

Glenn Stevens: Reserve Bank of Australia reviews Note Printing Australia and Securrency

Opening statement by Mr Glenn Stevens, Governor of the Reserve Bank of Australia, to the House of Representatives Standing Committee on Economics, Canberra, 8 October 2012.

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Madam Chair

Members of the Committee

Thank you for the opportunity to meet with you today. This is an occasion on which we can convey a good deal of information and answer questions.

In line with the commitment I made to the Committee in August, we have provided a folder of documents which shows the process that the Board of Note Printing Australia and the Reserve Bank conducted in 2007 when concerns were raised inside NPA regarding that company's use of sales agents in some foreign jurisdictions.

As the Committee knows, criminal prosecutions have been launched about these matters and the legal processes have some time to run. It is very important that the Reserve Bank does not say or do anything which would improperly impinge on any legal process, most particularly not in a public forum. There are accordingly documents which, I am advised, we should not table at this time. Others have had to be redacted. A number of the individuals accused have expressed concerns regarding the possibility of publication of this material and the Bank has decided we should not publish it. But there is a list of documents that are relevant. If at some stage the constraints are able to be lessened, then the Committee will know what documents may be of interest.

We have also provided a covering *memorandum* which does several things. First, it provides some background to two companies:

- Note Printing Australia (NPA), which prints banknotes; and
- Securrency, which produces polymer substrate.

This history dates back to their respective establishments in the 1990s. For Committee members or members of the public who want some general understanding of who these companies are and what they do, this may be helpful.

Second, the memorandum goes through in detail the sequence of events that began with the Reserve Bank Board asking about the use of foreign sales agents by both the companies in April 2006.

Thirdly, it gives an account of the way Securrency, NPA and the Reserve Bank behaved after the allegations, initially only about Securrency, were aired in the media in May 2009.

The memorandum shows how the various documents we have identified, many of which we have provided, fit into the chronology. I would like to go through that now.

Request to see policies on the use of agents in 2006

The Reserve Bank Board discussed the issue of the use of agents by the two companies at its meeting in April 2006. As a result of that discussion, the two companies were asked to provide the Reserve Bank Board with their policies on agents. Mr Thompson, at that time Chairman of the Boards of both NPA and Securrency, responded to this request in July 2006, and provided the policies and associated documents for both companies. This correspondence noted that the companies had recently reviewed and strengthened their

policies. While each company had its own policies and procedures, both articulated the following key elements:

- the respective boards reaffirmed the companies' policies against any direct or indirect involvement in corrupt, unethical or otherwise questionable practices, and asked management to ensure that all agents formally acknowledge and commit to this policy. The agency agreements provided for termination when this commitment was breached;
- a process was established to inform the respective boards about the appointment of agents, the applicable commission rates and payments made; and
- a process of annual review of these policies was established.

The NPA Board sought updates on implementation of its revised policies at the February 2007 NPA Board meeting. On hearing management's responses, the NPA Board requested that faster progress be made and that an Information Paper on the state of play with agents be prepared for the May 2007 meeting. The RBA, through the Assistant Governor (Corporate Services) and director of NPA, Mr Campbell, also sought or received updates on the implementation of the policies from the NPA Manager of Corporate Service. in November 2006 and March 2007. No probity concerns were raised in response to these requests for updates.

The May 2007 NPA Board Paper, the audit at NPA and the memo from the NPA manager

During the course of implementing the revised agent policies at NPA, in about mid April 2007, the NPA Manager raised concerns with Mr Campbell (Assistant Governor (Corporate Services) of the Reserve Bank, and director of NPA) about comments that had apparently been made by two of NPA's agents and about the conduct of certain NPA management. Mr Campbell encouraged the NPA Manager to seek answers to the queries he raised and to include his concerns in the May 2007 NPA Board paper on agents which had been requested by the NPA Board.

