FINANCIAL CONDUCT AUTHORITY

‘Progress and challenges’
5 Conduct Questions

Industry Feedback for 2018/19
Wholesale Banking Supervision

May 2019

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The 5 Conduct Questions

1. What proactive steps do you take as a firm to identify the conduct risks inherent within your business?
2. How do you encourage the individuals who work in front, middle, back office, control and support functions to feel and be responsible for managing the conduct of their business?
3. What support (broadly defined) does the firm put in place to enable those who work for it to improve the conduct of their business or function?
4. How does the Board and ExCo (or appropriate senior management) gain oversight of the conduct of business within their organisation and, equally importantly, how does the Board or ExCo consider the conduct implications of the strategic decisions that they make?
5. Has the firm assessed whether there are any other activities that it undertakes that could undermine strategies put in place to improve conduct?

Executive Summary

Culture and governance is one of our cross-sector priorities where we have a permanent and continuing focus. We introduced the 5 Conduct Question (5CQ) programme for wholesale banks in 2015 to help firms' improve their conduct risk management and, ultimately, drive cultural change. Many firms have made significant strides in improving their policies, processes, training and identification of conduct risk. However, overall progress or embedding in some cases has been patchy or in danger of stalling.

In this report we are responding with a separate Section 1 where we take a higher-level look back over several years to identify strategic factors that may help firms reframe, extend or energise their efforts. For a possible step-change in overall design and effectiveness, this may prove useful.

As in previous reports, in Section 2 we give an update on industry progress against each of the 5 Conduct Questions, based on our observations over the past year and provide a catalogue of good practice ideas.

Section 3 provides our brief assessment of 'speak up' and whistleblowing initiatives in wholesale banking. Non-financial misconduct is an inherent risk in any industry. Serious mis-behaviour is toxic to a working environment and can lead to bad outcomes for customers, staff, other stakeholders and the firm. This area clearly requires management attention and a broader change in firms' mindset.

As firm CEOs will attest, the effort to shape and improve conduct and culture does not have an end date. The more complex, long-term challenge of achieving sustainable firm-wide mindset change still lies ahead.

While this report covers supervisory activity and discussions with a sample of about 50 firms, the content is relevant for all firms in the financial sector, wholesale or otherwise. We encourage all to note this feedback as well as the broad conduct agenda and consider if and how they can effectively incorporate any of the approaches here in their own organisations. This report is relevant to Boards and Non-Executive Directors, to staff at all levels, clients, and to other stakeholders.

Striving for Mindset Change

To date we have focused the 5CQ discussions with firms on the design and effectiveness of their conduct programmes as well as noting related corporate initiatives. In this report we provide some strategic considerations emphasising the need for the provision of a full range of connected initiatives and that the connections between each component are important.

Early firm initiatives rightly concentrated on problematic aspects of process flows and bad behaviour. This led to the creation of new policies and procedures, new training programmes and the use of technology to enable better surveillance. We suggest that firms could also pay more attention to developing and safeguarding positive behaviour in its own right. This would reflect that firms more fully recognise that conduct is part of the corporate engine driving growth. It is a potential differentiating factor in competition for customers and potentially in restoring the reputation of financial services firms as positive contributors to the fabric of society.

We have regularly drawn attention to four important drivers of behaviour: Purpose, Leadership, People (approach to reward and management) and Governance. The importance of corporate purpose has become increasingly recognised as a key factor in engaging staff and potentially improving conduct.

In our CEO Roundtables, we discussed the importance of personal development as a complement to technical competence. Participants felt that a more strategic approach to long-term staff development which balances personal growth plans with corporate-focused competency training would be beneficial.

A pathway to more sustainable mindset change may be a fully integrated effort where firms identify the drivers of behaviour within their organisations, including the four drivers above, launch a suite of programmes with clearly understood connections and adopt a strategic approach to staff development. The importance of conduct can be integrated directly into the many strategic initiatives of a firm.

Annual Feedback on 5 Conduct Questions programme

While there is much more to be achieved, firms have continued to make significant progress in their conduct initiatives. A few more firms are beginning to reap direct benefits from this effort. This is demonstrated by improved staff engagement and the potential competitive advantage of positive and visible management of conduct risk, which clients have noticed.

Firms' plans frequently involve multiple workstreams with phased completion points. Last year we noted that completion of initial stages of conduct programmes could lead to a premature sense of achievement.The CEOs of at least 2 firms were able to step back and reassess their positions, acknowledge that anticipated progress had not been sufficient and take steps to renew momentum. We again observe that a key element of better established programmes is the clear business-led accountability for programme delivery.

Firms initially focused on meeting new regulatory requirements and related internal policies and procedures, such as ensuring compliance with Personal Account Dealing and completing training on time. Last year some firms also began to re-position their attention externally by considering whether their products or activity were causing, or could cause, harm to customers or markets. More recently, there is growing awareness of the positive impact of an approach that joins up conduct initiatives with business strategy and developing human skills. This reflects significant improvement.

We also summarise some early observations from speaking to firms in wholesale financial services, such as commodity traders, agency brokers, exchanges and benchmark publishers.

Speak up and Whistleblowing

During the latest round of annual conduct meetings with wholesale banks, we asked generally about the healthiness of speak up culture in the firm and programmes to encourage it. By a speak up culture we mean the willingness and opportunities for staff to challenge and discuss issues as a normal day-to-day activity, including escalating issues where needed.

On the separate topic of whistleblowing, our discussion focused on whether a fully functioning channel was available and whether staff could use it without fear of unwanted identification or reprisal. We noted that, perhaps due to active promotional efforts, a greater than usual number of cases were being reported. As a result, firms were uncertain about what a normalised volume would prove to be. The nature of escalated topics also varied significantly across firms, where similar cases handled in the normal course of business at one firm triggered a whistleblowing event at another.

We give more details further on in this report but our general observation is that most firms have effective programmes in place to address continuing policy and process problems. The challenge remains to fully embed the desired changes of mindset across the whole organisation.

Despite this progress, non-financial misconduct has emerged as a significant concern. This appears to be an issue where firms' risk identification, response and mitigation is under-developed. Clearly, more managerial attention is needed here.

