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Regulatory training programme

UK Regulation, Individual Accountability, Culture, Conduct Risk and Outsourcing

Post Office Limited

December 2015



pwc

Topics covered

***Regulatory
overview***

1

***Individual
accountability and
Potential extension
of Senior Managers
and Certification
Regime (SM&CR)***

2

Culture

3

***The regulator's view
on conduct risk***

4

Outsourcing

5

***Other regulatory
initiatives***

6



Regulatory overview

1

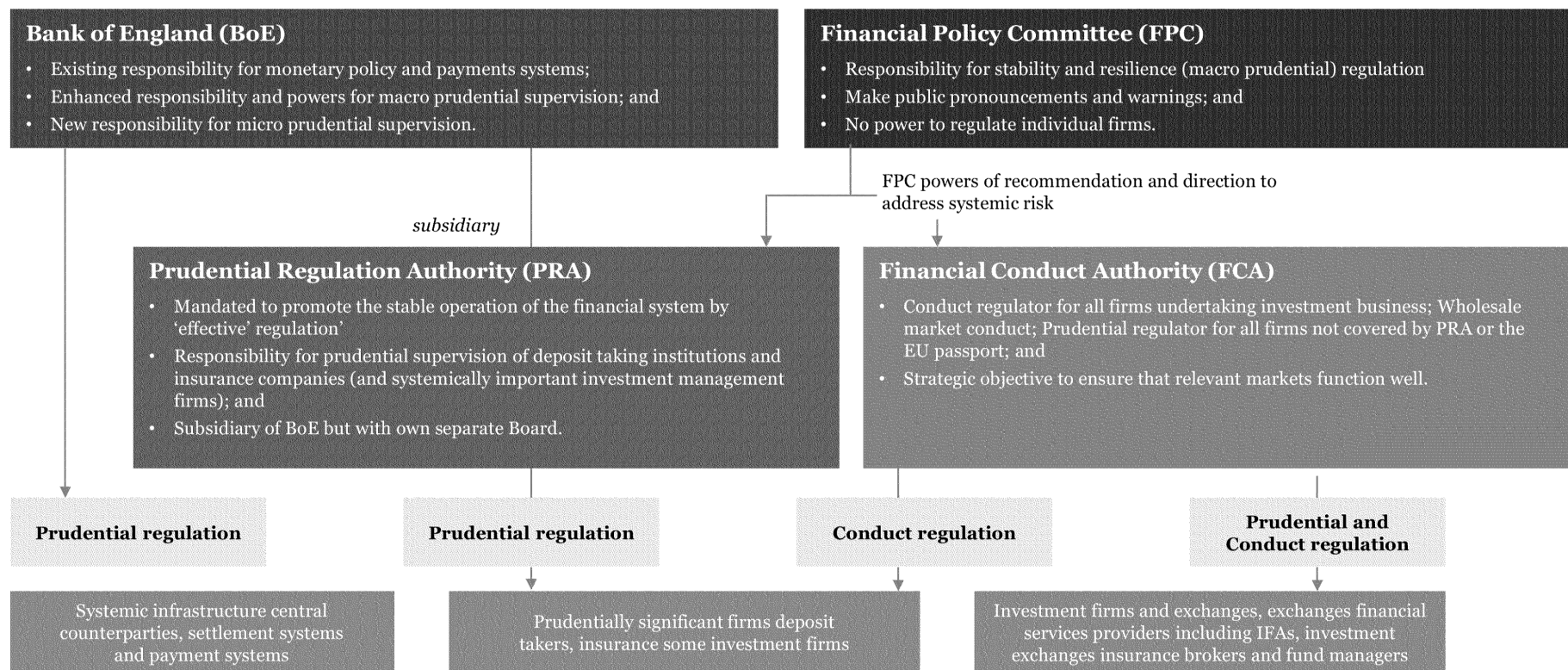
Regulatory overview - Agenda

1 *Regulatory architecture and approach – UK and globally*

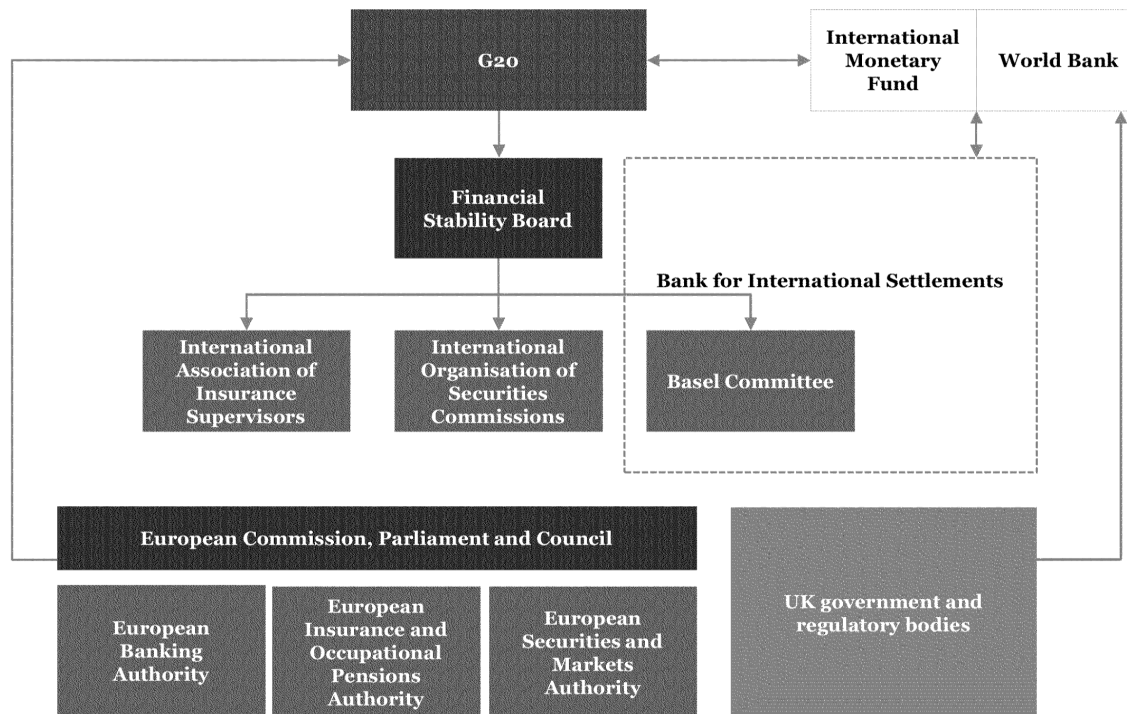
2 *Current agenda of the regulators*

3 *Changing face of regulation*

The UK's financial regulatory architecture



Supranational regulatory architecture



Change to FCA supervisory approach

- FCA now supervises over 70,000 firms – Up from 26,000 it regulated at launch
- It believes it now needs to take a different approach to regulating such a large and diverse range of firms (particularly it notes with resourcing levels remaining largely fixed)
- So supervision will now place more focus on:
 - Prioritising issues identified in a strategic way
 - Change intelligence and data analysis processes to form a more consistent and collective view of key markets and sectors
 - Sectoral and market-wide analysis



What has been happening in the industry?

The media have heightened their focus on Conduct and Culture within the FS Industry that has contributed to recent corporate “scandals”

Homeserve hit with record £31m FCA fine for mis-selling insurance

February 13 2014

Homeserve has been hit with the largest ever fine for mis-selling products to UK retail customers – drawing a line under an insurance scar

The Telegraph

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Barclays handed biggest bank fine in UK history over 'brazen' currency rigging

Financial Conduct Authority's £284.4m penalty comes amid \$6bn in fines for six banks for foreign exchange manipulation

UBS fined £9.45m for mis-selling to wealthy clients

565 customers had £816m invested in AIG Enhanced Variable Rate Fund at point fund was suspended Tuesday 12 February 2013

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Lloyds hit by record £117m fine over PPI handling

