



# Emerging retail conduct risks

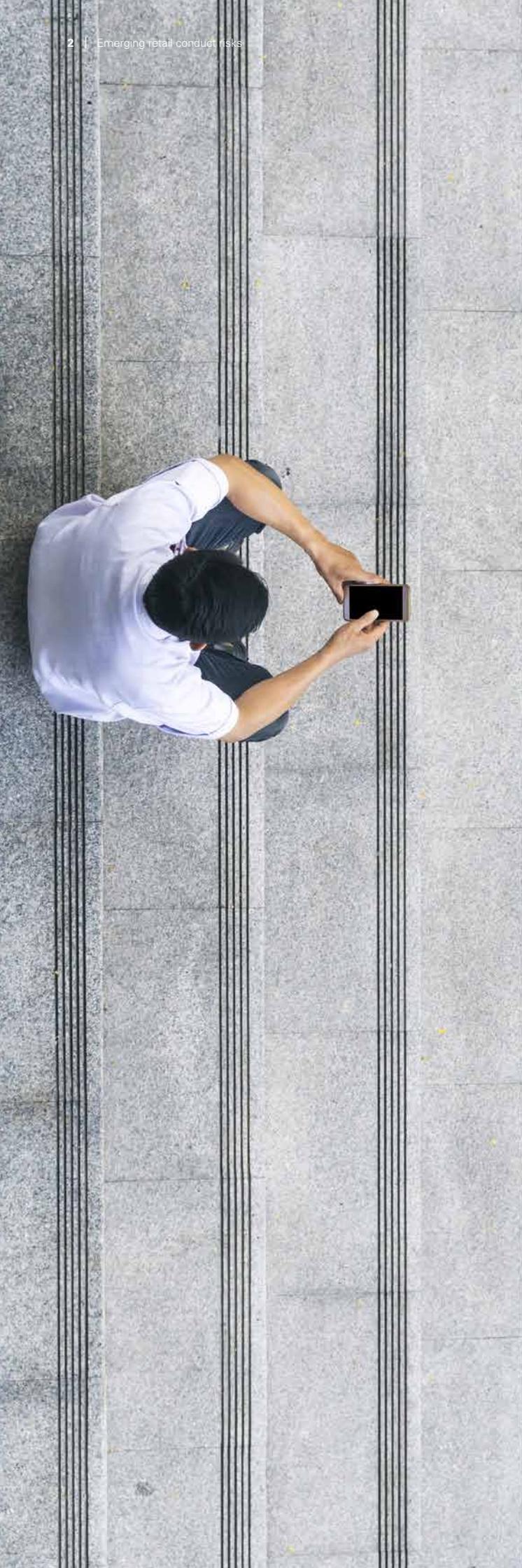
**UK firms adapt to hybrid-working**



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# Executive summary



This paper focuses on the new or heightened retail conduct risks that need to be identified, mitigated and managed effectively by UK firms to ensure that they continue to deliver good customer outcomes in the new reality of hybrid-working. All firms will, to a greater or lesser extent, adopt some form of hybrid working. For some it will be applied, as far as possible, across the whole firm, for others it will be focused on specific functions or levels of seniority. However, the risks generated are inherently interconnected and therefore firms need to ensure that they adopt a holistic approach to considering these conduct risks.

Culture will have played a pivotal role in how firms have fared through the pandemic. Firms will have developed tactical solutions to develop or maintain their culture during the extended period of remote working. As firms adopt hybrid working, more strategic and embedded solutions will be required to ensure that they have effectively balanced their own commercial interest with those of end customers – and that cultural values and customer outcomes are maintained consistently on a location-agnostic basis.

Customer vulnerability has been an emerging theme but further clarity on regulatory expectations during COVID-19 were designed to generate a step change in how firms' approach and embed consideration on the indicators of vulnerability. The FCA is seeking equity for vulnerable customers such that they are consistently able to achieve outcomes that are as good as for everyone else. Consequently, this is an area where the FCA will have sought to proactively understand how it has been embedded and how it is driving better customer outcomes as we move out of pandemic restrictions and into the new reality.

The pandemic has impacted every firms' products or services. Firms will need to reassess their products and services against the backdrop of the new reality to see whether they are still aligned to customer demand and needs. Firms will also need to reassess their product governance framework to ensure it remains fit for purpose.

Finally, looking further forward, as hybrid working becomes more normal, this should lead to further innovation and development in product and services to meet the augmented needs of some customers.

During the pandemic, the FCA has identified specific instances where COVID-19 has had an adverse impact on a product's or service's utility or value. Supported by a number of other parallel initiatives in different sectors, the FCA has moved its competition objective and the issue of value, utility and value for money out of the shadows and into the spotlight. As firms move into the new reality, there will not be a let-up in the attention that the FCA pays to this topic, especially given its high level of interconnectedness to both vulnerable customers and product governance. Although customers may be the ultimate arbiters of value, the FCA will expect firms to set up frameworks to assess fair value and where a firm concludes that a product may not be offering fair value there will be an expectation that firms take appropriate action. Firms will need to engage with end-customers routinely, robustly and objectively, in order truly to assess value. This more proactive engagement with end-customers should lead to a more balanced value exchange and improved customer outcomes.

Technology has been a significant enabler in firms’ immediate response to COVID. Out of necessity, firms have embraced and deployed technological solutions to address remote working and meet information and servicing needs of end customers. However, by implementing at such pace has meant that consequential conduct risks may not have been fully considered or mitigated. As firms move towards longer-term and more strategic solutions in moves to hybrid working, there is a risk that the impact of the technology deployments need to be re-examined in this more permanent light to ensure they remain fit for purpose and all key conduct risks have been considered.

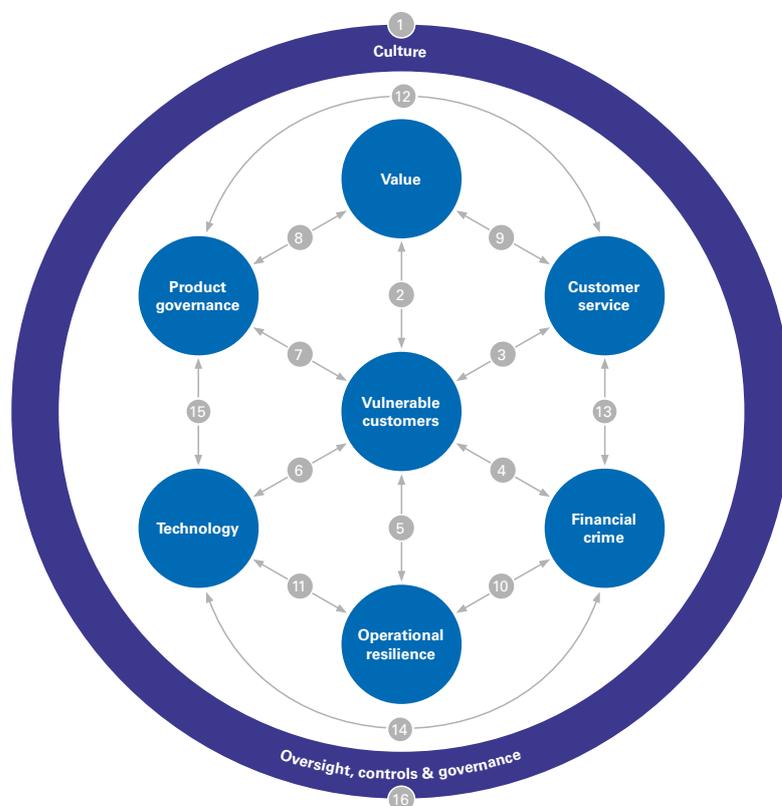
Customer service has experienced a significant increase in requests for support in response to the impact of the pandemic. Firms had developed contingency plans to deal with the wholesale move to remote working. Incremental conduct risks have been identified and mitigated. However, these tactical controls will need to be reconsidered as the firm moves to hybrid working to ensure that they remain as effective and able to deliver consistent good customer outcomes regardless of where the servicing physically takes place.

Operational resilience was a key area of regulatory interest before the pandemic struck. The pandemic proved to be a real-life stress test and firms now have the opportunity to leverage their learnings as they implement the final rules. Now that regulators have finalised their rules, firm’s more recent experience of navigating the pandemic gives them a real-life case study to help develop their implementation approach to the incoming requirements. Firms must act now to future-proof their businesses and, as they do, they need to ensure that they appropriately factor in associated conduct risks in order to minimise poor customer outcomes.

Financial crime controls have arguably been under more pressure than any others. Like other controls, firm have had to adapt them to remote working and will need to augment them again to be effective hybrid controls too. However, the broader economic impact of COVID-19 and lockdown pathways has also increased the number of businesses that are more susceptible to approaches from criminals (or motivated to commit crimes themselves). Customers are also more likely to become victims as criminals develop more sophisticated approaches.

Risk management, oversight, and controls will continue to be made more challenging, to varying degrees, by the move to hybrid work where there is a greater balance where and how risk management is actioned. Even once a hybrid risk model and oversight arrangement are developed, they will require inherent agility and it should be anticipated that further changes will be needed.

In conclusion, these conduct risks are not linear and discrete, there are inherently interconnected and therefore cannot be mitigated in a standalone or separate fashion. All the risks indicated are subject to the firm’s cultural approach as well as its overarching control environment. Culture will set the ethos and drive the manner in which the firm seeks to address these risks. Oversight, control, and governance will set the mechanism, appetite, formality, rigour, tenacity, and degree of objective challenge to which the risks will be subject. Firms will therefore need to ensure that they operate a holistic approach to addressing retail conduct risks so that they can be consistently and robustly addressed to deliver better customer outcomes in the new reality and beyond. Longer term, we are likely to see the FCA’s approach to a [Consumer Duty](#) as the umbrella under which these risks, and their interconnectedness will be addressed.



## Key questions for CEOs to self-evaluate in the context of a long-term hybrid-working arrangement

### Culture

- How is the firm’s culture and purpose regularly and objectively assessed to determine the alignment between purpose, leadership, and approach to rewarding and managing people, as well as psychological safety and diversity and inclusion?

### Customer vulnerability

- How can we evidence that the firm ensures that customers in vulnerable circumstances receive the same fair treatment and outcomes as other customers and that all relevant departments consider this issue?
- How can we draw comfort that the approach and outcomes would be consistent, regardless of where the activity is performed?

### Product governance

- What impact do new working practices have on the way customer demands and needs are evolving? Do we have the correct framework in place to ensure product and services continue to be fit for purpose and deliver good customer outcomes?

### Value

- How objectively and fairly can we evidence consideration of value (through the eyes of the customer) where changing working practices and broader government restrictions impact the product or services value and/or utility?

### Technology

- How can we illustrate the appropriate consideration of customer and associated conduct risk when deploying technology to respond to risks associated with hybrid working?

### Customer service

- Is the approach to customer service, SLAs and client outcomes consistent irrespective of whether it is conducted remotely or in office?

### Resilience

- Have we carried out sufficiently granular analysis/mapping of conduct risks and potential detriment to customers based on our operational resilience testing scenarios?

### Financial crime

- How has the risk profile of the firm and associated systems and controls been re-assessed to factor in the potential increase of financial crime risk from hybrid working?

### Oversight, governance & controls

- What consequential impacts of hybrid working have been factored into the firm’s systems and controls to ensure they remain robust?
- Are all oversight, governance and controls effective and equally effective regardless of the location where they are being performed?