We strongly encourage firms and senior management to be ambitious when designing conduct programmes and ensure that good practice becomes the resilient norm throughout their organisation. Some of the ideas in Section 1 together with relevant good practice points in Section 2 may raise overall programme effectiveness in firms.

All market participants should also note:

1. conduct programmes that reduce potential harm can significantly benefit your firm, similar in scale to how poor conduct can be hugely damaging
2. if your firm has not prioritised conduct and culture, you are behind your peers and may be running significant, unrecognised and unmanaged levels of conduct risk, and
3. if counterparties and other firms you deal with (e.g. via outsourcing arrangements) have not adequately prioritised their own approach to conduct, this can create a risk to your firm

Points to Consider

Questions that we might ask boards and executive management and that they might investigate in their firms include:

1. are conduct and related programmes suitably framed against your firm's purpose and longer-term competitiveness and sustainability?
2. do your conduct and related programmes include sufficient efforts to strengthen and support good behaviour rather than just reduce or eliminate bad behaviour?
3. is there an adequate bottom-up exercise to identify and help prioritise conduct risks throughout your whole firm?
4. do you have strategic HR programmes that focus adequately on developing the individual human skills that underpin conduct and culture change in line with the ambitions of the firm for itself and its staff?
5. in the shorter term, do your business managers and each of your lines of defence sufficiently recognise the variability and changing mix of conduct risks across your firm, and act on this?
6. in the longer term, does your firm adequately capture insights from bottom-up exercises, training programmes and crystallised events at an organisational level, such as in your overall corporate strategy, policy and updated training?
7. looking at the evolving use of technology and digitisation, are you giving enough consideration to conduct risks that can arise as a result?
8. finally, are you and management doing enough to address non-financial misconduct and personal misbehaviour?

Our next steps

Our Mission describes the main types of potential harm we aim to identify, prevent, reduce or correct. We will continue with our focused conduct engagement across all wholesale financial services. In the 5 Conduct Questions programme, we will increasingly include some degree of testing and challenge to management and staff below board and top management levels. A key objective will be to assess how the firm is embedding good conduct and the impact this is having. We will aim to augment our assessments with information from our other engagement work with firms.

As well as the feedback from ourselves or others, firms might consider how else to effectively assess and explain their own individual progress.

We will also carry on with our outreach efforts across industry and the academic community, as well as hosting CEO Roundtable sessions to influence and inspire innovative thinking and action. We welcome face-to-face meetings with a wider range of wholesale financial services firms of all sizes where possible.

Section 1
Striving for mindset change

The evolving role of regulation

Our regulation aims to serve the public interest by improving the way the UK financial system works and how firms conduct their business. Historically, the activity of regulators has typically been framed as disciplinarian, monitoring firms and markets, dealing with breaches of written rules and imposing penalties. This is a necessary function of regulation in financial services and remains fully in place. However, the role of regulators, particularly on issues like conduct and culture, has evolved to elevate a wider range of activity.

In our Approach to Supervision we consider a range of factors including business models, culture and prudential soundness when we assess potential harm. We have focused intensively on behaviour, conduct and culture as these matters sit at the core of good management and good outcomes. We have intensified our collaborative engagement to develop multi-disciplinary perspectives and develop thought leadership, that can help lead to healthy sustainable culture change.

In this section, we look back over the last few years to identify some strategic approaches that make a positive difference to conduct programmes.

The 5 Conduct Questions as a coaching tool

We introduced the 5 Conduct Questions as a supervisory programme for wholesale banks. It is a coaching tool for firms to help them gain a better understanding and context for assessing a broad range of conduct and culture change initiatives. The questions are also incorporated in our Approach to Supervision which applies to all financial sectors, retail and wholesale. Working through the 5 questions individually and using our collective industry feedback has enabled firms to benchmark themselves, use good ideas from others and improve their own programmes. We find that firm conduct has transitioned from a regulatory imposition to a business relevant initiative and firms are becoming ambitious in how they think about and implement improvements to conduct.

Our outreach efforts, including the connected CEO Roundtable programme, seek to convene and encourage senior leaders to explore and expand their efforts on relevant topics. We have hosted discussions with the CEOs on topics that reflect four key drivers of behaviour: Purpose, Leadership, People (reward/management) and Governance. The roundtable sessions enable participants to examine a concept, hear from others with practical experience or expertise, consider the practical aspects of applying the concepts and then draw their own conclusions on relevance, merit or applicability. We do not endorse the views of various presenters or theoretical models discussed in CEO Roundtables.

