

CONDUCT ASSESSMENT FRAMEWORK

CONDUCT RISK

Conduct risk is the risk of banks' conduct having a detrimental impact on customers, its own growth or the market stability. It may also be termed as the non execution/delivery of Fair Treatment of Customers (FTC) by the banks. SBP has rebranded consumer protection as a success proposition for banks rather than being a compliance issue and has ensured adoption of self conceived FTC frameworks by the banks based on the following principles:

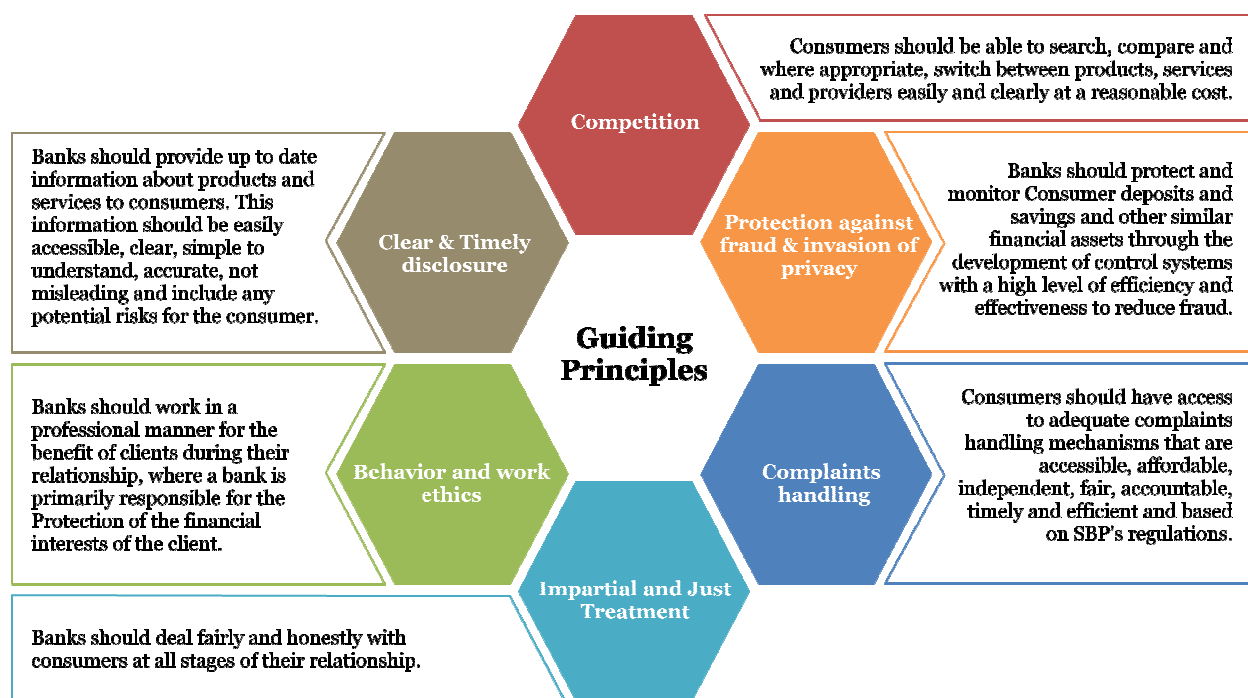


Figure 1 Guiding Principles for Fair Treatment of Customers

ASSESSMENT OF CONDUCT:

Banks need to continue to monitor their adherence to FTC central themes/principles on an ongoing basis and demonstrate how culture, strategies and controls deliver fair treatment to their customers through FTC framework. However, the effectiveness of the self conceived FTC framework to avoid or manage conduct risk needs to be continuously checked without which implementing FTC is merely a statement of intentions. In order to deliver consumer protection, assessment criteria indicating the state of conduct needs to be adopted by the bank.

CONDUCT ASSESSMENT FRAMEWORK

Conduct Assessment Framework (CAF) is a self assessment conduct tool for banks that will measure bank's state of conduct. The purpose to quantify conduct is to develop a periodic, reliable, diagnostic and comparable mechanism which helps bank deliver their commitment to FTC in the most optimum way. This will not only indicate the grey areas but will also help banks set measurable and realistic FTC goals and maintain the track of their progress on the same. The

quantification in CAF remains indicative only signaling safe, cautious and dangerous state of conduct. The tool consists of following three modules:

- Culture
- Product/Service Design and Disclosures
- Consumer Grievance Handling Mechanism/ Complaint Handling

Module being the major conduct risk area consists of **Conduct Risk Sub Areas**, the **Controls** to prevent the probable conduct risk from happening, the **Assessment tools** that gauge the effectiveness of the deployed control, the **Benchmarks** being the scenarios of conduct which can be classified into **Danger**, **Caution** & **Satisfactory** zone. The weightages assigned to assessment tools and the scores given to benchmarks produce a score/rate to the conduct of the bank. Such rate will indicate on a scale of 0-2 (where 0-0.99 represents danger zone, 1-1.99 represents caution zone and 2 and above represents satisfactory zone).