5 June 2015 | Business

HSBC pays \$4.2bn for fines and mis-selling in 2012

Barclays fined a record £290m

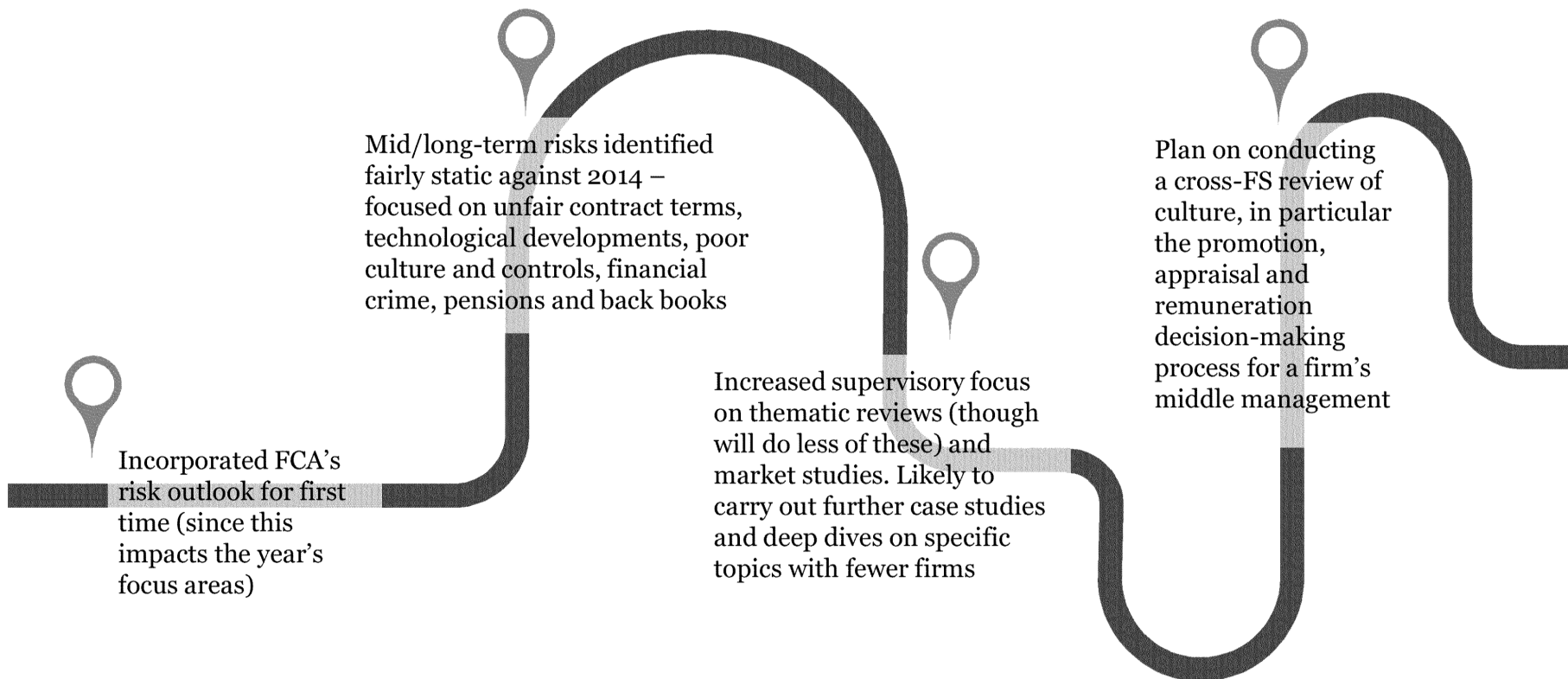
June 27 2012

US and UK authorities have fined Barclays more than \$450m for attempting to manipulate the London interbank offered rate, a benchmark interest rate that is used globally to set the price of everything from credit card fees to corporate loans.

December 2015

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FCA business plan 2015/16



FCA risk outlook

***Pension products and
distribution methods***

***Poor culture and practice
in consumer credit firms***

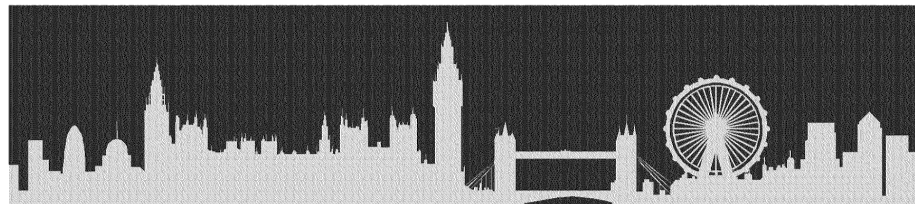
***Poor culture and controls
threaten market integrity***

Financial crime

***Pace of technology
developments***

***Use of large back books to
subsidise new customers***

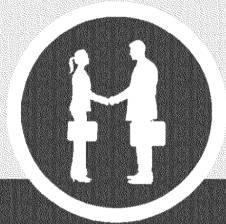
Unfair contract terms



Cross-sectoral reviews

Thematic review of culture

- Are culture change programmes driving the 'right behaviours'
- Reviewing employee complaints and how these are dealt with
- Analysing remuneration, appraisal and promotion decisions for middle management



Ongoing work on visibility of IT resilience and risks at board level

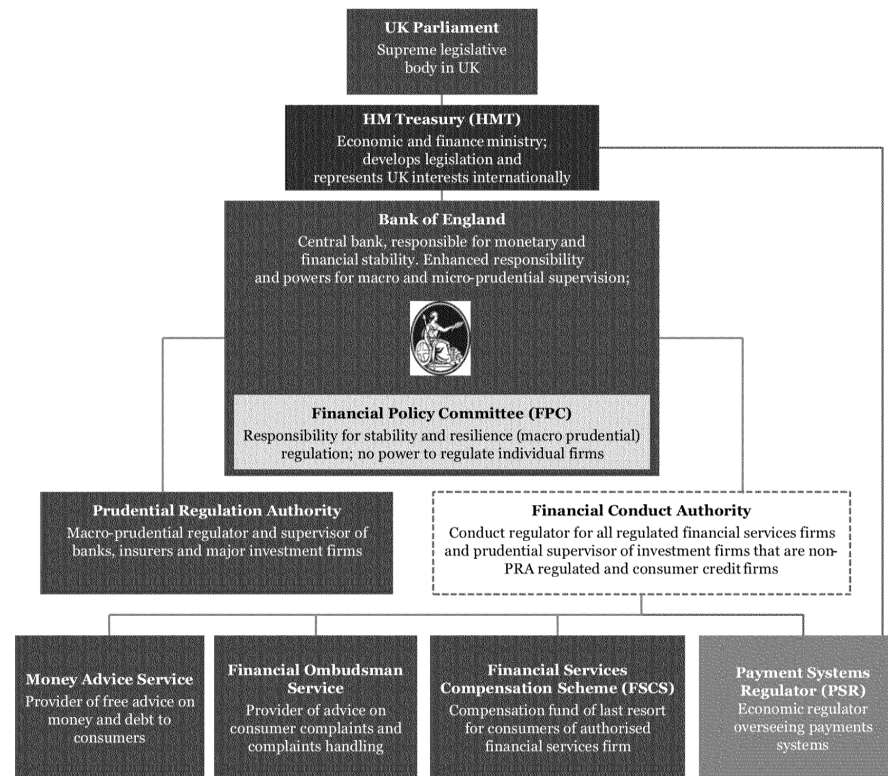
- FCA is working with PRA and Bank of England
- Also reviewing how firms are managing ongoing cyber risks



Potentially relevant reviews

Mortgage lending market study <ul style="list-style-type: none">• Assess how firms have implemented Mortgage Market Review (MMR) rules• Identifying barriers to competition (i.e. why might consumers not get access to credit and how can consumers switch providers) 1	Review staff remuneration and incentives <ul style="list-style-type: none">• Focused on consumer credit firms• Looking at whether remuneration and bonuses are linked to collecting debts or include Treating Customers Fairly (TCF) issues 2	Complete thematic review of unauthorised transactions <ul style="list-style-type: none">• Looking to ensure that firms are not placing unreasonable obstacles or responsibilities on their customers• Linked to FCA work on how firms treat and adapt processes for vulnerable consumers 3	Thematic review of packaged bank accounts <ul style="list-style-type: none">• Assessing how banks have implemented new FCA rules on packaged bank accounts• Likely to be the next big compensation issue for firms to manage 4
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Changing face of regulation: The UK Payment services supervisory architecture



The Payment Systems Regulator (PSR)

What is it?	What will it regulate?	What will it do?	How will it operate?	How does it work with FCA?
The PSR is a subsidiary of the FCA but has its own statutory objectives. Its staff of 50 is headed by Hannah Nixon. It has an annual budget of £15.9 million that is funded through annual fees from those the PSR regulates	The PSR will regulate six key interbank payment systems – Bacs, Cheque and Credit, CHAPS, Faster Payments Service, LINK and Northern Ireland Cheque Clearing and two card payment systems – MasterCard and Visa Europe but NOT American Express or Diners Club	The PSR has three statutory objectives: To promote 1) competition and 2) innovation in payment systems and to ensure that 3) payment systems are operated and developed in a way that considers the interests of all service-users	Economic, not conduct, regulator; concurrent competition powers but FCA and PRA have veto power	FCA is a conduct regulator. Firms that provide payment services must be authorised or registered by the FCA and comply with its conduct and reporting requirements.

