

AUSTRALIAN PRUDENTIAL REGULATION AUTHORITY

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1 November 2017

Committee Secretary
Senate Economics Legislation Committee
PO Box 6100
Parliament House
Canberra ACT 2600

Dear Secretary

APRA welcomes the opportunity to assist the Senate Economics Legislation Committee's Inquiry into the *Treasury Laws Amendment (Banking Executive Accountability and Related Measures) Bill 2017*. This submission focuses on how the Government's proposed accountability regime enhances and builds upon existing pillars of APRA's prudential framework.

APRA's mandate

APRA is the prudential regulator of the Australian financial services industry. Its mandate, as set out in section 8 of the *Australian Prudential Regulation Authority Act 1998*, is to administer relevant Commonwealth legislation, including the *Banking Act 1959*, that provide for the prudential regulation of financial institutions. In pursuing its mission, APRA is tasked to balance the objectives of financial safety and efficiency, competition, contestability and competitive neutrality and, in balancing these objectives, promote financial system stability in Australia.

As the prudential regulator of authorised deposit-taking institutions (ADIs), APRA seeks to protect the interests of bank depositors, who are afforded priority status under the Banking Act. APRA does this by establishing and enforcing requirements designed to ensure ADIs are well governed, prudently managed and financially sound.

Much attention given to APRA's regulatory framework focuses on the financial requirements that are imposed on ADIs, such as minimum capital and liquidity requirements. Financial resources themselves will not, however, be sufficient to protect depositors if an ADI is otherwise poorly governed or managed. Ensuring ADIs establish and maintain strong systems of governance, control and accountability are, therefore, equally important components of the prudential framework and have been given greater attention by prudential supervisors worldwide since the global financial crisis a decade ago.

Consistent with this goal, the overarching objective of the Government's proposed accountability regime is to establish clear and heightened expectations of accountability for ADIs and their senior executives, and to ensure there are clear consequences should there be a material failure to meet those expectations.

APRA's existing prudential requirements

Importantly for APRA, the Government's proposed accountability regime builds upon, and in some areas strengthens, APRA's existing prudential framework in relation to governance and

accountability. The key components of APRA's existing framework for ADIs (which also applies to the insurance sector and, in modified form, the APRA-regulated components of the superannuation industry) are found in:

- *Prudential Standard CPS 510 Governance* (CPS 510), which sets out minimum foundations for good governance of ADIs to ensure that they are soundly and prudently managed by a competent board, which can make reasonable and impartial business judgements in the best interests of the ADI and which duly considers the impact of its decisions on depositors. This includes specific standards in relation to remuneration;
- *Prudential Standard CPS 520 Fit and Proper* (CPS 520), which sets out minimum requirements for ADIs to determine the fitness and propriety of persons to hold positions of responsibility in the ADI; and
- Division 3 of the *Banking Act 1959*, which permits APRA to apply to the Federal Court to disqualify a director or senior manager.

The proposed Banking Executive Accountability Regime (BEAR)

The BEAR is designed to promote behaviour that is consistent with protecting the ADI's 'prudential standing' and 'prudential reputation'. That is, it is designed to reinforce and enhance APRA's existing requirements for ADI's to maintain - and be seen to maintain - sound governance arrangements, prudent management practices, and a financially healthy position.

The key elements of the proposed regime are:

- the establishment of a class of directors and executives within ADIs referred to as 'accountable persons';
- the identification of accountable persons within an ADI, which may be defined based on senior management or control, or a particular senior position relating to an identified responsibility;
- a requirement for accountable persons to register with APRA prior to taking up duties;
- a requirement for ADIs to provide APRA with accountability statements and maps covering the roles and responsibilities of accountable persons;
- the establishment of a core set of behavioural expectations for both ADIs and accountable persons;
- minimum deferral of variable remuneration and changes to remuneration policies;
- enhanced examination powers to improve APRA's ability to investigate matters of concern within ADIs; and
- a stronger penalty regime in the event that ADIs and/or accountable persons fail to meet the requirements within the accountability regime.

Each of these components, and APRA's role in them, is discussed in more detail below.

Accountable persons

As proposed, an accountable person will be a senior executive who performs key management or oversight functions as prescribed under the legislation or an individual who otherwise has significant influence over all, or a material part of, an ADI's operations. Non-executive directors are also identified as accountable persons, recognising their critical role of oversight while appropriately distinguishing from senior management responsibilities.

