AUSTRALIAN BANKERS' ASSOCIATION INC.
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Level 3, 56 Pitt Street
Sydney NSW 2000
Australia
+61 2 8298 0417
@austbankers
bankers.asn.au

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Senate Standing Committee on Economics
PO Box 6100
Parliament House
Canberra ACT 2600
By email economics.sen@aph.gov.au

Dear Sir/Madam

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

The Australian Bankers' Association (**ABA**) appreciates the opportunity to provide the Senate Standing Committee on Economics with comments on the *Treasury Laws Amendment (Banking Executive Accountability and Related Measures) Bill 2017* (**the Bill**) and accompanying Explanatory Memorandum (**EM**).

With the active participation of its 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 to ensure Australia's banking customers continue to benefit from a stable, competitive and accessible banking industry.

As noted in our submission of 4 August 2017 (**August submission**)[1] in relation to *Banking Executive Accountability Regime* (**BEAR**) *Consultation Paper* (**Consultation Paper**), and again in our 29 September 2017 submission (**September submission**)[2] on the Exposure Draft Bill; the ABA welcomes those reforms that strengthen accountability and competition in the banking industry.

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."

We will not repeat all of the issues raised in our earlier submissions. While some of those issues have not been addressed in the Bill and remain of concern, the ABA acknowledges and appreciates that some important issues were addressed in the legislation following consultation on the draft legislation. On that basis this submission focuses on a number of 'key' issues and makes some recommendations in relation to unresolved issues.

Key issues and recommendations

Section 37CA - Joint responsibility

Section 37CA(2) provides that where two or more individuals have the same responsibility, joint accountability applies.

[1] ABA submission (4 August 2017), http://www.bankers.asn.au/images/uploads/Submissions/ABA-131090-v1-ABA_Submission_BEAR_4_August.pdf
[2] ABA submission (29 September 2017), http://www.bankers.asn.au/images/uploads/Submissions/ABA-131659-ABA-Submission_Treasury_BEAR_Sept_17.pdf

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The ABA believes that each accountable person must be individually responsible and accountable for their own conduct, and execution of their own responsibilities (as set out in their accountability statement). This approach is consistent with the stated intention of the BEAR to ensure that senior bank executives are held personally accountable for a failure to meet their accountability obligations. An individual should not be made responsible for the performance or conduct of another accountable person, especially in light of the accountability obligations of accountable persons (such as to act with honesty and integrity and with due skill, care and diligence - section 37CA(1)(a)).

We note that under the UK Senior Managers Regime individuals with "shared" responsibility are individually responsible not jointly[3], i.e. not liable for the other person's actions. There is no policy rationale why the Australian regime should differ from the UK model in this regard.

Recommendation: Section 37CA(2) should be amended to provide that the obligations apply on an individual basis in accordance with responsibilities, so severally and not jointly (suggested drafting below).

Section 37CA – Extent of accountabilities

The ABA believes the accountability obligations of an accountable person should be considered to be discharged in circumstances where the accountable person has undertaken all steps that a reasonable person would undertake, having regard to the scope of the person's role and responsibilities and the particular circumstances of the ADI at the relevant time.

In our September submission we recommended that 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 accountability 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.

The ABA note that this approach has not been adopted. On this basis we strongly recommend that the discharge of an individual's accountability obligations are subject to him or her having taken reasonable steps in each case. This approach is consistent with the policy intent expressed in paragraphs 1.116 and 1.117 of the EM which states:

> *1.116 When an accountable person can show he or she has taken reasonable steps to meet his or her accountability obligations then he or she would not be in breach of those obligations. Section 37CB is not exhaustive in identifying what is a 'reasonable step'.*
>
> *1.117 Given the seniority of the role of accountable persons, reasonable steps are systemic in nature. An accountable person has taken reasonable steps where appropriate governance, control and risk management and policies and systems are in place; delegations are appropriate given the scope of responsibilities; and there are mechanisms for dealing with problems that arise or might arise.*

Recommendation: The drafting of section 37CA should be made consistent with section 37C such that the obligations are to take reasonable steps to discharge the responsibilities set out in paragraphs 37CA(a), (b) and (c).

The ABA recommends the following drafting changes to section 37CA.

> **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 conduct the responsibilities of his or her position as an accountable person by taking reasonable steps to:
>
> (a) ~~by~~ act~~ing~~ with honesty and integrity, and with due skill, care and diligence; and

[3] Prudential Regulator Authority, (May 2017), *Supervisory Statement Strengthening individual accountability in banking – SS28/15*, <http://www.bankofengland.co.uk/pra/Documents/publications/ss/2017/ss2815update.pdf>

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(b) ~~by~~ deal~~ing~~ with APRA in an open, constructive and cooperative way; and

(c) ~~by taking reasonable steps in~~ conduct~~ing~~ those responsibilities to prevent matters from arising that would adversely affect the prudential standing or prudential 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 ~~jointly~~ individually in relation to that responsibility.

