ASIC's focus on culture – digging into the detail

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Introduction

Thank you for inviting me to speak at your conference today about ASIC's focus on culture.

As I mentioned in the previous session, good governance is one of the core elements of a positive organisational culture. Therefore, as directors and corporate governance specialists, you can all make a difference by promoting a more positive culture, not just within your firms, but more broadly across the industries in which you work.

One of ASIC's key priorities is to promote investor and financial consumer trust and confidence. Trust and confidence is critical to the operation of the financial system. Poor culture can undermine that trust and confidence. By contrast, good culture, which is more conducive to good conduct, helps maintain trust and confidence.

I thought I'd start my presentation by addressing some fairly fundamental questions:

- What is corporate culture?
- Why does it matter?

From this starting point I will talk about the following themes:

- the general features of a positive corporate culture
- an overview of ASIC's work around culture and conduct
- what we consider to be some of the key drivers of culture, and
- some of the current thinking around the practical things that directors and boards can do to promote a more positive culture within an organisation.

Before I move on, I'd like to quickly say that, although my presentation will naturally have a financial sector bent, many of the concepts I will be talking about are very much relevant to the various industries in which you work.

What is culture and why does it matter?

So, what is culture?

Culture is a set of shared values and assumptions within an organisation. It reflects the underlying 'mindset of an organisation'. Culture represents the 'unwritten rules' for how things really work in an organisation. It works silently in the background to direct how an organisation and its staff think, make decisions and actually behave.

Because culture lies at the heart of how an organisation and its staff think and behave, it is an important driver of outcomes for investors and financial consumers.

While we've been talking a lot of about culture lately, corporate culture is not a new concept – it was actually captured in the Commonwealth Criminal Code over 20 years ago. The Criminal Code defines corporate culture as including an organisation's attitudes, policies, rules, course of conduct and practices.

Culture matters to ASIC because poor culture can be a driver of poor conduct – and we regulate conduct.

Bad conduct can flourish, proliferate and may even be rewarded in a bad culture. A good culture, on the other hand, can help uncover and inhibit bad conduct and reward and encourage good conduct.

However, it is not only regulators who should care about 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.

There are a number of ways that having a good culture can benefit your organisation. For example:

- increasing customer loyalty, brand and reputation
- reducing or avoiding the financial impact of fines or remediation, and
- attracting and retaining staff.

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 ten most-affected global banks was approximately US$250 billion between 2008 and 2012.

What do we mean by 'positive culture'?

At ASIC, we are particularly interested in the businesses we regulate striving for a culture of 'doing the right thing' by investors and consumers. So, what do we mean by this?

In practice, we think a business is 'doing the right thing' where it:

- ensures it takes into consideration the long-term interests of its customers, both when things are going well and when they are not – for example, in any remediation process
- ensures that products that are designed to provide utility to a specific target market take into account the needs of that target market and are appropriately tested
- ensures the right products and services are sold to the customers they were designed for, not just to any customer who may not understand or be suited to the product
- has controls in place to support good culture – for example, how products are developed, approved, marketed, distributed, monitored and reviewed
- has a recruitment, training and reward structure that is aligned to and reinforces a culture of 'doing the right thing' and good outcomes for customers, and
- provides an environment that encourages staff to challenge accepted practices and raise issues when mistakes are made or when things don't seem right.

What is ASIC focusing on in relation to culture and conduct?

Before I move on to talk about ASIC's focus, I'd like to emphasise that we do not intend to dictate how businesses should be run or what the culture of firms should look like. Nor are we advocating for change to the existing liability regime for directors in this area. This is because poor culture is not something that can simply be resolved through regulation with black letter law.

As I mentioned before, culture is the 'mindset of an organisation'. It is ultimately an issue that organisations themselves must address. However, as a regulator we do play an important supervisory and monitoring function because culture is a key driver of conduct.

Turning now to ASIC's focus area. We outlined in our four-year corporate plan[1] that we are focusing on gatekeepers, including lenders, directors and responsible entities.

We also outlined that we are incorporating culture into our risk-based surveillances. We will use our surveillance findings to better understand how culture is driving conduct among those we regulate.

