Culture in Financial Services

Lessons for a never-ending journey

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Foreword

More than a decade after the financial crisis, the financial services industry might be forgiven for wondering whether its rehabilitation is complete. But that would be a mistake. The need to address the very core of how financial services organisations operate – their cultural values and default behaviours – is as pressing as ever and, in many ways, now faces a period of even more heightened challenge.

Time, however, is still of the essence. Every day that goes by without properly addressing cultural failings or weaknesses increases the chance of mishap: an incident that exposes the organisation to regulatory censure, customer detriment or public opprobrium. Every missed opportunity to embed a safer approach to doing business prolongs risk. Covid-19 is a clear example of this, and a test of some aspects of an institutions' culture – particularly those aspects that support operational resilience.

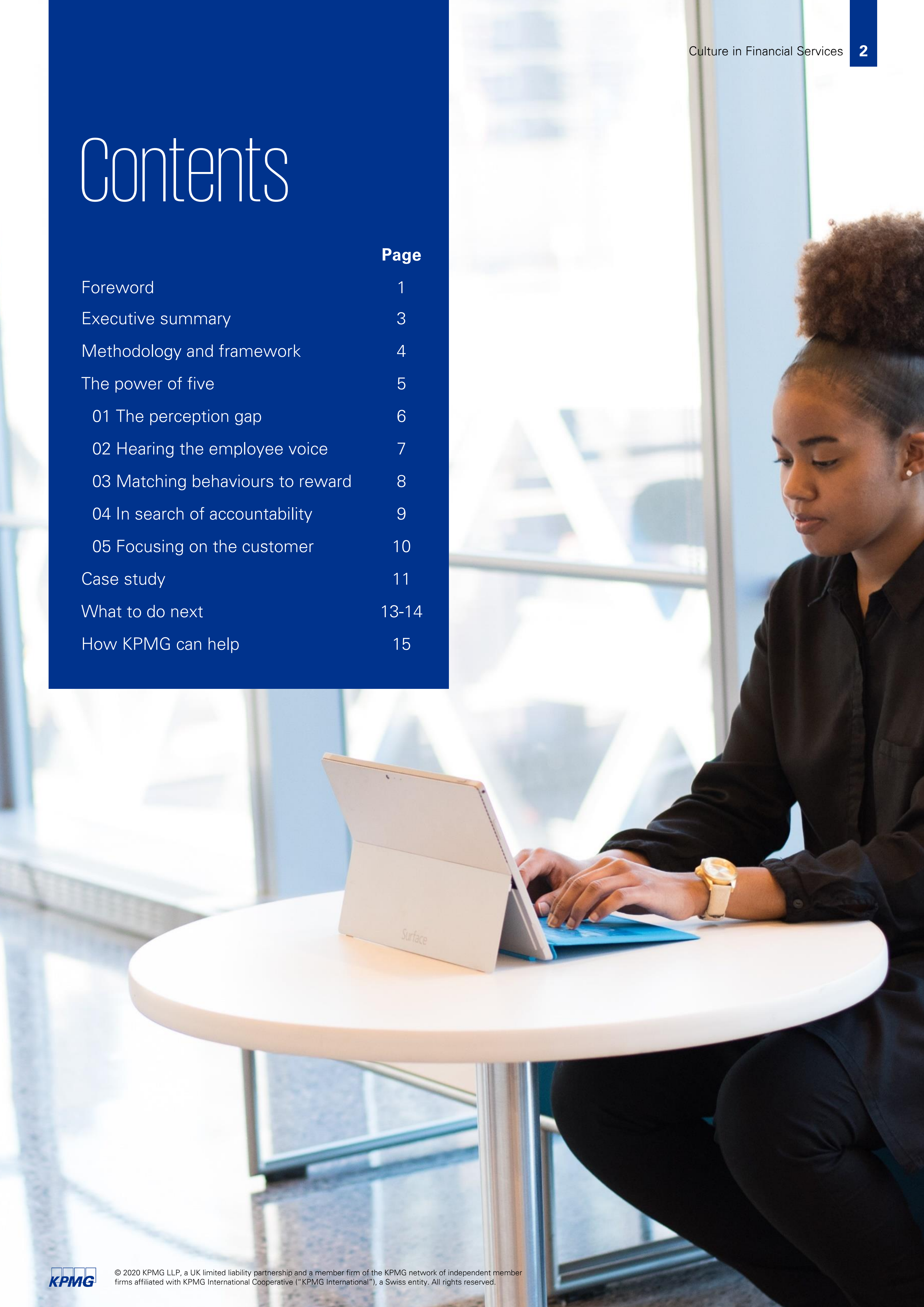
Regulators continue to sharpen their focus on the culture of financial services, developing new controls and checks on those organisations that fall short of the standards required. From the Financial Conduct Authority's plans with the extension of the reach of the Senior Managers Regime, to the recent Dear CEO and Dear Actuary letters in the Insurance sector, to the Financial Reporting Council's reforms of the UK corporate governance code, pressure is building.

