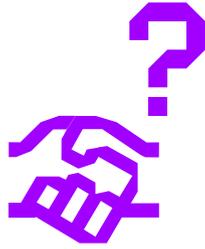


RISK CULTURE AND CONDUCT RISK MEASURE. MANAGE. ACT.



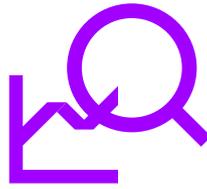
How a data-driven approach can transform risk culture and conduct risk proactively



The Problem

Australia's financial services industry has been put on the defensive in recent years following a series of revelations about misconduct and a failure to keep customers' best interests in mind. As a result, major regulatory changes are afoot: a Royal Commission into the financial services industry is expected to make significant recommendations to regulators when the final report is released. A new Banking Code of Practice intended to make financial products more customer-focused is also due to take effect, as is new legislation designed to make banks and their leaders more accountable for their actions.

As financial institutions grapple with increased regulatory scrutiny and the lowest level of customer trust in years, they will need to fundamentally rethink how they manage conduct risk. There is a commercial imperative to do so, as challenger banks and fintechs seek to take a greater proportion of their business, as well as an operational motive, to improve employee morale and improve talent retention. Carrying on as before is not an option.



The Solution

Since what cannot be measured cannot be managed, a data-driven approach to managing conduct risk is needed to enable the culture and conduct related policies and procedures. This is far from a simple task, since conduct risk affects almost every function across the organisation: improving it requires refining operating models, roles, reward structures, processes and governance, and monitoring whether these refinements are working. Data definition, capture and analysis are fundamental.

Moreover, conduct risk management needs to be holistic and proactive. This requires capturing and consolidating data from a wide variety of internal and external sources and using advanced analytics to generate deep insights that can help institutions draw connections between the activities of individuals and departments. In doing so, institutions can detect anomalies in behavioural patterns and pre-empt potential problems before they arise.

A data-driven approach to minimising conduct risk provides a holistic, forward-looking view to help business leaders understand their environment, actions and accountabilities. It also allows firms to easily carry out risk assessments across various business units, identify high-risk areas and drive proactive risk culture.



A lack of trust

The last few years have been a rough ride for financial institutions in Australia. The industry has been beset by negative press following a spate of damaging revelations about questionable practices.

The Royal Commission into misconduct in the financial services industry has investigated various instances of wrongdoing since its launch in 2017. Its interim report, released in September 2018, highlighted several examples of behaviour that failed to meet “community standards and expectations”.¹

Consequently, significant changes to the regulatory regime are expected. These will be designed to ensure that financial entities “apply basic standards of fairness and honesty: by obeying the law; not misleading or deceiving; acting fairly; providing services that are fit for purpose; delivering services with reasonable care and skill; and, when acting for another, acting in the best interests of that other.”²

Australian banks are also preparing for a new Banking Code of Practice (BCOP), due to come into effect in July 2019. The Australian Banking Association decided in early 2017 to overhaul the Code in order to “make banking products easier to understand and more customer focused”. By signing on to the new ASIC-approved Code, banks commit to earning and retaining the trust of customers and the community; to act honestly and with integrity; to deliver high customer service and standards; to be more accountable in their dealings with customers; and to be more transparent in communications with customers.³

On top of these changes, banks will have to adjust to the new Banking Executive Accountability Regime (BEAR). The regime, introduced in the 2017-18 Federal Budget, is designed to make authorised deposit-taking institutions (ADIs) and their directors and senior executives more accountable for their actions. The new legislation came into effect on 1 July 2018 for large ADIs and will be applied to small and medium ADIs on 1 July 2019.⁴

The regulatory moves are a response to a crisis of trust in the sector: according to research by Edelman, customer trust in Australia’s financial services sector had fallen to 49 percent at the start of 2018, the lowest level in years.⁵ There are serious commercial implications to this, not least given the rise of challenger banks and fintech firms that are poised to win an ever greater share of business from frustrated and mistrustful banking customers.⁶ Winning back trust is not just a commercial imperative, but a regulatory one as well.

The upshot of these trends is that financial services firms have begun focusing heavily on conduct risk. This has been defined by ASIC as “the risk of inappropriate, unethical or unlawful behaviour on the part of an organisation’s management or employees. That conduct can be caused by deliberate actions or may be inadvertent, because of inadequacies in an organisation’s practices, frameworks or education programs.”⁷ Minimising conduct risk is now more than ever a crucial focus for any financial services firm.

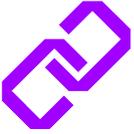
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How did the industry get to this point?

Misconduct in the financial services sector is the result of multiple failings by institutions which, added together, amount to a major crisis in the management of risk culture and conduct risk.