The rating method will produce state of conduct for a particular conduct sub area as well as a consolidative rate for overall conduct of the bank.¹

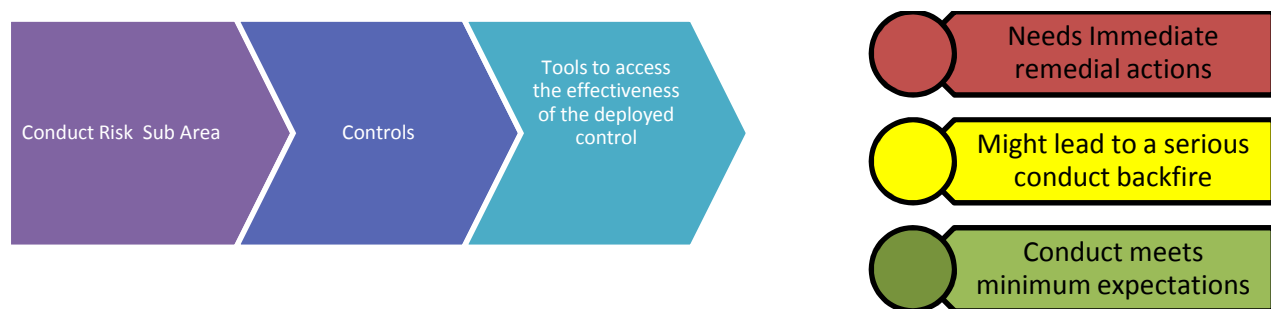


Figure 2 Conduct Assessment Framework_ CAF

Assumptions of CAF

It is expected that while implementing FTC banks must have adopted:

- Internal as well as external mandatory and specialized training modules explaining and embedding features of FTC in their staff members.
- Research tools to evaluate the perceptions of customers and their own staff regarding bank's delivery of FTC. The research methodologies described in CAF are only indicative. Banks may choose research methodology as deemed appropriate by them to extract such information.
- A relevant function/team as deemed appropriate by the bank management/BODs is entrusted with the responsibility to oversee, own FTC as well as liaise with SBP.

Using CAF:

As mentioned above, CAF is based on three modules – the grand three conduct areas. Appended below is an explanation of items used in these modules:

Conduct Risk Sub Area: These comprise of the sub areas where most crucial conduct risks/non delivery of FTC expectations pertaining to the specific module may arise. For better understanding the Conduct Risk Sub Areas are also provided with the risk/s itself which needs to

¹ The detailed CAF is placed at Annexure A.

be mitigated or managed. For example, while gauging the effectiveness of bank’s existing culture to ensure and promote FTC, the identity of FTC, its understanding and orientation across the bank and its visibility to customers are the bare minimum crucial elements. Accordingly, the Conduct Risk Areas and Probable Conduct Risks for Culture in CAF are:

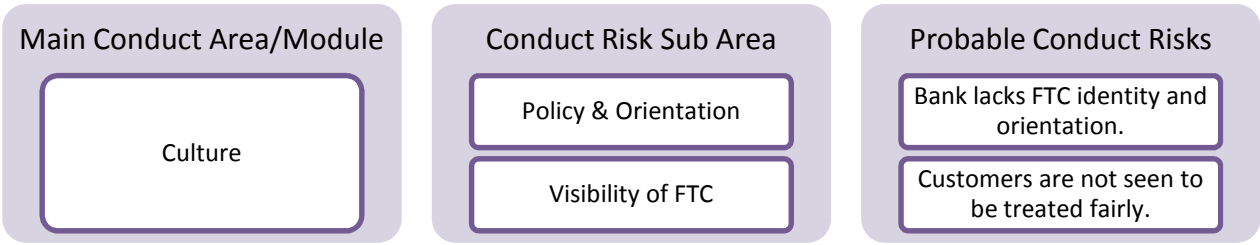


Figure 3 Probable Conduct Risks in FTC driven culture

Controls: It refers to the preventive measure deployed by the bank (ideally under FTC) to curb the probable conduct risks from arising. There can be multiple controls to prevent one conduct risk from happening. The controls elicited in respective modules against the conduct risk area shall not be construed as exhaustive. Banks can also add on other controls deployed at their end. For example, the controls to ensure presence of FTC in bank’s culture may atleast include:

