Introduction
Conduct risk is defined by the International Association of Insurance Supervisors ("IAIS") as "the risk to customers, insurers, the insurance sector or the insurance market that arises from insurers and/or intermediaries conducting their business in a way that does not ensure fair treatment of customers." 1

As regulators make their expectations for change in the financial services sector clear, boards look for insight and customers demand a new way of conducting business, it is more important than ever to proactively embed fair customer treatment into all aspects of a firm’s activities. We have seen over the years the major reputational and business impacts that a lack of customer focus has had on firms. KPMG reflects here on the crucial need for firms to strategically align people and risk in their long-term objectives.

These reflections are important as regulators have highlighted the need for firms to embed conduct risk and a customer-focused culture into their long-term strategies. With heightened regulatory focus in the area and the constant evolution of consumer protection challenges (e.g. differential pricing, vulnerable customers and complaints reviews) it is necessary for firms to work towards providing efficient responses to potential conduct and culture risks.

In light of the tracker mortgage and other restitutions, focus has been renewed on customer treatment and global regulatory expectations have been raised in the financial services sector. The release of the Consumer Protection Outlook Report in March 2021 by the Central Bank of Ireland ("CBI") has set out the main risks facing firms in this sector. For more information, please visit our website: Dealing with Consumer Protection in 2021 - KPMG Ireland (home.kpmg). Based on our analysis the key considerations for firms include:

- **Culture:** A customer-centric culture must be developed, with consumer interests considered when designing, marketing and pricing products. Fair treatment of customers must be considered throughout the product lifecycle;
- **Robust oversight:** Firms must put robust compliance and risk management measures in place. They should have strong internal governance arrangements over their control environment and oversight of algorithms, ensuring transparency and accuracy;
- **Transparency:** Clear information must be provided to customers in a timely manner across all engagement channels; and
- **Suitability:** Firms should ensure suitability throughout the consumer lifecycle, including at the product design stage, with particular care taken to identify and manage relationships when engaging with a vulnerable customer.

In addition, the introduction of the Individual Accountability Framework ("IAF") and the associated legislation will intensify the requirements and subsequent actions for firms on these key considerations. This regime will integrate individual responsibilities to the regulatory landscape and provide enhanced enforcement actions, as well as new conduct risks for individuals and firms to consider.

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Historically, firms have failed to address conduct risk in the way they operate their business and set their strategic objectives. This can lead to regulatory actions and fines but also to reputational damage and customer loss that can impact the business for years. Conduct risk is not a new concept but one that gets a lot of focus around the globe. Below are some of the main themes being addressed globally in conduct risk:

**What is Conduct Risk in Business?**

Over the past number of years, Irish regulatory focus and legislation have been enhanced resulting in improvements in consumer protection and conduct risk management across the financial services sector. Through the Consumer Protection Risk Assessment ("CPRA") Framework, the CBI is setting expectations for firms to become fully compliant with their transparency and suitability obligations while embedding firm-wide practices in a consumer-centric culture.

These expectations are set in response to the unfair customer outcomes of some major conduct issues observed in recent years in the Irish financial services sector. These include the tracker mortgage examination, payment protection insurance ("PPI") and differential pricing review led by the CBI, as well as continuous Consumer Protection ("CPC") breaches that have reduced consumer trust in the sector.

The intention of the CPRA is to be read as a proactive solution for firms to develop a fit-for-purpose framework and reduce conduct and culture issues by addressing key areas of poor customer outcomes in business, including:

1. Lack of information transparency in sales and communications;
2. Lack of alignment between the firm and its customers’ best interests; and
3. Lack of relevant security and system investments in a fast-changing technological environment.

In order to address these key areas, firms must embed a Conduct Risk Framework in their business. The Framework in place should be a robust tool to manage conduct risk in line with the firm’s risk appetite and business model.

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**UK:** Financial Conduct Authority ("FCA") focus on Value For Money assessments of new and existing products. The Five Conduct Questions have been introduced in the UK.

**COVID-19:** Has led to more intrusive supervision and enhanced monitoring across the globe.

**IRL:** Focus on CPRA Inspections and Individual Accountability.

**AUS:** Protecting your super and putting members interests first legislation in Australia.

**AUS:** Intensive scrutiny and analysis of conduct and culture of Australia’s financial services sector.

**NZ:** Conduct risk and culture thematic assessments within life insurers in New Zealand.
Information Transparency in Sales and Communications

Information asymmetry exists in the sale of financial products when the provider of a product has a detailed understanding of the product, while a consumer is generally less well informed. It is necessary that business takes place in an environment that enables customers to make informed decisions. Customers require transparent and adequate disclosures of products or services benefits, as well as their associated costs. To that extent, firms must address their customers’ financial literacy and provide them with appropriate information as to why a product or service is suitable to their needs.

This is particularly important when firms are interacting with vulnerable customers. Financial services firms should have a good understanding of their customer population and be able to identify actual or potential vulnerability characteristics during the sales process. Vulnerabilities may not be immediately apparent when engaging with customers and customers may not offer this information freely due to its personal nature (e.g. bereavement / mental illness). Firms should provide staff with the tools to enable them to consistently and effectively identify vulnerable customers. For more information, please visit our website: [Addressing Customer Vulnerability in Ireland - KPMG Ireland](home.kpmg).

Financial innovations, such as the rapid progress of data analysis, targeted advertisement and social media marketing are creating new risks of unfair treatments and business behaviours. Firms must ensure transparency and robustness in communications, recommendations and design to provide customers with a product or service that is clear, suitable, and fair. Firms should not only adhere to regulatory requirements but truly strengthen the way they approach their business to embed conduct risk management.