At KPMG, we have supported and reviewed the efforts to deliver culture change made so far by many financial services organisations, which have been considerable. In the past decade, we have worked on culture audits with businesses throughout the industry, talking to employees at every level of these organisations to build a detailed picture of where culture is becoming a positive force for good, and where there is still work to be done.

In this paper, we share the insights from this work, drawing on the qualitative and quantitative data we have compiled from across the financial services industry, to set out our view of what organisations' priorities should now be.

One lesson of our work has been that while many organisations recognise the need to change, they don't always know where to start or how to address the challenges to find sustainable long-term solutions. As a result, change is often piecemeal and the impact patchy. For example, while the senior leadership of financial organisations believe they have implemented meaningful reforms, colleagues at lower levels of the business are less convinced, or less sure of what it all means for their day to day work.

Having started the job, financial services organisations now have an opportunity to ensure that wholesale cultural transformation is embedded throughout every level of their businesses, uniting senior staff with more junior colleagues. What has become increasingly clear is that this will be a never-ending journey requiring sustained, consistent and focussed effort.



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Executive summary

Our research, based on a dataset built from work undertaking cultural audits for organisations throughout the financial services industry, identifies those areas where organisations should now focus their attention. Our key findings include:

01 The perception gap

Senior leaders have a higher opinion of the quality of their organisations' culture than their more junior colleagues.

How to tackle this issue?

Implement more robust, sophisticated and timely management information on culture, to ensure senior leaders have a truer picture of organisational culture so that solutions target the root cause of weaknesses.

02 Hearing the employee voice

While progress has been made on employees' perceptions of whether they can raise conduct issues or specific problems, more work is required.

There is more work to do to move towards a culture of genuine listening.

How to tackle this issue?

Provide further reassurance to employees that their views are valued and well-received. Examine current processes, such as whistle-blowing procedures and meeting protocols, to ensure that all opinions are sought and that there are no disincentives deterring employees from making their voices heard.

03 Matching behaviours to reward

Employees commonly find the link between their incentive structures and the cultural values of their organisations fuzzy at best, absent at worst.

There is still work to do on improving the alignment of reward to conduct.

How to tackle this issue?

Continue to tighten reward policy. Build on the good work in the area of taking account of negative behaviours, and expand this to approaches to reward positive behaviours.

04 In search of accountability

Whilst the Senior Managers and Certification Regime (SMCR) has helped clarify responsibilities at senior levels, we still see many examples of role confusion at middle and junior levels. The complexity of overlapping tax, legal, regulatory and operational drivers for operating models is adding to this challenge.

How to tackle this issue?

Prune and simplify entity and operating models where possible. Drive the principles (not necessarily the detailed approaches) of SMCR accountability further down the organisation.

05 Focusing on the customer

Senior leaders have a higher opinion of their organisations' customer centricity than more junior colleagues.

How to tackle this issue?

Find ways to bring those people who do not interact with customers on a daily basis (which may include business leaders) closer to their customers; measure the voice of the customer in real time and feed directly back to staff at all levels of the organisation.

Empower employees engaging with the front line to provide feedback and make suggestions to improve outcomes.

Top 10 tips to enhance organisational culture

- Improve management information on culture metrics for the Board
- Build aspects of culture into individual scorecards for executive leaders
- Design new feedback mechanisms to hear the employee voice
- Strengthen whistleblowing processes and publicise the changes
- Add culture-related criteria to targets in remuneration policy
- Improve alignment of reward for positive behaviours
- Simplify operating models to enable greater alignment between the front line and control functions
- Refine reporting lines to tighten middle-management accountability
- Audit perceptions of customer centricity throughout the business
- Support the development of leaders to help them assist middle managers to reconcile contradictory objectives or pressures

Methodology and framework

This paper reflects the lessons learned during our work over the past six years performing culture assessments for a range of banks, insurance companies and asset managers. Many of these assessments were co-sourced or in-sourced internal audits.

KPMG's model for assessing an organisation's culture is based on a considerable body of inputs including regulatory views, psychological research and practical experience of financial services operations. We carry out this assessment work across five 'soft controls' of culture:

