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Culture Ignited: A Perfect Storm

Culture. A term that has been a regular feature in news reports in 2018 and 2019 and (should be) at the top of every board and senior executive's agenda. However is culture the cause or a symptom of an underlying deeper problem in corporate Australia? What is the impact of a rapidly changing external environment on cultural change?

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What Is The Culture Problem?

In the Final Report to the Royal Commission Inquiry into Misconduct in the Banking, Superannuation and Financial Services Industry (**Royal Commission Inquiry**), Commissioner Hayne devoted an entire chapter and many other sections to the standard of culture and governance in Australia's banking, financial services and superannuation entities. The cultures observed by Commissioner Hayne were ones of greed and profit, often at the expense of basic standards of honesty[1]. Every financial services entity was tasked with looking into their culture and the way the organisation governed itself. Governance was viewed as encompassing not just the way in which a board operates but also how the corporation manages non-financial risks.

Hayne defined culture as "the shared values and norms that shape behaviours and mindsets"[2]. The definition of culture used in the Commissioner's final report was a broadly applied definition, but with one notable difference. Hayne explains in a footnote to the body of the Final Report that his definition of culture deliberately omitted reference to 'a system' of shared values and norms. This was to emphasise the point that "culture is observed and described, not created apart from, or imposed on, the corporation"[3].

It appears, what Hayne was suggesting was that culture is not a by-product of a poor 'culture system' or lack of regulation. Rather, the culture of a corporation is symptomatic of the "what we do around here" values and norms that are accepted and tolerated by the people in a corporation and most notably, its leaders. It would therefore seem that to change culture, corporations will need to take steps to change the values and norms that shape the behaviours, conduct and mindsets of their people, or change the people themselves. But to change these behaviours and norms, it is first necessary to understand them.

How Extensive Is The Problem?

The culture-problems in Australia would appear to be extensive and widespread. The APRA Capability Review confirmed that cultural problems in Australia extend further than just the corporate sector with similar problems in culture being identified in the prudential regulator itself[4]. The Review pointed to a variability in leadership, conformist culture and aversion to transparency within the regulator. The main conclusion being, that APRA's internal culture and regulatory approach, also needs to change[5].

Issues identified with Australian culture are not limited to corporations and regulators either. Many of the norms and behaviours observed in corporations and regulators appear to have also been bleeding into politics and how Australia develops policy. In a recent speech presented at the Melbourne Law School, Kenneth Hayne observed "Reasoned debates about issues of policy are now rare[6]." Hayne suggested there is a lack of depth and understanding of issues which causes a lack of reasoned debate with "reference only to slogans, coined by partisan participants".

There are also common themes emerging across institutions on the types of cultural issues being identified. Similar observations to those of Hayne in the context of politics (of a lack of reasoned debate and lack of understanding) have been made about the behaviours identified in some corporations.

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[1] Final Report - Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry; Commonwealth of Australia; 1 February 2019; Volume 1, page 1

[2] Final Report - Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry; Commonwealth of Australia; 1 February 2019; Volume 1, page 375

[3] Final Report - Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry; Commonwealth of Australia; 1 February 2019; Volume 1, page 375

[4] Australian Prudential Regulation Authority Capability Review (APRA Capability Review), Commonwealth Government, June 2019

[5] Ibid; page iviii

[6] Page 6

In the transcript of Catherine Livingstone commenting on the CBA's Anti-Money Laundering and Counter Terrorism Financing issues (which is referenced in the Final Report to the Royal Commission Inquiry[7]), Ms Livingstone makes a shocking revelation that upon reviewing the materials, her judgement as a director was that further questioning at the time "would not have changed the outcome" as it would have resulted in "unsatisfactory answers". Ms Livingstone's assessment was that "neither management nor internal audit could articulate the problem they were trying to solve". This either indicated a lack of depth and understanding of the issues or a lack of directness in reporting on the issues, or both.

In circumstances where cultural issues extend beyond the corporate sphere (as they apparently do) and common threads of behaviours are emerging, it points to a more fundamental, underlying cultural DNA in Australia which needs to be examined to determine the extent to which it exists in each corporation.

What Is Our Australian Cultural DNA?

An insight into some of these Australian traits which could be impacting how Australian institutions are run, may be evident from quintessential Australian phrases such as "she'll be right", "don't spit the dummy" and the overall laid back "don't rock the boat" mindset, together with a tall poppy syndrome. While these traits can be viewed fondly as the laid back "Australian way", applied in corporate context, they could undermine constructive criticism and challenge, the value of different opinions or debate and a drive to execution.

Observations into Australian corporate culture are most telling from the outside. In one small piece of research performed by an Australian Financial Review (AFR) journalist in 2017, expats interviewed by the journalist were asked to comment on Australian Corporate culture[8]. While there were many observations shedding Australian corporate culture in a positive light, some of the observations, were almost a premonition or window into many of the cultural failings in corporations we are seeing today.

