The changing nature of Conduct Risk

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The financial services landscape is evolving with changing expectations from customers and regulators.

Customer expectations are changing on a global, regional, and local scale

Digital only

Customers expect their products and services to be offered fully digitally across all customer touchpoints.

Seamless and personalised experience

New players have entered the Financial Services (FS) market with optimised customer experience and personalisation leveraging data analytics. This is becoming the expected level of experience.

Proactive financial advice and support

New players are deploying data analytics to gain a better understanding of their customers and their spending habits. Customers now expect their Bank's to provide useful guidance to them on a regular basis.

Continuous improvement, continuous delivery

New players are applying a proactive, rather than reactive, approach to FS with an innovative culture. Customers expect to see dynamic new features being deployed that are beneficial.

Risks and challenges in keeping up with the changing landscape

Customer experience challenges

Taking a product centric approach rather than a customer centric approach, which can **result in mis-selling or inappropriate recommendations.**

Complicated technology architecture

Many banks have legacy IT systems that are not fully connected to each other as part of a highly complicated architecture, which **can negatively impact a Bank's ability to operationally manage the customer relationship.**

Business and technology misalignment

Business and Technology functions may be siloed and misaligned with challenging interdepartmental relationships. This **can delay resolution of IT issues, negatively impacting the customer.**

Manual processes

Many processes are still manual with automation being adopted at a slower rate than is required to compete with new fully digital entrants and can **impact a Bank's ability to manage conduct risk effectively due to slower processing speed.**

The regulators want to see change in the UAE

The Central Bank of the UAE (CBUAE) has issued **two key Conduct related regulations** since 2020, indicating an **increased focused on this area.**

Additionally, the CBUAE aims to build a **mature FinTech ecosystem in the UAE** and position the UAE as the foremost **FinTech hub regionally and globally.**

In line with the issuance of two conduct related regulations and the UAE's vision of being a global FinTech hub, the **CBUAE has identified conduct risk as a key area of focus** for Licensed Financial Institutions (LFIs) established within the nation.

In order to meet both the customer's and regulator's expectations, banks need to apply a customer-centric approach with effective conduct risk management. Conduct risk is defined as the risks associated with an organisation's ability to deliver fair customer outcomes and to protect the integrity of the markets; ultimately, it is about managing for good customer outcomes.

Globally, regulators are taking increasing interest in conduct risk management conducted by banks.

Since the **2008 global financial crisis (GFC)**, regulators across the globe have **significantly increased their focus on conduct risk management which broadly involves providing appropriate products, to the right customer, through the right approach**. This has been demonstrated through the **establishment of regulatory authorities specifically focused on Conduct** and various **regulations, rules, and guidelines issued on the subject**. Below is an overview of some of the key conduct risk regulatory trends* in the UAE, UK, US, Hong Kong, and Singapore.

2022
2020
2018
2016
2014
2012
2010
2008

UAE

- 2021 - SME Market Conduct Regulation
- 2021 - Consumer Protection Regulation** & Standards

United Kingdom

- 2023 - Consumer Duty Guidelines
- 2018 - Markets in Financial Instruments Directive II
- 2016 - Market Abuse Regulation
- 2016 - General Data Protection Regulation***
- 2016 - Senior Managers and Certification Regime
- 2013 - Financial Conduct Authority established

United States

- 2021 - Debt Collection Rule
- 2019 - Regulation Best Interest (Conduct for Broker-Dealers)
- 2015 - TILA-RESPA**** Integrated Disclosure (TRID) Rule (mortgage loan disclosures)
- 2013 - Mortgage Servicing Rules
- 2010 - Consumer Financial Protection Bureau established
- 2010 - Dodd-Frank Wall Street Reform and Consumer Protection Act

Hong Kong

- 2023 - Code of Banking Practice (consumer protection)
- 2017 - Manager-in-Charge Regime
- 2012 - Personal Data (Privacy) Ordinance - Amendment
- 2012 - Securities and Futures Ordinance - Amendment (investor protection)

Singapore

- 2021 - Guidelines on Corporate Governance
- 2020 - Guidelines on Individual Accountability and Conduct
- 2018 - E-Payments User Protection Guidelines
- 2018 - Guide to Conduct & Market Practices for the Wholesale Financial Markets
- 2016 - Guidelines on Standards of Conduct for Marketing and Distribution Activities

Establishment of Conduct Authority | Consumer Protection | Individual Accountability | Market Integrity | Data Protection and Consumer Privacy | Business Conduct

