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26th Oct 2017

Ph: [REDACTED]

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

Dear Sir

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

Thank you for your email of 20th October inviting me to comment on the above matter. Details of my background were included in my first submission on the BEAR in August 2017.

I strongly support the intention of the legislation as I consider that the implementation of a personal accountability regime in ADIs is long overdue. Further I believe that this legislation will in the future be viewed as one of the most important reforms ever undertaken in prudential overview of ADIs in Australia.

Comments on the draft legislation:

Schedule 1—The Banking Executive Accountability Regime Banking Act 1959

Part IIAA—The Banking Executive Accountability Regime

Division 1—Obligations under the Banking Executive Accountability Regime

Subdivision A—ADIs

37 Obligations of ADIs

Clause 37BA Meaning of Accountable Person

The list at 37BA (3) does not include senior executives in charge of lending functions. This omission is rather glaring, so much so that it may, to some, seem deliberate. While I am sure it is not intended to exclude the primary revenue functions of ADIs I consider that their inclusion in the list, and in the Explanatory Memorandum, would serve as an important “for the avoidance of doubt” clause. At the risk of labouring the point Appendix 1 shows what I believe are CBA’s and NAB’s current senior executive positions. As is common with large banks the lending functions are broadly conducted within three separate divisions: corporate, business and consumer but the nomenclature varies between banks. Appendix 1 shows that each division is headed by separate senior executives. The three separate divisions may then have attached to them other streams of business, e.g. wealth or private banking. Smaller ADI’s have a variety of other structures.

Division 2—Accountability obligations

37C The accountability obligations of an ADI

and

37CA The accountability obligations of an accountable person

At 37C (c) and again at 37CA(c) (and at other places) the phrase; “adversely affect the ADI’s prudential standing or prudential reputation;” appears. I note that in the Explanatory Memorandum the word “systemic” is used in the context of the type of breach that the legislation is intended to address although the word “systemic” does not appear in the legislation. The word “systemic” appears not easy to clearly define in the sense used because it has only an accepted meaning in physiology –“the whole of the body”. My recommendation would be to amend the Explanatory Memorandum so that it is consistent with the legislation, i.e. replace “systemic” with the explanation of a breach being a matter which would “adversely affect the ADI’s prudential standing or prudential reputation;”

I make these comments because many matters which impact the reputation of banks do not affect “the whole of the body” but are still a cause for widespread concern, i.e. “adversely affect the ADI’s prudential standing or prudential reputation;”

In the context of the accountability obligations of an accountable person at 37CA I think it is important to be cognisant that an accountable person, within their area of control, could be managing more than one discrete business function. The consequences of the legislation should apply separately to each business function within the area of control of an accountable person. As an example an accountable person may have control of business banking and private banking which are discrete functions, with business banking being run through a series of hubs or business centres while private banking is usually centralized. Matters may arise in one of these business types which could give rise to concerns about the prudential standing or prudential reputation of the ADI. It should not be a defence that because the accountable person did not breach the *whole* of their accountability obligations, i.e. those, relating in this example, to *both* business and private banking, that a breach for the purposes of the act has not occurred.

37CB Taking reasonable steps

I recommend that taking reasonable steps should include those broadly suggested at clause 1.54 in the Explanatory Memorandum, but detailed as follows:

- (d) ensure that all subordinates are honest and diligent and are;
 - (a) adequately trained; and
 - (b) appropriately experienced; and
 - (c) sufficiently skilled; and
 - (d) posses the requisite judgement

commensurate with satisfactorily carrying out their duties.

Division 4—Deferred remuneration obligations

I agree with the whole of this division as I think it will profoundly change the way senior executives plan and execute their responsibilities.

Division 6—Enforcement and administration
Subdivision C—Disqualification of accountable persons
37J APRA may disqualify an accountable person

Written notice.

There does not seem to be a time limit specified in 37J (5) by which submissions must be lodged.

Schedule 2—Examination powers
61E Who may be present at examinations

At 61E (2) (c) it is stated that the examinee's lawyer may be present at the examination. It is highly likely that the examinee will be accompanied by the ADI's in house counsel or a lawyer appointed by, and paid for, by the ADI as the ADI would see the risk to the examinee as being inseparable from the risk of the ADI.

General Comments

Senior executives

There has been concern expressed that with the introduction of an accountability regime ADIs may find it difficult to attract and hold talented senior executives. I wish to express a contrary view that ADIs should seek to promote individuals who have the ability to strike the appropriate balance between the interests of the many stakeholders in the finance industry, including: the broader economy, customers, shareholders, regulators, the organisation, the community and the employees. This legislation emphasises the point that market share, growth and sales cannot be the only strategic imperatives of an ADI and individuals who are unable to manage more diverse objectives are probably not the right people for the job. Inevitably, highly talented and capable people will be found, or developed, to lead ADIs into a sustainable future, resulting in a restoration of trust and confidence in a worthwhile profession.