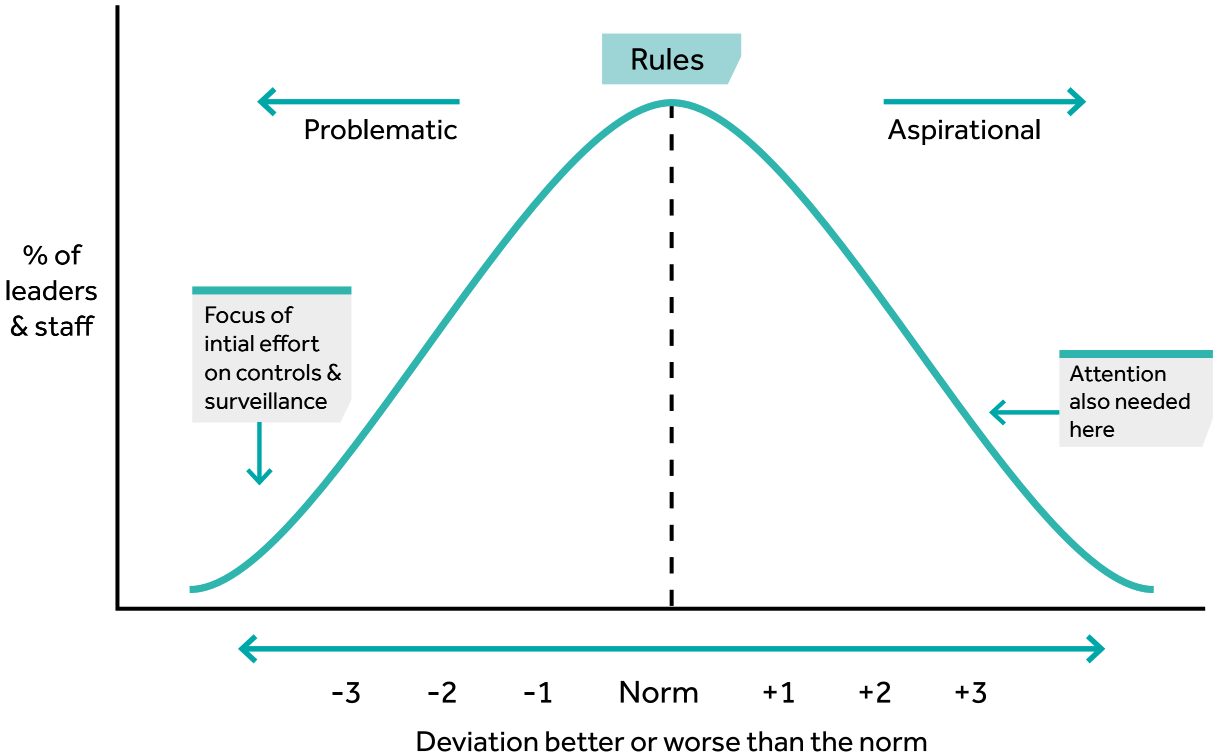
The Behaviour Curve

In the Figure below, we broadly summarise several concepts related to conduct activity. The normal distribution curve depicts the range of individual behaviour from good to poor. The shape of the curve and the mid-point line are presented for discussion purposes only. The curve is not intended to reflect any observations on the actual proportions of people on one side of the curve or the other, ie we do not suggest that only 50% of people exhibit good behaviour.

The dotted vertical line represents generally accepted rules such as social mores, corporate policies & procedures, the FCA Handbook and company law. It is desirable to have people operating to the right side of these reference points, largely reflecting good behaviour or conduct. Positions further to the right of the centre, or norm, might reflect a deeper expression of the 'spirit' of the rules moving well beyond the narrow question of 'could we' to the broader question of 'should we'? Moving to the right also reflects more focus on good conduct outcomes and sensitivity to harm versus a narrower concept of avoiding a rule breach.

Conversely, staff behaviour or attitudes that move towards the left of the dotted line are problematic. In moving to the left, people would display tendencies that make them less likely to be hired by a bank. Indeed, hiring them would increasingly risk remedial action, such as warnings, enforcement action, loss of employment and in more serious cases fine or imprisonment for those staff.

Conduct and behaviour



Early work by firms to address change in conduct focused heavily on the left side of the curve – improving policy and process, restructuring remuneration plans and basic training. Led by functions such as Compliance, Risk, Human Resources and IT, emphasis was on avoiding preventable breaches, addressing conflicts of interest and designing management information to help identify potential weakness. Regulators also focused on and supported these initiatives.

As well as addressing the problematic left side, we support efforts to move staff to the right side of the curve and to prevent any drift back from right to left. People can and do make mistakes or misjudgements, so the controls and tightened procedures are also designed to help staff on the right side of the curve avoid making a harmful mistake. As regulators, we are interested in and discuss conduct in its widest sense, not just the narrower concept of conduct risk which tends to evoke just the bad behaviour.

Positions on the behaviour curve are not static. There may be times or situations where poor behaviour and the potential for harm could be more likely to occur. We introduce the term Behaviour at Risk (BaR) to illustrate that the risk of poor conduct can rise and fall according to different circumstances. For example, corporate restructuring with significant redundancies or anxiety about challenging targets may increase the potential for misbehaviour. Managers need to be alert to this possibility across their firm or markets. They might also need to adjust their monitoring and mitigation plans and priorities accordingly.

Conduct and the Corporate Engine

Over the past few years it has become increasingly clear that conduct and behaviour fundamentally underpin a firm's brand and overall business. For some, it has become a key differentiating factor that partly explains why customers want to start or carry on doing business with one firm or another. We regularly hear about the appeal of 'a safe pair of hands', 'knowing we will be treated fairly', and 'knowing transaction structures will be above board'. This reflects the elevation of conduct as a unique sales proposition or a point of differentiation.

Firms increasingly recognise that conduct is fundamental and integral to ensuring their longer-term strategic health. CEOs and other executives signaled this important transition with 'town hall' presentations where they urged staff to follow through on conduct programmes as being constructive and productive, rather than driven by a narrower need to avoid rule breaches.

We have observed 2 or 3-year programmes that focus narrowly on regulatory adherence and avoiding rule breaches result in conduct being narrowly defined and treated like a tripwire. Staff were more likely to respond with fear than forward-looking enthusiasm. The reaction is quite different when firms integrate conduct with longer-term corporate goals and fully align it with franchise strength, corporate development and sustainability. Treating conduct risk as a regulatory tripwire has bred unhelpful fear. Framing conduct as a component of a broader strategic effort helps to breed the ambition to move to the right on the behaviour curve.

Shorter-term, narrowly focused conduct projects faltered or did not deliver the intended benefits. The progress, achievements and contribution of more integrated initiatives generate long-term benefits, financial for shareholders and personal for the people involved. These types of achievement may be sufficiently important to justify including them with a firm's shorter-term quarterly earnings per share updates.

Conduct and Authentic Corporate Purpose

Wholesale Banking firms have invested significant resources in developing their Purpose Statements and articulating their Vision, Mission, Values and Principles. During the CEO Roundtable discussion on Purpose, attendees felt that a higher level of staff impact or engagement could be achieved. Following the session, a number of firms followed up with initiatives to amend their Purpose Statements, websites or other training and communication channels in order to raise their level of visibility. Attendees identified some common features of a good Corporate Purpose statement.

These included framing from a high-level, perhaps harnessing some aspect of corporate history and underpinning a meaningful social impact that engages the wider stakeholder community as well as staff.

