Transforming Australia's Financial Services Sector Governance: The Case for Leadership in Compliance

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Abstract:

This paper examines the need for Leadership in Compliance by exploring recent legal reform in the Australian Financial Services sector. By focusing attention on how attempts at regulatory change have neither eradicated previous financial reporting problems nor offered organizational remedies, we argue that a notion of leadership in compliance needs to be put forward which might better govern senior leadership behaviours and be able to mirror cultural change for employees.

Introduction

This paper explores the recent spate of regulatory reforms in the Australian Financial Services sector which are placing a significant burden on leadership compliance. Recent reviews of misconduct have prompted this unprecedented level of emphasis on governance. However, little attention has been paid to new and revised notions of compliance, in particular the role of leaders in fostering a culture of change. Without *effective compliance* new laws are nothing more than empty symbolism - looking for scape goats in the event of misconduct. Given that most of the burden for triggering organizational culture change is placed on leaders this paper argues that they need to develop new strategies to cope with a new age of compliance. To this end, we examine the compliance regimes fostered by the new recommendations and alterations made in the Australian Financial Services Sector. Recent Government reports and legislation have enacted and imposed a range of compliance rules and behaviours on senior executives under the assumption that regulatory imposition on accountability equals change in organization culture. It is presumed that these acts as a deterrent against the risks of misconduct. However, as we argue, change needs to be fostered by what we would term *Leadership in Compliance* ensuring

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expectations laid out in corporate governance codes and the prescriptions and standards encapsulated in the recent reforms. Before doing so, we shall analyse the recent major Australian Commissions, Reports and regulatory changes outlining the implications of these for leadership and the role and duty of care of Company Directors. From there we identify some pitfalls the current frameworks and legislation have created before outlining a model of Leadership in Compliance as a way forward to achieving the objectives of those regulatory reforms.

The Banking Executive Accountability Regime (BEAR) and the Australian Prudential Regulation Authority (APRA)

The origins of BEAR can be traced back to the Australian House of Representatives Standing Committee on Economics *Review of the four major banks* (the Coleman Report), where they found that the major banks in Australia had, 'a poor compliance culture' and repeatedly failed to protect the interests of consumers. [3] A key recommendation of the Standing Committee was to introduce a form of executive accountability similar to the United Kingdom's Senior Managers Regime (SMR).[4] After a brief period of public consultation,[5] the Treasury Laws Amendment (Banking Executive Accountability and Related Measures) Act 2018 (Cth) came into effect.

Amongst a number of measures, the new legislation imposes a heightened accountability regime on the banks and people who have significant influence over their conduct and behaviour.[6] Furthermore, it introduces a new definition for an 'accountable person' within a bank and its substantial subsidiaries.[7] The regulator charged with enforcing BEAR is the Australian Prudential Regulation Authority (APRA).[8]

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[3] Parliament of the Commonwealth of Australia, 'House of Representatives Standing Committee on Economics: Review of the Four Major Banks: First Report' 15, 24th November 2016 < https://www.aph.gov.au/Parliamentary_Business/Committees/House/Economics/Four_Major_Banks_Review/Report>. Also see Angus Young, 'Restoring Trust in Australia's Financial Services Sector: From the Banking Executive Accountability Regime to the Strengthening Corporate and Financial Sector Penalties' (2019) 34(6) *Journal of International Banking Law & Regulation*, 185-93.

[4] Ibid., 20.

[5] Australian Federal Treasury, 'Banking Executive Accountability Regime' <https://treasury.gov.au/consultation/c2017-t200667/>.

[6] Ibid., 10.

[7] Ibid.

[8] Ibid.

The legislative meaning of accountable person is stipulated in section 37BA(1)(b) of the Banking Act 1959 (Cth). It targets senior executives with actual or effective responsibility in management or control of the ADI [Authorized Depositing-taking Institute] or for management or control of a significant or substantial part or aspect of the operations of the ADI or the relevant group of bodies corporate.[9] Apart from the board of directors, sections 37BA(3)(b)-(j) identifies senior executives through named functions deemed to be accountable persons. [10] More importantly, the expectations of the board and senior managers are stipulated in sections 37BA(3)(a), which states that Board member have a, 'responsibility for oversight of the ADI as a member of the Board of the ADI'. This has to be read in conjunction with section 37CA where the obligations of an accountable person are to:

- act with honesty and integrity,
- with due skill, care and diligence,
- are expected to deal with APRA in an open, constructive and cooperative way,
- are expected to take reasonable steps in conducting those responsibilities to prevent matters from arising that would adversely affect the prudential standing or prudential reputation of the ADI.