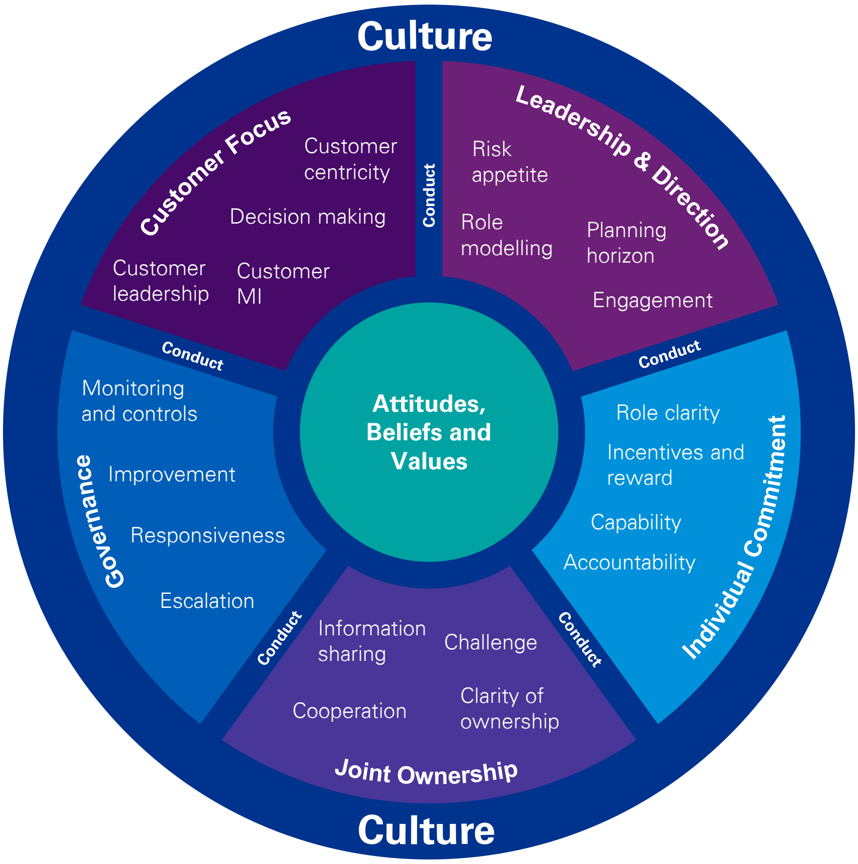
Leadership & direction: How senior leaders set expectations for the organisation relating to good risk ownership and the way in which strategy and direction influence conduct and culture

Individual commitment: The attitude and behaviour of an individual employee towards the management of issues affecting conduct and culture, and the extent to which incentive and reward structures support positive behaviours

Joint ownership: How the different functions of the organisation interact, cooperate, and collaborate, and the extent to which they take on joint ownership and accountability for the management of conduct and culture

Governance: How the organisation responds when conduct-related incidents and breaches come to light, how decisions are made and the factors affecting this, and how lessons are learned to drive future improvements

Customer Focus: The extent to which customer-centricity is embedded in the organisation's culture



KPMG's model employs a scoring system that provides a comparable assessment of an organisation's culture across each dimension of cultural control.

We test the five areas of culture outlined above using a mix of qualitative and quantitative methods, which typically include leadership interviews, mixed staff focus groups, artefact reviews and stakeholder surveys. We then analyse these sources of data to draw out key themes and to make recommendations to the organisation.

In the last six years we have performed these assessments at many organisations, interviewing over 200 people in leadership roles (typically at Board and ExCo level), and engaging with over 1,000 employees through focus groups.

Having applied this consistent model during the course of this work, we have also been able to aggregate a substantial body of data on the culture of the financial services industry and the extent to which it is evolving. It is the analysis of this data that has enabled us to identify the key themes and trends laid out in more detail throughout this paper.

The power of five

The key priorities that financial services firms must now address

01 The perception gap

02 Hearing the employee voice

03 Matching behaviours to reward

04 In search of accountability

05 Focusing on the customer

1. The perception gap

Senior leaders are consistently more positive in their views of culture within their organisations than their more junior colleagues

There is a significant gap between senior leaders' perceptions of the organisation and those of the rest of the organisation. In every assessment we have carried out, senior managers and non-executive directors have been consistently more positive about culture than those at the sharp end of operations. In particular, junior staff have tended to be much less convinced about the extent to which the organisation is 'client or customer centric'.

While a similar effect is often found in employee engagement surveys, where senior leaders are generally more positive than other staff, particularly middle managers, the perception gap is an important warning signal. It suggests there is a danger of complacency in the organisation, with leaders potentially lulled into a false sense of security. There is a risk that senior leaders will allow culture to slip off the priority list, with less time or effort devoted to this area.

It is also possible that the perception gap reflects a failure to translate the tone from the top into practical policy and procedures, or that leaders are asking middle managers for conflicting objectives, without providing them with the support to reconcile or prioritise these objectives. Where this is the case, it is challenging for staff throughout the rest of the organisation to understand their role in delivering the culture for which leaders are aiming.

What does good look like?

