Chapter 2

Views on the bill

2.1 The introduction of the BEAR represents a substantial change in how the banking sector is regulated in Australia. As the minster observed in his second reading speech, the reforms to the financial system, of which the BEAR is a part:

> …represent the most significant overhaul of APRA's powers since its creation by the Howard Government.[1]

2.2 Any legislative reform process of this scale involves a large amount of consultation. The role of consultation, including through this inquiry process, is to hear from stakeholders and consider their views on the legislation in relation to what is in the interests of the wider community.

2.3 The intention to make banking executives more accountable was announced in the 2017–18 Budget in May 2017 as part of *A More Accountable and Competitive Banking System*.[2] Since that time, an ongoing consultation process allowed affected parties and other interested stakeholders numerous opportunities to comment on, and provide suggestions for, the development of the BEAR legislation.

2.4 That said, a number of stakeholders noted that the time available to comment on the exposure draft was quite short. In response, Treasury indicated that:

> It was a serious process. We treated it seriously. We acknowledge that it wasn't as long as you would have liked to have had. Nevertheless, it was still effective, and I think that was evident in the way we were able to incorporate that feedback. As with any consultation process, not all of the issues or concerns that stakeholders raised are necessarily going to be addressed in the manner that they want—that's a matter for government.[3]

2.5 Indeed, during this inquiry on the legislation presented to parliament, stakeholders acknowledged that many of their original concerns had been addressed in the drafting process and focused their evidence on areas of concern that remained and/or new aspects that had been incorporated following consultation. This chapter examines the evidence received in relation to these concerns.

General comments on the bill

2.6 Most stakeholders strongly supported the objective of the proposed legislation. For example, Mr Damien Morris submitted that:

> I strongly support the intention of the legislation as I consider that the implementation of a personal accountability regime in ADIs is long

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1 The Hon. Scott Morrison MP, Second Reading Speech, *House of Representatives Hansard*, 19 October 2017, p. 2.

2 Australian Government, *Budget Paper No. 2 2017–18*, p. 160.

3 Mr Tony McDonald, Principal Adviser, Treasury, *Committee Hansard*, 17 November 2017, p. 28.

> 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.[4]

2.7 Similarly, the Consumer Action Law Centre (CALC) and CHOICE expressed their support:

> We support the Banking Executive Accountability Regime (BEAR) reforms, as it is clear the community expects banking executives to be held accountable for major scandals. We believe it is imperative that a better culture of personal accountability is instilled at the very top of banks.[5]

2.8 The major banks that made submissions also supported the intent of the bill:

> ANZ supports financial sector accountability for systemic issues that adversely affect customers or financial stability. This helps improve confidence in the financial system and, through that, the role of the system in intermediating credit and managing risk.[6]

> …Westpac is supportive of the rationale for the Banking Executive Accountability Regime (Regime) and agrees that the standards it will set will provide greater stakeholder confidence in how ADIs and individuals make decisions and respond when things go wrong.[7]

2.9 As did the Australian Bankers' Association (ABA):

> The ABA supports the enhanced responsibility and accountability of Authorised Deposit-taking Institutions (ADIs) and supports the BEAR's stated policy intent…[8]

2.10 While supporting the intent of the bill, the Customer Owned Banking Association (COBA) questioned whether the bill would affect the competitiveness of the banking system:

> Generally speaking, the regulatory compliance burden is a critical factor in determining whether the competitive fringe of second-tier ADIs can challenge the major banks. This is because the regulatory compliance burden is effectively a competitive advantage to the major banks, because they have vastly greater resources and capacity than their smaller competitors to cope with new regulatory obligations.[9]

2.11 Some submitters supported the intent of the bill but expressed concern about the impact of the reforms on the functioning of private companies. For example, the Australian Shareholders Association (ASA) stressed that:

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4 Mr Damien Morris, *Submission 1*, p. 1.

5 Consumer Action Law Centre and CHOICE, *Submission 4*, p. 1.

6 ANZ, *Submission 8*, p. 2.

7 Westpac, *Submission 6*, p. 1.

8 Australian Bankers' Association, *Submission 10*, p. 1.

9 Mr Luke Lawler, Director of Policy, Customer Owned Banking Association, *Committee Hansard*, 14 November 2017, p. 1.

> …while we remain supportive of the move to strengthen accountability in the Australian banking system, we also remain concerned that the proposed Bill undermines the function of company boards…we strongly oppose the government or government agencies prescribing, in detail, remuneration structures for the private sector.[10]

2.12 Similarly, the Australian Institute of Company Directors (AICD) noted that:

> …we continue to have reservations about the design and scope of the BEAR. For example, legislating remuneration structures for senior executives in private companies is a significant change to Australia's corporate environment. The AICD would prefer the boards and ADIs make decisions on remuneration structures appropriate to their organisation's needs and strategies, working with clear prudential standards on risk and accountability.[11]

