



Regulators' expectations on corporate culture for financial institutions

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Background

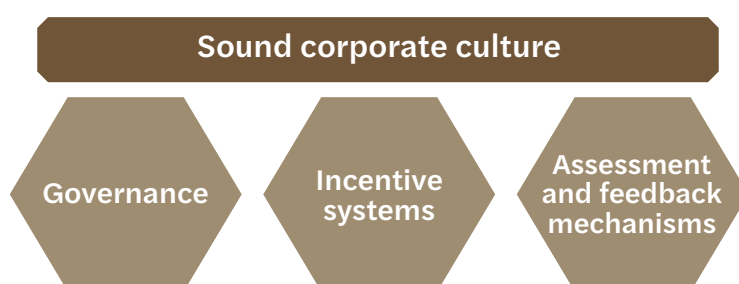
Given the increasing public concerns over financial institutions' misconduct behaviours, regulators, in particular the Hong Kong Monetary Authority, are raising their requirements on financial institutions' development of a sound corporate culture that supports prudent risk management and incentivises proper staff behaviour for positive customer outcomes and high ethical standards.

This publication summarises the key elements of a sound corporate culture for financial institutions. While the framework described here were formulated for banks in Hong Kong, most of the elements are equally applicable to other non-bank financial institutions such as brokers, insurance companies or asset managers.

With our in-depth experience and understanding of the regulatory landscapes in Hong Kong, Mazars can support you to remain compliant on regulators' expectations in maintaining a sound corporate culture framework to achieve your business goals.

Overview of a sound corporate culture framework

While there is no “one-size-fits-all” approach, the regulators generally expect a financial institution to adopt a holistic and effective framework for fostering a sound culture within the institution. Being one of the key financial regulators in Hong Kong, the Hong Kong Monetary Authority (“HKMA”) has introduced a framework of sound corporate culture for the banking industry under the following three pillars:



I. Governance

Corporate culture defines the expected ethical values and desirable behaviours within a financial institution that are governed by the board and senior management.

II. Incentive systems

The incentive systems of a financial institution, including staff recruitment, performance management, remuneration and promotion systems, should not only reward good business performance but also consider the adherence to the institution’s culture and behavioural standards, with a view to avoid incentivising short-term business performance at the expense of the interests of customers and the safety and soundness of the institution.

III. Assessment and feedback mechanisms

Management should develop appropriate tools to assess and monitor the adherence of individual business units and relevant staff to an institution’s culture and behavioural standards. On the other hand, effective upward feedback mechanism should be in place to encourage staff to timely report any illegal, unethical, or questionable practices observed without fear of adverse consequences.

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Regulatory expectations on the industry practices

Subsequent to the introduction of the bank culture framework in 2017, the HKMA commenced a self-assessment exercise in 2019 and required 30 banks, including all major retail banks and selected foreign bank branches with substantial operations in Hong Kong, to conduct self-reviews on their culture enhancement efforts. A summary of the recommended industry practices under the three pillars of the sound corporate culture framework are as follows:

I. Governance	
Ownership	<ul style="list-style-type: none"> Board and senior management are expected to set and take ownership of an institution's culture and values and behavioral standards For locally incorporated institutions, the board, through its board-level committees chaired by its independent non-executive directors, is expected to expand its remit to cover culture related matters For overseas incorporated institutions without a board locally, culture related matters are driven at the group level and adopted by local senior management
Regular review	<ul style="list-style-type: none"> Board-level committees should have a regular process to review the effectiveness of the overall culture enhancement initiatives at least annually Areas covered in the review includes the progress of the institution's culture initiatives, dashboard reviews, review of culture statements and behavioural standards, staff feedback, etc. Some institutions have engaged their internal audit functions to conduct those reviews External consultants have also been engaged to assist by some institutions in assisting the board with developing its culture framework
Communications and training	<ul style="list-style-type: none"> Banks should cascade "tone from the top" down to ensure that the culture, values and behavioural standards are understood and shared by different levels of staff, through effective and continual communications and training Common methods of communications include interactive channels such as town hall meetings or seminars conducted by senior management with topics on bank culture reform and unilateral channels such as distribution of regular culture-related newsletters
Language around culture	<ul style="list-style-type: none"> An easily understood language around culture should be used to communicate culture related matters
Relevance to different level of staff	<ul style="list-style-type: none"> The desired culture and expected behavioural standards should be relevant to different level of staff Templates with real-life examples could be established to facilitate individual business functions to develop their own summary sheets of code of conducts
Conduct risk champions	<ul style="list-style-type: none"> Banks should have clear ownership of risk and culture reform through appointment of senior staff members as "conduct risk champions" which are responsible for cascading messages relating to culture and conduct further down the institutions
Intragroup connection	<ul style="list-style-type: none"> The culture efforts in Hong Kong operations should be connected to an institution's headquarter or upstream entities as well as its downstream operations
Continuous professional development	<ul style="list-style-type: none"> Banks should facilitate the undertaking by relevant staff of the continuous professional development to complement the effort of promoting sound culture
Sustained effort	<ul style="list-style-type: none"> Banks should be mindful of "culture fatigue" and sustained effort is required in driving cultural changes of the institutions