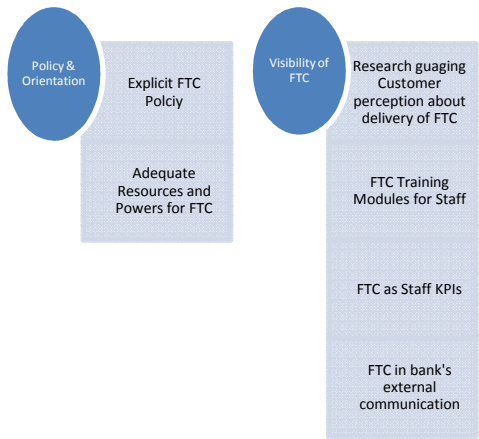


Figure 4 Controls to ensure FTC driven culture

Assessment Tools: These are ways or tools to evaluate the effectiveness of the deployed control that render three scenarios which can be classified into dangerous, cautious and satisfactory zones. An example covering assessment tools for a conduct sub area from the culture module is appended below

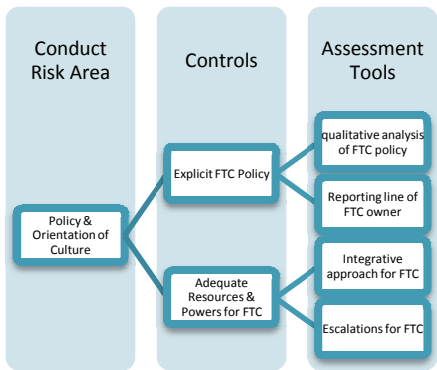


Figure 5 Assessment tools for effectiveness of control deployed to ensure FTC driven culture

Benchmarks: As stated earlier, CAF rating is based on three given/pre determined scenarios of red ,yellow and green zones where Danger (Red) stands for 0, Caution (Yellow) stands for 1 and Satisfactory (Green) stands for 2. The red zone indicates dangerous state of culture which requires immediate actions at bank's end. The yellow zone highlights issues which might appear subtle but can lead to disaster if not appropriately tackled within time. The green zone shows that the bank is responsibly catering to FTC minimum expectations in the current scenario, however, a green zone placement shall not be misunderstood as the most responsible deliverable of good conduct as expectations regarding conduct are dynamic and banks need to match the progressing mark.

Since FTC is a nascent concept, the scenarios are intentionally kept lenient. Banks may revamp the proposed scenarios and set their FTC mark higher. Any downward shift in the scenarios shall be approved by BODs and the respective rationales shall be documented within the CAF reporting.

Rating Mechanism: The rating mechanism of CAF evenly distributes weights to all assessments while the scores of the states/benchmarks of RED, YELLOW & GREEN remain constant as 0, 1, and 2 respectively. The product (assessments x benchmarks) render ratings on a scale of 0-2. The classification of the scale is as follows:

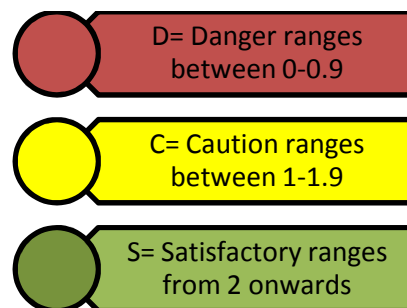


Figure 6 Conduct Ranges

Appended below is a consolidative explanation into CAF.

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	A	B	C	D	E	F
1	Sr.No	Conduct Risk Sub Area	Control	Assessment Tools	Benchmarks	Scores
2	1	The sub areas where most crucial conduct risks/non delivery of FTC expectations pertaining to the specific module may arise. All the sub areas carry equal weights in the respective conduct area .	These are the preventive measure deployed by the bank (ideally under FTC) to curb the probable conduct risks from arising. The prescribed controls have even distribution in the weight of the subject conduct risk	These are ways or tools to evaluate the effectiveness of the deployed control . Tools contribute evenly to the weight assigned to the control	These are predefined states carrying predefined scores where D=0, C=1 & S=2	It is the product of the weight of the given control with the score of the selected benchmark. For overall score of the module, the conduct risk sub area will be averaged out
3						

Figure 7 Rating Methodology

Expectations:

It is expected that:

- FTC/CAF will be an organizational effort with defined roles and responsibilities.
- CAF shall be reported periodically to BODs as assessment of FTC.
- Annual profiles (atleast) shall be maintained of the CAF reported to BODs/SBP along with the (relevant) proposed as well as actual improvements introduced. Such profiles will be subject to regulatory checks.
- Banks are encouraged to delve deeper into CAF. For example, banks may opt for product based assessment for second and third module.

