**Inside FCA Podcast: Interview with Jonathan Davidson and Jayne-Anne Gadhia on Culture and SMCR**

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| **OI:** | Hello and welcome to the Inside FCA podcast. I’m Ozge Ibrahim and today I’ll be talking with the FCA Executive Director of Supervision, Retail and Authorisations, Jonathan Davidson, and our guest, Dame Jayne Anne Gadhia, a former Chief Executive of Virgin Money and one of the best-known women in financial services. Today, we’ll be discussing the FCA’s work so far to improve culture in financial services and the Senior Managers and Certification Regime, or SMCR, which will replace the Approved Persons Regime and be extended to all FISMA authorised firms on the 9th December this year. |
|  | Jonathan, if we can start with you. Why is improving culture in financial services a priority for the FCA? |
| **JD:** | Well, as a supervisor of financial services, I’m looking at what is the root cause of things that go wrong, things that cause harm in financial services, cause harm to consumers, cause harm to market integrity and so on, and there are two things I think are fundamental root causes. One is the business models and strategies of firms and the other one, which probably sits even underneath that, is the culture of financial services. And when I say ‘culture’, what do I mean by that? I think it’s if you like the characteristics mindsets and behaviours that are typical for each organization and it varies hugely between organisations. So, it’s a huge priority for us to address root causes, not just deal with the symptoms. |
| **OI:** | And what is a healthy culture, what does it look like? |
| **JD:** | In our discussions and research, what we come across is probably two things which characterise across all the different kinds of healthy culture across many, many firms the two things they have in common: I’d say one of them is that they’re purposeful. Our people are there because they want to make a difference and it’s not just about the money and the second thing I’d say is it’s a culture of what I call psychological safety. Some people calling it a ‘speaking up’ culture but one of the things I’ve really heard as I’ve gone around is it goes a lot beyond a speaking up culture, it’s a listening up culture, where it’s not just about people calling out wrongdoing but it’s actually about people listening to one another, taking the advantage of diversity to get, if you like, innovation and spotting problems by having multiple different perspectives and that leads to healthy outcomes for everybody. |
| **OI:** | Jayne Anne, what’s been your experience with creating healthy cultures? |
| **JA:** | Well, I think over the years, I’ve experienced some unhealthy cultures and sometimes it’s easier I think to build from bad experiences that one’s had rather than just sort of create something from scratch. So, as Jonathan was talking, I was remembering that many, many years ago, I worked for Norwich Union which is now Aviva, the insurance company, and it was as long ago as 1994 and they had been closed down actually by a predecessor of the FCA for mis-selling life insurance policies and I’d been asked to try and get the show back on the road and I managed to do that and I thought being quite young at the time that having been successful, I would be the person that was offered a big job to try and, you know, take the business forward and I didn’t get this big job. And the guy that was running the Life Insurance Society at the time took me out to dinner and said, ‘I’m really sorry that you didn’t get the job’ and I said, ‘Why was it?’ And he said, ‘Because you lacked two things that are necessary in running an insurance sales force.’ And I said, ‘Really, what are they?’ And he said, and I’m not sure I’m allowed to use the exact language, he said, ‘You lack a thick skin and bullshit.’ And I remember even then, and I was quite young at that point in time, feeling devastated that those appeared to be the characteristics that were required to run a business and of course it was the reason that that business had got into travel. |
| **JA:** | So that was the first thing that made me realise this is not a healthy place, I want to move on and I moved on actually to Virgin at that particular point in time. I joined Virgin and after a few years there, that business was taken over by RBS and I was at RBS just until 2006 when the financial crisis started and in my view, the financial crisis, you know, there are lots of causes of it when we write the history of it but one of the big causes would be unacceptable culture, unacceptable ways of doing business in my view, not just at RBS by the way but for a lot of the big financial institutions at the time where Win/Lose culture was something that was so important where people wanted to make money at all costs, Jonathan’s alluded to that, where looking at shareholder returns rather than doing the right thing was something that was praised rather than not and actually where CEOs didn’t really understand some of the complex work that they were doing. |
