# Culture in banking

**Background and context**

A focus on the culture in financial services firms is a priority for the FCA. Culture drives individual behaviours which in turn affect day-to-day practices in firms and their interaction with customers and other market participants. Culture is therefore both a key driver, and potential mitigant, of conduct risk. The experience of the past demonstrates that a poor culture can lead to poor outcomes for consumers and markets. This is widely recognised and there has been a considerable amount of work done across the industry to increase the focus on culture.

Ultimately, to succeed in effecting long term culture change, firms and regulators must work together, building on the progress already made. The ultimate ambition we all have must be to have a financial services market which serves its clients in a way that is innovative, vibrant, competitive and clean focussing not just on what happens today but on the long term. Appropriate culture underpins this ambition.

The FCA wants to ensure that firms are managed in a way that reflects good governance and promotes the right behaviours to deliver the right outcomes for consumers and markets. We want senior individuals to feel responsibility for, to be held accountable for, and be appropriately remunerated for, the decisions they make and oversee. Personal accountability of senior management is closely linked to the systemic question of culture and ethics, as those individuals are tasked with setting the "tone from the top".

**The context of the thematic review**

The 2015/16 FCA Business Plan stated we would conduct a thematic review on "whether culture change programmes in retail and wholesale banks were driving the right behaviour, in particular focusing on remuneration, appraisal and promotion decisions of middle management, as well as how concerns are reported and acted on".

We believe that a firm's culture is a key driver of staff behaviour and, in many cases, where things have gone wrong in a firm, a cultural issue was a key part of the problem. The thematic work we planned was not an overall 'assessment' of culture across the sector, nor an attempt to measure cultural changes. It was an analysis of two specific indicators – remuneration, appraisal and progression/promotion decisions taken about middle management/MDs and heads of trading desks; and how staff concerns are raised and acted on. The aim was to focus on the impact that culture change programmes were having on middle management and front-line staff. This review sat within a portfolio of other activities, such as our work to implement the recommendations of the Parliamentary Commission on Banking Standards and on remuneration.

The initial planning for this thematic review covered a sample of retail and wholesale banks and involved two phases of work, beginning with an initial scoping or discovery phase. As explained further below, we decided to conclude the work after this first phase as we concluded that a thematic review would not be the best way to achieve our desired outcome of continuing to support and drive continued culture change across the sector. If we had decided to continue with the review it would have been likely that we would have produced a thematic report in the latter part of 2016. Our usual practice in such thematic reports is to set out general findings and highlight, for the benefit of the sector, examples of good and poor practice that they could learn from.

**Why didn't we complete the thematic review and publish a report?**

There are a number of reasons why we decided not to complete the second phase of this thematic review. It is important to be clear that we have not changed our views about the importance of firm culture and we will continue our work with individual firms.

Prior to commencing the review we engaged with stakeholders including the Financial Services Consumer Panel, the FCA Practitioner Panel, the British Banking Association (BBA) and Banking Standards Board about our plans for the thematic review. During the course of this engagement, we became aware that the Banking Standards Board had begun a piece of work focussing on similar issues and we were therefore conscious that we did not wish to duplicate that work.

As part of the scoping phase, we reviewed information we held internally and also requested further information from certain firms. As we analysed this information in more detail and considered how we could take forward the second phase of the work it became even clearer that each firm has, and needs to have, its own approach. They need to build a strong culture from the top down, leading by example and setting the right incentives that will work in their firm, and their culture. We therefore concluded that conducting the second phase of the thematic review was not the best way to achieve the cultural change required bank by bank. The idiosyncratic nature of each individual institution meant that issuing generalised good and poor practice guidance was unlikely to be of sufficient value to justify continuing to focus our resources on the cross-firm work rather than by addressing this firm by firm with individual institutions. Our initial scoping work did include some useful findings about the areas under review which we have fed back to firms and which we will use in our ongoing work. It did not however amount to an analysis of good and poor practice.

Given these factors, we decided that the best way to support and drive on-going efforts to improve culture is to continue to engage individually with firms to encourage their delivery of cultural change as well as supporting other initiatives outside the FCA. We will also continue to focus on the importance of culture and of incentives and reward in the other work we do whether as part of our thematic programme or in our day to day authorisation, supervision and enforcement work.

**What we are doing**

The work of the FCA has ensured that culture is firmly on the agenda in the boardrooms of financial services companies. Many firms have already done significant work to improve their culture. This cultural change must come from the very top and the tone must be right. It also requires staff throughout a business to understand and accept the values and practices that a firm espouses. This means that firms must ensure that all their processes support and reinforce the culture they want to create.

*Supervision*

Regulation cannot directly deliver an outcome whereby industry serves its clients in a way that society deserves and expects. Only the industry itself can do that – our role is to influence them and ensure this happens. Culture drives individual behaviours which in turn affect day-to-day conduct practices in firms and their interactions with customers.

