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Mr Tony McDonald
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Dear Mr McDonald

# Banking Executive Accountability Regime: Consultation Paper

The Australian Bankers' Association (**ABA**) appreciates the opportunity to provide The Treasury with comments regarding the *Banking Executive Accountability Regime* (**BEAR**) *Consultation Paper* (**Consultation Paper**)[1].

With the active participation of its 25 members, the ABA provides analysis, advice and advocacy for the banking industry and contributes to the development of public policy on banking and other financial services. The ABA works with government, regulators and other stakeholders to improve public awareness and understanding of the industry's contribution to the economy and the community to ensure Australia's banking customers continue to benefit from a stable, competitive and accessible banking industry.

## Introductory comments

Australia has one of the strongest banking systems in the world. Our banks are well capitalised, the system is highly competitive and strongly regulated. Yet financial and prudential strength is only one measure of success. Equally important is a strong social licence to operate, backed by a strong regulatory framework, and accountability and transparency by banks.

The ABA welcomes reforms that strengthen accountability and competition in the banking system. We support enhanced responsibility and accountability of ADIs executives and the BEAR's stated policy intent to "provide greater clarity in relation to responsibilities and impose heightened expectations of behaviour in line with community expectations."

In April 2016, the ABA launched the **Banking Reform Program**, a package of measures designed to ensure that Australia's banks meet the expectations of their customers and the community. The Banking Reform Program is a fundamental change in the ways banks do their business. The initiatives will transform the culture and conduct of our banks to the benefit of customers.

Significant progress has been made, including the introduction of dedicated customer advocates, improvements to protections for whistleblowers to encourage a 'speak up' culture and improvements to customer remediation and compensation programs.

Independent reviews have been conducted into how banks reward staff (Sedgwick Review) and into how banks interact with customers (Khoury Review), both which have made significant

[1] http://www.treasury.gov.au/~/media/Treasury/Consultations%20and%20Reviews/Consultations/2017/BEAR/Key%20Documents/PDF/BEAR_cp.ashx

recommendations to improve banking practices and standards. Banks are making headway on implementing the recommendations of these reviews, including making changes to the way they pay staff, and undertaking a comprehensive redraft of the Code of Banking Practice.

There is a great deal of work which has been completed and work that continues to be implemented. Of course, there is more to be done. The ABA will continue to support the Government's proposals to strengthen accountability and competition in the banking system, including the BEAR.

This submission outlines a number of policy and design issues and makes some recommendations to ensure the BEAR meets its policy objectives, without triggering unintended impacts. The BEAR should avoid introducing competitive or regulatory distortions that negatively impact the efficient and competitive operation of the financial services industry, Australian financial markets or the consumer protection framework.

This submission is divided into three parts:

- **Policy issues and recommendations**
  - Clear regulatory roles
  - Competitive neutrality
  - Governance
  - Scope
- **Implementation and timing**
- **Appendix A: ABA response to questions posed in the Consultation Paper.**

# Threshold policy issues

## Clear regulatory roles

The BEAR will sit beside a number of existing prudential and legal duties, including:

- APRA's existing Fit and Proper and Governance obligations as set out in APRA Prudential Standards CPS 520 *Fit and Proper* (**CPS520**) [2] and CPS 510 *Governance* (**CPS510**)[3]
- APRA's existing risk management and risk culture obligations set out in APRA Prudential Standard CPS 220 Risk Management (**CPS220**)[4]
- Directors and officers duties under the Corporations Act[5] and common law
- Trust law and requirements for trustee companies, and
- Licensing requirements, including obligations of an Australian Financial Services Licence (**AFS Licence**) holder under the Corporations Act and the obligations of a holder of an Australian Credit Licence (**Credit Licence**) under the National Consumer Credit Protection Act[6].

For both regulators and Authorised Deposit-taking Institutions (**ADIs**) there needs to be clarity about how these obligations and responsibilities inter-relate. The ABA suggests that clarity can be promoted through a clear definition of 'systemic and prudential' to inform the scope of the BEAR and clearly distinguish its operation from these other regimes. Defining systemic and prudential behaviours will provide vital context to the new expectations.

[2] http://www.apra.gov.au/CrossIndustry/Documents/Prudential%20Standard%20CPS%20520%20Fit%20and%20Proper.pdf
[3] http://www.apra.gov.au/CrossIndustry/Documents/Final-Prudential-Standard-CPS-510-Governance-(January-2014).pdf
[4] http://www.apra.gov.au/CrossIndustry/Consultations/Documents/Level-3-Draft-Prudential-Standard-CPS-220-Risk-Management-(May-2013).pdf
[5] *Corporations Act* 2001 (Cth).
[6] *National Consumer Credit Protection Act* 2009 (Cth).

Importantly, the ABA supports ASIC maintaining its existing role as conduct regulator and enforcing consumer protection and market integrity requirements.

**Recommendation:** *The BEAR clearly defines 'systemic and prudential' to inform the scope of and provide context to the interpretation of the BEAR expectations.*

In the circumstances where the same conduct potentially touches two or more of the above regimes, it will be necessary for the Australian Securities and Investment Commission (**ASIC**) and Australian Prudential Regulation Authority (**APRA**) to produce joint guidance on how the regulators will respond to an issue in a coordinated manner (e.g. breach reporting obligations, interactions of ASIC's existing banning and disqualification powers with the new APRA banning and disqualification powers under BEAR).

Such guidance is critical for ADIs to understand how they can most efficiently engage with regulators. Without such guidance there is a real risk of different regulatory standards and expectations between regulators on the same conduct. Additionally, uncertainty will create regulatory duplication, unnecessary compliance costs for banks and inappropriate administrative complexity for the regulators.

**Recommendation:** *ASIC and APRA develop joint guidance on the treatment of the same issues between ASIC and APRA regimes, including expectations on breach reporting and the interaction between ASIC's existing banning and disqualification powers and APRA's banning and disqualification powers under BEAR.*

## Competitive neutrality

### Financial services industry

The BEAR should operate to preserve competition, promote consistent consumer protection, enhance accountability, and lift standards across the entire financial services industry. The ABA strongly believes that consumers should have confidence that the proposed accountability framework ensures the financial services industry operates at the highest standards.

One way to achieve this is for the BEAR to apply consistently across APRA's regulated population from its inception. For example, a standalone APRA-regulated insurer should be held to same standard as an insurer within a banking group.[7] This would give customers of non-ADI entities equal protections. Inconsistencies will create competitive and regulatory distortions, but also result in gaps in the consumer protection framework.

The ABA notes the UK Senior Manager and Certification Regime (**SMCR**) will be extended to all sectors of the financial services industry from 2018. The UK rationale[8] for applying the SMCR to the whole financial services industry is to enable the effective and efficient regulation of groups with a variety of financial services firms within them, to support a level playing field for competition, and to remove opportunities for regulatory arbitrage.

Systemic trust in the financial services industry comes from customers being able to trust all financial institutions within the system, regardless of whether they are (or are subsidiaries of) an ADI. The ABA notes that the Government is currently consulting on proposals to provide APRA with new powers in respect of the provision of credit by entities that are not authorised deposit-taking institutions (non-ADI lenders), to complement APRA's existing powers in respect of ADIs. As the consumer credit market evolves and transforms, it is only logical that all of the prudentially regulated population should be held to an equal standard to ensure good outcomes for all customers regardless of where they choose to 'bank'[9].

[7] This was the effect of the UK Prudential Regulation Authority (**PRA**) Senior Insurance Manager Regime (**SIMR**), which came into effect at the same time as the Senior Manager Regime (**SMR**).
[8] HM Treasury, *Senior Managers and Certification Regime: extension to all FSMA authorised persons*, October 2015, p3 [1.3]: https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/468328/SMCR_policy_paper_final_15102015.pdf
[9] The ABA notes that this position is not shared by one member, who believes that the BEAR should apply only to ADIs.

**Competition in the banking system**

The variable remuneration proposal within the Consultation Paper will have a greater impact on the ability of smaller and regional ADIs to attract and retain talent, thereby damaging their ability to compete with other employers both within and outside the BEAR. The ABA suggests the Government consider specific mechanisms to address the impact on smaller ADIs. For example, the BEAR could apply a threshold or materiality to the value of variable remuneration, below which the deferral provisions will not apply.

The variable remuneration proposal may also cause another competitive distortion that impacts all ADIs regardless of size. The application of the BEAR only to ADIs and ADI parent groups will alter the competitive neutrality within the ADI sector, particularly the ability of ADIs to attract and retain talent (Regtech, Fintech, etc.) from other parts of the financial services industry, other industries or overseas where there is already intense competition for these skills.

**Recommendation:** *The Government expressly considers mechanisms in the BEAR to reduce competition impacts on smaller ADIs.*

## Governance

The introduction of the BEAR to the extent possible should simply integrate with existing governance frameworks and requirements.

**Link with existing APRA's Fit and Proper (CPS510) and Governance (CPS520) regimes**

The BEAR could be most efficiently implemented via CPS 520 and CPS 510 to include all of the features of the BEAR. Such an approach achieves the same policy intent more effectively, reduces legal uncertainty as the principles are established and well understood, and would likely have significantly lower implementation costs for ADIs and APRA.

The ABA considers it is unnecessary and inefficient to create an additional and separate prudential regime to implement the BEAR when APRA's strong prudential framework can be leveraged.

**Recommendation:** *The BEAR is implemented through principles based legislation that builds, expands, and enhances the existing Fit and Proper and Governance regimes set out in APRA Prudential Standards CPS 520 and CPS 510.*

**Directors and officers duties**

The BEAR should not conflict with or duplicate existing Corporations Act and common law duties for directors and officers. The existing legal framework governing director and officer responsibilities is well understood and effective.

The Consultation Paper raises a number of questions as to how the BEAR is intended to interact with the duties and obligations of the Board and officers of an ADI.

In particular, the Consultation Paper proposes that an accountable person will be expected to 'act with integrity, due skill, care and diligence and be open and co-operative with APRA', in addition to taking reasonable steps to undertake other responsibilities for compliance and control of an ADI. This expectation is similar to, but broader than the existing directors' duty of care and diligence set out in section 180 of the Corporations Act, which applies to both directors and officers of a company.

The ABA notes that the director's duty under s180 of the Corporations Act is subject to defences, and qualifications including the business judgment rule (section 180(2)), the ability of directors to rely on expert advice (section 189) and delegations (section 190). There is an established public policy basis for these defences and qualifications, to ensure a balance is struck that allows for prudent risk taking. We suggest the Government consider including similar defences and qualifications to the BEAR expectations for accountable persons.

**Recommendation:** *It should be made clear that the BEAR does not increase existing directors' and officers' liability under the Corporations Act, and the defences and qualifications that apply under section 180 (such as, the business judgment rule (section 180(2)), the ability of directors to rely on*

*expert advice (section 189) and delegations (section 190) are not eroded. This will need to be expressly addressed in legislation.*

**Recommendation:** *The legislation giving effect to the BEAR specifically provides that the BEAR legislation does not expand the duties imposed on directors and officers under the Corporations Act and applies only in relation to APRA's powers under the new legislation in respect of registration and remuneration and regulations of the ADI.*

## Scope

### Roles and responsibilities mapping

The ABA strongly supports a principles-based approach to identify and describe key areas of responsibility within the ADI group, as relevant and applicable to the institutions business model and business lines.

