

Conduct Costs: Definition and Reporting Issues

By Roger McCormick | January 2014

As we developed our research programme for the first phase of this project, our working definition of Conduct Costs evolved, informally, as the experience of research brought up various questions for "in or out" decisions. The working definition is reflected in the Overview of the Project set out in this blog. Defining Conduct Costs is important because one of our objectives, as regular readers will know, is to persuade banks to report Conduct Costs voluntarily. We sense that many of them, in principle, would not be opposed to this although none is terribly keen to be first mover. Another factor which may be inhibiting banks is the question of whether there is yet sufficient consensus as to what Conduct Costs actually means. Now that we are moving into phase two of the Project (to cover 2013 numbers and an expansion of banks covered) we feel that we should try to develop that consensus and so we are setting out a suggested more formal definition of Conduct Costs that could be used for reporting purposes.

This is as follows:

Conduct Costs means all costs borne by a Bank in connection with any of the following:

(i) Regulatory proceedings, specifically (but not exhaustively):

a) fines or comparable financial penalties imposed on the Bank by any Regulator;

b) any sum paid to a Regulator or at the direction of a Regulator in settlement of proceedings of any kind;

c) any sum paid to, or set aside to be paid to, any third party or parties to the extent required by any Regulator; and

d) any sum paid, or set aside, for the purchase (or exchange) of securities or other assets to the extent required by a Regulator and (if such information is available) to the extent such sum exceeds the open market value of such securities or other assets as at the date of purchase;

(ii) any costs, losses or expenses which are directly related to an event or series of events or conduct or behaviour of the Bank or a group of individuals employed by the Bank for which any fine or comparable penalty has been imposed or any censure issued by a Regulator;

(iii) any sum that has become payable as a result of, or in connection with, any breach of any code of conduct or similar document entered into, or committed to, at the request of, or required to be entered into or committed to by, any Regulator or any public, trade or professional body;

(iv) any loss of income or other financial loss attributable to a requirement imposed by a Regulator to place money on deposit with a central bank or other

institution at below the market rate of interest, being a requirement imposed in connection with a breach of law or Regulatory requirement;

(v) any sum paid in connection with any litigation (whether ordered to be paid by a court or tribunal or in settlement of proceedings) where the litigation involved allegations of material wrongdoing or misconduct by senior officers or employees of an institution which were not refuted;

(vi) any other sum, cost or expense, not falling within any of (i) to (v) above that is paid pursuant to an order or requirement of a Regulator and which is a result of any breach of any regulatory requirement or law.

We are very happy to take comments on this definition. Evidently, not all of the above heads are free of controversy. We have not, for example, included losses flowing from the activities of a "rogue trader" (although we would include any fine imposed on the bank) since we feel that the activities of such an individual cannot generally be attributed to the bank that employs him/her. Losses flowing from a "London Whale"- type scenario, on the other hand, would be included because such scenarios implicate more people than just an individual "rogue".

We do not, in the definition, address questions as to the "fairness" of fines or settlements although such questions would certainly seem to exist, for example, in relation to pre-acquisition "sins".

Our view is that, in an ideal world, the data relating to the above heads would be produced voluntarily by banks and presented by them in a readily comprehensible and comparable format rather than (if they are published at all) scattered around (and often obscured within aggregated entries) within a variety of voluminous, jargon-ridden documents where the facts can, effectively, be hidden from the view of ordinary members of the public. We would also encourage banks to let us have such data voluntarily as this project goes forward. It is, of course, their call but we feel that there would be very sound reputational and risk-management advantages in adopting such a practice. There must surely be a strong desire within the better banks to see these costs better managed and to take steps that will result in their sharp reduction. The data must therefore be properly compiled for internal purposes. This information should be shared with banks' stakeholders. A bank that truly wants to "restore trust" should welcome the opportunity to engage in this way.

About the author:

Roger McCormick: Managing Director, CCP Research Foundation