

CII Learning and Development Forum

What is Conduct Risk and Why Does it Matter?

12th March 2015

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With thanks to John Thirlwell FIOR

Overview

- The significance of conduct risk
- The FCA's current regulatory priorities
- Managing conduct risks in a compliant manner
- The role of training in conduct risk management

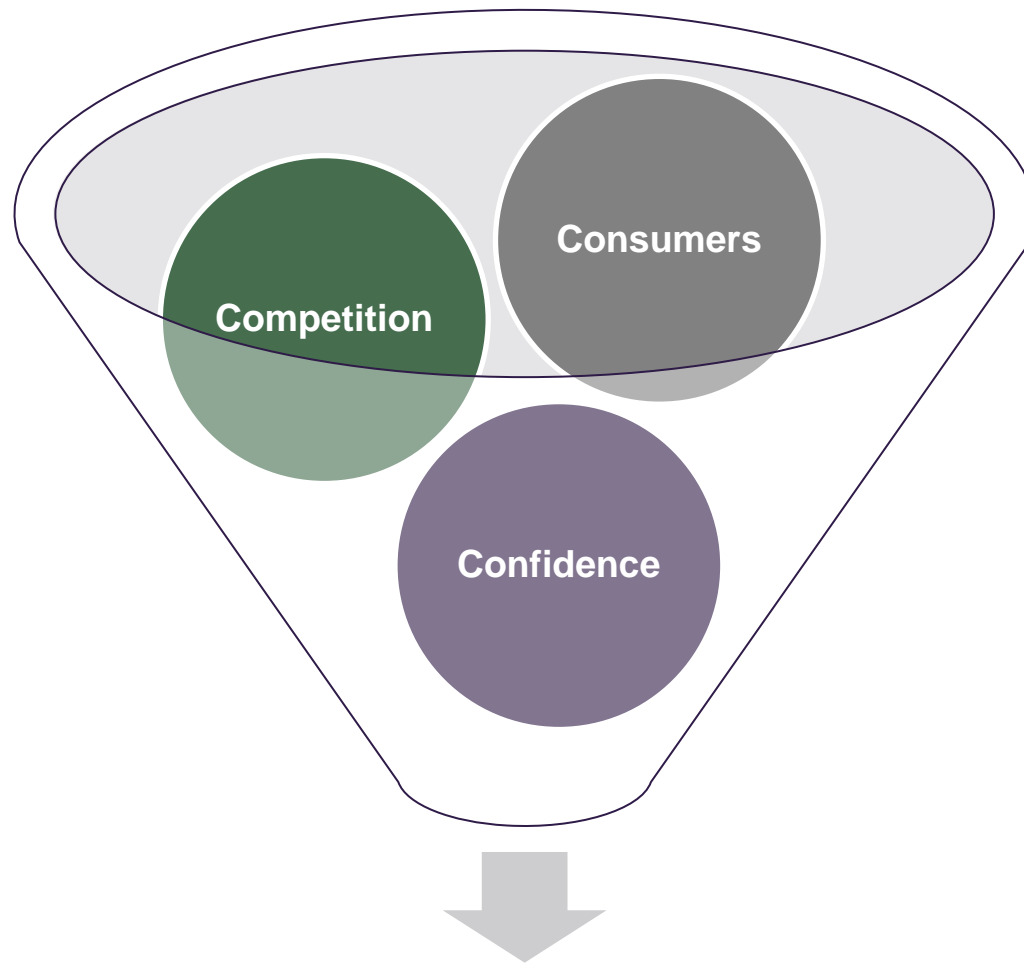


What is Conduct Risk?

- ‘Conduct risk is any action of an individual bank [or any other financial institution] that leads to customer detriment or negatively impacts market stability.’
[Philip Cooper, BBA Conduct Risk Seminar, Sept 2012]
- ‘the risk that firm behaviour will result in poor outcomes for customers’ [FSA, 2011]

Firm-Specific Definitions

- ‘The risk that detriment is caused to our customers, clients, counterparties and their employees because of inappropriate judgement in the execution of our business activities.’
- ‘The risk of customer detriment dues to inappropriate culture’
- ‘The risk of unfair outcomes to the end consumer and subsequent damage to the reputation of the firm and to the achievement of its strategic objectives.
[Thomson Reuters, Conduct Risk Report, 2013]

