



ASIC

Australian Securities & Investments Commission

Improving business through compliance: A regulator's perspective

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CHECK AGAINST DELIVERY

Introduction

Thank you for that kind introduction and for inviting me to speak with you today.

When asked to speak on the topic of 'Improving business through compliance' to a general counsel forum my first reaction was to ask, 'what do we mean by compliance in this context?'

To us at ASIC, compliance or regulatory compliance is about a firm's ability to achieve the outcomes it has promised its customers and stakeholders within the law. We think that any regulatory compliance program should reflect the key values and ethos of the firm. Specifically, it should focus on putting customers at the centre of the way the firm operates; rather than solely on a checklist approach to legal obligations.

This is central to achieving compliance from ASIC's perspective.

My next question was 'how does this understanding of regulatory compliance relate to the role of general counsel?' This is a question, which to me is best answered by considering the broad and significant role that contemporary general counsel play in successful firms.

I am a very proud former general counsel. My experience is that general counsel and internal legal departments have, over the past few decades, become more influential and more integral to the success of organisations. This is also the conclusion of much of the literature which examines the role of contemporary general counsel.

The description that best resonates with me is one that Benjamin W Heineman Jr (a Senior Fellow at Harvard University's School of Law and Harvard John F. Kennedy School of Government) uses and that is:

a lawyer-statesperson who is an outstanding technical expert, a wise counselor and effective leader, and who has a major role assisting the corporation achieve the fundamental goal of global capitalism, the fusion of high performance with high integrity and sound risk management.

For the lawyer-statesperson, the first question is: 'Is it legal?'

But the ultimate question is: 'Is it right?'¹

This perspective, with its emphasis not only on strict compliance with legal obligations, but also on an organisation's foundations – like its strategy, culture, ethics and risk appetite – correlates with a broader discussion that regulators like ASIC and others domestically and globally are keen to advance with their regulated communities.

Our view is that regulatory compliance is not achieved by a checklist approach to the law or indeed, to borrow from Mr Heineman's quote, from only asking the first question, 'Is it legal?'

At ASIC, we've seen large, well-resourced businesses that have policies and procedures in place for every manner of eventuality. And still, these arrangements have failed to prevent the very occurrences they were designed to avoid.

Why? Because regulatory compliance was undermined by poor culture.

Policies and procedures, the ones you write and review, only provide a framework for compliance. They cannot ensure compliance. It is a positive business culture that converts these arrangements into true regulatory compliance.

So, your roles as general counsel are not confined to advising the business on the boundaries of the law and how to negotiate grey areas. To do your job well, you need to emphasise the importance of fostering a positive culture to ensure compliance.

What is culture?

Culture is a very broad concept, and to an extent intangible. At ASIC, we speak of culture as set of shared values or assumptions – the underlying mindset of an organisation. As Dennis Denuto, the solicitor from the Australian movie, *The Castle*, might say, 'It's the vibe'.

On a more serious note though, culture is not an ASIC construct or preoccupation, notwithstanding that we have been criticised for focusing on this concept. In fact, the concept of corporate culture was introduced into the Australian *Criminal Code Act 1995* (Criminal Code) back in 2001. The Criminal Code defines culture as including:

- attitude

¹ Benjamin W. Heineman Jr., '[The Inside Counsel Revolution](#)', Harvard Law School and Harvard John F. Kennedy School of Government, 29 March 2016.

- policy
- rules, and
- course of conduct or practice.

Moreover, as I mentioned earlier, we are not the only financial regulator interested in this topic. In Australia, the Australian Prudential Regulation Authority has also underlined the importance of culture and indicated a strong focus on culture in its regulatory work. Likewise, the UK's Financial Conduct Authority lists poor culture as an area of 'significant interest' in its 2015/2016 business plan.

To my mind, culture is best understood by its impact – culture drives conduct, conduct dictates compliance. This is important, so I'm going to repeat it: culture, conduct, compliance.

Positive culture rewards and encourages good conduct which translates into regulatory compliance. A negative culture leads to, and may unwittingly reward, poor conduct which not only results in poor outcomes for customers, it can result in misconduct or regulatory non-compliance.

Increasingly, culture and its links to conduct and compliance have become central to discussions of how businesses operate, particularly in the finance sector. That's because culture matters – to ASIC, businesses and customers. I'll explain why now.

Culture matters to ASIC

Promoting investor and financial consumer trust and confidence is one of ASIC's strategic priorities. Compliance breaches clearly undermine trust and confidence.

Given the causal connection between poor culture, poor conduct and non-compliance, we think that culture is a key risk area which we must address. To us, it's just that simple. Why culture matters to you and the businesses you represent should be equally straightforward.

Culture matters to businesses

Poor culture doesn't just pose a compliance or risk issue for businesses. It can lead to significant costs, including:

- remediation costs
- fines, and
- compensation costs.

These costs can be quantified and, let me tell you, they are significant.

According to research by the London School of Economics and Political Science, between 2008 and 2012 the cost of poor conduct for the ten most-affected global banks was approximately USD250 billion. A report by KPMG also showed that, since 2011, the largest banks in Britain have paid almost 60% of their profits in fines and repayments to customers.

Then there are the costs associated with brand and reputational damage. Doubtless you're aware of organisations that have had their names splashed across the front page of the newspaper, in newsfeeds and on social media sites as a result of poor culture and conduct.

This is particularly so in recent times – with the focus on issues in the financial advice and life insurance sectors.

