



Impact of COVID-19 on front-office oversight at financial institutions

An equity trader throws client documents into a home office wastepaper basket, making a mental note to deal with its proper disposal later; a front-office salesperson unknowingly discusses confidential information in earshot of a roommate, who happens to work at a competing dealer; a bond trader working remotely leaves their computer unlocked and steps out to run an errand, and another house member quickly uses the computer to access the Internet, unaware that “hotkeys” are enabled, resulting in unintentional buying and selling of various securities; and a financial adviser, frustrated at being unable to dial into a recorded phone line, gives up and calls the client using his personal cell phone.

At a time when the COVID-19 disruption has triggered historic levels of trading volumes and market volatility, financial services organizations—like the rest of the economy—had to address the added challenge of a mass migration of employees to work from home. In these unprecedented times, the oversight of conduct and remote supervision and surveillance of employees, clients, and markets had to overcome some initial operational challenges. More significantly, first- and second-line functions were presented with a unique opportunity to stress-test their entire operations and gain insights to prepare front-office oversight for the reality of virtual trading floor environments.

Under “business-as-usual” conditions, financial services institutions are required to oversee the conduct of front-office personnel, such as salespeople, traders, financial advisers, and branch managers. They do so by supervising, monitoring, and surveilling their activities as they interact with each other, clients, counterparties, and the broader marketplace. Supervisors and second-line functions rely on a series of controls to perform their front office oversight responsibilities. This includes monitoring and surveilling for compliance with rules, regulations, and company policies and procedures, as well as to detect and/or prevent employee, client, and market-abusive behaviors such as inappropriate pricing and markups, insider dealing, collusion, and misleading and inappropriate sharing of material nonpublic information (MNPI), to mention just a few.

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In an unanticipated turn of events created by the pandemic, social distancing and stay-at-home orders sent entire workforces, including front-office personnel, away from corporate and disaster recovery sites—to home. Regulatory notices and statements from several financial services regulators quickly followed reinforcing the organization's responsibility to uphold market integrity and continue to oversee employee activities to detect and prevent misconduct. Organizations had a very short turnaround to get their front-office teams operational as quickly as possible and their supervisory, compliance advisory, and surveillance teams equipped to oversee a more distributed work environment than was ever anticipated in most business recovery plans and supervisory and surveillance protocols.

While most organizations successfully managed to perform their front-office oversight activities remotely, having close to 100 percent of their sales and trading population working from home has resurfaced some of the known control oversight inefficiencies and created momentum for supervision and surveillance teams to innovate, take advantage of new technologies, and improve how they oversee employees, clients, and markets, especially in an increasingly virtual workplace.

Common challenges: Operating a remote front-office oversight team

Challenges related to technological

factors: Technology capabilities were put to the test in a work-from-home environment. Not all front-office employees were kitted at home with appropriate network speed, bandwidth, and hardware to suitably perform their sales and trading activities. Access to remote environments was not always seamless, and some organizations had to implement login schedules to avoid latency. Additional challenges included enabling remote printing, obtaining wet signatures, and replication of face-to-face

interactions with clients and colleagues. All this can potentially expose organizations to vulnerabilities, such as improperly sharing information by using unapproved channels and failing to dial into recorded lines for conversations subject to voice recording and retention mandates. Organizations were also challenged to accelerate the onboarding of third-party collaboration tools in a timely manner to address the needs of clients and front-office personnel.

Challenges related to oversight

handicaps: In addition to technology aspects, front-office oversight activities were initially affected by a reduced workforce, whether due to inability to work or market conditions diverting control personnel to assist with operational issues and backlogs. There was also a sharp hike in surveillance and monitoring alerts and false positives given high market activity and volatility. Supervisors were challenged to triage an unusual number of trade and communication alerts alongside timely performance of pretrade approvals, review of operational reports, and end-of-day trade book close. And while some organizations have experienced no changes to their front-office control activities other than adjustments to alert thresholds and amount of compliance testing and quality assurance work performed in the earlier weeks of the pandemic, other organizations spent time evaluating "critical mission" controls across the first and second lines to double down in providing additional oversight on activities seen as higher-risk under pandemic circumstances, such as activities of more junior employees.

