RESERVE BANK OF AUSTRALIA

Parliamentary Joint Committee on the Australian Commission for Law Enforcement Integrity

Responses to Questions on Notice to the Reserve Bank

Question 1

What analysis has been done by the Reserve Bank following the Note Printing Australia and Securency scandal? What lessons have been learned from it, and what processes, if any, have been put in place to address the risk of such an occurrence in the future?

Response:

The main lessons learned to date from the experience are that targeted governance arrangements and processes are needed to seek to prevent corrupt behaviour and detect it if it occurs. Accordingly, over the past several years much has been done to strengthen governance and tighten controls at the two companies to mitigate the risk of corrupt conduct. In relation to Note Printing Australia and Securency, these measures include:

- those charged with offences are no longer with the companies
- the use of sales agents by both companies has ceased
- policies, procedures and controls at both companies have been thoroughly overhauled with the assistance of the companies' external advisers (more detail on this is provided in the response to Question 4 below)
- the Reserve Bank now draws all of its appointees to the boards of both companies from the Bank's executive or the Reserve Bank Board.

We note that these matters remain before the Courts.

Question 2

Has the Reserve Bank been asked for, or provided, advice to Commonwealth agencies on its experience of the Note Printing Australia and Securency scandal, to support the learning from the Reserve Bank's experience?

Response:

The Reserve Bank has neither been asked for, and nor has it provided, advice to Commonwealth agencies on its experience of the Note Printing Australia and Securency matter. We note, as above, that these matters remain before the Courts.

Question 3

Please outline integrity measures in place to address corruption risks and any monitoring arrangements in place to support the integrity framework.

Response:

The Reserve Bank has an integrated approach to managing risks, including those arising from the potential for corruption ('bribery and corruption' is a sub-risk category under 'fraud risk' in the Bank's risk library). This approach involves the following five key elements: leadership, culture and governance; appropriate standards and policies; a strong risk management framework and controls; ongoing awareness-raising and training; and regular monitoring.

(a) Leadership, culture and governance

The Reserve Bank seeks to manage risk carefully, reflecting the view that satisfactory fulfilment of its important public-policy responsibilities would be seriously jeopardised if poorly managed risks were to result in significant financial losses and/or compromise the Bank's integrity. The Bank's senior management is committed to the highest ethical standards, and this is reflected in the Bank's culture as well as its systems and processes.

These aims and expectations are supported by aspects of the Bank's governance structure, as follows:

- The Governor of the Reserve Bank, as chief executive, has overall responsibility for management of the organisation, but day-to-day management of the various groups and departments in the Bank – including risk management – is delegated to the respective Assistant Governors or Department Heads. The general philosophy underpinning the Bank's approach is that risk management, including the associated controls and ongoing monitoring process, is an integral part of the management function.

- The Reserve Bank Board Audit Committee seeks to ensure a high-quality, independent and effective internal and external audit process and to assist the Governor and the Board in fulfilling their obligations relating to financial reporting, compliance, internal control and risk assessment, employee conflicts of interest, business ethics and prevention of fraud. Its membership comprises two non-executive members of the Reserve Bank Board, and two external members who are company directors and former senior audit partners with extensive control experience in the financial sector.

- The Risk Management Committee oversees the Reserve Bank's overall risk management practices via a formal delegation from the Governor. The role of the Committee, which comprises several senior officers and is chaired by the Deputy Governor, is to ensure that the Bank's risks are identified, assessed and managed in accordance with its Risk Management Policy. The Risk Management Committee regularly provides reports to the Bank's Executive Committee and the Reserve Bank Board Audit Committee.

- The Risk Management Unit facilitates, coordinates and advises on the risk management process. The role of the Unit is to assist groups and departments manage their risk environment in a manner that is consistent across the Bank. The Unit does not, however, conduct risk management on behalf of groups and departments or assume ownership of, or responsibility for, those risks. (Responsibility for identifying and actively managing risks on an ongoing basis resides with the Bank's executive management and their staff.) The Risk Management Unit reports to the Risk Management Committee and the Deputy Governor.

