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**How do you know?
Conduct risk MI in an era of
changing supervisory scrutiny**

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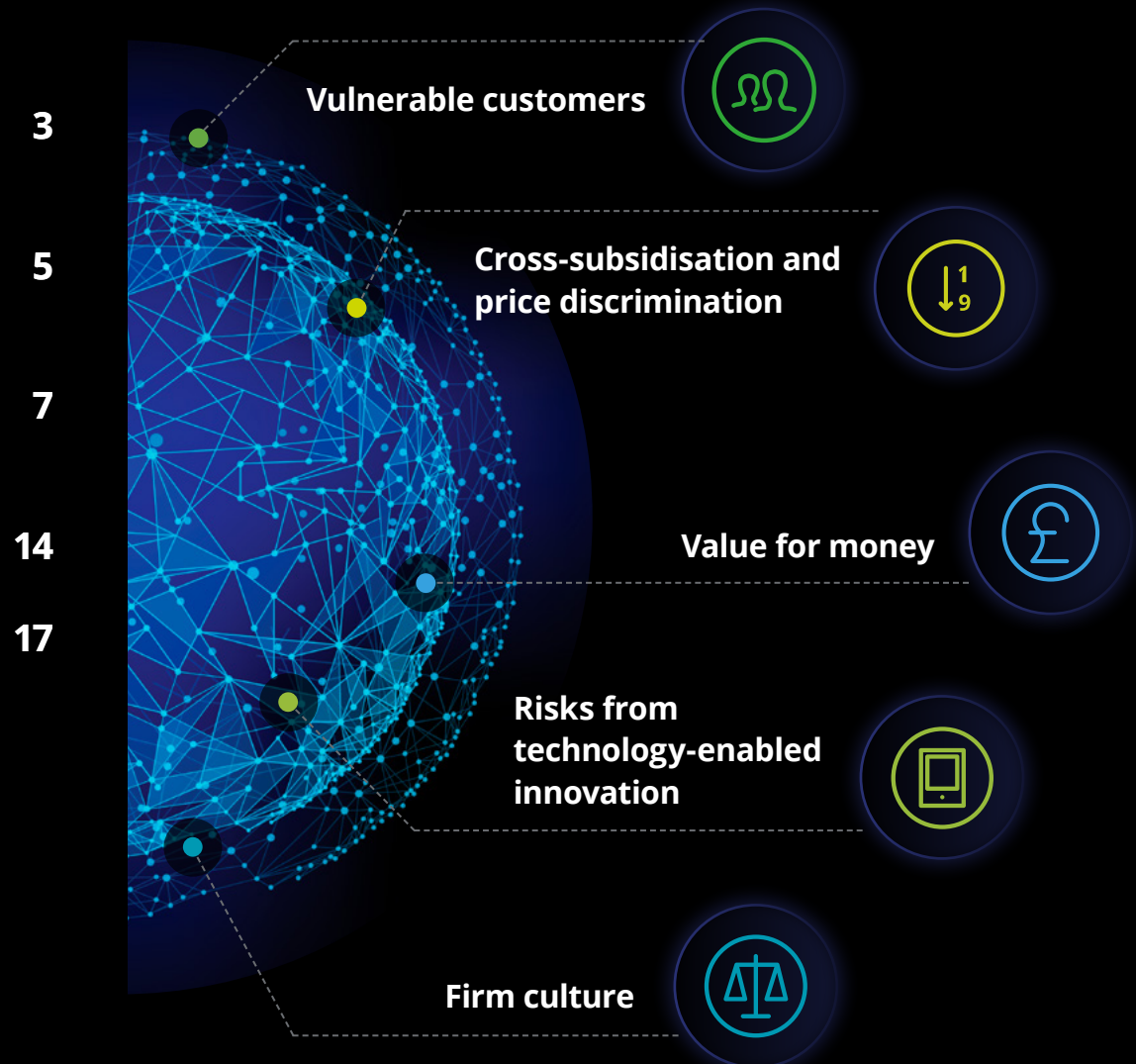
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Section 1: Overview

What this report does and for whom it is intended

This report is aimed primarily at Board Members, Senior Managers and other Executives who are subject to regulatory accountability regimes. Building on earlier Deloitte work on conduct risk management information (MI)¹ it:

- summarises how conduct supervision has evolved in the last few years, particularly in its focus on customer economic outcomes and vulnerability and on firms' business models and culture;
- sets out how, spurred by this changing approach, supervisors are likely in practice to probe and challenge on conduct risk; and
- explores what types of MI firms need, in response, to demonstrate that their Board and Senior Managers are monitoring and managing customer treatment and outcomes in the way, and to the standard, that their supervisors expect.

We expect that a core and persistent theme of firms' supervisory interactions will be **how the Board and Senior Managers satisfy themselves** that the firm is managing its conduct risks appropriately and treating customers fairly. The thrust of supervisory enquiry is likely to turn, rightly, on variants of the question **"How do you know?"** That is, how does the Board know that its customers, particularly those most vulnerable, are experiencing fair treatment and outcomes and receiving value for money?

Firms that are producing MI of the kind and scope set out in this report, in a streamlined and concise way, will be best placed to respond to this supervisory scrutiny, and to show, where necessary, how their Senior Managers are meeting their customer obligations under accountability regimes such as the UK's Senior Managers Regime. They will be able to demonstrate credibly how they are identifying

and managing conduct risks appropriately and, most importantly, monitoring and validating the outcomes being delivered to customers.

Why conduct MI makes sound commercial as well as regulatory sense

Firms face a number of **practical challenges** in gathering, analysing and reporting their conduct risk MI. Reliance on manual or legacy systems means that some firms find it difficult to make effective use of available data without significant labour-intensive intervention, whilst others are constrained by the quality of the raw data available to them. Firms with a group structure or global presence can also experience difficulty in aggregating and reporting their MI in a way that meets the needs of different audiences, businesses and regions.