How will the PSR achieve those objectives?

The PSR has set out its programme of work in its Annual Plan and Policy Statements. The main features of the PSR's work broadly fall into four work streams:

Payment strategy forum 	Market reviews 	Compliance reports and Disclosure 	Internal work stream 
<p>Developed to drive innovation in the Payments Industry</p> <ul style="list-style-type: none"> • It will help to develop and agree strategic priorities for the long-term development of payment systems • Some topics the forum will be considering include the Current Account Switching Service (CASS) and Account Number Portability 	<p>Developed to ensure that there is fair competition</p> <ul style="list-style-type: none"> • PSR has concurrent powers with the Competition and Markets Authority (CMA) to launch investigations where it suspects competition may be adversely affected • Two Market Reviews that the PSR intends to perform by April 2016 are: the supply of Indirect Access to payment systems and ownership and competitiveness of infrastructure provision • Other reviews are likely to be prompted by complaints the PSR receives 	<p>Developed to ensure that service users' interests are being considered</p> <ul style="list-style-type: none"> ii. Compliance Reports <ul style="list-style-type: none"> - To demonstrate that interbank operators are taking the interests of service users into account with decision makers ii. Disclosure <ul style="list-style-type: none"> - Pan-GB Operators will have to publicly-disclose Access Requirements and reporting, enabling the PSR to check compliance 	<p>Developed to improve the overall Payments System</p> <ul style="list-style-type: none"> • Develop a Sponsor Bank Code of Conduct • Evaluate the proposed EU Interchange Fee Regulation. • Reduce barriers through the 'Innovation horizon scanning' programme • Review of interchange ATM fees • Customer access to redress for payment systems failure • An industry led Hub to help Indirect Payment Service Providers (PSPs) obtain information on accessing payment systems

Changing face of regulation: Who are the competition regulators?

Firms operating in the UK

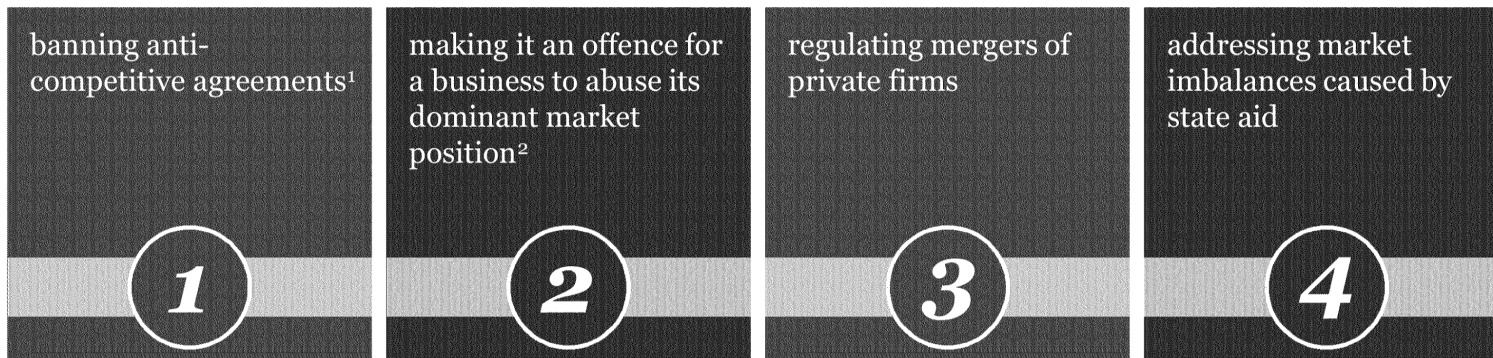
- As of 1 April 2015, the FCA and Payment Systems Regulator became 'concurrent' sector regulators alongside the Competition and Markets Authority (CMA)
- The FCA and CMA will share powers for the financial services' market, but cannot investigate the same subject matter at the same time

Firms also operating in the EU

- Subject to the EU Commission if the activity or issue is deemed to have a 'cross-border' impact in the EU

What is competition law?

Competition law aims to promote healthy competition in markets by:



¹ *anti-competitive agreements* are often referred to as the *Chapter I prohibition* in the UK or the *Article 101 prohibition* in the EU

² *abuse of a dominant position* is often referred to as the *Chapter II prohibition* in the UK or the *Article 102 prohibition* in the EU

Competition law remedies available to the FCA

Firm specific remedies	Market level remedies	Market investigation reference to the CMA	Undertakings in lieu of a reference
<ul style="list-style-type: none"> • Financial penalties – up to 10% of global turnover in the relevant market • Varying or cancelling permissions • Injunctions 	<ul style="list-style-type: none"> • Changing or withdrawing rules and recommending the same to the PRA • Issuing general guidance on how the Financial Services and Markets Act 2000 (FSMA) works, rules or FCA functions • Recommending the further development of industry self regulation 	<ul style="list-style-type: none"> • Referring a market to the CMA for in depth investigation if the FCA considers use of its powers would not be appropriate (e.g. covering non regulated firms) 	<ul style="list-style-type: none"> • Taking no further action in the market for 12 months subject to firms agreeing to change anti-competitive practices

Practical challenges for Post Office Limited

Understanding and
engaging with wider
regulatory bodies

The potential impact of new
regulators such as the PSR

Managing a relationship with
the regulator, given the profile
of the organisation and their
change in supervisory
approach

Impact on competitors –
both regulatory and
technological

The impact of the FCA's 'business
as usual' regulatory agenda

The potential impact of new
competition powers on strategy
and market

Keeping pace with
regulatory change



Individual Accountability and Potential Extension of the Senior Managers and Certification Regime (SM&CR)

