Conduct Risk is an ever growing area of focus for the FSA – firms are starting to look again at how they proactively manage this risk area

Essentially, Conduct Risk has developed from the FSA's strategy of Treating Customer's Fairly (TCF). Whilst it is expected that TCF is fully embedded within firms, and firms have in the main demonstrably applied resource to do so, Conduct Risk in today's world goes far beyond what has been expected of firms in the past.

The evidential standards demanded by the regulator are now far higher than previously expected – detailed supervisory reviews will be performed across firms, and the direction of focus now includes the operation of firms further up the value chain rather than just testing consumer outcomes after the point of sale.

This article looks at the key components of Conduct Risk today, which are namely:

- TCF as the back-drop
- The FSA Core Conduct Programme – core modules, new order of regulatory monitoring, the new response required
- Product Intervention
- FSA Retail Conduct Risk Outlook
- Conduct Risk implications

In short, we are now witnessing a far more interventionist FSA and firms must understand the implications of this in order to reflect on the management of Conduct Risk in order to satisfy the regulator and receive a good supervisory outcome.

TCF as the back-drop

The FSA's approach for Treating Customers Fairly (TCF) is the starting point for what is now referred to as Conduct Risk. There are six central pillars to TCF that the FSA expects firms to consistently deliver:

1. Fair treatment of customers central to corporate culture
2. Products designed to meet needs of identified consumer groups & targeted accordingly (retail market)
3. Clear information & kept appropriately informed before, during & after point of sale
4. Suitable advice geared to circumstances
5. Product performance & service standards in line with what led to expect
6. No unreasonable barriers to changing products or providers, making claims or complaints

Firms need to continue to monitor their adherence to these central themes on an ongoing basis and demonstrate they have dealt with any gaps identified. Although TCF is not new it remains a live issue in many Risk Mitigation Plans (RMPs) that firms receive. The key current issues that firms should be aware of are:

- TCF culture in your firm - Do you have a culture where challenge is welcomed and the customer's position and risks are taken consistently into account?
- TCF governance & systems – Is there evidence of challenge at both board and lower level meetings, and are your tolerances for action/inaction satisfactory?
- TCF MI – is it qualitative & quantitative and are you satisfied that your MI is robust and clearly marks where action should be taken?
- Your products – can you demonstrate that they are designed to reflect TCF thinking as it develops and are consistently appropriate for the target market?

Core Conduct Programme

The Core Conduct Programme (CCP) will shortly be rolled-out by the FSA as its main supervisory tool to assess conduct. Initially this is focussed on the largest firms; however the intention is that this will become the model for monitoring all firms on their conduct of business. The CCP takes the principles of TCF to a new level.

The CCP is referred to in the FSA Business Plan 2010/2011 – "Delivering consumer protection". It is designed to deliver:

- Intensive supervision to ensure firms are treating customers fairly
- Increased focus on identification and mitigation of risks before consumers suffer adverse outcomes
- Testing of product design and product governance arrangements.

The FSA sees the CCP as providing a more consistent supervisory framework to identify emerging risks earlier, with increased focus on the whole life cycle of products and more attention to product development and design. Firms will need to demonstrate how culture, retail strategies and controls deliver fair treatment to their customers. The CCP forms the basis of the FSA's 'intensive & intrusive' supervision model where there will be deep dives into major conduct related areas. There will be a strong focus on the culture and behaviours firms display, stronger remediation and enforcement strategies, and firms will be expected to provide evidence and examples to questions posed. The CCP is structured around five core modules:

- Business model analysis
- Culture, governance & controls
- Product development & approval
- Sales
- Post sales handling.

It will therefore bring new challenges and issues to firms and requires a new response to regulatory scrutiny. It also drives new evidential requirements and necessitates additional focus and oversight. The key impacts are likely to include:

- Governance arrangements – are they robust and do they cover the end-to-end product development process?
- Conduct Risk management – do you learn from the results of testing that you do and can you evidence this?
- People/Processes – are various roles clearly defined and do they cover the balance of appropriate considerations and regulatory expectations?
- Product suite, product testing and revalidation – do you know how to satisfactorily identify issues within products, and on what basis changes should be made?
- Propositions and trading partners – do third party and service-level agreements cover all the risks involved in the process and are issues escalated appropriately?
- Systems and controls – do these cover the balance of risks involved and are identified issues satidfactorily dealt with?

Product Intervention

Following on from the CCP there has been a marked increase in focus on product governance by the FSA as can be evidenced by its recent product intervention paper (DP 11/01). The interventionist approach by the FSA aims to anticipate consumer detriment where possible, and stop it before it occurs. This approach involves scrutinising the whole of the product lifecycle from start to finish rather than just focusing on the point-of-sale. The paper also sets out a range of future interventions that could be introduced in areas where the potential for customer harm is greatest. These might include interventions such as banning products or prohibiting the sale of certain products to specific groups of customers. Very recently, press reporting has suggested that the Financial Conduct Authority (FCA) may well be conferred powers to ban products or limit their distribution.

It is therefore clear that the FSA/FCA will, where it finds that poor outcomes may occur, consider specific actions including product bans, price interventions, consumer warnings, and further competence requirements for some products. Clearly there will be reputational and commercial impacts to firms if such actions are invoked.

We also understand that concerns have been raised around possible FSA endorsement of products and that possible 'kite marking' carries risks as well as potential benefits.

Retail Conduct Risk Outlook

The FSA has also recently published its 2011 Retail Conduct Risk Outlook. This focuses on the risk that the behaviour of firms will lead to poor consumer outcomes and provides examples of current, emerging, and potential risks.

The table below provides detail on some of the retail themes that are on the regulatory radar both now and in the future. Firms should be asking themselves whether they are fully satisfied with their position in these areas.

Current risks	Emerging risks	Potential risks
PPI	Reward policies	Packaged accounts
Unfair contract terms (mortgages)	Banking conduct	Cross selling
Mortgage arrears	RDR transition	Protection products (CIC / IP)
Complaints handling	Investment risk profiling	Bundled inv / deposit products
Structured investment products		
Structured deposits		

Conclusions

Conduct Risk is a critical area both for firms and the regulator. The FSA will increasingly be looking further up the value chain at how firms develop and approve products, and how they ensure they are fit for purpose over time. Governance is also a key area in terms of assessment of culture and also how firms learn and develop over time.

Firms are looking at the implications of this new focus and reflecting on how they can future-proof their businesses against the regulator's expectations going forward.

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