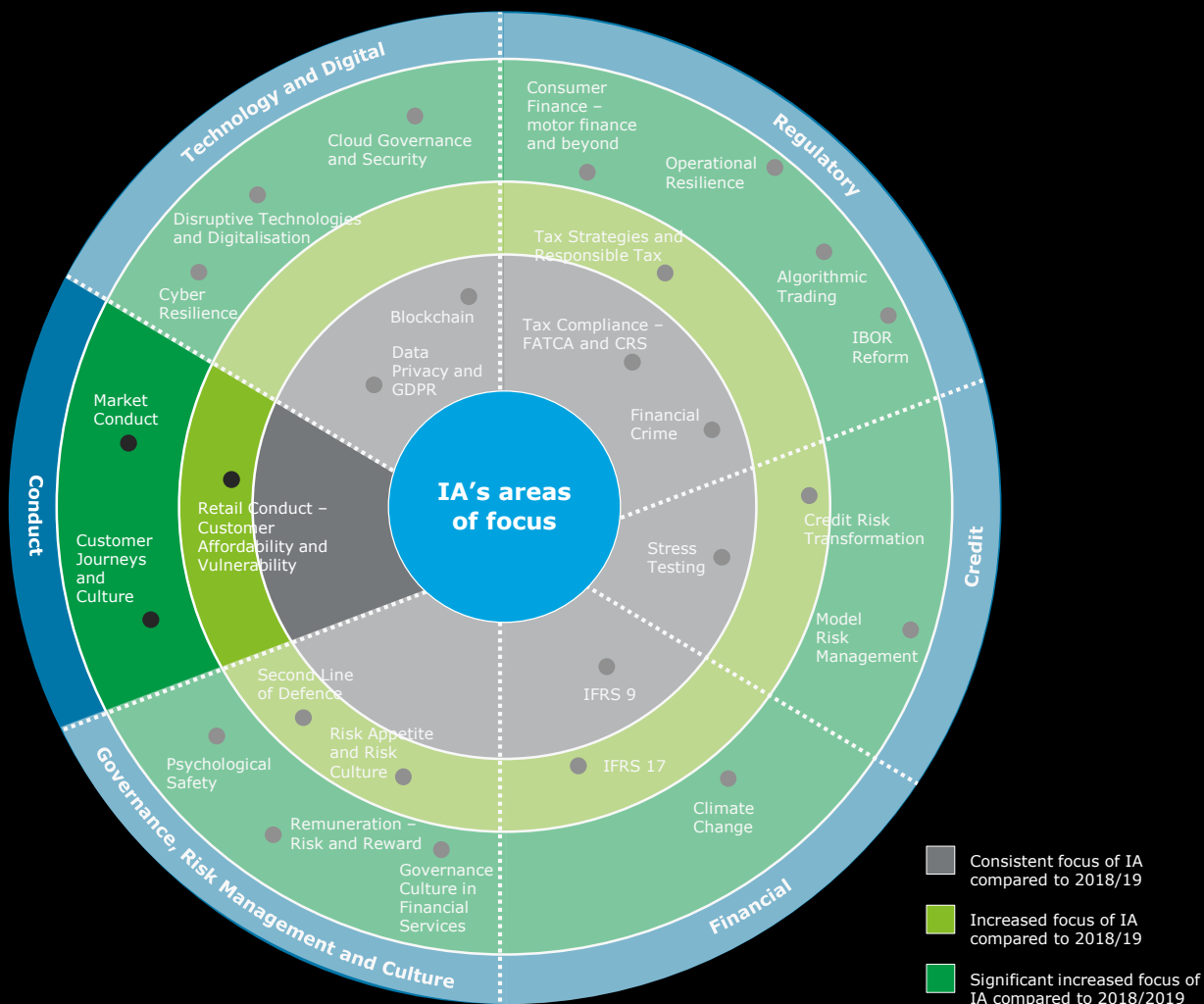




**Financial Services Internal Audit
Planning Priorities 2020 – Conduct Hot Topics**

Introduction

Conduct risk management remains crucially important within financial services, with focus in the areas of customer journeys and assessment of customer affordability. In particular, the treatment of vulnerable customers should remain high on the agenda for all firms and firms should have in place appropriate processes and controls to identify and monitor the different journeys that customers might face. In addition, in wholesale markets, there has been recent development in conduct codes and standards which provide a common set of guidelines to promote the integrity and effective functioning of the wholesale markets and also provide a helpful framework which IA can use when defining their audit scopes.



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Key Industry Icons



Banking and Capital Markets



Insurance



Investment and Private Equity

5.1 Customer Journeys and Culture



Why is it important?



The Financial Conduct Authority (FCA) expects firms to consider their impact on customers across the customer journey. Firms are able to evidence customer centricity and fair customer outcomes by implementing business plans, products and controls. Internal Audit are in a unique position in their ability to assess end-to-end customer journeys, cutting across common business silos.

What's new?