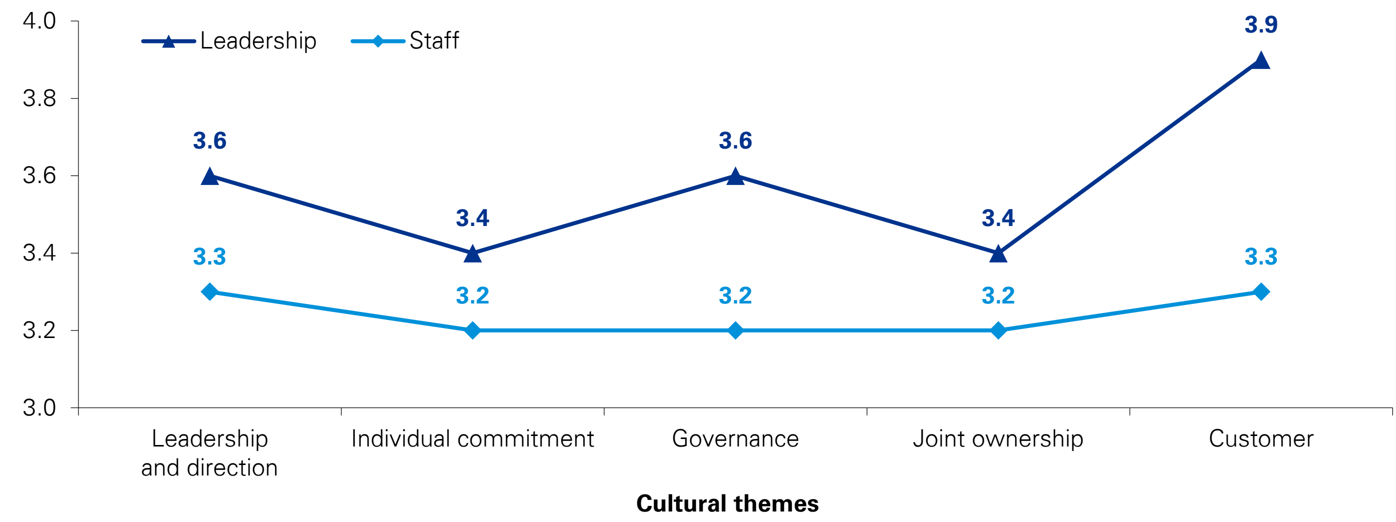
— Leaders and front-line staff share and can articulate a common understanding of what the organisation's desired and current culture looks like

— Regular monitoring and investment in the organisation's culture enables continuous improvement

— Front-line staff understand organisational strategy and risk appetite, and how to apply this in their roles

— Middle management enhances and builds upon senior leadership messages to make it real for their teams

Leadership versus staff average scores (out of 5) on the five dimensions of cultural controls in the KPMG model



2. Hearing the employee voice

The employees of financial services organisations' feel more able to raise cultural issues and difficulties, but further progress is required.

At many organisations, employees report strongly positive scores when asked whether they are able to raise difficult issues and what the reaction of senior leaders is when they do so. Indeed, organisations score more highly in this area than on any other theme in our data.

This is good news. For the most part, staff report that leaders actively listen to issues raised and visibly act on them. They also confirm that there is a willingness and ability for individuals to 'escalate issues without fear of recrimination'.

Nevertheless, this is not a universal finding. At some organisations, employees' perceptions of whether it is safe to speak up are low, or there is evidence of sub-optimal whistle-blowing procedures and processes such as 'hard to find' policies, or non-anonymous email channels. So, while this is an area where financial services culture is moving in the right direction, there is more work to do. This has been further reinforced by the regulator; treatment of 'non-financial misconduct' is a key FCA focus.

Taking this further, the FCA is advocating that as good practice in this area continues to progress, firm's move through a strong 'speak up' culture to a 'listen up' culture.

What does good look like?

— Leaders actively listen to issues raised by other areas of the organisation (e.g. relating to conduct, customers, risk, etc.) and visibly act on them

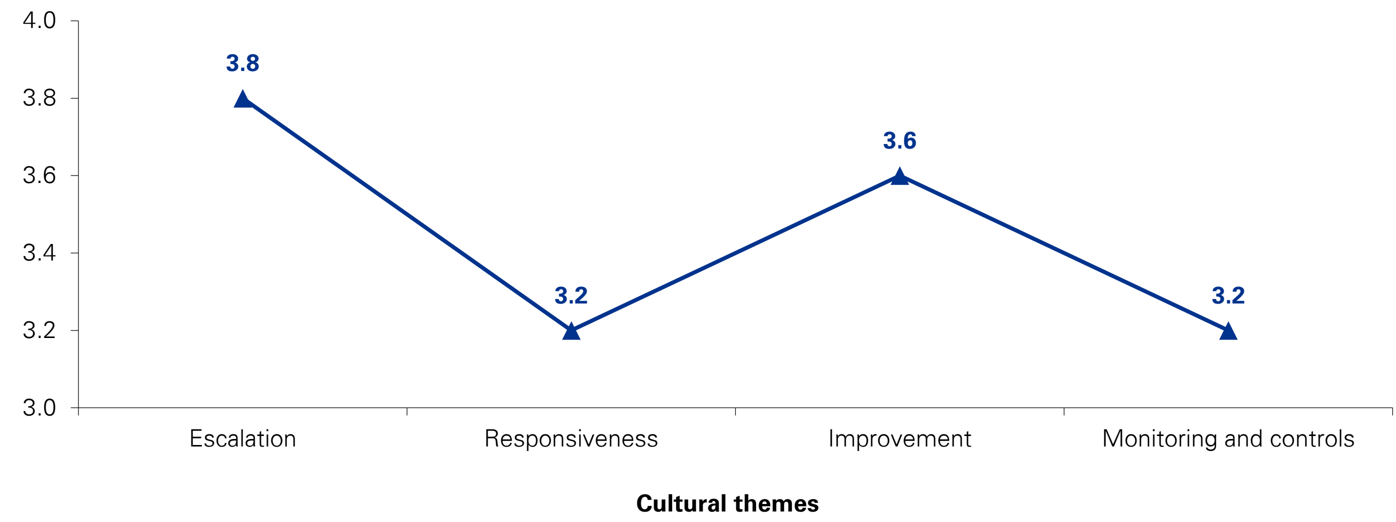
— Individuals are willing and able to escalate any issue that they come across without fear of recrimination to appropriate forums (Escalation)