| **JA:** | I remember I was lucky enough to be mentored at the time by a wonderful man called Sir Brian Pitman who used to be the CEO and then the Chairman of Lloyd’s Bank and I remember him saying to me at the time that ‘The problem with the financial crisis, Jayne Anne, is that no CEO understands what a CDO is’ and a CDO is one of the instruments that caused the problems in the crisis. So I think for me when I then went back after in 2007 after those sort of experiences to Virgin Money, one of the things that I and my team wanted to do was to try and learn from some of that and think about how do we build something that’s better or more healthy to use Jonathan’s earlier expression, something that we can all feel proud of. And we created a culture that we referred to as ‘making everyone better off’ and the idea there was to make sure that every decision that we took was going to be for all stakeholders. So, we wanted to make some profit for shareholders of course, the company had to perform, but as well as that we wanted to give customer good service, we wanted to give people good jobs so they could build on their own careers, we wanted to have good relationships with corporate partners so that we wanted Win/Win rather than Win/Lose relationships and we also wanted to do some good in our communities because we felt that business had become a bit disconnected from the local community. |
| **JA:** | And the thing that was brilliant there was that building that sort of culture enabled us, I think, to create a team of people who were very much more aligned with the overall objectives in the organization rather than people who were looking at bits of the organization to make money in a way that they could and it felt healthy and, you know, the really good news was it created, I hope, a thriving and profitable business. |
| **OI:** | So, Jonathan, if we go back to the culture change work of the FCA, what’s happened so far and what are you planning to do in terms of achieving a healthy culture and passing this message on? |
| **JD:** | Well, this is a very unusual challenge for a regulator. How do you deal with something as soft and hard to pin down as culture? And very early on, we’ve concluded that we weren’t going to try and legislate and write rules for specifying every firm’s culture, it’s just not possible. So what we have concluded is that what we need to do is create an awareness of the advantages of having a healthy culture and the only set of rules that we’re really writing which address culture, that address behaviours, are the rules that are sitting inside the Senior Manager and Certification Regime and I’ll talk more about them later. |
| **JD:** | But essentially, we believe that the drivers of a healthy culture are fourfold. First is having a purpose which is, if you like, as I said earlier, purposeful but also that it’s authentically realised throughout the company and everybody knows what it is and so it’s not just something that’s written on the door or on the wall in the boardroom. The second thing, and this is crucially important, it’s about leaders acting as leaders and not just decision makers at the top – it’s about them actually leading their people, setting a good example, making sure that there are the incentives for the right behaviour across the organisation and this is a core component of the Senior Managers Regime. Indeed, that’s why it’s called the Senior Managers Regime is that we’re saying that leaders need to step up and be leaders and we have a legal description that says they are responsible for taking reasonable steps to ensure that they’re compliant, if you like, in their area of responsibility. That’s a lawyer’s way of saying ‘Step up and lead your organisation – don’t just sit there on the top floor and issue edicts’. |
| **JD:** | And the second thing we said is the conduct rules which I’ll talk about it more in a minute, and there’s only five of them, that say these are the minimum standard for behaviours across the rest of the organisation and the third component I’ll look at, I’ll talk about later, is the certification part which is actually saying essentially you need to be fit and proper and competent at what you do. |
| **JD:** | So, that’s what we’re trying to do, if you like, the only bit of rulemaking which is the Senior Managers, I’m not trying to minimise the important of that but what we’re trying to do is help the industry to understand what does a healthy culture look like, how will I know when I’ve got it, how do I go about getting it and, you know, it’s great for us that we have Jayne Anne who’s actually had some experience coming and talking about how she’s achieved that, what her experience is on creating this healthy culture that we’re after and we hope that more and more the FCA can play this facilitative role of bringing together voices to talk about how we can all get there. |
| **OI:** | Jayne Anne, can you therefore tell us what your experiences have been of embedding the SMCR? |
| **JA:** | Well, it’s interesting because I think that if I'm honest, I’m not somebody that particularly likes rules. I remember all those years ago back at Norwich Union, the guy who was called Ron Carver who used to run the place said when I was very young, ‘The only thing to do with a rule book is to tear it up’. And I remember feeling very challenged by that and realising that the point in a sense I think is that for me, the reason that things like the Conduct Rules and SMR work is that they’re not hard to follow if you behave properly! You know, they’re not things that are there to catch you out, I’ve never experienced that ever in my life before. They seem to me to codify what is good behaviour as business people, professional people and human beings and sometimes I feel slightly frustrated that we need that codified, if you know what I mean, but clearly we do and I think that the codification of it is helpful because it does help to get everybody’s mind straight around what is good and what is bad behaviour if you like. |