Culture – Conduct Risk Area

Conduct Risk Sub Area	Control	Assessment tool	Benchmarks D=0, C=1 & S=2	Weight
<u>Policy & orientation</u> Bank lacks FTC identity and orientation.	Institution of an Integrated explicit policy framework on FTC	Qualitative	D= Board approved FTC without provisioning of FTC's scope and stakeholders' roles (owner & participants) C= Board approved FTC with scope and stakeholders' role but without review/reporting requirement S= Board approved FTC exists which includes scope, stakeholders' roles as well as a periodic review requirement	0.5
	Adequate powers are available to the function owning FTC	% of FTC owner's team/staff asserting (rating top 3 on a scale of 10) being adequately resourced	D= <60% C= 60-80% S=>80%	0.5
		Integration	D= disintegration exist between the functions overseeing different aspects of a product/service life cycle. C= integration exist on ad hoc or voluntary basis. S= predefined integrative setup exists between the functions of the bank.	
		Escalations	D= No reporting to top management /BOD on customer voice/experience C= There aren't any periodic reports on customer voice/experience to top management. S= Periodic reports on issues and achievements to top management/board is a regular or atleast bi annual feature.	

Visibility of FTC Customers are not seen to be treated fairly.	Independent research ² is undertaken to probe customers’ perception about the bank being fair & Honest with its customers	% of customers rating bank amongst top 5 points on a scale of 10 points	D= <50% C= 50-75% S=>75%			0.25
	Independent research is undertaken to probe customers’ perception about the bank being fair & Honest with its customers	Frequency of such Independent research conducted	D= no research conducted C= <3 years gap S=<2 years gap			
	FTC training modules	Annual completion rates for FTC mandatory trainings ³ preferably for relevant staff ⁴	D=<60% C=60-70% S=>70%			0.25
		Annual completion rates of the (new) Front line staff undertaking mandatory training before being permitted to interact with customers	D=<70% C=70-80% S=>80%			
	FTC as KPIs	FTC deliverables are part of relevant employee’s performance assessments ⁵ (FTC: business ratio in goals/KPIs)	Tier 1 D= 0:100 C= 50:50 S= atleast 60:40	Tier 2 D= 0:100 C= 30:70 S= atleast 40:60	Tier 3 D= 0;100 C= 20:80 S= atleast 30:70	0.25
	FTC part of bank’s publications & communications	FTC initiatives are published in internal as well as external communications of the bank	D= bank communicates FTC (only to the extent of) regulatory compliance C= bank has customer charters/mottos that are public S= bank publicize FTC related matters (additional to the regulatory requirements) to general public in a periodic manner.			0.25

² The banks may preferably use independent research function for the subject purpose. However, usage of internal research function is also permitted subject to disclosure of the same.

³ Include relevant trainings available on external forums complimented by the internally designed learning modules.

⁴ For the purpose of this framework, relevant staff includes but is not limited to departments directly or indirectly related to product life cycle of consumer banking products e.g. service quality, consumer banking, audit, compliance etc.

⁵ For performance assessment control, the banks may classify the relevant staff on a zone of relevance consisting of three tiers i.e. highly relevant, relevant and less relevant. The classification must be well justified and should be made part of the board approved FTC.

Product/Service Design and Disclosures _ Conduct Risk Area

Conduct Risk Sub Area	Control	Assessment Tool	Benchmarks D=0, C=1,S=2	Weight
<p><u>Understanding the Customers</u> Bank do not understand its target market</p>	Well defined target markets exist for products and deviations from the same are monitored/curbed/restrained	Number of complaints on product design and product proposition	<p>D= 5% of the total number of sales (for a particular product) made during that year.</p> <p>C= 3-5% of the total number of sales made during that year.</p> <p>S= Less than 3% of the total number of sales made during that year.</p>	0.33
		Mystery Shoppings	<p>D= >10% of the mystery shopping attempts/instances indicating customer product misfit</p> <p>C=10-5% of the mystery shopping attempts/instances indicating customer product misfit</p> <p>S=<5% of the mystery shopping attempts/instances indicating customer product misfit</p>	
	Survey results for bank providing all relevant information about its products in clear and simple manner	% of customers rating bank on top 3 ranks on scale of 10	<p>D=<50%</p> <p>C=50-75%</p> <p>S=>75%</p>	0.33
	Suitability Assessments	Number of failures ⁶ of checks on the completeness of the suitability assessment	<p>D=30% of the product sold</p> <p>C=29-10%</p> <p>S=<10%</p>	

⁶ Instances where suitability assessments were not conducted. Such data can be generated from internal/external audit or related functions of the bank.

