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## **Submission to the Treasury in relation to the Banking Executive Accountability Regime – Draft Legislation**

The Westpac Group (**Westpac**) is pleased to provide a submission in response to the Exposure Draft of the Treasury Laws Amendment (Banking Executive Accountability and Related Measures) Bill 2017 (**Draft Legislation**) and related Explanatory Memorandum (**EM**) released on 22 September 2017 in relation to the Banking Executive Accountability Regime (the **Regime**).

We continue to support the views expressed in our previous submission dated 3 August 2017, which was prepared in response to the Consultation Paper released in July 2017 and have generally not repeated those views in this submission.

### **Executive summary**

Westpac continues to be supportive of the rationale for the Regime and agrees that it will play an important role in rebuilding trust and confidence in the banking sector. Clear and transparent accountability for organisations and individuals is an essential part of good corporate governance. The standards set by the Regime will help provide greater stakeholder confidence in how ADIs and individuals make decisions and respond when things go wrong.

There are a number of areas where, in our view, the Draft Legislation does not reflect the stated intentions of the Government in the EM. Westpac recommends that the Draft Legislation be amended in these areas to provide certainty as to the scope and application of the Regime. This is particularly important to enable the Regime to be implemented and operating effectively in a short timeframe.

It is also important from a principles-based perspective that APRA's disqualification powers are exercised fairly and consistently. Given the severity of the consequences of disqualification, our view is that a merits-based review should apply.

The changes to the Regime that we recommend in this submission are critical to providing clarity as to how the Regime will operate, thereby ensuring that there is trust and confidence in the Regime from the outset.

While recognising the importance of implementing the Regime in a timely manner, the one-week consultation period to review the Draft Legislation was, in our view, insufficient. A review of the submissions received in response to the Draft Legislation will therefore be important to address unintended consequences such as duplication and conflicting legal standards.

Westpac is of the view that an implementation period of one year from the date of Royal Assent is required in order to ensure that organisations have sufficient time to prepare for and comply with the new requirements.

Westpac would welcome the opportunity to participate in further consultations or discussions as the Draft Legislation is developed.

## Key issues and recommendations

| Individuals covered by the Regime / definition of accountable persons                       |   |
|---|---|
| <i>Meaning of accountable person – general principle</i>                                    | The Draft Legislation currently captures senior management and directors of all subsidiaries. We understand from our review of the EM that this not the intention. We recommend that the Draft Legislation be amended to reflect the principle that responsibility for all parts or divisions of an ADI’s business should be allocated to an accountable person but that simply holding a management role in, or being a director of, a subsidiary does not of itself mean the person is an accountable person.   |
| <i>Application to non-executive directors of the ADI</i>                                    | Westpac continues to recommend that non-executive directors be excluded from the Regime.<br><br>However, we understand from the guidance in the EM that the obligations of non-executive directors will reflect their performance of an oversight function and they will not be responsible for day-to-day management. Westpac recommends that this distinction is clarified in the legislation.  |
| Entities covered by the Regime  |   |
| <i>Application of the Regime to subsidiaries of ADIs</i>                                    | The Draft Legislation appears to apply the Regime to each of an ADI’s subsidiaries. However, the EM seems to suggest that subsidiaries are only caught where there is not already an accountable person with responsibility for that subsidiary at the ADI-Group level. We recommend that the Draft Legislation removes the obligations imposed on ADI subsidiaries or alternatively clarifies that these obligations will not apply where there is an accountable person at the ADI-Group level with responsibility for a particular subsidiary. Applying the Regime to each subsidiary would significantly impact the regulatory burden of the Regime for no practical improvement in executive accountability. |
| <i>Foreign subsidiaries</i>   | Westpac recommends that foreign subsidiaries of ADIs that meet particular conditions should be excluded from the application of the Regime.   |
| Accountability obligations of ADIs and accountable persons under the Regime                 |   |
| <i>Matters that would adversely affect the prudential standing or reputation of the ADI</i> | In our view, the reference to “reputation” in the accountability obligations set out in the Draft Legislation should be removed as it could result in unintended consequences. For example, there may be situations in which an ADI will need to take action to protect its prudential standing despite such action potentially having an impact on its reputation.   |
| <i>Reasonableness standard for accountable persons and business judgment rule</i>           | The requirement for accountable persons to act with due skill, care and diligence is a subjective test. We recommend that this obligation is amended to be an objective test by making it subject to a “reasonable person” test.<br><br>Westpac recommends that the protections available under the directors’ and officers’ framework in the <i>Corporations Act 2001 (Cth) (Corporations Act)</i> (including the business judgment rule and the ability to rely on expert advice and delegations) should be included in the legislation.  |

