

COVID-19

From controls to purpose – conduct in a COVID-19 world

June 2020



Driving good conduct and high performance in banking

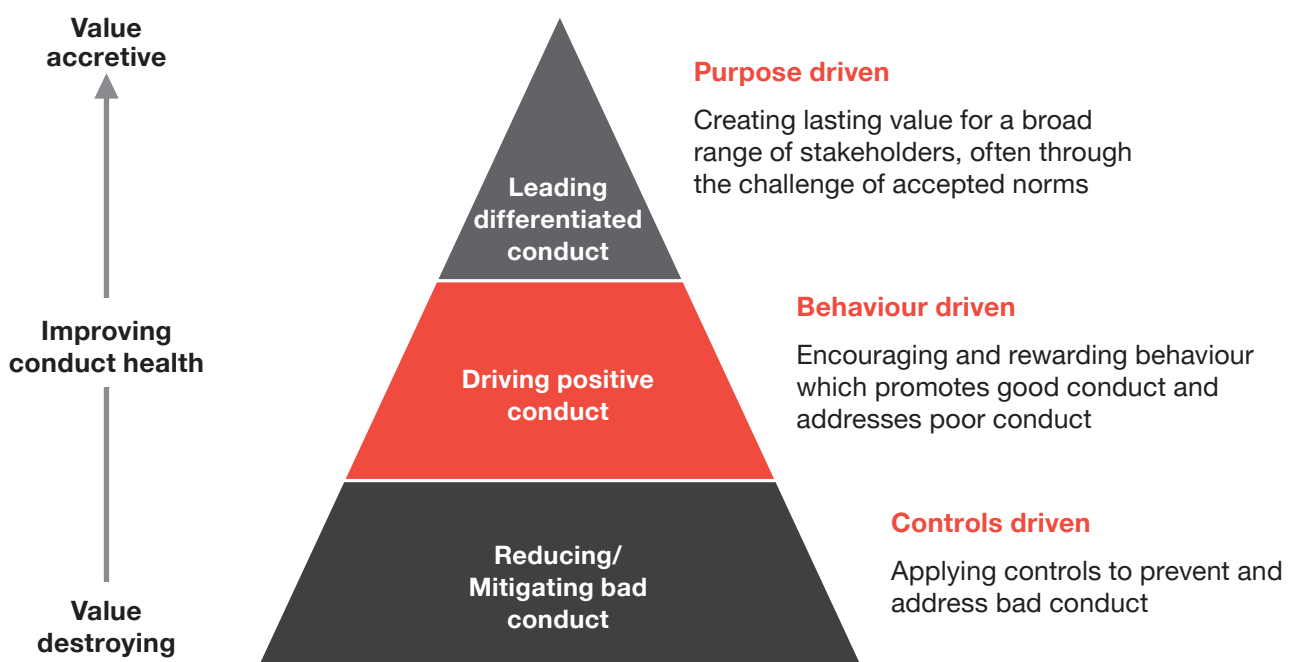
Background

Larry Fink's sentiment below had echoes in PwC's industry supported paper, developed November 2019, in which we examined the linkages between clear purpose, good conduct and higher business performance. We developed this as a conduct hierarchy, which we believe holds true in the working environment created by COVID-19 and can be developed further to consider and measure conduct health.

The COVID-19 pandemic has necessitated a profound shift in working patterns for business, controls and operational staff. Crisis response typically occurs in three waves; mobilise, stabilise and strategise. Having mobilised quickly, banks are rapidly stabilising around

new working practices. Through mobilisation, banks have been exposed to the full range of non-financial risks and have generally found that technology, processes and controls have stood up well in maintaining the operational risk control environment.

Whilst operational risk will continue to be reviewed and controls developed, other non-financial risk aspects of the emerging business and operating models should be re-visited. Cyber risk, fraud risk and conduct risk must all be considered in the context of a multi-location environment. Here we explore conduct risk from a controls, behaviour and purpose perspective and outline some key considerations for banks.



Ultimately, purpose is the engine of long term profitability.

Larry Fink, Annual letter to CEOs, January 14, 2020



The Conduct Health Pyramid

The Conduct Health Pyramid outlines the core elements required to create a culture of good conduct. Failure to address the bottom layer is value destroying and achieving an organisation's full health potential is increasingly value accretive.

In The Conduct Health Pyramid we have used the terms 'bad conduct/misconduct' and 'poor' conduct.