The ABA understands that the proposed roles and responsibility mapping under the BEAR is intended to cover the entire business of an ADI, including governance mechanisms, risk frameworks, internal systems and procedures, and compliance with prudential standards.

When considering the practicalities of implementation, the ABA's preference is that the BEAR adopts an approach similar to the Hong Kong Managers In Charge regime (**HK MIC regime**) where an organisational chart must be provided to the regulator, setting out the Licensed Corporation's governance and management structure, business and operational units, key human resources and their reporting lines, including all managers in charge and their roles and responsibilities.

The ABA recommends the Hong Kong approach (in addition to the provision of accountability statements) rather than the responsibility mapping adopted in the UK SMCR, on the basis that the Hong Kong model appears to be a more practical and effective design in identifying accountabilities. This approach will ensure the BEAR achieves a coherence between the individuals and the behaviours the regime is intended to capture. Any approach should also consider the obligations already applicable to individuals who are subject to comparable regimes, in other (multiple) jurisdictions...

**Recommendation:** *The BEAR adopts the HK MIC approach (in addition to the provision of accountability statements) rather than the responsibility mapping adopted in the UK SMCR.*

### Application to directors

The remaining expectations are, in some cases, framed in a way that does not reconcile with the role of a non-executive director (**NED**). Notions such as "controlled effectively", and "activities or businesses for which they are responsible" are synonymous with the role of executives and management, rather than the oversight role of a non-executive director. We note that the issue was considered in the development of the UK SMCR[10] and the FCA concluded that NEDs should not assume executive responsibilities, and should therefore be excluded.

Given the ABA's support for a principles based approach to identifying BEAR impacted executives, and having regard to precedent in the UK, we believe the BEAR should exclude NEDs in principle, unless and to the extent they are fulfilling a role that would otherwise be identified using the reasonable persons principle in CPS520. For example, the BEAR might capture non-executive directors who are the chair of the audit, risk and remuneration committees but would not include other non-executive directors. In such cases, the expectations should correspond with the scope of their duties as committee chairs.

**Recommendation:** *The BEAR should exclude NEDs in principle, unless and to the extent they are fulfilling a role that would otherwise be identified using the reasonable person's principle in CPS520.*

[10] Consultation Paper FCA CP15/5*** PRA CP7/15 Approach to non-executive directors in banking and Solvency II firms & Application of the presumption of responsibility to Senior Managers in banking firms. Bank of England, Prudential Regulation Authority, February 2015. https://www.fca.org.uk/publication/consultation/cp15-05.pdf

**Subsidiaries**

The intended application of the BEAR to subsidiaries within an ADI group (both within and outside Australia) is unclear in the Consultation Paper. Most large-ADI groups will have hundreds of subsidiaries. Many of these subsidiaries will be holding companies, trustee companies, investment vehicles or companies that exist for historical reasons, most of which will not materially impact the ADI's business as a whole. In addition, for the most part, a potential 'accountable person' operating within the ADI subsidiary will report into a group executive and will not have autonomous management responsibility for the subsidiary on a standalone basis.

On that basis, the ABA strongly recommends a principles-based approach, using the concept of 'responsible person' contained in CPS 520 to identify impacted individuals. That is, where an ADI in cooperation with APRA would identify those persons who can influence or impact the whole, or substantial part of, the ADI by capturing those subsidiaries within an ADI group that can have a material impact on the ADI's business as a whole and which are APRA regulated.

Such an approach not only achieves the policy intent of BEAR in the most efficient manner possible, it resolves or removes many of the legal uncertainties raised in this submission which will promote an orderly and cost-efficient implementation of an effective Australian regime

**Recommendation:** *BEAR impacted executives should be identified through a principles-based approach, using the concept of 'responsible person' contained in CPS 520.*

**Foreign subsidiaries and banks with operations or functions outside of Australia**

The extent to which the regime extends to offshore subsidiaries of domestic ADI groups and foreign banks which operate branches in Australia is unclear, including the effect of the BEAR on activities of foreign banks and subsidiaries with no connection to Australian operations or functions.

The ABA seeks confirmation that, for example, an overseas parent entity which is also a bank, remains outside the BEAR apart from its operations and functions within Australia. If not, then further detail is required of which overseas activities are to be covered.

Global banks, and their senior accountable individuals, are subject to similar frameworks which have been put in place by regulators offshore (e.g. UK, HK).

When drafting legislation and rules, the ABA believes that Treasury should consider how it will reconcile BEAR with these overseas regimes or to the extent that there are deliberate differences, how these will be recognised and what ADIs who are subject to multiple regimes are expected to do to comply.

For ADIs that are already subject to other similar regimes, the ABA believes that the BEAR should take into account that operational controls have been put in place to meet these offshore regimes and to the extent appropriate, align requirements so that there is less additional operational burden on these banks to comply with BEAR. Consideration should also be given to whether ADIs and individuals subject to comparable regimes in other jurisdictions should be given substituted compliance status.

**Expectations of ADIs and accountable persons**

The BEAR will include 2 sets of expectations, a set for the ADI and a related set for the accountable person. The BEAR should make clear how a breach of the BEAR will be determined between the ADI and the accountable person. It should be clear how the expectations of an accountable person are to be linked to the outcomes or the impact for the ADI, and the ADI's consequent failure to meet expectations on it.

The intention of the BEAR is to ensure that senior bank executives are accountable, therefore the accountable person's duty of responsibility (and their liability) must be linked directly to the impact of their behaviour on the ADI. This approach is important to ensure an accountable person is not liable just because the ADI has breached a requirement – it is because they have personally failed to meet an expectation (based on a reasonableness test in the circumstances) causing a relevant prudential and systemic impact on the ADI. Furthermore, the onus of proof should be on APRA to prove, before a court, that the accountable person did not act reasonably (see our comments on natural justice below).

**New prudential concepts within the BEAR regime**

*Expectations*

The new 'expectations' should be clearly defined, unambiguous and solely relate to the prudential requirements overseen by APRA.

*Open and co-operative with APRA*

The proposed expectations also include a requirement for an accountable person to 'be open and co-operative with APRA'. Openness is consistent with the industry's current relationship with APRA, and has been central to Australia having a strong and stable banking system, however the term has not been previously enshrined in legislation and introduces a significant level of uncertainty.

For example, APRA may consider that claiming privilege is not being open and co-operative, notwithstanding that this is a legal right, or APRA could contend that a failure to bring issues to its attention when no reporting obligation has been triggered evidences a lack of openness and co-operation.

An unclear duty of openness may drive each ADI to over-report to APRA until courts or APRA have had the opportunity to interpret the duty.

To promote certainty and reduce unintended consequences, an alternative formulation could be to "be *honest* and co-operative with APRA". This achieves the same policy outcome whilst clarifying the standard of conduct to be applied in assessing compliance.

The BEAR must ensure that any such expectation is subject to the usual protections afforded to individuals accused of failing to comply with legal and regulatory obligations, such as in relation to self-incrimination. A failure to meet an 'expectation' may in itself bring serious consequences and risks are heightened where the link to civil and criminal liability under the Corporations Act is not express, and where deregistration is the "remedy" because of the detrimental lifetime effect such action is likely to have on an individual's employability.

**Recommendation:** *The expectation to be open and cooperative with APRA is amended to be 'honest and cooperative with APRA'.*

*Integrity and due skill*

A new expectation requires an accountable person to act with 'integrity and due skill'. This expectation is phrased similarly to the language contained in the definition of 'prudential matters' in the *Banking Act*[11].

**Recommendation:** *If used in a statutory duty the ABA recommends that there is an appropriate definition of the terms included in the legislation, possibly referring to the Banking Act definition, and APRA prudential guidance as to how the term is to be objectively assessed.*

*Behaviour that is of 'a systemic and prudential nature'*

As stated at the start of this submission, how behaviour is defined as of 'a systemic and prudential nature' is the lynch-pin to the success of the BEAR. The BEAR is intended to only apply to prudential obligations. This is borne by the fact that the Consultation Paper does not propose to adopt all the SMCR conduct rules into the BEAR regime and states that ASIC will remain responsible in its role as conduct regulator. In the Australian context, the ABA agrees with the Consultation Paper in that limiting the BEAR to prudential obligations is appropriate, having regard to ASIC's existing role and powers as the conduct regulator.

To ensure clarity, the BEAR legislation should clearly define the expectations as relating to prudential obligations. A clear definition of 'systemic and prudential nature' will also assist in interpreting the expectations for both ADIs and accountable persons.

[11] s5, *Banking Act* 1959 (Cth).

**Recommendation:** *The BEAR clearly defines 'systemic and prudential' to inform the scope of and provide context to the interpretation of the BEAR expectations.*

**Recommendation:** *The ABA recommends that the boundary between prudential expectations and conduct expectations is clarified, in depth, to ensure the BEAR regime operates as intended. This boundary should also be reflected in the Government's Statement of Expectations for ASIC and APRA.*

**Natural justice**

The ABA considers the additional powers and responsibilities granted to APRA as part of the BEAR are significant. In light of these, the ABA encourages the Government to ensure APRA is subject to appropriate checks and balances to accompany these new powers.

In regards to the proposed removal and disqualification power for APRA, the ABA fully agrees with Government that the community expects APRA to be able to move quickly in removing or disqualifying individuals. The Consultation Paper correctly states that APRA already has the power to direct an ADI to remove a director or senior manager if APRA is satisfied that the person is disqualified from acting in that position or does not meet the fit and proper criteria set out in the prudential standards.

The ABA is concerned by the lack of detail in the consultation paper regarding the checks and balances around APRA's powers to remove or disqualify an individual. We are concerned that there may be a fundamental reversal of the onus of proof regarding a breach of the BEAR expectations, contrary to Australian judicial principles[12]. The BEAR should build on the existing APRA powers and maintain the requirement for APRA to apply to the Federal Court to disqualify an individual. This will ensure the rights of all parties are protected and there is certainty.

The ABA notes that the UK SMCR legislation initially provided for a 'presumption of responsibility' which required individuals to prove to the regulator that they had not broken the rules, rather than the regulator having to prove wrongdoing. However, this presumption reversing the burden of proof was removed by the UK Government prior to the commencement of the SMCR as it was not considered to be a proportionate means to achieving the SMCR's objective. The presumption was instead replaced by a 'duty of responsibility' which required regulators to show that 'the senior manager did not take such steps as a person in the senior manager's position could reasonably be expected to take to avoid the contravention occurring (or continuing)'[13]

An alternative approach could be for the decision to be made by an administrative body made up of representatives from APRA and others across the financial services industry[14]. For example, in the UK, the Financial Conduct Authority (**FCA**) established[15] the Regulatory Decisions Committee (**RDC**) to help "ensure that decisions are taken fairly". The members, appointed by the FCA Board come from across a spectrum of business, consumer and industry backgrounds. The RDC is operationally separate from the regulator but is empowered to take certain decisions on behalf of the FCA, including relating to enforcement and supervisory actions. A similar concept is being implemented through ASIC's proposed Financial Services Panel[16].

