

Has APRA just outsourced its job?

Written by The Conversation

The Australian Prudential Regulation Authority APRA has [announced](#) an independent inquiry into the Commonwealth Bank of Australia, “focusing on governance, culture and accountability frameworks and practices within the group”.

Hold on a minute. Isn't that what APRA should have been doing all along? According to the [principles of corporate governance for banks](#) (that APRA helped author), it has both the right and obligation to talk to anyone in the bank, at any time, to discuss corporate governance.

One of the key principles of [corporate governance for banks](#) relates specifically to the “role of supervisors” (regulatory speak for regulators):

Supervisors should provide guidance for and **supervise corporate governance** at banks, including through comprehensive evaluations and **regular interaction with boards and senior management**

This principle means that regulators are meant to be participants in, not merely spectators to, banking regulation. This requires, for example, “improvement and remedial action, as necessary”.

Among the relatively few things that regulators are required to provide is guidance into the internal organisations of bank boards.

In order to do that, APRA is required to have “processes in place to fully evaluate a bank's corporate governance”. These evaluations are conducted “through regular reviews of written materials and reports [for example, board minutes], interviews with board members and bank personnel”. Importantly:

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the evaluations should also include regular communication with a bank's board of directors, senior management, those responsible for the risk, compliance and internal audit functions, and external auditors

So, assuming that APRA does have processes in place to evaluate a bank's corporate governance, why does it feel the need to outsource its own job? Who knows (*or who should know*) CBA and its governance processes better than APRA?

Corporate Governance and board size

Corporate governance is not an easy concept, especially questions of how much is enough. In particular, how many directors are needed to oversee management and what skills should they bring to the board? The Basel principles require that:

The board should be comprised of individuals with a balance of skills, diversity and expertise, who collectively possess the necessary qualifications commensurate with the **size, complexity and risk profile of the bank**

In short, APRA is required to ensure that there are sufficient and adequately skilled directors to oversee a bank as systemically important as CBA.

Until this week, there were eleven directors of CBA and its subsidiaries. Each of these subsidiaries, such as [Commlnsure](#), is bigger than most Australian companies.

After the [recent board shakeup](#), two CBA directors were dropped and one was brought on board. A future retirement was also announced. Altogether this is a reduction of almost 25% of the board's experience.

But are nine board members enough? Who knows - presumably APRA does and has no

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problems with a board of this size.

In [2010](#) , there were 11 directors of CBA, so APRA must have felt (despite [numerous scandals](#)) that they could sanction the reduction in the board of Australia's biggest company (at the time) by two directors (a drop of around 18%).

But it is not only CBA. In the same period APRA has (presumably) felt happy with the axe being taken to the boardrooms of the other three big banks. Aside from [ANZ](#) , which has had eight directors since 2010, [W](#)
[estpac](#)
has dropped from ten to eight and
[NAB](#)
from 13 to nine.

Overall, according to their own annual reports, the number of directors in the largest banks in Australia has dropped some 16% since 2010.

Board experience and expertise

But maybe it is not all about board size. What about quality?

Presumably APRA accepted that Catherine Livingstone, appointed Chairperson of CBA [last year](#) , is not a banker but an accountant from the medical industry. They must also have been happy that the CEO who was put in place after banker Ralph Norris left CBA in 2011, was a management consultant, [Ian Narev](#) .

And presumably APRA was not unhappy that the latest two CBA directors are a [lawyer](#) and a [technology specialist](#) , not bankers. In fact today, bankers make up less than a third of CBA's board directors.

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That in itself would not be too much of a problem, except that the [executive management committee](#) of CBA is packed with management consultants and lawyers, with less than 40% having significant banking experience.

Having experience outside of banking is very important for bank directors. But a lack of in-depth experience can also lead to problems. In the UK, a damning [report](#) on the failure of the Halifax/Bank of Scotland (HBOS) found that:

As a group, the non-executive directors (NEDs) on the [HBOS] Board lacked sufficient experience and knowledge of banking. [...] The lack of experience and knowledge of banking amongst the NEDs was compounded by similar lack of banking experience within the executive management team.

CBA is definitely not HBOS, although HBOS was a star performer until it became unstuck. Nonetheless APRA should pay heed to the warnings of its fellow regulators.

Since 2010, APRA has overseen a significant reduction in the size of boards across the banking sector and a dilution of seasoned bankers on the board of CBA.

When its senior staff had regular communication with the bank's directors and senior management, APRA should have picked up on the risks and scandals that CBA has become embroiled in in the last decade.

They would have shared "information on corporate governance with other supervisors" such as [AUSTRAC](#) and ASIC. APRA would not have been surprised when the CBA board [threatened](#) to fight the latest money-laundering allegations in court.

This is why it comes as a surprise that APRA, an independent regulator with unparalleled

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access to the inner workings of all major banks and bristling with internal expertise, should need to outsource its inquiry of corporate governance at CBA.

If APRA cannot evaluate a bank's governance, who can?

Or maybe APRA is embarrassed that somewhere along the line it has dropped the ball and become far too cosy with the banks it is supposed to regulate.

Maybe an inquiry into APRA should be on the cards?

Quis custodiet ipsos custodes? Who regulates the regulators?

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