GLASSBOX

Why Digital Record Keeping Holds the Key to Successful Past Business Reviews

Contents

1. An increasingly complex conduct risk landscape

Following the global financial crisis of 2008, customer redress has emerged as a significant challenge for the financial services industry. In the wake of the "credit crunch," which brought financial hardship for millions of consumers around the world who were caught in the crossfire, global regulators have placed far greater emphasis on the theme of conduct.

Conduct-related risks stem from situations where a financial provider's behavior has the potential to result in poor outcomes for its customers. One of the biggest conduct risk failures in recent memory is the UK's £50 billion payment protection insurance (PPI) scandal. While the product itself was not found to be at fault, the enormous profits that PPI generated for institutions selling retail lending products, such as credit cards, unsecured loans and mortgages, gave rise to significant conflicts of interest. The resulting over-ambitious sales targets and poorly devised incentive schemes employed by many UK lenders led to a slew of mis-selling activity.

In some cases, PPI policies were sold to customers who either did not need coverage, perhaps because they already had similar protections in place, or who would otherwise struggle to claim should the need arise based on their personal circumstances. Other customers reported feeling pressure to purchase PPI coverage for fear of being turned down for credit, while others still claimed they didn't realize the policy was optional. Some customers even denied knowledge that PPI had even been added to their credit facility in the first place.

Regardless of context, numerous firms were found to have prioritized sales over customer interest. In 2011, a landmark High Court ruling dismissed a legal challenge brought by UK banks to the Financial Services Authority's (FSA's) action on PPI mis-selling. This decision kicked off a decade of costly past business review activity for many UK financial services institutions, and effectively opened the floodgates to the largest customer redress bill in British banking history. In the years that followed, the regulator's focus on conduct risk has intensified. Today, financial services institutions must satisfy the regulator that they can effectively identify and manage their conduct risk. Implicit in this requirement is that firms have the records they need to prove exactly what happened. This includes a record of the information provided to the customer, what the customer themselves did, what information the customer provided back, and whether all necessary disclosures were made. Most importantly, firms need to be able to prove it, step-by-step. The growth of digital channels makes them an ever-increasing focus for past business reviews.

The key question for firms is whether they have the records and the capabilities to respond effectively?

The global pandemic has only added fuel to this fire by changing the lives of consumers in myriad ways, both subtle and fundamental. In financial services, it has accelerated the well-established shift from physical to digital channels. It has also seen many consumers - particularly those categorized as vulnerable[1] by the Financial Conduct Authority (FCA) - disadvantaged by multiple lockdowns, the withdrawal of services and the economic hardships of the pandemic. In response, the FCA has redoubled its efforts in the consumer protection arena, including the launch of a wide-ranging consultation on a new consumer duty of care for institutions. Focusing on what the regulator defines as *"areas of persistent weakness"* in UK financial services, the FCA consultation encompasses broad themes including product pricing, product design, customer communication and complaints handling.

It is expected that the consultation will result in more stringent rules and guidance for the industry. In the case of the vulnerable, for example, the regulator has already published new guidance for firms making it clear how they should be protected throughout the customer lifecycle. Such targeted measures, together with more general requirements for how institutions should ensure they deliver fair outcomes for their customers, especially those in arrears or default, place growing pressure on firms to demonstrate they are up to the task of identifying, monitoring and correcting conduct issues as they arise. And where standards do fall below expectations, the regulator is taking tangible steps.

This is particularly true in areas like collections, where we again hear the echoes of COVID-19. The challenge firms face in responding to individual customer circumstances has been magnified by the economic impacts of the pandemic - from catastrophic changes in circumstances arising from job losses and long-term illness to the practical complications arising from government-backed mortgage repayment holidays.

[1]See FCA website for a current definition of vulnerable customers (Feb 2021) https://www.fca.org.uk/news/press-releases/fca-launches-guidance-firms-fair-treatment-vulnerable-customers

The impact has been compounded further by customers having to use digital channels, perhaps for the first time, in the absence of a ready alternative.

Processes impacting customers that fail to consider their individual circumstances will inevitably fall short of the regulator's expectations and may easily trigger costly action. However, regulators like the FCA are not the only sources of pressure on the financial services industry. Large-scale conduct risk breaches, like the UK PPI scandal, have also given rise to a thriving claims management industry, which is constantly scanning the horizon for evidence of the next big issue that might trigger another lucrative wave of remediation payments. Firms must satisfy themselves that, should the spotlight fall on a digital journey, they have the right tools in place to deliver evidence that all required checks and balances were in place and properly applied at the time, effectively leaving no case to answer.

