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GOOD CULTURE WHAT DOES IT LOOK LIKE AND HOW DO YOU GET THERE

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The importance of "culture" has emerged as a key regulatory theme around the globe, as regulators, enforcement authorities and courts seek to promote cultural change in the financial services industry. These developments raise interesting and complex questions for firms around what is the "right" culture, how do you measure whether you have it, and whose responsibility is it to set the organisation's culture? Here, Clifford Chance partners and representatives from the UK's Financial Conduct Authority discuss expectations of firms and what needs to be done.

A culture can be defined as a series of values, behaviours, norms and beliefs shared by a group of people, and the prevailing view amongst regulators and politicians appears to be that the culture in the financial services industry needs to change. A first step on this journey however, is to recognise the barriers to change. Assessing a group's culture involves more than just assessing the values and behaviours of individuals. Individuals behave differently in a group, for an example of this witness how individuals behave when they are part of a football crowd. Changing a group's behaviours therefore involves understanding the complex dynamic of a group – for example, who are its role models and who holds the power in the group.

A second challenge for regulators is that cultural change takes time and whilst there may be many levers that can be used to bring about change, they don't necessarily work quickly. An example of this is the time it took to change cultural attitudes towards drink-driving, notwithstanding the educational and coercive tools used.

Finally, of course, assessing whether a group's culture is "good" is very difficult to measure empirically, thereby making progress hard to chart.

Despite these barriers, as Carlos Conceicao, a contentious regulatory partner at Clifford Chance in London, points out: "In the financial services world, the question is increasingly, what does a good culture look like, and how can a firm make that culture a reality."

The regulator's expectations

Nick Poyntz-Wright, Director of Long Term Savings and Pensions at the Financial Conduct Authority (FCA), who was part of a working group at the regulator looking at the issue of

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culture, engaging extensively both internally and externally, gave his thoughts at a recent seminar. He pointed to recent evidence of poor culture driving some of the bad behaviour in the industry but said the FCA is not trying to tell firms what their culture should look like. "We care about this because we observe that at the root of some of the poor behaviour we can see poor culture," he says. "So it could be that a more effective way of curing the problem and making sure it doesn't happen again is going to be cultural change, rather than treating the symptoms."

As such, the regulator's interest in culture is through the narrow lens of its own statutory objectives, and no broader. Poyntz-Wright says the FCA realises how challenging the topic is for firms, and does not have a magic recipe to provide an answer to what "good should look like". However, he gives an insight as to how regulators assess culture by "joining the dots", collating all the information on interactions with an institution, including discussions with individuals, executives, the board, its customers and its business partners. Using all of that information the FCA pieces together a picture of what makes each firm tick, and what its culture appears to look like from the regulator's point of view.

"We are reflecting that back to firms," he says, "and pointing out our experience of the business, what happened in a particular circumstance, and how board members or employees may have behaved. We know it's just our impression, but we then enable the firm to compare and contrast what we are seeing with how the firm is seeking to develop its culture over time."

If the FCA finds evidence of a culture that leads to poor practice or bad outcomes for customers, it is taking enforcement action.

But Poyntz-Wright emphasises the FCA is not trying to dictate what each firm's culture should be, or to define what "good" looks like. Different firms operate differently in the same way that individuals have different personalities.

In April 2014 the Financial Stability Board issued guidance on indicators of a sound risk culture, pointing to four factors: a positive tone from the top; accountability; effective communication and challenge; and incentives. "I would add a fifth," says Poyntz-Wright, "which is how organisations respond when things go wrong. That instinctive response, and how lessons are learned from mistakes, can be quite informative."

The FCA is not trying to score firms' cultures nor measure progress, but is instead keen to see institutions recognising issues, taking steps to effect change, and assuring themselves that they are moving in the right direction. Poyntz-Wright concludes: "If you think about all the systems and control mechanisms, the governance frameworks – if they are really effective they can and do work. But actually, if you notice firms that have more

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often than not done the right thing, are they the ones with perfect governance and control frameworks? I would argue having the culture can overcome all of that, and if the culture is there to think 'should we be doing this', rather than 'could we do this', that's a very significant risk mitigant."

Incentivising good behaviour

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. This can be done using the "carrot" of incentives and remuneration, or the "stick" of workplace rules backed up by disciplinary action.

