INSURANCE COUNCIL OF AUSTRALIA

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Dear Ms Wall

## BANKING EXECUTIVE ACCOUNTABILITY REGIME CONSULTATION PAPER

The Insurance Council of Australia[1] (Insurance Council) appreciates the opportunity to comment on the Treasury's Banking Executive Accountability Regime Consultation Paper (the Consultation Paper). Our submission focuses on the section of the Consultation Paper that canvasses options to expand APRA's removal and disqualification powers[2]. We recognise that any expanded powers would apply to all APRA-regulated institutions.

However, the Insurance Council would also like to provide our general observations about the BEAR, which was formally announced[3] by the Treasurer, the Hon Scott Morrison MP, on 9 May 2017, and released in the 2017-18 Budget. In doing this, the Treasurer stated that:

> "… the Government will legislate for a new Banking Executive Accountability Regime that will ensure banks and their executives are held accountable when they fail to meet expectations".

The Consultation Paper[4] reaffirmed the connection between the additional measures and the need to ensure prudential strength and better consumer outcomes:

> "ADIs are in scope of the BEAR due to the critical role they play in the economy and in response to community concern regarding recent poor behaviour. It is imperative that they maintain the trust of financial sector participants and depositors in particular."[5]

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[1] The Insurance Council of Australia is the representative body of the general insurance industry in Australia. Our members represent more than 90 percent of total premium income written by private sector general insurers. Insurance Council members, both insurers and reinsurers, are a significant part of the financial services system. March 2017 Australian Prudential Regulation Authority statistics show that the private sector insurance industry generates gross written premium of $45 billion per annum and has total assets of $123.6 billion. The industry employs approximately 60,000 people and on average pays out about $142 million in claims each working day.

Insurance Council members provide insurance products ranging from those usually purchased by individuals (such as home and contents insurance, travel insurance, motor vehicle insurance) to those purchased by small businesses and larger organisations (such as product and public liability insurance, professional indemnity insurance, commercial property, and directors and officers insurance).

[2] The Treasury's '*Banking Executive Accountability Regime*' Consultation Paper. July 2017, pages 12-13 refer.

[3] Press release from the Commonwealth Treasurer, The Hon Scott Morrison MP: '*Building an accountable and competitive banking system*', 9 May 2017.

[4] The Treasury's '*Banking Executive Accountability Regime*' Consultation Paper. July 2017, page 7 refers.

[5] The Treasury's '*Banking Executive Accountability Regime*' Consultation Paper. July 2017, page 4 refers.

The Consultation Paper also emphasises that the BEAR is intended to make clear the expected conduct of ADIs and will apply in that context where there is poor conduct or behaviour that is of a *systemic* and prudential nature.[6]

The Insurance Council notes the Consultation Paper explicitly recognises that:

> "The proposed scope would mean that the BEAR would apply in relation to a business (such as an insurer) that is part of an ADI group or subgroup, but not to its competitor that is not part of an ADI group or subgroup. ***This difference reflects the unique position of ADIs. ADIs enjoy a privileged position of trust in the financial system, with prudential regulation designed to provide consumers with confidence in the safety of their deposits."*** [7] (Our emphasis)

The Insurance Council takes no position on the application of the BEAR to ADIs, trusting that the Government will proceed after a careful cost/benefit analysis of the additional regulation proposed. However, the Insurance Council submits that any extension of the BEAR to apply to the general insurance industry more broadly would be entirely inconsistent with the Government's intent and fails to recognise the strength of the existing regulatory framework applying to the general insurance sector. Critically, the Insurance Council is not aware of any issue in the general insurance sector that is systemic and prudential nature, or that remains without a remedy under the broader regulatory regime protecting general insurance policy holders.

## APRA's removal and disqualification powers

The Insurance Council is very concerned about the potential approach suggested in the Consultation Paper to permit APRA to disqualify a person *without* applying to the Federal Court. This would allow APRA to disqualify a person from being a senior manager, director or auditor of an APRA-regulated institution or non-operating holding company (NOHC) where it alone is satisfied that the person is not a fit and proper person for the role, subject to appeal.

