

# The Ethics and Conduct Challenge for US Banks: Learning from the UK Experience

A large, stylized orange arrow pointing to the right, with a slight 3D effect and a shadow.

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A pink infographic titled "REGULATORY" in white capital letters. It features two icons: a bar chart on the left and a line graph with an upward-pointing arrow and a magnifying glass on the right. There is also some small, illegible text below the icons.

REGULATORY

A pink infographic titled "BANKING" in white capital letters. It features two icons: a padlock on the left and a magnifying glass over a document on the right. There is also some small, illegible text below the icons.

BANKING



# RISK MANAGEMENT



Banking regulations have proceeded at a fast pace around the world since 2008, but not at the same pace in every jurisdiction. In the UK, for example, the Financial Conduct Authority (FCA) was one of the first regulatory authorities to recognize that culture (or lack of culture) was a major contributor to misselling as well as the source of many of the problems that caused the market meltdown in 2008 and the FCA started to aggressively push banks to change employee behavior.

As a result, UK banks have been forced to define what conduct means for them, and these banks have matured significantly on this front. They have completed initial diagnostics, designed performance indicators, and revamped policies, processes and controls.

We expect US banks to undertake a similar journey. This paper explores lessons learned from the implementations in the UK and how this might affect what financial services firms in the US should do.

The same elements stressed by UK regulators—including culture, conduct and ethics—are the focus of regulators seeking to effect changes in the US banking system. To date, US regulators have issued both formal regulations and informal policy guidance on these subjects, and regulators including the Federal Reserve Bank of New York, the Department of Justice, the Securities and Exchange Commission, Financial Industry Regulatory Authority (FINRA) and the Consumer Financial Protection Bureau (CFPB) are stepping up their efforts.

In this environment, US banks should emphasize customer-centricity and cultural change, not only to avoid legal and regulatory risk, but more importantly, to help drive lasting customer and, ultimately, shareholder value. Banks are responding to regulatory pressure, but they are also seeking to improve their competitive position, to attract and retain clients and customers, and to protect themselves from reputational damage. And, of course, they hope to avoid costly litigation and fines.

We believe that US banks can apply lessons learned from the UK banking experience, both to make their regulatory and compliance-related activities more effective and more efficient and use this as a platform to differentiate themselves in clients' and customers' minds. To accomplish this, US banks should look closely at the conduct journey that UK banks have undertaken.

# The Expanding Conduct and Ethics Agenda

Over the past three decades, regulators' concerns with banks have expanded dramatically, from a rather narrow focus on corporate governance to treating customers fairly.

After the global financial crisis of 2007–2008, however, regulators began to address broader issues, including banks' market conduct, the suitability of products sold to specific customers, and a culture that rewarded excessive risk-taking with little accountability on the downside. Banks themselves became highly aware of the need to rebuild customers' trust and to protect their reputations.

Due to the interconnected nature of these concerns, regulators have continued to expand their agendas as they relate to ethics and conduct. From our analysis of existing regulations, banks are now expected to embed a culture of customer-centricity; to review their business models and strategies to put customers' interests first; to have

senior managers take personal accountability for what happens; to protect and encourage "whistle blowers" and people inside the organization who point out wrongdoing; to monitor customer complaints through traditional channels and through social media to spot signs of improper practices; and to protect potentially vulnerable customers from harm. In our view, financial services firms that do not embrace this change not only open themselves up to large regulatory fines but also to legal actions in the form of lawsuits filed on behalf of their customers.

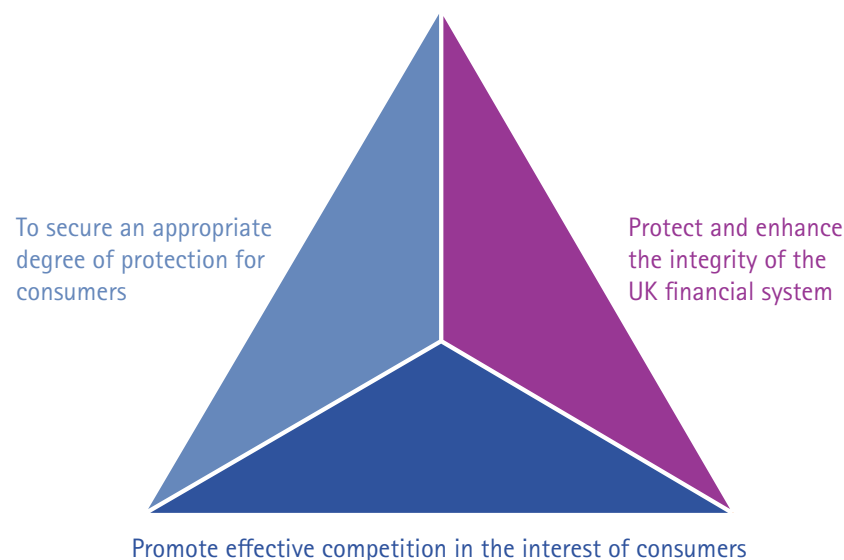
In 2013, the UK implemented a new regulatory structure that established the Financial Conduct Authority as the specialist regulator with the responsibility for conduct of business. It has both