### FCA consultation on a new consumer duty

Our paper, “[Consumer Duty. Final stage of the journey](#)” considers the FCA’s proposal for a new Consumer Duty. It explores the drivers behind the FCA’s thinking, along with practical insights in how it will be implemented using existing regulatory requirements. It also considers the implications on firms from this heightened expectation and how the FCA might supervise differently as it transitions to outcomes-based supervision.

# 01. Culture

Culture will have played a pivotal role in how firms have fared through the pandemic. Firms will have developed tactical solutions to develop or maintain their culture during the extended period of remote working. As firms adopt hybrid working, more strategic and embedded solutions will be required to ensure they effectively balance their own commercial interest with those of end customers, and that cultural values and customer outcomes are maintained consistently on a location-agnostic basis. Culture is, and will continue to be, a top regulatory priority and therefore firms should expect a significant volume of regulatory interest on this fundamental driver of conduct risk.

The FCA has long [championed](#) the role that a firm's healthy culture and purpose can play. The pandemic has brought culture into even sharper focus. The FCA defines culture as the "typical, habitual behaviours and mindsets that characterise a particular firm". The behaviours are the "way things get done around here". It is the way that firms act, speak and make decisions without thinking consciously about it. To quote organisational psychologist, John Amaechi OBE "Culture is defined by the worst behaviour you tolerate."

Each firm's culture is different and the FCA has stated that it does not believe there should be a one-size-fits-all model. It does not prescribe what any firm's culture should be. Its work is focused on promoting healthy cultures across the industry.

**“ Culture is defined by the worst behaviour you tolerate. ”**

John Amaechi OBE

Culture is widely accepted as a key root cause of recent major conduct failings in the industry that have caused harm to both consumers and markets. For markets to work and firms to be successful, they must be seen as trustworthy. However, the FCA acknowledges that changing culture can be hard. Some firms still see culture as a 'soft' discipline and clarifying how to define, measure, and manage it in practical terms is difficult. Its intangible nature has left firms' senior management pondering how to influence and transform culture. However, more than ever, culture will be central to how firms meet the FCA's expectations and, critically, how the FCA will supervise them.

## Key drivers

Culture and purpose extend far beyond just compliance and conduct. Culture is all-encompassing and pervading. It is impossible not to have one and impossible to fake a good one. The FCA is keen to use culture as a supervisory lever and has highlighted four common characteristics of a good culture:

- A meaningful purpose
- An inclusive environment where it is safe to speak up
- Effective leadership and governance
- Employees that have the necessary capabilities and are motivated by appropriate incentives

## Diversity & inclusion

Consideration of diversity and inclusion has, quite rightly, risen significantly in importance and priority in recent years. To illustrate this, the PRA, FCA and Bank of England have published a [discussion paper](#) to see how they can accelerate the pace of meaningful change on diversity and inclusion. Further, the FCA is considering mandating specific board diversity targets and for listed entities to publish diversity data on their boards and executive management. A healthy culture is fundamental to supporting inclusion and encouraging employees to bring their 'whole selves' to work. Diversity and inclusion tend to be referred to interchangeably, but they are different. As the FCA [clarifies](#), without an inclusive culture, the value of diversity will not be realised. Without inclusion, diversity will not lead to better decision making and firms will not be able to meet the needs of all consumers. Essentially, firms need to be representative of the diversity of the customers they serve, to ensure they are developing and delivering product or services that are aligned to customer demands and needs.

How (or indeed whether) a firm prioritises and embeds diversity and inclusion is a strong cultural indicator. A healthy and inclusive culture creates an environment where employees feel psychologically safe to share issues, problems, concerns and ideas. Senior

management must acknowledge their status and actively recognise how their behaviour and actions can influence and support an environment of psychological safety and collaboration. Encouraging employees to speak up is only half the battle. Senior management also needs to listen when they do. Otherwise, employees' psychological safety will be eroded and they will be less likely to continue to speak up.

The coincidence of broader recognition and realisation of the need to improve outcomes relating to diversity and inclusion and to the pandemic has had a positive and accelerating impact. Firms have restructured and re-appraised their approach and many have a discrete programme of work to ensure that they create a diverse and inclusive environment. However, diversity and inclusion should not be viewed as a single discrete programme. It must be part of "business as usual". In many ways, large-scale remote working has helped to flatten previous hierarchies. Many of the typical barriers of office working have been removed. Access to management has become easier. However, unless there is genuine appetite and momentum for change, the transition to hybrid working may see progress stall as senior management re-embrace office working and revert to pre-pandemic approaches and practices.

## Purpose

Purpose is a comparatively new area of focus within the culture remit, which was first referenced in the FCA's 2019/20 business plan. The FCA has since added colour to what it means by purpose and why it is necessary. It is a firm's *raison d'être* – but from the perspective of the end consumer and the role of the employee.

Employees should see the value that they bring to the firm and the value that the firm offers to them beyond their remuneration. Purpose is more powerful than just stating what the firm does. It is the articulation of why it does what it does and helps to drive a firm's thinking from a customer perspective. It should enable the FCA to understand the firm's motives

beyond simply the business model. It should be inherent within the firm, not only a high-level mission statement. To use the FCA's own analogy, "*purpose is the grain running through the company – it is not a thin veneer*".

The pandemic has not fundamentally changed the deep-seated purpose of firms. However, it has driven firms to recognise that a sense of societal value can be galvanising and motivational for employees. Instilling a deeper sense of a meaningful culture across a firm helps to ensure a consistency of approach and mindset.

## Governance

The '[tone from the top](#)' has been a longstanding feature of the FCA's priority relating to culture and, whilst other features have gained in popularity and focus, the overall governance of the firm by senior management will continue to be a key driver of conduct risk.

The decisions of the firm, and more importantly, how they are made, will still have a material impact on the outcomes that are delivered for end customers. More recently, focus has been on middle managers and the role they can play. They are often cited as being conflicted. They are measured and rewarded against performance targets, risk ratings and KPIs, and they feel compelled to focus on these hard metrics. On the other side, they are being challenged to flex and take a broader holistic view by staff who are engaging with end customers.

Where other cultural factors are also positive, governance has been generally positively impacted by remote working. Firms will be keen to continue to progress made as firms move towards a hybrid working pattern. Many of the advantages flagged in our new reality [paper](#) on remote governance and controls continue to deliver benefits but the move to hybrid working is not challenge free. For example, having every individual operating remotely created a level playing field. Whilst "meetings" tended to take longer, it is generally agreed that better decisions and outcomes for customer prevailed. Hybrid working creates new challenges in ensuring



that this level playing field is maintained when some of the meeting attendees are now in the same location. Therefore, how the firm's governance arrangements will be augmented and operated in a hybrid environment will need to be carefully considered to ensure that they do not adversely impact customer outcomes.

### Employees

This driver covers whether employees have the necessary capabilities and whether they are motivated by appropriate incentives. As noted above, where a firm operates a healthy culture, it has tended to fare well through remote working and is well-positioned to continue to operate effectively in a hybrid working environment. The level of direct oversight has reduced for many employees and this tactical enforced situation may become a permanent one as firms adopt a hybrid model (to a greater or lesser extent).

“...empowered to operate in line with the appropriateness of the outcomes”

Beyond technical competence, which was unlikely to have been materially impacted by the pandemic, softer skills have become more important as a driver of conduct risk. The regulatory direction of travel from the FCA is towards outcomes rather than inputs. Suitably skilled employees, who are able to understand and deliver to the firm's culture and purpose, can be empowered to operate in line with the appropriateness of the outcomes. This may result in firms giving latitude to remote, hybrid employees and office employees alike, to operate “freedom within a framework” rather than following restrictive processes for the sake of it. This may require a degree of upskilling to help some employees transition to this approach. However, there are other specific conduct risk considerations that need to be worked through to ensure that the firm retains a consistency of approach and that the

reduced level of process focus does not create a splintered approach or one that fragments customer outcomes.

The intended transition to more of a focus on outcomes will only be truly effective and embedded if the firm's approach to incentive is appropriately aligned. A firm cannot support one course of action but reward another. This extends beyond just pay and rewards but also promotions, broader recognition and new opportunities.

### Key challenges

Culture and purpose have played a pivotal role from two differing, but aligned, perspectives. However, challenges remain as firms embed a hybrid working arrangement.

### End-customer considerations

The pandemic has generated new or heightened conduct risks that have placed a strain on firms when seeking to ensure that they have fairly considered the implications on their end-customers.

In response, the FCA has, both consistently and proactively, [communicated](#) in a clear and concise manner about its expectations that throughout the pandemic, regardless of the circumstance, customers' considerations need to be balanced with the firm's own commercial interests. Some of the guidance was detailed and specific; others simply echoed the overarching need to treat customers fairly.

In general terms, firms that, prior to the pandemic, had embedded customer-centricity and purposeful culture were able to move more effectively and efficiently in not only understanding these new conduct risks but also inherently knowing how to mitigate them. Whilst firms were encountering risks they had not considered before, their culture and purpose provided them with a strong sense of how best to respond to those challenges.

“freedom within a framework”



When considering how to balance the firm's own interests with those of a customer, it is not always about factors that have a direct financial impact on the firm (e.g. forbearance, payment holidays or waiving premiums). By preempting, reacting to and proactively considering similar challenges customer could face, firms have made significant advancements in better meeting their customers' information needs by communicating more clearly and concisely.

### Oversight

We cover governance and oversight in more detail [here](#), but it is important to highlight the pivotal role that culture has had to play. Existing control mechanisms and oversight arrangements have been less efficient or unable to function due to large-scale remote working. Consequently, a firm's culture can help plug the gaps and ensure that individuals are given appropriate empowerment to address issues. Interim governance and risk control arrangements followed the spirit of the intentions rather than being overly-concerned about inappropriately prescriptive policy or process.

As firms move out of reactive and into more proactive priorities, we are seeing an increase in firms seeking to better articulate and/or embed their culture. The pandemic has forced firms to a more mainstream realisation that culture and purpose is what will help them consistently meet regulatory obligations in relation to conduct and respond with more agility and drive.

The FCA's recent [consultation](#) on a new consumer duty is designed to create higher expectations in this regard.

“ serious and deep thinking about what the firm stands for ”

Purpose is being elevated from a window-dressing acronym or mission statement on office walls to serious and deep thinking about what the firm stands for. This requires thinking beyond just shareholder value into broader considerations of its societal purpose. This thinking generates meaningful positives because, as well as the advantages captured above, it creates more engaged employees.

Whilst the FCA's fundamental approach has not altered, there has been an evolution of themes and specific areas of focus that have come more to the fore since the pandemic started. In conclusion, there's a growing consensus that a purposeful, diverse and inclusive culture is one where:

- Employees feel that they have a purpose beyond the financial remuneration they receive
- All employees feel safe from harassment and victimisation, and empowered to speak up
- Firms value and reward doing the right thing and following the spirit of regulation

- Firms have, and can evidence, an effective balance between their own commercial interests and the interests of their customers
- Firms genuinely recognise the benefit of diversity and inclusion in all their various forms

As remote working becomes hybrid working, this sense of belonging and deep-seated understanding of what a firm stands for will continue to be an effective enabler of good customer outcomes. With hybrid working, there are less likely to be regular requirements to attend the office and to help maintain alignment of a meaningful culture.

The key challenge for firms will be not only how they develop and maintain a purposeful culture, but critically how they can evidence that it has been appropriately embedded, is authentic and genuinely drives decisions.

### Example conduct risk

With the adoption of hybrid working, there is a risk of a divergence from the firm's current or desired culture. This could result in pockets of misaligned cultures forming, which could lead to poor customer outcomes.



