Keeping pace with innovation
Managing conduct risk in a digital era
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“The most immediate priority here for us – and the most pressing, I think – is to ensure tech-led improvements to customer experience can be safely fast-tracked into the UK. And to help this happen, the FCA is working closer than ever before with financial service firms who are developing innovative approaches to service that aren’t explicitly covered by regulatory rules – or where the guidance looks ambivalent.”

**Martin Wheatley**, FCA Chief Executive

The effective management of conduct risk is high on the Financial Conduct Authority’s (FCA’s) agenda. In its annual **Business Plan**, for the second year in a row the FCA identified technological development as one of its forward-looking areas of focus for 2015/16.

In this paper, we look at how the evolving digital landscape is impacting on consumer behaviours; the regulator’s concerns about the new risks that can arise from the increased use of technology in providing financial services; and specifically, where and how firms should be considering conduct risk.

Consumer behaviour is changing. The way in which we communicate with each other has changed beyond recognition within a generation and, with it, the way in which we interact with our financial services providers. The pace of change shows no sign of slowing down, with the relentless advance of the mobile device and the dominance of social media.

The UK is fast becoming a central hub for financial technology and product innovation. An explosion of start-ups are taking advantage of digitalisation and declining consumer satisfaction with the financial industry, to challenge and compete with firms that have traditionally dominated the market. Well-established ‘bricks and mortar’ providers are responding by investing heavily in new technologies to provide products and services to customers.

Innovation is essential to the growth and progress of the financial services sector in the UK. But with innovation comes the potential for increased risk to consumers.

So, in the face of these challenges, how do firms embed effective risk frameworks that maintain the balance between rapid expansion into the digital space, keeping pace with the lightning speed of innovation and fair customer outcomes?

**EY believes that firms can be better equipped to manage new risks to consumers by understanding how these can arise throughout the product life cycle.**

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The digital revolution has invariably changed the way consumers bank, buy insurance, shop and communicate. Conventional thinking that people know what is in their best interest and always act on that knowledge has been widely disproven. Consumers can often be confused by financial services and, even when they do know what is best for them, they don’t necessarily make that choice. Firms need to consider how best to tailor the education and advice they give to consumers to solve this.

Customers can already open a bank account via an in-store tablet within minutes, a process that would have previously taken up to an hour.

This is good for consumers who, helped by the new legislation that makes switching easier, may now be more inclined to consider alternative providers. It is said that customers are more likely to get divorced than switch banks. Conversely, this ability to transact quickly may lead to more spontaneous decisions, where consumers have not had sufficient time to understand the product.

Firms need to consider how their policies and processes should be adapted to address this instantaneous decision-making. We already have a culture of ‘immediate’ access to credit, fuelled by digital advances in data analytics from high-cost, short-term loan providers.

Enhanced choice via the convenience of digital may cause unintended unfair outcomes for consumers. As consumers, we now expect fast transactions when we make digital purchases. We have become accustomed to ticking boxes during the course of an online transaction – to accept terms and conditions, update mobile applications or opt in or out of marketing – often without taking the time to read or consider the implications. When we transpose this onto the financial services industry, the consequences for consumers can be significant.

Detailed consumer research conducted by the FCA revealed alarming insights, including customers who had unintentionally clicked their way to taking out products, such as personal loans.

“I couldn’t believe it – I was just looking at a banking app and suddenly there was £2,000 in my account!”

Customer feedback, *FCA Risk Outlook* 3

A particular concern to the UK regulator is present bias – the difficulty that people have in postponing immediate returns. When this is combined with the greater accessibility provided by digital, there is a danger that the required consideration of customer outcomes is not given sufficient prominence.


Online warnings and disclaimers, unless framed correctly, could lead consumers to biased choices. Research in the UK has shown that more consumers turn to the internet for information to help make a decision on purchasing a financial product than any other source. With levels of financial literacy across some socio-economic groups still a concern in the UK, making information easily accessible and understandable can help consumers make better decisions. For example, displaying costs in terms of both a percentage and numerical value, supported by descriptive language, can help consumers to consider affordability more effectively. Treating customers fairly and ensuring that those in the lower bands of socio-economic classes have access to financial services is critical for addressing the current concerns about financial inclusiveness.

Firms will need to consider what products and services could and should be provided on a digital platform. The changes under the Retail Distribution Review and, more recently, the Mortgage Market Review (MMR) have prompted providers to consider the way consumers interact with them and how they access products and services.

The increase in the number of providers offering customers the opportunity to purchase investment products without advice, as well as the clear rules set out under MMR for execution-only mortgage transactions, have resulted in firms developing new distribution strategies. These are no longer necessarily confined to a single channel per transaction.

While the development of digital execution-only sales capability remains high on the agenda for many providers, there is recognition that some complex transactions or customer segments will still benefit from advice. However, we expect this to take a very different shape from traditional advised transactions. EY’s experience shows that, even in a face-to-face environment, it is challenging to build and implement a sales process that is flexible and can adapt to the information needs of customers. This challenge is even greater on a non-interactive platform. Some firms have found that, when undertaking post-sales outcome testing with customers who considered themselves mortgage ‘savvy’ and felt they had purchased the right mortgage, the same customers still admitted that they did not fully understand all of the product features and financial implications of the transaction. This highlights the need for greater flexibility in the level and depth of information provided to meet customer need.

