

Transforming Culture in Financial Services — The FCA Renews Its Approach

New FCA Discussion Paper demonstrates how the regulator’s thinking in relation to culture has evolved.

Introduction

In [Discussion Paper \(DP\) 18/2](#), the FCA has taken an unusual approach to a topic that has received considerable attention in recent years. Instead of introducing new rules, or issuing guidance, the FCA has collated a series of essays (28 of them, covering 85 pages) in order to stimulate further debate within the industry on the importance of culture, and how to improve it. In the overview section of DP18/2, Jonathan Davidson, FCA Director of Supervision, pulls together the key themes and sets them out along with the FCA’s latest thinking.

The FCA’s Historic Position

The FCA has a long history of commenting on the importance of culture in financial services, and has been quite consistent in its views that:

- Culture is the way that things get done within an organisation
- The tone from the top is very important
- Culture can be measured if firms try hard enough, and the FCA is able to measure it too
- Individual accountability is an important aspect of managing the culture within firms

DP18/2: Modifying the Traditional Approach

The overview contains some of the FCA’s traditional thinking. For instance, the statement “the financial services industry, in particular, has demonstrated instances of rate-rigging, rogue trading and mis-selling in the last ten years since the global financial crisis. Despite record fines, increasing investigations and an expanding compliance industry, misconduct remains. Why? What have we not learned?” This statement could have been made at any time over the last ten years — indeed, remove the reference to rate-rigging, and it could have been made at pretty much any time. The FCA also repeats its favourite phrases — that culture is “the way things are done around here” and can be defined as “the habitual behaviours and

mindsets that characterise an organisation". But, amongst the orthodoxy, a number of new observations are made and emphasised.

The FCA clarifies that its focus is on assessing what management is doing to manage culture, using four of the main drivers of behaviours and mindsets as set out in a [speech delivered by Jonathan Davidson](#) in September 2017:

- A firm's purpose
- A firm's leadership
- A firm's approach to rewarding and managing people
- A firm's governance arrangements

DP18/2 does not go into any detail on how the FCA carries out these assessments, but this is a useful statement so that firms can ensure that they are considering the right topics.

The FCA points out that two fundamental concepts underpin all of its thinking about culture. The first is that the FCA needs to hold individuals as well as firms to account — and in the UK, the Senior Managers and Certification Regime certainly gives the FCA the tools it will need to determine who is to blame for any particular failing. Second, the FCA now acknowledges that "leaders can manage culture even if they can't measure it very well". Previously, the FCA has often encouraged firms to measure culture. For example, in a [2016 speech](#), Jonathan Davidson stated "There are a number of survey methods and metrics being used by firms and others in the field to try to understand the mindsets that are the foundations of culture. We are watching developments in this area with interest".

Indeed, this acknowledgement that measuring culture may be more complex than the FCA had previously indicated is an important theme of DP18/2. Several of the essays address the topic. Measurements are described as merely the "tip of the iceberg", and potentially giving a false level of confidence to management that because they are getting some data, everything must be ok. Instead, the FCA seems to take the view that culture can be sensed, rather than statistically identified. Some data may help, but caution is advised on the weight that should be attached to, for instance, employee engagement surveys.

The FCA also goes further than it has in the past on emphasising the role of middle managers. This is not to detract from senior management responsibility — the FCA clearly still thinks that things can go wrong from the top. But, in addition, even if the right tone is set at the top, that may not be enough given the influence of middle management over conduct "on the ground".

A detailed example is given of an organisation that sets unrealistic targets. Employee-facing customers accept those targets as unrealistic, and do not even try to meet them — their behaviour is not influenced. But middle management are incentivised financially to hit these unrealistic targets, and they pressure employees to hit them. Middle managers "creatively search for what we call structural vulnerabilities, which are placed in the overall performance structure of the organisation that can be exploited to create and conceal fake performance".¹ In the example given, the definition of a sales call was expanded to include emails. Staff were instructed to enter into quid pro quo arrangements with colleagues. Sales data was delayed on entry into a system to prevent it from being identified as a potentially fake call. And so on. Whilst focusing on the impact of middle management is not entirely new, the extent to which the FCA emphasises it in this approach is striking.

Next Steps

Firms will need to take into account the points raised by the FCA in its ongoing work on culture. They may also wish to focus on the “actionable insights” highlighted in the DP by the FCA, such as “applying strategic focus to the continuous process for adapting culture”. Helpfully, at least, the FCA still understands that culture change takes time, and that firms cannot undergo a fundamental shift overnight. As Jonathan Davidson puts it, “Like losing weight, culture change is not an eight-week crash diet...but a whole lifestyle change — an ongoing business priority”.

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Endnotes

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- ¹ Essay 3.5: "The invisible role of middle management — unethical behaviour and unrealistic expectations" (Trevino, den Nieuwenboer, da Cunha).