Alignment between the Firm and its Customers’ Best Interests

Firms in the Irish market are facing new challenges regarding the way they align their long-term business interests with their responsibility towards consumers. The organisational structure of the firm and especially the remuneration policies must guarantee that potential conflicts of interest or excessive risk-facing are avoided and that staff act in the customer’s best interests. The cultural component in firms’ governance is a key driver for achieving good customer outcomes and is why customer value and products need to be aligned.

Regulators are still showing concerns relative to the impact of cross-selling or mis-selling on potential harm to customers. Cross-selling happens when an existing customer is sold an additional product or service while mis-selling refers to the deliberate and unsuitable sell of a product or service to a customer.

Treating customers fairly and delivering good customer outcomes is more than just a regulatory requirement, it goes hand in hand with increasing customer trust, reputation and brand advocacy, as well as helping to reach firms’ commercial goals.

Responsible business conduct must be monitored, and metrics put in place to implement best practices. If sales incentives are a driver of competition for firms, they must form part of adequate and clear structures to ensure that customer-centric behaviours are at the heart of all decisions.

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Relevant Security and System Investments in a Fast-Changing Technological Environment

Over the past number of years, we have seen increased technological innovation and digitalisation in the financial services sector. Although the new digital offerings are allowing more customers to access products and services it also increases the security risk from possible data and privacy breaches.

It is important that firms have adequate systems and controls in place to reduce the potential errors and associated costs that might arise from cybersecurity threats, fraud or mishandling of customers, particularly vulnerable groups. The ethical implications of these risks are growing for firms and therefore risk mitigation strategies must be aligned with a customer-centric approach to ensure that customers and their data are protected.

Technology and proper investments may just be the solution to embed a Conduct Risk Framework into firms’ long-term strategies. The proper use of data analysis and dedicated technology such as reporting or stress testing tools can help identify strong metrics and provide early alerts of potential threats, unnecessary costs or firm misconduct.
Managing Conduct Risk in Business

In order to meet the CBI’s (and other regulators) expectations and ensure conduct risk is properly managed, firms must embed a Conduct Risk Framework in their business. This Framework should be tailored to the needs of each firm based on size, business model and geographic reach. Firms must work within their business’ risk appetite and align their ambitions to their risk management process when they integrate a Conduct Risk Framework into their operations. The Conduct Risk Framework should be subject to board level review and regularly challenged.

The heightened focus on conduct risk across the financial services sector has increased the need for firms to take a holistic approach to managing and mitigating conduct risk. KPMG have identified six key components that need to be considered to avoid customer detriment and further culture risk. There is no one-size-fits-all solution but the areas covered in the diagram below should be a point of focus for all firms implementing their Conduct Risk Framework. It covers governance and organisation, culture and people, risk management, conduct risk strategy, continued engagement and metrics and monitoring.

**Governance and Organisation**

Conduct risk requires both a top-down and bottom-up approach. Firm-wide governance is required to ensure that frameworks are in place to support those managing the conduct risks day-to-day.

**Risk Management**

How firms classify and identify conduct risks.

**Conduct Risk Strategy**

How firms define, manage and communicate their conduct risk strategy.

**Culture and People**

Firms’ risk culture is set through the tone at the top, messaging and training. The behaviour of employees is linked to how staff are measured and rewarded.

**Metrics and Monitoring**

Key conduct management information (“MI”) and behaviour metrics allow management to develop a clearer view of areas of higher conduct risk.

**Continued Engagement**

Firms must develop and maintain the appropriate governance structures.

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**Continued Engagement**

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**Conduct Risk MI**

Appropriate MI is a crucial component of a firm’s Conduct Risk Framework. It is necessary to show the quality of the firm’s risk management process through effective reporting of key conduct risks, as well as the identification and escalation of any unexpected trends. Monitoring conduct risk not only shows where poor conduct is happening but also where good conduct is happening across your organisation.

- MI must be aligned with the key conduct risk areas and provide a clear view of overall risk management;
- MI should be used to support each key component of the Conduct Risk Framework and to connect conduct risk assessment with metrics and monitoring activities;
- MI should provide reporting based on both quantitative and qualitative analysis to explain the data; and
- MI should be proactive and use real-time data where possible.

A firm with appropriate MI will be able to identify relevant information and demonstrate that conduct risk is correctly integrated in consideration of its risk appetite and management process. The below diagram displays how conduct risk MI forms part of the firm’s overall risk management:

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**How can KPMG help?**

KPMG’s Risk Consulting experts have extensive experience in conduct risk and regulatory support across financial services including insurance sectors. KPMG provide risk and regulatory advice, proposition design, operational risk, and control optimisation services. Our team can assist on the following situations:

- Implement a Conduct Risk Framework to ensure that the risks are managed and controlled to avoid poor customer outcomes and weak market stability due to inappropriate actions and practices;
- Provide guidance on regulatory expectations and industry practice in terms of what a comprehensive Conduct Risk Framework looks like;
- Assist with design and implementation of a Conduct Risk Framework including conduct risk training;
- Assess the completeness and effectiveness of the organisations’ Conduct Risk Framework, identify any gaps and make recommendations;
- Complete a CPRA assessment within the organisation to identify areas of weaknesses; and
- Use our specially designed data-led risk assessment framework to assist clients in managing its conduct risk using quantitative data which is overlaid with qualitative key performance indicators.