

CEO & Managing Director
Level 29 Brisbane Square
266 George Street
BRISBANE QLD 4000
GPO Box 1453
Brisbane QLD 4001
Telephone: 07 3135 3222
Facsimile: 07 3135 4388

3 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,

SUNCORP SUBMISSION – BANKING EXECUTIVE ACCOUNTABILITY REGIME

Suncorp believes senior executives in Australia's corporate sector should be held to the highest levels of accountability and conduct standards.

We support Treasury's observation that banks enjoy a privileged position of trust and consumers need to have confidence and appropriate safeguards to protect their interests.

Australia has a long and proud history of good corporate governance which has helped protect the national economy from global financial impacts and contributed to strong periods of economic growth, often the envy of developed countries around the world.

Indeed, a significant part of Australia's economic success can be traced back to a healthy relationship between financial institutions and financial regulators such as the Australian Prudential Regulation Authority (APRA).

In addition, there is often a good balance struck between free enterprise that drives competition and necessary regulation that safeguards consumers.

However, Suncorp is concerned about policy responses that wield blunt regulatory instruments unevenly across the financial services sector creating scope for anticompetitive regulatory arbitrage.

We note that all APRA-regulated institutions, including authorised deposit-taking institutions (ADIs) must comply with an already strong regulatory framework that governs prudential standards, executive conduct and propriety, remuneration policy, board governance, through to product, pricing and distribution.

An additional layer of regulation to further oversight and control executive conduct and board governance must be carefully designed and scoped with a clear policy intent to avoid unintended consequences.

At a time when the financial services industry is working diligently to raise customer outcomes, attracting and retaining high performing talent to the sector may become more difficult under the BEAR, given the broad obligations and consequences imposed on accountable persons.

It risks causing the sector to lose high performing executive managers to non-regulated organisations. This situation is more acute for Suncorp due to the unique structure of the Group's operating model.

Suncorp requests that Treasury considers the following points when developing the BEAR:

1. Accountable institutions are given **appropriate flexibility** to apply a principles-based approach; to achieve alignment to the greatest extent possible with existing regulatory frameworks (e.g. 'responsible persons' already exist under Prudential Standard CPS 520 Fit and Proper), and in recognition that every regulated entity's structure and business model is different;
2. APRA limits its regulatory actions under the BEAR to clearly defined incidences of poor conduct or governance of a systemic nature to minimise the extent to which the BEAR could discourage breach reporting or decisions to invest in innovation and new ideas, that could deliver significantly improved consumer outcomes;
3. Accountable persons are afforded natural justice before being found liable under the BEAR and receiving penalties by APRA;
4. Accountable institutions or persons are not liable under the BEAR for poor conduct by independent intermediaries, such as mortgage brokers, if it can be demonstrated that a defined level of oversight was in place;
5. A principles-based approach to variable remuneration is appropriate, with APRA encouraged to consider:
 - a. greater guidance be provided to effectively define 'variable remuneration';
 - b. a pragmatic and proportionate approach to deferral should be applied to allow risk-based determination of outcomes and the ability for pro rata vesting over the deferral period;
 - c. limiting extension of powers, recognising the risk of usurping the independence of remuneration committees and boards;
6. Implementation timeframes for accountable institutions should be practical and realistic.

Suncorp's reasoning behind these recommendations is set out below.

About Suncorp and its operating model

Suncorp Group Limited is a top 20 ASX-listed company with \$97 billion in assets. The company has evolved to become a unique, diversified financial services company, delivering highly-valued banking and wealth, and insurance products and services, across Australia and New Zealand.

Today the Group employs approximately 13,400 employees and serves close to nine million customers through its trusted brands including Suncorp, AAMI, GIO, Shannons, Vero and Apia.

Integral to meeting customer needs are our operational businesses:

- Banking & Wealth;
- Insurance;
- Strategic Innovation; and
- Suncorp New Zealand

The Customer Experience and Customer Platform functions support these operational business units and use data, insights and forward-looking analytics to inform product innovation, and deliver experiences and solutions that meet more of our customers' needs.