Corporate ambition typically involves big picture visions and strategic goals that pre-suppose the health, vigour and long-term sustainability of the business. Staff members, individually or collectively are a vital part of this picture. The CEO Roundtable session acknowledged the power of a corporate purpose statement when it aligns strongly with the purpose of individual staff members. Academic and business studies have shown that when staff collectively feel a strong sense of purpose and satisfaction with their work, the firm produces superior results.

Training that puts 'theory into practice' could be re-framed as 'putting corporate purpose into context'. Purpose can create common ground for internal conduct debates and be a practical guiding reference point when addressing grey areas and choosing from alternative courses of action. This is only possible when corporate purpose is fully understood and embedded in the day-to-day life of the firm. Connecting conduct initiatives to an active concept of purpose should naturally lead to better outcomes.

Conduct and Psychological Safety

"When people have psychological safety at work, they are comfortable sharing concerns and mistakes without fear of embarrassment or retribution. They are confident that they can speak up and won't be humiliated, ignored, or blamed". This description by Professor Amy Edmondson underpins our general approach on this topic. We have widely engaged with others on culture and psychological safety in conference discussions, webinars and short publications. More information is available on the FCA website.

At the CEO Roundtable on this topic participants were open about their personal fears, which included competency failure, the relentless pace of change, negative technology events and many others. They discussed the fears of their executive team members, which also included balancing conflicting priorities, the viability of business models and managing staff. Continuing vigilance of the well-being of staff and colleagues was felt to be crucial to establish and maintain a corporate climate of psychological safety.

It was also felt that training on a wide range of human development skills is essential to support psychological safety. The learning point for firms is the benefit that can be delivered by human resource management through a strategic focus on well-developed staff.

Boards and C-suite executives are generally providing much improved leadership on conduct. Junior employees are now heavily trained at the point of entry. The middle layers are also highly influential in providing day-to-day leadership on conduct. These layers will benefit from more attention and investment on conduct initiatives.

Leadership Character and Diversity & Inclusion

In the Roundtable session on Character Based Leadership, the presenters described misconduct and misbehaviour as being more about poor 'judgement' than about moral or ethical failings. Character is important in making good judgement calls, both day-to-day and during times of pressure. Dimensions of character all have behavioural elements which are measurable and can be strengthened. A modest investment of time in understanding this straightforward model could strengthen the enabling capabilities needed for the full range of the personal development training programmes, such as unconscious bias and the inclusivity aspect of diversity. Visibly connecting such initiatives to conduct programmes would be helpful.

The Roundtable session explored diversity in the widest possible sense of the term and the importance of enabling inclusion to maximise the benefits of working with an enriched mix of staff. Cognitive diversity, the way people think, is the clear objective rather than just an enriched mix of gender, race, education and other staff profiles. A growing number of studies show that diversity and inclusion have a positive impact on both a firm's financial and overall performance. This supports the view that managerial effectiveness is much more than an intellectual, analytical matter. It requires a willingness to invest the time to understand and relate to your staff, peer group and others.

Conduct and Programme Connections

We have emphasised 4 key drivers of behaviour and firms have launched many initiatives under these drivers, together with other corporate specific projects. Training related to these drivers and other initiatives is often about influencing good judgement and behaviour that serves long-term business goals.

In our supervisory work, we have noticed a positive impact when firms brought conduct initiatives into their broader corporate ambitions, linking them with Purpose or Mission statements. CEOs remarked that training that elevates the development of human skills along with corporate competency was increasingly important.

Elevating these connections to the same level of importance as the individual initiatives, could deliver additional results, support changes in mindset and build sustainability.

Section 2
Annual 5 Conduct Questions Feedback

With finite resources and a large and diverse number of firms to regulate, we sought to create a supervisory programme for wholesale banking that would achieve effective reach and impact. The simplicity of our 5 Conduct Questions was designed to appeal to firms and serve as a useful reference point for discussion, programme design and, ultimately, progress. The results so far have been positive with productive firm engagement and solid progress. Based on our observations, sustainable positive change in mindset will require further effort and a shared ambition between firms and their staff.

In 2018, we began wider rollout of the 5 Conduct Questions programme to other wholesale financial services firms, including commodity trading, benchmark publishers, agency brokers and exchanges. As this work is at an early stage, we give only a brief summary at the end of this section, but the whole of this report is addressed to these firms as well.

Overall programme design and effectiveness

To make basic progress clearly requires leadership from the business. It also needs an integrated framework that addresses all aspects of business activity, customers, employees (front, middle, back) and the market. To make greater progress requires a sense of purpose, clear accountability from business heads and sustained commitment from staff at all levels.

As in our earlier reports, the basic design features of a successful programme are:

1. determined board and CEO sponsorship, engagement and participation
2. visible business-led ownership of good conduct
3. senior executive accountability for programme design and delivery
4. front-to-back programmes that include business, control and support functions
5. integration within strategic or operational risk management frameworks
6. standardised conduct risk self-assessment processes across the firm
7. comparing conduct risk across businesses and functions (read-across), and
8. full integration of recruitment, training, performance assessment, promotion and remuneration systems that include conduct objectives

Similarly, we continue to observe that the following design features are less effective and result in a slower pace of progress:

1. programmes where the COO, Compliance or another Second Line of Defence unit is the primary driver, seeking to achieve buy-in from business units and others
2. one-off or stand-alone projects with 1-3 year timeframes
3. top-down approaches to identifying risk which are not counterbalanced by substantial, bottom-up efforts by smaller business units
4. overemphasis of defensive efforts focused on 'controls' rather than more positive, fundamental drivers of behaviour

5. exempting significant business units, control teams or operational functions
6. a narrow focus on client-facing activity, given that conduct risk can arise anywhere

Nearly all firms responded to our design feedback by implementing or strengthening business leadership of conduct programmes. However, in recent regulatory visits the respective CEO's of 2 firms were surprised when members of the Compliance Function and/or the COO were significantly better able to field and answer questions on conduct programmes and firm initiatives than the business heads. This might have been less important were the firms not slipping behind their peers in the effectiveness of their conduct programmes. Further steps are now being taken by those firms to strengthen business ownership.