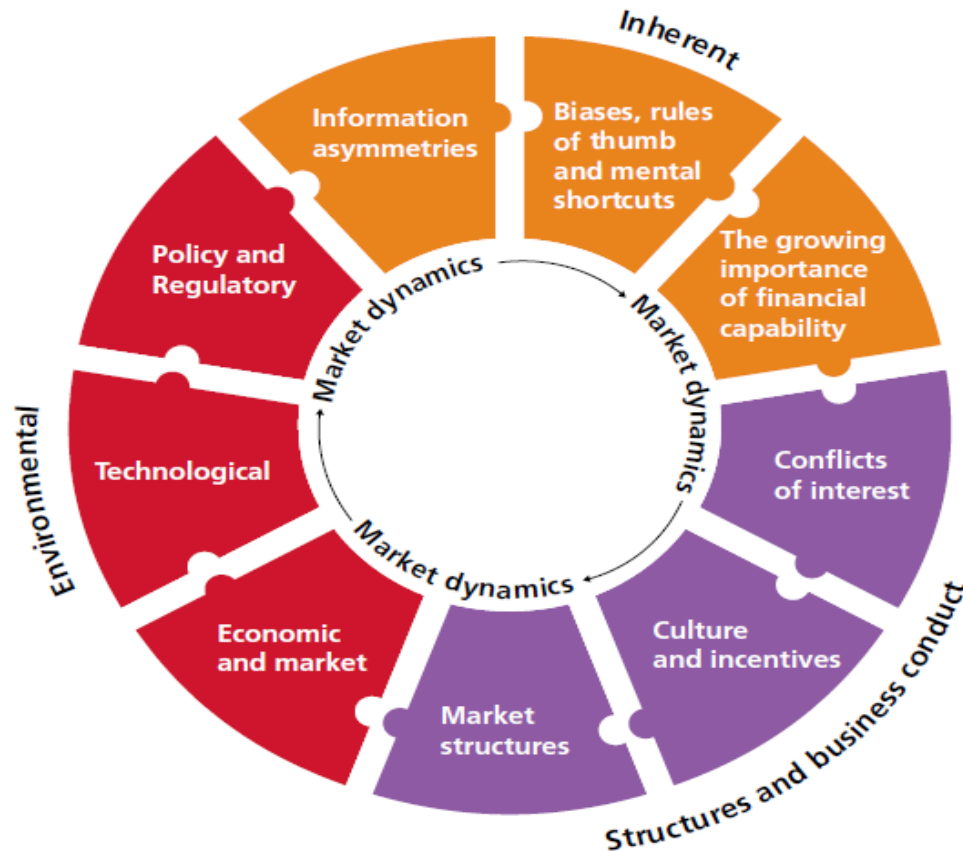


**Efficient and Fair
Markets**

Sources of Conduct Risk

[FCA Risk Outlook 2014]

Key drivers of risk



FCA Objectives

- Strategic Objective:
 - Ensure that the relevant markets function well.
- Operational Objectives:
 - To secure an appropriate degree of protection for consumers.
 - To protect and enhance the integrity of the UK financial system.
 - To promote effective competition in the interests of consumers.

Key Current Risks

- From the 2014 FCA Financial Risk Outlook:
 - Pressure on business model sustainability and strategies
 - Continued pressure to balance profitability, shareholder returns, cost base and financial soundness with good consumer outcomes
 - Misalignment of expectations with underlying fundamentals

<http://www.fca.org.uk/static/documents/corporate/risk-outlook-2014.pdf>

FCA Forward Looking Focus

- Technological developments may outstrip firms' investment, consumer capabilities and regulatory response
- Poor culture and controls continue to threaten market integrity
- Large back-books may lead firms to act against their existing customers' best interests
- Retirement income products and distribution may deliver poor consumer outcomes
- The growth of consumer credit may lead to unaffordable debt
- Terms and conditions may be excessively complex
- House price growth that is substantial and rapid may give rise to conduct issues

What Must Insurers Do?

- Have a properly implemented customer centric strategy, which produces sustainable profits;
- Have a board-led culture which supports that strategy and good consumer outcomes;
- Develop products that operate in the interests of customers, and use behavioural techniques to ensure that those customers also understand them; and
- Take a prospective view on the products that you sell, stress-testing and ensuring appropriateness for your customers.

Managing Conduct risk

- Culture
- Corporate governance
- Conflicts of interest
- Reputation
- Sales practices
- External economic factors
- Technological influences
- Competitors

[Components of Conduct Risk taken from Thomson Reuters Accelus, Conduct Risk Report, 2013]

Salz review (Barclays) 2012

‘It is understandable, and in many respects necessary, that since the start of the financial crisis, there has been an explosion of new regulation and in the intrusiveness of regulators. However, regulation alone cannot address the fundamental underlying causes that led to the business practices which are in the spotlight – the cultural shortcomings we found.’

‘. . .board conformity with laid down procedures such as those for enhanced risk oversight will not alone provide better corporate governance. . . . Principal deficiencies in boards related more to patterns of behaviour than to organisation.’ (David Walker, Review of corporate governance, 2009)

‘A move from a compliance to a learning culture will require those working in child protection to be given more scope to exercise professional judgement . . .forces have come together to create a defensive system that puts so much emphasis on procedures and recording (Prof Eileen Munro, Review of child protection, 2011)

Conduct Risk and Training

- **Embedding** conduct risk strategy and policy
- **Manage** culture: influencing hearts and minds
- **Communicate** conduct risk framework and appetites
 - Product design
 - Sales process
 - Post-sales service

Concluding Questions

- Is training part of your firm's conduct risk management strategy?
- How embedded is this training, it is mostly procedural or is it trying to influence attitudes and behaviours?
- When trying to influence attitudes and behaviours what works best?

Thank You

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