

Conduct Risk

Presentation to the JCOA

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The presentation will be posted under the news section of our website www.oben.je should you wish to obtain a copy of the slides. You will also find an online version of the survey.

What is Conduct Risk?



- No universally agreed comprehensive definition
- It is rooted in the TCF- Treating Customers Fairly initiatives
- It may be easier to define it by what it is not
 - It isn't market risk
 - It isn't credit risk
 - It isn't liquidity risk
 - It isn't operational risk
- Largely subjective: looking at the way an entity conducts itself through the conduct of its employees

What is Conduct Risk?



“Conduct risk is often defined as risk to the delivery of fair customer outcomes, or to market integrity. In other words, conduct risk touches every part of an enterprise framework.”

[Thompson Reuters]

What is Conduct Risk?



“A firm’s culture is the key driver behind the behaviour of those in it. In many cases, where things have gone wrong in a firm, a cultural issue is at the heart of the problem”

[Chairman’s foreword UK Financial Conduct Authority (FCA) Business Plan 2015/2016]

Any Clearer?

- FCA has not provided a comprehensive definition
- FCA are conducting Annual Conduct Meetings engaging the largest firms- introduced in 2016
- FCA priority- culture and governance (2016/17 Business Plan)
- As part of ACMs asked firms to define conduct risk

ACM response to definition

- Definitions included reference to client outcomes in terms of:
 - Sustainability of their business
 - Market integrity
- Danger of actions or behaviours or conduct of business that may:
 - Harm clients
 - Cause the firm reputational damage
 - Risk undermining the integrity of the financial markets

Channel Islands definition?

- No definition to be found on JFSC or GFSC websites.
- JFSC document outlines its approach to risk-based supervision in which Conduct Risk is mentioned

JFSC Risk Overview

The JFSC allocated risks to three groupings namely “inherent”, “causal” and “effect”.

