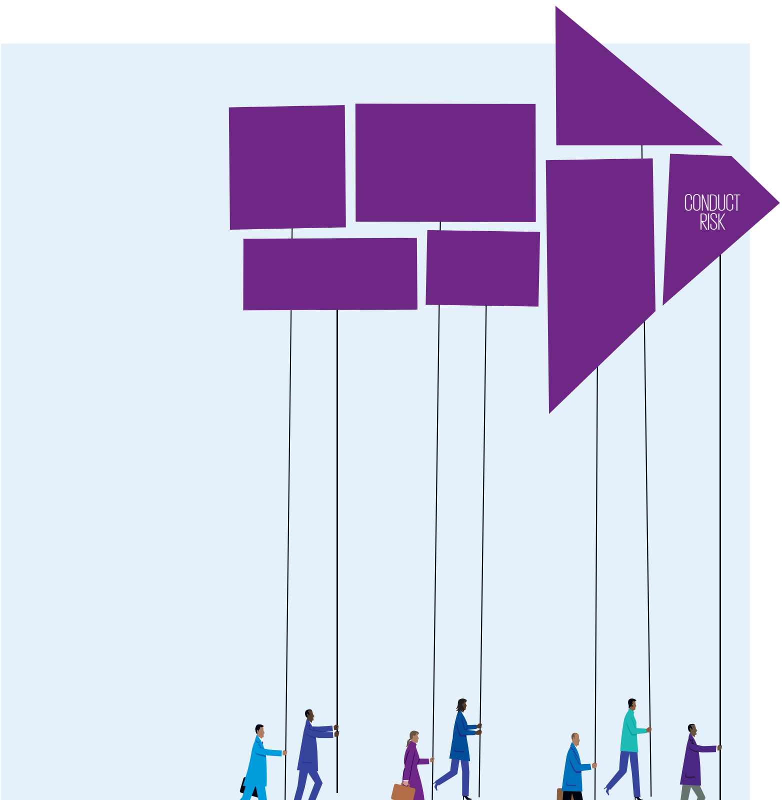
Market Conduct

Regulators have historically sought to enhance a customer's understanding of the products they purchase, imposing prescriptive requirements for disclosure, as well as setting professional standards for sales advisers.

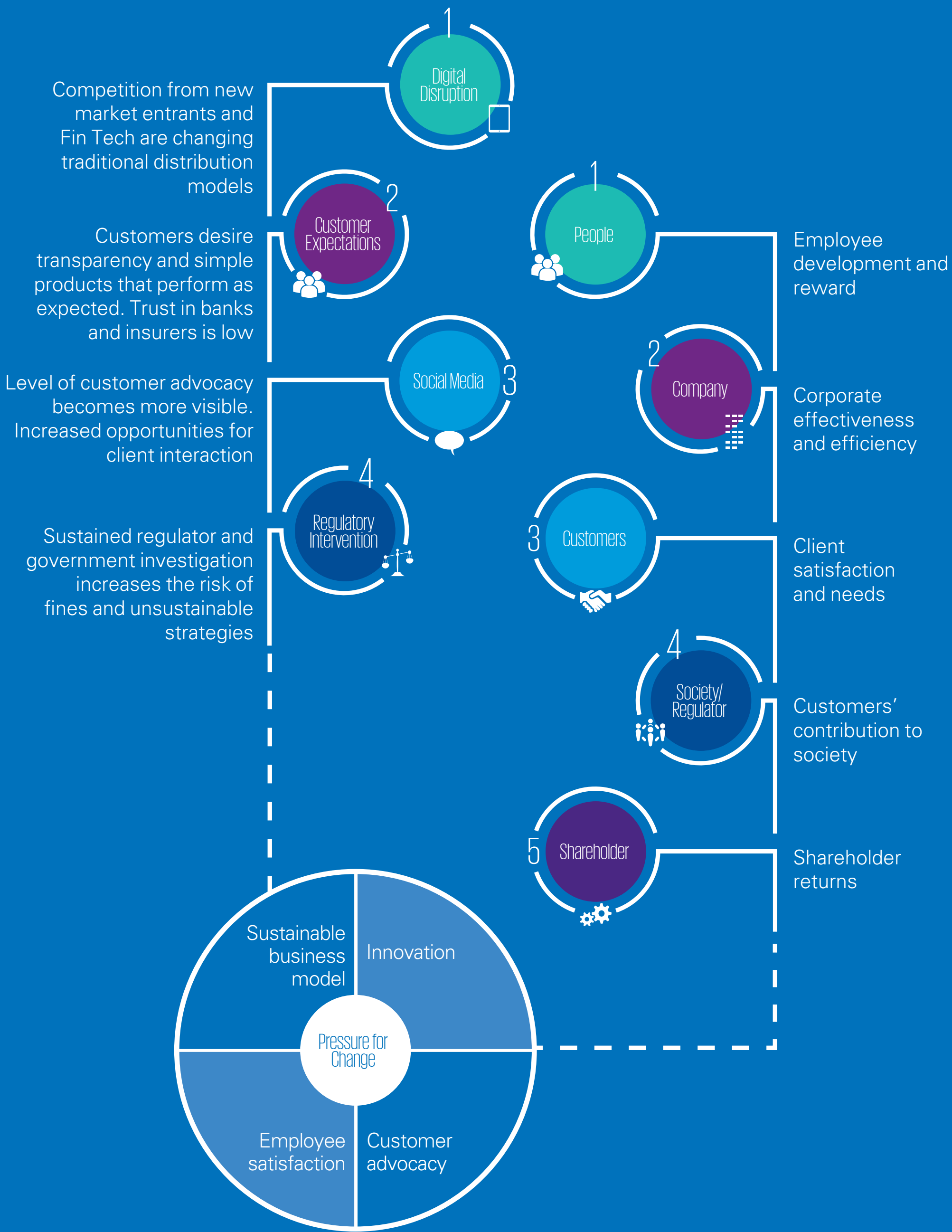
The goal is to rebalance the 'information asymmetry' - however issues have continued to arise. A new regulatory mantra has emerged: 'conduct risk'.