2.13 The Financial Services Union (FSU) was concerned about the ramifications of the BEAR on non-executive bank employees:

> …although well intentioned, the proposed BEAR will further enforce the cultural divide of accountability between frontline workers and banking executives…[12]

2.14 Only one submission was opposed to the intent of the bill. Mr John Colvin[13] vehemently objected to the bill being passed in its current form:

> The BEAR Bill is misguided and an unprecedented intrusion into privately owned companies and shareholder property rights.
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> …
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> The BEAR Bill substantially interferes with and disrupts accepted principles of corporate governance, particularly the role of boards, executives and shareholders.[14]

Comments on specific aspects of the legislation

2.15 While submitters were generally supportive of the intention of the BEAR and recognised the need for banks and their executives to be made more accountable for their actions, concerns were noted about the following specific aspects of the bill.

Clarity in terminology

2.16 A number of stakeholders noted that many of terms used in bill were not adequately defined. In particular, the terms 'prudential standing' and 'prudential

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10 Australian Shareholders Association, *Submission 2*, p. 1.

11 Australian Institute of Company Directors, *Submission 16*, p. 1.

12 Financial Services Union, *Submission 19*, p. 4.

13 Mr Colvin is a Consultant at Herbert Smith Freehills, an Adjunct Professor at Sydney University Business School and was formerly head of the Australian Institute of Company Directors.

14 Mr John Colvin, *Submission 20*, [p. 1].

reputation' caused considerable consternation among stakeholders. For example, the ABA highlighted their concerns at the hearing:

> There are concepts of prudential standards and prudential reputation, which are concepts that don't exist in the UK and don't exist in the Hong Kong regime and have no comparison. For these to translate into legislation and then to be interpreted by courts is where the novelty and ambiguity is causing concerns.[15]

2.17 The AICD considered that, while the intent of the bill is to 'capture serious matters that are systemic and prudential in nature':

> …the Bill instead uses the much broader language of 'prudential standing' and 'prudential reputation', which is ambiguous and likely to lead to protracted court disputes.[16]

2.18 Westpac considered that:

> …if the term 'prudential reputation' is not clarified, this may cause uncertainty about the expected conduct of ADIs and accountable persons.[17]

2.19 At the hearing on 14 November 2017, Dr Ann Wardrop summarised the confusion surrounding the use of 'prudential' in the bill:

> There are quite different views in the submissions about whether or not the application of the ideas of prudential regulation are too expansive or too limiting. So I think what that actually tells you is that it is quite confusing and that the legislation as drafted at present is therefore ambiguous and unclear…[18]

2.20 In response to these concerns, APRA indicated that it doesn't have a pre-existing definition for the terms 'prudential standing' and 'prudential regulation', and neither does the legislation:

> Prudential standing is supervisory judgement that we make day to day. We look at their [ADIs] financial health and that's what most observers normally look at. We look at their capital strength and, in the case of an ADI, their liquidity strength and funding strength. We also look at their governance and their risk management and, through our fit and proper regime, whether the individuals are appropriately skilled and doing a good job.[19]

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15 Mr Aidan O'Shaughnessy, Director of Policy, Australian Bankers' Association, *Committee Hansard*, 14 November 2017, p. 11.

16 Australian Institute of Company Directors, *Submission 16*, p. 1.

17 Westpac, *Submission 6*, p. 3.

18 Dr Ann Wardrop, *Committee Hansard*, 14 November 2017, p. 27.

19 Mr Pat Brennan, Executive General Manager, Australian Prudential Regulatory Authority, *Committee Hansard*, 17 November 2017, p. 17.

2.21 Dr Ann Wardrop, Dr David Wishart and Associate Professor Marilyn McMahon also raised concerns about the use of the terms 'honesty', 'integrity', and 'due skill and diligence':

> The most contiguous area of law, corporations law, does not actually use the term 'integrity', and 'honesty' has effectively been replaced (for reasons of clarity) by duties to act for the benefit of the company and without conflicting interests.
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> 'Skill', while referred to in cases as a requirement of officers depending on what qualifications that person has held themselves to have, is not otherwise required by legislation, mainly because it is too difficult to comprehensively define.
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> 'Diligence' is indeed referred to in s 180(1) of the *Corporations Act 2001* (Cth). In that context it refers to that which ought to be demonstrated by a reasonable person in that person's job in a similar occupation.[20]

2.22 Similarly, the AICD considered that:

> Some of the obligations on ADIs and accountable persons, such as the duty to deal with APRA 'openly', 'cooperatively', and with 'integrity', are highly subjective and open to interpretation. In the AICD's view, it would be difficult for a person or a Court to determine whether a person has acted openly without forming a subjective view of the person's intentions, which will ultimately frustrate BEAR's aim.[21]

