ASIC

Australian Securities & Investments Commission

Why are we talking about culture?

Opening remarks by Peter Kell, Deputy Chairman,
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Thank you for inviting me to participate in the panel on culture and conduct risk.

Culture, and its links to conduct and regulation, has become central to discussions of how business operates, particularly in the finance sector. Given the massive global costs of misconduct arising out of poor finance sector culture, this should not be surprising.

ASIC has been highlighting the importance of culture in financial firms. Our aim is to promote trust and confidence in the financial system, and poor culture clearly undermines that trust and confidence.

We haven't been the only regulator discussing this issue. In Australia, for example, APRA has also underlined the importance of culture and has indicated a strong focus on culture in its regulatory work. Overseas, the UK Financial Conduct Authority has said:

> It is only through establishing the right culture that senior management can convert their good intentions into actual fair outcomes for consumers.

And it's not just regulators. The most in-depth review of the Australian financial sector in recent times was of course the recent Financial System Inquiry (FSI), headed by David Murray. This inquiry highlighted the issue of business culture. Several of its key recommendations went to ensuring that both financial firms and regulators were better placed to address the problems we've seen in finance sector culture.

What I'd like to briefly do is provide some context for today's panel session by outlining the FSI's findings on culture and providing some examples of the responses recommended by the FSI. In particular, I want to focus on those observations and recommendations that impact on ASIC's role and responsibilities.

To start with, the FSI recognised the central importance of culture in the financial system:

> To build confidence and trust in the financial system, firms need to take steps to create a culture that focuses on consumer interests.
> (Financial System Inquiry Final Report, p. 195)

The FSI also clearly signalled that regulators have a critical role to play in ensuring better market outcomes:

> Appropriate firm culture is critical, but needs to be supported by proactive regulators with the right skills, culture, power and funding. (p. 233)

In looking at the experience of the financial system over the last 10–15 years, the FSI Committee formed the view that the current regulatory framework does not do enough to encourage a better culture in finance, as indicated in the following comment:

> The [regulatory] framework needs to more effectively align the governance and corporate culture of financial firms, employees and other representatives. (p. 193)

In discussing consumer outcomes, the FSI identified a particular problem with finance sector culture, being a *misalignment* between the corporate culture of firms and consumer outcomes, and suggested that the regulatory system could be improved to help address this problem.

> Recent examples of poor conduct suggest the alignment [with consumer outcomes] needs to start at the point of product design, and then be strengthened through distribution and advice. (p. 193)

The FSI recommended a package of reforms that would enhance both the obligations of firms and the powers of the regulator, including a product intervention power. This package:

> …would strengthen the accountability of product issuers and distributors, reduce the risk of significant consumer detriment from unfair treatment, and encourage a customer-focused culture in financial firms. (p. 197)

ASIC strongly agrees with these recommendations, as we have argued that our current regulatory toolkit does not allow us to effectively address emerging risks and conduct problems that arise in financial markets. These FSI recommendations have been accepted by the Government, and an implementation process is underway.

Mr Murray's inquiry also had recommendations that went to reforming particular sectors in the broader financial system. A notable example is the set of recommendations around the financial advice industry. Why did the FSI focus on this sector? Here's what they said.

> Recent cases of poor financial services provision raise serious concerns with the culture of firms and their apparent lack of customer focus. (p. 218)

ASIC agrees with this observation and it is why we have a major focus on this sector.

As a result the FSI recommended a series of reforms to the regulation of financial advice, including reforming remuneration around life insurance advice and improving adviser professionalism. The FSI also recommended that the Government should amend the law:

> …to provide ASIC with an enhanced powers to ban individuals, including officers and those involved in managing financial firms, from managing a financial firm. (p. 217)

Why does ASIC need these powers? The FSI pointed out that at present:

> ASIC [cannot] remove individuals involved in managing a firm that may have a culture of non-compliance. (p. 218)

As set out in the final report of the FSI, the objective of these recommendations about raising standards in the financial advice sector is to:

> Improve the culture of financial firms and build consumer trust in those firms. (p. 217)

Again, the Government has implemented, or is developing, reforms that address these recommendations.

In other words, the FSI, the most substantial inquiry into the state of the finance sector for more than a decade, identified significant problems with culture in financial services, a lack of alignment between the interests of firms and their customers, and significant consumer detriment.

Following these observations, the FSI also identified that the regulatory framework, and the powers of regulators, needed to be strengthened to help raise the bar on culture and conduct. Of course, the FSI said very clearly that financial firms themselves must take the lead in dealing with culture. But there's also a clear recognition that regulators have a role to play in encouraging better culture and dealing with misconduct that arises from poor culture.

ASIC is not trying to micro-manage the culture of financial firms. But we have a strong interest in business culture. It matters because it sets the framework for behaviour, both good and bad. We are interested in reducing poor outcomes arising from poor culture. We are also interested in how good culture is set in place and supported by appropriate incentives.

The FSI underlined that culture in the finance sector matters because it impacts directly on trust and confidence in our financial system. ASIC agrees. As we've seen, the stakes are too high to ignore this issue.