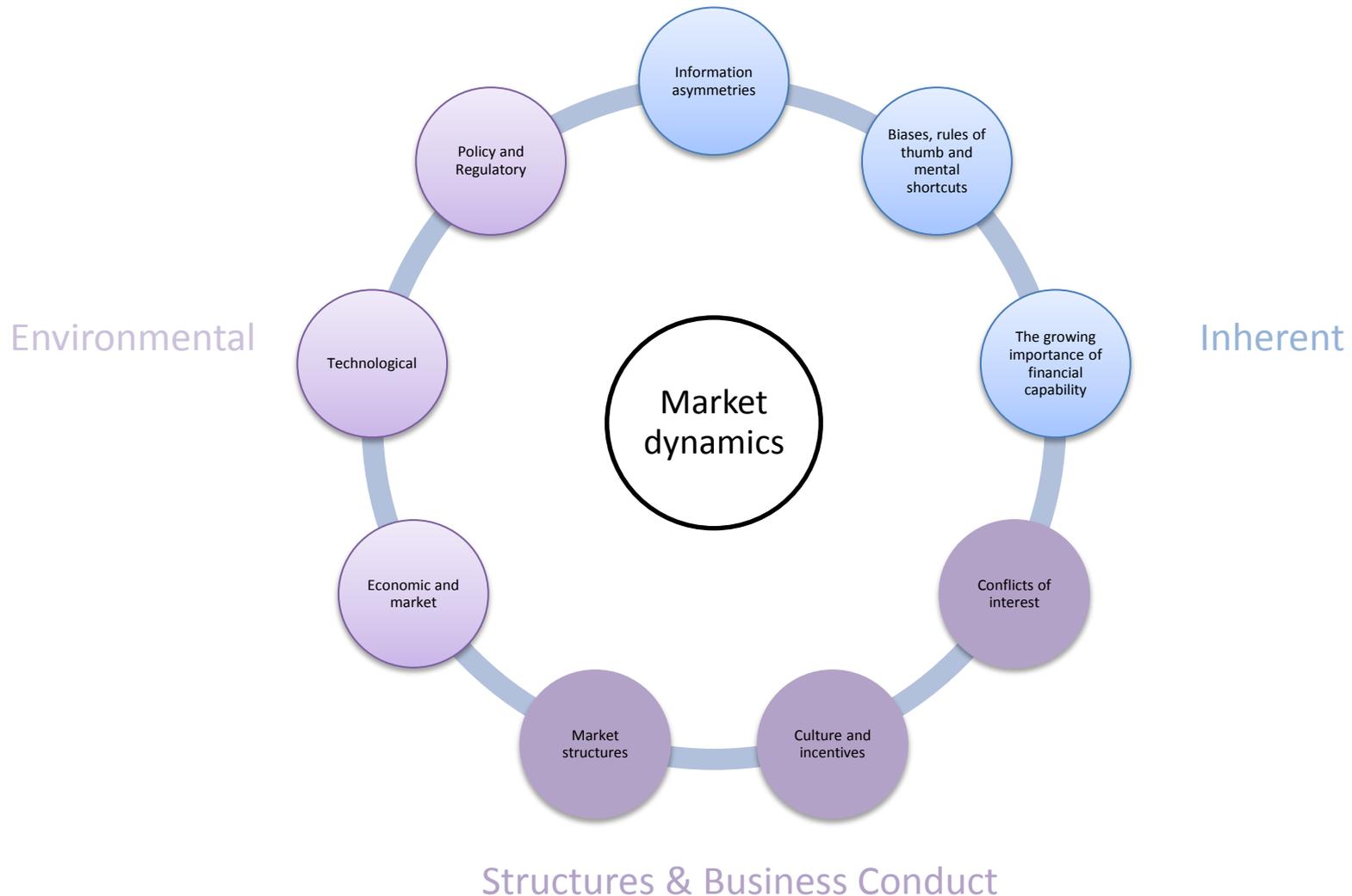
- Inherent risk is defined as *“risks caused by the strategy, business model and structure of a supervised firm”*
- Causal risks are defined as *“risks that relate to the operation of financial services firms, and arise from a firm’s people, policies, processes and systems”*
- Impact risks are defined as *“risks that have a direct and negative impact, causing harm. They are a result of an individual or set of action(s) or omission(s) on the part of a firm.”*

JFSC Risk Overview- cont'd

JFSC identifies conduct risk as arising from the following:

- An entity being deliberately structured to defraud its customers
- An employee defrauds its customers
- Aggressive tax avoidance products or services
- Predatory business practices
- Reputationally damaging activities
- Customers suffering loss or other detriment due to an inability to transact
- Third party causing material disruption to services
- Customer data being stolen by employee or third party
- Loss or inadvertent disclosure of customer data
- Mismanagement of conflicts of interest
- Deliberate or negligent mis-selling
- Provision of misleading information to customers
- Over-charging
- Failure to follow agreed terms of business
- Poor levels of service to customers

Sources of conduct risk- FCA



Confused...



Conduct Risk - Oben's views

- Much turns on behaviours
- Measuring behaviour is difficult
- Ethics and Morality
- Addressing conduct risk is essential
- 4 overriding “C” components:
 - Culture, ethics and integrity
 - Competence
 - Corporate governance and tone from the top
 - Conflicts of interest

Mapping conduct risk

Enterprise Risk Management Framework



Conduct risk should be at the centre of your risk assessment and all risks should be referenced to Conduct Risk.

