5. CORPORATE GOVERNANCE

Corporate governance provides the system by which companies are directed and controlled, to ensure that duties are exercised according to laws, regulation and codes of conduct.[98] Company leadership, specifically the board of directors and the executive management team, are progressively held responsible for the design, implementation and monitoring of sustainability objectives and performance.[99] This is no different for banks. It is crucially important that the leadership drives social and environmental causes, as they create a precedent for the entire firm. However, the governance of sustainability is still at an early stage, as there are few directors with direct responsibility for sustainability.[100]

Indicator	ANZ	CBA	NAB	WBC	Asia	Europe	N. America
Board	✔	✘	✘	✔	1/8	6/11	6/7
Management	✔	✘	✘	✘	3/8	2/11	1/7

Sustainability committees mark the priority given to sustainable governance mechanisms at the peak of the organisational pyramid. Half of the Australian banks have a board committee, while only one has a management committee that deals with sustainability matters. Yet a closer look reveals little real commitment, as demonstrated by the committee charters: ANZ's Governance Committee merely includes an ambiguous statement that its task is to "[…] review and approve the proposed corporate sustainability objectives for the Company, and review progress in achieving them."[101]

The board committee at WBC that addresses sustainability, called the "Board Risk and Compliance Committee", formulates a similarly general and vague statement by mentioning that the committee will "[…] review and approve other risk management frameworks not specifically referred to in this Charter, and/or review the monitoring of performance under those frameworks (as appropriate)."[102] These are described as including "[…] other risks (including environmental, social and governance risk, equity risk, related entity risk, insurance risk, anti-money laundering, counter terrorism financing, bribery and corruption, and others as identified by the Committee)."[103]

At the executive management level, ANZ's "Corporate Sustainability & Diversity Committee" is somewhat more encouraging. The committee is described as "[…] a strategic leadership body performing an oversight, advisory and advocacy role in achieving the Group's agenda and priorities."[104] Its purpose is to advise management and other governance bodies, set strategies, policies and targets, and ensure leading practice in the management and disclosure of corporate sustainability. Yet the committee's efficiency is questionable, as ANZ is the largest funder of coal mining projects in Australia, and has lead the funding efforts of the Maules Creek mine as well as the Alpha Coal Project. Therefore, while a management focus on sustainability issues is laudable and desirable, it does not automatically mean that adverse impacts are avoided.

Overall, the findings suggest that leadership in banks is not commonly focused on, or driving, social and environmental strategy. Indeed, the fact that leadership – management specifically - needs to make significant advances in the area of governance is illustrated by the comments of employees involved in the Australian financial planning scandal, who want to "[…] bring to light senior management as the drivers of much that is wrong in the industry. Until senior managers are named and shamed the bank will continue to chew through the bottom ranks as the body count rises as an accepted cost of doing business."[105]

Business Ethics

Research shows that "[…] prevailing business culture in the banking industry weakens and undermines the honesty norm."[106] The majority of banks, including all four Australian banks, have formulated and disclosed a code of conduct outlining appropriate behaviour and ethics. It is important to note that some corporate governance regimes, such as the ASX Corporate Governance Principles and Recommendations, require listed companies to establish a code of conduct and to publicly disclose at least a summary of the code. Thus the compliance of Australian banks is not surprising. More remarkable is the considerable divergence in the types of codes, their content, and whom they apply to.

Indicator	ANZ	CBA	NAB	WBC	Asia	Europe	N. America
Code of Conduct	✔	✔	✔	✔	6/8	11/11	7/7

For example, CBA lists eleven codes of conduct on its website, of which only five have been made public.[107] Despite the description in the ASX Corporate Governance Principles and Recommendations, it is unclear which of the codes describes "[…] the practices necessary to maintain confidence in the company's integrity, to take into account their legal obligations and the reasonable expectations of their stakeholders, and the responsibility and accountability of individuals for reporting and investigating reports of unethical practices."[108]

WBC's code "[…] describes the standards of conduct expected of our people, both employees and contractors […] to help us make the right decision every time."[109] It is unclear whether the code applies to directors as well. Another document, called the "Principles for Doing Business", sets out WBC's "[…] commitment to sustainable business practice."[110] Similar to the code of conduct, the Principles do not seem to apply to directors: "[…] employees and contractors who breach the Code of Conduct or Our Principles may face disciplinary action including termination of employment or termination of their contracts."[111]

ANZ has codes of conduct for its staff[112] and its directors.[113] In the codes, the bank states that it "[…] aims to deliver superior long-term total shareholder return, taking proper account of employees, customers and others with whom we do business as well as the communities and environments in which ANZ operates. In striving to achieve these aims, we should not compromise our ethics or principles."[114] While the codes apply to staff and directors, they suffer from the shareholder primacy paradox: what happens when the focus on maximising shareholder profits conflicts with community and environmental factors?