The establishment of a similar committee within APRA could facilitate enforcement action to be taken more quickly (in line with community expectations) and may provide greater confidence to all parties as to the independence of the decision-making. It may also improve the quality of decisions.

**Insurance**

The ABA suggests that the proposition that ADIs and accountable persons should be prevented from taking out insurance is treated with caution. The existing provisions in the Corporations Act allow

[12] We note that ASIC under s920A of the Corporations Act, has a power to ban, however this is subject to a private hearing.
[13] *Financial Services and Markets Act* 2000, UK s.66A (5)(d).
[14] See also : 17-111MR ASIC consults on establishing a Financial Services Panel, http://www.asic.gov.au/about-asic/media-centre/find-a-media-release/2017-releases/17-111mr-asic-consults-on-establishing-a-financial-services-panel/
[15] https://www.fca.org.uk/about/committees/regulatory-decisions-committee-rdc
[16] See: http://www.asic.gov.au/about-asic/media-centre/find-a-media-release/2017-releases/17-111mr-asic-consults-on-establishing-a-financial-services-panel/

institutions to indemnify their officers for costs related to proceedings unless they are found guilty of an offence (s199A Corporations Act). These provisions have an established public policy basis.

The ABA believes that similar provisions should apply to the BEAR, to enable ADIs to confidently pursue competitive new innovations when competing with non-ADI lenders or others outside the BEAR regime.

The ABA would hold that it is only logical that all of the prudentially regulated population should be treated equally, therefore the BEAR should not seek to unduly restrict ADIs from competing on a level playing field. Furthermore, it is inappropriate for rules to apply differently to accountable persons in an ADI and other directors and senior executives in corporations, where insurance is an acceptable part of the governance framework.

**Recommendation:** *Treasury leverage the existing provisions in the Corporations Act which allow institutions to indemnify their officers for costs related to proceedings unless they are found guilty of an offence (s 199A Corporations Act).*

## Implementation and timing

The additional powers and responsibilities granted to APRA as part of the BEAR are significant. The equivalent regime in the UK was implemented over a three year period and the Prudential Regulation Authority (**PRA**) is still consulting on the design of their regime, so the complexity of the task at hand should not be underestimated.

Experience with implementation of the UK SMCR suggests that effective implementation of the BEAR in Australia will require significant time and resources. This is necessary to ensure appropriate consideration of the key employment issues surrounding contracts, job descriptions, policies and procedures and training to roll out and embed a sustainable BEAR framework model.

The proposed changes to pay structures will require consultation with impacted individuals. Critically, these changes are most effectively accomplished when they are undertaken in alignment with the ordinary performance cycle (i.e. the annual review). Furthermore, this would be underpinned by various formal governance procedures including for example Board or shareholder approval and changes to an individual's key performance indicators.

The Financial System Inquiry's Final Report recognised this ever increasing burden of complex regulatory reform with the Government accepting recommendation 31, namely to increase the time available for industry to implement complex regulatory change. Government agreed to provide industry appropriate time to implement regulatory change and also committed to reflect this in their Statement of Expectations to all regulatory agencies[17].

Importantly, implementation costs, and the costs of managing unintended consequences and impacts can be managed early on through more extensive consultation with industry on the BEAR legislation as an exposure draft, and the relevant amendments to APRA standards (where applicable).

**Recommendation:** *Treasury and Government take the time necessary to ensure the legislation is precise, unambiguous and designed in a way such that unintended consequences and unnecessary costs are avoided.*

**Recommendation:** *APRA are currently conducting a review of the implementation of CPS 520 and CPS 510. The findings of this review should also inform the design of BEAR.*

**Recommendation:** *Adequate time and opportunity be given to ADIs, consumer advocates, governance and legal experts to provide input into a further round of consultation and the Exposure Draft of the legislation.*

17 https://www.treasury.gov.au/~/media/Treasury/Publications%20and%20Media/Publications/2015/Government%20response%20to%20the%20Financial%20System%20Inquiry/Downloads/PDF/Government_response_to_FSI_2015.ashx

**Recommendation:** *The implementation date be set at least one year from when the rules are published, with specific transitional provisions for the remuneration proposals that takes into account the varied remuneration and performance review cycles for individuals.*

**Recommendation***: The legislation should include a mandatory post-implementation review (**PIR**) of the BEAR after two years of operation, to assess and address unintended consequences. A PIR should focus on the effectiveness of the regime and to understand the operational issues and scope (i.e. application to broader industry), and consider whether there is a need for refinement.*

## Concluding remarks

The BEAR represents a significant reform to the landscape of ADI regulation and oversight in Australia. It also provides an opportunity to strengthen accountability in the financial services industry and align expected standards of behaviour with community expectations. The policy and design issues and recommendations set out in this submission are intended ensure the BEAR meets its policy objectives, without triggering unintended impacts.

The ABA also strongly believes that additional consultation on the exposure draft legislation will be essential to yielding a well-designed Australian regime that works together with existing prudential frameworks, efficiently implemented to support the financial system and achieve the consumer outcomes intended without complex and costly unintended consequences.

Importantly, implementation costs, and the costs of managing unintended consequences and impacts can be managed early on through more extensive consultation with industry on the BEAR legislation as an exposure draft, and the relevant amendments to APRA standards (where applicable).

We strongly encourage the Government to consult on the exposure draft legislation.

The ABA looks forward to discussing our submission with Treasury. If you would like any further information, please contact me on 02 8298 0408, or Christine Cupitt on 02 8298 0416.

Signed by

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# Appendix: A

**Chapter 4 —Individuals to be covered by the BEAR**

***1. Does the prescriptive element of the proposed definition of accountable persons capture the roles which, at a minimum, should be subject to enhanced accountability under the BEAR?***

***1.1. Are there any other roles which should be included at a minimum?***

***1.2. Should any of the roles be excluded?***

The ABA recommends a principles-based approach to capture the roles that should be subject to enhanced accountability under the BEAR. Using the concept of 'responsible person' contained in CPS 520, an ADI in cooperation with APRA would identify those persons who can materially influence conduct or behaviour, and whose actions could impact the whole or a substantial part of the ADI. The ABA believes that flexibility on how accountable persons are identified will allow APRA and the ADI to correctly and efficiently identify the right people within an ADI without the net being cast incorrectly.

The ABA recommends a simple principle based legislative mechanism that allows the responsibilities for the ADI to be allocated to a cohort of responsible persons. This will allow ADIs, in consultation with APRA to specify the responsibilities in more appropriate detail. APRA should also have the ability to approve modifications (applying an "if not, why not" rationale) where appropriate.

***2. Does the principles-based element of the proposed definition of accountable persons provide sufficient flexibility to reflect differences in business models and group structures?***

The principles-based element of the proposed definition of accountable persons should make it clear that the individual should have both significant influence over conduct and behaviour and the capacity to pose risks to the business and its customers that are material in the overall scope of the ADI's business or customers. Whilst providing flexibility, the principles-based element lacks the essential test and threshold of materiality on 'significant influence' and 'pose risks'. Such ambiguity will lead to ADIs casting the net too wide.

***3. Should the definition of accountable persons apply to individuals in the subsidiaries of a group or subgroup with an ADI parent, including where the subsidiaries are not regulated by APRA?***

The ABA strongly recommends a principles-based approach, in that by using the concept of 'responsible person' contained in CPS 520, an ADI in cooperation with APRA would identify those persons who can influence or impact the whole or substantial part of the ADI by capturing those subsidiaries within an ADI group that can have a material impact on the ADI's business as a whole and are APRA regulated.

Such an approach not only achieves the policy intent of BEAR in the most efficient manner possible, it resolves or removes many of the legal uncertainties raised in this submission which will lead to an orderly and cost-efficient implementation of an effective Australian regime. For example, such an approach addresses the issue of how to deal with partly-owned subsidiaries, subsidiaries of an ADI which operate solely outside of Australia and which are subject to the oversight of foreign prudential regulators and subsidiaries of ADIs. Special consideration should be had to the impact on trustee companies and that potential for the BEAR obligations to conflict with or confuse trustee duties and obligations.

A principles-based approach also addresses the issue of whether or not it is appropriate for the Senior Officer Outside Australia (**SOOA**) (CPS510) to be included as an accountable person in the BEAR. The SOOA is effectively a representative of the head office offshore entity. By attempting to capture the SOOA, the Australian regulator would effectively be seeking regulatory oversight of the head office entity board via its SOOA representative. However the Australian regulator's mandate is only to regulate the activities conducted onshore by the entity's Australian Branch.

It is therefore appropriate that the definition of accountable persons not go beyond the "Head of Foreign Bank Branch." Otherwise, the Australian regulator will effectively be seeking to interfere with the governance structure and arrangement of the offshore entity.

A further element which must be considered is that an Australian foreign bank branch is not a separate legal entity from its offshore head office entity. This has implications for the entity's structure and how it operates. The ABA would hold that APRA is concerned with the governance of the Australian branch itself, rather than the entity as a whole. In supervising the branch, APRA relies upon the supervision of the wider entity by the head office regulator. It would appear inconsistent with that position if the head office board of a foreign bank branch was captured within the BEAR, which should instead be focusing on those responsible for the daily running of the Australian branch. The SOOA role, should not be included in the scope of BEAR where its role is only in setting the wider entity's strategy, and does not extend to involvement in implementing that strategy in Australia. This is to be contrasted with the role of Head of the Foreign Bank Branch, who is ordinarily involved in the day to day running of the Australian branch.

The ABA considers that the SOOA's role is already appropriately covered by the existing prudential approach by APRA and should not be included in the BEAR. The role and responsibility of the SOOA is defined by APRA in CPS 510 and CPS 520. Accordingly, the appropriate "accountability statement" for a SOOA under BEAR is a statement which is consistent with the role and responsibilities set out in CPS 510 and CPS 520.

## Chapter 5 —Expectations of ADIs and accountable persons under the BEAR

### *4. Do the options canvassed for the expectations of ADIs capture the behaviours that should be expected under the BEAR?*

The ABA would hold that greater clarity around the definitions of 'reasonable steps' & 'systemic' is essential. It is important that the BEAR focuses on systemic conduct (i.e. a series of behaviours) and not capture one-off breaches that are not the result of misconduct or reckless management by delegates of the accountable person, where it can be demonstrated that appropriate steps were taken to control risks with an appropriate level of oversight and that customers' interests were not overlooked.

### *4.1. Are there any other behaviours which should be included?*

The suggested behaviours are largely aligned with duties and obligations already in place for ADIs under other Australian regimes. As discussed in the main part of this submission the ABA strongly recommends that the legislation giving effect to the BEAR specifically provides detail on how BEAR will interact with these other duties.

### *4.2. Should any of the behaviours be excluded?*

The suggested behaviours are largely aligned with duties and obligations already in place for ADIs under other Australian regimes.