Identifying conduct risk

Standalone risk (some incorporate it as a subset of other risks)

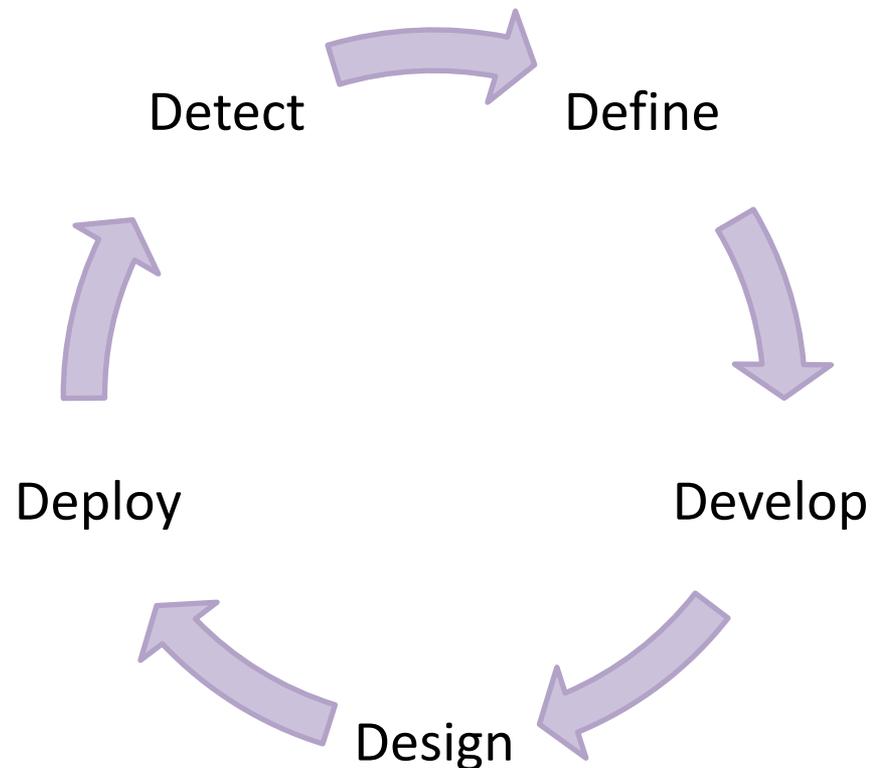
Look at your business model and DETECT risks.