2.23 The Financial Services Institute of Australasia (FINSIA) also called for greater clarity:

> FINSIA agrees that terms such as 'honesty', 'integrity', 'due skill' and 'diligence' have been considered in case law and have 'well understood common usage'. However additional guidance from the regulator on their meaning in the context of the BEAR legislation is warranted, because of the serious consequences of not meeting the accountable person obligations.[22]

Reasonable steps

2.24 Some stakeholders noted that the reasonable steps provision does not extend to obligations on accountable persons:

- acting with honesty and integrity, and with due skill, care and diligence; and
- dealing with APRA in an open, constructive and cooperative way.[23]

2.25 For example, the ABA believed that:

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20 Dr Ann Wardrop, Dr David Wishart and Associate Professor Marilyn McMahon, *Submission 14*, p. 2.

21 Australian Institute of Company Directors, *Submission 16*, pp. 1–2.

22 Financial Services Institute of Australasia, *Submission 17*, [p. 2].

23 As provided for in respect of accountable persons, in proposed Section 37CA(1) (a) and (b) of the bill.

> …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.[24]

2.26 Similarly, ANZ were concerned the accountability obligations of an accountable person were expressed without reference to whether a person has taken reasonable steps.[25]

2.27 These stakeholders argued that the provisions should be consistent with the obligations on ADIs to take reasonable steps.

2.28 In this context, it is important to note that these absolute requirements for accountable persons (to act with honesty and integrity, with due skill, care and diligence, and deal with APRA in an open, constructive and cooperative way) apply to individuals, instead of ADIs.

2.29 Other stakeholders considered that the bill, as drafted, was appropriate. For example, CALC commented that:

> Insofar as the BEAR legislation talks about honestly and integrity and due skill, care and diligence, that's not inconsistent with the current key requirements for financial services licensees under the Corporations Act. So we don't see the need for there to be a 'reasonable steps' type amendment that would weaken those obligations.[26]

Joint responsibility

2.30 A number of stakeholders expressed concerns about how the joint responsibility provision was expressed in the proposed legislation. The ABA outlined the issue:

> The concept of accountability is very much for the individual. The individual is accountable for their own behaviour. The UK regime says: you, the individual, are accountable for your own behaviour. The bill that's in front of you here has joint liability: you're responsible for the behaviour of another individual where you share joint responsibilities. As I say, that's not present in the UK regime. We have said here, for an accountability regime, it also has to rest with the individuals. To make an individual responsible for the behaviour of someone else is unusual.[27]

2.31 The ABA argued that accountable persons with joint responsibility should be individually responsible and accountable:

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24 Australian Bankers' Association, *Submission* 10, p. 2.

25 ANZ, *Submission 8*, p. 4.

26 Ms Katherine Temple, Senior Policy Officer, Consumer Action Law Centre, *Committee Hansard*, 17 November 2017, p. 4.

27 Mr Aidan O'Shaughnessy, Director of Policy, Australian Bankers' Association, *Committee Hansard*, 14 November 2017, p. 11.

> 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, integrity and with due skill, care and diligence – section 37CA(1)(a)).[28]

2.32 Noting that accountable persons would be accountable for the actions of another accountable person regardless of the competency with which they approach their own role, ANZ advocated for the introduction of a concept that allows the behaviour of each individual accountable person to be recognised in determining their culpability.[29]

2.33 In response, APRA commented that in the case of joint liability for executives:

> …when there's matrix reporting there are aspects of the roles that are clearly distinct and there are aspects of the roles that might be harder to distinguish between. In the first instance, having a clearer delineation would be a good thing, but to the extent that there are truly joint accountabilities that the ADI either cannot or does not want to separate, then for that activity there will be two accountable people.[30]

2.34 Responding to a hypothetical situation where there was joint responsibility but only one person was to blame, APRA made the point that:

> …you have to consider whether the other person should have reasonably known it was going on. If they are working in the same area doing the same thing, would they have visibility of it and chose to ignore it? It would really depend on the facts at the time.[31]

2.35 APRA also noted that the concept of joint responsibility would potentially be interpreted differently for non-executive directors:

> You have non-executive directors and boards act as a board and so all non-executives will be caught somewhat equally.[32]

2.36 Treasury explained that the joint responsibility provision was inserted to ensure that blame could be attributed to someone:

> To summarize, when everyone is responsible then no-one is…Having greater clarity on who is doing what reduces the risks of things falling between the cracks. But if there is dual responsibility, then the reason that

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28 Australian Bankers' Association, *Submission 10*, p. 2.

29 ANZ, *Submission 8*, p. 5.

30 Mr Pat Brennan, Executive General Manager, Australian Prudential Regulation Authority, *Committee Hansard*, 17 November 2017, p. 10.

31 Mr Pat Brennan, Executive General Manager, Australian Prudential Regulation Authority, *Committee Hansard*, 17 November 2017, p. 10.

