

29 September 2017

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Dear Tony

Treasury Laws Amendment (Banking Executive Accountability and Related Measures) Bill 2017

The Australian Bankers' Association (**ABA**) takes the short opportunity to provide The Treasury with comments regarding the exposure draft of the *Treasury Laws Amendment (Banking Executive Accountability and Related Measures) Bill 2017 (Exposure Draft Bill)*¹ and accompanying draft Explanatory Memorandum (**Draft EM**).²

With the active participation of its 24 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

As we noted in our letter of 4 August 2107 (**August letter**)³ in relation to *Banking Executive Accountability Regime (BEAR) Consultation Paper (Consultation Paper)*⁴ the ABA welcomes those reforms that strengthen accountability and competition in the banking system. The ABA supports enhanced responsibility and accountability of Authorised Deposit-taking Institutions (**ADIs**) and supports 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".

Given industry support for responsible reform it is most regrettable that only one week has been allowed to comment on the complexities of the Exposure Draft Bill and Draft EM, this cannot be the acceptable standard for Australian Public Service (APS) policy design and development envisaged by the PM&C⁵. This is important legislation, it deserves appropriate consultation and consideration. The ABA strongly recommends further consultation and consideration to avoid unintended consequences. In the short time made available ABA have limited opportunity to fully consider the implications of the

¹The Exposure Draft Bill can be accessed at: <https://static.treasury.gov.au/uploads/sites/1/2017/09/EXPOSURE-DRAFT.pdf> . All references to sections in this letter are to sections in the Explanatory Draft Bill.

² The Draft EM can be accessed at: <https://static.treasury.gov.au/uploads/sites/1/2017/09/EXPLANATORY-MEMORANDUM.pdf>.

³ ABA letter of 4 August 2107 http://www.bankers.asn.au/images/uploads/Submissions/ABA-131090-v1-ABA_Submission_BEAR_4_August.pdf

⁴ The Consultation Paper can be accessed at: https://static.treasury.gov.au/uploads/sites/1/2017/08/c2017-t200667-BEAR_cp.pdf.

⁵ PM&C letter to ANAO <https://www.anao.gov.au/work/performance-audit/design-and-monitoring-national-innovation-and-science-agenda#24-0-appendices>

Exposure Draft Bill, but have identified a number of critical issues which go to the heart of an effective and efficient regime.

The ABA will not repeat all of the issues raised in our August letter but note that many of those issues have not been addressed in the Exposure Draft Bill and remain of considerable concern to the development of responsible and certain legislation. ABA would welcome an opportunity to engage further in relation to those issues.

On the basis that such little time has been allowed for consultation this submission focuses on a number of key issues and makes some recommendations in relation to those issues.

This submission is divided into four parts:

- **Implementation and timing**
- **Key issues and recommendations**
 - BEAR to apply on an ADI group basis
 - Context of entity and accountable person, objective standard
 - Extent of accountabilities
 - Limitation to matters affecting an ADI's prudential standing
 - Disqualification of accountable persons
 - Legal Professional Privilege
 - Class Actions and other litigation
 - Clear regulatory roles
- **Annexure 1: Additional issues for consideration**
- **Annexure 2: Proposed amendments to 37C and 37CA**

Implementation and timing

The Exposure Draft Bill provides for the substantive changes in Schedules 1 and 2 to commence on 1 July 2018 (**Commencement Date**), with some additional phasing provided to accommodate changes in employment arrangements.

As ABA noted in our August letter, the additional powers and responsibilities granted to Australian Prudential Regulation Authority (**APRA**) as part of the BEAR are significant. Effective implementation of the BEAR in Australia will require significant effort and reallocation of resources by industry and APRA to meet the proposed deadline.

The proposed Commencement Date does not allow enough time for effective implementation

The 1 July 2018 commencement of the obligations under the BEAR is far too short a timeframe for implementation of significant new requirements. The Financial System Inquiry's Final Report recognised the burden of complex regulatory reform with the Government accepting recommendation 31, namely to increase the time available for industry to implement complex regulatory change. The 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.⁶ ABA note that for all our members the burden of continual regulatory change is very material and, the more so, when the time to implement these reforms is so compressed. The impact on regional and smaller banks with more limited resources is particularly acute and the complexity facing ADIs with a large footprint is challenging.

Clarity around affected entities and roles is essential to an efficient and compliant implementation and further work is required by Government and APRA before that certainty exists. For example, the

⁶ Financial System Inquiry, *Final Report* (2014) 257.

Exposure Draft Bill contains broad powers to exempt certain ADIs, or subsidiaries of ADIs, from certain responsibilities.⁷ Clarity around the processes and timelines on how such exemptions are to be obtained is necessary well ahead of the regime taking effect.

Further the definition of large, medium and small ADIs needs to be determined (ss 37EB and 37G(3)).