<u>Effectiveness/coverage of Disclosures</u> Customers do not get the intended message through the published disclosures	Consumer testing ⁷ gauging customers' level of understanding regarding product disclosure	Question/probe on whether the main product features were explained to the customer	D=>15% C=10-15% S=<10%	0.25
	Key fact Statements for products	Customer's sign off is taken on products' KFS	D= <60% of consumer products ⁸ have KFS with verifiable acknowledgement. C=60-80% consumer products have KFS with verifiable acknowledgement. S=>80% consumer products have KFS with verifiable acknowledgement	0.25
	Product Specific Misselling Complaints (alleged)	Composition of mis sellings amongst product specific issues	D=<50% C=50-40% S=>40%	0.25
	Customer feedback from cancellations	Feedback from cancellations – reason missell	D=>40% C=40-20% S=<20%	0.25
<u>Service Standards</u> Non delivery of commitment	Standardized TATs & SOPs (SLAs) in place	Procedures or events that are defined	D=<80% C=80-90% S=>90%	0.33
	Monitoring of SLAs	Number of events highlighted through audit or other monitoring tools	D=>25% breaches out of the total events/procedures (sample) audited C=24-10% breaches out of the total events/procedures audited S=10% breaches out of the total events/procedures audited	0.33
			D= no such practice in place C= policies requiring probes/queries into	0.33

⁷ On -going Surveys/pre launch probes into customers' level of understanding regarding product disclosure

⁸ The benchmark also includes other products being sold to individuals by the bank.

	<p>Policies for enforcement of SLAs (risk managing policies)</p>	<p>Qualitative</p>	<p>reasons of failures/non observance.</p> <p>S= policies requiring escalations along with action plan and follow ups by higher management.</p>	
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Dispute Resolution Mechanisms/Complaint Handling Conduct Risk Area

Conduct Risk Sub Area	Control	Assessment Tool	Benchmarks D=0, C=1, S=2	Weight
<u>Voice & Vitality</u> Complaint handling is considered as low priority function of the bank	Complaints escalation matrix in place	Qualitative	D= No escalation matrix C= Escalations at max to SQ/Ops/com/any other business head S= Escalations to President /CEO	0.25
	Adequate resources (Trainings & Systems) are available to complaint handling staff/department	% of complaint handling staff asserting (rating top 3 on a scale of 10) being adequately resourced	D= <60% C= 60-80% S=>80%	0.25
	Higher management oversees the bridging gaps exercise periodically	Qualitative	D= not a regular feature C= reporting includes suggestions/recommendations S= reporting includes the measures taken in order to avert recurrence of issues	0.25
	Complaint Handling is visible to customers	Complaints/number of customers	D= more than half customers do not complaint in the manner prescribed by the bank. C= 50% and above do complaint to bank in laid down way/manner. S=70% of customers avail complaint handling facility of the bank.	0.25
		Complaints entailing opinions on visibility of complaint handling	D= 10% and above of total complaints C=9-3% of total complaints S=less than 3% of the total complaints	
		% of customers rating bank amongst top 5 points on a scale of a 10 point for visibility of complaint handling	D= <70% C= 70-85% S=>85%	
<u>Functionality</u> Complaint handling is mere complaint handling	Scope of complaint handling stretches beyond resolving complaints	Mandate of complaint handling function	D= handles and reports number of complaints resolved. C= handles and reports trends in complaints S= handles, does system based trend analysis, collaborate with internal stakeholders to conceive solutions, updates adoption status of approved solutions to higher management	0.25
	Monitoring of unresolved complaints	Monthly % of complaints which remained unresolved	D=>15% C=10-15% S=<10%	0.25

	Monitoring of complaints TATs against internal & regulatory standards	TAT exceeds by 2 days	D=<75% C=75%-85% S=>85%	0.25
	Effective Complaint Handling	Number of complaints against complaint handling at the bank	D=>20% C= 20-10% S=10%	0.25