To: APRA Capability Review Secretariat

The Treasury

Langton Crescent

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**RE: Public submission to the APRA Capability Review**

This submission wishes to address the Panel’s capability review in support of APRA to deliver its statutory mandate in particular, “[c]ulture that supports supervisory and enforcement actions in support of strategic objectives”. The following comments shall be made in conjunction with the Hayne Royal Commission Final Report Recommendation 5.7, concerning APRA’s prudential supervision of APRA-regulated institutions. Specifically about a supervisory program focused on building culture to mitigate the risk of misconduct, the use a risk-based approach to its reviews, assess the cultural drivers of misconduct in the entities and to encourage entities to give proper attention to sound management of, as well as conduct risk and improving entity governance. Therefore, in order for APRA to effectively deliver a supervisory and enforcement outcomes to achieve its statutory mandate under BEAR and Hayne Royal Commission Final Report Recommendation 5.7, preemptive intervention would more than likely be necessary to prevent or interject in instances and/or allegations of misconduct.

Preemptive regulatory intervention in itself is reasonable as a preventive measure to avoid or reduce possible harm to the either the customers or other stakeholders of banks and financial services sector in Australia. Such intervention has been used in Australia, for example in preventive detention of suspects in the public’s interest like terrorist suspects. Early intervention is also used when authorities have come to the view it is necessary to protect individuals from potential danger. In such instances the justification to intervene before an actual crime has been committed is to prevent physical and other sorts of harms from being inflicted upon individuals or the community at large. And central to making such a judgement authorities have to be satisfied depending of factors considered in their risk analysis that the risks of non-intervention would extreme. Often the risks considered is the magnitude of harm or injury that would constitute a crime being committed or the likelihood of criminal activities is involved.

Highlighting the above justifications for regulatory intervention as a preemptive measure before a crime is committed is not to argue that APRA’s enforcement of BEAR based on risk of misconduct is inappropriate. On the contrary this submission agrees with the Hayne Royal Commission Final Report recommendations and the introduction of BEAR, in particular to mitigate the risk of misconduct. The concern is ‘the when’ and ‘the how’ such regulatory intervention by APRA is justified and reasonable without unnecessary disrupting the operation of financial institutions. And more importantly, consider how APRA could reduce incidences of ‘false alarms’ with their preemptive enforcement actions that in effect interfere with the smooth operation of financial institutions. If mismanaged such regulatory intervention could have the potential of adversely impacting on the efficient workings of the financial system because unwarranted disruptions from erroneous regulatory judgements could undermine the confidence in Australia’s financial institutions. As such a set of robust criteria in which APRA is required to warrant and justify their enforcement actions.

Whilst the set of criteria will undoubtedly be considered by the panel in the review process, this submission wishes to highlight a much neglected issue; the contributions compliance professionals in the mitigation of risks of misconduct and thus improving the entity’s governance.

I have raised this previously in print and on other forums. Compliance professionals play a key role in improving corporate compliance and hence the governance of an entity. And since compliance personnel is at the front line of conduct risk management, their contributions to reducing instances of misconduct and mischief can be substantial. However, boards had overlooked and neglected this. APRA’s ‘Prudential Inquiry into the Commonwealth Bank of Australia Final Report’ published in April last year did implicitly reveal this. Compliance personnel were not able to communicate compliance matters directly to the board. Besides, compliance risks did not receive sufficient attention by CBA and the board, as the result the bank’s failed to detect and report money laundering activities to AUSTRAC. The lesson from this inquiry is clear, compliance is important. Part of what a compliance professional does is to undertake compliance and conduct risk assessments so these individuals are well place to detect early signs of misconduct.

For APRA to effectively supervise the culture of regulated entities and if required to achieve this end through enforcement actions, it needs to identify the risks of misconduct and other mischief of as an early stage where it could be rectified and remedied before harm is inflicted on customers or other stakeholders. However, preemptive intervention can be tricky if in hindsight those actions were found to be excessive or a false alarm. Such actions would lend APRA to criticisms. Therefore, securing the assistance of compliance professionals in financial institutions to detect and rectify misconducts would be an effective means for APRA to achieve its regulatory objectives with lower risk of being deemed excessive or overzealous in its enforcement actions.

The seeds of such intervention and assistance from compliance professionals in banks have already been laid out in section 37BA(3)(h) of the Banking Act 1959 (Cth). To maximize the assistance from the compliance professionals of the regulated entities further guidance on how APRA should obtain information and remedy potential misconduct should be spelled out. Even though this might be beyond the scope of this capability review to go into the details, the Panel should recommend APRA actively engage compliance professionals to assist in detecting and mitigating the risks of misconduct. This could entail APRA giving directions to the regulated entity through the board and the head of compliance department of the regulated entities. Another measure could be to oblige the head of compliance of the regulated entities to make periodic reports on potential misconducts to APRA. This would in effect heighten the board’s attention on risk mitigation as a core governance priority and ensure the right culture is instill because the reports would demonstrate ongoing efforts by the entity and its board to nurture desirable corporate culture.

To reiterate, this submission supports intervention by APRA when early signs of misconduct in regulated entities are detected as well as ensuring financial institutions foster a corporate culture that rejects any form or manifestation that leads to misconduct and mischief. Such supervisory and enforcement actions by APRA is necessary to restore the public’s trust in the regulated entities and financial system. To summarize, the focus of this submission is to raise the possibility of compliance professionals assisting in the supervisory and enforcement actions of APRA. Suggestions include either periodic reporting requirements or implement directions by the regulator to mitigate the risks of misconduct. In short, to secure the cooperation of compliance professionals in the regulated entities to help APRA achieve its regulatory objectives.

End of submission