Conduct risk is changing the global regulatory landscape. The aim is to drive financial services firms to revisit their approach to enterprise risk management; to move from a profit driven business model to a strategy that places customer centricity at its heart to rebuild trust in the market.

Conduct risk, and placing the customer's best interest at the heart of everything you do, requires a shift in mind-set. Our clients often ask where do we start, how do we embed conduct risk, what sort of framework should be established? This document seeks to respond to common issues our clients are facing.



Conduct risk and the need for change



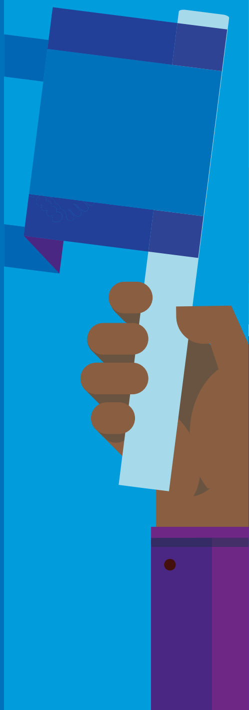
Internal drivers of poor conduct.....

STRATEGY AND BUSINESS MODEL

- Strategy is driven by poor profitability and skewed towards shareholder return
- Drive for profitability creates product complexity and lack of customer value
- Desire to be quick to market on fintech innovation creates unexpected and unique customer impacts

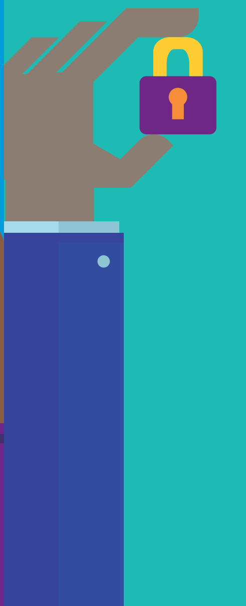
CULTURE

- Culture does not foster an environment where employees are encouraged to identify and escalate concerns
- Target driven employee incentives create conflicts of interest in sales process
- Limited top down communication on expectations of staff behaviour and desired customer outcomes