Section 37EB - Minimum amount of variable remuneration to be deferred

Section 37EB(2)(b) states that variable remuneration is to have the value it would have had if it had instead been paid to the person at the time the decision to grant it was made. The EM, at paragraph 1.129, states that, as a general rule, variable remuneration is valued at face value rather than fair value.

The ABA considers that more clarity could be provided to ADIs concerning how they should value variable remuneration.

For example, an ADI may decide to grant $100 in variable remuneration to an accountable person in the form of a 'performance right'. Performance rights are the right to receive a share of the ADI in the future, subject to certain hurdles (such as the total shareholder return of the ADI exceeding a threshold).

At the time of the decision, the $100 would be converted into performance rights based on the fair value of the performance rights. Thus, if the ADI's shares were worth $20 on the day of grant, each performance right may have a fair value of $10. On this valuation, the accountable person would receive 10 performance rights (i.e. the right to receive 10 shares of the ADI).

The performance rights have a lower value than the underlying shares, in part because the hurdles make it less than certain that the accountable person will actually receive 100 per cent of the shares that the rights otherwise entitle them to. Further, the value of the shares in the future is unknown (e.g. they may be worth less than $20).

The interpretational dilemma arises because, on the day of grant, the monetary value of the variable remuneration is $100. If an ADI follows section 37EB(2)(b), it is arguable (but not certain), that the value of the variable remuneration on the day it is paid is $100. This is because the section asks ADIs to perform a counterfactual valuation of what the variable remuneration would be worth if it were paid, in full, to the accountable person on the day the decision was made to grant it. If ADIs needed to pay the variable remuneration in full on the day of grant, they would pay $100.

In contrast, the EM uses the concept of "face value". Because the 10 performance rights entitle the accountable person to 10 shares with a value of $20 each on the day of grant, the face value may be $200.

The issue with using this higher value is that the grant of the 10 performance rights is made in the expectation that the accountable person will only receive 10 shares in unlikely circumstances. The highly discounted probability of the accountable person actually receiving the 10 shares is taken into account when the decision is made to convert the $100 in variable remuneration into 10 performance rights. Few, if any, executives receive 100 per cent of the shares that performance rights granted as part of variable remuneration seem to entitle them to.

Recommendation: The ABA asks the Committee to recommend an alignment and clarification of the language used so that the Bill and EM are both consistent in describing the methodology that ADIs should use to value variable remuneration. Specifically, we would recommend that the wording in the Bill be updated to clarify that the value of deferred variable remuneration be valued at face value at the date of grant, regardless of any internal or external performance hurdles attached to the deferred instruments. This approach will ensure consistency between organisations, regardless of whether they use a fair or face value calculation.

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37AA - Inconsistency with corresponding foreign laws

The ABA asks the Committee to recommend minor changes to the language used in sections 37AA and 37BC to clarify the drafting such that it clearly includes the regulatory mechanisms, rules and instruments of appropriate Foreign Governmental Authorities.

The proposed change is intended to capture a wider range of possible scenarios where an ADI's overseas subsidiary is required to comply with BEAR, but that conflicts with another obligation that has similar force to legislation (but is not directly linked to a legislative requirement) in that overseas jurisdiction. For example, in the case of a subsidiary of an ADI located in New Zealand, the requirement to comply with 'minimum standards' of eligibility to be granted a financial market services licence specified by the New Zealand Financial Markets Authority.

In addition, the ABA asks the Committee to recommend amendments to section 37AA to enable the Australian Prudential Regulation Authority (**APRA**) to provide a notice under that section when a subsidiary of an ADI, rather than the ADI itself, is at risk of breaching a foreign law. This would cover the situation where the ADI would otherwise be required to ensure its subsidiary acts in a way that would be contrary to a foreign law, but no breach of foreign law by the ADI will occur (given that the ADI captured under BEAR may not be subject to that foreign law).

Recommendation: The ABA recommends the following drafting changes to section 37AA and 37BC.

37AA Inconsistency with corresponding foreign laws

(1) If APRA is satisfied that an ADI or a subsidiary of an ADI would contravene a ~~law of a foreign country~~Foreign Law if the ADI were to comply with a particular obligation under section 37, APRA:

(a) may give to the ADI a written notice specifying that obligation; and

(b) may specify in the notice:

(i) the extent to which the ADI need not comply with that obligation; and

(ii) conditions to which the notice is subject.

(2) An ADI is not required to comply with that obligation:

(a) to the extent compliance would result in the ADI or a subsidiary of an ADI contravening that ~~that law of a foreign country~~ Foreign Law; or

(b) if the notice specifies the extent to which the ADI need not comply with that obligation—to the extent so specified;

if the conditions (if any) specified in the notice are complied with.

