Industry Practice Note

Data Driven Approach to Managing Culture and Conduct Risk

ABS Culture and Conduct Steering Group
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1. Introduction

In May 2021, ABS published an Industry Practice Note ("IPN") on Culture and Conduct Dashboards ("CCD"). It recommended useful practices for banks on the development on CCD and provided a view on the range of metrics used by member banks of the Culture and Conduct Steering Group ("CCSG").

Since then, many banks are using the CCD as a tool to support the board and senior management to effectively promote and embed the desired conduct outcomes. Banks are also using the CCD to gauge the culture of the organisation and potential conduct risks that they may be exposed to.

This IPN on a data driven approach to managing culture and conduct risk is an extension of the IPN on CCD. It serves to outline good practices for banks to consider as they strive to enhance their culture and conduct agenda with a data driven approach as part of the CCD. These practices are meant to serve as resource for banks to draw upon, providing ideas that can be tailored to their specific organisational context.

2. Benefits of a Data Driven Approach

Taking a data driven approach provides objective insights into employee behaviour, customer interactions, and operational practices. This approach makes the decision-making process more accurate and reliable. It allows banks to identify trends and patterns, pinpoint areas of concern, as well as proactively address potential risks before they escalate.

<u>Leading and Lagging Indicators</u>

Understanding leading and lagging indicators is important in the context of using the CCD for culture and conduct monitoring.

- **Lagging indicators** provide retrospective analysis of past events and incidents, such as complaints, misconduct investigations, and regulatory fines. They help to identify existing vulnerabilities and evaluate the effectiveness of the organisation's strategy, framework, and controls.

- **Leading indicators** offer predictive insights into potential future risks by monitoring trends and patterns in behaviour and sentiment. These trends may help to arrest any emerging signs and concerns, allowing senior management to intervene timely before further manifestation.

Both leading and lagging indicators are critical components of a data-driven approach. Extensive use of these indicators is essential to ensure culture and conduct risks are managed in a holistic manner while avoiding blind spots.

Conventionally, banks tend to rely more on lagging indicators to inform the board and senior management on what has already happened. As banks' culture and conduct practices evolve, there is a growing emphasis on using leading indicators for pre-emptive monitoring.

3. Use Cases

Banks face a variety of culture and conduct risks as part of their business and operations. These risks may significantly impact the banks' long-term sustainability, leading to repercussions such as regulatory breaches and erosion of customer trust. These risks can manifest in various forms, including:

- **Misconduct**: Acts of fraud, bribery, corruption, data mishandling, insider trading, or misconduct related to financial products and services (e.g., misleading or deceiving customers).

- **Toxic workplace culture**: Bullying, harassment, discrimination, lack of transparency, or poor communication, fostering an environment that undermines ethical conduct.

- **Risk management lapses**: Inadequate risk management processes, systems, and controls, creating vulnerabilities which may put the FI at risk. This also includes the element of "people", such as weak risk awareness and apathy.

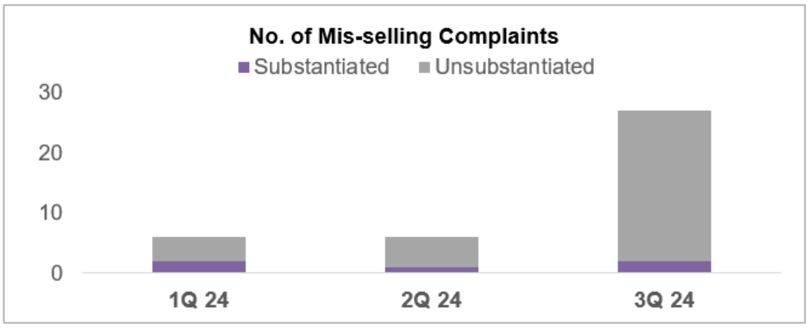
- **Unfair treatment of customers**: Unfair treatment of customers, mis-selling of products, or failure to meet client expectations, leading to erosion of trust and customer attrition.

- **Regulatory breaches**: Persistent deliberate failure to comply with applicable laws and regulations, resulting in prohibition of regulated commercial activities or significant losses and reputational impact.

