

9 September 2017

Senior Adviser
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The Treasury
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via email: crisismanagement@treasury.gov.au

Dear Sir / Madam

APRA crisis management powers

Thank you for the opportunity to provide a submission on the *Financial Sector Legislation Amendment (Crisis Resolution Powers and Other Measures) Bill 2017 (Exposure Draft)*, and the associated draft explanatory material (together, the **Crisis Management Reforms**), released on 18 August 2017.

The Australian Institute of Company Directors (**AICD**) is committed to excellence in governance. We make a positive impact on society and the economy through governance education, director development and advocacy. Our membership of more than 40,000 includes directors and senior leaders from business, government and the not-for-profit sectors.

The Exposure Draft proposes to provide APRA with an enhanced suite of crisis resolution powers which are applicable to prudentially regulated ADIs, general insurers, life insurance companies, and certain group entities.

The AICD recognises the importance of APRA having the necessary powers to enable it to perform its functions effectively and expeditiously, including the resolution of regulated entities in distress. While the proposed powers in the Crisis Management Reforms are extremely broad, it is desirable that, in the event of a crisis or impending financial crisis, APRA has as many options in the 'regulatory toolkit' as is reasonably necessary to ensure the effective management of the crisis.

For this reason, the AICD supports this package in principle, and the government's efforts to promote a resilient financial system for the benefit of the economy and society. We note that reform to strengthen APRA's crisis management powers was a key recommendation of the Financial System Inquiry and we welcome their progression.

However, noting the breadth of the proposed new APRA powers, and the fact they apply to entities which are not otherwise regulated by APRA, it is also essential that they be subject to appropriate checks and balances.

While our submission focusses on the immunity provisions for directors when complying with an APRA direction, we encourage the government to give further consideration to appropriate checks and balances such as merits review mechanisms, direct ministerial oversight and court supervision as appropriate.

1. Summary

In considering the Crisis Management Reforms, our submission is concerned with the proposed immunity for directors and other officers when complying with an APRA direction.

In summary:

- The AICD strongly supports the introduction of a specific immunity provisions¹ for directors and management when complying with an APRA direction within the Industry Acts. An immunity is clearly necessary to ensure that directors can fulfil an APRA direction without reluctance, distraction or delay.
- The AICD recommends that the immunity provisions also apply to protect the entities which are subject to the direction, including ADIs, NOHCs, and related bodies corporate. There is a significant risk that, in the event of an APRA direction, an entity will be subject to legal claims (including class action claims) as a consequence of contraventions which, but for the APRA direction, would not have occurred.
- The AICD is concerned that the new immunity provisions are unnecessarily qualified by a 'reasonableness' requirement. This qualification should be removed. It risks unintentionally inhibiting the ability of directors and officers to act quickly, and with certainty, in implementing a direction from APRA.
- Directors and officers of some APRA-regulated entities are also subject to foreign legal obligations. The AICD is concerned that the proposed immunity provisions would not protect directors and officers from liability for breaches of foreign laws. Given the importance of the immunity in enabling directors and officers to fulfil an APRA direction without reluctance, distraction or delay, the AICD strongly recommends the government establish measures to ensure directors and officers are protected from liability resulting from a breach of foreign laws.

2. Period of consultation provided

It is essential that any reforms purporting to change regulatory settings be progressed in a careful manner, to avoid unintended consequences and legislative anomalies. In the AICD's view, the consultation period provided for the Crisis Management Reforms has been insufficient.

The AICD recommends that a meaningful opportunity be provided for the community and business to consider the Crisis Management Reforms and their practical implications. In light of the limited time available for review, the AICD has focused only on the immunity proposals in relation to directions by APRA.

3. Immunity provisions

As an APRA direction may require a director or officer to act in a manner that may breach another law, it is important and just that they be provided with an appropriate and effective immunity. The AICD agrees that the current immunity within s 70A of the Banking Act is inadequate.