## 02. Customer vulnerability

Customer vulnerability has been an emerging theme for some time, but further clarity on regulatory expectations during the pandemic was designed to generate a step change in how firms' approach and embed consideration of the indicators of vulnerability. The FCA is seeking equity for vulnerable customers such that they are consistently able to achieve outcomes that are as good as for other customers. Further, it seeks to move many firms from a mindset that vulnerability is considered solely within customer service functions. It expects consideration of vulnerable customers to take place in every department and activity of the firm and at all stages of the customer journey. COVID-19 has created a significant volume of new vulnerable customers. Consequently, the FCA will seek to understand how firms have embedded vulnerability considerations and how they are driving better customer outcomes as we move out of the pandemic.

Consideration of [vulnerability](#) has been a key regulatory topic of interest since at least 2015. However, more recent activity has indicated how importantly the FCA views this issue and how it is factored into its approach. As exacerbated by the pandemic, when consumers are vulnerable, it adversely impacts the way they engage and the decisions they make. The FCA has broadened the definition of vulnerability to consideration beyond the historic mindset of health or age factors. Drivers of vulnerability include life events (e.g. bereavement), resilience (e.g. indebtedness) and capability (literacy/numeracy skills).

Therefore, vulnerability is not binary. It is not temporary or permanent. It is a complex spectrum across four independent drivers – some may be fleeting and require minimal treatment, while others can be permanent and require significant intervention by the firm to ensure comparable outcomes for all other customers. For example, if a customer suffers from depression, the treatment strategy could vary dramatically over a short space of time depending on how they are feeling on any given day.

### Key drivers

Vulnerability has been a mainstay of the regulatory response to [COVID-19](#). It is a theme that the FCA has constantly reiterated to firms in sector-specific and broader vulnerability scenarios. It is clear that the FCA wants firms to think differently about vulnerability and recognise that, during the pandemic, all customers have suffered from a degree of vulnerability. However, there is a risk that, despite being a good headline or soundbite, it is over-simplistic and potentially underestimates the immeasurable nuances of vulnerability.

To align with the mindset shift, the FCA's finalised guidance [paper](#) is the fundamental source of this desired step change for how firms need to approach vulnerability. The guidance signals a material shift in the FCA's expectations of firms' consideration of vulnerable customers and essentially moves vulnerability from a side-show to a main stage activity. This approach is also echoed in the FCA's [consultation](#) on its new consumer duty.

The finalised guidance is designed to drive improvements so that vulnerable customers are consistently able to achieve outcomes that are as good as for everyone else. The paper should have wide-ranging impacts. It intends to move many firms from a standalone policy mindset towards a more embedded approach where vulnerability is, objectively and proactively, considered across the firm and at all stages of the customer journey. It is therefore no longer the sole preserve of the customer service call centres. It promotes consideration of vulnerable customers into every department and activity of the firm.

How firms design, and operate, their processes in relation to vulnerable customers is a strong cultural indicator and, as such, it is also a strong focus for FCA supervision. Firms will be expected to be able to demonstrate how their business model, the actions they have taken and their culture ensure the fair treatment of all their customers in relation to any project or initiative (rather than being conducted via a standalone review).

The FCA has identified key topics for consideration, as well as highlighting that firms should adopt a continual cycle of learn-develop-monitor-analyse. These topics give an illustration of the depth of consideration and embeddedness that firms should be striving for:

- Understanding customer needs of its target market
- Having the right skills and capability to recognise and respond to the identified needs of vulnerable customers

- Responding to customer needs throughout product design, flexible customer service provision and communications
- Monitoring and assessing whether they are meeting and responding to the needs of customers with characteristics of vulnerability and making improvements where necessary

### Key challenges

Given the innumerable indicators of vulnerability, it is impossible to operationalise all these complexities (and inter-related indicators) of vulnerability into a process or procedure. Therefore, a firm's solution needs to transcend this by upskilling and empowering employees and embedding a healthy culture to make decisions. For complex scenarios, employees should have the autonomy to increase the level of controls (or remove them completely) depending on the needs of the customer and the best way to achieve a good customer outcome. Such changes will take time to deploy and many firms are using their product governance framework to kickstart how they embed consideration of customer vulnerability across all aspects of the customer journey.

As well as an issue to be addressed now, customer vulnerability has both forward-looking and retrospective aspects in terms of key challenges.

### Forward-looking

The FCA's expectations are clear that the responsibility for vulnerable customers rests with most departments as it should be considered across the entire customer journey. Therefore, for future process augmentation, product or service development, or training and competence, such consideration will need to be factored in to ensure that the development does not lead to a poorer outcome for vulnerable customers. Further, existing data and MI and meeting packs will need to be reconfigured to ensure that firms can evidence appropriate consideration and treatment of vulnerability.

### Remediation

For relatively recent backward-looking activity, whilst the regulatory expectation may not be as high as looking forward, there are still a number of considerations that need to be addressed. This is to ensure that any remediation activity planned or in progress appropriately considers the implications for vulnerable customers. Firms will want to understand how different treatment strategies are warranted per cohort/customer type depending on the additional lens of vulnerability. Further, it may also lead firms to consider the appropriateness of current conduct risk MI to evidence this fair treatment.

Firms need consciously to seek to understand (and document) a customer's specific circumstances in order to improve the quality of the treatment strategy and, ultimately, the outcome generated. However, there are consequential risks to consider. Firms will need to ensure that they are complying with GDPR when collecting this data – especially as, where it is health/medical related, it could constitute "special category" personal data.

#### Example conduct risk

As COVID-19 has created new and more complex circumstances, there is a risk that new indicators of vulnerability are not being appropriately identified and therefore addressed to ensure that these impacted customers received the same outcomes as all other customers. This could lead to poor customer outcomes.

## 03. Product governance

The pandemic has impacted every firm's products or services. Firms will need to reassess their products and services against the backdrop of the new reality to see whether they are still aligned to customer demand and needs. Firms will also need to reassess their product governance framework to ensure it remains fit for purpose. Finally, looking further forward, as hybrid working becomes the norm, this should impact product/service manufacture and distribution alike. Many traditionally held assumptions (e.g. many customers travelling to a permanent place of work, five days a week) will no longer be consistently true. This should lead to further innovation and development in product and services to meet the augmented needs of some customer circumstances to deliver good customer outcomes.

The principal driver of the product governance rules is to ensure products and services are developed, not just to meet the firm's own commercial interests, strategies and/or generate shareholder value, but that the firm objectively and robustly considers the customer at every stage of a product or service design, manufacture, distribution and maintenance, and the outcomes being generated. Although this objective has not altered, it has certainly been core to the FCA's response. A significant volume of regulatory [announcements](#) in response to COVID-19 point back directly to product governance.

Finally, the FCA wants to ensure that firms are readily reassessing their products and services (and the framework too) to ensure they remain fit for purpose and make incremental improvements at every stage based upon their (and their customers') experience.

### Key drivers

Four factors are driving an increasing focus on product governance. Regulatory focus is one – as discussed on the previous page.

### Customer expectations

This was a driver before the pandemic, but COVID-19 impacts provide a good example – essentially, a mini case study of how customers’ expectations are changing. We are seeing that customers want to interact in a more digital manner and that their needs and wants are also developing – seeking flexibility and choice and closer alignment to the “greater good” (e.g. sustainable finance).

### Centralised system and control

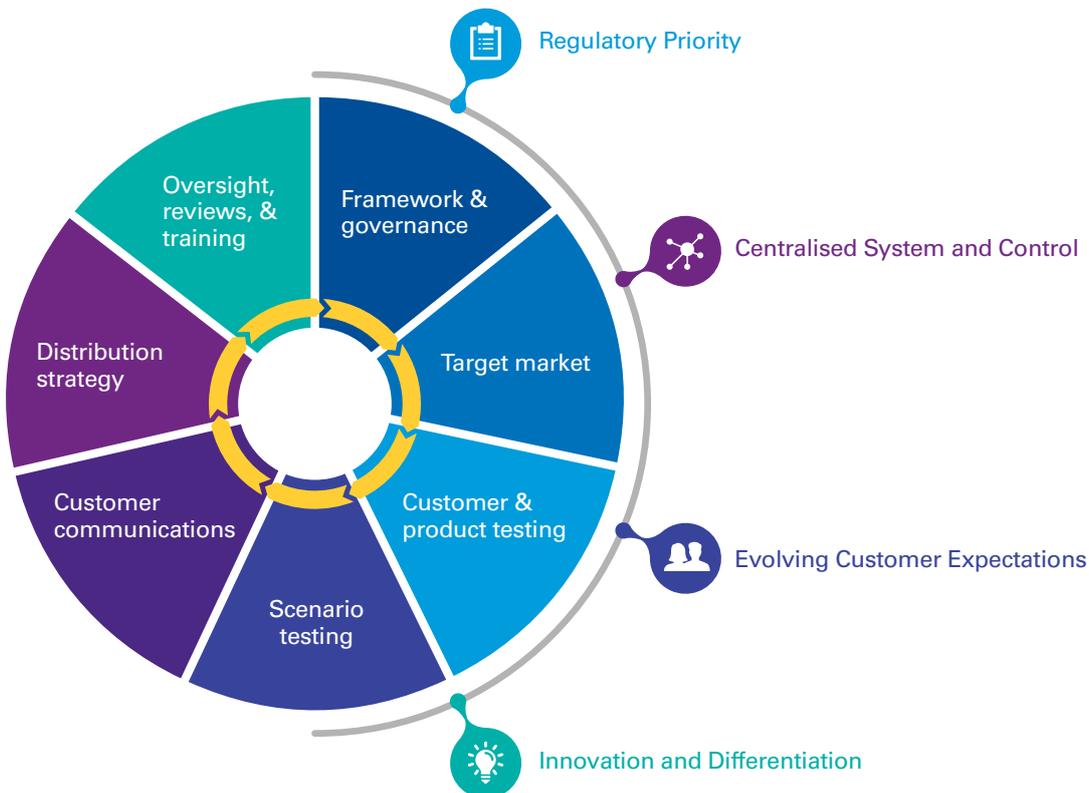
Product governance acts as a centralised system and control. It is a framework that is, by design, intended to cut across all the different business areas. It will include people from legal, compliance, operations,

product, IT, finance and sales. It assists firms in being less siloed in their thinking and, where it is effective, it has a disproportionately positive impact on the firm’s overall systems and controls. Consequently, a firm’s product governance arrangements have provided a solid overarching mechanism to enable them to respond appropriately to COVID-19 and beyond.

### Innovation

Firms are also using product governance to drive innovation and differentiate themselves. The more data, intelligence and insights that a firm gathers for building new products or services, the more it is empowered to identify new innovative solutions to address emerging customer needs. By routinely and robustly engaging with customers about its product and services, a firm can become more successful and innovative – a virtuous circle.

## Product governance framework





## Key challenges

COVID-19 impacts will have strained firms' existing product governance arrangements. If it has not, product governance may not be as well-embedded and impactful as the FCA expects. New conduct risks, which would not have been considered in the design or review phases, have arisen and need to be factored in more formally in future, especially in relation to stress and scenario testing. Further, many firms have identified that the framework itself did not operate as efficiently as it could have as they tried to respond with agility to a constantly evolving landscape. A good acid test of a firm's product governance model is how much it was used in response to the pandemic. This will give firms an insight into how well embedded into the business it is.

