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Conduct Risk: Lessons Learned from the Banking Sector

Gary Martin
Nick Ireland

24 October 2014



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Introduction

Enterprise
Sponsorship
Thought leadership
Progress
Community
Sessional Meetings
Education
Working parties
Volunteering
Research
Shaping the future
Networking
Professional support
Enterprise and risk
Learned society
Opportunity
International profile
Journals
Support

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Who we are



Gary Martin

Senior Manager

Financial Risk Management – Life Actuarial

KPMG



Nick Ireland

Senior Manager

Financial Risk Management – Regulatory

KPMG

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Overview

- | | |
|---------------------------------------|------|
| A. What is Conduct Risk? | Gary |
| B. Lessons from the Banking Sector | Nick |
| C. Implications for the Life Industry | Gary |
| D. Questions | |



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What is Conduct Risk?

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Conduct Risk in Numbers

2800 16:1

60,000 £ 16bn

£10bn 90% 315,046

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What is conduct risk?

- Principles based, no prescriptive rules
- Firms are creating their own definitions
- FCA wants firms to demonstrate that they are managing risks to customers and market integrity



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FCA Approach to Conduct Risk



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The differences between TCF and Conduct



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The importance of culture

“Culture change within firms is essential if we are to restore trust and integrity to the financial sector and the FCA will continue to focus on how firms are managed and structured so that every decision they make is in the best interests of their customers”

– FCA Risk Outlook 2013



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Conduct Risk... getting it wrong

Individual Fine

St James's Place Wealth Manager – Inappropriate financial advice

Fine/loss: £300,000

Lloyds Banking Group

Failings relating to financial incentives of sales staff

Fine/loss: £28 million

Industry Fine

Credit Card Insurance

Fine/loss: £1.3 billion (est)

Redress Payments

PPI

Fine/loss: £16 billion

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Approaches to Conduct Risk from the Banking sector

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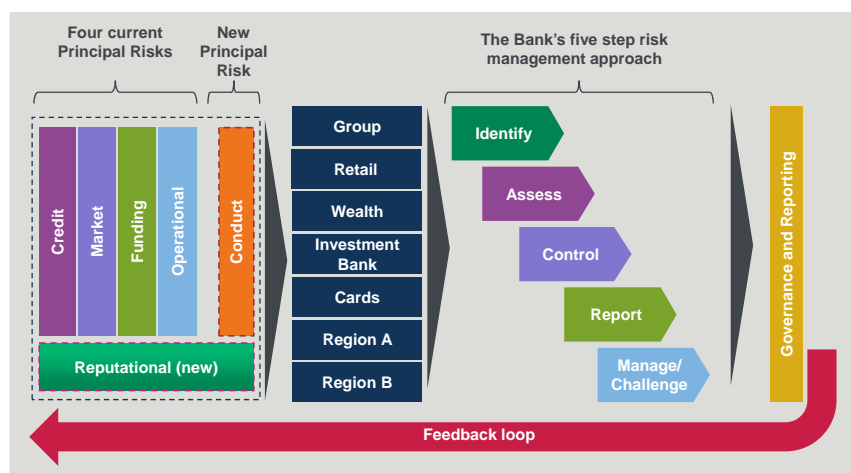
Key challenges



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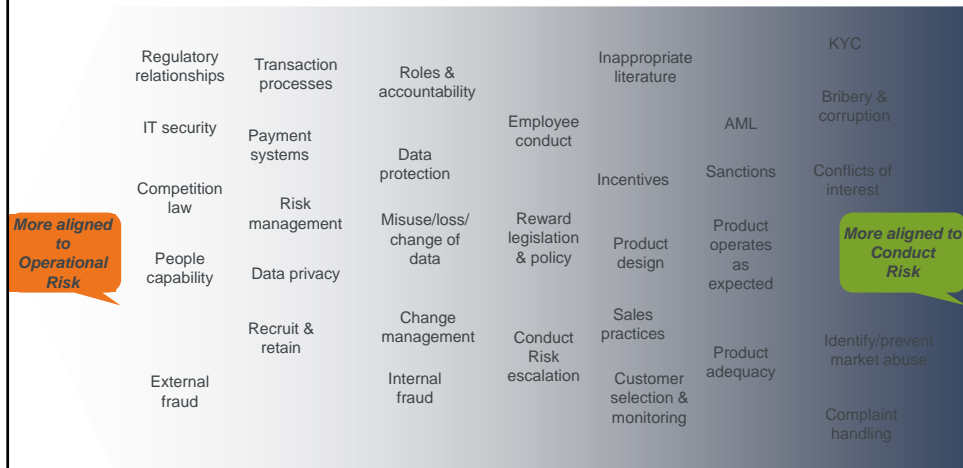
Fit within the Enterprise Risk Framework