The first of these tools has been somewhat blunted by regulators in recent years, with increasing legislation about financial services pay, bonus caps, and the new clawback provisions relating to variable pay introduced in the UK at the start of this year. At the same time, it remains difficult for firms to take disciplinary action against individuals unless there are clearly defined rules in place that they can be shown to have breached. When it comes to culture and ethics, employers often rely on more generic guidance across jurisdictions, which may prove hard to enforce in employment tribunals.

Alistair Woodland, an employment partner at Clifford Chance in London, says firms need to do three things to modify behaviour:

- work out ways of measuring ethical conduct;
- consider non-financial means of rewarding good behaviour and actively build those into review processes; and
- revisit workplace rules, moving away from the very generic and instead grappling with specific rules that make absolutely clear what is tolerated and what is not.

Woodland says: "Effective non-financial incentives might include development of role models within the organisation, such that it becomes clear that good conduct leads to enhanced career progression."

Enforcement and prosecution

Effecting cultural change is a multi-tooled exercise, and enforcement and prosecution have a role to play, with both regulatory actions and criminal prosecutions working to deter misconduct. After considerable public criticism that individuals allegedly involved in the LIBOR scandal were not to face criminal investigation or prosecution in the UK, in July 2012, and in a change to its previous stance, the Serious Fraud Office (SFO) announced that it was formally to accept the LIBOR matter for investigation. The SFO has since made clear that the prosecution of major economic crime does have a role to play, both in sanctioning but also in encouraging good behaviour.

This stance is consistent with the thrust of the corporate offence contained within the UK

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Bribery Act, which came into force in 2011, and which marked a shift towards a new expectation of high ethical standards in organisations, bringing corporations and senior management within the reach of criminal prosecutors for poor policies and procedures. It also brought with it the concept of a "tone from the top", suggesting six principles that should inform ethical procedures in organisations: risk assessment, due diligence, monitoring and review, proportionate procedures, top-level commitment, and communication, including training. Those concepts are similar to the hallmarks of good compliance programmes being discussed in the United States.

Judith Seddon, a white collar crime specialist at Clifford Chance in London, says: "We are also seeing sentencing guidelines that refer to good corporate culture as a mitigating factor, both in the UK and the US. In the UK, the potential difference in fine that can apply to a corporate where there has been a wilful disregard for compliance with no effort to put effective systems in place, versus another that has made some effort that has proved inadequate, could be very significant."

Georgina Philippou is acting executive director of enforcement and market oversight at the FCA. She says culture is one of the regulator's key concerns, and many regulatory initiatives over the last few years have focused on improving culture: "For example, with our initiative on treating customers fairly, we talked about leadership at all levels of the organisation, setting the right tone, driving the behaviour of staff, setting priorities for the business, proper controls, management information being essential, and so on," she says.

Other recent examples of efforts to change cultural behaviour in certain markets include the Retail Distribution Review, the Fair and Effective Markets Review, and the Senior Managers Regime.

In day-to-day supervision work, Philippou identifies certain issues that continue to come through as indicators of a poor culture:

- Multinational firms dominated by an overseas entity
- An aggressive growth model
- Poor conduct and risk controls
- Interaction with regulators handled entirely through lawyers
- Legal and compliance seen as gatekeepers, with no interaction or influence to the board or senior management
- Board has poor oversight, lacks management information
- Senior managers unable to clearly articulate the firm strategy
- Slow or inadequate responses to things going wrong, not learning from mistakes

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She says: "On the enforcement side, Final Notices are a good source of information when firms are asking themselves about their own cultures. The driver for enforcement is credible deterrence, not only changing behaviour at the firm that's the subject of enforcement action, but also more broadly, so all firms can see what they might learn from the conduct of others."

"Despite all the actions we take as a regulator, culture is not something we can tackle alone," concludes Philippou. "We have got a staff of 3,000, we regulate 70,000 firms and 150,000 individuals. We can set a framework and we can describe our expectations, and show you what good and bad look like, but you know your firms best and you know where the risk areas are. We would like to get to a position where we can have good dialogue about something as challenging as culture, and get to a place where we are both moving forward in the same direction in terms of improving it."

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