### *5. Do the options canvassed for the expectations of accountable persons capture the behaviours that should be expected under the BEAR?*

Yes, however any new 'expectations' should be clearly defined and unambiguous. The expectations should not expand the existing Corporations Act and common law duties on directors and officers, the existing prudential requirements overseen by APRA, and the conduct obligations regulated by ASIC; which operate alongside the ASX Corporate Governance Council Principles and Recommendations which listed ADIs adhere to.

### *5.1. Are there any other behaviours which should be included?*

The proposed behaviours are what should be expected for accountable persons. However APRA should have the discretion to vary or exclude a behaviour to avoid unintended outcomes.

***5.2. Should any of the behaviours be excluded?***

As above, the proposed behaviours are what should be expected for accountable persons. However APRA should have the discretion to vary or exclude a behaviour to avoid unintended outcomes.

**Chapter 6 —Remuneration**

***6. Would deferring variable remuneration be likely to result in a shift from variable to base remuneration? Would this be problematic and, if so, can anything be done to prevent this outcome?***

It is unlikely that increasing deferral levels and/or periods for certain senior executives (i.e. those whose remuneration arrangements are already individually disclosed publicly in an institution's Remuneration Report which is subject to shareholder vote at the AGM) will result in a shift from variable to base remuneration. However, it is a possible outcome for roles below this level. If this were to happen, there could likely be a number of downstream impacts:

- A possible upward pressure on base remuneration levels across the financial services market for executive talent. Remuneration structures are generally designed to apply to groups of roles at a particular level to promote the transfer and development of executive talent, and equitable treatment. Board Remuneration Committee's will consider how remuneration structures should change both to facilitate compliance with the BEAR for directly impacted roles and to meet the talent needs of the institution for executives at the same level but who do not hold accountable executive roles.
- A possible increase in retention arrangements to help mitigate the cash-flow impacts of increased deferral, particularly if a reasonable transition period does not apply.
- A perceived decrease in the value of awards by executives. Recommend that tranche vesting be allowed on a pro-rata basis or alternatively from the three year point to counter this.
- An increase in costs associated with sign-on awards as executives will hold higher values of awards in unvested remuneration.
- Increased complexity for individuals on redundancy and retirement (good leaver situations) due to the taxing point for equity on exit that applies in Australia.

***7. What are the complexities in defining variable remuneration, including in relation to non-cash remuneration?***

The ABA would recommend a principles-based definition of performance-based remuneration e.g. remuneration subject to performance conditions as an input to the award and remuneration where the award itself is subject to a performance condition(s). Variable remuneration should include STIs and LTIs irrespective of whether the award is subject to further performance-based vesting requirements.

**Better banking and the Sedgwick Review**

The banking industry recognises that customers expect banks to keep working hard to make sure they have the right culture, the right practices and the right behaviours in place. The industry's Better Banking program is a multi-million-dollar investment by the industry, aiming to strengthen cultural and ethical standards and improve the delivery of products and services.

In April 2017, Mr Stephen Sedgwick AO completed an Independent Review of product sales commissions and product based payments in retail banking (Sedgwick Review). This related to bank staff and third parties who receive payments for selling bank products such as deposit accounts, mortgages and credit cards. The aim of the Sedgwick Review was to assess whether and how product sales commissions and product based payments in retail banking could lead to poor customer outcomes.

The Sedgwick Review[18] made recommendations in relation to the detailed remuneration structures of customer facing staff and near managers, as well as recommendations on governance and performance management that apply across the bank. The banking industry has committed to implementing the final recommendations of the Sedgwick Review, including the recommendations on the remuneration of third parties and many banks have begun implementing changes to remuneration structures and governance and performance management systems.

This work is strongly aligned with the objectives of the BEAR in promoting better customer outcomes and managing risk. The ABA strongly supports reward structures that encourage the right behaviour.

***8. Does the proposed principles-based definition of variable remuneration provide sufficient clarity as to the application of the BEAR to current and potential future remuneration structures?***

The ABA would recommend a principles-based definition of variable remuneration. Provided the definition is sufficiently broad, it should then be able to apply to any new innovative remuneration structures going forward. That said, leaving it too broad may present definitional and interpretive issues within the ADI and not provide Board's or Board Remuneration Committees with sufficient guidance to manage executive remuneration effectively. The ABA is happy to facilitate a workshop with Treasury and ADIs to assist in the definition of variable remuneration.

The ABA recommends that hurdled equity be valued at face value at the time of grant, in line with push by shareholders and proxy advisors for this method of valuation to promote simplicity and transparency.

***9. Is the proposal for deferring 60 percent of the variable remuneration of certain executive accountable persons appropriate?***

The ABA would caution against prescription in this area. Remuneration is a matter that is properly the duty of the Board and Board Remuneration Committees, who are best placed and responsible for setting the incentives and risk appetite of the ADI.

Limiting the requirement for 60 percent deferral for four years to just CEOs is considered appropriate. However the ABA would suggest a phased implementation approach by building to the 40 percent / 60 percent over a two to three year period, so that those impacted do not have a sudden change to available income.

The proportion of variable remuneration proposed for deferral is less of an issue than the period of deferral as awards are perceived to be less valuable the longer they are held. To mitigate this, allowing tranche vesting from three years is also recommended.

***10. Are the proposed enhancements to APRA's remuneration powers appropriate?***

Boards and Board Remuneration Committees should retain their existing accountability for setting and managing remuneration arrangements. APRA already has a range of powers and tools to address concerns where they believe Boards are setting and managing remuneration arrangements inappropriately.

The ABA would also welcome a definition of what constitutes an "inappropriate outcome" as remuneration is a complex field and involves understanding of the significant variables and details that are particular to each organisation. Even between ADIs, the inputs into remuneration differ and it requires careful consideration and guidance of the Board to ensure these inputs are properly considered and structured within a remuneration model. Even with additional resources APRA may not have this same level of insight and knowledge across each bank in order to appropriately exercise these powers in a consistent manner.

[18] link

The BEAR should also consider the relationship with the Corporations Act provisions relating to shareholder votes, and the impact of making any changes to arrangements that have been subject to a shareholder vote.

## Chapter 7 —Implementation of the BEAR

### Accountability mapping

***11. Should ADIs be required to map the allocation of prescribed responsibilities, similar to the approach under the Senior Managers Regime in the United Kingdom?***

The ABA is open to the introduction of a regime which includes mapping the allocation of prescribed responsibilities across an ADI. However, the UK regime's uses jurisdiction-specific concepts that would not translate well to Australia.

The ABA's preference is that the BEAR adopts an approach similar to the Hong Kong Manager- In-Charge regime (**HK MIC regime**) where an organisational chart must be provided to the regulator. The organisational chart will set out the Licensed Corporation's governance and management structure of eight core functions including overall management oversight; key business line; operational control and review; Risk management; Finance and accounting; Information Technology; Compliance; and Anti Money Laundering / Counter Terrorism Financing and their reporting lines, including all Managers In Charge and their roles and responsibilities.

The ABA recommends the HK approach (in addition to the provision of accountability statements) rather than the responsibility mapping adopted in the UK SMCR. The outcome of this is to strengthen the corporate governance of Licensed Corporations which is achieved by the personal responsibility element of the HK MIC regime and is mirrored in the SFC enforcement priorities. The HK MIC regime is looking to establish where responsibility for breaches lie and the degree of responsibility borne by each member of senior management including the extent of each individual manager's authority in the firm's business; the individual's level of responsibility within the Licensed Corporation concerned, including any supervisory duties he or she may perform, and the level of control or knowledge he or she may have concerning any failure by the Licensed Corporation or persons under his or her supervision, to follow the Code of Conduct.

***11.1. Are there any other prescribed responsibilities which should be included?***

A principles-based approach should apply to identify and describe key areas of responsibility within the ADI group, as relevant and as applicable to that institution's business model and business lines. The principles should be applied by ADIs in consultation with APRA.

***11.2. Should any of the prescribed responsibilities be excluded?***

In consultation with APRA, ADIs should determine what responsibilities are most relevant to their business model and business lines, and allocate these according to their corporate structure.

***12. Should ADIs have discretion to add to the prescribed list of responsibilities?***

If a prescribed list is introduced, yes, in consultation with APRA, ADIs should determine what responsibilities are most relevant to their business model and business lines, and allocate these according to their corporate structure.

### Removal and disqualification

***13. Are the options canvassed for enhancing APRA's removal and disqualification powers appropriate?***

The Consultation Paper contemplates that APRA will have enhanced powers in circumstances where an ADI and or an accountable person has failed to meet expectations of the BEAR. The ABA considers

that the Treasury should clarify whether such powers will only be exercisable in circumstances where there is a systemic or prudential matter which would have a material impact on the ADI. Whilst the ABA recognises the rationale for providing APRA with enhanced powers in certain circumstances, the exercise of these powers – based on the proposed new expectations under the BEAR – could result in a fundamental, and detrimental shift, in regulation of the industry. It could also mark a very material departure from Australian legal jurisprudence.

The ABA's preferred approach is for the BEAR should build on the existing APRA powers and maintain the requirement for APRA to apply to the Federal Court to disqualify an individual which will ensure the rights of all parties are protected and there is certainty.

An alternative approach could be to provide for the ultimate decision to be made by an administrative body with representatives from APRA and others across the financial services industry. For example, in the UK, the Financial Conduct Authority (**FCA**) established[19] the Regulatory Decisions Committee (**RDC**) to help "ensure that decisions are taken fairly". The members, appointed by the FCA Board, come from across a spectrum of business, consumer and industry backgrounds. The RDC is operationally separate from the regulator but is empowered to take certain decisions on behalf of the FCA, including relating to enforcement and supervisory actions.

The ABA has two primary concerns. The first is in relation to the role of APRA, and the strength and efficacy of its relationship with ADIs as a prudential regulator. Our second concern is in relation to the proposal that APRA will have the ability to executively remove and disqualify an accountable person who fails to meet an expectation, without clarity on the process or right to appeal.

The effect of APRA having the ability to determine when an accountable person is removed or disqualified means that the regulator, interpreting the statutory expectation (however it is framed) can impose a very material, and probably career ending, enforcement action on an individual. Contrast this to an enforcement action by ASIC, or another interested party, on the failure by a director or officer to satisfy their directors' duties, when ASIC must prove that there has been a failure and there are defences, and a right of appeal to the Administrative Appeals Tribunal. This is a fundamental reversal of the onus of proof, contrary to Australian judicial principles. Even with prudential standards or guidance the ABA would not consider it just or appropriate for APRA to have the ability to judge (while also retaining the ability to set the standards through Prudential Standards) without appropriate checks and balances and a right of appeal. This power to remove or disqualify should remain as an application to the Federal Court (or another independent body).

The ABA notes that the UK SMCR legislation initially provided for a 'presumption of responsibility' which required individuals to prove to the regulator that they had not broken the rules, rather than the regulator having to prove wrongdoing. However, this presumption reversing the burden of proof was removed by the UK Government prior to the commencement of the UK SMCR as it was not considered to be a proportionate means to achieving the SMCR's objective. The presumption was instead replaced by a 'duty of responsibility' which required regulators to show that a 'the senior manager did not take such steps as a person in the senior manager's position could reasonably be expected to take to avoid the contravention occurring (or continuing)'[20].