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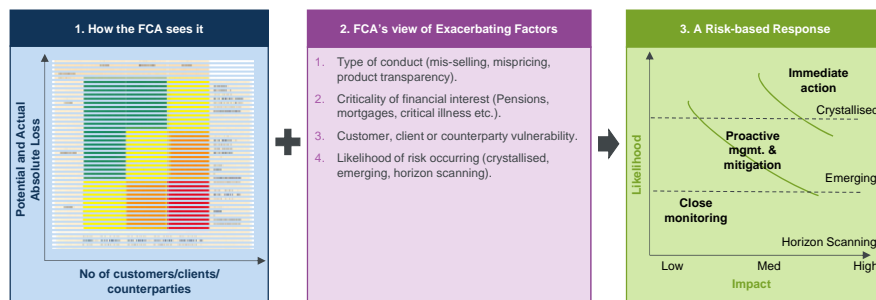
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Boundaries with Operational Risk



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A Conduct Risk Appetite that drives decision making



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What is 'risk culture'?

- Risk culture is part of the overall culture of the organisation, referring primarily to the demonstrated attitudes, behaviours and outcomes that are related to risk management within a firm.

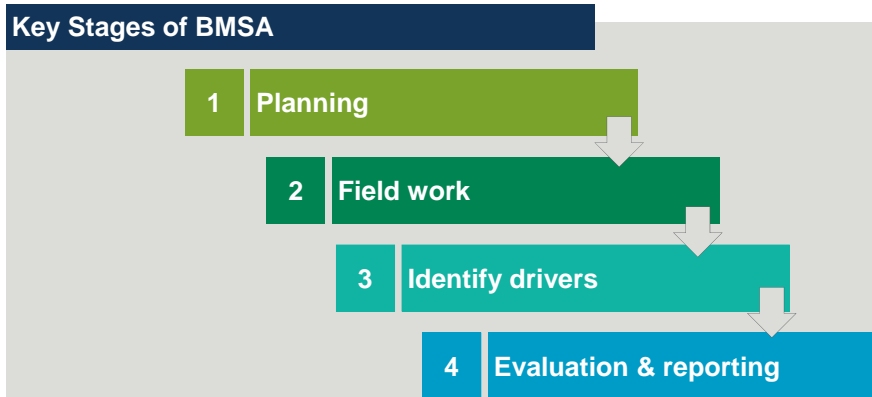


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Business Model and Strategy Assessment

BMSA is a top-down assessment of an entity's business model and strategy to determine inherent Conduct Risks



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Product Governance



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Value for Money

“It is necessary for the regulator to make judgements on the **value for money** of products, and to possess the powers to take action.”

“Both investors and advisers can compare the costs of investing through different platforms and make an informed decision on whether using a platform represents good **value for money**.”

“It likely the FCA will go further than the FSA in challenging providers on the **value for money** of their products.”

“The FCA will consider exercising its powers to take action where **costs or charges are excessive**.”

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Product stress testing

- Stress testing is well-established for prudential risk management.
- But not many firms have applied the same thinking to test customer outcomes – yet!

Objectives	Behaviour	
	Circumstances	
PST is	Forward-looking	Collaboration
	Mitigation	Wide-scoping
PST is not	A panacea	Solely quantitative
	A tool	A one off

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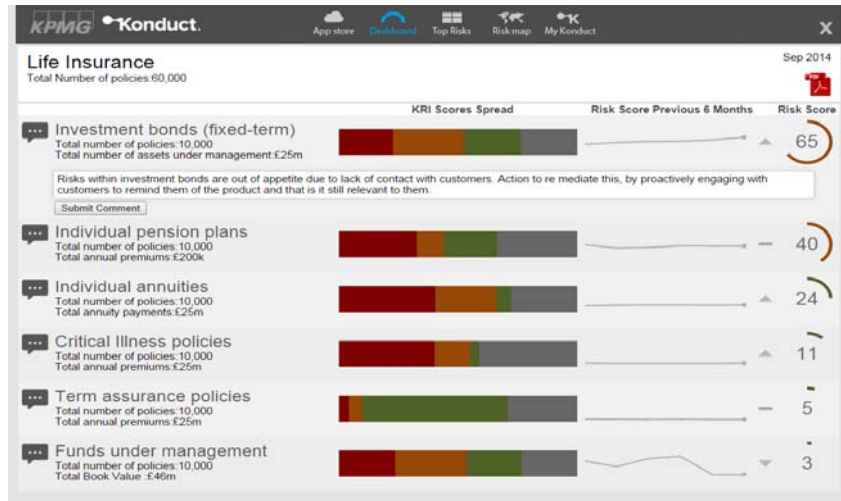
Conduct Risk MI & Monitoring