Some features of leading design and execution that we found in firms this year include:

1. positive framing of key initiatives by strongly emphasising openness, transparency, accessibility and safety. We have observed that programmes framed in this manner seem to embed well.
2. rather than declaring 'zero tolerance for conduct risk' which can make staff fearful and reluctant to disclose problems, re-positioning as 'zero tolerance for unmanaged conduct risk' where staff are positively encouraged to be alert and respond to risks.
3. reframing initiatives to focus more on rewarding efforts such as identifying and resolving policy deficiencies, rather than solely punishing breaches as they happen.
4. having launched a programme focused more narrowly on risk remediation, controls and breach avoidance, shifting the focus to prioritise topics such as speak up and escalating concerns.
5. simplifying overly complicated conduct oversight infrastructure, which was hindering responsiveness and also acting to ensure that passive oversight was not misconstrued as conduct risk management.
6. noting how staff attitudes had now shifted to include more specific focus on personal conduct rather than just concerns about enforcement and avoiding technical breaches.
7. taking care to discuss firm conduct separately from individual conduct and understanding that several individual decisions, while narrowly correct, may result in the firm doing something it should not.
8. recognising the importance of establishing the right balance between defining and refining concepts and taking sufficient steps toward getting the programme actually embedded.
9. taking steps to bring conduct and conduct risks front of mind in Operations units.
10. removing the responsibility for design and organisation of firm-wide conduct events from Compliance and Risk enabling them to actively participate.
11. where practical, upgrading UK-focused conduct initiatives to global programmes.

Question 1:
‘What proactive steps do you take as a firm to identify the conduct risks inherent within your business?’

Defining conduct risk

We consider it is essential – and more productive – for firms to put in the effort to create a definition of conduct risk tailored to their own history and circumstances, rather than adopt a standard definition from a regulator or industry body. This effort typically leads to an exploratory discussion that highlights the nature of the firm’s conduct issues and, potentially, how they might tackle them.

These definitions have steadily evolved from their initial focus on rule breaches or poor customer treatment to reflect the importance of their own staff, the wider stakeholder community, market integrity and competition. They also increasingly reflect a more outward-looking view of actual or potential harm. However, competition as a reference point remains a weak point for many, with a few notable exceptions.

Firms most often see the phrase ‘conduct risk’ in terms of fines, sanctions and reputational damage from events at what we referred to earlier as the problematic end of the behaviour curve. Our discussion has evolved to focus on conduct more broadly on the whole curve of behaviour, good and bad. Firms are paying more attention to the risk of good standards of conduct and behaviour coming under pressure. Firms are also recognising the important contribution that good behaviour makes to their overall health, vitality and, ultimately, their contribution to society as a whole.

Identifying conduct risk

Conduct risk can occur anywhere and, if not prevented, needs to be managed wherever this happens. This includes the risk of existing good standards of behaviour deteriorating. Firms have generally made progress in identifying and managing conduct risk. Additionally, while many use a top-down approach to start with, for example, using a Risk and Control Self-Assessment (RCSA) exercise or similar, this is now commonly supplemented by a bottom-up approach.

With the right encouragement and motivation, the bottom-up approach creates the opportunity to harness a wide range of different professional competencies and develop new insights. This ultimately adds to the organisational store of knowledge about conduct and risks for individuals, business units or the organisation as a whole.

Working bottom-up can generate strategic value by introducing new risks or competitive business responses that top-down approaches are unlikely to have identified. We find that firms that have made the most use of bottom-up exercises and capturing relevant results at the organisational level are leaders among their peers. They have become able to respond quickly to new and evolving risks with appropriate controls and newly created, highly targeted training.

We found that firms' training initially focused on raising awareness of conduct risk. This has been replaced with training to raise alertness and ability in spotting potential conduct risk. This training mainly involves grey area scenarios where a single, clear and correct answer may not be obvious, with the training delivered by the firm's senior management, often using illustrative personal stories. Our findings confirm the importance of staff developing their own sense of what should or should not be acceptable, rather than relying on centrally provided instruction which might not cover an emerging risk. Training scenarios which do not have a clear outcome help ensure that judgement and choice are prioritised. Another benefit of this approach is that it makes staff appreciate the value and importance of discussion, challenge and the relevant, prompt escalation of issues.

Most firms have now defined conduct risk as a separate category that sits sensibly alongside other major risk types such as Credit, Counterparty, Market and Operational risk. As mentioned in Section 1, it is helpful to frame conduct with reference to the whole range of good to bad behaviour.

Here are some suggested good examples:

1. widening the working scope of conduct risk, as framing it more narrowly limited both the design of efforts to identify it and the outcomes
2. raising the profile of, and actively promoting, competition concerns as a business as usual consideration where firms have a large market share
3. taking action to reduce the conduct risk challenges from staff using smartphones and social media by creating short breaks and safe locations to step out and log on or connect.
4. assessing the impact and harm of potential events from the customer's point of view
5. formalising the bottom-up approach as a monthly exercise for each key business unit over the course of the year
6. introducing approaches that immediately feed newly identified risks or crystallised risk into the delivery of targeted training
7. updating risk taxonomies to ensure sensible aggregation and useful reporting
8. analysing conduct risks over the lifecycle of a trade, paying particular attention to points of interface between different business or control units
9. specifically analysing remote booking end-to-end seeking to identify all the conduct risks that can arise
10. clearly interweaving conduct topics with business discussions, rather than relegate them to more narrowly focused discussions in, for example, an Operational Risk Committee as this made discussions less siloed and more thoughtful

Some of the relatively weak examples include firms that:

1. still had little impetus to identify new risks through forward-looking proactive efforts
2. still relied almost entirely on top-down exercises where key risks are not comprehensively apparent or captured
3. invested a lot of effort into identification exercises but then underinvested in the steps to take action on the risks identified

4. continued to have difficulty differentiating conduct risk from operational risk; and still largely treating it as operational risk which means that business line ownership of conduct risk remains weak
5. showed that support service and second line of defence units were not conferring with each another
6. believed that conduct permeated all things and so approached it in a diffused way, instead of defining it as a category, which is more effective at focusing attention on the risk

Our letter to the Women and Equalities Committee in 2018 explains, non-financial misconduct, such as personal misbehaviour, bullying or sexual misconduct is as important an aspect of conduct as financial misconduct. Firms' identification efforts for this risk category are underdeveloped, while the public commentary on the unhealthy atmosphere this can cause at work continues. We are concerned both by the fact these events continue to happen, and with the inadequacy or preparedness of managerial responses. We comment further on this in the Speak Up and Whistleblowing Review below.