When it comes to monitoring the horizon for conduct risks, the threat vectors for firms are numerous and overlapping. For example:

1. The UK FSA's initiation of action over the mis-selling of **PPI** policies[2] highlighted numerous failings relating to staff incentives.

2. A high-profile review of the UK's **high-cost short-term credit**[3] (i.e., 'payday lending') market was linked to shoddy sales practices and a lack of care for customer's ability to service debt.

3. The **G10 spot FX trading**[4] scandal hinged on critical failures of governance.

4. Meanwhile, a joint Securities & Exchange Commission (SEC) and Justice Department investigation into the retail banking activities of a **major US bank** highlighted numerous issues relating to culture.

Past business reviews are becoming a greater risk for all firms thanks to the broad landscape to address, intensifying pressure to monitor conduct and identify potential breaches rapidly, and the added complications of the COVID-19 pandemic.

[2] https://publications.parliament.uk/pa/jt201314/jtselect/jtpcbs/27/27ix_we_j12.htm
[3] https://www.fca.org.uk/firms/high-cost-credit-consumer-credit/high-cost-short-term-credit
[4] https://www.fca.org.uk/news/press-releases/fca-fines-five-banks-%C2%A311-billion-fx-failings-and-announces-industry-wide-remediation-programme

2. Introducing past business reviews

Typically, a past business review (PBR) will be ordered by a regulator if evidence emerges of historic misconduct, malpractice or failed governance. They can be directed at individual firms, groups of firms or an industry sector at large where a specific product or service has been offered widely to the detriment of customers.

One current example of a PBR is the FCA investigation into the advice provided to members of the British Steel Pension Scheme (BSPS). BSPS members had been required to decide whether to switch their existing defined benefit pensions to a new plan or stay in the existing fund, which was itself to be moved as part of a larger restructuring of British Steel's pension liabilities, back in 2017. Around 8,000 scheme members transferred £2.8 billion to the new vehicle, but concerns soon arose about the suitability of the advice provided.

In response, the FCA ordered a wide ranging PBR covering more than 1,500 potential cases of unsuitable advice. At the time of writing, the regulator has 30 enforcement investigations running alongside its ongoing review, although they have stopped short of exercising their powers under the Financial Services & Markets Act 2000 (FSMA) to order formal redress. Lawyers for the victims estimate that a mandated redress scheme could cost the industry as much as £300 million. Although the regulator is holding that option in abeyance for now, it has written to more than 7,000 former scheme members, informing them that they may have received unsuitable advice and should consider complaining, setting out the process to do so.[5]

5 https://www.ftadviser.com/fca/2021/09/10/fca-board-opts-against-bsps-redress-scheme/

There are several potential triggers for targeted and/or generalized industry PBRs. These include:

- Internal or external compliance reviews of specific organizations.
- Skilled person reviews ordered under s166 of the FSMA (see boxout below).
- Regulatory thematic work conducted by the regulator that reveals a potential market-wide issue.
- Regulatory breaches, regulatory reporting, whistleblowing allegations and/or customer complaints.
- Proactive root cause analysis conducted by an institution and shared with the regulator.
- "Dear CEO" letters.

It should be noted that, in the event a firm chooses not to commence a PBR at the request of the FCA, the regulator has the power to conduct the review itself under section 404A(1)(k) of the FSMA 2000[6]. Likewise, should a business change hands and cease to be directly regulated by the FCA, it can still be ordered to undertake a detailed review of past business.

What is a skilled person review?

When the FCA serves a regulated firm with a s166 notice, it will nominate (or require the firm itself to nominate) a "skilled person" to investigate the firm and produce a report. The review is an independent evaluation of the firm concerning the specific issues and activities the regulator identifies for investigation.

The resulting report is then used to establish the extent of any issues and the extent of the customer detriment caused. It also helps the FCA to determine whether remedial action is required, how the ongoing supervisory relationship should be structured, and whether further regulatory enforcement action is needed. During this review, the firm will be required to furnish evidence of its activities, which might include digital interactions between the institution and its customers where advice has been delivered virtually as part of a sales process.