Further, the 1 July 2018 date does not take into account:

- 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 for regulators should not be underestimated.
- APRA's existing Fit and Proper and Governance obligations as set out in APRA Prudential Standards CPS 520 Fit and Proper (CPS520) and CPS 510 Governance (CPS510) mean that a longer or phased implementation is feasible without any risk to the Australian financial system (noting that the interaction of that guidance with BEAR will also require consideration by APRA).
- The Commencement Date also fails to take into account the current absence of APRA's prudential guidance, practice notes and reporting requirements to support the implementation of the BEAR which are required by ADIs to provide definition of the expectations behind the broad obligations reflected in the BEAR. The ABA requests that Treasury and APRA discuss and publish the timing and sequence of tasks required for APRA to complete the steps necessary for the implementation of BEAR within APRA. This should inform an appropriate start date.

Recommendation: *The BEAR should have an implementation date that is the earlier of:*

- 1) 1 January 2019; or
- 2) one year from the finalisation of the legislation, all relevant exemptions, determinations and APRA prudential standards, guidance and reporting requirements.

In the alternative, to ensure that the regime can be implemented as soon as possible for key affected entities and individuals a phased approach to implementation should be adopted. This could operate by:

- a) *providing for obligations to apply first to the ADI, and then to affected subsidiaries (if any) 12 months after all relevant determinations are made; and*
- b) *phasing obligations to apply first to ADI Directors only and the most senior management of the ADI (such as the Chief Executive Officers and the responsibilities listed in paragraphs 37BA(3)(c) and (d), and then to any additional roles 12 months later after the relevant exemptions and classifications have been promulgated).*

Key issues and recommendations

BEAR to apply on an ADI group basis

The ABA strongly objects to the application of the BEAR to all subsidiaries within an ADI group (both within and outside Australia).

The Exposure Draft Bill does not limit the scope of the BEAR to subsidiaries of significance to an ADI group. Most large ADI groups have hundreds of subsidiaries. Many of these subsidiaries will be holding companies, trustee companies, investment vehicles, special purpose vehicles or companies that exist for historical reasons, the vast majority of which do not materially or significantly impact the ADI group's business or prudential standing as a whole.

⁷ Sections 37A, 37BB, 37KA of the Explanatory Draft.

In relation to accountable persons, it is common for subsidiary boards to be staffed by mid-level executives. In addition, for the most part, a potential accountable person operating within an ADI subsidiary will report into a group executive, or more likely through a manager reporting to a group executive, and will not have autonomous management responsible for the subsidiary on a standalone basis.

As we set out in the August letter the ABA strongly recommends that the BEAR apply to an ADI group: that is, “accountable persons” must be able to influence or impact the whole, or substantial part of, the ADI and its subsidiaries as a consolidated group. Further, the BEAR should be limited to the most senior executives only (not reports to such persons).

Such an approach not only achieves the policy intent of the BEAR in the most efficient manner possible, it resolves many of the legal uncertainties raised in this submission and would promote an orderly and cost-efficient implementation of an effective Australian regime. Analysis and implementation for each and every subsidiary in an ADI group will greatly delay implementation and add material cost for no real enhancement to the intended accountability of those executives with responsibilities that impact the prudential standing of an ADI.

The ABA considers this recommendation is consistent with the policy stated in paragraphs 1.29 – 1.30 of the Draft EM.

Recommendation:

- 1) *BEAR should apply to an ADI consolidated group and accountable persons must have effective responsibility for the whole, or substantial part of, the ADI group.*
- 2) *If this recommendation is not adopted it is critical that the Exposure Draft Bill is amended to limit the application of BEAR to subsidiaries which have a substantial impact on the prudential standing of the ADI consolidated group. Accountable persons should be defined by reference to their role in the ADI group that is with actual or effective responsibility for management or control of the ADI group, or a substantial part or aspect of the ADI group taken as a whole (regardless of which entity is their employer). Supporting guidance and the Draft EM should be clear that the BEAR does not apply to subsidiary non-executive directors or executives of such subsidiaries, unless they also hold the ADI group role.*

The ABA notes that the concerns raised in our August letter regarding the competitive distortions that will impact all BEAR ADIs regardless of size have not been addressed. Systemic trust in the financial services industry comes from customers being able to trust all financial institutions within the system, regardless of whether or not they are an ADI. The BEAR regime will have an impact on the ability of ADIs to attract and retain talent, damaging their efforts to grow, innovate and compete with other financial services and fintech employers outside the BEAR regime.

Context of entity and accountable person, objective standard

The BEAR should also make clear what standard a potential breach of the BEAR will be measured against. As currently drafted, an accountable person has an obligation to conduct the responsibilities of his or her position as an accountable person with honesty and integrity, and with due skill, care and diligence⁸. Similar obligations apply to the ADI. The BEAR is silent as to what standard these concepts will be measured against.