In spite of the challenges, in Deloitte's view, Board-level MI that provides a clear and comprehensive picture of the outcomes a firm is delivering to its customers is the hallmark of a well-managed business and a prerequisite for good long-term reputation, brand strength and hence success in the market. Good quality, insightful MI on customer needs, trends and the root causes of any breaches or problems will both enhance Board oversight and decision-taking, help identify new and emerging risks to good customer outcomes, as well as opportunities for improvements to business processes and the products and services provided to customers.

As supervisors shift increasingly from reforming to operating the post-crisis supervisory system they will look for evidence that Board Members and Senior Managers are responding to the pronounced changes in supervisory focus and expectations that we explore in this report. Most importantly, they will look for compelling evidence that firms have a purpose and culture that places sufficient emphasis on customer outcomes and the avoidance of harm. They will expect that Boards and Senior Managers understand and are actively monitoring customer outcomes and have satisfied themselves, especially from vulnerability and value for

¹For more information, see Deloitte's 2015 paper, Management Information for Conduct Risk- Underpinning better decision-making, which sets out 10 principles for achieving strong conduct risk MI.

money perspectives, that these outcomes are fair.

Crucially, and not least as an insight into the firm's governance and culture, supervisors will want to understand how MI informs the decision-making of the firm. And where firms identify harm or potential harm to customers, supervisors will want to understand what action the firm is taking to address this.

Conduct supervision and accountability regimes are evolving in a way that places more importance on effective conduct MI

Since the financial crisis, and in response to its lessons, the supervision of conduct risk has been gradually but radically transformed, leading to increased senior management accountabilities and more wide-ranging supervisory expectations.

Understanding this change in approach and expectation is essential to the design and operation of conduct MI.

Where once supervisors were focussed predominantly on the processes around the design, sale and distribution of financial services products, they have come increasingly to focus on **economic outcomes for consumers**, and whether these are fair, provide value for money or result in harm to customers. This shift has been founded on the following key changes in supervisory perspectives, priorities and practical approaches:

- the concept of, “**caveat emptor**”, once prominent in senior supervisors’ and ombudsman speeches or policy documents, **generally now receives less overt emphasis**. This reflects a view that in certain situations, particularly those involving vulnerable consumers, information asymmetries and market dysfunctions, or outright market failure, the supervisory value of caveat emptor is severely limited;
- a stronger emphasis upon **the economic outcomes** consumers experience from their use of financial services and products;

- a much sharper focus on **firms’ business models**, particularly the fairness issues arising from the sale of **technology-enabled products and services** and, increasingly, their use of **cross-subsidies and price discrimination** between different consumer groups; and
- a parallel prioritisation, again from a quasi-market failure perspective, of consumers deemed **most vulnerable**. The definition of vulnerability is widely drawn because it turns essentially on situations any consumer may find themselves in at some point.

Where supervisors have identified concerns in the above areas on a scale that has led them to conclude that market failure is occurring, they have **become more willing to intervene**, including, albeit as a last resort, and where nudge tactics have failed, **directly on the prices firms charge**.

Two further key changes have accompanied this transformation in the conduct supervision approach:

- several jurisdictions have brought in, or are proposing to bring in **tough new accountability regimes** for Senior Managers and Board Members, holding them directly accountable for conduct risks and the consumer outcomes firms deliver; and
- an increasing emphasis on **firm culture**, for which Board Members and the Board collectively are being held to regulatory account, reflecting the perception that cultural failings have been at the root of most major misconduct episodes.

Section 2: The regulatory and business imperative for effective conduct risk MI

“MI has no purpose if it is not used”

UK Financial Conduct Authority

Conduct risk MI enables firms to demonstrate fair customer and market outcomes, manage the risk of regulatory censure and limit reputational damage. Whilst UK regulators have been particularly proactive in setting out their expectations of firms' MI, changes introduced by regulations such as MiFID II and the trend towards increased personal accountability have made it a more important concept globally. Figure A sets out select regulatory developments with implications for firms' conduct risk MI.

In the absence of good quality, insightful MI, firms may find it hard to demonstrate to their supervisors how they are achieving fair outcomes for their customers, as well as managing the risks to themselves. As the UK's Financial Services Authority (FSA) previously highlighted, “it is not possible for a firm to demonstrate that it is actually delivering...consumer outcomes without some evidence”. Although this guidance was published in 2007, it remains on the website of the FSA's successor, the Financial Conduct Authority (FCA), who refer firms to it as a “relevant” source document in helping them develop their MI.

Episodes of failure, whether as a result of misconduct or operational breakdown, will also drive intensive scrutiny of a firm's MI and the steps that the Board and Senior Management took to prevent such an outcome occurring. Firms will be expected to show the flow of information to the Board, including how key risks and issues were identified and escalated and the actions taken to address or mitigate them.

Aside from the regulatory drivers, firms that adopt a proactive approach to the identification, assessment and monitoring of their conduct risks and outcomes stand to gain considerable business benefits. They can more easily identify areas of the business or products and services that are not performing as expected and take action before risks and issues crystallise. Furthermore, in a social media-enabled world, where any conduct failures can result in reputational damage, strong MI helps firms better understand the needs and wants of their customers, allowing them to tailor their products and services appropriately.

The importance of outcomes

Over the past few years there has been a shift in conduct supervision strategy away from reactive, “tick-box” compliance checks towards a more forward-looking approach that places increasing emphasis on the outcomes achieved for customers and the market and whether these have led to harm.