It is apparent that the board has overall responsibility overseeing the senior executives in various departments listed in sections 37BA(3)(b)-(j). Whilst this is implicit in the statutory directors' duty of care in section 180(1) of the Corporations Act 2001 (Cth) the amendment denotes that any failure by senior executives could be regarded as a breach of directors' duty under section 37BA(3)(a) of the Banking Act. However, this differs from section 180(1) of the Corporations Act 2001 as section 37CB which stipulates that 'taking reasonable steps' meant:

[9] Also see Angus Young, 'Restoring Trust in Australia's Financial Services Sector: From the Banking Executive Accountability Regime to the Strengthening Corporate and Financial Sector Penalties' (2019) 34(6) *Journal of International Banking Law & Regulation*, 185-93.
[10] Ibid.

> 'Without limiting what constitutes the taking of reasonable steps in relation to a matter for the purposes of this Division, the taking of reasonable steps in relation to that matter includes having:
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> (a) appropriate governance, control and risk management in relation to that matter; and
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> (b) safeguards against inappropriate delegations of responsibility in relation to that matter; and
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> (c) appropriate procedures for identifying and remediating problems that arise or may arise in relation to that matter.'

Therefore, expectations of the board are high and the legal risk for directors is considerably higher under BEAR. However, these new legal expectations on directors are not meant to be a substitute for good leadership.

Other amendments include deferral of remuneration sections 37E, 37EA, 37EB, 37EC(3)-(5), 37ED and 37E(1)(b)-(c). These sections are aimed at a proportioning the remuneration of accountable persons.[11] Also worth noting are sections 37G, 37J, 37JA and 37JA dealing with enforcement and penalties. With regard to penalties, section 37G stipulates that the ADI is liable to a pecuniary penalty if it contravenes its obligations under this Part (other than this Division) of BEAR and prudential matters. The amount of the pecuniary penalty is an amount not exceeding 1,000,000 penalty units for large ADI (Authorised Deposit-taking Institution), 250,000 penalty units for medium ADI or 50,000 penalty units for small ADI. Note that each penalty unit amounts to AUD210.

The Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry Final Report (the Hayne Report) was released on the 4th February 2019 and made a total of 76 recommendations to reform how the financial services industry in Australia should be regulated. Amongst its many recommendations it repeatedly referenced regulators' poor performances. [12]

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[11] For more details see Angus Young, 'Restoring Trust in Australia's Financial Services Sector: From the Banking Executive Accountability Regime to the Strengthening Corporate and Financial Sector Penalties' (2019) 34(6) *Journal of International Banking Law & Regulation*, 187.

[12] Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry, 'Final Report: Volume 1', 455 <https://www.royalcommission.gov.au/sites/default/files/2019-02/fsrc-volume-1-final-report.pdf>.

In conjunction with this, the government initiated a review of APRA's enforcement strategy in November 2018, which was prompted by the introduction of BEAR as well as the Hayne Royal Commission.[13] A final report, the enforcement strategy review was published on the 29th March 2019 and made 7 recommendations to, 'further strengthen APRA's enforcement approach'.[14] In particular, there are two recommendations of relevance to BEAR. The first suggest that APRA's enforcement appetite change from a 'last resort' to a 'constructively tough' approach. The second that APRA build a more forceful supervisory culture that better empowers and supports supervisors to hold entities and individuals to account, including through the use of enforcement action.[15] On 16 April 2019 APRA published its new enforcement approach stating that APRA would be prepared to use enforcement to prevent and address serious prudential risks and to hold entities and individuals to account.[16]

With the introduction of BEAR, the Hayne Royal Commission and APRA's new enforcement strategy, directors of financial services companies are under considerable pressure to treat conduct risk as a governance priority. However, this is only half the story, the other half rests with the other regulator as well as recent legislative amendments to increase corporate and individual penalties for a wide range of wrongdoings.

Reforming Corporate and Financial Sector Penalties and ASIC's Regulatory Strategies

In response to the recommendations of the Financial System Inquiry the government established the ASIC enforcement review taskforce (ASIC taskforce) on the 19 the October 2016.[17] The taskforce made a number of recommendations aimed at increasing the regulatory powers of

[13] Australian Prudential Regulation Authority, 'Enforcement Strategy Review: Final Report' (2019) 4 <https://www.apra.gov.au/sites/default/files/apra_enforcement_strategy_review_-_final_report_web.pdf>.
[14] Ibid., 9.
[15] Ibid., 9-10.
[16] Australian Prudential Regulation Authority, 'APRA's Enforcement Approach' 4 < https://www.apra.gov.au/sites/default/files/apras_enforcement_approach_web.pdf>.
[17] The Parliament of the Commonwealth of Australia, 'Treasury Law Amendment (Strengthening Corporate and Financial Penalties) Bill 2018: Revised Explanatory Memorandum' 5 <https://parlinfo.aph.gov.au/parlInfo/download/legislation/ems/r6213_ems_33c00c5c-5a07-41ac-bdab-b6212e81d691/upload_pdf/690762_Revised%20EM.pdf;fileType=application%2Fpdf>.