- The Audit Department coordinates closely with, but is separate from, the Risk Management Unit. The department liaises with the Australian National Audit Office, the Reserve Bank's external auditor, and their representatives to coordinate overall audit work for the Bank, with a view to providing the most effective and efficient audit approach. This audit framework provides independent assurance that the Reserve Bank's risk management policy is adhered to. In addition, Audit Department independently reviews departmental procedures to assess the effectiveness of their control measures. This work draws on risk documentation and reports from core business areas to help ensure that the approach reflected in these documents is both risk-focused and consistent with the views of management in the areas being audited. Audit Department reports independently to the Reserve Bank Board Audit Committee on both the risk profiles of groups and departments as well as the effectiveness of relevant controls. Copies of these reports are provided to the Risk Management Unit.

(b) Standards and policies

The Reserve Bank has in place a number of key standards and policies that seek to support its culture in terms of both the integrity of its people generally, and its lack of tolerance for corrupt behaviour. These standards and policies are periodically reviewed by the Reserve Bank's executive to ensure that they remain appropriate and deal effectively with the risks they seek to manage.

The overarching Code of Conduct articulates the Reserve Bank's core values, stating that 'every employee must act honestly, not only in the narrow sense of staying within the law, but also in the broader sense of exhibiting high standards of ethics, integrity and professional conduct at all times'. Further, it specifies the standards of behaviour expected of the Bank's employees, outlines what constitutes unacceptable behaviour and provides information on how breaches of the Code will be dealt with. The Code of Conduct expressly prohibits the use of one's position in the Bank for financial gain for oneself, relatives or associates. It also explicitly considers a number of corruption-related risks, including:

- Conflicts of interest: the Code states that employees need to be alert to any situations where their private interests could possibly conflict with their duty to the Reserve Bank. It deals with a number of circumstances in which conflicts may arise, including if an employee (or their associates) has a financial interest in a business that is involved with the Reserve Bank, or is seeking outside employment.

- The giving or receiving of gifts and hospitality: the Code prohibits the receiving or giving of gifts or benefits that may, or be perceived to, compromise an employee's judgement in their official capacity at the Reserve Bank, damage relationships with other persons or organisations, and/or indicate favouritism towards a person or a group of people. Employees may receive gifts in connection with the discharge of official duties, such as giving a presentation, although gifts valued over $100 are accepted on behalf of the Reserve Bank and handed to the Secretary, who maintains a register of such gifts received. Modest offers of hospitality, valued below $100, that play a role in relationship building, professional development or community liaison may be accepted.

- Personal dealings in financial instruments: the Code states that Reserve Bank employees must not profit, or enable others to profit, from non-public or market-sensitive information available to them because of their Reserve Bank duties and responsibilities.

- Financial speculation on the Reserve Bank's monetary policy decisions is strictly forbidden.

There are a number of other mechanisms that support the Reserve Bank's management of corruption risks, including:

- a Fraud Control Policy sets out the mechanisms that the Reserve Bank has in place to prevent, detect and investigate fraud

- a framework for reporting fraud and unethical behaviour (such as suspected corrupt behaviour) supported by an Anonymous Concern Reporting hotline, which is provided by a specialist independent provider

- procurement guidelines that ensure there is a transparent, robust and defensible framework for making decisions about the purchase of goods or services.

(c) Risk management framework and controls

Internal and external fraud risks and the related controls are identified and assessed as part of the Reserve Bank's risk management framework. In addition, fraud risk specifically associated with bribery and corruption has been included in the annual risk assessment process for 2012. Each department maintains a register of these and other business risks it faces in its day-to-day operations and the systems and controls that are in place to mitigate exposure to these risks. The registers are updated regularly, particularly when there are key changes in policies, structures or functions. The assessment of fraud risk undertaken by departments is supported by the Risk Management Unit and reviewed annually by the Risk Management Committee.

(d) Awareness-raising and training

To ensure that all staff are aware of their roles and responsibilities, the Reserve Bank has an ongoing awareness-raising and training program for staff, which deals with corruption-related risks. Staff are asked to review the Code of Conduct annually and formally acknowledge that they have read and understood the

requirements it contains. Training is also made available to staff on ethics, fraud control and anti-money laundering, and for staff in positions that have been explicitly identified as having a greater capacity to engage in fraud, face-to-face training is conducted by an external facilitator on a regular basis. Any changes to Reserve Bank policies following periodic updates are communicated to staff via email, staff notices, the Bank's intranet and/or face-to-face awareness-raising sessions.