2

Individual Accountability and Potential Extension of SM&CR– Agenda

1 *Background and timeline*

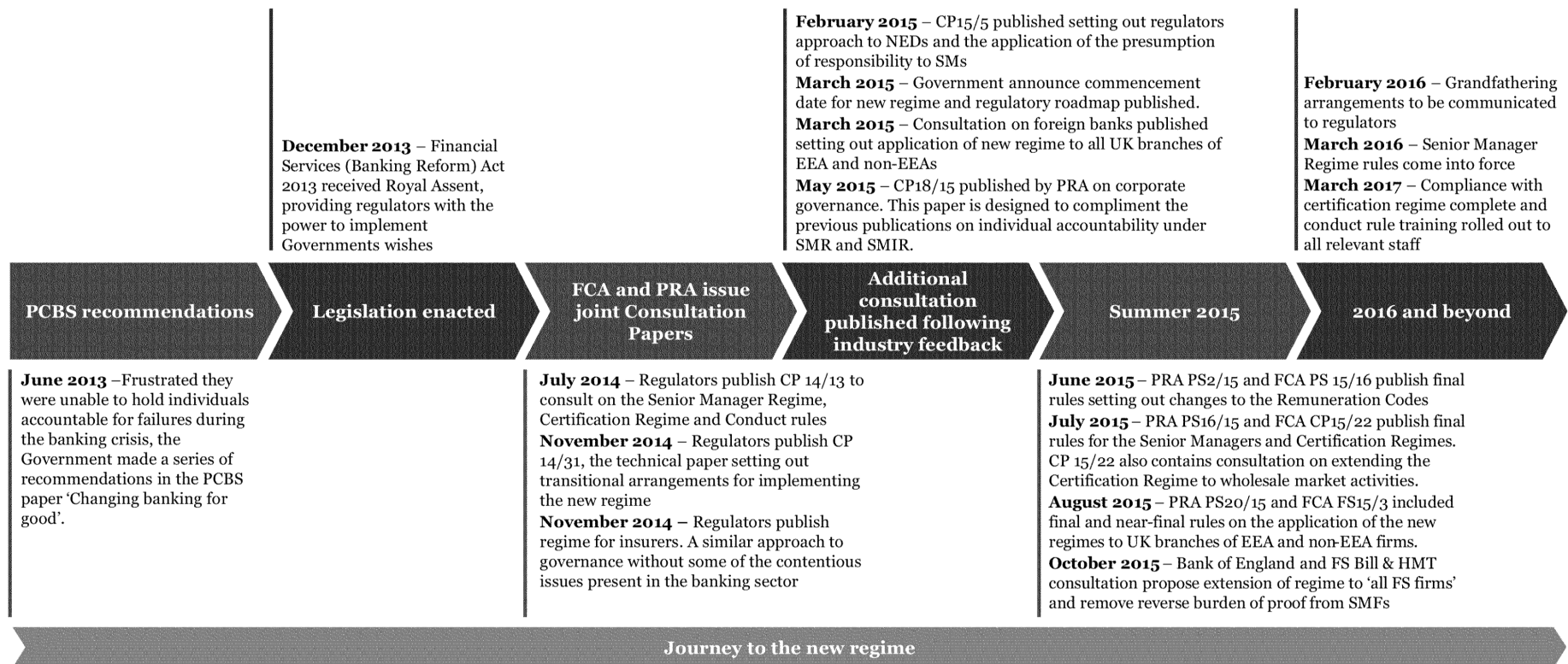
2 *Scope extension*

3 *Possible impact on you*

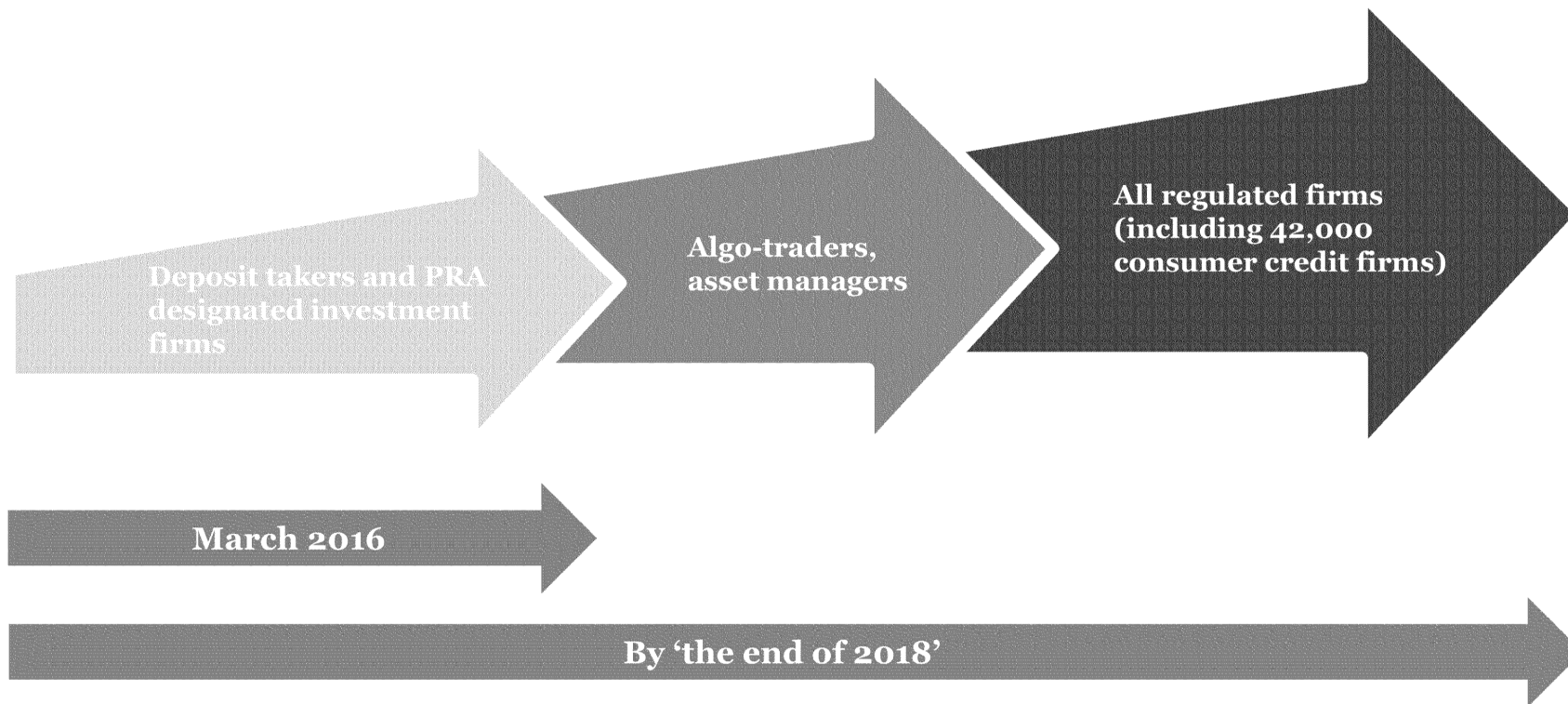
4 *Individual conduct rules*

5 *Wider Impact*

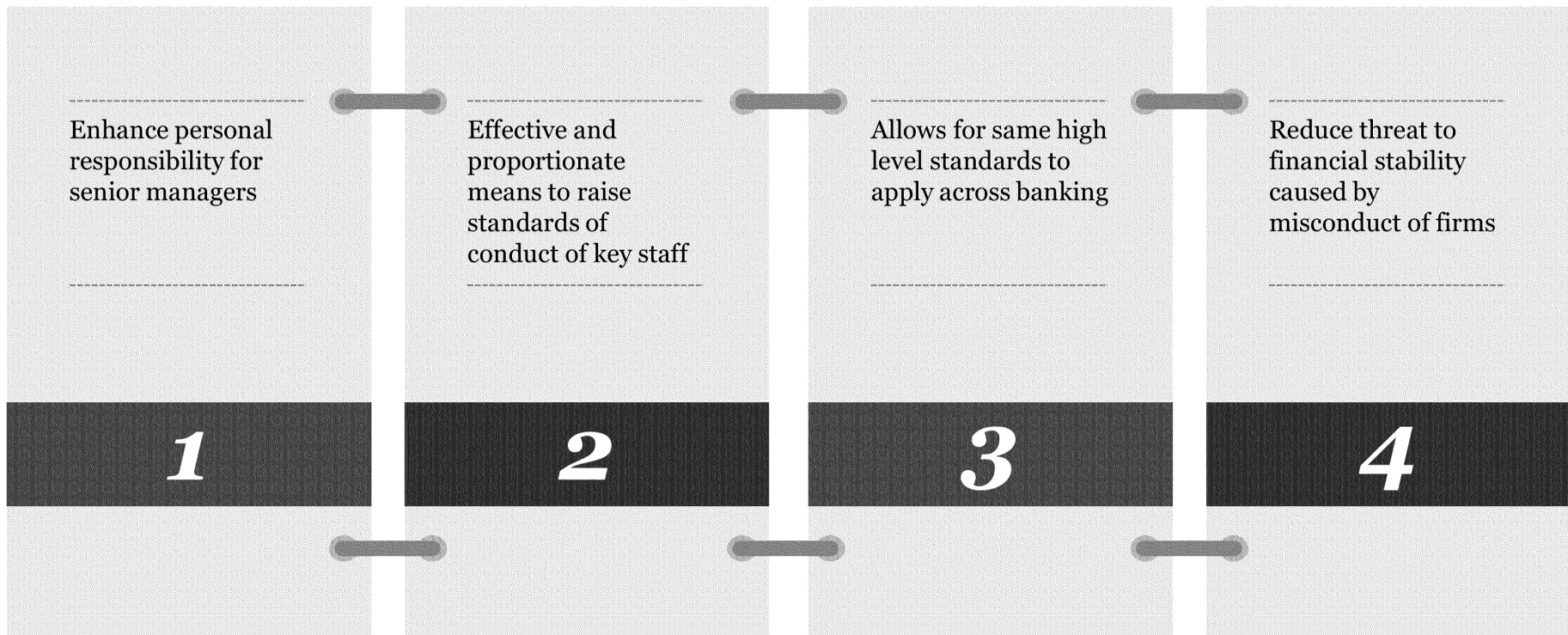
