Conduct Risk Management
‘The long and winding road’

Many financial institutions have made significant progress on their journeys to mitigate conduct risk issues. But it may feel as though the journey is a long and winding road.

Sadly, many have seen conduct issues manifesting in their businesses and the resultant dismissals, fines and arrests. With the increasingly stringent regulations and scarce resources, budgets have rightly been focused on remediation exercises alongside the launch of new policies, procedures and governance models.

Despite this, we are still seeing conduct issues arising. Some relate to historical misconduct cases where the penalties are now catching-up. But it raises the question of what else is out there? And how do we future-proof against further conduct issues?

We must continue to evolve and constructively question our approaches to conduct risk management. It’s time to pose some questions ...

01

What is the optimal organisational construct to create an ethical organisation?

No-one would debate that the business must understand, own and manage the conduct risks inherent in its business.

However, there is some debate[1] as to whether organisations should appoint a chief ethics &/or compliance officer reporting to the board to champion ethical behaviour and ensuring good conduct is an integral part of its overall strategy. The challenge in a large, complex organisation is the viability of such a role and particularly if the role is accountable for the 'day-to-day operational responsibility for the company's global ethics ... programme'[2]. Undoubtedly, to operate effectively, this function would require an army of resources which could result in scarce resources being taken away from the businesses, who actually manage conduct risk on a daily basis.

What we are seeing in many organisations is the appointment of specialised heads of conduct within compliance functions and focused on specific lines of business. These roles often set the high-level policies specific to that line of business and provide an arm's length challenge. They are often also the prime contact points with the regulators. That said, regulators increasingly want to meet directly with the heads of businesses to get their insights into how they are managing their conduct risks. They want an open discussion around the actual conduct risk scenarios they seeing, and most importantly, how is the fair treatment of clients playing out in the day to day execution of transactions and deals?

Whilst regulations have rightly focused heavily on client and market facing processes (eg. best execution, pricing, suitability and appropriateness), misconduct can and does occur everywhere. Conduct accountability sits throughout the organisation, hence we must not forget the operational and support functions. Having dedicated conduct compliance teams for these functions, and with knowledge and experience of those functions, is just as important as having dedicated teams for the Front Office.

In the aftermath [of the crisis] some of these bankers started to believe it was due to their genius, they should take the rewards and they took the eye off the ball, which was the customer

PETER COSTELLO
Former Australian treasurer in The Australian, May 2018

02

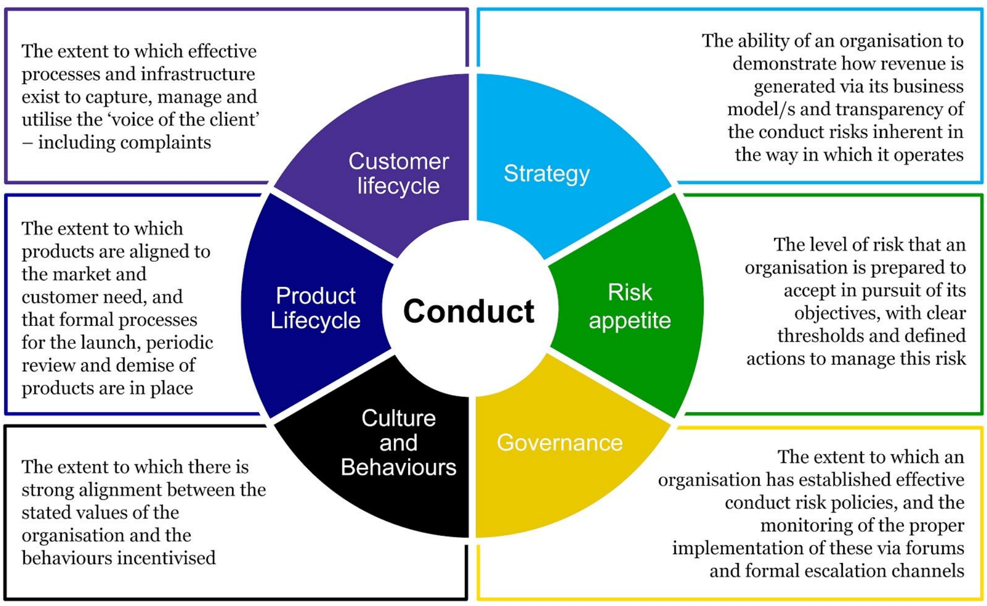
How do you demonstrate that the business understands and is managing its conduct risks?

How do businesses effectively demonstrate that they are managing their conduct risks?

Data alone is not effective, businesses also require focused resources not only to compile the information but, more critically, to understand what it means. They need to be able to dig into root causes and provide robust narrative around why a metric may be increasing or decreasing alongside any remediation action being taken.

Ideally, the team should also be able to make direct links between the successful delivery of key initiatives and associated trending metrics. For example, if improvements are made to a sub-optimal process that receives a high level of customer complaints, there should, over a period of time be a decrease in the number of complaints specific to that process. Ultimately, by telling customers that the organisation listened and acted on their feedback, and made changes to improve the process, the organisation should also see an increase in associated client engagement scores. This is perhaps one of the most powerful means of demonstrating that a business understands and is managing its conduct risks.