While the Insurance Council appreciates the need for APRA to have powers appropriate for the differences between each regulated sector, we do not support the potential approach suggested in the Consultation Paper. We submit that the existing Federal Court-based disqualification process is well understood and operates effectively to enable disqualification as appropriate.

Importantly, the Insurance Council is concerned that the Consultation Paper does not identify any proven need for an expansion of APRA's removal and disqualification powers, nor has the Consultation Paper assessed the efficacy of the established Federal Court-based disqualification process, which has been in place since 26 May 2008 and was settled after a robust consultation process and the release of a numerous consultation papers from the Treasury seeking public views.

The basic rationale in the Consultation Paper to expand APRA's removal and disqualification powers is that expanding its powers would "… *make it easier for APRA to ensure that individuals who do not meet standards of competency and conduct cannot remain in their position*…[8]".

However, this view appears to overlook the origins and fundamental policy rationale underpinning the current Federal Court-based disqualification process.

As the Treasury would be aware, prior to 26 May 2008, APRA was able to disqualify an individual from holding a senior role in an APRA-regulated institution without having to apply to a court. In December

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[6] The Treasury's '*Banking Executive Accountability Regime*' Consultation Paper. July 2017, page 7 refers.
[7] Ibid.
[8] The Treasury's '*Banking Executive Accountability Regime*' Consultation Paper, July 2017, page 13 refers.

2006 however, the then Government initiated consultation[9] on proposals to reform the framework for reviewing administrative decisions by APRA.

In light of stakeholder concerns raised during that consultation process, the then Treasurer Peter Costello AC announced[10] in April 2007 a proposal to introduce a court-based process for decisions to disqualify individuals under APRA-administered legislation, similar to the disqualification framework used by ASIC[11]. The proposal received broad support from stakeholders[12], some of which observed significant problems with APRA's discretionary disqualification power and the need to align APRA's powers with ASIC's powers.

For example, the Law Council of Australia[13] pointed to an increasing propensity by APRA to exercise its disqualification powers and that APRA's use of its power did not seem consistent with the legislative intent, adding that a number of APRA's disqualifications were overturned upon independent review by the Administrative Appeals Tribunal.

As a further example, the Australian Institute of Company Directors[14], in support of that proposal, emphasised that a court-based disqualification process offers an independent and transparent process for determining sensitive matters that potentially have far reaching and very damaging consequences for individuals concerned.

The *Financial Sector Legislation Amendment (Review of Prudential Decisions) Act 2008* subsequently introduced the current Federal Court-based disqualification procedure. In terms of understanding how this Act addresses the aforementioned stakeholder concerns, it is instructive to consider; for example, the Second Reading speech of the then Government leader in the Senate explained that:

> "*The Financial Sector Legislation Amendment (Review of Prudential Decisions) Bill 2008 introduces measures to improve the accountability, transparency and consistency of decisions made by the Australian Prudential Regulation Authority*." [15]

Under the Federal Court-based disqualification process[16], APRA may become concerned about an individual's fitness and propriety or conduct through its normal supervision work, formal investigations, information provided under the whistle-blower provisions or from other regulators. If a concern is identified, APRA would first undertake a preliminary assessment of the situation and evidence available and, if satisfied that a sound case has been made for disqualification, APRA would commence proceedings in the Federal Court.

Any further deliberation on changing APRA's removal and disqualification powers should therefore be undertaken in light of clear and specific evidence of examples that cannot be addressed through the Federal Court-based disqualification process or any other APRA enforcement mechanism more broadly.

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[9] The Treasury's Proposals Paper, '*Streamlining Prudential Regulation: Response to 'Rethinking Regulation*', December 2006.

[10] Press release from the then Commonwealth Treasurer Peter Costello AC: '*Framework for reviewing administrative decisions by the Australian Prudential Regulation Authority (APRA)*', 16 April 2007. See also the Treasury's Consultation Paper, '*Review of Prudential Decisions*', 31 May 2007.

[11] As explained on APRA's website, the process is not dissimilar to that which occurs when ASIC commences proceedings under sections 206D or 206E of the *Corporations Act 2001* (court powers of disqualification).

[12] Department of Parliamentary Services, '*Financial Sector Legislation Amendment (Review of Prudential Decisions) Bill 2008*', Bills Digest, 31 March 2008, no. 73, 2007–08, page 8 refers.