Challenges related to front-office

controls environment: To facilitate the transition to working remotely, some organizations considered introducing temporary changes to policies and controls to allow for the new normal to settle in, creating potential inconsistencies across their footprint and, in some cases, temporary blind spots that could put their

front office and the enterprise at risk. Areas of heightened exposure include use of personal devices to take client orders and access to video and chat rooms sitting outside the firm's firewall, where conversations may not be logged. In addition, supervisory and surveillance challenges point to the level of digitization in their control environment; some examples include gaps in electronically available inputs and outputs to their trade and communications routines and market data feeds to understand material events and shifts in behavioral patterns. Other backlogs did occur in areas with built-in manual steps not easily performed off-premises.

The solution: Front-office oversight model in a virtual world

Initial response: Focus on managing business continuity

During March and April this year, agility to adjust alert thresholds to new market conditions and ability to source market data timely to process and investigate alerts were significant factors in staying on top of backloads. Some of the immediate actions that first- and second-line functions have adopted include:

Issue reminders—Provide policies reminders, practical FAQs, and training on how to stay compliant and manage risk while working from home (for example, phoning into a recorded line, remote printing, secure document disposal, wet signatures, handling of MNPI, and deactivation of home listening devices)

Consider controls to keep, kill, or modify—Focus first on critical risks affecting employee, client, and market conduct under pandemic scenarios, and assess controls that may needed to be adjusted or turned off for alternative work arrangement (such as off-premises alerts or more frequent attestations)

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Trust, but verify—Check that procedures are being followed and perform targeted supervisory and compliance monitoring reviews in areas where policies have been relaxed or businesses have been most disrupted (for example, volumes, alert triggers, change of processes, and affected resources)

Connect—Replicate office environment in a virtual world and maintain open communication lines between front-office personnel and supervisory, compliance advisory, and surveillance teams to reinforce responsibilities, available reporting tools, and specific escalation points

Trending now: Recover and thrive under a sustained remote front-office environment

The conditions generated by the pandemic have accelerated the move toward flexible work-from-home arrangements and need for reliable and high-speed connectivity. Although changes embraced at the onset of the pandemic may only be short-lived, the extended period of working from home could lead to more permanent adjustments to the way supervisory and surveillance teams operate.

As the US economy considers how to safely return to the office, supervision and surveillance teams should evaluate the following:

Coordinate reentry strategy with the front office—Assess work, workforce, and workplace and pace in the return to the office of supervisors and product compliance and surveillance teams in tandem with the reentry of front-office personnel

Improve resilience—This is broader than technology upgrades; organizations are soliciting input on lessons learned across the three lines of defense to understand drivers and cultural traits shaping behavior and risk under COVID-19 and to optimize detective and preventative scenarios

Assess capabilities to oversee distributed environments—Evaluate investments in digital technologies and analytic capabilities to add scalability and improve effectiveness of monitoring and surveillance routines in an increasingly virtual front-office workforce

Additional monitoring and surveillance—

Explore new ways to digitally monitor and surveil what employees do in the office and while remote (for example, surveillance of video tools and enhanced surveillance of communications on personal devices connected to firm infrastructure) Longer-term, this period may lead to the adoption of a more integrated front-office oversight operating model across some first- and second-line activities. Some areas that can assist financial institutions to move with the times and into the next normal could include:

Tighten supervision and surveillance models—Determine long-term location footprint and accountability model jointly across the first and second lines of defense to benefit from synergies and address additional coverage needs

Better productivity—Deploy collaboration and workflow tools alongside data visualization to support a more effective and efficient monitoring of employees, clients, and market activities in virtual environments

Reimagine control oversight—Transition toward a more integrated operating model between the first and second lines of defense and jointly agree targets for:

- Digitizing monitoring and surveillance inputs and outputs, such as gaining better access to employee, trade, and market data and improving control coverage
- Automating supervisory and surveillance activities (for example, targeting low-value but high-effort controls)
- Redesigning controls from rules-based solutions to more dynamic models leveraging more analytics to assist with

improved triaging and flexibility in times of big market swings (such as better alert correlation models)

- Consolidating employee, trade, and market data architectures to improve coverage of employee, client, and market conduct activities

In forcing organizations to rapidly adopt a remote workforce model, the pandemic has provided a glimpse into what the future workplace may resemble. At the same time, organizations have felt the urgency for better tools, technology, and process digitization to enable employee productivity, as well as effective oversight and supervision. By leaning into this opportunity now, organizations can accelerate the transition to a more digital and flexible workplace and be more prepared to effectively supervise and oversee their employees.

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