FCA [guidance and announcements](#) since the pandemic first impacted have consistently indicated the need for firms to make objective and balanced decisions in relation to the customer and the impact their products and services can have in different stressed scenarios. This expectation will not diminish and there will be an emerging regulatory expectation that this mindset and approach is more widely and consistently applied (and appropriately evidenced). This is reinforced in the FCA's [consultation](#) on a new consumer

duty. Consequently, firms will need to be able to demonstrate that product development and/or distribution are genuinely aligned to the customer's best interest. Firms must manage the entire product lifecycle (from a customer's perspective) to generate good outcomes. Whilst firms will have implemented solutions, they were previously not as well-implemented as regulators would expect. The FCA [findings](#) on the asset manager sector is a case in point, which contained an almost palpable sense of frustration that previously identified [issues](#) have not been improved – especially as MiFID II came into effect back in 2018.

With firms' assessments considering the new reality of hybrid working, customer expectations and longer-term implications of COVID-19 they need to focus on the specific new or heightened retail conduct risks that should be identified, mitigated, and managed effectively to ensure they continue to deliver good customer outcomes. This may require firms to change some "hearts and minds" to appreciate the genuine value of a robust product governance framework. This change in culture should be focused on ensuring that all those involved need to recognise the process should be genuinely "fulfilling" – not "form-filling" – by prioritising, resourcing, training and empowering accordingly.

Further, the quality of inputs into the process may also need to be refined to ensure there is a genuine direct assessment of outcomes rather than proxies that may not provide the full picture. For example, whilst complaint data and net promoter score results may indicate customer satisfaction, this does not automatically equate to good customer outcomes being delivered. Customers may, unknowingly, have the wrong product or service, albeit they are pleased with it, and/or do not understand the salient aspects of the product or service. Consequently, we are seeing more and more firms engaging directly with their customers to understand the nature of what they were looking to achieve, how the process operated in practice and how much they understand the product or service purchased, its key features, benefits and risks (i.e. genuine outcomes testing).

### Example conduct risk

COVID-19 has created unforeseen conduct risks, which may not have been adequately considered and/or appropriately communicated to the end-customer. Therefore, there is a risk that the product or service is not operating as originally intended and may not have been meeting the customer's demands and need for the product or service. Consequently, customers may experience a poor outcome and/or detriment.

“ the process should be genuinely ‘fulfilling’ – not ‘form-filling’. ”

## 04. Value

During the pandemic, the FCA has identified specific instances where COVID-19 has had an adverse impact on a product's or service's utility or value. Supported by a number of other parallel initiatives in different sectors, the FCA has moved its competition objective and the issue of value, utility and value for money out of the shadows and into the spotlight. As firms move into hybrid working, there will not be a let-up in the attention that the FCA pays to this topic, especially given its high level of interconnectedness to both vulnerable customers and product governance. Although customers may be the ultimate arbiters of value, the FCA will expect firms to set up frameworks to assess fair value and where a firm concludes that a product may not be offering fair value there will be an expectation that firms take appropriate action. Firms will need to engage with end-customers routinely, robustly and objectively, in order truly to assess value. This more proactive engagement with end-customers should lead to a more balanced value exchange and improved customer outcomes.

When the FCA was formed in 2012, it was given a [new competition objective](#) which the FSA did not previously have. This objective was "promoting effective competition in the interests of consumers." In the early years, the FCA stated that it was "not a price regulator" and it predominately used its consumer protection objective "securing an appropriate level of protection for consumers" to drive its retail conduct regulatory priorities. This led many firms to conclude that the FCA would not engage with firms on the more commercial aspects of their business. This has now changed.

Although the FCA is not a pricing regulator as such, over the last few years, the FCA has proactively considered pricing, value for money and broader competition aspects in banking, insurance and wealth and asset management, whether via market studies or other broader initiatives. On some pension products and current account overdrafts, it has now set maximum charges. On financial advice, it has banned contingent charging on pension transfer advice. However, the

FCA's [findings](#) from its Assessment of Value review illustrates that the FCA still has material reservations about how well it has been considered and implemented to date.

### Key drivers

The FCA is emerging from the COVID-19 pandemic with a clear and consistent approach. The FCA specifically faced into the challenges of firms evidencing [value](#) as a direct result of pandemic impacts, and this focus and priority will not recede. On the contrary, the FCA is looking to accelerate the remedies it was already pursuing pre-COVID-19, and potentially broadening their scope and application with its [consultation](#) on a new Consumer Duty.

### Customer engagement

In well-functioning markets with engaged and appropriately knowledgeable consumers, firms will proactively compete on features and benefits of their product or services as well as the associated costs and charges. Customers will understand the trade-off between the features and benefits and the prices they are paying. Consequently, firms will develop propositions to engage with different target markets along this continuum. Some will develop a "pile it high, sell it cheap" business model while others adopt a more boutique, tailored and bespoke solution with associated premium pricing. Neither is wrong or right. Customers should be able to make an informed decision and choose the most appropriate solution

for their needs and budget – in theory. However, the FCA has identified that this is not always the reality. Further, customers generally had an understanding that firms would reward loyalty and they would be looked after more favourably as a result. The FCA has identified that this is not true either – its recent work on [Gl pricing](#) practices is a good example.

The significant impact of customer vulnerability in relation to financial capacity and other limiting factors that discourage customer engagement are explored further [here](#). However, there is still a residual apathy or more general information asymmetry that results in customers not engaging as fully as they could (or, indeed, do so in other comparable purchasing decisions). The FCA published a significant volume of [guidance and information](#) to assist firms better communicate with their customers. However, the FCA equally extended significant resources to offer a comparable level of [information and education](#) to retail customers about the impact of COVID-19 on the product and services they hold. Whilst the FCA continues to see an inappropriately low level of customer engagement, this will continue to be an area of focus.

### Behavioural economics

This topic has seen a significant uptake in understanding and utilisation across all retail sectors. When used correctly it can be used to promote customer engagement to address some of the drivers summarised above. However, it is not always used as a force for good. It has been subverted by some

to proactively drive commercial outcomes for the firm without an appropriate balance of customer-based considerations. As the use of technology is accelerating, so the level of data and MI that can be utilised is increasing exponentially. If firms fail to use behavioural economics effectively in their pricing decisions, it could lead to a lack of effective price competition, resulting in poor customer outcomes.

### Customer outcomes

There is uncertainty generated by the ongoing challenges associated with recovery from COVID-19. This, coupled with the issues captured above on customer engagement and use of behavioural economics, are good examples of how these drivers can result in poor customer outcomes in relation to product value and utility. However, it can be more nuanced than this.

By way of example, car insurance immediately lost its utility as the majority of people were told to stay at home and not to drive. This meant that the normal volume of claims dropped significantly. In response, some insurers offered a refund on premiums, to represent the loss of value. However, it has also helped drive further innovation in the marketplace, which could generate new conduct risks. Car insurance being offered by the mile is a good example. Similarly, private medical insurance claims also reduced in immediate response to COVID-19 as routine operations were cancelled to create capacity for the NHS. However, unlike car insurance,

when routine operations were re-allowed, these insurers had a backlog of claims and therefore there is less of an argument that the product's utility, and therefore value, has diminished in the same way (or magnitude) as car insurance. These nuances are certainly something that the FCA was interested in at the end of 2020, when it required all GI product providers to consider ["whether and how coronavirus may have materially affected the value of their insurance products."](#)

### Key challenges

In terms of value of exchange, very few firms will set out with a determined and proactive strategy to exploit their customers. The FCA developed a number of approaches across different sectors to assist firms consider and evidence how they assess value/value for money and/or utility. For example, the FCA published documentation in relation to its approach to [GI pricing](#), the [findings](#) from its review of the implementation of its assessment of value for asset managers, and the findings from the RDR and FAMR [review](#) of the financial advice sector.

Whilst the broad direction of travel is the same for all sectors, there are differences. Consequently, where firms operate across different sectors, each with nuanced approaches, the ability for firms to be able to illustrate a holistic consistent, coordinated and robust consideration of value are, and will remain, a challenge. In the longer term, the FCA's consumer duty [consultation](#) is designed to create this consistency of approach. For example, the FCA have defined "value" for general insurers as "the relationship between the overall price to the customer and the quality of the products and/or services provided." As the FCA's seeks to build out the consideration of value to a wider industry priority via the new Consumer Duty, this definition could become more widely applied.

“ Customers are ultimately the true arbiters of value. ”

Further, even if a firm forms a view on how to accurately measure value, it cannot do this alone. Customers are ultimately the true arbiters of value. Firms will need to determine how best to engage with them and this is not straightforward. As captured elsewhere, a low level of complaints or high satisfaction score do not directly correlate with agreement that the customer values the product or service. Firms need to dig deeper than this by conducting genuine outcomes testing with end-customers.

Finally, where the firm's sector is known to be relatively price inelastic, the exercise of rebalancing value may, in the short term, only have a negative impact on the firm's revenue. Therefore, there is no first-mover advantage in redressing any value imbalance. Firms need instead to consider first mover disadvantage. As mentioned above, this is why culture is such a strong driver of customer outcomes. Further, when determining value, it results in firms having to consider conceptual questions such as when does a charge become a penalty? That is, at what point does the charge stop being the cost of administration to complete the request versus a punitive penalty designed to dissuade that decision?

Firms that have proactively engaged with customers on the conversation of value have used this intelligence to generate products and services more aligned to their customers' needs and wants and will, in the longer term, experience increase in demand. Where customers see the genuine value that a product or service brings to help them achieve their objectives, they are prepared to pay more than the cost and charges generally operating in the sector.

#### Example conduct risk

If a product's or service's utility or value have changed as a result of the impact of COVID-19, there is a risk that the firm's existing products or services may not be offering an appropriate value for the end-customer, which could lead to customer detriment.



## 05. Technology

Technology has been a significant enabler in firms' immediate response to COVID. Out of necessity, firms have embraced and deployed technological solutions to address remote working and meet information and servicing needs of end-customers. However, implementing technology at pace has meant that consequential conduct risks may not have been fully considered or mitigated. As firms move towards longer-term and more strategic solutions and to hybrid working, the impact of technology deployments need to be re-examined in this more permanent light to ensure they remain fit for purpose and all key conduct risks have been considered. For example, technology could be perceived as a panacea for firms, hybrid working and customers. However, there is a risk that a tranche of customers (whether through digital poverty or another aspect of vulnerability) need analogue solutions to remain an option. Critically, to align to FCA guidance on Vulnerable Customers, these options cannot be inferior when compared to the digital solution.

Firms will generally maintain a long list of technological priorities, but there is either a lack of time, resource or appetite to implement such large-scale change within a business as usual context. As explored further (and more broadly) in our New Reality accelerating digital finance [paper](#), COVID-19 has been a technological catalyst. It has caused change, on a greater scale and at a faster pace than any firm's planned IT strategy or any regulatory initiative. Some firms were better placed to handle this rapid increase in use of technology and digitalisation of services and delivery – others less so.

Disruption by new technologies became more palatable during the pandemic, resulting in faster adoption and progress. However, technology is not a panacea. It has introduced conduct risks that will outlast the pandemic. Further, advancements in technology does not suit all and there is a real risk that the most vulnerable could be the most disadvantaged.

“ technology is not a panacea ”

### Key drivers

Like other factors, technology has experienced a number of drivers from a retail conduct perspective. However, the sequencing and different facets have been more complicated. The immediate response was to “keep the lights on” and ensure that the firm could still meet the fundamental and core services with large-scale remote working. This evolved into developing more innovative solutions to engage with customer queries to try and reduce the burden. The forward-looking phase is more centred on how to augment the current technology solutions for a realisation that for many firms/departments, hybrid working is



likely to be the default (to a greater or lesser extent). Consequently, more tactical responses need to be revisited to ensure they are appropriately robust for the longer term.

