On Regulation, Risky Shifting and Internal Cultures

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Stand first:

At the same time as they increase emphasis on customer-centred delivery, regulators are holding financial sector Boards as responsible for their internal cultures, as much as they are for more tangible aspects of their organisations. Roger Miles and Tony Moroney discuss the change of approach, the move from a tick-list to conduct based culture and contemporaneous risks.

Body:

People no longer take their cues or confidence from paperwork, but from what family, colleagues and social peers accept is the right thing to do. Through social media consumers now regulate markets and new models that help understand and utilise this in beneficial ways. Meanwhile, financial regulators seem to be forcing focus on customer outcomes, pushing customers into regulatory positions. This already permeates other markets, and although the financial sector has had a temporary reprieve, it must now adapt to social pressures exerted online.

INTERNET IMPACT

RM: There is a new transparency resulting from the internet. This has enormous benefits and, as yet, largely untapped potential for both good and bad. In particular, it has the potential to enhance or disrupt financial services in a market that clings to outdated supply driven models.

[illustration]

In an age where customers are more than ever willing to judge their customer experience according to the personal response they get from frontline staff, it is no longer good enough for corporate providers to assert hopeful claims to good service. Widespread public mistrust of big organisations of all kinds is fomenting an atmosphere of suspicion into which any providers with an 'authentic' or 'customer centric' offering will score ready success. In the past, the customer has rarely been consulted in the financial services sector and thanks to social media, new expectations are now shaped at super fast speeds. For this reason old 'boxed product' models of distribution no longer cut it. The challenge towards conventional providers who are damned simply by having been around so long, is to create an appeal at a personal level which gets beyond the customer's preconception of big-as-careless.

[illustration]Q. And what has been the role of social media, specifically?

RM: Applying a behavioural and conduct risk perspective, social media is a significant social amplifier that denies providers the old opportunities to exert control since both customers and staff check with their neighbour for the social acceptability (and therefore legitimacy) of an organisation's claim. Add to this, that the online medium has an established tendency to induce so-called 'risky shift' in its participants – the effect whereby an individual's stance is exaggerated by their perception of others approval for it, irrespective of whether the perception is accurate - and you start understanding why new models are required.

One such instance is that: Customers perceive that an official complaint is simply a mechanism to capture and bury problems; and that publishing a criticism online is a surer way to see bad service acknowledged. They feel validated because financial service providers appear sensitive to social media criticism. It is likely that someone who has so publically taken an incorrect stance may be very upset and are likely to turn with anger on to the very organisations they required to respond in the first place. to similar exaggerated stances may then be subject to an exaggerated overcorrection and further criticism as customers regret their initial confidence.

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REGULATORY APPROACH

TM: The EBA looks at risks from the point of view of investor protection. While fintech is designed to increase privacy and streamline the business, such an increasing interconnectedness brings an increasing exposure to IT-risk. Potential opportunities for subversion such as money laundering follow. Regulators don't want to be seen as using a sledgehammer to crack a nut, but they want to see banks deliver a better (and better received) customer experience, without market destabilisation. This requires providers to change in the way they approach the market.

http://www.frbsf.org/our-district/files/Williams-Speech-Fintech-The-Power-of-the-Possible-and-Potential-Pitfalls.pdf

https://www.eba.europa.eu/documents/10180/1315397/JC+Risks+and+Vulnerabilities+Report+%28JC+2016+17%29%20-+Spring+2016.pdf

https://www.eba.europa.eu/documents/10180/1315397/JCRisksandVulnerabilitiesReport28JC+2016+17%29%20-+Spring+2016.pdf

Q. What new behaviours does the regulator want to see from financial services providers?

TM: Regulators are now themselves using social media and a host of consumer-oriented approaches to try and force banks to educate their customers. These can be general or very specific. By forcing banks to give ample time to the customer to consider their products and the consequences of taking these products, they are forcing the bank to sit down with customer and provide proper advice on suitable affordable products.

On one hand they want to see this create more innovation, which is why they are encouraging and supporting innovative mechanisms. On the other hand they have worries. The European banking authority has recently highlighted Fintech risks that could destabilise or force massive change to the existing system so they are collectively in a difficult position and treading a fine line. "In a way, you can see the FCA as forcing a focus on customer outcomes, effectively putting customers into positions of regulatory influence."

http://www.garp.org/#!/risk_intelligence_detail/a1Z40000002w8KFEAY

REGULATORY FOCUS ON CORPORATE CULTURE

TM: The FSA has come to understand that tick lists don't work in isolation, and don't work at all without the appropriate culture, which is why it is making senior managers more directly responsible.

