



1 November 2017

Committee Secretary
Senate Economics Legislation Committee
Parliament House
Canberra ACT 2600
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Dear Committee Secretary

Inquiry into the Treasury Laws Amendment (Banking Executive Accountability and Related Measures) Bill 2017 [Provisions]

Thank you for the opportunity to provide a submission on this Bill to implement the Banking Executive Accountability Regime (BEAR).

About COBA and its members

COBA is the industry association for Australia's customer owned banking institutions, i.e. mutual banks, credit unions and building societies. Collectively, our sector has \$108 billion in assets and 10 per cent of the household deposits market.

The customer owned model provides a genuine alternative to the listed bank model in the retail banking market and consistently delivers market-leading customer satisfaction.

Our members are all Authorised Deposit-taking Institutions (ADIs) regulated by APRA under the *Banking Act 1959*. This means that our entire sector will be subject to the BEAR.

We estimate that around one-third of "accountable persons" under the BEAR will be from the customer owned banking sector.¹

Implementing the BEAR

COBA accepts that the Government is determined to impose a heightened accountability regime for the banking sector in response to the erosion of trust caused by the behaviour of major banks.

We do not oppose the principle of greater accountability and we accept that all ADIs should be subject to the same prudential regulatory framework, subject to that framework being proportionate and taking account of size, risk and complexity.

In addition to enhanced accountability, the Government also wants a "robustly competitive" banking system and recognises that "competition and innovation are the keys to improving the customer experience for all Australians."²

¹ Based on BEAR Bill Explanatory Memorandum estimate of total accountable persons of 2,535

² Second Reading Speech, BEAR Bill

To meet the twin objectives of an “unquestionably accountable” banking system and a “robustly competitive” banking system, it is critically important to minimise the regulatory compliance cost burden on smaller ADIs.

In the case of the BEAR, this can be achieved by giving small and medium ADIs sufficient time to plan and prepare for the BEAR and for APRA to give due consideration to relevant guidance and prudential standards to implement a proportionate BEAR.

COBA recommends that commencement of the BEAR for small and medium ADIs should be two years after commencement for the major banks (“large ADIs”).

The additional time for smaller ADIs to comply with the BEAR is justified because:

- the BEAR is a response to the findings of an inquiry into the major banks and this inquiry did not find any accountability problems with smaller ADIs
- there is no evidence that the existing accountability regime for ADIs has failed in the case of smaller ADIs and smaller ADIs will continue to be subject to that regime until the BEAR commences for them
- there is no urgency to apply the BEAR to smaller ADIs
- rushed commencement for smaller ADIs will harm their competitive position and damage the Government’s objective of a promoting competition in retail banking
- rushed commencement will force smaller ADIs to reallocate resources that have been earmarked by orderly planning processes to other, arguably more important, projects (e.g. delivering better risk management or customer benefit)
- delayed commencement for smaller ADIs will, appropriately, see major banks bear the costs of teething problems and unintended consequences during initial implementation, and
- the bulk of the compliance costs of the BEAR are upfront costs and a phased commencement process will allow these costs to be reduced for smaller ADIs.

Creating a smoother transition to the BEAR

COBA’s objective in seeking the phased commencement process is to ensure that the transition to the BEAR is achieved in the least costly way possible for smaller ADIs while delivering on the Government’s policy intent.

Most submissions on the original Consultation Paper and on the Exposure Draft Bill highlight that ADIs need more time to implement the BEAR than the 6 or 7 months implied by the proposed 1 July 2018 start date.

Previous international and domestic experience indicates that measures similar to the BEAR require a significant amount of consultation with industry and hence adequate implementation timeframes. (*See Attachment.*)

The BEAR marks a significant change in APRA’s powers and imposes significant new obligations on ADIs. If an ADI breaches its BEAR obligations, significant civil penalties may be imposed by a court. If an accountable person breaches BEAR obligations, that person may face disqualification or financial consequences through the reduction of variable remuneration. The BEAR is intended to work with existing legislative and regulatory frameworks but it is not clear how this will be achieved and there is a high risk of ADIs having to comply with two distinct prudential regulation frameworks – the existing prudential standards and the BEAR.

For smaller ADIs, the problems posed by these realities are particularly acute because they don’t have the large legal and compliance divisions of a major bank to deal with the changes in the time proposed. KPMG has described the implementation timeframe as “punishingly short”.³ Smaller ADIs should not be punished for the sins of major banks.