## “ hybrid working is likely to be the default ”

### Necessity versus choice

The immediate and fundamental driver in the rapid deployment of technological solution is obvious: necessity. Other than key workers, all other branch and office employees could not travel to, nor operate from, their normal place of work. The immediate response saw large-scale investment in hardware and software to ensure employees could continue to perform their core duties and meet the needs of their customers. The degree to which the firm already embraced remote working, both culturally and technologically, determined how well they fared.

Technology has allowed firms to operate remotely and firms are now recognising the benefits. Many employees are appreciating the additional flexibility it brings and expect to be empowered to determine or shape where they discharge their responsibilities. The investment in technology has made the choice between working remotely and in the office a more balanced one by addressing potential shortcomings that large-scale remote working remotely typically suffered from. Where the investment in technology (and a change in mindset) now allows roles to be performed entirely remotely, it removes many of the geographical limitations and commuting challenges related to recruitment, allowing firms to recruit from a more diverse background.

### Customer choice

Customers have experienced a similar journey to employees. Firms have embraced and deployed technological solutions to help support their front-line employees meet the needs of customers. Firms developed bespoke triage call centres and self-service portals to deal with capacity

challenges, freeing up call centres for customers in need of human interaction. Although initially borne out of necessity, some customers are now embracing new technology and are happy to self-serve the more basic interactions rather than waiting on hold to talk to customer services. This may suit the majority of customers, but firms need to continue to think about all their customers and ensure that those for whom this is not a welcome advancement are not left behind or dis-engaged – especially [vulnerable customers](#). Despite the economies of scale that technology generated, the use of technology as a communication tool needs to remain an option.

### Use of data

Available data and new types of data sources are increasing at a considerable pace. Firms regard data as an essential resource for economic growth, competitiveness, innovation, job creation and societal progress. Data-driven applications are benefitting customers and businesses in many ways. However, regulated firms face challenges in the collation, storing, analysis and transfer of data, especially customer data, including reliance on third parties. The transfer of customer data between firms and across borders is being encouraged via “open finance” initiatives but is also subject to data protection laws. And the ethical use of data is to be [defined](#) by the FCA.

### Technology & digitalisation: a regulatory priority

Lastly, the FCA has made the utilisation of technology a key priority, as it recognises the significant benefits it can bring to end-customer outcomes. It has developed a significant suite of [regulatory initiatives](#) designed to help firms develop innovative solutions, with benefits from additional support and guidance from the FCA as they do so.

The FCA's appetite to be seen as a centre of innovation and excellence means that the role of technology is only going to accelerate – encouraging firms to embrace it. The FCA is also utilising technology itself as it continues to make [progress](#) in its own transformation into an intelligence and data-led regulator.

## Key considerations

Implementation of technology at such pace may mean that consequential conduct risks have not been fully considered. There may also be instances where a lack of co-ordination has occurred, resulting in disjointed customer journeys, which could impact the quality of outcomes experienced. For example, tactical solutions have tended to have been delivered in silos and therefore the ability for firms to have a consistent single customer view in relation to the rapidly deployed solutions could be compromised. This may result in firms being unsighted on the holistic position of customers in relation to their employment status, payment holidays, status of outstanding insurance claims or other aspects impacting their personal circumstances, which could impact their relationship with the firm.

The FCA has consistently promoted due consideration of [vulnerable customers](#), which includes ensuring that customers with indicators of vulnerability are not left behind as firms have embraced technology. Vulnerable customers are more likely to have been adversely impacted

by COVID-19 and much of a firm's immediate responses may have further disengaged them. Whilst the self-serve solutions were designed to free up capacity to allow the vulnerable to still access call centres to get the support they need; this may not have occurred consistently. As employees were experiencing a significant backlog of calls, they may not have been able to dedicate as much time as they would have wished to fully serve the needs of vulnerable customers. This will have led to customer detriment as these vulnerable customers may consciously disengage, regardless of their need and heightened risk of poor outcomes. Whilst it could not be helped and is not directly attributable to technology, the temporary closure of some local banking branches will also have had an adverse impact.

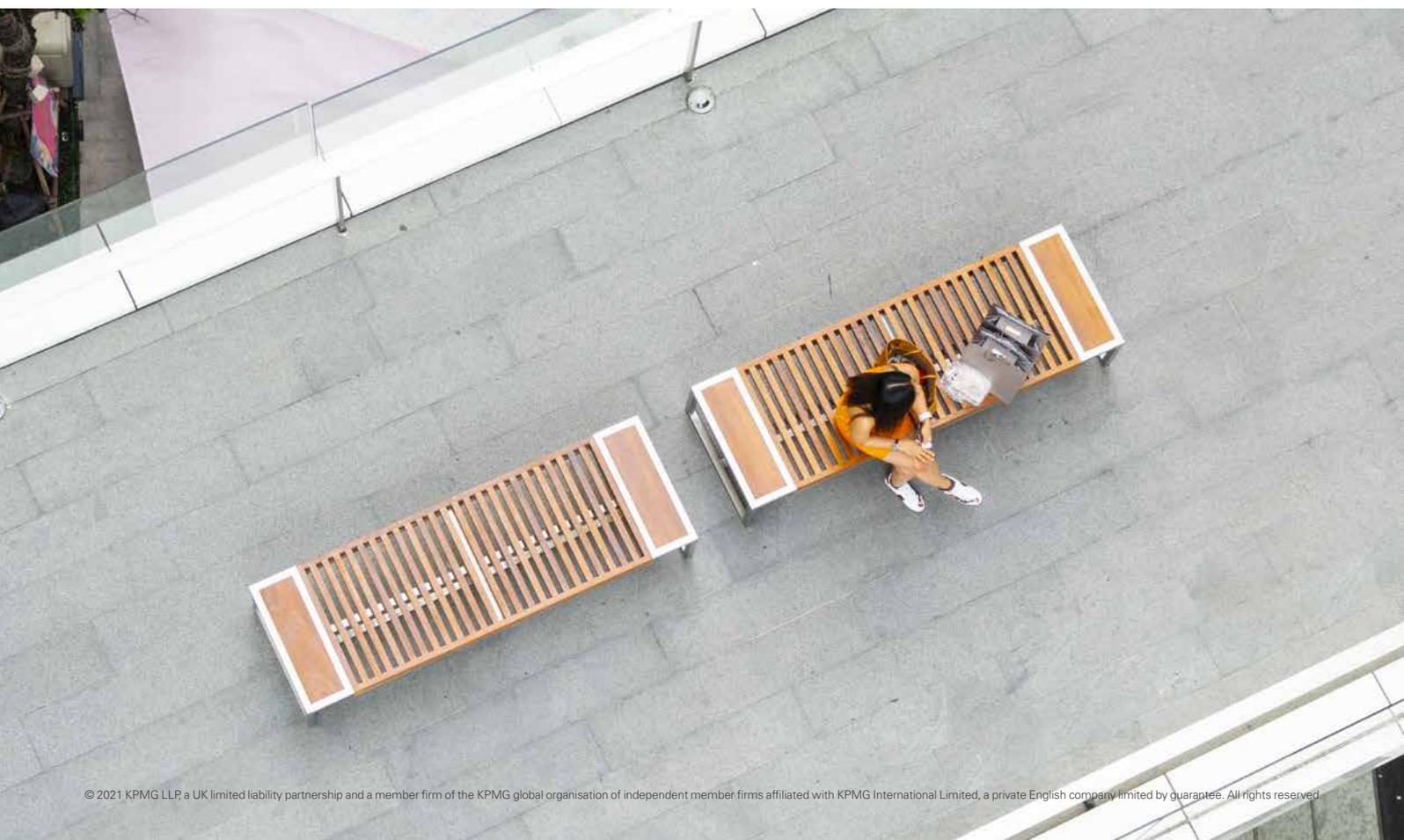
As the level of data, and access to that data, continues to rise, data and data ethics becomes even more critical. The FCA recognises that the better a firm's understanding of specific behavioural bias and a customer's circumstances, the better the outcome is likely to be. Unfortunately, the reverse is also true – this data and information

asymmetry can be used to drive commercial benefit to the detriment of good customer outcomes. [Data and data ethics](#) are an existing regulatory priority, but the rapid expansion in the utilisation of technology driven by the response to the pandemic has significantly heightened the associated conduct risks.

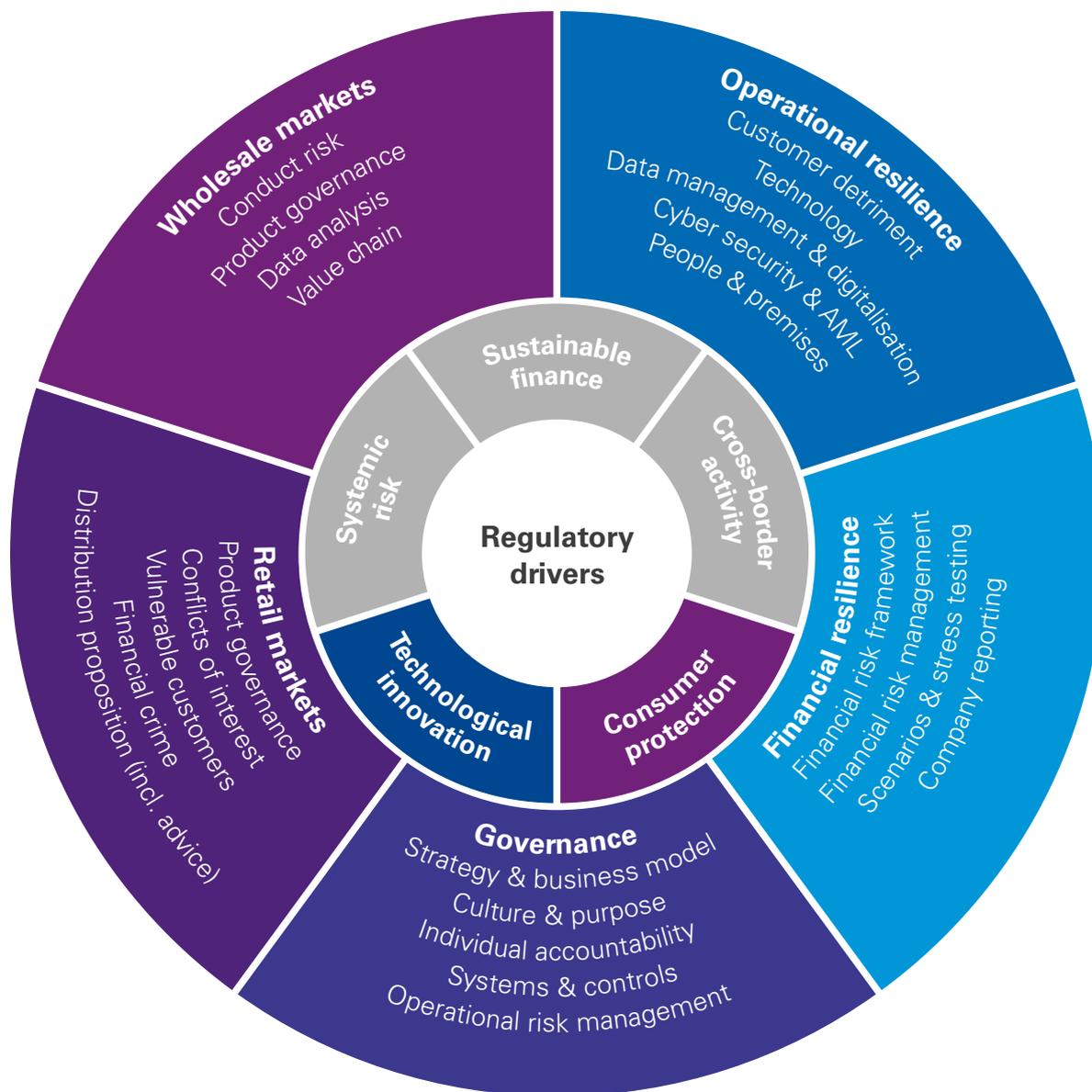
As highlighted above, the rapid advancement of technology and digitisation in response to COVID-19 is explored in further detail, in a separate paper '[Accelerating digital finance](#)' from our New Reality series of publications.