[13] The Law Council of Australia's 2 July 2007 submission to the Treasury's Consultation Paper, '*Review of Prudential Decisions*'.

[14] The Australian Institute of Company Directors' 28 June 2007 submission to the Treasury's Consultation Paper, '*Review of Prudential Decisions*'.

[15] The then Government leader in the Senate, Joe Ludwig: '*Cross-border Insolvency Bill 2008 – Financial Sector Legislation Amendment (Review of Prudential Decisions) Bill 2008*', Second Reading, 13 February 2008.

[16] The current Federal Court-based disqualification process as explained on APRA's website.

The Insurance Council also submits that the Consultation Paper fails to address the possible severe impact of its suggested approach on APRA-regulated institutions and their customers. We are particularly concerned that unnecessarily abandoning the Federal Court-based process would create a significant level of uncertainty for industry. Directors, for instance, when their company faces challenging circumstances may prefer to resign when their expertise is most needed, rather than risk disqualification for making what could be necessary – albeit, unpopular – decisions that may help support a company's long term financial viability.

### Suggestion to prevent individuals from purchasing insurance

The Insurance Council is also very concerned that the Consultation Paper suggests it may be necessary to prevent individuals from taking out insurance against removal and disqualification, to give the prospect of removal and disqualification "*a deterrent effect against poor behaviour*[17]". The Insurance Council strongly disagrees with any view that suggests insurance contributes to poor behaviour – this is a misguided view that fails to properly consider the core role of insurance and its necessary conditions and exclusions.

While it is not clear which type of insurance the Consultation Paper is referring to, the Treasury may wish to carefully consider Directors' and Officers' Liability Insurance (D&O insurance) as one example. D&O insurance covers the assets of company directors and other officers of a company against personal liability claims. Directors and officers can face unlimited personal liability as a result of their actions and the activities of their colleagues, and claims against directors and officers often involve substantial damages or financial penalties and defence costs. It is widely accepted that D&O insurance is required by a company to protect its directors and officers and therefore to secure their appointment.

The need for D&O insurance is further highlighted by the continued uncertainty in the regulatory and economic landscapes, which appear to be having an unsettling effect on many Australian companies. As a result, company directors and officers are under greater scrutiny from their stakeholders than ever before, to the extent that some can be found personally liable for decisions made in good faith.

Given the above, it is important to emphasise that D&O insurance is critical to any modern, global economy like Australia's. Without D&O insurance, the scale of potential personal exposure would operate as a material disincentive for business decisions upon which future innovation and growth in Australia are often founded. As the Treasury would appreciate, this would damage national productivity and therefore Australia's ability to compete effectively with rival foreign economies.

The Insurance Council understands from its members that the insurance market generally has the capacity to provide companies with D&O insurance policies that enable them to satisfy their evolving requirements. Industry feedback is that companies that have difficulties in obtaining insurance are likely to have business models or processes that create a higher probability of directors and officers breaching their professional duty of care, or have an adverse claims history. It is not uncommon for D&O insurance providers to receive applications for insurance where it is not clear what financial services the company proposes to provide – these are generally taken to be an unacceptable risk.

While there are a number of situations where D&O insurance may not react to reimburse an insured fully, or in part, the largest proportion of situations where insurance policies do not reimburse the insured concern fraud by the insured, or the insured's director or officer. This is why D&O insurance policies typically do not cover fraudulent, criminal or deliberately unjust actions, or where an individual acted for personal profit or gained illegal remuneration.

[17] The Treasury's '*Banking Executive Accountability Regime*' Consultation Paper, July 2017, page 13 refers.

Additionally, the Insurance Council is not aware of any evidence suggesting that the prospect of removal and disqualification – under the current regulatory process – is not an effective deterrence against poor behaviour. Reputational damage incurred from being removed and disqualified can have long term negative consequences on an affected person's professional outlook and their personal wellbeing more generally, particularly as it may operate as a significant barrier to future labour market participation.

If you have any questions or comments in relation to our submission, please contact John Anning, the Insurance Council's General Manager Policy, Regulation Directorate, on (02) 9253 5121 or janning@insurancecouncil.com.au.

Yours sincerely

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