³ <https://www.rfigroup.com/australian-banking-and-finance/news/who-bears-wins>

Rushed commencement will lead to the BEAR being a hasty tick-a-box exercise rather than a useful and effective underlying change in governance and accountability.

Some customer-owned ADIs will have to immediately reallocate internal resources in order to meet the BEAR requirements. These resources may have been earmarked for other priorities, in some cases years in advance. These activities may be activities that would deliver a greater prudential benefit than the BEAR or would significantly improve customer service.

Many customer-owned ADIs will need to go to the market for external advice to implement the BEAR. Rushed implementation for smaller ADIs could bid up the costs of this advice.

Phased commencement still delivers on the policy intent

Given the BEAR focuses on prudential matters,⁴ a phased approach to commencement does not lead to excessive prudential risk as it would cover the main sources of risk from day one—the major banks.⁵

The “identified accountability gap” discussed in the Bill’s Explanatory Memorandum is based on the failings of the major banks and no such gap has been demonstrated to exist with smaller ADIs. Until BEAR commencement, smaller ADIs will continue to be covered by existing accountability mechanisms covering:

- culture: *Prudential Standard CPS 220 Risk Management (CPS 220)*
- remuneration & governance: *Prudential Standard CPS 510 Governance (CPS 510)*
- risk management: *CPS 220* requires an ADI to maintain a risk management framework that is appropriate to its size, business mix, and complexity, and
- fit and proper: *Prudential Standard CPS 520 Fit and Proper* sets out criteria for determining the fitness and propriety of responsible persons.

These standards apply in addition to the duties of directors under the Corporations Act.

Hence, phased commencement deals with the immediate accountability risk in the major banks but provides the least costly and most orderly transition to heightened accountability for all ADIs. In terms of protecting consumers, ASIC remains responsible for matters of corporate conduct and poor behaviour. ASIC’s powers to protect consumers could be increased in the near future, notably in relation to capacity to ban or penalise senior executives.⁶

Providing time to iron out the details of the BEAR

There is a lot of work to be done by APRA in the transition from the BEAR legislation to the practical governance outcomes. COBA member feedback notes that there is a high degree of uncertainty about APRA’s requirements under the legislation. It is not clear how this can be resolved by 1 July 2018, or how it will be done in a manner that does not excessively burden smaller ADIs.

Expert commentators quoted recently in the media⁷ point to significant challenges in terms of implementing the BEAR, including the potential need for broader governance changes and examination of BEAR practicalities:

⁴ The BEAR RIS (page 65) refers to the “BEAR having a focus on prudential matters”

⁵ These banks are identified by APRA as domestic systemically important banks.

⁶ The Government consulted last month on a proposal to increase ASIC’s power to ban senior officials in the financial sector.
⁷ <http://www.afr.com/business/banking-and-finance/financial-services/banks-win-more-bear-concessions-but-no-extension-20171019-gz4487>

- "There are structural changes that need to be made within banks, including changes in reporting lines, moving cost centres, and budgets and compliance." - Dom Graham, Deloitte director
- "The devil is in the implementation." - Tim Bednall, partner at King & Wood Mallesons
- "The real risk is that, when banks sit down and examine what needs to be done against the words in the law, they will find that many things don't work in practice. APRA will need to play an important role in engaging with industry to identify, understand, and resolve problems and ensure the regime achieve its objectives. We expect there to be a lot of focus on determining what those requirements mean in practice, and we expect that there will be areas of continuing debate." - Deloitte's lead partner on BEAR, Karen Den-Toll

A phased implementation will allow the major banks to resolve practical BEAR issues in conjunction with APRA. APRA will also be able to further develop its thinking on the BEAR and engage in discussions with smaller ADIs on its expectations and the development of clear guidance.

Without clear guidance, there will be uncertainty around the BEAR and this is likely to increase the compliance costs of the BEAR. In order to effectively and efficiently implement the BEAR there are a number of things that must happen prior to the implementation date:

- APRA develops its initial expectations (e.g. standards and guidance)
- APRA consults with industry on these expectations
- APRA communicates its finalised expectations
- ADIs understand the impact these expectations have on their business model
- ADIs implement these expectations through training and process reviews etc.

