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Appendix 2 – Make Executives Accountable

“There are certainly individuals...who have had some consequences relating to remuneration...we have not had individuals terminated” *Mr Ian Narev, CEO of the Commonwealth Bank on the mishandling of claims in CommInsure*¹

“It is not just a problem with the bad apples; there is generally often a problem with the tree...let us deal with the tree” *Mr Greg Medcraft, ASIC Chairman*²

Recommendation 2

- 2.1 The committee recommends that, by 1 July 2017, the Australian Securities and Investments Commission (ASIC) require Australian Financial Services License holders to publicly report on any significant breaches of their licence obligations within five business days of reporting the incident to ASIC, or within five business days of ASIC or another regulatory body identifying the breach.**
- 2.2 This report should include:**
- a description of the breach and how it occurred;
 - the steps that will be taken to ensure that it does not occur again;
 - the names of the senior executives responsible for the team/s where the breach occurred; and
 - the consequences for those senior executives and, if the relevant senior executives were not terminated, why termination was not pursued.

¹ Mr Ian Narev, CEO of CBA, *Committee Hansard*, 4 October 2016, p. 16.

² Mr Greg Medcraft, Chairman of ASIC, *Committee Hansard*, 14 October 2016, p. 3.

- 2.3 The FSI concluded that the interests of financial firms and consumers are not always aligned.³ The major banks' appearance before the committee confirmed it.
- 2.4 According to the evidence presented, no senior executives have so far been terminated in relation to the extremely serious cases of:
- the provision of poor financial advice at NAB;⁴ and
 - the mishandling of life insurance claims at CommInsure.⁵
- 2.5 Similarly, no senior executive was terminated following:
- NAB's failure to pay 62,000 wealth management customers the amount that they were owed;⁶
 - the poor administration of hardship support at CBA;⁷
 - ANZ's OnePath improperly collecting millions of dollars in fees from hundreds of thousands of customers;⁸ and
 - ANZ improperly collecting fees from 390,000 accounts that had not been properly disclosed.
 - In regards to ANZ's improper collection of fees, the bank did not believe that any staff members were responsible for the breach because:

The issue existed for a number of years...and there have been a number of organisational and staffing changes through that period.⁹
- 2.6 This is unacceptable and clearly demonstrates the accountability deficit that exists within these organisations.
- 2.7 The major banks seem to believe that it is appropriate that no senior executive has been terminated for these failings and that a reduction in responsible executives' remuneration will be sufficient to improve consumer outcomes. For example, Mr Andrew Thorburn, NAB's CEO, noted that:
- I think the people in this line of business definitely feel accountable...I think reputations have suffered.¹⁰
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³ D. Murray et al., *Financial System Inquiry, Final Report*, 2014, p. 217.

⁴ Mr Andrew Thorburn, CEO of NAB, *Committee Hansard*, 6 October 2016, p. 4.

⁵ Mr Ian Narev, CEO of CBA, *Committee Hansard*, 4 October 2016, p. 16.

⁶ Mr Andrew Thorburn, CEO of NAB, *Committee Hansard*, 6 October 2016, p. 5.

⁷ CBA, *Response to Questions on Notice: Question Six*, 18 October 2016, p. 6.

⁸ Mr Shayne Elliot, CEO of ANZ, *Committee Hansard*, 5 October 2016, p. 40.

⁹ ANZ, *Response to Questions on Notice: Question Two*, 27 October 2016, p. 3.

- 2.8 NAB also argued that more severe consequences for executives were not appropriate because they were not directly responsible for the misconduct. For example, in justifying his decision not to terminate any executives, Mr Thorburn stated that 'the [financial] planners were the culpable parties, really.'¹¹
- 2.9 The committee disagrees with this assessment.
- 2.10 The major banks have a 'poor compliance culture'¹² and have repeatedly failed to protect the interests of consumers.¹³
- 2.11 This is a culture that senior executives have created.¹⁴ It is a culture that they need to be held accountable for.
- 2.12 The committee is aware of the progress that is being made to improve culture and accountability within the sector. The committee supports:
- the Government's decision to allow ASIC to ban managers guilty of poor conduct from operating in the financial services industry;
 - the industry's work to develop a register of 'rogue' employees to help ensure that they cannot rotate between financial services firms; and
 - Mr Stephen Sedgwick AO's review of commissions and payments (including referral payments) made to bank staff and third parties to ensure that they do not encourage behaviour contrary to consumers' interests.
- 2.13 However, even with these measures in place gaps will remain.
- 2.14 Clearly there will be some cases where an executive's conduct has been sufficient to justify banning. However, not all misconduct is severe enough to warrant ASIC taking this action.
- 2.15 The proposed framework does not strengthen the consequences for responsible executives where banning would be excessive, but where mere reputational or remunerative penalties are grossly inadequate.
- 2.16 To fill this gap, and better align executives and consumer interests, the committee recommends that ASIC require all AFSL holders to publicly report on any significant breaches of their regulatory obligations within five business days of reporting the breach to ASIC, or within five business days of ASIC or another regulatory body identifying that breach.

¹⁰ Mr Andrew Thorburn, CEO of NAB, *Committee Hansard*, 6 October 2016, p. 5.

¹¹ Mr Andrew Thorburn, CEO of NAB, *Committee Hansard*, 6 October 2016, p. 10.