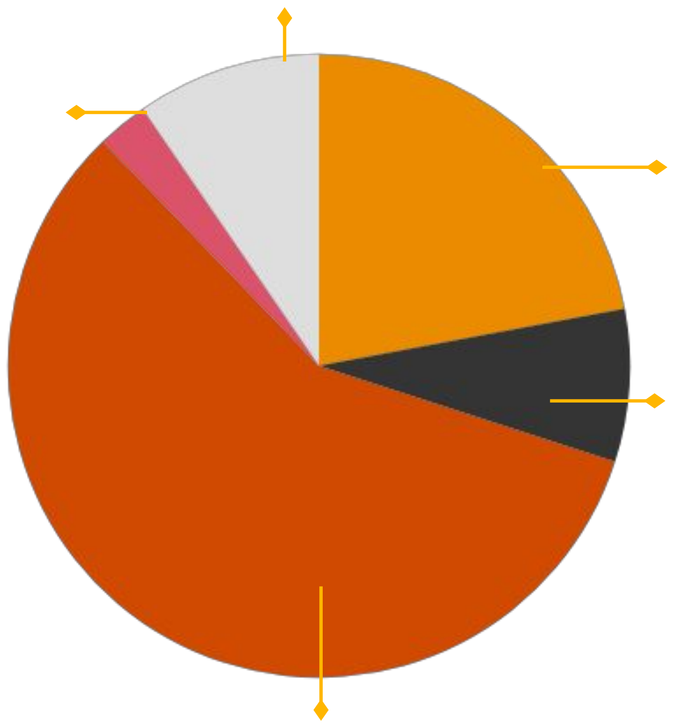
*These are regulatory trends specifically from a conduct risk perspective. The mentioned details are not exhaustive, but capture some of the key trends identified.
**The regulation was issued in 2020, and the Standards were issued in 2021.
***This was issued by the EU, but UK banks had to comply.
****TILA-RESPA: Truth in Lending Act-Real Estate Settlement Procedures Act

Regulators on a global scale are issuing significant fines and punishments for conduct risk mismanagement. In some cases, the fines can reach into several billions of dollars.

Since 2019, regulators on a global scale have been issuing **significant fines to LFIs for conduct risk breaches**. There are five key areas of conduct risk in which LFIs have been fined for with the total value exceeding US**$41+ billion***.

Regulatory fines issued for conduct risk mismanagement

2019 - 2024



Key insights

Areas of focus for regulators

- There are **five key areas** of conduct risk that Global Regulators have issued fines for: Consumer Protection, Anti-Competitive Behaviour, Governance and Risk Management, Bribery and Corruption, and Employee Discrimination.
- **The largest fines that have been issued for violations relate to Consumer Protection** (both in terms of value and number of fines).

Consumer protection

- Regulators issue significant fines for issues that result in **consumer detriment**.
- The key reasons for regulatory fines included but were not limited to **illegal or unnecessary fees, mortgage abuses, consumer privacy violations, and investor protection violations.**

What can banks do to avoid fines?

- **Effective conduct risk management** is essential to mitigate the risk of regulatory fines.
- **Strong risk management controls across all customer facing functions, product life cycles, and internal processes** is key to managing conduct risk.

*The dataset analysed is limited to fines issued by US regulators against global LFIs. The minimum value of fines issued in the dataset is $10,000,000 or above. Consequently, the total value of fines issued for conduct risk mismanagement during 2019-2024 is greater than the value presented above.

Conduct risk spans the customer lifecycle from pre-onboarding to ending the relationship. Effective management of each stage is vital for building customer trust. Here's a summary of key touchpoints.

Key Conduct risk pillars

Customer

Protection and fair treatment of customers is a key element of conduct risk management

- **Complaints -** What are the customer complaints trends and impact from a conduct risk perspective?
- **Customers in Debt -** Is the LFI selling products and services which increase debt?
- **Employee Behaviour Monitoring -** Are employees conducting unethical selling practices?

Product

Products must be designed in a way that does not result in customer detriment

- **Product Risk Assessments -** Are product risks being properly identified?
- **Price Monitoring -** Are prices indicative of anti-competitive behaviour?
- **Market Analysis -** What are competitors doing more effectively?

Process

Bank's internal processes must be effectively designed to manage conduct risk

- **Governance and Risk Management -** Is risk management being effectively conducted?
- **Market Surveillance and Risk Analytics -** Does the LFI have excessive exposure?
- **Whistleblower Reports -** What internal issues are being flagged?