This move has led supervisors to focus increasingly on the potential drivers of harm and poor outcomes created by firms' culture, business models and product and service design. It has also resulted in a change of perspective on many of the principles that underpin the legislative and regulatory framework. For example, supervisors increasingly recognise that legislation, and products and services, are often developed with the average customer in mind, and that, while this works satisfactorily for many, vulnerable customers may be at greater risk of poor outcomes.

For firms, this means greater supervisory expectations that they have in place appropriate measures, including MI, to monitor, manage and test the outcomes delivered to customers and the market, including the risk of harm. Conduct risk MI should enable supervisors to assess a firm's performance against fair outcomes, and demonstrate how the firm fixes any causes of outcomes that are not, or may not in the future, be fair.

Figure A: Recent regulatory developments with implications for conduct risk MI

National level	<p>In South Africa</p> <ul style="list-style-type: none"> • In its recent strategy document, the Financial Sector Conduct Authority (FSCA) indicated that, in order to monitor whether the financial system is delivering fair outcomes for customers, it needs access to meaningful, reliable, measurable and comparable information on Treating Customers Fairly (TCF) indicators. It further indicated that it will implement a number of conduct-based statutory returns to provide it with the qualitative and quantitative data required to make meaningful assessments. • In February 2019, the FSCA issued an updated Conduct of Business Returns for Insurers, with the expectation that insurers are to complete accurate and good quality returns by the first quarter of 2020. There are indications that the development of an equivalent return is underway for Banks. • In May 2019, the FSCA issued the first draft Conduct Standard for Banks. The FSCA indicated it will develop a reporting framework against the conduct standard and that the data obtained through this framework will be used as an offsite supervisory tool. The FSCA further stated that “On-site supervision will also be conducted to examine and assess processes and management information relating to the fair treatment of customers.” • One of the recommendations of the 2018 Financial Markets Review was that Regulators consider implementing an accountability regime. Globally, such regimes have sharpened senior managers’ focus on ensuring that they have evidence, including strong MI, to demonstrate that they are discharging their responsibilities appropriately.
	<p>European level</p> <ul style="list-style-type: none"> • The introduction of MiFID II has strengthened requirements around governance and MI for investment firms, requiring Board members and Senior Managers to have “adequate access to information and documents which are needed to oversee and monitor management decision-making.”⁵ • MiFID II and IDD⁶ set out product governance requirements, including that product manufacturers gather MI from their distributors in order to monitor whether products are being sold to the intended target market. Senior Managers also need MI to demonstrate compliance with other requirements including training and competence requirements for staff. • The ECB has made clear its expectation that banks’ risk appetite frameworks should include conduct risk and, where the bank cannot put concrete numbers to these risks, to “at least use qualitative statements”⁷. • EIOPA has published a framework to help EU national supervisors assess conduct risks throughout the lifecycle of insurance products. The framework covers conduct themes that are of growing importance and visibility across EU markets including firms’ culture, value for money, innovation and customer vulnerability. EIOPA expects this work to evolve in the future into more systematic ongoing conduct risk monitoring. <hr/> <p>Global level</p> <ul style="list-style-type: none"> • The Financial Stability Board (FSB) has produced a toolkit aimed at mitigating misconduct, which encourages firms to gather information to “provide insight on behaviours that could lead to misconduct”. It sets out how supervisors can use qualitative and quantitative information to understand how firms’ governance processes work and provide them with insight into the “behavioural norms and culture” of a firm ⁸. • The Fixed Income, Currencies and Commodities (FICC) Markets Standards Board produced a statement of good practice on conduct risk which encouraged firms to “develop management information based on their conduct risk taxonomies that allows governance fora and senior management to consider and challenge the conduct risks identified in the market transactions of the firm” ⁹.

Section 3: Recent trends in conduct supervision that need to be captured in a firm's MI

The evolution of conduct supervision described earlier means that supervisors are now prioritising the following areas:

- customer vulnerability;
- value for money;
- cross-subsidisation and price discrimination;
- the risks arising from technology-enabled innovation; and
- firm culture.

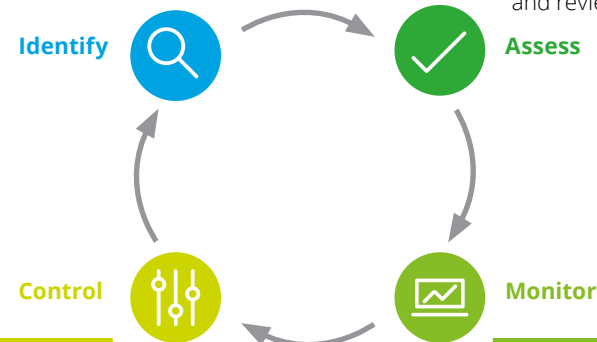
To help firms understand how supervisors may probe and challenge them on these areas, we set out on pages 9-13 examples of the lines of enquiry they may pursue during their interactions with firms. These are accompanied by examples of MI that the Board and Senior Managers could use to demonstrate how they assure themselves that the firm is identifying and managing these risks appropriately, and how they monitor the consumer outcomes being delivered.

Through their various interactions with firms, supervisors look to gather evidence and insights to develop a comprehensive regulatory view of a firm and to make forward-looking judgements about whether it is being managed in a safe and sound manner and with a responsible approach towards customer outcomes. They will probe the areas that they consider most likely to pose a risk of harm to the firm, its customers or the market. They will also test the extent to which the Board and Senior Managers understand the firm's strategy and business model, how they assure themselves that risks and concerns are identified and addressed appropriately, and how outcomes are monitored and delivered.