In the AFR journalist's research, the tall poppy syndrome was alive and well. It was observed that while in Silicon Valley workers were "encouraged to be as visible as possible and to have a loud voice", in Australia, workers learned how to "subtly talk". Australian workers were seen to do "just enough" rather than "going the extra mile". Short term thinking was viewed by the expats interviewed as a problem.

The expat observation that Australians tend to be overly 'subtle' is particularly relevant in a corporate or institutional context. In a business environment, people who are too direct may be seen as alarmist or confrontational. The tendency to be overly subtle or indirect in conveying important messages is perhaps best illustrated in observations of Hayne in the Final Report to the Royal Commission Inquiry[9] in the context of how issues were reported to the NAB board. In Hayne's view, "Not enough was done" in making it clear to the board that the:

- the issues were not new but were nevertheless being reported to the board for the first time;
- the seriousness of the issues; and
- the consequences of the issues.

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[7] Final Report - Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry; Commonwealth of Australia; 1 February 2019; Volume 1, page 397

[8] 24 things expats find surprising about Australian working culture, S Kimmorley, 30 January 2017

[9] Final Report - Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry; Commonwealth of Australia; 1 February 2019; Volume 1, page 398

What Is The Role Of Governance, Risk And Compliance In Improving Culture?

While all corporations will need to consider their own cultural DNA and how this needs to change, there is no question that immature or poorly designed governance, risk and compliance (GRC) frameworks have a direct correlation to the cultural deficiencies we have seen in recent times. The manner in which these frameworks are addressed, could be the difference between meaningful, sustainable cultural change and culture change which only touches the surface.

In the Final Report to the Royal Commission Inquiry, Hayne was clearly of the view culture and governance must be addressed concurrently. When discussing governance, Hayne was referring to this in the broadest sense to encompass all levels of "governance" of a corporation including how it manages its legal and compliance obligations and other non-financial risks. Hayne considered governance as referring "to the entirety of structures and processes by which an entity is run". In looking at culture and governance Hayne said "every entity must consider how it manages regulatory compliance and conduct risks"[10].

In a number of the issues concerning cultural weaknesses of Australia's largest financial institutions, many of these issues have been identified as contributing or being linked to, poor governance or poor management of non-financial risk. For instance in the 'CBA-Style' Prudential Review published by Westpac, a tendency to overcomplicate and to privilege upfront conceptual work over execution and implementation were identified as being key cultural issues relating to "Corporate DNA strands" at Westpac[11] as well as immature processes and systems around management of non-financial risks[12].

More robust GRC frameworks set a stronger foundation for culture to thrive. To illustrate, accountability and remuneration (which form part of good governance) have been a key focus of regulatory enhancement to lift human behaviours and conduct. Changes or proposed changes to enhance enforcement and tighten legislative obligations (such as recent changes to whistleblowing laws) have been increasingly directed at improving the standards of GRC frameworks.

However, enhancing GRC frameworks beyond the regulatory change agenda will be necessary to drive the cultural change which is needed. For example, ensuring appropriately qualified risk and compliance professionals are in place report on risk and compliance matters, will lead to a deeper understanding of these issues so they are properly considered and managed by the board and senior executives. Well-designed frameworks, policies and procedures, will create more certainty on the conduct which is acceptable but will also lead to more efficient performance and decision-making. Better systems and monitoring to identify issues early, will mitigate the amount of detriment suffered when things go wrong.

Those corporations which consider enhancements of GRC frameworks alongside their cultural change programs will therefore experience more meaningful and sustainable change than those which fail to consider enhancements in GRC or address these matters in silos. While Hayne and others have recognised there is a need for culture and governance to go hand in hand, a component which has perhaps been missed when considering the broader context of culture change is the rapidly changing landscape and the impact this may have on the change agenda.

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[10] Ibid; Volume 1, Page 333

[11] Governance, Accountability and Culture Self-Assessment – Westpac Banking Corporation, 28 November 2018; paragraphs 1.3.4 and 1.3.5, pages 8 and 9

[12] Governance, Accountability and Culture Self-Assessment – Westpac Banking Corporation, 28 November 2018, paragraphs 1.3.4 and 1.3.5, pages 8 and 9; paragraph 4.2.1, page 25

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Could External Factors Put The Culture Change Agenda At Risk?

Changing culture and enhancing governance, risk and compliance frameworks takes time but can also be expensive. The culture costs to Westpac, ANZ and NAB were recently reported to be in the order of $500 million of capital to address major flaws in culture and the way the banks were run[13]. In 2018, APRA forced the Commonwealth Bank of Australia to carry an additional $1 billion in regulatory capital[14]. Allianz was has also been forced to meet more stringent capital requirements becoming the fifth financial services entity to have additional capital requirements due to heightened operational risk[15].