Sales processes do not necessarily need to be binary: interactive advice or non-interactive execution only. For example, many providers are developing end-to-end online advice processes, this is now more likely to be combined with the ability for customers to access interactive help and guidance, through web chat, webcams or telephony.

In the face of changing consumer behaviour and the relentless pace of innovation, senior managers will be faced with an increasing number of new risks in the way that they conduct their business, which will need to be identified, understood and effectively managed.

EY believes that financial services firms have an important role to play in shaping the future of our industry, by demonstrating that innovation and competition can be effectively balanced with consumer protection.
The FCA has identified the key risks to consumers through technology. We highlight their importance in this section.

The regulator expects firms to proactively identify and manage the new conduct risks that will inevitably arise from innovation and the increasing interaction with customers online.

The types of questions that financial services providers should be asking themselves are:

**Do our customers understand their rights and obligations, and what are we doing to help to educate them?**

Consumers should understand that they have the same regulatory protections in place when using digital products and services. For example, when building advice models on digital platforms, are you able to demonstrate clearly whether or not customers are receiving advice? Do your processes and controls allow for an appropriate assessment of the customer’s circumstances and needs in order to provide an advised service? Are there some products that are too complex to ever be made available online?

**Do we have adequate oversight of third parties and outsourced functions, including sufficient due diligence checks?**

Outsourcing functions to third parties may be beneficial to both firms and consumers, but does not discharge the firm’s responsibility for customer treatment. Conduct risks may be realised where the service is customer-facing or a material arrangement, as the duty of care will be higher. While oversight over outsourcing arrangements is being stepped up to address resilience issues, firms should not lose sight of the need to take adequate steps to protect both their own customers and their brand from detriment. One way of addressing this is to ensure that staff responsible for oversight activities have the right level of expertise and training to understand the full range of risks that can arise from outsourcing, including conduct risks.

**How will we help customers who are inexperienced or reluctant to use technology?**

While digitalisation is driving seismic change in the industry, some consumers will inevitably lag behind or may be forced into using platforms they do not understand. Firms need to recognise and adapt to the different needs of customers to ensure that some segments are not marginalised. The high-street bank of the future is likely to incorporate the use of tablets; it is not difficult to imagine a scenario that places the hesitant customer in the position where they would rather do business in a different manner but is too embarrassed to refuse.

At the other end of the spectrum, digitally advanced consumers are increasingly happy to share their personal data with businesses, particularly where brand loyalty provides enhanced benefits or service. However, firms must be able...
to demonstrate that they are using this data safely and responsibly. A small digital breach can undermine consumer confidence in digital services. How are best practices for online security and preventative measures against hackers communicated? What safeguards are in place? How quickly (or even if at all) do we tell consumers that they may have been affected? How do we react to any breach stories proliferating on social media to stop unnecessary consumer panic?

EY can help with the assessment of your current framework and the implementation of strategies to mitigate conduct risk in the evolving digital landscape.

As well as rethinking conduct risk in a digital era, the regulator has raised a number of other risks related to the advances in technology. In this regard, firms should be considering these questions:

Are our technology frameworks robust enough to maintain the security of personal data and funds?

Most firms already analyse their own system traffic to predict when their digital services are most in demand, in order to avoid major outages. The financial services sector in the UK has already seen the consequences of major disruptions when demand exceeds the capabilities of frameworks.

Are our frameworks flexible enough to cope with future changes?

Given the rapid pace of change in technology and consumer behaviours, the integrity of IT infrastructure is increasingly important, including the ability to continue to innovate. This will be particularly significant for firms using legacy systems.

How are we addressing the increased risk from cyber crime?

Financial service providers must play a key role in protecting their customers from cyber crime. Those seeking to benefit from crime are becoming increasingly sophisticated and innovative in their use of technology, and staying ahead will be a perpetual challenge for firms.

For more information on how EY can help, please contact:

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About EY’s digital conduct risk capability

► We are leaders in the conduct risk space and were named ‘Best Consultancy/Law Firm – Conduct Risk including CASS’ at the Compliance Register Platinum Awards® in 2014.

► We combine discrete disciplines, such as performance improvement, data analytics and business intelligence to bring in new perspectives and insight to your digital capability.

► We have recent experience of delivering an impact assessment and risk mitigation strategy to a major UK high-street bank. This was specifically focused on replacing a legacy system with a new digital platform for account servicing.

► We have helped clients in defining conduct risks and are innovators in the field of conduct risk management information, supporting our clients to identify and manage risks proactively.

► We can bring insight into the digital world and we are at the forefront of regulatory developments in this area.

► Our knowledge of behavioural economics can help our clients to understand evolving consumer behaviour and financial decision-making so we can help deliver digital solutions that are focused on achieving the right customer outcomes.

► Firms need to be able to overcome the historical challenge of their legacy systems and react as the world changes around them. New entrants have quicker or leaner systems and are more experienced in key digital channels. We can help drive your strategy to retain the digital customer.

► We are able to advise firms in the practical development, application and delivery of their digital offering.
About EY
EY is a global leader in assurance, tax, transaction and advisory services. The insights and quality services we deliver help build trust and confidence in the capital markets and in economies the world over. We develop outstanding leaders who team to deliver on our promises to all of our stakeholders. In so doing, we play a critical role in building a better working world for our people, for our clients and for our communities.

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