ASIC and the penalties for corporate and financial sector misconduct.[18] A Bill was subsequently submitted to the Federal Parliament on 24th October 2018.[19] It came into effect on the 12th March 2019.[20] This new Act in effect amends provisions of several legislations including the *Corporations Act 2001*, *Australian Securities and Investments Commission Act 2001*, *National Consumer Credit Protection Act 2009* and *Insurance Contracts Act 1984.*[21]

The key highlights of the new Act include increasing the maximum term of imprisonment from 6 months to 2 years and others from 2 to 5 years.[22] Other changes included removing imprisonment for strict and absolute liability offences,[23] and modernizing and expanding the civil penalty regime with increases for a contravention of a civil penalty provision.[24] It also expanded a number of provisions in the *Corporations Act, Credit Act, Credit Code and Insurance Contracts Act* into the civil penalty regime,[25] thus harmonizing and expanding the infringement notice regime.[26] Finally, it clarified the operation of the criminal provision for breaching directors' fiduciary duties in section 184 of the *Corporations Act*.[27]

The regulator, ASIC, has responded to the Australian government's legal reform and criticisms from the Hayne Royal Commission. In a speech in February 2019 by John Price, Commissioner of ASIC, he said:

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[18] The Parliament of the Commonwealth of Australia, 'Treasury Law Amendment (Strengthening Corporate and Financial Penalties) Bill 2018: Revised Explanatory Memorandum' 6 <https://parlinfo.aph.gov.au/parlInfo/download/legislation/ems/r6213_ems_33c00c5c-5a07-41ac-bdab-b6212e81d691/upload_pdf/690762_Revised%20EM.pdf;fileType=application%2Fpdf>.
[19] The Parliament of the Commonwealth of Australia, 'Treasury Law Amendment (Strengthening Corporate and Financial Penalties) Bill 2018' <https://www.aph.gov.au/Parliamentary_Business/Bills_Legislation/Bills_Search_Results/Result?bId=r6213>.
[20] Ibid.
[21] The Parliament of the Commonwealth of Australia, 'Treasury Law Amendment (Strengthening Corporate and Financial Penalties) Bill 2018' <https://www.aph.gov.au/Parliamentary_Business/Bills_Legislation/Bills_Search_Results/Result?bId=r6213>.
[22] The Parliament of the Commonwealth of Australia, 'Treasury Law Amendment (Strengthening Corporate and Financial Penalties) Bill 2018: Revised Explanatory Memorandum' 13-19 <https://parlinfo.aph.gov.au/parlInfo/download/legislation/ems/r6213_ems_33c00c5c-5a07-41ac-bdab-b6212e81d691/upload_pdf/690762_Revised%20EM.pdf;fileType=application%2Fpdf>.
[23] Ibid., 27.
[24] Ibid., 34.
[25] Ibid., 43.
[26] Ibid., 46.
[27] Ibid., 61.

> ‘Issues around culture (the way we do things around here), governance (systems and processes that people should follow) and remuneration (what people get paid to do) all have a very strong influence on how people behave. So, it should be of no surprise to anyone that culture, governance and remuneration are all matters that ASIC will focus on using a variety of new supervisory and enforcement approaches.’[28]

Furthermore, he states that:

> ‘Close and continuous monitoring involves regularly placing ASIC staff on-site in major financial institutions to closely monitor their governance and compliance with laws. A key goal of this new approach is to modify the behaviour of the large institutions to further encourage them to place consumers first in their decision-making and quickly identify and respond to conduct that produces unfair outcomes. ASIC’s enforcement approach will have at its centre a focus on deterrence, public denunciation and punishment of wrongdoing by way of litigation… As regards Corporate Governance, ASIC has sought and received funding to undertake targeted reviews of corporate governance practices in large listed entities. This will allow us to shine a light on ‘good’ and ‘bad’ practices observed across these entities… The first is the role of the board and officers in the oversight (and in the case of officers, the management) of risk… Our review will look at how directors are actively exercising their stewardship functions, particularly in relation to non-financial risk.’ [29]

In terms of regulatory approaches, the Chair of ASIC, James Shipton said in a speech in March 2019 that:

> ‘The aim of this stance is to deter future misconduct and address the community expectation that wrongdoing be punished and denounced through the courts. This means that once:
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> ASIC is satisfied that breaches of the law are more likely than not and:

[28] Australian Securities and Investments Commission, ‘Keynote address at Group of 100 Dinner’ (Speech at G100 Dinner, Melbourne, 26 February 2019) <https://asic.gov.au/about-asic/news-centre/speeches/keynote-address-at-group-of-100-dinner/>.
[29] Ibid.

