Rebalancing act: how should firms approach the push for growth and greater risk-taking?

Introduction

The Government and policymakers have been clear in their view that regulation, particularly in the financial services sector, has been too restrictive. A recent policy paper from the Treasury, on its approach to ensuring that regulators support growth, promised that administrative costs for businesses would be cut by a quarter before the end of the current Parliament.

The regulators have been supportive of this agenda but also clear about the trade-offs that the push for growth entails. They have repeatedly advised that it will involve allowing financial services companies to take more risks. The Financial Conduct Authority's (FCA's) new five-year strategy made this explicit, with a focus on 'rebalancing risk' and an acknowledgement that there needed to be more 'focus on risks that regulation should allow in the context of our current environment.'

The Prudential Regulation Authority's (PRA's) business plan for the next year acknowledges its role in supporting competitive, dynamic and innovative markets, as part of its duty to facilitate international competitiveness and growth. Nonetheless, the PRA is also clear that it will continue to focus on identifying and addressing emerging risks, horizon-scanning and identifying emerging trends in the sectors it regulates.

While the two approaches are broadly aligned in that they both support growth, it is reasonable to ask how divergent the two regulators' approach to risk will be. The FCA's emphasis on rebalancing suggests a greater willingness to allow for some failures in the pursuit of innovation, whereas, as a prudential regulator, the PRA's first instinct will often be to prevent failures.

The PRA's primary concern for stability could lead to a more cautious approach to certain innovations or market developments that the FCA might be more willing to explore. Dual-regulated firms in particular may therefore start to feel the inherent tension between these two impulses.

The regulators' approach: Could culture be the answer?

The regulators can be expected to lean on existing rules covering behaviour to bridge the gap between stability and risk. They will be concerned that as companies adopt more risk-taking, the chance that negative behaviours are tolerated or ignored in pursuit of innovation and growth rises. Over time, this compounds to create a poor culture, leaving consumers to suffer the consequences of egregious risk taking when things go wrong.

Both the Senior Managers and Certification Regime (SMCR) and the Consumer Duty were implemented to ensure that firms embed strong cultures at senior level and more widely. Protecting consumers from harm arising from poor company cultures remains the regulators' primary objective, particularly in the case of the FCA.

Work by the FCA to reform SMCR, and make it more efficient and outcomes-focused, shows that where regulators are concerned about greater risk-taking, they can be expected to look to company culture as a bulwark against irresponsible or excessive behaviour. In a recent speech, Emily Shepperd argued that failures in governance and culture were the root causes of most failures in firms' conduct.

What firms can do: Hiring for growth

Boards need to be prepared for closer scrutiny regarding their firm's culture, and will be under pressure to ensure it encourages decision-making that aligns with both regulatory expectations and business objectives. Navigating the complexities of increased risk-taking with ongoing regulatory requirements will be a complicating factor as they provide the necessary oversight and challenge of their executives.

An obvious question that arises is whether companies have the right people in the right roles for now and for the future, and whether their succession planning or appointment processes are robust and in-depth.

Appointment processes should be fully integrated as part of a broader strategy; firms need to ensure they continue to appoint people with a balanced profile to key roles, in order to mitigate for a greater degree of risk-taking. When making hiring decisions, boards should be clear in their expectation that cultural competencies will be considered alongside technical qualifications. Effective Leaders need to be broad and versatile, in order to be able to determine the right course of action in a given situation. Versatile thinking enables leaders to rapidly adapt their approach to different markets, cultures and business challenges. Firms should be looking for evidence of ethical decision-making, broad consideration of both risk and innovation and the interplays and trade-offs between them, collaborative leadership and openness to providing and receiving challenge.

The UK's move towards a regulatory framework that places greater emphasis on innovation and growth is both a challenge and opportunity for firms. The benefits of greater innovation and faster growth are clear. For boards, there is an additional opportunity to show leadership by proactively managing culture. In doing so, they will make their firms ready to pursue growth opportunities while protecting market integrity and their consumers.