This paradox is also present in NAB's code of conduct, in which the bank states it is "[…] committed to achieving sustainable performance and delivering value to our customers and shareholders while maintaining our beliefs, behaviours and trusted reputation."[115] Yet, the bank does not explicitly mention what sustainable performance means. While the code mentions "community and respects human rights", it does not mention the environment. Overall, it is unclear which codes of conduct apply to whom, while the principles in the codes are often vaguely formulated and can at times be contradictory.

More importantly, it should be noted that the codes of conduct are accompanied by different accountability mechanisms. For staff members, directors and parties with whom banks are engaged in contractual relationships, the codes of conduct express duties, which means that transgression can result in the termination of employment or the business relationship. Yet, for community stakeholders, the codes of conduct convey social norms, meaning that transgression results in public disapproval. Consequently, societal stakeholders can use the codes of conduct to question a bank's **social license to operate.**

Remuneration

In general, firms are increasingly integrating non-financial elements into their remuneration structures, although still to a limited extent and in a narrow manner. Research using data covering 3,512 international companies shows that only ten companies linked staff remuneration to environmental and social performance at the board level, while only 32 firms did so at executive management level.[116] A study covering 600 publicly listed companies demonstrates that 7% explicitly link executive compensation to social and environmental matters, while an additional 9% of companies do so without making reference to targets and weighting of social and environmental issues.[117]

Indicator	ANZ	CBA	NAB	WBC	Asia	Europe	N. America
Non-financial performance	✔	✔	✔	✔	0/8	8/11	2/7
Health & Safety performance	✘	✘	✘	✔	0/0*	0/8*	0/2*
Environmental performance	✘	✘	✘	✘	0/0*	0/8 *	0/2*
Customer satisfaction	✔	✔	✔	✘	0/0*	4/8*	1/2*
Employee satisfaction	✔	✘	✔	✘	0/0*	1/8*	1/2*
Community	✘	✘	✔	✘	0/0*	2/8*	0/2*

* Banks that incorporate non-financial measures in remuneration

This report looks at a number of non-financial performance measures relating to executive management compensation. Sixteen banks mention that they link non-financial measures to remuneration of executive management. Only a few banks further elaborate on specific performance areas. Considering the figures in other studies, banks in the sample seem to perform above average. Yet, a closer look shows that customer and employee satisfaction are mentioned most often, which is unsurprising considering their link to financial performance. Conversely, health and safety, environmental performance and community indicators are linked to remuneration to a lesser extent or not at all.

Remuneration structures that integrate environmental and social performance are often considered a missing piece of the corporate responsibility puzzle. [118] In the survey, 58% of respondents believe that rewards in the banking sector should be linked to social and environmental performance. Yet, several hurdles are associated with linking remuneration to environmental and social goals. Challenges concern balancing of short and long-term objectives, as well as the quantifying and weighting of environmental and social measures. [119] The major concern here is that the percentage of compensation related to environmental and social measures may be small and unlikely to be a significant motivator, especially compared to bonus packages linked to profits.[120]

While all four Australian banks have incorporated non-financial performance in the remuneration schemes of senior management, there are indications that it should be a part of remuneration schemes throughout the entire organisation. For example, remuneration structures in one of the scandal-ridden financial planning divisions in Australia are said to have "[…] a heavy bias to product sales and new clients rather than existing clients."[121] This suggests that, beyond integrating non-financial indicators in the remuneration of the executive management team, compensation structures throughout the banking sector need to be balanced in order to abolish perverse performance incentives.

Summary

The figures suggest that social and environmental matters are not commonly prioritised at the board or management levels of banks, nor does the leadership convincingly champion sustainability strategies. Relevant committees either do not exist or inadequately address sustainability issues, as evidenced by the range of banking malpractices outlined in this report. While business ethics are described in codes of conduct, it is not always apparent to whom they apply, nor are social and environmental responsibilities clearly formulated. In addition, banks create a moral conundrum by emphasising shareholder profits together with their social and environment commitments.

Although banks link non-financial measures into executive compensation, social and environmental objectives are inadequately integrated, as shown by the emphasis on customer and employee satisfaction, which suggests profit and reputation motives. Overall, it should be noted that these indicators only reveal a part of corporate governance mechanisms in banks. Yet the earlier discussion of lending policies and risk management, particularly the continued financing of unsustainable activities, suggests environmental and social matters are not generally integrated into corporate governance systems. If those systems are authoritatively regulated – they can achieve increased accountability and the embedding of sustainability principles in banking strategies.