### Example conduct risk

As firms continue to implement 'digital first' solutions, there is a risk that customers that cannot (or will not) engage in digital solutions may be left behind with no (or inferior) alternatives, which could lead to customer detriment, especially for vulnerable customers.



## Consumer protection: a key driver influencing regulatory priorities



**Five key drivers** are influencing priorities in regulatory agendas. Consumer protection and financial stability are the bulwarks of much financial services regulation, but the impacts of the pandemic and lock-down measures have brought additional topics to the fore. Volatility in capital markets has led to a renewed focus on systemic risk in relation to margin, computer-led trading strategies and certain types of funds. Also, the pandemic has accelerated trends in the use of technology and demands for sustainable finance, and there are new challenges to doing business across borders. These three trends are now equally prominent drivers of regulatory priorities.

## 06. Customer service

Customer service teams have experienced a significant increase in requests for support in response to the impact of the pandemic, which is expected to continue as customers continue to face challenges. Firms need to develop additional engagement and communication channels to meet these expectations and to provide this support. Firms developed contingency plans to deal with the wholesale move to remote working and incremental conduct risks were generally identified and mitigated. However, these tactical controls will need to be reconsidered as the firm moves to hybrid working to ensure they remain as effective and able to deliver consistent good customer outcomes, regardless of where the servicing physically takes place.

Customer service has traditionally been operated in a relatively standard format utilising a hierarchical command and control structure. Front-line employees are overseen by team leaders who report into a suite of managers and/or senior managers and then to the Operations Director/Chief Operating Officer. This structure has operated effectively and efficiently and has been a robust structure within which to manage the unique array of customer queries and requests with a high degree of certainty on service levels, call durations and expected KPIs.

Firms operate either (i) a General Practitioner approach, where all customer service can generally be picked up by any customer service agent, (ii) disparate and discrete teams that deal only with their own specific areas, topics or expertise, or (iii) a combination of these approaches. The way that firms were set up pre-COVID-19 impacted how quickly they could respond to remote working. As the primary point of interaction with the end-customer, customer-facing teams play an instrumental role in aligning customer service to the firm's culture and purpose, managing conduct risk and ultimately delivering good customer outcomes.

## Key drivers

### Servicing volumes

Firms have seen a significant rise in volume of customer service needs, ranging from routine servicing requests and complaints to refunds, cancellations and claims. Firms experienced some challenges in meeting customers' expectations as well as internal KPIs. As firms adopt hybrid working, there is likely to be a long tail to servicing volumes, which some firms are already experiencing.

### Servicing effectiveness

Some firms have not been able to access all systems remotely. Typically, the older (or more rarely used) the systems, the higher the likelihood that customer services may not be able to access them as effectively (or at all) as pre-COVID. Where firms operate hybrid working, this will remain a driver of conduct risk as it can result in a two-tier customer experience related to where the servicing is taking place. It is also likely to involve a manual workaround to obtain the information or update accordingly, which creates consequential risk of poor customer outcomes or customer detriment.

### Health and well-being

Customer service agents have been under considerable pressure for a prolonged period of time. Like most staff, they have not previously had such prolonged periods of remote working. Also, they are less likely to benefit from natural breaks in their call handling or the ability to de-compress after a particular difficult interaction. The ability for the team leader and/or manager to spot indicators of stress and intervene is reduced. Working remotely and hybrid working is reliant upon self-identifying and administering self-care. Further, the nature of calls may have an adverse impact on mental health and

wellbeing. Customer service agents will be dealing with very vulnerable customers at their lowest ebb, financially or emotionally. Regularly dealing with issues of this nature, without more normal calls that act as breaks and reset the mind, can create consequential well-being concerns as well as conduct risk and risk of customer detriment. Whilst the move to hybrid working will help mitigate some of these risks, there will be residual conduct risks to be addressed.

### Key considerations

Working under pressure, in a sub-optimal working environment with incomplete systems access supported by manual workarounds, will inevitably have impacted the efficiency and effectiveness of customer service. A consequence could be poor customer outcomes and/or customer detriment. Different firms will have, to a greater or lesser extent, experienced these challenges during remote working. The move to hybrid working may help mitigate these risks, but will create additional complexity. Customer service staff may be required to operate two separate and disparate processes and procedures depending on the location they are working from. This will increase the risk of errors. Further, operating dual processes will mean that customers will experience different levels of customer service and potentially different outcomes depending on where the customer service is taking place. The regulator is unlikely to be comfortable with this arrangement if the delta is material.

The relentless pressure that some customer service teams have been experiencing can drive errors from a different perspective. Many firms have fully embraced the FCA's persistent message in relation to due consideration and fair treatment

of vulnerable customers. However, having dealt with a higher volume of vulnerable customers than previously, they will naturally be more attuned and comfortable agreeing concessions which fit an existing fact pattern. Whilst this consistent approach is a positive, it also exposes customer service to an increased risk of automatically agreeing concessions without gaining a full understanding of a customer's specific circumstances. As criminals find more and more sophisticated ways of exploiting firms, some are mimicking vulnerable customers' situations to obtain debt forbearance and other benefits. Customer service agents may be too trusting, busy or emotionally-spent to ask the appropriate questions to determine whether the enquiry is genuine or not.

Further, the relentless nature of persistent client queries centred around bereavements and/or financial hardship is draining for client service agents and can adversely impact their performance. Regularly rotating employees onto other less emotional and draining tasks as well as training and broader support helps to mitigate this risk. This is more important where client serving is likely to be maintained as a remote activity as the typical signal of stress that colleague or team leaders/managers can spot will not be as obvious for remote workers.

#### Example conduct risk

With the expected wide scale adoption of hybrid working, there is a risk that unless more remote access to legacy systems is more efficient, there is a risk of a poorer and/or slower customer outcome if the client service is undertaken remotely.

## 07. Operational resilience

Operational resilience was a key area of regulatory interest before the pandemic struck. Given the incoming [rules](#), firms should already have started to consider how they would prioritise and strengthen their operational resilience. The pandemic proved to be a real-life stress test and firms now have the opportunity to leverage their learnings as they implement the final policy and rules. Robust operational resilience strategies need to reflect the accelerated adoption of technology, increasing sophistication of external bad actors, the interconnectedness of the financial system and firms' dependencies on third parties and people. All these have the potential to increase the risk of customer detriment. Firms must act now to future-proof their businesses and, as they do, they need to ensure that they appropriately factor in associated conduct risks in order to minimise poor customer outcomes.

Regulators view operational resilience on an equal footing with, and as a key driver of, financial resilience. They recognise that poor resilience has the potential to impact not only individual firms and wider financial stability, but to lead to conduct risks resulting in poor customer outcomes.

There has been a tangible shift in perspective. Regulators are taking a new approach to resilience: not if, but when. They now expect firms to consider not only what would happen if they were to experience disruption, but how they will respond when it does. The FCA defines operational resilience as "the ability of firms, financial market infrastructures and the financial sector as a whole to prevent, adapt and respond to, recover and learn from operational disruption".

Historically, the primary resilience focus for regulators was cyber and ICT security. These remain critical, particularly under the stresses of the [COVID-19 pandemic](#) and beyond, with accelerated adoption of technology and increasing sophistication of external bad actors. Firms must consider the possibility of multiple concurrent disruptions and the emergence of new threats and vulnerabilities. Extreme events arising from climate change, from floods to wildfires



to unexpected snowstorms, could impact physical operations. The regulations highlight the importance of identifying severe but plausible tailored scenarios, and of performing stress-tests to reveal weaknesses in operating models.

### Key drivers

In order to meet the operational resilience [expectations](#) of the UK regulators, firms need to plan to be able to continue providing the services most relied on by customers and markets – “important business services”. These are services provided by a firm, or by another person on behalf of the firm, that, if disrupted could potentially, cause intolerable levels of harm to one or more of the firm’s customers. Boards and senior management must ensure they have a clear understanding of the level of service disruption that could cause intolerable levels of harm. For many firms, this will mean a shift away from thinking about the resilience of individual systems and resources and towards considering the ways in which customers use and view services provided to them. When identifying important business services, firms should consider both the size and nature of the consumer base. It is possible that in some cases, only a

small number of customers would be affected by disruption but that, having considered all other factors, the firm may still consider a service to be important. Firms must also clearly define the point at which disruption to an important business service would cause intolerable harm by setting “impact tolerances”.

Financial crime has increased significantly as a result of the pandemic and is unlikely to recede quickly (see [here](#) for further details). Criminal activity is becoming ever-more sophisticated and scams have become more prevalent, heightening the need for resilient ICT including cyber security to protect customers. Firms will require protection, detection, response and recovery programmes that are regularly tested and are able to adapt to and keep pace with external developments.

Increased regulatory expectations around treatment of customers when disruptions occur will drive the need for robust internal and external communication plans, with an emphasis on ensuring the timeliness and accuracy of information provided. If these are not appropriately implemented, customers may be unable to make informed decisions, understand the prognosis, or progress/plan for resolving issues, all of which could lead to customer detriment.

### Key considerations

Firms are expected to define for themselves what constitutes an important business service. This will depend on the size, nature and customer base of each firm and the potential impact of each service on customers and markets. The FCA has not provided a one-size-fits-all definition and instead encourages firms to take a proportionate approach. From a retail conduct perspective, there is a risk of significant customer detriment if a firm is not sufficiently customer-centric in this analysis. Firms will need to reach intelligence and evidence-based conclusions to ensure that all important business services are captured from the perspective of the end-customer (rather than purely from source of revenue, reputational damage for the firm or any other firm-driven metric). The relative importance and impacts of business services may change over time and therefore firms will need to keep this under review. For example, access to mobile or online banking may not have been an important business service many years ago as it was only used by a minority of customers.

Intolerable harm is defined as harm from which consumers cannot easily recover. Considerations should include: the number and types (such as vulnerability) of consumers adversely

impacted; financial loss to consumers; financial loss and reputational damage to the company where this could harm consumers; impacts to consumer confidence; loss of functionality or access for customers; and any loss of confidentiality, integrity or availability of data. Note that “intolerable” harm is much more severe than “inconvenience” or “harm”, which can be remediated by firms so that no ill-effects are felt in the medium to long term.

Although impact tolerance is not the same as risk appetite, there is value in understanding the degree to which they are appropriately aligned. As for important business services, impact tolerances should be determined from a customer perspective to minimise customer detriment and poor customer outcomes. Firms should use a variety of metrics, including a mandatory metric of time/duration, to measure their impact tolerances – these should consider both the number of customers affected and the associated materiality/impact.

Firms will need to test their impact tolerances against “severe but plausible scenarios”. Pre-COVID, although a pandemic has been a consistent standard risk scenario, it is unlikely that it was envisaged in the scale and speed of transmission being experienced. Firms should consider the likelihood of multiple simultaneous disruptions e.g. pandemic plus cyber-attack, cyber-attack plus extreme weather event plus hybrid working. This requires firms to think more about the interactions of different impacts and how to prioritise responses and make difficult trade-offs. The list of scenarios should not be seen as static and will need to be reviewed regularly, ensuring that considerations underpinning operational resilience are proactively maintained and adjusted as necessary. Firms should also ensure that the outcomes of testing feed into other relevant key controls such as the product governance framework.