Suncorp is one of Australia's largest general insurers by gross written premium (GWP) and the second largest general insurer in New Zealand.

Suncorp Bank is one of Australia's leading regional banks serving one million personal, small to medium enterprise (SME), and agribusiness customers.

Life insurance and superannuation products are provided through the Group's brands and via aligned and independent financial advisers.

All areas of the Group are supported by mainly centralised corporate functions including Finance & Advice, Technology, Data & Labs, People Experience, Risk, Legal, and Program Excellence.

Suncorp's purpose is to create a better today for all of our stakeholders, including our customers, shareholders, people and communities.

A highly regulated financial services system

Suncorp operates in a highly regulated financial services system and complies with all regulations and policies across banking, wealth and insurance.

As the consultation paper points out, APRA already oversees a comprehensive prudential framework with standards covering:

- culture: Prudential Standard 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: Prudential Standard 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. Moreover, Prudential Standard CPS 232 Business Continuity Management requires an ADI to maintain a business continuity management policy that ensures it is able to meet its financial and service obligations to its depositors, policyholders and other stakeholders; and
- fit and proper: Prudential Standard 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.

These standards apply over and above the duties of directors under the Corporations Act.

In addition, the Australian Securities and Investments Commission (ASIC) oversees an equally comprehensive and rigorous regulatory framework governing market conduct.

Similar stringent prudential standards and regulatory requirements apply to all APRA-regulated entities, not just ADIs.

Suncorp has rigorous and appropriate arrangements, systems and processes in place to meet existing regulatory requirements and we invest in a highly disciplined culture of compliance to ensure we are upholding all rules and regulations regarding governance and conduct.

Suncorp submits that the BEAR must not bring confusion and duplication to the existing framework which has largely been effective in ensuring good governance and conduct across the Australian financial services industry.

Areas of concern and related suggestions

- 1. Accountable institutions should be given appropriate flexibility to apply a principles-based approach, to achieve alignment to the greatest extent possible with existing regulatory frameworks (e.g. 'responsible persons' already exist under Prudential Standard CPS 520 Fit and Proper), and in recognition that every regulated entity's structure and business model is different.*

As noted above, Australia's financial services system is characterised by a strong regulatory framework that aims to strike a balance between competitive markets and consumer protection.

The paper states the BEAR's objective is not to replace or change the existing prudential framework.

On that basis, the group of accountable persons under the BEAR should be permitted to align to the greatest extent possible with the institution's Prudential Standard CPS 520 Fit and Proper list of responsible persons.

Accountable institutions could then apply the principles flagged in the paper, and ultimately contained in the framework, to finetune the list in accordance with APRA's expectations and the Government's policy intent, noting that it is to capture only "the most senior and influential directors and executives".

This would minimise complexity between the two lists, respective obligations, regulatory frameworks and compliance systems. This would also minimise the disproportionate compliance burden the smaller ADIs face due to industry reform.

Suncorp's business profile and model presents unique challenges in producing a short list of accountable persons when 'carving out' ADI-only roles of significant influence and accountability. Few roles are aligned solely to the ADI.

This could unintentionally disadvantage Suncorp because its executives may be held to a different set of rules and regulations to those employed by other insurance companies, presenting challenges in recruiting and retaining high performing talent.

More broadly, the more onerous and restrictive regime could result in a drain of quality executives from the wider industry to non-ADI sectors, ultimately resulting in poorer outcomes for customers.

The BEAR may also result in organisations restructuring, or being compelled to relocate their operations, to minimise impacts.

The consultation paper foreshadows significant complexities in the way it attempts to capture only a segment of the sector, without taking full account of the different structures and models that exist among multi-service groups.

- 2. APRA limits its regulatory actions under the BEAR to clearly defined incidences of poor conduct or governance of a systemic nature to minimise the extent to which the BEAR could discourage breach reporting, or decisions to invest in innovation and new ideas that could deliver significantly improved consumer outcomes.*

The new regime will establish expectations on how executives and directors conduct their business consistent with good prudential outcomes.