(e) Regular monitoring

The controls that the Reserve Bank has put in place to manage corruption risks are monitored and reviewed on a regular basis. In particular:

- The Reserve Bank's operations in financial markets are undertaken by the Financial Markets Group. Monitoring of the Financial Markets Group's trading activity and compliance with credit and trading limits is undertaken on a daily basis by the Risk Management Unit. The Unit, which also ensures the valuation of the Bank's portfolio of financial assets is accurate, has a separate reporting structure that is outside the Financial Markets Group.

- Audit Department conducts audits annually on areas assessed to have a high level of fraud/corruption risk and the terms of reference for these audits explicitly address such issues.

Question 4

Please outline the main corruption risks facing staff and affiliates when engaged overseas as compared to the domestic context and any analysis conducted by the Reserve Bank on corruption risks.

Response:

The Reserve Bank has maintained representative offices in both London and New York for many years. The primary function undertaken by those offices is managing the foreign exchange reserve portfolio held by the Bank. The operations of these offices are overseen by Chief Representatives, who are senior officers of the Bank. The Chief Representatives of both offices also have broader representative responsibilities.

The offices are small, comprising around 10 staff each. Three of the staff in each office are recruited locally, while the remainder, including the Chief Representatives, are Australians on two- to three-year postings from the Reserve Bank's Head Office in Sydney.

The purpose of these offices is to manage a portfolio of financial assets to the advantage of the Reserve Bank and Australia. The control framework around this activity is designed specifically to minimise the potential for fraud or corruption. The integrity measures and monitoring arrangements that apply in the two offices are the same as those that apply in Head Office, as noted in the response to Question 3 above.

More specifically, since the primary functions undertaken in these two offices are also conducted in Head Office, the main corruption risks facing the offices are principally the same as those in Head Office, namely fraudulent transactions with a counterparty and inappropriate allocation of trading business to a counterparty for personal gain.

The controls in place to mitigate these risks are the same as those that apply in Head Office. All value transactions must be recorded in a dedicated trade capture system, which is common to the offshore offices and Head Office. This system enables real-time compliance checks and exception reporting as well as real-time access for compliance staff. All transactions are tightly monitored by a separate settlements (back office) and a portfolio monitoring (middle office) function. Both representative offices have back office staff located in their offices, while the middle office function is run from Head Office. This monitoring independently verifies that each trade is executed for the appropriate purpose. This reporting is then endorsed by senior management in Head Office on a daily basis. All back and front office telephone calls are recorded for ex-post trade verification, if necessary. Finally, these processes are subject to regular internal auditing by Audit Department.

The staff who conduct these transactions are not remunerated on the basis of the number or profitability of their transactions. That is, the traders do not participate in any form of profit sharing generated by their transactions that is usually available in similar circumstances in the private sector. The absence of such bonuses significantly reduces the susceptibility of staff to fraud, bribery or corruption. Further, staff appointed to positions that involve undertaking or settling financial transactions are required to be absent from their desk on continuous leave for a minimum of 10 days within any 15-month period to enable another staff member to undertake their duties.

The allocation of transactions among counterparties is subject to a similar monitoring process by the middle office, senior management and internal audit. Regular analysis is conducted to ensure that transactions are appropriately allocated among counterparties. As in Head Office, a hospitality register records interactions between staff and their counterparties. The register is reviewed regularly by senior management to identify any possible anomalies and during audits.

The corruption risk around procurement in these two offices is also closely managed in accordance with delegations of authority and approved budgets. All payments to service providers must be approved by two officers, one of which must either be the Chief Representative or the Deputy Chief Representative. All payments are reported to Head Office at the time they are made. In addition, a regular monthly reconciliation of all payments with the representative office's bank account balance is done by local staff and reported to Head Office.

Audit Department reviews the offshore offices, including trading, settlement and administrative functions, on an annual basis. The findings of these audits are reported to relevant senior management in Head Office and to the Reserve Bank Board Audit Committee.