enforcement and advisory capabilities and conducts supervisory work as well as issuing regulatory guidance to firms. As shown in Figure 1 below, the FCA also highlights key conduct risks to firms in its annual risk outlook, and has the power to ban any product or promotion it believes could be detrimental to customers' interests.


The FCA is supported by the Financial Ombudsman, who deals with disputes between banks and customers and produces reports on causes of customer complaints, and by the Information Commissioner, who provides guidance, monitors data privacy and responds to any breaches of the Data Privacy Act. In addition, the Prudential Regulation Authority (PRA), whose role is to protect and improve the stability of the UK financial system, supports the FCA wherever conduct poses a systemic risk.

The new regulatory approach has led to sweeping changes in UK banks' conduct. The Financial Services Authority's Retail Distribution Review (RDR), for example, forced all financial advisors to disclose fees and charge customers separately for services. Furthermore, these advisors must now describe their services clearly as either independent or restricted (meaning they are making advice based on a review of part of the products available in the market rather than all relevant products). Financial advisors are no longer allowed to accept fees from the firms whose products they are advising their customers to buy without disclosing this to the customer up front. In addition, these investment advisors must adhere to consistent professional standards, including a code of ethics, and must undertake continuing professional development to maintain their competency to advise the public.

Figure 1: The Objectives of the FCA



Source: Accenture analysis based upon publicly available documents, February 2016



Other measures have changed the way UK banks can promote their services in the digital channel. The FCA has made it clear that the rules for printed promotions apply even for social media posts where the content is restricted. FCA directives now require that an authorized person must approve all financial promotions (including social media posts on social media channels), and communications supporting any promotion must contain details about the firm. Information must be accurate, without an undue emphasis on benefits over risks, and must be phrased in a way that is understandable to the target market.

New UK regulations are not limited to customer-facing activities. Banks find themselves having to establish compensation policies which are not only consistent with but which actually promote risk effective risk management. Compensation is to avoid any conflicts of interest and prevent outcomes that are to the detriment of the customer or to the stability of the firm. Similarly, firms are to identify specific senior management responsibilities and how these responsibilities are assigned to named individuals, and to certify those individuals who pose material risks to the firm or to its clients and customers.

# The UK Experience

We believe that US banks can learn lessons from the UK experience to avoid problems with regulators but also to establish points of competitive differentiation.