- it is evident from the facts of the case that the pursuit of the matter would be in the public interest,
- then we will actively ask ourselves: *why not litigate* this matter?'[30]

In addition, Mr Shipton said:

> 'Moving forward, ASIC will continue to enhance the way we regulate, particularly with the adoption of a *more intensive supervisory approach*. Our new supervisory approach helps detect cultural failings that lead to conduct problems and breaches of the law. Supervision adds a focus beyond current known breaches to look at factors that create significant risk of future breaches. An important element of our new supervision approach is the use of data and market analysis to detect misconduct early. Since supervision has a strong focus on governance and culture, it allows ASIC to thoroughly understand the business models and risk management of firms and adjust our regulatory approach to the complexity, innovations and continuous change in entities and markets.'[31]

The amendments to increase penalties for corporations and individuals, the clarifications to section 184 that impose criminal liabilities for breach of directors' duties, as well as regulatory and enforcement approaches by ASIC in the post Hayne Royal Commission, have meant that directors' role in preventing wrongdoing or misconduct has become indispensable to good governance.

Trying to Turn Round a Tanker – Culture and Financial Regulation

Even though the Hayne Report is a significant step in the sense that it makes much of leadership and culture and the need for change, it does adopt a very 'managerialist' stance in its definitions. Whilst this is not unsurprising, this approach does argues in favour of leaders being the vanguard in changing culture. However, as Freiberg notes, 'Culture is a social phenomenon and can be understood as learned knowledge, belief, art, morals, law and custom in society. It is a powerful force that may determine the development and operation of a regulatory system.'[32] It is evident

[30] Australian Securities and Investments Commission, 'The Fairness Imperative' (Speech at the AFR Banking and Wealth Summit, Sydney, 27 March 2019) <https://asic.gov.au/about-asic/news-centre/speeches/the-fairness-imperative/>.
[31] Ibid.
[32] Arie Freiberg, *The Tools of Regulation* (The Federation Press, 2010) 104.

that culture is more than a set of written rules which in turn challenges legislators and leaders alike attempting to draft a set of rules to regulate such a social phenomenon.

This does not mean that law and culture exist in isolation from each other. The law can help to shape culture, and as such be perceived as a product of a social construction,[33] or a creature of culture.[34] Culture also plays a role in the *voluntary* compliance of the law by supporting moral congruence, motivating adherence and reducing deviancy.[35] However, internal contradictions between competing values may provoke discord or contests for dominance.[36] Therefore, the relationship between the law and culture is a complex one that is not easy to untangle into a neat set of statutory statements.[37] If we adopted a more social constructivist perspective then we might perceive that an organization *is* rather than *has* a culture. This makes it difficult for leaders alone to change that culture and attempts at change can be diverted or side-tracked by sub-cultural groups with a vested interest in the status quo (for example those with a vested interest in perpetuating remuneration terms and conditions). Similarly, is expecting financial leaders to completely mend their ways wholly realistic? Liu, Cutcher and Grant argue that for Australian Banking Chief Executives, the GFC was contextualised by them and the media to enhance both their authentic leadership skills and dynamism.[38] Liu also provides evidence that, 'vivid metaphors of crisis leadership….served to reinforce the romance of leadership and potentially elide considerations of banking reform in the aftermath of the GFC.'[39]Having been major players in creating the GFC leaders wallowed in their leadership bravado in resolving it.

[33] Helen Stacy, *Postmodernism and Law: Jurisprudence in a Fragmenting World* (Ashgate, 2001) 57.
[34] Sionaidth Douglas-Scott, *Law after Modernity* (Hart Publishing, 2013) 4.
[35] Christopher Hodges, *Law and Corporate Behaviour: Integrating Theories of Regulation, Enforcement, Compliance and Ethics* (Hart Publishing, 2015) 35.
[36] Fiona Haines, *The Paradox of Regulation: What Regulation Can Achieve and What it Cannot* (Edward Elgar, 2011) 45-6.
[37] Sionaidth Douglas-Scott, *Law after Modernity* (Hart Publishing, 2013) 383.
[38] Liu, H., Cutcher, L., & Grant, D. (2017). Authentic leadership in context: An analysis of banking CEO narratives during the global financial crisis. Human Relations, 70(6), 694–724. https://doi.org/10.1177/0018726716672920
[39] Liu, H., Cutcher, L., & Grant, D. (2017). Authentic leadership in context: An analysis of banking CEO narratives during the global financial crisis. Human Relations, 70(6), 694–724. https://doi.org/10.1177/0018726716672920

If one reads both Tomasic[40] and 'Managing Culture: A good practice guide'[41] one might be forgiven for assuming that the authors of both were discussing completely different topics. Tomasic's argument rests on the notion that culture is inherently uncertain and therefore not useful as a legal or regulatory tool and, 'unlikely to provide the 'quick fix' that some regulators had hoped for.'[42] The CAANZ publication, however, adopts a far more 'managerialist' perspective in both defining and examining how to embed culture. Assumptions here are that culture can and should be managed and that it is both leaders and the Board that are responsible for this. So, for example, 'Management is responsible for implementing and monitoring the desired culture as defined and set by the board.'[43] Both these conceptualisations seem to adopt a very singular assessment of the notion of culture and appear to have either a fatalist or problem resolution stand point.