The paper, authored by the NPA Manager (as Company Secretary) and the CEO, was presented at the 16 May 2007 NPA Board meeting. It noted that two of three agents had yet to sign on to the new arrangements. The paper raised issues as to whether the management of NPA's agents was occurring in accordance with the strengthened policies put in place in 2006. It expressed the concerns about the two agents, partly based on things that they had apparently said to the NPA Manager. In one case the agent had replied to questions in writing denying any improper conduct. In the other case a verbal explanation had been offered but no written response. There were some other irregularities noted.

The paper's recommendation was simply that "Directors note this paper". The NPA Board in fact expressed deep concern as to the management of NPA's agency agreements. The NPA Board at that May 2007 decided, among other things, to:

- terminate the contracts of two agents; and
- ask that a review of all agent files be undertaken by management.

After the NPA Board meeting Mr Campbell advised the Governor and the Deputy Governor of the NPA Board's decisions. After discussion they formed the view that NPA's response could be strengthened if, rather than simply a review by NPA management being conducted, the Reserve Bank's Audit Department were asked to carry out an audit of NPA's use of agents. This was conveyed to Mr Thompson, who agreed and made a request to the Head of the Audit Department. The Reserve Bank Board was advised at its 5 June meeting about this.

The draft audit report of NPA agents was received by the Chairman of NPA, Mr Thompson, on 5 June 2007. It was also received by Mr Battellino in his capacity as Chair of the Reserve Bank Audit Committee, which served as the Audit Committee of NPA. The draft report contained findings of poor business practice and controls and noted that the behaviour of some agents should have raised suspicions by NPA staff and management. Based on these findings, the draft report made a number of recommendations. Two key ones were that:

- the use of agents should be limited to the extent possible; and
- NPA staff should be counselled on the risks associated with the use of agents in some countries.

The draft report also contained a number of recommendations for tightening controls in relation to agents.

Mr Battellino as chair of the Audit Committee of NPA discussed the draft audit report's recommendations with the Head of Audit Department and suggested that the recommendations should be strengthened to say that NPA should cease all use of agents, and that the NPA Board should conduct an urgent investigation on the role of management and staff in dealing with agents, to ensure that there had been compliance with Australian laws. These suggestions and some other proposed drafting changes were accepted.

Mr Battellino also asked that the NPA Manager, who had played a key role in preparing the May 2007 NPA Board paper, had assisted the audit, and who had voiced concerns to Mr Campbell in April, be requested to come to the Reserve Bank's Head Office in Sydney and to put any concerns he had directly to the Bank, and to do so in writing. The NPA Manager agreed to do so, but only on the condition that his visit be kept strictly confidential and having been assured that his statement would be read only by a very small number of people – the Deputy Governor and perhaps the Governor. (It was not provided to the Governor.)

The meeting between the NPA Manager and the Deputy Governor took place on 5 June, the same day as the draft audit report became available. At the request of the Deputy Governor, on 8 June the NPA manager supplied a written statement through his lawyer to the Reserve Bank's legal counsel on strict terms of confidentiality required by him. The Deputy Governor read it. The same document with some very minor changes was, at the Bank's request, subsequently provided by the NPA Manager's lawyer directly to the Freehills team who were engaged by the NPA Board sub-committee, also on terms of strict confidentiality and on the basis that it would be returned to the NPA Manager's lawyer which it was.

On 7 June 2007 the Reserve Bank senior management discussed the draft audit report with Mr Thompson. It was agreed that the draft audit report contained serious findings and that the NPA Board needed to meet and put in place a detailed response to the matters raised. It was agreed that, in line with the audit recommendations, the NPA Board should establish a sub-committee to investigate NPA management and staff in their dealings with agents. It was also agreed that a similar audit of the use of agents by Securrency should be requested, pending which payments to Securrency's agents would be suspended.

The final NPA audit report, which contained the strengthened recommendations, was provided to the NPA Board on 8 June 2007. On that day, Mr Battellino sent to the Reserve Bank Audit Committee a copy of the audit report, as well as a copy of a file note of the meeting with the NPA Chairman the prior day.