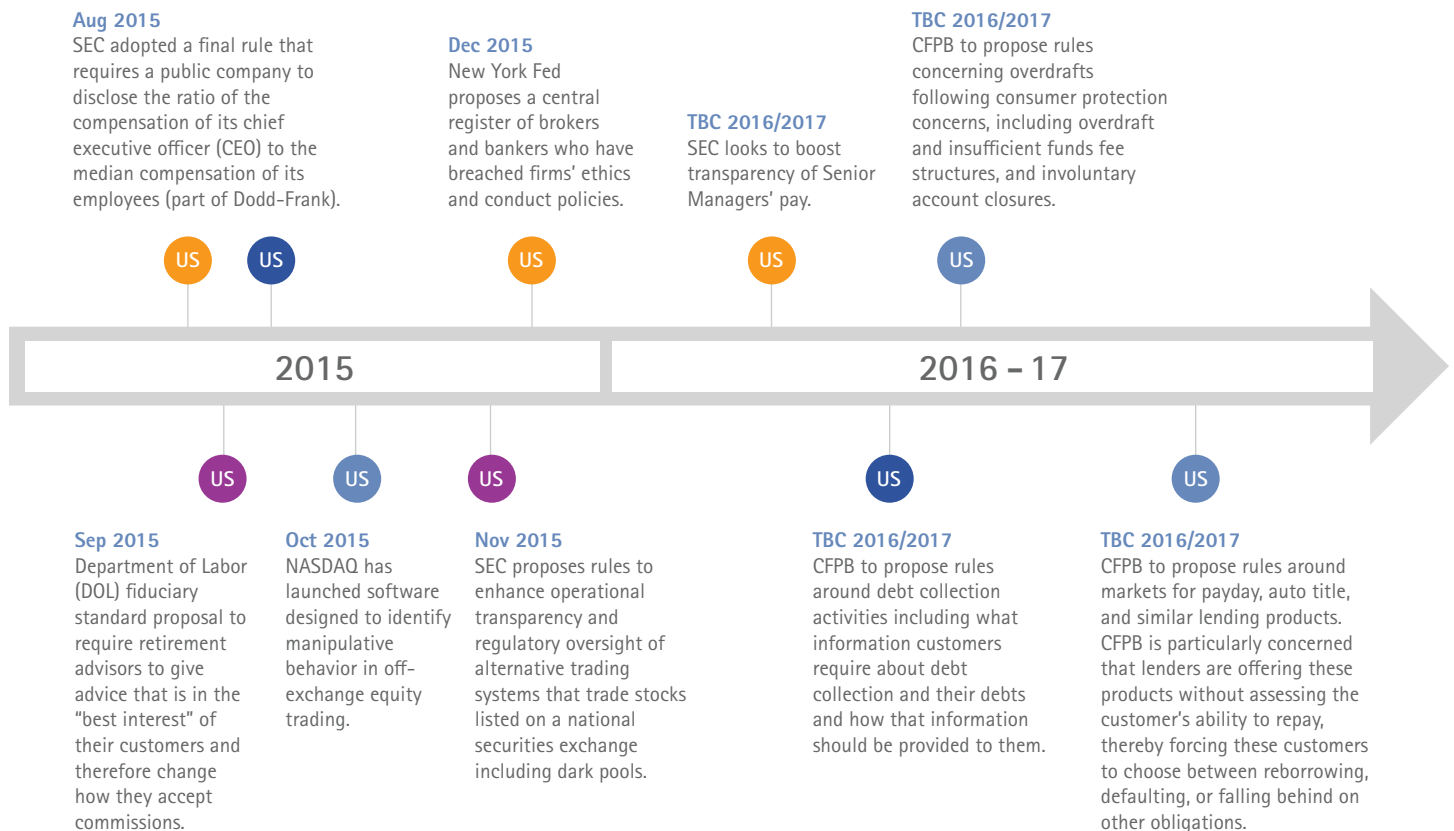
We anticipate that US regulators will adopt many of the UK conduct regulations and guidelines as they have been used as a model by other regulators around the world and are considered to represent preferred practice, with the FCA regarded as one of the most mature regulators in this space.

To help US financial institutions cope with this risk and to determine how best to respond we have reviewed regulatory white papers, speeches, press releases, and media articles to identify the key conduct themes likely to be most prominent in the US.

As seen in Figure 2 below, US regulators have different perspectives and concentrate on different themes, but there are extensive overlaps with the UK.

**Figure 2: Summary of Key US Conduct Regulations and Guidelines – 2015 to 2017**

Regulatory drivers continue to advance the agenda beyond a narrow focus of "tone from the top" and remuneration.



**Key Themes:** ● Personal accountability ● Informational needs ● Misselling ● Market conduct

Source: Accenture analysis based upon publicly available documents, February 2016

We have identified five themes the UK regulator and banks have been dealing with for some time, and which we now see the US regulators prioritizing.

## Cultural change

At the core of managing conduct risk is the firm's culture. A poor culture may be the result of a firm's management creating incentives for short-term profits, or reflect the pursuit of rapid growth at the expense of customer benefit. US regulators are now looking for mechanisms to improve compliance with the "spirit of the law," above and beyond strict adherence to the "letter of the law." For example, FINRA have set out in their 2016 priorities that they will formalize their assessment of a firm's culture while continuing their focus on conflicts of interest and ethics.<sup>1</sup>

In the UK, firms have taken drastic steps to effect real change in how they conduct their business. For example, they have changed their operating models as well as their commission and fee structures, and they have reviewed and reconsidered sales targets, bonuses and criteria for promotion to make sure staff do not have incentives to sell the wrong products or products customers do not really need.