These expectations would cover matters such as conducting business with integrity, due skill, care and diligence and acting in a prudent manner.

A new civil penalty will be created with a maximum penalty of \$200 million for larger ADIs, and a maximum penalty of \$50 million for smaller ADIs, that fail to meet these new expectations, increasing incentives for processes that ensure operations are conducted appropriately.

These are significant new powers for APRA that should be treated very carefully and governed by their own necessary accountabilities and rights of appeal.

Suncorp contends that the behaviours expected of accountable persons are ambiguous and give rise to concerns that the scope could be broader than “poor conduct or behaviour that is of a system and prudential nature.”

New ‘expectations’ should be very clearly defined and build on existing requirements such as those set out in the Corporations Act and other instruments such as ASIC’s market conduct regulatory regime.

Some of the proposed expectations are uncertain including the duty to be ‘open’. Greater clarity is needed to ensure all parties have a comprehensive understanding of what is expected and how they should manage their accountabilities and responsibility mapping.

For example, a new regime that meted out significant penalties, even deregistration, for a broad range of ASIC breaches, including isolated cases, could potentially drive a culture where reporting of outcomes is reduced out of fear of repercussions under the BEAR.

Equally, executives may be dis-incentivised from investing in innovation, due to concerns that new initiatives could lead to poor outcomes and subject them to BEAR penalties.

- 3. Accountable persons are afforded natural justice before being found liable under the BEAR and receive penalties by APRA.*

Suncorp has comprehensive performance management and governance processes in place which support ethical behaviour and integrity and aligns rewards to performance including good outcomes to customers.

Situations which may arise and result in a negative outcome are closely examined and measures implemented to improve performance.

Consideration is given as to whether it is appropriate for consequences (i.e. remuneration or other), to apply to those responsible.

The BEAR should only be enacted after internal remedial and investigative actions have occurred, or where there is evidence that the financial institution has not taken appropriate action.

Specifically, the accountable institution should be afforded every right to demonstrate how it has assessed an incident and its determination of whether adequate safeguards, oversight and risk management occurred.

These steps are fundamental to informing how the BEAR should apply, if at all.

A concerning aspect of APRA's new powers is the proposal for APRA to essentially remove accountable persons without reference to due process.

This provision would not be in keeping with a fair and just society nor provide an adequate level of accountability and safety net for APRA's decisions that may effectively end a person's career.

4. *Accountable institutions or persons are not liable under the BEAR for poor conduct by independent intermediaries, such as mortgage brokers, if it can be demonstrated that a defined level of oversight was in place.*

As described above, careful judgement should be made about accountabilities for harmful and systemic conduct that occurs outside the accountable institution, such as non-ADI-owned aggregators or intermediary businesses.

The BEAR must be designed based on the full recognition that ADI oversight over intermediary services will always be limited.

5. *A principles-based approach to variable remuneration is appropriate with APRA encouraged to consider*
 - a. *greater guidance be provided to effectively define 'variable remuneration';*
 - b. *a pragmatic and proportionate approach to deferral should be applied to allow risk-based determination of outcomes and the ability for pro rata vesting over the deferral period;*
 - c. *limiting extension of powers recognising the risk of usurping the independence of remuneration committees and boards.*

Prudential Standard CPS 510 Governance (CPS 510) requires the entity to establish a Board Remuneration Committee and maintain a Remuneration Policy that aligns remuneration and risk taking. The requirements of remuneration practice are further informed by other laws and regulations.

The most significant influence on remuneration is the company's strategy. Accordingly, overly prescriptive approaches may have unintended or negative impacts on entities that operate prudent, risk-balanced remuneration policies.

Variable remuneration requires appropriate definition. This need not be problematic but reference could be made to CRDIII/IV in the European Union which provided a definition of variable pay in the context of introducing a set ratio of variable to fixed pay, noting this led to complexity in the form of additional allowances.