COBA notes that, in general, APRA consults for at least 3 months on proposals that it considers will lead to material changes, including with a period for public consultation. Similarly, APRA generally aims for a period of 1 year from finalisation for ADIs to implement any material prudential standards. Six months is clearly insufficient time to do this.

The proposed timeframe also does not take into account the potential areas of overlap and uncertainty. For example, there are questions as to how the BEAR will interact with the existing prudential regime. The EM Part 1.111 notes that there may be revisions to the existing prudential framework: "APRA may update CPS 520 to reflect the new and strengthened BEAR expectations as appropriate." In COBA's view, it would be sensible for APRA to update CPS 520 in order to ensure that the BEAR and the existing prudential framework work together as seamlessly as possible. Similarly, further clarification is required on the role of non-executive directors in their 'supervisory oversight' role.

The Minister and APRA still need to determine a large number of operational details. The EM notes that Government intends to determine some of these in consultation with industry. Once again, it is not clear how long there will be for meaningful consultation. These include:

- 37A – Ministerial exemptions from the BEAR for an ADI or class of ADIs
- 37BA – APRA by legislative instrument to determine additional responsibilities
- 37BB(2) – APRA by written notice to exclude specified responsibilities to an ADI or subsidiary of an ADI
- 37BB(3) – APRA by legislative instrument to exclude specified responsibilities for a class of ADIs or a class of subsidiaries
- 37DA – APRA to determine period person can act as an accountable persons without registration

- 37EA – APRA determinations on what is and isn't variable remuneration (for individual ADIs and more broadly)
- 37EB – APRA determinations on the way to work out the value of variable remuneration
- 37EC – APRA's application process to approve a shorter deferral period in relation to variable remuneration
- 37G(3)(c) – Ministerial Determination of large, medium and small ADIs
 - Noting that the Government intends to consult on this instrument (EM Part 1.83)
- Schedule 1 Part 3, 17 – APRA by legislative instrument to determine how to meet accountability statement and accountability maps in 37F

APRA will also need to determine how to approach subsidiaries, as well as cases where ADIs are subsidiaries and there is the potential for some functions to sit outside the immediate ADI subsidiary.

Providing time for ADIs to undertake broader governance reviews

A longer timeframe provides greater scope for ADIs to undertake governance and structural reviews. This will ensure that the BEAR leads to sustainable and meaningful change rather than just being seen as a tick-a-box exercise. In some cases, the BEAR may necessitate an overhaul of the accountability framework within an ADI. This is not necessarily due to a lack of accountability but rather to ensure that sufficient evidence is available to show that the ADI and accountable persons have taken "reasonable steps".

Similarly, the EM Part 1.119 highlights the potential for further APRA guidance in this area: "Following appropriate consultation, APRA may issue further guidance on what factors it would consider in determining reasonable steps and the behaviour and conduct it expects will meet the accountability obligations."

It is clearly preferable for this "appropriate consultation" to take place well ahead of BEAR commencement, at least for the great majority of ADIs, i.e. small and medium ADIs.

Law firm Allens' submission⁸ on the draft bill drew on the UK experience with a similar regime to the BEAR to indicate the magnitude of the compliance challenge.

"The experience of advising clients on accountability regimes in those jurisdictions is that a very significant amount of work was required in implementing the requirements of the regime, revising policies and procedures and employment terms, ensuring that senior managers properly understood the requirements of the new regime and assisting senior managers with documenting the governance and management arrangements in place to assist in demonstrating the taking of reasonable steps."

Law firm Clayton Utz, in a recent note,⁹ set out the steps ADIs will need to take to prepare for BEAR commencement, including:

- Update Policies, Systems and Training: understand the new set of BEAR obligations to be met by ADIs and "accountable persons", update governance policies, procedures and systems to reflect the BEAR and ensure that their accountable persons understand those obligations
- Identify and register all "accountable persons": identify each "accountable person" within the organisation, being a director or senior executive who exercises significant influence over conduct of and behaviour within the ADI, so that their

⁸ <https://static.treasury.gov.au/uploads/sites/1/2017/10/c2017-t228532-Allens.pdf>

⁹ <https://www.claytonutz.com/knowledge/2017/october/changes-to-corporate-governance-in-banking-groups-impacts-of-the-banking-executive-accountability-regime-bear>

names and roles can be registered with APRA on commencement of the BEAR,
and

- Review Governance Structures and prepare Accountability Statements and Maps: review their governance structures and prepare accountability statements and accountability maps which will need to be provided to APRA and kept updated.