In addition, most UK firms now conduct screening to hire staff with the appropriate values. They also have designed induction processes to teach new employees about their culture. New practices such as quality assurance checks on sales calls have been instituted to improve customer outcomes. When any breach occurs, action is taken and recorded, with management monitoring this data closely.

## Personal accountability

Employees need support in understanding their responsibilities and senior managers need support in taking responsibility for what occurs within the firm. In the US, regulators are focusing increasingly on individual accountability and on senior managers in particular. For example, the Federal Reserve Bank of New York (FRBNY) has proposed that, when traders or bankers leave a firm, any instances in which they have violated the firm's ethics or conduct rules would be listed on a central database.<sup>2</sup>

The UK is implementing the Senior Managers Regime—with related certification—which sets out steps for staff at all levels from chairman to junior employees. Under the regime, all senior managers will have clearly defined statements of responsibility, with responsibilities mapped to produce a clear understanding of who does what within the firm. What this implies is that firms have greater responsibility for vetting candidates for senior management, for conducting annual reviews of their performance, and for producing documents that show, when a senior manager steps down, that the individual has exercised his responsibilities and identified potential problems for his replacement.

We expect US firms will need to look more closely at performance management, governance procedures and information, and the training given to senior management on ethics, conduct and emerging risks and how that drives the culture of the firm. Roles and responsibilities should be clear and documented, with potential gaps identified. In addition, firms should have a clear plan for detecting, dealing with, recording and reporting breaches of ethics.

## Misselling

Many business models, strategies and operating models can lead to bad customer outcomes due to embedded conflicts of interest. FINRA has cited sales practices as a key area of focus, with concerns including seniors and vulnerable people, product features as well as sales and/or distribution practices.<sup>3</sup> Complex products are to receive particular attention. Throughout 2015, there were numerous enforcement actions against banks for poor practices including hidden fees, inadequate communication of risks and lack of transparency. This is a major source of reputation as well as legal and regulatory risk and can also lead to substantial fines.

In the UK, regulation of sales practices has become quite mature, partly as the result of a number of misselling scandals. For example, firms are now required to review business strategies and operating models to consider conflicts of interest, and they can no longer offer incentives to staff based on sales figures. As well, commissions are to be clearly explained and, in some cases, are not allowed; users pay for advice instead.

We are seeing staff trained on product risks, features and target markets. Firms are also encouraged to use technology-enabled suitability assessments that prompt questions and identify risks.

UK firms have also been grappling with how to best identify and support vulnerable people.<sup>4</sup> As vulnerability can be temporary or permanent, firms should consider their product portfolio and end-to-end customer journeys to identify challenges and consider where action is required to support these customers. For banks, keeping the best interest of clients and customers in mind, rather than just driving shareholder value, should be a guiding principle.

The Office of the Comptroller of the Currency (OCC) has identified that its large bank supervision will focus on (among other areas) assessing banks' effectiveness in identifying and responding to risks posed by new products, services, or terms.<sup>5</sup> US banks will need to review end-to-end sales practices to deliver the right outcomes. Key considerations include identifying the target market for products and who they are and are not suitable for, incentives offered, potential conflicts of interest, and customer communications. Based on the UK experience, US banks should look at whether their technology supports the disclosure requirements—including fees—and whether staff has been trained as to product features, risk and target markets. Finally, plans should be in place to review complaints for early warning signs of potential problems. This assumes that banks are able to collect data indicating that there is a problem. Our experience indicates that this type of data is often missing in many institutions, meaning that senior management is not aware of how its sometimes-aggressive performance targets create bad behaviors.

## Market conduct

The focus on insider trading continues, but regulators' attention is widening to address any information leakage and conflicts of interest. FINRA has identified market integrity as a key area of focus, including both a review of fixed income (including wash sales, marking the close and trading ahead) as well as looking at the wider issues of cross-market and cross-product manipulation.<sup>6</sup>

High volumes of data and the various permutations of market conduct require effort to understand and to monitor efficiently. It is easy to miss key alerts and just as easy to spend time reviewing false positives. In the US, regulators have stepped up enforcement activities against both firms and individuals for market abuse and insider trading. They are also looking at possible weaknesses in compliance programs.

