systems and internal controls to identify and promptly remedy errors, fraud or other misuse by the firm or its employees.

5. The firm must handle complaints and errors in a manner that is fair and expedient

48. The firm must implement a complaints management framework that seeks to deal in a timely manner with any customer complaint. Where a customer complaint identifies a valid error, the firm must seek to resolve the error within a reasonable timeframe, relative to the nature of the issue.
49. The customer should not be burdened with unnecessary costs when seeking to resolve a complaint.
50. The firm must document a complaint handling procedure that includes at a minimum processes for:
- a. Making a complaint
 - b. Handling complaints in a fair, timely and appropriate manner
 - c. Acknowledging receipt of complaints
 - d. Maintaining a complaint register, containing details of complaints received and how they have been dealt with and/or resolved, including an indication of whether any action was required by the firm
 - e. Analysing the patterns of complaints and errors
51. Information on the complaint handling procedure and the contact point for complaints must be made publicly accessible (i.e., provided on the company website and available upon request).

6. Where dealing with retail customers, the firm must ensure that individuals are aware of their responsibilities within the business relationship and have access to appropriate financial educational resources

Clear Customer Responsibilities

52. Whilst customers maintain a level of accountability for their own choices and decisions, the firm should appropriately remind customers of their responsibilities to:

- a. Read and understand the terms and conditions of products and services
- b. Disclose relevant information as it relates to the firm's legal obligations, including but not limited to its Anti-Money Laundering and Anti-Terrorism Financing (AML/ATF) obligations, and inform the firm of any changes to such required information
- c. Disclose relevant information to assist the firm in managing the relationship and ensuring the suitability of its products and services for the customer
- d. Verify statements for correctness and inform the firm of any suspected errors
- e. Protect sensitive personal information used to access money/accounts

Customer awareness

53. Where appropriate to do so, having regard to the nature, scale and complexity of the business undertaken by the firm, the firm should develop programmes and resources to assist customers with developing the knowledge and skills necessary to:
 - a. Understand risks (including financial risks)
 - b. Make informed decisions
 - c. Access competent and professional advice and assistance when needed
54. Firms should clearly signpost the directory of educational resources through an appropriate communication channel for the benefit of a customer.

Scope of Application

55. The Authority intends for these principles to generally apply to financial service providers serving both wholesale and retail customers. The Authority aims to allow proportional application of the principles to more sophisticated professional customers, where it is appropriate to do so. Primarily, the regime will aim to ensure that there will be sufficient regulatory protections for financial services customers which it deems more susceptible to experiencing negative outcomes when doing business (i.e., retail customers, including small-to-medium enterprises).
56. The Authority proposes, in the first instance, to amend existing codes of practice and codes of conduct for each regulated sector to specifically include the conduct of business principles. Where a code does not exist for a particular sector, the Authority will develop one that will incorporate the aforementioned principles. The Authority will look to provide clarity regarding the application of the principles to each sector based on the particular nature of the business being conducted. This will also include a consideration of the types of customers served, their location and the applicability of group supervision by the Authority.
57. The Authority recognises that many licensees in Bermuda's financial services sector may have conduct of business codes, policies and practices embedded within their operations. Consequently, the Authority will consult with stakeholders to codify industry practice thereby mitigating the cost of implementing a conduct of business regime in Bermuda. As the oversight for this regime matures, the Authority may choose to further enhance the regime, including issuing guidance to clarify its position on certain matters.

IV. **CONCLUSION**

58. As a responsible financial regulator, the Authority deems it important to develop comprehensive oversight of the conduct of financial services firms in order to secure an adequate degree of protection for their customers. The above proposals are intended to deliver the means to achieve this goal. At the same time, these proposals seek to ensure that the Authority continues to meet both its strategic objectives and the expectations of global standard-setting agencies.