Australian Council of Superannuation Investors

Towards Improved Corporate Culture and Diversity

May 2019

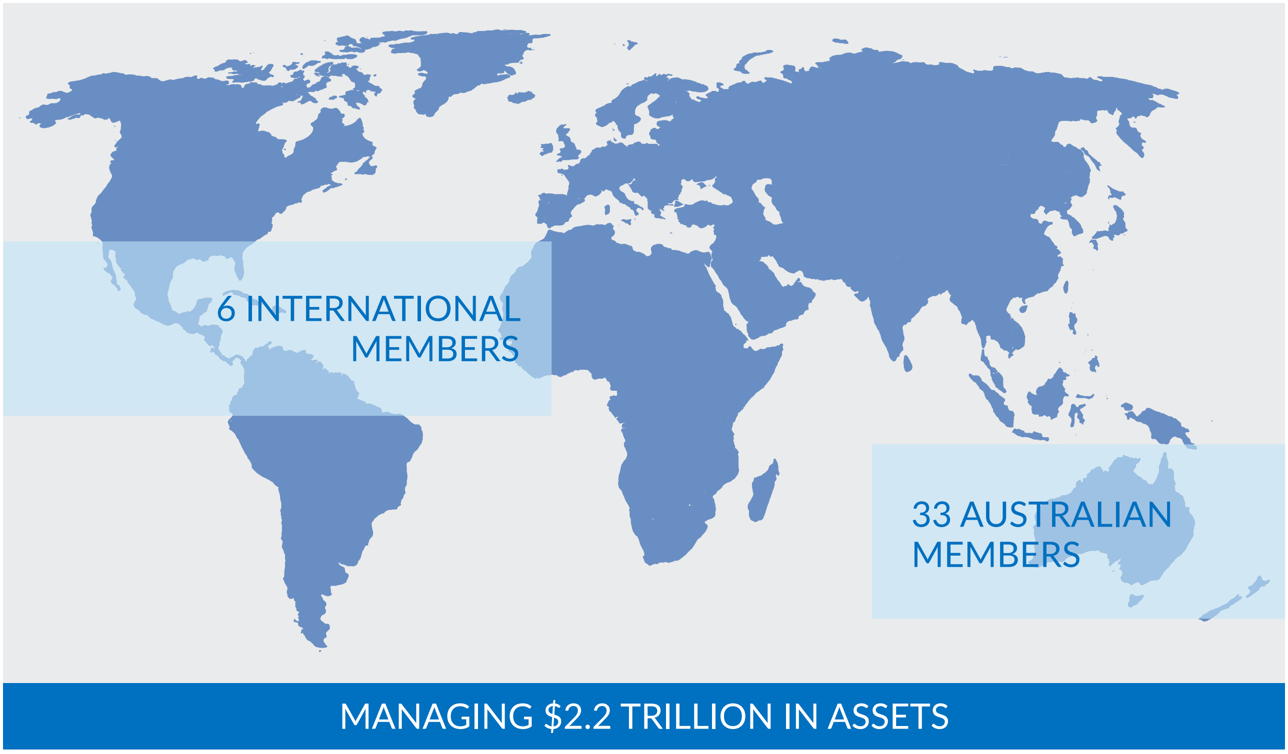
acsi

ABOUT ACSI

ACSI provides a strong, collective voice on environmental, social and governance (ESG) issues on behalf of our members.

Our members include 39 Australian and international asset owners and institutional investors. Collectively, they manage over $2.2 trillion in assets and own on average 10 per cent of every ASX200 company.

Through ACSI, our members collaborate to achieve genuine, measurable and permanent improvements in the ESG practices and performance of the companies in which they invest.



INTRODUCTION

The Final Report of the *Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry* outlined the need for change in the finance sector. It is widely accepted that poor culture is a key contributor to major behavioral and governance failings, which harm consumers, investors and markets.

