FINANCE & RISK

Protecting and Building Firm Reputation: Addressing the Conduct Challenge

ADDRESSING THE CONDUCT CHALLENGE

Financial institutions are facing increased pressure from regulators and customers to demonstrate appropriate conduct.

Implementing a conduct control framework and embedding ethical values and customer centricity in a firm's cultural DNA are critical to managing conduct risk and protecting a firm's reputation. Recent misconduct events among some financial institutions have highlighted that inappropriate, unethical, or unlawful behavior on the part of an institution's management or employees exposes the firm to regulatory censure, reputational damages and potential losses in customer base and overall market share.

Strong reputation can help build customer and client trust and loyalty, lowering the cost of acquisition and making willingness to try new products. In retail banking, for example, this is all the more important in an industry offering limited product differentiation and in which the costs of customer transfer are low.[1] In response, financial institutions should place an increased focus on customer relationships and reputational branding as a key differentiator in the market.

Reputation is also a key factor in building and nurturing regulatory relationships as regulators look for mechanisms to improve compliance with the "spirit of the law" above and beyond strict adherence to the "letter of the law." Research from the Reputation Institute shows that those institutions with strong reputations are often proactively engaged by regulators as new regulations are outlined.[2] This is important as regulatory agencies such as the Office of the Comptroller of the Currency (OCC) have stated intent to place increased focus on conduct governance.[3]

Reputation can also become a key lever for financial institutions in competing for talent in areas such as risk management, compliance and technology.[4] This becomes increasingly important as institutions vie for talent with new industry entrants such as financial technology ("FinTech") firms as well as established competitors.

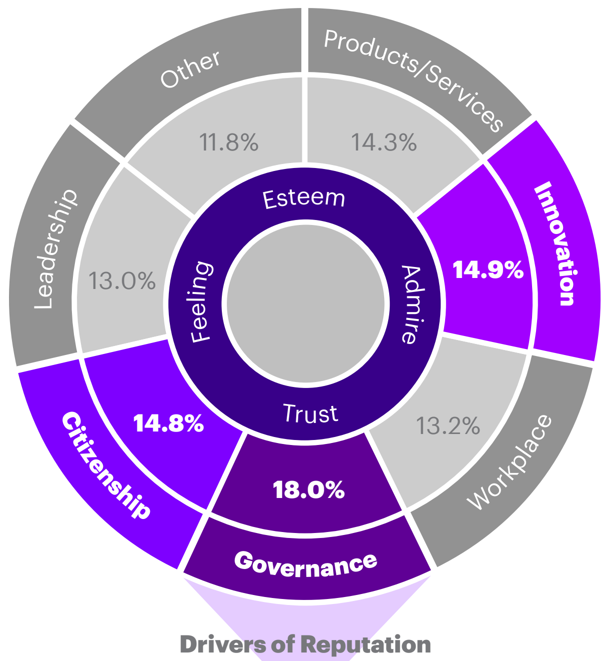
UNDERSTANDING THE DRIVERS OF REPUTATION

Financial institutions are seeking more and more often to identify the specific components that constitute a firm's reputation.

In a 2015 study of over 100 most recognized global companies, including many Fortune 500 banking, insurance, and debit and credit card institutions, the Reputational Institute identified six primary dimensions for building and maintaining a strong firm reputation—products and services, innovation, workplace, governance, citizenship and leadership. As seen in Figure 1, two of the top three drivers of how a firm is perceived in the market—governance and citizenship—are directly related to conduct and behavior.[5]

This analysis points to the need for financial institutions to invest in strong corporate governance and maintain customer-centricity in their interactions as well as support community causes that are aligned with customer interests, such as investment in local non-profit groups. Leaving such actions unaddressed can contribute to potential reputational damage, leading to losses in brand value, customers and potential fines and penalties. Fines levied against financial institutions based on misconduct between 2010 and 2016 alone are estimated at over $300 billion.[6]