Current MI	MI is fixed
	MI predominantly backward looking, and is over-reliant on snapshots, rather than trending
Conduct Risk MI	Periodic reviews are undertaken
	MI alerts the business, as to what may happen in the future, utilizing trending and data from stress testing

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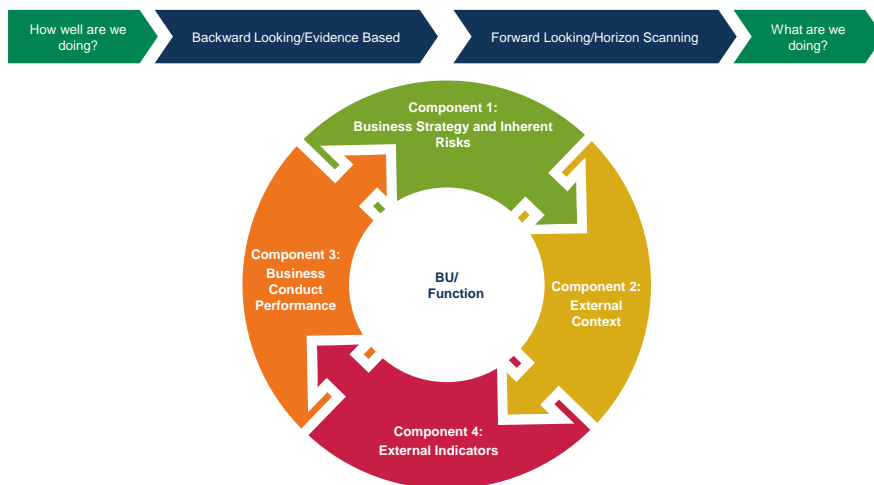
Smart Conduct MI – Konduct



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Sample Conduct Risk Reporting Dashboard



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How does the Life industry compare?

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Some past issues in Life Insurance

Pensions Mis-
Selling
(80s/90s)

With Profits
Governance
Overhaul
(2000+)

Mortgage
Endowments
(late 90s)

Strachan
Review
(2005)

And more recently...

- Retail Distribution Review
- Annuity Thematic
- Legacy Thematic

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Backdrop of massive industry change

- Retirement income reforms
- Work-based pensions reforms
- Long Term Care reforms
- Post-RDR advice landscape
- Growth in D2C offerings
- Solvency II
- FCA agenda

All these could give rise to Conduct Risk

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Different perspectives?



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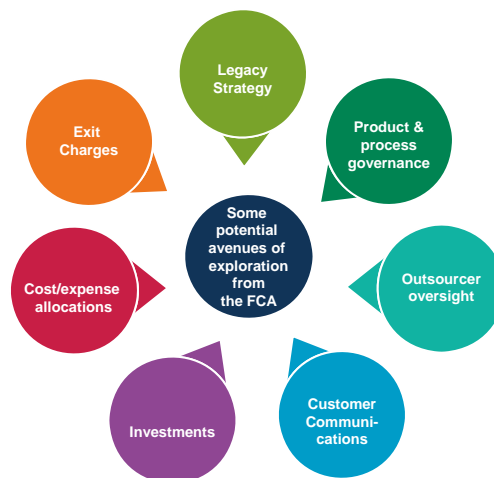
How the Life industry compares to banks?

Topic	Banks	Life insurance
FCA scrutiny	Lots	Growing
Culture	Short-term profit focus	Internal focus
Embracing Conduct Risk	Forced to demonstrate	Sense of denial
Forward looking	More risk prevention	Still issue-led
Customer Outcomes	Significant effort	More could be done
Conduct Risk MI	More progressive	MI largely TCF-issue

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Legacy Thematic review: potential areas of FCA exploration



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Challenges for the life industry

- Complexity of long-term business
- Capacity for Change
- Increased pressure on profit margins
- Internal constraints
- Customer behaviours
- Uncertainty

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Opportunities for the life Industry?



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Forecast for insurers?



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Questions

Comments

Expressions of individual views by members of the Institute and Faculty of Actuaries and its staff are encouraged.

The views expressed in this presentation are those of the presenter.

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