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Manager
Banking, Insurance and Capital Markets Unit
Financial System Division
The Treasury
Langton Crescent
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Dear Sirs

Banking Executive Accountability Regime

On 13 July 2017, the Australian Treasury released a Consultation Paper seeking feedback and comments in relation to policy considerations involved in the design of a Banking Executive Accountability Regime (**BEAR**) announced by the Government in the 2017-18 Budget.

The intention of the BEAR is, in the words of the Consultation Paper, to: *"enhance the responsibility and accountability of ADIs and their directors and senior executives".*

Clifford Chance welcomes the opportunity to provide submissions in relation to the Consultation Paper.

Clifford Chance

We are one of the world's pre-eminent law firms, with more than 3,300 lawyers across 5 continents led by a single integrated partnership. We were named the number 1 law firm in Chambers Global Top 30 for the years 2014, 2015 and 2016.

We have significant experience working with clients globally in relation to individual accountability regimes, including with respect to implementation assignments for global banks in relation to the United Kingdom Senior Managers and Certification Regime (**SMR**) and Hong Kong Manager-in-Charge Regime (**MIC**), preparing joint submissions on behalf of global banks to regulators in relation to the SMR and assisting regulators (via secondees) with drafting proposed rules and consultation papers.

Submissions

Our views and recommendations expressed below are confined to the Australian commercial and jurisprudential context. Further, the content of our submission is not intended to be

exhaustive nor does it constitute legal advice. We have not addressed all questions in the Consultation Paper and we have raised some additional matters for consideration.

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?*

Save for the Senior Officer Outside Australia (**SOOA**) role, which we address at 1.2 below, we think that the Consultation paper captures the core roles likely to be able to influence *"systemic and prudential matters"*. We generally prefer a principles-based test to identify accountable persons within an ADI group, though we note the SMR's partially prescriptive approach in this regard and so think a minimum prescriptive element to the definition is acceptable so as to avoid any regulatory arbitrage (i.e. key differences in comparable and potential overlapping regulatory regimes). Some level of consistency across ADIs in implementing the BEAR is also likely to be beneficial.

Our response is qualified by:

- our comments regarding ADI subsidiaries at 3 below;
- our understanding that one individual may have multiple roles; and
- our understanding that an ADI without these existing roles should not then have to create them or to significantly modify existing roles to comply with the BEAR. If an ADI proposes not to have an individual fill one of the prescribed roles, the expectation should be *"comply or explain"*, with reasonable explanations being acceptable to APRA.

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

No. The risk of additional prescribed accountable person roles reduces ADIs' flexibility in adapting to the regime. In particular, for foreign ADIs with their generally more complex organisational structures and reporting lines. Like the SMR, the BEAR focuses on legal entities, however, most banks are structured along geographical or divisional reporting lines.

1.2 Should any of the roles be excluded?

The SOOA role should be excluded as a prescribed role. It does not clearly fit within the prescribed roles set out in the SMR, therefore a risk of regulatory

arbitrage exists. We also note that APRA already has significant oversight and regulatory powers regarding the SOOA role.[1]

Otherwise, while not in the list, the General Counsel function should not be a prescribed role. We make this point explicitly because this issue is currently under consideration by UK authorities (after a period of industry consultation has finalised). Inclusion of the legal function within the BEAR would threaten to erode legal professional privilege and the utility of the legal function as an internal sounding board/check on inappropriate conduct.

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?*

Yes, subject to our comments above and the guidance that is provided for e.g., what does "significant influence" translate to in practice? This said, the principles-based element should not be overly proscriptive nor overreaching. For e.g., the Head of Global Equities in a large global bank with a small domestic branch may not need to be an accountable person, provided that there is an individual with sufficient information and control in the ADI group (see 11 below). The Consultation Paper does not directly engage with what will be the territorial limitation of the BEAR; there is no territorial limitation under the SMR.

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?*[2]

The definition should not extend to individuals in subsidiaries not regulated by APRA, nor should it apply to related-bodies corporate noting our comments concerning foreign ADI structures above. It should not apply to APRA-regulated subsidiaries as a prescribed matter; ADIs should be able to elect to have accountable persons in subsidiaries under the principles-based definition only if it aligns with their structure.

If an ADI subsidiary's actions could pose a risk to an ADI group's business and customers, the ADI group will likely have an accountable person by virtue of the principles-based definition and/or via the prescribed responsibilities (see 11 below).

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1 For e.g., under s 23 of the *Banking Act 1959* (Cth).

2 The following statement in the Consultation Paper is relevant to this question: *"The scope of the BEAR is also intended to include all entities within a group with an ADI parent. This will include subsidiaries of ADIs, including those that provide non-banking services and those that are foreign subsidiaries."*

Mandatorily delving beneath the ADI parent increases the compliance burden and may give rise to a number of issues and unintended consequences for e.g., enforcement complications vis-a-vis overseas subsidiaries, regulatory overlap, etc.