The ABA is also concerned by the proposal to prevent ADIs and individuals from taking out insurance in order to enhance the deterrent effect. It is unclear in terms of the type of insurance the proposal applies to, and whether this would prevent the giving of indemnities. At a minimum any insurance prohibition should be clear it refers to the uninsurable penalty component only and does not apply more broadly to defence or investigation costs.

The ABA recommends that Treasury leverages existing provisions in the Corporations Act which allow institutions to indemnify their officers for costs related to proceedings unless they are found guilty of an offence (s 199A Corporations Act). Thought has already been given about such policy and when it might be appropriate to allow indemnities.

[19] https://www.fca.org.uk/about/committees/regulatory-decisions-committee-rdc
[20] Financial Services and Markets Act 2000, UK s.66A(5)(d)

**Civil penalties**

***14. Are the proposed circumstances in which the civil penalties should apply appropriate?***

The ABA is concerned about the lack of clarity on the circumstances where APRA could be able to seek a civil penalty. Of particular concern is the fact that Consultation Paper contains no consideration of materiality e.g. a one-off breaches as opposed to systemic breaches, and the lack of a defined APRA threshold of acceptable level of risk or oversight.

There is no clarity on what would be reasonable steps of an ADI to *"hold accountable persons to account under the BEAR"* given that the Consultation Paper states: *APRA **may** require ADIs to inform it where individuals have been subject to internal disciplinary proceedings, including where they have been subject to dismissal, suspension or a reduction in variable remuneration for not meeting the new expectations under the BEAR."*

The risk of a civil penalty combined with the proposed statutory duty of openness is only likely to drive each ADI into excessive over-reporting to APRA until courts have had the opportunity to interpret the new duties and expectations within the regime.

It is also unclear what *"appropriately monitor the suitability of accountable persons"* means given the Consultation Paper states: "*APRA will have power to impose penalties on ADIs not appropriately monitoring the suitability of executives".* This implies that Boards will now have an explicit new obligation and duty in regards to their oversight of the decisions of the CEO, which may conflict with delegation principles.

***15. Is the proposed definition of large ADIs appropriate?***

The prescribed distinction does not address the policy outcome the Government seeks to achieve in having proportionality between the seriousness of the contravention and the quantum of the penalty.

Given the reputational damage an ADI would seek to avoid, the ABA would hold that BEAR provides ample incentive for all ADIs, regardless of size, to avoid any civil penalty.

The ABA notes that the proposed civil penalties of up to $200 million are at the larger end of the scale that an Australian Court would be able to impose and that amount is not proportionate with penalties that could be imposed for other types of similar misconduct in Australia. Civil penalties should be applied based on the egregiousness of the conduct and the impact on customers with reference to other civil penalty regimes in Australia, rather than an ADI being deemed 'large'.

**Size of the proposed civil penalties**

The ABA suggests that the Treasury provide more insight on why the proposed penalties of $50M and $200M were proposed, the relevance of deterrence in that consideration and the materiality of introducing such significant penalties in the financial system.

The ABA would also hold that the size of the civil penalties proposed does not adequately reflect the significant number of industry-led initiatives underway all of which are closely aligned with the objectives of the BEAR in promoting better customer outcomes and managing risk.

The banking industry recognises that customers expect banks to keep working hard to make sure they have the right culture, the right practices and the right behaviours in place. On 21 April 2016, the Australian banking industry announced a comprehensive package of initiatives to protect consumer interests, increase transparency and accountability, and build trust and confidence in banks.[21] The industry's Better Banking program is a multi-million-dollar investment by the industry, aiming to strengthen cultural and ethical standards and improve the delivery of products and services.

The Banking Reform Program was developed following close consultation with key stakeholders and regulators. It targets areas of concern to the community about governance, conduct and culture in

[21] http://www.bankers.asn.au/media/media-releases/media-release-2016/banks-act-to-strengthen-community-trust

banks. The six initiatives cover the areas of remuneration, complaints handling and dispute resolution, whistleblowing, reference checking and stopping misconduct moving round the industry, banking standards and regulation of banks.

The banks and the ABA continue to work closely with key stakeholders and regulators on implementation. Progress with the implementation of the reform program is being overseen by an independent governance expert[22], Mr Ian McPhee. Quarterly progress reports have been published by Mr McPhee since the announcement outlining implementation results, challenges and identifying areas requiring additional attention[23].

Banks work hard to promote the right behaviours of their employees, and in recent years many banks have made changes to remuneration practices to place more of an emphasis on good behaviour rather than sales targets.

**General implementation and transition issues**

**16. What would be a reasonable period of time after the passage of legislation for ADIs to implement the BEAR?**

The ABA again encourages Treasury and Government take the time necessary to ensure the legislation is precise, unambiguous and designed in a way such that unintended consequences and unnecessary costs are avoided.

*The implementation date be set at least one year from when the rules are published, with specific transitional provisions for the remuneration proposals that takes into account the varied remuneration and performance review cycles for individuals. The legislation should include a mandatory post-implementation review (**PIR**) of the BEAR after two years of operation, to assess and address unintended consequences. A PIR should focus on the effectiveness of the regime and to understand the operational issues and scope (i.e. application to broader industry), and consider whether there is a need for refinement.*

**17. How significant are the costs associated with implementing the BEAR? How can these costs be mitigated consistent with the policy intent of the BEAR?**

The existing powers and prudential oversight of APRA could be efficiently expanded via APRA Prudential Standards CPS 520 *Fit and Proper* and also CPS 510 *Governance* to include the features of BEAR, rather than the introduction of an entirely new regime. Such an approach achieves the same policy intent with significantly lower implementation costs.

The introduction of the SMCR introduced such complexity that the ABA understands that UK banks each established and resourced a permanent SMCR office within their bank to ensure ongoing compliance with the SMCR regime.

In the UK the introduction of the SMCR required the development of new Human Resources processes for employees including enhanced recruitment procedures, periodic appraisal and assessment procedures; employee termination scenario planning and handover procedures for employees acting in more senior position or promoted to a new role. The SMCR also required changes to compliance systems for monitoring, tracking and reporting potential conduct breaches. Significant time was required to design build and implement the new technology to ensure a bank could comply with the SMCR.

In particular, the allocation of senior management functions and responsibilities to specific individuals, including the development of a comprehensive accountability map, was a complicated process and required adequate transition provisions for UK banks. The implementation of the SMCR required a detailed review of governance structures and reporting lines, manager remits and bank policies and procedures.

The introduction of the SMCR resulted in the need for new and enhanced training requirements in order to ensure individuals understood and had the capability to be accountable to their revised remits and

[22] http://www.betterbanking.net.au/accountability/
[23] http://www.betterbanking.net.au/faster-industry-repair/ian-mcphee/

duties. This included training for managers designated as senior managers, and also other personnel, to fully embed the SMCR requirements.

Importantly, implementation costs, and the costs of managing unintended consequences and impacts can be best mitigated early on through more extensive consultation with industry on the BEAR legislation as an exposure draft, and the relevant amendments to APRA standards (where applicable).

Strong banks – strong Australia

# Attachment B: Summary of recommendations

| Ref. | Recommendation |
|---|---|
| 1 | The BEAR clearly defines 'systemic and prudential' to inform the scope of and provide context to the interpretation of the BEAR expectations. |
| 2 | ASIC and APRA develop joint guidance on the treatment of the same issues between ASIC and APRA regimes, including expectations on breach reporting and the interaction between ASIC's existing banning and disqualification powers and APRA's banning and disqualification powers under BEAR. |
| 3 | The Government expressly considers mechanisms in the BEAR to reduce competition impacts on smaller ADIs. |
| 4 | The BEAR is implemented through principles based legislation that builds, expands, and enhances the existing Fit and Proper and Governance regimes set out in APRA Prudential Standards CPS 520 and CPS 510. |
| 5 | It should be made clear that the BEAR does not increase existing directors' and officers' liability under the Corporations Act, and the defences and qualifications that apply under section 180 (such as, the business judgment rule (section 180(2)), the ability of directors to rely on expert advice (section 189) and delegations (section 190) are not eroded. This will need to be expressly addressed in legislation. |
| 6 | The legislation giving effect to the BEAR specifically provides that the BEAR legislation does not expand the duties imposed on directors and officers under the Corporations Act and applies only in relation to APRA's powers under the new legislation in respect of registration and remuneration and regulations of the ADI. |
| 7 | The BEAR adopts the HK MIC approach (in addition to the provision of accountability statements) rather than the responsibility mapping adopted in the UK SMCR. |
| 8 | The BEAR should exclude NEDs in principle, unless and to the extent they are fulfilling a role that would otherwise be identified using the reasonable person's principle in CPS520. |
| 9 | BEAR impacted executives should be identified through a principles-based approach, using the concept of 'responsible person' contained in CPS 520. |
| 10 | The expectation to be open and cooperative with APRA is amended to be 'honest and cooperative with APRA'. |
| 11 | If used in a statutory duty the ABA recommends that there is an appropriate definition of the terms included in the legislation, possibly referring to the Banking Act definition, and APRA prudential guidance as to how the term is to be objectively assessed. |
| 12 | The BEAR clearly defines 'systemic and prudential' to inform the scope of and provide context to the interpretation of the BEAR expectations. |
| 13 | The ABA recommends that the boundary between prudential expectations and conduct expectations is clarified, in depth, to ensure the BEAR regime operates as intended. This boundary should also be reflected in the Government's Statement of Expectations for ASIC and APRA. |
| 14 | Treasury leverage the existing provisions in the Corporations Act which allow institutions to indemnify their officers for costs related to proceedings unless they are found guilty of an offence (s 199A Corporations Act). |
| 15 | Treasury and Government take the time necessary to ensure the legislation is precise, unambiguous and designed in a way such that unintended consequences and unnecessary costs are avoided. |

| | |
|---|---|
| 16 | APRA are currently conducting a review of the implementation of CPS 520 and CPS 510. The findings of this review should also inform the design of BEAR. |
| 17 | Adequate time and opportunity be given to ADIs, consumer advocates, governance and legal experts to provide input into a further round of consultation and the Exposure Draft of the legislation. |
| 18 | The implementation date be set at least one year from when the rules are published, with specific transitional provisions for the remuneration proposals that takes into account the varied remuneration and performance review cycles for individuals. |
| 19 | The legislation should include a mandatory post-implementation review (**PIR**) of the BEAR after two years of operation, to assess and address unintended consequences. A PIR should focus on the effectiveness of the regime and to understand the operational issues and scope (i.e. application to broader industry), and consider whether there is a need for refinement. |

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09 August 2017

Mr Tony McDonald
Principal Adviser
Banking, Insurance and Capital Markets Unit
Financial System Division
The Treasury
Langton Crescent
PARKES ACT 2600
By email bear@treasury.gov.au

Dear Mr McDonald,

# Banking Executive Accountability Regime: Consultation Paper

As flagged in the Australian Bankers' Association (**ABA**) main submission to the *Banking Executive Accountability Regime* (**BEAR**) *Consultation Paper* (**Consultation Paper**), dated 4 August 2017. The ABA had commissioned PricewaterhouseCoopers (**PwC**) to conduct an analysis of the UK Senior Manager's Regime (**SMR**), examine the lessons learnt from the UK experience and draw out any unintended consequences or areas for further clarification to ensure an orderly introduction of any Australian regime.