- Bad conduct/misconduct represents a breaking of defined rules, be they criminal, contractual or policy driven. In the markets/trading controls sense, this frequently results from deliberate attempts to exploit asymmetry of information to the disadvantage of the counterparty or customer
- Poor conduct refers to behaviour that undermines performance as a whole but does not break specific rules, examples may include; failure to collaborate and/or share, opting out, bias, providing no or poor feedback

Preventing misconduct – A refreshed controls environment

In their transition to remote working, banks had to consider the availability and resilience of local infrastructure as well as cybersecurity. As a whole, the pivot from 90% office to 90% home working in sales and trading has been remarkably successful. Technology has been resilient. Since much of the conduct control environment depends on technology, and sales and trading continues to be executed on bank infrastructure, core conduct controls have held up.

As we move through stabilisation, and the probable emergence of a mixed core/secondary/home working model, certain conduct control areas are getting greater focus. These include:

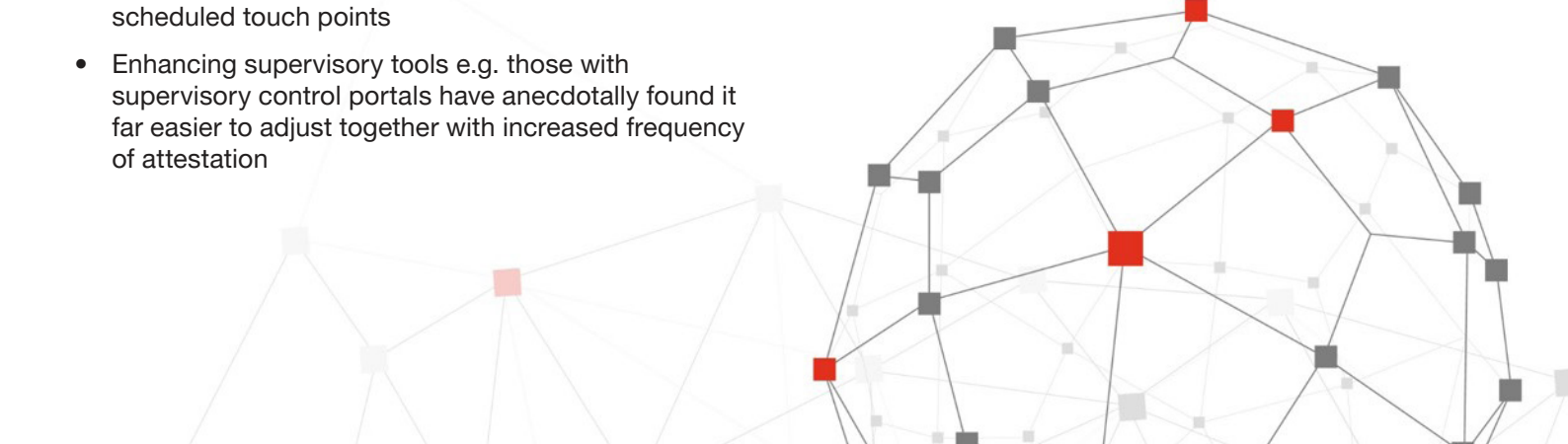
- Adapting supervisory frameworks and policies to take account of on-site/off-site working and management (and determining how supervisors and compliance can 'observe' sales staff and traders)
- Extending delegated supervisory models, which can relieve the supervisor of some required tasks by carrying them out centrally. Documentation is essential to clearly define each participant's responsibilities and scheduled touch points
- Enhancing supervisory tools e.g. those with supervisory control portals have anecdotally found it far easier to adjust together with increased frequency of attestation

- Formally governed updates to policies and procedures to align to the new normal (rather than temporary dispensations)
- Team wellbeing practices e.g. buddying of traders on-site and off-site, use of collaborative tools e.g. jam boards, additional one-to-one interactions
- Enhancing and/or increasing frequency of risk and control assessment practices to take account of the rapidly changing situation as well as potential changes in risk appetite and tolerance

The most challenging elements to address are the informal mechanisms that contribute to an overall view of behaviour and conduct. Physical proximity, being able to see day-to-day activity, unusual behaviour, indications of stress are all harder to assess when 100% remote. Traditional methods, such as daily one-to-one check-ins, have been one avenue of response. Additionally, many banks have already explored emerging technologies to address some of these issues:

- Scripting software, capable of capturing conversations, analysing text, detecting sentiment and prompting next steps
- Proximity software, tracking location and connectivity with other devices and individuals
- Active video monitoring, allowing adhoc 'check-in's'

Under consideration is effectively a new working contract with staff, as the balance between privacy, security and control are reconsidered. Whilst technology and new controls and processes may address some emerging conduct concerns, banks will need to decide strategically what their locational balance looks like. Will home working be confined to certain people, products, tasks or indeed time periods? If so, how will a 'them vs. us' culture be avoided? Could there be mandatory periods when people are required to be on-site (a kind of reverse block leave), so that in-person interaction and observation can occur? The strategic answers to these questions will not only be based on risk and control; health and safety, functional effectiveness, productivity, cost and employee preferences, among other factors, will play their part.



Driving good conduct and high performance

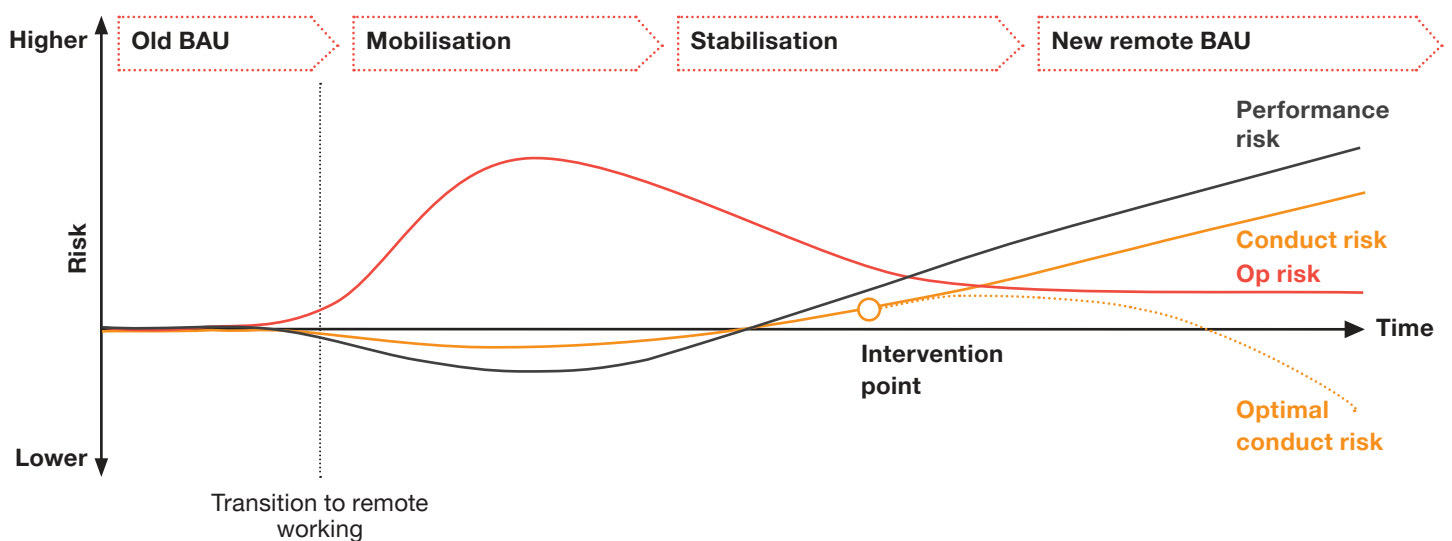
Despite the applied controls addressing bad conduct, key aspects of good conduct can degrade in a remote working environment. Even if the immediate stresses of the emergent pandemic have passed, working remotely creates different pressure points. As one banker put it:

'There are concerns around the fact that the informal questions someone would ask a colleague or

supervisor aren't happening as they don't merit a phone call or email, which in the old world would make it more of an issue than it is'.

The natural sharing, the testing of ideas, the learning from others, the buzz of the team, the sharing of a win and the consolation after a loss, can all degrade rapidly when remote or fragmented.

