

# Submission

to

The Australian Treasury,  
Banking, Insurance and  
Capital Markets Unit  
Financial System Division

on the

Banking Executive  
Accountability Regime  
(BEAR) – Exposure Draft

29 September 2017

## About NZBA

1. NZBA works on behalf of the New Zealand banking industry in conjunction with its member banks. NZBA develops and promotes policy outcomes that contribute to a strong and stable banking system that benefits New Zealanders and the New Zealand economy.

## Background

2. Thank you for the opportunity to provide The Treasury with comments regarding the exposure draft of the Treasury Laws Amendment (Banking Executive Accountability and Related Measures) Bill 2017 (**Draft Bill**).
3. If you would like to discuss any aspect of the submission further, please contact:

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## Introduction

4. This submission primarily addresses the definition and provisions relating to "subsidiaries" in the Draft Bill. This is in circumstances where four of NZBA's sixteen registered bank members fall within the definition of subsidiaries within the Draft Bill. These banks are ANZ Bank New Zealand Limited, ASB Bank Limited, Bank of New Zealand, and Westpac New Zealand Limited (**NZ Subsidiaries**). Their respective Australian parents are Australia and New Zealand Banking Group Limited, Commonwealth Bank of Australia, National Australia Bank Limited and Westpac Banking Corporation.
5. In summary, our view is that foreign subsidiaries that are subject to prudential regulation in their own jurisdiction, including New Zealand registered banks, should not be subject to the regime in the way the Draft Bill proposes. Specifically, we have serious concerns about: the interplay between the existing New Zealand prudential regulatory framework and the New Zealand Reserve Bank's (**RBNZ**) role as prudential regulator and the provisions in the Draft Bill; and how the added complexity of those provisions may impact on the New Zealand banking system.
6. While the Draft Bill makes provisions for APRA to exclude certain accountable persons from application of the proposed obligations, our view is that the final statute that implements BEAR should contain clear and appropriate parameters in respect of directors and employees of foreign subsidiaries of an ADI. We understand that since the release of the Draft Bill, you may have already been actively reconsidering how the Draft Bill applies to foreign subsidiaries and their directors and employees. However, for present purposes we provide submissions based on the Draft Bill as released.

## Background: New Zealand regulatory environment

7. New Zealand banks are regulated (from a prudential perspective) by the RBNZ. The RBNZ has powers under Part 5 of the Reserve Bank of New Zealand Act 1989 (**RBNZ Act**) to register banks and undertake prudential supervision of registered banks.

8. New Zealand registered banks are subject to conditions of registration (**CoR**) that are imposed by the RBNZ. These CoR differ slightly between banks but all include provisions relating to the suitability for their positions of the directors and senior managers of the bank; the bank's internal controls and accounting systems; and the bank's risk management systems.
9. The NZ Subsidiaries are also subject to CoRs that: ensure bank directors only act in the best interests of the bank (and not its parent); require that their boards have a majority of independent directors and manage the affairs and business of the bank; and require that all staff employed shall have their remuneration determined by the board or the CEO and be accountable directly or indirectly to the CEO of the bank.
10. There are various consequences for failing to comply with a CoR ranging from fines (up to a maximum of \$1,000,000 for a body corporate) to cancellation of a bank's registration.

## Principles of International Comity & Cross-Border Issues Point Against Including Foreign Subsidiaries

11. We have reviewed Westpac Group's submission dated 3 August 2017 to Treasury in relation to the BEAR consultation paper and agree that, to ensure international comity and avoid the potential for conflicts of law, the application of BEAR in respect of foreign subsidiaries of ADIs should be limited. As above, New Zealand domestic law contains a detailed prudential regulation regime and the RBNZ has jurisdiction to supervise and enforce that regime. Against that background, our view is that the BEAR should not extend to subsidiaries of ADIs which:
  - operate solely outside Australia;
  - are subject to the rules and oversight of prudential and financial market regulators in their home countries; or
  - do not have customer-facing operations in Australia.

We submit that the definition of the Draft Bill is amended to reflect this approach.

12. Notably, adopting this approach would also result in a regulatory framework consistent with the UK Senior Managers Regime (**SMR**) and the Hong Kong Manager in Charge regime.
13. In relation to the SMR, our understanding is that the SMR does not determine the entities to which it applies by using a subsidiary concept. Instead, the SMR applies only to certain categories of UK based firms (**relevant authorised persons**) that are required to be licensed/regulated by the Prudential Regulation Authority (**PRA**) or Financial Conduct Authority (**FCA**), including UK branches of foreign headquartered firms. Subsidiaries are, therefore, only caught by the SMR if they themselves are relevant authorised persons. The SMR is extra-territorial only to the extent that individual senior managers outside the UK may fall within the regime if they have the required level of control/influence over a relevant authorised person (ie a UK based firm/branch).

## Potential impact of Draft Bill

14. The remainder of this submission examines aspects of the Draft Bill which we consider give rise to international comity and cross-border issues at both legal and practical levels.