- The FCA has continued to emphasise their focus on the treatments applied to vulnerable Customers. Consideration is now being given to how firms establish and monitor the differing 'Journeys' these customers may and should face.
- The FCA drew attention to the importance of Culture within its 2019/20 Business Plan: a healthy culture, focused on delivering consumer outcomes, helps individuals in firms make the right judgements that do not result in consumer harm. Assessment of Culture is notoriously subjective, however, the output of customer journey and outcomes testing often provides invaluable insights into cultural weaknesses and strengths that may not otherwise be identified.



What should Internal Audit be doing?



Area of focus	Description
Audit Planning	Embed consideration of customer journeys (including direct and indirect customer impact) in audit planning and execution.
Testing Methodologies	Review customer journey mapping, including processes and controls over the identification of customer interaction points and points of potential influence. This mapping should then be used to inform the regulatory, risk and process implications and inform Internal Audit's testing plans.
Vulnerability	Review 'non-standard' customer journeys, specifically those that have variations due to identified vulnerability. Consider the effectiveness of exceptions' processes and the ongoing monitoring of these customers.
View on Culture	Utilise the output of all customer journey outcome-testing for any cultural indicators.



5.1 Customer Journeys and Culture



Are there any potential challenges?



Challenge	Description
Planning	Customer journey reviews regularly span several business areas and require input and influence from multiple sources. All interested parties should be included within planning to ensure support is available at the appropriate time.
Ownership and accountability	Issues identified may have multiple solutions and require input from multiple sources, business buy-in is required to ensure appropriate ownership of any remedial activities and Internal Audit may face challenge from the business.
Labour-intensive reviews	By their nature Customer Journey assessments are labour intensive and outcomes are often subjective. Internal Audit should ensure sufficient time for review, feedback and challenge of outcomes is built into test plans.
Sample Selection	When specifically considering longer term products such as mortgages, some unfair outcomes may take years to materialise. Internal Audit will need to ensure sample selection considers a relevant time period.

What Internal Audit skills are required?



- Knowledge of conduct risk regulation.
- Strong product and corporate knowledge across the business.
- Internal Audit should have the ability to manage the stakeholders as business functions will experience some disruption caused by data requirements and support may be required to facilitate audit testing.

What's next?



With the rapid advancement in technological testing solutions, including voice analytics, the reliance on labour intensive file review outcomes testing may be reduced.

Regulatory focus is expected to remain on the fair treatment of existing customers. Internal Audit will increasingly need to consider and challenge the implications of pricing and innovation benefits which benefit new customers but are not available to existing customers.



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5.2 Retail Conduct – Customer Affordability and Vulnerability



Why is it important?



Vulnerability continues to be high on the agenda of the industry and the regulator and whilst progress is being made there remains a number of challenges. Vulnerability is a 'state' not a 'trait' – many people will experience some form of vulnerability at a point in their lives and firms have to be flexible and forward-thinking in their approach to identifying these changing vulnerabilities and have operations that are designed to address them.

The FCA has acknowledged that creditworthiness and affordability assessment is not an exact science, and that implications outside of normal controls, such as a change in the customer's circumstances or wider economic events can impact affordability. Nonetheless, firms are expected to have effective processes in place aimed at eliminating lending that is foreseeably unaffordable, without having a process that may be so conservative as to decline applications where credit would be affordable.

What's new?



In June 2018 the FCA published 'The financial lives of consumers across the UK', which summarised key findings from a survey carried out in 2017.

Findings from this and earlier studies such as the Financial lives of UK Adults (Oct 2017) continue to highlight the necessity for Industry-wide focus on the improved identification and management of vulnerability; *In that report we [the FCA] looked at issues relating to vulnerability and found that 50% of UK adults display one or more characteristics that signal their potential vulnerability, namely limited financial resilience, low financial capability, suffering a recent life event (such as redundancy, bereavement or divorce), or a health-related problem that affects a person's day-to-day activities a lot.*



What should Internal Audit be doing?



Area of focus	Description
Technical Innovation	Assess digital/remote channels to ensure the following: optionality ('get out of digital' options), designed with inclusivity in mind (such as integration with screen readers/ build in options for third party access/ encryption and use of alternatives to passwords which are easily forgotten), and that appropriate testing has been undertaken.
Assessing Affordability	When considering a customer's affordability the regulator expects firms to make a reasonable assessment, not just of whether the customer will repay, but also of their ability to repay affordably and without this significantly affecting their wider financial situation. Internal Audit should ensure processes that are in place to assess affordability can adequately demonstrate this.
Lack of affordability – Arrears Management	Assess customer outcomes at each stage of the customer life-cycle: pre-arrears, early arrears, late arrears and litigation.
Tailored vulnerability management	Assess the work undertaken to understand types of vulnerability and the processes in place to address them.



5.2 Retail Conduct – Customer Affordability and Vulnerability



Are there any potential challenges?



