



FINANCIAL
SERVICES
INSTITUTE
of Australasia

ARE PROFIT-BASED INCENTIVES COMPATIBLE WITH A RISK CULTURE?

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FINSIA, Australasia's peak body for finance professionals, today releases new research findings into risk culture across the financial services sector, based on a Macquarie University experimental study that is a first of its kind to be conducted in Australia.

Associate Professor Elizabeth Sheedy says, "The results of this new experimental research into risk culture, conducted with over 300 financial services executives - all members of FINSIA - sheds light on the compliance behaviour of financial professionals. It reveals the impact of incentives and how signals from managers and co-workers affect organisational culture."

"The key finding of the study is that profit-based incentives have an adverse impact on compliance. When staff incentives are linked to profits, rates of compliance with risk management policies fall. The effect is felt via risk culture."

Chris Whitehead, CEO FINSIA says, "FINSIA was keen to support this important experimental study which reveals the relationship between risk culture, incentives and the behaviour of financial services staff. We knew this research was very timely given current community concerns and falling trust in the sector."

"The research is also very valuable to the financial services sector as it can be used to investigate further how risk culture may be improved in financial institutions."

Dr Sheedy continues, "We wanted to design and conduct an experimental study to demonstrate that 'culture' experiments can be meaningfully conducted in a lab environment. The study validates that risk culture is an important determinant of compliance behaviour effected by incentives and the behaviour of managers and co-workers."

"To ensure it was based on real life scenarios, the participants had to do some simple analysis (with a calculator) and then decide whether to invest. During the one-hour lab session, they could invest in up to 60 transactions. The experiment also reflected the industry context where the participants were given a risk policy/limit to follow."

Mr Whitehead added, "It is very evident that the key results of the study support the careful consideration of profit-based incentives currently being debated within the financial services industry and as reviewed recently in the Sedgewick report released by the Australian Bankers Association."

"In FINSIA's view this type of research points to the need for professionalism in financial services. Incentives need to be balanced and individuals also need demonstrated competency, a clear and enforced code of conduct and an ethical culture."

Other key findings include:

- When the burden of calculations on participants were reduced an increase in compliance with risk policy was noticed. This is probably because people are less able to resist the temptation to breach policy when they are tired. This suggests that to increase risk compliance it is important for the industry to take better account of cognitive load — i.e. to automate analysis where possible and design work patterns in such a way that staff are not unduly depleted when making crucial decisions.
- Personal attitudes to risk management/compliance are a significant determinant of compliance behaviour. This finding has implications for the screening of job candidates, such as considering candidates' attitudes towards risk management in recruitment/promotion decisions.
- Workers from the superannuation sector were less likely than others in financial services to comply with risk policy. This finding should be treated with caution due to the small sample (10% of sample) but it warrants further investigation. If confirmed, it may mean that additional work is needed to improve risk culture in this sector.
- The research project has demonstrated that 'culture' experiments can be usefully conducted in the lab.

You can access a copy of the research paper here, ['Are profit-based Incentives Compatible with a Risk Culture?'](#).

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FINSIA — the Financial Services Institute of Australasia — is Australasia's leading membership organisation for the financial services industry.

FINSIA's heritage is over 130 years of progressing financial service knowledge and conduct to high standards. More importantly than ever FINSIA is the connector of key stakeholders, industry regulators, government and education providers to help deepen trust in financial services by raising standards of professionalism. FINSIA enables the advancement of competence and integrity for the benefit of professionals, consumers and society.

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