Expected remote team engagement, productivity and conduct journey



COVID-19 had an immediate impact on non-financial risk profiles and employee performance. In the short-term, as organisations mobilised their transition to remote working, the following outcomes were observed:

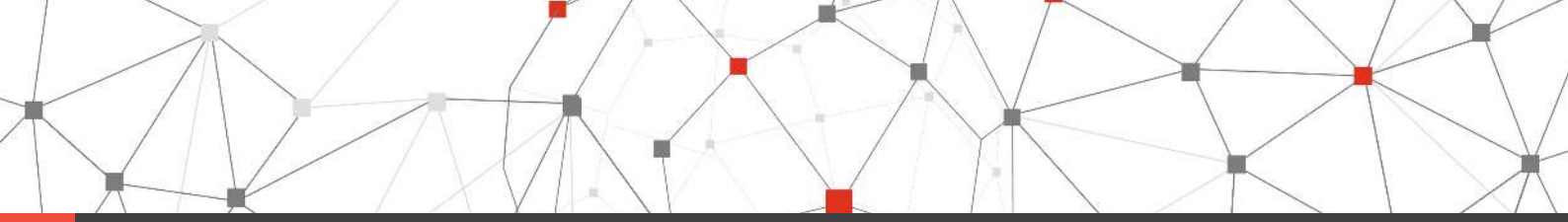
- Operational Risk increased initially given the lack of controls and infrastructure to handle mass remote working. Heavy focus on this by banks meant that operational risk decreased as the pandemic response stabilised. As 'remote' shifts to 'distributed', continued intervention will lead to a long-term reduction
- Employee performance in most organisations increased during mobilisation given a 'call to arms' attitude and a strong team spirit 'we're in it together' to do what it took to make remote working effective
- This team spirit, together with a concerted effort by organisations to focus on ways of working and operational risk, helped contain conduct risk through the mobilisation period

As banks prepare for a more distributed working model, intervention is necessary in the form of tools, technologies and ways of working to contain conduct risk as well as maintain performance. A reduction in conduct risk is likely to be positively associated with an increase in performance as motivated, engaged employees are less likely to engage in poor behaviour.

To drive and reinforce good conduct, supervisors need to:

- Align behaviours supporting virtual working and set new standards in behaviour e.g. setting a clear operating routine, being disciplined about it, encouraging participation, making it personal
- Establish remote working practices, bringing emphasis to often neglected practices and routines when in the office e.g. goal setting, feedback and development
- Renew focus on training for conduct, maintaining and developing scenario-based training delivered through a virtual classroom
- Maintain focus on personal conduct and conflicts of interest e.g. personal account dealing
- Deploy enabling tools that support collaboration and participation, leveraging what is available and selecting additional tools where needed, from aligned/single CRM systems to regular use of collaboration tools

In terms of technology, the sophistication of tools that start to capture mood and sentiment will develop rapidly e.g. through conversation analytics. Bringing these elements into the natural performance metrics of the organisation will be a key part of tracking and measuring conduct health.



Good leadership behaviours from supervisors in the physical environment – think inclusion, setting clear goals, regular and timely feedback, active interest and participation, regular formal and informal communication – will not change in a mixed location working model, but their importance is being amplified. Deprioritising or paying lip service to these activities, something that may have been tolerated historically, will have an increasingly adverse impact on the performance of a fragmented workforce. Understanding the differences between a good trader or sales person and a good supervisor and manager is increasingly important.

Remote and distributed teams can be high performing and productive. Both technology and management behaviour help drive this. However, if remote working is to become embedded and fully optimised in the operating model, individuals need an increasingly strong understanding of where they fit and why they are doing the things they are doing. They need to have a clear understanding and alignment to the purpose of the organisation.

Doubling down on purpose

Many organisations have recognised the way they behave through this crisis will determine the way they are perceived by a broad range of stakeholders long afterwards. Many firms have responded with strong messaging and some consistent themes;

- Messages are direct from the top and frequent. Everyone has a clear understanding of management intent
- They explain a higher purpose, linking organisational intent with staff roles
- They are balanced with respect to the desired outcomes for a wide group of stakeholders