RISK MANAGEMENT

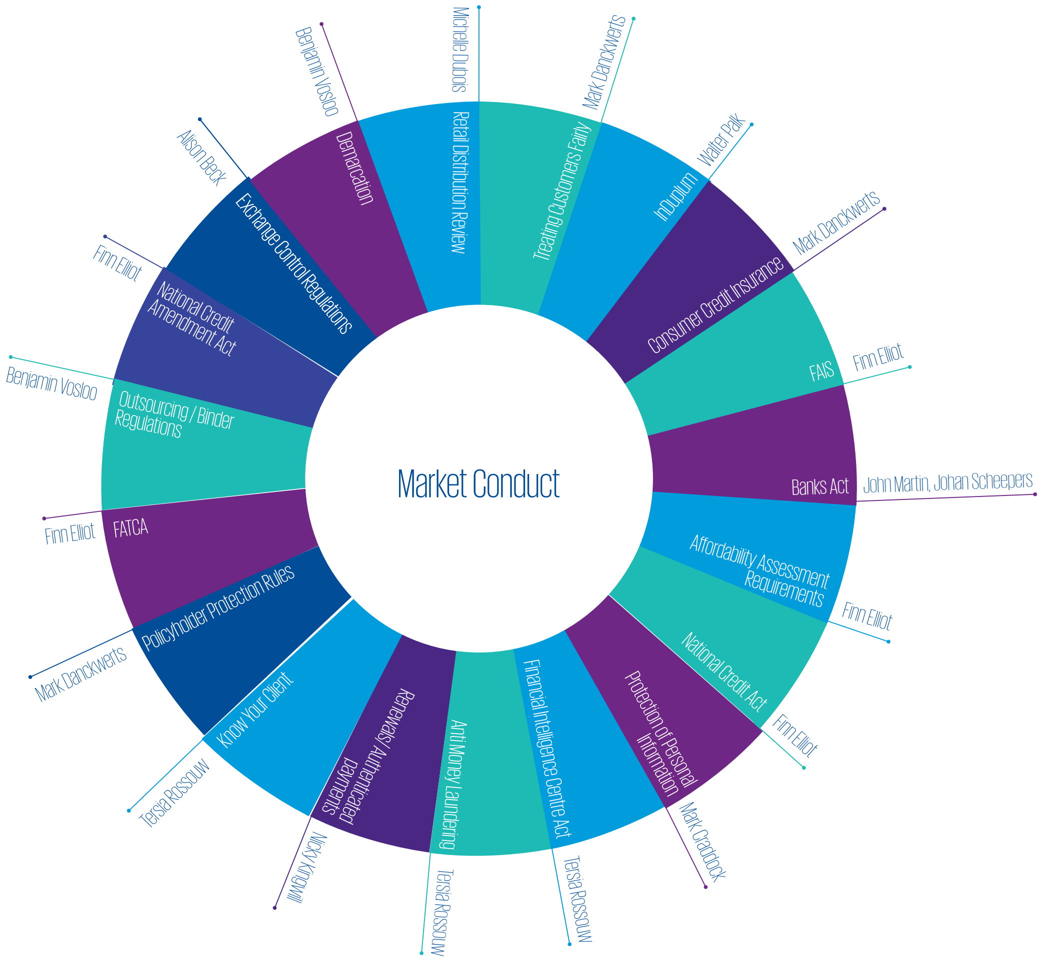
- Risk management, quality assurance and reporting is focused on internal; operational or reputational risks and fails to identify emerging or crystallised conduct risks
- Good conduct and customer outcomes is measured only through customer satisfaction
- Risk is owned by second line assurance functions rather than embedded into strategy and business process

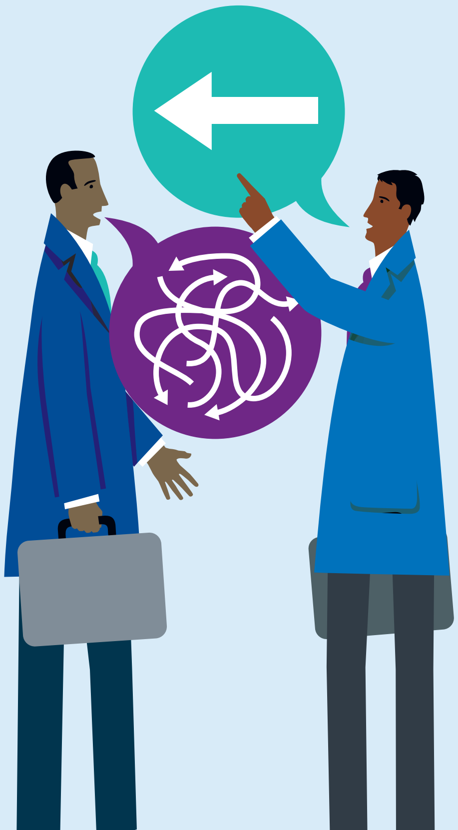


PROCESSES AND PROCEDURES

- Processes and procedures fail to manage poor employee behaviours and do not prevent the risk of poor customer outcomes
- Controls manage business risk rather than customer risk
- Risk culture is not embedded through first line processes and performance management