Across each of the five regulatory trends we discuss in this section, we expect supervisors to focus on the broad issues set out under Figure B:

Figure B: High-level areas of supervisory focus

- The conduct risks to which the firm is exposed
- The identification of new and emerging conduct risks
- Identifying potential, as well as known, risks
- Product and service development including identification of customer segments/target market



- The controls in place to monitor and manage conduct risk including the risk of harm or other poor outcomes for customers
- The fitness for purpose of these controls
- The mitigation of potential customer harm or poor outcomes
- Actions taken to address harm or poor outcomes where they have crystallised

- How the Board determines the key conduct risks to the business and sets an appropriate conduct risk appetite.
- How the Board assesses the impact of its strategic decisions on the firm's conduct risk profile
- The governance and oversight of the product development and review process

- How the Board and Senior Managers assure themselves that customers are getting fair outcomes
- The approach to embedding conduct risk awareness and management at all levels of the firm
- The monitoring of product and service performance including value for money

The importance of cross-cutting, horizontal MI to proactive conduct risk management

As conduct supervision continues to evolve in the way described, firms could improve their MI through developing horizontal MI that cuts across individual business and product lines to provide a thematic perspective.

This horizon scanning should pay particular attention to emerging risks and themes (for example, themes highlighted across several jurisdictions or sectors) and high priority issues as well as the lessons learned from wider misconduct scandals and enforcement actions.

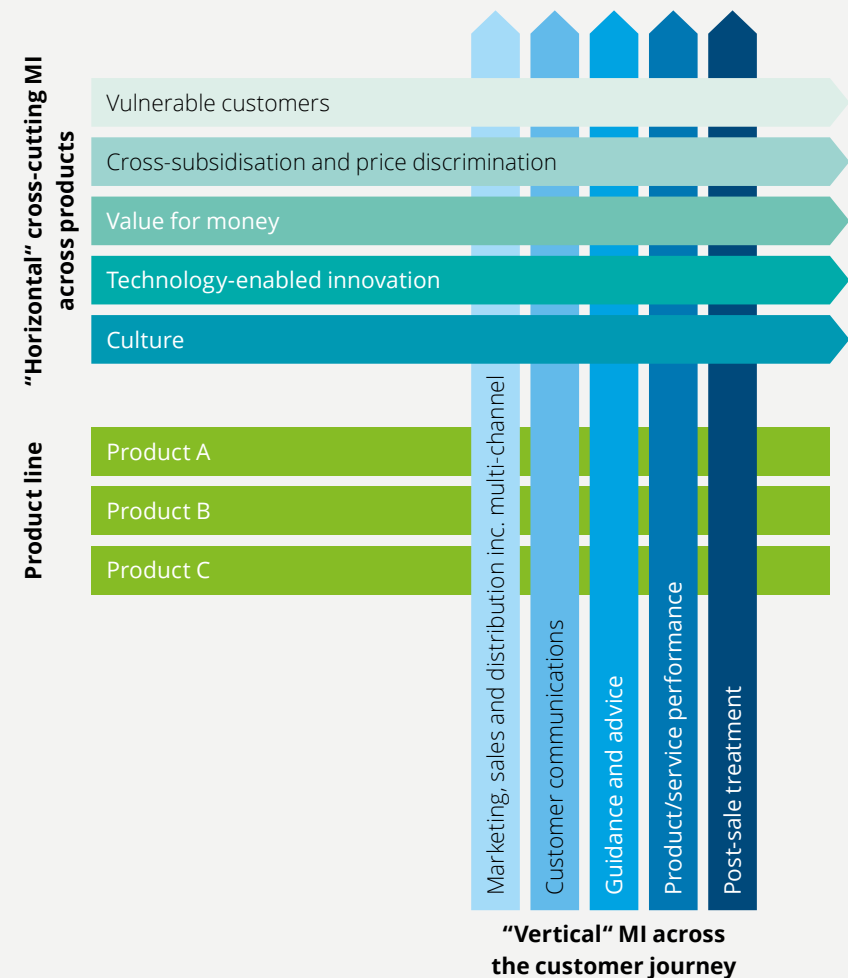
Horizontal, cross-cutting MI should be reported periodically to allow the Board and Senior Management to assess how the business is performing against supervisory trends and concerns. Collating cross-cutting MI can prove challenging for some firms, particularly those with a number of different legal entities. One approach would be to perform “deep dive” or thematic reviews into emerging regulatory trends, which can be used to identify priority areas for action.

Thematic reviews could analyse emerging regulatory trends from a number of different angles to identify whether they give rise to specific risks and issues within the business. Issues around value for money, for example, could be identified:

- across products- assessing whether certain products offer poorer value for money than others;
- across business lines- identifying whether divergent approaches to assessment of value for money in different parts of the business create poor outcomes for some customers;
- across customer segments- determining if certain groups of customers receive poorer value for money than others; and
- across the customer journey- identifying whether a given product continues to offer customers value for money on an on-going basis.

Figure C sets out how the cross-cutting trends discussed in this section of the report could be identified across key stages of the customer journey.

Figure C: “Horizontal” versus “Vertical” MI





Vulnerable customers

Regulators are attaching increasing importance to customer vulnerability and are embedding it in their supervisory programmes.

Firms will need to demonstrate what measures they are taking to identify vulnerable customers, both within their existing customer base and on an ongoing basis, bearing in mind that vulnerability is a complex, dynamic state. Once vulnerable customers are identified, supervisors will further expect that these customers have been treated fairly, their needs met and their circumstances kept under review.

Identifying and capturing data on vulnerable customers can prove challenging for some firms as existing systems often require significant manual intervention to extract the necessary information, and vulnerability can be situational or change over timeⁱⁱ. To begin building up a profile of their vulnerable customers, firms can start by undertaking periodic “deep dive” reviews to generate more qualitative MI. Such reviews also afford firms the opportunity to review and confirm the accuracy of any data they hold on their vulnerable customers.