The ABA would like to share this PwC report with Treasury, the views are that of PwC but the report does offer insights on potential issues and overlaps with existing local regulatory requirements that should be considered in the design and implementation of the BEAR in Australia.

Yours sincerely,

*Signed by*

Aidan O'Shaughnessy
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aidan.oshaughnessy@bankers.asn.au

Encl.

# *Banking Executive Accountability Regime*

## Response to Consultation Paper

***August 2017***

pwc

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pwc

Anna Bligh
Chief Executive Officer
Australian Bankers' Association Inc
Level 3, 56 Pitt Street
Sydney NSW 2000
cc: Aidan O'Shaughnessy

3 August 2017

Dear Anna

***Banking Executive Accountability Regime response to Consultation Paper***

As one of Australia's leading professional services firms, we believe it is critical for us to share our perspectives on the banking regulatory landscape as it evolves in an environment of unprecedented scrutiny. We are committed to positively contributing to the Australian community and supporting and enabling initiatives that will strengthen the future prosperity of our country.

As part of the 2017-18 Budget to address the recommendations of the Coleman Report and strengthen accountability and competition in the banking system, the Government announced that it will legislate to introduce a new Banking Executive Accountability Regime (the BEAR).

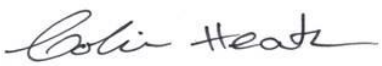
The Government's intention is to enhance the responsibility and accountability of Authorised Deposit taking Institutions "ADIs" and their directors and senior executives. The spirit of BEAR is to improve risk culture through greater accountability and more effective corporate governance. The regime, if legislated appropriately should recognise that leadership is key to driving cultural change, and offers opportunities to empower people to do the right thing. The impact to ADIs and the extent of work required will vary depending on previous programs undertaken.

We have an opportunity to learn from the UK's experience in the implementation of its Senior Manager's Regime "SMR" to ensure a more efficient and effective regime is designed and implemented in Australia.

Whilst the consultation paper provides guidance of policy and the spirit of the BEAR, it lacks details of the key components of the proposed regime. It is important that the legislation process is not rushed and that industry be given appropriate time to consult with Treasury to ensure that the right outcomes for all stakeholders are achieved and that as few unintended consequences arise as possible.

Our detailed feedback, as per our engagement letter dated 28 July 2017, is enclosed and we would welcome the opportunity to discuss our views further. I can be contacted on 02 8266 2231 or at sarah.hofman@pwc.com.

Kind regards



Sarah Hofman
Partner

Colin Heath
National Banking & Capital Markets Leader

## *Proposed measures of BEAR*

| | |
|---|---|
| Executive registration with APRA | All current "accountable persons", which include certain senior executives and directors of ADIs, will be required to be registered with APRA, and APRA will need to be advised prior to any future senior appointments. APRA will have the power to deregister and disqualify senior executives without applying to the Federal Court. |
| Accountability mappings | ADIs will be required to provide APRA with accountability statements and maps of senior executives' roles and responsibilities across all business areas of the ADI and its subsidiaries. |
| APRA powers over remuneration policy | APRA will be given stronger powers to require ADIs to review and adjust their remuneration policies when APRA believes these policies are not appropriate. |
| Remuneration deferral | ADIs will be required to defer a minimum of 40% of bank executives' variable remuneration for a minimum of four years, increasing to 60% for certain executives (CEOs). |
| Increased expectations and penalties for executives | Conduct standards for executives and directors - covering matters such as conducting business with integrity, due skill, care and diligence and acting in a prudent manner.<br>Introduction of civil penalties for ADIs who fail to meet the new expectations (e.g. hiding misconduct), or who do not appropriately monitor suitability of executives to hold senior positions.<br>Executives may no longer be able to be registered or employed in senior roles if they are found to have breached their accountabilities. |
| Penalties for ADIs | APRA will be able to impose civil penalties of up to $200 million for large ADIs (Liabilities >$100B) and $50 million for smaller ADIs that do not appropriately monitor the suitability of their executives to hold senior positions and who do not hold accountable persons to account. |

## *Existing APRA accountability frameworks in Australia*

| | |
|---|---|
| Culture | CPS 220 Risk Management (CPS 220) requires the board of a bank to form a view on the ADI's risk culture and the extent to which that culture supports the ability of the ADI to operate consistently within its risk appetite, and ensure that the ADI takes steps to make desirable changes to its risk culture |
| Remuneration | CPS 510 Governance (CPS 510) requires the ADI to establish a Board Remuneration Committee and maintain a Remuneration Policy that aligns remuneration and risk taking |
| Governance | CPS 510 sets out minimum standards for good governance of an ADI to ensure that it is managed soundly and prudently by a competent board |
| Risk management | CPS 220 requires an ADI to maintain a risk management framework that is appropriate to its size, business mix, and complexity. It also requires boards to form a view on their risk culture. There are also a large number of prudential standards covering key material risks. |
| Fit and proper | CPS 520 Fit and Proper sets out criteria for determining the fitness and propriety of responsible persons. APRA may direct an ADI to remove directors or senior managers who lack the requisite fitness and propriety. |

## *Individuals to be covered by the BEAR*

The definition of accountable persons is intended to clearly identify the most senior directors and executives who will be held to a heightened standard of responsibility and accountability. It is intended to build on, rather than replace, existing concepts of responsibility and accountability, such as definitions of 'responsible persons', 'directors' and 'senior managers' under APRA's Fit and Proper framework.

The table below lists the prescribed list of senior managers in the UK's Senior Manager's Regime "SMR".

*Table 1 — Senior Management Functions UK Senior Manager's regime "SMR"*

| PRA-designated functions | FCA-designated functions |
|---|---|
| Chief Executive | Executive Director |
| Chief Finance | Head of Compliance |
| Chief Risk | Money Laundering Reporting Officer |
| Head of Internal Audit | Other Overall Responsibility |
| Head of Key Business Areas | Chair of the Nomination Committee |
| Group Entity Senior Manager | Overseas Branch Senior Manager |
| Credit Union Senior Manager | Notified Non-Executive Director |
| Chair | |
| Chair of the Risk Committee | |
| Chair of the Audit Committee | |
| Chair of the Remuneration Committee | |
| Senior Independent Director | |
| Head of Overseas Branch | |
| Chief Operations | |

*Table 2: Proposed prescribed accountable persons functions under the BEAR*

| Descriptor | Function |
|---|---|
| Oversight functions | |
| Chair | Responsible for chairing and overseeing the performance of the Board. |
| Chair of the Risk Committee | Responsible for chairing and overseeing the performance of any committee responsible for the oversight of the risk management systems, policies and procedures. |
| Chair of the Audit Committee | Responsible for chairing and overseeing the performance of any committee responsible for the oversight of the internal audit system. |
| Chair of the Remuneration Committee | Responsible for chairing and overseeing the performance of any committee responsible for the oversight of the design and the implementation of the remuneration policies. |
| Senior Officer Outside Australia | Under the authority of the Board of a foreign ADI, outside Australia and responsible for overseeing the Australian branch operation of a foreign ADI. This function already exists under APRA's prudential standard CPS 510. |
| Executive functions | |
| Chief Executive | Under the immediate authority of the Board, responsible for carrying out the management of the conduct of the whole business (or relevant activities). |
| Chief Finance | Responsible for the management of financial resources and reporting directly to the Board in relation to financial affairs. |
| Chief Risk | Responsible for overall management of risk controls, including the setting and managing of risk exposures, and reporting directly to the Board in relation to its risk management arrangements. |
| Chief Operations | Responsible for the management of operations and for reporting directly to the Board on the operations function. |
| Chief Information | Responsible for the management of information technology and for reporting directly to the Board on the information technology function. |
| Head of Internal Audit | Responsible for the management of the internal audit function and for reporting directly to the Board on the internal audit function. |
| Head of a Foreign Bank Branch | Ordinarily resident in Australia and responsible for the conduct of the Australian branch operation of a foreign ADI. This function already exists under APRA's prudential standard CPS 510. |

## *Questions asked in the consultation paper*

1. Does the prescriptive element of the proposed definition of accountable persons capture the roles which, at a minimum, should be subject to enhanced accountability under the BEAR? Are there any other roles which should be included at a minimum? Or excluded?

   The prescribed roles listed are very similar to the UK equivalents and we are supportive of the use of a list. The inclusion of Chief Information is helpful as this was not formally included within the UK equivalents and many organisations in the UK added it as part of the SMF 18 category (which is essentially an 'other' category for anyone seen as a senior individual but is not captured by the prescriptive requirements of the regime). The roles that are not included, which may be helpful, are:

   1. Head of Human Resources (also not included in the UK, but again included by many organisations within the SMF 18 category); and
   2. Head of Key Business Area, which the majority of organisations have used within the UK. The latter is included within BEAR's 'principles' element but was given greater prominence in the UK equivalent.

   Another approach that could be considered for use by Treasury in identifying the prescribed list of accountable persons is Key Management Personnel ("KMP") of ASX listed corporations.

It is unclear from the prescribed list the requirements for large foreign ADIs, and whether solely, Senior Officer Outside Australia and Head of the Branch should be included or should other functions also be incorporated.

We support the inclusion of the prescribed NEDs in table 2 and this corresponds with the UK regime. The inclusion of NEDs has been subject to some debate in the UK, in particular about 'two tier boards' and the need for collective responsibility alongside personal accountability. We do not support the view that all NEDs are included, however, this is an issue that Boards will need to consider.

2. Does the principles-based element of the proposed definition of accountable persons provide sufficient flexibility to reflect differences in business models and group structures?

We also support a principles-based definition of accountable persons. This is a practical approach and will assist with effective implementation as a principles-based approach allows each ADI to reflect their own business model. One of the key messages in the UK, throughout the implementation journey, was that organisations should ensure that their governance and operating model is appropriate for their business and then apply the regime, rather than the other way around. This principles based approach seems to be in line with that. It may lead to greater ambiguity in the short term, however will mean ADIs will need to more carefully consider how the principles will apply in their organisation, relative to a fully prescriptive approach but the outcome should potentially be better for the business.

The alternative approach would be to have only a prescribed list of accountable persons. We do not support this approach as we do not believe it would achieve the best outcome in the context of the different size, complexity and nature of Australian ADIs.

3. Should the definition of accountable persons apply to individuals in the subsidiaries of a group or subgroup with an ADI parent, including where the subsidiaries are not regulated by APRA?

We support the approach of including accountable persons in the subsidiaries of a group or subgroup with a parent ADI, only to the extent that the entity is regulated by APRA. We do not support including subsidiaries of unregulated APRA entities. This is consistent with the approach in the UK.

## *Expectations of ADIs and accountable persons under the BEAR*

The new expectations are intended to set a higher standard of conduct and accountability rather than replacing existing concepts such as contained in APRA's Fit and Proper framework. The SMR has relied on the existing fit and proper framework rather than adding new concepts of heightened standard of conduct. Well known and understood concepts of acting "efficiently, honestly and fairly" already exist in Australia, these should be considered when drafting the BEAR requirements.