Therefore, to manage the substantial change that is needed in many corporations and the heightened risks which are posed until such time that they do resolve these issues, financial and economic stability will need to be maintained. While entities in the financial services sector are seemingly financially stable and appear to be able to afford the substantial costs needed to improve culture and how they are run today, signs of a slowing economy and other external risks are becoming more prevalent and could impede this ability in the future.

The possibility of negative interest rates has reportedly "ballooned" following a decision by the Reserve Bank of New Zealand to reduce its rate down to 1 per cent[16]. Although the RBA Assistant Governor (Financial Markets), Christopher Kent has maintained messaging that a negative interest rate environment in Australia is 'unlikely', it has equally been acknowledged that it is 'possible'. The possibility of a negative interest rate environment has also been linked as a driver behind the recent draft provisions to restrict cash transactions in Australia[17]. In a recent presentation by RBA Deputy Governor, Guy Debelle, other external factors regarded as material to Australian corporations are the trade dispute between the US and China (which was considered a "major risk" for the Australian outlook) and the slowing of consumption (which was considered a "primary risk")[18].

In the launch of the Government's road map for of legislation to implement the Royal Commission Inquiry recommendations (many of which were directed at driving improvement in corporate culture), Mr Frydenberg acknowledged "While Australia's financial system has withstood the enormous stresses of the global financial crisis… it was clear on coming to office that not all the international lessons of the crisis had been learned in Australia[19]." The Government considers that restoring trust through the proposed legislative changes will be "a key part of the Morrison's government plan for a stronger economy".

APRA Chairman Wayne Byres, has recently acknowledged that five years ago, external factors such as financial stability, technological disruption and climate change received little attention or were 'over the horizon' risks to be managed[20]. However today, Mr Byres considers, APRA is being asked to do more, and more assertively, than it has traditionally done before.

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[13] APRA Media Release; APRA applies additional $250m capital requirement to three major banks in response to self-assessments; 11 July 2019

[14] Australian Financial Review; Commonwealth Bank hit with $1b capital charge after scathing APRA report; J Eyers and J Shapiro; 1 May 2018

[15] APRA Media Release; APRA applies additional $250m capital requirement to Allianz Australia; 1 August 2019

[16] Roddan M, RBA deputy Christopher Kent: negative interest rates 'unlikely', The Australian, 14 August 2019

[17] Negative Interest Rates and the Cash Ban are Definitely Linked, Adams and North, 7 August 2019

[18] G Debelle, Risks to the Outlook; Keynote Address, 15 August 2019

[19] M Cranston and J Eyers, Josh Frydenberg fast-tracks royal commission response, Australian Financial Review, 19 August 2019

[20] W Byres, Reflections on a changing landscape, 26 August 2019

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Lifting standards of governance, culture and accountability are now key strategic priorities for APRA. One of the reasons put forward by Mr Byres for this renewed focus are the limitations in monetary policy in dealing with both economic and financial risks which have become clearer thereby increasing focus on APRA's ability to "lean against the wind" as imbalances emerge. According to Mr Byres, regulators and risk managers alike needed to be ready and able to respond to the demands of a "rapidly changing landscape".

Thus the interrelationship between external factors and the management of non-financial risk is becoming increasingly important not just in terms of the ability of corporations to effect change, but also in sustaining a financially viable corporation and stable economy. It will therefore be a critical success factor for a corporation to deeply analyse the potential risks that it faces and the impacts this may have on its culture and how it is governed.

Conclusion

The significant cultural change which is needed to uplift standards in the financial services sector may seem like an issue for boards, senior management and human resource departments. However, examined more closely, the robustness of governance, risk and compliance frameworks will be of critical importance to ensuring improved cultures are effective and long-standing.

There are a number of underlying external factors that are in the making of a perfect storm if culture and governance are not urgently addressed. Survival will not only be in the financially fittest but those with strong cultures and sufficiently robust and mature GRC frameworks. If corporations are already lagging behind in the health of their culture and standards of GRC, there is a material risk that the failures we have seen to date will become more intense and widespread, with substantially more detrimental impacts to customers and other stakeholders. There has never been a stronger burning platform to enhance culture and governance in your organisations.

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Our Team

The Ash St. Governance, Compliance and Regulation Team (GCR) is a blended legal, compliance and governance practice that draws on the private practice and in-house experience of our Practice Director, Samantha Carroll and Special Counsel, Michelle Bradshaw. Their approach is to listen, understand and then provide our clients with quality advice informed by their experience of what works in the real world.

Consistent with the Ash St. approach, the GCR team leverage the complementary skill sets of our Corporate/M&A, Finance, Projects IT, IP, Real Property and Employment Legal Practices and Advisory Services to ensure that the right people are involved in our client's Governance, Compliance and Regulatory matters. This translates into achieving the best results and high quality outcomes, for our clients.

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Our team of lawyers (many from top-tier law firms) have decades of experience in mergers & acquisitions; corporate and commercial law; governance, compliance and regulation; finance; IT; IP; real property; contracting; projects and employment law. Our firm's culture is based on providing clients with high value, technical (but pragmatic), advice.

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