Question 2: 'How do you encourage the individuals who work in front, middle, back office, control and support functions to feel and be responsible for managing the conduct of their business?'

While we typically discuss firms' entire conduct and change management programmes in our conduct meetings with them, we did spend extra time on this important question early on. Below we set out our observations and feedback, with some new examples of strong and weak initiatives.

Tone from Above (Message Content/Frequency/Speaker)
We continued to stress the importance of Tone from the Top while focusing some of our attention on less senior management and staff to find out how well understood and embedded the firms' key messages were. As noted in the 2018 G30 Report on Banking Conduct and Culture: A Permanent Mindset Change, it may now be more appropriate to reframe this as 'Tone from Above', which recognises the importance that most staff give to messages from their immediate manager and other senior staff.

Looking at the now common place CEO-led town hall sessions on conduct, we noted that some firms:

1. now hold smaller town hall events hosted by desk or area heads. This reflects the fact that staff listen carefully to their more immediate line managers who are also able to actually observe their day-to-day behaviour
2. changed attendance at their town hall sessions so that more junior staff and their management do not attend together. This achieved more lively discussions and both the staff and management acknowledge the benefits

We were occasionally disappointed, for example, when a senior executive promoted the general importance of the firm's conduct messages but could not explain what any of those messages were. It remains important that firms continue to prioritise ongoing education of the most senior management and governance layers including Non-Executive Directors. Business and function heads need to be able to reflect the key messages from above as well as explain the arising conduct risks in their units and how they are evolving.

Accountability of Business/Unit Heads
We have clearly set out our expectations of firms that come under the Senior Managers & Certification Regime (SM&CR) and the behaviour of their employees in the Code of Conduct (COCON) section of the FCA Handbook. As part of this, most employees will be subject to 5 Conduct Rules that represent minimum standards of behaviour. They must:

1. act with integrity
2. act with due care, skill and diligence
3. be open and cooperative with the FCA, the PRA and other regulators
4. pay due regard to the interests of customers and treat them fairly
5. observe proper standards of market conduct

Firms consistently reported that the SM&CR had a significant and positive impact on governance and conduct specifically, and that it supported their culture initiatives. From 9 December 2019, the SM&CR will be extended more widely across the wholesale financial services sector.

For example, a senior manager put up a poster that listed mistakes made in the past year, inviting staff to a session to discuss how they happened and make they couldn't happen again. The poster stayed up as a reminder.

Less encouragingly, we also observed the following:

1. an issue being escalated too rapidly, which risked bypassing key individuals who may be more directly accountable for managing and resolving the problem
2. undermining programme objectives by not ensuring that Desk Heads and other more senior managers attended open session Conduct Risk Forum meetings

Remuneration
Some firms had clearly drawn a stronger link between conduct and behaviour on the one hand and performance assessment and remuneration on the other. Our last report noted some firms needed to accelerate their efforts, but progress continues to be patchy as the proportionality of the rewards or penalties are inconsistent and seen to be this way by staff.

Most firms have introduced a conduct element to annual staff performance assessments that inform remuneration and promotion. This is often based on separate feedback on how goals were achieved versus standards and what was achieved versus agreed objectives.

Many firms have increased the weighting of the conduct element to 50%, putting it on equal terms with other performance measures. However, we note that the financial impact of this re-weighting often remains rather modest when measured against the variable component of remuneration.

We cannot overlook the gender pay gap, which in some firms, was quite marked. It is important that firms give considerations to the fairness of its renumeration policy.

Question 3:
'What support (broadly defined) does the firm put in place to enable those who work for it to improve the conduct of their business or function?'

Some firms have maturing support infrastructure and there is evidence of an increase in stronger positive feedback loops. In a few firms, the governance structure presented a stumbling block with management struggling under weighty, complex, centrally-led committees and programme management infrastructure. This sometimes led to fractured accountability in the firm, noticeably slower or stifled progress and less ability to summarise its position and progress. Some early leaders in improving conduct have fallen back because of this and they have taken steps to address it.

Other examples include firms:

1. framing risk appetite statements as a series of expectations of its staff and developing metrics around those desired outcomes. This complements typical metrics around tolerance for the incidence of actual events expressed as 'events no more frequently than x and no more serious than y'.
2. participating in industry-led initiatives to address conduct issues.
3. looking beyond their own boundaries to assess conduct standards and risks from clients, counterparties, outsourced service providers and others.
4. not looking the other way if a client mistreats a member of the firm's staff.
5. introducing a reverse mentoring programme where staff significantly more junior than an executive meet regularly to share feedback.
6. introducing a one-off, tailored internal survey to assess conduct and culture and prevailing views among staff rather than use a more wide-ranging annual staff survey for this purpose.
7. introducing a specific communication programme around disciplinary outcomes to provide transparency on how the firm decided and applied them. This was to achieve consensus on the perception of fairness.
8. specifically analysing the potential conduct risk in examining, preparing and implementing changes from EU withdrawal
9. shifting beyond gender-based diversity by raising the importance of other aspects, such as race, educational background, economic background and other skills or experience.
10. explicitly adopting a three-level approach to support by linking (a) awareness, (b) identification & assessment and (c) governance & oversight in its structure and communications programme.
11. going beyond simply encouraging people to speak up by providing them with specific tools and training on how to raise a challenge with more senior staff. Correspondingly, providing related training for senior staff on how to receive and deal with a challenge. There are now a number of such toolkits in use across industry.

Training
The transition from e-learning to broader use of face-to-face sessions continues and ethics based training remains popular with some firms.