Risk assessment

Risk identification

Identification of the **inherent risks, controls required, and residual risk**

Gap analysis and implementation roadmap

Once the risks and controls are identified, a **roadmap should be developed for mitigating the risks**

Controls implementation

LFIs should then **implement controls following a risk-based approach**

Ongoing monitoring

Ongoing monitoring including **regular risk assessments** should be conducted to ensure identification of **changing and/or new risks and deficiencies in controls**

Key considerations for robust MI to monitor conduct risk

Conduct risk framework

Conduct risk MI must be an **integral part** of the conduct risk management framework to achieve **data driven insights** and **effective actions to achieve improvements**

Results focused

MI should be leveraged to **determine key areas of improvement** and **monitoring** should be conducted to **ensure these improvements are being achieved**

Holistic trends

MI of each conduct risk area **should not be examined independently**. Identification of broader trends can **determine deeper issues within an organisation**, even at a culture level

Regular, accurate, and appropriate

MI reporting to be **conducted regularly** to enable **proactive monitoring**. Reporting needs to be **appropriate and tailored for the respective audience**

Open and honest communication

The MI insights should **drive discussions** on how to achieve **genuine improvements**, and key areas relating to deficiencies **should not be misrepresented or ignored**

Effective actions and record maintenance

Based on MI findings, effective actions need to be **defined** and then **implemented**. This needs to be **recorded** and then **followed up on**

Based on the Management Information collected, LFIs can manage Conduct Risk more effectively through a robust framework covering Governance, Processes, People (Resource Allocation and Knowledge & Expertise) and Technology

Conduct Risk can be effectively managed holistically through utilization of a Management Information reporting framework and mechanism across the three pillars of conduct risk.

Conduct risk throughout the customer lifecycle **fundamentally involves three key considerations: clear communication and disclosures, ethical, proactive and beneficial advice and support, and adherence to SLAs.** Management of these three considerations will enable LFIs to **build genuine trust with customers**.

In addition to the LFI's conduct whilst interacting with customers, LFIs need to ensure there are **sufficient, standardised and effective controls** in place to maintain adherence to these considerations.

Marketing

- Clear **disclosure and transparency**
- Communications are **not misleading**
- **Target audience** is identified

Sales agents

- **Ethical behaviour** and selling
- **Employee incentives** and remuneration
- Understanding of the product and **customer needs**

Branches

- Staff are **available and supportive**
- Locations should cater to **People of Determination**

Digital channels

- Optimised **customer experience**
- **Personalisation** of services
- Data analytics to provide **appropriate and beneficial financial advice**

Application for product or service

- **Risk disclosures** are provided
- **Product is beneficial** for customer based on understanding

Usage of product or service

- Product use **does not result in consumer detriment**
- **Advice provided on a continuous basis** on how to optimise finances
- **Regular communication**

Customer support

- Customer support is easily **available and accessible**
- **Monitoring** to ensure support agents are being **effective and supportive**
- **No discrimination** against customers

Complaints management

- Complaints and resolutions are **recorded, monitored and analysed**
- Complaint resolution **SLAs are adhered to**

Debt / Arrears management

- **Proactive support** to customers to **avoid / manage debt**

Ending of relationship

- **No restrictions** on **customer mobility**
- **Support to customer** to manage transfer of assets

Conduct risk controls must be considered and applied across the product lifecycle for all products and services an Licensed Financial Institutions offers.

Product lifecycle

Conduct Risk Considerations

Product design and development	Marketing and communications	Sales process	Sales process review	Product monitoring and governance	Customer servicing
Customer centric	Disclosure and transparency checklist	Training for sales staff	Review on customer outcomes	Identification, mitigation and monitoring of risks	Training for customer support staff
Conduct risk assessment	Training for marketing staff	Employee incentives and remuneration	Assurance of ethical behaviour and fair treatment	Review product metrics and KPIs	Monitoring of customer support effectiveness
Product approval framework	Monitoring of marketing channels	Monitor sales activity	Implementation of corrective actions	Product governance framework with regular risk assessments	Monitoring customer complaints and taking action to address trends

By deploying conduct risk controls across each element of the product lifecycle, LFIs can effectively demonstrate to regulators that there is an effective approach to ensuring that conduct risk is managed at the product level. The key components of an effective regime consider the following aspects:

- **Customer focused design**
- **Governance structures**
- **Risk assessments**
- **Data analytics and reporting**
- **Staff training**
- **Monitoring**

Conduct risk management should be integrated throughout the internal control framework and processes of an LFI. This ensures effective conduct risk management across all three lines of defence for a bank.