32 Mr Pat Brennan, Executive General Manager, Australian Prudential Regulation Authority, *Committee Hansard*, 17 November 2017, p. 10.

> provision is there is to ensure that there is not that buck passing that can occur and that no-one is, ultimately, held responsible.[33]

Deferred variable remuneration

2.37 The ASA voiced concerns about the potential of deferred variable remuneration to change remuneration structures, particularly in smaller and foreign owned ADIs:

> It is not uncommon for a portion of variable remuneration for senior executives at listed companies to be deferred for a period, but this is not necessarily the case at smaller and foreign owned ADIs. Accordingly, the introduction of this reform is likely to require significant changes to the way remuneration is structured at these entities…The threshold of $50,000 may accommodate this concern, but the application of the deferral of variable remuneration for smaller Australian and foreign owned ADIs is likely to lead to a shift from variable to base remuneration, and possibly higher base remuneration.[34]

2.38 The ABA raised concerns about the methodology used to calculate variable remuneration and requested that:

> …the Bill be updated to clarify that the value of deferred 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.[35]

2.39 APRA noted that remuneration practices vary widely across ADIs and are often based on complex arrangements. It also acknowledged that:

> Given some ADIs utilise fair value to value variable remuneration, APRA may need to provide additional guidance on how such calculation should be undertaken with a view to ensuring consistent application of the new regime.[36]

2.40 At the hearing on 17 November 2017, APRA also indicated that:

> …the legislation gives APRA the flexibility to, over time, refine and define what is variable remuneration and what is not and, to the extent that these can sometimes be competent arrangements, what the appropriate valuation mechanism is.[37]

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33 Mr Tony McDonald, Principal Adviser, Treasury, *Committee Hansard*, 17 November 2017, pp. 28–29.

34 Australian Shareholders Association, *Submission 2*, p. 2.

35 Australian Bankers' Association, *Submission 10*, p. 3.

36 Australian Prudential Regulation Authority, *Submission 11*, p. 5.

37 Mr Pat Brennan, Executive General Manager, Australian Prudential Regulation Authority, *Committee Hansard*, 17 November 2017, p. 16.

Penalties associated with breaches of the BEAR

2.41 The ASA raised concerns about fines being levied on ADIs, rather than the non-complying accountable person:

> The Bill proposes that an ADI can be fined up to 1m [million] penalty units for failure to comply with the legislation. The ASA notes that this has the effect of penalising shareholders rather than the non-complying accountable persons, when shareholders bear no responsibility for the lack of compliance.[38]

2.42 Some smaller ADIs were concerned about the disproportionate impact of penalties on smaller ADIs. For example, MyState Limited (MYS) submitted:

> The penalties proposed under the BEAR are of a vastly disproportionate nature and have a far greater impact on smaller ADIs in comparison to the larger ADIs. This proposal materially disadvantages smaller ADIs and may result in unintended consequences; such as potentially impacting on the viability and stability of smaller ADIs.[39]

2.43 Bendigo and Adelaide Bank raised concerns about the disproportionate penalty unit maximums between the different sized ADIs:

> …the current maximum penalty units outlined in section 37G(2) disproportionately penalise small and medium sized ADIs in comparison to large ADIs. That is, the largest four ADIs may receive a maximum penalty only four times greater than a medium sized ADI, despite the largest four ADIs holding on average approximately 24 times greater in resident assets. In the case of small ADIs, the largest four ADIs may receive a maximum penalty 20 times greater than small ADIs, despite the largest four ADIs holding on average approximately 267 times greater in resident assets.[40]

2.44 Bendigo and Adelaide Bank advocated for adjusting downwards the maximum penalty for small and medium ADIs to have a more proportionate impact on these entities (Table 4).[41]

2.45 However, taking the opposite approach and adjusting the maximum penalty to be proportionate to the current small ADI median resident asset penalty would increase the maximum penalty for large ADIs to $4.8 billion and medium ADIs to $126.5 million.

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38 Australian Shareholders Association, *Submission 2*, p. 2.

39 MyState Limited, *Submission 5*, p. 3.

40 Bendigo and Adelaide Bank, *Submission 18*, [p. 1].

41 Bendigo and Adelaide Bank, *Submission 18*, [p. 1].

Table 4: Penalty unit relatively based on ADI size

ADI Size	Median Resident Assets ($m)	Current max penalty units	Current max penalty ($m)	Median max penalty as a % of resident assets	Suggested max penalty units	Suggested max penalty ($m)	New median max penalty as a % of resident assets
Large	703 959	1 000 000	210.0	0.030%	1 000 000	210.0	0.030%
Medium	18 570	250 000	52.5	0.283%	30 000	6.3	0.034%
Small	1541	50 000	10.5	0.681%	2000	0.4	0.027%

Source: Bendigo and Adelaide Bank, *Submission 18*, [p. 2].