Areas of supervisory enquiry

- The identification of vulnerable consumers.
- The monitoring of existing customers for signs of vulnerability or changes in circumstances which may result in vulnerability.
- The reassessment of vulnerable customers and their circumstances.
- How the firm's products and/or services meet the needs of vulnerable customers.
- The assessment of the potential impact of strategic decisions or known events on vulnerable customers.



Examples of MI

MI to identify and manage risk:

Periodic reporting which demonstrates that the firm understands the profile of its vulnerable customers. For example:

- Data on the number of vulnerable customers.
- Information on the nature of the vulnerable situations disclosed by customers.
- Data on the point of the customer journey or product life cycle at which customers are identified as vulnerable.
- The length of time that customers are tagged as vulnerable if vulnerability is transient.

MI to monitor outcomes:

Data on the actions taken by the first line to monitor/assist customers once they are identified as vulnerable e.g. referral to specialist teams, tagging/flagging customer records; signposting to alternative external services (for example, debt management agencies).

Periodic reporting on the number of customers handled by specialist teams and the length of time the customer was being dealt with by the specialist team.

Analysis of the impact of key decisions on vulnerable customers. For example, a requirement to consider and report on whether a product or service will result in poor outcomes for vulnerable customers relative to other customers as part of the product and services development process.

Analysis of the impact of known or expected events such as rate rises, on vulnerable customers.

ⁱⁱWhen recording data on vulnerable customers firms will need to be cognisant of their obligations under data protection regimes including the General Data Protection Regulation (GDPR), which came into force in May 2018. Firms should communicate with their customers about how and why they collect and process their data and ensure that they have a valid basis for doing so. Personal data should be processed in a way that is accurate, relevant and limited to what is necessary.



Cross-subsidisation and price discrimination

The increasing importance supervisors place on understanding firms' business models is leading to greater scrutiny of pricing practices that may result in financial and distributive unfairness for customers.

Supervisors will expect the Board and Senior Managers to know whether their business model relies to a material extent on such pricing practices. If so, they will expect assurance – supported by adequate MI and analysis – that potential harm to customers and competition has been considered and is being appropriately monitored and managed.

As the use of Big Data grows, the personalisation of pricing based on a customer's profile or other data is likely to attract particular challenge from supervisors. Where firms use personalised pricing, supervisors will look for evidence that their use of data is appropriate (i.e. that it does not exploit information about sensitive characteristics such as race, gender or vulnerability) and that it does not result in unfair outcomes for customers.



Areas of supervisory enquiry

- The existence of cross-subsidies between different lines of business, groups of businesses or groups of customers such as legacy customers vs new customers or new customers vs renewal customers.
- Justification for the practice of charging different prices to customers, particularly when the cost to serve or underlying risk is the same.
- The outcomes of cross-subsidies and price discrimination on customers, particularly vulnerable customers.
- The monitoring of cross-subsidies and price discrimination.
- The extent to which cross-subsidies and price discrimination cost or benefit different groups of customers.
- The setting of prices based on a customer's profile or other data.



Examples of MI

MI to identify and manage risk:

Reporting that demonstrates that the business has identified and is monitoring all material cross-subsidies or instances of price-discrimination. For example, analysis to compare the fees paid by different customers/groups of customers for the same product.

Monitoring to identify outliers (books of business, cohorts of customers or individuals) in terms of margin or profitability. For example, analysis of the profitability of core products vs. optional extras and of new vs. renewing/longstanding customers.

Data on loss making/loss leading products and any products sold to cover the cost of providing these loss making/loss leading products.

MI to monitor outcomes:

Analysis of pricing structures to determine potential harm or unfair outcomes for certain groups of customers (for example, vulnerable customers) or to identify aspects of pricing based on customer "elasticity".

Data on actions taken to rectify pricing practices that are resulting in unfair outcomes or harm to customers.



Value for money

Supervisors are increasingly looking at the value for money delivered by financial products and services. In the UK, the FCA has sought to address poor value offerings across a number of sectors including retail banking, insurance and asset management while supervisors in Europe have stepped up their scrutiny of value for money in investment funds.

Value for money is a subjective and multifaceted issue. The information needed to assess and monitor value will vary by product and by sector, and there is, in many cases, a lack of commonly agreed measures. Nevertheless, supervisors will expect to see that firms have considered, and are monitoring, how products and services deliver value to customers.



Areas of supervisory enquiry

- The value for money of the firm's products and services.
- The firm's most profitable products/services.
- How value is affected by different distribution chains, and the oversight and remuneration arrangements in place.
- The fees and charges that are monitored from a conduct risk perspective.
- The fairness of fees and charges.
- The extent to which certain fees and charges may restrict customers from shopping around.
- The loss ratio/claims ratio on certain products (insurance).
- The extent to which existing customers may be trapped in poor value products.



Examples of MI

MI to identify and manage risk:

Periodic reporting that demonstrates that the business is monitoring the value for money of products/services. For example:

- Data on the number and level of fees and charges applied by product/service type.
- The number of fees and charges that have not been cost justified (e.g. that the fee/charge is proportionate to the cost of providing the service).
- Data on the number of fees and charges reimbursed on customer accounts.

Analysis of the fees and charges for comparable products/services offered by competitors.

Benchmarking against relevant industry standards, for example, fund performance benchmarks or mandated price caps.

MI to monitor outcomes:

The results of monitoring to ensure that individual products/services do not produce unexpectedly or disproportionately high profits or margins. For example, in excess of plans or projections.

Outputs of value for money assessments for new or existing product or service propositions.

