

'This newsletter is translated from the Japanese edition distributed on November 27th.  
Center for Risk Management Strategy at Deloitte Touche Tohmatsu LLC.

# Global Risk Watch Newsletter

## The Consequences of “stagnant prices”, etc.

Global Risk Watch Vol.32  
12 December 2017

=====

«index»

1. [# The Consequences of “stagnant prices” \(Tsuyoshi Oyama\)](#)
2. [# Prescription for conduct risk \(Shiro Katsufuji\)](#)
3. [# A Brief Look at Wage Trends \(Toshikazu Kumagai\)](#)
4. [Seminars, Conferences & Publications](#)

=====

### 2. Overview of Development in Financial Regulations (Trends & Topics)

#### **# Prescription for conduct risk (Shiro Katsufuji, Director, Center for Risk Management Strategy at Deloitte Touche Tohmatsu LLC)**

Financial institutions and corporate firms are facing a growing need for enhanced conduct risk management. A series of misconduct incidents in financial and non-financial industries have contributed to the heightened attention to conduct risk. Among financial institutions, typical examples of materialized conduct risk include sales practice of securitized products backed by subprime mortgage loans (which triggered the global financial crisis), and the manipulation of benchmark rates like LIBOR. Harassment, labor issues (i.e. illegally long overtime hours), accounting fraud, data falsification for product quality, and tax evasion are common issues across industries. For effective management of a range of conduct risks, the following steps are called for.

First, it is necessary to properly define and categorize conduct risk as well as clarify its scope. Conduct risk may be interpreted as “risk of undermining stakeholders’ benefits, or damaging a company’s value due to the misconduct of the corporate executives/employees that negatively impacts the clients, markets, environment, society, employees, etc.” One of the distinct features of conduct risk is that it considers not only a company’s internal losses, but also the broader interests of the stakeholders such as the company’s clients and employees. In order to categorize various kinds of conduct risk, it is effective to divide stakeholders into groups, and determine the area of risk the firm should focus on. Another feature of conduct risk is that it is a “hybrid” risk of conventional operational risk and compliance. Specifying this unique position in the existent internal risk categories is essential.

Second, firms need to assign a specific department in charge of conduct risk management. Since conduct risk contains elements from both operational risk and compliance, it involves both the risk management and compliance departments within a firm. Parts of conduct risk may be already covered by the existent framework of these teams. However, the perception of clients and society on misconduct are constantly changing, often becoming more critical. This demands a company's response in areas that are not defined in within the scope of conventional business operations. What matters is to ensure the definition of and responsibilities for conduct risk, so that it does not fall into the crevice of the existing business structure.

Third, firms should recognize that some parts of conduct risk are regulated/standardized and others are not, and each firm should ascertain their own policies on conduct risk. Regulators are proceeding to reinforce regulation upon an increasing number of misconduct incidents. For instance, in 2018, the European Union (EU) will implement detailed regulation called MiFID II for investor protection in market transactions. As for labor issues, the relevant authorities in Japan are enhancing their supervision on compliance of the Labor Standards Act. In these areas, rule-based legislation and standards are well established, thus heightened supervisory effort for compliance is an unequivocal target. To the contrary, less established areas require respective firms to create and comply with their own code of conduct. The Japanese Financial Services Agency has prompted financial institutions to implement "Customer-Oriented Business Conduct" in sales of financial instruments and other activities. This is principle-based supervision, thus specific measures are left to each institution for their voluntary judgement. Furthermore, areas such as harassment and tax evasion have yet to have rule-based standards where firms must manage conduct risk based on their own value judgements.

Finally, firms must establish an internal framework equipped to handle two phases of conduct risk management. The first is a post-misconduct phase that requires a risk management framework for during and after the incident. The second is a pre-incident phase with a forward-looking risk management framework that prepares for potential misconduct by taking preventative measures of risk level evaluation and mitigation efforts. For the forward-looking conduct risk management, it is effective to develop a process to identify risk factors for internal and external misconduct phenomena through case studies and scenario analysis, regularly evaluate these frameworks and create mitigation measures.

Development of these risk management structures and their penetration into firms' operation can, to certain extent, benefit from common frameworks within a specific industry. However, since conduct risk management also includes unstandardized areas, there can be a gap in levels of compliance required in accordance with business models and stakeholders' expectations. In order to establish a proper conduct risk management structure firms have to hold thorough internal discussions on appropriate conduct with reference to practice of regulators and other players in the industry.

---

[Home](#) | [Security](#) | [Legal](#) | [Privacy](#)

Deloitte Tohmatsu Group (Deloitte Japan) is a collective term that refers to Deloitte Tohmatsu LLC, which is the Japan member firm of Deloitte Touche Tohmatsu Limited (DTTL), a UK private company limited by guarantee, and firms affiliated with Deloitte Tohmatsu LLC that include Deloitte Touche Tohmatsu LLC, Deloitte Tohmatsu Consulting LLC, Deloitte Tohmatsu Financial Advisory LLC, Deloitte Tohmatsu Tax Co., DT Legal Japan, and Deloitte Tohmatsu Corporate Solutions LLC. Deloitte Tohmatsu Group is known as one of the largest professional services groups in Japan. Through the firms in the Group, Deloitte Tohmatsu Group provides audit & assurance, risk advisory, consulting, financial advisory, tax, legal and related services in accordance with applicable laws and regulations. With about 11,000 professionals in nearly 40 cities throughout Japan, Deloitte Tohmatsu Group serves a number of clients including multinational enterprises and major Japanese businesses. For more information, please visit the Group's website at [www.deloitte.com/jp/en](http://www.deloitte.com/jp/en).

Deloitte provides audit & assurance, consulting, financial advisory, risk advisory, tax and related services to public and private clients spanning multiple industries. Deloitte serves four out of five Fortune Global 500® companies through a globally connected network of member firms in more than 150 countries and territories bringing world-class capabilities, insights, and high-quality service to address clients' most complex business challenges. To learn more about how Deloitte's approximately 245,000 professionals make an impact that matters, please connect with us on [Facebook](#), [LinkedIn](#), or [Twitter](#).

Deloitte refers to one or more of Deloitte Touche Tohmatsu Limited, a UK private company limited by guarantee ("DTTL"), its network of member firms, and their related entities. DTTL and each of its member firms are legally separate and independent entities. DTTL (also referred to as "Deloitte Global") does not provide services to clients. Please see [www.deloitte.com/about](http://www.deloitte.com/about) to learn more about our global network of member firms.

This communication contains general information only, and none of Deloitte Touche Tohmatsu Limited, its member firms, or their related entities (collectively, the "Deloitte Network") is, by means of this communication, rendering professional advice or services. Before making any decision or taking any action that may affect your finances or your business, you should consult a qualified professional adviser. No entity in the Deloitte Network shall be responsible for any loss whatsoever sustained by any person who relies on this communication.

© 2017. For information, contact Deloitte Touche Tohmatsu LLC.