



# Conduct risk and IAD

**Do you have the current developments on your radar?**

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# Agenda

- Introduction
- Conduct risk defined
- Quick Quiz
- EY's view on conduct risk
- Conduct risk & IA – research results
- Conclusions & Recommendations





# ➤ Introduction

# Introduction: Research EY/IIA

## Research question:

“How is conduct risk currently addressed by the Internal Audit?”



## Data collection method:

- Interviews with the heads of IA departments
- Detailed questionnaire

## Research goal:

- Conclusions and recommendations
- Publication of research paper



## ➤ Conduct risk defined

# Conduct risk aspects



# Increasing regulatory focus

- Treating customers fairly has evolved into the more broader term conduct risk
- Broader questions are now being raised about where conduct risks arise and how they are managed
- New areas of discussion include culture, behaviour and ethics



“...with great trust comes great responsibility....banks should treat their customers fairly when providing various services and financial products to them, and should stand in customers’ shoes in pursuing profit.”

(Norman Chan, HKMA, October 2015)

We continue to believe that a cultural shift within firms to celebrating good conduct that places consumer interests and market integrity at the heart of the financial sector will benefit all stakeholders. We continue to address conduct issues arising from failures in firm culture and are committed to ensuring this momentum is not lost (John Griffith Jones, FCA, April 2016)

Supervision of behavior and culture has proved to be a valuable supplement to the more traditional forms of supervision, as it addresses the causes of behavior that impacts the performance and risk profile of financial institutions and consequently on financial stability (The Dutch Central Bank, September 2015)



# The main focus is on customer conduct risk

Embedding a culture which places consumer interests at the heart of the business will ensure the **protection of consumers, market integrity** and **effective competition**.



## Customers

- Central focus point of the conduct risk
- Increasing focus on vulnerable customers

**Suitability aspect: ensure right customer buys right product.**

### Typical challenges

- ▶ Information asymmetry
- ▶ Unsuitable products and services
- ▶ Remediation



## Markets

- Focus on price transparency, market abuse and financial benchmarks.
- Protecting and enhancing the integrity of markets
- Helps to regain the trust in corporations

### Typical challenges

- ▶ Cultural and conduct improvements
- ▶ Communication to society
- ▶ Manipulation of information



## Competition

- Promoting healthy functioning of markets e.g. innovation.
- More client specific products and services (customer value).

### Typical challenges

- ▶ High entry barriers to the market
- ▶ Innovative culture
- ▶ Supply and demand misalignment



# Conduct risk: a hot topic in the news

## Banks Manipulated Foreign Exchange in Ways You Can't Teach

The way you push an FX fixing up is, you buy a lot at the fixing, or sell a lot, or do neither. One of those should work. Maybe.

Samsung men sentenced to five years in jail after corruption conviction

KPN moest 30 miljoen betalen wegens benadelen concurrentie



Foto ANP / Koen van Weel

KPN heeft van de Autoriteit Consument en Markt (ACM) in 2011 een boete opgelegd gekregen van bijna dertig miljoen euro voor het benadelen van concurrenten bij een overheidsaanbesteding voor vaste telefonie in 2010. [KPN heeft hoger beroep aangetekend](#), meldt de ACM.

