Implementing ethical culture across the Australian financial landscape

Richard Brandweiner* and Susan Morey**

Received (in revised form) 6th February, 2017

*Leapfrog Investments, Suite 601-603, 35 Grafton St, Bondi Junction 2022, Australia
E-mail: richard.brandweiner@gmail.com

**Head of Advocacy Australia and New Zealand, CFA Societies Australia,
GPO Box 4805, Sydney NSW 2001, Australia
E-mail: advocacy@cfas.org.au

Richard Brandweiner

Susan Morey

Journal of Financial Compliance
Vol. 1, No. 1 2017, pp. 56–63

2398-8053

Richard Brandweiner *CFA is a partner at global impact investment firm, Leapfrog Investments. Richard has over 20 years of investment experience and prior to joining Leapfrog in January 2017, he was Chief Investment Officer for First State Super, one of Australia's largest superannuation funds with more than AU$54 billion in funds under management and over 750,000 members. Before this much of Richard's career in investment management was spent at Perpetual Investments. Richard is a member of the Australian Advisory Board for International Social Impact Investment Taskforce, a G8 initiative to help develop the global impact investing market. Additionally, he is a past President of the CFA Society of Sydney. He has a Bachelor of Economics from University of New South Wales.*

Susan Morey *is Head of Advocacy for CFA Societies Australia and CFA Society New Zealand, member societies of the CFA Institute. Sue has over 20 years' experience in senior corporate affairs and investor relations roles across diverse industries working for listed and non-listed entities and in government. Prior to joining the CFA, Susan was Group Director for global engineering firm WorleyParsons Limited and General Manager Corporate Affairs and Investor Relations at Australian listed fund manager, Perpetual Limited. She has also held a number of lead corporate affairs and investor relations roles globally and locally in financial services with the Australian Prudential Regulation Authority, Swiss Re, HSBC and Commonwealth Bank. She has combined qualifications in communications and branding.*

Abstract

This paper invites readers to think about:

- *the worsening issue of cultural integrity and why it has become a concern for the financial services industry, specifically in Australia and at a broader global level;*
- *the purpose of the financial services industry, the importance of factors such as trust and reputation that are associated with culture based in high standards of integrity and professionalism versus short term market gains;*
- *the concept of stewardship of other people's money and the dilemmas and conflicts for industry behind that concept of stewardship, the relevance of stewardship to industry's moral compass and the relevance of culture in being good stewards;*
- *identifying what culture is, why it matters and why the community deserves an industry with strong cultural integrity to be stewards of their money;*
- *the role of professionalism in culture, how the foundations of culture are built and sustained through the core components of professionalism: competency, compliance and ethics; and*
- *the benefits to industry that adopts and sustains such a culture.*

This paper aims to build awareness and knowledge of culture and the vital role it plays in the long-term sustainability of the financial services industry.

Keywords: culture, cultural integrity, professionalism, competency, compliance, ethics

INTRODUCTION

> Our financial system has stopped serving the real economy and now mainly serves itself … Our system of market capitalism is sick … Our economic illness has a name: 'financialization' … Makers, the people, companies and ideas that create real economic growth, have come to be servants to Takers including financiers and financial institutions as well as misguided leaders in both public and private sectors including CEOs, who don't seem to realize how this undermines economic growth, social stability and even democracy.[1]

There is a real underlying purpose to the system of finance and, as it drifts away from intermediating between savers and borrowers towards self-service, it is likely to fulfil that purpose at the expense of ethics and moral virtues. Good compliance alone is not sufficient to save us from an absence of ethics.

So, have we become truly the masters of a sick industry culture?

In its recently released information paper on 'Risk culture',[2] Australia's prudential regulator, the Australian Prudential Regulation Authority (APRA), noted:

> an assertion made by most institutions that they believe they have a good, if not strong, risk culture; to the extent there are deficiencies in the industry, most institutions consider they exist within their peers. And where there have been specific problems identified among their own businesses, 'bad apples' are typically seen as the cause.