Assessment of measures that indicate the quality of service provided to consumers. For example, willingness to recommend the product/service to others; peer comparisons on the length of time taken resolve key issues; claims frequency, acceptance and pay-out ratios (general insurance); consideration of the value of investment services (asset management).

Analysis of how each party in the supply chain splits the total product cost paid by the customer, with rationale on the role of each party.



Risks from technology-enabled innovation

Understanding the risks associated with firms' use of technology-enabled products and services is already high on the supervisory agenda, which seeks to balance encouraging responsible innovation with consumer protection.

MI is critical to demonstrating to supervisors that the Board and Senior Managers have a thorough overview of the technology-enabled products and services offered by the firm and that there are strong controls in place to manage any risks.



Areas of supervisory enquiry

- The technology-enabled products and services offered or sold by the firm.
- The oversight and challenge around the development and use of technology-enabled products and services.
- How the Board and Senior Management ensure that the use of technology does not reduce access to products/services.
- The delivery of key information to customers purchasing products through digital channels.
- How the Board and Senior Managers assure themselves that customers have read key documents or disclosures when presented digitally.
- The potential for bias or poor customer outcomes from the use of algorithms.
- The understanding of, and justification for, decisions generated by "black box" technology or algorithms.



Examples of MI

MI to identify and manage risk:

Periodic reporting which demonstrates that technology-enabled products and services are being monitored appropriately. For example:

- Data on whether technology-enabled products and services are being sold to or used by the intended customers.
- Data on the volume of customer dealings/transactions being pushed to human agents to resolve.
- Reporting on customer drop-out rates for innovative products and services and data on the point during the customer journey at which customers drop out.
- Monitoring of customer communications usage. For example, the percentage of customers accessing key information during an online journey or the length of time spent reading them.

MI to monitor outcomes:

The results of monitoring of a firm's profit and customer base to identify material decline in certain customer segments which may indicate poor customer outcomes, discrimination in the technology or issues with access.

Comparison of the metrics for technology-enabled products and services against traditional products and services to determine if the innovative ones are producing discriminatory results.

The outputs of counter-factual and "edge-case" assessments to determine if the data being used by technology-enabled products and services is producing discriminatory results.

The results of consumer testing on innovative products and services both pre-launch and post-launch (to identify continuous improvements).



Firm culture

Culture has become a key focus for supervisors in their strategic response to the global financial crisis and subsequent misconduct scandals. Supervisors will challenge the Board and Senior Managers on how they assure themselves that their target culture is operating in practice and delivering acceptable outcomes, from a regulatory, strategic and commercial perspective.

Culture is inherently difficult to measure and almost all information can potentially provide an indication of a firm's culture. However, the Board and Senior Managers can make a good start by looking at the attitudes and behaviours that are in evidence throughout the firm and the conduct outcomes that they expect to achieve for customers and the market. These can then be used as the basis for identifying sources of MI on culture as well as appropriate metrics.



Areas of supervisory enquiry

- The extent to which the firm and its employees prioritise good customer outcomes over mitigating risks or commercial benefits.
- The extent to which the firm's culture attaches the right importance to issues such as vulnerable customers, cross-subsidies, etc.
- The values and attitudes of staff and how these are developed.
- The culture and values of the Board and Senior Managers, how these are monitored and the influence they have on the wider firm.
- How the Board and Senior Managers ensure that staff understand conduct risk and its importance to the firm.
- The degree of confidence the Board and Senior Managers have that employees escalate important issues.



Examples of MI

MI to identify and manage risk:

Periodic reporting on behaviours exhibited by staff which may indicate an underlying cultural issue. For example:

- Timeliness of issues/breach reporting.
- Non-completion of mandatory training.
- Number of whistle-blowing reports.
- Complaints on behaviour escalated to compliance/HR/legal.
- Staff resignation/turnover rates.
- Breaches of key policies including codes of conduct, conflicts of interest, etc.

Claims and service data, e.g. resolution times, queries, and call volumes, to indicate customer treatment and overall outcomes.

MI to monitor outcomes:

Feedback from staff exit interviews/surveys which identify whether firm culture was a factor in departures.

Feedback from customer surveys, particularly where they include questions designed to test whether customers received fair outcomes. For example, testing whether customers adequately understand key features of the product.

Results of staff surveys intended to capture the view of staff on whether the firm is treating customers fairly.

Results from media/social media scanning to identify issues and assess public opinion of the firm.

Results of reviews which assess the attitudes and behaviour of the Board.

Section 4 – Improving conduct risk MI: questions to consider

While regulators have not set prescriptive requirements on how firms should develop MI, a number of recent reviews in the UK shed light on some of the challenges that firms face in producing insightful MI, and provide important pointers as to current regulatory perspectives and expectations. From the findings of these reviews, and our experience of working with firms to implement conduct risk MI frameworks and reporting technology, we set out below some key questions for firms to consider when reviewing their existing conduct risk MI.

Is MI appropriately tailored to different audiences?

Firms occasionally find it challenging to find the right balance between MI which is detailed enough to provide meaningful information and high-level enough to allow readers to identify the key risks and issues. In some firms, for example, senior management receives large MI packs from which key conduct risks are not readily discernible; while in others conduct risk dashboards are summarised and aggregated to such an extent that they potentially obscure underlying risks and issues.

In its review of wholesale banks, the FCA observed that firms more advanced in their approach to MI were refining their choice of metrics or tailoring reports specifically to their intended audience¹⁰. Firms should take a proportionate, risk-based approach to reporting MI to ensure that audiences see the information they need in order to identify key issues and take meaningful action. At the business line level, information that is useful in the performance of individuals' day-to-day roles could include detailed information on changes to individual conduct risk metrics. At the entity or group level, it may be more helpful to present trend information to allow the audience to identify material changes to the firm's conduct risk profile. At all levels, there should be sufficient qualitative information to allow the audience to understand what is driving any changes to risk ratings, as well as clear information on the root causes of risks and issues and the actions taken to address them.

