REPRINT

CONDUCT AND CULTURE IN FINANCIAL SERVICES

REPRINTED FROM:
RISK & COMPLIANCE MAGAZINE
OCT-DEC 2018 ISSUE

Published by Financier Worldwide Ltd
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ONE-ON-ONE INTERVIEW

CONDUCT AND CULTURE IN FINANCIAL SERVICES

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Joe Hill is a senior consultant within the Financial Services practice of FTI Consulting in London and assists a wide range of financial services clients in dealing with matters arising from regulatory compliance and risk management issues. Mr Hill has previously worked on major change programmes in both the public and private sectors and has particular experience of delivering complex projects in the banking industry in the fields of conduct, governance and financial crime.

R&C: Could you explain the difference between good conduct and good culture?

Hill: A broad consensus has emerged on how to define 'culture' and 'conduct'. Culture is commonly viewed as the values, attitudes and assumptions manifested by a company in its interactions with stakeholders, while conduct is seen as the way in which these characteristics reveal themselves in behaviour. Agreeing what 'good' looks like, particularly with respect to culture, has proved more challenging. This is demonstrated by the UK Financial Conduct Authority's (FCA's) decision to drop its proposed 2016 thematic review of banking culture, blaming the "idiosyncratic nature of individual institutions" for the difficulty of issuing generalised guidance. A firm's culture must be unique – consistent with its strategic objectives, values and approach to interacting with stakeholders. It is imperative that a firm's culture promotes the fair treatment of customers, particularly in how it incentivises employees to act, and this is where conduct – the measurable behaviours that influence customer outcomes – becomes so important. Good conduct follows good culture.

R&C: In the financial services sector, to what extent has the regulatory focus shifted from conduct to culture?

Hill: In March 2018, the FCA published its discussion paper on 'Transforming Culture in Financial Services' announcing cultural reform as a priority. Proscribing a 'one size fits all culture' is impossible, making the enforcement of good culture hugely challenging, as shown by the FCA's recent investigation into the Royal Bank of Scotland's Global Restructuring Group (GRG). Despite identifying major concerns with GRG's culture and the prioritisation of profit above the fair treatment of customers, the FCA was unable to act against GRG's senior managers, partly because the cultural issues did not represent a failure of fitness or propriety. The introduction of the Senior Managers and Certification Regime (SM&CR) will help to increase senior managers' individual accountability for encouraging appropriate organisational behaviours, but this is more of a conduct consideration. Indeed, as the FCA highlights, a focus on supporting firms with their unique cultural challenges will be needed to enable change.

R&C: How can financial institutions (FIs) inculcate good conduct and culture?

Hill: Conduct frameworks are well-established in most sophisticated financial services firms, but these are often poorly aligned with cultural change initiatives. As culture has moved up the regulatory agenda, firms have scrambled to document core values and mission statements, investing heavily in change programmes and employee engagement initiatives, often led in isolation by risk or communications departments. To implement sustainable cultural change, a more integrated approach is required. This should involve collaboration between business functions and alignment with key conduct risk considerations, including compliance policies, remuneration practices and approaches to people management. Firms must think creatively about how to link culture with conduct. Modern theories of behavioural science suggest that while financial incentives and disincentives undoubtedly influence individual behaviour, intrinsic motivators such as goals, positive relationships and moral identity must also be considered. Although a remuneration approach linked to customer outcomes is helpful, it is not the key to cultural reform.

R&C: Where should culture sit within the governance structure of an FI?

Hill: Ownership of cultural change sits with the board and senior management. As the body responsible for defining corporate values, objectives and strategies, the board plays a crucial role in holding senior managers to account for the promotion of good culture – a role which is particularly important following the introduction of SMCR. Much is made of the importance of setting the correct 'tone from the top'. While it is of course essential for boards and senior managers to use value statements and corporate communications to promote desired behaviours, culture cannot simply be imposed upon an organisation. Leaders should recognise that culture is shaped by the interactions at every level of the organisation and should empower middle managers to translate organisational expectations as appropriate. A sustainable culture can only be embedded if individuals can see their peers, as well as their leaders, embodying the firm's stated values.

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R&C: How can FIs measure whether their conduct and culture has improved?

Hill: Conduct metrics are nothing new to the financial services industry. Many firms collect data regarding the number of disciplinary incidents or completion rates for mandatory compliance training courses. Measuring the success of cultural change requires more insightful management information (MI) though. For example, if the number of recorded breaches increases, is this a reflection of an improved culture of transparency and disclosure, or of disregard for compliance policies? To measure culture, firms should combine traditional conduct metrics with data obtained through observation, surveys and surveillance. The rise of RegTech presents exciting opportunities, with some firms already capable of drawing trends and predictions regarding specific behaviours from the unstructured data found in electronic communications. However, data regarding behaviours, employee perceptions and customer outcome only facilitate the measurement of cultural change when distilled into a concise, clearly defined set of metrics, tracked over time and regularly scrutinised at appropriate governance forums.

R&C: Looking ahead, are we still going to be talking about conduct and culture in five years' time?

Hill: The number of open FCA investigations hit a record high of 504 in April 2018. While customers continue to experience unfair outcomes, culture and conduct will remain major talking points in the financial services industry. The FCA's March 2018 discussion paper highlights several areas of consensus, such as the importance of incorporating behavioural science in the assessment of culture and the pitfalls of rule-based methods of enforcement. However, it also raises numerous questions requiring further investigation. To what extent can culture be reliably measured? Is cultural change a top-down or bottom-up exercise? What are the limitations on senior managers' accountability for fostering a good culture? Firms and regulators alike are only just starting to tackle these questions and we should expect to see more sophisticated approaches to the challenge of linking conduct and culture in the coming years. R&C