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Financial regulators need cultural change to avoid another crisis

Britain's financial regulators must change to avoid sleepwalking into another financial crisis that will have a devastating effect on our economy and political system, according to a new report by Cass Business School for New City Agenda.

Headline findings

Unless we change the culture of regulators, we will be sleepwalking into the next financial crisis: This will have a devastating effect on our economy and political system. Crucial change following the 2008 economic crash is already being watered down.

The Prudential Regulation Authority (PRA) and Bank of England need to go much further to improve transparency and reduce group think: There have been significant efforts to improve by both organisations, notably the 'One Bank' initiative and the 'Open Forum'. However, both institutions need to improve efforts to engage with the public.

New Financial Conduct Authority (FCA) chief executive Andrew Bailey will need to demonstrate his independence from politicians and the financial industry and prioritise cultural change. Leadership changes and the perception of political interference are in danger of making the FCA into a timid and cowed regulator.

Politicians should support cultural change and tackle the culture of secrecy in UK regulators: Politicians must reform financial legislation so regulators are transparent and can be held accountable. Government must also appoint diverse leadership and board members.

Read the full report here.

The Most Reverend and Right Honourable **Justin Welby, Archbishop of Canterbury** and New City Agenda Advisory Board Member said:

"New City Agenda's report into cultural change in the UK's financial regulators is an important piece of work which reminds us that restoring trust requires regulators to practise what they preach. The report sets out clearly the progress made by the FCA, PRA and Bank of England and where improvements are still needed.

As the FCA has demonstrated with its action in the payday lending market, financial regulation can play a key role in protecting consumers. Regulators also need to ensure that their culture promotes access to financial services and supports the development of smaller community institutions and new entrants.

I commend this report and encourage all those who care about developing a financial regulatory system which prioritises the needs of society to read it and act on its recommendations."

New City Agenda Non-Executive Director **Lord Sharkey** said:

"The New City Agenda report serves as a warning against the culture of box-ticking which contributed to the financial crisis, allowed widespread misconduct to occur and let bank executives escape sanction. Andrew Bailey, the new CEO, has a unique opportunity to put cultural change at the heart of his plans for the FCA. It is encouraging that he has prioritised creating a clear mission for the FCA and ensuring that it can be held accountable for progress. It is vital that this process of cultural change in the FCA is consistent and helps restore confidence in the regulator."

The report's author, **Professor André Spicer**, Professor of Organisational Behaviour, Cass Business School, said:

"Britain's financial regulators must change to avoid sleepwalking into another financial crisis that will have a devastating effect on our economy and political system. If we want to avoid this, just making minor tweaks to the ever expanding rule book is not enough. We need to ensure a meaningful change of culture at our major financial regulators – they must practise what they preach. There is evidence of positive change but more needs to be done – or there is a big risk these important transformations will be derailed."

The researchers interviewed current and former staff at the regulators together with stakeholders from large and small financial institutions, consumer and SME groups and regulatory experts. The report includes the reactions from staff at the regulators to the cultural change programmes and the perceptions of external stakeholders.

The report finds:

Stuck in regulatory spin-cycle: Following a crisis, politicians respond to public outrage by introducing new legislation and more detailed regulation. However this new regulation is being progressively watered down. This lays the foundations for the next crisis.

A deep seated culture of box-ticking: The UK's regulatory system is costly, complex, centralised and captured. The administrative costs of regulators are now over £1.2 billion a year – six times what they were in 2000. There are over 13,000 pages of rules, guidance and supervisory statements published by the FCA and PRA. The FCA handbook costs £3,641, the same as a second hand Mini Cooper. This creates regulation which is both bureaucratic and ineffective.

From rhetoric to reality: The Bank of England and the PRA sought to transform their cultures through the 'One Bank' initiative and have made steady progress. The FCA also made piecemeal efforts to change its culture and was blown off course by pressure from powerful stakeholders.

Forgetting the lessons of the crisis: The FCA scrapped its review of bank culture and is failing to make effective use of its new powers. The CEO of the FCA was removed in what was widely perceived to be a political sacking orchestrated by the Treasury. The PRA is disagreeing with Sir John Vickers on extra capital as it has an unevidenced faith that its supervision will stop banks taking excessive risks. Weakening rules designed to hold senior banking executives to account is the fastest example in over 300 years of watering down regulation following a crisis.

External perceptions: Stakeholders viewed the Bank of England and PRA as high quality regulatory agencies. However some stakeholders thought they lacked transparency and could be closed and even arrogant. Stakeholders were less positive about the FCA. They pointed to the variable quality of staff, excessive box-ticking, a culture of secrecy, a lack of willingness to use new powers granted by Parliament, a lack of clarity about what the regulator was trying to achieve, a lack of independent evaluation, internal silos and poor engagement with small players in the financial industry.

Internal barriers to cultural change: Within the Bank of England / PRA, we found that the 'One Bank' strategy received a mixed assessment from employees, with some stating that it was not yet having a positive impact on the way they worked. Within the FCA we found that employees felt they had been better supported to take a more proactive approach but this was in danger of fading. We identified some significant barriers to change at the FCA including bureaucracy, silos in the organisation, lack of opportunities for career progression, and internal and external pressure on the organisation.