As a comparator, the degree of care and diligence to which a director or other officer of a corporation is required to exercise their powers and discharge their duties under the Corporations Act is measured against how a “**reasonable person**” would exercise those duties if they were a director or officer of a corporation **in the corporation’s circumstances and occupied the office held by, and had the same responsibilities within the corporation as, the director or officer**⁹.

⁸ Section 37CA(1) and 37C(1) of the Explanatory Draft.

⁹ Section 180 of the *Corporations Act 2001*.

The inclusion of such a standard to measure against would be consistent with current concepts of assessing a person's accountability and conduct in other regimes to which the community has become accustomed. The ABA believes that greater clarity is needed to differentiate the roles of Boards from management, the differences between ADIs, the relevant circumstances of the organisation at the time and the role of the person concerned. The inclusions we have suggested will assist with making this distinction clear.

Further, 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 own 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 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).

Similar principles should apply to ensure an objective test for ADIs themselves, and the circumstances of the particular ADI are considered.

Recommendation: *Language similar to that in section 180(1) of the Corporations Act 2001 (Cth) (duty of care and diligence) should be adopted to qualify the obligations of accountable persons, recognising that the responsibilities of an accountable person should be discharged to the standard a reasonable person would exercise subject to the circumstances of the relevant entity, role and scope of responsibility at the relevant time.*

Extent of accountabilities

Directors and senior executives are largely responsible for ensuring resources, systems and processes are in place to ensure the relevant business is soundly, efficiently and safely conducted. The drafting of clauses 37C and 37CA do not make this clear but rather suggest that the taking of reasonable steps is **one** of their obligations. This does not reflect the commercial reality. The obligation to take reasonable steps should be the criteria which applies to the specific obligations.

Recommendation: *Sections 37C and 37CA should be amended to provide that the obligations are to take reasonable steps to discharge the responsibilities set out in paragraphs 37C(a), (b) and (c) and 37CA(a),(b) and (c). (Annexure 2 sets out possible drafting).*

Protections available under the directors and officers framework in the Corporations Act should also be available under BEAR. The existing legal framework governing director and officer responsibilities is well understood and effective. The BEAR should replicate and acknowledge the principles that apply to the discharge of director and officer duties constitute reasonable steps for the purposes of section 37CA(1). We also expect that APRA will work with ADIs to establish acceptable standards and to provide guidance for a transparent regime. It is obviously essential that a reasonable, consistent and fair standard is applied across the industry.

Recommendation: *The defences and qualifications that apply under section 180 of the CA (such as, the business judgment rule (section 180(2) of the CA), the ability of directors to rely on expert advice (section 189 of the CA) and delegations (section 190 of the CA) should be expressly included in the Exposure Draft Bill. This could be effected by specifying that such measure discharges the new duties or would constitute "reasonable steps". APRA is requested to work with industry to develop guidance and standards to provide further clarity on how these obligations can be discharged.*

Limitation to matters affecting an ADI's prudential standing

The scope of the BEAR obligations remains unclear.

The Draft EM indicates that the BEAR will cover conduct that is *systematic and prudential* (Draft EM paragraph 1.22) and that civil penalties are only meant to apply where there is evidence of a failure to comply with the BEAR "relating to prudential matters," with directions applying in minor cases (Draft EM

paragraph 1.23). The Draft EM also states that APRA should only seek civil penalties for significant breaches of the BEAR (paragraph 1.126).

This intention to have BEAR focus on prudential matters is not reflected in the words of the legislation.

For example, the accountability obligations in section 37C and section 37CA do not contain a concept of breaches that are minor or otherwise, or of there needing to be an adverse effect relating to prudential matters, except in section 37CA(1)(c).

The ABA recommend that the legislation should reflect the intention for the BEAR to relate only to activity which has a significant or material prudential impact on the ADI.

Further section 37CA(1)(c) is problematic in the following respects:

- i) the adverse effect need not be “material”;
- ii) the prohibited effect is on “prudential standing or reputation”.

It is not clear whether reputation is to be read disjunctively or in conjunction with “prudential standing”. Reputation may be impacted in many ways – and while obviously important to the success of any enterprise it should not be subject to independent regulation. Reputation is a matter of personal opinion that can vary and evolve over time. A reputation is impacted by many environmental factors, including political, economic and social media, as well as the populist views of the day. Reputation can also be seriously damaged by allegations that later prove to be unfounded. The focus of BEAR legislation must only be based on objective matters effecting prudential standing (with that term adequately defined in the legislation), with other conduct matters remaining within the purview of the Corporations Act and Australian Securities and Investments Commission (**ASIC**).