This IPN proposes some use cases as exploratory ideas for banks to consider as leading indicators, with the recognition that a lagging indicator may also be used as a leading indicator, depending on the insights that a bank may draw. This could be done through a reframe of perspective to treat the lagging indicators as risk signals to trigger deeper reviews and determine if early interventions are warranted. For example, a high rate of staff turnover may be viewed as a leading indicator that may signal the escalation of deeper issues.

The illustrations of these use cases are intentionally simplified to convey the principles behind the exploratory ideas. Where advanced data analytics or machine learning have been deployed for predictive analysis of culture and conduct risks, banks are encouraged to continue to be innovative.

Use Case 1 – Total Mis-Selling Complaints Received



- Many banks have established practices to track the rate of mis-selling complaints, which provide insights on the handling of customer engagement and fair treatment of customers.

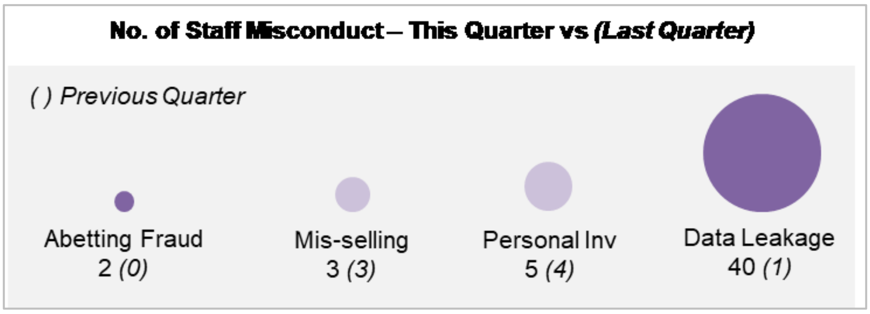
- There is generally a greater focus on substantiated mis-selling complaints (as opposed to unsubstantiated ones). This allows the banks to understand the root cause of such complaints and avoid recurrence. However, there is also value in analysing all substantiated and unsubstantiated complaints holistically.

- Monitoring total mis-selling complaints (including unsubstantiated cases) could offer a more holistic view of customers' feedback and early insights into emerging issues that may indicate gaps in service delivery or internal processes.

- Unsubstantiated mis-selling complaints may also provide a more comprehensive view of the underlying organisational culture or uncover areas of improvement such as improving customer communications or staff awareness. For instance, higher rate of complaints on a certain product may suggest a need for enhanced product training or a review of client interaction protocols.

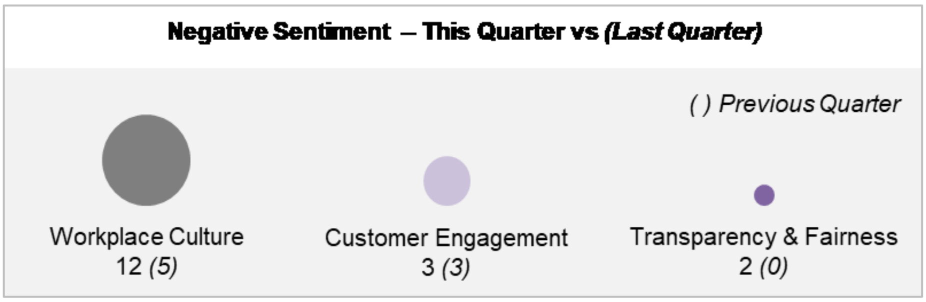
- High volume of mis-selling complaints may also signal a potential sign of reputational risk for the bank, which may warrant early intervention to avoid further escalation.