Figure 1. Drivers of Reputation



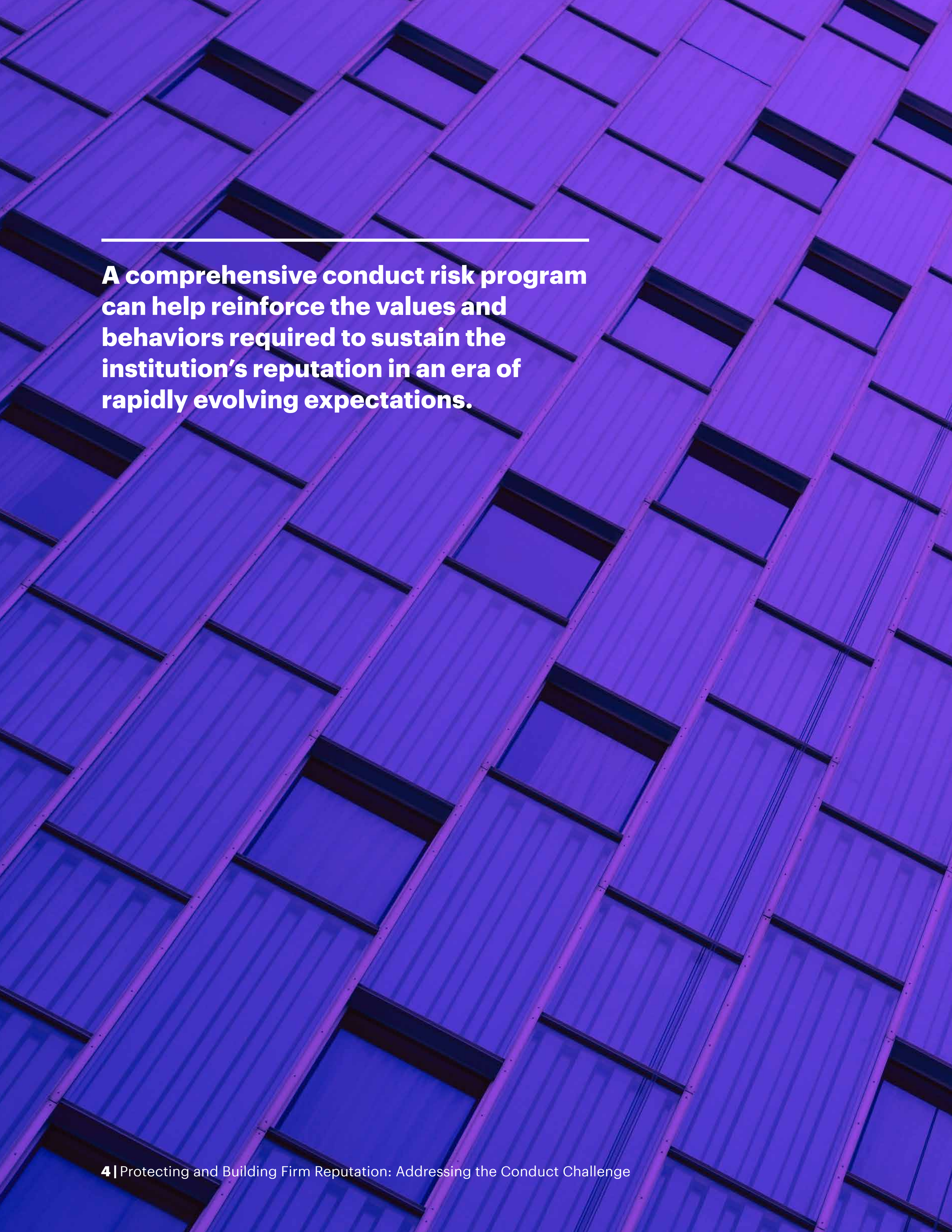
2 of the top 3 drivers are directly related to conduct and behavior

1. Governance
"The company is ethical, fair, and transparent."

2. Innovation
"The organization is innovative and adaptive."

3. Citizenship
"The organization is environmentally friendly, a supporter of good causes and a positive contributor to society."