Regulators in the UK have been focused on market conduct and have stressed the need for increased personal accountability—with minimum standards for training and qualifications—as well as developing forward-looking conduct risk identification methods. Firms have been advised by the FCA and PRA of the need to identify root causes of conduct problems and how issues identified in one area might extend to other parts of the bank.

In our view, US banks should take steps to strengthen their surveillance capabilities to deter and detect abusive conduct. This includes describing how cultural change is taking place and how senior individuals will be held accountable for risks taken. US banks should also prepare themselves to explain what trades are being monitored, the scope of their electronic surveillance, the number of false positives and how all of this information is reported to management.

## Information and social media

On January 11, 2016, the Securities and Exchange Commission (SEC) announced its Office of Compliance Inspections and Examinations (OCIE) 2016 examination priorities, one of which was product promotion.<sup>7</sup> Different clients and customers have different communication needs and the channel used—whether face-to-face, by telephone or online—means a “one size fits all” approach is rarely appropriate. In the UK, regulators are reviewing digital advice to make sure customers' information needs are being met while data privacy is safeguarded.

There are similar implications for US institutions. For example, firms should develop communications with the customer's interest in mind, and that information should be presented clearly even in small-screen digital platforms such as mobile phones. Communications should be tested by real customers including those with higher information demands, such as seniors. Customer protection groups can provide useful insight to help develop clear language and visualization.



# Lessons for US Banks

UK banks have been implementing mandated changes throughout their operations, with varying degrees of success.

Our experience has shown that firms with the most successful experience have had certain features in common, including:

## Involvement of senior leadership

Strong and visible senior leadership commitment helps push through change at big, complex organizations with large books of regulatory change. This should include business heads and board members as well as heads of compliance.

## Careful gap analysis

It is helpful to identify and understand where gaps exist between the current state and where the banks want to be. This needs to include a review of the business strategy, including products and distribution channels.

## Operating model change

Firms should be prepared to make changes in how they operate, to be customer-centric and establish and maintain desired behaviors. This means considering how and when to charge customers, how to incentivize staff, and considering where conflicts of interest arise in the business and how to manage these.

## An effective change management process

Good change management includes regular communication with stakeholders as well as effective training, including real examples and in-person discussions. Change teams can be key to identifying influencers and overcoming any resistance to change.

## Considered customer behavior

Firms can gather intelligence on real customers' behavior by using tools such as behavioral economics, behavioral insight from data held within the bank, and/or the sample customer group testing to understand how customers actually behave. The intelligence gathered can be used to redirect promotions and communications toward a positive outcome. "Nudges" could include texting customers to alert them before they become overdrawn or providing data-fed visualizations to show customers how their savings are aggregating towards their personal financial goals.

## Effective use of technology

End-to-end solutions can support conduct monitoring and production of management information, while utilizing technology to provide reminders to help change staff and customer behavior. Examples include helping to improve transparency and supporting disclosure of fees, reminding staff of the risks associated with the products being sold to customers, and/or identifying products that are not utilized as expected.

## Invest in programs driving a strong culture

This starts with analyzing the firm's current culture to best determine how to drive change; for example, a consensus-driven culture versus a mercenary culture requires different performance incentives and controls to avoid putting the bank and its clients and customers at risk.

# Preparing for the Conduct Journey

By building upon the experience of UK financial institutions (as seen in Figure 3 below), US firms can prepare themselves for the transformative journey which the new regulatory environment will require.

In the initial stages, firms can establish their values and strategy, conduct risk assessment (including product risk assessment) and determine whether the current business and operating models deliver outcomes that benefit clients and customers as well as the institution itself.

Additional preparatory work includes the development of data policies, as well as processes and standards for the creation, review, testing and approval of customer communications. The firm