— The organisation reacts quickly and decisively to incidents (e.g. conduct, reputational, financial, and operational risks), with individuals empowered to take the appropriate action (Responsiveness)

— The organisation is openly committed to learning from its challenges and mistakes. It actively assigns and monitors improvement activities (Improvement)

— There is regular and effective gathering and management of data related to conduct, reputational, financial and operational issues (Monitoring and Controls)

Average organisation scores across the four elements of the Governance dimension



3. Matching behaviours to reward

Too few financial services organisations operate reward structures that incentivise positive behaviours reflecting the culture to which they aspire.

Financial services organisations score particularly badly on the extent to which employees' rewards packages are designed with positive cultural issues in mind. Asked whether their 'reward framework is clear' and whether it 'recognises appropriate conduct', employees consistently give low scores. In fact, organisations score worse on this area than for any other theme in our research.

Whilst there may be an element here of 'people always rate questions about pay poorly', the data suggests that remuneration and performance are still not adequately aligned with organisations desired cultural values and behaviours – or at least that employees do not recognise any alignment.

Our work suggests progress is being made. For example, organisations' policies and processes increasingly indicate that breaches and clear examples of bad behaviour will be considered when remuneration decisions such as bonus awards are made. Furthermore there are usually strong controls over these processes, a good example of where second- line functions are more joined up and consistent.

The FCA business plan emphasises its expectations for firms to foster healthy cultures where conduct and fair customer outcomes are at the forefront of their business. It views one of the key culture drivers in firms is the approach to rewarding and managing people.

These kinds of healthy cultures can also complement and support businesses' financial performance. The mere absence of negative behaviours is not sufficient to signify a healthy culture.

Nevertheless, many staff still feel that the way behaviours are taken into account in remuneration decisions is murky at best, which dilutes the clear line of sight between positive cultural behaviour and reward. The quality of documentation in performance reviews also varies considerably.

What does good look like?

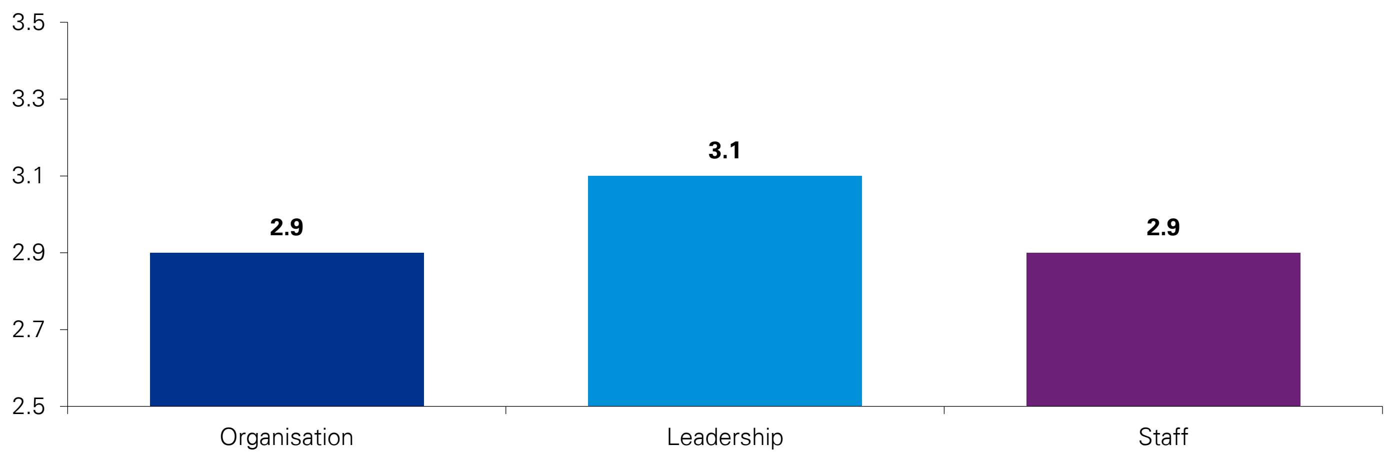
— The reward framework is clear, recognises appropriate conduct, and supports all aspects of the way in which the firm wants to be seen to treat its customers and other stakeholders

— Conduct and compliance issues are raised during performance reviews, and affect performance and reward outcomes

— Control functions are represented at performance review sessions, alongside HR and Reward functions

— There is evidence of conduct or behavioural breaches impacting an individual's performance or reward outcome

Incentives and reward average scores



4. In search of accountability

Below the level of senior management, accountability and ownership still appear to be elusive.