Recommendations

Bank of England / Prudential Regulation Authority (PRA)
The Bank of England and the PRA should conduct a transparent and independent assessment of the progress made with their cultural change programme and have it independently audited. The Bank needs to continue its efforts to improve on two core aspects of its strategy: 'openness' and 'accountability'. This means extending engagement with the public, beyond the closed circle of the financial sector. The Bank also needs to tackle group-think by doing more to encourage internal and external challenge and independent thinking. The PRA also needs to better acknowledge the interactions between misconduct and prudential issues and that significant bank misconduct can have issues for financial stability.

Financial Conduct Authority (FCA)
The FCA should ensure it does not get distracted from its attempts to institute a new culture.
This means developing a new comprehensive programme of cultural change, establishing the key purpose of the regulator and developing the metrics which will be used to measure success. Senior leadership must demonstrate independence from politicians and the industry and provide support for frontline staff to take a more proactive approach. The FCA must make use of the new powers to name and shame misleading adverts, secure redress for consumers and take action against senior executives. It should set up an Independent Evaluation Office as exists within the Bank of England.

Policy makers
There is an urgent need to reform the legislation that has allowed a culture of secrecy to develop in regulators by removing section 348 of FSMA. The current framework has damaged efforts to hold regulators accountable. There remains a strong case for introducing a duty of care owed by financial services firms to their customers. Politicians must ensure they appoint boards that provide a diverse range of experiences – beyond people from the financial industries. Finally, they must develop a greater understanding of the views of staff, consumers and SMEs about the culture of the regulator.

Financial services industry
The financial services industry must recognise that those who work in regulators are not inferior to those who work in the industry. They should avoid generic criticism and engage with more focused and specific ways of improving regulations and regulators.

Launch details:
The Report will be launched on Tuesday 25 October from 9.00 – 10.30 am in Committee Room 14, House of Commons. Details here.

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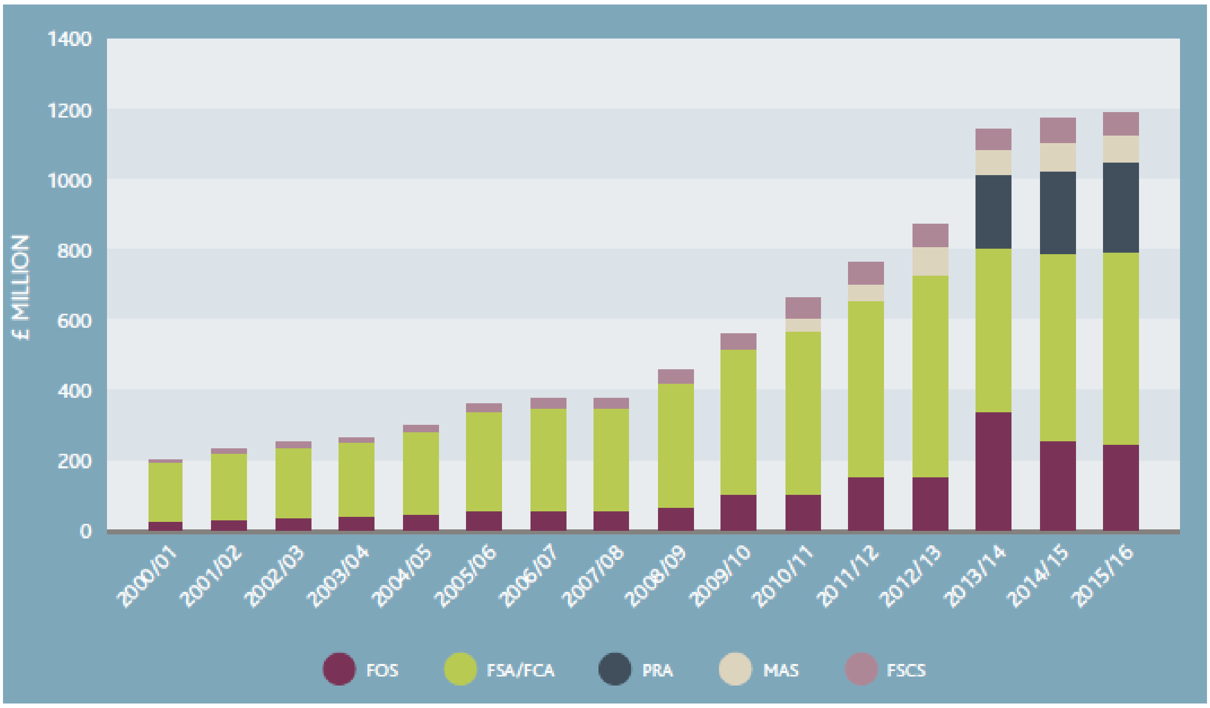
Administrative cost of UK financial services regulatory bodies



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Notes to Editors:

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New City Agenda is a not-for-profit financial services forum and thinktank founded by the Rt Hon David Davis MP, Lord McFall and Lord Sharkey. The Rt Hon David Davis MP stepped down as a director of New City Agenda in July 2016. www.newcityagenda.co.uk @newcityagenda