CCP RESEARCH FOUNDATION
Conduct, Culture, People

Bank Conduct Costs and Disclosure Requirements

The Conduct Costs Project, as is widely known, produces periodic data about bank conduct costs. Its work includes a so-called "league table" featuring the conduct costs of major international banks. The project's work has been well covered in the media and its work will continue for the foreseeable future. Although the project is not primarily a campaigning organisation, its activities do imply certain assumptions about what the public is entitled to expect as regards the information that is made available about conduct costs. This note sets out the project's position on this.

We believe it is reasonable for all stakeholders (not just shareholders) to be concerned about the conduct record of banks and, therefore, for stakeholders to expect banks to present conduct data in a way that enables them (i) to review a bank's conduct record in any given financial year (ii) to understand the cost of all misconduct recorded (iii) to compare year on year performance and (iv) to compare banks with each other.

If this is accepted, the **following requirements** arise:

(1) A bank should adopt a **clear definition of 'Conduct Costs'** (which should, for example, include not just regulatory fines and settlements, but all amounts paid by way of compensation or settlements of legal proceedings in connection with any mis-selling of any kind (whether or not formally admitted) or any regulatory breach or criminal offence. (Ideally, all banks should use the same definition).

(2) **Conduct Costs should be presented, comprehensively, in one place in a bank's annual report** (in addition to any formal requirements for presentation in the accounts). There should be no reliance on cross-reference to other parts of the annual report or any other document. This presentation is referred to below as the CC Report.

(3) The **CC Report** should be clear and unambiguous and presented in language that a lay reader can readily understand. Ideally, all banks should use the same format.

(4) The CC Report should include:

a. Details of all **Conduct Costs that have crystallised during the year** (i.e. following a judgement, settlement or award), irrespective of when the bank pays the Conduct Cost or makes provision for it. The bank should not use aggregation except for very minor items (e.g. involving a cost less than £10,000). In any event, Conduct Cost items should not be aggregated with items that are not Conduct Costs (e.g. by lumping items together as "legal costs" or "litigation");

b. Details of all '**significant**' Conduct Costs incurred over the previous 2 years (e.g. where the cost exceeded £1,000,000 or related to a criminal offence);

c. The **total Conduct Costs for the year**;

d. The **total Conduct Costs for a rolling 5 year period** ending 31 December of the reported year;

e. **Management's estimate of all costs consequential** to any misconduct reported (and not included in the definition of Conduct Costs) such as the cost of hiring advisers or extra staff to deal with any conduct incident or its aftermath; and

f. A detailed, **itemised account of all amounts included in any provision that relates to anticipated Conduct Costs.**

(5) The CC Report should also identify the main board director who accepts responsibility for conduct cost reduction and include a report by him or her on the data and his or her plan for bringing about a significant reduction of conduct costs over (i) the next 12 months and (ii) the next three years. This plan should include details of any metric by which the

bank intends to judge it success in improving behaviour of the kind that leads to conduct costs (or if there is no such metric) an explanation of why this is the case).

Against this background, we make the following general points in connection with bank conduct cost disclosures within Annual Reports and Accounts:

General Disclosure

(1) Banks does not disclose, in one place, and in a manner that is clear and comprehensive, all Conduct Costs for a given year. Neither are the indirect costs of misconduct (referred to above) disclosed;

(2) While certain matters are often detailed (within the Notes to the Financial Statements), there is, at best, **sporadic reference to the actual cost of the misconduct** and no specific disclosure of the total Conduct Costs within the Bank's Annual Report, Financial Statements, or Sustainability (or equivalent) Report;

(3) What quantitative information is ascertainable within Reports (see below) is of **limited assistance** in calculating a bank's Conduct Costs. The disclosures are principally designed to provide an indication of future risk (in the case of financial provisions and legal proceedings), and are subject to IAS37, which does not necessarily fulfil the purpose behind a CC Report. What is disclosed is driven by a balance sheet 'materiality' test and not, it is suggested, reflective of what stakeholders would consider 'material' in terms of appreciating conduct risk or assessing the cultural change and trust agenda of the Bank and industry;

(4) While the banks must be commended for their discussion on culture and behavioural change - with the introduction of Board level oversight of conduct and values - - they do not appear to offer an objective metric against which it asks its stakeholders to assess its success in terms of conduct. Banks might refer to 'metrics' deployed in the identification and monitoring of compliance risk, but further detail is unavailable.

Banks' reports on reputational risk) are to be most welcomed with enhancements to governance arrangements, policies, compliance priorities and training mandates. However, there is a lack of third party assurance or disclosures of any objective metrics by which stakeholders can test the success of such changes and the performance of the bank, year on year and comparatively across the industry;

(5) Within Financial Reviews and Corporate Governance Reports, the banks often only disclose a select few proceedings relating to misconduct, and do not state the value of associated Conduct Costs;

Financial Statements

(6) For further information, one has to wade forensically through the financial statements. Specifically:

a. It appears that the best available proxy for a total Conduct Costs figure is often the 'provisions utilised' figure (in the Notes to the Financial Statements). However, these are aggregated sums assigned to the broad categories of 'Legal Proceedings and Regulatory Matters', 'Customer Remediation' and 'Other Provisions', which (certainly in regard to the latter category) may include non-Conduct Costs;

b. While further information on certain matters may be provided, one cannot readily reconcile Conduct Cost instances with the aggregated figures. For example, it is difficult (if not, possible) to fully reconcile the sum in respect of utilised provisions for say 'Legal and Regulatory Matters', with the various matters detailed within the Notes on legal proceedings elsewhere within the Financial Statements.

c. In any event, the disclosures noted above do not include the more indirect costs associated with a Conduct Cost event;

Citizenship/CSR/Sustainability Reporting

(7) Most banks subscribe to the Global Reporting Initiative's G4 guidelines for sustainability reporting. There are a number of key conduct-related indicators included within the GRI 'G4' reporting framework:

a. Environment category, G4-EN29: "Monetary value of significant fines and total number of non-monetary sanctions for non-compliance with environmental laws and regulations";

b. Social category, G4-SO8: "Monetary value of significant fines and total number of non-monetary sanctions for non-compliance with laws and regulations"; and

c. Product responsibility category, G4-PR9: "Monetary value of significant fines for non-compliance with laws and regulations concerning the provision and use of products and services".

Bank's disclosures in respect of these core, material, indicators are often the same: a reference back to the Annual Report and Accounts, which, for the reasons given, provides neither a comprehensive nor particularly comprehensible picture as to the bank's Conduct Costs.

Aside from some very generalist remarks on fines and penalties, banks do not report on what their Conduct Costs represent for their stakeholders, in terms of meeting their 'trust and cultural change' objectives, risk management, and financial performance. Accordingly, stakeholders are unable to hold banks to account on its Conduct Costs and judge for themselves whether the banks' conduct and reputational risk profile is improving.

We are aware that a number of banks would like to improve their disclosure (which we would see as welcome evidence of a determination to control conduct risk) but there is a reluctance to be "first mover". With colleagues at ShareAction, we are, as of May 2015, embarking on a series of discussions with banks to try to persuade them of the need for, and advantages of, change.