Our view of the legislation conduct universe





The Conduct Risk Assessment-

Identifying risk, driving accountability and opportunity through the Business Model & Strategy Analysis framework

The Conduct Risk Assessment is designed as a 'first step' in managing conduct risk in an organisation. It is a business owned, top down assessment of a firm's business model and strategy which aims to identify inherent Conduct Risks and the materiality of those risks. The aim is to leverage the breadth of knowledge in an organisation to identify risks so they can be managed and monitored, drive understanding and embed ownership and accountability so conduct risk becomes an opportunity rather than a hurdle.

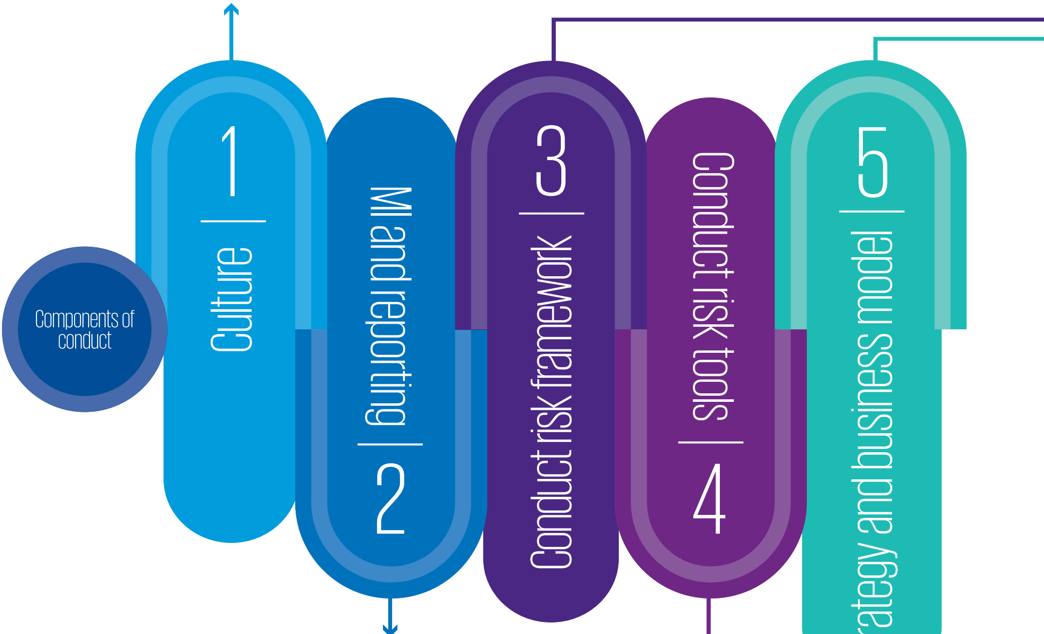
1 Approach

Our approach is based on a series of KPMG facilitated senior management workshops.
They are applied at a business or sub business unit level and are designed to mirror the scale and nature of the client business and minimise impact on day to day activities.

2 Output

The output of the Conduct Risk Assessment is a clear indication of the conduct risks in the business, their materiality and where these risks manifest in the customer lifecycle. We provide suggested next steps where necessary working with key stakeholders to identify practical and pragmatic action plans.