In partnership with metrics, case studies bring conduct and ethical behaviour to life. They highlight what good conduct looks like within a specific business. Importantly, they help to set the right tone, 'Highlighting efforts to promote ethics—both to internal and external audiences—illustrates the value placed on doing the right thing.'[3] (Ethical Systems.org)



03

Have you seen tangible benefits of publishing a code of conduct?

Does having a published code of conduct actually prevent misdemeanours happening in the first place? There seems to be two schools of thought.

In an article published in The Harvard Business Review[4] companies are advised to 'Establish and post online ethical and compliance standards and procedures ***to prevent, detect, and remedy illegal or unethical conduct.*** Well-crafted and company-specific mission statements and codes of conduct are critical to educating directors, officers, and employees about the company's core values, standards, and procedures'

Meanwhile, research undertaken in 2010[5], claims 'there is no evidence of correlation, let alone causation between publishing a code of conduct or corporate values, and either ethical behaviour or even the intention to behave ethically'.

It is without doubt that HR professionals and independent hearing managers in a disciplinary case will find invaluable the policy document that sets out an organisation's code of conduct. It is against these that an alleged misdemeanour can be assessed. But it would seem that having a published document - in and of itself - is unlikely to stop misconduct from arising.

Conduct risk is any action of a financial institution or individual that leads to customer detriment, or has an adverse effect on market stability or effective competition.

FINANCIAL CONDUCT AUTHORITY

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Is it possible to future proof your organisation against conduct risk?

Sadly, the short answer to this is probably ‘no’. We know from experience, that good people do bad things.

What is interesting is the lag between the alleged misconduct and the penalties. Two recent and notable examples:

- In April 2018, an ex HSBC FX trader was sentenced to 2 years jail for currency rigging with the offences dating back to 2011.
- In July 2018, two former traders (Deutsche, Barclays) were jailed for plotting to rig the Euribor global interest rate between 2005 and 2009.

On the basis of the historical cases we are witnessing being played out in the courts right now, we can surmise that more will surface. Certainly, there is plenty of archived material in the form of voice recordings, chat messages and emails, alongside a plethora of expert litigation lawyers ready to pull together a case!

As an industry, we have of course developed much more sophisticated tools to detect potential misconduct. Just one example is the advancement made in the surveillance of chat rooms, instant messaging and emails. Potential infringements are being caught and investigated much sooner and disciplinary action taken much more swiftly.

Critical to future-proofing an organisation against conduct issues is establishing the appropriate culture and behaviours. Supporting this, incentives must be linked to visible and promoted behaviours. If these are not aligned, then conduct issues are sure to follow.

One question organisations should be posing is whether it is rewarding only for the short-term. A focus purely on shareholder value, for example, may be at the expense of customer focus, integrity, and collaboration amongst employees.

We should all be asking ourselves ‘in 5 years’ time, would others see this as an ethical way to operate?

And finally, let me end on a quote:

We had a bad banking situation. Some of our bankers had shown themselves either incompetent or dishonest in their handling of the people's funds. They had used the money entrusted to them in speculations and unwise loans.

This quote is from Franklin D Roosevelt's Fireside Chat on Banking, in March **1933**. Sadly, it sounds all too familiar. It just goes to show, we probably still have quite a long way to go.

About the author - Emma Parry
For the past 12 years, Emma has held various global leadership roles at the Investment Banking arm of a Tier 1 Global Bank, with the most recent focused on conduct and product governance. She has seen first-hand the impact on customers, firms and individuals of conduct issues.

Prior to this, Emma held various programme management roles at JPMorgan alongside Deloitte Consulting. Emma is now working as a Senior Advisor focused on helping her clients mitigate against conduct risk issues within their businesses.

Emma holds an Honours Degree in English from the University of Adelaide.

References

1. American Banker, Dec 2014. 'To restore trust in banks, build ethics into business decisions'. Harvard Business Review 21 Dec 2017. 'How Boards Can Reduce Corporate Misbehaviour'
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3. EthicalSystems.org, Nov 2017. 'Ethics Pays – How an investment in ethics translates to profit, productivity, and prestige'
4. Harvard Business Review, 21 Dec 2017. 'How Boards Can Reduce Corporate Misbehaviour'
5. MindGym Sept 2017. 'The Only Way is Ethics' quoting research undertaken in 2010 by Kish-Gephart, J.J, Harrison, D.A, & Trevino, L.K.

How we help....

“Sadly, I’ve witnessed first hand how conduct issues impact customers, firms and individuals. My aim is to use that experience positively, by supporting clients on their own conduct journeys”

EMMA PARRY
Senior Adviser

We have a proven track record in helping Financial Institutions understand and mitigate conduct risk

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Our approach involves workshops, interviews with your teams and execs, and a review of your risk metrics and governance framework, followed by a full playback of findings and recommendations to you and your management team

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We then document the findings in an actionable roadmap

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If you’d like more information, please contact us, request a factsheet or find us online at AuroraSDE.com