Accountability model

The accountability model proposed, based as it is on the emphasis on prudential breaches, is not an easy one to enforce due to the somewhat subjective nature of the term. However the prudential model has the benefit of a significantly more rapid implementation time frame than the prescriptive version which was my original inclination and which I think will eventually occur over the next several decades. I have no doubt that the legislation will take time to develop as it is reviewed and fine tuned over time in the light of experience and reflection. Delaying implementation until the perfect formula is found is not, I believe, an option that can be considered.

Application of Corporations Law in place of BEAR

I consider that any suggestion that Corporations Law provides adequate provisions for senior executive accountability in ADIs is flawed due to the necessarily generic nature of that law. ADIs are complex organisations that require a myriad of specialised policies and procedures that are unique to finance. It is essential that senior executives in ADIs understand how their profession operates and, from a prudential perspective, be accountable for failure to perform. Further, to suggest that senior executives in ADIs be not held accountable ignores the fact that there are very few professions (and for that matter – trades) that do not have standards imposed by professional bodies or regulation.

ADI's reaction to BEAR

The BEAR represents a significant change to the regulatory environment and I would contemplate that ADIs will react by a comprehensive review of:

- Policies
- Products
- Process and procedures
- People
- Projections –growth, sales, market share

to ensure that all risks which could lead to prudential breaches are identified and, as much as possible, mitigated. The process will be lengthy and it occurs to me that consultation with APRA on progress to compliance will be required. I also suggest that some forbearance on the part of APRA may be required if an ADI, despite best endeavours, is struggling to meet the implementation date. I consider that ADIs which view the BEAR as a legal risk, and react accordingly, are far more likely to experience breaches than ADIs adopting a comprehensive approach to the new environment.

Ignorance or remoteness no excuse

There are numerous processes carried out by ADI's which are highly specialised, often involving information technology and which are consequently somewhat esoteric, e.g.

- Automated loan approval
- Risk grading
- Derivative and hedging instruments
- In wealth management, complex investments

In addition ADIs outsourcing and offshoring what are considered non core functions may increase the possibility of problems which could lead to breaches if management is too remote from the function. I include in this category:

- Offshore call centres
- Fulfilment centres
- Valuation firms
- Loan brokers
- Document storage centres

ADIs may need to be reminded that under BEAR all such processes and functions must ultimately wrap up under the obligations of an accountable person(s), either through the ADI or its subsidiaries.

Emerging risks

One of the benefits of the BEAR will be to curb enthusiasm for the unwise acceptance and adoption of initiatives, products or technology in the absence of thorough risk assessment. In this category I include:

- crypto currencies
- artificial intelligence
- quasi payment systems
- cloud based applications

As an example it seems to me that one issue which could arise is an IT failure at a company providing cloud based accounting services. One such company has around 250,000 business subscribers in Australia. The cloud based accounting software includes a type of quasi payment system. An outage, either through hacking or some other failure, would result in a significant number of ADI clients

being unable to carry out accounting and banking functions (including payments and receipt of funds) unless other arrangements were made or the system was restored. It appears to me that too much reliance is placed on the bland assurances of cloud based software providers in the absence of evidence of their risk management processes. Over time a failure at a cloud based company providing vital services could result in a “contagion” type event flowing on to parties unwittingly integrated into the platform.

Yours sincerely

Damien Morris

APPENDIX 1

Commonwealth Bank of Australia

Group Executive Positions

MANAGING DIRECTOR AND CHIEF EXECUTIVE OFFICER
GROUP EXECUTIVE, WEALTH MANAGEMENT
GROUP EXECUTIVE, RETAIL BANKING SERVICES
GROUP EXECUTIVE, BUSINESS AND PRIVATE BANKING
GROUP EXECUTIVE INSTITUTIONAL BANKING AND MARKETS
GROUP CHIEF RISK OFFICER
GROUP EXECUTIVE, FINANCIAL SERVICES AND CHIEF FINANCIAL OFFICER
GROUP EXECUTIVE, CHIEF EXECUTIVE AND MANAGING DIRECTOR ASB
GROUP EXECUTIVE, INTERNATIONAL FINANCIAL SERVICES
GROUP EXECUTIVE MARKETING AND STRATEGY
GROUP GENERAL COUNSEL AND GROUP EXECUTIVE GROUP CORPORATE AFFAIRS
GROUP EXECUTIVE HUMAN RESOURCES

National Australia Bank

Executive Leadership Team

GROUP CHIEF EXECUTIVE OFFICER & MANAGING DIRECTOR
CHIEF CUSTOMER OFFICER – CORPORATE AND INSTITUTIONAL BANKING
CHIEF OPERATING OFFICER
CHIEF LEGAL AND COMMERCIAL COUNSEL
CHIEF RISK OFFICER
CHIEF CUSTOMER OFFICER - CONSUMER AND WEALTH
CHIEF EXECUTIVE OFFICER BANK OF NEW ZEALAND
CHIEF FINANCIAL OFFICER
CHIEF CUSTOMER OFFICER, BUSINESS & PRIVATE BANKING
CHIEF PEOPLE OFFICER
CHIEF TECHNOLOGY AND OPERATIONS OFFICER