The EM lists the following “upfront” costs:

- initial costs to update IT systems
- initial costs to understand the changes to legislation, update documentation, policies and procedures, and develop and implement training
- internal reviews of remuneration policies and procedures and updating to meet the new requirements
- initial registration of accountable persons
- initial provision of accountability maps and statements, and
- education of accountable persons on new requirements.

A COBA member has provided the following feedback about the compliance task:

“The new regime proposed by BEAR will necessitate a complete overhaul of the current accountability framework and processes within the Bank. Transitioning to meet the requirements of the new legislation will not only require the production of new policy and administrative guidelines in regards to the content of accountability maps, responsibility statements, job descriptions, organisational charts, but will require levels of foresight as to the appropriateness and completeness of key documentation, role architecture and processes that conceivably could be used to evidence ‘reasonable steps’.

“The changes also demand further consideration of the interplay between existing organisational functions, i.e. HR, Risk and Company Secretary and the potential for centralisation of responsible manager, fit and proper and BEAR accountabilities. In addition a number of existing processes including the engagement, on-boarding and transfer of new senior management will need to be reviewed and potentially overhauled in light of requirements.

“Given the magnitude of the changes which span governance, people, policy, process and information management and the current tight implementation window, BEAR will need to be formally tagged as a strategic regulatory project and project resources reallocated to complete the work. At this stage, there has not been adequate opportunity to scope BEAR with any level of detail. It seems critical given the nature of the legislation that there is adequate attention paid to defining required outcomes and in turn, to ensure sustainability, to be clear how all of the different components will be integrated and aligned. Given the prescriptive requirements outlined to date, and the cultural implications, undoubtedly the initial setup and ongoing compliance with BEAR will demand additional resourcing. It remains to be seen if the changes will necessitate external legal oversight.

“Given historical experience relating to similar types of projects, i.e. fit and proper & responsible managers, the project will demand a multi-disciplinary team plus administrative support from Project Office. Conservatively this translates into 3.5-5 FTE over the duration of the transition project. Once the new framework has been established there will be an ongoing requirement of circa 1.5 FTE over three different functional areas to monitor and ensure compliance with the new standard.”

Creating a more proportionate and orderly regulatory approach

APRA Chair Wayne Byres noted in remarks at the recent COBA Convention that the BEAR is not necessarily designed for smaller banking institutions and that while there is some scope for APRA to implement a proportional BEAR it will not be as flexible as APRA's existing prudential approach.¹⁰ This underlines the importance of smaller ADIs having enough time to transition to the BEAR. A phased approach will also allow APRA to explore areas where it can make the BEAR more proportional and efficient for smaller ADIs.

A delayed implementation for smaller ADIs will give due recognition that the BEAR is not the only regulatory change over the next year. In addition to the BEAR, the current regulatory reform schedule facing ADIs comprises dozens of new measures, including:

- new credit card rules
- new consumer credit insurance rules
- new breach reporting rules
- new product design and distribution obligations
- new product intervention power for ASIC
- new co-regulatory model for industry codes
- new external dispute resolution scheme
- new data breach notification requirements, and
- new reporting obligations about foreign tax residents.

Similarly, smaller ADIs are also responding to APRA's supervisory priorities (such as Financial Claims Scheme testing and crisis resolution & recovery planning initiatives)¹¹.

Other potential regulatory initiatives that will call on the resources of smaller ADIs are participation in Open Banking and comprehensive credit reporting (CCR). ADIs choosing to participate in Open Banking and CCR are likely to deliver significantly greater benefits, prudential and otherwise, to the wider community than the BEAR.

Given the limited resources of smaller ADIs, the regulatory reform agenda should take into account where the greatest benefits lie. The BEAR may provide some marginal benefit in terms of the prudential safety for smaller ADIs relative to the current prudential regime, but it is far from clear whether this benefit is sufficient to be given priority over other projects and regulatory measures.

Imposing unnecessary compliance costs on smaller ADIs due to unrealistic implementation timetables for significant regulatory changes will worsen the competition problem in banking.

