ASIC

Australian Securities & Investments Commission

Why culture matters

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CHECK AGAINST DELIVERY

Introduction

Thank you for inviting me to speak at BNP Paribas's Conduct Month. It is good to have this opportunity to speak about why culture matters. ASIC sees the influence of culture in the entities it regulates every day, and culture can be the driver of either good or bad conduct within an organisation. Spending time thinking about culture is time well spent, as good culture is critical for organisations that want to be around for the long term.

We are at an exciting time in history, when technological innovation is rewriting almost every industry, including the financial services industry. We are seeing innovative business models in financial services, including marketplace lending, crowd-sourced funding, robo-advice, payments and the potential of blockchain technology. This is digital disruption in action – it is radical, fast and innovative.

In this environment, maintaining a culture that puts your customer first is imperative. Failing to keep your customer happy will result in the customer voting with their feet. There are more choices and information available to customers now than there has ever been before.

Organisations that do not have a good culture are going to be losing their customers to organisations that do. You need to ask yourself – does my organisation have a good culture and, if not, what can we be doing to change it?

I'd like to address the following three topics today:

- first, what culture is and why it matters
- second, I'd like to talk the drivers of good culture, and
- last, I will provide you with an overview of ASIC's work around culture and conduct.

What is culture?

Culture is a set of shared values or assumptions. It can be described as the 'mindset' of an organisation. Culture is the 'unwritten rules' that govern how things actually work in an organisation. It shapes and influences people's attitudes and behaviours towards, for example, customers and compliance.

This is not a new concept. It was actually captured in the Criminal Code over 20 years ago, where it is defined as including an organisation's attitude, policies, rules, course of conduct and practices.

Why culture matters

ASIC is concerned about culture because it is a key driver of conduct within the financial industry. Poor culture inevitably leads to poor outcomes for investors and consumers, impacts on the integrity of the Australian financial markets, and erodes investor and consumer trust and confidence. Ultimately, this has flow-on effects on the Australian financial system and broader economy.

As ASIC has said on numerous occasions, poor culture has been at the root of some of the worst misconduct we saw during the global financial crisis. Domestically, the ongoing issues within Australia's financial advice industry, along with recent media reports relating to life insurance and the manipulation of the bank bill swap rate (BBSW), are continuing to undermine investor and financial consumer trust and confidence in the system.

It is not only regulators that should be interested in culture. Companies should also be interested in culture because many studies have found that good culture is good for business and generating long-term shareholder value. Poor culture, on the other hand, can lead to misconduct and result in significant financial costs – including the cost of remediation, compensation and fines. According to research by the London School of Economics and Political Science, the cost of poor conduct for the 10 most-affected global banks was approximately US$250 billion between 2008 and 2012.

Good culture enhances brand loyalty and bolsters reputation, which has a very real financial impact. Individuals now have unprecedented access to information and, as a result, companies are held to account by the crowd, especially through social media.

The drivers of good culture

We think culture is vitally important for the organisations we regulate – however, we are not going to dictate the kind of culture a company has. I want to be very clear that we are not trying to regulate culture.

We do, however, see that there are particular drivers of good culture – and these should be relevant to any organisation.

We think there are seven key drivers of good culture:

- First – tone from the top:
  - The board and senior management are responsible for creating a culture where everyone has ownership and responsibility for ‘doing the right thing’.
  - The board and senior management should set the values and principles of an organisation’s culture and ensure they are reflected in the organisation’s strategy, business model, risk appetite, and compliance and governance frameworks.
  - The board and senior management should lead by example, by demonstrating the conduct that supports the organisation’s values.
- Second – cascading values to the rest of the organisation:
  - Senior management needs to ensure the organisation’s values are cascaded and understood throughout the organisation.
  - This is important, because quite often the message gets lost in the middle and is not received by the frontline. It is important that middle and frontline managers model the organisation’s values, because this is how new and junior employees learn ‘how things are done around here’.
- Third – translating values into business practices:
  - Senior management should ensure the organisation’s values are incorporated into all of its business practices. For example, how problems and mistakes are identified internally, elevated and fixed. Translating the organisation’s core values into business practices is important, because it ensures there isn’t a gap between the organisation’s desired values and the actual conduct that occurs.
- Fourth – accountability:
  - Senior management should ensure the compliance and governance frameworks that are in place are monitored and enforced.
- Fifth – effective communication and challenge:
  - The board and senior management should promote a culture of open communication and effective challenge to allow current practices to be tested.
  - The board and senior management should encourage a positive critical attitude among employees, and promote an environment of open and constructive engagement.
- Sixth – recruitment, training and rewards:
  - The board and senior management should include behaviours and attitudes that lead to good conduct and outcomes for customers as part of the selection of all staff.
  - The board and senior management should ensure training is available to maintain staff knowledge about the organisation’s values and the attitudes and behaviours expected of staff.