Culture is a highly contested subject and as Alvesson and Sveningsson note, 'Research treating culture as a variable sees organizational culture as something the organization has, while the root metaphor refers to culture as something the organizations is.'[44] This offers an explanation as to how attempts at regulating culture in a legal/managerialist sense might not be successful, 'Organizations exist as systems of meanings which are *shared* to *various* degrees, a sense of commonality, or taken for grantedness is necessary for continuing organized activity so that interaction can take place without constant interpretation and re-interpretation of meaning'.[45] The notion of a singular organizational culture which doesn't take account of variety, differentiation and fragmentation is highly problematic. All societies, whether business, national or tribal will have different groups which express different values. Hence, attempting to impose culture change from the top is likely to meet barriers or hurdles, 'Cultural manifestations shared by a larger collective constitute a very heavy counterweight to the possibilities of a top figure

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[40] Tomasic, Roman A., Exploring the Limits of Corporate Culture As a Regulatory Tool – The Case of Financial Institutions (October 11, 2017). (2017) 32 Australian Journal of Corporate Law 196-221. Available at SSRN: https://ssrn.com/abstract=3051449 or http://dx.doi.org/10.2139/ssrn.3051449

[41] Managing Culture: A good practice guide' (CAANZ, 2017)

[42] Ibid, 4.

[43] Ibid.

[44] Alvesson M and Sveningsson S (2008) *Changing Organizational Culture*. London: Routledge

[45] Smircich, L. (1985). Is the concept of culture a paradigm for understanding organizations and ourselves? In P. J. Frost, L. F. Moore, M. R. Louis, C. C. Lundberg, & J. Martin (Eds.), *Organizational culture*, Thousand Oaks, CA, US: Sage Publications, 55-72.

exercising influence on people's thinking and feelings.' [46] It would be surprising if leadership at Board level were able to enact culture change when tasked by a regulatory body. Similarly, 'the phenomenon of leadership in being interactive is by nature dialectical. It is shaped through the interaction of at least two points of reference, i.e. of the leaders and the led.'[47] Therefore, within an organizational construct, an individual is only being led only to the extent that he/she accepts leadership and the terms it offers, and that these terms or offering coincide with acceptance amongst one's own organizational sub-culture. However, this does neglect the fact that leadership must steer the company towards compliance.

A Different Tack – Leadership in Compliance

As Lager argues that, 'A leader who strives for compliance is unlikely to lead an ethical organization…. and may miss key opportunities to increase workplace efficiency'.[48] For example, compliance with the equal employment laws may vitiate legal liability for discrimination, but will hardly assure that the workplace provides an equal opportunity for all, or that the unique talents are employees, partners and other stakeholders are well-applied. It is important to note that compliance will not overcome the limitations in corporate governance and directors' duty of care. Critics have argued that having compliance systems in place as part of risk management procedures will not, of itself, prevent directors from breaching the law.[49] This is why leadership is integral to achieving accountability. At a broader level, the board's role is to provide entrepreneurial leadership of the company with prudent and effective controls which enable risk to be assessed and managed.[50] To this end, it should set strategic aims, ensure financial resources are in place and review executive management performance. Similarly, non-executive directors should satisfy themselves that financial information is accurate and that controls and systems of risk management are robust and defensible within the company. Bridging the gap comes from the correct leadership skills mix applied less as compliance and more as *Leadership in Compliance*. Leaders of financial institutions would be best served

[46] Alvesson M and Sveningsson S (2008) *Changing Organizational Culture* (London: Routledge) 42.
[47] Ibid.
[48] Lager, J. M. (2010), Governments demand compliance, ethics demands leadership. J. Publ. Aff., 10: 216-224. doi:10.1002/pa.361
[49] Jason Harris, Anil Hargovan, and Michael Adams, *Australian Corporate Law* (4th edn, LesxisNexis, 2013) 411.
[50] Higgs, D., 2003. Review of the role and effectiveness of nonexecutive directors www.dti.gov.uk/cld/non_execs_review

embedding compliance within their organizational culture rather than attempting to apply rules and regulations imposed on them. Even though the International Standards Organization's manual on Compliance Management Systems Guidelines offer some explanations on leadership, it focuses on structural, procedural, policy and commitment issues.[51] We would suggest in Diagram 1 an argument for how Leadership in Compliance is both organizationally and culturally inhibited. Utilising Pfeffer's assessment of the condition which lead to organizational politics we argue that to achieve leadership in compliance it is necessary for Boards to recognise the magnitude of the task. This involves:

1. A wider organizational engagement of what and how to change culture and the design of engagement processes which are both clarified, signalled and ultimately embedded. If leaders have a 'vision' of cultural change which incorporates a new era of compliance what does this look like?
2. Recognition of the notion of sub-cultures in organizational life, how these can predominate and derail change. Assessing methodologies for sub-cultural engagement in change programmes.
3. Within a culture of compliance how is organizational scarcity managed? Do those with the greatest power and influence continue to 'play politics'?
4. How do Directors ensure what is done at the top will cascade down the organization?

