

Making Sense of Conduct Risk

Rebecca Copley's insight into effective conduct risk management in the financial services world – underestimate its importance at your peril.



WHY IS CONDUCT RISK IMPORTANT?

Good conduct risk is considered to be a critical step towards restoring market integrity and customer confidence in the financial services sector. It is no exaggeration to say that it has become a global priority for all major regulators. We are living in an environment of heightened scrutiny, demonstrated by the increase in supervision and enforcement activity where hefty fines for improper conduct and regulatory breach are increasingly widespread. Firms who fall below the regulators' expectations now do so at their peril as the repercussions of poor conduct risk management can be business critical and not only include financial penalties, but also extensive redress programmes, damage to reputation and criminal sentences. Accordingly, firms need to ensure that they dedicate sufficient time and resource to preparing effective risk management policies and that they fully practice what they preach.

WHAT IS CONDUCT RISK?

There is no universal definition of "conduct risk", which presents its own challenges to those tasked with preparing conduct risk policies. In essence, conduct risk refers to the risks attached to the way firms do business. This includes the way firms treat clients, deal with conflicts of interest and remunerate their staff. It means ensuring that as a business, firms not only act competently and lawfully but fairly and appropriately with an awareness of and consideration for the wider impact of their actions.

Firms should always consider and regularly review the specific risks attached to the way they do business. Different businesses will have different considerations such as their customer base, products, services, size and people. Consequently, those firms that try to take a "One Size Fits All" approach will simply set themselves up to fail as the regulators expect to see tailored policies that evolve in line with the business and the surrounding landscape.

SEVEN KEY STEPS

Whilst there is no text book definition of "what good looks like", those responsible for managing conduct risk may benefit from taking the following seven key steps in order to ensure that they create policies that are fit for purpose and tailored to the business:

- **Define** “conduct risk” in the context of your business.
- **Assess** any risks by undertaking a gap analysis.
- **Remedy** and mitigate those risks and share lessons learned with other business areas.
- **Measure** performance against those risks identified.
- **Review** the scope of your definition and assessment of risks regularly as your business evolves and market conditions change.
- **Evidence** the steps taken towards embedding good conduct in your organisation.

KEY CONSIDERATIONS

Regulators are working increasingly hard across the globe to steer firms away from taking a fire fighting approach to conduct risk, focusing instead on ensuring that a proactive long term strategy is put in place. Senior management are definitely considered to be a key starting point in delivering against this objective, with regulators expecting there to be absolute clarity around their responsibilities and an increasing focus on holding them to account. Those in senior positions of control should be aware of any such personal liability and provide a “first line of defence” for the business to ensure that its firm

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is doing the “right thing” from both the bottom up and the top down, with effective controls, testing and mitigation strategies put in place as considered appropriate.

Culture can also be controlled through recruitment and reward. Ensuring sufficient processes are in place to secure the right people in the right roles can prove fundamental to effective conduct risk management. By way of example, many firms are making an increased use of psychometric testing

to support those recruitment processes designed to hire senior individuals in positions of trust. Firms are also overhauling their remuneration structures to ensure that individuals are neither encouraged nor motivated to take excessive risk. Clear job specifications should also be put in place at all levels so that employees understand their responsibilities, thereby minimising the risk of anything “falling between two stools”.

WATCH OUT

Drafting a policy on conduct risk is however only the



Policies need to be communicated and implemented at all levels in an organisation

start of the story for any organisation. The regulators will expect to see clear evidence of the policy being fully implemented and in a way that ensures it remains fit for purpose. This is likely to include evidence that:

- The policies are communicated and implemented at all levels.
- Individuals are held accountable for managing conduct risks.
- There is no significant mismatch between policy and practice.
- The policies evolve in line with business and industry change.
- When things go wrong, the root cause of any problem is properly identified without delay, solutions found and lessons learned ensuring full and prompt compliance with all regulatory notification requirements.

CONCLUSION

Changing culture is never easy and firms need to take a more holistic approach to their overall risk management strategies. There is no overnight solution or tick box answer. Those who continue to see the law and profit margins as their only boundaries within which to do business, do so at their peril. Our global regulators have made it quite clear that fair conduct and “doing the right thing” are key priorities, which are here to stay, for the long term. If firms have not already done so, they should invest the time and resource needed to deliver a fit for purpose conduct risk policy and see it as a future pathway to regulatory sound practice that should keep them on the right side of the regulators for years to come. 📌



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