The Reserve Bank recently established an office in China, staffed by one secondee from Head Office and one locally engaged employee. The role of the office, which is located within the Australian Embassy in Beijing, is to assist in the Bank's monitoring of economic and financial developments in China – the activities, therefore, are not financial in nature. Accordingly, the risk of corruption emanating from the Bank's activities in China is assessed to be low. Staff in China are subject to the same requirements that apply in Head Office in relation to access to and release of Reserve Bank information, and they are also bound by the security requirements of the Embassy. Staff in China have no access to sensitive information stored in the Reserve Bank's information systems.

The staff member seconded from Head Office is required to undertake a formal security assessment (Negative Vetting 2) to ensure that there is nothing in his/her background that makes him/her susceptible to corruption. Prior to taking up the posting, the staff member also receives briefings from the Department of Foreign Affairs and Trade (DFAT) relating to safeguarding physical and information security. The locally engaged staff member at the China Office is employed by DFAT using DFAT employment procedures, which include a background check, and was also required to sign a declaration that they had read and understood the Reserve Bank's Code of Conduct.

The assessment of a low risk of corruption also reflects tight oversight of spending and other activities from Head Office. While the staff member from Head Office has authority to approve certain expenditure, within limits, any approval has to be communicated to Head Office immediately. Most of the expenditure (apart from that using petty cash) is done through DFAT. Major items of expenditure (including salaries, rental of office space and residential accommodation) are approved by senior staff in Head Office. The locally engaged staff member only has access to petty cash, the use of which must be approved by the staff member seconded from Head Office, and reconciliations must be sent to Head Office on a regular basis.

Staff located in China keep a register of gifts and hospitality given and received, a contacts register and a record of all meetings, which are sent to Head Office regularly. Furthermore, using an external database, the Reserve Bank undertakes background checks on some individuals with whom staff are likely to have regular contact.

The Reserve Bank also has two affiliate companies, namely Note Printing Australia Limited (NPA) and Securency International Pty Ltd.

(a) Note Printing Australia

NPA is the Reserve Bank's wholly owned subsidiary. It is based in Victoria and has no foreign offices. Its primary purpose, as set out in its Charter, is to print banknotes for the Reserve Bank. It also prints Australian passports and banknotes for a small number of other countries. As noted in response to Question 1, over the past several years much has been done to strengthen governance and tighten controls at NPA to mitigate the risk of corrupt conduct, including a comprehensive overhaul of policies, procedures and controls.

Under current arrangements, NPA deals directly with foreign central banks and does not use sales agents. Business from foreign central banks is either under a long-term supply contract or through an open tender. All tenders are approved by the NPA Board, which comprises senior Reserve Bank officers. NPA has a number of policies and procedures to address the potential for fraud, corrupt practices and bribery. Specifically, it has a Code of Conduct and policies dealing with fraud, foreign customers, travel and entertainment, delegations of authority and whistleblowing. Each is reviewed annually and approved by the NPA Board. NPA has an externally run whistleblower hotline. Anti-corruption training by external advisers has also been conducted. Visits to overseas central banks by the CEO are approved by the Chair of the NPA Board and overseas travel expenditure is reported monthly to the NPA Board. NPA has also established a Risk and Compliance Committee, which is responsible for ensuring that NPA's processes for identification, assessment, management, monitoring and rectification of risk and compliance issues are fully functional and properly managed.

(b) Securency

The Reserve Bank has a 50 per cent share in Securency International Pty Ltd, a joint venture with Innovia Films. Securency manufactures, markets and supplies a range of polymer substrates on which banknotes are printed by NPA, foreign central banks and overseas commercial banknote printers. Securency no longer makes use of sales agents in selling to foreign customers. All sales staff are now Securency personnel. In some instances, Securency engages consultants to provide expert advice on developing foreign markets. These consultants are paid on a fee for service basis and engaged mostly for short terms. Payments are recorded in a central register of payments. Foreign countries are assessed against a transparency index. Board approval is required before Securency personnel can engage with low-ranked countries, and activities in countries sanctioned by DFAT, the United Nations, United States, European Union or United Kingdom are strictly prohibited. Securency is in the process of establishing offices in China, India and the United Arab Emirates. These offices are/will be staffed by Securency personnel. Key suppliers and commercial printers are currently undergoing a rigorous due diligence process with Securency.