The AICD considers the introduction of protection from liability for directors and other officers (including senior managers) when complying with an APRA direction to be a critical component of the proposed reforms. Directors and officers are subject to a wide variety of obligations and liabilities, and a range of statutes impose both civil and criminal personal liability on officers for

¹ Schedule 1, item 115, Schedule 2, item 118, Schedule 3, item 92, section 70AA of the *Banking Act*, section 127C of the *Insurance Act*, and section 246B of the *Life Insurance Act*.

their actions, or the actions of their companies. Many of these are strict liability provisions, or reverse the onus of proof, requiring a director to establish that he or she took reasonable steps to prevent a contravention taking place.

A strong and clear immunity will avoid unnecessary delay on the part of directors and officers in responding to a direction. Given that a failure to comply with an APRA direction is itself a criminal offence, it is in accordance with justice that appropriate immunity provisions be provided to directors and officers.

The introduction of new immunity provisions will also reduce the risk of APRA's directions power being read down by a court. Without appropriate immunity provisions, there is a risk that a court could construe APRA's direction power to be only exercisable to the extent that the direction did not require a person to do something which would result in the contravention of any other state or federal law.

4. Coverage of entities

APRA's directions power, as proposed, has the capacity to supplant ordinary lines of governance and accountability within regulated entities. An APRA direction may leave that entity exposed to potential liability for actions or omissions which are not otherwise protected by the equivalent of s 70A of the Banking Act.

It is foreseeable that, in the context of the use of an APRA direction or secrecy determination, there is a risk that shareholders or others may suffer loss or damage. The AICD has concerns that the failure to provide strengthened immunity provisions for entities themselves which are subject to an APRA direction risks opening them up to a significant risk of legal liability, including opportunistic class actions.

In addition, given that directors and officers are subject to legal duties which relate to the interests of the entity (including directors duties under the Corporations Act), directors and officers will be exposed to a conflict of duty, given that they are entitled to an immunity while the entity they govern is not. It is clearly desirable that the entity and the director's interests align, particularly during a crisis, so that concerns as to legal liability and conflict are minimised to the greatest extent possible.

For these reasons the AICD recommends that immunity be extended to entities, as well as directors and officers.

5. Qualification of Reasonableness

The new immunity provisions in the Exposure Draft only apply to a person who is doing a thing, or omitting to do a thing, to comply with an APRA direction where it is 'reasonable' for the person to do so to achieve that purpose.

Little guidance is given in the Exposure Draft, or any of the explanatory material, as to what actions might be considered reasonable, or what criteria is to be used in considering whether an action is reasonable or unreasonable. The only interpretative assistance is given in the draft explanatory memorandum, which states that the reasonableness standard applies to the course of action taken by the person to facilitate the direction.

The AICD is concerned that the standard of reasonableness imposed as a condition precedent for immunity risks importing a significant degree of ambiguity into the immunity provisions, defeating its purpose of ensuring legal certainty and avoiding reluctance or hesitation to act. In a crisis scenario, where complex decisions need to be made urgently and with often imperfect information, it is critically important that directors and officers are focussing on the issues at hand, and not on whether their actions will satisfy an ambiguous legal criteria. This risk is

exacerbated by the knowledge that any contested actions will be judged on an objective basis with the benefit of hindsight.

The meaning of 'reasonableness' within the context of the tort of negligence has been given many decades of judicial consideration, enabling it to be used with a degree of clarity in that particular area of the law. It is also a well-understood term within the interpretation of contractual clauses.

However, so far as we are aware, no such body of case law exists which could guide a director or officer on what might be considered 'reasonable' in the context of a statutory immunity. Given the rare circumstances in which APRA's directions power will likely be used, it is very unlikely that a significant body of case law will develop.

In addition, the AICD has not been able to identify any equivalent condition precedent in other immunity provisions in different contexts. Statutory immunities are commonly found within laws which enable government authorities to do certain things which would otherwise contravene laws. For instance, s 246 of the *Australian Securities and Investments Commission 2001* (Cth) provides that the Minister, ASIC, a member of ASIC, and several other persons listed in the provision are not liable to an action or proceeding for damages for the performance of their functions. Other immunity provisions can be found through numerous federal acts of parliament, including APRA's immunity provision in s 58 of the APRA Act. None of these immunity provisions are qualified by a criterion of reasonableness.