An accountable person may be identified when in a senior executive position with responsibility for management or control of a significant or substantial part of the overall ADI group, and this is not restricted to the ADI itself. This includes a material subsidiary of the ADI that has the potential to impact the ADI's prudential standing or prudential reputation; for example, one engaged in insurance or funds management.

An individual will also be an accountable person if they have one of the particular responsibilities listed in the legislation. The legislation also grants APRA flexibility to identify additional particular responsibilities, allowing APRA to expand the responsibilities over time where required to ensure the effectiveness of the accountability regime.

APRA's existing framework for determining fitness and propriety of individuals holding positions of responsibility in APRA-regulated institutions, found in CPS 520, remains in place for the time being. In most cases, this will encompass a wider group of individuals within ADIs than will be covered by the group of accountable persons under the BEAR. While the two sets of arrangements can co-exist, APRA intends to assess the existing CPS 520 requirements in due course with a view to streamlining requirements and avoiding duplication.

Registration of accountable persons

APRA's existing prudential requirements require notification of the fitness and propriety of responsible persons within 28 days of being appointed to a role. In other words, formal notification of appointments generally occurs after the event.

Under the proposed legislation, accountable persons will be required to register with APRA prior to taking up duties, with an exception for temporary or unforeseen vacancies. APRA will maintain a register of accountable persons based on information provided by each ADI and will update the register as staffing changes occur. ADIs must also notify APRA when an accountable person has been dismissed, suspended or had reduced variable remuneration due to a failure to comply with the accountability obligations.

Appropriately, the proposed legislation does not give APRA authority to veto appointments or refuse registration in the normal course. Nor does APRA envisage conducting detailed vetting of all proposed accountable persons. It is important for accountability that it remains the role and responsibility of boards and senior management of ADIs to ensure they recruit appropriate individuals into executive positions: if APRA did take a more active role in judging the merit of appointments, this would risk reducing accountability by virtue of ADIs relying on APRA's vetting rather than their own decision-making processes. However, the registration process does allow APRA the opportunity to raise any concerns prior to an accountable person assuming a role, such as, for example, where APRA is aware of previous behaviour by the individual that may mean they are unsuitable for a role of significant influence.

Accountability statements and map

Under the proposed legislation, each ADI will be required to provide APRA with an accountability statement describing the area of responsibility for each accountable person. ADIs will also be required to provide APRA with an 'accountability map' which will provide a

complete view of the aggregate set of allocated responsibilities for the ADI and its subsidiaries. The proposed legislation permits the content and design of these accountability statements and maps to be refined over time by APRA as the regime evolves.

APRA expects these accountability statements and maps will also provide benefits to ADI boards and senior management by providing a clearer and more precise view of the lines of accountability within an ADI. It is possible that at some ADIs, this process will lead to a reallocation or refinement of responsibilities across executives in order to ensure all of the prescribed roles are covered appropriately.

The proposed legislation also provides APRA the power to direct an ADI to reallocate responsibilities amongst accountable persons. This is a useful reserve power but, where APRA had concerns about the allocation of responsibilities within an ADI, APRA expects that, consistent with its current approach to supervision, it would typically seek to engage with an ADI to seek an allocation outcome that is amenable to both ADI and APRA, thereby alleviating the need to issue such a direction. APRA therefore envisages the usage of such a direction is likely to be rare. In the case where a reallocation is directed by APRA, this would most likely be an element of broader governance-related actions being pursued by APRA.

Behavioural expectations

The proposed legislation establishes a set of expectations for ADIs and accountable persons including acting with honesty and integrity, due skill, care and diligence, and dealing with APRA in an open, constructive and co-operative way. These expectations are set with a view to promoting an ADI's prudential standing and prudential reputation.

Should an ADI or an accountable person not meet these expectations, and therefore undermine or put at risk the ADI's prudential standing or prudential reputation, APRA can disqualify an individual so that they can no longer be appointed to a role with significant influence or, in the case of an ADI, apply to the courts to impose significant civil penalties.

In exercising the disqualification power, APRA's actions will be governed by the legislation and will be supplemented by internal requirements for investigating and substantiating any such decision. An affected individual will have protections and rights to procedural fairness, including the provision of notice in writing before the decision is made and the opportunity for the individual to make submissions to APRA prior to a decision. An individual is also able to request that APRA review its decision and APRA must consider those submissions (and, as a matter of practice, would do so with a new decision-maker). Where an individual remains dissatisfied with APRA's decision (including any review), the affected person is able to seek a review by the Administrative Appeals Tribunal.