Could technology achieve greater efficiencies in collating, analysing and reporting MI?

Firms often face challenges in making effective use of their existing data due to issues with manual or legacy systems, because they have different systems in different business lines or jurisdictions, or because they are confronted with large amounts of data, making meaningful analysis challenging. It can occasionally be the case that by the time the MI suite has been produced, there is minimal time for analysis and action. This can severely limit the ability of conduct MI to add value to staff's day to day roles. This is compounded by the increasing complexity of MI required to manage new and emerging regulatory concerns such as culture or customer vulnerability.

Firms can enhance their MI capability through the application of new technologies such as robotics and artificial intelligence (AI). Robotic process automation (RPA), for example, can be utilised to extract data from a number of source systems, thereby reducing the need to overhaul manual or legacy systems to access data. Where firms have different systems in different businesses/jurisdictions, RPA can also assist those systems in communicating with each other and eliminate the need to implement new, uniform systems. AI and analytics tools can be used to link data and enable the identification of underlying conduct issues or to assist firms in their assurance oversight of the delivery of good customer and market outcomes, for example, through the use of customer survey technology, call monitoring and analysis systems or trade surveillance systems.

Is MI sufficiently outcomes-focused and forward-looking?

Recent FCA reviews¹¹ have found that MI is often inward-looking, focusing on compliance and controls, rather than outward-looking, providing measures of potential harm or the outcomes produced by firms' conduct or products and services.

¹⁰The FCA's 5 Conduct Questions Programme found that "measures are most often inward-looking and related to controls. These far outweigh more outward-looking measures of potential harm" and "offered little on controls for new product development, complaint volumes or 'harm' related measures" The FCA's **review** of Automated Investment Services found that MI "focused on compliance, marketing and PR, operations and risk issues. Firms should consider how they review the outcomes produced by the service".

To begin developing outcomes-focused MI, firms can start by establishing their vision of what good outcomes look like, as part of their overall conduct risk strategy, taking into consideration the need to avoid harm to customers and market integrity. They can then calibrate their conduct risk appetites against these outcomes and assess what information is needed to monitor them. Firms may need to develop or gather new types of information, rather than looking to repackage what is already available.

MI should be forward-looking, helping firms to identify and address future risks, rather than purely reactive. In Deloitte's experience, many firms' conduct risk MI tends to focus on known problems, rather than identifying new and emerging risks. Firms should ensure that MI contains a good spread of "leading", as well as "lagging", risk indicators.

Is MI sufficiently challenged and analysed?

Having MI is not an end in itself. Supervisors will expect that MI is usable, critically analysed, challenged, and acted upon. The Board and Senior Managers should expect MI to be usable, to challenge the content of MI (for example, satisfying themselves that any numbers are correct) as well as the substance and quality of the MI presented to them. Supervisors will assess whether the MI is not only comprehensive, but also succinct enough so that it is usable and the user can easily understand any key messages. Supervisors will further expect the Board and Senior Managers to adopt a critical mindset when reviewing MI, querying whether the right conclusions have been drawn or the right root causes identified. For example, in its recent review of pricing practices in the UK general insurance sector, the FCA highlighted that, in many firms, there was no evidence that MI was subject to sufficient analysis or discussion by the Board or Senior Managers¹¹.

Does your firm's MI adequately identify the root causes of issues?

Used well, MI can provide firms with important intelligence on the underlying causes of issues and help identify systemic or systematic problems. However, a recent FCA review of complaints handling by UK Non-deposit Taking Mortgage Lenders found that firms' MI reporting often contained only operational data and not details on symptoms of complaints,

root causes and preventive actions¹². The FCA stressed the importance of using MI to identify and remedy any recurring systemic issues and tackle the root causes of problems.

Once conduct risks and issues are identified, good practice is for firms to investigate the root causes and to take action to address them. Root cause analysis should be incorporated into conduct risk reporting to establish a clear link and audit trail between the identification of the risk or issue and the efficacy of the action taken to address it.

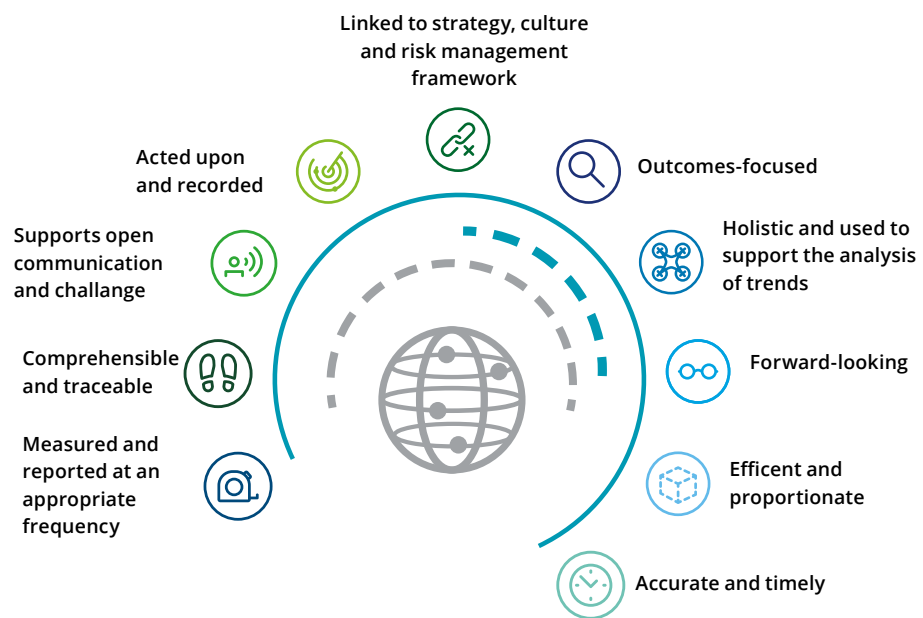
Does your firm's MI prompt action?