Candidly, APRA also noted that:

> much of the attention on global regulatory responses to the global financial crisis has focussed on strengthening the balance sheet of financial institutions. While these measures help to strengthen the resilience of financial institutions, they do not address the risks of poor behaviours and/or attitudes to risk by the decision-makers within an institution. Tackling risk culture is, to a large degree, the final frontier in the post-crisis response.

WHY WE EXIST AS AN INDUSTRY

Like the health industry, the financial services industry comprises a series of vital commercial entities that contribute to a strong and successful system, and to the stability of the broader economy. Also, like the health industry, our role as stewards of other people's well-being *should* require that commercial gain is underpinned by the highest standards of professionalism and ethics. The importance of our industry and its role in building a strong economy also means we must be sustainable. Indeed, no one questions the need for industry to be financially successful; it is just the means some have chosen to achieve success that is now being scrutinised. By far, the greatest threat to sustainability is trust, and it is here the Takers have damaged the industry in recent times.

It is this dislocation between the way the system functions and the moral imperative of stewardship that creates the dilemma around the dual and conflicting purpose of why we exist as an industry: one as a commercial entity with a mandate to protect the financial system by ensuring it thrives and flourishes; the other as a profession with a focus on the well-being of the beneficiaries served by that very same system.

One such example of conflict of purpose is the superannuation (pension) system. Superannuation saving is an extremely long-term investment prospect. Yet many industry participants are increasingly pressured to produce short-term profits, potentially at the expense of longer-term returns for superannuation members.

Regulation rightfully exists to punish those individuals and companies who break the law; however, this is not a question of law. Our industry's dilemma or concern is primarily an issue of moral compass, which can only be addressed through moral imperative, not increased legislation.

It is here we must learn how to find that crucial balance between the bottom line, ethical behaviour and delivering on the important promises we have made to beneficiaries of the system we manage on their behalf. Without that fine balance, industry will constantly be dogged in an everlasting cycle of spiralling investor trust and regulatory oversight.

And this situation serves no one's purpose.

THE MORAL IMPERATIVE

Why we exist as an industry raises an even more important question around moral imperative, that is, our industry's broader responsibility to society. Again, superannuation presents a great ethical case study within the Australian financial system. It is mandated in Australia and yet accountability sits with the beneficiary. Every working Australian must contribute nearly 10 per cent of their monthly salary to superannuation. Even the government recognises the important political 'sway' the success or failure a mandated superannuation system potentially has over the community and more importantly its constituents. It is therefore the only regulatory regime within the financial system over which the government has the right to last say.

More than 25 years of mandated superannuation has created for Australia one of the largest savings pools in the world and the model is touted as being the envy of the developed world. The ongoing and guaranteed weight of money pouring from superannuation into industry coffers each year is nothing short of a financial windfall for many participants at many stages along (an ever increasing) value chain. This begs many questions: does the mandated nature of superannuation in Australia place a greater moral or ethical imperative in the hands of providers towards investors, particularly retail investors? Does this same imperative demand that regulators use a heavier hand or even a different regulatory regime with mandated super than with discretionary investing? Would that imperative be reduced if the regime were discretionary?

While probably extremely just from a moral perspective, these questions hark back to only one issue: industry's purpose in maintaining that crucial balance between the bottom line, ethical behaviour and delivering on the important promises made to beneficiaries. Only when we fail in this endeavour, should we be subjected to the heaviest hand of the law.

CULTURE: THE FINAL FRONTIER

In Australia, a litany of breaches in recent years has meant industry is rightfully under scrutiny from the government, regulators and the community to better our standards and professionalism. Community trust is at an all-time low and we are being taken to task over it. To what extent these breaches would have been prevented through a greater focus on ethical culture is not clearly defined; however, numerous government inquiries have determined that culture has more than played its role. Thus, there is now a popular movement to improve industry culture, either voluntarily or through increased regulation and oversight.

