“Reputation and conduct: the pillars of financial transactions”
Conference on Reputational and Conduct Risk

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Good afternoon.

I would like to thank FinReg, in particular Gloria Hernández, and Analistas Financieros Internacionales for inviting me to the opening of this conference.

Today's conference focuses on a key aspect of business management: the control of reputational and conduct risk.

Reputation and, in general, business conduct, are the pillars on which trade and financial transactions have been based since their inception. Commercial relations have always been based on concepts such as the "fides" of the Romans or the "good faith" of the commercial codes. And nurturing this trust has always been a priority. Already in ancient Greece, according to the quote attributed to the philosopher Hesiod, it was recognised that "a bad reputation is a burden, light to lift, heavy to carry, difficult to unload".

That said, the current context introduces new elements that make reputation management particularly relevant. There are several reasons for this.

On the one hand, the new digital communication environment - which favours the use of social networks and forums and facilitates access to information - has empowered the end client and transformed bilateral relationships (between company and client) into relationships in the public domain. And this is also done instantly, without filters or records of severity or importance. At the same time, the effects are amplified. It only takes a single case to escalate quickly and end up having global repercussions throughout the business.

On the other hand, society demands greater social and environmental involvement from companies in their activities. Thus, companies are increasingly expected to make a greater commitment to the well-being of the environment in which they operate, taking into account all stakeholders, not just shareholders and clients.

And the third element to consider is the growth of new investment opportunities outside the regulated sphere, whose boundary with the regulated sector is sometimes difficult to define. I am referring, for example, to digital assets such as cryptoassets and other services based on DLT or blockchain technology.

There is no doubt about the benefits and the major transformation that these developments are driving in the securities markets. But it is also true that in the absence of a clear regulatory framework and given the highly speculative component of some of the digital proposals, the use of some technologies can be an easy breeding ground for illicit activities, which ultimately undermines their development.

All of this places us in an environment that offers risks and opportunities for corporate reputation management. On the one hand, if companies do not ensure that they provide the best customer service and follow best practices of conduct, the factors I have just described, I believe, can be an explosive cocktail for their reputation.

On the other hand, this environment can also be an opportunity to enhance the reputation and trust offered by professional management.

Logically, this seal of quality that comes with being a regulated entity only works if best practices are ensured in the relationship with the client and with the environment in which it operates.

How can we manage reputational risk in this new environment?

There is no simple answer. Reputation is an accumulation of perceptions and opinions that different stakeholders (clients, employees, suppliers, investors) have about an organisation. And its management is complicated.

- Firstly, there is no homogeneous understanding of what reputational risk means. It is a risk that arises from the materialisation of other risks and their deficient management (operational, strategic, market, liquidity, credit risks, etc.), making it difficult to control in all areas.

- Secondly, reputation is an intangible asset, which does not appear on balance sheets, and as such, is somewhat ethereal and difficult to quantify. Unlike other risks, this one does not produce direct losses to companies, but materialises in an indirect way, although it ends up having repercussions on future losses of income and/or higher costs.

- Finally, it is very difficult to repair, insofar as it attacks the foundations of business confidence that I pointed out at the beginning, and social and media circulation can amplify its effects.

In my opinion, reputational risk management has to evolve towards a more advanced, more sophisticated concept, which could encompass the following three meanings cumulatively:

a. Reputational risk as a compliance risk
b. Reputational risk as an impact derived from operational risks
c. And reputational risk as a strategic risk, linked to the management of trust with stakeholders.

And it is this third element that seems to me to be the most differential because, in short, the challenge now facing companies, especially large listed companies, is to move towards a more comprehensive management of corporate reputation.

This requires, on the one hand, tools to diagnose and measure the perception that the main stakeholders have of the entity; and, on the other hand, it requires the articulation of organisational structures that allow for a better assessment and management of reputational risk.

In short, it entails having policies and controls that help to identify the key levers of reputation in order to be able to actively influence what is of most concern.

I honestly believe that the industry is well prepared. The data show that more and more companies are committed to reputational risk management: 91% of Ibex 35 companies already identify reputational risk in their annual corporate governance reports as one of the possible risks.

This is consistent with the growing importance of these risks from a corporate governance point of view. It should also be remembered that there are irregular practices, with repercussions in the criminal sphere, which are particularly serious. These, although attributable to a small number of people, can compromise the image and reputation of a company, and even an entire sector.

Therefore, in the latest review of the Good Corporate Governance Code, the CNMV reinforced several of the recommendations in this area. The aim was to prevent and detect situations in which a company's image and reputation could be damaged, and to establish mechanisms to manage these cases and ensure adequate transparency[1]. At the end of the day, it is all about strengthening the image and reputation of our companies and, therefore, of the stock market as a whole.

There are many factors that can affect the reputation of companies, such as cases of fraud or lack of ethics and social responsibility. And I am sure several of them will be mentioned today.

I would like to take the opportunity today to go into two specific conducts in more detail.

Firstly, in poor product sales or marketing practices, commonly known as mis-selling; and secondly, in the disclosure of misleading information by companies, known as misleading disclosures, with special attention to information related to sustainability and social commitment.

Code of conduct

I shall start with the reputational risk associated with poor marketing practices and the sale of products that may not be appropriate or suitable for the client. This is a risk well known to entities and one that we have seen materialise in the past, and to which they have devoted time and resources in recent years to improve their financial customer service.

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[1] See the press release of 26 June, "The CNMV approves the reform of the good governance code for listed companies" and that of 25 November 2019, "Statement by the CNMV following the cases of alleged irregular practices related to some listed companies of which it has learned in recent months".