SM&CR: Background and timeline



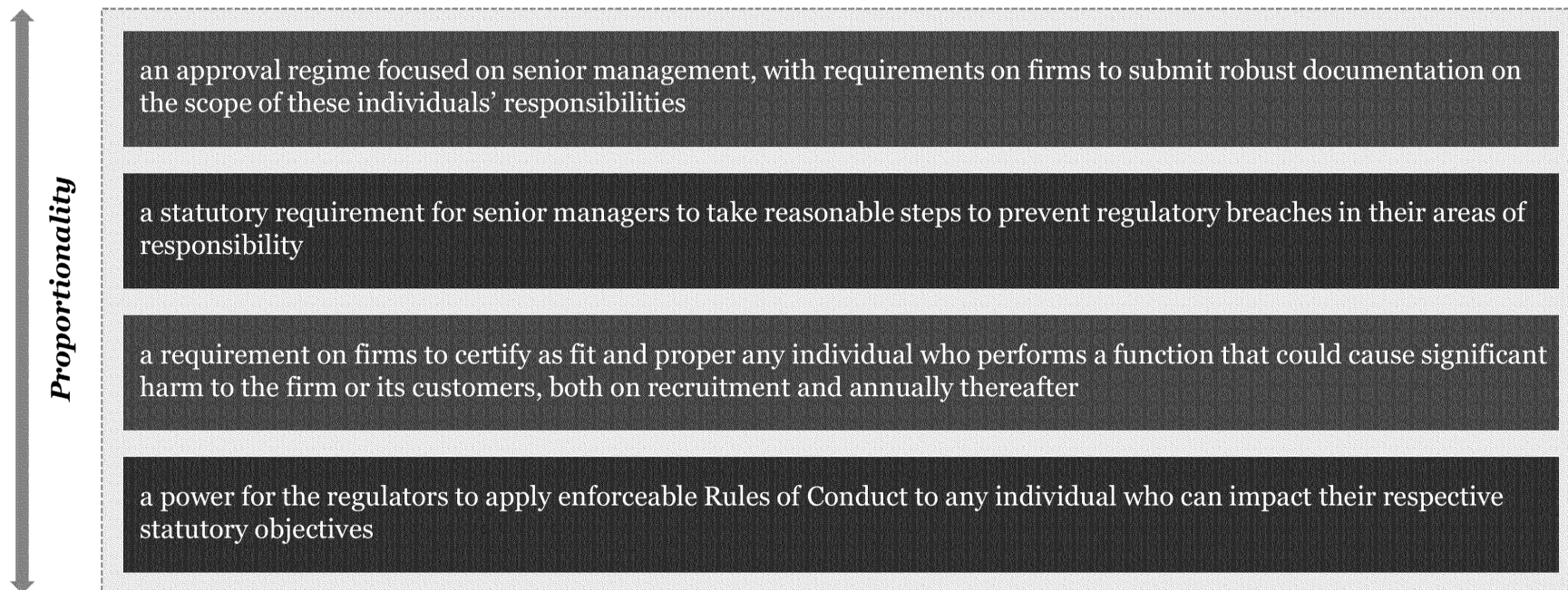
Scope extension



Why is it being introduced?



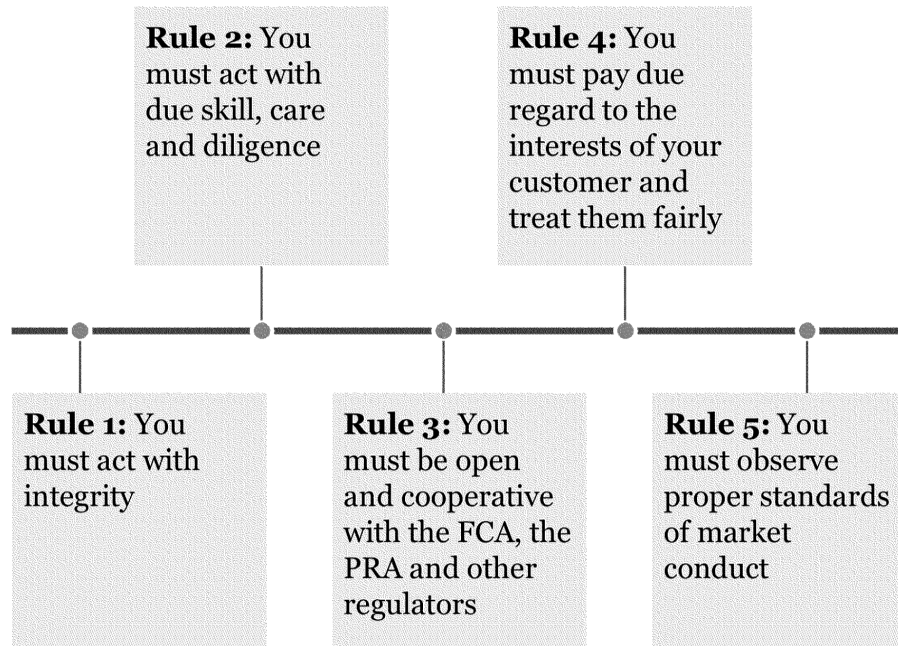
How might this impact you?



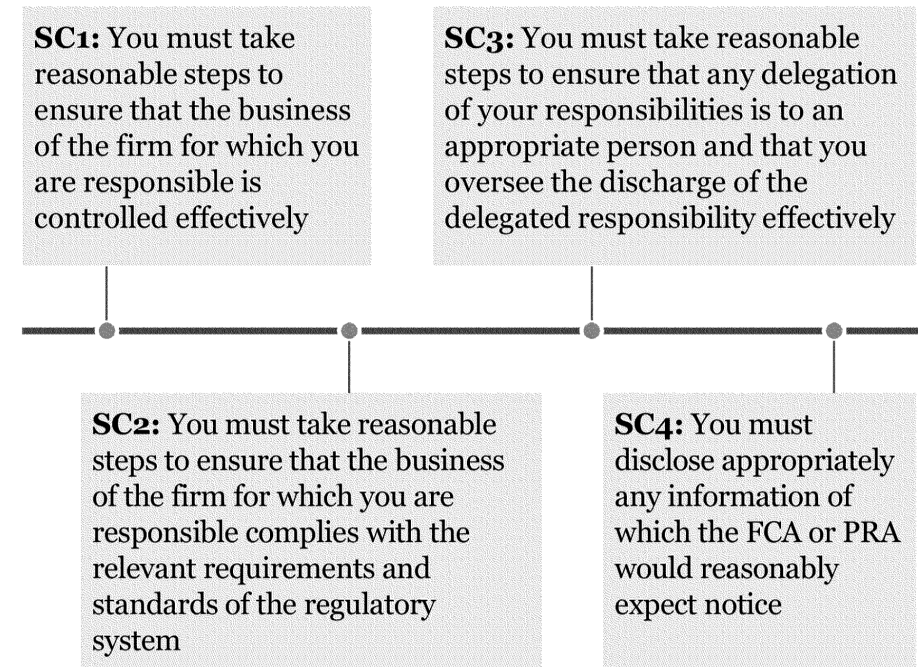
HM Treasury
Senior Managers and Certification Regime: extension to all FSMA authorised persons
October 2015

