

Bond University

Enterprise Governance eJournal

Volume 1 Issue 1

Editorial Commentary (Non-peer reviewed)

2019

Why Hayne May Change Compliance Internationally

Niall Coburn
Thomson Reuters

Follow this and additional works at: <https://egej.scholasticahq.com/>



This work is licensed under a [Creative Commons Attribution-Noncommercial-No Derivative Works 4.0 Licence](https://creativecommons.org/licenses/by-nc-nd/4.0/).

WHY HAYNE MAY CHANGE COMPLIANCE INTERNATIONALLY

NIALL COBURN*

Australia's Hayne Royal Commission report into the financial sector outlines 76 recommendations involving significant changes to the way the financial sector should change in a bid to end misconduct and ensure that organisations act in the best interests of their clients. The major themes were concentrated around culture, governance, management accountability, conduct, remuneration and the performance of regulators. Hayne's simple message is that organisations should obey the law, not mislead or deceive and be fair in the services they provide, and ensure products are fit for purpose and be delivered with skill and care in the best interests of their clients. The upshot of Hayne's report will provide compliance and risk teams within organisations, a more principled based mandate to "call out" corporate wrongdoing. The main message for financial institutions, senior executives and directors, is to "ignore compliance advice at your peril".

INTRODUCTION

The burning question is that when all these issues were emerging, such as "fees for no service", anti-money laundering, misconduct and dishonesty, why wasn't this misconduct not exposed or elevated to senior management and boards by the compliance and risk staff within the organisations? Or was it that the board and senior management turned a "blind eye"? In an industry full of compliance and risk officers and lawyers, it seems extraordinary how many of these institutions got it so wrong! What is clear is that there are compliance and risk lessons for organisations, internationally, who can learn from the outcomes of Hayne's report. In this context, Hayne's report will have an international impact where organisations will be looking to avoid some of the obvious gaps in corporate governance that jilted the Australian financial sector and its leaders.

CULTURE

The Hayne report has sent a very clear message that the responsibility for corporate conduct and misconduct lies with the board of directors. This will mean that those boards must ensure that they receive accurate information from senior management and ensure that there are adequate governance and oversight frameworks in place.

Culture is central to Hayne's deliberations in his final report although not defined. He has left it up to the organisations to embark on their own clean-up exercise. This issue of culture is not new and was raised by the Australian Securities and Investments Commission (**ASIC**) and the Australian Prudential Regulation Authority (**APRA**) as an important 'red flag' at least five years ago. Research has indicated that the failure of

* Governance, Risk and Compliance, Thomson Reuters.

financial institutions to have the right cultural approach, especially in risk, was the root cause leading up to the global financial crisis.

Even before the Royal Commission, there is no doubt that all organisations were working on their culture and risk approaches. In a Thomson Reuters report, in 2017, in the ASEAN region, 60% of all organisations had a framework in place to address culture and conduct risk, with all firms acknowledging that there would be heightened regulatory focus in this area. This may indicate that although culture is acknowledged as an issue, it is difficult to get right and may take several years.

In the context of the Hayne report, even though organisations had an emphasis on improving culture and conduct risk, there appeared to be a direct failure or a realistic acknowledgement from institutions that they needed to align their interests with those of the clients and hold senior managers accountable for poor conduct outcomes. Although culture was acknowledged as needing to improve in theory, in practice, it was clearly not applied. In fact, not one senior executive, prior to Hayne's report, lost their job despite the internal knowledge of misconduct and the inappropriate treatment of clients. Instead of calling out the misconduct, many organisations sought to disguise or bury their mistakes and even lied to regulators.

It was only when the Royal Commission unfolded, that numerous chairs of boards, chief executives and senior managers lost their jobs as the misconduct was exposed. Organisations had to finally look themselves in the eye and say, "this can't go on".

What Hayne's report pushes home to organisations is that you can't just talk about "culture"; you have to ensure that people are accountable for misconduct at all levels and set the tone – there are no excuses! There are clear lessons for all industries, both in Australia and internationally, about how culture is only effective if it is linked with accountability where peoples' jobs are on the line.