The momentum for change is strong and represents an opportunity for businesses, boards and governments to rebuild trust with Australians. We must adopt long-term, sustainable practices, underpinned by responsible management of assets. Good culture is at the heart of the change we need to see.

Corporate culture can be described as the shared values and norms that shape the behaviours and mindsets of a company's staff. That said, it is a broad and qualitative concept which raises many questions. One thing is certain, culture can drive or discourage misconduct.[1]

Our members consider that long-term, sustainable investment is underpinned by sound management of environmental, social and governance (ESG) risks and opportunities. They recognise that good culture is not supplementary to effective management, but integral to it. They understand the link between corporate culture and organisational diversity.

In particular, gender diversity can assist in developing corporate culture, with diverse directors more likely to identify a broader set of risks and opportunities, and a diverse board demonstrating the company's commitment to diversity and inclusion more broadly.

This policy outlines proposals to improve corporate culture, which we will advocate for on behalf of our members and investors.

POLICY PROPOSALS	
1	All listed entities should be required to regularly conduct assessments of their culture, and disclose the action taken.
2	Listed companies should be required to set a time frame within which they will achieve gender balance (40:40:20) on their boards. If companies are unwilling to set a reasonable time frame or those targets do not improve diversity by 2025, regulatory intervention should occur.

IMPROVING CULTURE AND DIVERSITY

The Australian people will not tolerate behaviour by corporate Australia which is out of line with community expectations. Australians want their investments safeguarded and enhanced in a way which is consistent with their expectations. ESG risks and opportunities have a material financial impact on their investments, and effective stewardship aims to protect and enhance the long-term value of investments.

The Financial Services Royal Commission[2] has created the impetus for change. It is now imperative to deliver on that momentum and achieve better culture and diversity outcomes. Improved culture and diversity can be achieved through:

Foundations of culture → Require regular assessment → Targets for gender balance

[1] *Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry*, website, https://financialservices.royalcommission.gov.au/Pages/default.aspx, accessed 28 February 2019 p.375.

[2] Governor-General of Australia, *Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry*, website, https://financialservices.royalcommission.gov.au/Pages/default.aspx, accessed 28 February 2019.

FOUNDATIONS OF CORPORATE CULTURE

A healthy corporate culture can contribute to building brand value, attraction of talent and can promote performance and productivity. Poor corporate culture can have a profound impact on a company's reputation, social licence to operate and value. Loss of social licence to operate puts companies at risk of reputation damage, intervention by regulators, and loss of customer and community support. Accordingly, investors recognise that poor corporate culture is a material risk to the value of their investment.

In March 2018, ACSI published research that analysed codes of conduct and whistleblowing systems among ASX200 listed companies, based on the premise that they have an important influence on the behavior of employees.[3] We found that while almost all ASX200 companies disclose a code of conduct, coverage of key topics is weak,[4] only 11 of those conformed with leading practice[5] and fewer than half addressed key business risks such as cyber-security, anti-money laundering and human rights.

While corporate culture can be difficult to define, the Final Report of the Royal Commission outlined the basic norms of behavior that underpin a healthy corporate culture.[6] The Final Report also observed that financial services entities around the world have focused on culture, predicated on the idea that the behaviour and culture of a financial organisation influence its financial and organisational performance'.[7]

Many reviews and papers have highlighted the importance of corporate culture.[8] For example, as long ago as 2003, Justice Neville Owen considered aspects of corporate culture in his *Report on HIH Insurance*, noting that a culture of not questioning leadership decisions had developed at HIH, and highlighting that *'those responsible for the governance of a company should have an interest in inculcating within the company a culture and processes that enable instances of questionable conduct to be brought to attention outside normal reporting lines without fear of retribution*'.[9]

In 2015, ASIC outlined its interest in corporate culture, on the basis that culture can be a key driver of conduct. ASIC highlighted research by the London School of Economics and Political Science that found that the cost of poor conduct for the 10 most affected global brands was approximately US$250 billion between 2008 and 2012.[10]

Despite the observations and focus on corporate culture, the pace of improvement in Australia has been slow. After identifying numerous failings attributable to poor culture, the recent Financial Services Royal Commission recommended that financial services entities regularly review their culture. The observations and recommendations on corporate culture in the Final Report are welcome and there is an opportunity to apply them beyond the financial services sector to drive improvement across the market.