## Dutch Rabobank fined \$1 billion over Libor scandal

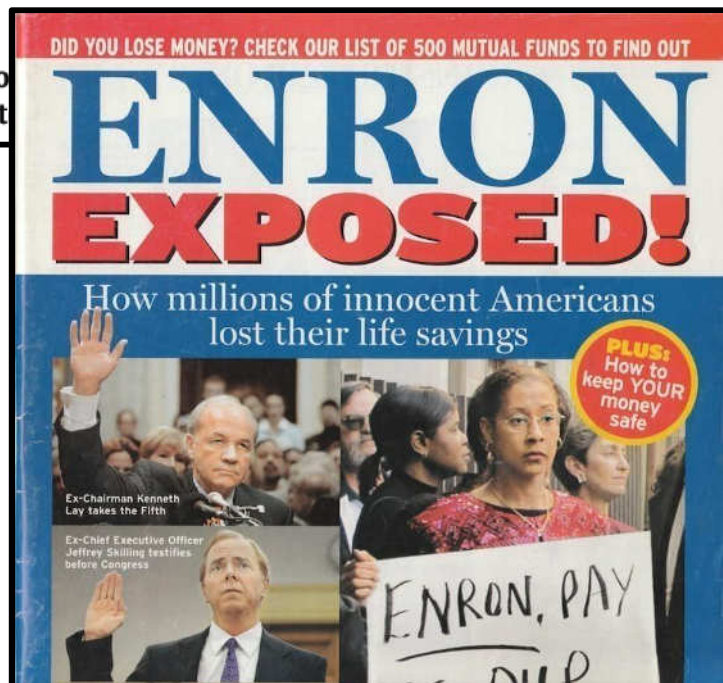
Sara Webb

6 MIN READ

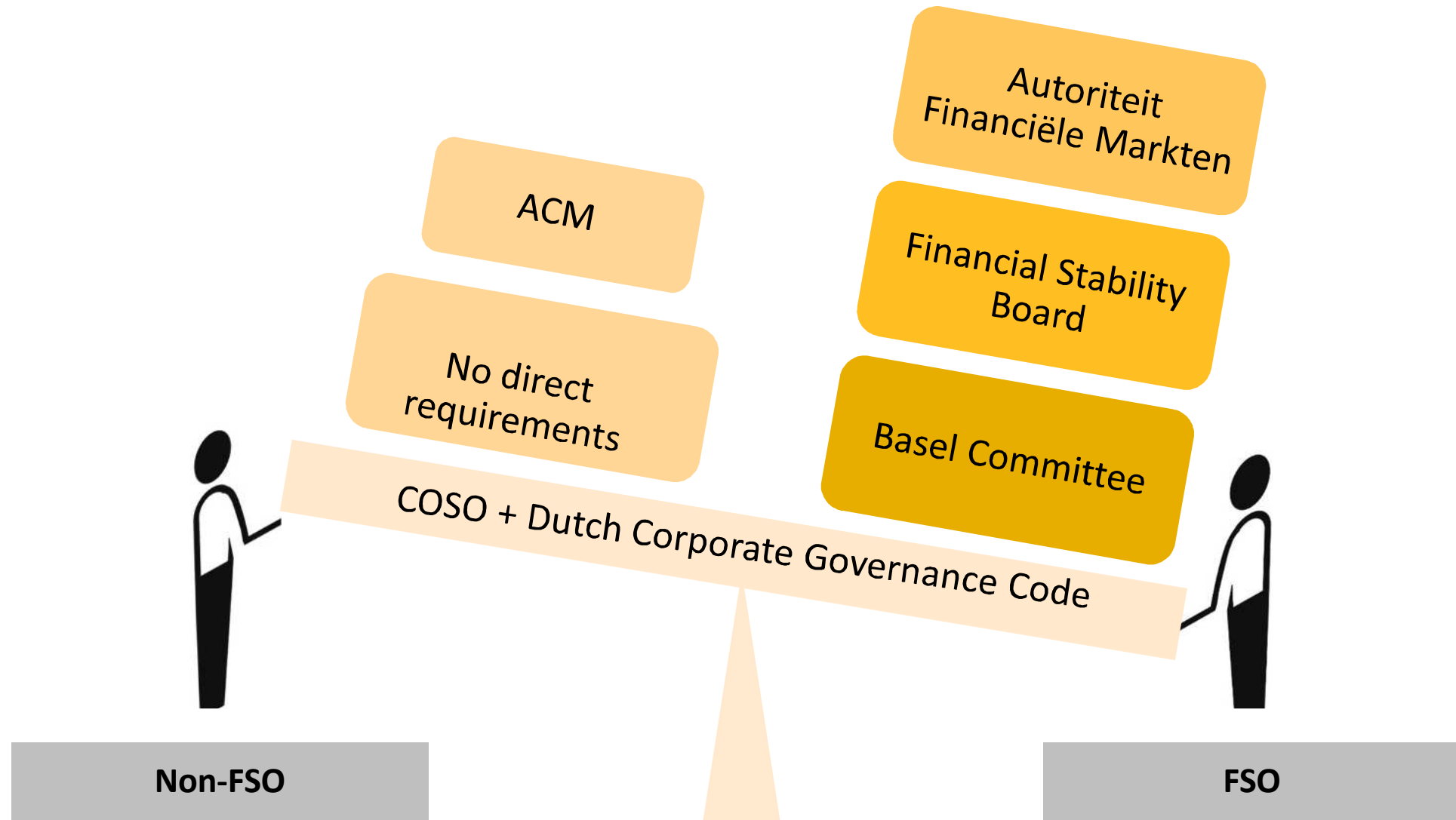


## Wells Fargo banking scandal a financial crisis we can finally understand

Only insiders could decode 2008's fallout, but the bank's latest offense is a clear example of what Americans face - and one regulators will be forced to address



# Institutions and frameworks focus on conduct risk





# ➤ Quiz

# Quick Quiz #1

What is the total conduct-related fines and charges for the 15 largest global banks between 2011 and 2016?

A € 330 million

B € 988 million

C € 198 billion

D € 733 billion



# Quick Quiz #2

What should be integral to firm's conduct risk frameworks?



A

Consumer Protection and market integrity

B

Market integrity

C

Consumer protection

D

Business revenue





# Quick Quiz #3

Which of these is not  
a type of market abuse?

- ☒ A Benchmarking and price manipulation
- ☐ B Misuse of information
- ☐ C Collusion
- ☐ D Bribery



# Quick Quiz #4

True or False?

US regulators do not officially recognize Conduct Risk as a term.