- A firm's culture must drive, enable and empower its employees if it is to avoid poor customer and market outcomes
- Firms should have conduct centric values and principles at the heart of their business
- The right tone has to be set at the top and values should be cascaded throughout the firm
- Individuals should be empowered to do the right thing and there should be real consequences for individuals that exhibit the wrong behaviour
- Objectives, measuring, training, reward and recognition arrangements should clearly reflect focus on good conduct
- Control functions should be empowered to stop wrong behaviours



- MI should provide a current and forward looking perspective on conduct risk and exposure to allow the business to proactively identify and manage conduct risks
- MI should identify emerging risks not just crystalise issues
- Reporting should drive the Board and senior management to have meaningful discussions on the most material conduct risks
- Conduct risk MI should evolve over time, reflecting the changing risk profile of the business
- Metrics should provide a view on the performance of the business against the risk appetite
- MI should be provided in a usable format and at an appropriate level of detail
- Firms must measure their market conduct effectiveness and make future decisions based on what their management information is telling them (root-cause analysis)

- Firms should manage their conduct risks within an established risk management framework and target operating model that is embedded in the business
- Firms should formally define conduct risk and establish a conduct risk appetite statement that includes qualitative and quantitative tolerances
- Firms should implement a conduct risk framework, aligned with the wider risk management framework, that determines how conduct risk is managed by the business
- Conduct risk governance should be established, either within or aligned to existing governance structures
- The business should own the management of conduct risk
- The second line should establish the risk management framework for conduct risk and provide oversight
- Firms must identify their conduct risk universe and establish tolerances based on materiality

- Tools and approaches across the business lifecycle to support the delivery of the conduct risk framework and facilitate successful customer and market outcomes
- "A range of conduct risk tools may be requested to assess and manage conduct risk across the business life cycle:
  - *Business Model and Strategy
  - *Governance and controls
  - *Product design
  - *Sales and transaction process
  - *Post-sales handling
- Conduct risk tools may already exist within the business but should be refreshed to integrate with the conduct risk management framework

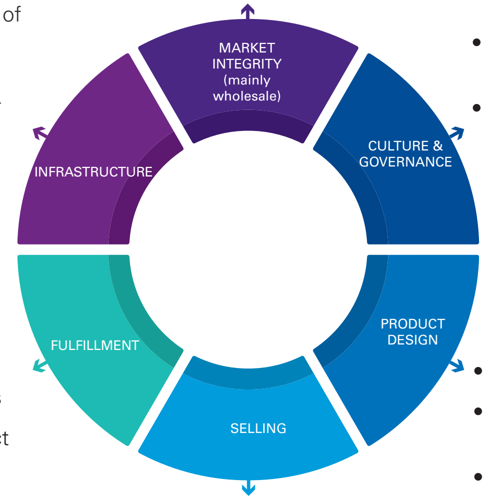
- The strategy and business model and its execution, should reflect customer and market outcomes and should be assessed regularly to identify how conduct risks manifest
- Firms should have a clear understanding of the inherent conduct risks arising from their business model and strategy
- The strategic planning process should explicitly take into account the potential impact on customer and market
- The business model and strategy should be aligned to the firm's conduct risk appetite
- There should be a regular assessment of the inherent conduct risks arising from the business model and strategy
- Where there are conduct risks inherent in the strategy and business model, firms need to take action in respect of these whether it be creating controls or refraining from activity

Business Model & Strategy Analysis Framework

- People
- Information technology
    - Reporting on conduct
    - Support management of conduct risk
    - Operations and customer outcomes

- Market abuse
- Insider-trading
- Anti-money laundering

- Strategy
- Management participation
- Remuneration, incentives and KPIs
- Skills, training and awareness
- Management information
- Oversight and lines of defense



- Customer communications
- On-going product appropriateness
- Recoveries, collections and claims
- Complaints
- Switching and exiting products
- Personal data protection

- Product appropriateness
- Provision of advice, disclosure, and transparency distribution: intermediation and call centres digital channels
- Conflicts of interest
- Product marketing

- Product complexity
- Pricing, fees and value
- Customer targeting

Top 10 conduct risks identified

1. Robustness of technology, infrastructure, digital transformation and fintech
2. Legacy products and lazy money
3. Incentives and remuneration
4. Pricing models and value for money
5. Complex products, terms and conditions, misleading marketing
6. Intermediation and outsourcing
7. Add on products
8. Ageing populations
9. Call centres
10. Poor management information and root cause analysis

Market Conduct- What KPMG can do

Analyse → Teach → Report → Comply

Analyse

Business Model and Strategy Analysis (BMSA)

Market Conduct risks evolve through the way firms do business, their business processes and models and the firm's strategies. KPMG's bespoke BMSA methodology is designed to identify the key Market Conduct risks in an organisation, focusing on the business model and the strategy that drives it by looking at "what could go wrong". These analyses result in a Market Conduct risk universe which forms the basis of the firm's Market Conduct programme and informs areas of additional focus and organisational change.The BMSA can be conducted for the Business as a whole or separately for different parts of the business.

