

Thinking ahead and
responding rapidly

THE BANKING ROYAL COMMISSION (BRC)

An analysis of what has arisen so far and lessons for organisations

WHAT IS IT ABOUT?

The BRC is a twelve-month \$75 million enquiry into the banks and the broader financial services industry.

It is investigating the conduct of banks, insurers, financial service providers and superannuation funds (not including self-managed superannuation funds).

While the enquiry does not have the authority to address misconduct itself, it will provide recommendations for the government to act on as it sees fit.

When considered in conjunction with the Australian Prudential Regulation Authority (APRA) report into the Commonwealth Bank (CBA), with its conclusion that "CBA's continued financial success dulled the senses of the institution", there are clearly some issues to consider.

It all ultimately comes back to culture, with this paper providing an overview of the top three areas arising from the BRC, and some insights as to how to deliver more satisfactory outcomes.

Having a "social licence to operate" requires not only a focus on long-term value creation, but importantly, recognition of the importance of engagement with all stakeholders and the need to meet community expectations.

WHERE THINGS HAVE BEEN GOING WRONG

Outcomes thus far reflect instances of failures of leadership, governance and accountability, as well as complacency about governance and culture, and a lack of management non-financial risks.

One example highlighted by the BRC is CBA's Audit Committee sitting over a "red" audit report, a second report noting the issues had not progressed, and a third report about the failure to close issues in a timely manner.

APRA stated that while the CBA Audit Committee had been diligent, it had "exhibited a lack of rigour and urgency in holding management to account".

PRACTICAL APPLICATION

In this paper we share what we have seen arising from the BRC, and how organisations can use these outcomes to continuously improve their governance structures and processes.

GOVERNANCE, BOARDS AND COMMITTEES

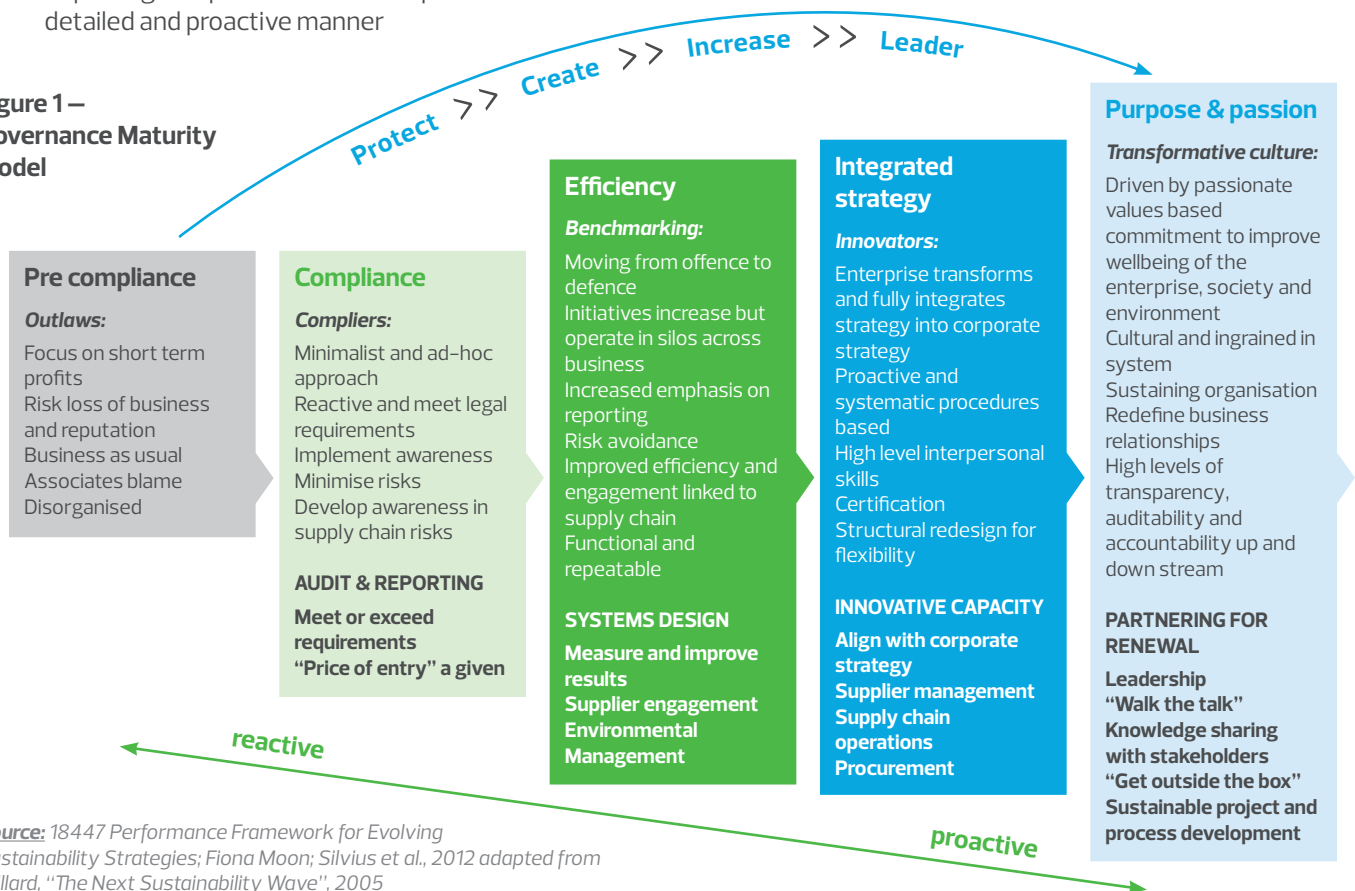
- Impact on the board's role, composition and operation, performance evaluations for all boards and committees (how often, how prescriptive?)
- Risk identification and remediation is not just reactive and complacent but empowered, challenging and striving
- Adoption of a proactive approach for managing and reporting on operational risk and compliance controls
- Assurance that senior management is appropriately governing risk and focusing on the quality, independence and reliability of internal processes to manage risk
- Board supports leading technology innovation, exhibits a high level of trust in management and identifies areas to enhance governance practices
- Comprehensive reporting that clearly highlights matters warranting specific attention
- See Figure 1 – Governance Maturity Model