Oversight, Governance, and Culture

- Risk appetite atatement
- Code of conduct
- Board and senior management accountability
- Roles and responsibilities
- Product governance
- training
- Tone from the top

Policies and procedures

- Whistleblowing
- Personal trading
- Conflicts of interest
- Ethical walls
- Anti-bribery and corruption
- Complaints management
- Consumer protection

Conduct risk monitoring

- KRIs
- Performance metrics
- Monitoring mechanisms Across all business lines
- Incident reporting and analysis

Reporting

- Internal reporting across All business lines
- External reporting to regulators
- Reporting processes

Risk assessment

- Inherent risk identification
- Risk rating across high, medium, and low
- Defining of preventive, corrective, and mitigative controls

Conduct risk management is the responsibility of all employees and departments of an LFI. It must be fully understood and integrated across the Three Lines of Defence to ensure a comprehensive approach.

Three Lines of Defense Model

Board of directors and senior management

Third line of defense
(Internal Audit)

Second line of defense
(Control Functions - Compliance, Legal, Risk)

First line of defense
(Business)

Roles and responsibilities

Accountable for the overall Conduct Risk management framework, with a responsibility to set the **tone from the top** and foster a **strong risk management culture**.

Responsible for independent assurance of the conduct risk management framework and processes across the Board of Directors, Senior Management, Second Line of Defense and the First Line of Defense

Responsible for conducting risk assessments, monitoring, and reporting on Conduct Risk to Senior Management, provision of **training** and management of **compliance with regulatory requirements**.

Responsible for implementing policies and procedures, embedding **controls into business processes,** and effectively **understanding customer needs.**

We have extensive experience in supporting LFIs enhance their conduct risk framework. Our team of experts can assist you in achieving your management objectives in this area.

01 Conduct risk impact assessment

- Gap assessment of the current state versus **regulatory requirements**
- Analysis of the current state against **industry leading standards** and **international best practice**
- **Risk assessment for conduct risk**
- Identification of **gaps and deficiencies** and **actions to achieve enhancements**
- Development of a **roadmap to achieve the required enhancements**

02 Implementation support with controls

- **Project management support** of control implementation
- Support in updating and developing **policies and procedures**
- Optimisation of **conduct risk management processes**
- Enhancement of the conduct risk management **framework and target operating model**
- **Support in operationalisation** of conduct risk control enhancements

03 Management information solution implementation

- Deployment of a **risk assessment tool** which can be leveraged for MI generation
- **Identification of missing conduct risk data points** from existing MI dashboards
- **Alignment and standardisation** of conduct risk MI across the organisation
- Optimisation of conduct risk MI **governance and reporting dashboards**
- Enhancement of **remediation processes and monitoring of actions**

We can effectively support you in identifying deficiencies in your conduct risk management framework through deployment of our management assessment tools.

Conduct Risk Management Assessment Tool

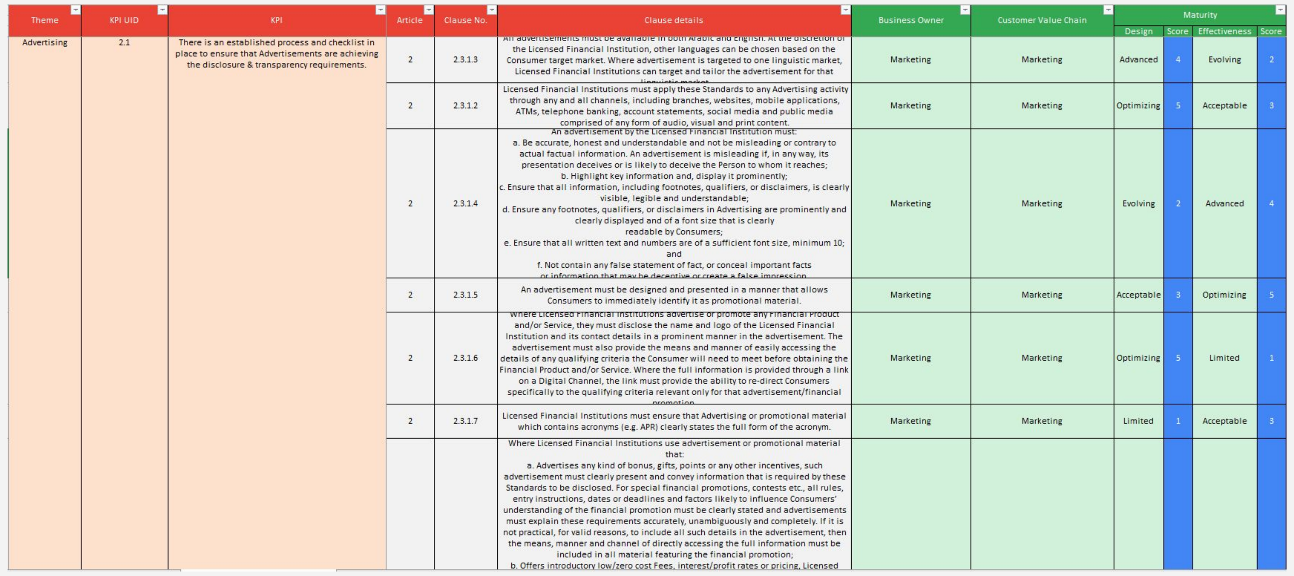
Assess your organisation against **multiple aspects of conduct risk** to identify deficiencies and areas requiring improvement