The response to the audit

The NPA Board met on 12 June 2007. In response to the audit, it decided to cease the use of agents. It also decided to establish an NPA Board sub-committee to investigate the conduct of NPA management in the use of agents, to implement the recommendation in the audit report. The sub-committee was to be chaired by Mr George Bennett, former KPMG

managing partner and independent member of the Reserve Bank's Audit Committee. Other members were Mr Warburton, a non-executive director of NPA and former Reserve Bank Board member, and Mr Campbell. Since NPA had no legal counsel, the Reserve Bank's General Counsel was appointed legal counsel for the NPA Board for the investigation. The Reserve Bank Board secretary, who also acted as secretary of the Reserve Bank Audit Committee, was secretary of the sub-committee.

A special meeting of the Reserve Bank's Audit Committee (which, as noted above, served as the Audit Committee of NPA) was convened on 13 June 2007 to consider the audit report. The Audit Committee endorsed the decisions taken by the NPA Board. It also took the view that the terms of reference of the sub-committee should be widened to include an assessment of compliance with appropriate business standards and conduct, as well as Australian law, and that independent legal advice should be sought. Minutes of the Audit Committee were, as per normal practice, provided to the Reserve Bank Board at its next meeting, which was in early July. The Reserve Bank Board was informed at that July meeting of the results of the audit and the steps that were being taken in response. It asked that the investigation be carried out quickly and that, if necessary, serious disciplinary action be taken. The Reserve Bank Board was also informed that a similar audit at Securrency had been commissioned.

The NPA Board sub-committee decided to engage Freehills to carry out an independent investigation into the question of whether Australian law had been breached and into NPA's business standards. The sub-committee had an initial meeting with the Freehills team on 18 June 2007 and subsequent meetings on 16 July, 25 July and 10 August 2007. The Freehills team had access to documents, including the audit report and the NPA Manager memo, and a substantial volume of emails held at NPA, including materials that the auditors had not reviewed. It also interviewed several NPA managers including the NPA Manager who had been invited to prepare the memo, the CEO and others.

Mr Bennett provided an update on progress of the NPA Board sub-committee's work to the Reserve Bank Audit Committee at its 30 July meeting.

The Freehills team provided their final report to the NPA Board sub-committee on 10 August 2007. The sub-committee considered the report. On 13 August the sub-committee Chair, Mr Bennett, provided the final report to the Chairman of the NPA Board, Mr Thompson, together with a cover note. Mr Bennett noted that the inquiry had not found evidence of a breach of Australian law, but had found deficiencies of varying seriousness in relation to business practices. By this time the NPA Board had, as noted above, already taken the decision to cease using agents. A copy of the sub-committee's report including the Freehills report was also reviewed by the Deputy Governor. At its 7 August 2007 meeting, the Reserve Bank Board was briefed about the draft findings of the Freehills report. It was also informed about the results of the audit at Securrency, which are discussed in more detail below.

Mr Bennett attended the NPA Board meeting on 16 August to brief the NPA Board on the sub-committee's findings. On 29 August 2007, the NPA Board met again to discuss the report of the NPA Board sub-committee in more detail. It concluded that after an extensive investigation with assistance from external lawyers, the sub-committee had identified instances of weakness in controls and documentation, and in contract management, but it had found no evidence of illegality or impropriety by NPA managers and staff.

The NPA Board resolved that proper process meant that the NPA employees who had been interviewed as part of the sub-committee's investigation should be given the opportunity to read relevant parts of the Freehills report, and to provide comments to the NPA Board if they wished. Subsequently, extracts of the Freehills report were shown to those NPA employees.

The NPA Board met again on 13 September 2007 to consider the comments received from the employees.¹

A follow up review of NPA agent arrangements was conducted by the Reserve Bank Audit Department in late 2008. That report concluded that NPA had implemented all the recommendations of the May 2007 NPA audit report.