Some of the key drivers of misconduct are:



Linking performance (employee and organisation) too closely to sales, often at the expense of the customer's best interests.

According to the Royal Commission, this was one of the chief causes of misconduct, leading to mis-selling and irresponsible lending, among other problems.



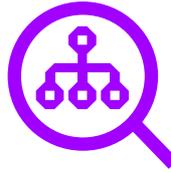
A "tick-box" approach to governance rather than a risk-focused approach.

Rather than look across the enterprise to identify risks proactively, the focus has been on being compliant with specific rules and regulations as they have been imposed.



Focusing on tactical reporting rather than analysis, limiting holistic views.

The common approach to dealing with misconduct has been tactical and reactive; in other words, reporting is typically focused on incidents that have already taken place – institutions are doing little to identify predictive insights that can be used to monitor and manage risk culture and conduct risk across the business.



Flawed compliance structures leading to a breakdown in accountability.

The Royal Commission noted that financial institutions frequently explain away misconduct as the actions of "a few bad apples". This lack of accountability and ownership of risk "serves to contain allegations of misconduct and distance the entity from responsibility" while ignoring "the root causes of conduct, which often lie with the systems, processes and culture cultivated by an entity," the Commission said.⁸

In order to address these shortcomings, financial services firms will need to go beyond traditional control systems. What is needed is an effective risk culture and conduct risk model to convert behavioural codes and policies into human capabilities and accountabilities.

3



Challenges in embedding risk culture and conduct risk

Financial firms around the world have begun to rethink their approach to risk culture and conduct risk. There is some debate about whether conduct or culture should come first, but in reality, the two go hand-in-hand: a robust risk culture fosters the desired employee conduct, and good conduct sets the foundation for a strong risk culture.

CONDUCT RISK

Embedding risk culture implies balancing risk against day to day business activities and performance



RISK CULTURE

“Good” conduct means going beyond what is legal and compliant, and keeping both customers and business’ best interest in mind

Source: Accenture Analysis 2019

Australian institutions have made great progress in the culture and conduct space but face a number of challenges in operationalising the concepts across every part of the organisation, including the following:

Right operating model.

It is essential for firms to identify the right operating model in order to improve proactivity and coordination between the compliance and risk management functions, something that is vital if they are to effectively manage their risk culture and minimise conduct risk. However, many institutions struggle with knowing how to apportion ownership and accountability for conduct risk across different functions.

Responsibility and reinforcement at the right levels.

Many institutions have developed strong frameworks and approaches, but mid-level or line managers are often unsure about

how to recognise and reinforce the right risk culture and proper conduct.

Clear understanding of expectations.

Actionable policies and procedures are often not well-developed, well understood, or consistently implemented throughout all levels of the organisation. Employees sometime struggle to understand what it means to “do the right thing”. Culture and conduct initiatives are often perceived as punitive, compliance-focused actions.

Disparate siloed reporting.

Reports and metrics are often limited by immediate, tactical needs and data availability. Metrics and reports are often siloed and duplicated across various functional areas. Lack of consistent standards and escalation procedures limit usefulness. In addition, a reliance on manual methods of consolidating data shifts the focus to reporting rather than analysis.

To some degree, these issues have been identified and are in the process of being tackled in other markets, from which lessons can be learned that are applicable to Australian institutions. These include adopting a more balanced line of accountability, as well as leveraging various data sources, tools and technologies to establish end-to-end solutions to support conduct risk monitoring. For instance, some North American Banks are implementing a dashboard based on key risk indicators and correlations to uplift risk culture and conduct risk. Other key success drivers for compliance with new initiatives like BCBS 239 include executive support, an emphasis on change management and establishing centres of excellence to house reporting and analytics talent – as well as deploying the right technology to make use of advances like robotic process automation (RPA), machine learning and artificial intelligence (AI).⁹ Key to many of these initiatives has been a focus on identifying the right metrics and data.

4



Why a data-driven approach is key

In order to address the above points, financial institutions need to refine their operating models, roles, rewards, processes, and governance to better manage conduct risk. This means implementing a monitoring program to make sure processes are working, people are playing their roles as expected, governance is providing the right insights, and the right behaviour is being rewarded. To do this effectively, firms need to harness the power of data: what can't be measured can't be managed.

Data problems are not unique to conduct risk: according to a 2018 Accenture survey, 31 percent of respondents feel that data quality issues are key barriers hindering their organisation from delivering on its key mandates over the next three years.¹⁰ But it is particularly acute in the context of conduct risk, since it cuts across every function. Many of these issues can be resolved by a focused effort on data quality, which starts with defining datapoints that are fit for purpose.