Product design/strategy development

- Conduct Risk Assessment: identification of conduct risks by product or business
- Product Design and Governance Framework Review
- Value for Money and Pricing Review
- Legacy and Back book review

Communications and Marketing

- Marketing Material Review: review of advertising, product disclosures and terms and conditions for clarity and misleading information
- Marketing Controls Review: review of approval process and associated guidance and tools for effectiveness and efficiency

Sales quality advice and customer outcomes

- Sales Quality Review: review of sales for appropriate customer outcomes
- Financial Advice Quality Review
- Sales Remuneration and Incentives Conduct Risk Assessment
- Sales Controls design and Operation Assessment

Sales Quality assurance

- Business Quality Assurance Effectiveness review (1st line controls)
- Compliance Quality Assurance Effectiveness Review (2nd line control)
- Training and Supervision Assessment

Post sales and servicing

- Insurance: Claims Handling and Decision Making Review
- Banking: Arrears and Collections Management Assessment
- IM and Banking: Trader Surveillance
- Complaints Management and Root Cause Analysis Assessment

Bottlenose Technology

Firms receive data from multiple sources in unprecedented volumes, some of which are difficult to track and manage. One of the biggest difficulties is knowing how to identify relevant insights from this information to address the opportunities, issues and challenges facing your organisation. Utilising Bottlenose Technology, KPMG can help you track news and social media chatter / activity to detect and isolate patterns and actionable trends using real-time streams of data.

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Teach

Market Conduct awareness sessions and training

The KPMG Market Conduct practice is aligned with our global member firm regulatory practices to stay abreast of international developments. As a service to many of our clients, we provide C-suite level training covering issues which non-executive directors, directors and other executives should be focusing on in respect of Market Conduct. We also provide bespoke training for larger audiences focused on the needs of specific business units within organisations e.g. call centre staff, sales staff etc.

Online Training (E-learning)

Online training course designed to educate members of staff on Market Conduct and the fundamental principles of TCF. Through the use of voice, video, animation and sound the user is guided through an interactive presentation consisting of four modules leaving them with an understanding and appreciation for Market Conduct, its objective and common drivers of risk. It concludes with a fifteen question assessment which KPMG, via the use of dashboards is able to interpret and share with you. The number of employees who have concluded the modules and passed the assessment is also a valuable piece of management information.

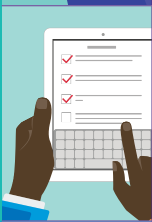
Report

Konduct

Management Information and reporting are essential components of Market Conduct programmes, attracting increased emphasis and scrutiny from the regulator. MI and reporting are clearly a priority, with all indications suggesting that the regulator will be focusing on:

- how the entity is pulling MI together and analysing it from an outcomes lense;
- whether the entity has a summarised, sensible and meaningful view of MI on Market Conduct; and
- whether this view results in a risk-based prioritisation of Market Conduct risk.

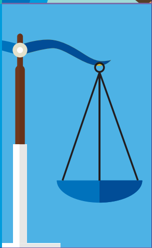
Smart analysis and interpretation of data enables entities to make informed decisions and identify potential conduct issues. Konduct is an analytics platform that helps organisations measure, manage and predict Market Conduct risk by presenting and visualising complex data in a summarised, sensible and meaningful way.



Conduct DQM Assessment

One of the key influencers in the Market Conduct Journey is the availability and accessibility of quality data. KPMG understands the issues and challenges faced with data and have developed the Conduct DQM Assessment, to identify issues with the integrity and completeness of key data elements within currently available data structures in organisations, to assist in identifying possible issues in data retention procedures, isolate root causes and provide gaps in data quality management, data ownership and processes.