| **JA:** | But I do agree completely with Jonathan actually that it comes down to leadership because leaders I think are role models broadly and it’s impossible to say to people, you know, ‘I’m going to behave like this but the FCA rules say you should behave like that, so we’re going to hold you to these rules and not me’ if you see what I mean. So I think that leadership behaviours are hugely important and I do think that having codification of these rules has definitely meant that board members and senior executives, certainly in my experience, have taken much more seriously their responsibility to lead and be role models within the context of that regime and I think that’s what’s really important about it. |
| **JA:** | So, even at Virgin Money years ago, I and my team could talk about good culture and talk about how we should be but it was easier for people to knock that down, you know, whether they were shareholders or board members occasionally. I remember, you know, we had a private equity investor at one particular occasion who was very, very keen for us to be developing the Treasury function as a profit centre and something that we’d learnt from the financial crisis, we felt, was that isn’t the way to run a bank, if you see what I mean. Once the SMR rules were in, I don’t think those people would even have asked – they might have asked about it but it’s much easier to say, ‘Well, we can’t do that because look, this is something specific that we have to think about as senior managers and this doesn’t fit with our interpretation of those rules’. |
| **JA:** | So anyway, I think that’s a longwinded way of saying that I think they’re not – it is not difficult to be compliant and to follow the Senior Manager Regime, it is completely and utterly in my experience the normal behaviour of people that want to run a good business and a healthy culture but the codification of those rules means that when you’re pushed back against, because, you know, people want you to take additional risk or drive more profit in a way that you feel uncomfortable with, they actually give people a bit of a safety net and say my fiduciary duty here with my regulatory responsibility here is something I think about very hard and so it does give people the opportunity both to understand how to behave and to justify that behaviour when they’re challenged in some way. |
| **JA:** | So, I mean, I’ve always been from day one a complete supporter because I think it’s right and relevant for the way in which the financial services system should operate. |
| **OI:** | And how do you think it benefits customers? |
| **JA:** | Oh, I mean, I think that because financial services is so intangible, I think that the financial crisis and other specific scandals along the way has proven that not all customers know explicitly what they’ve committed to when they commit sometimes and so of course there are other rules that mean that organisations have to be transparent and have to offer products in particular ways but I do think that the Senior Managers Regime means that every one of us that’s executive in those organisations has a personal obligation to make sure that products are right for customers and transparent for customers and that we’re looking after vulnerable people and, you know – I think it means that the complexity of financial services has to be unbundled such that customers do understand what they’re buying, do think that they can get good service, do feel that they get the right sort of prices and know that the products that they are getting are likely to be right for them and if they’re not, that they’ve got an opportunity to come back. |
| **JA:** | So I think it directly affects customers and I think where organisations are not prepared to sign up – or I know they have to sign up but you know don’t take to heart the spirit of the rules, then customers should definitely not be dealing with those organisations. |
| **JD:** | I think it’s a terrific description to talk about the Senior Managers Regime and its impact on customers which goes back to my point about, you know, if I was a senior manager, I would hope that I would turn round and say, ‘What’s my purpose, what am I trying to do for customers and how can I do something good for them and how can I avoid harming them?’ and then start thinking about, ‘Well, what does that mean in terms of governance, what does that mean in terms of the training of my people, what does it means in terms of the incentives and the product design’ – all of those things that you could call reasonable steps that follow. |
| **JD:** | And that’s the kind of culture I’m looking for amongst senior managers or call it leaders, it’s the step-up and be a leader. If I could say that I think a lot of the industry is working along the basis of actually let’s carry on as before but let’s try and make ourselves as compliant as possible and I’m not saying that is a bad thing but what I’m saying is that I think that can sometimes leads to huge compliance activity and still mistakes occur because people are going – it’s so complicated, the rules, that I don’t really understand what I’m trying to do and then mistakes occur and it’s expensive and it’s bureaucratic so I think this sort of – the culture amongst senior managers, of leaders who sit there and say, ‘I’m the leader, I need to think about the higher purpose, what we’re really trying to do and articulate it’ and especially if they do it around the customer as Jayne Anne is talking about – I think that would be a great outcome for the culture of financial services coming from the senior manager part of the regime. |
