



Lessons learned from the private sector November 2019

Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry

Accountable authorities should be mindful of inquiries and reviews undertaken in the private sector, and consider any lessons that could be learned in their entity's context.

Overview

In 2019 the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry handed down its findings, with 76 recommendations to fix the finance industry, in particular the banking and superannuation sectors, in Australia. Although much of the commentary focused on issues specific to the finance industry, the Report contained many lessons that could be learned by Government. Commissioner Hayne (Hayne) provided an extensive examination into the issues of culture, governance and remuneration. According to Hayne, improvements in each of these areas should reduce the risk of misconduct in the future. These issues are all interconnected; taking positive steps in one area will reinforce positive steps taken in others. Similarly, failings in one area will undermine progress in others. The recommendations Hayne made on culture and governance can be readily translated into the APS, in particular recommendation 5.6:


All financial services entities should, as often as reasonably possible, take proper steps to:

- assess the entity's culture and its governance;
- identify any problems with that culture and governance;
- deal with those problems; and
- determine whether the changes it has made have been effective.¹

A key characteristic of this recommendation is that culture and governance are never "fixed". Entities must regularly examine their culture and assess the quality of their governance in order to identify issues rather than waiting to respond to issues. There is an opportunity here for entities to consider a standing agenda item on the issues of culture and governance at executive meetings. However, importantly, culture needs to be owned by everyone in the organisation, not just those at the top.

The Hon Justice Owen (Owen) discussed comparable ideas in the 2003 Royal Commission into HIH Insurance. Similarly, Owen made only two formal recommendations on corporate governance. The first recommendation was that the Corporations Act and the ASX Listing Rules be amended to force appropriate disclosure of executive remuneration. The PGPA Rule was updated this year to require all Commonwealth entities and companies to disclose details of the remuneration of each of their key management personnel, senior executives and other highly paid staff. Accountable authorities need to be conscious of how compensation, incentive or remuneration practices can drive behaviours and culture.

The other recommendation was to apply the duties to all persons performing functions for or on behalf of the corporations, whether employees or contractors. Owen highlighted the danger in emphasising the role of the board, particularly in larger organisations where the employees down the line have decision making powers and control.



Generally, employees of companies are subject to the duties imposed on directors and senior management through a trickle down of delegations and authorisations, through internal controls, or through employment frameworks. These links were not always clear to people, particularly those unfamiliar with the financial framework. All employees involved in the decision-making process and on whom the directors rely, should be accountable. The application of the PGPA Act duties on all officials ensures that all Commonwealth officials are aware of their personal duties, rather than having these duties trickling down from delegations or authorisations.

Entities must also be aware that an overly prescriptive approach to systems and structures may encourage a “tick the box” approach to the achievement of governance objectives. This issue formed the foundation of the Australian Prudential Regulation Authority’s Prudential Inquiry into the Commonwealth Bank of Australia (APRA Prudential Inquiry). All three Reports urged organisations to adopt the “should I do this” test, rather than a “can I do this” test, into all key decision making processes. Entities will fail to recognise the inter-relationships between various types of risks and the broad impact they have, if the focus is simply on compliance with systems and structures. The PGPA Act provides the flexibility to establish systems and structures to create an operating environment that supports the proper use and management of public resources, while applying the minimum controls in order for entities to achieve their outcomes without stifling innovation. Accountable authorities must take a proportional, risk-based approach to imposing compliance burdens on others (section 18 of the PGPA Act). It is important that officials are given the opportunity to understand the risk and use their judgement to decide “what is the right thing to do?”

All three reports highlighted the importance of strategic oversight of non-financial risks such as compliance, conduct and regulatory risks. The following questions have been based on the set of questions that Hayne developed as a result of the APRA Prudential Inquiry², that every Commonwealth entity and company should ask themselves.

- 1. Challenge:** The accountable authority cannot simply rely upon the information presented by senior executive staff, they have the responsibility to request more information where necessary to fulfil their duties. Is there adequate oversight and challenge by the accountable authority and the audit committee of emerging non-financial risks?
- 2. Accountable:** The accountable authority may delegate their powers to senior executive staff under section 110 of the PGPA Act, but this does not discharge the duties of the accountable authority to ensure that those powers are being exercised correctly. Is it clear who is accountable for risks and how they are to be held accountable?
- 3. Process:** An entity must establish and maintain an entity specific risk management policy and a risk management framework that contains how the entity will report risks to both internal and external stakeholders. Are issues, incidents and risks identified quickly, referred up to senior executive staff, and then managed and resolved urgently? Or is red tape getting in the way?
- 4. Evaluate:** The practical effectiveness of an entity’s governance model and internal controls should be periodically tested. Technically ticking every best practice box is not functional as culture and governance are never “fixed”. Is compliance working in practice, or is it a “box ticking” exercise?
- 5. Penalise:** Do compensation, incentive or remuneration practices recognise good risk management and penalise poor conduct? How does the remuneration framework apply when there are poor risk outcomes?

¹ See *Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry* (Final Report, February 2019) vol 1, 36.

² See *Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry* (Final Report, February 2019) vol 1, 333-4.