The UK Senior Manager and Certifications Regime definition of fixed pay is a reasonable starting point but there could be stronger emphasis on fixed remuneration being a specified, predetermined amount of money in exchange for services that does not vary with performance.

By contrast, the key consideration for variable remuneration is payment being contingent on performance goals, which in Suncorp's approach takes into account customer outcomes, and ultimately is subject to the Remuneration Committee's determination.

Additional considerations requiring clarity include the treatment of termination payments where reference should be made to provisions in the Corporations Act.

A termination payment should not be considered variable remuneration. Deferred remuneration under 'good-leaver' provisions should also be addressed.

Noting the restrictions within the Corporations Act on accelerated or automatic vesting of share-based payments or entitlements on termination, clarity should be provided in the proposed legislation.

Suncorp believes acceleration of vesting should, generally, not be permitted but whether a deferred award is reduced by future service forgone, should be a matter for the Board.

Consideration should also be applied to Long Term Incentives (LTI), which typically constitute a significant proportion of executive remuneration. By definition, all LTIs are deferred and constitute value at risk. The calculation of the ratio between the variable and the deferred component should take LTIs into account.

Suncorp agrees that the intention of deferral is to provide for an appropriate period for potential risks to emerge that if known at the time of award determination would have led to a different award outcome.

The period of deferral should reflect inherent risk, but should provide appropriate flexibility given the cumulative nature of value at risk.

We encourage a pragmatic approach such as allowing awards to vest pro rata over the prescribed period.

We would also support principles that allow for proportionality so that a company can comply with the BEAR in a manner that is appropriate to its size, internal organisation and the nature, scope and complexity of its activities.

Suncorp believes flexibility and a principle-based approach is vital to attract relevant talent to the industry who may not be 'career financial services employees'.

Overly prescriptive remuneration arrangements could serve as a dis-incentive or require a premium in fixed remuneration.

A clear example is within technology where the expertise required to develop, implement and sustain critical enabling technology is often sourced from a global market outside of financial services.

Further examples exist in other areas of the industry and without access to such talent, outcomes for customers could be negatively impacted.

Suncorp understands the intent of the BEAR is to enhance accountability of ADIs and key accountable roles.

Enhancing APRA's 'powers to require ADIs to review and adjust remuneration policies' should be clearly articulated.

We draw attention to the governance of remuneration already in place that provides for Remuneration Committee and shareholder disclosure and approval. The independence of such governance should not be undermined.

Importantly, without an appropriate change period, consultation with shareholders and their representatives arising through changes to policy may have adverse consequences due to the Corporations Amendment (Improving Accountability on Director and Executive Remuneration) Act 2011 (Cth).

The interaction of these proposals with the 'two-strikes' rule suggest that boards are best placed to balance stakeholder interests regarding remuneration policy.

Further to this, Suncorp is concerned about the risk of any new regime conflicting with existing laws governing duties of directors.

Boards have clear obligations to their shareholders about strong and prudent management of the company, strategic objectives and making sure senior executives are appropriately qualified and skilled according to their roles and responsibilities.

The 'expectation' for accountable persons to 'act with integrity, due skill, care and diligence and be open and co-operative with APRA' appears to sit awkwardly alongside existing provisions in the Corporations Act around duty of care and diligence for directors.

Suncorp would like to be satisfied that the BEAR will not cause undue confusion over similar provisions in different pieces of legislation.

The BEAR should not override the duties imposed on directors under existing legislation and should only apply to APRA's new powers to determine registration and remuneration of the BEAR-accountable entities.

Suncorp thanks Treasury for its consideration of these matters. Should you wish to discuss any of the points raised in this submission, please contact Joshua Cooney, Senior Manager, Government, Industry and Public Policy, Suncorp, on 0477 391 260 or joshua.cooney@suncorp.com.au.

Regards,



Michael Cameron
CEO and Managing Director