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Corporate culture guide

*The essential role of legal
and compliance leaders*

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When it comes to corporate culture, the benefits of getting it right are manifold – enhanced reputation, greater retention and recruitment of value-driven staff, increasing shareholder value and alignment with community expectations. Conversely, the price of getting it wrong is high – greater regulatory penalties, enormous reputational harm and added exposure for executives in an age where regulators are both eager and willing to litigate, matched by a global trend of shareholder and consumer activism.

While the focus of this guide is Australia, the scrutiny on corporate culture is a global trend. This guide therefore looks at international (as well as domestic) sources to obtain insight into best practice and trends.

This guide is intended to be of relevance across all sectors of the Australian economy, but, given the scrutiny the financial sector has faced in Australia and overseas since the global financial crisis, much of the most recent learning, practice and regulation emanates from this sector.

Foreword

Corporations face unprecedented scrutiny of misconduct within their organisations and value chains, and it is increasingly common for the blame to be laid, in whole or in part, on the *culture* of an organisation.

How, though, does one assess and, where necessary, *change* the culture within an organisation? It's all good and well to say 'yes, this is something that must be done', but the explanation of *how* is complex territory. There is no question that a multi-functional approach to assessing and setting culture in an organisation is needed. This guide focuses on the essential role of legal and compliance teams in that process.

Ultimately, the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry merely confirmed what many already knew: that 'corporate culture' has squarely become both a legal and compliance risk for businesses, and the regulators are increasingly focused on the adequacy of corporate culture when assessing liability. In response, as the legal and reputational risks increase, so too should the involvement of legal and compliance teams in reviewing, assessing and, where necessary, changing a company's approach to culture. To assist, this guide provides an insight into the legal frameworks and principles that can be drawn upon by legal and compliance leaders and teams when contributing to the corporate culture debate, regardless of sector of operation.

We hope these observations provide food for thought for you and assist in advising your leadership teams and boards and steering your businesses on how best to thrive under scrutiny.



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Executive summary

Corporate culture is firmly a boardroom issue.

Courts and regulators are increasingly assessing corporate culture. The clear expectation of regulators is that the board is responsible for the culture of the organisation it governs, and that organisations should regularly assess their culture and seek continuous improvement. At the same time, the law is increasingly regulating corporate culture, through direct and indirect means. This increased focus on corporate culture creates significant legal and reputational risk for corporations and boards, as well as opportunities.

What does an organisation need to do to undertake an effective culture assessment?

The starting point is the development of a clearly articulated culture and an explanation of how that aligns with the business strategy, organisational structure and governance frameworks.

The assessment must test how the organisation lives up to this vision. It must be independent, cross-functional, and rigorous, making findings based on evidence, not conjecture. It must be adapted to the organisation and thoughtful, not a box-ticking exercise. It must identify root causes, not symptoms. It must be continuous, not a one off or periodic process.

Guided by that framework, the review itself must then draw upon all available data points to identify the culture within the organisation – ranging from senior board and senior executive interviews, employee, supplier and customer feedback, to compliance, risk and audit reviews. Reviewing real case studies can also help identify cultural strengths and weaknesses. Whatever the data points chosen, the assessment process must focus on ‘tone from the top’, governance, accountability, remuneration and issue/risk identification and escalation. The assessment must document findings, cite evidence to support findings, and encourage and empower those involved to speak honestly and openly.

It is critical that legal and compliance leaders participate in the assessment process. They can help ensure the findings of the assessment are supported by evidence and documented clearly. They can help ensure the assessment focuses on what courts and regulators consider to be the key drivers of culture. They can ensure that the review of governance, compliance and risk frameworks has rigour.

In this guide, we explore the key factors recognised by the law and regulators as important drivers of corporate culture. Focusing on these drivers will help to ensure a culture assessment focuses on what matters, is robust and defensible in the eyes of regulators and courts, and helps your business to capitalise on the benefits of a positive and thriving culture.



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Overview



Unprecedented scrutiny on misconduct and corporate culture

Corporations face unprecedented scrutiny of misconduct within their organisations and supply chains, and a greater focus on why such misconduct was tolerated or not prevented.¹ In Australia, nowhere has this scrutiny been more intense than in the recent Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry (FS Royal Commission).

The reaction of the law

Over the last quarter of a century or so, the law (both globally and domestically) has been slowly adapting to this growing scrutiny and focus on culture. Corporate culture is increasingly a mandatory consideration in decisions relating to enforcement against corporates; whether by comprising an element of an offence or breach, a defence, or a mitigating or aggravating factor when it comes to prosecution, sentencing or penalties. It is also an area that courts and regulators are increasingly willing to make orders in relation to as part of the resolution of enforcement proceedings. Regulators are also increasingly active in assessing corporate culture and expecting those they regulate to do the same. The clear expectation of regulators is that the board is responsible for the culture of the organisation it governs.

This focus and associated legal developments create significant legal and reputational risk for corporations and boards. This risk is increasing, with greater financial penalties and prison sentences for misconduct, and greater appetite within regulators to pursue enforcement.²

As a result, 'corporate culture' is firmly a boardroom issue.

¹ See, for example, the Group of Thirty, *Banking Conduct and Culture: A Call for Sustained and Comprehensive Reform*, (2015), which concluded that 'poor cultural foundations and significant cultural failures were major drivers of the recent financial crisis and continue to be factors in the scandals since then'.

² See, for example, *Treasury Laws Amendment (Strengthening Corporate and Financial Sector Penalties) Act 2019* (Cth) and ASIC's 'why not litigate?' approach to enforcement: *ASIC update on implementation of Royal Commission recommendations* (February 2019), <https://download.asic.gov.au/media/5011933/asic-update-on-implementation-ofroyal-commission-recommendations.pdf> page 3.

To assist legal and compliance teams, this guide addresses the following questions:

What is corporate culture?

What is driving scrutiny of corporate culture?

What role does the law play in regulating corporate culture?

What factors does the law consider to be important influences on corporate culture?

In light of the above, how should a corporation go about assessing its corporate culture?

Legal risk and opportunity

Whilst the focus on corporate culture creates legal risk, it also creates opportunity. Many corporations now view having a 'good' or 'ethical' culture as an area for differentiation, whether in relation to attracting the best employees, making better business decisions, attracting investment or winning new customers. In a legal context, a 'good' corporate culture can also act as a shield against legal enforcement when misconduct does occur within a corporation's ranks.

The essential role of legal and compliance in assessing and improving corporate culture

The scrutiny of corporate culture has led to a focus on assessment and cultural improvement programs. While assessing and implementing cultural change are cross-functional endeavours, because of the legal implications and expectations of regulators when it comes to culture assessments, legal and compliance teams have an important role to play in this process. Governance arrangements, including compliance frameworks, are also fundamental drivers of culture, and must form part of any culture assessment.

What is corporate culture?



While there is no universally accepted definition of 'corporate culture', it is generally accepted that 'culture' determines the way behaviour is normalised and how 'things are done'.³ In the FS Royal Commission Final Report, Commissioner Hayne noted that it has been described as 'the shared values and norms that shape behaviours and mindsets';⁴ or, more memorably, 'what people do when no-one is watching'.⁵

From a legal perspective, and as we explore further in section 4, in Australia, the Commonwealth Criminal Code has defined 'corporate culture' since 1999. Although in other legal contexts, law makers and regulators have traditionally been less comfortable defining corporate culture or prescribing what a good corporate culture looks like, both are increasingly willing to:

- › explain what the most important drivers of corporate culture are;
- › provide examples of good and bad practice in relation to corporate culture;
- › explain what they expect corporations to do when they go about assessing their culture; and
- › mandate corporations to improve their culture as part of a resolution of enforcement proceedings.

³ Terrence Deal and Allan Kennedy, *Corporate Cultures: The Rites and Rituals of Corporate Life* (2000).

⁴ FS Royal Commission, Final Report, page 334, citing the CBA Prudential Inquiry, Final Report, 81 but deliberately omitting 'reference to a 'system' of shared values and norms if only to emphasise that culture is observed and described, not created apart from, or imposed on, the entity'.

⁵ FS Royal Commission, Final Report, page 334, citing G30, *Banking Conduct and Culture: A Call for Sustained and Comprehensive Reform*, July 2015, 17.

Focus on corporate culture



The focus on corporate culture is driven by a number of influences.