Comply



Regulatory Readiness Assessments

The Market Conduct regulator is increasing the intensity of its supervision and its intention is to conduct risk-based interviews with organisations. This means that the Regulator already has a good idea of what it will focus on, depending on firms' operating models. Having delivered many remedial plans following regulatory visits, the KPMG Market Conduct practice is well placed to help firms prepare for regulatory inspections, particularly in identifying shortcomings and formulating plans for the identification and coordination of appropriate evidence to be available for the regulator.

Konduct

Konduct is KPMG's Conduct Risk technology solution that helps organisations measure and manage Conduct Risk using actionable intelligence.

- Developed based on KPMG expertise
- Can be updated by business users
- Workflow and action tracking
- Real time, intelligent insights
- Trending and base-lining risk
- End to end solution
- Time/cost saving
- Smarter visualisation

Automation, aggregation and action management within Konduct enables risks to be identified, understood and actioned in a quick and cost-effective manner.

Konduct helps focus resources on risk analysis and mitigation rather than data collection and reporting.

The Konduct tool can be configured quickly and easily to address specific business issues and present complex data in a way that enables firms to manage their business and risks more easily.

Business users can easily update the application without the need for expertise:

- Create, amend and delete metrics
- Add new users and manage user access
- Amend dashboards, both in terms of layout and charts

This allows the platform to evolve in tandem with your business and risk frameworks

Analytics engine

Sophisticated data aggregation

Powerful in-memory analysis and modelling

Configurable rules engine

Data capture

Interactive UI for manual data entry

Real-time automated data collection
Connection to existing data stores and systems

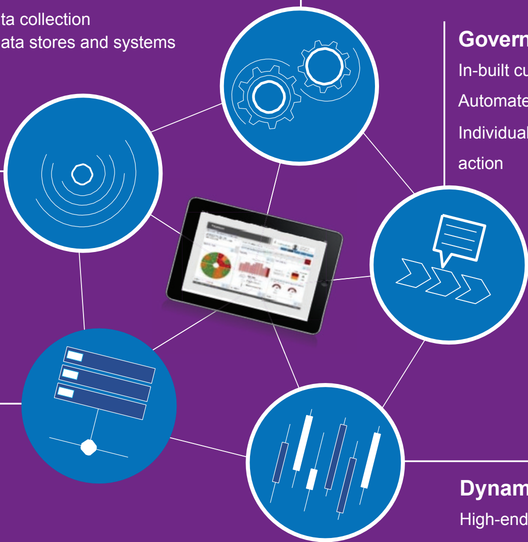
Governance & action tracking

In-built customisable work flow

Automated triggers and alerts

Individuals assigned to each

action



Data storage

Extensible object data

model Scale quickly

Time-varying data

Dynamic reports

High-end D3 visualisation

Personalised and

configurable Drill-down to

underlying data

Conduct risk assessment methodology

Define		Assess
Phase 1	Phase 2	Phase 3
Planning and Scoping	**Business Analysis and Conduct Risk Hypothesis**	**Conduct Risk Workshops**
Initial groundwork to plan and scope the Conduct Risk Assessment including timing, stakeholders, the scale and scope of the review to tailor it to the operating group.	Independent analysis of key strategy, business model information and the external risk environment. Development of initial conduct risk exposures and themes.	Facilitation of workshops with senior business management based on key Conduct Risk Themes, identification of inherent conduct risks specific to the business.
Week 1	Week 2	Week 3
Key Activity		
• Identify business sponsor • Work with sponsor and key stakeholders, plan the scope and plan the assessment review based on the nature and scale of the operating group • Identify any key areas for specific focus (new products, areas of regulatory concern, recent change in strategy or commercial focus) • Plan and deliver assessment logistics: document request, stakeholder lists, suggested workshop dates, workshop attendees, diary invites • Agree checkpoints and timelines with sponsor	• Develop conduct risk hypothesis through business model and strategy analysis • Generic: identify the generic conduct risks inherent to the business model • Specific: critically analyse internal documentation and data for specific conduct risk exposures inherent in the business • External: analyse the external environment for emerging conduct risks in the market, economy, regulatory environment and customer activity • Document initial hypothesis and themes for discussion (phase 3)	• Risk identification workshop • Facilitate workshop sessions for senior stakeholders to: - Create understanding of conduct risk; and - Identify the material conduct risk exposures in their business. • Use output of phase 2 to structure discussions by theme and as input to drive rich discussion and challenge. • Document outputs of workshop • Risk validation workshop • Share output at a final workshop to validate findings and identify gaps. Initial discussion of next steps • Follow up individual discussions with key individuals where necessary to explore key areas