| **JA:** | I mean, I completely agree with that and what you made me think, Jonathan, is I think that organisations who think that the Senior Manager Regime is the remit of the compliance team have probably missed the point entirely. I mean, the compliance team of course need to make sure that it’s being adhered to but the real essence of that regime likes squarely at the heart of the people in the leadership, doesn’t it? |
| **JD:** | Absolutely. |
| **OI:** | So how would you overcome some of these challenges, Jonathan? |
| **JD:** | The Senior Manager part is about leadership and stepping up and actually saying this can be a positive thing for your firm as opposed to just a compliance thing which in a sense is constricting. |
| **OI:** | Jayne Anne, I was wondering how far you think we should go to help the industry get this right? |
| **JA:** | I genuinely think that the fact that the FCA are focusing on culture is hugely progressive and likely to be the most impactful thing that’s been done for a while, if I might say that. Because I do think that if you, you know, if you put good business disciplines into a business, you’re likely to get good business outcomes coming out of it and if the way of making that consistent across large and small organisations is the Senior Managers Regime, then I think it absolutely should be something that’s at the core of the rules that the FCA are implementing and supervising. So, yes, I think it’s good. |
| **OI:** | Turning our attention to the Conduct Rules now, Jonathan, can you explain what the Conduct Rules are? |
| **JD:** | So, the first one is act with integrity. The second one is act with due care, skill and diligence. And the third is essentially treat customers fairly. The fourth is be open and honest with your regulators and the fifth is observe proper standards of market conduct. Now, those aren’t very onerous and most people when they say, ‘What’s the deal with these Conduct Rules, these five Conduct Rules?’ they’re saying ‘Aren’t those already everything that people are doing?’ What I hope though is that the Conduct Rules become in a sense almost a pledge and that when you’re asked to do something which is in breach of those, instead of saying, ‘Well, that’s what my boss told me do’, you say, ‘No, actually you’re asking me to break the rules’ and actually people, not just the leaders stepping up here, it’s every employee in financial services steps up into the spotlight, if you like, and says, ‘No, I am an ethical person, I abide by these Conduct Rules’. |
| **JD:** | But my question is does every employee know what those Conduct Rules mean for them, do you think? |
| **JA:** | I doubt it, I’m afraid, although I don’t know but I doubt it and the reason that I say that is, I mean, to be honest, Jonathan, even I couldn’t have trotted off those five rules in the way that you just have done although having heard them, of course, they all make complete sense and again I just think that’s the way of doing good business. |
| **JA:** | We tried to, we at Virgin Money tried to align people through this culture of making everyone better off which I hope would have meant that most of those or if not all of those aspects of conduct would have been covered but I think where the most important I think for everybody probably beyond financial services but definitely in it, is to take accountability, personal accountability. |
| **JA:** | And the thing that’s really interesting to me is that in challenged cultures, and for challenged leaders, right, I mean, I’ve been through this myself in a negative way, if you like, I think what a lot of people say wherever they fit in the organisation is, ‘I need more empowerment’. And I think senior people have often felt it’s difficult to empower more junior people because the senior people feel they’re accountable when it goes wrong, if you see what I mean. And I think throughout the organisation, it’s really important to help people feel both empowered and accountable because then that makes us all feel like we’ve got real vested interest in getting things right. Sometimes I think people feel either they’re accountable and not empowered or empowered and not accountable, and those two things that aren’t aligned I think can create some of the gaps that you might be concerned about. |
| **JA:** | But I also think that where people are properly empowered and accountable, the culture’s healthier because everybody wants to know what they should be doing and wants to get it right and is going in a similar direction. |
| **JD:** | So I completely agree with that and in fact I always actually describe the SMCR not as the SMCR regime - internally and every time I go out and talk to firms, I call it the Accountability Regime for exactly that reason. And I guess one of the things that I would love to have happen is that people have a sense of the purpose of what I’m trying to do, every single person in terms of their job, what does ‘good’ look like so that they can be safely empowered, if you like and that they also get the training and the competence building that comes out of it. |
