

## Bank Conduct and Culture Review – Impacts for governance and not just for banks

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7 December 2018

Now that the dust has settled on the [Bank Conduct and Culture Review](#) (Review) by the Financial Markets Authority (FMA) and the Reserve Bank of New Zealand (RBNZ) it is time to consider what it means not just for banks, but for the financial sector more generally.

While the Review did not find anything like the kind of issues identified by the [Royal Commission in Australia](#), it did identify enough to act as a warning to the financial sector, and to signal that the FMA and RBNZ expect higher standards from boards and senior management, with a particular focus on how conduct and culture affects customers.

The clear message from the Review is that the FMA and RBNZ will be monitoring conduct and culture closely. They may also look for wider powers and resources to deal with conduct issues.

Leaving aside the comments of regulators, trust has always been critically important for financial institutions, whether that means 'mums and dads' depositing money with their bank, or large corporates undertaking complex swaps on financial markets using published benchmarks.

The City of London Lord Mayor, Charles Bowman recently famously said: "trust arrives on foot and leaves on a galloping horse". Conduct and culture are critical to developing and maintaining trust and it is something that, because it can only be rebuilt slowly, needs to be carefully guarded. The Review serves as a good reminder of the culture and conduct matters that directors and senior management of all financial institutions (not just banks) should be focusing on. These include:

- Monitoring **compliance with the [FMA Conduct Guide](#)**. This document was one of the benchmarks for the Review and it is very clear that the regulators expect all directors and senior management of regulated financial institutions (not just banks) to be well aware of it. All financial institutions should review the FMA Conduct Guide and the extent to which it is embedded into their policies, training and culture generally. Given its importance, and the likely focus of regulators on it, it is something which boards should potentially look to audit using internal or external resources on a regular basis
- Determining whether effective policies and procedures are in place for staff to report deviations from good conduct and culture. 'Whistleblower' policies need to be readily accessible and **genuinely protect whistleblowers** (in ways which haven't always been the case)
- Reviewing **how customer outcomes are measured** to ensure the right metrics are included. The regulators expect this to be measured not just at the point of sale, but on an ongoing basis
- Finding ways for directors and senior management to **engage with customers and frontline staff** to get a hands on view of the customer experience
- **Reviewing core products for suitability**, looking to remove complexity where possible, and to identify products which may be particularly profitable but don't actually meet customer needs (eg, insurance policies with very low claims payouts)
- In addition to monitoring lag indicators, such as customer complaints, identifying **'lead' indicators** which could identify conduct and culture issues early in the process and have them reported
- Ensuring that the institution is undertaking its **core operational functions**. This includes minimising errors and time outages and focusing on getting the core things right (even if that is not particularly glamorous)
- Appointing someone whose responsibility it is to be the customer's advocate. This means that everything should be tested on the basis of **"how would I feel if I was the customer?"**.

The FMA has also recently released findings from its [Bank Incentive Structures](#) review.

The findings from the incentive structures review emphasised the importance for boards of financial institutions to **review incentive structures** for salespeople to ensure they are aligned with doing the right thing for the customer. The FMA has expressed concerns at the highly sales focused nature of bank incentive schemes and the inherent risk of inappropriate sales practices (eg, selling customers more expensive products than they need). While the FMA is going to ask banks again in March 2019 about their sales practices, we suggest that it is important that all boards of financial institutions review the way they

incentivise sales and consider whether their institution should adopt incentive scheme features that can decrease risk identified by the FMA in its report. These could include things such as risk and behaviour gateways, outcomes reviews, caps or variable remuneration deferrals and non-sales measures.

Separately in a speech to the Institute of Directors, Rob Everett (the chief executive of the FMA) emphasised the importance of boards demonstrating behaviour that showed they put customer's interests first. That meant more than just customer satisfaction at the point of sale, but required boards to care about the long term interests of customers and demonstrate that to create the right corporate culture.

While it is reassuring that New Zealand does not have the same culture and conduct issues that existed in Australia (at least not to the same extent), we should not be complacent. It is increasingly clear that boards will be expected to put aside 'short-run profitability' in favour of 'doing the right thing by customers'. Arguably, this is just consistent with putting the long-term interests of the institution ahead of the short-run interests and profits ahead of people – something which the financial sector has not always been that good at.

The RBNZ and FMA have certainly laid down the gauntlet for boards of all financial institutions to make sure their institutions do a better job of looking after customers.

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