MI must also be used to prompt firms to take action. Supervisors will want to understand how MI informs the decision-making of the Board and Senior Managers, and will expect firms to take action off the back of MI in order to address any conduct risks. Documenting any actions taken is key to evidencing how conduct risks and issues have been addressed. For Senior Managers subject to accountability regimes, in particular, documenting actions taken will be essential in demonstrating the "reasonable steps" they have taken to address risks and issues.

The principles of strong conduct risk MI

To identify and manage their conduct risks effectively, firms need strong conduct risk MI. We set out below 10 principles the Board and Senior Managers can use as a guide to assess the effectiveness of their existing MI governance, processes and data. Further details on the principles can be found in our 2015 paper – Management Information for Conduct Risk: Underpinning better decision-making.

Figure D: The principles of strong conduct risk MI



Section 5 – How Deloitte can help

The challenge of managing risks across multiple activities, locations, and business units means more and more firms are looking at technology – including advanced analytics and machine learning – to help them generate the MI and intelligence they need to detect and monitor conduct risks.

Deloitte has developed leading technology-driven solutions which provide firms with the MI and insight they need to identify new or emerging risks and monitoring conduct outcomes whilst taking an effective, efficient approach to conduct risk management.

True Voice – Behavioural and Emotional Analytics

True Voice (formerly known as BEAT) is an integrated voice and interaction surveillance solution that monitors the treatment of customers. Using advanced cognitive technology and machine learning, True Voice monitors voice interactions, scoring them based on speech, behavioural and human emotional tendencies. True Voice helps firms quickly understand what their customers are feeling, enabling them to identify risks, as well as opportunities to improve customer outcomes.

True Voice can identify conduct risks both proactively and reactively (by identifying episodes of mis-selling, for example), as well as instances of customer vulnerability or expressions of dissatisfaction, and provide tailored support for customers' needs. By automating manually-intensive listening processes, True Voice also offers businesses excellent cost efficiencies.

Case study

A financial services firm wanted more efficient oversight of its advised sales process, including customer outcomes. Deloitte deployed True Voice to analyse recordings of face-to-face interactions with the firm's advisors, mapping what it "heard" against the firm's quality assurance (QA) framework and flagging those interactions that did not meet the firm's standards.

Through automation, True Voice enabled the firm to QA all their customer interactions, whilst reducing manual oversight to targeted, high risk areas. True Voice also analysed voice and behavioural indicators during the interactions to detect whether customers were exhibiting signs of vulnerability, and to identify potential conduct risks including mis-selling.

DART

Deloitte's DART (Delegated Authority Risk Tool) is used by firms to manage their products and distributors in a streamlined and risk-based way so that oversight is targeted on the key conduct risks outlined in this paper.

DART enables firms to assess their conduct risks across their products and distributors to identify the areas of highest risk. This spans all different types of distributors, for example, agents (e.g. delegated authorities), brokers, IFAs, branches, affinities and appointed representatives. It brings users together in a controlled way through a proportionate workflow of product governance and distributor oversight that focuses activity on the key conduct risks. Conduct MI is automatically produced on an ongoing basis. DART therefore provides visibility, clarity and certainty of oversight to the complex matrix of products and distributors.

Case study

A financial services firm was struggling with manual, disjointed processes for product governance and distributor oversight. Key stakeholders were unable to gain confidence around a complete record of all products and distributors, as well as knowing that the key conduct risks were being addressed across this total population.

DART was implemented "out of the box" and rapidly identified the key conduct risks across all products and distributors, such as vulnerable customers and value of products. This provided clarity of the key areas of the business that required greater oversight, as well as the areas that required proportionately less oversight. The automation and workflow then enabled users to work together, such as through product design or distributor on-boarding processes, with a full audit trail. MI was automatically produced on an ongoing basis to give key stakeholders the required confidence.

Surveillance Grid

Surveillance Grid is a monitoring and business conduct management platform. It provides a holistic view of trader surveillance activities, utilising trade, voice, e-communications and unstructured or structured market data to provide an independent, dynamic and continuous monitoring capability to the first and second lines of defence. By using Surveillance Grid, a firm can better focus and drive the detection of potential misconduct, and thus reduce the risk of

significant losses or large fines.

Surveillance Grid uses advanced cognitive technology, including machine learning, natural language processing and anomaly detection capabilities, developed by our global data science team in collaboration with our risk and regulatory subject matter experts. It fully integrates with existing client infrastructure, consolidating and augmenting outputs, alerts and processes, providing a clearer, consolidated view of prioritised risks and issues, ultimately supporting the creation and delivery of quality, proactive monitoring.

Risk sensing

By combining leading-edge technology with the insights of experienced industry analysts, Risk Sensing synthesises large volumes of online media as well as geopolitical, regulatory, and financial data to deliver real-time intelligence on the global issues most relevant to a firm. By scanning over 700,000 data sources in 190 countries and 13 languages Risk Sensing delivers predictive intelligence, allowing firms to:

- Monitor intelligence about events as they occur, in order to mitigate the impact of a crisis in real-time.
- Identify social conversations about the firm and its people, products, and services to predict how they will evolve over the next 72 hours. This enables firms to pre-empt issues and stop them escalating or take advantage of opportunities to enhance brand and reputation.
- Scan the horizon to identify risk events that may emerge over the coming year, giving organisations the runway they need to respond to risks and capitalise on opportunities as they emerge.

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