But, in my opinion, there are new elements that make compliance with the code of conduct particularly relevant in today's circumstances:

- Firstly, after the crisis caused by the pandemic, our economy is going through a phase of adjustment of the productive structure. In these cases, interesting investment opportunities arise that allow capital to be channelled to companies that need it for their transformation. This is reflected in the number of IPOs, capital increases and other corporate transactions. This is positive, as it helps the process of economic recovery and technological change in the economy. But it also entails certain risks because, in times of crisis, it is common for companies' financial difficulties and, consequently, failed investment strategies to increase.

- In addition to this, we are at a time of low interest rates, which encourage the search for returns in more complex and risky assets, and with greater volatility. This also encourages the sale of a wide range of products, both in the investment and insurance sectors, which are not generally subject to the same marketing rules. This can lead to client confusion and increase the complexity of the investment.

- Finally, technological development changes the way in which companies relate to the client. Digital interfaces offer great advantages in direct communication with the client. Now we all operate instantly with our mobile phones. But they also favour more aggressive and direct client attraction strategies and may prioritise the immediacy or convenience of the transaction, to the detriment of a more detailed analysis of it.

In this context, it is key that entities advising on or selling investment products always ensure that they are vigilant in their compliance with the code of conduct. At the end of the day, this is the only successful strategy in the medium and long term.

And what does conduct regulation tell us?

It has evolved over the years to strengthen the protection of retail investors.

In Europe, the development of a regulatory package was promoted in which the review of MiFID, the Directive regulating the provision of investment services, was the main exponent. MiFID regulations have led to a significant improvement in market transparency; better and more homogeneous information received by investors; and greater knowledge of clients by firms, such as that obtained thanks to appropriateness and suitability tests. It should also be noted that it introduced the possibility of prohibiting the marketing of certain products to retail investors.

At the same time, an important point is that MiFID strengthens the management of conflicts of interest between investment firms and end clients, to ensure that firms always act in the best interests of clients.

Do not misinterpret me. Conflicts of interest will always exist. The important thing is to identify them and manage them properly.

Of course, there are certain aspects that can be improved. The MiFID II review process is currently ongoing in the European Union and there are several issues that may be on the table, such as the regulation of inducements.

In this debate, I believe that it is essential to harmonise regulation as far as possible, and to avoid different practices between the countries of the European Union. All EU investors should enjoy the same level of protection.

And we must also make an effort to simplify the information and the framework for action for investors. There is no doubt that financial clients are becoming increasingly demanding and show greater interest in learning about the characteristics of investment alternatives. But for this to be possible, the information they receive must be clear and understandable.

Similarly, regulation should be as homogeneous as possible across sectors, and thus avoid different practices, not justified by the risk of the service, regardless of whether you buy a banking product or invest in an investment fund.

Undoubtedly, how entities manage investment demand will determine client confidence in the sector. And as entities are well aware, further instances of malpractice or unsuitable product sales could do great damage to the image and integrity of the entire investment services industry.

Information integrity

Finally, the second aspect I wanted to highlight concerns the damage that can be caused by publishing misleading information or information without the necessary quality required by today's standards. And this effort should not only refer to financial information, which is also the case, as has traditionally been so.

Non-financial information or information on sustainability and social commitment is of growing importance.

In Spain, for four years now, reporting on these issues has been mandatory for a good number of companies, including listed companies. And at the end of April, the EC published a draft Directive to regulate the group of entities obliged to report corporate information on sustainability in Europe.

In this area, it is essential to avoid false shortcuts in order to look good in the photo.

Companies have to provide reliable and comparable information regarding the impact of their activity on the environment, as well as the activities they carry out in the interests of social factors or better governance. That is, to avoid greenwashing practices and not to mislead the potential investor.

It is true that we are at a time when this can be particularly complicated for issuers, due to the absence of a complete and stable regulation that allows for homogeneous information to be available.

But this should not justify any relaxation in the rigour of companies' reporting. Again, their reputation is at stake and therefore the future development of their business, i.e., companies’ own long-term sustainability.

The ability of other stakeholders, such as investment funds, to consistently present themselves as sustainable to investors will also depend on this information.

Of course, it is of the utmost importance to ensure that an investment fund that presents itself as sustainable does indeed have the necessary proportion of sustainable investments in its portfolio. But it will be very difficult to have this certainty if the information coming from the issuing companies is not of sufficient quality and reliability.

It is, in short, an area where we have a lot at stake and where we must act collectively in a responsible manner.

I shall finish by saying that

reputational risk management is a challenge that affects us all.

Cases of irregular practices and misconduct do not only affect the entity that carries them out. Seemingly separate and narrow cases can bring an entire sector into disrepute; and vice versa. The disrepute of a sector, due to the proliferation of fraud and irregular practices, can question the reputation of any entity that wants to offer similar services.

The investment services industry is well positioned, but there is always room for improvement. According to a recent survey, the majority of retail investors, around 75%, believe that their financial adviser is legally bound to act in the client's best interests above their own, but this percentage drops significantly when asked whether they believe their adviser always puts their interests first.

We therefore need comprehensive reputational risk management that can meet the challenges introduced by the current status quo. In short, it is a question of valuing the confidence offered by a professionalised management of the activity.

And regulation must also improve. It must be more comprehensive and in line with the times, and an additional effort must be made to simplify the rules for the investor.

In short, we must all work together to promote ethical and responsible behaviour by companies and thus ensure the transparency and integrity of the securities markets.

Thank you very much.