According to the ACCC¹², retail banking markets in Australia, exhibit a number of indicators that suggest the current oligopoly structure is not vigorously competitive and has not been for some time. These indicators include:

- a concentrated market structure with the largest players maintaining significant market shares over a considerable time and sustaining very high margins and overall profits without attracting significant new entry or expansion by smaller players, and
- a high degree of symmetry in the product and service offerings of the large banks and "we do not observe strong rivalry between them to be the first to roll out new products and services to better meet the needs and wants of consumers."

¹⁰ Under APRA's existing prudential approach, APRA has broad scope to create prudential standards (legislative instruments). APRA can still make BEAR prudential standards but these are necessarily bound by requirements in legislation and may not be as flexible.

¹¹ APRA's strategic plan for 2017-2021 highlights "building recovery and resolution capability" as one of its priorities over the next four years.

¹² ACCC submission to Productivity Commission inquiry into competition in the Australian financial system, September 2017

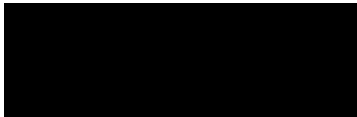
The ACCC says that “in situations of oligopoly, all else being equal, a market structure that enables a competitive fringe of second tier firms to effectively challenge the price and service decisions of large incumbents is likely to produce significantly better outcomes for consumers than one that does not.”

The regulatory compliance burden is a critical factor in determining whether the competitive fringe of second tier firms can challenge the major banks. This is because the regulatory compliance burden is effectively a competitive advantage for the major banks because they have vastly greater resources and capacity than their smaller competitors to cope with new regulatory obligations.

In relation to compliance costs, the EM states that a regulatory offset has not been identified. “However, Treasury is seeking to pursue net reductions in compliance costs and will work with affected stakeholders and across Government to identify regulatory burden reductions where appropriate.”

COBA asks the Committee to recommend a phased commencement process for the BEAR, giving small and medium ADIs a commencement date two years later than the BEAR’s commencement for major banks.

Yours sincerely



LUKE LAWLER
Director – Policy

ATTACHMENT

Previous international and domestic experience indicates that measures similar to the BEAR require a significant amount of consultation with industry and hence adequate implementation timeframes.

APRA's APS 520 Fit and Proper (2004-2006) – 24 months

2 March 2004	APRA releases consultation paper on Fit and Proper Requirements and draft Fit and Proper prudential standards ¹³ At this point APRA intends for the new standard to commence on 1 January 2005.
28 May 2004	Submissions due on above consultation paper & draft standards
29 June 2005	APRA releases another discussion paper, revised draft fit and proper standards and guidance notes ¹⁴
24 August 2005	Submissions due on discussion paper & associated documents
March 2006	Final prudential standard commences ¹⁵

UK Senior Managers Regime (SMR) (2013-2016) – 27 months – note this list is not exhaustive

18 December 2013	Passage of Banking Reform Act 2013 which introduces the SMR ¹⁶
30 July 2014	PRA/FCA releases <i>Consultation Paper (CP) 14/14 Strengthening accountability in banking: a new regulatory framework for individuals</i>
31 October 2014	Responses to CP 14/14 due to PRA/FCA.
19 December 2014	PRA/FCA releases <i>CP 28/14 Strengthening accountability in banking: forms, consequential and transitional aspects</i>
23 February 2015	PRA/FCA releases <i>CP 7/15 Approach to non-executive directors in banking and Solvency II firms & Application of the presumption of responsibility to Senior Managers in banking firms</i>
27 February 2015	Responses to CP 28/14 due
23 March 2015	PRA/FCA releases <i>Policy Statement (PS) 3/15 - Strengthening individual accountability in banking and insurance – responses to CP 14/14 and CP 26/14</i>
27 April 2015	Responses to CP 7/15 due
7 July 2015	PRA/FCA releases <i>PS 16/15 - Strengthening individual accountability in banking: responses to CP 14/14, CP 28/14 and CP 7/15</i>
7 March 2016	SMR commences

¹³ <http://www.apra.gov.au/CrossIndustry/Consultations/Pages/draft-prudential-standards-fit-and-proper.aspx>

¹⁴ http://www.apra.gov.au/MediaReleases/Pages/05_33.aspx

¹⁵ <http://www.apra.gov.au/adi/Documents/cfdocs/APS-520-consolidated-Sept-06-1-2.pdf>

¹⁶ <https://www.gov.uk/government/news/banking-reform-act-becomes-law>