

## Culture in financial services – a regulator’s perspective

Speech given by Andrew Bailey, Chief Executive Officer, Prudential Regulation Authority (PRA), May 2016

### Summary

In his last speech as Chief Executive of the PRA given at the City Week 2016 Conference before becoming CEO of the Financial Conduct Authority (FCA) in July, Andrew Bailey explains why organisational culture is of the upmost importance to both prudential and conduct financial regulators.

The speech covered:

- What is meant by culture in financial services
- The risks to the good governance of firms, and how these can lead to bad outcomes
- The role of regulators when dealing with the question of culture in financial services
- The significance of the new Senior Managers and Certification Regime (SM&CR) in embedding the notion of personal responsibility at the level of senior management
- How regulators and the regulated can work together to demonstrate the change in financial services culture to the public.

The speech provides an excellent overview of the importance regulators now place not just on the compliance but on the **culture** of firms.

### What is meant by ‘culture’ in Financial Services?

**“ In this respect culture is no different to strategy; where we are today, where do we aspire to be tomorrow, how will we get there and what risks must we mitigate along the way.”**

Mr Bailey describes culture within financial services as something that is not recognisable as ‘a tangible thing sitting on a shelf that can be prodded and changed of itself’, but is instead recognised by regulators as an overall picture of a firm illustrated by a wide range of contributory factors, such as:

- the stance and effectiveness of management and governance
- the structure of remuneration and the incentives it creates
- its risk management
- the willingness of people throughout the organisation to adopt and adhere to the ‘tone from the top’.

It is Mr Bailey’s assessment that there has not been a case of a major prudential or conduct failing in a firm which did not have among its root causes a failure of culture as manifested in the areas listed above, and thus where culture has shaped and encouraged bad outcomes.

## Can regulators prescribe a good ‘culture’ to organisations?

**“As supervisors, we cannot go into a firm and say “show us your culture”. But we can, and do, tackle firms on all the elements that contribute to defining culture, and from that we build a picture of the culture and its determinants.”**

Mr Bailey believes that culture cannot be enforced or changed from outside, but that a ‘good culture’ has to be desired by the management and employees of firms themselves. Regulators can instead *influence* culture by:

- ensuring that firms have robust governance, including appropriate challenge from all levels of the organisation
- promoting the acceptance that not all news can be good and the willingness to act on and respond promptly to bad news
- insisting that remuneration is structured to ensure that individuals have ‘skin in the game’, namely that a meaningful amount of past remuneration is retained or deferred and that senior people are at risk should problems then emerge
- requiring that risk management and internal audit in firms are effective and act to root out poor incentives and weak controls.

## Senior Managers and Certification Regime (SM&CR)

**“There is, let me be clear, no magic bullet to change culture, but the new regime is a big step forward in my view.”**

The Senior Managers and Certification Regime introduced in March 2016 for banks, and the SIMR for insurers which will apply to other firms from 2018, will be implemented across the regulated financial services sector to replace the Approved Persons Regime. Personal responsibility at the level of senior management is central to this new approach to improving individual accountability in the banking sector - just as senior management has a responsibility for the strategy of an organisation, it also has a duty to form and implement a positive culture.

This notion of responsibility contained in the Senior Managers Regime provides the means by which firms can shape their own culture, and the powers with which regulators can conduct supervisory oversight.

## Aligning the public interest of the regulator with the private incentives of the firm

**“... the incentives facing a firm will determine its culture and will determine its success in terms of outcomes. One of the most important elements of the regulatory changes since the crisis is that we have adopted an approach of seeking to align those incentives with our public interest.”**

The principal difference between the role of the regulator and the management of firms should be that although the objective of the former is framed in the terms of the public interest, a sustainable and viable business model for the latter is one that provides an acceptable rate of return to those who take the risk of providing the necessary loss absorbing capacity.

The major regulatory changes implemented as a result of the Banking Act have helped to improve the behaviour of firms towards their customers, who also make up the public interest. However, public opinion of banking and other areas of finance broadly has not recognised these developments – the prevailing wisdom being that the lessons of the financial crisis have not been learned. Mr Bailey argues that culture within organisations and the industry more widely is crucial to demonstrating this change to the outside world.

## **Demonstrating change of culture and restoring trust**

**“I think there should be greater clarity in terms of the outcomes that firms are seeking from the changes they make, how progress is assessed and whether there is sufficient consistency across the organisation.”**

The Senior Managers Regime will be crucial to furthering the goal of restoring trust in financial services through strong culture, but both the regulator and the regulated can work in partnership to demonstrate this culture change. The PRA’s approach as supervisors will be based on the application of judgement set against a framework of rules, and to provide a clear sense of direction and guidance through clear and open communication with senior management about what is expected of firms.

## **Links**

Further information about the new regulatory regime, see the CII briefing:

[http://www.cii.co.uk/media/6436792/insurance\\_simr\\_final\\_rules\\_nov15update.pdf](http://www.cii.co.uk/media/6436792/insurance_simr_final_rules_nov15update.pdf)

For the importance of ethical culture and regulation for firms, see the CII’s materials on Ethical Conduct overleaf

### ***CII Group Policy & Public Affairs 01 June 2016***

The CII is the world’s leading professional organisation for insurance and financial services, with over 100,000 members in 150 countries. We are committed to maintaining the highest standards of technical expertise and ethical conduct in the profession through research, education and accreditation. In 2012 we are celebrating our Centenary as a Chartered body.

For more information on the CII and its policy and public affairs function, including examples of the range of issues in financial services and insurance that we cover, please see: [www.cii.co.uk/policy](http://www.cii.co.uk/policy).