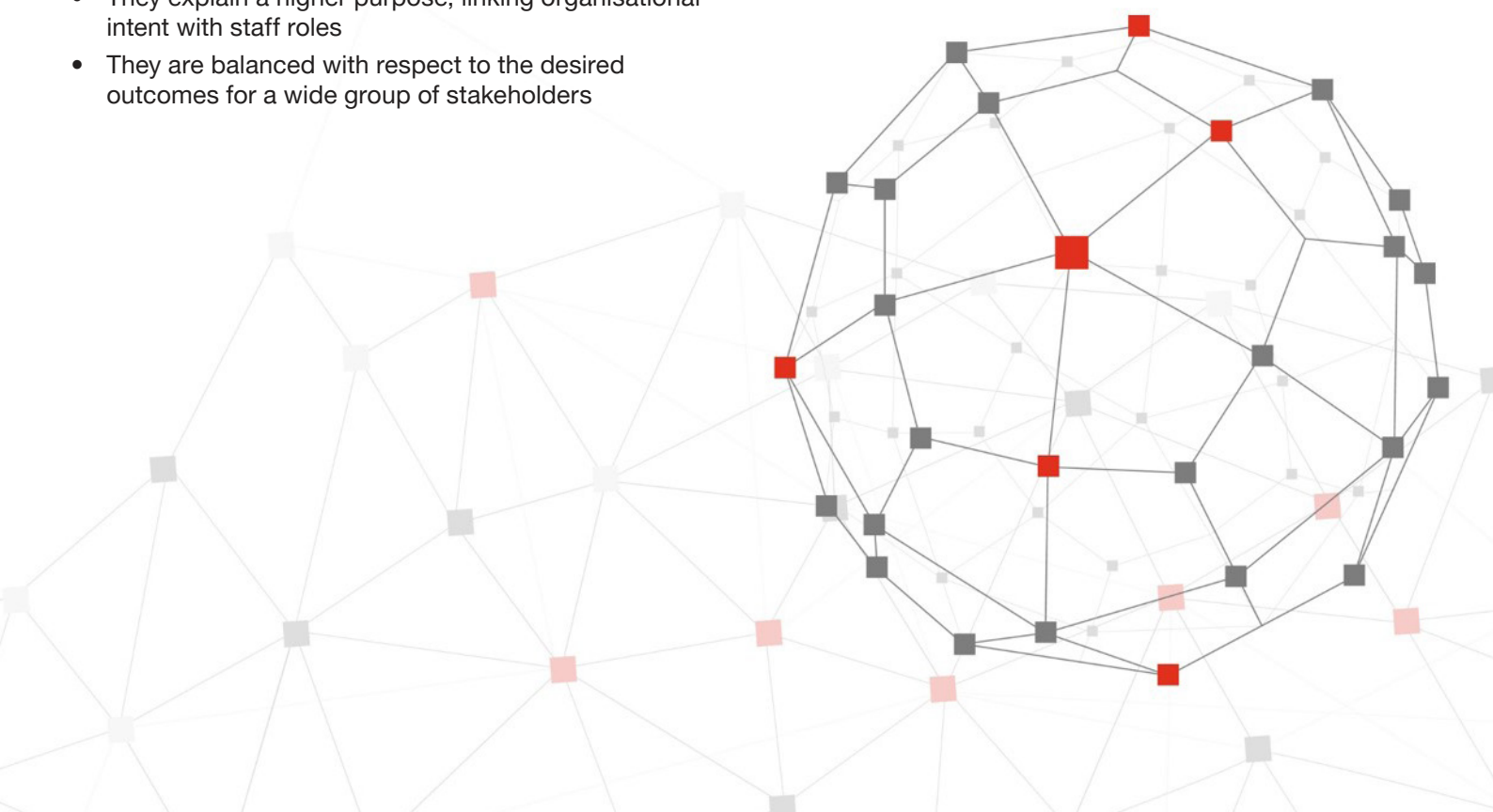
This messaging has played a key role in helping banks respond, largely successfully, to Covid-19 and remote working. In terms of conduct and overall performance banks must now consider:

- How do they keep the intimacy and frequency of messaging from the top?
- How do they make sure individual objectives, feedback and reward are aligned to the organisational purpose?
- How do they maintain balance in stakeholder outcomes, protecting, not sweating the organisational assets and their performance?

Pulling it all together

From a strategic perspective, it is already clear that institutions will not return to historical ways of working. The implications of pandemic risk are now better understood and operating models will be expected to cope with those risks. It is likely that remote and distributed working will be a significant feature of the organisation, and conduct – both control over misconduct and the support and drive of ‘good’ conduct, will need to be addressed.

Leading organisations will measure ‘conduct health’ and consider controls, behaviour and purpose as part of that measurement. Coming back to Mr Fink’s annual letter we feel the reporting of conduct health will become a central part of improved disclosure to a wide group of stakeholders.



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