| Consequences for accountable persons                          |   |
|---|---|
| <i>Disqualification of accountable persons</i>                | The Draft Legislation does not address the factors that APRA must consider in exercising its disqualification power. We recommend that in order to promote consistency of application and clarity as to what conduct would prompt a disqualification, the criteria that APRA must consider should be specifically set out in the legislation. This is particularly the case given the severity of the consequences for the individuals concerned. |
| <i>Overlap with proposed expansion of ASIC banning powers</i> | In our view, the potential overlap of the Regime and the enhanced ASIC banning powers proposed under the current Treasury consultation risks the unintended consequence of double jeopardy. We recommend the scope for overlap between the two regimes be reviewed and an agreed approach taken as to how these powers will operate going forward.  |
| <i>Right of appeal</i>  | Given the serious consequences of disqualification, we recommend the legislation provide for a merits review of APRA's decision to ensure fairness to the individual and consistency with equivalent legislation.   |
| Other   |   |
| <i>Insurance and indemnity</i>                                | In our view, the wording in the Draft Legislation prohibiting indemnities and insurance should be made consistent with the existing restrictions set out in the Corporations Act.   |
| <i>Implementation and timing</i>                              | Westpac recommends that an implementation period of one year from the date of Royal Assent be adopted to ensure that organisations have sufficient time to prepare for and comply with the new requirements. This will also enable ADIs to use the implementation of the Regime to drive greater cultural change.   |

## Detailed issues and recommendations

### Individuals to be covered by the Regime / definition of accountable persons

#### *Meaning of accountable person – general principle*

We recommend that the general principle definition of an accountable person in section 37BA(1) of the Draft Legislation should be amended to clarify that it applies to those with responsibility at an ADI-Group level.

The general principle has been framed to capture those with actual or effective responsibility for the management or control of the ADI or its subsidiary (or a substantial part of their operations). As drafted, this potentially captures *each* senior executive of *every* subsidiary within an ADI-Group (even if the subsidiary is non-operating or has a minimal ability to influence the activities, behaviour or prudential standing of the ADI or ADI-Group).

We understand that this is not the intention – the EM supports this view as follows:

- Senior executives “with actual or effective management or control of the ADI, or the management or control of a substantial part of the ADI group’s operations” (as opposed to a particular subsidiary) are captured (paragraph 1.79);
- “It is not the Government’s intention that simply being in a management role in a subsidiary means the person is an accountable person” (paragraph 1.80); and
- “Where the activities of a subsidiary are significant, then an accountable person should have responsibility for that subsidiary” (paragraph 1.29).

Westpac recommends that the Draft Legislation be amended to clarify that the Regime only applies to those individuals with responsibility for the management or control of the ADI or *ADI-Group* or a significant or substantial part of the ADI’s or *ADI-Group*’s operations.

Inadvertently capturing individuals at the subsidiary level as accountable persons would impose a substantial additional compliance cost and result in unintended consequences, and would not advance the stated objectives of the Regime. ADI-Groups may have hundreds of subsidiary directors (in Westpac’s case, over 150 individuals would be captured).

#### *Meaning of accountable person – particular responsibilities*

Westpac recommends that each of the particular responsibilities set out in section 37BA(3) of the Draft Legislation should be qualified by the term “overall” to reflect the Group-wide governance policies and arrangements of ADI-Groups and to avoid duplication throughout the ADI-Group. As currently drafted, the only particular responsibility set out in section 37BA(3) that is qualified by the word “overall” relates to risk.

We note that section 37BA(3)(a) of the Draft Legislation appears to include a drafting error. While all of the other particular responsibilities refer to the ADI, subsection (3)(a) includes a reference to directors of subsidiaries who would not be responsible for oversight of the ADI. The Draft Legislation should be amended to be consistent with Table 1.2 of the EM.

#### *Application to non-executive directors of the ADI*

In our view, the policy objectives of an “executive” accountability regime are best served by preserving the existing distinction between the role of non-executive directors and management, and not duplicating or adding confusion to what is an established area of the law and corporate governance. Consequently, we believe non-executive directors should be excluded from the Regime.