- ☒ A True
- ☐ B False

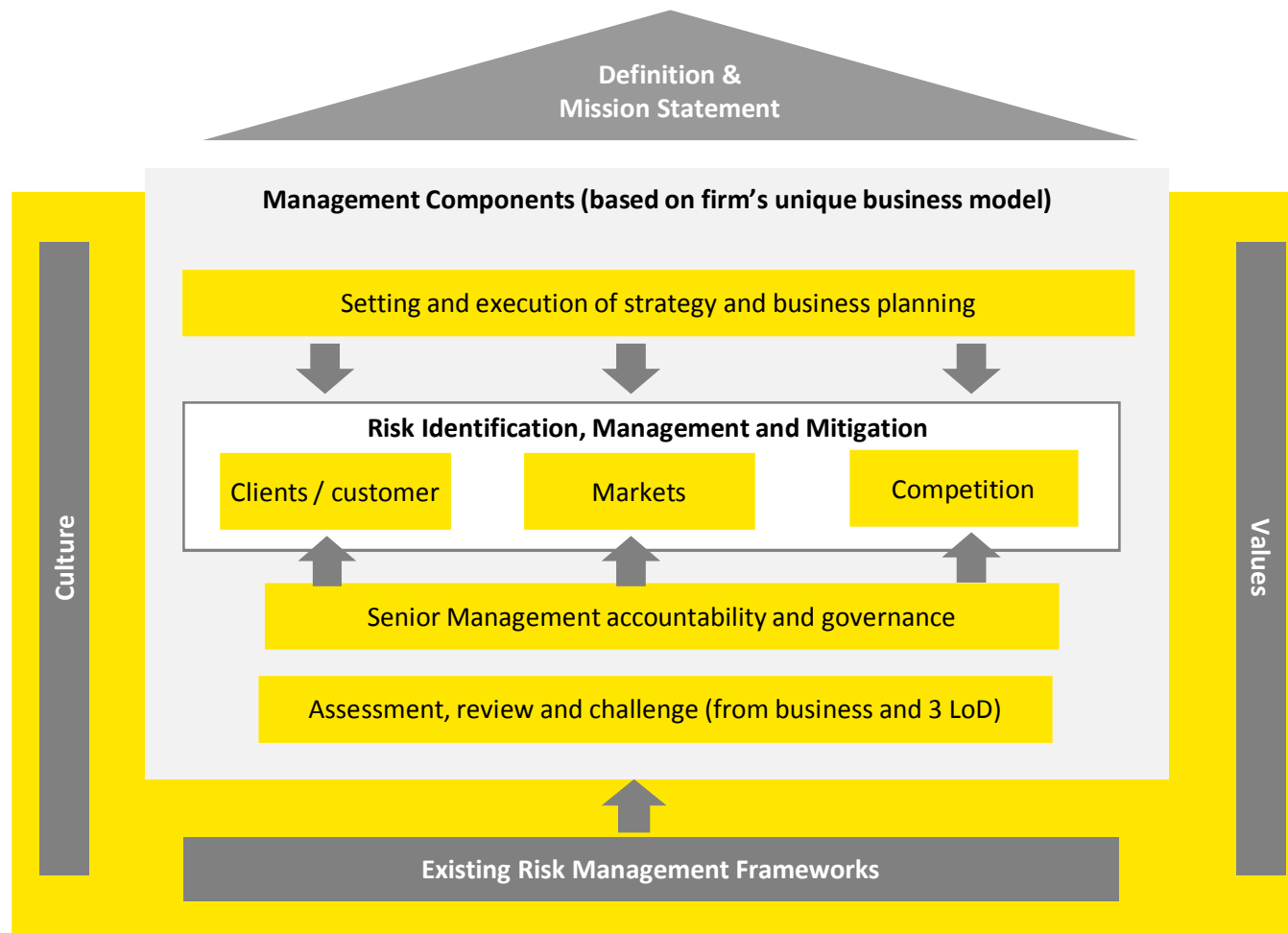






# EY's conduct risk framework

*Moving towards a strategic based approach*

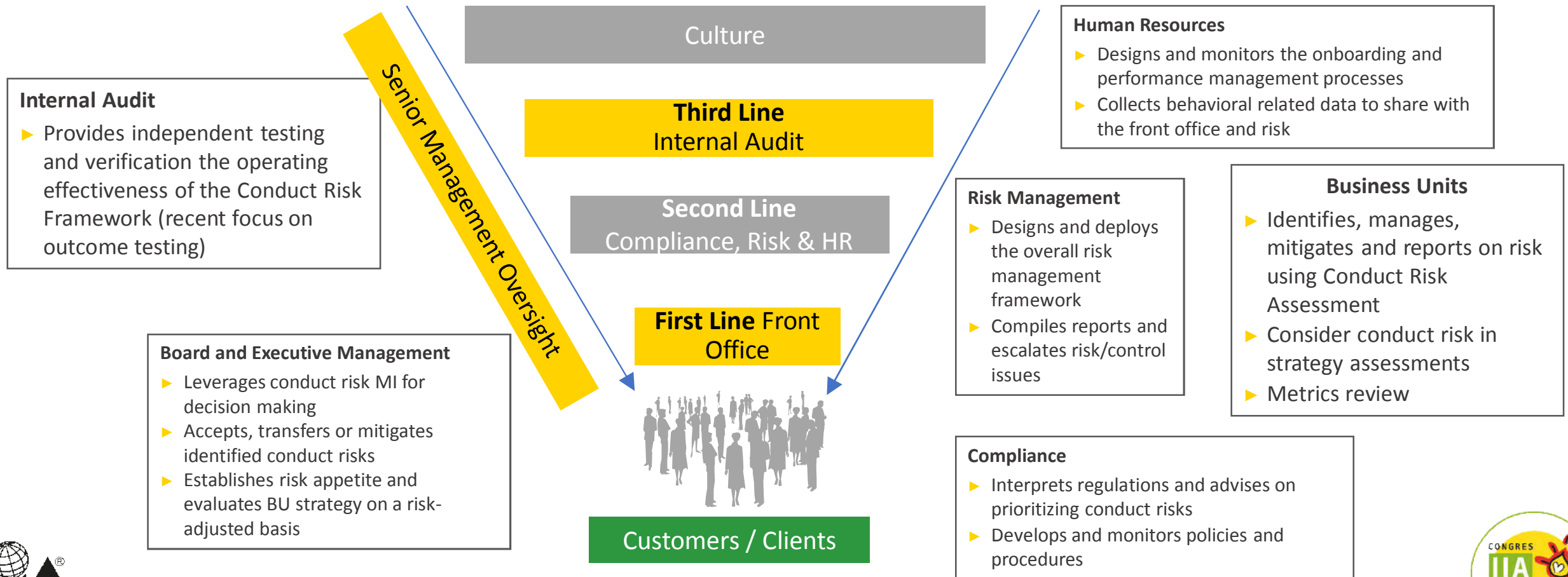


## Important notes:

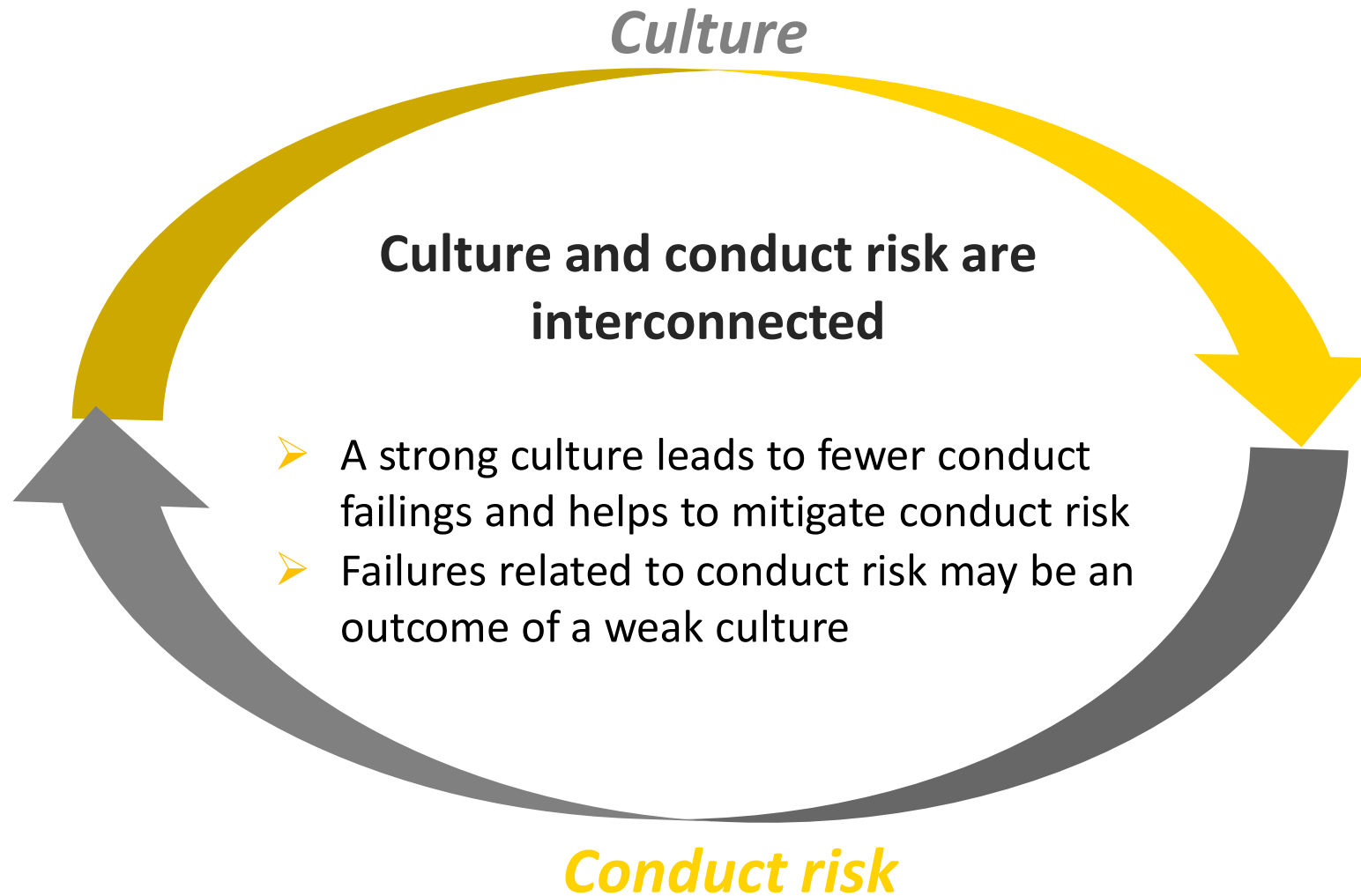
- Align conduct risk with ERM framework
- Set a risk appetite for conduct risk
- Align conduct risk with mission statement

# Delivering and embedding a Conduct Risk framework is the responsibility of the business...

Conduct should never be 'outsourced' to the risk functions....

