

29 September 2017

Manager
Banking, Insurance and Capital Markets Unit
Financial System Division
The Treasury
Langton Crescent
PARKES ACT 2600
(Email: BEAR@treasury.gov.au)

Dear Madam/Sir,

RE: Response to Banking Executive Accountability Regime – Draft Legislation

I refer to your invitation for submissions on the Exposure Draft of the Treasury Laws Amendment (Banking Executive Accountability and Related Measures) Bill 2017.

Please find annexed to this letter a Response to the Exposure Draft submitted by myself, Stephen van de Mye and Dan Hunter from the Swinburne Law School. I am the Course Director, Master of Corporate Governance, Swinburne Law School. Stephen is an Adjunct Professor of Business and Law, Swinburne University of Technology. Dan Hunter is a Professor and Foundation Dean, Swinburne Law School.

We hope that this response assists Treasury in considering possible revisions to the draft legislation. If you have any questions in relation to our response, please do not hesitate to contact me.

Yours sincerely

Ms Helen Bird





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

By Helen Bird, Stephen van der Mye & Dan Hunter¹

Introduction

We welcome the opportunity to respond to the Exposure Draft of the Treasury Laws Amendment (Banking Executive Accountability and Related Measures) Bill 2017 (Cth) (*'the Exposure Draft'*)².

1. Our submission concerns the intended scope and operation of section 37CA(1), the accountability obligations of an accountable person.
2. We contend that:
 - (a) The scope and operation of s 37CA(1) is wider than described in para 1.93 of the *Explanatory Memorandum*³ accompanying the *Exposure Draft*.
 - (b) Section 37CA(1), as currently drafted, creates confusion and uncertainty as to the relationship and overlap (if any) between the obligations of 'accountable persons' under the proposed BEAR regime and the obligations of directors and officers under the *Corporations Act 2001* (Cth).
 - (c) The operation and legal effect of ss 37CA(1)(c) is unclear. In particular, whether it is intended to:
 - (i) impose a further obligation on accountable persons, in addition to those imposed by ss 37CA(1)(a) and 37CA(1)(b); or
 - (j) to provide a form of defence, based on taking reasonable steps, to a claim that ss 37CA(1)(a) and 37CA(1)(b) have been breached.

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² Commonwealth of Australia, *Treasury Laws Amendment (Banking Executive Accountability and Related Measures) Bill 2017* (Cth), at <https://static.treasury.gov.au/uploads/sites/1/2017/09/EXPOSURE-DRAFT.pdf> (accessed 28 September 2017) (*'Exposure Draft'*).

³ Commonwealth of Australia, *Explanatory Memorandum to the Exposure Draft Treasury Laws Amendment (Banking Executive Accountability and Related Measures Bill 2017)* at <https://static.treasury.gov.au/uploads/sites/1/2017/09/EXPLANATORY-MEMORANDUM.pdf> (accessed 28 September 2017) (*'Explanatory Memorandum'*).

- (k) If ss 37CA(1)(c) is intended to impose a further obligation, there would appear to be a degree of unnecessary duplication between the three obligations in ss 37CA(1)(a), 37CA(1)(b) and 37CA(1)(c).
- (l) If ss 37CA(1)(c) is intended to impose an obligation and not to provide a defence, there is no statutory basis for the claim in para 1.99 of the *Explanatory Memorandum* that accountable persons who can show that they have taken reasonable steps to meet their accountability obligations would not be in breach of those obligations. The term 'reasonable steps' only appears in ss 37CA(1)(c) and thus the guidelines in 37CB regarding taking reasonable steps would appear to only apply to the content of the obligation in that provision.

Nature and scope of obligations under s 37CA(1)

1. Section 37CA(1) of the *Exposure Draft* currently provides:
 - (1) The accountability obligations of an accountable person of an ADI, or a subsidiary of an ADI, are 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.

Section 37CB provides:

Without limiting what constitutes the taking of reasonable steps in relation to a matter for the purposes of the Division, the taking of reasonable steps in relation to that matter includes ensuring that:

- (a) there is appropriate governance, control and risk management in relation to that matter; and
 - (b) any delegations of responsibility in relation to that matter are appropriate; and
 - (c) there are appropriate procedures for identifying and remediating problems that arise or may arise in relation to that matter.'
2. Paragraph 1.93 of the *Explanatory Memorandum* accompanying the *Exposure Draft* states '[T]he accountability obligations make clear the behaviour and conduct expected of an

accountable person – they relate to conduct or behaviour that is systematic and prudential in nature with the obligations of accountable persons being a function of their role, the systematic nature of reasonable steps, and related to prudential matters’.