- The board and senior management should also ensure that the company's remuneration and incentives (including promotions) across the organisation are linked to good conduct and good outcomes for customers.
- Rewards play a big role in driving culture and conduct, because they impact on priorities and act as a motivator and reinforcer of conduct. It is therefore crucial that organisations recognise performance in a way that not only promotes good conduct, but penalises poor conduct as well.

- Seventh – governance and controls:
  - Under the board's stewardship, the leadership team should promote, monitor and assess the impact of the organisation's culture on conduct and make changes where necessary. It's important that there is direct access to the board and leadership team. It's also important that there is a process in place for periodic reporting to the board on culture, conduct and compliance issues.

ASIC's focus on culture and conduct

We have outlined in our four-year corporate plan that we are focusing on gatekeepers, including lenders, directors and responsible entities. We also have outlined that we are incorporating consideration of an organisation's culture into our risk-based surveillance reviews.

To support this, we have developed an internal guide for our teams to use when they are considering an organisation's culture as part of their risk surveillance. We will use our surveillance findings to better understand how culture is driving conduct among those we regulate. We are particularly focused on remuneration structures, conflicts of interest, complaints handling, treatment of whistleblowers and timeliness of breach reporting to ASIC.

We are focusing on these areas for three reasons:

- First, the policies, procedures and systems in these areas generally provide a good indication of the organisation's culture, since they tend to reflect the underlying values of the organisation and what the organisation considers to be important.
- Second, the key performance indicators and metrics that are used to evaluate and remunerate staff, particularly those in the frontline, can lead to a misalignment between an organisation's values and actual staff behaviour. In practice, if an organisation's objective is to have a customer-focused culture, but staff performance and remuneration are solely based on sales volume, then this will likely result in a sales-driven, rather than a customer-focused, culture.
- Third, in cases where policies, systems and controls have been implemented to support a culture of 'doing the right thing', this does not automatically ensure that they are being appropriately monitored and enforced in practice. For example, if an organisation has put in place a whistleblowing policy and program, but in practice complaints by whistleblowers are merely ignored or rejected, then the policy clearly isn't worth the paper it is written on.

Conflicts of interest report

The report we released a few months ago – on our findings of a review of conflicts management practices in vertically integrated businesses in the funds-management industry[1] – emphasised the role that remuneration and incentives play as a driver of the behaviour of organisations. For example, conflicts can arise or be exacerbated where incentives reward high-risk, short-term business strategies.

From our review, we found that some organisations take conflicts management seriously. We found some good practices, such as separate boards for subsidiaries, which may help to manage conflicts. However, we remain concerned that some policies may have been adopted without sufficient attention to genuinely addressing the underlying conflicts.

We encourage all organisations to assess their approach to conflicts management.

We recognise that culture is not something that can be regulated with black-letter law. We know that it isn't feasible to check over every company's shoulder to test their culture, or dictate how an organisation should be run. Culture is at the heart of how an organisation and its staff think and behave. It is an issue that companies themselves must address.

Senior management plays an important role in setting the 'tone at the top' for an organisation. Culture requires senior leaders to think carefully about how their actions and behaviours support and advance the organisation's desired culture.

Conclusion

I want to conclude by saying that from both my perspective – and from your perspective – culture matters. If you don't have a culture that genuinely puts the customer first, or if your customers don't feel that this is the case, you will see the very real impacts of this on your bottom line or the value of your organisation. These impacts are heightened by the technological world in which we live. Social media and the 24-hour news cycle have changed everything.

It is the responsibility of each organisation to look at what steps they can take to improve their culture and sustain a 'customer first' culture over the long term. To improve trust and confidence, companies need to create and nurture a culture that goes beyond maximising profits; companies need to focus on achieving and rewarding good conduct and good outcomes for customers.

At the end of the day, you need to have a culture that your customers can believe in. If your culture genuinely reflects 'doing the right thing', this will be rewarded with longevity and customer loyalty.

It's not enough to talk the talk. You've got to walk the walk too.

[1] Report 474 *Culture, conduct and conflicts of interest in vertically integrated businesses in the funds-management industry* (REP 474).