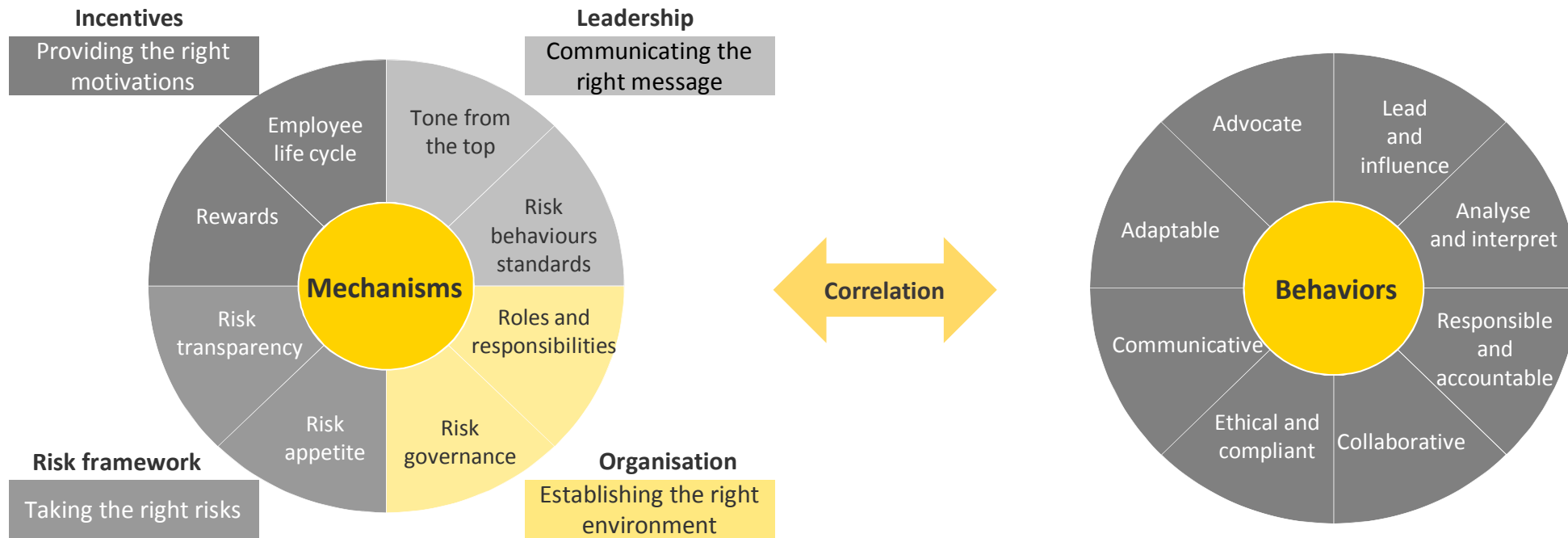


# Embedding conduct risk in the risk culture



# View on EY's risk culture framework

Strengthening culture includes using  
**culture mechanisms** and **enforcement of behaviors**





# ➤ Conduct risk & Internal Audit – Research results

# How would you respond to these questions?



Do we have a framework in place to manage, measure and analyze our Conduct Risk exposure?



Are we confident we nurture the right culture of risk awareness and business ethics?



Do we have adequate controls in place, and are they effective?



What is our definition of Conduct Risk?



Do we understand those “moments that matter” particularly prone to Conduct Risk?



Do we have early-warning indicators for misconduct in place?



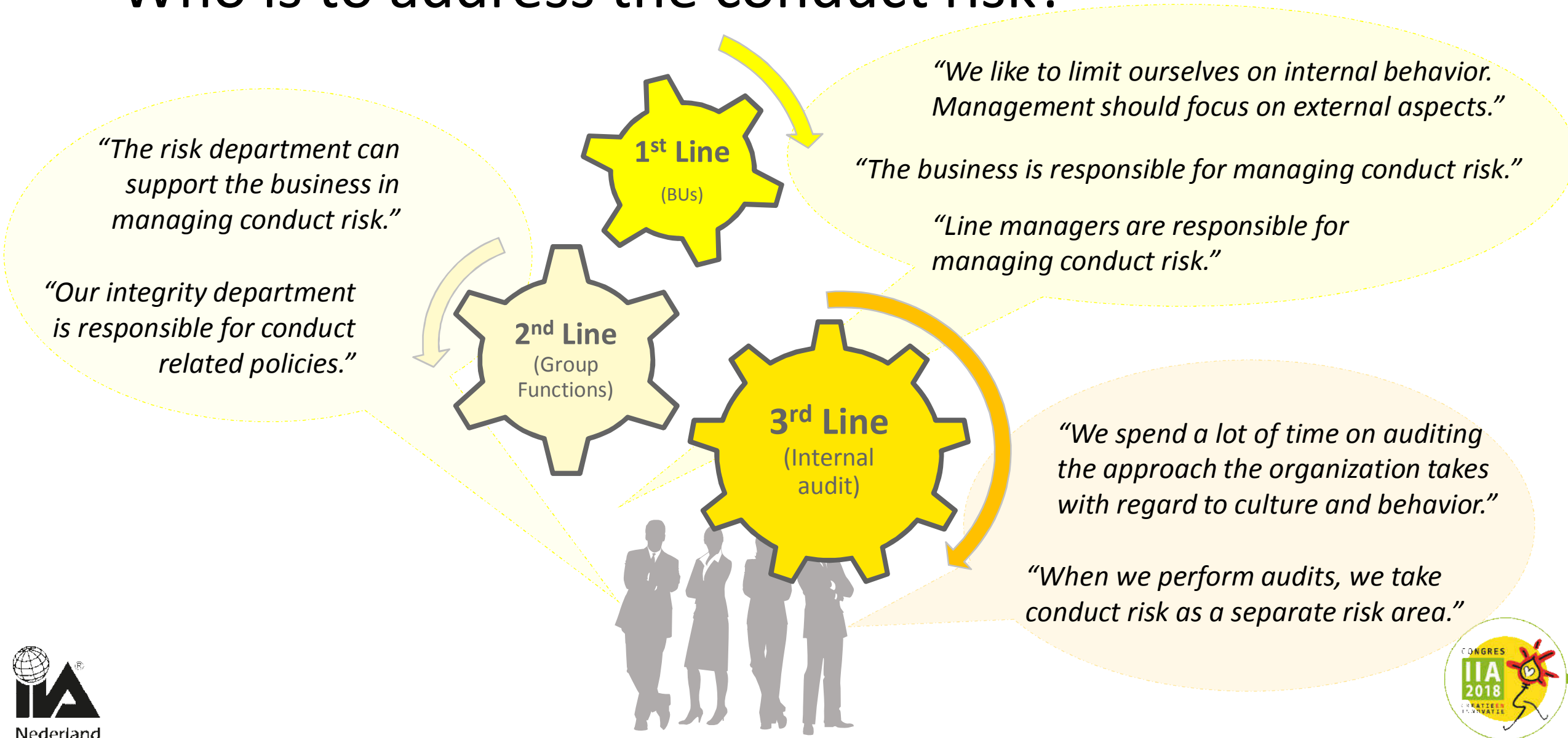
Do we have appropriate data in place for implementing predictive controls?