The Fourth Edition of the ASX Corporate Governance Council's Corporate Governance Principles and Recommendations asks entities to consider their culture. We support the Corporate Governance Council's recommendation that entities articulate and disclose their values, and have and disclose codes of conduct and whistleblowing and anti-bribery and corruption policies. We encourage entities to adopt these recommendations.

In addition, we think that entities should ensure that their policies include the best practice indicators (as articulated in our research), are regularly reviewed, and that entities take tangible action to promote compliance with their own policies. We support the ASX Corporate Governance Council's recommendation that entities disclose these actions, along with any material breaches and how they are addressed, on the basis that this is useful information for investors.

[3] https://www.acsi.org.au/images/stories/ACSIDocuments/generalresearchpublic/ACSI-Codes-of-Conduct-Whistleblowing-and-Corporate-Culture-March-2018.pdf.

[4] Sixty-seven per cent failed to cover 5 of the 13 recommended topics. The recommended topics being EEO/non-discrimination; safety; gifts; environment; bribery; fraud/corruption; conflict of interest; bullying; human rights; anti-competition/anti-trust; AML/CTF; data protection/cybercrime; fair dealing/product responsibility.

[5] Leading practice was measured by being two years old or less, using examples, Q&As or case studies, and setting a tone from the top by having a CEO introduction.

[6] Those basic norms are 'obey the law'; 'do not mislead or deceive'; 'act fairly'; 'provide services that are fit for purpose'; 'deliver services with reasonable care and skill' and 'when acting for another, act in the best interest of that other'. *Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry*, website, https://financialservices.royalcommission.gov.au/Pages/default.aspx, accessed 28 February 2019 p.376.

[7] For example, the assessments conducted by the Dutch Central Bank De Nederlandsche Bank (DNB); the Financial Stability Board's focus on risk culture, the Group of Thirty's paper on 'Banking Conduct and Culture: A call for sustained and comprehensive reform' (as outlined in pages 378-386 of the *Final Report of the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry.*

[8] For example, *Retail banking Remuneration Review Report* Stephen Sedgwick 19 April 2016; ASIC's January 2018 report Financial Advice: Vertically Integrated Institutions and Conflicts of Interest; APRA Information Paper *Risk Culture* October 2016; ASIC article *'Corporate Culture, corporate values and ethics'* September 2016.

[9] Report of the Royal Commission into HIH Insurance section 6.5.

[10] ASIC article *'Culture, Conduct and the bottom line'* September 2015, citing the London School of Economics and Political Science.

CULTURE ASSESSMENTS

The Royal Commission highlighted that culture can and must be assessed by financial services entities themselves.[11] At the same time, it noted that the culture of each entity will be unique. There is no single best way to address it. Although culture cannot be prescribed or legislated, it can be assessed. A careful and detailed assessment of the culture of an entity can be of great value.[12]

APRA's Prudential Inquiry into the Commonwealth Bank of Australia (CBA) assessed CBA's broader 'frameworks and practices in relation to governance, culture and accountability', rather than just focusing on risk.[13] The CBA report identified cultural failings that contributed to misconduct and explained how those problems could be addressed.

The public and transparent nature of the CBA report served the entire industry. APRA subsequently required many of its regulated institutions to complete self-assessments against the matters identified in the CBA report. The value of the report was widely appreciated and many organisations outside the financial services sector have since considered how its findings might apply to them.