We are looking out for cultural indicators that suggest we should take a 'deeper dive' around issues concerning poor conduct. For example, policies not lining up with what people say and do, or a lack of action when things go wrong. This might mean more intensive surveillance or a broadening of the scope of our surveillance.

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[1] ASIC's Corporate Plan 2015–16 to 2018–19: Focus 2015–16.

Where we identify poor culture, we will make this clear to the firms in which we see it. We think it is important to share this information with directors given their role in guiding and monitoring the management of the company. I will say more on this later.

By focusing more on culture, we expect to get early warning signs where things might be going wrong, which should help us disrupt bad behaviour before it happens and catch misconduct early. We also think it will help us identify broader more pervasive problems and not just individual instances of misconduct. This might be on an individual firm level, but it could extend more broadly to particular activities across firms or within industry sectors.

While we are now specifically looking at culture as part of our surveillances, this isn't completely new – we have always considered various indicators and factors that drive poor behaviour.

The key areas we are focusing on relate to remuneration structures, conflicts of interest, complaints handling, treatment of whistleblowers, and breach reporting to ASIC.

We are focusing on these areas for three reasons.

Firstly, the policies, procedures and systems adopted by a firm in respect of each of these areas generally provide a good indication about the firm's culture, since they tend to reflect the underlying values of the organisation and what the organisation considers to be important. An organisation with a good culture will have a strong focus on addressing and resolving customer complaints on a timely basis, ensuring the right products are developed and sold to the right people at the right price, and encouraging staff to speak up and report issues.

Secondly, the key performance indicators and metrics that are used to evaluate and remunerate staff, particularly those in the front line, may lead to a misalignment between a firm's values and actual staff behaviour. In practice, if a firm's objective is to have a customer-focused culture, but staff performance and remuneration are solely based on sales volume, then it will likely result in a sales-driven rather than customer-focused culture.

Thirdly, in cases where policies, systems and controls have been implemented to support a culture of 'doing the right thing', it doesn't necessarily mean that they are being appropriately monitored and enforced in practice. For example, if a firm has put in place a whistleblowing policy and program, but in practice the complaints by whistleblowers are merely ignored or rejected, then the whistleblowing policy and program are really only worth the paper they are written on.

Beyond surveillance, ASIC is also looking at:

- *Peer review* – One good way to shape culture is through peer review. One option we are currently considering is a financial services industry panel made up of respected industry experts who assess the conduct of their peers on disciplinary matters.
- *Industry-wide initiatives* – We are looking at the potential for industry-wide initiatives. As I mentioned before, some of the issues within the Australian financial

sector may be due to underlying cultural issues at the industry level, rather than a case of a few bad apples. Where this happens we think industry-level initiatives, as well as regulatory action, are important to ensure there is meaningful impact across the financial sector.

- *Whistleblowers* – Effective internal whistleblower policies and programs are important in ensuring whistleblowers are able to come forward to management or ASIC to report problem areas that undermine culture. Whistleblowers should feel free to report issues without feeling that they will be stigmatised or suffer from potential loss of employment or income.

What can organisations do to promote a more positive culture?

At ASIC, we consider there are a number of key drivers that will help maintain a culture of 'doing the right thing'. I stress that ASIC is not trying to micro-manage the culture of firms. As the regulator, we won't be trying to design a firm's culture, nor dictate how a business is run. However, we strongly encourage firms to take action to consider cultural issues themselves, particularly in areas where the culture of a firm has the capacity to cause damage to customers or market integrity.

We think a company's board, senior executives and management all play a critical role in influencing and overseeing each of these areas. In particular, boards should take all reasonable steps to place themselves in a position to guide and monitor the management of the company. Let me now discuss some possible areas where boards and senior management have the opportunity to influence or oversee culture.

Tone from the top

Together, the board and senior management are responsible for creating a culture where everyone has ownership and responsibility for 'doing the right thing'.

The board should lead by example by demonstrating conduct that supports the firm's values.

Cascading values to the rest of the organisation

This includes taking steps so that the firm's values are communicated 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 line.