Under its twin-peaked regulatory system, APRA and Australia's corporate regulator, the Australian Securities and Investment Commission (ASIC), have both been granted more funding and resources to engage more effectively in industry culture. The direction and tone of culture is undoubtedly set by an organisation's leadership, something industry itself has publicly acknowledged. APRA's report[3] noted that this was attributed to the direct and highly visible nature of the interactions between leadership and employees. Senior executives were seen to have an immediate and tangible impact on behaviours both through what they said and what they did. Institutions noted the direct impacts on behaviour and risk culture where there were disconnects — both real and perceived — between stated values and actual behaviours. Employees were seen to be particularly aware of instances of 'do as I say, not as I do'.

The report[2] also noted many institutions were aware that clarity and a shared understanding of organisational purpose and values were central to driving cultural and behavioural outcomes, and felt strongly that there needed to be clear alignment between organisational purpose, stated values and actual behaviours. In the report, however, institutions also acknowledged that this was a challenge, often referencing culture as a crucial element in framing how decisions were made when there were 'competing tensions', 'moments of truth' or 'dilemmas'.[2]

Culture itself is hard to define. It is largely dynamic and intangible, but every employee operates within its confines, wittingly or unwittingly, as either a Maker or a Taker. Essentially, culture is the coming together of the customs, traditions and values of a given set of individuals, who share a level of like-mindedness and collectively set the culture of the community they inhabit, whether it is a tribe or an organisation.

In theory, 'culturally successful' organisations have a universal mindset that, under the guise of enterprise, provides employees with a moral code that largely determines their decisions and actions, and ultimately become employers of choice for individuals who share their same values. What this does not determine, however, is the actual nature of the organisational culture: it is just culture, good or bad.

It is this lack of definition and its innate subjectiveness to individual interpretation that questions the suitability of subjecting culture to regulation and potential liability.

WHO OWNS THE MONEY?

The most fundamental question in the debate on trust in the financial services industry today is: who owns the money? Any debate on improving ethics, building trust and raising standards of professionalism — in other words culture — must begin and end by acknowledging who owns the money. What culture looks like, who is accountable for it and how you measure its success are all secondary. Any discussion on trust can only be had by an industry whose culture fundamentally acknowledges investors as the source of all money in the system. If the organisational culture conversation is not beginning and ending with the idea of stewardship of money, then it is the wrong conversation.

Without doubt, some industry members believe they own the funds they invest and manage, and this could not be more wrong. Industry's role is that of a fiduciary to whom the funds are entrusted as stewards of other people's money. Financial stewardship is essentially the role of the financial services industry. By its simplest definition, it is the assumption of responsibility of the financial well-being of another or a group. The expectation being that this responsibility will be carried out with great care, keeping in mind the good of the individual or group being served.

This is a key reason why we exist.

THE FOUNDATIONS OF GOOD CULTURE

One common challenge for industry is how to create meaningful frameworks to build high integrity culture, and how to identify and adapt the right processes and tools to support such frameworks in a sustainable way. Importantly, these frameworks must create a robust mechanism for monitoring and measuring culture against the organisation's value system and its dual mandates to deliver for beneficiaries and for the financial system.

To fulfil and deliver on its mission of stewardship, the culture of an industry serving such a role must adopt a principles-based approach to culture. That culture must be cross-functional and multi-disciplinary in nature, build frameworks that are genuinely embedded in day-to-day operations and has as its foundation three fundamental ingredients: competency, compliance and ethics.

Competency

Enforcement history tells us competence plays an important role in making properly informed decisions that deliver on the promises made to beneficiaries by the industry. It is understood a large proportion of regulatory enforcements are the product of incompetence and not mal-intent, meaning that lack of appropriate technical skills poses a greater risk to beneficiaries than a lack of governance or ethics. Sadly, the term 'promoted to his or her right level of incompetence' is alive and well in most industries today.

Competence also means the individuals serving as industry stewards should continue to grow their skills, knowledge and know-how as they progress through an organisation. In other words, their technical capabilities are rightfully aligned with the responsibilities and accountabilities directly associated with the requirements of their role.

Competence, or lack thereof, does not make an individual more ethical; however, a highly competent person is not only more capable of interpreting data and information correctly, and making highly informed decisions, they are also more aware of when they are making a wrong decision and the impact it will have on beneficiaries of the system. Any individual acting with the right intent should at this point of the equation, make a right decision.