Developments in the law relating to corporate liability

In recent decades, the way in which the law holds corporations liable for misconduct or failure has evolved alongside a general increase in enforcement activity against corporations. This evolution started in the criminal law as a result of major environmental and health and safety incidents that were attributable to corporate failure, but which went unpunished. More recently, it has spread to other areas of corporate crime, such as bribery and tax evasion. In Australia, there is now a focus on holding financial institutions accountable for misconduct within their organisations.

While the approach has varied between jurisdictions, the general trend has been towards holding corporations strictly liable for the conduct of employees or agents unless there is an effective compliance programme in place to mitigate the risk of the conduct occurring.

Recognition of the limitations of the law

Alongside this evolution of the law, there has been a recognition that the law has not (and cannot) prevent all misconduct or failure within large and complex organisations. There is now a greater focus on the multitude of influences on conduct and behaviour, including governance, remuneration, accountability frameworks, recruitment, training and development and organisational structures. There is also greater focus on boards and leadership, and the impact they have on organisational behaviour.

The increasing influence of social norms and ethics

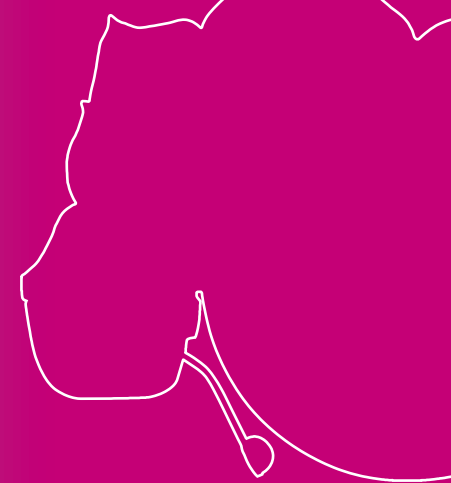
The line has been blurred between compliance with the law and ‘community’ or ‘ethical’ standards. This has forced corporations to focus more on building an organisational culture that can make more sophisticated decisions that align with these more fluid concepts. Executives talk about a ‘social licence to operate’; regulators instruct corporations that they must focus not just on the question of whether they ‘can’ do something under the law, but also whether they ‘should’; and the FS Royal Commission has examined not just breaches of law within financial institutions but also conduct or behaviour that ‘falls below community standards and expectations’.

Rise of soft law

Connected to the point above, many corporations are now subject to a range of ‘soft laws’ that have been adopted by industry bodies or with which they have voluntarily agreed to comply. Examples of soft laws include the *ASX Corporate Governance Principles and Recommendations* (4th edition), which recommends listed entities ‘...instil and continually reinforce a culture across the organisation of acting lawfully, ethically and in a socially responsible manner’. There are many other examples of soft laws or international or industry standards to which corporations either voluntarily subscribe or which, by virtue of their general acceptance, corporations will be held to account.⁶

⁶ Other examples of soft law include the OECD Guidelines on Multi-National Enterprises, the UN Global Compact, the UN Principles for Responsible Investment, UN Guiding Principles on Business and Human Rights to name a few.

The role of the law in relation to corporate culture



KEY TAKEAWAYS

- > Criminal law has, for some time, used corporate culture as a mechanism for holding corporations to account, as a defence to strict liability offences or as a public policy factor relevant to prosecution and sentencing.
- > 'Corporate culture' is defined under the Commonwealth Criminal Code.
- > 'Corporate culture' can be identified in some regulatory frameworks and is a relevant consideration in relation to many civil penalty regimes.
- > Regulators have generally been reluctant to prescribe what a good corporate culture is, but are increasingly vocal in guidance and public statements in relation to culture, what drives it, and – in some instances – indicators of poor and good corporate culture. A consistent theme is the focus on the importance of leadership and effective compliance systems.
- > Regulators are increasingly focussed on assessing corporate culture as part of their supervisory role.
- > There is also an increasing regulatory expectation that corporations will conduct their own culture assessments and commit to continuous improvement of culture.
- > Board and senior management are expected by regulators to take responsibility for the culture of the corporations they govern.
- > There are an increasing array of laws and regulations that are having an impact on corporate culture, eg whistleblower laws, accountability regimes and prudential regulation.
- > Improvements to corporate culture (or components of it) is something that courts and regulators may order as part of a resolution of enforcement proceedings for misconduct.

Understanding the role of the law in relation to corporate culture can help corporations conduct more effective assessments and protect the organisation from legal and regulatory risk.

Criminal law

In the criminal sphere, corporate culture has, for some time, been recognised as a basis for holding corporations accountable for misconduct or failure, as a potential defence for a corporation, or (at a minimum) as a public policy factor relevant to prosecution and sentencing.

The price of getting it wrong: corporate culture as a ground for attribution of liability

Australia has gone furthest in making corporate culture a component of an offence. In 1999, the Federal Parliament passed amendments to the Criminal Code as a response to criticism that the traditional English common law mechanism of attributing liability to corporates for conduct committed by employees or agents (the identification principle) was both too difficult to establish and unrealistic given the size and complexity of most corporations. These amendments permitted attribution of liability for offences committed by employees or agents to a corporation if a 'corporate culture existed within the organisation that directed, encouraged, tolerated or led to non-compliance with the relevant provision', or, alternatively, if a corporation 'failed to create and maintain a corporate culture that required compliance with the provision'.⁷ Corporate culture is defined in the Criminal Code as 'an attitude, policy, rule, course of conduct or practice existing within the body corporate generally or in the part of the body corporate in which the relevant activities takes place.'⁸

Corporate culture means an attitude, policy, rule, course of conduct or practice existing within the body corporate generally or in the part of the body corporate in which the relevant activities take place.⁹

Quoting academic commentary, the relevant committee that proposed the 'corporate culture' provision explained its rationale as follows:

...the policies, standing orders, regulations and institutionalised practices of corporations are evidence of corporate aims, intentions and knowledge of individuals within the corporation.

Such regulations and standing orders are authoritative, not because any individual devised them, but because they have emerged from the decision-making process recognised as authoritative within the corporation.¹⁰

⁷ Criminal Code Act 1995 (Cth) s12(3).

⁸ Criminal Code Act 1995 (Cth) s12(6).

⁹ Criminal Code Act 1995, Schedule, Section 12(6).

¹⁰ Criminal Law Officers' Committee of the Standing Committee of Attorneys-General, *Final Report: Chapter 2 – General Principles of Criminal Responsibility* (December 1992), page 111 see *Field and Jorg*, 'Corporate Manslaughter and Liability: Should we be Going Dutch?' [1991] *Crim LR* 156 at 159.

Somewhat surprisingly, despite having existed for twenty years, and applying not just to the Criminal Code offences, but also some offences under the *Corporations Act 2001* (Cth),¹¹ no record of a corporation being prosecuted under the Criminal Code corporate culture provision has been identified.¹²

In the UK, a similar move towards attribution of liability for corporates on the basis of their culture (rather than under the identification principle) has been observed in the *Corporate Manslaughter and Corporate Homicide Act 2007* (Corporate Manslaughter Act), which came in response to a public outcry that corporations in the UK were escaping liability for serious health and safety incidents. The Act imposes an offence on organisations (including corporations) if the way in which the organisation is managed or organised causes the death of a person and amounts to a gross breach of a relevant duty of care owed by the deceased; and the way in which the organisation's activities are managed or organised by senior management is a substantial element of the gross breach of the relevant duty of care.¹³

Similarly to the UK, some 'industrial manslaughter' laws in Australia incorporate 'inadequate corporate management, control or supervision' into the fault elements for liability.¹⁴ A recently published government review of Australia's model work health and safety laws advocated for the introduction of a uniform industrial manslaughter offence¹⁵. Corporate liability for such an offence would be determined by assessing a company's conduct, 'viewed as a whole by aggregating the conduct of its employees, agents or officers'.¹⁶

The benefits of getting it right: corporate culture as a defence to an offence committed by a corporation

While the Corporate Manslaughter Act represented an example of corporate culture forming a component of the corporate offence, starting with the *Bribery Act 2010* (UK), the UK has preferred a model of imposing strict liability on corporations, with the availability of a defence if a corporation can prove that it had in place an effective culture of compliance (referred to as 'adequate procedures' in relevant legislation).¹⁷ Relevant guidance issued by the UK Ministry of Justice in relation to the concept of 'adequate procedures' is awash with references to the importance of 'procedures' in achieving an effective anti-bribery 'culture'.¹⁸

This mechanism has been extended to the offence of failure to prevent the criminal facilitation of tax evasion.¹⁹ The UK government is also consulting on whether to extend the mechanism to a broader range of 'economic crimes'.²⁰

This model has also been adopted for bribery offences in Ireland, India and Malaysia. Proposed amendments to the Criminal Code in Australia will introduce a new absolute liability offence and an 'adequate procedures' defence for foreign bribery.²¹

Further reform is anticipated in Australia, with the Commonwealth Attorney General referring to the Australian Law Reform Commission in April 2019 terms of reference for a comprehensive review of Australia's corporate criminal responsibility regime.²²

11 Offences relating to providing false or misleading statements, false information and obstructing or hindering ASIC. See section 1308A of the *Corporations Act 2001* (Cth). A similar corporate culture provision can be found at s255 of the *Crimes Act 1958* (Vic), which imposes liability on corporates for the destruction of evidence, an offence under s254. This was introduced in 2006 but no prosecutions have been pursued under this provision either.