Individual conduct rules

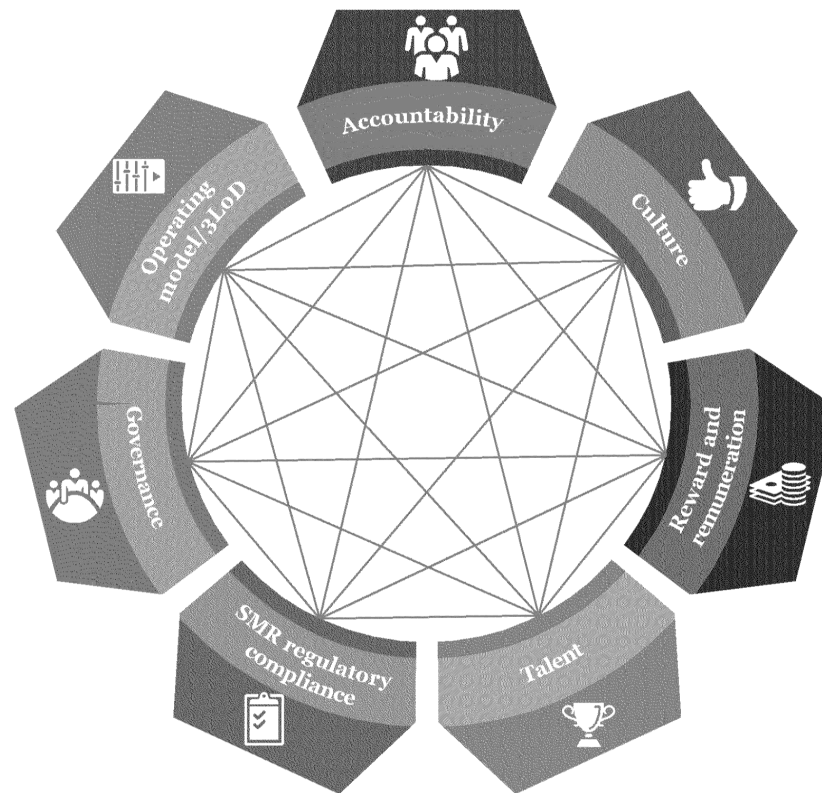
Individual conduct rules



Senior manager conduct rules



The wider impact



Industry views



Culture

3

Culture – Agenda

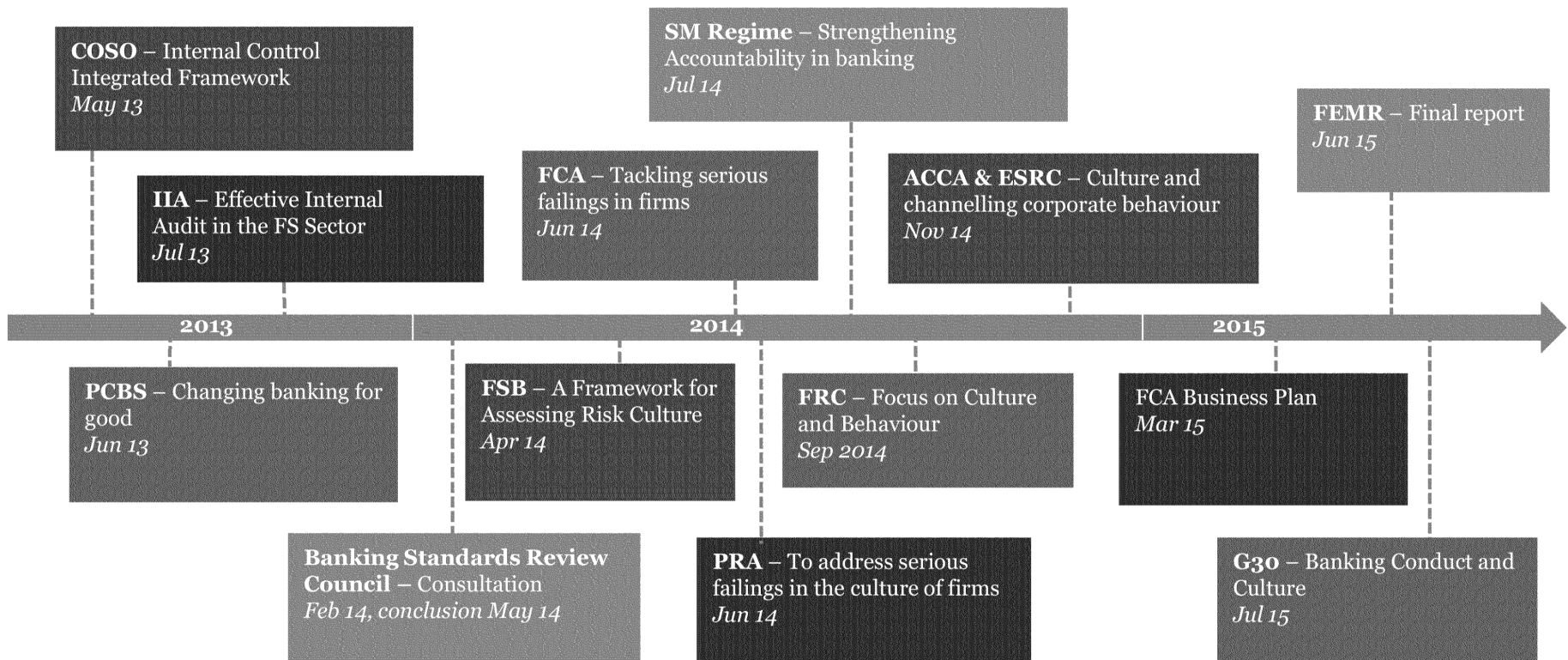
1 *Timeline of regulation*

2 *Key challenges*

3 *Assessing culture*

Culture regulation

A timeline



Some key challenges



You can take tangible action

Define your cultural aspirations in line with your strategy **1**

Assess your current culture **2**

Identify your behavioural priorities **3**

Intervene to evolve and align your culture **4**

Monitor your progress **5**

Assessing culture

Values and behaviours – Your criteria

Your values and behaviours should articulate your cultural aspiration and should form the basis of your assessment criteria

Value 1 e.g. Customer focused	Value 4 e.g. Respect
Value 2 e.g. Innovate	Value 5 e.g. Sustainability
Value 3 e.g. Excellence	


Reinforces – How you drive aligned behaviours

Assessment should also consider the extent to which the values and desired behaviours are being reinforced. The six levers below are how we conceptualise broad categories of behavioural reinforcer

Leadership action	Performance mgmt. and reward
Communication	Organisational structure
People practices	External environment

Techniques – How we assess effectiveness of reinforcers and alignment of actual behaviours

The following techniques and data points are utilised to provide evidence needed to draw conclusions about culture

Desktop review and walkthrough 	Focus groups and interviews 	KPIs and other metrics 	Surveys 
Behavioural observations 	Customer voice 	Psychometric testing and tools 	Big data 

The regulator's view on conduct risk

4

The regulator's view on conduct risk – Agenda

1 *What is Conduct Risk?*

2 *Conduct management framework*

3 *Industry response to conduct agenda*

4 *5 conduct questions*

5 *Client challenges*

What is conduct risk?

Continuing, sharper focus on the treatment of customers

“The risk of a firm treating its retail customers unfairly and delivering inappropriate outcomes”

-FSA guidance consultation for NEDs, Dec 2011

- Top of the FCA agenda following its inception in April 2013
- Core reference to fair treatment of customers – Next stage following ‘TCF’ theme
- Specific focus on risks to customers (rather than the business)
- Fast becoming a global issue and not simply confined to firms regulated in the UK



Key areas of concern identified

Number of key areas of concern identified by FSA/FCA

Generic practices 1	Market-specific risks 2	Product governance 3
<ul style="list-style-type: none"> • Mis-selling • Complexities, bundling • Inertia and pressure selling • Charging practices • Reliance on unfair terms • Complaints handling • Reward structures • Third Party/outsourcing controls • Provider/distributor responsibilities 	<ul style="list-style-type: none"> • Payment Protection Insurance • Low value products e.g. Card / ID protection • Complex products with options/add-ons; use of medical terminology • Unfair contract terms and claims declinature • Self-certification • Interest-only • Lending into retirement 	<p>Including –</p> <ul style="list-style-type: none"> • Product design – suitability, complexity, terms • Product development, testing and approval • Product governance • Ongoing review

Conduct – FCA expectations

Pro-active engagement with conduct and market integrity

‘Customer at the heart of the business’

- Board/senior management lead
- Robust approach and management framework –
With *measurement*
 - Risk identification and appetite – All customer touch points
 - Active monitoring and remediation/improvement
 - Horizon scanning for emerging risks
 - Effective oversight and governance
 - Delivering good behaviours and customer outcomes
- Detailed framework – *Business-specific*
 - Appropriate to business and conduct profile
+ market integrity risks