Look at your business strategy and DEFINE an aligned conduct risk strategy

DEVELOP conduct risk appetite ¹

DESIGN systems and controls

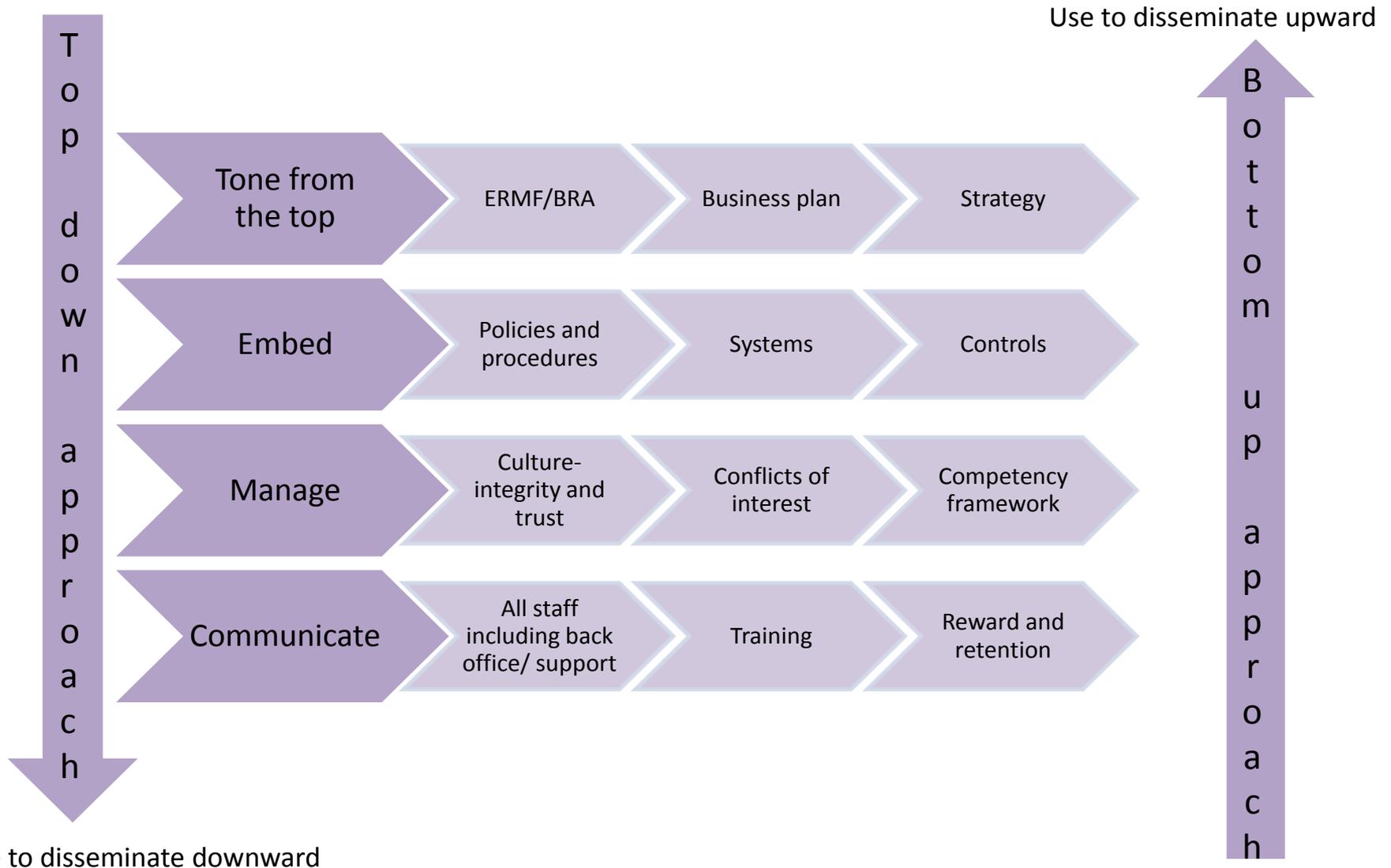
DEPLOY the systems and controls, then monitor the effectiveness of the above framework and go back through the cycle if inadequacies identified



¹ FCA recent study shows that a zero risk tolerance is not practical or realistic

Conduct Risk- mind map

Oben's view



Red flags

- Diversification, regulated and unregulated
- Acquisition- failure to integrate
- Conflicts- identify and manage
- Lack of systems and controls
- Integration of systems and controls
- Employees doing same job entirely different ways
- High staff turnover
- Fees
- Complaints
- Lack of appropriate training or not completing in a timely fashion
- Infrequent board meetings
- Lack of clear reporting lines
- Failure to undertake due diligence
- Poorly populated breaches register
- Reward system based purely on performance not conduct

Why is managing conduct risk important?



- Past 6 years large fines (>£200 billion for 2010 to 2014₁) levied relating to CONDUCT by financial services firms
- UK :
 - UBS £244m fine for FX fixing
 - Lloyds Bank £105m fine for Libor rate rigging
- Focus of regulators on integrity
- Regulatory sanctions
- Reputational risks
- Jersey PLC

Risk Mitigation

- The onus (in our view) should not be on the Compliance department
- Top down approach- tone from the top is important but ensure engagement from all
- Meaningful M.I.
- Ensure policies and procedures are accessible, easily deciphered and actually followed
- Culture: integrity and trust paramount
- Promote a “lessons learnt” culture
- Stakeholder relationships

What should YOU be doing?

- When was the last review of Enterprise Risk Management framework / BRA?
- Is the reporting line/ committee structure effective?
- Are your manuals/ policies and procedures current and effective?
- Have you considered how you assess and reward employees?
- Is your training effective?
- How do you monitor conduct risk?
- What M.I. is available to you?

How can we help you?



- Presentation can be found on our website www.oben.je
- We have produced a survey which may be completed and left on your chair. Alternatively, please complete it via our website. The results will be posted on our website in two week's time.
- We have considerable experience in designing, revising and assisting entities with risk frameworks.

Questions?

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