ASIC will remain responsible in its role as conduct regulator and its focus on consumer detriment and market integrity.

We agree with the approach to draw upon the expectations of behaviour contained in the SMR and the Fundamental Rules in the United Kingdom, as outlined below, **but keeping the focus on systemic and prudential matters.**

Using this approach, an **ADI** would be expected to:

- conduct its business with integrity
- conduct its business with due skill, care and diligence
- deal with APRA in an open and cooperative way

- take **reasonable steps** to:
  - act in a prudent manner, including by meeting all of the requirements of APRA's prudential standards, and maintaining a culture which supports adherence to the letter and spirit of these standards
  - organise and control its affairs responsibly and effectively
  - ensure that these expectations and accountabilities of the BEAR are applied and met throughout the group or subgroup of which the ADI is parent.

An **accountable person** would be expected to:

- act with integrity, due skill, care and diligence and be open and co-operative with APRA; and
- take **reasonable steps** to ensure that:
  - the activities or business of the ADI for which they are responsible are controlled effectively
  - the activities or business of the ADI for which they are responsible comply with relevant regulatory requirements and standards
  - any delegations of responsibilities are to an appropriate person and those delegated responsibilities are discharged effectively
  - these expectations and accountabilities of the BEAR are applied and met in the activities or business of the ADI group or subgroup for which they are responsible.

## *Questions asked in the consultation paper*

4. Do the options canvassed for the expectations of **ADIs** capture the behaviours that should be expected under the BEAR?
   - Are there any other behaviours which should be included? Should any of the behaviours be excluded?

   AND

5. Do the options canvassed for the expectations of **accountable persons** capture the behaviours that should be expected under the BEAR?
   - Are there any other behaviours which should be included? Should any of the behaviours be excluded?

   APRA has existing requirements with respect to risk culture as part of CPS 220 which requires firms to form a view on their risk culture and identify and manage enhancements to strengthen their culture. This has driven a significant focus on the issue of culture in Australian ADIs. This focus had led to a considerable amount of work by ADIs to develop effective risk management frameworks.

   The behaviours that are included are appropriate and in line with the UK equivalent.

   There has historically, however, been limited focus behaviours related to customer outcomes, which may be helpful to include in the BEAR. The UK's reasonable steps measure is a useful benchmark for BEAR - when legislating, it will be important to consider what evidence will be required in order to demonstrate reasonable steps were taken.

In the UK, this concept allows for the fact that, in the event of an issue arising, executives are held accountable only if they are unable to demonstrate that they took reasonable steps to manage the risk. In the UK, whilst there has been high level guidance, it has been up to each organisation to define such steps. Delegation of responsibilities is considered in some detail in the UK regime.

Under BEAR, it is proposed that a senior manager must ensure that delegation is to someone who is competent and has appropriate capacity. A key ingredient of appropriate delegation is the maintenance of an appropriate level of monitoring and supervision by the delegate. The issue of appropriate capacity has been debated in the UK, particularly in matrix structures where the senior manager may not know the full workload of those who they delegate to. It has meant that senior managers in the UK have needed to work together more effectively to ensure that they are delegating appropriately.

## *Remuneration*

### *Executive Accountable Persons*

The remuneration elements of the BEAR will apply to accountable persons that perform executive functions only. Accountable persons that perform oversight roles are not covered because, under the ASX Corporate Governance Council *Corporate Governance Principles and Recommendations*, they should not receive variable remuneration.

## *Questions asked in the consultation paper*

6. Would deferring variable remuneration be likely to result in a shift from variable to base remuneration? Would this be problematic and, if so, can anything be done to prevent this outcome?

ADIs have different remuneration structures and different approaches to variable pay - for some the deferral requirement will be a small change, for others this change will be more substantial. As such, it is hard to categorically state that fixed remuneration will increase but the regime is certainly likely to lead to modifications to remuneration policies and possibly structures. A comparable reference point is the introduction of APRA's Prudential Standard CPS 510 when most ADIs first introduced a short term incentive (STI) deferral concept. When this change came into effect, we did not observe a noticeable shift from variable to fixed pay.

Generally there were three transition approaches taken by APRA regulated institutions:

1. No change to any other reward element meaning that participants generally experienced a reduction in annual cash STI due to a portion now being deferred
2. A slight increase in STI opportunity (to keep annual cash component comparable)
3. A moderate increase in fixed pay component to keep annual cash component comparable (however this certainly wasn't a common approach and only tended to happen where pay was not already in line with the market).

If fixed pay were increased, this could be problematic for several reasons:

1. ADI remuneration structures may become more (or less) attractive relative to other industries or other financial services businesses (e.g. insurance or asset management) which could result in it being more (or less) difficult to attract talent to the banking sector relative to other financial services sectors

2. The shift from variable to base pay for senior executives could prove to be problematic for external stakeholders of listed ADIs (e.g. institutional investors and proxy advisors) who, in general, prefer the majority of pay to be variable because it aligns executives' interests
3. Inability to financially recognise high performing individuals (or penalise low performing individuals) where a greater portion of remuneration is fixed. This could put pressure on performance and talent management systems and leader capabilities to recognise strong performance and ensure there are appropriate consequences to manage under performance.

There is probably not too many ways the regulator can explicitly prevent companies moving variable into fixed pay. However, we expect to see a level of self-regulation in constraining fixed pay increases given publicly available information remuneration information that exist and is reported, at least for Key Management Personnel (KMP) of ASX listed institutions. ASX listed companies are to prepare a Remuneration Report within their Annual Report, disclosing the remuneration details of KMP. The Remuneration Report is put to a shareholder vote at the AGM.

The shareholder view is heavily informed by benchmarking analysis conducted by proxy firms who would likely recommend a vote 'against' a company remuneration report if fixed pay was particularly generous relative to 'market'.

7. What are the complexities in defining variable remuneration, including in relation to non-cash remuneration?

AND

8. Does the proposed principles based definition of variable remuneration provide sufficient clarity as to the application of the BEAR to current and potential future remuneration structures?

The proposed principles based definition of variable remuneration provides SOME clarity as to the application of BEAR however there are several elements where a more prescriptive definition would be of benefit including:

- *Discretionary payments* - The proposed definition refers to payments that are 'discretionary AND conditional upon performance and the delivery of results'. We would point out that 'discretionary' payments are often conceived to be very different to performance based remuneration as they can operate purely at the Board or Management's discretion and are typically not clearly tied to specific performance targets or hurdles. As such, to avoid confusion, variable remuneration could be defined to include that part of total remuneration that is 'discretionary and/or conditional upon performance'
- *The nature of performance metrics / results* - The definition points to "including individual and business performance and results" and whilst it may be implicit, it might be helpful to explicitly reference that this could include both financial and non-financial measures of performance. Furthermore, we would expect un-hurdled grants of options under long-term incentive (LTI) plans to be considered as variable pay
- *STI definition and value* - There are several 'versions' of STI value including the target opportunity, the maximum opportunity, and the actual payment. Further clarity is needed regarding which definition the deferral requirement would be tested against but we would imagine the most logical definition, to support ease of administration and consistency in application, would be actual STI payment.
- *LTI definition and value* - There are also several 'versions' of LTI value due to the long-term nature of the award and the additional performance conditions typically attached. There is a 'grant value' determined at the commencement of the performance period

(which may or may not eventuate) and then there is the 'vested' or 'realised amount' which is only determined at the end of the performance period (typically 3 - 4 years). The 'vested' amount could actually be zero if performance hurdles aren't achieved. And so clarity is also needed regarding the definition of the LTI that would qualify for the 60% deferral and we would suggest it would make most sense to consider the grant value only given the realised value will not typically be known for some time

- *Equity valuation approach* - For equity based variable pay (either STI that is deferred into equity or LTI), different valuation approaches exist. The most common equity valuations would be the 'face' value (being the value of the award based on the instrument price) and the accounting 'fair' value (which considers the risks associated with the equity award such as market performance conditions, the length of the vesting period, among others). These valuations could vary at different points in time - such as at grant, at the reporting year end, at the vesting date. Further guidance is needed as to which value the deferral would be calculated on with respect of equity awards. Our initial view would be that grant date face value would be the simplest approach. This has the added benefit of aligning with the typical approach used by ASX 100 companies to determine the number of instruments allocated, providing for consistent communication and aiding understanding.

Typically, we would expect non cash elements- with the exception of equity- to be recognised in fixed remuneration (such as additional superannuation, housing allowances, etc.) rather than in variable pay. The only variable non cash elements to consider may be ad hoc awards (such as movie tickets/travel/consumer goods prizes that are awarded based on accumulation of recognition points, entertainment, travel, conference/course attendance etc.) but these tend to be minor in cost and not overly common for the roles in question.

9. Is the proposal for deferring 60 percent of the variable remuneration of certain executive accountable persons appropriate?

There are likely many and varied tests of 'appropriateness' in relation to the extent of deferral including:

- *Australian market practice* - One test of appropriateness may be the extent to which these requirements align to market practice. On this front, generally the remuneration policies of most ADIs (particularly the larger ones) will already include a requirement for substantial short term incentive deferrals due to requirements under APRA's Prudential Standard CPS 510. For example, in FY16 79% of ASX 100 companies reported having an STI deferral arrangement in place for the CEO and direct reports, with a median deferral amount of 40% and a median deferral period of 2 years. Furthermore, these same companies are likely to have a significant portion of pay already in LTI evidenced by CEO packages in FY16 being made up of 30% LTI on average, and other executives total reward packages including a 27% weighting on LTI on average
- *Global market practice* - Another test of appropriateness, might be extent of deferrals under similar regimes - Senior Managers Regime (SMR) in the UK and Managers-In-Charge (MIC) in Hong Kong. In the UK, the PRA Remuneration Code impose greater deferral requirements on variable pay for Senior Managers, with deferral periods of up to 7 years (with no vesting permitted between years 0-3, and vesting no faster than on a pro-rata basis). Furthermore, the deferral requirement increases from 40% to 60% where variable remuneration is GBP 500,00 or more OR is awarded to the director of a firm that is significant in terms of its size, internal organisation, and the nature, scope and complexity of its activities. There is merit in scaling the requirements based on the significance of the firm. In Australia, this could be restricted to the most senior accountable persons in the D-SIBS (domestically systemically important banks i.e. 4 majors)
- *Ability to apply meaningful clawbacks* - A third test of appropriateness, is whether or not this allows for sufficient risk adjustment in the face of misconduct. It is our view that this

quantum would allow for significant downward adjustments to deferred remuneration, particularly given there would be multiple tranches of deferred remuneration running concurrently (given annual deferrals) and so the ability to clawback amounts greater than 60% of annual variable remuneration exists should this be considered necessary

- *Impact on perceived value of rewards* - The proposed proportion of deferred variable pay should provide sufficient incentive (to ensure the performance and results upon which variable pay is based is sustainable), although it's important to recognise that the perceived value of reward is reduced the longer an executive needs to wait (hence the potential pressure on fixed pay to compensate).