Too many financial services organisations are still scoring badly on the extent to which it is clear who ‘owns’ particular tasks or has responsibility, undermining their ability to hold owners accountable for key cultural values and behaviours. Organisations scored more poorly on this theme in our assessments than on any area other than matching performance to reward.

In fairness, scores tend to be higher at more senior levels of the organisation. It seems that the SMCR has had a positive impact on clarifying accountability at the senior levels. Further, given the nature of their roles it is more likely that senior leadership feel that the 'buck stops with them’. Lower down the organisation, however, the visibility of who owns a process or task is often less clear.

These issues tend to be particularly problematic at financial services organisations with complex matrix structures, and those with a headquarters outside the UK, but with a UK- regulated business. The tension between the legal entity structure and regulatory requirements in the UK on the one hand, and the global business model on the other is well recognised but difficult to resolve. Our data and assessment work suggest this tension is ongoing.

What does good look like?

— Culture has clear ownership within senior leadership and lower down in the business

— Role models or champions are in place to champion the desired behaviours and cultural traits

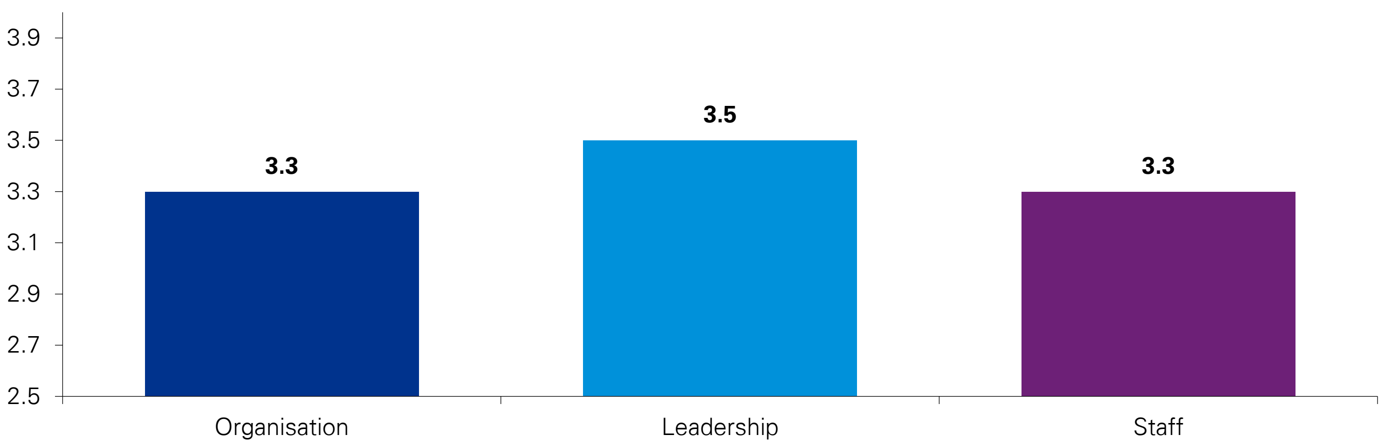
— There is clarity on roles and responsibilities with regards to conduct breaches and escalation

— There is clarity of expectation on 'how' to role model the desired behaviours

— Front-line teams rely and trust control functions to act as a line of defence seeking their advice on a regular basis

— Front-line and control functions work in a collaborative manner, perhaps even physically in the same place to facilitate clear processes and decision-making

Accountability average scores



5. Focusing on the customer

While senior leaders believe their organisations are increasingly customer-centric, more junior employees don't always agree.

Our data suggests many financial services organisations have worked hard to better wrap their values, strategies, decision-making and operations around the needs of their clients – and that they strive to balance their own commercial interest with those of their customers.

While organisations scored more highly on this theme than any other area of culture considered in this paper, it is also the area where the divergence between the views of senior leaders and their more junior colleagues is greatest. In responses to a range of questions aimed at establishing 'the emphasis of the organisation on the customer or end-user of its activities and the manner in which they are treated appropriately', more junior employees were consistently less positive.

This finding is reinforced by the external marketplace. Last year there was almost a 4-fold increase in issues raised by whistle-blowers to the FCA, specifically concerning 'treating customers fairly.'

This is again emphasised in the recent FCA purposeful cultures publication, which recommends having a healthy organisational culture to drive better outcomes for consumers and markets.

Link:
https://www.fca.org.uk/news/news-stories/fca-encourages-firms-develop-purposeful-cultures

What does good look like?