Definitional consistency

In order to effectively monitor and manage risk culture and conduct risk, financial institutions need to make sure they are tracking metrics consistently across all departments. This means first they need to get better at defining key metrics and collecting data, as well as cleaning and consolidating it. Of course, this starts with identifying the right metrics: definitional consistency won't matter if the metric is not the correct one to begin with.

Currently, many banks' procedures involve various teams across the business manually collating data, meaning it is often subject to selection biases, unreconciled across sources, difficult to trace, and ultimately unhelpful or misleading. There is often no reliable triangulation of conduct risk issues across the organisation.

For example, consider the utility in a metric that tracks which employees are rated as a "role model". If the definition of role model varies among different business lines, a lack of definitional consistency will preclude accurate monitoring across the business. To be useful on an enterprise-wide basis, data definitions need to be standardised across the board.

It is also important to create a program that is relevant across every department of an organisation but can also be rolled up to senior management. A branch manager might monitor 40 metrics but cannot report all of them to the board. These metrics need to be consolidated and boiled down to a small number and still have the same consistency of understanding.



From monitoring to prediction

A data-driven model should go beyond simply monitoring things that have already happened; ideally it should provide a holistic, forward-looking view to help business leaders understand their environment, actions and accountabilities. It should also allow firms to easily carry out risk assessments across various business units, identify high-risk areas and anticipate problems. In other words, a data-driven approach to managing conduct risk will enable firms to move from a reactive to a proactive stance.

It can do this partly by consolidating data from a wide variety of internal and external sources — things like complaints, customer remediation, call centre logs and even social media comments — and using natural language processing, machine learning and other types of artificial intelligence to generate deep insights that can help institutions draw connections between the activities of individuals and departments. In doing so, institutions can detect anomalies in behavioural patterns and preempt potential problems before they arise.

5



Seeing the benefits in practice

**So how does it work in practice?
There are three maturity stages.**

1 Explore

Define a base set of metrics and explore trends and correlations among metrics to triangulate root causes of risk culture or conduct risk potential issues.

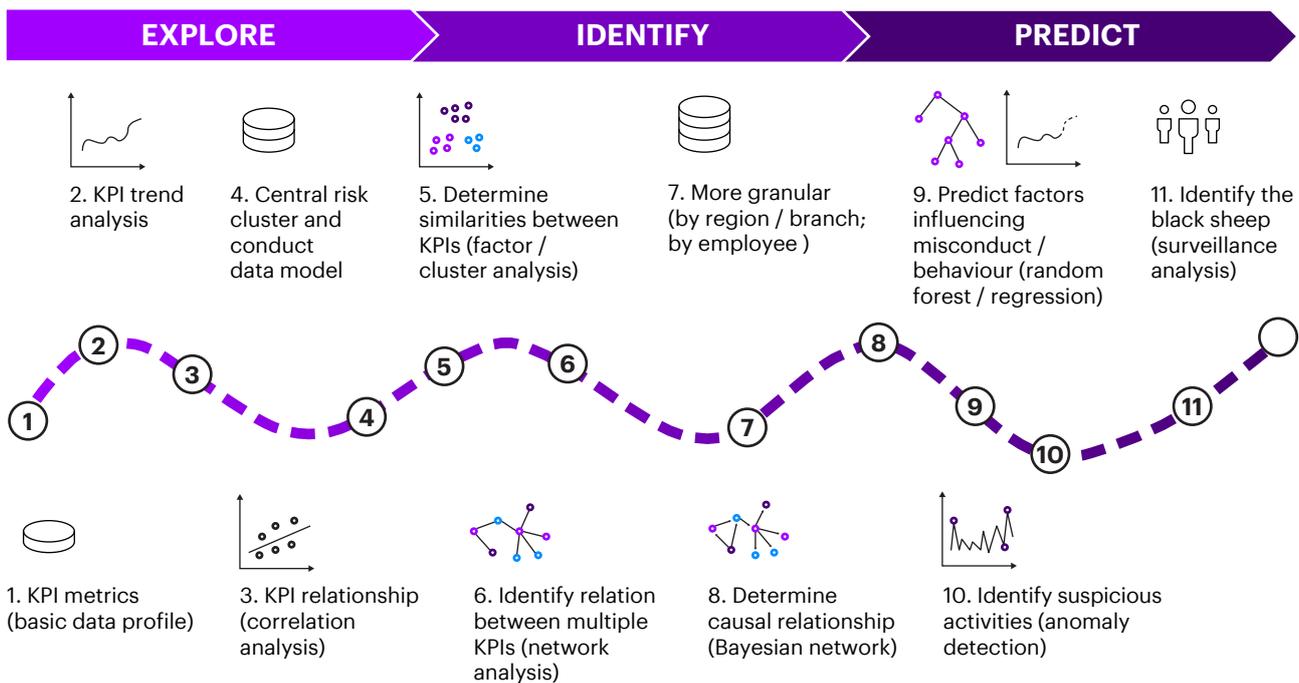
2 Identify

Enhance base set of metrics by incorporating topics outside of operational risk and compliance. Apply statistical techniques (e.g. correlation, regression) to identify relationships or causalities among metrics with a greater level of granularity, for instance by region/branch or by employee.