Use Case 2 – Outlier Staff Misconduct Analysis



- Sudden spikes in specific types of misconduct (e.g. data mishandling), or emergence of rare misconduct (e.g. abetting fraud) could be red flags that warrant deeper analysis to be conducted to understand the root cause(s).
- Monitoring these trends and conducting deeper analysis thereafter allow early intervention, enabling the bank to prevent escalation of issues. It may also provide insights into employee behaviour and organisational culture.
- For example, rare events can shed light on whether certain expected controls are broken or have inherent loopholes, thus prompting a reassessment.
- Departments with repeated misconduct types or increasing trend of misconduct may suggest a need to conduct deeper analysis to better understand the root cause. This may help to shed light on the underlying issue, which may be related to competency of manager(s) or underlying culture issues.
- An increasing trend of misconduct cases (even if within acceptable thresholds) may indicate emergence of cultural issues requiring heightened attention by senior management. Senior management may respond by encouraging and promoting open dialogue, trust, and accountability.

Use Case 3 – Staff Sentiment Analysis



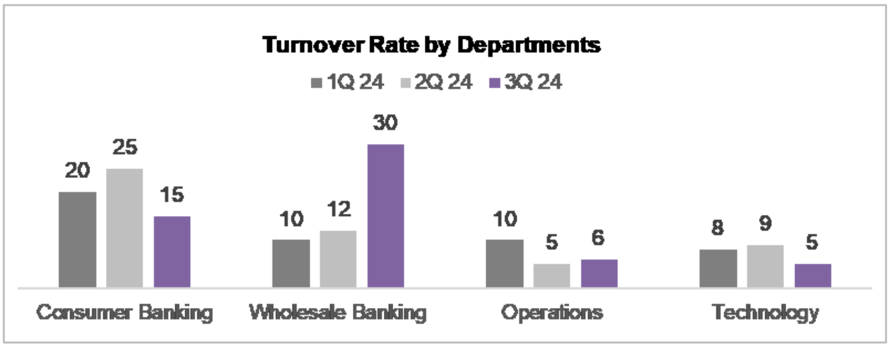
- Staff may express their work experience via internal channels (e.g. staff engagement surveys) or external forums (e.g. Glassdoor). Their sentiments can be diverse and range from employee well-being to how customers are treated fairly.
- Negative sentiments can reveal patterns of discontent, such as perceptions of unfair treatment. Identifying these issues early is crucial, as they may signal deeper underlying problems that, if not addressed promptly, could escalate into serious organisational culture issues.

- Proactive monitoring and analysing employee's sentiments allow banks to identify potential conduct issues early and take active measures to address them. These sentiments can also be examined with the reasons for leaving identified during exit interviews, which may help to uncover potential undesirable cultural drivers.

- External forum comments or posts, while potentially being biased toward disgruntled employees, nonetheless provide an alternate source of feedback. These external data can be used to corroborate with internal data, particularly if verbatim feedback indicates any particular team, location, or product having elevated dissatisfaction.

- Employees may also be more willing to share concerns on such public forums under the protection of anonymity, as opposed to internal staff surveys and channels. Such views, whilst harder to verify, can be a leading indicator to allow relevant teams to investigate independently for any emerging signs.

Use Case 4 – Staff Turnover



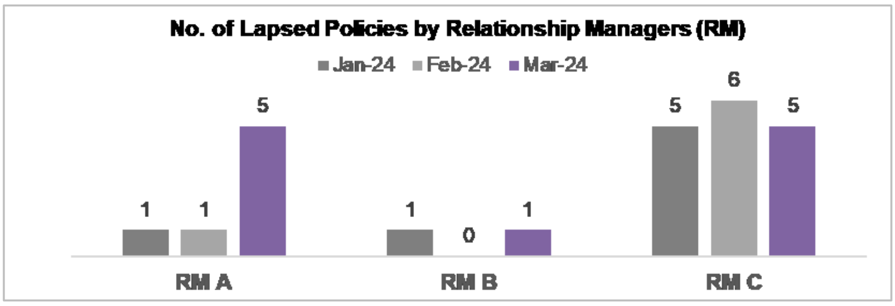
- Many banks have processes in place to monitor staff attrition rate, for the purpose of resource and business planning. Beyond this, turnover rate and the underlying reasons of resignation may also reveal insights on culture and conduct-related issues.

- An excessive turnover rate may signal dissatisfaction or lack of confidence in the bank's culture, or hint at potential concerns in managers' competency in maintaining positive culture and conduct.