Recommendation:

- 1) *“Reputation” should be deleted from section 37C(c) and section 37CA(c), or at least the relevant sections should be amended to make reference to “prudential reputation”, so that there is no implication that there is an attempt to regulate more general concepts of reputation. Guidance as to what is intended by “prudential reputation” is also required.*
- 2) *Division 2 needs to specify that it will only apply to matters where there is a material prudential impact.*
- 3) *Division 6 must only apply to contraventions materially adversely affecting the prudential standing of an ADI.*
- 4) *Disqualification should only be “justified” where the accountable person has materially adversely impacted the prudential standing of an ADI – assessed on the basis of an objective test and section 37J amended accordingly.*

Disqualification of accountable persons

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 that APRA is subject to appropriate checks and balances to accompany these new powers.

The ABA is deeply concerned by the lack of guidance given to APRA in exercising its power to disqualify accountable persons and the lack of checks and balances in the BEAR around APRA's powers to deregister, remove or disqualify an individual.

We are also concerned that there may be a fundamental reversal of the onus of proof regarding a breach of the BEAR expectations, contrary to Australian judicial principles¹⁰. As we have previously argued, disqualification under 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 would ensure the rights of all parties are protected and there is certainty.

¹⁰ We note that ASIC under s920A of the Corporations Act, has a power to ban, however this is subject to a private hearing.

Any decision to remove or disqualify a person made by APRA is a most serious decision and has the potential to destroy an individual's career.

There must be clear guidance regarding the circumstances in which such a decision may be made. ASIC, for example, is given guidance as to the circumstances in which it may ban or disqualify a person from managing a corporation¹¹ or providing financial services¹².

Transparent procedural fairness is also essential – and required if the new regime is itself to have integrity. Any such disqualification decision must also be reviewable on the merits.

A mechanism for procedural fairness presently resides within Part VI of the *Banking Act 1959*. However, the Exposure Draft Bill does not presently contemplate that Part VI would apply to decisions, including disqualification decisions, made by APRA under subdivisions B and C to Division 6 of Part IIAA of the Exposure Draft Bill. Even if it did, while Part VI provides that a reviewable decision of APRA may be reviewed by the Administrative Appeals Tribunal¹³, the Part VI process does not expressly permit a person to provide submissions to APRA in respect of the reviewable decision or have a private hearing before APRA before the decision is made.

As a comparator, ASIC can only exercise its power to ban or disqualify a person from providing financial services after the person is given an opportunity to appear or be represented at a hearing before ASIC that takes place in private and to make submissions to ASIC¹⁴. The ASIC hearing regime and procedural requirements are governed by Division 6 of Part 3 of the *Australian Securities and Investments Commission Act 2001* and ASIC Regulatory Guide 8¹⁵. Any banning or disqualification decision, after the private hearing, can then be reviewed by the Administrative Appeals Tribunal on the merits¹⁶. A similar, transparent and fair process should apply to disqualification decisions made by APRA.

At the very least, a process demonstrating procedural fairness is required with fair notice, access to relevant material and representation. Such a significant decision should also be subject to a merits review and in the absence of a judicial process must be subject to review by the Administrative Appeals Tribunal in the same way as applies to similar significant and other decisions made by ASIC¹⁷.

Recommendation:

- 1) *The Exposure Draft Bill should contain clear guidance on circumstances in which an accountable person could be disqualified. See also our comments above in relation to the standards expected of accountable persons.*
- 2) *The Exposure Draft Bill should build on the existing APRA powers and maintain the requirement for APRA to apply to the Federal Court to disqualify an individual.*
- 3) *The Exposure Draft Bill should, in relation to the disqualification or potential disqualification of an accountable person, contain procedural and hearing requirements, similar to those imposed upon ASIC under section 920A(2) of the Corporations Act 2001, Division 6 of Part 3 of the Australian Securities and Investments Commission Act 2001 and ASIC Regulatory Guide 8.*
- 4) *Alternatively, Part VI of the Banking Act 1959 should apply to decisions made by APRA under subdivisions B and C to Division 6 of Part IIAA of the Exposure Draft Bill.*

¹¹ Section 206F of the *Corporations Act 2001*.

¹² Section 920A of the *Corporations Act 2001*.

¹³ Section 51C(1) of the *Banking Act 1959*.

¹⁴ Section 920A of the *Corporations Act 2001*.

¹⁵ ASIC Regulatory Guide 8 is available at: <http://asic.gov.au/regulatory-resources/find-a-document/regulatory-guides/rg-8-hearings-practice-manual/>.

¹⁶ Section 1317B of the *Corporations Act 2001*.

¹⁷ See, for example, section 244 of the *Australian Securities and Investments Commission Act 2001* and section 1317B of the *Corporations Act 2001*.

In considering disqualification (or making directions in relation to accountable person's roles) regard should also be given to any adverse effect which might arise where an accountable person has a responsible role at a foreign regulated entity. (See Item 2 in Annexure 1).

Legal Professional Privilege

The Exposure Draft Bill imposes accountability obligations on an ADI¹⁸ and on an "accountable person" to deal with APRA in an "open, constructive and co-operative way"¹⁹. The Draft EM states (at paragraphs 1.39 and 1.97 respectively) that these obligations do not displace legal professional privilege.