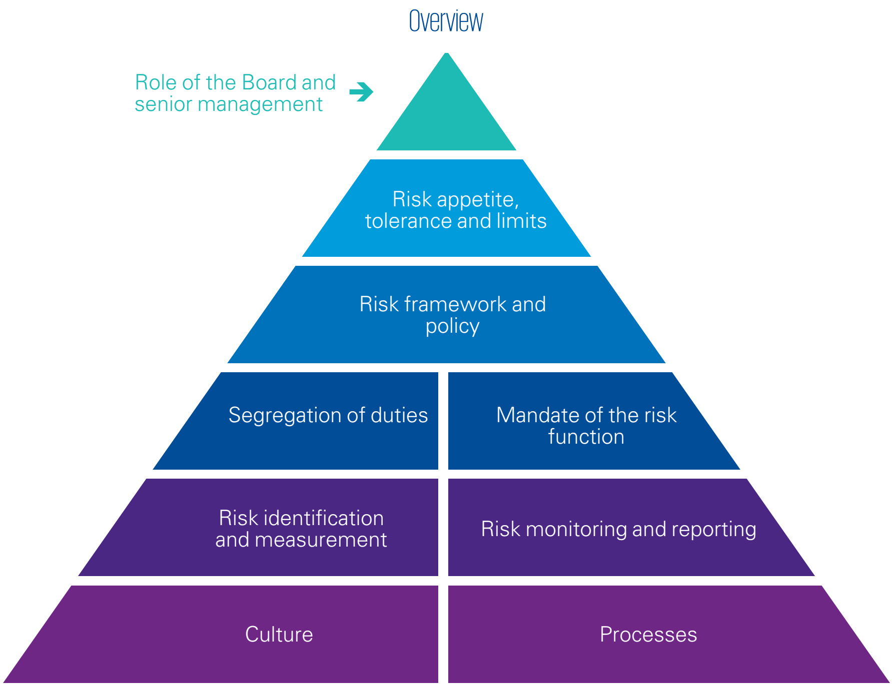
Conduct risk assessment methodology (continued)

Assess	Embed
Phase 4	Post Assessment Activity
Report and Recommendations	**Enhance and Embed**
Creation of a detailed report of all risks identified and practical recommendations for next steps and enhancement of key risk exposures.	Deliver recommended enhancement actions and develop approach to management and monitoring of identified conduct risks.
Week 4	Week 5 Ongoing
Key Activity	
• Document all conduct risks identified including: • Description of conduct risk and context • Potential customer impact should it crystallise • Materiality/priority rating • Identification of risk owners • Suggested next steps, e.g. take action on crystallised conduct risk exposures, consider adequacy of current control framework, embed consideration of potential conduct risk into strategy planning and commercial decisions	• Risk owners drive enhancement actions in the business and report back on progress • Management information and dashboard created based on Conduct Risks identified in workshops • Develop key risk indicators • Reporting should drive the senior management to have meaningful discussions on the most material conduct risks • Conduct risk MI should evolve over time, reflecting the changing risk profile of the business

Creating a Conduct Risk Framework

Do Firms:

- View Conduct Risk as a new principal risk with board ownership and sponsorship.
- Drive more effective change through the development of a new framework (policy, risk register, governance arrangements) and carve out from other risk types e.g. Operational / Regulatory risk.



- Establish Conduct Risk Steering Committees (sub committees of Board / Risk Committee).
- Mobilise distinct first line Conduct Risk functions mobilised.
- Appoint Accountable Executives for Conduct Risk in every Business Unit and Function.
- Emphasise on identifying current and inherent Conduct Risks as a ‘first step’. Arguably, one needs to know where conduct issues lie before you can set up arrangements to manage and monitor them.
- Manage current conduct risks by designing an approach to risk reporting, monitoring and oversight against key conduct risks identified.
- Embed consideration of conduct risk into discussions about strategy at board and BU level.
- Initiate a BU roll-out worksteam to raise awareness of Conduct Risk across the Group, drive cultural change, clearly communicate expectations and drive compliance with the new Conduct Risk policy and risk and control framework.

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