DIAGRAM 1 HERE

Calls for leadership in compliance were echoed in APRA's self-assessments of governance, accountability and culture released in May 2019 as a response to an earlier Final Report of the Prudential Inquiry into the Commonwealth Bank of Australia in May 2018.[52] The key findings from this self-assessment exercise were:

[51] International Standards, 'Compliance Management Systems: Guidelines – ISO 19600' (International Standards Organization, 2014) 8-9.

[52] Australian Prudential Regulation Authority, 'Information Paper: Self-assessments of Governance, Accountability and Culture, 22 May 2019', 4 <https://www.apra.gov.au/sites/default/files/information_paper_self-assessment_of_governance_accountability_and_culture.pdf>.

'• the weaknesses identified in the Prudential Inquiry are not unique to CBA;

• there are consistent findings relating to non-financial risk management, accountabilities, and risk culture; and

• institutions may not have fully identified the root causes of findings, resulting in the risk that actions to address weaknesses may not be effective or sustainable.'[53]

APRA concluded that:

'Ultimately the responsibility for risk culture, and embedding strong frameworks and practices to deliver outcomes, rests with boards and senior leadership of regulated institutions. APRA cannot regulate good culture into existence, or design and implement strong frameworks for institutions. APRA does however have a role to play to provide a sound foundation and reinforce effective practices. To that end, APRA will strengthen and clarify its prudential framework, and concurrently broaden and deepen the scope and intensity of supervision. Under its newly adopted "constructively tough" enforcement appetite, APRA will also use its formal enforcement powers and the full extent of its toolkit as and where necessary to hold institutions and individuals to account.'[54]

Clues to achieving *leadership in compliance* can also be found in the new fourth edition of the ASX Corporate Governance Principles and Recommendations released in February 2019. The ASX Corporate Governance Council stated that, 'proposed changes anticipate and respond to some of the governance issues identified in recent enquiries, such as, the Hayne Royal Commission.'[55] Whilst the changes to this new edition have not been substantial compared to the third edition, Principle 3 'Instil a culture of acting lawfully, ethically and responsibly' offers some assistance towards improving compliance from the board. In particular, recommendation 3.2, where a listed entity should:

'(a) have and disclose a code of conduct for its directors, senior executives and employees; and

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[53] Ibid., 11.
[54] Ibid., 24.
[55] ASX Corporate Governance Council, 'Review of the ASX Corporate Governance Council's Principles and Recommendations: Public Consultation, 2 May 2018' 5 <https://www.asx.com.au/documents/asx-compliance/consultation-paper-cgc-4th-edition.pdf>.

(b) ensure that the board or a committee of the board is informed of any material breaches of that code.'[56]

In addition, the commentary section of recommendation 3.2 stated that:

> 'A listed entity should articulate the standards of behaviour expected of its directors, senior executives and employees in a code of conduct.
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> The board or a committee of the board should be informed of any material breaches of the entity's code of conduct, as they may be indicative of issues with the culture of the organisation.
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> For a code of conduct to be effective, all employees must receive appropriate training on their obligations under the code. Directors and senior executives must speak and act consistently with the code (again, setting the "tone at the top") and reinforce it by taking appropriate and proportionate disciplinary action against those who breach it.'

Therefore embedding and ensuring all employees adhere to a code of conduct offers a tangible system of compliance.

It is important to note that compliance is not simply policies, processes and procedures. It is a continuous process where the level of compliance achieved incrementally.[57] Aligning a code of conduct with compliance obligations is vital to reducing compliance risks. The role of the board is to ensure the code of conduct is abided to by all employees, including themselves. This might require a risk committee at the board level to oversee that the code of conduct is enforced and that revised from time to time to meet new or amended regulatory obligations.

The challenge of a code of conduct is to ensure a set of rules designed to induce desirable attitudes and behaviours which are consistent with the standards expected by the leaders who drafted it.[58] These also provide a moral foundation by conveying principles setting standards of behaviour towards those that these codes would apply.[59] In a more technical sense, codes form

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[56] Ibid., 16.
[57] Angus Young, *A Concise Guide Corporate Compliance Management* (Wolters Kluwer, 2018) 5.
[58] Steven Dellaportas, Kathy Gibson, Ratnam Alagiah, Marion Hutchinson, Philomena Leung, and David Van Homrigh, *Ethics, Governance and Accountability: A Professional Perspective* (John Wiley & Sons, 2005) 64.
[59] Ibid.