— Leaders drive the fair treatment of customers in their areas, and demonstrate it personally in their values and behaviours

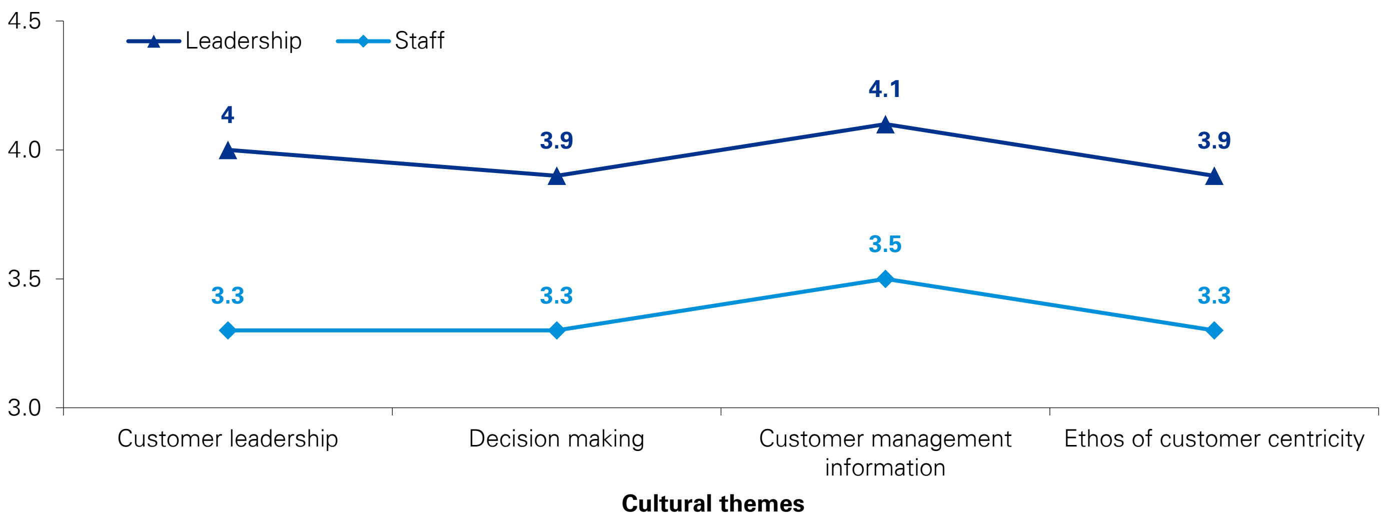
— Decision making at all levels reflects the fair treatment of customers, and this is evidenced in communications and Governance forum minutes

— There are effective controls in place to protect customer data and ensure that it is used ethically

— Customer interest is paramount to organisational activities, and is ensured by effective processes being in place (e.g. complaints management and data security)

— Staff are empowered and competent to deal appropriately with customers that display indicators of vulnerability; thereby allowing them to flex the firms internal controls up or down as appropriate to the needs of the customer."

Customer average organisation scores



Case study

KPMG carried out two cultural assessments for a client four years apart. This case study demonstrates that culture within organisations evolves over time.

The first assessment of the client's organisational culture found the following cultural strengths. Overall, people understood and were committed to 'do the right thing'. They operated with a 'measured' approach to risk-taking and there was zero-tolerance to misconduct. The senior leaders recognised the importance of cultivating a positive organisational culture.

Initial areas to improve

— The assessment found an inconsistent understanding of roles and responsibilities throughout the organisation, which increased the risk of conduct events 'by accident'

— For many employees, there was a lack of clarity about the link between desired behaviours and reward. This is a common challenge we have observed in the industry

— Some of the basic processes required to provide evidence of cultural controls – such as mandatory training completion, or consequences of breaches – were not always efficient or comprehensive

— Communication from senior leaders about the organisation's desired culture was often inconsistent, cascaded unsystematically, and hard for front-line employees to follow

In the second assessment, we found communications were now clear, consistent and cascaded systematically through the organisation so that front-line employees had a better understanding of their leadership's expectations. They also reported that they could see their managers leading by example. Basic reporting processes had been significantly tightened up. The culture of zero tolerance for bad behaviour endured, with many interviewees citing (a small number of) real examples of visible action when such behaviour had occurred.

Areas still to progress

The second cultural assessment also identified cultural weaknesses in the organisation where further remedial action was necessary.

— The organisation had made positive progress in clarifying the link between behaviours and reward (including promotion) especially for more senior people. However at the middle and junior levels we still found confusion over the remuneration policy, and a view that it had become overly complicated

— The main issue that was impacting the culture of conduct and risk management had now become the complexity of the organisation and the international matrix which led to – in some areas – a feeling that some managers did not have authority to act without wide consultation

This journey is typical of many of our clients. They make visible, tangible changes to those aspects which support the desired culture. However, they leave behind more complex enduring cultural challenges. These challenges will require a multi-disciplinary lens to address over a period of time. It is a never-ending journey.