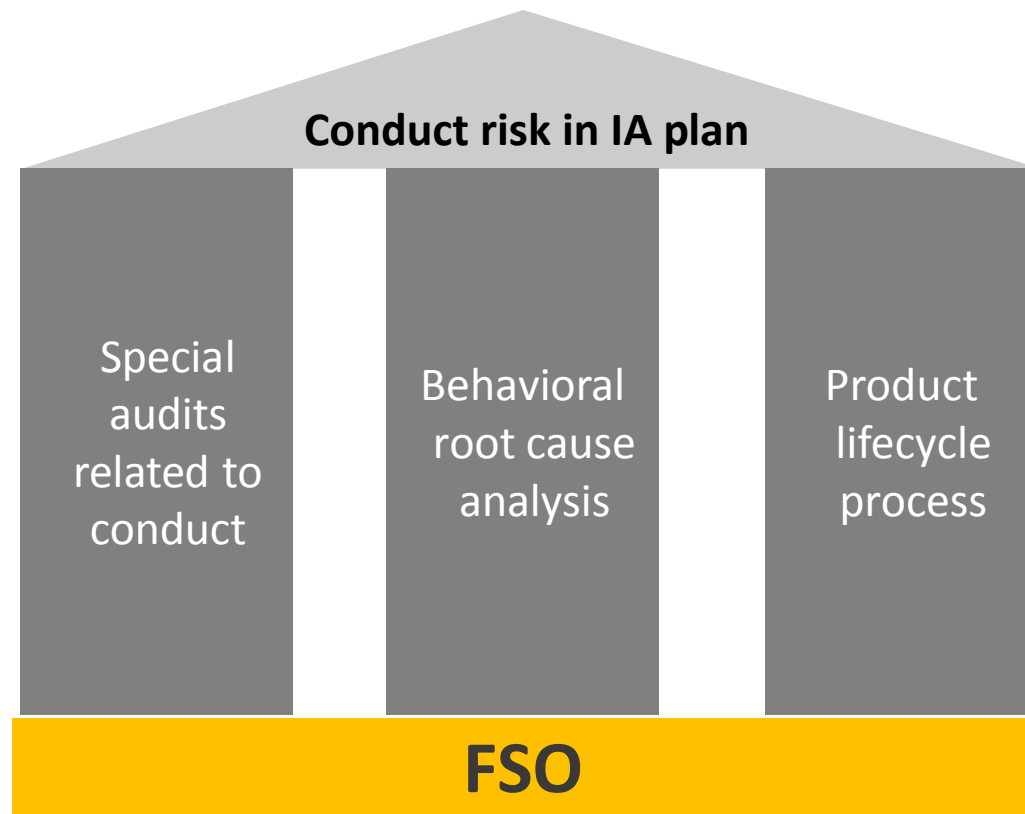
What is our Conduct Risk appetite?