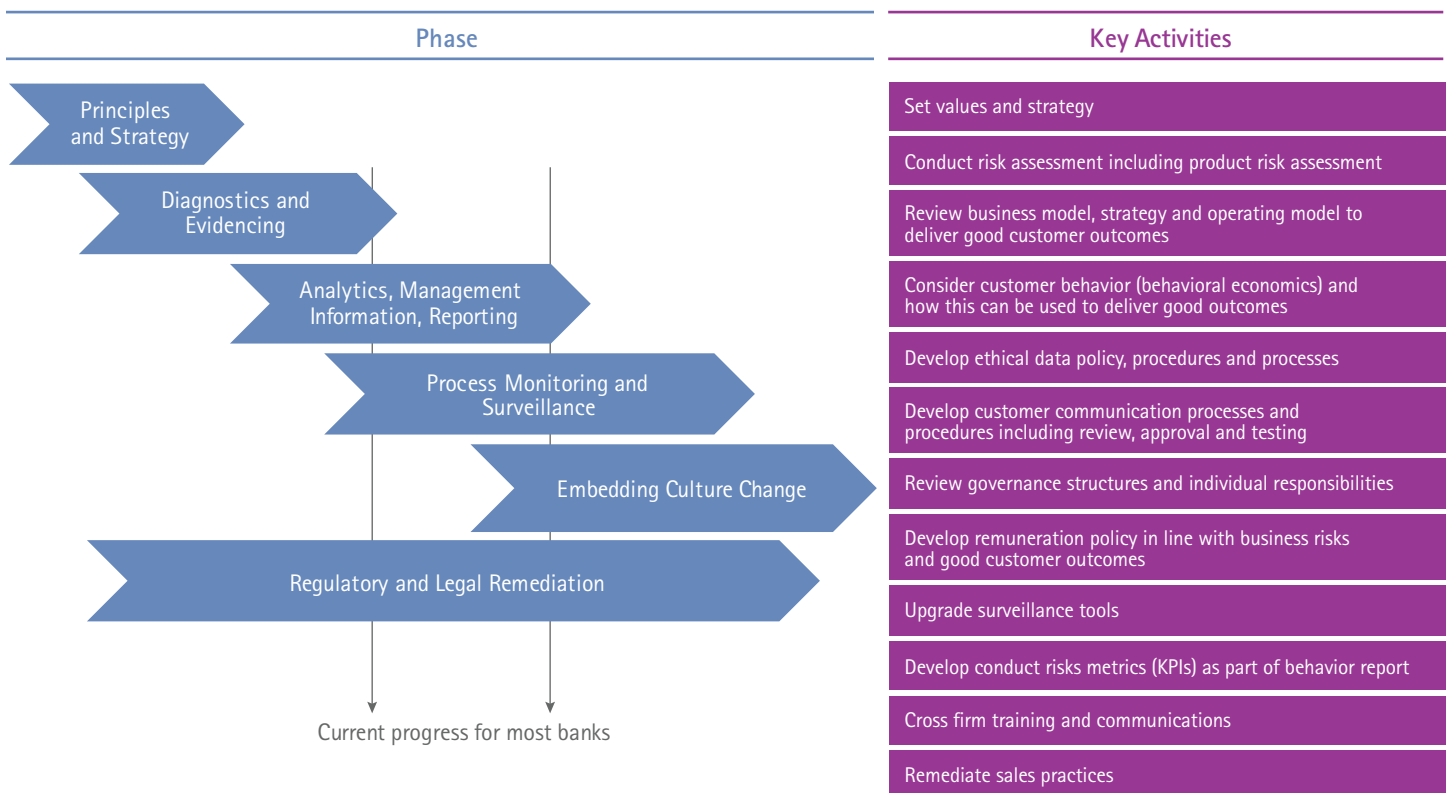
should review its governance structure and make sure that individual responsibilities are clearly defined and articulated. Compensation policies should not reward undue risk-taking and should align with customer interests.

Once these foundational elements are in place, the firm can concentrate upon upgrading surveillance tools, developing conduct risk metrics and/or key performance indicators for regular reporting, and training initiatives.

As the UK experience has indicated, an active, collaborative approach to culture and conduct transformation can do more than help banks avoid regulatory problems. Successful programs can help banks re-position themselves with customers and regain the trust and confidence needed for steady, profitable growth.

**Figure 3: How UK Banks Responded to the Conduct Agenda**

Industry responses varied according to three imperatives: response to Regulator/Monitor enquiries (e.g. FCA, FRBNY); remediation of prior misconduct; or ramping up for future steady-state compliance.



Source: Accenture, February 2016



CONDUCT  
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## About the Authors

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Anne Godbold is a Manager in Accenture's Finance & Risk Services and has deep experience in conduct, anti-bribery and corruption, fraud investigations, anti-money laundering and sanctions compliance as well as conduct-related regulations and regulatory guidance. She has worked with leading financial institutions to address regulatory change and its impact on people's behaviors and ways of operating. Anne's research paper, "Ethical Innovation in Finance" was recognized during the fifth Ethics in Finance – Robin Cosgrove Prize awards ceremony in 2015.

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