The 2007 audit of Securrency

Given the results of the audit of NPA, and given that Securrency also used agents, it was considered necessary to have a similar audit at Securrency. Although Securrency had its own external auditors, the senior management of the Reserve Bank agreed with Mr Thompson that, in his capacity as Chairman of Securrency's Board, he would ask the Reserve Bank Audit Department to conduct the audit, due to their experience with the NPA audit. Mr Thompson subsequently emailed the Head of Audit, asking for the audit to be undertaken, with the scope of the audit to be similar to that carried out at NPA. The Securrency Board meeting on 3–4 July noted this had occurred. It also endorsed a decision that had been taken by the Securrency management to terminate the Malaysian agent.

The same audit team that had conducted the audit at NPA conducted this audit at Securrency. The audit began on 18 June. At the same time, Securrency also suspended its payments to agents, pending the result of the audit.

The Securrency audit report was issued on 1 August 2007. The conclusion was that Securrency had a "good and robust process" in relation to the use of agents, and that Securrency's practices were consistent with the company's policy. The audit made a number of recommendations. The audit team supported Securrency's termination of the Malaysian agency agreement, which took effect from 15 July 2007. The Securrency board was informed at its 11–12 September 2007 meeting that the audit recommendations had been implemented.

The findings provided no basis to insist on the termination of Securrency's other agents. The suspension of payments to agents was therefore lifted.

A copy of the Securrency audit report was forwarded by Mr Battellino to the Reserve Bank Audit Committee and the results of the audit were also noted at the August 2007 meeting of the Reserve Bank Board. The following year – in December 2008 – a further audit of agent activity at Securrency was undertaken. It reached similar conclusions as the 2007 Securrency audit.

Post-termination payments to agents by NPA

The NPA Board considered what payments were due to agents who had been terminated. It sought legal advice on the question of payments to one agent in particular. After a lengthy process of legal advice which concluded that the agent would likely succeed in a legal action claiming an entitlement to commission, NPA management proposed at the 26 September 2007 NPA Board meeting that a commercial settlement be sought. On the basis of the legal advice received, the NPA Board approved the recommendation and further discussions took place through the respective lawyers of NPA and the agent. A settlement was finally agreed between the agent and the CEO of NPA, and advised to the NPA Board in May 2008.

¹ Following the September 2007 NPA Board meeting, Mr Thompson resigned as Chairman. The Reserve Bank then appointed Mr Campbell as interim Chairman. A new CEO of NPA was appointed in early 2008. In April 2008, Mr Campbell was succeeded by Dr Bob Rankin. Dr Rankin also took on the chairmanship of Securrency after Mr Thompson resigned from that role in March 2008.

Post-termination payments to agents by Securrency

Securrency sought legal advice from its external legal advisers on its obligations to the agent that it terminated. On the basis of this advice, the Securrency Board at its 11–12 September 2007 meeting decided that the agent should be paid for work done prior to termination in terms of the contract.

The 2009 allegations about Securrency

On or about 20 May 2009, *The Age* sent Securrency a number of questions regarding Securrency's use of agents, which Securrency responded to on 22 May 2009. On 21 May 2009, the Chairman of Securrency, Dr Bob Rankin (who had succeeded Mr Thompson as Chair of the Board of Securrency) contacted KPMG to discuss conducting a review of Securrency's agent policies and procedures. *The Age* subsequently indicated, on 22 May 2009, that it was going to run a story on the matter.

On 22 May 2009, Dr Rankin contacted the Australian Federal Police regarding the matter and proposed that an investigation be conducted.

On 23 May 2009, *The Age* published articles regarding Securrency's use of agents. Subsequent stories noted that NPA had discontinued the use of agents in 2007.

That same day, Dr Rankin formally requested that the AFP conduct an investigation in connection with the allegations made in the media. Dr Rankin consulted with the Reserve Bank prior to making this request.