Firms are expected to develop an appropriate range of communication strategies to keep customers informed. Communications in the event of an operational disruption should be “clear, timely and relevant”. Firms should be mindful of consumer access to different channels and should consider how they would provide important warnings or advice quickly to all customers, including when there is no direct line of communication. There is value in testing communications with retail customers to ensure that they are fit for purpose and align with consumers’ expectations, in order effectively to mitigate associated conduct risks.

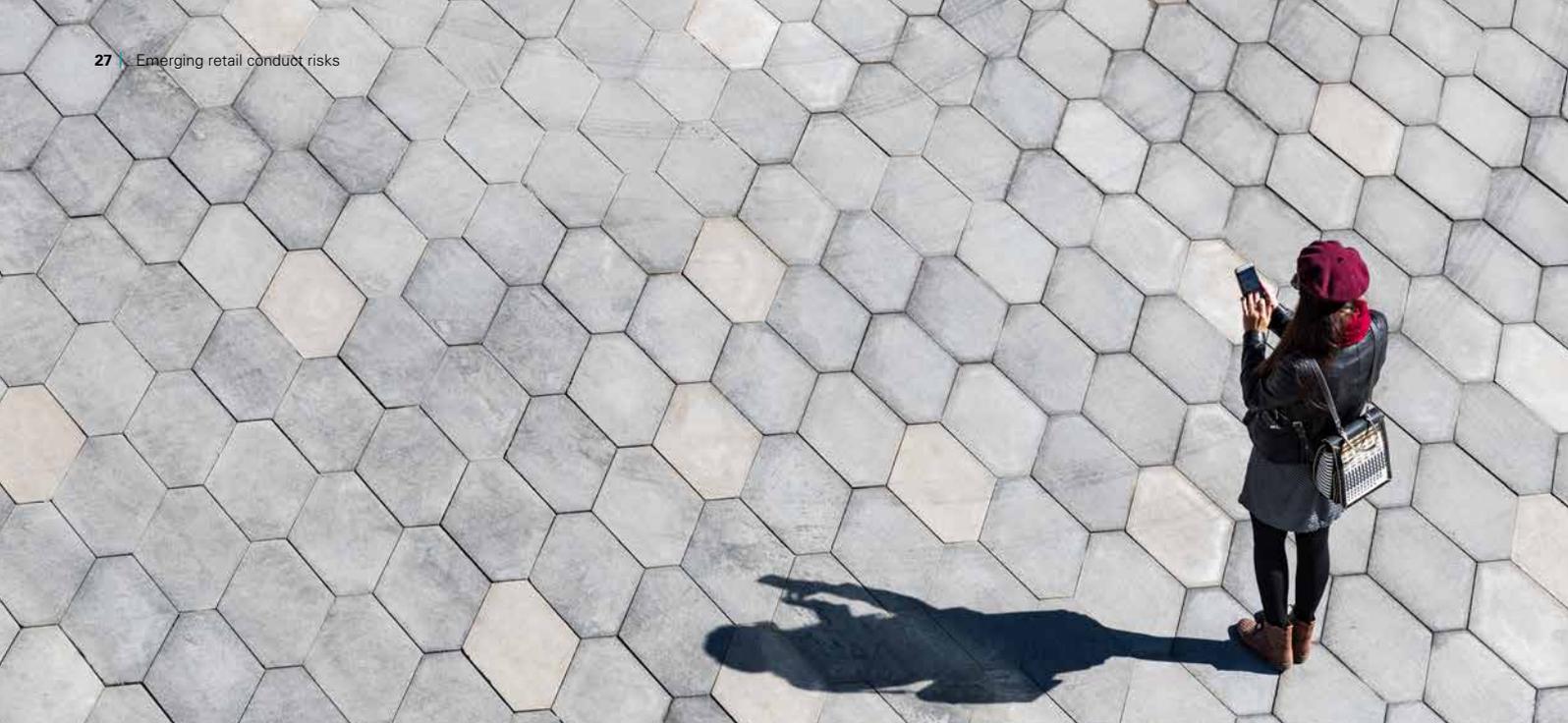
A firm’s governance arrangements can also create the potential for poor customer outcomes if the Board and senior management fail to deliver effectively against the incoming operational resilience requirements. There is an expectation that Board and senior management will sign-off firms’ mapping exercises, setting of impact tolerances and self-assessments. If the mindset of the Board or senior management deters or prevents effective consideration of the firm’s obligations from a retail conduct and end-customer perspective, there is a risk that the firm’s approach may not effectively manage customer detriment risk.

As with other topics covered in this paper, operational resilience should be viewed as an outcome rather than a tick-box exercise. It is critical to supporting good customer outcomes.

See our New Reality paper [Redefining operational resilience](#), which considers how regulatory perspectives on operational resilience are developing, how the landscape has shifted as a result of COVID-19 and what firms can do now to strengthen their operational resilience through the recovery and beyond.

#### Example conduct risk

Unless the firm’s operational resilience framework appropriately considers the customer throughout its design and deployment, there is a risk that aspects of retail conduct risk and impacts are not fully considered, which could lead to poor customer outcomes and customer detriment.



## 08. Financial crime

Financial crime controls have arguably been under more pressure than any others. Like other controls, firms have had to adapt them to remote working and will need to augment them again to be effective controls with hybrid working. However, the broader economic impact of COVID-19 and lockdown measures has also increased the number of businesses that are more susceptible to approaches from criminals (or motivated to commit crimes themselves). Customers are also more likely to become victims as criminals develop more and more sophisticated approaches. Scammers tend to target people who are more vulnerable as they have a greater chance of success, which can inflict significant and irrecoverable consumer harm.

Financial crime is a consistent regulatory priority in the FCA's business plan – for good reason. It is estimated that serious and organised crime costs the UK at least [£37 billion](#) each year, posing a serious threat to the UK's economy, reputation, citizens and national security, and leading to significant customer detriment.

Even prior to the pandemic, the FCA was [encouraging](#) firms to build greater resilience to economic crime through sustainable improvement in their systems and controls so that they can spot, disrupt and stop these activities. However, the FCA recognises that reducing financial crime is not solely the remit of regulated firms. Since 2019, it has committed to implementing changes

in its approach to reducing financial crime. These include making greater use of data to identify firms or areas that are potentially vulnerable. It also introduced the [ScamSmart](#) campaign to educate consumers and help to mitigate harm to consumers.

### Key drivers

The level of financial crime and scams has risen [significantly](#) since the start of the pandemic and this heightened risk is likely to persist as firms implement hybrid working. There are three key drivers, which are inter-related and connected, and combine to illustrate just how difficult it will be for firms, and the FCA, to spot, disrupt and prevent financial crime.

### Economic environment

The UK's economic environment is in a unique situation. Elements of the economy have thrived during COVID-19, but many have suffered or ceased. Some businesses have been closed for over 18 months. There is therefore significant pent up demand and, as sectors gradually open up, consumers who have been saving their money are likely to embark on a flurry of spending, potentially for a prolonged period of time. The amount of money in circulation in the UK will be exacerbated by continuing restrictions on, or appetite for foreign holidays. This unpredictable profile of spending increases the opportunities for criminals to take advantage of consumers, as unusual transactions become harder to spot.

### Customer circumstances

The driver here is twofold. As a result of COVID-19, customers are more likely both to be a victim of financial crime and to commit it. The underlying motivation for committing crimes is likely to be a combination of greed, desperation and vulnerability. Many businesses are in a precarious financial position. They may not currently have the luxury of integrity and therefore may be more susceptible to approaches from criminals to launder money through their failing business. The number of businesses that have been significantly impacted by COVID-19 provide a strong pipeline of businesses that criminals can seek to exploit. To illustrate the challenge, FCA has [reported](#) that pension savers were nine times more likely to accept advice from someone online than they would from a stranger met in person.

### Employer and employee exposure

The level of exposure to the pressures of financial crime will have increased for firms as well as their employees. Even as some employees move back into the office, criminals are aware that the increased level of remote working will mean that some existing controls have failed, been weakened or are simply not as effective. Criminals will continue to seek to exploit those opportunities.

Even for employees whose role is to mitigate financial crime risk and who are now familiar with remote working, there will be inherent inefficiencies and residual conduct risk as hybrid working is established. Hybrid working may drive many advantages for both employer and employee, but it is potentially also a driver of risk through increased isolation of employees and increased likelihood of unpermitted access to laptops and other technology.

### Key considerations

The potential scale of financial crime is unprecedented and even with perfect systems and controls, firms may not be able to cope with the increased number of bad actors, the more so if they are under financial strain.

Firms' pre-COVID financial crime controls were not designed to be operated purely remotely and firms have extended significant effort to make them as effective as possible. However, residual gaps and weaknesses remain. Neither the changes made to operate remotely nor the pre-COVID controls will necessarily be effective in a hybrid working environment and further changes will be required. This may, in the short term at least, reveal new inefficiencies or weaknesses that criminals will seek to exploit while the new control environment is developed, deployed and embedded.

Beyond the sheer scale of criminal activity is the risk of ineffective detection controls. As businesses start to open up, neither they, nor their banks, will have accurate forecasts about future revenue flows. Many businesses have re-invented themselves and will operate very differently in the future. Criminals may not need to convince a small number of firms to launder significant volumes of cash, but instead seek to launder comparatively small amounts of cash via a large number of firms. This risk may be exacerbated for cash-intensive business such as bars, clubs and casinos.

Although employee risk may reduce as firms move into hybrid working, there will remain a residual risk that is hard to mitigate fully, at least in the short term: the risk associated with unpermitted access to screens or

documentation by family and friends will increase as access to homes returns to normal. Financial crime departments have experienced an unprecedented level of demand for their resource, expertise and insights. Without taking sustained breaks away from work (and the current working environment), there is a risk that fatigue will adversely impact the quality and levels of detection and that errors will be more likely. This will be exacerbated by the lack of ability to share insights and intelligence freely and proactively, as was possible in a purely office-based environment.

Finally, the current environment has also made consumers more susceptible to scams and fraud. As loneliness and mental health challenges have increased, so has the level of online and telephone scams that prey on vulnerable consumers. Banks' automated detection systems will need to be re-calibrated as consumers' spending patterns change again, albeit not necessarily back to the same shape and style as pre-COVID. There is therefore further challenge to augment associated systems and controls to try to predict future trends and help guard against customer detriment.

#### Example conduct risk

As a result of a change of approach by criminals, there is a risk that firms' existing configuration and trigger limits may be insufficient accurately to identify incidents of potential financial crime, which could lead to customer detriment.

## 09. Oversight, governance and controls

Risk management, oversight and controls will continue to be made more challenging, to varying degrees, by the move to hybrid working, which will require a different balance of where and how risk management is actioned. Even once a hybrid risk model and oversight arrangement are developed, they will require inherent agility and further changes will be needed, alongside changing business models. Hybrid working practices will take some time to evolve and associated controls will need to evolve with them. Risk mitigation and control will take on a different emphasis.

### Oversight

With any large-scale move to hybrid work, the ability to perform physical oversight in the office will re-occur, but this will require a greater degree of co-ordination than the historic office-only default approach. The tactical risk management processes and controls developed in the immediate response to COVID-19 will need to be revisited and re-appraised to ensure that risk management is location-agnostic to allow for the frequent and seamless transition between locations. Likewise, risk identification, mitigation and monitoring will be impacted as the shift away from remote-only working takes place.