Some welcome initiatives include:

1. one firm has steadily built a library of approximately 50 'grey issue' scenarios for use across a wide range of businesses.
2. one firm made extensive notes about the discussions in 'grey area scenario' training. They then used these to tailor additional, targeted training and consider where revised policy and procedures might be helpful.
3. more firms have employed professional actors to role-play risk scenarios. This served to strengthen the session's impact and make it a wider talking point.
4. more firms have extended their training to include the recruitment process. This is to ensure that training includes conduct and behaviour assessments so that they are carried out consistently across all businesses.

Again, we are concerned that some firms may not be providing sufficient conduct risk training or adequate follow-on support for Non-Executive Directors.

Question 4:
'How does the Board and ExCo (or appropriate senior management) gain oversight of the conduct of business within their organisation and equally importantly, how does the Board or ExCo consider the conduct implications of the strategic decisions that they make?'

Some firms are finding their earlier investment in data design, creation aggregation and trend analysis is now beginning to pay off with the creation of dashboards and management information that Managers and Boards can use to steer more effectively. Management data directly available for people management and development purposes is growing in depth and scope. Key Risk Indicators continue to be inwardly focused on misbehaviour, rule breaches or policy compliance.

These could be supplemented with more indicators to assess whether the firm's operating franchise is becoming stronger or weaker. In other words, some firms still focus entirely on the remedial part of the behaviour curve, rather than including strengthening and reinforcing more positive conduct and behaviours across the whole curve.

We note that:

1. firms have generally developed more focused and streamlined processes to collate and aggregate perceived risks, which are useful for management oversight. Nevertheless, some firm' processes are still insufficient.
2. one firm introduced a semi-formal 'Shadow Executive Committee' of staff several levels below the actual Exco. This forum raises new or unique challenges and also represents a new channel that others can use with very good results.
3. provide clear evidence that conduct risk is a key component of the review of strategic business initiatives, including business expansion. This is demonstrated in the committee papers and minutes of some firms.
4. we do see evidence of challenge on new product approvals. However, the quality or relevance of this challenge can vary significantly across firms, as well as between a firm's departments or business units.
5. some firms make better use of feedback that, while it may not be an actual complaint, can alert the firm to potential problems such as loss of a client.

Question 5: 'Has the firm assessed whether there are any other activities that it undertakes that could undermine strategies put in place to improve conduct?'

Firms' horizon-scanning initially focused on remuneration and factors that could undermine conduct goals. As the concept of conduct broadens across the whole behaviour curve, there may be new threats to improving and maintaining overall corporate conduct profiles.

We were pleased to see that:

1. one firm formally includes a horizon-scanning element to strategic business planning and explicitly includes tipping point analysis for risks that appear to be growing
2. another firm set up a completely new working group specifically to address Question 5 and the conduct issues from new or evolving products or other business initiatives such as an acquisition
3. we are encouraged to see some senior and middle-level executives actively participating in industry-wide initiatives, such as the various FICC Markets Standards Board working groups. Engagement like this with industry peers acts as both a source and a delivery channel of progressive views.

We were concerned that one firm does carry out a periodic horizon-scanning session for the firm as a whole, but does not include any business representatives in this session. Even if these business leaders are subsequently asked to review the session's results, this misses a valuable opportunity to get business area input at the outset.

We note that our feedback under Question 5 is lighter compared to other sections. This reflects the level of activity that we have been observing. We would have preferred to find that firms have developed a healthier approach to considering potential new sources of risk or the changing profile of existing risks. This is an area of relatively scarce activity that appears to be under developed.

Wider Rollout of the 5 Conduct Questions Programme

We have visited about 20 firms so far in the rollout of our wider programme. The range of strong and weak practices generally mirrored those reflected in our earlier annual reports. Only a few of these firms had a collection of conduct initiatives that approached the breadth of the larger wholesale banks'; for many other firms, the focus on conduct was a brand-new initiative this year and this is unacceptable.

Most firms were able to give a definition of conduct risk that included avoiding harm, fair competition and market integrity. Often missing from the working definition was treatment of their own staff. Regarding non-financial misconduct, firms were vocal about prevention efforts on bullying, intimidation and sexist misbehaviour. A few firms demonstrated their determination to achieve change and broadcast their expectations by the dismissal of a number of significant revenue generators. There remains much to do.

Raising awareness of conduct scenario-based training using real-life examples was widespread among firms but identifying risk, including conflicts of interest, remains a significant weakness for many firms. Initial efforts at risk identification are predominantly top-down only.

Some firms continue to embrace the idea that the close proximity of senior managers to the trading floor, and managing by walking around, would in itself make a preventative difference for conduct risk. We find that it may discourage only a small and narrow slice of the wide range of conduct risks that can occur and overconfidence in this approach is misplaced.

Commission-based remuneration dominates the wholesale/agency brokerage sector. Some firms in this sector stated that senior management intend or have started quarterly reviews of compensation paid. Employment contracts are starting to include the potential for partial income deferrals and claw-back clauses. Some firms said they had a component of their assessment process devoted to how people achieved their goals but it is too soon to assess how they are being applied and their impact. Overall, the evidence reflects very little progress in re-structuring remuneration so as to avoid contributing to the potential for harm.

Finally, many firms had established new conduct committees, typically chaired by the CEO, and were exploring how these might contribute effectively to change efforts. The importance of strong governance is heightened in some sectors where a few key individuals are major revenue producers for a firm.

We look forward to further engagement with other firms in the broad wholesale sector.

Section 3
Speak up and Whistleblowing Review

We asked wholesale banking firms to update us on the general health of speak up and, in more depth, on their Whistleblowing infrastructure, including their recent experience of that process. Despite progress, we feel both the more generalised speak up culture and the whistleblowing channel need improvement, as we outline below. While our whistleblowing comments focus more on process, we consistently find that non-financial misconduct is a significant problem that firms need to tackle with far more energy at senior management and staff at all levels than we have seen so far.

Speak Up, Speak About, Listen Up

The overall health of day-to-day conversation, discussion and challenge across the whole firm is important for achieving good conduct outcomes.

We found that firms have been very active in Speak Up, Speak About or Listen Up initiatives. We refer separately to whistleblowing as the distinct channel for escalating more serious issues. Some firms have labelled their whistleblowing process as Speak Up or the Integrity Channel, which may cause confusion by blurring the lines between day-to-day healthy challenge and the specific whistleblowing channel.