GOVERNANCE

A sound risk culture can only exist within a robust organisational risk governance framework. Hayne's report has clearly emphasised that all organisations need to better act in the interests of clients. It is essential that the tone from the top ie both the board and the CEO are able to communicate the message to staff at all levels to ensure that there is the desired consistent behaviour throughout the whole of the organisation. A sound risk culture can only exist within a robust organisational risk governance framework.

There are no clear guidelines about what "good governance" looks like. However, Hayne's guiding principle is that, obey the law, do not mislead or deceive and provide services fairly, should be a guiding principle.

The International Monetary Fund (IMF) Financial Stability Assessment in relation to Australia, coincidentally published recently, emphasises that more work needs to be done by the regulators in Australia to reduce corporate governance gaps and organisations need to be self-starters in ensuring that their governance frameworks are effective.

In order to ensure appropriate outcomes, organisations need to look at their long-term business strategy and align incentives with behaviours to ensure that you obtain the right outcomes in the best interests of clients.

CONDUCT

What was so disturbing and surprising about the Australian financial sector was that many of the financial institutions had known about their internal misconduct for years, such as “fees for no service”, yet chose not to disclose the extent of the problem or repay the clients or even fix it. What was fundamentally indefensible was that several well-known financial institutions, systematically lied to the regulators, or chose to mislead them, highlighting further mistrust in the community against large financial institutions. It is this dishonest mindset that needs to be addressed immediately.

The proposed Hayne recommendations will eventually impact the financial sector and address the woes of the past, involving conflicts of interest, remuneration and commission structures in mortgage broking and financial advice, ensuring that organisations act in the best interests of clients and address conflicted remuneration models. It will make organisations breach report more timely and effectively about internal issues and hold the boards accountable for that disclosure.

The Royal Commission called out a plethora of misconduct in the approach of banks to clients. Hayne’s recommendations included the need to change how banks deal with distressed agricultural loans, or at least not charge a default interest on agricultural loans during drought and natural disasters.

The Hayne recommendations will also go as far as strengthening the mandates of compliance and risk teams within organisations both in Australia and internationally – “if you ignore us and our advice, then look what happened in Australia”.

MANAGEMENT ACCOUNTABILITY

The misconduct exposed by the Royal Commission has serious implications for Australia’s senior bankers, with at least twelve directors and senior executives being forced to resign - unheard of in Australian corporate history. It would not be surprising if many organisations initiate reviews on the capabilities and skills of their senior risk and compliance staff.

The Banking Executive Accountability Regime (**BEAR**) is a step towards enshrining individual accountability and ensuring that organisations act in the best interests of their clients. It will mean that boards and management teams will challenge information to ensure that they receive direct and sound communication about what is occurring within the organisation. Organisations will need to strengthen their governance frameworks to be able to assess their effectiveness.

A consequence of the recommendation may be that executives responsible for an area will only sign off on products which are in the best interests of clients and where there is adequate explanation and disclosure. This could be a driver for a greater simplification of financial products sold by organisations.

CONDUCT OF REGULATORS

Hayne accused both ASIC and APRA as being ineffective and asleep at the wheel. The recent IMF report on financial stability, emphasised, in its recommendations that APRA needs to be more proactive. Hayne has recommended setting up an independently chaired body to oversee the conduct of ASIC and APRA. He has also recommended the need for capability reviews of the regulators be conducted every four years. Additionally, he has recommended extending the jurisdiction of the Federal Court to fast-track the trials in relation to criminal misconduct. Under the current regime, complex corporate prosecutions can take between four to six years to become to finality. There is no doubt, under Hayne's criticisms, that both ASIC and APRA have lost credibility.