If the definition is to be applied to all subsidiaries, APRA-regulated or not, on the basis stated in the Consultation Paper that consumers equate the activities provided by subsidiaries' with the ADI brand,[3] then some limitation criteria should apply. For e.g., the subsidiary shares the ADI brand, provides like financial services, etc.

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?*

Four of the six expected behaviours have their near direct equivalents in the UK FCA's Handbook – Principles for Businesses / the SMR, being broad principles-based regulation. The additional two behaviours (i.e. *"taking reasonable steps to...* [1] *act in a prudent manner...* [2] *ensure expectations and accountabilities of the BEAR are applied"*) are no less broad.

Cognisant that the overarching goal is to raise standards of conduct in the ADI sector, the guidance given by policymakers and authorities as to what these behaviours mean in practice will be the critical component. For e.g., does acting with integrity mean simply abiding by applicable laws or is something else required? (This debate is currently occurring in the UK.) Does dealing with APRA in an open and cooperative way mean that APRA would expect an ADI to waive privilege over internal investigatory materials, as has been put forward by certain UK regulators?[4] (This should not happen in Australia, including for the reason that it would place serious constraints on the extent to which fact gathering for the purposes of any internal investigation could be carried out under the cloak of litigation privilege.) What will constitute "reasonable steps" for the purpose of organising and controlling the ADI's affairs responsibly and effectively? What does "effectively" mean in this context?

Additionally, guidance needs to be given as to how APRA will exercise its powers. See our comments at 14 below here. The UK has the benefit of guidance from

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3 In our view, there is an issue with this reasoning insofar as there exist restrictions on non-bank entities holding themselves out as such under s 66 of the *Banking Act 1959* (Cth). Prudential Standard APS 222 is also relevant in this regard.

4 The situation is compounded in the UK by various judgments which have limited the scope of litigation privilege, including in relation to entities under investigation by regulatory or criminal authorities; see *The Director of the Serious Fraud Office v Eurasian Natural Resources Corporation Ltd* [2017] EWHC 1017 (QB).

regulators, including in the form of final notices issued to firms. ADIs will also need that guidance to adjust to the BEAR.

Also, where an ADI accedes to failings, including that it did not conduct a particular business line with due skill, care and diligence, the position needs to be made clear regarding the individual in charge of that area. For e.g., what probative value, if any, will be afforded to that evidence in any investigation as against the individual? It also appears unclear at this stage as to what the ADI group or subgroup will consist of in terms of definition, in particular in the context of foreign ADIs. This need to be made clear so that the scope of the expectations can be fully appreciated by ADIs.

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

No, while others could be imported from the UK (e.g. *"you must pay due regard to the interests of customers and treat them fairly*"), to do so may give rise to appreciable tension with directors' duties, which are more broadly framed under the UK's legislation (see: s 172 of the UK *Companies Act 2006*) and principles-based regulation overload. This is especially so given the current lack of a body of practical guidance.

4.2 *Should any of the behaviours be excluded?*

We do not have any particular issue with the broadly stated behaviours expected of ADIs, however, our response is caveated in terms of the guidance that needs to be given as to what these behaviours mean in practice.

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

Our comments at item 4 above apply equally here. Accountable persons will be concerned with what will constitute "reasonable steps", especially viewed through the prism of their directors' and officers' duties and other obligations, for e.g. as an ASIC "Fit and Proper" person. Guidance from policymakers and regulators will be critical.

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

No. See 4.1 above.

5.2 Should any of the behaviours be excluded?

Yes, the obligation to take reasonable steps to ensure that *"the expectation 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."* There is no

direct equivalent under the SMR, it appears to be redundant and it is also liable to cause confusion when viewed in light of the other expectations / the equivalent expectation on the ADI (which we submit is more appropriate, including given the comparable obligation regarding implementation of the "Fit and Proper Policy" under CPS 520).

Remuneration

We have not addressed questions 6 to 8 and 10 in the Consultation Paper.

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

This is taken from the SMR. Under that regime there is a cap; if an individual does not earn over a particular figure, certain of the remuneration rules need not apply. Appropriate to the Australian landscape, which includes a number of foreign bank branches which are ADIs, and cognisant of flight of talent, we think that:

- a materiality cap should apply to the deferral of remuneration proposals;
- the deferral should only apply to variable remuneration which is not linked to objectives the BEAR is trying to achieve (i.e. customer satisfaction, etc);
- the SOOA role should not be subject to the restrictions. While, under the definition provided in the Consultation Paper this role has an oversight function, a SOOA may also have an executive role within the broader organisation; and
- vesting on a pro-rata basis should occur.

