"Culture and Conduct - A Regulatory Perspective" - Speech by Mr Lee Boon Ngiap, Assistant Managing Director, Monetary Authority of Singapore, at the 2017 Annual Luncheon of the Life Insurance Association Singapore on 6 March 2017

Distinguished guests,

Ladies and Gentlemen,

1 Thank you for inviting me to speak at today's luncheon. Let me start by acknowledging Kah Siang for his work as LIA President for the past three years when many of the recommendations under the Financial Advisory Industry Review (FAIR) were implemented. As Chairman of the Institute of Banking and Finance (IBF) Financial Planning Working Group, Kah Siang was also active in raising the competency of financial advisory representatives through the development of the IBF Financial Planning Competency Standards. May I also welcome Patrick as the new LIA President. I look forward to working with Patrick and his team to further raise the standards of financial advisory practices and strengthen the life insurance industry in Singapore.

2 In my remarks today, I will share MAS' regulatory perspective on the importance of culture as a key driver of conduct, and set out some thoughts on what more can be done to promote a positive culture in financial institutions. To begin, let me first briefly take stock of global developments in this area, to underscore why regulators worldwide, including MAS, are stepping up our focus on culture and conduct.

3 In the aftermath of the global financial crisis, regulators introduced a slew of reforms aimed at strengthening the resilience and stability of the financial system. The initial focus of the reforms was primarily directed at micro- and macro-prudential issues such as capital adequacy, liquidity risk and measures to dampen pro-cyclicality of financial markets. In recent years, however, there has been a growing regulatory emphasis on culture and conduct. There is a good reason for this - apart from the recognition that ethical failure was one of the root causes that got many firms into trouble during the crisis, the financial industry continues to be dogged by egregious misconduct nine years on from the

crisis. According to research by the CCP Research Foundation, the cost of poor conduct for 20 global banking groups for the 5-year period from 2011-2015 was £252 billion, an increase of 27.6% compared to the 5-year period from 2008-2012 when the research on conduct costs was first carried out[1]. And this does not include the cost of remedial compliance or risk management actions that these entities have been directed to take by their regulators, nor the loss in their franchise values. Conduct costs are now so significant that it is not uncommon these days to read about big financial groups reporting higher or lower profits largely because of a decline or increase in regulatory fines or litigation costs related to misconduct. It is therefore no surprise that the International Monetary Fund has acknowledged that the problem of poor culture has become systemic in the financial sector, and the Financial Stability Board now has workstreams looking into conduct issues given its potential to impact financial stability.

4 While the life insurance industry may not have been at the forefront of the major misconduct cases making global headlines, some of these conduct costs involve mis-selling of products and inappropriate advice. The need to pay attention to culture to avoid paying the price of misconduct is clearly equally applicable to the life insurance industry, particularly when it involves poor financial advisory practices.

What is culture and why it matters

5 So what is culture? Definitions and descriptions abound in the literature but in the main, we see it as the shared values, attitudes and norms that guide behaviour in an organisation. Culture reflects the underlying mindset of an organisation and affects how an organisation and its staff act and make decisions, oftentimes without thinking consciously about it.

6 Getting the culture right in financial institutions is critical because poor culture can be a driver of poor conduct. The financial industry’s most valuable asset – trust – can be significantly undermined by poor conduct. And all financial institutions need their customers to trust them in order to build a sustainable business.

7 From a regulatory perspective, one of the outcomes that MAS seeks to promote is transparency and fair dealing by financial institutions – among others, this involves instilling fair business practices in the marketing and distribution of financial products and services. MAS is therefore interested in the culture in financial institutions as it has a dominant influence on the way they conduct their business with customers.

MAS' approach to culture and conduct

8 To be clear, the focus on culture is not a new concept to MAS. Some of our rules and guidelines already set out our regulatory expectations on culture and conduct. For the financial advisory business in particular, let me highlight three initiatives:

• First, the Guidelines on Fair Dealing issued by MAS in April 2009. The Guidelines hold the board and senior management of financial institutions accountable for setting the culture and direction to align business practices with fair dealing outcomes.

• Second, the balanced scorecard framework under FAIR, which adds non-financial performance measures to volume-based remuneration arrangements, to better align the interests of financial advisers and their representatives with that of their customers.

• Third, regulations on complaints handling and resolution, which require financial advisory firms to establish an independent and prompt process for handling and resolving complaints from retail customers.

At their core, all of these initiatives can be seen as measures to promote and reinforce the right culture in financial institutions and among their staff. In our supervisory engagements with individual financial institutions, where relevant, MAS also includes observations on culture and our assessment of its impact on selling and advisory practices.