What to do next

Our work assessing the culture of financial services organisations suggests the financial services industry has learned many lessons from the financial crisis over 10 years ago and worked hard to improve. Many positive organisational changes have already been successfully achieved and there is much good progress to be proud of.

Nevertheless, significant outstanding issues remain and these are usually the deeper, more complex ones which are harder to address. Leaders and second and third line functions must renew their resolve to promote and drive a culture that reflects the organisation's values and translates down to those at the coal face. In addition, heads of internal audit and other senior leaders with responsibility for cultural areas should think about how they can be more targeted in their approach, focusing on those areas where their organisations still requires the most development.

Our recommendations focus on:

01 The need to close the perception gap between the views of senior leaders and more junior employees

From the perspective of the board, the perception gap points to the need for clearer and more timely management information. This insight will ensure senior leaders are much better informed about the culture of their organisations at every level. Our experience is that while many banks and some insurers have made big strides on this issue, other financial services sectors still have some way to go to make culture transparent to their boards.

For executive leaders meanwhile, it may now be necessary to do more work building aspects of culture into individual scorecards - as well as into the 'rhythm' of the ExCo through agendas, off-sites and quarterly business unit reviews, for example. The key is for leaders to garner a better understanding of how their businesses operate in practice – not least since what they say does not necessarily always translate into action on the ground. "Moreover, the existing culture on the ground may include elements that are more aligned to what the organisation needs."

02 The need to better hear the employee voice

While many employees no longer feel reluctant to raise cultural issues or fear that escalating particular problems will have negative consequences for them personally, problem pockets remain. It is therefore important for executive leaders to regularly reassess the extent to which employees feel their voice is heard, including whether they are reluctant to raise concerns. Where this audit work identifies failings, remedial action is required.

The detail will differ according to the organisation. For example, whistleblowing processes may need to be redesigned to eliminate disincentives currently deterring employees from speaking out. Clearer feedback loops may be needed to ensure employees see their concerns have been addressed or that their suggestions for improvement have been acted upon.

03 The need to match strong cultural performance to reward

Where employees do not see an obvious link between their day-to-day performance in respect of the organisation's cultural values and their reward packages, there is less incentive to embrace change. Employees may even come to think that the organisation is not serious about its messaging on culture.

There are potentially two problems to address here. First, does remuneration policy include setting rewards with culture-related criteria in mind? And second, even if it does, is it clear to employees what these criteria are and how they are considered? Improvements in both areas may be necessary, with clearer communication a consistent theme. For example, while employees may understand that poor behaviours or performance are likely to have an adverse impact on their total reward package, do they appreciate how a record of positive behaviour might translate into greater reward?

Any improvements made in this area should be considered holistically across the employee life cycle, ensuring that corresponding attention is paid to recruitment, performance management and role definition, alongside incentives and reward.

04 The need to improve accountability and visibility of ownership

In many organisations, particularly multi-national businesses, where lines of accountability appear to be well-established, there remains a tension between the legal entity view, business unit view, and Group view. This can cause challenges for senior managers ("am I really empowered?") as well as to more junior staff ("who do I ask?"). This problem is especially common with cross-functional working; where different functions collaborate on practices and processes, in areas such as risk and compliance, for example, clarity around accountability is very often lacking.

Whilst it is easier said than done, simplifying operating models, and where possible driving alignment across the control functions, including areas such as Regulatory, Legal, and Tax will help. Ensuring senior people outside of country appreciate the regulatory priorities in-country is also important. Step two will be to focus on middle manager accountabilities, with reference to SMCR without the associated process overhead.

Maintaining accountability and visibility will inevitably be consistent priority areas for attention. Lines of reporting may need refining as problems emerge or the nature of the organisation's work changes.

05 The need to focus on the customer

In many organisations, senior leaders appear to have a much higher regard for the extent to which their businesses have embraced customer centricity than their more junior colleagues. This should be a serious worry, given that many of these more junior members of staff will be closer, day-to-day, to the customer; their insights into the customer experience are invaluable.

For this reason, it will be important to regularly audit perceptions of customer centricity at every level of the organisation, paying particular attention to the views of employees who spend more time engaged in frontline work. Organisations can also utilise product governance arrangements as a critical feedback loop to ensure that issues are pro-actively identified, and reviewed regularly. Where organisations want to change their policies and practices based on what they learn from these exercises, it is important to build mechanisms to incorporate the suggestions and advice of all employees – and to reward those who make a positive contribution.

KPMG Nunwood uses best-in-class customer experience measurement, voice of the customer and NPS tracking programmes to help organisations rapidly improve their customer experience and maximise value. Firms should also focus on assessing whether they are delivering good outcomes. These approaches focus on managing real-time customer feedback to pinpoint focus and coordinate action.

That said, there is no substitute for a culture where senior leaders see customer interaction (at different hierarchical levels) as a key part of their role.

How KPMG can help

KPMG is at the leading edge of cultural change. We can help you to assess the culture of your organisation to identify where change is required, and to secure the greatest possible impact, ensuring that you are aligned to regulatory expectations.

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