However, we understand that the obligations of non-executive directors will reflect their oversight function and they will not be responsible for day-to-day management functions (paragraph 1.83 of the EM). Westpac recommends that this distinction is clarified in the legislation.

We expect that this oversight role would also be recognised in the accountability statements for non-executive directors, meaning that their obligations under the Regime would only extend to their oversight responsibilities.

### **Entities covered by the Regime**

#### *Application of the Regime to subsidiaries of ADIs*

While the EM appears to adopt the general principle that the Regime applies in an overall ADI-Group context (for example, through the approach to accountable persons), this concept is not reflected in the drafting of sections 37C(e), 37D(1)(d), 37E(1)(d) and 37F(1)(d), which require the ADI to take reasonable steps to ensure that each of its subsidiaries complies with the obligations as if they were an ADI (**ADI Subsidiary Obligations**).

We recommend that the ADI Subsidiary Obligations be removed from the Regime. The cost implications and administrative burden of having these obligations apply to all ADI-Group subsidiaries<sup>1</sup> would be significant, particularly given the short implementation period. However, acknowledging that there are different ADI-Group structures, to the extent that the ADI Subsidiary Obligations are retained, it should be clarified that these do not apply where there is an accountable person at the ADI-Group level with responsibility for that subsidiary.

#### *Foreign subsidiaries*

To ensure international comity and avoid the potential for conflicts of law, Westpac is of the view that the application of the Regime should not extend to offshore subsidiaries of Australian ADIs that are subject to the oversight of foreign prudential regulators. The recommended exclusion of foreign subsidiaries is consistent with the UK Senior Managers Regime and the Hong Kong Manager-in-Charge measures.

### **Accountability obligations of ADIs and accountable persons under the Regime**

#### *Matters that would adversely affect the prudential standing or reputation of the ADI*

In our view, the reference to “reputation” in the accountability obligations in sections 37C(c) and 37CA(1)(c) of the Draft Legislation should be removed as the reference could result in unintended consequences. We note that there may be situations in which an ADI will need to take action to protect its prudential standing despite such action potentially having an impact on its reputation. For example, during a severe financial crisis, there may be a tension between matters that would impact on the ADI’s prudential standing (such as a decision to stop lending to some sectors in order to preserve cash reserves) and the impact of this on the ADI’s reputation with the general public.

#### *Reasonableness standard for accountable persons and the business judgment rule*

The requirement for accountable persons to act with due skill, care and diligence in section 37CA(1)(a) is a subjective test. We recommend that this obligation is amended to be an objective test by making it subject to a “reasonable person” test in order to place appropriate

<sup>1</sup> For example, Westpac currently has 192 consolidated controlled subsidiaries.

parameters around an otherwise widely cast obligation with serious consequences for individuals.

This would be consistent with the long-standing Corporations Act position where the obligations for directors and officers to act with due care and diligence are qualified by the “reasonable person” standard.

Westpac also recommends that the defences and qualifications available under the directors’ and officers’ framework in the Corporations Act (such as the business judgment rule and the ability to rely on expert advice and delegations) should be included in the legislation to ensure alignment between the position of directors and officers under the two regimes.

*Systemic and prudential in nature*

We recommend that sections 37C and 37CA are qualified by including the wording “systemic and prudential in nature” in respect of all of the accountability obligations listed in these sections. This would reflect the statement in the EM that the accountability obligations of ADIs and accountable persons under the Regime cover “conduct that is systemic and prudential in nature” (paragraphs 1.22 and 1.93).

*Joint responsibility*

The Draft Legislation provides that where more than one accountable person has responsibility for the same area, all of the persons are jointly responsible (section 37CA(2)). It is unclear how this concept would be interpreted in the context of a Board of Directors. In our view, this should be clarified in the legislation.

**Consequences for ADIs**

*Civil penalties for ADIs*

We understand that the Court must have regard to the impact that a potential penalty might have on the ongoing viability of the ADI, as well as the factors in existing Schedule 2 to the Banking Act (paragraph 1.131 of the EM) when considering whether to apply a civil penalty. We assume that section 37G(5) of the Draft Legislation should therefore refer to subclause 1(3) of Schedule 2 (that is, the provision outlining the relevant factors) rather than subclause 3(1).