12 A case brought by the CDPP against Securrency and Note Printing Australia was the first successful prosecution of a company in Australia brought under the 1999 foreign bribery laws. In sentencing employees and agents of these companies – for example in *R v Ellery* [2012] VSC 349 and *CDPP v Boillot* [2018] VSC 739 – Hollingworth J made numerous adverse findings about Securrency and Note Printing Australia's corporate culture – however, 'corporate culture' was not itself a focus in the separate sentencing of the two companies.

13 *Corporate Manslaughter and Corporate Homicide Act 2007* (UK), s1.

14 *Crimes Act 1900* (ACT) s49C and Criminal Code 2002 (ACT) s55. The only other Australian jurisdiction that has introduced specific a 'industrial manslaughter' offence is Queensland: *Work Health and Safety Act 2011* (Qld) ss34C and 34D. The Queensland offence does not expressly include corporate management, control or supervision in the applicable fault element.

15 Safe Work Australia, *Consultation Regulation Impact Statement: Recommendations of the 2018 Review of the Model Work Health and Safety Laws* (June 2019), pages 33–39.

16 *Ibid*, page 33.

17 *Bribery Act 2010* (UK), s7.

18 UK Ministry of Justice, *UK Bribery Act 2010 Guidance*, (March 2011), page 15.

19 *Criminal Finances Act 2017* (UK), s44 and s45.

20 UK Ministry of Justice, *Corporate liability for economic crime: call for evidence*, Published 13 January 2017, <https://www.gov.uk/government/consultations/corporate-liability-for-economic-crime-call-for-evidence>.

21 Crimes Legislation Amendment (Combating Corporate Crime) Bill 2017 (Cth), s70.5A.

22 Office of the Attorney-General for Australia, *Review into Australia's corporate criminal responsibility regime*, <https://www.attorneygeneral.gov.au/Media/Pages/Review-into-Australia%E2%80%99s-corporate-criminal-responsibility-regime-10-april-19.aspx>.

Corporate culture as a mitigating or aggravating factor in prosecution and sentencing decisions

Corporate culture has also long been a mitigating or aggravating factor in relation to prosecution and sentencing decisions. For example:

- › In the US, since 1991, a compliance program that ‘promote[s] an organizational culture that encourages ethical conduct and a commitment to compliance with the law’ is a mitigating factor at the sentencing stage for corporations convicted of federal crimes.²³ An organisation’s commitment to a ‘culture of compliance is also a consideration that the US Department of Justice and Securities Exchange Commission take into account when considering whether to pursue enforcement against corporations for breaches of the *Foreign Corrupt Practices Act 1978*.²⁴ Similar statements are found in the US Department of Justice’s *Principles of Federal Prosecution of Business Organizations*.
- › In the UK, corporate culture is a factor a prosecutor must take into account when determining whether it is in the interest of justice to invite a corporate defendant to enter into a deferred prosecution agreement.²⁵ By contrast, a ‘culture of wilful disregard of commission of offences by employees or agents with no effort to put effective system in place’ is an aggravating factor for sentencing of corporates for bribery offences.²⁶
- › A similar consideration is proposed in the Australian Government’s draft deferred prosecution agreement code of practice²⁷ and the current joint *CDPP/AFP Self-reporting Guidelines for Foreign Bribery and Related Offences* states that: ‘the extent to which there was a culture of compliance with’ an organisation’s compliance framework for foreign bribery will be a public interest factor relevant to whether an organisation should be prosecuted for a foreign bribery offence.²⁸
- › In the criminal cartel context, in the recent Australian case of *CDPP v Nippon Yusen Kabushiki Kaisha* the Federal Court took into account evidence of a ‘culture of compliance’ when determining the appropriate criminal penalty for a cartel.²⁹ The defendant, Nippon Yusen Kabushiki Kaisha (NYK), was fined \$25 million for its involvement in an international cargo shipping cartel. The fine of \$25 million incorporated a significant discount of 50%, which in part reflected the fact that NYK demonstrated that it had rehabilitated itself (or demonstrated prospects of rehabilitation), including by changing its corporate culture of compliance, showing contrition, demonstrating a commitment to comply fully with competition law and policy, and establishing systems and programs (including training, education and structures to prevent reoffending (for example, resignations and salary reductions for those involved in the contravention)).³⁰

23 United States Sentencing Commission, *Guidelines Manual 2018*, Chapter 8.

24 The Criminal Division of the U.S. Department of Justice and the Enforcement Division of the U.S. Securities and Exchange Commission, *A Resource Guide to the U.S. Foreign Corrupt Practices Act*, 2012, page 57.

25 Director of the Serious Office and Director of the Crown Prosecution Service, *Deferred Prosecution Agreements Joint Code of Practice* (2014), [2.8.2(iii)].

26 UK Sentencing Council, *Fraud, Bribery and Money Laundering Offences Definitive Guideline*, page 49.

27 Commonwealth Attorney General’s Department, *Deferred Prosecution Agreement Code of Practice*, [7.1(c)].

28 Australian Federal Police and Commonwealth Direction of Public Prosecutions, *Best Practice Guidelines on Self-reporting Foreign Bribery and Other Related Offences* (2017), paragraph 15.

29 [2017] FCA 876.

30 In addition, when considering the factors in the relevant cartel provision (section 16A of the *Crimes Act 1914* (Cth)), the court noted, relevantly, in relation to the extent to which the conduct was deliberate, systematic and covert that ‘the processes involved in giving effect to [the cartel] appear to have been well known... and indeed appear to have been part of its corporate culture, steps were taken, including by senior management, to ensure that the collusive conduct would not be readily apparent to those who might seek to put an end to it...’ (at paragraph 241).

Civil law and regulation

Relevance of corporate culture in relation to regulatory frameworks and civil penalties

Whether there is a ‘culture of compliance’ within a commercial organisation is often a relevant consideration in civil penalty decisions, including, for example, in proceedings involving the Australian Competition and Consumer Commission (ACCC). Among the factors relevant to the Federal Court’s decision to impose civil penalties for an infringement of the *Competition and Consumer Act 2010* (Cth) (CCA) include whether the company has a corporate culture conducive to compliance with the CCA and takes corrective measures in response to an acknowledged contravention. There is no rule about the required components of the corporate culture or the extent to which this will be taken into account in setting or discounting the penalty (ie, the quantum or the percentage of any discount) – rather, the assessment will depend on the surrounding facts. The court will examine whether there is a substantial compliance programme in place that was actively implemented and whether the implementation was successful (ie, whether the contravention was an isolated incident). That is, was the compliance policy ‘one to which mere lip-service’ was paid.³¹ Other relevant factors based on case law to date include:

- › whether the programme was regularly updated and involved employees attending lectures or seminars in regular intervals including in the period covering the contravention;
- › whether the compliance programme required attendance by key staff involved in the contravention (ie, those with exposure to competition law risk);

- › evidence of lack of commitment by senior executives; and
- › whether the company voluntarily addressed any deficiencies in the compliance programme when the contravention came to its attention.

