PATHLIGHT
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Culture in financial services: less conversation more action

Introduction

The FCA's latest publication on the importance of culture, a speech from COO Emily Shepperd, argues that culture directly drives conduct and decision-making, which in turn impacts consumers, markets, and the economy. Shepperd says that when investigating regulatory failures they find, "The same root cause: failings in culture and governance."

Indeed, many of the recent fines and failings highlighted by the FCA, as well as warnings issued to individuals at the top of organisations such as Crispin Odey and Terry Smith all have this common thread.

Despite the admission that failings in culture and governance are root causes, between 2019-2024 only 12% of Section 166 reviews commissioned by the FCA involved a culture element. This prompts the question as to whether the regulator is taking sufficient action on culture and if the industry requires a mindset shift.

Are the regulators holding firms to account on culture?

Regulators have been referencing the importance of culture and good governance for several years. At Pathlight, we reviewed circa 115 articles published in the last 18 months (by the PRA, FCA, FRC, ICAEW, IoD, CGI) that relate directly or indirectly to governance. We found that 30% of these allude to the need for and importance of oversight over a range of regulatory issues, while only 13% overtly reference culture.

There is an argument that culture should form part of every Skilled Person Report - after all failures in almost every regulatory domain can be traced back to either inadequate controls or as is more often the case a failure in behaviour … and we're back to culture!

Why is culture hard to change?

One of Shepperd's key arguments is that culture is contagious whether good or bad - "The good news is that healthy firm cultures are contagious too."

However, this is not strictly true, as from a psychological perspective humans are primed for negative bias.

In evolutionary terms we are primed to respond more quickly and for longer to negative emotion than positive. Psychologists have called this an 'adaptive evolutionary function' - or in simple terms - a survival mechanism. And this pattern pervades in organisational culture. It's easier for toxicity to appear, take root, and last for longer than positivity, tolerance, and inclusion.

Which is why so many firms struggle to address issues of culture. Our clients often don't know where to start. Culture is a complex mechanism much like an ecosystem in nature, where each action has a reaction and often where least expected. Most culture change programmes start with positive intent, but few succeed. Why is that?

Our view is that culture change (or maintenance) requires sustained effort and leadership attention (and an effective board to actively set the tone) and that this is hard to achieve in an environment that is increasingly complex and ever changing. To state the obvious, Boards and Executives have many demands on their attention and the link to, and business case for, culture is not always obvious or easy to articulate. We have found that our clients can shy away from addressing culture issues head-on for fear of uncovering more/unexpected problems. Instead, they often do what they can to avoid further scrutiny - completing a 'checklist' of documents and policies.

Firms also grapple with what support they need in this space. Regulatory experts will focus on regulatory compliance, culture experts will focus on culture, but it is the overlap between the two that is the most challenging for organisations to conceptualise and deal with. The areas of governance, board effectiveness and culture are inherently connected and interdependent.

Do we need a mindset shift?

Given the FCA's commitment to healthy firm culture as a regulatory concern, it could be argued that there needs to be a fundamental shift in mindset around culture in the financial services sector. Firstly, it's not as easy to measure or quantify as most other aspects of regulation, such as fraud, or systems and controls. Secondly, there needs to be an acceptance both from regulators and firms that changing and improving culture is not a fast fix - it takes a significant investment of time and resource and most importantly sustained leadership attention. Nor is it an easy fix - it can be a difficult challenging process which may lead to uncovering other issues along the way. Finally, the incentives for addressing culture (other than avoiding regulatory scrutiny or trouble) often feel intangible and nebulous despite the commonly acknowledged business case that better cultures lead to better outcomes.

Having said all this and despite the obstacles in the way, we strongly believe now is the time to stop talking about and start acting on culture. In part this is because cultural change takes time, but also acting now will get you ahead of the game and prepare your firm for when the regulator begins to catch up.