Compliance

The second element of culture framework is compliance. As an industry, we believe and often talk about the challenges of this environment as something never experienced before. Some industry leaders would suggest it was the global financial crisis that caused consumers to lose trust, not the behaviour of industry.

Historically, market regulation, including prudential regulation, is largely a reactive process. While Australia has an extremely strong regulatory system governed by a series of tried and tested regulatory acts, by nature the system aims to facilitate market conduct generally applying its rule at institution and/or industry level. The rule of law only extends to individuals in the event of enforcement action and only in very specific circumstances.

ASIC wants to penalise responsible officers who are found to have empowered or allowed a corporate culture that has fostered an environment in which an employee commits an offence. The problem is that culture does not really work like that.

Basically, all organisations have a culture, regardless of whether this is actively considered or managed. Culture can only be objectively evaluated as per the innate value system associated with that culture; it is extremely difficult to appraise it using rigid regulatory standards.

Generally, industry codes and standards in Australia often fall short of good practice benchmarks simply because there are no universally accepted independent benchmarks by which organisational culture can be set and measured on an apples-with-apples basis. Regulators are also taking notice.

APRA's focus on risk culture intensified in 2013 when it commenced a review of how the prudential framework established the roles and responsibilities for risk management within financial institutions. The regulator has sought since to understand the structures institutions use to define the acceptable bounds for risk taking. This has resulted in a greater focus on the need to establish clearly articulated risk appetite frameworks.

Most institutions are still grappling with how best to clearly articulate what type of risk culture they aspire to, identify any specific weaknesses in their current risk culture and how they most effectively address those weaknesses.

Nevertheless, APRA recognises that ultimately, a sound risk culture across the industry is not something that can be regulated into existence. It requires persistence by those tasked with the stewardship of financial institutions to ensure that the industry operates within a risk-taking framework that appropriately balances risk and reward, and seeks to operate in a manner that is sustainable over the long run.

At their most fundamental, the codes and standards that govern an institution in the context of good culture must mirror the structure of the organisation they inhabit, addressing the organisation at three distinct levels: whole of enterprise, business unit and individual.

At enterprise level, compliance is often represented by a series of high level mission statements and values that are set and audited internally and therefore are difficult to evaluate in any tangible way. Organisational leadership heavily influences organisational culture, but most codes and standards are not publicly pledged by leadership or regularly repeated and they are rarely held to account to them.

At business unit level, codes and standards are not sufficiently detailed, dedicated or prescriptive to provide an efficient governance framework for each of the businesses and disciplines that make up an organisation.

At individual level, codes and standards are often set during on-boarding and then promptly forgotten. Organisations rarely put compliance front and centre of employee's minds as part of daily operations; they also rarely redress and test employees to ensure standards are being maintained and more importantly embedded.

Ethics

Ethics, and their essential embodiment in 'good' culture, is largely about moral compass.

It is the behaviour of understanding and living 'do the right thing' in the context of the individual's ability to competently assess and make an appropriate decision on that issue within a robust set of guidelines that incorporate the key moral principles of honesty, fairness, equality, dignity, diversity and individual rights that serve to combat our demons.

These principles most importantly must take the age-old issue of remuneration into account and ensuring employee bonuses, performance fees and other incentives are perfectly aligned with the interests of beneficiaries. Here again, the conundrum for industry is to attract the best quality talent focused on delivering outcomes in the best interests of beneficiaries. Equally essential is safeguarding that process by putting mechanisms in place to ensure it does not succumb to pressure from individuals motivated by incentive and institutions driven by the bottom line.

In an organisational sense, ethics is about building strong moral creed by continuously educating and instilling a high awareness of what constitutes ethical behaviour at individual, business unit and whole of enterprise level to make it innately fundamental to the organisational mindset.

It is the essential glue that binds high levels of competency and strong compliance frameworks together to form the third element of good culture.