In the UK, the Competition and Markets Authority (CMA) offers a 10 per cent discount on fines for contravention of UK competition law if the company has a compliance programme that is legitimate and enforced within the company in good faith. The CMA emphasises the importance of factors similar to those set out in the UK’s Ministry of Justice’s *Bribery Act 2010* guidance on adequate procedures.³² A similar policy, affording up to 20 per cent discount in fine levels, is available under the Canadian competition regime.³³

Improvements to corporate culture after the conduct has occurred can also be a mitigating factor when it comes to penalties. The US Department of Justice, for example, grants credit for extraordinary compliance measures taken during or following an investigation.³⁴ Evidence that a corporation acted diligently in the promulgation, dissemination, and enforcement of an antitrust compliance programme in an active good faith effort to ensure that the employees would abide by the law can also be taken into account in the US when determining whether or not a corporation had the required intent.³⁵

Having a good corporate culture and effective compliance plan has also been highlighted as a means of achieving indirect leniency in the corporate sphere, by allowing a company to benefit from the US Department of Justice Antitrust Division’s leniency policy (on the basis that an effective compliance system will identify wrongdoing at an early stage, allowing a corporation to claim leniency by ‘blowing the whistle’).³⁶

31 *ACCC v Harvey Norman Holdings Ltd* [2011] FCA 1407.

32 Competition and Markets Authority, *Guidance as to the Appropriate Amount of Penalty*, 18 April 2018. Recent cases where corporations have achieved discounts include the Residential agency services case (2017) [Case 50235]; Online resale price maintenance in the bathroom fittings sector (2016) [Case CE/9857-14]; Conduct in the ophthalmology sector [Case CE/9784-13]; Restrictive arrangements preventing estate and lettings agents from advertising their fees in a local newspaper (2015) [Case CE/9827/13].

33 Government of Canada Bulletin, *Corporate Compliance Programs* (27 September 2010).

34 See, for example, *Plea Agreement between the United States of America and Barclays PLC in relation to allegations of fixing the spot market for foreign exchange of USD to euro*, 19 May 2015, 13.

35 *United States v. International Paper Co.*, Crim. Nos. 78-H-11, 78-H-12 (S.D. Tex. 1978).

36 Brett Snyder (Deputy Assistant Attorney General Antitrust Division, U.S. Department of Justice), *Compliance is a Culture, Not Just a Policy*, (New York, 9 September 2014).

Aspects of corporate culture also form the basis of broad regulatory principles. In the UK, for example, the UK Financial Conduct Authority's (FCA) principles for business list many principles of business that are drivers of corporate culture and which regulated firms must comply with, for example the requirement to conduct business with integrity (Principle 1) or the requirement to take reasonable care to organise and control one's affairs responsibly and effectively, with adequate risk management systems (Principle 3).

Reluctance to prescribe in law what makes a good corporate culture

Civil regulators have been willing, in the context of public statements and speeches, to define what is corporate culture. ASIC, for example, has defined corporate culture as:

*[a corporation's] set of shared values or assumptions. It can be described as the underlying mindset of the organisation. Culture shapes and influences people's attitudes and behaviours towards, for example, customers and compliance.*³⁷

Civil regulators are, however, generally reluctant to prescribe what having a 'good' corporate culture involves. ASIC has stated:

*Culture is not something we want to regulate with black letter law. We know it isn't feasible to check over every company's shoulder to test their culture or dictate how a business should be run.*³⁸

Similarly, for the FCA, 'it is for firms to decide the type of culture they want'³⁹; and for the Dutch Central Bank (DNB) 'there is no blueprint for an ideal culture. Neither 'good' nor 'bad' cultures exist. Only effective or ineffective cultures'.⁴⁰

In the FS Royal Commission Final Report, Commissioner Hayne affirmed this position, concluding that culture is not something that can be prescribed.⁴¹

Increasing trend of public commentary on corporate culture

While unwilling to prescribe what good corporate culture means, regulators such as ASIC, APRA, ACCC and the FCA are increasingly willing to provide public commentary on corporate culture and associated conduct risk. ASIC, for example, has made public speeches or statements on the following matters in recent years:

- 3 C's message on conduct risk: communication, challenge and complacency;⁴²
- Outline of ASIC's approach to corporate culture;⁴³
- Reinforcing culture in a climate of low trust;⁴⁴
- What you walk past is what you accept – how the 'tone from the top' matters and practical things directors can do to promote good corporate culture;⁴⁵ and
- Good corporate culture, corporate values and ethics.⁴⁶

37 Greg Medcraft, Chairman (Australian Securities and Investment Commission), 'Corporate culture, corporate values and ethics' <https://asic.gov.au/regulatory-resources/corporate-governance/corporate-governance-articles/corporate-culture-corporate-values-and-ethics/>

38 Speech by John Price (Commissioner, Australian Securities and Investments Commission), *Outline of ASIC's approach to corporate culture*, AICD Directors' Forum: Regulators' Insights on Risk Culture (19 July 2017).

39 Speech by Linda Woodall (former Director of Mortgages and Consumer Lending, the FCA), *Building a common language in the mortgage market*, Council of Mortgage Lenders – Mortgage Industry Conference and Exhibition (6 November 2013).

40 Wijnand Nuijts, *Managing culture: the role of regulation and supervision*, (Financial Conduct Authority Discussion Paper 18/2, March 2018), page 56.

41 Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry, *Final Report*, vol 1, page 374.

42 Australian Securities and Investment Commission, Market Supervision Update Issue 57, *Conduct Risk*.

43 Speech by John Price (Commissioner, Australian Securities and Investments Commission), *Outline of ASIC's approach to corporate culture*, AICD Directors' Forum: Regulators' Insights on Risk Culture (Sydney, 19 July 2017).

44 Speech by John Price, (Commissioner, Australian Securities and Investments Commission), *Reinforcing culture in a climate of low trust*, (Governance Institute of Australia – Governance and Risk Management Forum, Sydney, 7 June 2018).

45 Speech by John Price, (Commissioner, Australian Securities & Investment Commission), *What you walk past is what you accept* (*Governance Directions*, Governance Institute, September 2016).

46 Greg Medcraft, (Chairman, Australian Securities and Investment Commission), *Corporate culture, corporate values and ethics* (*Governance Directions*, Governance Institute, September 2016).

In the Prudential Inquiry into the Commonwealth Bank of Australia (CBA Prudential Inquiry), the APRA Panel identified key questions an organisation should ask itself in relation its culture and the closely connected issues of remuneration and governance:⁴⁷

- › Is there adequate oversight and challenge by the board and its gatekeeper committees of emerging nonfinancial risks?
- › Is it clear who is accountable for risks and how they are to be held accountable?
- › Are issues, incidents and risks identified quickly, referred up the management chain, and then managed and resolved urgently? Or is bureaucracy getting in the way?
- › Is enough attention being given to compliance? Is it working in practice? Or is it just ‘boxticking’?
- › Do compensation, incentive or remuneration practices recognise and penalise poor conduct? How does the remuneration framework apply when there are poor risk outcomes or there are poor customer outcomes? Do senior managers and above feel the sting?

The broader findings in the CBA Prudential Inquiry Final Report can also be seen as a guide to other corporations as to what is required to achieve expected practice in relation to corporate culture, as well as poor practices to avoid.

The UK Prudential Regulatory Authority (PRA) has published details of some of the indicators of poor risk culture.⁴⁸ It cites, non-exhaustively, the following indicators of poor risk culture:

- › The observation of multiple examples of a firm failing to conduct its business in a safe and sound manner, including failings in different business areas, that may not be related or that when examined individually may not be considered serious.
- › A poorly functioning board that fails to challenge management or take a lead on conducting business in a safe and sound manner, embedding culture in the firm and drawing up clear policies and guidelines.
- › Evidence of weak control areas such as in risk and compliance.

The DNB has also explained that when it assesses culture, it considers the following:⁴⁹

- › Board effectiveness: this involves focussing on behaviours with respect to leadership, decision-making and communication.
- › Change effectiveness and culture change: this involves focussing on whether certain group behaviours contribute to or impede organisational transformations, for example relating to the firm’s business model, performance or culture.
- › Risk culture: this involves focussing on how particular groups handle the trade-offs in decision making with respect to risk and reward; and whether group behavioural patterns and their cultural drivers increase the risks for unethical conduct.

⁴⁷ CBA Prudential Inquiry, Final Report, 3 (approved in the FS Royal Commission, Final Report), pages 333–334.

⁴⁸ Prudential Regulation Authority, Statement of Policy: The use of PRA Powers to Address Serious Failings in the Culture of Firms (June 2014).