This is not clearly reflected in the drafting of the Exposure Draft Bill.

In circumstances where:

- a) on the current drafting of the Exposure Draft Bill, APRA is given the power to investigate the conduct of ADI's and accountable persons, and conduct examinations²⁰ in relation to that conduct²¹; and
- b) APRA also has the power to disqualify an accountable person²².

It is critically important that claims to legal professional privilege be preserved.

Where legislation has been silent as to whether legal professional privilege is a valid ground to refuse to answer a question or produce a document to a regulator, other regulators, such as the ACCC and ASIC, have in the past taken the view that their investigative powers override claims of legal professional privilege.

It took a High Court challenge²³ to the ACCC's position in this regard to clarify this point in respect of one particular section of the relevant legislation.

Under the Exposure Draft Bill, APRA may reach a conclusion that an ADI or accountable person claiming legal professional 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. The consequence could be that an ADI or accountable person is prosecuted by APRA for failing to be open and co-operative as a result of a claim to legal professional privilege being made. This consequence would be clearly undesirable and unfair.

Such uncertainty and the expense of challenging any such position could easily be avoided if claims to legal professional privilege were expressly preserved in the Exposure Draft Bill.

Recommendation: *The Exposure Draft Bill should expressly preserve claims to legal professional privilege in relation to an ADI's and an accountable person's obligations.*

Class actions and other litigation

We noted above that the ABA welcomes reforms that strengthen accountability and competition in the banking system. One can readily foresee that with this regulatory strengthening comes a real possibility that class actions and other civil litigation will be commenced against accountable persons (as opposed or in addition to the ADI itself) in relation to breaches or potential breaches of their BEAR obligations.

The ABA is concerned that unmeritorious proceedings could be commenced personally against, for example, Chief Executive Officers of banks in order to make issues or grievances "personal". This issue

¹⁸ Section 37C of the Explanatory Draft.

¹⁹ Section 37CA(b) of the Explanatory Draft.

²⁰ Sections 13(4), 13A(1) and 61(1) of the Banking Act 1958.

²¹ Section 61A of the Explanatory Draft.

²² Section 37J of the Explanatory Draft.

²³ *Daniels Corporation International Pty Ltd v Australian Competition and Consumer Commission* [2002] HCA 49.

is heightened given the proposed prohibition on indemnifying or insuring an accountable person against the consequences of breaching their BEAR obligations.

As a corollary to this issue, in relation to any investigation regarding a potential breach of an accountable person's obligations:

- a) the BEAR should expressly prevent the provision of transcripts of interview and any associated books and records by APRA to any third party; and
- b) the BEAR should expressly provide that any person (including the accountable person and the relevant ADI) that may be affected by the provision of such books, accounts or documents to third parties should be afforded an opportunity to oppose the disclosure.

Recommendation:

- 1) *The Exposure Draft Bill should expressly provide that class actions and other civil litigation cannot be prosecuted against “accountable persons” in relation to their BEAR obligations.*
- 2) *The Exposure Draft Bill should otherwise prevent access by third parties to documents the subject of any investigation regarding the breach or potential breach of an accountable person's BEAR obligations.*

Clear regulatory roles

As we noted in our August letter the BEAR will sit beside a number of existing prudential and legal duties.²⁴

For both regulators and ADIs there is an absolute need for clarity about how these obligations and responsibilities inter-relate.

Where the same conduct potentially touches two or more of the above regimes, it will be critical for ASIC and 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).

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. Any joint guidance, however, should not amount to a situation where fairness and checks and balance protections are overridden by choice of regulator (refer disqualification of accountable persons comments above).*

Additional issues

We have set out in Annexure 1 a number of issues identified during the short consultation period which gives rise to the ABA recommendation that further work and consultation is required in relation to the Exposure Draft Bill.

²⁴ Including:

- APRA's existing Fit and Proper and Governance obligations as set out in APRA Prudential Standards CPS 520 Fit and Proper (CPS520) and CPS 510 Governance (CPS510)
- APRA's existing risk management and risk culture obligations set out in APRA Prudential Standard CPS 220 Risk Management (CPS220)
- Directors and officers duties under the Corporations Act 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.

Concluding remarks

The BEAR regime represents a significant reform to the landscape of ADI regulation and oversight in Australia. The ABA urges Treasury to take the necessary time to get this right by addressing the issues raised in both this submission and our August submission. Responsible and certain legislation for the Australian regime is both necessary and achievable.

The ABA believes that additional (and adequate) consultation on updated exposure draft legislation is essential to yielding a well-designed regime that can work in harmony with existing prudential frameworks, and can be efficiently implemented to achieve the required consumer outcomes without costly unintended consequences. The ABA looks forward to assisting Treasury in that task, if you would like any further information, please contact me on 02 8298 0408.