Strong messaging has raised the importance of speaking up but, in some circumstances, it can be counterproductive in encouraging staff to speak out. We note that crossing boundaries such as business lines, functions, managerial levels or professional disciplines can feel complicated and result in people hesitating to complain.

In a few firms, the messaging about speaking up had become too strident, and staff took it to mean 'speak up or else' or 'you have a clear obligation to speak up, it is a failure not to do so'. One firm improved the messaging by framing it in a more inclusive way: 'managing a bank is very difficult, we need help from all of you, please speak to us'.

Some business lines in the same firm used escalation in very different ways, reflecting differences in how easy it was to access senior managers. Informal challenge, discussion and speak up depends completely on other staff being available to listen and act on what they hear.

One firm made a point of trying to ensure that escalations were made effectively, for example, not skipping levels unnecessarily which would have limited the potential contribution of others in the managerial chain.

Whistleblowing

Making a well-functioning whistleblowing channel available became a regulatory requirement for firms in September 2016. While it is clearly important to have the channel in place, it is also vital that staff members feel that they can use it without fear of reprisal, embarrassment or other problems arising. We published a brief thematic report in November 2018 which summarised our expectations of firms on designing and implementing a whistleblowing programme. Our 2018 5 Conduct Questions report also summarised good practice and areas for improvement in policies and procedures, arrangements for a Whistleblower Champion, annual reporting and staff training.

All firms now have a well-organised policy and process around an established whistleblowing channel and staff have good awareness of the process. Firms clearly demonstrated that having a good working whistleblowing process is essential, even in a healthy environment where people feel comfortable expressing themselves.

We did not undertake a detailed statistical cross-comparison among firms. However, this was not necessary to recognise the troubling fact that non-financial misconduct in the form of bullying, sexual harassment and other forms of personal misbehaviour are widespread. This is also evident in our day-to-day supervision work as firms report and update us on issues they face.

Volume Most firms had analysed the flow and trends of cases launched via the whistleblowing channel. The volume of these cases varied markedly from firm to firm. Some reported having very few cases, while many others felt that the process had become almost overwhelmed by high volumes.

The heavier volume was thought to be the result of recent, high profile press coverage on whistleblowers as well as firms' own internal promotion of the channel. Separate initiatives related to Speak Up may have resulted in some unwanted crossover cases. Firms expected the number of cases to settle at a lower level with further training and internal discussion, but firms could not judge what they thought a normalised volume would be or should be. Either way, it will be important to understand the drivers of this data.

Case Content Some firms suggest whistleblowing was the appropriate channel for cases of misconduct or possible legal breach. They felt other types of cases should be considered, at least initially, via managerial escalation or healthy speak up channels. Firms acknowledged they need to be surer about what ought to be directed to the whistleblowing channel, noting that topics found in the whistleblowing channel in one firm were routinely covered in working-level discussions in other firms.

Firms expected to see whistleblowing cases being mainly serious issues, such as breaches of law, key policies or risk limits, harm to clients, conflicts of interest, serious personal misbehaviour or other similar issues. Many cases did not meet this more serious threshold having been caused by important but lower-level matters such as:

- individual performance assessment objections
- highly personal grievances
- minor product concerns without any initial engagement with the product sponsor.

The largest component of investigated cases in the Whistleblowing channel were categories like Dignity at Work or Non-financial misconduct which captured topics such as bullying, favouritism, exclusion and sexual harassment. There appeared to be an increase in the overall number of these cases, as well as the number that required investigation. Firms told us that, while it is unclear, they suspect the increase may reflect more active reporting rather than a deterioration in behaviour.

Fair Treatment Firms universally acknowledge the need for guaranteed anonymity and safety from retaliation but it remains a continuing source of risk and therefore hesitation by staff in reporting issues. There is a follow-on need to ensure such anonymity and forms of retaliation, subtle or otherwise, do not happen.

A few firms noted that the target of a whistleblowing allegation also deserves support. They suggested that this support should include a fair presumption of innocence until proven otherwise and accompanied by an efficient adjudication process. Firms also mentioned the importance of considering the stressful impact that an often-lengthy investigation can have on individuals, especially if it requires temporary absence from work, whether formal or informal.

Some encouraging whistleblowing initiatives include:

1. several firms mentioned the importance of managers or staff directly engaging with a whistleblower to understand fully what the employee would like to achieve and make a sustained effort to appropriately manage the whistleblower's expectations.
2. several firms outsourced the analysis of all whistleblowing cases to ensure fair and confidential treatment.
3. one firm conducted a detailed end-to-end review of the whole process chain for a whistleblowing event. This involved all disciplines (HR, Legal, Compliance, Business Heads, etc) typically engaged at the outset, through due diligence, adjudication and final decision-making in an effort to make it more transparent, fair and quick.
4. one firm created a 24 hour, multilingual hotline for anonymous escalations
5. one firm's policy included a minimum 3-year timetable for discreet monitoring to ensure a whistleblower is not treated badly.

Some firms raised the following concerns which we share:

1. many firms had no sense of what a normalised level of whistleblowing events should be. While not a major concern at this early stage, it will be important to establish expectations of case levels for management and oversight purposes.
2. a central unit, located at head office outside the UK and solely responsible for the firm's whistleblowing channel, raised the issues of adequate contextual knowledge and timely local responsiveness.

Speak Up and Whistleblowing are two highly important attributes of a healthy firm and both are dependent upon a good degree of psychological safety in the workplace. Accordingly, they will continue to attract periodic testing and validation as part of our business as usual supervisory activity.

While culture is widely accepted as a key root cause of major conduct failings that have occurred within the industry, it is also a powerful mitigant of harm. We expect firms to foster healthy cultures which support the spirit of regulation in preventing harm to consumers and markets.

A culture where non-financial misconduct is tolerated is not one which encourages people to speak up and be heard, or to challenge decisions. Tolerance of this sort of misconduct would be a clear example of a driver of unhealthy culture. A firm which effectively addresses non-financial misconduct, encourages people to speak up and be heard or challenges behaviour and responses is demonstrating an aspect of a healthy culture.

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