Source: The Global RepTrak® 100: The World's most Reputable Companies (2015), Reputation Institute



A comprehensive conduct risk program can help reinforce the values and behaviors required to sustain the institution’s reputation in an era of rapidly evolving expectations.

THE CONDUCT CHALLENGE

The conduct agenda has expanded exponentially in the past 25 years beyond its 1990s roots in corporate governance.

In the 2000s, the agenda expanded to include the fair treatment of customers, and expanded even more dramatically after the global financial crisis. Topics such as product governance, protecting vulnerable customers, and effective management of complaints via social media channels are good examples of how the agenda is further diversifying as the 21st century progresses.

The expanding scope of conduct risk is only heightening the need for financial institutions to understand the key drivers of misconduct in order to develop the right mitigating strategies and tools. In the UK, the regulatory emphasis on conduct began in 2012 and has since rapidly matured as a concept. As we have previously discussed,[7] global financial institutions may look to UK institutions' experience when formulating their own approaches. In the US, recent sales practice misconduct events have exposed the risks of financial institutions not understanding or managing the changing components of the conduct agenda and heightened the focus to address these issues to prevent further reputational damage.

Regulators have sharpened their focus on the implicit and explicit norms, practices and behaviors within financial organizations and how those practices affect the conduct of business. Institutions are therefore responding to regulatory pressure but are also seeking to improve their competitive position, to attract and retain clients, and to protect themselves from reputational damage. In Accenture's experience, five major thematic challenges have emerged as institutions have looked to refine their strategies and tools to manage conduct risk:

1. **Cultural change and incentives.** Changing a firm's culture takes time and involves understanding both the overall culture and the sub-cultures that exist within divisions and teams.
2. **Personal accountability.** Group think and decision by committee has meant that individuals are not used to taking responsibility for what occurs in the firm. Employees need support understanding their responsibilities.
3. **Product suitability and mis-selling.** Business models, strategies and operating models can support bad client outcomes by having conflicts of interest embedded within them.
4. **Market conduct.** The volumes of data and various market conduct permutations require effort to understand and to monitor in an efficient way as it is easy to miss key alerts and/or spend the effort reviewing false positives.

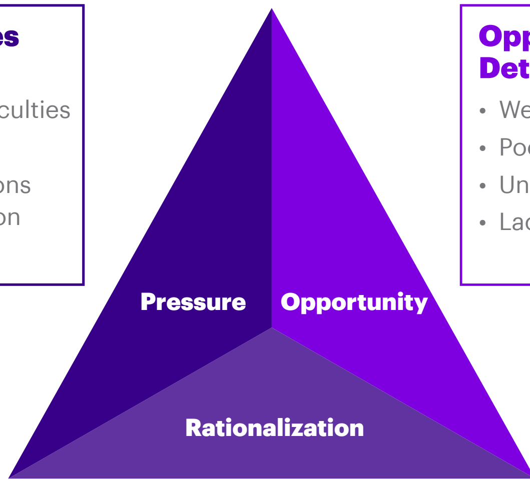
5. **Informational need.** Different clients have different communication needs and the channels used means "one size fits all" is rarely appropriate.

Our experience with financial institutions indicates that these challenges can be magnified by three key elements—pressure, opportunity, and rationalization. As seen in Figure 2, institutions should understand these environmental elements and how they connect to the sources of reputational risk.