Yours sincerely

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02 8298 0408

Annexure 1 - Additional issues for consideration

Item	Bill ref.	Description	Comments
1	Section 37BA	Definition of “accountable person”	<p>The ABA is concerned that the drafting of the definition of “accountable person” in the Exposure Draft Bill is uncertain for the following reasons:</p> <p><u>Overlap with the definition of “senior manager” currently in the <i>Banking Act 1959</i> (Cth) (Banking Act).</u></p> <p>The uncertainty of the overlapping of these two regimes is not addressed and it appears that the Senior Manager Regime of the Banking Act will run in parallel.²⁵</p> <p>Recommendation: <i>Guidance is sought as to how the regimes will be administered to avoid uncertainty and double jeopardy. Affected persons need certainty of legislative approach.</i></p> <p><u>Acting persons</u></p> <p>People often become unwell, take extended leave or assume other roles for a period. An ADI may be required to appoint people for short periods of time. It would be unreasonable for those appointed for a short period of time 3-6 months to be registered as an accountable person and subject to the BEAR Regime.</p> <p>Recommendation: <i>The definition of accountable persons includes an express carve out for employees that are appointed for a short period of time 3-6 months.</i></p> <p><u>NOHC Board Members</u></p> <p>It is unclear whether or not NOHC Board Members are subject to BEAR. Further, section 37BA(1) of the Exposure Draft Bill indicates that a corporate could be considered an accountable person as a <i>controlling</i> person. This is however, inconsistent with the drafting of section 37B of the Exposure Draft Bill which imposes obligations in regards to “his” and “her” accountability obligations, suggesting that only natural persons are subject to the obligations contained in the BEAR Regime.</p>

²⁵ Section 19-23 (Div. 3) of the Banking Act.

Item	Bill ref.	Description	Comments
			<p>Recommendation: <i>NOHC boards should not be subject to the regime – and the definition clarified accordingly. Deletion of the reference to “control” would alleviate this issue.</i></p> <p><u>Foreign ADIs</u></p> <p>As drafted it is not clear whether only the country head is intended to be subject to BEAR or the applicable foreign supervisory boards / global management are also intended to be covered.</p> <p>Recommendation: Only the country head should be subject to BEAR, Foreign regimes will apply to the global group.</p>
2	Section 37BA	Banks with operations or functions outside of Australia	<p>In the August letter the ABA noted that when drafting legislation Treasury should consider how it will reconcile BEAR with 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.</p> <p>Recommendation: <i>The Exposure Draft Bill should expressly provide that where ADIs / subsidiaries and accountable persons are subject to a foreign regime, the local law will apply and they are not expected to comply with BEAR so as to be in breach of such laws. The BEAR will not apply in such circumstances to the extent of any inconsistency.</i></p> <p>Further, to the extent that an accountable person is holding a position at a foreign prudentially regulated entity that is part of an ADI group, the exercise of APRA’s powers under BEAR over that foreign entity, e.g. action to disqualify (or reallocate responsibilities of) that person, should only be undertaken in consultation with the relevant foreign regulator – consistent with international norms for regulated groups with cross-border businesses.</p>
3	Section 37CA(2)	Joint Responsibility	<p>Section 37CA(2) proposes that where there is shared responsibility, joint accountability applies. Under the UK regime individuals with “shared” responsibility are individually responsible not jointly, i.e. not liable for the other person’s actions.</p> <p>Recommendation: <i>Section 37CA(2) should provide that all accountable persons have individual accountability which is then individually assessed (including as to reasonable steps taken which may have regard to actions of others).</i></p>

Item	Bill ref.	Description	Comments
4	Section 37DA(2)	Unforeseen vacancy registration	<p>The EM at paragraph 1.59 recognises that the 21 day allowance in effect means the ADI has only seven days to submit an application to APRA to have the person registered (due to registration taking effect 14 days after the application is made).</p> <p>Internal processes require a longer lead time - a minimum period of at least an effective 2 weeks is required.</p>
5	Section 37E(1)(b)(ii)	<p>The reduction of a person's variable remuneration:</p> <ol style="list-style-type: none"> 1) by an amount that is "proportionate to the failure" 2) where there is a "likely failure". 	<p>The ABA is concerned as to the uncertainty of these concepts and seeks clarification as to what is intended.</p> <p>It is very unclear as to how an ADI should determine an appropriate amount of the reduction: proportionate to what – loss, role, conduct?</p> <p>There are also material concerns regarding the requirement that, where a person is <u>likely</u> to have failed to comply with their obligations, variable remuneration should be reduced. How would / could this be assessed? No action can fairly be taken unless a failure actually occurs.</p> <p>Recommendations: <i>Amend from proportionate to "fair amount".</i></p> <p>APRA to provide guidance as to how the proportionality equation will be calculated.</p> <p>The words "likely failure" to be deleted from clause 37E(1)(b)(ii). It may be fair, however, if variable remuneration was frozen in situations where the ADI is investigating whether an accountable person had failed to comply with their accountability obligations. The variable remuneration would then be reduced if, after investigating, the ADI is satisfied the accountable person has actually failed (instead of being likely to have failed) to comply with their accountability obligations.</p> <p>It is recommended that guidance is provided as to expectations of how remuneration should be reduced. To the extent that remuneration that relates to the year(s) of the failure is still subject to deferral, it is recommended that any adjustment should be made to remuneration that is deferred and / or relates to the year in question. Current year remuneration would be assessed as usual – no doubt taking the relevant issue into account.</p> <p>There are many issues regarding the practical application of the remuneration provisions, for example where an employee has not been an accountable person for the full year.</p>