Since this time, ASIC Deputy Chairman, Daniel Crennan, has revealed that ASIC had 25 active investigations flowing from the Royal Commission and that the Royal Commission had also indicated criminal charges for at least three organisations. It is less likely now that ASIC engage in negotiated outcomes and will take a more prosecutorial approach. In the meantime, APRA is reviewing its enforcement strategy with both regulators beefing up their enforcement staff. There are also moves to shift corporate criminal trials to the Federal Court.

PRACTICAL IMPROVEMENTS FOR GLOBAL FINANCIAL INSTITUTIONS

The Hayne Royal Commission and Final Report has delivered considerable insight for the global governance community, particularly Boards and senior management teams of financial sector enterprises;

- Improve culture
- Ensure management accountability
- Make sure you have the skill sets inhouse to protect the organisation
- Ensure there is effective information flows to the board from management about serious compliance and other issues
- Make the organisation transparent and accountable
- Introduce a “no blame” culture
- Report problems immediately and openly
- Be honest with the regulator
- Strengthen the third line of defence
- Ensure whistle-blowing procedures are adequate
- Align remuneration with shareholder interests and community expectations.

ORGANISATIONS HAVE A LOT TO LOSE

The Royal Commission shows just how serious major compliance failures are. If compliance issues are ignored and mistakes are allowed to fester, there are serious consequences which can be outlined as follows:

- Billions can be wiped off share value
- Loss of brand and reputation
- Loss of customer trust in business
- Withdrawal of funds from investments (AMP lost one third of its investments)
- Billions in remediation payouts
- Class actions for years
- Diversion of resources of key staff to shore up failures
- Regulatory scrutiny that leads to product issues
- Ongoing political scrutiny
- Clawback of executive remuneration
- Increased insurance premiums
- Product intervention by renewed and vigorous regulators
- No deal regulatory actions
- Financial firms' psychological mindset shifts to "gun shy" risk taker.

LESSONS FROM AUSTRALIA FOR OTHER FINANCIAL INSTITUTIONS

- Need for better quality information to be provided from management to boards
- Serious compliance problems need to be dealt with immediately
- Regulators need to be respected and not lied to
- Boards need to improve their scrutiny over serious compliance issues such as AML misleading conduct or using clients' funds illegally
- Senior managers or board members who do not perform, lack integrity or are not effective, should be released
- Obtain the skills on the board that are needed to protect the organisation as a whole
- Respect whistle-blowers and listen to them
- Deal with conflicts of interest
- Focus beyond pure regulatory and compliance
- Change or have change forced upon you
- What you do when things go wrong, counts. Always act with integrity.

CONCLUSION

Hayne has not left any clear guidelines for organisations to change their culture and corporate governance strategies. However, he has provided one over-arching principle – be honest and act in the best interests of your clients. Only time will tell whether Hayne's report will change the conduct in the industry. There is no doubt, however, that banks and financial institutions are entering a new era with unprecedented scrutiny by regulators.

Things will definitely be different in the future if misconduct is exposed. Regulators will not hesitate to use litigation and enforcement as the primary tool in responding to wrongdoers. Organisations and regulators internationally will be assessing the lessons Australia has learned in the wake of the Royal Commission. This all adds up to a new mandate for compliance and risk teams within organisations to be more effective and call out misconduct earlier. Financial institutions have entered an era where they need to consider political realities and broader community expectations and regard themselves as providing a critical service with huge responsibilities attached. Other countries should heed the lessons learned in Australia or ignore them at their peril.

****About the Author***

Niall Coburn is the Regulatory Intelligence Expert at Thomson Reuters in the Asia-Pacific region. Prior to joining Thomson Reuters, he was the Regional Managing Director at FTI Consulting, responsible for leading its regulatory and forensic investigation practice in Australia. Niall was also a Senior Lawyer and Specialist Adviser at the Australian Securities and Investments Commission. In this role he led high-profile investigations into complex corporate crime cases. He has also worked internationally, being part of a team that created the regulatory structure for the Dubai International Financial Centre (DIFC). He is a Barrister of the High Court of Australia and a member of the Queensland Bar Association and the International Bar Association.