Legal professional privilege

2.46 A number of submissions outlined concerns about the availability of legal professional privilege to lawyers only. For example, the ABA considered that section 62AA of the bill addresses claims of legal professional privilege and the production of privileged documents by 'lawyers' only, clouding the issue of whether claims to legal professional privilege by non-lawyers are preserved at common law.[42]

2.47 The ABA noted that section 62AA of the bill appears to mirror section 69 of the *Australian Securities and Investments Commission Act 2001* (ASIC Act), which took some time to get to a clear position with ASIC:

> The position with ASIC, while now clearer, was not always the case. 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.[43]

2.48 The Bank of Queensland (BOQ) also drew parallels with the interpretation of legal professional privilege in the ASIC Act, particularly when accountability obligations require dealings with APRA to be conducted in an 'open' way:

> The person with responsibility for the legal function must be able to provide advice freely to the ADI and is subject to professional obligations and rules applying to legal professionals. Any doubt about the application of the BEAR to the person with responsibility for the legal function creates an untenable predicament for that person insofar as the BEAR may apply to them and they are potentially required to deal with APRA in an "open" way.[44]

2.49 The ABA highlighted what seemed to be an inconsistency between the proposed legislation and the intention as described in the Explanatory Memorandum:

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42 Australian Bankers' Association, *Submission 10*, p. 5.

43 Australian Bankers' Association, *Submission 10*, p. 5.

44 Bank of Queensland, *Submission 12*, [p. 2].

> The intention of the EM simply isn't reflected in the bill, so a lawyer could get legal professional privilege, but, if you weren't a lawyer, APRA could get the same document because the individual who isn't a lawyer wouldn't have legal professional privilege.[45]

Ability to attract talent

2.50 MYS raised concerns about the impact of the BEAR on the ability of smaller ADIs to attract and retain executive talent:

> MYS have serious concerns of the impact the BEAR will have on the ability for smaller ADIs to attract and retain executive talent due to the increased personal risk introduced by the BEAR and the relatively modest remuneration packages offered by smaller ADIs.[46]

2.51 The BOQ also raised concerns about the effect of restrictions on indemnification and insurance in the bill on attracting and retaining talent:

> …the Government and APRA should be ensuing that the most talented of directors and officers remain and are attracted to role within ADIs. BOQ has concerns that these provisions in the Bill, as stated, may have the opposite effect.[47]

2.52 FINSIA noted that the BEAR could change the nature of banking executives:

> In previous submissions we have observed that the regime potentially has unintended consequences for ADIs in attracting talent at executive and non-executive levels. The BEAR's evidence requirements may lead to executive being overly legalistic and defensive with the effect that they become risk adverse.[48]

Foreign laws

2.53 Given the links between Australian and New Zealand banking institutions, the New Zealand Bankers Association (NZBA) noted their support for:

> …the introduction of s 37AA and 37BC to the Bill, which operate to clarify the relationship between the Bill and corresponding foreign laws, and considers the inclusion of those sections brings greater alignment between the Bill and the intention of the legislation as that is expressed in the Explanatory Memorandum.[49]

2.54 However, NZBA, the ABA and ANZ all requested changes to sections regarding foreign laws. The ABA recommended:

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45 Mr Aidan O'Shaughnessy, Director of Policy, Australian Bankers' Association, *Committee Hansard,* 14 November 2017, p. 15.

46 MyState Limited, *Submission 5,* p. 2.

47 Bank of Queensland, *Submission 12,* [p. 2].

48 Financial Services Institute of Australasia, *Submission 17,* [p. 2].

49 New Zealand Bankers Association, *Submission 3,* p. 2.

> …minor changes to the language used in section 37AA and 37BC to clarify the drafting such that it clearly includes the regulatory mechanisms, rules and instruments of appropriate Foreign Governmental Authorities.[50]

2.55 The NZBA agreed with this recommendation, noting that such amendments would make:

> …certain those sections contemplate situations where the New Zealand subsidiary of an ADI is required to comply with the Bill, but that conflicts with an obligation that has similar force to legislation but is not directly linked to a legislative requirement. For example, requirements to comply with 'minimum standards' of eligibility to be granted to a financial market services licence specified by the New Zealand Financial Markets Authority.[51]

2.56 The NZBA and ABA also advocated for a further amendment to section 37AA that would:

> …enable APRA to provide 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 situations where the ADI would otherwise be required to ensure its subsidiary acts in a way that would be contrary to Foreign Law, but no breach of Foreign Law by the ADI would occur (given that the ADI may not be subject to that Foreign Law.[52]

Extension to consumer matters

2.57 The CALC and CHOICE noted that the BEAR only applies to conduct that is systemic and prudential in nature, and does not tie accountability measures to poor consumer outcomes:

> As it stands, the Bill does not deal with the behaviour from industry that causes the greatest harm to consumers and creates the greatest need for intervention.[53]