| **OI:** | Jonathan, can you tell me about the certification element of SMCR? |
| **JD:** | Well, the certification element is one where instead of the FCA authorising individuals to perform, if you like, high customer impact roles and judging once at the beginning of their time with the firm whether they’re fit and proper and whether they can do the job, we’re actually handing it back to the firm. So senior managers have to take accountability for making sure that people are fit and proper and they can really do their jobs well, not just at the beginning but annually. So what I hope it leads to is a culture where people think about their jobs almost like as a professional, they have a continuing professional development approach to their careers, they need to stay up, they need to stay competent because my perception is they’re not just culture in terms of intent, it’s also culture in terms of competence, things that cause harm are when people don’t know how to do the right thing even though they want to do it just as often it is, you know, misconduct in the sense of people doing things deliberately. |
| **JA:** | What you were just making me think about was PPI and so I was working at RBS when, and I was running some of the credit card businesses actually, talking 2005/2006, and it was quite clear that unsecured loans weren’t making money on their own because everybody had cut the prices so much, and so the only way to make this business profitable was to sell payment and protection insurance, and we had three different levels of it – gold, silver and bronze, right? And I remember going to see somebody very senior at RBS back then, 14, gosh, 14 years ago, not Fred Goodwin but somebody very senior there, and saying ‘This doesn’t feel right, this PPI thing’. I can remember exactly where I was, right? And he said to me, ‘No, of course it’s not right but we can’t be the first people to pull it because it would affect our share price.’ I’ve said this on a number of occasions. |
| **JA:** | Now, because I’d said it on a number of occasions, a few years back, a journalist from The Times actually, actually wrote a little sentence and said, ‘Well, if Jayne Anne knew it was wrong, why didn’t she report it to the regulators at that point?’ And I thought, ‘Gosh, that’s a really interesting question of me’ because I was – certainly, I wasn’t very senior at RBS but I certainly wasn’t junior, you know, I reported into the top team, as it were and yet it didn’t feel to me like it was my responsibility having raised it with the very senior team, didn’t feel like it was my responsibility to address that, right, and so I think the question for me for the accountability regime, as we will call it, is do you think, because I do think your work on whistleblowing is good as well and I don’t think that’s gone far enough if I’m honest, but do you think that the accountability regime now would put someone like me in the position where – and don’t forget, I’ve tended to be quite mouthy over the years, it’s quite odd that – it never occurred to me that I should raise it with the regulator, right – do you think that this is something now that people at my sort of level and below in big organisations where they see an issue now feel that they should be able to talk about it outside their own hierarchical structures? |
| **JD:** | Well, you pose a really – you know, that is the billion-pound question, isn’t it? I think I would love it if that was the case and in a way I think the Conduct Rules, I want people to say ‘The Conduct Rules are not there to catch me out, they’re to give me the courage to say ‘I need to call this out’ and coming back to the ‘we want a culture of safety’ – you should be safe to call it out, I think you should be safe to call it out to the FCA, I think, you know – so we really need this culture of safety in the thing and that is the objective. |
| **JD:** | I’m interested in what we can do to help and create that culture of safety. I think part of it is about making sure there are protocols including in the FCA but also inside firms, and we’ve written rules about how to make it safe and how to make there’s a whistleblowing champion and there are policies to protect people and indeed we monitor what’s going on in the banks in terms of what the whistleblowers, what the volume is, you know, what topics are coming up, to make sure that that is being handled properly. |
| **JD:** | So, it’s a huge priority, I don’t think we’ve got there by any means yet but that is ultimately our objective, to make it this sort of purposeful, ‘I am here to do good as an accountable person and I am safe to bring up things which aren’t good’. |
| **JA:** | Well, and I think, you see, for me, the interesting lesson from that was that, which I tried to follow through at Virgin Money with I hope some degree of success but not completely, was that the problem at RBS at the time was everybody was quite frightened about to take up bad news, right, and so what we tried to do at Virgin Money was to say that making a mistake from a compliance perspective wasn’t a problem at all but not telling us about it was the problem, and we created this thing called ‘JAWS’ which was Jayne Anne’s Warning System, and just said to everybody, ‘If you’ve got anything you think we should worry about, just write it down here and the more the merrier sort of thing, so at least we know where you think that there’s an issue’. |