Item	Bill ref.	Description	Comments
			<p>Note: Remuneration will generally not be “reduced”; rather, STI and LTI will lapse or be forfeited. The drafting of the bill will need to reflect this also. Similarly, most deferred remuneration will not be “paid” but “provided” in equity instruments and the drafting of the Exposure Draft Bill should be further amended to reflect this.</p>
6	Section 37E(3) Section 37EA	Remuneration – content	<p>The definition of ‘remuneration’ in section 37E(3) will capture amounts collateral to an individual’s core pay. For example, buy-outs that are needed to bring individuals into an ADI from other organisations (including non-ADIs) and housing and relocation allowances would be caught. These sort of arrangements should clearly be excluded from the definition of remuneration and are not capable of deferral.</p> <p>Recommendation: <i>Remuneration should be limited to amounts referable to annual reward and exclude one-off items such as compensation and allowances paid on commencement or transition.</i></p> <p>Similarly, it is not practicable to include retention bonuses or project-specific awards in variable remuneration. The purpose of such awards is to protect the business or reward extra duties on a relatively short term basis. These sort of payments are not capable of deferral or their purpose is defeated, they serve to secure or reward the services of the person to whom they are awarded for an express and temporary purpose.</p> <p>Recommendation: <i>The definition of variable remuneration in section 37EA(1) should exclude retention bonuses and project-specific bonuses.</i></p> <p>The definition in section 37EA(1)(a) of variable remuneration “conditional on achievement of objectives” may be too broad. This could conceivably capture base pay; achieving the minimum objectives of a role could be seen as a prerequisite of retaining that role and its base salary.</p> <p>Recommendation: <i>We would suggest that the words “excluding base pay” be inserted after ‘objectives’ to avoid an unintended consequence.</i></p>
7	Section 37EB(2)	Remuneration (value)	<p>The Draft EM at [1.109] states that variable remuneration is to be valued at face value, rather than fair value for the purposes of calculating an amount to be deferred. Section 37EB(2) of Exposure Draft Bill makes reference to “value” at time of grant but is not clear as to value methodology.</p> <p>Recommendation: <i>The ABA recommends that hurdle 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. The ABA</i></p>

Item	Bill ref.	Description	Comments
			<i>recommended a uniform valuation methodology is prescribed in regulations or clear guidance provided.</i>
8	Section 37F	Notification Obligations	<p>The obligations in section 3F will require extensive discussion with APRA to ensure industry consistency, and fairness. This will take considerable time and require immediate guidance to meet even the implementation timetable the ABA proposes urgent development of such guidance is required. Further, industry expects that if APRA accepts accountability statements and maps from an ADI that it would not later be able to hold an ADI to be in breach of these provisions. Updating obligations would of course continue.</p> <p>Recommendation: <i>Clear guidance as to expectations needs to be developed in consultation with industry to ensure consistency and fairness between ADI's and a procedure for submitting statement and plans and reflecting comments from APRA clearly recognised.</i></p>
9	Div 6 Sub-Div B	Register of accountable persons	<p>The ABA is concerned about the lack of clarity surrounding whether the register of accountable person will be confidential or public.</p> <p>The ABA members would also like to know if members have the ability to interrogate the register before an employee is hired or appointed in a role that would fall within the BEAR.</p> <p>Recommendation: <i>APRA's registers and all reports to APRA should be confidential but APRA should be able to respond to confidential enquiries from an ADI to confirm a person is not disqualified</i></p>
10	Sections 37KA - 37A 37BA(4) 37BB(2) 37EA(4) 37EA(3) 37BB(3) 37DB 37 EC 37JA(1)	Minister's / APRA's Exemptions / Determinations	<p>The ABA is concerned with the transparency of the process undertaken by the Minister and APRA in exercising their various notice / exemption powers. Uncompetitive effects may result if there is not transparency in the approach the Minister / APRA takes in reaching a determination. Furthermore, there are no matters set out that the Minister / APRA must have regard to when making relevant determinations. We note that no merits review is intended and accordingly criteria for decision making needs to be clear.</p> <p>Recommendations: <i>The BEAR should include a requirement for the Minister / APRA to publish decisions made under this act.</i></p> <p>All relevant provisions should include matters to which the Minister / APRA must have regard to in making a determination / issuing notices [or in some circumstances publication of guidance setting out such criteria might be</p>