2.58 At the hearing, CALC gave a scathing assessment of the bill:

> …this legislation creates a baby BEAR, but consumers of financial services needs a grizzly.[54]

2.59 Further, CALC suggested that executives responsible for oversight during recent scandals would have been unlikely to be covered by the BEAR:

> Executives would be unlikely to face consequences for these scandals under the proposed BEAR regime because prudential regulation of ADIs, as opposed to consumer protect regulation, focuses on risk to the stability of

50 Australian Bankers' Association, *Submission 10*, p. 4.

51 New Zealand Bankers Association, *Submission 3*, p. 3.

52 New Zealand Bankers Association, *Submission 3*, p. 4.

53 Consumer Action Law Centre and CHOICE, *Submission 4*, p. 2.

54 Ms Katherine Temple, Senior Policy Officer, Consumer Action Law Centre, *Committee Hansard*, 17 November 2017, p. 1.

> the financial system rather than the fair treatment of individual consumers.[55]

2.60 In the United Kingdom, the equivalent of the BEAR covers consumer harm and is being extended to non-bank firms in the financial sector:

> [CALC and CHOICE] note that the Financial Conduct Authority (FCA) is extending the United Kingdom's equivalent regime to cover insurers and non-prudentially regulated firms as well as banks.[56]

2.61 CHOICE went on to explain how the UK scheme makes executives accountable for consumer harm:

> The UK regime gave new powers to the prudential regulator, the PRA [Prudential Regulatory Authority]; and the consumer and conduct regulator, the FCA [Financial Conduct Authority] in the UK. Those regulators have worked together to clarify the requirements that industry must meet, so the whole regime covers prudential and consumer matters. Crucially, the UK regime requires managers to take reasonable steps to prevent regulatory breaches in the areas of the bank for which they're responsible and requires senior managers to act with integrity, pay due regard to the interests of customers and treat them fairly. These components are missing from the Australian regime.[57]

2.62 When asked about the scope of the BEAR, Mr Greg Medcraft, then Chairman of ASIC, noted that the BEAR only addresses prudential conduct and does not address conduct that could result in poor consumer outcomes or that could affect shareholders' interests. From his perspective, Mr Medcraft considered that:

> The area of concern we have is that perhaps what we need to think about is that power perhaps in a further stage, actually, being extended to ASIC. Essentially, it's for when something's identified that is a conduct issue by APRA that is not a prudential issue. They go, 'Here, this is something you should look at.' Having those powers they're getting there to be able to deal with the conduct issues in terms of customers and shareholders is important. The UK has already rolled out this power to prudential regulators…[58]

2.63 The CALC and CHOICE also considered that the BEAR should include consumer harm and be extended to non-ADI entities:

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55 Ms Katherine Temple, Senior Policy Officer, Consumer Action Law Centre, *Committee Hansard*, 17 November 2017, p. 1.

56 Consumer Action Law Centre and CHOICE, *Submission 4*, p. 2.

57 Ms Erin Turner, Director of Campaigns and Communications, CHOICE, *Committee Hansard*, 17 November 2017, p. 2.

58 Mr Greg Medcraft, Chairman, Australian Securities and Investments Commission, *Committee Hansard for Parliamentary Joint Committee on Corporations and Financial Services*, 11 August 2017, pp. 29–30.

> We also believe it is imperative that ASIC is given equivalent powers to ensure it can effectively regulate non-ADI entities…[59]

2.64 Acknowledging this apparent disparity, Mr Medcraft commented that:

> …at the moment it [BEAR] is restricted to banks, while in the UK it extends to insurance companies. That might be an area to be thinking about in the next phase. In the UK it has rolled out even beyond that, to financial services entities…If we did think about it, we would need have to watch what the UK does in rolling it out more broadly to financial services, because obviously it needs to be proportional.[60]

2.65 APRA also commented on the potential extension of the BEAR to other financial sectors:

> Whilst, from a legislative point of view, this is an ADI regime, I don't believe it's been ruled out forever for other industries, but I don't think there's been any firm plan.
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> …
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> My understanding is that Treasury is open to considering a broader application at some point but without making any commitment as to whether it would definitely proceed and under what timing.[61]

2.66 At the hearing on 17 November 2017, ASIC discussed the potential for the BEAR to be expanded:

> Given that the BEAR is focused on prudential issues, an obvious next step is insurers, and generally we think that is likely to be a good step in the future. But, from a BEAR perspective, given it's the prudential regulator and it's focused on prudential issues, it would make less sense to extend it beyond prudentially regulated institutions.[62]

Implementation timeframes

2.67 Many submissions noted that the timeframe for implementation—that is, around six months if the legislation is passed before the end of 2017—would make it difficult to undertake the required changes to policies, contracts and systems.

2.68 The ABA considered that:

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59 Consumer Action Law Centre and CHOICE, *Submission 4*, p. 1.