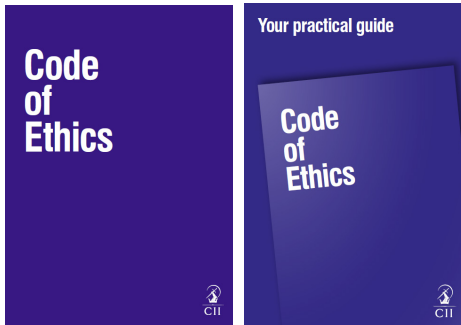
Please do not hesitate to contact Lawrence Finkle, tel 020 7417 3586; email address [Lawrence.finkle@cii.co.uk](mailto:Lawrence.finkle@cii.co.uk)

# Ethical conduct: CII materials



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## CII's Code of Ethics



### Code of Ethics

The code sets down the principles which all members of the CII should follow in the course of their professional duties. Members are obliged to comply with this code.

### Code of Ethics: your practical guide

We have developed a practical guide to the Code - which can also be used as part of a member's CPD activity - to demystify ethical issues with case studies and a simple guide to understanding the five principles which underpin the Code.

CII: <http://www.cii.co.uk/about/professional-standards/code-of-ethics/>

PFS: <http://www.thepfs.org/about/about-the-pfs/code-of-ethics/>

## Ethics guidance Series



### Ethical culture: building a culture of integrity

The first paper in the CII's ethical guidance series proposes a ten-part framework for promoting integrity, which is built around the central principles of setting the right tone, supporting ethical decision-making, promoting openness and managing incentives. [www.cii.co.uk/27326](http://www.cii.co.uk/27326)

### Ethical culture: a practical guide for small firms

Every firm has a culture. It doesn't matter if you employ 10 or 10,000 people: culture influences how your firm goes about its business. It also helps shape how your firm develops and how it succeeds. *Ethical culture: a practical guide for small firms* offers guidance on how to shape culture within your firm. It will help you to understand how you can steer your firm's ethical culture in a more productive and trustworthy direction.

[www.cii.co.uk/27327](http://www.cii.co.uk/27327)



### Ethical culture: Developing a culture of responsibility in a regulated environment

#### NEWLY UPDATED

The creation of the Financial Conduct Authority brought an increased focus on culture and attitudes within firms. *Ethical culture: Developing a culture of responsibility in a regulated environment* considers how financial services regulation, in particular the new Senior Managers regimes, impacts on the development of an ethical culture and highlights pointers from within the regulation which can assist in securing ethical behaviour.

[www.cii.co.uk/39598](http://www.cii.co.uk/39598)



### Ethical culture: Speaking up – information for members about whistleblowing

This guide provides background on the legal and regulatory position on whistleblowing and provides encouragement for those looking to speaking up within firms and across the profession. [www.cii.co.uk/31018](http://www.cii.co.uk/31018) Currently being updated for Q2 publication



### **Ethical culture: Changing the story – reasons to believe**

This paper sets out how it is important to use narratives and examples of ‘doing the right thing’ to help encourage good culture. [www.cii.co.uk/32573](http://www.cii.co.uk/32573)



### **Coming soon to the Ethical Culture series**

**Ethical culture: Marketing** – building customer centric and ethical marketing into processes.

**Ethical culture: tone from the top** – this guidance document, created in conjunction with the CMI, will look at the importance of leadership in setting the ethical tone for an organisation.

## **Online tools**

**Online ethics course** – this course - free to members - introduced in 2010 takes approximately three hours to complete and provides a general introduction and specific content on what ethics means in a business environment.

[http://www.ciihost.co.uk/CII\\_Ethics\\_Oct2014/story.html](http://www.ciihost.co.uk/CII_Ethics_Oct2014/story.html)

## **Exams & training**

The CII’s examination syllabus has ethical content running through its core. Units such as IF1, CF1 and RO1, as well as many others, include ethical components. Our range of regulatory training content also covers the topic of ethics.

## **Thought leadership**

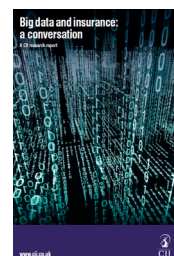
The CII regularly publishes articles on ethical conduct and practice in our Journal and Financial Solutions member magazines. In addition, ethics has been covered on a number of occasions as part of our *Thinkpiece* series. These have included:

Martin Wheatley *Ethics and economic growth* [www.cii.co.uk/29507](http://www.cii.co.uk/29507)

Judith Cork *A social marketing perspective of Treating Customers Fairly*

<http://www.cii.co.uk/31129>

Our wider series of research and policy reports also touch on how the sector should consider the ethical angle of specific issues, such as big data. [www.cii.co.uk/37620](http://www.cii.co.uk/37620)



## **Fellowship & Chartered**

The CII runs a Business Ethics programme as part of its Fellowship programme and we are currently reviewing how a similar approach can be built into Chartered as well as revising practical scenarios and ethical dilemmas.



### **Chartered firms**

As part of the support structure for Chartered firms we have an ethical ‘toolkit’ designed for firms to test and develop their people covered by the chartered membership. This supports the ambition of Chartered firms to aspire to higher profession standards across the sector.

## **The CII Code and Disciplinary Enforcement**

The CII has a full disciplinary process in place to enforce the CII Code for members. Decisions are overseen by a Disciplinary and appeal committee process with final oversight by our Professional Standards Board, which has a lay majority. For full details visit: [www.cii.co.uk/about/professional-standards/](http://www.cii.co.uk/about/professional-standards/)

Qualified CII members please note: reading these materials may count towards your CPD.



All these publications and more can be found at: [www.cii.co.uk/40380](http://www.cii.co.uk/40380)