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culture in governance matters

CULTURE VERSUS INSTITUTIONAL DESIGN

Independent board members, aligning pay incentives, internal controls, risk management, and so on. These corporate governance arrangements are no longer new concepts. Since the Cadbury Report in 1992, there have been innumerable publications, codes and laws on this subject.

Yet, despite these guides and exhortations, we continue to witness corporate scandals – Enron, WorldCom, Countrywide Financial, VW, Wells Fargo, to name a few. The 2008 global financial crisis exposed massive failures of ethics and leadership in finance, business and government.

CONDUCT AND ETHICS

The consensus is that many of these issues boil down to the lack of a culture of ethical behaviour. Many employees within organisations that purportedly subscribed to 'best practice' in governance, were in fact living a different ethical culture. They role modelled after their leaders. They were driven by the wrong incentives or they may have operated under undue influence.

In 1994 when the UK Nolan Committee published the *Seven Principles of Public Life,* the principles were considered "revolutionary" simply because the focus of the discussion was on behaviour and culture, not on process.

Today, the expectation of corporate boards to play an active role in ensuring corporate culture is explicit. The UK Corporate Governance Code, for example, states that the board is to assess and monitor culture. The ASX's Corporate Governance Principles and Recommendations requires the board charter to include the role of the board to approve the entity's statement of values and code of conduct to underpin the desired culture within the entity.

THE CHALLENGE

The reality is that ethics and integrity have always been part of the governance conversation. A significant challenge is that ensuring this "culture" is impervious to implementation and measurement.

In the financial services world, at least we are beginning to see this change. In 2015, the Group of 30 published the *Banking Conduct and Culture:A Call for Sustained and Comprehensive Reform,* reflecting a global regulatory agenda to pin down this slippery issue of culture. What is interesting is that regulators today have begun to use behavioural science to assess how institutions are treating consumer interests. An international survey has reported that 25 regulators from across the world are now using behavioural tests to check on customer

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outcomes. This is with the view to assess, understand and influence behaviour, so that they may achieve a greater impact on culture within organisations.

De Nederlandsche Bank, the Dutch central bank – now widely regarded as a leader in the supervision of conduct and culture – has established a comprehensive supervisory framework on behaviour and conduct. It has even placed organisational psychologists to observe boards and management in order to assess their regulatees' organisational culture. The UK Financial Conduct Authority published a series of discussion papers on the very topic of transforming culture in the financial services. Supported by the Dutch central bank, the Irish Central Bank published the findings of its assessment of the conduct and cultural review of five large Irish retail banks. In April 2019, the International Organization of Securities Commissions issued a report on how financial regulators around the world are using a "culture measurement" to question customer outcomes.

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GOVERNANCE AND CULTURE IN THE PUBLIC SECTOR

Opening of conversation on culture in the global regulatory agenda signals the preparedness of regulators to change the old approach. At the same time, the conversation about culture has not stopped at the culture of regulatees.

A challenge of framing the public sector's culture relates to finding the right balance between getting feedback and 'undue' influence from the many stakeholders with diverse interests.

According to the Organisation for Economic Co-operation and Development (OECD), 'governance' for regulators "…helps ensure that regulatory decisions are made on an objective, impartial and consistent basis, without conflict of interest, bias or improper influence." The OECD observed, "What distinguishes an independent regulator is not simply institutional design. Independence is also about finding the right balance between the appropriate and undue influence that can be exercised through the regulators' daily interactions with ministries, regulated industries and end-users."

Achieving that 'right' balance is in some cases clearer than others. The ongoing Boeing 737 Max saga is a case in point. The failure of safety checks on the plane model resulted in two fatal crashes and the deaths of a total of 346 people. This has raised questions about the competence of the Federal Aviation Administration (FAA) responsible for safety oversight. The other significant question is this: Did the FAA suffer from excessive industry influence when it certified Boeing 737 Max as safe? A look into its history reveals that this issue is not new to the FAA. In 2008, the Congressional Committee on Infrastructure and Transportation criticised it for being too close to the industry it regulated.

The global financial crisis also highlighted the problems that arise when regulators insufficiently challenge the prevailing thought of the sector it regulates. To counter this, some financial regulators incorporated independent units within their own organisations to reduce the influence of unconscious cognitive biases in their thinking.

Even as such developments have taken place, regulators are also subject to scrutiny. In October 2016, for example, a not-for-profit think tank, New City Agenda, published a report titled *Cultural Change in the FCA, PRA and Bank of England: Practising What They Preach?*. This report set out to examine what the UK's financial regulators – the FCA, PRA and Bank of England – have done to change their own culture following the 2008 financial crisis.

CONCLUSION

It is clear that behavioural studies and the use of behavioural tools are increasingly seeping into the thinking of regulators around the world. As evident from the Boeing 737 Max case, the culture of regulators themselves are also important matters to consider. Much as there is an expectation for leaders within those organisations to role model desirable conduct, there is also an expectation for public sector bodies to do the same. ✱

■ *PIDM is a statutory body that provides protection against the loss of deposits and insurance or takaful benefits with its member institutions in the event of a failure. As an integral part of the national financial safety net, PIDM promotes and contributes to the stability of the financial system.*