### *Extra-territoriality issues*

15. If New Zealand registered banks are treated as subsidiaries within the Draft Bill, we consider that a number of extra-territoriality related issues arise. This is in circumstances where the NZ Subsidiaries have no Australian presence or operations and the RBNZ has existing jurisdiction over them:<sup>1</sup>
  - (a) section 37DB which would allow APRA to give a New Zealand registered bank a written direction to reallocate a responsibility from an accountable person to another person;
  - (b) section 37J which would allow APRA to decide to disqualify an accountable person within a New Zealand registered bank and give that person notice of that disqualification; and
  - (c) section 37JB which would place a New Zealand registered bank in contravention of Australian civil offence provisions if it allowed a disqualified person to be or act as an accountable person.
16. Our view is that it is neither appropriate, nor necessary, for APRA as a foreign regulator to have these powers in respect of New Zealand registered banks. The existence of these powers may give rise to a lack of clarity about which country or body will or should have jurisdiction to make inquiries and decisions. We also have concerns about fairness and due process.
17. Further, the ability for civil pecuniary penalties to be imposed by Australian courts against entities in New Zealand that APRA does not regulate may give rise to enforcement complications.

### *Tension between existing New Zealand regulatory framework and Draft Bill*

18. There are also a number of provisions within the Draft Bill that sit uncomfortably with the existing New Zealand regulatory framework. Examples are as follows:
  - (a) As explained in the regulatory background section above, directors of New Zealand registered banks must act in the interests of the bank, not their parent company. There is an element of tension with this requirement and the obligation set out in s 37CA(1)(c) of the Draft Bill, which would require accountable persons in NZ Subsidiaries to take reasonable steps to prevent matters from arising that would adversely affect the prudential standing or reputation of the applicable ADI. In most instances, we would expect that the interests of the NZ Subsidiaries would align with the obligations placed on accountable persons under the Draft Bill. However,

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<sup>1</sup> We acknowledge that the New Zealand banks may from time to time undertake limited activities in Australia such as raising money through the issue of debt securities to wholesale investors (as is permitted under the Banking (Exemption) Order No. 82). However these types of activities are ancillary to the New Zealand operations and do not amount to carrying operations in Australia in any substantive way.

in extreme circumstances, issues could arise that require those accountable persons to act in a way that diverges from compliance with the obligations in the Draft Bill.

- (b) The CoRs for NZ Subsidiaries require that the business and affairs of the bank are "managed by, or under the direction or supervision of, the board of the bank". If APRA is able to intervene, for example, by attempting to remove a director or executive or reallocating responsibilities within the bank, this would create tension with the bank's New Zealand obligation.
- (c) There are restrictions within the Draft Bill on remuneration arrangements for accountable persons within subsidiaries. These are not consistent with the intention in the CoRs for NZ Subsidiaries which require the board or the CEO (acting in the best interest of the NZ Subsidiary) to determine employees' remuneration.
- (d) As set out above, APRA's ability to reallocate responsibilities and disqualify accountable persons within ADI subsidiaries, may cut across the RBNZ's role in respect of vetting directors, chief executive officers, and executives. Appointments to these positions are not permitted unless the RBNZ has first been supplied with a copy of the curriculum vitae of the proposed appointee and the RBNZ has advised that it has no objection to that appointment.
- (e) A key feature of the RBNZ's regulatory toolkit is its ability to recommend that a registered bank is placed under statutory management. This could occur, for example, where the RBNZ has reasonable grounds to believe that the registered bank is or is likely to become insolvent or where the registered bank or one of its directors fail to comply with a requirement under the RBNZ Act. A statutory manager would appear to fit within the meaning of accountable person for the purpose of the Draft Bill, and would therefore be subject to the vetting and approval process contemplated by the Draft Bill. We would expect that this outcome would be unacceptable from the RBNZ's perspective.
- (f) In addition, directors of New Zealand Banks are subject to statutory duties under the New Zealand Companies Act 1993 and at common law. There is a well-developed body of jurisprudence that informs directors on how to act in relation to these duties. The introduction of additional obligations under the Draft Bill, particularly given the similarity of the obligations under s 37CA(1)(a), is likely to complicate the application of these established duties.

### ***Practical implications for New Zealand Banking System***

19. In addition to potential legal issues touched on above, the Draft Bill may have a number of unintended practical implications for the NZ Subsidiaries. For example, any uncertainty and confusion caused by being subject to two potentially contradictory accountability regimes will likely result in:
- (a) uncertainty around management reporting lines within New Zealand banks;
  - (b) delays in decision making by both management and board in extreme scenarios, which increases risk within the New Zealand banking system;

- (c) more complicated governance and management decisions, which would likely result in a greater number of unduly risk-averse decisions being taken by management and board; and
  - (d) duplication. For example, there may be duplication in respect of the registration and vetting of an accountable persons (under Subdivisions B and C of Division 6 of the Draft Bill) as CoRs require New Zealand registered banks to undertake a similar process in relation to the appointment of directors, chief executive officers, and executives that report to, or are accountable directly to, the chief executive officer.
20. We also have concerns that the provisions in the Draft Bill applying to New Zealand registered banks may reduce the number / quality of directors willing to take up directorships. New Zealand directors (particularly independent directors) will (understandably) be highly nervous of being subject to an unfamiliar foreign regime and regulator, given the serious personal consequences if they are deemed by APRA to have breached their accountability obligations. Similar observations apply to New Zealand executives.
21. We would be happy to discuss or provide further submissions if required.