The focus will now be on reassessing relevant risks, re-evaluating and re-calibrating the risk universe, and validating the appropriateness of associated controls, including increased use of technology for hybrid working. This exercise will likely impact all aspects of risk management (including all three lines of defence), take the form of both top-down and bottom-up analysis, and involve both business and control functions. The outcome could be significant for some firms and could further reshape their business model or strategy.

Given hybrid working will evolve, once a hybrid risk model is developed, it will require inherent agility and further changes to risk management and controls should be expected. Firms will need to be more reliant on the individual conduct of employees in the longer term. They may seize the opportunity to replace narrow controls with a greater emphasis on culture, behaviours and outcomes, reflecting the FCA's stated ambition for firms.

## Governance

Firms' governance arrangements have generally stood up well to the test of full-scale remote operation and dealing with the unprecedented circumstances that the pandemic created. Some key meetings will have been adversely impacted by the lack of face-to-face engagements – typically when those engagements are more creative or investigative in nature. However, many firms are experiencing more positive impacts than negatives. As firms start hybrid working, they will want to continue (in full or in part) the technological aspects of conducting meetings online where they help to make a firm's corporate governance mechanisms more efficient and effective while delivering fair and consistent customer outcomes. Firms are likely to operate both in the new reality, alternating between face-to-face and remote, as and when appropriate.

However, what is still unclear is how firms can ensure that a meeting with mixed attendance is as effective as a face-to-face or purely remote meeting. There is a risk that one set of participants may experience a more productive meeting depending on the dynamics of meeting. Therefore, the challenge for firms will be to ensure that there is no unfair advantage in engaging in either format. The regulator has expectations that a firm's control environment should be effective and consistent, regardless of location.

## Controls

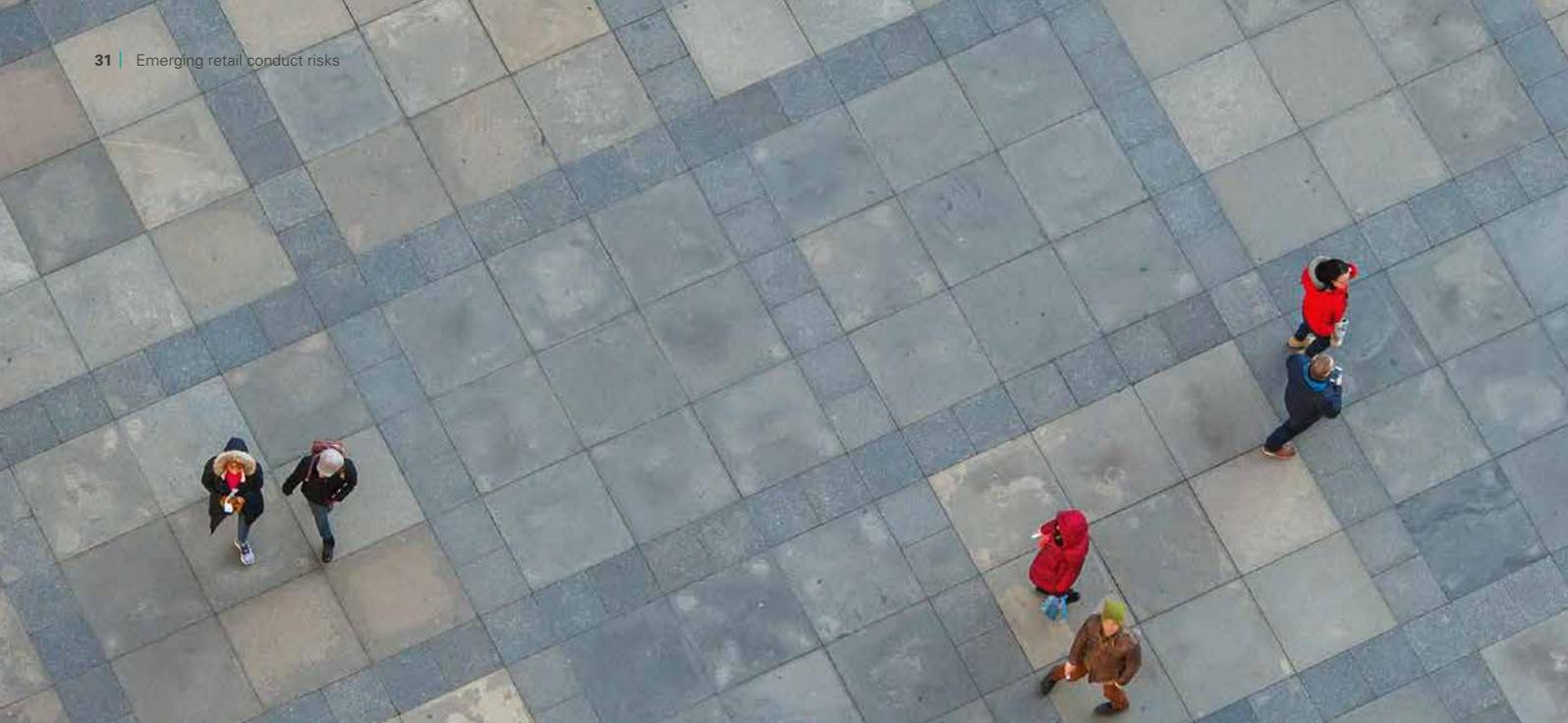
In seeking to delivery good customer outcomes, firms need to manage a portfolio of conduct risks via a range of effective controls. Viewed in isolation, each of other topics provide an indication of the size of the challenge for firms to ensure that new or heightened specific conduct risks are appropriately identified and managed as firms emerge out of remote working to a hybrid model.

However, there is a further complicating factor that needs to be incorporated into the associated oversight, governance and controls relating to those risks. The risks captured in this paper are not standalone risks and will inform, and be informed by, the other risks captured. Whilst illustrative rather than exhaustive, the diagram [here](#) captures how these new or heightened risks are inter-connected. This requires the associated systems and controls to be agile and robust enough to ensure that the unique combinations of these risks are effectively managed and there is a strong flow of MI across the lines of defence.

See our New Reality paper [Remote controls and governance](#), which explores how the industry is overseen and governed is changing and how regulators will look to respond to and drive change.

### Example conduct risk

As a result of a move towards a more strategic hybrid working environment, the firm's prior controls, augmented for remote working, may not be fit for purpose to allow the firm effectively to oversee, control and govern the firm. This may result in new or heightened conduct risks not being effectively mitigated, which could lead to customer detriment.



## 10. The interconnectedness of conduct risks

As the other sections have illustrated, conduct risks are not linear and discrete, they are inherently interconnected and therefore cannot be mitigated in a standalone or separate fashion. The following diagram provides illustrative, non-exhaustive examples of how the conduct risks highlighted within this paper are interconnected.

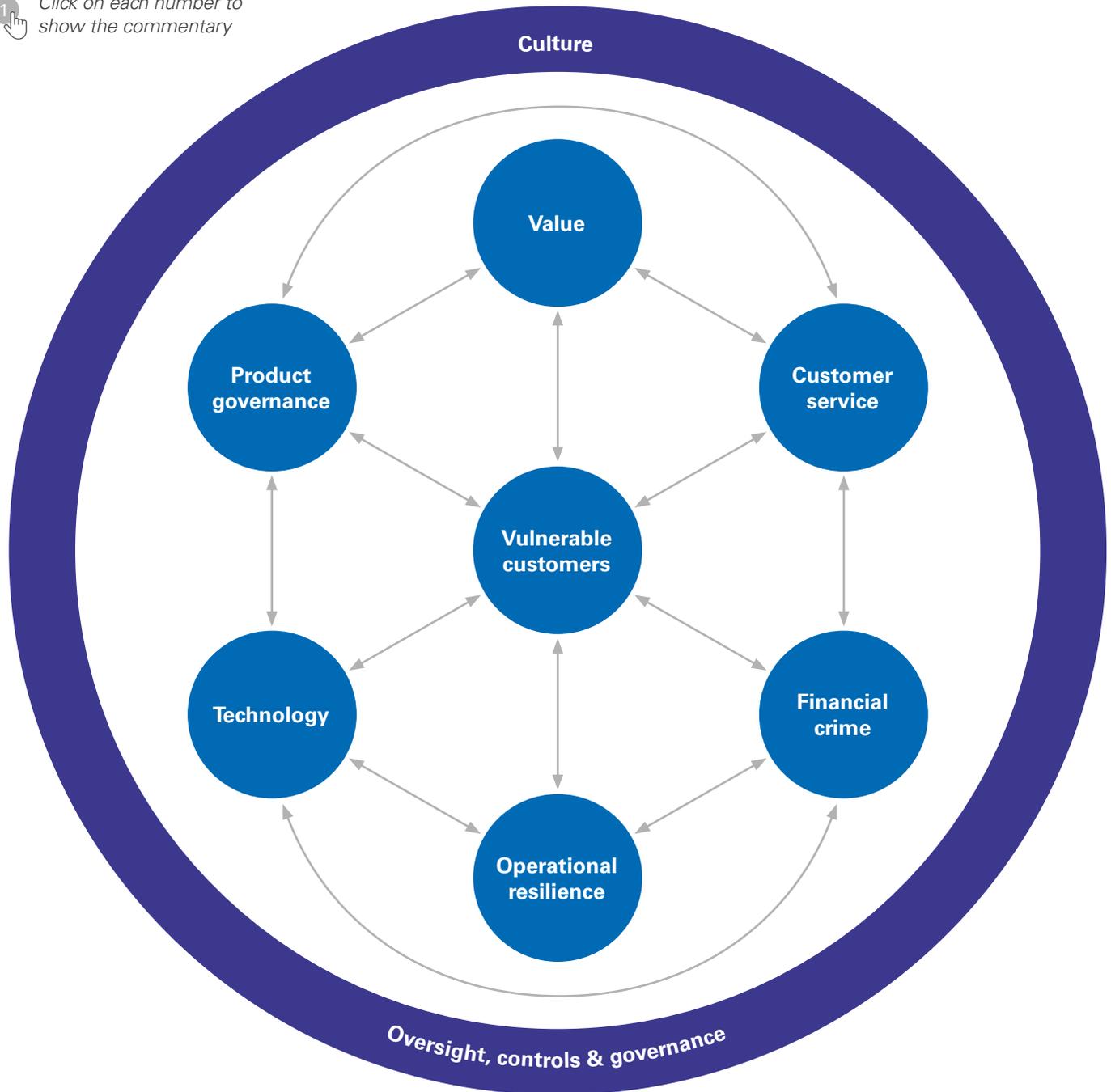
All the risks featured are also impacted by a firm's culture as well as its overarching governance and oversight arrangements and control environment. Culture will set the ethos and drive to the manner in which the firm seeks to address conduct risks. Oversight, control and governance will define the approach, mechanism, appetite, formality, rigour and degree of objective challenge these risks will be subject to.

Firms must ensure that they operate a holistic approach to addressing retail conduct risks so that they can be consistently and robustly addressed to deliver better customer treatment and outcomes, in response to the existing regulatory landscape and beyond.

Whilst the topic of vulnerable customers is central to the illustration, it is not meant to indicate that it is more important than other risks. However, the FCA expects vulnerable customers to be considered at all stages of the customer journey and therefore by all relevant departments within a firm's operation. Vulnerable customer risk is likely to have more intended touch points than some of the other risks captured.

## The interconnectedness of conduct risks

1  Click on each number to show the commentary



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