Securency has a Code of Conduct and Ethics, an Integrity and Ethics Policy (including anti-bribery), an Antitrust Policy and Guideline, a Sanction Policy, a Travel and Expense Reimbursement Policy and Procedure, a Business Risk Management Policy and a Whistleblower Policy. These policies were approved by the Board and are reviewed periodically. The Board oversees the implementation of, and compliance with, these policies. Securency has also introduced an externally run whistleblower hotline.

The Integrity and Ethics Policy states that Securency has zero tolerance for bribery, while the Code of Conduct and Ethics says Securency personnel must not provide or confer upon a person (or offer or promise to do so) a benefit or advantage in order to influence a public official, foreign public official or any other person in a position of influence in the exercise of his or her official or professional duties. Staff receive training in these policies when they join the company and annually thereafter. Those personnel that undertake commercial activities on behalf of the company (including the entire executive team) undergo a due diligence process. The policy further requires all personnel to disclose gifts, hospitality or expenses either given or received above a $100 threshold and prohibits all facilitation payments. The company has appointed a Chief Risk & Compliance Officer, who is responsible for leadership of the risk and compliance functions. It has also established a Risk and Integrity Committee with the role of assisting the Managing Director with managing Securency's risks and being satisfied that management has developed and implemented a sound system of risk management and internal control and is operating with a high level of integrity.

Question 5

Does the Reserve Bank recruit locally engaged staff or agents outside Australia? If so, how are they recruited and what integrity measures are in place to address the specific corruption risks pertaining to locally engaged staff?

Response:

The Reserve Bank has a small number of locally engaged staff in its offices in London, New York and Beijing. The Bank does not employ agents to act on its behalf.

(a) London and New York

As noted above, the Reserve Bank's presence in London and New York is to contribute to its foreign exchange reserves management and financial market analysis.

Locally engaged staff in London and New York are recruited through professional recruiting agencies using merit-based selection processes. Background checks on prospective staff are requested from the relevant recruiting agency, which in turn uses a specialist firm to provide these reports. At appointment, these staff sign an employee declaration stating that they will abide by the Code of Conduct and all other policies and procedures as directed by the Reserve Bank.

Since the nature of the work involved in London and New York is the same as in Head Office in Sydney, and given the jurisdictions in which the work takes place, namely the United Kingdom and United States, the Bank's assessment is that unique corruption risks do not apply specifically to these locally engaged staff. As a result, locally engaged staff are subject to the same Code of Conduct and procedures as Australian staff, described in the response to Question 3. While bill and expenses payments made by the offshore offices are processed by locally engaged staff, all such payments must be approved in advance by the Chief Representative or the Deputy Chief Representative.

(b) Beijing

The Reserve Bank's office in Beijing is to assist in the monitoring of economic and financial developments in China. The locally engaged staff member at the China office is employed by DFAT. The staff member was recruited using a merit-based selection process and DFAT conducted background checks on the appointee as part of the selection. While not employed by the Reserve Bank, the employee was nevertheless required to sign a declaration that they had read and understood the Reserve Bank's Code of Conduct, as noted in the response to Question 4. The budget of this office and procurements are modest, and the office does not undertake transactions in financial markets.

Question 6

Is there a common understanding of corruption and bribery risks across Australian and foreign agencies that the Reserve Bank deals with?

Response:

Corruption and bribery risks are not specific matters that have been discussed with the Australian and foreign agencies with which the Reserve Bank interacts.

Question 7

What pre-overseas engagement training and awareness-raising is conducted for Reserve Bank staff or affiliates? Please also outline any in-country support and post-overseas de-briefing and monitoring initiatives.

Response:

The Reserve Bank ensures that staff posted to its overseas offices have had appropriate training relevant to their position. They receive ongoing training while overseas. The requirements for training of staff posted overseas vary according to the location. For instance, the Representative in the China Office is required to undertake a formal Security Assessment (as described in the Australian Government's Protective Security Policy Framework) to further ensure their suitability to undertake the role. They also receive briefings relating to safeguarding physical and information security from DFAT prior to taking up the posting, as noted in the response to Question 4.