Conduct management framework

Conduct strategy and business model

Conduct risk identification and measurement

Conduct risk appetite(s) and tolerances

Control measures – Policies, processes, etc

Conduct monitoring – Metrics, triggers and trends

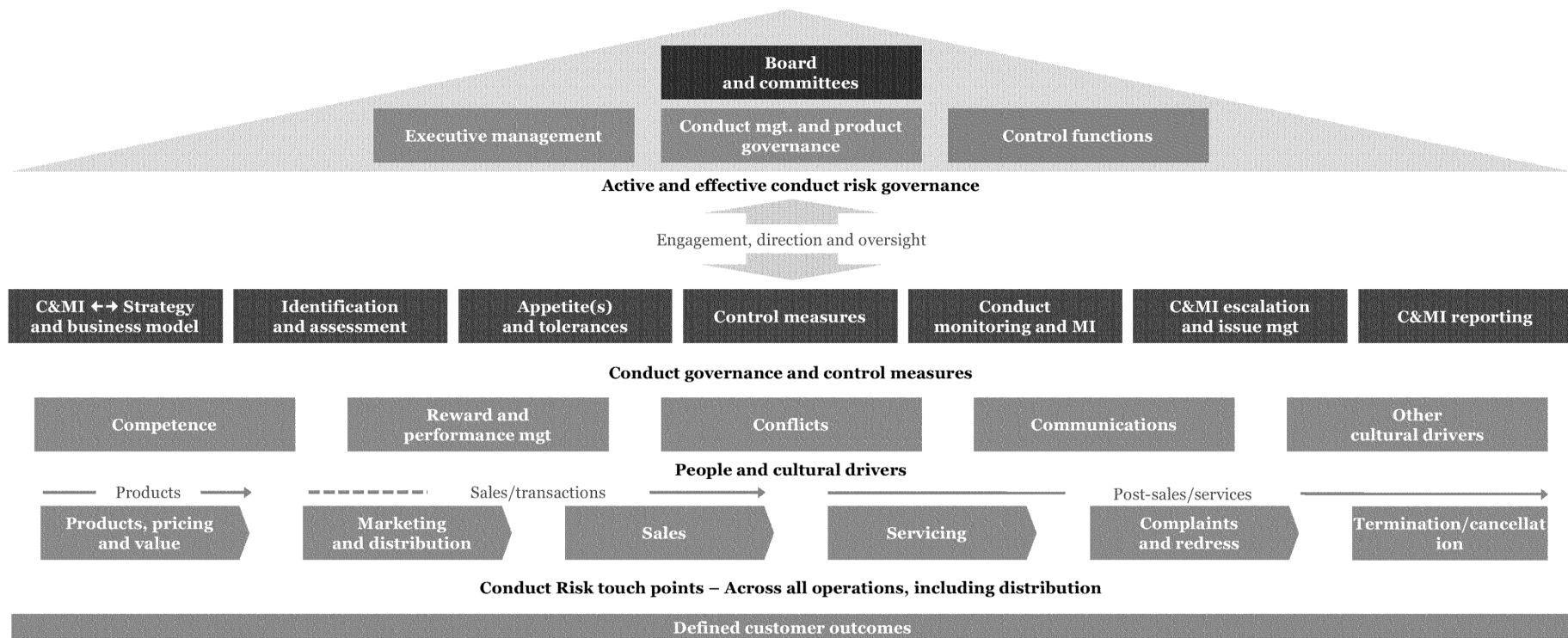
Escalation and issue management

Conduct reporting and governance mechanisms

Regular review of Conduct arrangements

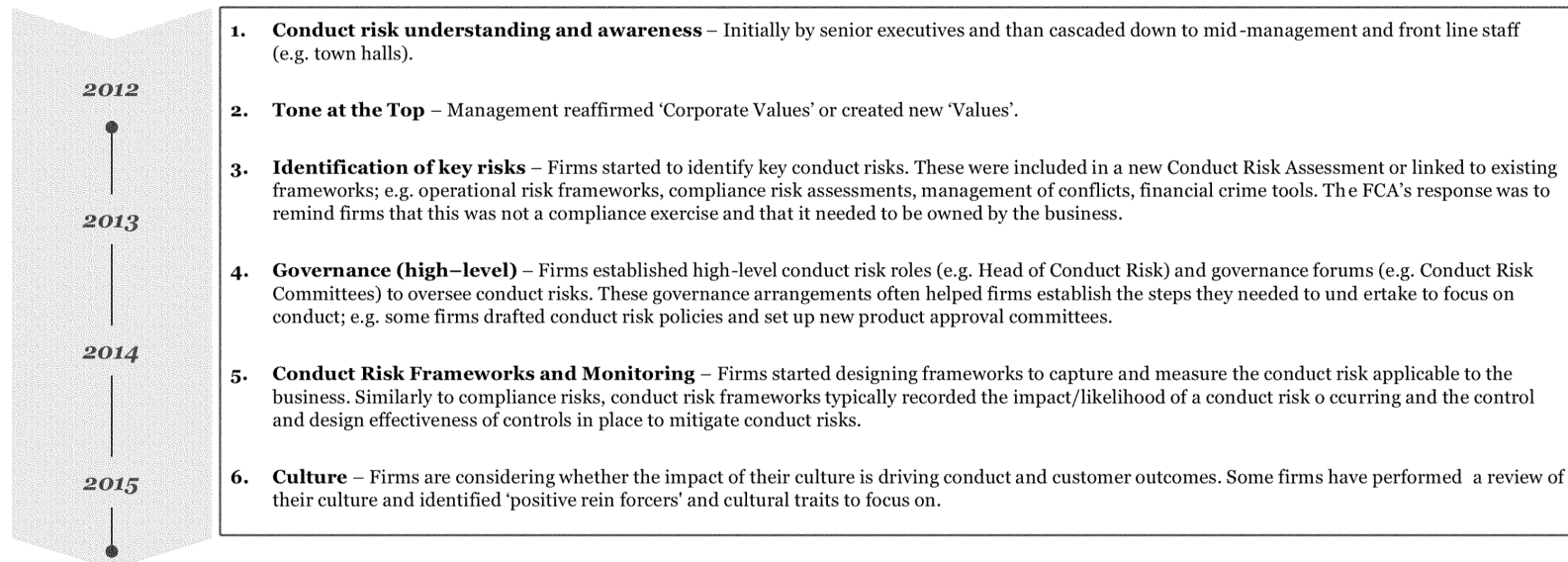
Conduct management framework

Example overview: 'What does good look like?'



Initial industry response to conduct agenda

Since the FCA published their 'Journey to the FCA' paper (October 2012) and the regulator was launched (April 2013), firms, stimulated by early Risk Mitigation Programme (RMP) requirements, made progress in establishing their conduct risk governance arrangements and frameworks. Whilst firms have varying methods and timeframes to embed conduct risk, they have generally used the following steps:



- Firms have had mixed experiences in improving their identification, monitoring and managing conduct risks.
- Many firms have self-identified weaknesses to their conduct framework and are taking additional steps.
- FCA recognises further work is required and have provided additional guidance on their expectations – 5 new conduct questions asked of firms.

5 conduct questions

- 1** How do you identify the conduct risks inherent within your business?
- 2** Who is responsible for managing the conduct of your business?
- 3** What support mechanisms do you have to enable people to improve the conduct of their business or function?
- 4** How do the board and executive committees gain oversight of the conduct of the organisation?
- 5** Do you have any perverse incentives or other activities that may undermine any strategies put in place to answer the first four questions?

Key client challenges

What MI do you use or do you need to create to manage conduct risks?

What do you need to do differently?

Who should be responsible for conduct and associated initiatives?

How do you demonstrate that you are managing conduct risks and achieving fair customer outcomes?

How does conduct risk link to your other risk types e.g. operational, reputation, compliance

What is required in a good conduct risk management framework and how do you link it to existing frameworks?

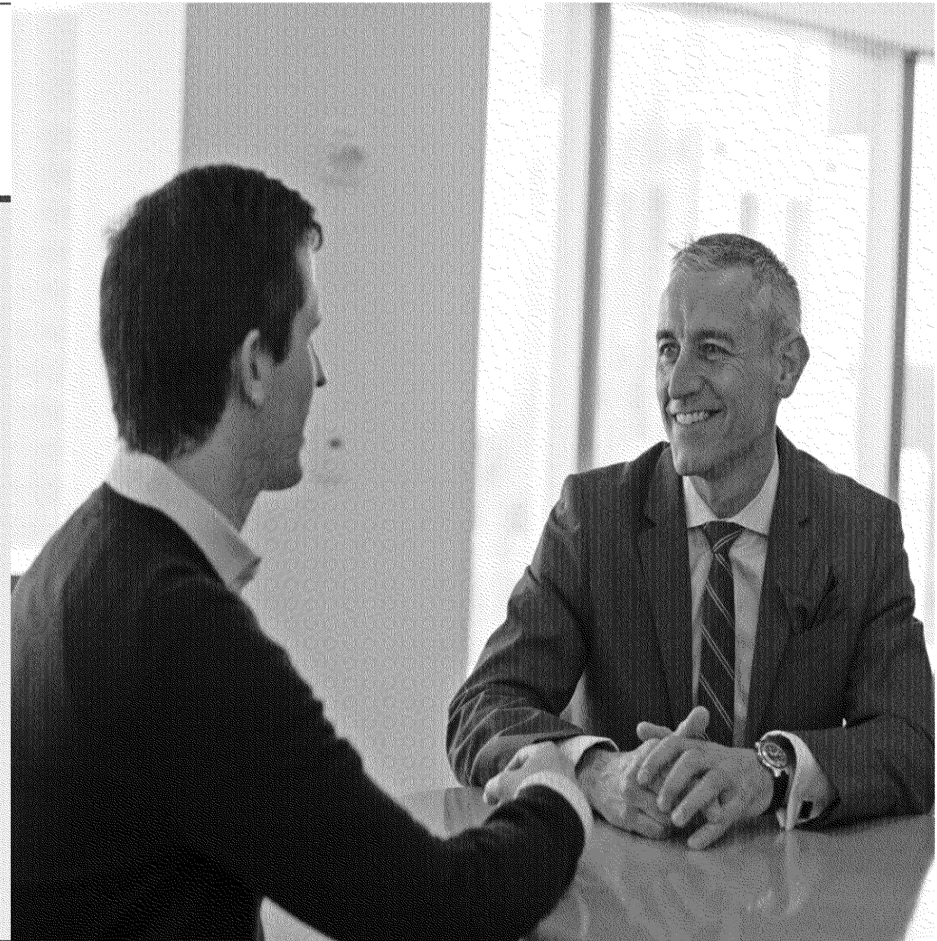
How do you define 'fair treatment' or 'conduct risk'?

