Quantifying conduct risk: understanding drivers of behavior

Milliman

FI's struggle with defining conduct, let alone measuring it

Most financial institutions agree conduct is linked to culture. There are many factors that drive it: information asymmetry, incentives, conflicts of interest, market dynamics, etc. Conduct is an outcome driven by a complex interplay of these factors where firms don't know how to attribute operational losses resulting in "bad" conduct. Standard approaches like assessments and questionnaires resulting in some type of red / amber / green (RAG) dashboard appear to be lacking.

Unlike traditional frameworks, CRisALIS is a causal model that quantifies conduct risk. Conduct is a complex risk due to dependencies, interconnectedness and behavioral dynamics. Modeling conduct risk must do more than analyze historic events, rather it must detect warning signals, model plausible breaches, and provide forward looking capabilities so that decision makers can implement effective strategies.

Complex Risk Analysis "CRisALIS"

CRisALIS provides a bespoke holistic forward-looking approach to modelling how conduct risk may materialize. CRisALIS is based on complexity theory and incorporates data driven analysis, expert-derived causal modelling and artificial intelligence. It learns and evolves as your understanding of the risk landscape evolves. Our solution:

1 Leverages qualitative and quantitative data to enhance credibility of the model and adapts to new information as it becomes available

2 Expresses the outcome in a financial loss distribution with underlying drivers

3 Distinguishes "signal from noise" from unstructured data to identify anomalies, patterns or emerging threats

4 Provides real insights into how outcomes occur enabling meaningful scenario analysis

5 Incorporates Milliman's tried and tested intellectual property and proprietary methodology

6 Explains tail risk and its components enabling mitigating actions and strategic decision making

Benefits

- Analyze conduct at either the enterprise level or across multiple business units

- Identify the drivers of specific outcomes, which creates the ability to optimize a mitigation strategy

- Explain non-linear relationship between risk events, including causes, triggers and potential tipping points

- Provide executive information which allows for establishing and monitoring of risk tolerance and other key metrics in real time

- Elucidate the root causes and cumulative impact of risks enabling better decision making (e.g., 2nd and 3rd order effects impacting the firm, control decisions, external threats, etc.)

Key Features

1. Incorporate multiple scenarios to test controls and outcomes

2. Learns and adapts as information evolves

3. "What if" and reverse stress investigations

4. Aggregates or decomposes conduct by drivers and triggers

5. Identify correlations between operational losses and conduct