⁴⁹ Wijnand Nuijts, *Managing culture: the role of regulation and supervision*, (Financial Conduct Authority Discussion Paper 18/2, March 2018), page 56.

An increasing focus on supervision of culture and assessment

As noted above, ASIC and other financial regulators have expressed a reluctance to prescribe what a good corporate culture means.

Regulators are, however, increasingly focussed on supervising and assessing culture, because they consider poor culture to be a cause of misconduct and risk management failure, and good culture to be an important factor in discouraging such outcomes.

From a regulator's perspective, ASIC is concerned about culture because it is a key driver of conduct within the financial industry. Bad conduct flourishes, proliferates and may even be rewarded in a bad culture. A good corporate culture uncovers and inhibits bad conduct, and rewards and encourages good conduct.⁵⁰

A trend of more proactive regulatory assessment and supervision of corporate culture is emerging as a consequence:

- ASIC has said it will be focusing more on the culture of entities it regulates to obtain early warning signs of problems, helping it to catch misconduct earlier and identify more pervasive problems within a corporation, as well as across industries.⁵¹ It has expressed particular interest in remuneration structures, conflicts of interest, complaints handling, treatment of whistleblowers and timeliness of breach reporting.⁵² Its immediate focus will be the financial sector, but through the Corporate Governance Taskforce, it has already demonstrated that its interest in corporate culture extends beyond the financial sector.
- In 2016, APRA set out how its focus would be 'on supervision of institutions' risk culture, rather than the regulation of risk culture', focusing on 'strengthening its capacity to more systematically assess a regulated institution's risk culture'.⁵³ Since this announcement, APRA conducted one pilot review into an authorised deposit-taking institution's culture followed by CBA Prudential Inquiry.
- Following the CBA Prudential Inquiry, APRA wrote to thirty-six financial institutions requesting that they conduct and produce to APRA board-endorsed self-assessments as to the operation of governance, culture and accountability frameworks and practices at their institutions. APRA has said that its 'key focus will be on how each entity assesses itself against the CBA Prudential Inquiry Final Report, as well as how they went about forming their views', and that it will 'review and benchmark the individual self-assessments to identify both institution-specific actions needed as well as areas requiring improvement industry-wide'.⁵⁴ In the FS Royal Commission Final Report, Commissioner Hayne recommended that APRA adopt a more proactive (and broader) approach to assessment of culture, in effect asking them to undertake assessments like that undertaken in the CBA Prudential Inquiry on a regular basis.

⁵⁰ Speech by Greg Tanzer, *The importance of culture to improving conduct within the financial industry*, (Thomson Reuters' Third Australian Regulatory Summit, 27 May 2015).

⁵¹ Speech by John Price, (Commissioner, Australian Securities and Investments Commission), *ASIC's focus on culture – digging into the detail digging into the detail*, (GIA's Corporate Governance Forum 2016, Sydney, 25 May 2016).

⁵² ASIC Corporate Plan 2018 – 2022, page 18.

⁵³ APRA Information Paper, *Risk Culture* (October 2016).

⁵⁴ Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry, *Written Submissions of the Australian Prudential Regulation Authority (APRA) in response to the Interim Report*, [101] and [102].

The Commissioner recommends that APRA should:

- build a supervisory program focused on building culture that will mitigate the risk of misconduct;
 - use a risk-based approach to its reviews;
 - assess the cultural drivers of misconduct in entities; and
 - encourage entities to give proper attention to sound management of conduct risk and improving entity governance.⁵⁵
- › Some prudential regulators are creating teams with specialisation in assessment of culture. The DNB, for example, has established a dedicated team to assessing culture, focussing on behaviours observed in specific areas.⁵⁶ In 2015, APRA developed ‘a small, central team to coordinate work and provide a centre of expertise on the related issues of governance, culture and remuneration.’⁵⁷ It is expected that in order to fulfil the broader remit that Commissioner Hayne has recommended, it will need to increase the size and broaden the expertise of its team.
- › In light of ASIC’s increased focus on corporate culture, we expect ASIC will follow a similar path.

Potential future regulatory requirement for corporates to assess their own culture regularly and make improvements

In the Australian financial services sector, it is likely that regulated entities will be compelled to regularly assess their culture and governance, and to implement improvements where a requirement is identified, following the recommendation of Commissioner Hayne in his Final Report in the FS Royal Commission.⁵⁸

While limited to financial services entities at present, this development may influence other regulators to adopt more prescriptive requirements or guidance to require or encourage corporations to assess their culture.

Imposing responsibility on boards and senior management in relation to culture

Regulators have also made clear their expectations, in guidance and in public statements, that responsibility for culture ultimately lies with boards and senior management.⁵⁹

In the UK, the FCA’s Senior Manager and Certification Regime (SMCR) requires an executive (usually the CEO) of a regulated firm to oversee the adoption of the firm’s culture in the day-to-day management and a leader (usually the Chair or another non-executive director) to lead the development of the firm’s culture by the governing body as a whole.

Paragraph 9(b) of APRA Prudential Standard CPS 220 requires the Board of an APRA-regulated institution to form a:

view of the risk culture in the institution, and the extent to which that culture supports the ability of the institution to operate consistently within its risk appetite, identify any desirable changes to the risk culture and ensures the institution takes steps to address those changes.

Regulatory Guide 259 articulates ASIC’s similar expectation that Australian Financial Service Licence-holders will foster a strong risk management culture throughout their organisations.⁶⁰ Similar regulatory expectations can be found internationally; eg in Hong Kong, Singapore and the Netherlands.⁶¹

55 Recommendation 5.7 sets out the Commissioner’s recommendation in relation to supervision of culture and governance. This Recommendation adopts the recommendations of the Financial Stability Board, the international body that monitors the financial system, in its *Strengthening Governance Frameworks to Mitigate Misconduct Risks: A Toolkit for Firms and Supervisors* report dated April 2018.

56 Speech by Wijnand Nuijts & Mireia Raaijmakers, *Supervising Culture and Behaviour at Financial Institutions: The Experience of DeNederlandsche Bank*, (November 2015).

57 APRA Information Paper, *Risk Culture*, (October 2016).

58 Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry, *Final Report*, vol 1, page 393.

59 CBA Prudential Inquiry, *Final Report*, page 13.

60 ASIC Regulatory Guide 259, *Risk Management Systems of Responsible Entities*, [46].

61 Hong Kong Monetary Authority 2010, *Supervisory Policy Manual, General Risk Management Controls*, s2.1 and the Netherlands Authority for the Financial Markets, *Investigation into behaviour and culture: How is this conducted in practice?* (undated), p. 3.

In APRA's view, the Australian equivalent to the SMCR, the Bank Executive Accountability Regime (BEAR) 'presents an opportunity to establish and refine frameworks and practices that, when cascaded down throughout the institution, strengthen risk culture in practice at all levels'.⁶²

Outside the financial sector, the ASX Corporate Governance Principles and Recommendations also charges boards with approving an entity's statement of values and charging senior executive with the responsibility of inculcating those values across the organisation.⁶³ In the UK, similar guidance has recently been issued by the Financial Reporting Council for large private companies.⁶⁴

Increasing number of laws which impact corporate culture

There is also an increasing range of laws that impact corporate culture, sometimes indirectly. In Australia, in addition to the prudential and accountability regimes referenced above, the proposed changes to the *Corporations Act and Taxation Administration Act 1953* whistleblower regimes were introduced with the express intention of 'improving the compliance culture of corporations'.⁶⁵

The importance of protecting whistleblowers has been recognised for many years as a means of improving the compliance culture of corporations...⁶⁶

Law and regulation are also increasingly extending corporations' legal and reputational responsibilities beyond the bounds of their organisations. The bribery laws described above in the UK, Ireland, Malaysia and India, and the proposed changes to foreign bribery laws in Australia, impose criminal liability on corporations for the actions of third parties. In the UK and Australia, modern slavery legislation makes certain organisations more accountable for their supply chains through the requirement to publish statements about the risks of modern slavery in their supply chains and how they are managed.⁶⁷

Increasing tendency for improvements in corporate culture to form part of resolution of allegations of misconduct

In the competition sphere, courts often order companies to review their programs and internal policies to ensure awareness of responsibilities and obligations. Often this is coupled with an order for the company to have its programme independently reviewed or audited for a certain number of years and to provide copies of the audit report each year to the ACCC.⁶⁸

Similar requirements have been agreed to as part of deferred prosecution agreements reached in relation to criminal wrongdoing in the US and UK⁶⁹ and in relation to enforceable undertakings agreed in Australia with ASIC. ASIC has stated it views enforceable undertakings as an important component in influencing behaviour and encouraging a culture of compliance for the benefit of all participants in the market it regulates.⁷⁰

62 APRA Information Paper, Implementing the Banking Executive Accountability Regime, (17 October 2018).

63 ASX Corporate Governance Principles and Recommendations (4th edition), Principle 3.

64 Financial Reporting Council, *The Wates Corporate Governance Principles for Large Private Companies* (December 2018).

65 Treasury Laws Amendment (Enhancing Whistleblower Protections) Bill 2017.

66 Explanatory Memorandum to the Treasury laws Amendment (Enhancing Whistleblower Protections) Bill 2018 at 2.136.

67 *The Modern Slavery Act 2015* (UK); *Modern Slavery Act 2015 (Transparency in Supply Chains) Regulations 2015* (UK); *California Transparency in Supply Chains Act 2010* (US).