Figure 2. Measuring Inherent Conduct Risk Dangers

Pressures Influence Sales Practices Issues

- Personal life and financial difficulties
- Unrealistic expectations
- Missing targets and expectations
- Performance and compensation impacts to self and team



Opportunity of Limited Detection or Recourse

- Weak internal controls
- Poor security
- Unchecked management access
- Lack of policy enforcement

How Individuals Rationalize Behavior

- Undercompensated and sense of entitlement
- Underappreciated and undervalued
- Environment in which those who cheat get rewarded
- Organization is too big to notice

Source: Accenture, February 2017

Four Popular Conduct Myths

MYTH	REALITY
"We hire good people: good culture and behaviors should come naturally."	Behaviors develop in networks, not only in individuals, and culture has to be worked.
"99% of our people behave right; bad apples let us down."	Past misconduct has sometimes been in accordance with policies, norms or the business model.
"Sorting this out is all about aligning compensation and incentives."	Non-financial factors have a greater and more sustainable effect on behaviors of high earners.
"It is only a problem on the trading floor."	Cultural issues vary across financial services. For example, mis-selling is not generally a trading floor issue.

Source: Risk Culture and Conduct in Practice: What does 'good culture' look like? Accenture, December 2015

RESPONDING TO THE CONDUCT CHALLENGE

As the conduct agenda continues to evolve, financial institutions have responded and started implementing conduct program changes with varying degrees of success.

Our global experience across major geographic hubs indicates there are five key facets to an effective conduct program as highlighted in Figure 3, each of which have considerations for institutions to adopt and permit an effective mobilization.

Designing an effective conduct program requires an understanding of broader business strategy to help identify and validate priorities for the program in addition to the expectations of key external stakeholder groups. In line with the highlighted facets, Accenture has defined the following steps to help mobilize delivery of an effective conduct program.

Tone from the top. As seen in Figure 4, implementing an effective conduct program is a cross-organizational effort requiring a strong and visible leadership commitment from each participant to either provide leadership or support peers depending on the ownership construct elected by senior management. In Accenture's experience, close management of inter-dependencies across the three lines of defense is critical to allow consistent delivery against roles and responsibilities and therefore sustain the efficacy of controls. (See sidebar, "Three Lines of Defense.")

Conduct and reputational risk framework. Inherent product risks need to be identified and communicated to marketing and sales teams with an initial focus on product suitability and transparency for customers. This is a key example of the operating model changes that should be mobilized once latest requirements of the conduct framework have been understood and a gap assessment completed to identify priority gaps that require focus for an institution.

