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Client Alert Commentary

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Conduct and Culture Update from the FCA

The FCA published its annual Industry Feedback for 2019/20 in relation to its 5 Conduct Questions Programme.

Messages from the Engine Room

"Conduct and culture will remain a key focus of our engagement activity". FCA, 2020

The 5 Conduct Questions Programme forms an integral part of the FCA's firm supervision strategy.

In 2019, the FCA hosted Conduct Roundtables with 18 wholesale banks, each of which was represented by a group of staff at the vice president level or equivalent — termed the "Engine Room". The roundtables culminated in the FCA's latest report on the 5 Conduct Questions Programme, 'Messages From the Engine Room', which reflects the FCA's findings and perspectives.

While the participant firms were wholesale banks, **the Report's findings are equally relevant to all firms across the financial services spectrum.** This *Client Alert* summarises the key takeaways from the Report; overlaid with the author's commentary and questions that firms might usefully address.

Key Findings

The FCA found that identification of conduct risk remains weak, and advised that, "an active approach to identifying conduct risk is an essential first step for firms, given that a risk that has not been identified cannot be managed or reduced."

While the FCA observed a "generally positive impact of training rolled out over the past few years … the depth of understanding and the ability to identify conduct risk in day-to-day working life remains unacceptably weak". Specifically, the FCA commented that:

- There was a "worrying lack of awareness or depth in the wide range of conduct issues" (beyond the well-understood topics, such as: conflicts of interest, inside information, customer fairness, diversity and inclusion, and non-financial misconduct).
- Deeper, wider topics might include: enabling client misbehaviour, failure to train or be trained, glossing over 'Know Your Client' gaps, new automation risks (e.g., through use of robots), and remote working risks.
- Firms can take further steps to improve employees' ability to identify new sources of conduct risk as they emerge.

- "We highly applaud the effort of firms to raise the profile of non-financial misconduct."
- Firms have taken good steps to make conduct risk training engaging through face-to-face delivery and use of real-life scenarios. **However**, there was often little (if any) meaningful subsequent engagement on the topic.

The FCA identified some emerging best practices, including:

- Active participation of CEOs and other business heads in conduct and culture initiatives
- Training sessions, including time for self-reflection
- Providing upfront training to new arrivals before assumption of their line roles
- Establishing conduct as a standing agenda item at regular team meetings

Comment: Clearly, the FCA expects to see a more sophisticated and deeper focus on conduct risk training and identification, going beyond well-recognised areas, such as conflicts of interest and misuse of sensitive information.

Questions:

Have staff had **sufficient training to be able to identify conduct risk in their day-to-day roles** beyond general awareness?

Does the firm's overall framework for identifying and mitigating conduct risk reflect **adequate bottom-up exercises** to understand those risks?

Are the right people (with the requisite knowledge) involved in these bottom-up exercises?

Do staff **(across all three lines of defence and not just in the front office)** properly understand how their own roles and responsibilities can potentially create conduct risk or harm for customers, the firm, or markets?

As a manager, am I focusing my team's minds sufficiently and regularly on conduct risk? Could/should I use team meetings as a forum for this?

Remuneration and performance assessments

The FCA found that many firms have taken steps to ensure that the contribution of personal conduct and behaviour (the 'how') in achieving objectives is a prominent factor alongside *what* is achieved. However, some firms have taken "insufficient steps to ensure substantive feedback discussions with staff, keep future-oriented records, analyse trends and develop a governance feedback loop".

Considered and well-directed feedback "deserves to be supported". More generally, the importance of providing **meaningful feedback** is referenced throughout the Report.

Comment: The significance and potential (positive) impact of thoughtful and balanced feedback cannot be overstated. Feedback appears to have become something of an expectation across the younger generation; and should help to ensure continued 'buy-in' and constructive participation from those concerned.

In a similar vein, the FCA found that transparency around promotion decisions "has become a clear staff expectation".

Comment: This may serve as an opportune time for firms to reconsider whether there is sufficient transparency around promotion decisions so that staff are clear as to the success criteria and any associated relative weightings.

More generally, a perceived lack of transparency is commonly cited as a root cause of workforce discontent and distrust. Enhanced (and meaningful) transparency can go a long way in helping to address any internal scepticism or lack of faith in management and / or process.