60 Mr Greg Medcraft, Chairman, Australian Securities and Investments Commission, *Committee Hansard for Parliamentary Joint Committee on Corporations and Financial Services*, 11 August 2017, p. 30.

61 Mr Pat Brennan, Executive General Manager, Australian Prudential Regulation Authority, *Committee Hansard*, 17 November 2017, p. 15.

62 Mr Greg Kirk, Chairman, Australian Securities and Investments Commission, *Committee Hansard*, 17 November 2017, p. 24.

> Effective implementation of the BEAR regime will require material effort and reallocation of resources by ADIs and APRA to meet the proposed deadline.[63]

2.69 The ABA suggested that a six month deferral for the start date would be appropriate:

> The ABA has always said a simple solution would be: instead of a six-month implementation time frame, make it a year; instead of 1 July 2018, make it 1 January 2019, and that will give APRA six months to design and consult on the prudential standards and prudential guidance which the EM has envisaged and will give the ADIs six months to implement the regime.[64]

2.70 Westpac advocated for a 12 month implementation period from Royal Assent, given that between the legislation passing and the BEAR starting:

- APRA would need to provide guidance on the requirements that will apply to accountability maps and accountability statements, and issue relevant prudential standards that support the BEAR;
- ADIs would need to understand and apply APRA guidance on the application of the BEAR;
- ADIs would need to prepare relevant maps and statements, and register accountable persons; and
- ADIs would need to develop and implement support structures for the BEAR.[65]

2.71 In response to calls by the ABA and larger banks for a longer implementation period, the FSU argued that:

> Senator Macdonald asked about the potential for a delay in implementation of the BEAR in order to execute the implementation properly and alluded directly to the political risk that that involved for the government, and the ABA's response is that they need 12 months. This is a sector where when one bank decided to drop its ATM fees the rest of them did so inside 72 hours. If they want to move quickly, they can. They're big organisations; they've got the resources to prioritise and focus on things.[66]

2.72 COBA proposed a delayed implementation for small and medium ADIs of two years after the large ADIs. COBA argued that the additional time is justified because:

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63 Australian Bankers' Association, *Submission 10*, p. 6.

64 Mr Aidan O'Shaughnessy, Director of Policy, Australian Bankers' Association, *Committee Hansard*, 14 November 2017, pp. 12–13.

65 Westpac, *Submission 6*, p. 2.

66 Mr Nathan Rees, National Assistant Secretary, Financial Sector Union of Australia, *Committee Hansard*, 14 November 2017, p. 24.

- 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.[67]

2.73 COBA also noted that:

> 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.[68]

2.74 COBA elaborated on this point at the hearing:

> …if it's rushed, they [ADIs] will be trying to get to that point as quickly as possible, simply meeting their minimum legal obligations without necessary making a change to the governance and structure of the business which might be consistent with the BEAR's objectives and a better way to do it. If you rush it, I think you run the risk that you won't get the outcomes that the regime is trying to achieve.[69]

2.75 A number of other measures aimed at promoting a more accountable and competitive banking system are also due to be developed and implemented in the near future. MYS highlighted that there were a number of other reforms either being, or due to be, implemented next year (such as proposed Australian Financial Complaints Authority (AFCA) and the Code on Banking Practice), and concluded:

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67 Customer Owned Banking Association, *Submission 13*, p. 2.

68 Customer Owned Banking Association, *Submission 13*, p. 3.

69 Mr Luke Lawler, Director of Policy, Customer Owned Banking Association, *Committee Hansard*, 14 November 2017, p. 5.

> Reform regulation can have a disproportionate impact on smaller ADIs and their ability to effectively manage and implement the new regulatory requirements within the specified timeframes due to the very limited amount of resources that smaller ADIs have at their disposal.[70]

2.76 Similarly, COBA commented that:

> Many of those [reforms] are reaching the point of proposals turning into draft bills turning into legislation. The new EDR scheme is an example, as are reforms to credit cards...Some of these things we're very supportive of and we think they will have a pro-competitive effect, particularly if they're implemented in a way that maximises the pro-competitive potential. But, nevertheless, they're all issues that require resourcing. For smaller players to understand these things and make sure they're compliant with them, it's just a bit more challenging and a bit more of a resource issue than for larger players.[71]

2.77 In response to concerns about the compliance burden for smaller ADIs, Treasury remarked that:

> …a number of steps were made in legislation itself to try and ensure that it applies in a proportionate manner. Also, we wanted to ensure that there was the appropriate flexibility within the legislation so that APRA, as it does already in applying prudential rules, applies the same rules and same principles to all ADIs but does so in a proportionate manner so as to limit the extent that that compliance and regulatory burden creates a barrier to competition.[72]

2.78 COBA outlined APRA's general timeframes for consultation and implementation:

> In general, APRA consults for at least three months on proposals it considers will lead to material changes, including the period for public consultation. Similarly, APRA generally aims for a period of one year from finalisation for ADIs to implement any material prudential standards.[73]

2.79 Indeed, APRA also commented on the implementation timeframe:

> Following the 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

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70 MyState Limited, *Submission 5*, p. 2.