What does 'putting the customer at the heart of the business' mean practically for your business?

Value to your business

The benefits of getting it right:

- ***Understanding your business*** – Greater understanding of impact and risks associated with strategy and business model
- ***Decision making*** – Creating alignment between business decisions and regulatory concerns
- ***Senior Management engagement*** – Increase senior management and business awareness via interview discussions, their review of risk assessment and management information
- ***Reputation and brand management*** – Brand reputation in the UK maintained by overt recognition of regulator philosophy



Outsourcing

5

Outsourcing – Agenda

1 *What is outsourcing?*

2 *SYSC 8 requirements*

3 *What the regulator wants to see*

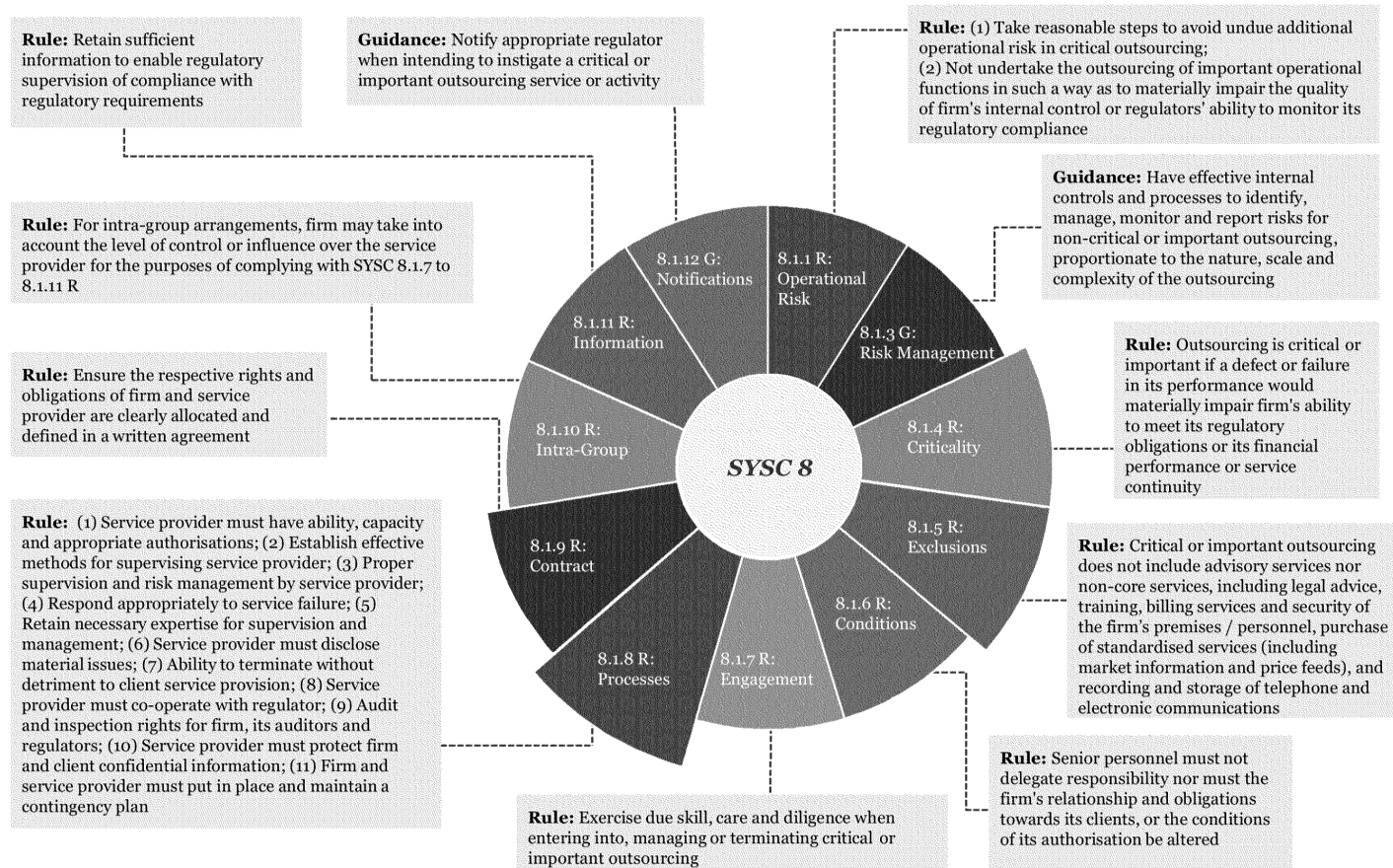
4 *Key challenges*

Outsourcing

The FCA defines outsourcing as:

“An arrangement of any form between a firm and a service provider where the service provider performs a process, a service or an activity, which would otherwise be undertaken by the firm itself.”

SYSC 8: the requirements



Outsourcing: What the regulator wants to see

In order to be SYSC 8 compliant, firms need to demonstrate embedded operational policies and procedures to tackle all the items listed.

Specifically, firms need to evidence effective management control and oversight of all critical or important outsourcing arrangements, including those through group affiliates (both core legal entities and shared service centres).

Key requirements and expected activities

- Defined board-approved outsourcing risk appetite
- A senior governance body responsible for overseeing and managing outsourcing risk to regulated entities, including approving all new or materially changed critical or important outsourcing
- Entity specific outsourcing MI and concentration risk metrics
- Clear definition of 'outsourcing' and 'critical or important' outsourcing that captures both traditional third party vendors and inter-affiliate arrangements through both off-shore service centres and primary operating entities
- Inventory of outsourcing and critical or important outsourcing arrangements supporting UK regulated entities that is maintained for completeness and accuracy
- Robust procedures for risk assessing, identifying and managing new or materially changed critical or important outsourcing arrangements, including material sub-outsourcing and effective 'perimeter management' and exit planning
- All critical or important outsourcing arrangements appropriately papered
- Defined standards for performing and evidencing effective ongoing supervision of critical or important arrangements by appropriately skilled personnel (retained capability)
- Effective processes for managing the sub-contracting of critical or important outsourcing arrangements
- Mechanisms for notifying the regulator for all new or materially changed critical or important outsourcing
- Outsourcing training and awareness for key personnel, including governance body and board members
- Clear linkage with other associated regulatory areas, including operational risk management and RRP

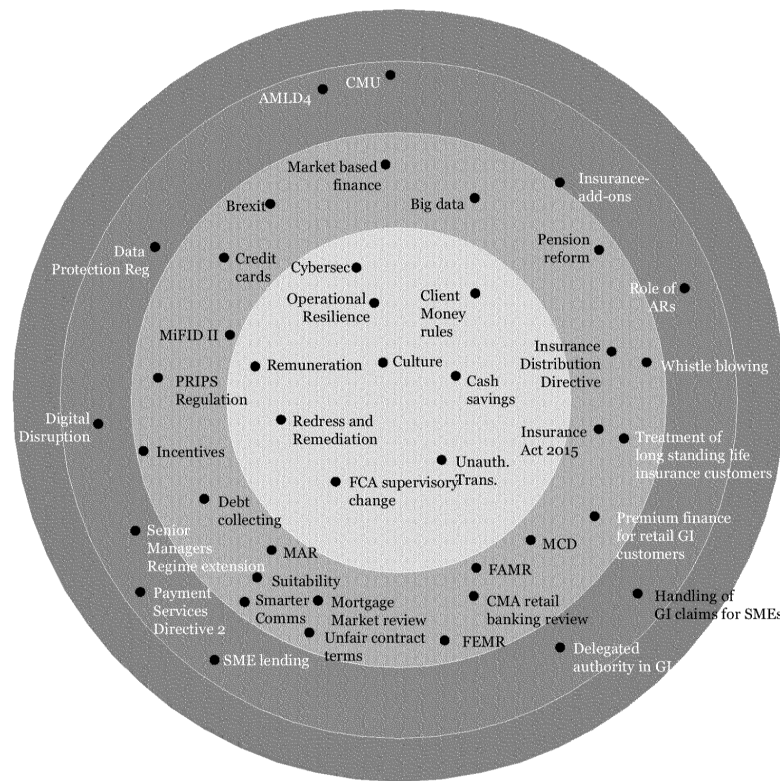
Key challenges



Other regulatory initiatives

6

Indicative range of regulatory initiatives



Timing and relevance

- Crystallised and ongoing issues – Compliance currently required
- Potential issues firms need to comply with in 2016
- Potential 'horizon scanning' issues for firms to comply with in 2017 or later

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