68 See, eg: *ACCC v Renegade Gas Pty Ltd (trading as Supagas NSW)* [2014] FCA 1135 / ACCC media release; *ACCC v Midland Brick Co Pty Ltd* (2004) 207 ALR 329 / ACCC media release; *ACCC v Pepe's Ducks Ltd* [2013] FCA 570 / ACCC media release; *ACCC v Virgin Mobile Australia Pty Ltd (No 2)* [2002] FCA 1548 / ACCC media release; *ACCC v Econovite Pty Ltd* [2003] FCA 964 / ACCC media release.

69 See, eg: Deferred Prosecution Agreement – *Serious Fraud Office v Rolls Royce PLC* (2017); Deferred Prosecution Agreement between Société Générale SA and the U.S. Department of Justice, United States Attorney Southern District of New York, (18 November 2018).

70 ASIC Regulatory Guide 100, *Enforceable Undertakings*, page 5, [100.6].

What factors does the law consider to be important influences on corporate culture?

KEY TAKEAWAYS

The law emphasises the following factors when determining a corporate's culture:

- > Governance (including compliance and risk management frameworks)
- > Tone from the top
- > Remuneration frameworks
- > Accountability frameworks
- > Incident and risk identification and response
- > Customer feedback
- > Allocation and prioritisation of investment

An organisation's culture is impacted by a range of factors. We set out below the key factors that the law and regulators have recognised as important drivers of corporate culture. Focussing on these factors will help ensure that a culture assessment produced is robust and defensible in the eyes of regulators.

Governance

In the Royal Commission, Commissioner Hayne concluded that governance, as well as remuneration, were closely connected with culture, and mutually reinforcing in effect. He defined 'governance' as meaning 'the entirety of structures and processes by which an entity is run' and includes 'not only how, and by whom, decisions are made, but also the values or norms that the processes of governance are intended to affect'. He explained that 'by shaping *how* the business is run, governance shapes culture'.⁷¹

Policies and other documents that articulate rules and processes are consistently identified by the law and regulatory guidance as key components of culture. See for example the definition of 'corporate culture' in the Criminal Code, which includes 'policies' and 'rules'.

An important aspect of governance is the tone from the top set by the board and senior management.

Tone from the top

ASIC and APRA consider that an important function of boards is to set the right tone within an organisation.⁷² Tone from the top is frequently recognised as a critical influencer of conduct within organisations and a key element of corporate compliance frameworks.⁷³ It is reflected in the Criminal Code definition of 'corporate culture', which captures 'attitudes' within its definition. The board is responsible not just for ensuring compliance with the law, but also creating an ethical framework.⁷⁴

This influence on culture intersects closely with directors' duties, particular the duty of care and diligence at section 180 of *Corporations Act 2001* (Cth). In recent cases, courts have been willing to hold directors in breach of this provision for failing to prevent reasonably foreseeable breaches of the law by the company that result in harm for the company (see for example, *ASIC v Cassimatis (No 8)*⁷⁵ and *ASIC v Flugge & Geary*⁷⁶). In *Cassimatis*, the Federal Court went as far as to find there need not necessarily be an underlying breach of the law if the director has allowed the company to expose itself to a high degree of risk of harm. In a recent speech, the Chief Justice of the Supreme Court of New South Wales acknowledged that it could be argued that directors could be liable for conduct of the company falling short of a strict breach of the law, which is nevertheless inappropriate or unethical, where such conduct results in significant reputational damage, with consequent financial implications.⁷⁷

⁷¹ Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry, *Final Report*, vol 1, pages 334 to 335.

⁷² CBA Prudential Inquiry, *Final Report*, page 13.

⁷³ See, eg, the UK Ministry of Justice Guidance on the UK *Bribery Act 2010*.

⁷⁴ Institute of Internal Auditors – Australia, The Ethics Centre, The Governance Institute of Australia and Chartered Accountants Australia and New Zealand, *Managing Culture: A good practice guide*, First edition 2017, page 5.

⁷⁵ [2016] FCA 1023.

⁷⁶ [2016] VSC 779.

⁷⁷ Speech of the Hon T F Bathurst AC (Chief Justice of New South Wales), *Directors' and Officers' Duties in the Age of Regulation*, (Conference in Honour of Professor Baxt AO, 26 June 2018, [35]).

In the FS Royal Commission Interim Report, Commissioner Hayne noted the duty of directors to pursue the long-term advantage of the enterprise they are responsible for, which necessarily entails preserving and enhancing its reputation. He noted that to preserve and enhance its reputation, the enterprise ‘must do more than not break the law. It must seek to do ‘the right thing’’.⁷⁸

*While all levels of management and indeed individuals contribute to culture, what the board says, does and most importantly expects, is absolutely critical in setting the tone for the organisation.*⁷⁹

The Chairman of ASIC has stated that some of the key ways in which boards set the tone within their organisation:

- > through the selection of a chief executive officer who has values aligned with the company’s desired culture;
- > the board’s review of the company’s strategy; and
- > the board’s role as gatekeeper of the strategic initiatives of management.⁸⁰

Senior management also perform an important role in setting the tone within an organisation. In ASIC’s view, senior management should set the values and principles of a firm’s culture and ensure these are reflected in the business’s strategy, business model, risk appetite, and compliance and governance frameworks. They also need to ensure the firm’s values are incorporated into all of its business practices and are cascaded down and understood throughout the organisation.⁸¹

For APRA, the board also sets the tone from the top through its treatment of, and sense of urgency, surrounding risk management issues as well as monitoring and demanding mitigation of key risks and closure of control weaknesses.⁸²

While the focus of regulators is on the actions and statements of the board and senior management, in a recent publication on culture by the FCA, essayists counselled against focusing solely on tone from the top when considering culture, noting that everyone from middle managers to the most junior employees influence culture.⁸³ This message was reiterated by Commissioner Hayne in the FS Royal Commission Final Report.⁸⁴

78 Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry, *Final Report*, vol 1, pages 54 to 55

79 Speech by Greg Medcraft, (Chairman of the Australian Securities and Exchange Commission), *The Importance of Corporate Culture*, (Thomson Reuters, 4th Annual Australian Regulatory Summit, 21 June 2016, page 2).

80 Ibid, pages 2 and 3.

81 Speech by Greg Medcraft, (Chairman of the Australian Securities and Exchange Commission), *The Importance of Corporate Culture*, (Thomson Reuters, 4th Annual Australian Regulatory Summit, 21 June 2016, page 3).

82 CBA Prudential Inquiry, *Final Report*, page 13.

83 Wijnand Nuijts, *Transforming Culture in Financial Services* (Financial Conduct Authority Discussion Paper 18/2, March 2018), page 15.

84 Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry, *Final Report*, vol 1, page 35.

Remuneration and performance

An organisation's performance management framework can encourage employees to behave in particular ways or discourage particular behaviours.

What gets rewarded gets done: but that might not always be what was intended.⁸⁵

In recent years, particularly in the financial sector, the prevailing view is that incentive schemes that place too much emphasis on direct profit or sales can lead to patterns of poor conduct that place these above the interests of customers. For example, in the FS Royal Commission Interim Report, remuneration practices and policies were identified as one of the key causes of employee misconduct. In the Interim Report, Commissioner Hayne makes the observation that:

...all the conduct identified and criticised in this report was conduct that provided a financial benefit to the individuals and entities concerned. There are exceptions, but they are immaterial. For individuals, the conduct resulted in being paid more. For entities, the conduct resulted in greater profit. The culture and conduct of the banks was driven by, and was reflected in, their remuneration practices and policies.⁸⁶

What impact would no incentive structure have on culture? Would it stifle innovation or encourage mediocrity? Globally and in Australia, banks have (and are) seeking to adapt to the criticism that their remuneration structures reward the wrong kind of conduct.