Although not specified under the BEAR legislation, it would be APRA's intent that individuals who are disqualified would be disclosed on APRA's disqualification register.

In regard to civil penalties, APRA cannot itself impose fines on ADIs. Any such penalty would be imposed by the Federal Court considering an application by APRA.

Remuneration

The proposed legislation will require ADIs to have in place a remuneration policy that requires reduction of variable remuneration for accountable persons who do not meet their accountability obligations. To facilitate this, the legislation also requires the deferral of a minimum amount of an accountable person's variable remuneration.

These aspects of the proposed legislation are broadly in line with APRA's existing prudential framework, which requires ADIs to have an appropriate remuneration policy in place, including providing for downward adjustment of performance-based remuneration under certain circumstances. However, unlike the current prudential framework, the BEAR introduces an explicit minimum deferral amount.

Remuneration practices across ADIs vary widely and are often based on complex arrangements. While the proposed legislation establishes default definitions of remuneration and method for valuation, the legislation also provides power for APRA to determine that remuneration of a particular kind is, or is not, variable remuneration, and to determine the way to value variable remuneration other than the default method. Given some ADIs utilise fair value to value variable remuneration, APRA may need to provide additional guidance on how such calculations should be undertaken with a view to ensuring consistent application of the new regime.

Enforcement powers

The proposed legislation grants APRA a range of additional powers to assist in enforcing the accountability regime.

This new regime includes the power to examine witnesses and the power to obtain information relevant to considering an enforcement action. The additional information gathering powers will allow APRA to have the ability to obtain documents not just from an ADI but from anyone who is believed to have relevant information subject to the investigation. This recognises the reality that ADIs are not the only parties that may have relevant information regarding an investigation under the Act.

It is important to note that these examination and information-gathering powers serve to bring APRA's powers for ADIs into alignment with other industries that APRA regulates. This has been a long-standing shortcoming within the Banking Act and, left unaddressed, would serve to materially impede APRA's ability to investigate matters of prudential concern.

The accountability regime also includes significant consequences for accountable persons and ADIs that breach the requirements of the accountability regime. These include the potential for fines to be applied to the ADI, and the potential for accountable persons to be disqualified. Importantly, the consequences are intended to apply to conduct that is systemic and prudential in nature. It grounds the accountability regime in the prudential standing of the ADI, which is consistent with APRA's mandate and long-standing approach to regulating and supervising ADIs and other APRA-regulated entities.

APRA Resourcing

To implement the BEAR by 1 July 2018 and maintain the regime on an ongoing basis, APRA was provided with additional funding as follows:

	2017/18	2018/19	2019/20	2020/21
Additional budget (\$m)	0.4	1.4	1.2	1.2
Additional FTE	2	6	5	5

In addition, APRA was provided with an additional \$1 million per annum to build up its contingency enforcement fund (currently \$6 million).

Implementation

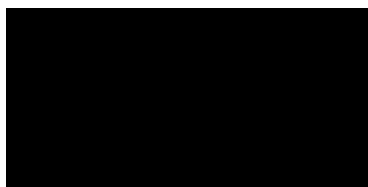
Following passage of the legislation, both APRA and the banking industry will have a great deal of work to do to implement the accountability regime by the scheduled commencement date of 1 July 2018. APRA expects that this timeframe will be challenging; for this reason, the legislation provides some additional transition arrangements in some areas.

In the short-term, APRA will need to prepare reporting and data management systems and processes to accommodate the accountable person register and the submission of accountability maps and accountability statements. APRA will also need to consult with industry on their preparation for the implementation of the regime, and consider whether and where guidance may be useful.

Looking forward, there are a number of areas that APRA will need to consider as the accountability regime is integrated with the APRA's overall prudential framework, with two areas of particular importance noted below.

Firstly, as noted above, there will be overlap between the existing set of responsible persons under APRA's Fit and Proper framework, and the accountable persons under the BEAR. APRA will consider how to best update the concept of responsible persons following the initial implementation of the accountability regime. At a minimum, there are likely to be efficiencies in aligning the process for notification to APRA.

Secondly, there are aspects of the accountability regime that could be applied over the longer term to other APRA-regulated industries. For example, the concept of accountability maps and statements may enhance an APRA-regulated entity's governance and risk management by establishing a clearer view of accountabilities. While this could be achieved through broader legislation at some future time, it may be more readily implemented by APRA enhancing its own prudential standards.



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