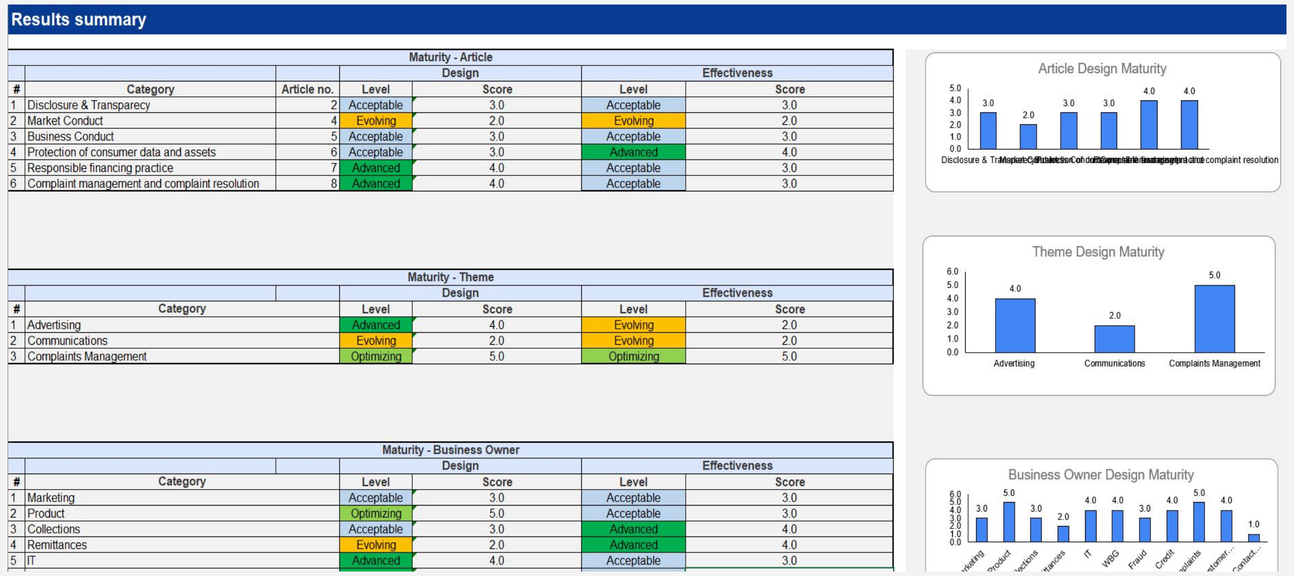
Consumer Protection Maturity Assessment Tool

Assess the **maturity** of your organisation against the requirements of **Consumer Protection**.

Ethical Selling Assessment Tool

Assess the **effectiveness** of your organisation in conducting **ethical selling**.





Results summary

Maturity - Article						
			Design		Effectiveness	
#	Category	Article no.	Level	Score	Level	Score
1	Disclosure & Transparecy	2	Acceptable	3.0	Acceptable	3.0
2	Market Conduct	4	Evolving	2.0	Evolving	2.0
3	Business Conduct	5	Acceptable	3.0	Acceptable	3.0
4	Protection of consumer data and assets	6	Acceptable	3.0	Advanced	4.0
5	Responsible financing practice	7	Advanced	4.0	Acceptable	3.0
6	Complaint management and complaint resolution	8	Advanced	4.0	Acceptable	3.0

Maturity - Theme					
		Design		Effectiveness	
#	Category	Level	Score	Level	Score
1	Advertising	Advanced	4.0	Evolving	2.0
2	Communications	Evolving	2.0	Evolving	2.0
3	Complaints Management	Optimizing	5.0	Optimizing	5.0

Maturity - Business Owner					
		Design		Effectiveness	
#	Category	Level	Score	Level	Score
1	Marketing	Acceptable	3.0	Acceptable	3.0
2	Product	Optimizing	5.0	Acceptable	3.0
3	Collections	Acceptable	3.0	Advanced	4.0
4	Remittances	Evolving	2.0	Advanced	4.0
5	IT	Advanced	4.0	Acceptable	3.0

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Thank you