RM: Any providers whose plan is simply to carry on as if customers have not changed will soon face a crisis of disengagement. Simply extending the tick-list of operational risk controls will not work; since products and their risks are now evaluated within a social system, every employee needs to be involved in, and working with, a corporate invitation to 'work risk aware'. A better plan is to engage all staff and change their awareness of how customers now view product opportunities, how they make decisions about risk, and how decision making is influenced by social norms. Under this approach each employee's intuition becomes valued as a more authentic, sensitive mechanism for recognising and responding to customer needs than any amount of conventional modelling. This change relies on understanding how customer's own norms change in response to new media and wider social influences.

Q. What are the challenges for providers in managing in such a fluid environment?

RM: For many operational risk managers the scary thing about conduct risk is its lack of definition, or, more precisely, that it will be defined with reference to customer expectations.

Add to this the idea that senior managers are being asked to bring to account the people under their influence and you could have over 60,000 regulated businesses and around a million people to incorporate into these customer outcomes. The question isn't whether such requirements go away, but: How can the necessary changes and their outcomes be implemented to optimise customer benefit?

More unsettling still is that it will never be possible to define acceptable conduct with any rigidity because what is acceptable is a moving target since the customers' expectations inevitably change with age and experience.

TM: I think the only way of seeing conduct risk is the new way, in that responsibility moves from the corporation to the directors and senior executives. To a large bank, a £10-50 million fine is a mere inconvenience and changes nothing but real change can be made if you publish findings widely and put people in prison, as has been done in Australia and the US.

https://www.linkedin.com/pulse/conduct-fines-political-theatre-roger-miles

Q. How do you think risk managers should change the way they operate?

[illustration]

RM: Well, one influential group of behavioural analysts sees the world as a 'Risk Society' in which each individual makes up their own mind about what information to believe, which choice options to consider, and which policies to accept or reject. Within this world view we are each of us islands of risk sensing and decision making, influenced not just by official accounts of cost benefit but by the push and pull of social proof and changing personal viewpoints. Although some people mourn this as a loss of social cohesion, it is also a bright opportunity for service providers who understand how the

modern consumer makes choices based on complex combinations of rational, emotional and experiential evaluations.

TM: A major issue for existing banks is that they are product-led as opposed to consumer-led. I've heard talk of the single view of the customer for 39 years, but even now instead of asking "this person is in a demographic of x and shares requirements of 500,000 customers so how do we design to meet these needs?" they mostly operate in independent product silos because it's easier that way. Lumbered with legacy systems, a multiplicity of brands acquired over years and the patchwork that results, it is far more difficult for the existing big banks to move to a customer centric view than it is for a narrower-scoped fintech starting from scratch.

LESSONS FOR THE FINANCIAL SECTOR

RM: I think we can take two lessons from this.

First that the old financial marketer maxim that 'products are sold not bought' will only hold true for as long as consumers resist self-education; and that is, not much longer. Second, that it would be unwise to predict any particular direction for consumer preferences when, as we have seen with national assets christened Boaty McBoatface; marine lobbyists forced to name their prodigy Mr Splashy Pants; a vote requesting Justin Bieber to play in Chernobyl and, of course Brexit, these have habit of taking perverse turnings off the beaten track. In plain terms, it is no longer sufficient to expect a customer for any product to make up their minds on the basis of 'the facts'. Context and social proof are all.

The challenge is to design structures which better approximate real customer experiences and which leave behind corporate constructions of a worldview in which idealised landscapes have too often been treated as truths.

The successful providers of the future will be those who use dynamic sensing as a matter of course. That is, they will remain alert and responsive to change in customers perception of risk and to social acceptability. They will also be aware of the implicit social contract beneath any commercial contract an offer maybe technically allowable, but is it 'legitimate' within today's customer definition of that term? As the Panama Papers have shown, technically legitimate legal manoeuvres may nevertheless come to be seen as more characteristic of privilege than 'ordinary' customer experience.

"Our priority is no longer to manage the internet of everything but to interpret the behaviour of everyone". Assisted by regulators and social media, even the most monolithic financial organisation must change its culture, focus on customer outcomes, and not just put customers in greater positions of authority, but demonstrate that this is being done.