Translating values into business practices

The board should test that a firm's values are incorporated into all of its business practices, for example how new products are approved and how the firm responds to customer complaints and claims. This ensures there is no gap between a firm's desired values and actual conduct.

Accountability

The board should test that the compliance and governance frameworks that are in place are monitored and enforced.

Effective communication and challenge

The board should promote a culture of open communication and effective challenge to allow current practices to be tested.

Recruitment, training and rewards

The board should promote behaviours and attitudes that lead to good conduct and outcomes for customers as part of the selection of all staff.

They should monitor the training available to maintain staff knowledge about the firm's values and the attitudes and behaviours expected of staff.

The board should also monitor that the company's remuneration and incentives 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 crucial, therefore, that firms recognise performance in a way that not only promotes good conduct but penalises poor conduct as well.

Governance and controls

Under the board's stewardship, the leadership team should promote, monitor, and assess the impact of the firm's culture on conduct and make changes where necessary.

It is important that there is direct access to the board and leadership team.

It is also important that there is a process in place for periodic reporting to the board.

What are some practical ways to promote a more positive culture?

I want to spend a couple of minutes now to talk about some of the current thinking around practical things that boards and directors can do to promote a more positive culture within their organisations.

As I mentioned earlier, the board plays an important role when considering the 'tone at the top' of an organisation.

Therefore, as a start, a board may wish to consider:

- how they are modelling the firm's desired behaviours and values when interacting with management and staff, and
- how their actions and behaviours support and advance the firm's desired culture.

Another important consideration is how a board can gain better insights into the company's culture. For directors who are not involved in the daily operations of a company, overseeing culture can be challenging. But there are a number of levers available to help with this.

For example, boards may wish to consider the following questions to help gain insights into a company's culture:

- Is culture a regular feature on the board and audit committee agenda?
- Do directors have regular interaction with staff across the organisation and not just with the CEO and executive management?
- Are there good relationships with key employees, such as line managers, to help with gathering insights about team-specific issues and sub-cultures?
- Is there periodic engagement with all stakeholders to get a broad perspective on the issues impacting on customers, suppliers, regulators, and the community? This should help with balancing various competing and conflicting interests.

As the Chair of ASIC's Diversity Council, I think promoting more diversity within organisations, particularly at the executive and board level, is an important mechanism for fostering a more positive culture within firms. This is because, for many of us who have spent our careers looking at our specific area of expertise, we can become conditioned to look at information in a certain way. Ensuring diversity of thought and perspectives throughout an organisation, including at the executive and board level, should help mitigate the risk that issues that should be apparent end up being neglected or go unnoticed.

Another aspect to consider is putting in place mechanisms to help with measuring and monitoring a firm's culture. This includes measuring the level of alignment between a firm's desired values and staff perceptions – basically it is about measuring the 'gap' between a firm's desired culture and the actual mindset of the organisation. It also involves monitoring how the various indicators change or move together over time.

Many firms are currently looking at creating 'culture dashboards' to help with capturing data on key indicators gathered through employee feedback and surveys, customer complaints, and progress on employee training on culture issues. Internal and external audits can also help with the periodic monitoring of a firm's culture, since they generally touch many parts of the organisation and expose a variety of cultural indicators.

Last, but not least, a board should consider monitoring the composition and behaviour of the board on a regular basis to see how this is impacting on the culture of the organisation.

The ASX Corporate Governance Council has published specific recommendations for the regular review of board performance for entities listed on ASX.[2]

[2] ASX Corporate Governance Council, *Corporate Principles and* Recommendations, 3rd edn, 2014.

Similar best practice recommendations have also been adopted in Canada, the United Kingdom, and the United States.[3]

The periodic review of board performance can, for example, be extended to include the impact of the board's composition and behaviour on the organisation's culture.

Conclusion

I'd like to wrap up my presentation today by urging you all to think about your organisation's culture, and reflect on some of the changes you can make to foster a more positive culture of 'doing the right thing', both within your firms and, more broadly, across the industries in which you work.

[3] GC Kiel and GJ Nicholson, 'Evaluating boards and directors', *Corporate Governance: An International Review* 13(5), 2005, pp. 613–31.