3. We contend that the current drafting of s 37CA(1) in the *Exposure Draft* does not support the interpretation of accountability obligations advocated in para 1.93 of the *Explanatory Memorandum*.
4. The current drafting of s 37CA(1) makes the meaning of the provision unclear in the following respects:
 - (a) The opening words of s 37CA(1) provide: ‘The accountability obligations of an accountable person of an ADI or a subsidiary of an ADI are to;’ and then lists those obligations in ss (a), (b) and (c) respectively. A first reading of s 37CA(1) therefore suggests that it imposes three discrete sets of obligations.⁴ However, as explained further below, a deeper analysis of ss 37CA(1)(c) reveals that the legal effect of that provision is far less certain than it appears on initial reading.
 - (b) Sub-section 37AC(1)(a) imposes an obligation on accountable persons to conduct their responsibilities with honesty and integrity and with due skill, care and diligence. None of these terms are defined in the *Exposure Draft* or the *Banking Act*, suggesting that they take their meaning from the ordinary, commonly understood meaning of those terms and in some cases, their legal applied meaning.⁵ In this context, legal interpretations of the duties of directors and company officers under *Corporations Act 2001* (Cth) ss 180-184 are significant and highlight the need for a clear understanding of the relationship between the two statutory regimes.⁶ The *Explanatory Memorandum* to the *Exposure Draft* does not address this issue, except to note that ASIC, the Corporate Regulator, will continue to regulate instances of poor conduct or behaviour that is not prudential in nature.⁷
 - (c) Sub-section 37AC(1)(b) imposes an obligation on accountable persons to deal with APRA in an open, constructive and co-operative manner. Neither ss 37AC(1)(a) nor 37AC(1)(b)

⁴ Allens Linklaters, ‘Client Update: The BEAR Roars Into Action’, *Financial Services Regulation Publication*, 28 September 2017, at <https://www.allens.com.au/pubs/fsr/cufsr26sep17.htm> (accessed 28 September 2017).

⁵ *Explanatory Memorandum*, above n 3 [1.98].

⁶ The *Exposure Draft* is silent on the relationship between the accountability obligations proposed by the BEAR reforms and the duties of directors and officers under the *Corporations Act 2001* (Cth). The *Explanatory Memorandum* does not discuss the issue directly but clearly contemplates that the two regimes are separate but serve complementary functions. Para 1.95 states that ‘ASIC will continue to regulate instances of poor conduct or behaviour that are not prudential in nature and consequently do not result in a breach of the BEAR accountability obligations’.

⁷ *Explanatory Memorandum*, above n 3, [1.95].

as currently drafted make any express or implied reference to ‘behaviour that is systemic and prudential in nature’ as claimed by para 1.93 of the *Explanatory Memorandum*. No such limitation as to the scope of the respective statutory obligations can be implied from the current drafting of these sub-sections.

- (d) Sub-section 37AC(1)(c) imposes an obligation on accountable persons to take reasonable steps in conducting those responsibilities to prevent matters from arising that would adversely affect the prudential standing or reputation of their ADIs. This provision gives rise to a number of interpretative difficulties:
- (i) The expression ‘take reasonable steps’ derives meaning from the guidelines in s 37CB, set out above. According to para 1.100 of the *Explanatory Memorandum*, they are to be interpreted as involving actions that are systematic in nature. Section 37BC is not intended to be an exhaustive guide as to what constitutes reasonable steps. It is therefore unclear what, if any, role *Corporations Act 2001* (Cth) ss 189 and 190 might play in determining reasonable steps on the part of an accountable person who is also a director and/or officer of a corporation for the purposes of the *Corporations Act*.
 - (ii) The expression ‘those responsibilities’ is not defined in ss 37(1)(c). In the absence of a definition, ‘those responsibilities’ takes its meaning from the surrounding provisions with the reasonable implication being that they refer to the responsibilities described in ss 37CA(1)(a) and 37CA(1)(b). This suggests possible overlap, if not duplication, between the three obligations in s 37CA(1). For example, ss 37CA(1)(a) requires an accountable person, inter alia, to conduct their activities with due skill, care and diligence. Due skill, care and diligence connotes a requirement of reasonable care. Sub-section 37CA(1)(c) requires the accountable person to take reasonable steps in conducting, inter alia, the responsibility of due skill, care and diligence in 37CA(1)(a). In this narrow respect, ss 37CA(1)(c) would seem to add little of substance to the obligation in ss 37CA(1)(a).
 - (iii) Para 1.99 of the *Explanatory Memorandum* asserts that ‘[W]hen an accountable person can show he or she has taken reasonable steps to meet his accountability obligations, then he or she *would not be in breach of those obligations*’ (emphasis added). When discussing ‘those obligations’, it is unclear whether para 1.99 of the *Explanatory Memorandum* intends to refer to all accountability obligations in s 37CA(1) or merely those in ss 37CA(1)(c). If the

taking of reasonable steps is intended to be a defence to the alleged breach of any obligation under s 37CA(1), then the operation and intended effect of ss 37CA(1)(c) must be called into question. Is it an obligation, as it purports to be, *or* a defence to a claim for breach of the accountability obligations in s 37CA(1)? Sub-section 37(1)(c) is not expressed as a defence but rather as an obligation. Yet, in scoping that obligation, as discussed earlier, it references the responsibilities in ss 37CA(1)(a) and 37CA(1)(b). This points to fundamental difficulties with the operation and legal effect of ss 37CA(1)(c) as currently drafted.

