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Manager
Banking, Insurance and Capital Markets Unit
Financial System Division
The Treasury
Langton Crescent
Parkes ACT 2600

ASA SUBMISSION – BANKING EXECUTIVE ACCOUNTABILITY REGIME

Dear Sir/Madam

The Australian Shareholders' Association (ASA) represents its members to promote and safeguard their interests in the Australian equity capital markets. The ASA is an independent not-for-profit organisation funded by and operating in the interests of its members, primarily individual and retail investors and self-managed superannuation fund (SMSF) trustees. ASA also represents those investors and shareholders who are not members, but follow the ASA through various means, as our relevance extends to the broader investor community.

We refer to the consultation paper on the Banking Executive Accountability Regime (**BEAR**) dated July 2017 (**Consultation Paper**).

While we are supportive of the move to strengthen accountability in the Australian banking system, our view is that some of the proposed changes go too far in terms of seeking to manage organisations and have the effect of undermining the function of company boards. In particular, while the ASA generally agrees with the deferral of a proportion of variable remuneration for senior executives, we are not convinced that there is a need for such structures to be mandated by legislation, particularly as this will have ramifications for other elements of remuneration.

Our specific comments are set out below. We note that our submission does not seek to answer all of the specific questions raised in the Consultation Paper.

The need for increased accountability

ASA agrees with the need for increased accountability in the Australian banking system, both at a company and individual level. As mentioned in our submission to the Senate Economics Reference Committee on its inquiry about *Penalties for white collar crime and corporate and financial misconduct in Australia*, in 2015, executives from Macquarie, ANZ, NAB and CBA faced a Senate inquiry into problems in their financial planning and wealth divisions. This concerned misconduct

(including systematic dishonesty and fraud) by some financial advisers over many years and a large number of bank customers have suffered immensely as a result. Yet to date, whilst compensation schemes have been established and some enforceable undertakings given, we are not aware of any action being taken against Macquarie, ANZ, NAB and CBA or financial or other penalties imposed on any of their executives.

In the CBA case, we understand some of the financial advisers provided enforceable undertakings, under which they agreed not to provide financial services for a period of time and, at the more serious end of the scale, permanently. Yet, we are not aware of any other penalties (monetary or otherwise) being imposed on those advisers or CBA executives or employees.

The recent revelations about the misconduct in respect of the bank bill swap rate and foreign exchange rates at certain banks, amongst other malpractices, at the wholesale level, also disrupts market integrity and raises costs indirectly for all system users.

Role of government and regulators as managers of the company

We strongly believe that the government, either directly or via the Australian Prudential Regulation Authority (**APRA**), should ensure that the measures taken do not put government or APRA in the position of managing the banks. We would prefer the focus of the BEAR to be on mechanisms to increase accountability and promote a strong culture of accountability within ADIs, without adopting a 'one-size-fits-all' approach to how boards should run their companies and structure executive remuneration.

We also question whether APRA is in a better position than a board to make a determination in relation to some of the circumstances which are captured by the BEAR. In particular, executive remuneration is an area that should be determined by the board of directors, having regard to the views of shareholders and other stakeholders, and not government or APRA. The introduction of the two-strikes rule has put in place sufficient mechanisms for shareholders to voice concerns about remuneration at listed companies and at least in the case of listed ADIs, we have witnessed improved engagement between company boards and shareholders on remuneration issues and a willingness by companies to explore different ways to design effective remuneration structures.

Institutions covered by the BEAR

We agree that the BEAR should cover all ADIs to promote a culture of accountability across the banking industry. However, consideration should be given to whether all elements of the BEAR should apply equally to all ADIs without regard to their size. For example, while it is not uncommon for a portion of variable remuneration for senior executives at listed companies to be deferred for a period, this is not necessarily the case at smaller Australian and foreign owned ADIs. Accordingly, the proposals would require significant changes to the way remuneration is structured at these entities and we would certainly expect that APRA will use its powers in respect to executive remuneration under the BEAR sparingly.

Remuneration

For many years, ASA has encouraged listed companies to defer a portion of short-term incentives (STIs) awarded to senior executives into equity for a two-year period. In 2017, that period was reduced by ASA to 12 months, in light of our acknowledgement that companies generally have both a short and long-term incentive plan, with long-term incentives (LTIs) measured over a long term and hence not available to senior executives until at least three years (and sometimes over four or five years) after they are granted. ASA prefers LTIs to be measured against performance hurdles over a period of at least four years (preferably five years). In a handful of listed companies, incentives are deferred for up to seven years after grant. ASA no longer requires the deferral of LTIs once they have been tested against the relevant performance hurdles and vested.

Our concerns regarding the proposed deferral arrangements are as follows:

- We would be concerned if government is requiring LTIs to be deferred for a period of four years after they have been tested against the relevant performance hurdles (which are currently measured over a minimum of three years). It is not clear to us from the Consultation Paper when the deferral period will begin — from grant or from the date of testing against the relevant performance hurdles. If it is the latter, this would mean that executives would have to wait around seven years after the granting of the awards before they are able to access the benefit of the incentives. While some listed companies already do this, we would be concerned if this was a mandated position.

- A requirement for variable remuneration to be deferred over a minimum of four years would likely lead to a rebalance towards base remuneration (ie higher base remuneration) and/or a shift away from LTIs in their current form, since any STIs would not be accessible until a longer period (so may be viewed by an executive as essentially an LTI even though the performance measures are measured over a shorter period). Shareholders prefer that a portion of pay is based on performance hurdles measured over the long term.

- As mentioned above, mandating deferral of variable remuneration for relevant executives at all ADIs could present difficulties for smaller Australian and foreign owned ADIs and is likely to lead to a shift from variable to base remuneration, and possibly higher base remuneration. In this regard, we would prefer to see a tiered structure or threshold, where variable remuneration below a certain threshold would be excluded from the deferral rules.

Implementation and transitional periods

While we acknowledge the desire to implement the BEAR as soon as possible, we agree that ADIs will need time to undertake changes to policies, contracts and systems. We would expect that a minimum of 12 months is provided for ADIs to implement the BEAR after passage of the legislation. Moreover, we are of the view that considerable work is required to the framework outlined in BEAR before it could be introduced as a draft bill.

Finally, we note the limited time provided for consultation on the BEAR, being three weeks. Whilst ASA understands that Treasury is working to a tight time-frame, it is difficult to expect that all relevant stakeholders will have an opportunity to provide a comprehensive response within such a short period. Our view is that it is in the interests of all stakeholders to provide an adequate amount of time for productive industry consultation to occur.

If you have any questions about this submission, please do not hesitate to contact me on (02) 9252 4244.

Yours sincerely

Judith Fox
Chief Executive Officer
Australian Shareholders' Association