At the most extreme end of the spectrum, UK Bank TSB Bank scrapped sales driven targets and rewards, as well as access to sales data at branch and area level. Staff are now rewarded purely on service to customers and the bank claims that the change in strategy has improved not just the bank's reputation but also performance.⁸⁷

More broadly, many public companies are seeing a growing investor scrutiny of executive remuneration, with investor strikes of remuneration frameworks becoming more common.⁸⁸

The debate about what the right remuneration structure is continues, but it is now generally accepted that although remuneration impacts culture, it is not the only influence on the conduct of employees. Others influences include setting values that employees understand and believe in, praising good conduct and promoting those who align with an organisation's values.

Accountability frameworks

Clear accountability frameworks are essential to achieving a desired culture. If it is unclear what staff are accountable for, they cannot be held accountable when failings occur. In the view of the Chairman of APRA, Wayne Byers, clarifying accountability within organisations is key to improving culture.⁸⁹ This conclusion is reiterated in the CBA Prudential Inquiry Final Report⁹⁰ and the FS Royal Commission Final Report.⁹¹ In both the UK and the US, accountability of senior management is now increasingly regulated within the financial sector. This sentiment is the driver behind the introduction of the Banking Executive Accountability Regime (BEAR),⁹² the FS Royal Commission's recommendation to extended BEAR to superannuation and insurance entities,⁹³ and the Australian Government's recommendation to introduce a similar regime for Australian financial services licensees.⁹⁴

85 Stephen Kerr, *On the folly of rewarding A while hoping for B*, (*The Academy of Management Executive*, Vol 9, Number 1, February 1995), page 7.

86 Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry, *Interim Report* (2018), page 301.

87 Wijnand Nuijts, *Transforming Culture in Financial Services* (Financial Conduct Authority Discussion Paper 18/2, March 2018), page 13.

88 Australian Securities and Investments Commission, annual general meeting season 2018.

89 Commonwealth of Australia, Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry, Round 7, 30 November 2018, Transcript, page 7443 [15].

90 CBA Prudential Inquiry, *Final Report*, page 47.

91 Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry, *Final Report*, vol 1, page 407.

92 *Banking Act 1959* (Cth), Part IIA.

93 Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry, *Final Report*, vol 1, page 39.

94 Commonwealth of Australia, *Restoring trust in Australia's financial system*, (February 2019) <https://static.treasury.gov.au/uploads/sites/1/2019/02/FSRC-Government-Response-1.pdf>.

One of the most dismal features of the banking industry to emerge from our evidence was the striking limitation on the sense of personal responsibility and accountability of the leaders within the industry for the widespread failings and abuses over which they presided. Ignorance was offered as the main excuse.⁹⁵

In the UK, too, the focus on accountability has extended beyond senior management to include *all* employees. According to Linklaters, ‘the importance of embedding individual accountability and ensuring individuals at all levels are suitable to undertake their role and contribute to an appropriate culture, has been at the forefront of the UK regulatory agenda for a number of years...’⁹⁶

Incident and risk identification and response

The way in which an organisation’s desired culture is policed, and the extent to which deviations from that culture are identified and resolved, can influence (and reveal) an organisation’s culture.

ASIC has stated that its Breach Reporting Review is being used in part to understand the extent to which an organisation’s culture supports the ability of the organisation to meet its breach reporting obligations and investigating some of the elements that it believes a sound breach reporting culture is likely to demonstrate, including transparency, effective communication and escalation, accountability, responsiveness and customer remediation.⁹⁷

The existence (or lack) of effective whistleblowing policies, procedures and protections, for example, can impact the degree to which employees feel empowered to ‘speak up’ if they identify issues or practices they perceive to be unethical, inappropriate or unaligned with the organisation’s ethos and values; as can how issues reported are in fact dealt with. When investigating companies, regulators often focus on whether whistle-blower reports are dealt with and how well, to gauge whether the organisation is in fact committed to rooting out problematic conduct within the organisation.

⁹⁵ House of Lords and House of Commons, *Changing banking for good: Report of the Parliamentary Commission on Banking Standards*, (Volume 1: Summary, and Conclusions and Recommendations, June 2013) page 17.

⁹⁶ *Ethics in Banking and Finance*, (Linklaters, February 2019), page 25.

⁹⁷ Andrew Fawcett (Senior Executive Leader, Strategic Policy, Australian Securities and Investments Commission), *Once more unto the breach: The impact of firm culture on breach reporting in Australian financial services firms*, (Financial Conduct Authority Discussion Paper 18/2, *Transforming Culture in Financial Services*, March 2018, page 55).

Customer feedback

When considering culture, regulators have explained that they see how customers are treated as illustrative of a corporation's culture.⁹⁸

Similarly, robust customer complaint and feedback policies and procedures, and the degree to which an organisation is receptive and responds to customer feedback, can ensure that an organisation is alerted to, and resolves, issues and concerns that are raised by customers. By contrast, a lack of regard to customer feedback (or an approach that glosses over negative feedback and focuses too much on aggregate figures) can dull an organisation's alertness to its customers' needs.

Employee recruitment practices and development

ASIC has recognised that recruitment practices can also be a powerful influence on culture.⁹⁹ Organisations often recruit candidates that reflect, or appear adaptable to, a set of values and principles that align with the organisation's existing culture or the culture it is seeking to achieve. Individuals involved in the recruitment process, whether consciously or not, often look for people with similar values or approaches to thinking.

The image and values which an organisation presents to the employment market can also influence the kinds of candidates it attracts, and in turn, its cultural profile.

How staff are developed after recruitment is also an important driver of culture.

Allocation and prioritisation of investment

Where an organisation devotes its resources will drive its priorities and culture, be that investment in innovation, risk management, technology or other areas. The extent to which an organisation focuses resources on short term or long-term projects can also have a profound impact on its culture. APRA has criticised the 'voice of finance' dominating the 'voice of the customer' and the 'voice of risk'.¹⁰⁰

⁹⁸ See, eg, Speech by Linda Woodall (former Director of Mortgages and Consumer Lending, the FCA), *Building a common language in the mortgage market*, Council of Mortgage Lenders – Mortgage Industry Conference and Exhibition (6 November 2013).

⁹⁹ *ASIC update on implementation of Royal Commission recommendations* (February 2019), <https://download.asic.gov.au/media/5011933/asic-update-on-implementation-ofroyal-commission-recommendations.pdf> page 3.
¹⁰⁰ CBA Prudential Inquiry, *Final Report*, page 47.

How to assess corporate culture

KEY TAKEAWAYS

1. Process

- › The assessment process must be independent. External review or input can add a degree of impartiality, fresh thinking and peer benchmarking.
- › Assessment must be cross-functional and have depth in terms of access to employees.
- › Culture assessments can have legal and regulatory consequences for the company and directors. Legal and compliance frameworks also impact a corporation's culture. Legal and compliance therefore have an important role to play in culture assessments.
- › Culture assessments must involve an identification of the root cause of any failings or misconduct. Assessments must avoid confusing root cause and symptoms.
- › Cultural assessments should be ongoing, providing real-time feedback to board and management, to see whether improvement initiatives are working and to spot emerging issues more quickly.

2. Key data points

Key resources for data points include:

- › Interviews with board members and senior management
- › Review of board and senior management papers and interviews
- › Employee survey data
- › Other human resources data
- › Incident data
- › Compliance and risk reviews
- › Procurement data
- › Internal audit review
- › Customer data

Assessment of corporate culture is challenging. It cannot be a box-ticking exercise and necessarily involves qualitative judgement. The law and regulatory guidance provide a helpful roadmap as to how to go about assessing culture from a process perspective and what data points to focus on as part of an assessment.