Implementation and transitional issues

We have not addressed question 17 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?*

Yes, we consider that certain minimum prescribed responsibilities should be mapped from the perspective of global regulatory cohesion and to provide ADIs with certainty (which will decrease the regulatory burden). We do not think that such prescribed responsibilities should be directly transplanted from the SMR, not the least because of the pre-existing regulatory and prudential framework in Australia to which the prescribed responsibilities will need to correlate for e.g., CPS 510 and 520.

In our considerable experience with implementation projects in the UK, the accountability mapping exercises were generally not simple given the potential implications for senior managers, in particular as the UK took a "no gaps" approach to allocation of responsibilities. Differing views of roles and responsibilities, when forced to be reduced to 300 words or less in the pro-forma templates, arose amongst Senior Manager populations which needed to be resolved and reconciled.

Accountable persons will be concerned with both information and decision-making authority, that is *"For the areas of the business for which I am liable under the BEAR, do I have the requisite information and, separately, the authority to enable me to discharge my duties?"*. (We note ADIs with offshore reporting lines may be particularly affected.) In the UK, asking these questions led to comprehensive reviews of employment contracts, policies, frameworks, management information flows and governance arrangements (with accompanying training regimes). In addition, accountable persons may seek to have their reports set out in writing their own roles and responsibilities and provide compliance attestations in order to give comfort.[5]

ADIs will need to refine or set-up processes to regularly review and update responsibility statements / accountability maps and monitor the ongoing suitability of their accountable persons population against their defined responsibilities (including capturing customer complaints, training records, internal feedback, etc.). In relation to the latter, the detail does not yet exist to know to what extent existing arrangements regarding implementation of the "Fit and Proper Policy" under CPS 520 (which include annual fit and proper assessments) will need to be modified. The accountability mapping exercise is thus likely to permeate deeply into the ADI.

Given their importance, we think that the minimum prescribed responsibilities should be the subject of a separate consultation exercise by APRA. In our view, such responsibilities should properly be the subject of regulatory guidelines which have a degree of flexibility to achieve the right balance, in particular for ADIs whose offshore functions may fulfil many of the prescribed responsibilities. Detailed consultation was a feature of the UK's introduction of the SMR and the same should apply in Australia.

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

See 11 above.

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[5] For e.g., with the proposed duty to take reasonable steps to ensure that accountable persons delegate their responsibilities to an appropriate person and those delegated responsibilities are discharged appropriately.

11.2 Should any of the prescribed responsibilities be excluded?

See 11 above.

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

Yes, we see no reason to prevent ADIs from adding to the prescribed list of responsibilities (as with their flexibility to control their accountable person population), though we do not think that there should be a requirement to do so.

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

The Consultation Paper does not provide a great deal of information on the new powers, raising a number of questions. Will the power to disqualify individuals mirror ASIC's powers under the *Corporations Act 2001* (Cth) (noting ASIC's power is subject to rights of due process/appeal)? Will details of the disqualification be made public or otherwise shared with third parties? How long will disqualification last for? More clarity is required before meaningful comments can be provided in this regard.

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

See 4 and 5 above. The proposed circumstances are very broad; guidance needs to be given to ADIs in order for them to meaningfully appreciate the onus placed upon them. For e.g., what does it practically mean to *"hold accountable persons to account under the BEAR"*? Does it mean that every time an accountable person fails to fulfil their duties under the BEAR then the ADI has *ipso facto* also failed? The Consultation Paper states that *"The BEAR will apply where there is poor conduct that is of systemic and prudential nature"*[6]. Is there some conditionality here? Will APRA consider that it may take enforcement action where ADI failings are "systemic" notwithstanding that they are not "prudential" in nature for e.g., like the UK situation with respect to the mis-selling of payment protection insurance. Otherwise, how does APRA propose to quantify the penalties it will seek using its new power? Many such questions arise.

The lack of detail is exacerbated by the fact that there is not an equivalent liability under the SMR, though there is under the FCA Handbook, and by the quantum of the fines themselves; those civil penalty maximums will be the largest in Australian history. (See also our comments below regarding the unresolved interplay between

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6 The Consultation Paper later emphasises, in relation to the expectations for ADIs and individuals, that focus is on *"systemic and prudential matters"*.

regulators.) The High Court noted in *Markarian v R (2005) 228 CLR 357* that careful attention needs to be given to maximum penalties as: the legislature has legislated for them; they invite a comparison between the worst possible case and the case before the Court; and they provide a yardstick to balance with other relevant factors.

