

# The importance of culture in driving behaviours of firms and how the FCA will assess this

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Speech by Clive Adamson, Director of Supervision, the FCA, at the CFA Society - UK Professionalism Conference, London. This is the text of the speech as drafted, which may differ from the delivered version.

## Introduction

Good afternoon and my thanks to CFA Society for inviting me to speak today.

The subject of my speech today is the importance of culture in driving key behaviours in firms and how the FCA will assess this. But before I take you through that, I would like to provide some context.

As many of you will know, the Financial Conduct Authority (FCA) came into official being earlier this month, taking over the conduct supervision of 25,000 firms in the UK. This is a significant moment in UK financial regulation, with the creation of a focused conduct regulator seeking to protect consumers, enhance market integrity and promote effective competition.

I think it is fair to say that we are all aware of the erosion of trust in financial services. This has been caused partly by the financial collapse in the banking sector, but also by a series of large-scale conduct failings stretching back over many years, from pensions mis-selling, endowment mis-selling, split caps to more recently, PPI and the sale of interest rate hedging products to SMEs. In the wholesale space too we have seen the LIBOR scandal. These events, and associated lack of trust, have imposed substantial costs on consumers, firms and the economy.

## So what has gone wrong?

We accept that the FSA has not been as effective a conduct regulator as it could have been. But there are other reasons too.

Firms have designed, manufactured and sold products not always with the needs and interests of their customers in mind but instead, seeing the customer as somebody to maximise profit from. This has been accentuated by a view, and it has to be said encouraged by the FSA, that disclosure at the point of sale absolves the seller from a real responsibility of ensuring that the product or service represents a good outcome for the customer. This, in turn, has led in many cases to a tick-box and overly legalistic compliance culture within firms, encouraged by what has been seen as a tick-box regulatory approach.

Underpinning all of this is the issue of culture. In many cases, where things have gone wrong, whether it is mis-selling of PPI or in attempting to manipulate LIBOR, a cultural issue is at the heart of the problem. It is fair to say that to many in the outside world, the cultural approach of doing the right thing has been lost for financial services. It is clear to us, therefore, particularly as a conduct regulator, that the cultural characteristics of a firm are a key driver of potentially poor behaviour and I would like to explore this further with you today.

## What do I mean by culture?

Culture is like DNA. It shapes judgements, ethics and behaviours displayed at those key moments, big or small, that matter to the performance and reputation of firms and the service that it provides to customers and clients.

For us, we view culture through the lens of what matters to us as a conduct regulator. This means an effective culture is one that supports a business model and business practices that have at their core, the fair treatment of customers and behaviours that do not harm market integrity.

This is very different from what we have today where, as I said earlier, the focus has been on ensuring compliance with a set of rules rather than doing the right thing for customers. Looked at this way, the responsibility for ensuring the right outcomes for customers resides with everyone at the firm, led by senior management, and not something delegated to compliance or control functions.

The challenge for many firms is that culture is hard to change and requires dedicated and persistent focus over a number of years in order to embed different approaches and ways of behaving. As the Saltz Review recently concluded, if culture is left to its own devices, it shapes itself, with the inherent risk that behaviours will not be those desired.

## Drivers of culture at a firm

It seems to me that we can identify key drivers of culture at a firm. These include:

- setting the tone from the top;
- translating this into easily understood business practices; and
- supporting the right behaviours through performance management, employee development, and reinforcing through reward programmes.

Let me say a few words about each of these.

### 1. **Setting the tone from the top**

Setting the tone is all about creating a culture where everyone has ownership and responsibility for doing the right thing, because it is the right thing to do. It is about setting values and translating them into behaviours. This can only be established by the CEO and other members of the senior management team, who need to not only set out the key company values, but also personally demonstrate they mean them through their actions. These clearly go wider than those that directly impact what we, as the conduct regulator, are looking for but should clearly include these.

We have been encouraged to see that a number of firms are re-articulating their key values and principles, led by their respective CEO – and we support this move. For us, though, we will want to see this new tone translated into behaviours through the organisation.

## **2. Business practices and ways of behaving**

The task then is to translate this tone into business practices that drive how business decisions are made, how the firm responds to events, how individuals should behave and how issues are elevated in an open way. For me, therefore, translating culture into business practices is a way to make culture into something more hard edged. I heard one CEO say earlier this year that one of their key values was to 'treat our clients like you would a member of your family. If you see a product feature you wouldn't feel comfortable selling to a relative, then we shouldn't be selling it to our customers either'.

Let me give you an example that was passed on to me last week.