37BC Inconsistency with corresponding foreign laws

(1) If APRA is satisfied that an accountable person, of an ADI or a subsidiary of an ADI, would contravene a ~~law of a foreign country~~Foreign Law if he or she were to comply with a particular obligation under section 37B, APRA:

(a) may give to the accountable person a written notice specifying that obligation; and

(b) may specify in the notice:

(i) the extent to which the accountable person need not comply with that obligation; and

(ii) conditions to which the notice is subject.

(2) An accountable person is not required to comply with that obligation:

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(a) to the extent compliance would result in the accountable person contravening that ~~law of a foreign country~~ Foreign Law; or

(b) if the notice specifies the extent to which the accountable person need not comply with that obligation—to the extent so specified;

if the conditions (if any) specified in the notice are complied with.

(3) APRA must give a copy of the notice to the ADI or subsidiary.

The following two definitions would also be included in the Act:

- "Foreign Law" means any applicable law, statute, rule, regulation, code, order, ordinance, judgment, injunction and decree of any Foreign Governmental Authority.
- "Foreign Governmental Authority" means any government or agency, regulatory body, board, commission, court, department, official, political subdivision, tribunal or other instrumentality of any government of a foreign country.

Conduct that is systematic and prudential

The ABA believes that further clarity is still required as to the circumstances when the regime is intended to apply. The EM indicates that the BEAR will cover conduct that is "systematic and prudential" (EM paragraph 1.25), 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 (EM paragraph 1.26). The EM also states that APRA should only seek civil penalties for significant breaches of the BEAR (EM paragraph 1.158).

Recommendation: The ABA asks the Committee to recommend that APRA, in developing the prudential standards, guidance, practice notes and reporting requirements (as envisaged in the EM – paragraph 1.157), also provide clear prudential guidance on conduct that is systematic and prudential.

Legal Professional Privilege

The Exposure Draft of the Bill did not contain any references to legal professional privilege. In our September submission we recommended that the Bill should expressly preserve claims to legal professional privilege in relation to an ADI's and an accountable person's obligations. Section 62AA of the Bill, as tabled, now addresses claims of legal professional privilege and the production of privileged documents by "lawyers" only. This section appears to mirror section 69 of the *ASIC Act*. As with the *ASIC Act*, the Bill is silent regarding claims to legal professional privilege by persons other than lawyers (such as their clients).

The specific inclusion of a section dealing only with claims to legal professional privilege by lawyers significantly clouds the issue of whether claims to legal professional privilege by non-lawyers are preserved at common law. This is so, notwithstanding that the EM at, for example 1.46 and 1.114, contemplate the preservation of claims to legal professional privilege that are made by ADIs and accountable persons.

It would be an illogical outcome if for example, under the current section 62AA, APRA could issue notices in the same terms, requiring the production of documents to both a law firm and one of its clients, with the result being that the law firm could make a valid claim to legal professional privilege with certain documents and not produce them, but the client could not in respect of his/her copies of the same documents. If that were the case there would be no practical utility in section 62AA of the Bill at all.

The position with ASIC, while now clearer, was not always that way. For a period of time, and notwithstanding case law, to the contrary ASIC asserted that privileged documents had to be produced. That uncertainty, and the potential for APRA to make similar assertions, could easily be avoided if the position was clarified in the Bill.

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Recommendation: The ABA recommends that section 62AA be amended, or that a further section be included, to specifically provide that all persons (including the relevant ADI) and not only 'lawyers' may make claims to legal professional privilege under the Bill and, on that basis, be entitled to refuse to comply with certain requirements under the Bill - in the same way that the Bill currently contemplates that 'lawyers' may.

Implementation and timing

As noted in our August and September submissions, the additional powers and responsibilities granted to APRA as part of the BEAR are significant. Effective implementation of the BEAR regime will require material effort and reallocation of resources by ADIs and APRA to meet the proposed deadline.

Clarity around affected entities and roles is essential and further guidance is required from both the Government and APRA before that certainty can exist for the industry. For example, the Bill contains broad powers to exempt certain ADIs, or subsidiaries of ADIs, from certain responsibilities.[4] The ABA would also welcome guidance on what constitutes a 'significant or substantial' part of an ADI, for the purpose of determining accountable persons. Clarity around the processes and timelines on how any guidance and/or 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)).

The implementation timeline does not take into account the current absence of APRA's prudential standards, guidance, practice notes and reporting requirements (as envisaged in the EM – paragraph 1.157) 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. Until guidance and prudential standards have been finalised by APRA, it will be difficult for ADIs to progress and finalise their implementation of the regime.

Concluding remarks

The BEAR regime represents a significant reform to the landscape of regulation and oversight in Australia for ADIs. Clear and certain legislation, along with prompt guidance from APRA on its intended operation, is critical to achieve the required consumer outcomes without costly unintended consequences.

Yours faithfully

Signed by

Aidan O'Shaughnessy
Executive Director - Industry Policy (Acting)
[redacted]

[4] See for example sections 37A and37BB.