[6]See CONRED 1.5.4, https://www.handbook.fca.org.uk/handbook/CONRED/1/?view=chapter

3. An international perspective

So far, this paper has purposefully focused on the UK experience, allowing for a more detailed and connected look at PBRs. However, PBRs are not unique to the UK and are a live issue for both regulators and firms in many jurisdictions.

For example, the **Australian Royal Commission into Misconduct in the Banking, Superannuation & Financial Services Industry**[7] was launched in December 2017 to look at evidence of widespread mis-selling of financial services products. The investigation concerned multiple industry failings around quality of advice, systems and processes. Its findings also fired the starting gun for federal criminal cases brought by the Australian Securities & Investments Commission (ASIC) in the years that followed. These include:

1. The prosecution of one Australian bank[8] for alleged false and misleading representations it made to multiple mortgage customers. These related to interest rates and repayments, and representatives of the bank appeared in court in September 2021 to plead their case. The matter is ongoing.

2. ASIC also brought criminal charges against another Australian bank[9] concerning failures to provide crucial updates on portfolio companies to customers of its advisory businesses. This case impacted around 32,000 customers and led to a redress bill for the bank of A$87 million.

[7] https://financialservices.royalcommission.gov.au/Pages/reports.html
[8] https://www.reuters.com/business/australian-regulator-slaps-bank-queensland-unit-with-criminal-charges-2021-09-15/

The Royal Commission also covered historical sales of consumer credit insurance (CCI), finding multiple and widespread shortcomings in the sector. Recently, another bank pled guilty to 30 federal charges of mis-selling CCI. With echoes of the UK's PPI scandal, criminal charges brought by ASIC refer to *"false or misleading representations to customers that the insurance policies had uses or benefits to those customers when part or all the benefits were not available."*[10] In its response, the bank noted it had self-reported the issue to ASIC in 2015, making a formal apology and providing redress to the 165 customers involved. However, it should also be noted that this recent case comes hard on the heels of a AU$7 million fine[11] for misleading and overcharging borrowers from earlier this year, which also saw the bank repaying a total of AU$3.7 million to an additional 2,269 affected customers.

Turning to the US, in 2020 **a large US bank** was forced to pay $3 billion to settle criminal charges and civil actions arising from a customer mis-selling scandal that had gradually unravelled over a period of 14-years. A joint SEC and Department of Justice (DOJ) investigation found that employees committed multiple acts of fraud to meet unreasonable sales targets set by the bank. This included opening millions of unauthorized customer accounts, completing applications for new credit cards and bill payment schemes without the customers' knowledge, forging customer signatures, and even transferring customer funds between accounts to meet their sales goals.

This case is a good example of the cultural issues that can arise at financial institutions and, like PPI in the UK, illustrates what can happen when outcomes and incentives are misaligned. It should be noted that the US$3 billion fine included $500 million that the bank was required to set aside to compensate investors who suffered from their fraud, adding a complex and costly layer of redress into the mix for the bank to manage.

[9] https://www.reuters.com/article/westpac-regulator/australian-regulator-says-westpac-to-compensate-customers-for-advice-lapses-idUSL3N2OD4GQ
[10] https://asic.gov.au/about-asic/news-centre/find-a-media-release/2021-releases/21-251mr-asic-brings-criminal-charges-against-cba-for-mis-selling-consumer-credit-insurance
[11] https://www.reuters.com/world/asia-pacific/australias-cba-ordered-pay-5-mln-fine-over-charging-interest-2021-04-07/

4. Counting the cost of PBRs

As a significant driver of regulatory scrutiny, conduct risk is a key preoccupation for the boards of regulated institutions. Indeed, forward-thinking firms often conduct ongoing early warning horizon scanning activities to ensure incidents of poor conduct or malpractice lurking in the woodwork are quickly identified, quantified and neutralized. This proactive stance should be considered the leading practice given the high potential costs associated with PBRs, which can be thought about in four ways (see Exhibit 1).

1	**PBR admin costs**	Planning and running a PBR will cost precious staff time and resources, requiring firms to put a range of governance arrangements in place. They must also acquire and deploy the skilled resources to conduct a review promptly and per the requirements of the regulator involved.
2	**Redress costs**	If problems are found in a PBR, firms face the cost of "making good" their wronged customers, usually in the form of financial payouts.
3	**Redress admin costs**	The operational and administrative cost of managing and running aredress program at scale can be high. This was the case with PPI, which cost the UK banking industry billions of pounds in fees.
4	**Intangible costs**	There is a "soft cost" associated with reputational damage, foregone business and boardroom time diverted from the work of running a profitable organization.