| **JA:** | Now, I would say that that was pretty successful, not entirely successful, people still have concerns about calling out issues but I think it was pretty successful and I just wonder whether as part of the regime, and you’re going to tell me that it exists and if so, I’m sorry, I’ve missed it, as part of the regime, tries to identify or tries to encourage speaking up as a positive even if the subject is a negative, if you see what I mean, because I think that for me is the remaining cultural tension. |
| **JD:** | Yes, I think it is but I think unless you get rid of the fear, then if you like the inspiration can’t come in because the fear blocks out, if you like, the purposeful inspirational part of it which brings me back to something that I'm very passionate about and I know you are and I’d like to get your thoughts on this, which is the thing – diversity and inclusion because diversity is a wonderful thing, as I’ve said, it brings different perspectives, it brings perspectives on things that might go wrong, it brings perspectives on things that might go better, how to innovate, but if you don’t have that safety, the inclusion, the speaking up, being encouraged and in fact expected, then it’s almost completely useless or maybe worse. |
| **JD:** | And when I look across the industry, and people often ask me, ‘What’s your attitude to non-financial misconduct?’, now they define that as things that don’t appear to be breaches of financial services conduct rules affecting customers and markets, and my view of that is that non-financial misconduct, for example, bullying, harassment, sexual harassment, any form of that, creates an unsafe atmosphere to work in and it’s not just wrong, it will lead to poor outcomes, it will not lead to speaking up. So I completely believe that it’s not in that regime that I can tackle that primarily but it is if there is an environment that is not leaders being fit and proper who tolerate that sort of thing. |
| **JA:** | If we started with culture, we should sort of end with culture, if that’s the right way of thinking about it because I don’t think you can have good financial conduct culture and bad personal conduct culture, if you know what I mean. For me, leadership’s about the whole individual and if you are in a place where, you know, that your personal conduct is not going to be satisfactory, then probably your business conduct isn’t and I feel very strongly about that. I absolutely believe that diversity is a major way forwards but what I don’t think, to be slightly controversial is that just putting women on boards is the answer to diversity and, you know, there are women of my age, let’s face it, some of whom have had to behave like men – I have two in particular examples in order to get to particular levels of seniority and that’s not necessarily diverse, if you see what I mean. |
| **JA:** | So, the diversity that I think we should be looking at is a real challenge of different views that come from different social backgrounds, different education, different cultures, different religion etc, as well as gender and sexual differences, if you like, or sexuality differences. And I think if we can get to a place where we properly listen and hear, then we’ll be listening to our customers, not just to our colleagues, because they’ll be representing the views of our customers going forwards. I think everybody deserves to operate in a business world of integrity, I think everybody can get much more out of being in a business that operates for good. I mean, who wants to get out of bed in the morning to go and do bad? |
| **JA:** | We can change and transform people’s lives by the way we are as leaders, the way we are at work and the way that we offer our customers brilliant products and I think that’s definitely worth fighting for. |
| **OI:** | Thank you, Jayne Anne. I was just going to ask you to, bearing in mind everything that you’ve spoken about today, summarise your key advice for firms converting to SMCR at the moment. |
| **JA:** | I think that sometimes I hear boards and firms complaining and challenging about regulation, supervision and, you know, let’s just get on with it. I would urge all firms and all individuals to embrace the regulations and understand the substance of them, as well as the rules, if you like, but the substance is the most important thing. Engage in the substance, it’s all – I mean, my experience has always been that substantively the rules of the regulations in the UK are there to do good things and to create better businesses and to create better customer outcomes. So, embrace them, do them well, celebrate successes and that will be a really good thing for your business. |
| **OI:** | Thank you. Jonathan, is there anything you’d like to add? |
| **JD:** | Well, I don’t think I can really top what Jayne Anne said. In fact, Jayne Anne talked about culture as being the way we want to be in financial services, so I’m just going to steal from Ghandi who always has a good point for this which is ‘Be the change you want to see in the world’. |
| **OI:** | Thank you. That’s all we have time for in this podcast. It’s been great talking with you Jonathan and Jayne Anne, and learning about this priority area for the FCA. Thank you for listening and join us again soon for the next Inside FCA Podcast. |