part of agreements in business-to-business and business-to-consumers contracts.[60] The effectiveness of any code would involve the enforcement for breaches against certain parts or provisions of that code in the form of a disciplinary mechanism and process.[61] The threat of punishment is an essential part of this disciplinary process.[62] Sanctions are designed to reflect the severity of the actions of the individual rather than a punishment and more importantly be deterrent.[63] Ultimately, the most serious misconduct of any individual in the company is to have their employment terminate. To what extent leaders play a role in such a disciplinary process is an important matter that needs to be considered. If leaders are members of a disciplinary panel or committee, this can be construed as an authority partaking in the enforcement process of the code. Even if they are not part of this process, leaders could attest to the vigour of compliance by establishing a set of procedures and penalties for misconduct which are subsequently administered. However, this begs the question of whether a Director's involvement in the disciplining of staff for alleged misconduct is overextending their mandate of accountability towards the shareholders into become a quasi-regulator being deputized by regulatory authorities to enforce the law or regulations via codes of conduct. This is where compliance professionals can play an important role in assisting leaders.

Leaders and the Compliance Professionals

The Banking Act, section 37BA(3)(h) stipulates that, 'senior executive responsibility for management of the ADI's compliance function' is an accountable person. As accountable persons, senior managers are involved in compliance functions that have the same obligations as directors set out under section 37CA discussed in above; therefore they have the common aim to ensure compliance functions are effective. As such, effectiveness would require compliance professionals to help management achieve this goal. However, the Hayne Royal Commission failed to acknowledge the role of compliance professionals.

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[60] Anna Beckers, 'Corporate Codes of Conduct and Contract Law: a Doctrinal and Normative Perspective' in Roger Brownsword, Rob van Gestel and Hans-W. Micklitz (eds.) *Contract and Regulation: A Handbook on New Methods of Making in Private Law* (Edward Elgar, 2017) 89, 89.

[61] Steven Dellaportas, Kathy Gibson, Ratnam Alagiah, Marion Hutchinson, Philomena Leung, and David Van Homrigh, *Ethics, Governance and Accountability: A Professional Perspective* (John Wiley & Sons, 2005) 78.

[62] Ibid., 79.

[63] Ibid.

Young argues that,

> '[T]he reforms in BEAR and strengthening corporate and financial penalties appeared to assume compliance is a process-orientated task like a black box where input is at one end and output at the other because there was no discussion on how organisations and individuals go about achieving various regulatory objectives.'[64]

He adds that,

> '[T]he complexity of implementing BEAR and ensuring its effectiveness should not be underestimated. Compliance professionals intervene at the first signs of trouble, whether that may be at the departmental level or specific individuals no matter what position these people hold. This means proactive monitoring, reporting all concerns irrespective of the compliance risks or position of personnel involved, and repeat training organization wide. To accomplish such a robust compliance management regime, compliance professionals must be authorised to intervene so as to halt possible mischief by any individuals and police the organisation from top to bottom. In short, compliance professionals should be proactive gatekeepers to prevent and rectify any conduct by staff that might put the organisation at risk of regulatory breach.'[65]

Therefore, for leadership in compliance to work, leaders need to work closely with compliance professionals. Currently, there is no consensus as to which department compliance professionals should be assigned or whom they report to.[66] Some companies prefer compliance professionals report to the general counsel or chief legal officer, others report directly to senior management like the CEO, CFO, COO or CRO.[67] Given the importance of the compliance under BEAR and recent amendments to the Corporations Act, boards should be directly involved in compliance, at least in the monitoring of compliance risks.[68] Further, the implication from the regulatory obligations is clear, leaders have to work closely with compliance professionals.

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[64] Angus Young, 'Restoring trust in Australia's financial services sector: from the banking executive accountability regime to the strengthening corporate and financial sector penalties' (2019) 34(6) *Journal of International Banking Law and Regulation*, 185, 193.
[65] Ibid.
[66] Peter Kurer, *Legal and Compliance Risk: A Strategic Response to a Rising Threat for Global Business* (Oxford University Press, 2015) 109.
[67] Ibid., 110.
[68] Ibid., 115-8.