We note that whilst the BEAR requirements in relation to remuneration deferral currently focus on the quantum of the deferral, consideration should perhaps also be given to the timeline associated with the deferral. CPS 510 and the current related review being undertaken by APRA examines not only the existence of deferral, but also the determination of a reasonable time frame over which each specific regulated institution may realise the impact of unnecessary or poor risks taken. There was no rationale provided in the consultation paper describing the 4 year deferral period. We do not believe that four years is an appropriate deferral period for all ADIs and Treasury should consider different periods depending on the ADI's business strategy, product and business model. If this requirement of the regime is limited to D-SIBs this would alleviate our concern.

10. Are the proposed enhancements to APRA's remuneration powers appropriate?

In order to judge whether or not the proposed enhancements to APRA's remuneration powers are appropriate, much clarity is still required regarding the nature of these powers including who has the ultimate say (Boards, shareholders or APRA) and over what aspect (remuneration policy vs remuneration outcomes).

We understand the need for enhanced powers in relation to overriding payment outcome decisions (and the enactment of related claw backs), we still have concerns about how this will be integrated into existing remuneration governance processes.

For example, can APRA make a decision that overturns a Board / Remuneration Committee (RemCo) decision? What if that Board / RemCo decision has already been supported with a majority shareholder vote as per related disclosures in the company remuneration report? How would APRA become sufficiently and equally informed in terms of being privy to all the same data points that were considered by the Board in arriving at their original decision? Perhaps rather than an override power, APRA could have a say/ voice on remuneration outcomes and require the Board to comply or explain.

We have more empathy for enhanced APRA powers in relation to overriding remuneration policy, although we note that APRA already has a certain degree of decision making power in this respect.

We believe increasing APRA's powers in relation to remuneration does further confuse an already confusing landscape when it comes to remuneration governance.

## *Registration and Accountability Mapping*

The table below sets out the prescribed responsibilities under the UK's SMR.

*Table 3 — Prescribed Responsibilities from the UK SMR*

| All firms |
|---|
| Responsibility for the firm's performance of its obligations under the senior management regime |
| Responsibility for the firm's performance of its obligations under the employee certification regime |
| Responsibility for compliance with the requirements of the regulatory system about the management responsibilities map |
| Overall responsibility for the firm's policies and procedures for countering the risk that the firm might be used to further financial crime |
| Responsibility for the allocation of all prescribed responsibilities |
| **All firms except small firms** |
| Responsibility for:<br>(a) leading the development of; and<br>(b) monitoring the effective implementation of;<br>policies and procedures for the induction, training and professional development of all members of the firm's governing body |
| Responsibility for monitoring the effective implementation of policies and procedures for the induction, training and professional development of all persons performing designated senior management functions on behalf of the firm other than members of the governing body |
| Responsibility for overseeing the adoption of the firm's culture in the day-to-day management of the firm |
| Responsibility for leading the development of the firm's culture by the governing body as a whole. |
| Responsibility for:<br>(a) safeguarding the independence of; and<br>(b) oversight of the performance of:<br>the internal audit function in accordance with SYSC 6.2 (Internal Audit) |
| Responsibility for:<br>(a) safeguarding the independence of; and<br>(b) oversight of the performance of;<br>the compliance function in accordance with SYSC 6.1(Compliance) |
| Responsibility for:<br>(a) safeguarding the independence of; and<br>(b) oversight of the performance of;<br>the risk function in accordance with SYSC 7.1.21R and SYSC7.1.22R (Risk control) |
| Responsibility for overseeing the development of, and implementation of the firm's remuneration policies and practices in accordance with SYSC 19D (Remuneration Code) |
| Responsibility for the independence, autonomy and effectiveness of the firm's policies and procedures on whistleblowing, including the procedures for protection of staff who raise concerns from detrimental treatment |
| Management of the allocation and maintenance of capital, funding and liquidity |
| The firm's treasury management functions |
| The production and integrity of the firm's financial information and its regulatory reporting in respect of its regulated activities |
| The firm's recovery plan and resolution pack and overseeing the internal processes regarding their governance |
| Responsibility for managing the firm's internal stress-tests and ensuring the accuracy and timeliness of information provided to the PRA and other regulatory bodies for the purposes of stress-testing |
| Responsibility for the development and maintenance of the firm's business model by the governing body |
| Responsibility for the firm's performance of its obligations under Fitness and Propriety (in the PRA Rulebook) in respect of its notified non-executive directors |
| **Specific types of firms** |
| If the firm carries out proprietary trading, responsibility for the firm's proprietary trading activities |
| If the firm does not have an individual performing the Chief Risk function, overseeing and demonstrating that the risk management policies and procedures which the firm has adopted in accordance with SYSC 7.1.2 R to SYSC 7.1.5 R satisfy the requirements of those rules and are consistently effective in accordance with SYSC 4.1.1R |

| |
|---|
| If the firm outsources its internal audit function taking reasonable steps to ensure that every person involved in the performance of the service is independent from the persons who perform external audit, including<br>(a) Supervision and management of the work of outsourced internal auditors and<br>(b) Management of potential conflicts of interest between the provision of external audit and internal audit services |
| If the firm is a ring-fenced body, responsibility for ensuring that those aspects of the firm's affairs for which a person is responsible for managing are in compliance with the ring-fencing requirements. |
| Overall responsibility for the firm's compliance with CASS |
| Small firms only |
| Responsibility for implementing and management of the firm's risk management policies and procedures |
| Responsibility for managing the systems and controls of the firm |
| Responsibility for managing the firm's financial resources |
| Responsibility for ensuring the governing body is informed of its legal and regulatory obligations |

## *Questions asked in the consultation paper*

11. Should ADIs be required to map the allocation of prescribed responsibilities, similar to the approach under the Senior Managers Regime in the United Kingdom? Are there any other prescribed responsibilities which should be included? Should any of the prescribed responsibilities be excluded?

    The management responsibility map, required under SMR in the UK, has been a useful tool in helping organisations understand the allocation of prescribed responsibilities. It has led to increased clarity among senior managers, better understanding of the chains of accountability and, ultimately, more efficient and effective business decision making.

    The document itself, however, has become quite cumbersome in the UK. The documents can be 60+ pages long and include a wealth of information on broader governance issues. The updating of this document is causing a lot of work for individuals within the organisations and may not be the best use of time. A counter argument to this is that incoming senior managers have said how helpful they have found it to have all of the governance information in one place.

    We support the use of a mapping of prescribed responsibilities similar to the UK however, we propose that a much simpler document than the UK's requirements setting out the prescribed responsibilities is designed by APRA. We are happy to assist Treasury in that process.

12. Should ADIs have discretion to add to the prescribed list of responsibilities?

    Yes, for the same reason as above - any accountability requirements should be driven by the business model, which will differ by organisation.

## *Removal and disqualification*

## *Questions asked in the consultation paper*

13. Are the options canvassed for enhancing APRA's removal and disqualification powers appropriate?

    Prior to the Financial Sector Legislation Amendment (Review of Prudential Decisions) Bill 2008, APRA had the power to determine disqualification and this was replaced with a court-based disqualification regime that exists currently. Previously, APRA was able to make an administrative (internal) decision to disqualify an individual, which was then subject to internal and external review, upon request.

The rationale for the change away from APRA determined disqualification in 2008 to a court-based approach, which are important for the proposed amendments under the BEAR including industry submissions that raised concerns about the inconsistencies of the APRA-based approach with the court-based regime under the Corporations Act (particularly given many APRA regulated entities are also subject to the Corporations Act) - the change sought to ensure consistency with the court disqualification regime available to ASIC under the Corporations Act and ensure that disqualification decisions are subject to a consistent level of scrutiny. Will the reversal create the same inconsistencies?

Another important issue raised was that given disqualification could have a significant reputational impact on an affected individual or entity, it is important that the disqualification process is transparent and efficient. Some industry participants have raised the idea of an expert panel made up of independent experts and APRA to act as the "disqualification panel"? The Takeovers Panel is a good example that creates an efficient and timely mechanism for decisions and has an independent and good mix of panel participants for each decision.

The key issue will be how APRA applies its powers in practice. The UK regulators have talked about being proportionate, reasonable and not applying hindsight to situations, all of which we believe is required. To date, the UK has not seen any enforcement in practice, so many organisations are, understandably, nervous about how the powers will be used in practice.

Another thing for treasury to consider is that the FCA has recently proposed a requirement for firms to provide a "regulatory reference" where an employee moves between firms, perhaps such a reference would be useful in the Australian BEAR to assist ADIs in implementation and compliance with the BEAR?

## *Civil penalties*

## *Questions asked in the consultation paper*

14. Are the proposed circumstances in which the civil penalties should apply appropriate?

It is unclear from the consultation paper what reference was used to determine the level of civil penalties except for the statement that there will be strong incentives for arrangements to be put in place to improve the culture and behaviour within the ADI sector.

If we look at enforcement actions in the conduct space in regards to the National Credit Code, the highest recorded civil penalty has been BMW finance $77m, however these monies were paid to customers as remediation. The highest fine in the Corporations Act is 45,000 penalty units (for things like market manipulation by a body corporate), which at the current rate of $210 per penalty unit comes to $9.45m. It would be helpful to industry if Treasury explained why $200m and $50m were selected as penalty levels.

15. Is the proposed definition of large ADIs (liabilities > $ 100 billion) appropriate?

We believe that APRA should be prescriptive from the outset and identify which ADIs are defined as large as was the precedent when it identified the D-SIBS and Level 3 Conglomerates.

## *General implementation and transition issues*

## *Questions asked in the consultation paper*

16. What would be a reasonable period of time after the passage of legislation for ADIs to implement the BEAR?

    It took many organisations in the UK much longer than they originally anticipated to implement the regime. This was in part because there were lots of changes to the UK requirements and the final rules were not defined until quite late in the process.

    Nonetheless, we think sufficient time is needed to ensure that organisations can implement the regime appropriately and not in a 'tick-box' manner. Given the tight timeline that is being imposed on ADIs and the fact that many ADIs have not had the opportunity to engage directly with Treasury, we recommend at least a year, once the rules are published for implementation and to be mindful of the complexities involved in a new regime. It is also important to recognise how personal this regime will be for many people, and therefore there are emotional aspects that need to be dealt with, in a way which is not common for most pieces of regulation.

17. How significant are the costs associated with implementing the BEAR? How can these costs be mitigated consistent with the policy intent of the BEAR?

    The UK regime was costly to implement. For the large organisations, the cost would have been several £m. Lessons learnt from the UK to avoid unnecessary costs for Australian ADIs include:

    - Industry should be given the opportunity to consult further to ensure that the draft legislation is appropriate and effective and to give the regulators and government the opportunity to explain policy and to avoid unintended consequences
    - Industry should be also given the opportunity to comment on the draft legislation
    - After the period of consultation, ensure that the rules are finalised and then not amended so that organisations can focus and therefore be more efficient during implementation
    - Ensure that the accountability mapping templates and any other templates that form part of the BEAR are simple, have clear and consistent definitions and are not unnecessarily onerous.

    The consultation paper has not made reference to the UK's Certification Regime which came into effect in March 2017. We request that Treasury provides further guidance as to whether there are any plans to extend BEAR beyond the scope proposed in the consultation paper.

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