Those who commute around London will be aware of the problems some weeks ago on the M25, which meant hundreds of passengers ran late for flights out of Heathrow and Gatwick. One airline, which spotted this, and in light of so many of its passengers facing disappointment at the prospect of missing their flights, chose to hold back certain planes so that passengers had a chance to make their flights. Of course this meant it faced complaints at the other end from the domino effect of the delayed flights, not to mention the additional costs due to inactive planes sat on the runway. I am told though, that once the announcement made it to the other end, there were no customer complaints made.

The key point from this example is that the airline took a judgement call and did what it thought was the right thing for its customers, even though it came at a cost. This is the kind of consumer-focused behaviour that customers would reasonably expect to be shown by the financial services industry.

But we have also seen cases when this has not been the case. Take our use of mystery shopping as a supervisory tool, as an example. When we assessed the quality of investment advice at the major retail banks and building societies, we found that the messages communicated from the top of a firm were not fully embedded into the day-to-day operations on the shop floor. This translated into poor advice being given to consumers - in fact we found that in one quarter of cases, consumers were given unsuitable advice or the adviser hadn't gathered enough information to ensure their advice was suitable.

The point here is that, although senior management may have thought that good advice was being given, this wasn't happening on the ground.

## **3. Performance management, employee development and reward programmes**

Performance management, employee development and reward programmes are clearly a powerful lever to influence the culture of any organisation. We have seen in financial services how the

misalignment between incentives structures and corporate values has led to significant damage. Our own work on financial incentives noted that high-risk incentive schemes with the potential for sales staff to earn big bonuses were common across authorised firms. Sadly, we also uncovered a catalogue of serious failings, including firms struggling to understand their own incentive schemes because they were so complex. So it is not surprising that we see more events such as the 'shareholder spring' last year, which sent a strong message to the executives of those firms that financial incentivisation is still a critical factor that needs to be carefully balanced to reinforce positive corporate expectations.

I am pleased though that many firms have either already changed or are currently changing their sales incentives plans.

The question is then, how can a firm incentivise and reward its employees in a responsible way to encourage the right outcomes? I mentioned remuneration as being an important lever, but so too are effective recruitment and promotion policies, development and performance management of employees – so, if by advancing someone you are essentially telling them that their behaviour within the workplace is appropriate, or even outstanding, then you need to ensure, and be able to demonstrate, that they are reinforcing the right values before making that decision and embedding that behaviour.

## How will the FCA assess culture?

I'd like now to turn my attention to how the FCA will be assessing culture.

Our approach today is to draw conclusions about culture from what we observe about a firm – in other words, joining the dots rather than assessing culture directly. This can be through a range of different measures such as how a firm responds to, and deals with, regulatory issues; what customers are actually experiencing when they buy a product or service from front-line staff; how a firm runs its product approval process and the considerations around these; the manner in which decisions are made or escalated; the behaviour of that firm on certain markets; and even the remuneration structures.

We also look at how a board engages in those issues, including whether it probes high return products or business lines, and whether it understands strategies for cross-selling products, how fast growth is obtained and whether products are being sold to markets they are designed for.

We are able, from all of this, to draw conclusions about the culture of a firm. This includes assessing if the perceived customer-focused culture is supported by, for example, regular discussions on conduct at board level and appropriate sales incentives plans.

## How will the FCA encourage positive culture change in firms?

We don't have direct rules about culture, although our high-level principles for business come close to this in some respects. As I have set out here, we don't directly supervise 'culture'. However, as culture and business practices are so important in driving behaviours, we do want to encourage positive culture change in firms.

We will therefore increasingly, as I have indicated, draw conclusions about a firm's culture and reflect that back to firms as part of the risk assessment process. Where we believe cultural measures expose the firm to a high level of risk in the context of our objectives, we will expect the firm to take account of it.

Of course, there are other ways to improve standards. With the Retail Distribution Review (RDR), we have set new professional standards and I am pleased with the progress industry made to meet these by the deadline of last year. In addition, as part of our new supervisory approach, we will be placing greater emphasis on individual accountability as well as corporate accountability for meeting our standards and we will be more prepared to hold these to account when things go wrong.

## Summary

I hope this has given you a better idea of why we at the FCA are interested in the culture of firms and how we are going about assessing it.

There is no doubt that this is a complex subject and one where our thinking will continue to evolve as the FCA establishes itself, which is why we would like to encourage wider debate about it and how we can positively influence it.

So to summarise, culture is important to us as a conduct regulator because of its role in driving behaviours in firms and direct impact on our intended outcome of ensuring that customers get the right outcomes.

We certainly support the role of the CFA Society in raising professional standards and look forward to discussing this issue over the years ahead.

Thank you.