As noted above, the activities of staff in the London and New York offices are extensively monitored to ensure that these offices continue to adhere to the trading and investment controls in place. Chief Representatives return to Australia at least once each year to debrief senior Bank officers on the activities of the overseas offices and to receive face-to-face briefings on developments that are relevant to their responsibilities. They also regularly discuss operational and other matters with the Assistant Governor, Financial Markets and other senior officers. Senior staff from Head Office, including the Governors, regularly visit the overseas offices. Audits are also conducted annually on these offices.

Question 8

How does the Reserve Bank deal with cultural variations and country-specific interpretations of corruption and bribery?

Response:

For the main form of corruption risk to which the Reserve Bank is exposed, which flows from its operations in financial markets, the Bank's assessment is that the counterparts with which it deals are from jurisdictions with broadly similar cultures and legal frameworks. Therefore, as noted in response to Question 5, since the nature of the work involved in London and New York is the same as in Head Office in Sydney, the Bank's assessment is that there are not unique corruption risks that apply specifically to these locally engaged staff.

Staff in the China Office are expected to conduct themselves in accordance with the Codes of Conduct of the Reserve Bank and DFAT in order to avoid behaviour that could be considered to be corrupt by Chinese officials.

Question 9

In relation to the development of the Attorney-General's National Anti-Corruption Plan, has the Reserve Bank made a submission, and does it expect to play a role in the development or implementation of the plan?

Response:

The Reserve Bank has not made a submission in relation to the development of the Attorney-General's National Anti-Corruption Plan, and it does not expect to play a role in the development or implementation of the Plan.

Question 10

The Reserve Bank's Annual Report 2010–11 notes that the Reserve Bank participates in global and regional fora and has 'close bilateral relationships with other central banks'.[1] Please outline the personnel and institutional corruption risks associated with staff engaging in international and regional fora.

Response:

The Reserve Bank participates in a number of global and regional fora. These include the G-20, the Executives' Meeting of East Asia-Pacific Central Banks, the International Monetary Fund, the Bank for International Settlements and the Organisation for Economic Co-operation and Development. It also has close bilateral relationships with a number of central banks in the Asia-Pacific region as well as elsewhere in the world.

The focus of these various fora and relationships is generally discussions of economic and financial policy matters. The Reserve Bank views the corruption risks in this area as inherently low, i.e. there is little scope for corruption in such discussions. All policy positions put by Bank staff in international meetings are developed at the Bank's Head Office and are discussed by senior management before international meetings take place. The outcomes of these meetings are also closely monitored by the Bank's senior management, and where international agreements are reached they are well documented, with summaries of the discussions routinely prepared. In addition, meetings are often attended by more than one staff member.

There are only a limited number of instances in which the Bank's involvement with international institutions has a direct financial aspect. The Bank's Code of Conduct applies in all these instances, as do the other elements of the integrity framework outlined in response to Question 3. In addition, the Bank has a policy of paying for the travel and accommodation costs of its staff. The only exception is where accommodation costs of all participants are met by a meeting host, which occurs infrequently.

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1 Examples include the Group of Twenty, Financial Stability Board which includes representatives from 24 economies, Bank for International Settlements, Basel Committee on Banking Supervision, OECD, Executives' Meeting of East Asia-Pacific Central Banks (Reserve Bank, *Annual Report 2011*, pp 35–39, http://www.rba.gov.au/publications/annual-reports/rba/2011/pdf/2011-report.pdf (accessed 9 May 2012).

There have been no recent changes to the integrity framework as a result of the Bank's increased participation in international fora.

Question 11

The Governor's Foreword to the 2010–11 Annual Report notes that international engagement has been 'absorbing more of the Reserve Bank's staff resources' and 'particularly participation in international groups working towards international regulatory reform'.[2] Please outline any changes to the integrity framework of the Reserve Bank directed at addressing the heightened exposure of staff to corruption risks during international engagements.

Response:

See response to Question 10 above.

Reserve Bank of Australia
SYDNEY

31 May 2012

2 Reserve Bank, *Annual Report 2011*, Governor's Foreword, p 1.