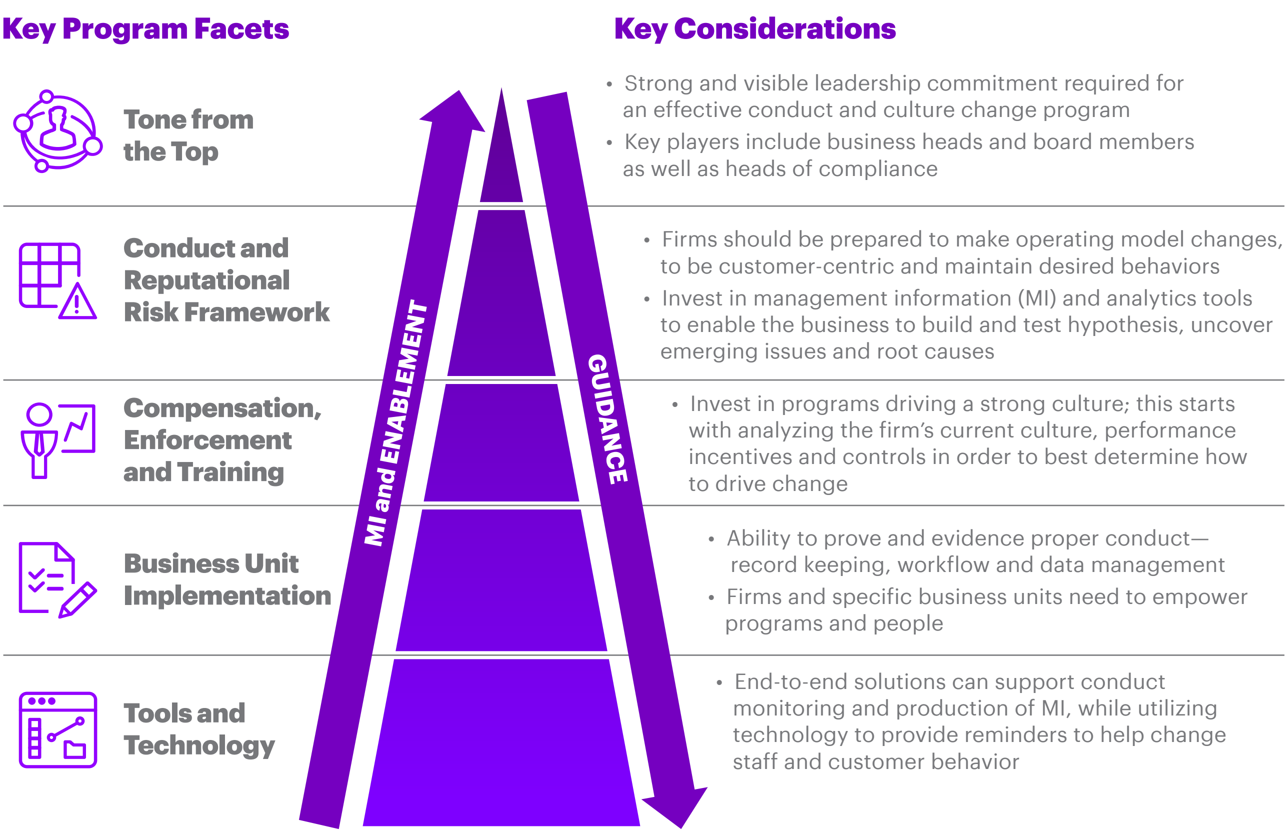
Compensation, enforcement and training. Institutions should establish regular communication with stakeholders and develop an effective training program including real misconduct event case studies and in-person discussions to embed change. Performance incentive structures also need to be reviewed to support alignment with the institution's business strategy, risk profile, and culture—a consensus-driven culture versus a mercenary culture requires different performance incentives and controls.

Business unit implementation.
Data held within the institution, for example from sample customer group testing, can help describe how customers actually behave and lead to more informed capability change. In addition to delivering a new capability, institutions should also assess how existing processes and tools, for example to manage customer complaints and internal whistleblowing, require review and re-engineering to meet regulatory expectations.

Assessing and defining conduct risk data, analytics and reporting capabilities.
Stakeholders for metrics should be identified and segmented to better understand their expectations of program reporting. Key performance indicators and key risk indicators can then be developed and shared to enable ongoing conduct monitoring that drives continuous improvement of the program.

Throughout the mobilization process, availability of stakeholders at different levels of the institution—senior management through to business analysts—is key to enable understanding of responsibilities in what can be a transformation journey for institutions. Governance and program management support can drive such alignment with focus on training and communications to support adoption of new ways of working within the institution.

Figure 3. Key Facets and Considerations of a Conduct Program



Source: Accenture, February 2017

Figure 4. Cross-Organizational Effort for Managing Conduct Risk

Source: Accenture, February 2017

Three Lines of Defense

First Line of Defense → **Risk Identification and Assessment**: Business operations perform day-to-day risk management activity.

Second Line of Defense → **Risk Management**: Oversight functions, such as compliance, define policy and provide assurance of business operations.

Third Line of Defense → **Audit**: Independent assurance includes internal audit, external audit and other independent challenges to the levels of assurance provided by business operations and oversight functions.

Source: Delivering an Integrated Approach to Non-Financial Risk Assessments, Accenture, February 2017

CONCLUSION

It remains difficult to put a monetary value on an institution's reputation. It is clear, however, that the consequences of reputational damage stemming from improper conduct can be severe, and not just in terms of fines and other penalties imposed by regulators.

It can take years to repair reputational damage, to rebuild shareholder and customer loyalty, and to attract and retain the best people. A comprehensive conduct risk program can help reinforce the values and behaviors required to sustain the institution's reputation in an era of rapidly evolving expectations.

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