- Requires:

- Tailored content – don't get lost in detail!
- Quality data, advanced analytics, tracking of risk mitigation, not just completing actions/"box ticking"
- Reporting on operational and compliance risk in a detailed and proactive manner

- Boards with capabilities in operational risk and compliance, as well as risk culture
- Board to have a highly visible presence in dealing with both non-financial and financial risks

Figure 1 – Governance Maturity Model



REMUNERATION AND INCENTIVISATION

- Sales incentives harming financial industry integrity – leading to poor customer outcomes
- Systematic application of remuneration and work systems that drive employees to sell/push products/services to customers
- Nature of accountability, reinforced by remuneration practices
- Formal remuneration framework with a strong link to organisational values, and risk and compliance outcomes
- Risk gate opener that allows for rewarding via performance-based remuneration because of good risk management
- Requires:
 - Recognition of good management – adjust remuneration to encourage business to raise issues
 - Increased transparency / prioritisation of remedial activities
 - Non-complex, transparent remuneration framework
 - Proactive reporting approach highlighting key indicators related to risk and reputation

CULTURE, LEADERSHIP AND ACCOUNTABILITY

- As stated by Australian Institute of Company Directors (AICD), every board and director in Australia should focus on this
- Risk culture consistent with risk appetite/strategy, embedded across business
- Messaging from leadership drives cultural change; senior leadership demonstrating commitment to objectives through actions
- Staff understand what is expected of them, take ownership, escalate issues quickly
- Board's interaction with business for lapses in internal controls and "red" audit issues creates strong sense of accountability
- Regular interactions on audit issues allows the Board to directly set the tone on having a sound control environment

- Requires:
 - Constructive challenge throughout senior management and Board
 - Clear roles and responsibilities across business units (not a federated organisational structure)
 - Proper reporting on issue closure and appetite for consequence management
 - A proactive culture with respect to addressing risk management shortcomings
 - Investment by leadership in tools and systems that support effective risk management
 - Proactive leadership culture and timely compliance with regulatory requests



UNDERSTAND

There are many lessons to learn, arising from the BRC, particularly as it pertains to transparency, efficiency and a focus on culture. How can we be sure that we are pursuing best practices and responsible conduct with our own customers, staff, colleagues and other stakeholders? Some of the outcomes anticipated, that should be considered and planned for by all organisations include:

A review of service standards, consumer redress mechanisms, and internal systems of financial institutions, as well as industry codes of conduct, self-regulating systems, etc. The potential for millions of dollars in bonuses to be clawed back if revelations of misconduct are upheld (e.g., AMP, CBA), and the processes required to manage this.

Consideration of the competency/capacity/composition of boards, limit on number of directorships, tenure limits of NEDs, limit on max terms without re-election.

The possibility of class orders, changes to ASX expectations on Corporate Governance, extension to already sizeable financial penalties, civil cases, and the implications thereof.

Key steps to consider, and areas for management focus to ensure the lessons learned become practical realities include:

- **Transparency:** product and service transparency in the relationship with customers requires development and training to explain clearly what customers can expect from different products, and that they understand the terms, obligations and risks of what they are taking on.
- **Prompt response:** rectify errors promptly and take due care in effecting any changes in servicing arrangements with customers and do that in ways that explain causes and reasons simply, professionally and clearly.

- **Manage culture:** develop and deliver the right culture for staff with customers and stakeholders – this includes transparency of communications, and intervention to correct prolonged systemic issues.
- **Performance systems:** ensure incentive systems motivate staff to pursue an appropriate and ethical sales culture and manage relationships with customers, rather than focusing on incremental sales as a proportion of total potential remuneration.
- **Manage risk:** ensure that there are appropriate risk management and quality assurance functions at all levels of operations, that all stakeholders operate within the law and the requirements of regulators and respond efficiently to customer experiences.

And lastly, there needs to be a greater focus on measuring culture, especially around risk and behaviour – what you don't measure is what you don't manage!

- Do your staff feel confident enough in your management to raise issues of concern, and are they confident those issues will be addressed?
- What type of behaviour is being rewarded, what is driving the behaviour, including goals and pressure from middle managers?
- Is risk management considered to be a "box-ticking" process, or is there ownership of outcomes?

For more information, please contact your local adviser:
www.rsm.com.au/offices