- (iv) The expression ‘to prevent matters from arising that would adversely affect the prudential standing or reputation of the ADI’ in ss 37CA(1)(c) is also not defined despite being critical to the scope of the obligation or possible defence available pursuant to its terms. It has been suggested that this element was designed not only to improve the conduct of banks executives by heightening their efforts to safeguard against reputational risks, but also to keep them out of the media.⁸ Certainly, the ‘prudential standing and reputation’ formulation is different to the Government’s original proposal for the obligation now found in ss 37CA(1)(c).⁹ Absent any definition, it is hard to realistically assess the scope of this requirement and in particular, whether it addresses the issues raised in the earlier consultation paper. The *Banking Act 1959* (Cth) provides for the prudential supervision and monitoring of ADIs by APRA,¹⁰ but does not define what constitutes the term ‘prudential’ for this purpose. Prudential standards published by APRA address issues such as governance, risk management, fit and proper persons requirements for management roles.¹¹
- (e) For the obligations in ss 37CA(1)(a) and 37CA(1)(b) as currently drafted to be read down as applying only to behaviour that is systematic and prudential in nature, as posited in para 1.93 of the *Explanatory Memorandum*, it is necessary to interpret their meaning by reference to terms outside the provisions themselves. One possibility is to take into account the meaning of ‘an accountable person’ pursuant to s 37BA. Section 37BA

⁸ Allens Linklaters, above n 4.

⁹ Australian Government, *Banking Executive Accountability Regime Consultation Paper*, July 2017, at https://static.treasury.gov.au/uploads/sites/1/2017/08/c2017-t200667-BEAR_cp.pdf (accessed on 28 September 2017) [Chapter 5, page 8].

¹⁰ *Banking Act 1959* (Cth) ss 11AF, 11A, 11B.

¹¹ See APRA, ‘Authorised Deposit Taking Institutions Prudential Framework’ at <http://www.apra.gov.au/adi/PrudentialFramework/Pages/adi-prudential-framework.aspx> (accessed at 28 September 2017).

declares a person to be an accountable person if they have responsibility for the management of an ADI or subsidiary or particular function within an ADI including, inter alia, information technology, audit, human resources and anti-money laundering. While these responsibilities are obviously governance related, it is not immediately clear that all of them are prudential in nature and thus, we contend, it might be difficult to infer a limited scope to the obligations under s 37CA(1) based on s 37BA.

- (f) An alternative way is to interpret ss 37CA(1)(a) and 37CA(1)(b) by taking into account the requirements of ss 37CA(1)(c) and, by deduction, the guidelines on taking reasonable steps in s 37CB. However, this would only be appropriate if ss 37CA(1)(c) was intended to operate as a form of defence for the obligations in s 37CA(1) as a whole. We contend that this interpretation of ss 37CA(1)(c) is contentious and problematic. It follows that we consider the obligations in ss 37CA(1)(a) and 37CA(1)(b) as currently drafted to be wider than the *Explanatory Memorandum* would suggest. We also contend that they trigger questions as to duplication and overlap with duties under the *Corporations Act 2001* (Cth) and the possible relevance of defences available to directors and offices under the *Corporations Act 2001* (Cth) in those circumstances.

Flow On Effects of S 37CA for Other BEAR Reforms

1. The intention of the proposed BEAR regime, inter alia, is to require all senior executives and directors of ADIs, who satisfy the definitional requirements of accountable persons for the purposes of s 37BA, to be registered under the *Banking Act 1959* (Cth). Section 37DA prohibits a person from being an accountable person unless they are so registered.
2. Registered accountable persons can subsequently be disqualified under s 37J on grounds that they have not complied with the accountability obligations in s 37CA and the disqualification is justified. The disqualification power can apply in respect of a particular ADI or its subsidiary, a class of ADIs or subsidiaries or any ADI or any subsidiary of an ADI (at large).
3. The upshot of the registration and disqualification reforms is that they work to deny accountable persons, in breach of their s 37CA(1) obligations, employment in a senior management role at an ADI for a definite and possibly indefinite period, dependent on the nature of any disqualification process. Given these serious consequences, it is important to ensure that s 37CA is properly drafted, does not duplicate existing legal obligations under other legislation and provides a clear and appropriate defence of reasonable conduct. The current drafting of s 37CA does not do this.
4. One of the accountability obligations imposed on ADIs by *Exposure Draft s 37C(d)* is to take reasonable steps to ensure that each of its accountable persons meets their accountability

obligations under s 37CA. This obligation is very difficult to fulfil where the operation of s 37CA(1) remains under the interpretative cloud now outlined. Failure by an ADI to carry out this obligation, exposes the ADI to civil penalties under s 37G of the *Exposure Draft* and empowers APRA to withdraw the ADI's authority to carry on a banking business pursuant to *Banking Act 1959* (Cth) s 9A(2)(i). Revocation of an ADI's authority to carry on a banking business obviously denies ADI the legal means to continue in business for the period of the revocation. The serious consequences attaching to non-compliance by ADIs with s 37C underlines the importance of getting the current drafting of s 37CA right.

Recommendation

Treasury should re-evaluate the purpose, operation and scope of section 37CA(1) as presently drafted and make extensive revisions to address the issues raised in this response.