3 Predict

Predict factors influencing misconduct using advanced statistical techniques (e.g., network analysis, random forest etc.) and potentially more sophisticated machine learning algorithms. This can then identify suspicious anomalies and lead to more targeted surveillance analysis to pinpoint “black sheep”.

Many Tier 1 US / UK financial institutions are leveraging in culture / conduct MI driven insights to enable and operationalise a strong risk culture and conduct framework



Source: Accenture Analysis 2019

The benefits of this approach have been realised by a number of financial institutions around the globe. Using various data-mining techniques, the global leaders in tackling conduct risk in this way identify potential issues, enabling them to take pre-emptive action. The majority of Tier 1 financial institutions in the US and the UK are already practising basic methods of analysing metrics, trends and correlations.

By using data-driven conduct risk techniques banks have been able to deliver tangible results, identify risk areas and take appropriate action.

In one case a financial institution found that an unusually high employee turnover in a specific branch/region was linked with a higher workload per full-time equivalent

(FTE) unit, which was leading to procedure violations. This conclusion was reached when the institution compared the number of customer complaints by type over a set time period with the number of employees who left the company (whether voluntarily or involuntarily).

In another case, a bank discovered that conflicts of interest were not being closely monitored and, as a consequence, were being used inappropriately to sell products. This resulted in inflated individual sales, which were tied directly to variable compensation awards, therefore incentivising inappropriate behaviour. In this case the base data element was the annual compensation rating, and the comparison data element was conflicts of interest investigations.

6



The roadmap to proactive conduct risk management

When implementing a data-driven risk culture and conduct risk monitoring program, it is important to lay a strong foundation and scale up gradually, starting with one business unit or product. We recommend rolling out a program over the course of a year, using a three-phase approach:

Phase 1: Build a Foundation

- Identify a base set of key metrics to provide insights on risk culture and conduct risk.
- The metrics need to be standardised, consistent, intelligible, and parsimonious.
- Identify and establish common source(s) of data.
- While a fully automated data management process, with a “golden source” of data, is ideal, the focus should be on getting the foundations of process and data collection right.
- Define select use cases, keeping in mind the key target audience.
- Outline processes and escalation procedures for design, analysis, interpretation, and corrective action (i.e., how to leverage metrics to investigate root causes, what types of actions to take to initiate change and so on.)
- Outline roles, responsibilities, and reporting requirements.
- For scope and timing reasons, focus on one business unit or one set of products only.
- Deploy on an enterprise system or integrate with existing tech ecosystems.

Phase 2: Scale Up

- Expand metrics library beyond the basics.
- Identify and formalise additional use cases to support expanded audience and additional products/lines of business.
- Roll out the program to an entire business unit or product.
- Include additional sources of data.
- Automate high-value data ingestion processes.
- Enhance integration with tech ecosystem, including downstream reporting tools.

- Formalise processes, roles, and responsibilities, and standardise reporting and escalation procedures.
- Provide support and training to stakeholders to adapt to new ways of working.

Phase 3: Industrialise

- Roll out the program to multiple business units or products.
- Identify use cases for advanced analytics (e.g., machine learning driven, network analysis etc.)
- Establish a “golden source” of data for a single version of truth.
- Standardise processes, responsibilities and controls across the enterprise.
- Fully integrate with existing tech ecosystems.

One of the key benefits to this kind of program is that it can be scaled on technology, which is much more sustainable than scaling on FTEs. By using intelligent technologies to perform otherwise labour-intensive tasks such as collecting data and reporting, firms can free up staff for more high-value activities such as analysis and generating actionable insights.

As financial institutions in Australia adjust to the new regulatory landscape, they will find that traditional methods of managing conduct risk are simply no longer adequate. They will need to harness the power of data if they are to effectively protect themselves from further reputational damage and win back customer trust. Fundamentally, to manage the increasing regulatory burden efficiently, financial institutions need to reform their risk culture and conduct risk management journeys to focus on data. Only then can they measure, manage and act proactively.

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- 9 Accenture BCBS 239 Roundtable Event (June 2018) and Risk Culture and Conduct Roundtable Event (September 2018)
- 10 2018 Compliance Risk Survey: Comply & Demand, Accenture (2018). https://www.accenture.com/t20180322T192051Z__w__us-en/_acnmedia/PDF-74/Accenture-2018-Compliance-Risk-Study.pdf

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