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

The distinction between large and small ADIs is, in our view, arguably arbitrary. Real unfairness could result for institutions which fall on the wrong side of the dividing line, wherever that is drawn. There is no precedent for such a dividing line in the UK.

The above stated, we think that any definition should properly form the subject of guidance to be issued by APRA and not legislation, being inherently less flexible.

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

The UK *Financial Services (Banking Reform) Act 2013*, which gives legislative effect to the SMR, was passed in December 2013. The SMR went live in March 2016, over two years later, in which period there were extensive consultations with the industry and rules published by the regulators.

Given the SMR had a precedent in the Approved Person Regime, and the UK has had a longer experience with broad principles-based enforcement regulation, we think that at least the same period should be afforded to Australian firms to implement the BEAR. There will be significant organisational and legal challenges faced by ADIs in terms of implementation, including ADIs whose reporting lines are offshore.

Additional considerations

In addition to the matters we have addressed above, some further issues arise for consideration from the Consultation Paper, including:

- How will the BEAR sit alongside the SMR and MIC? Will there be substituted compliance (or at least recognition) where an individual or subsidiary is covered under one or the other of these regimes.

- The conduct in the scope of the BEAR is also covered by other civil penalty regimes (for e.g. ASFL obligations[7]). This emphasises the issues we raise at 14 above, in terms of guidance being required as to how APRA will exercise its powers as the threat of

[7] See also, relevantly, s. 13 of the *ASIC Act 2001* (Cth),

multiple regulatory sanctions for a common set of facts will be particularly disturbing to ADIs. Also, how will APRA and ASIC coordinate investigations? We would hope to see a situation, like with the FCA and PRA in the UK, where one regulator would take the lead in a single investigation. An ADI faced with separate regulatory investigations into the same or similar conduct could be unduly vexatious and otherwise lead to unintended consequences, for e.g. disjointed outcomes.

The growing trend of collateral class actions is another reason which enhances the risks posed to ADIs with respect to overlapping civil penalty regimes, especially if not managed in a coordinated fashion. Also relevant is how the BEAR will interplay with AFSL's breach reporting obligations to ASIC, itself the subject of a current review which is considering adopting to some extent Principle 11 of the FCA Handbook's Principles for Businesses, which requires a firm to deal in an open and cooperative way with regulators and to disclose to its regulators anything relating to the firm of which the regulator would reasonably expect notice. Will this involve providing names of individuals who may have breached the BEAR to ASIC?

- An internal register which stores information about (among other things) *"issues that could affect a candidate's suitability for* [a] *role"* and is exempt from privacy and freedom of information legislation is concerning. Any adverse indication made by APRA about an individual's suitability could have a profound effect on their career.

  For this reason and reasons of natural justice, we think that individual should be able to access information held about them by APRA (and see to correct such information if it is incorrect).

- The Consultation Paper notes that policy consideration is being given to precluding insurance being taken out for breaches of the BEAR by individuals (i.e. against removal and/or disqualification) and ADIs. The rationale is that such insurance may undermine the deterrent effect of civil sanctions administered under the BEAR.

  We do not think that a preclusion of insurance is warranted. The reputational and corollary implications (e.g. potential collateral claims, loss of clients, etc) of civil sanctions under the BEAR are, quite aside from financial implications (including increased premiums, etc), a sufficient deterrent in and of themselves. Accountable persons will be concerned about their careers, reputations and personal finances and will seek that appropriate protections be put in place in the form of indemnities, D&O insurance and/or access to documents (including after they leave the ADI).

- On 26 July 2017, the FCA and PRA published their proposals to extend the SMR to all sectors of the insurance and reinsurance industry regulated by the FCA and/or

PRA. A full scope SMR regime will apply to Solvency II firms and large Non Directive Firms (**NDF**s) and a streamlined regime will apply to small NDF's, small run off vehicles and Insurance Special Purpose Vehicles. Insurers will be subject to the Certification regime, Fit and Proper test obligations and Conduct Rules requirements.

Noting the above, is the intention for the BEAR to be extended beyond ADIs in the future? If so, inter alia, that will add emphasis to the final matter we raise below.

- We note the additional budget to be provided to APRA to administer the BEAR in the 2017-18 Budget papers. The regulator's resources to engage with the industry around implementation, including the accountability mapping exercise and registration issues will be critical to ensure effective implementation of this significant reform.

  A sizable number of consultation papers and guidance notes were issued and industry-engagement exercises undertaken by the UK regulators in connection with the SMR; we very much hope to see the same take place in Australia.

We thank you for considering our submission in relation to the Consultation Paper.

If you wish to discuss our submission, please contact Angela Pearsall, Partner at angela.pearsall@cliffordchance.com or Liam Hennessy, Senior Associate at liam.hennessy@cliffordchance.com.

Yours faithfully

Clifford Chance