  - Where there is concentration in attrition (e.g. high turnover in a particular team), it may be a red flag for potential bullying, mismanagement, etc. Analysis of exit interview remarks may reveal insights that other data trends are unable to detect.

  - Similarly, high attrition following significant events such as change in management or revision in policies may also suggest a degree of correlation, which can be further assessed for any issues.

Use Case 5 – Lapse in Insurance Policies



- Lapses of insurance policies may be red flags for mis-selling. It could indicate that customers were misled or uninformed when purchasing the policies, leading to a failure to meet payment requirements or a lack of understanding about the policy's value.

- Analysing patterns of lapsed policies may reveal insights on staff misconduct or gaps in assessing the customers' affordability.

- For instance, an unusually high rate of lapsed policies (by count or percentage) sold by a particular Relationship Manager may signal a need to review other policies sold by him, or adequacy of supervisory oversight. It may also suggest a need to enhance the training and marketing materials relating to such policies, to ensure the bank continues to promote fairness and transparency in customer communications.

- By understanding the root causes of policy lapses, banks can improve their practices to ensure clients are fairly treated. A trend analysis over time could also be useful to detect potential misconducts.

- In the same vein, similar analysis can also be extended into key sales drivers, such as rate of cancelled trades, product switching and high-risk products sold.

Use Case 6 – Customer Satisfaction Surveys

- A deterioration in customer satisfaction survey results may be indicative of general dissatisfaction with the bank's level of service. Well-designed survey questions, complemented by robust analysis, can potentially help to identify customers' opinion and trust in the bank.

- Qualitative feedback from survey respondents may allow earlier risk identification, to facilitate timely intervention. For instance, verbatim on negative customer perception of sales terms & conditions may suggest weakness in relevant controls / processes. More importantly, feedback concentrated in a specific area may be indicative of a systemic issue.

- By responding effectively to such feedback, it gives customers reasons to trust and deepen their relationship with the organization, correlating satisfaction with positive business performance.

Use Case 7 – Regulatory Issues

Key Indicators

- No. of regulatory breaches / regulatory incidents
- No. of exceptions identified from compliance review and testing
- No. of **deliberate** regulatory breaches / regulatory incidents
- No. of regulatory compliance risk related controls that are not fully effective
- No. of overdue reviews
- No. of regulatory actions and severity by types
- No. of negative media coverage due to regulatory obligations
- No. of staff terminated due to regulatory breaches

- Many banks are already tracking the number of breaches in legal and regulatory compliance requirements. Instead of serving as a single point-in-time snapshot, such data points could also serve as predictors of further undesirable behaviours.

- Apart from the number of incidents that have already occurred (i.e., lagging indicators), banks can also leverage historical data as leading indicators, such as the number of regulatory compliance risk related controls that are not fully effective and number of exceptions identified from compliance review and testing. These indicators can be useful to identify hotspots and areas of concern, such as departments with weak control environments.

- By analysing patterns and trends over time, the underlying structures that are reinforcing the behavioural patterns and trends may be identified. Intervention measures can then be implemented to pre-empt breaches, before the situation aggravates.

- Some banks have started distinguishing between deliberate and non-deliberate regulatory breaches. This practice allows banks to determine the necessity of a further deep-dive into the mindsets and beliefs that are the driving force behind these breaches.

- For instance, deliberate breaches could indicate an underlying mindset of the need to “win at all costs.” By diagnosing such mindsets and beliefs and putting in remediation measures to inculcate more positive ones, banks would be able to address the issue at source, leading to a more holistic and sustainable solution.

* *For additional information on patterns and trends, underlying structures and mindsets and beliefs, please refer to IPN 3: Integrating Culture into Root Cause Analysis*

4. Conclusion

Banks may consider dialling up on a data-driven approach to measure and manage culture and conduct risk. The use cases illustrated in this IPN could be considered to identify potential hot spots which warrant further root cause analysis or review that could be helpful to design appropriate solutions.

By leveraging a comprehensive set of leading and lagging indicators, banks can also gain valuable insights into the effectiveness of their culture and conduct framework, identify potential risks early, and take proactive measures to prevent negative consequences.

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