In the UK, the rules governing such schemes are set out in the Consumer Redress section of the FCA's Conduct of Business Sourcebook. To begin with, the FCA defines a Consumer Redress Scheme as follows[12]:

"[A] consumer redress scheme is a set of rules under which a firm is required to take one or more of the following steps:

1. *investigate whether, on or after a specified date, the firm has failed to comply with particular requirements that are applicable to an activity it has been carrying on;*
2. *determine whether the failure has caused (or may cause) loss or damage to consumers; and*
3. *if the firm determines that the failure has caused (or may cause) loss or damage to consumers, the firm must:*
   a. determine what the redress should be in respect of the failure; and
   b. make the redress to the consumers.

[12]See CONRED 1.1.1, https://www.handbook.fca.org.uk/handbook/CONRED/1/?view=chapter

The FCA is focused on ensuring required remediation happens and that impacted customers are treated fairly and receive proper outcomes. In this last dimension, firms are responsible for investigating individual cases themselves within the FCA's approved framework. The regulator also has multiple options when formulating the terms of any redress scheme. As the Sourcebook makes clear, they can require firms to:

1. Undertake a **proactive file review** of all cases falling within the time period covered by the scheme.

2. **Contact their customers individually** to ask whether they wish their cases to be investigated under the scheme, and only investigate those cases where the customer opts-in.

3. **Publicize the existence of the scheme themselves** (e.g., through media advertisements), again only investigating cases where the customer has opted in.

4. Publicize the existence of the scheme through an **FCA publicity campaign** and require firms to investigate the cases of any customers who subsequently opt-in.

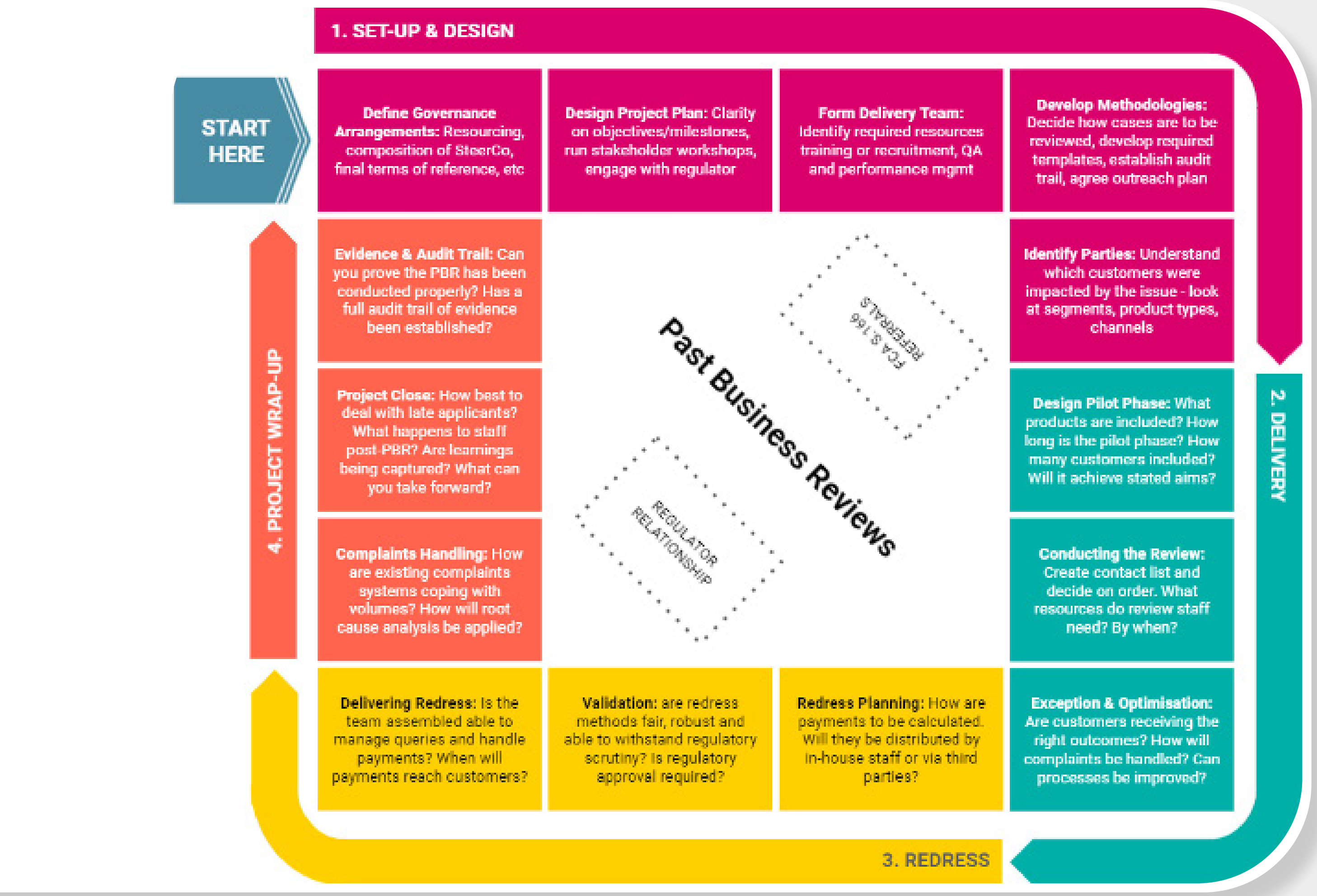
While this paper focuses on the PBR element of consumer redress process, it is useful to recognize it as a component part of a larger regulatory continuum. And, given the high stakes connected with PBRs, it also makes sense for firms to monitor their business activities and customer interactions to accomplish two valuable objectives:

1. To ensure they can **locate and diagnose costly issues quickly and easily** for escalation and remediation as appropriate; and

2. If a review has been ordered but the institution believes it has acted correctly, to **ensure they can evidence their position and avoid costly and unwarranted redress.**

As shown below, PBRs typically involve highly complex decisions and potentially costly process chains.

Key considerations in running a past business review



Given the complexity of the PBR process, it would be best to ensure as much efficiency in the proceedings as possible. Likewise, if redress can be avoided through the provision of compelling evidence of leading practice, that is also a good outcome for all institutions concerned. As the table below shows, there are numerous examples of PBRs leading to costly fines, remediation and even changes to the landscape of the market.

Recent regulatory action involving PBRs

Year	Firm(s) Involved	Issue	Total Cost
2009	**GMAC-RFC**	Unfair treatment of vulnerable mortgage borrowers	**£10.1 million** Including £2.4 million in fines and £7.7 million of restitution.
2011	**Industry-wide**	Payment protection insurance (PPI)	**£50.0 billion** Including £33 billion in customer restitution payments.
2012	**Industry-wide**	"Dear CEO" letter concerning wealth managers conflicts of interest	**N/A** The industry was instead kept under review and required to improve their conflicts processes
2014	**Citi, HSBC, JPMorgan Chase, RBS & UBS**	G10 spot FX trading	**£1.1 billion** All fines
2014	**Industry-wide (inc. 1,400 lenders)**	High-cost short-term credit (aka "Payday Lending")	**>£30 million** Plus, the FCA review resulted in a mass exit of smaller lenders from the sector.
2016	**Industry-wide (inc. 656 firms)**	Suitability of investment advice	**N/A** The latest review was abandoned in favor of ongoing thematic work.
2021	**At least 30 UK pension advisors connected with the British Steel Pension Scheme**	Suitability of advice and mis-selling of pension products	**TBC** FCA has foregone its s404 powers to order redress, which were estimated could cost £300 million, but individual claims are expected.

5. Mitigating the business impacts of a PBR

If the institution engaged in a past business review has delivered fully compliant customer journeys, the task at hand is to execute the PBR quickly, efficiently and in full compliance with the regulatory requirements. Firms will also want to ensure the upheld rate (the percentage of complaints ruled in favor of the customer) reflects the harm caused to customers, rather than being an unfortunate by-product of being unable to evidence their compliance. This is achieved when:

- The firm has captured the evidence it needs to prove that the customer was given all necessary information at the right times.
- They can show that their processes contained required checks on understanding (e.g., during a credit application).
- Through effective monitoring of digital interactions, customers who were struggling were identified early and given additional help and support as needed.

Unpacking the evidence

At the heart of any PBR is the requirement to be able to produce a complete 'forensic' record to prove what happened during a particular transaction. Clear records that show all crucial elements – from what information had been provided to the customer, what they themselves did, the information provided back by the customer to the institution, and evidence that all necessary disclosures were made – help firms react quickly to such investigations and minimize their costs.