Item	Bill ref.	Description	Comments
			appropriate.] For example, in what circumstances would APRA direct a reallocation of responsibilities due to prudential risk (section 37DB).
11	Section 37KB	Anti – indemnification provisions	<p>The BEAR prohibits an ADI or a related body corporate of an ADI from indemnifying or insuring an accountable person in respect of the consequences of breaching an obligation.</p> <p>Recommendations: <i>ADIs should be able to provide protection from liabilities to third parties (i.e. other than APRA) that do not arise out of the BEAR but are a result of the same set of facts (and have possibly been enlivened because of a determination that has been made under the BEAR Regime). Section 37KB should be limited to consequences under this Act.</i></p>
12	Not addressed in the Bear Bill	Remuneration (remuneration cycles and deferral calculation)	<p>The ABA also seeks clarity on when remuneration consequences of decisions made in one remuneration cycle but that result in a breach in a different remuneration cycle are to be imposed. Variable remuneration is commonly provided in the form of short-term incentives (STI) at the <i>end of a</i> performance year and long-term incentives at the commencement of a multi-year performance period with vesting of none / some / all of the award only at the end of that period. There are material complexities in determining which remuneration should / could be impacted and the tax consequences of the same, as well as ensuring compliance with deferral requirements.</p> <p>Recommendation: <i>It is requested that APRA work with members to provide guidance as to expectations for deferral / forfeiture / lapse regimes.</i></p> <p>In Part 3, Section 3 (Deferral of variable remuneration) of the Exposure Draft Bill the words “and relating to employment / performance after that date” should be inserted immediately after the words “1 January 2019” – decisions relating to performance prior to that time should not be subject to the retrospective application of the BEAR.</p>
13	Not addressed in the Bear Bill	Existing rights	<p>The ABA is concerned about the impact of the implementation of the BEAR Regime on employees who have yearly remuneration cycles that have already been implemented. As noted above, STI is commonly awarded only at the end of a performance year.</p> <p>Recommendation: <i>Awards granted after commencement of relevant provisions in relation to prior periods should not be subject to BEAR.</i></p>

Item	Bill ref.	Description	Comments
14	Part 3 of Schedule 1 3(2)	Transition of employment arrangements	<p>Paragraph 1.157 of the Draft Explanatory Memorandum is much clearer than the language in section 3(2) and it would be preferable to use that simpler clearer language here.</p> <p>Further, the remuneration obligations need to recognise that accountable persons may only become accountable persons during a remuneration period. Accordingly, a person's existing employment contract may not comply with the remuneration obligations. Thus, upon entering a role as an accountable person, the individual may carry entitlements to variable remuneration for the remuneration period that is not deferrable as required by section 37(1)(a).</p> <p>Recommendation: <i>There should be a mechanism that allows newly appointed accountable persons to receive their legacy variable remuneration in accordance with the employment contract that applied before they became an accountable person.</i></p>

ANNEXURE 2 - Proposed amendments to 37C and 37CA

Division 2—Accountability obligations

37C The accountability obligations of an ADI

The accountability obligations of an ADI are to take reasonable steps to ensure that:

- a) it conducts its business with honesty and integrity, and with due skill, care and diligence; and
- b) it deals with APRA in an open, constructive and co-operative way; and
- c) ~~take reasonable steps in it conducting~~ its business to prevent matters from arising that would adversely affect the ADI's prudential standing or reputation; and
- d) ~~take reasonable steps to ensure that~~ each of its accountable persons meets his or her accountability requirements under section 37CA; and
- e) ~~take reasonable steps to ensure that~~ [each of its subsidiaries that is not an ADI complies with paragraphs (a), (b), (c) and (d) as if the subsidiary were an ADI]²⁶.

37CA The accountability obligations of an accountable person

- 1) The accountability obligations of an accountable person of an ADI, or of a subsidiary of an ADI, are to take reasonable steps to:
 - a) conduct the responsibilities of his or her position as an accountable person with honesty and integrity, and with due skill, care and diligence; and
 - b) deal with APRA in an open, constructive and co-operative way; and
 - c) ~~take reasonable steps in~~ conducting those responsibilities to prevent matters from arising that would adversely affect the prudential standing or reputation of the ADI.
- 2) If more than one of the accountable persons of an ADI or a subsidiary of an ADI have the same responsibility mentioned in section 37BA in relation to the ADI or subsidiary, all of those accountable persons have the accountability obligations individually jointly in relation to that responsibility.

²⁶ See our earlier comments in relation to subsidiaries