Challenge	Description
Subjectivity	Both the state of vulnerability and the notion of affordability are subjective, and therefore open to differing interpretations as customers can be vulnerable in some customer journeys and not in others. Distinguishing who needs additional support can be challenging with different people taking different views. This may be exacerbated by the non-prescriptive nature of the regulators' requirements in these areas.
Knowledge	Due to the subjectivity in assessing the affordability and vulnerability of customers, Internal Audit teams require sufficient training similar to customer-facing staff to ensure appropriate knowledge exists within the Internal Audit teams.

What's next?



- Further guidance from the regulator in relation to the management of vulnerability is expected.
- There will be changes to the Responsible Lending rules as a result of the March 2019 Mortgage Market Study Report. These changes are likely to allow for more proportionate affordability assessment for consumers who are up-to-date with payments on their existing mortgage and are seeking to move to a more affordable mortgage without taking on additional borrowing.
- There is regulatory focus on consumer protection from high-cost credit markets including: continuing harm, business models that drive unaffordable lending, and consumer awareness of the alternatives to high cost credit.

What Internal Audit skills are required?



- The ability to evaluate “outcomes” as well as knowledge of the applicable regulations.

Find out more



- <https://blogs.deloitte.co.uk/financialservices/2019/04/the-fca-highlights-the-importance-of-firm-culture-and-customer-vulnerability-as-part-of-its-debt-man.html>



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5.3 Market Conduct



Why is it important?



The wholesale market codes and standards articulate good practice in the Fixed Income Currencies and Commodities (FICC) Markets. Given that these codes and standards are at the top of the Financial Conduct Authority's (FCA) and Bank of England's (BoE) priority list, in the short term a greater level of scrutiny on firms that fall under scope is expected. Market participants are expected to promote and maintain robust controls and effective processes to meticulously identify, manage and report on the risks associated with their engagement in the market. The FCA has put the onus on the Senior Manager and Certification Regime (SM&CR) to oversee that staff are observing proper standard and market conduct.

What's new?



Over the past 12 months, the FCA and BOE have expanded to buy side firms and brokers. The shift in stance will have a direct impact on these firms and they will need to make sure they embrace, adopt and adhere to these codes and standards.

- **Buy-Side Focus** – As large and active players in financial markets, buy-side firms have a vital role to play. By signing up to these wholesale market codes, they signal a commitment not just to uphold these standards, but also to hold others accountable and in so doing help ensure markets remain liquid, safe and fair.
- **Brokers** – The FCA is concerned that wholesale brokerage firms have not made sufficient progress in embedding a culture of good conduct compared to other sectors.
- **Banks** – It has been nearly two years since some of the codes such as FX Global Code, Global Precious Metals Code and the UK Money Markets Code were first published and it will be critical for banks to scrutinise their adoption of these codes and standards. Banks need to perform periodic reviews of their controls and governance against these codes and standards.



What should Internal Audit be doing?



Area of focus	Description
Gap analysis	Identify gaps by analysing and assessing the firm's current governance and control frameworks against the requirements of the wholesale market codes and standards.
Implementation of codes and standards	Review the governance, lines of accountability, skills and knowledge of staff and involvement of senior management across the business to ensure that there is strong governance from all lines of defence and trading activity.
Control and Compliance Frameworks	Review the robustness of control and compliance frameworks to effectively identify misconduct and/or divergence from market best practice.
Remediation	Review the business plans on remedial activities and test remediated front-to-back processes and procedures prior to "go live". Review post implementation support and check-in sessions.
Controls testing	Review the operating effectiveness of the controls over confirmation and settlement to ensure post trade processes are efficient, transparent and risk-mitigating.



5.3 Market Conduct



Are there any potential challenges?



Challenge	Description
Implementation of controls	Ensuring all the necessary and required controls have been implemented correctly and effectively within a reasonable time is a challenge.
Legacy systems	Acknowledging and identifying old legacy systems used by market participants which might become a hurdle in adopting and implementing these codes is complex.
Pricing	Expertise is required in understanding and reviewing pricing for products and identifying any inappropriate industry practices, advocating price transparency and fair customer treatment.
Documentation	Ensuring all the correct documentation is in place is a challenge, whether this is documentation of adherence with regulatory requirements or internal trading procedures.

What Internal Audit skills are required?



- Internal Audit will need to be flexible in their approach given the wide range of considerations in this area.
- Technical knowledge to check compliance with latest regulatory changes.

What's next?



- As the focus on buy-side firms increases so will the need to review processes and controls of such firms. Not all codes and standards will be applicable, but a robust governance structure will be critical.
- The FCA's micro-scoping evaluation of brokers targeting their governance, culture, compensation structure and conflict of interest will lead to some major overhaul changes in the way these firms are working.
- Banks that have already committed to these codes and standards will require some thorough analysis of their process to check the robustness of their implementation.

Find out more



- <https://www2.deloitte.com/content/dam/Deloitte/global/Documents/Financial-Services/gx-fsi-dcfs-2019-banking-cap-markets-outlook.pdf>
- <https://www2.deloitte.com/content/dam/Deloitte/global/Documents/Financial-Services/gx-the-investment-bank-of-the-future.pdf>

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