# Three lines of defense: Who is to address the conduct risk?



# How do you address conduct risk in the audit plan?



# How do you react to conduct risk?

## FSO

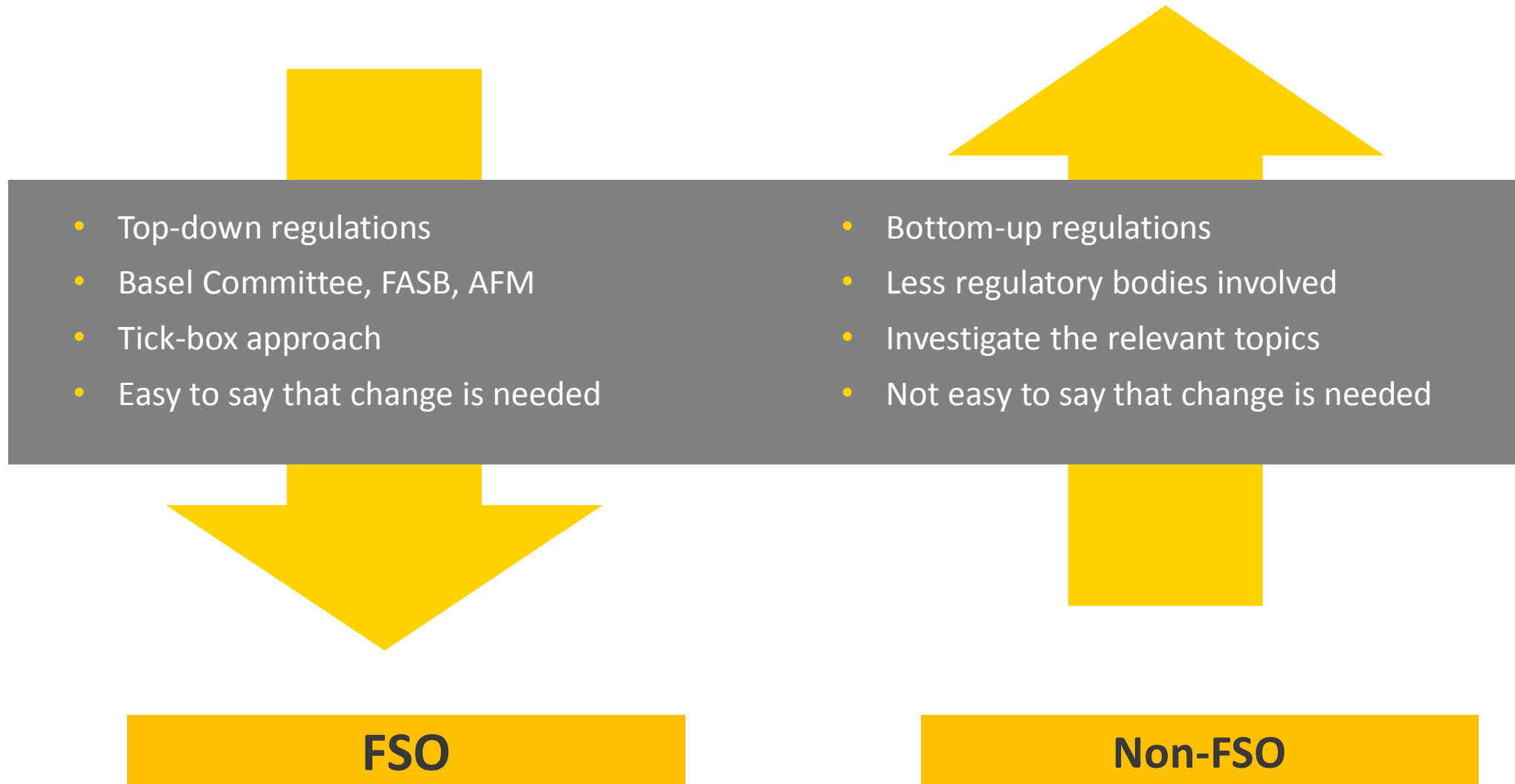
- ▶ Proactive
- ▶ Forward looking perspective
- ▶ “We need to be ahead of the curve”



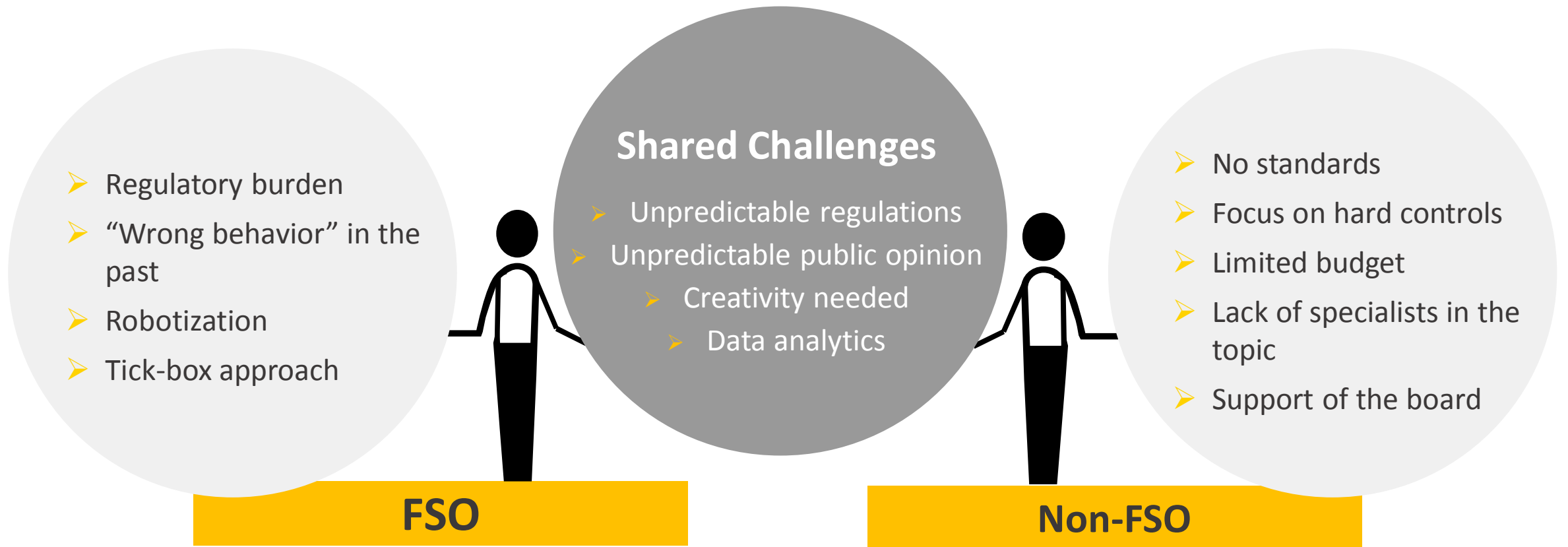
- ▶ Reactive
- ▶ Backward looking perspective
- ▶ “We only do audits on culture and behavior when it turns out to be a key risk”