Process

Independence of the assessment and the importance of anonymity

- › Regulators and law enforcement expect to see an assessment process that is independent of the board and management.¹⁰¹ This does not necessarily mean the assessment needs to be outsourced to an external consultant, although such consultants can often add insight, fresh thinking and a degree of objectivity.
- › While the Board and senior management should have a chance to contribute to the assessment process with their own views and experiences, there should be careful governance placed around the degree to which they are able to shape or influence the findings of the assessment.
- › Where views of directors, senior management, employees, customers and third parties are sought, more accurate and insightful results will be achieved where anonymity is assured. Stakeholders asked to provide views may be more comfortable sharing responses with a third-party consultant on the assurance of anonymity, than an internal contact.

[Culture assessment] demands intellectual drive, honesty and rigour. It demands thought, work and action informed by what has happened in the past, why it happened and what steps are now proposed to prevent its reoccurrence.¹⁰²

101 ASIC update on implementation of Royal Commission recommendations (February 2019), <https://download.asic.gov.au/media/5011933/asic-update-on-implementation-ofroyal-commission-recommendations.pdf> page 3.
102 Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry, *Final Report*, vol 1, page 392.

Legal and compliance leaders must participate in the conversation on culture across their organisation

- › Undertaking a culture assessment is a multi-disciplinary project and will produce more insightful results if it is undertaken as a cross-functional endeavour.
- › Legal and compliance teams have a key role to play because policies, procedures, framework and the law, and how they are addressed in the corporation, have a profound impact on the culture of a corporation.
- › The findings of the assessment can also have serious implications for the board and the company under criminal and civil law. For example, if a corporate culture assessment found that a company had a culture that tolerated non-compliance with the law, should an employee or an agent of the company commit a criminal offence under the Criminal Code, a prosecutor might use such an assessment as evidence with which to attribute the company with liability under the corporate culture provisions of the Criminal Code.¹⁰³
- › Legal and compliance functions can ensure the findings of the assessment are forensically sound and articulated accurately.

Root cause analysis

To produce results that are insightful, a cultural assessment must be informed by the events of the past, and the reasons why they happened.¹⁰⁴ Only then can steps be proposed to prevent their reoccurrence. One way of analysing the past is to choose case studies for analysis, to understand what causes the outcome. Balance needs to be achieved through this process. Assessments that only focus on instances of failings will necessarily identify defects in culture. Examples of successes should also be chosen for analysis, to understand what the root cause of the success was. This will produce a more balanced assessment and more insight into the organisation's culture.

¹⁰³ *Criminal Code Act 1995* (Cth) sch 2 s12.3(c) and (d)

¹⁰⁴ Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry, *Final Report*, vol 1, page 392.

¹⁰⁵ Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry, *Final Report*, vol 1, page 390.

¹⁰⁶ Financial Reporting Council, *Corporate Culture and the Role of Boards: Report of Observations*, July 2016

Be dynamic and help the organisation make a shift in mindset

A cultural assessment will be less effective if it is a one-off event conducted periodically. While certain more resource intensive aspects such as interviews with management may be better done on a periodic basis, certain aspects such as culture focussed reviews of employee surveys and incident/risk report should be conducted regularly so that the board and management can gauge whether improvements are effective. Cultural assessment processes that focus on conducting smaller assessments within an organisation on a rolling basis, with particular areas of the business being re-assessed regularly to pick up changes in culture, has been praised by Commissioner Hayne in the FS Royal Commission Final Report.¹⁰⁵

A healthy culture both protects and generates value. It is therefore important to have a continuous focus on culture, rather than wait for a crisis.¹⁰⁶

Assessment data points

Board and senior management papers and information

Reviewing Board and management committee minutes and papers can reveal the extent to which these bodies consider issues relevant to culture and communicate their will. They can also reveal the degree to which there is debate and challenge of management from the Board and how much news, whether good or bad, is communicated to the Board and management.

Key questions organisations can ask themselves that are relevant to culture include:

- › What governance arrangements are in place in relation to corporate culture?
 - How often, if at all, is corporate culture discussed at Board (including Board committee) or senior management meetings?
 - Is there a framework for how corporate culture will be assessed and the frequency of assessments?
 - Is there a corporate culture officer or a committee?
- › How does the Board model the firm's desired behaviours and values when interacting with management and staff?
- › How does the Board support and advance the firm's desired culture through its actions and behaviours? Are values and cultural expectations clearly articulated by the Board and management? If so, how? At Board or management meetings, town hall meetings, intranet pages, firm wide videos, social media style campaigns?
- › Are issues, incidents and risks raised to the Board and management? If they are, how are they dealt with?
- › Does the Board and management engage with employees and external stakeholders such as customers, suppliers, NGOs and regulators on matters relevant to culture?

In relation to Board committees specifically:

- Does the Remuneration Committee consider the organisation's cultural aims when approving remuneration frameworks and assessing their performance?
 - What roles does the audit committee have in relation to culture?
 - What, if any, arrangement is there between Board committees for sharing risk or conduct trends?
- › How are senior management held accountable for corporate culture performance?
 - › Is the Board regularly monitoring the composition and behaviour of the Board to see how this is impacting on the culture of the organisations?
 - › Where relevant, how can the Board demonstrate to its shareholders that it manages its business in accordance with its ethical code?

Board and management interviews

Interviews with Board members and senior members of the executive and leadership teams, on an anonymised basis, will reveal more frank assessments of strengths and weaknesses of culture at the top of the organisation. This can provide a roadmap for exploring issues in more granular detail involving some of the following steps.

Employee data

Employee data can be the most valuable data in understanding what happens in practice within an organisation and what people on the ground think:

- › Most organisations will have existing data that can be useful, including performance reviews, firm wide discussions and exit interview notes.
- › Culture surveys provide an opportunity to engage with employees on their views on that organisation's culture and can be a highly effective way of obtaining a firm wide view.
- › Focus group interviews on corporate culture can provide an opportunity to explore in greater depth particular issues raised from the above sources, in particular the potential underlying causes of cultural issues.

This data is frequently cited by corporates as the most informative data when assessing culture.

Other human resources data that may provide valuable insights into an organisation's corporate culture include:

- › Whether there are frameworks that ensure that cultural values are reflected in recruitment decisions and training of staff.
- › Data on how cultural values are taken into account in relation to development and promotion of staff.
- › Data concerning the level of employee turnover, absenteeism, sick leave and untaken leave.
- › The degree of diversity amongst employees, such as their background, age and sex.

Incident data

Data relating to the frequency and seriousness of any breach of compliance controls, legal and regulatory requirements can highlight issues and gaps in an organisation's corporate culture.

A lack of data, however, could reveal a reluctance in employees to speak up about problems or in the organisation's identification processes, which may be driven by a concern about reprisals and/or apathy – a sense that nothing will be done about their complaint. It may also reveal a lack of quality in reporting systems.

Whistleblower data can reveal the willingness of staff to speak up, trends in reporting, how whistleblower complaints are investigated and how often complaints are corroborated or otherwise resolved. This data can be benchmarked against peers to see whether the company's performance in relation to whistleblower complaints is outside of the range expected for a company of its size, shape and risk profile.

Compliance and risk reviews

Compliance reviews which involve mapping the legal, regulatory and best practice standards that apply to an organisation and assessing the extent to which the organisation exceeds or falls short of its required and/or desired cultural standards can identify cultural traits, strengths and deficiencies in how an organisation approaches compliance and risk.

Risk reviews can reveal the company's attitude towards risk, its level of sophistication and strengths/deficiencies in governance processes.

Procurement data

Procurement data can provide insight into the way in which an organisation interacts with the market:

- › Procurement teams can seek feedback from third party sub-contractors, suppliers and service providers, on their experiences dealing with the organisation.
- › Any records kept by procurement teams on the way in which an organisation responds to third-party feedback can be equally relevant to an assessment of corporate culture.

Internal audit

Reviewing internal audit reports and interviewing members of the internal audit team to understand whether their findings are properly addressed, whether they feel truly independent and have the right resources and skills can also be instructive when assessing a corporation's culture.

Customer data

Assessing customer feedback data can identify trends in customers' experience interacting with the organisation, which can be reflective of its corporate culture. Specific measures that customer facing teams can use to assist with measuring and assessing corporate culture include:

- › Customer surveys and focus groups;
- › Social media audits and reputational analysis.
- › In assessing customer data, it is important to focus not just on aggregate results, but to examine the 'tail' of the most serious complaints/incidents to understand what this reveals.

Notes

Risk & compliance advisory contacts

To discuss your organisation's approach to culture, please contact one of our team.

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