The corollary is that good culture is good for the bottom line. Research has shown that businesses with a positive culture tend to have sustained high performance over the longer term.²

Moreover, businesses with a positive culture are also more likely to be considered a desirable place to work. This enables them to attract and retain the best employees, improving performance.

Culture matters to consumers

Consumers have become increasingly sophisticated at making their views known and exacting consequences from businesses that fail to meet their expectations. I call this 'consumer regulation'.

Certainly, the traditional method – voting with their feet – is still the most powerful tool in a consumer's armory. In a competitive industry, customer satisfaction is a primary driver of customer loyalty and retention. If a business does not have the right culture, they will see the effect of this as they lose their custom (potentially to their competitors).

In addition, the advent of the digital world has significantly magnified consumers' ability to hold businesses responsible for poor conduct, for example, by sharing their views (sometimes very loudly) through social media.

If you don't think culture matters to consumers, take a look at any of the product review sites that proliferate on the internet. A brief scan reveals that the way a consumer was dealt with, made to feel or had their query or concerns resolved is as big an issue to them as the product or service provided in the first place.

Essentially, a positive culture leads to good outcomes for investors and consumers. This enhances brand loyalty and bolsters reputation, which has a very real impact for businesses.

What is ASIC doing about conduct?

Both ASIC, the financial services industry and the broader corporate community have a role to play in promoting positive culture.

² The Harvard Business School and Forbes completed an extensive research project detailing the corporate cultures of 200 companies and how each company's culture affected its long-term economic performance. One of their findings was that strong corporate cultures that focus on the needs of customers are associated with strong financial results.

For our part, we are incorporating cultural indicators into our surveillance work. We have prepared a comprehensive guide for our surveillance teams to help them do this. This guide includes positive and negative indicators of culture, documents to ask for and questions to ask.

To be clear, we have always looked at individual elements of culture in our surveillances – for example, remuneration, breach reporting, whistleblower policies, and complaints handling. Likewise, we have always considered indicators and factors that drive poor conduct.

What we are doing now is ‘joining the dots’ – bringing the elements of culture together and considering whether they indicate a more pervasive problem. By doing this, we hope to identify warning signs that will enable us to deter bad behaviour before it occurs and catch misconduct early.

Where we think there may be pervasive problems, we will ask more questions and probe more deeply, for example, by conducting a more intensive surveillance or a broadening of the scope of our surveillance.

However, we understand that ultimately culture is an issue that businesses themselves must address.

What can businesses do to foster positive culture?

Putting customers first

At the centre of what industry can do is creating a ‘customer-first’ culture. We think that focusing on the long-term interests of consumers will assist businesses to embed a positive culture. This means focusing on and preferring the interests of consumers (ahead of maximising profits).

Businesses that want to capture the next generation of customers and be around in the long term are putting customers at the heart of everything that they do. These businesses tend to compete more effectively, have higher customer satisfaction and better customer retention.

Monitoring and outcomes

Compliance requires a focus on monitoring and outcomes. Having a code of conduct, compliance program, and policies and procedures in place are critical. However, it is equally important for these arrangements to be monitored and enforced on an ongoing basis.

For example, if a bank puts a whistleblowing policy and program in place, but in practice complaints by whistleblowers are ignored or rejected, then the whistleblowing policy and program are really only worth the paper they’re written on.

Businesses must continually monitor and assess the impact of culture on conduct and compliance and make changes as necessary.

Taking responsibility

Let me give you two examples of responses we see when we raise compliance issues with various businesses.

The first is businesses who blame compliance failures on a few 'bad apples'. They do this rather than looking more closely at their organisation and the root causes of the problem.

To ASIC, this attitude is a red flag that there may be broader regulatory problems at play. These organisations have given us a 'heads up' that we should scrutinise them more closely.

The second example is of businesses that take responsibility when things do go wrong. They demonstrate a willingness to engage with ASIC to correct deficiencies. We work with these organisations to manage and resolve the compliance issues.

In our experience, this approach tends to have a more enduring and positive impact on businesses. That's because, proactively engaging with the issue is far more likely to result in the identification and remedy of systemic weaknesses, and prevent more serious problems down the track.

Tone from the top

A company's board, senior executives and management play a critical role in fostering a positive culture. These groups are responsible for creating a culture where everyone has ownership and responsibility for 'doing the right thing'.

They must demonstrate conduct that supports positive culture and ensure the business values are cascaded and understood throughout the organisation. This is important, because quite often the message gets lost in the middle and does not make its way to the front end.

Recruitment, training and rewards should all be linked to demonstrating positive culture and achieving good outcomes for clients.

Your role as general counsel

I mentioned in my introduction that, as a practical matter, contemporary corporate counsel act as 'lawyer-statespeople', to use Ben Heineman's phrase.

As general counsel, you play an important role in major corporate initiatives, focusing not just on questions that relate to checking legal process but more broadly in discussions about whether or not an initiative is consistent with the broader corporate culture.

You occupy a position of privilege that provides you with access to information and influence – things consumers and customers do not have. As such, you are in a position to influence how businesses approach regulatory compliance.

At ASIC, we expect you to use your position to prevent behaviour that has the potential to damage trust and confidence in our financial markets.

Conclusion

A positive culture drives good conduct which dictates regulatory compliance.

This is good for the bottom line and building a sustainable business model. It is also good for your relationship with the regulator. We think the contemporary general counsel, indeed all corporate counsel, perform best when they are contributing to the core business fundamentals reflecting the organisation's culture.