9 Assessing culture and its impact on conduct inherently poses a greater challenge than prudential supervision because culture cannot be quantified nor easily monitored. But we believe it is as important as capital and liquidity, and should receive equally close attention from regulators and financial institutions.

10 Close attention does not necessarily mean that MAS will introduce more rules. But financial institutions can expect MAS to engage them more regularly on what they are doing within their own organisations to shape the right culture. We are interested in looking beyond the existence of a compliance and control framework to assess if financial institutions have a supporting culture that incentivises their employees and agents to do the right thing, rather than just doing what's legal.

11 Where MAS assesses that poor culture poses a risk to fair dealing outcomes for consumers, we will make this clear to firms, which may be asked to consider measures to mitigate the misconduct risks arising. We will also be placing greater emphasis on individual accountability for meeting conduct standards and expectations, including that of supervisors of staff involved in misconduct, and will consider enforcement actions against those who commit serious misconduct.

12 While regulation can play a role to promote the right culture, it is not a substitute for the actions that financial institutions should take to shape the right behaviours within their own organisations. Regulation alone cannot eradicate bad behaviour because it cannot specifically address the unique circumstances relating to each and every financial transaction or advisory and sales process. More importantly, what constitutes right or wrong behaviour cannot be reduced to what is permissible under the law. The shared values, attitudes and norms that guide behaviour in an organisation cannot be dictated solely by external, nor internal rules.

Role of financial institutions in promoting a positive culture

13 So what can financial institutions do to shape the right culture in their organisations? There is no silver bullet but I would like to suggest a few key drivers that boards and senior management can focus on to promote a positive culture.

14 First, a strong and clear tone from the top. This is not just about statements on values that are routinely repeated during staff events. This is about 'walking the talk' – making decisions that reflect what is said. This is about board and senior management treating culture with the same importance as capital, and demonstrating that values matter as much, if not more, than valuations. This tone from the top must percolate to middle management, as employees and agents are more directly influenced by their supervisors whom they interact with on a daily basis. Firms should put in place governance structures to regularly monitor that the mood-in-the-middle and the echo-from-the-ground resonate with the tone from the top, i.e., are people doing the right thing even when nobody is watching? A good way to validate that the tone from the top is effectively being heard and practiced throughout the organisation is for culture and conduct issues to be a regular feature on the agenda of board meetings, where culture and conduct outcomes are actively monitored and where feedback from customers, both good and bad, are also presented.

15 Second, people management and incentives. How a firm rewards and manages its employees and agents send a clear signal about the accepted corporate culture. If they see that high revenue producers are rewarded despite, or even because of poor conduct, that is a sure recipe for poor culture to take root in an organisation. Organisational policies should send a clear signal that profits do not come before values and ethics. Remuneration policies must not just motivate high performance based on sales or profits but also penalise poor conduct so that they can serve as an effective deterrent to bad behaviour.

16 Third, escalation policies. A firm's employees and agents are its best monitors. They should feel safe to speak up and effectively challenge practices and decisions that they may have concerns about. A culture of openness will encourage staff to raise potential red flags on misconduct with confidence and without the fear of reprisals or jeopardising their jobs. It can help firms detect poor conduct at an early stage before the problems take root and become widespread in the organisation.

17 Fourth, recruitment and training. In making hiring decisions, apart from looking at the individual or team's ability to bring in sales, it would be critical for firms to also consider if the individual or team's values are aligned with that desired by the organisation. As the quote attributed to Warren Buffet goes "in

looking for people to hire, you look for three qualities: integrity, intelligence and energy. And if you don't have the first, the other two will kill you". Firms should also have regular training on the organisation's values and the ethical behaviours expected of staff, as a constant reminder of the need to adhere to good conduct practices.

18 Lastly, self-policing. Where an instance of misconduct is detected, the firm's leadership should ask if the behaviour is pervasive and where else the behaviour could have occurred. In addition to just addressing isolated instances of misconduct, firms should always seek to identify if there is a root cause of the bad behaviour that needs to be fixed so that the problem goes away for good. Where instances of misconduct occur at other firms, the same introspection should apply – "do we have a similar problem?"; "how do we prevent this from happening to us?"

Conclusion

19 Let me briefly conclude. Good culture drives good conduct, and good conduct is good for business. A good culture bolsters reputation and strengthens customer loyalty. As a regulator, MAS can design rules and supervisory approaches to foster the development of the right culture in financial institutions. But it is the efforts within firms that will make a real difference. Firms should spare no efforts to develop and sustain the right culture that genuinely puts customers first if they want to be around for the long term. I urge all of you to regularly think about your organisation's culture and reflect on changes that you can make to promote a more positive culture of doing the right thing.

20 Thank you.

[1] *CCP Research Foundation Conduct Costs Project Report 2015*

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