ACSI's view is that the observations on culture from around the world, the CBA report and the Royal Commission apply to all listed entities and are not limited to the financial sector. That is, all listed entities should be required to regularly assess their culture and governance to identify and address any issues.

We think that boards should openly and transparently conduct culture assessments for the entities they lead. The words of Commissioner Hayne have relevance beyond the financial services sector to listed companies broadly:

What entities must do can be stated in the form of a recommendation expressed only at a level of generality that some may too easily say 'does not apply to us'. But it does…And to ignore the recommendation would be foolish and ignorant. It would be foolish because… every entity is and must be accountable for what it does. It would ignorant because those who will not learn from history will repeat it.[14]

PROPOSAL 1

All listed entities should be required to regularly conduct assessments of their culture, and disclose the action taken.

[11] Governor-General of Australia, *Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry*, p.391, website, https://financialservices.royalcommission.gov.au/Pages/default.aspx, accessed 27 March 2019.

[12] *Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry*, p.376, website, https://financialservices.royalcommission.gov.au/Pages/default.aspx, accessed 27 March 2019.

[13] Australian Prudential Regulation Authority, *Commonwealth Bank of Australia Prudential Inquiry*, Terms of Reference as set out in the Final Report, p.105.

[14] *Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry*, p.392, website, https://financialservices.royalcommission.gov.au/Pages/default.aspx, accessed 27 March 2019.

GENDER BALANCE TARGETS

In the Royal Commission Final Report, the Commissioner raised questions about how entities can properly reflect and 'hold up a mirror' to their culture and practices.[15] For some time, ACSI's approach has reflected the position that diversity and inclusion provides a good opportunity to identify issues, challenge the status quo and prevent 'group think'.

Suitably diverse boards better govern companies and maintain more effective oversight of ESG risks and opportunities. Diversity of thought assists boards to set and challenge company strategy and to better understand the markets in which they operate. Review and renewal are integral to ensuring a board has access to perspectives that allow it carry out its duties effectively.

Diversity supports different thought processes, more varied opinion and a wider range of capabilities. It helps immunise against 'group think'. Diversity can help an organisation make better decisions, which ultimately makes for better business. Companies that demonstrate their commitment to diversity will attract the best talent throughout the organisation and do better over the long-term. Moreover, the clients, customers and other stakeholders of any business are diverse. To properly understand their interests and how they impact the organisation, the organisation's governing body should be reflective of its stakeholders.

Targets provide a way for companies to assess their culture and diversity, but they also provide incentives for cultural change. One measurable indication of cultural norms and beliefs is a target aimed at achieving board gender balance.

ACSI thinks that companies should be required to set a time frame within which they will achieve gender balance on their boards. Gender balance typically refers to a minimum of 40 per cent of either gender, with 20 per cent unallocated to allow flexibility for appropriate renewal. If companies are unwilling to set a reasonable time frame or those targets do not achieve outcomes by 2025, regulatory intervention should occur.

PROPOSAL 2

Listed companies should be required to set a time frame within which they will achieve gender balance (40:40:20) on their boards. If companies are unwilling to set a reasonable time frame or those targets do not improve diversity by 2025, regulatory intervention should occur.

[15] Ibid p.377.

CALL TO ACTION

The actions outlined in this document will help establish a stronger, more sustainable business sector for Australia over the long term.

Momentum currently exists across capital markets towards further strengthening culture and diversity in the financial services sector. This momentum should extend to all listed entities with an opportunity to instigate changes in the Australian corporate sector that are good for Australian investors, sustainable and in line with community expectations.

We are calling on policy makers and regulators to make a commitment to the proposals in this document:

1. **All listed entities should be required to regularly conduct assessments of their culture, and disclose the action taken.**

2. **Listed companies should be required to set a time frame within which they will achieve gender balance (40:40:20) on their boards. If companies are unwilling to set a reasonable time frame or those targets do not improve diversity by 2025, regulatory intervention should occur.**

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