Immunity provisions are also used to protect persons who are assisting certain government agencies or regulators, or who make complaints which assist regulators in the performance of their functions. For instance, s 23 of the *Interactive Gambling Act 2001* (Cth) provides immunity from civil proceedings for a person who makes a complaint or a statement to the Australian Communications and Media Authority relating to persons who believe end-users in Australia can access prohibited internet gambling content using an internet carriage service. These immunity provisions do not contain a condition precedent of 'reasonableness'.

The AICD opposes the inclusion of a condition precedent of 'reasonableness' to the proposed immunity protections. It will add a significant degree of ambiguity to the protection. The need to obtain professional advice on the 'reasonableness' of proposed action before implementing a direction may cause undue delays. This is clearly undesirable, and would hamper expeditious resolution of prudential issues. Under the proposed reforms, immunity would only be enlivened in circumstances where the actions or omissions of the director or officer were done in 'good faith'. In our view, the good faith requirement provides a sufficient safeguard against improper reliance on the immunity.

If, contrary to our concerns, a 'reasonableness' condition precedent is adopted in the final legislation, the AICD strongly recommends the requirement be amended to reflect the concept of 'Wednesbury' unreasonableness.

Within Australian administrative law, an act or decision can be judicially reviewed on the ground of its 'unreasonableness', which is known as 'Wednesbury' unreasonableness. This ground expressly appears within ss 5(2)(g) and 6(2)(g) of the *Administrative Decisions (Judicial Review) Act 1977* (Cth). For a decision to qualify as unreasonable, it must have been 'so unreasonable that no reasonable authority could ever have come to it'.² In other words, the decision must be characterised as absurd, or bordering on absurdity.³

² *Associated Provincial Picture Houses Ltd v Wednesbury Corp* [1948] 1 KB 223 at 230.

³ Mark Aronson, Matthew Groves, *Judicial Review of Administrative Action*, (2013, Lawbook Co, 5th Edition) 369.

As an alternative to 'unreasonableness', consideration should also be given to other well-established concepts, such as 'dishonesty'.

6. Foreign legal obligations

There is a risk that an APRA direction may require an entity, or its directors and officers, to take an action which attracts civil or criminal liability in, or breaches statutory obligations or other duties of, a foreign jurisdiction. This issue is particularly relevant where the APRA direction is subject to a secrecy determination, given that entities are often also subject to duties under foreign disclosure laws.

The AICD is concerned that the proposed immunity provisions would not protect entities, directors and officers from liability for breaches of foreign laws in the event of a conflict between an APRA direction and the foreign law. Given the importance of the immunity in enabling a full and timely response to an APRA direction, the AICD recommends that the government investigate measures to ensure entities, directors and officers are protected from liability resulting from a breach of foreign laws.

In particular, the AICD strongly recommends that the government consider including a statutory indemnity for directors and officers from civil and criminal liability in the Exposure Draft. The indemnity should be triggered in circumstances where those directors and officers were implementing an APRA direction.

Without a statutory indemnity, directors and officers could be faced with criminal liability for failing to comply with an APRA direction or breaching a foreign law. Such a situation would clearly be unjust. While a statutory indemnity would not be able to protect directors and officers from certain types of criminal penalties (i.e. imprisonment) it would at least protect directors and officers from other forms of liability.

Consideration should also be given to qualifying APRA's directions power, or its secrecy provisions, so that APRA must have regard to the obligations of an entity, along with its directors and officers, in making a determination.

7. Conclusion

The Crisis Management Reforms contain a number of proposed changes to APRA's powers. As stated above, given the short period of consultation provided, the AICD has restricted its comments in this submission to the new immunity provisions at this time. The AICD may be able to comment in relation to other aspects of the reforms as they progress.

We hope our comments will be of assistance to the government. If you would like to discuss any aspect of this submission, please contact Matt McGirr, Policy Adviser, on (02) 8248 2705 or at mmcgirr@aicd.com.au.

Yours sincerely



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