## Non-FSO

# What is the foundation for your approach to conduct risk?



# What are your challenges for the future?



# ➤ Conclusions & Recommendations



# Research conclusions

**Large difference between industries**

**Conduct Risk areas are evolving, encountering challenges**

**Priorities not always clear**

**Internal Audit Department in the  
right place to tackle developments**

**Increasing importance of data  
analytics**



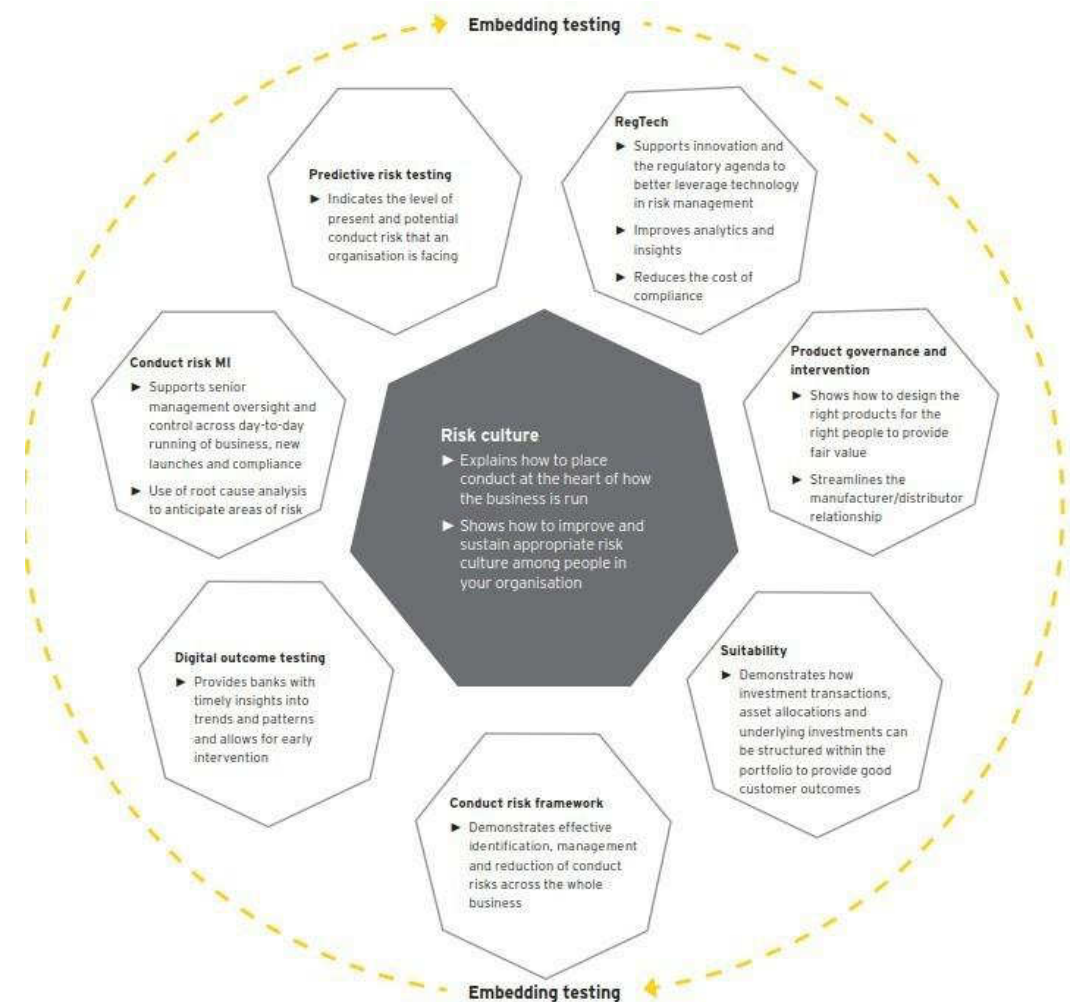
# Recommendations

## Lessons learned

- Need to establish robust framework to manage conduct risk.
- Beyond regulation: to be embedded in strategy, values and culture.
- More and more forward looking: greater emphasis on reporting and data analytics.

## Role of the IAD

- Managing and mitigating conduct risk integral part of IA plans
- Asses whether controls in place are adequate and effective to mitigate risk
- Assess whether the organization has the right forward-looking view



**Learn from each other!**

➤ Your questions?



# THANK YOU!