**Consequences for accountable persons**

*Disqualification of accountable persons*

It is important to ensure that APRA’s disqualification powers are exercised consistently. Given the punitive nature of these powers, consistent application is essential in providing individuals with due process, which will help underpin confidence in the Regime.

The Draft Legislation does not address the factors that APRA must consider in exercising its disqualification power. We note that ASIC’s disqualification power in section 206F of the Corporations Act is similarly expressed and also uses the term “justified”. However, the criteria to be considered by ASIC in determining whether disqualification is justified are set out in that legislation. We recommend a similar approach be taken under the Regime.

The Draft Legislation has insufficient detail about the process that APRA will need to follow to disqualify an accountable person (for example, fair notice and a right to be heard, to be represented and to access relevant material). We note that ASIC’s banning power under section 920A of the Corporations Act can only be exercised 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 ASIC. There are also hearing regime and procedural requirements relating to an exercise of ASIC's disqualification and banning powers contained in legislation and ASIC guidance. In our view, similar fundamental protections should be available to affected persons under this Regime.

#### *Overlap with proposed expansion of ASIC banning powers*

We note that Treasury is also consulting on a proposal to expand ASIC's banning powers. Westpac sees a number of areas of overlap for ADIs between the regimes, including the possibility of APRA disqualifying a person under the Regime and ASIC also banning the person under the Corporations Act for the same conduct. For example, if APRA disqualifies a person for breaching their accountability obligation to act with honesty and integrity and with due skill, care and diligence, ASIC's banning powers may also be enlivened in relation to a breach of their directors' and officers' duties under the Corporations Act. In addition, as the Banking Act is a "financial services law", ASIC could rely on a breach of the Regime to support a banning order.

Westpac recommends the scope for overlap between the two regimes be limited so that where one regulator bans or disqualifies an individual, the other regulator would be prevented from imposing a sanction for the same conduct.

#### *Right of appeal*

While APRA's enhanced disqualification powers are subject to a Court-based review, we are concerned by the proposal to limit this to a legal process review (procedural fairness) and to not include any form of merits review.

We note that for disqualification by ASIC under section 206F of the Corporations Act (which also provides for disqualification on the basis that it is "justified"), a merits review by the Administrative Appeals Tribunal is available. We therefore do not see use of the term "justified" in the context of section 37J of the Draft Legislation as providing the requisite protection where there is no merits review.

Given the serious consequences for the individual concerned in the event of disqualification and the need for consistency in application, Westpac recommends the inclusion of a merits review in the Regime.

#### **Insurance and Indemnity**

Westpac recommends that the restrictions on indemnity and insurance coverage in respect of the Regime in section 37KB of the Draft Legislation be aligned with the limitations in sections 199A and 199B of the Corporations Act, which prohibit a company from indemnifying, or paying for insurance that covers, company officers for liabilities (other than legal costs) arising from conduct which was not in good faith, the wilful breach of a duty, the misuse of their position or the misuse of information.

If the current wording in the Draft Legislation is retained, these limitations may have an impact on the existing indemnification and D&O framework outside of the Regime. One possible way to address this is to amend each reference to "...the consequences of breaching an obligation under this Part" in the section 37KB of the Draft Legislation as follows: "...the consequences under this Part of breaching an obligation under this Part".



## **Notification and registration obligations**

### *Accountability mapping*

We note that section 37DB(1) of the Draft Legislation allows APRA to re-allocate responsibilities between accountable persons where APRA considers there is a “prudential risk”. This term is not used elsewhere in the Banking Act or Regime. The legislation should define this term and provide clarity as to what level of “risk” would be required for this to be triggered.

### **Implementation and timing issues**

The Draft Legislation proposes a commencement date of 1 July 2018, with transitional provisions for remuneration. This allows for an implementation period of less than 9 months.

Westpac recommends that an implementation period of one year from the date of Royal Assent be adopted for the new Regime. This should allow organisations the minimum time necessary to prepare and comply with the new requirements, particularly in relation to the development and implementation of accountability maps, support structures and delegations, amendment of remuneration policies and frameworks and delivery of the requirements of the Regime across the three lines of defence model.

ADIs will also need sufficient time to review and consult on any prudential standards and guidance notes that APRA will provide.

For further information in relation to any matters raised in this submission, please contact Brett Gale, Group Head of Government Affairs and Communication Strategy on (02) 8253 4159 or [bgale@westpac.com.au](mailto:bgale@westpac.com.au).