BUILDING AND SUSTAINING CULTURE

It is here that we would like to look at the mission of the CFA (Chartered Financial Analyst) Institute in attempting to advance the professionalism of the financial services industry. The focus of the CFA Institute has been on fostering true professionalism, which it believes will build and then sustain culture over time as a natural by-product of institutions continuously adhering to the three important elements of competency, compliance and ethics. Its Professional Integrity Framework is targeted towards any organisation in the financial services industry regardless of size, nature or complexity but whose business is based on the stewardship of other people's money. The Framework is overlaid against an institution to develop a Professional Integrity Map.

From a competency perspective, it maps the necessary competencies for each role type across an institution from entry level right up to senior executive level and identifies competency commensurate with the level of required technical skills, decision-making and personal accountability. From a compliance perspective, it looks at an array of purpose-built codes and standards from an enterprise wide, business specific and personal level, each of which hold accountable every employee from the most senior executives to the most junior employee through an annual public attestation process. From an ethics perspective, it outlines and provides training on ethical behaviour and decision-making tailored to the institution.

By providing a process and a series of 'tried and tested' quality tools to support the process, the Framework aims to build the foundations of 'good' culture based upon high standards of integrity as per an institution's stated cultural objectives. The Framework puts competency, compliance, ethics front and centre of the institutional mindset to guide the way it thinks and acts, every day from the top down and from the bottom up.

CFA Institute is clear that the Framework is not is a panacea to resolve all cultural issues within an institution. But, if properly adhered to, it will build over time a level of professionalism within an institution which naturally supports a culture of the highest integrity.

WHERE TO NOW?

The truth is that where there is money, there has always been temptation and Takers have always existed in our industry. Human nature, greed and misaligned incentives will always test the boundaries of morality. Mark Twain's idea that 'history doesn't repeat but it rhymes' is true because as human beings we are truly the devils of our own design.

Two questions come to mind: is it even possible to focus on culture as a solution to the lack of trust in financial services or does it have to be around better rules? Also, if culture is the issue, how do we ensure our industry's culture is defined by the Makers, not by the Takers?

For the sake of the system, the answer must be thus: only an industry whose very nature is based in highest standards of cultural integrity and which is largely self-regulating will prevail over the long-term. In this world, regulators would tread lightly with an extremely large stick to ensure that those who insist on being Takers rightfully feel the full effect of the law.

In defining culture, it is necessary to define and work towards an end game of the sort of industry we want to be. Not only will this help guide us and prioritise initiatives, it will also be a constant reminder of what the benefits of 'good' culture looks like.

So, what sort of world will an industry culture based in high standards of competency, compliance, ethics and market integrity potentially give us?

To begin with, our industry should be regarded by the community as highly competent, deserving guardians of their money and trusted champions for their rights and welfare. Secondly, we would hopefully be acknowledged by regulators as an industry whose culture is largely self-governing and serving the best interests of the community. Regulatory scrutiny would be rightfully focused on stronger enforcement, not supervision.

Good culture will not stop mal-intent; but it will, if properly built and maintained, reduce the incidence and impact of losses incurred from bad conduct over time. Good culture will serve the greater good by creating an environment where beneficiary rights come first and trust in industry is restored, markets function at their best and economies grow. And our industry will efficiently serve its dual purpose of moral imperative of stewardship and economic imperative of supporting the health of the system.

Only such an industry will restore investor confidence and market integrity, and ultimately deliver the financial prosperity essential to maintaining its long-term reputation.

References

(1) Rana Foroohar, TIME magazine's Assistant Managing Editor in charge of economics and business. 'Saving capitalism', 12th May, 2016, available at: http://time.com/4327419/american-capitalisms-great-crisis/. She has since joined the *Financial Times* in March 2017. See: http://aboutus.ft.com/2016/12/05/rana-foroohar-joins-the-financial-times/#axzz4fyJ1OtXD (accessed 15th May, 2017).

(2) APRA (2016) 'Risk culture', Information paper, October 2016, available at: www.apra.gov.au/CrossIndustry/Documents/161018-Information-Paper-Risk-Culture.pdf. (accessed 15th May, 2017).

(3) Ibid.