In this context, firms must seize the opportunity to be proactive. For example, by monitoring and capturing their customers' digital sessions – whether through a sales journey or the process of making a complaint – firms can watch for signs of consumer harm and intervene to prevent it. Likewise, automated outcome testing can prevent issues before they arise.

Anecdotally[13], while previous investigations of past business have indicated that in up to 80% of cases firms are fully complying with regulatory standards, many are still penalized in the absence of the evidence that would prove this. In a situation where firms are effectively rendered non-compliant by default, institutions must take steps to build that all important digital evidence base.

Without these core evidential assets, firms leave themselves vulnerable to regulatory action and decisions falling against them. In many cases, decisions may go against institutions simply because their compliance cannot be proven due to incomplete or inadequate records. As a result, redress and compensation are paid out on cases that would otherwise have met the regulators compliance threshold...if only compliance could be proven.

[13]Source: Glassbox

This is a prevalent issue when it comes to interactions through digital channels, which are at their peak and will continue to rise. There is a growing risk for institutions in their browser- and app-based dealings with customers, which is magnified if firms are not using technology to track the customer journey, by:

- Monitoring the digital sessions of customers to trace and review individual interactions.
- Maintaining 'forensic grade' records, where every swipe and click of a digital interaction is captured.
- Rapidly identifying and offering relevant support to customers who need additional help (e.g. vulnerable customers who may face challenges with their literacy, numeracy, financial means, disability or mental health needs).

Firms must position themselves for any targeted or industry-level past business review scenario, particularly as they relate to the digital customer journey. A good example here is the Woolard Review[14], which has called for the "buy now, pay later" (BNPL) market to be urgently regulated. Woolard found that 11% of consumers (~5 million shoppers) have used a BNPL product since the onset of COVID-19. However, the product carries multiple consumer-related risks that could trigger the need for an industry-wide PBR. These include:

- **Affordability** - Many providers use 'soft' credit checks to assess the suitability of borrowers, focusing on the credit risk to the provider, not affordability for the consumer.
- **Skewed incentives** - In the same vein, Woolard charged that BNPL providers do not give "due consideration for the affordability of the commitment the consumer is taking on" since they rely on the merchant fee generated by each transaction.
- **High debt risk** - Credit limits with individual providers are also rendered useless given the broad range of BNPL options available to consumers. According to 2020 research by Which?[15], 1 in 4 shoppers using BNPL facilities spend more than they intended to, indicating a potential lack of awareness about the debt being accrued.
- **Market opacity**[16]- BNPL providers do not report back to credit rating agencies on whether consumers pay their debts on time and in full. As a result, it is difficult to get an accurate picture of the credit position of consumers using BNPL products, with broader implications for the UK's unsecured lending sector.

In these and other scenarios, technology can be used to minimize the risks for providers when faced with a PBR by reducing both the time and cost of undertaking the exercise. In addition, records of your treatment of customers can deliver a stronger evidence base should the matter result in redress, helping to ensure the "upheld rate" of complaints reflects reality rather than a simple lack of proof.

[14] https://www.fca.org.uk/publication/corporate/woolard-review-report.pdf
[15] https://www.which.co.uk/news/2020/12/think-less-spend-more-how-buy-now-pay-later-firms-encourage-impulse-buying/
[16] https://www.grantthornton.co.uk/insights/the-woolard-review-what-does-this-mean-for-bnpl/

6. Introducing Glassbox

Glassbox is a digital experience analytics platform that captures, analyzes and allows you to replay any digital customer interaction from your web or mobile apps. It enables a firm to keep a forensic record of every digital session where there is a legitimate interest – such as information about suitability, affordability, product terms and features as well as all the appropriate disclosures and caveats.

Glassbox enables firms to retain the individual sessions that matter for as long as required using our new Session Vault feature. Sessions can be instantly retrieved and replayed exactly as seen by the customer – even months or years after the event. All the data is indexed so you can rapidly identify the individual session or group of sessions you need to prove what happened. This means you can:

- Identify issues or root causes and all the customers impacted by them.
- Gather relevant data for reporting and/or evidential purposes.
- Analyze the data to assess the nature, scope and scale of any issues.
- Establish precisely what happened, promoting clear communication with the regulator – and prove that you did all that was required of you.
- Validate whether there is a case for the firm to answer.

To see how Glassbox can support your digital record keeping and compliance reviews, request a demo today.