¹² Mr Greg Medcraft, Chairman of ASIC, *Committee Hansard*, 14 October 2016, p. 5.

¹³ D. Murray et al., *Financial System Inquiry, Final Report*, October 2014, p. 218.

¹⁴ APRA, *Information Paper: Risk Culture*, October 2016, p. 16.

- 2.17 Critically, in addition to explaining how the breach occurred and what steps will be taken to ensure that the breach does not occur again, the report should include:
- the names of the senior executive/s responsible for the team/s where the breach occurred; and
 - the consequences for those senior executives and, if this did not include termination, why termination was not appropriate.
- 2.18 The committee believes that this will have two significant benefits:
- 1 the risk of being publicly named will create further incentives for executives to prioritise good consumer outcomes; and
 - 2 the need for AFSL holders to publicly justify the consequences imposed on senior executives will force institutions to more comprehensively engage with questions of executive accountability on a more regular basis.
- 2.19 To further increase institutional accountability these reports should be sequentially numbered so that consumers and investors can easily determine how many significant breaches a licensee has had in a given year.

Australia's breach reporting framework

- 2.20 AFSL holders must advise ASIC in writing as soon as practicable (and within 10 business days) about any significant breach (or likely significant breach) of sections 912A, 912B and 912A(1)(c) of the *Corporations Act 2001*.
- 2.21 In 2015-16, ASIC received 1,172 breach reports from AFSL holders and managed investment schemes.¹⁵
- 2.22 Table 2.1 summarises the obligations that, if not met by an AFSL holder, could trigger the need for a breach report.

Table 2.1 Australian Financial Services License obligations that can trigger a breach report

Obligations under sections 912A and 912B	Obligations under section 912A(1)(c)
<p>An AFSL holder must:</p> <ul style="list-style-type: none"> • do all things necessary to ensure that the financial services covered by your AFS licence are supplied efficiently, honestly and fairly; • have adequate resources to provide the financial services covered by your licence and to carry out supervisory arrangements (unless you are regulated by APRA); • be competent to supply the financial services covered by your licence; • have trained and competent representatives; • take reasonable steps to ensure that your representatives comply with the financial services laws; • have a dispute resolution system for retail clients; • have adequate risk management systems; and • have compensation arrangements for retail clients. 	<p>An AFSL holder must comply with the following financial services laws:</p> <ul style="list-style-type: none"> • Chapter 6 of the Corporations Act (takeovers); • Chapter 6A of the Corporations Act (compulsory acquisitions and buy-outs); • Chapter 6D of the Corporations Act (fundraising); • Chapter 7 of the Corporations Act (financial services and markets); and • Division 2 of Part 2 of the ASIC Act (unconscionable conduct and consumer protections for financial services).

Source: ASIC, Regulatory Guide 78: Breach reporting by AFS licensees, p. 6.

- 2.23 A failure to report is also a significant breach. This has a maximum penalty of \$42,500 for a company and \$8,500 or imprisonment for one year (or both) for an individual.
- 2.24 Under this framework, breaches that must be reported to ASIC include failures such as:
- an AFSL holder or their representatives providing inappropriate financial advice to clients;
 - fraud by an AFSL holder or their representatives or the AFSL holder's failure to prevent that fraud from occurring;
 - the AFSL holder or their representatives supplying financial services that they are not licensed to supply; and
 - an AFSL holder's failure to detect previous breaches.
- 2.25 When such a breach is detected, the AFSL holder must report to ASIC on:

- the type of breach (or likely breach), why it was significant, and how long it lasted;
 - how the breach (or likely breach) was detected;
 - information on any authorised representatives involved in the breach (or likely breach); and
 - how the breach (or likely breach) has been rectified as well as the steps that will be taken to ensure that it does not happen again.
- 2.26 The committee believes that expanding this framework to include public reporting of this information, as well as additional detail on the consequences for responsible executives, is an appropriate response to the numerous cases of serious misconduct that have occurred in recent years.
- 2.27 Notwithstanding this conclusion, the Government – as part of its review of ASIC’s enforcement regime (which includes a review of penalties and the financial services licensing breach notification network) – should consider whether additional penalties are required to support a more public breach reporting regime.

Potential future reforms

- 2.28 The committee is committed to increasing executive accountability in the financial sector.
- 2.29 In seeking to achieve this outcome, the UK recently published new rules for senior managers. These are known as the Senior Managers Regime (SMR).
- 2.30 The SMR introduces specific prescribed responsibilities for senior managers (among other measures) and is expected to focus supervision and enforcement action on the actions of individual managers rather than the overall actions of the institution.¹⁶
- 2.31 The committee is aware of potential problems with the SMR. In particular, concerns that parts of the regime may undermine businesses’ internal accountability structures¹⁷ and that the SMR runs counter to traditional concepts of criminal and civil liability.¹⁸

¹⁶ Deloitte, *Senior Managers Regime Individual Accountability and Reasonable Steps*, 2016, p. 5.

¹⁷ Mr Wayne Byres, Chairman of APRA, *Committee Hansard*, 14 October 2016, p. 11.

¹⁸ Argent, J and Colvin, J, ‘Liability for Corporate Culture’, *Company Director*, Vol. 31. No. 11. December 2015-January 2016, p. 57.

- 2.32 The committee will monitor the effectiveness of the UK's regime as well as reforms announced but not yet enacted in Australia and consider the need for additional reforms throughout future inquiries.