Many firms have already commenced significant work to improve their culture. We remain committed to ensuring that customers are treated fairly and put at the centre of firms' business models. For culture change to be sustainable, it needs to come from within firms, driven by the commitment of boards and senior management who recognise the challenges and commercial benefits of creating good culture.

We use a range of supervisory tools and methods to engage with firms individually on issues of conduct and culture. For example, in wholesale banks we encourage them to look at five key questions. These questions help us assess how firms identify conduct risks, manage these risks, the support mechanisms in place to improve conduct, the role of the board and executive committee in oversight of conduct, and whether there are any perverse incentives or other activities which undermine strategies to improve conduct[1].

*Accountability*

The Senior Managers and Certification Regime (SM&CR), created in statute following the recommendation of the Parliamentary Commission on Banking Standards (PCBS), is based on the understanding that the banking sector needs to change and that a culture of personal responsibility has to be embedded in firms. The work that we are doing to implement the SM&CR and other recommendations of the PCBS are at the heart of our programme to drive through cultural change in industry.

The SM&CR has accountability at its core. The cultures in financial institutions only exist as a result of the collective actions of individual employees, so driving cultural change is really about influencing individuals to act in certain ways. Professional integrity, accountability and appropriate remuneration are therefore key foundations for this cultural change.

The new regime will ensure that individuals, their employers and regulators know who is responsible for what, and when things go wrong the right people will be held to account. A map showing individuals' and firms' responsibilities will cover the Senior Managers with overall responsibility in a firm, ensuring that the regulators can focus on the individuals whom firms genuinely see as accountable.

The Certification Regime captures individuals outside of this senior layer, but who still have the potential to cause 'significant harm' to either the firm or its customers. Firms will need to put in place procedures to certify that these people are fit and proper, formally reconfirming this at least annually, and we will monitor on an ongoing basis how they do this. It is not our intention to monitor each decision, and these individuals will not be subject to regulatory pre-approval.

We envisage a shift to a culture where senior managers at firms are genuinely accountable for the conduct of the business. Where there are failings, it should be firms themselves who identify them and hold those responsible to account in the first place. A culture of responsibility should permeate the business at all levels, so that everyone is personally responsible for how they do their job and the decisions they make that affect customers and markets.

*Remuneration*

We have changed our Remuneration Code to encourage more effective risk management and to better align individual decision making with good standards of conduct for dual-regulated firms. Key changes include introducing longer deferral periods, so that Senior Managers must apply deferral periods of at least seven years to variable remuneration rewards and all other Material Risk Takers must apply deferral periods of at least three to five years. The rules on clawback have been tightened, extending the seven year period to ten years for PRA-designated Senior Managers if the firm has been notified of a regulatory investigation or commenced an internal investigation which is likely to lead to the need for adjustments to remuneration.

We have also published guidance on performance management which looks at the undue pressures that may be placed on front line staff through performance management and the mis-selling risks this can create. We have made it clear that firms should not simply replace bonus schemes with other performance management measures which can put undue pressure on sales staff and are just as capable of causing poor sales practice, increasing the risk of mis-selling.

Once embedded, these changes should go a long way to addressing some of the root causes of the failures we have seen.

[1] Speech by Tracey McDermott to the British Bankers Association, 13 July 2015.

*Conduct Rules*

The Conduct Rules create clear expectations for all staff. They include acting with integrity and treating consumers fairly. Firms are required to monitor and record any breaches of the Conduct Rules. These rules will help to shape the culture, standards and policies of firms and raise overall conduct standards in the industry.

*Whistleblowing*

We have also issued final rules on whistleblowing in deposit-taking institutions and other firms. These rules aim to improve whistleblowing within firms and to encourage a culture where individuals feel able to raise concerns and challenge poor practice and behaviour. The changes include requiring banks, building societies and insurers to appoint a whistleblowers' champion, requiring firms to tell UK-based employees about our services, and requiring firms to inform us of cases in which an employment tribunal finds in favour of a whistleblower when the finding relates to a claim that the whistleblower was victimised.

**What's next?**

We will continue to carry out the extensive work on accountability, incentives, remuneration and performance management we have referred to above. We will also continue to engage with individual firms and other bodies building on the collaborative and constructive dialogue that currently exists, and are planning to convene a number of sessions bringing together individuals from regulation, banking, other industry sectors, consultants, academics and other key stakeholders for the purposes of better understanding how to achieve long-lasting cultural change.

We will continue to support and drive culture change in the most effective way which we believe is by:

1. Focusing on engagement with individual firms through supervision.
2. Using our position as the conduct regulator to promote constructive discussions with various stakeholders including industry and consumer groups.
3. Offering support to the increasing number of initiatives outside the FCA on banking culture, such as the work being done by the G30 and by the BSB.
4. Continuing to demand high standards of conduct, backed by supervision and enforcement action if necessary, such that an appropriate culture remains a top priority for banks' management.