At his first meeting with the AFP on 26 May 2009, Dr Rankin referred to the audit conducted at NPA in 2007 and the Freehills report and made them aware of the documents and the AFP indicated that it would request those documents if and when they were required and that they had a certain process to follow. Those documents were subsequently requested in approximately January 2010 and provided on 1 February 2010.

At the meeting on 26 May 2009, Dr Rankin also raised with the AFP the prospect of Securrency obtaining an independent review of Securrency's agent policies and procedures by KPMG. At the request of the AFP, Securrency did not immediately retain KPMG, so as not to hinder the AFP's initial access to documents.

In early June 2009, the Reserve Bank Board was provided with an update on Securrency's referral to the AFP for investigation. The Reserve Bank Board was informed that the AFP's investigation was in an assessment phase, during which the AFP would determine whether a further investigation was necessary. The AFP informed Securrency around the end of June 2009 that the AFP would proceed with a full-scale investigation and that it did not object to Securrency engaging KPMG.

Securrency offered full cooperation to the AFP, as did NPA when the AFP inquiry was subsequently widened to include possible wrongdoing at NPA.

In July 2009, with the AFP's agreement, the Board of Securrency approached KPMG and asked them to conduct an independent investigation of Securrency's policies and procedures regarding agents. The Reserve Bank Board was subsequently informed at its July 2009 meeting that Securrency had engaged KPMG to conduct an independent review of Securrency's agent policies and procedures.

In October 2009, KPMG informed Dr Rankin that KPMG had discovered documents indicating that a former employee of Securrency had raised concerns over the use of overseas agents in early 2007. A progress report was provided by KPMG to the Securrency Board in November 2009 which confirmed that their forensic work had discovered material which indicated concerns about possible corrupt payments had been raised by a Securrency employee with Securrency senior management in early 2007. These concerns had never been made known to the Securrency Board or the Audit Department when it conducted either

the 2007 or 2008 audits. At the time the CEO and CFO of Securrency were stood down and the use of agents suspended pending further inquiry. The preliminary findings reported by KPMG also indicated that there had been failures to fully implement the procedures specified in Securrency's agent policies and procedures.

KPMG's final report was released publicly by Securrency in March 2010. It contained a number of recommendations, which have been implemented.

The charges

Charges were laid against a number of individuals who were former employees of NPA and Securrency from July 2011. The companies were also charged. Further charges were laid against Securrency in August 2011, and NPA in September 2011. The charges alleged conspiracy to offer to pay, or pay, a benefit to a foreign official not legitimately due, in a total of four foreign jurisdictions. Malaysia (October 2001 – December 2003, both NPA and Securrency), Indonesia (December 1999 – February 2001, both NPA and Securrency), Vietnam (January 2001 – September 2004, Securrency only) and Nepal (February 2000 – May 2002, NPA only, with no individuals as yet charged over Nepal).

At the time of writing, matters remain before the Courts.

What has been done at the companies?

While this is perhaps not really a question for today, it is worth recounting what steps have been taken to strengthen arrangements at both companies. I outlined in July 2011 a number of these.

Of course the persons charged with wrongdoing are no longer with either company.

The use of foreign sales agents at NPA ceased in 2007 as a result of the NPA audit at that time. NPA these days operates under a tighter charter to keep its focus more closely aligned with the Bank's core objectives and risk tolerance. The Bank has changed the composition of the Board. NPA's principal focus over the years ahead will include the production, later this decade, of a series of upgraded banknotes for Australia.

In the case of Securrency, the use of sales agents was also discontinued after the KPMG report. Policies were overhauled as recommended in that report. We have also, as you know, announced our intention to exit our shareholding in Securrency.

Both companies are of course continuing to cooperate with the authorities in resolving the issues.

The Bank has continued to give a good deal of thought to its overall governance of the two companies. The Reserve Bank Board has had discussion on these issues over the past year or so, and has benefited from advice from external experts on corporate governance. I am of course happy to provide any further information that the Committee may wish on these matters.

That concludes my opening remarks.