Regulatory expectations on the industry practices

II. Incentive systems	
Recruitment	<ul style="list-style-type: none"> Banks should recruit individuals who align with the desired culture, values and behavioural standards Cultural fit assessments on candidates' conduct credentials, ethics, honesty and integrity could be referenced for recruitment consideration
Remuneration framework	<ul style="list-style-type: none"> Remuneration practices should be designed to encourage desired behaviours A balanced scorecard approach, which considers both financial and non-financial factors in determining the variable remuneration for staff, should be established Remuneration frameworks should not overly rely on financial targets and non-financial factors should have real impact on remuneration decisions
Regular review	<ul style="list-style-type: none"> Banks should have regular reviews of their remuneration framework to assess the effectiveness of their remuneration structures and practices in promoting sound culture and preventing incidents of misconduct
Linkage between remuneration outcomes and staff performance	<ul style="list-style-type: none"> Banks should strengthen the linkage between remuneration outcomes and staff performance on adherence to corporate values regardless of their financial performance
Consequence management framework	<ul style="list-style-type: none"> Consequence management framework should be established promote culture of accountability Clear and appropriate consequences should be established, articulated and applied for staff engaging in any undesired behaviours, including poor management oversight
Promote positive behaviours	<ul style="list-style-type: none"> Banks should promote positive behaviours through proper incentive systems. They should be designed to not only sanction mis-behaviours but also promote positive behaviours through monetary or non-monetary rewards (e.g. a simple thank-you card, recognition emails, certificate, achievement award, and praise from senior management) for those employees who demonstrate behaviours that enhance the bank's culture Sharing of positive behaviours is important to promote positive behaviours
III. Assessment and feedback mechanisms	
Assessment with tools	<ul style="list-style-type: none"> Banks should assess whether their initiatives are effective in driving behavioural changes among bank staff Banks could develop appropriate tools (e.g. dashboard of indicators) to monitor adherence of individual business units and relevant staff to an institution's culture and behavioural standards
Foster "speak up" culture	<ul style="list-style-type: none"> Banks should establish multiple channels for staff to speak up and escalate behavioural issues Banks should promote an environment which provides "psychological safety" to encourage staff to speak up without fear of adverse consequences An effective escalation policy, such as "whistle-blowing" mechanism, should be put in place to allow timely reporting of any illegal, unethical, or questionable practices observed by staff and stakeholders in a confidential setting without the risk of reprisals The effectiveness of escalation channels should be reviewed from time to time
Benchmark analysis	<ul style="list-style-type: none"> Banks should perform deeper benchmark analysis against the findings from the reviews of the major overseas misconduct incidents Banks should understand the underlying root causes of the misconduct incidents and identify whether similar incidents could possibly arise in their own institutions



How can Mazars help?

At Mazars, we have extensive experience working with the diversity of financial services players. We assist major financial institutions including brokerage houses, asset managers, insurance companies, investment and corporate banks, retail and private banks, central banks, and national regulators in dealing with business and regulatory issues with impacts, domestic and international.

Mazars is here to assist you in complying with the relevant regulatory requirements. Depending on the scope, coverage and specifics of your needs, our services would typically involve one or more of the following:

How can Mazars help?

A. Regulatory reviews and advice

- I. Review and provide advisory on your institution's culture framework with respect to the following
 - policies and procedures;
 - governance and internal controls;
 - risk management framework and controls in relation to corporate culture;
 - compliance with rules and regulations; and
 - operational capabilities.
- II. Provide observations and recommendations to assist you in complying with regulators' requirements and expectations, as well as common industry practice on a sound corporate culture.

B. Design and implementation of policies and procedures

- I. Provide advice / assistance in designing and implementing enhancements to your corporate culture framework, including governance framework, as well as your policies, procedures, and controls.

C. Training and insights

- I. Provide training and education for staff, the board, senior management, and culture team.
- II. Provide ongoing insights into how peer firms are dealing with the regulatory requirements on corporate culture and any common challenges encountered along the way.

We also take on special projects and ad-hoc mandates. We are flexible in our approach and offerings. Please feel free to contact us with any enquiries.

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