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Good insurance business: Culture - understand how to walk the walk, not just talk the talk

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"It is easy to become overwhelmed by 'culture', it seems far too nebulous a concept to get your arms around" said Georgina Philippou, Senior Adviser to the Financial Conduct Authority ("FCA") on the Public Sector Equality Duty, in a **speech** on 28 January 2021.

The speech sought to explain how diversity and inclusion ("D&I") relates to the conduct which the FCA would like to see.

Why D&I?

The speech highlighted the discrete nature and effects of diversity:

- "The McKinsey 'Diversity Wins' Report, published in May 2020, notes that … the most ethnically diverse companies are 35% more likely to outperform the least diverse.
- … the 2017 McGregor-Smith Review … [estimated] the potential benefit to the UK economy from full representation of B[A]ME individuals across the labour market … to be £24 billion a year …"
- In their 2018 report, Paying attention [sic], the research firm Randstad revealed that members of the BAME community currently hold fewer than 1 in 10 management jobs in UK financial services."

Promoting D&I

In relation to inclusion, Ms Philippou's propositions were that:

- "Safe cultures … support … inclusion …
- Without an inclusive culture, the value of diversity will not be realised.
- Without inclusion, diversity will not lead to better decision making …"

The above propositions lead to the following expectations from the FCA:

- "… a healthy financial services industry with cultures that reduce the potential for harm.
- How a firm prioritises and embeds diversity and inclusion are clear indicators of its culture …
- it is the responsibility of … everyone in the financial services industry … to create and maintain cultures which embody diversity and inclusion."

The harm to be reduced

The FCA's concept of "harm" was addressed in a November 2020 letter to the CEOs of "Lloyd's and London Market Intermediaries and Managing General Agents …" ("LLMI firms") from Charlotte Cross, FCA Head of Wholesale General Insurance (see our article "Has Covid changed the insurance market for the better?").

The letter described conduct failings among LLMI firms as “often widespread and embedded cultural issues which will require considerable and consistent commitment to address at all levels of the organisation … [requiring] improvements [to] … actively boost … diversity, inclusion and openness …”

The letter specified four “drivers of harm” which firms needed promptly to “identify and address …”:

- “[insufficient] Financial Resilience
- Ineffective Governance and Oversight of businesses
- … Non-Financial Misconduct …
- Business Models which provide poor oversight of distribution chains”.

Sustaining D&I to mitigate harm

Ms Philippou explained that “cultures which embody diversity and inclusion” have the following attributes:

- “… psychological safety in the workplace – creating an environment where employees feel safe to share ideas and speak up …
- Leaders [who] acknowledge their status and actively recognise how their behaviour and actions can influence and support an environment of psychological safety and collaboration …
  - one small mis-step from a senior person can undermine a brilliant strategy and years of action …
  - [b]eing a strong leader means creating an environment where employees feel listened to …
- [employees who are] able to ‘speak up’, leaders [who] ‘listen up’ when they do …
- When employees do speak out, the response of [the] organisation is to [make them] … feel safe to do so again …”

Evidence of sustaining D&I

Between Ms Cross’ letter of November 2020 and Ms Philippou’s January 2021 speech, the FCA and Prudential Regulation Authority (“PRA”) published a notice of voluntary imposition of requirements on Tokio Marine Kiln (“TMK”) in December 2020 which highlights specific metrics for psychological safety, and shows how any LLMI or other firm might –

- take a “mis-step” (as per Ms Philippou), but
- make “improvements” (as per Ms Cross) on a precise and practical basis in order to give concrete effect to a healthier culture.

The notice shows that in 2019 TMK (both its Lloyd’s managing agent and its insurance company) “made a disclosure to the [regulators] … on the outcome of its investigation into whistleblowing allegations ... including potential shortcomings in the operation of its whistleblowing systems and controls.”

The notice refers to requirements imposed pursuant to section 55L(5)(a) and 55M(5)(a) of the Financial Services and Markets Act 2000 (“FSMA”), which empower the regulators to take steps if it “appears” to them that certain grounds have arisen, including (s55L(2), M(2) if –

- a firm “is failing, or is likely to fail, to satisfy [its] threshold conditions …” and
- “it is desirable to exercise the power in order to advance one or more of the FCA's operational [“or any of the PRA’s”] objectives”.

The FCA’s operational objectives are set out in s 1(b)(3), and 1C – E of FSMA, and relate to “consumer protection”, “the integrity of the UK financial system” and “competition”. The PRA’s objectives are in s2B of FSMA and involve in essence the promotion of the “safety and soundness of PRA-authorised firms”.

TMK applied for a voluntary requirement (“VREQ”) to be imposed. The notice does not give any details as to TMK’s decision-making on its application for a VREQ, but the notice shows that neither of the regulators sought to impose requirements on their own initiative under s55L(3) or M(3).

The notice does not state which of the grounds in FSMA may have given rise to the requirements, but explains that:

“… Although the Investigation did not uphold all of the allegations made, [TMK] acknowledged that [it] had identified certain cultural issues and issues concerning the effective operation of [TMK’s] whistleblowing systems and controls that needed to be addressed … Whilst the regulators have not conducted their own investigation … they identified that some areas of the whistleblowing systems and controls required strengthening. In particular, they considered there to be a need to improve awareness of how to recognise a possible whistleblowing disclosure, and effective handling of such disclosures (including avoiding actual or perceived whistleblower detriment).”

The requirements in the notice include annual reports from TMK to the regulators as to:

- “… steps [TMK] has taken to enhance awareness of whistleblowing processes and to ensure any barriers to their utilisation are addressed effectively …” including training and “non-training initiatives”;
- “the number of whistleblowing reports received [and] … cases opened and/or investigated during the relevant year [including] the number of any such cases or investigations involving allegations against a Senior Manager and/or Director of the Firm, in which case TMK must also provide the regulators with … the nature of the allegations made, the steps taken by TMK to investigate the allegations, including the management oversight and reporting structure of that investigation, any conclusions reached and any resulting outcome …”
- “the number of instances … that a person has alleged that they were the subject of detriment or other retaliatory action as a result of raising concerns as a whistleblower … [and] a written overview setting out the steps taken by it to investigate those allegations, the conclusions reached in that investigation and any resulting outcome.”

Whistleblowing is one area where employment law and regulatory rules interact within firms’ HR processes. However “strong” a firm’s stated “commitment” to a healthy culture (as per the notice), it is its HR function’s acts – eg in relation to recruitment, promotion, termination, reward or discipline, and in what circumstances – that truly represent a firm’s culture. It is these acts – and omissions – which actually “resonate” with a firm’s personnel (see our article referred to above) and result in culture and conduct which is good or not.

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