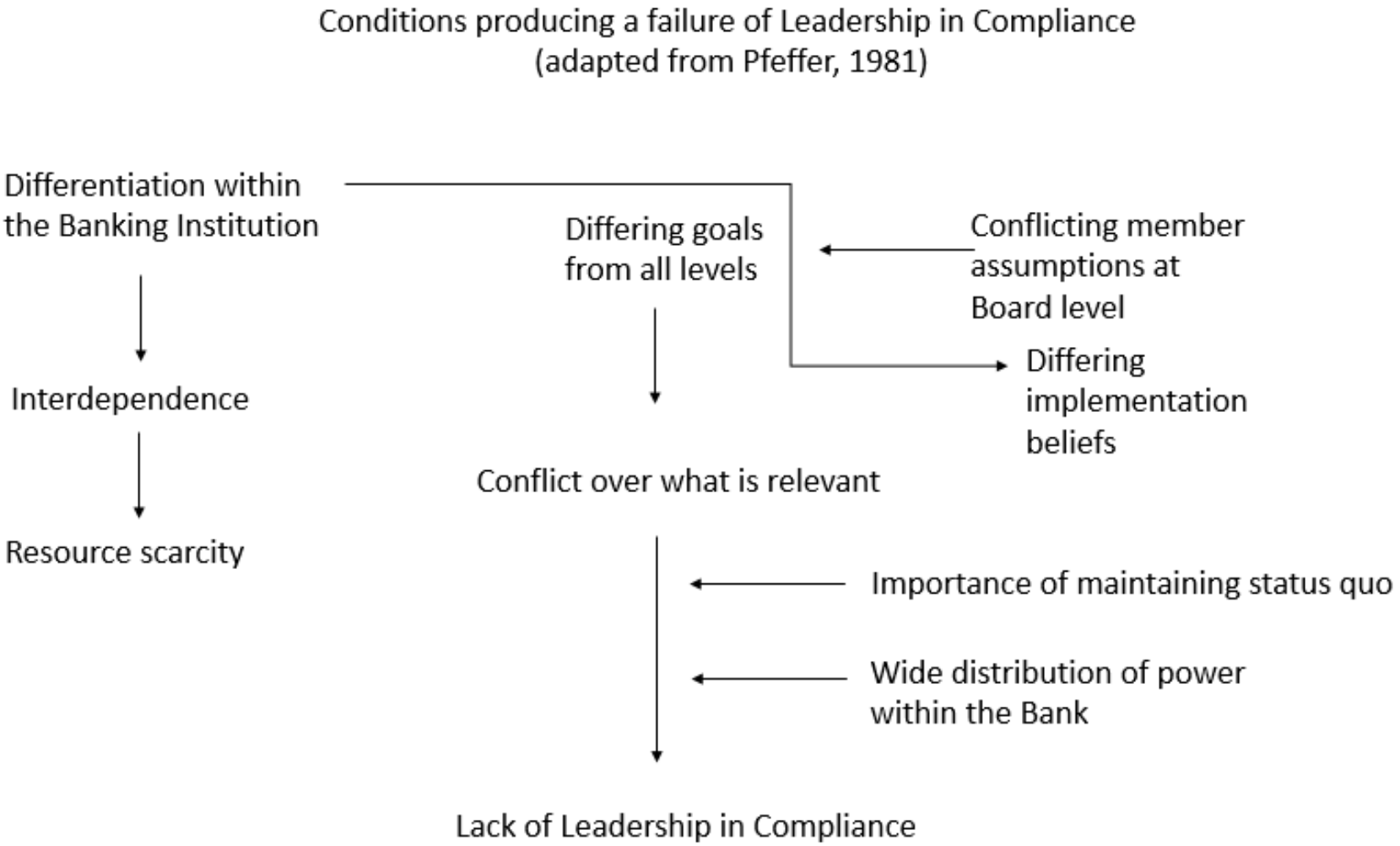
Conclusions

The regulatory reforms in Australia thus far placed more emphasis on directors to lead and change conduct. This is supported by increasing the deterrent effect with greater penalties placed on both the entity and senior managers including directors for failures to rein in misconduct committed by the companies and the staff. Whilst such reforms are not ground-breaking, it certain ups the ante for those deemed under the law to be accountable.

A natural and instinctive response from directors and senior management could be greater shrewdness and pragmatism. The implication is negative where individuals could carefully calculate their risk exposures and be better prepared to defend their decisions and indecisions. Being self-protective and limiting their personal liability could be a new norm for leaders. If this becomes the new practice, a new sort of impairment could emerge in financial services companies in Australia, one of guardedness and apprehension, which would likely lead to 'harm' from a business perspective.

An alternative this article has proposed is leadership in compliance. The proposition is simple; to embed the right culture with the aid of a code of conduct. Through this code companies create a culture of compliance. This would also involve the board and senior management taking the lead by overseeing policies, processes, and procedures. More importantly, this would continuously improve the level of compliance achieved incrementally. This might also require a risk and compliance committee at the board level to oversee that the code of conduct is enforced. Implementation would also require compliance professionals to execute, monitor, and perform other aspects compliance tasks. Thus having them reporting directly to senior management and the board would be integral to actualizing leadership in compliance.

DIAGRAM 1


Conditions producing a failure of Leadership in Compliance
(adapted from Pfeffer, 1981)
Differentiation within the Banking Institution
Interdependence
Resource scarcity
Differing goals from all levels
Conflicting member assumptions at Board level
Differing implementation beliefs
Conflict over what is relevant
Importance of maintaining status quo
Wide distribution of power within the Bank
Lack of Leadership in Compliance