Leading firms are demonstrating attributes of a learning organisation by collecting data related to the 'how', analysing trends, refining approaches, and reviewing results at board level.

Comment: 'Point in time' or 'in isolation' assessments can only ever provide a momentary snapshot. However, trend analyses (together with attendant board oversight and consideration) can help to monitor direction of travel **over time** and identify any potentially troubling themes.

Questions:

How (if at all) is the firm monitoring for (and subsequently analysing) trends?

Is there room for improvement?

Is any significant trend data routinely escalated to the board (or a relevant sub-committee)?

Culture, safety, and leadership

"How easily staff can safely challenge day-to-day business decision-making exposes the health of the corporate culture or environment." While the FCA was encouraged to see that clear official whistleblowing and other escalation channels were in place, it "saw a persistent and significant lack of psychological safety in day-to-day speak up and challenge. Firms need to address this."

Recently, culture has evolved to take broader factors into account, rather than just focusing on shareholders' needs. This is leading to a closer alignment of the interests of shareholders, clients, employees, and other stakeholders.

Managers (at all levels) must lead by example. This will involve, amongst other things, displaying a consistent degree of empathy, self-reflection, self-awareness, diplomacy, and civility.

Comment: Experience has shown that toxic cultures can often be traced back to a conspicuous absence of these attributes within (senior) management ranks.

Questions:

Would managers benefit from receiving behavioural training?

How else is the firm equipping managers with the necessary behavioural skill-sets?

Most firms will have implemented a form of 'speak up' policy. However, it is equally important that those who do choose to speak up are assured that the firm is **actually listening**.

Comment: An absence of action and / or meaningful updates (whether real or perceived) is likely to prove counter-productive and erode trust, deterring future escalations. Many firms may feel that they could do better on this front.

Questions:

Do we systematically provide feedback and updates to those who speak up?

Do we have the necessary processes to ensure that this actually happens?

Is there room for improvement?

Purpose, Principles, and Values

"Improving clarity [of purpose] is essential, as these concepts often feature in important conversations both internally and externally with clients and other stakeholders."

Previous feedback reports have focused on the importance of 'tone from the top' and, more recently, 'tone from above'. The Report introduces the notion of 'tone from within' "as an important new operative phrase to consider when issues of conduct arise." The FCA elaborates:

> *"This represents one's individual mindset, preferences, beliefs, habits and pre-dispositions. It is one thing to have an idea about how your CEO or line manager might respond in a situation, it is another to be clear about how you might respond on your own and why. Whether stated directly or not, the development of Tone from Within via training, self-reflection and self-challenge is a pre-cursor to wider corporate change."*

Comment: Interestingly, the FCA is now focusing on 'tone from within' — a development that we have long suspected would eventually materialise. In essence, this notion draws out the potential mismatch in answers to the following questions: "What would I do?" versus "What should I do?" (or, alternatively, "What would my CEO [expect me to] do)?". In Latham's experience, a hypothetical scenario involving an ethical dilemma and an opportunity to 'turn a blind eye' will often elicit a very broad range of responses. By way of a simple example:

In the staff canteen, you spot a colleague (who also happens to be a good friend) smuggling a sandwich into his bag without paying. How would you respond?

If nothing else, scenarios of this nature can prove extremely effective at focusing minds and helping to convey expectations. Despite much talk about "doing the right thing," but there is precious little elaboration as to what that really means in practice. Is it the "right thing" by me (it being the selfish/convenient/easy course) or the "right thing" by my firm (something which my firm would want to be made aware of)?

Questions:

Are messages from the top, including corporate purpose and values, translated in a meaningful way to the specific roles and responsibilities, targets, and objectives at the individual level and unit level across the firm?

Is enough being done to support line managers in their efforts to enable their teams to perform at their best?

Are line managers being equipped with the right skills to set the 'tone from above'?

Are employees clear as to what is expected of them in the kind of 'moral dilemma' scenario above? Do they 'buy into' this?

If you have questions about this *Client Alert*, please contact one of the authors listed below or the Latham lawyer with whom you normally consult:

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