71 Mr Luke Lawler, Director of Policy, Customer Owned Banking Association, *Committee Hansard*, 14 November 2017, p. 7.

72 Mr Tony McDonald, Principal Adviser, Treasury, *Committee Hansard*, 17 November 2017, p. 29.

73 Mr Luke Lawler, Director of Policy, Customer Owned Banking Association, *Committee Hansard*, 14 November 2017, p. 2.

> legislation provides some additional transition arrangements in some areas.[74]

2.80 When questioned about the challenging implementation timeframe, APRA responded that:

> If the decision is that it is phased in in some way that means that we can work not as intensively for the same quality outcome.[75]

Committee view

2.81 The committee believes the introduction of the BEAR reflects community expectations that banks and their executives should be made more accountable for their actions. The BEAR imposes heightened accountability obligations on ADIs and their executives which can result in significant penalties. The enabling legislation also gives APRA enhanced powers to examine witnesses.

2.82 The committee welcomes the in-principle support given to the BEAR by the majority of stakeholders. The committee notes the consultation process undertaken by the Treasury prior to the legislation being introduced and the considerable changes made to the legislation that reflect the feedback received through that process. Nonetheless, the committee also recognises that a number of concerns have been raised in this inquiry.

2.83 With regard to the clarity in terminology used in the bill, the committee considers that the inclusion of further definitions in the bill is not required. APRA has a cooperative working relationship with the sector and seeks to actively resolve problems before considering legal actions. However, in the development of materials to assist ADIs to implement the BEAR, APRA could give consideration to providing guidance to clarify terms such as 'prudential standards', 'prudential guidance', 'honesty', 'integrity', and 'due diligence and skill'.

2.84 The committee notes concerns that the 'reasonable steps' provision does not extend to accountable persons: acting with honesty and integrity, and with due skill and diligence; and dealing with APRA in an open, constructive and cooperative way. However, the committee questions why a reasonable steps provision should be applied—for example, to acting with honesty and integrity. Either accountable persons act with honesty and integrity or they do not—this is not a moot point and to think so is morally obtuse.

2.85 The committee is more sympathetic to the issue of joint responsibility between accountable persons where there is an arguable case on both sides. The intent of the BEAR is to ensure that banks and their executives are held to account and, as a result, joint accountability provides an incentive for executives to make sure that issues that could affect prudential standing or reputation are addressed. However, the committee shares the concerns of stakeholders that an accountable person should not

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74 Australian Prudential Regulation Authority, *Submission 11*, p. 6.

75 Mr Pat Brennan, Executive General Manager, Australian Prudential Regulation Authority, *Committee Hansard*, 17 November 2017, p. 12.

be made responsible for the performance or conduct of another accountable person, and notes that this provision is not a feature of the UK regime. As such, the committee urges the government to reconsider whether the joint and several liability provisions in the bill are necessary.

2.86 The committee notes that penalties for ADIs based on size do appear to be disproportionate. Given that many of the issues the BEAR seeks to address are the result of the actions of the larger ADIs, the government may wish to consider whether a more proportionate penalty regime should be introduced relative to ADI size.

2.87 The committee also notes the concerns raised by stakeholders regarding legal professional privilege, the methodology for determining deferred remuneration, and interactions with foreign laws. The committee considers that these issues can be worked through during the implementation process and, if issues arise that require a legislative solution, APRA should seek to work with the government to find a resolution.

2.88 Consumer protections are just as important as prudential matters in establishing and maintaining community trust in the financial sector. While the BEAR is a welcome and important start, the committee believes that, in time, heightened accountability obligations should be extended to non-ADI firms in the financial sector and also to matters that affect consumer outcomes (as has been done in the United Kingdom).

2.89 The committee accepts the importance of introducing the BEAR regime as soon as possible and notes that APRA has the capacity to apply transitional arrangements for elements of the regime. However, the committee shares the concerns of submitters, particularly those representing smaller ADIs, regarding the logistical difficulties of implementing the BEAR in a relatively short timeframe. The committee is also cognisant of other major regulatory changes that are being imposed on the banking sector and the associated compliance burden. Consequently, the committee recommends that the bill be amended to change the date of implementation of the BEAR to start not less than 12 months after the bill is passed. In addition, the committee believes that the government should give consideration to phasing in the BEAR implementation for smaller ADIs.

Recommendation 1

2.90 The committee recommends that the government change the date of implementation of the Banking Executive Accountability Regime to start not less than 12 months after the bill is passed.

Recommendation 2

2.91 Subject to consideration of the previous recommendation, the committee recommends that the bill be passed.

Senator Jane Hume

Chair