The Senate

Economics Legislation Committee

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

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Senate Economics Legislation Committee

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Introduction and overview of the bill

1.1 On 19 October 2017, the Senate referred the provisions of the Treasury Laws Amendment (Banking Executive Accountability and Related Measures) Bill 2017 (the bill) to the Senate Economics Legislation Committee (the committee) for inquiry and report by 24 November 2017.[1]

1.2 The purpose of the bill is to amend the *Banking Act 1959* (Banking Act) to establish the Banking Executive Accountability Regime (BEAR). The BEAR is a strengthened responsibility and accountability framework for the most senior and influential directors and executives in authorised deposit-taking institution (ADI) groups. It requires them to conduct themselves with honesty and integrity and to carry out the business activities for which they are responsible effectively.[2]

1.3 The BEAR does this by creating a new definition of 'accountable person'. An accountable person is a board member with oversight over the ADI or a senior executive with responsibility for management or control of significant or substantial parts or aspects of the ADI group.

1.4 The Treasurer explained why this reform was necessary in his second reading speech:

> Banking executives share responsibility for the stewardship of the Australian economy and they make decisions that impact upon the lives of ordinary Australians who have no choice other than to engage with the system they help run. As a consequence, the community reasonably expects higher standards of accountability and integrity of banking directors and executives.
>
> The BEAR ensures that where these community expectations are not met, appropriate consequences will follow. It makes clear individual accountabilities so that it is clear where the buck stops in decision making and responsibility.[3]

1.5 This bill implements the accountability measures of the banking and financial services reforms announced in the 2017–18 Budget.[4] The measures in the bill will enhance the integrity, stability, resilience and competitiveness of the financial system.[5]

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1 *Journals of the Senate*, No. 67, 19 October 2017, p. 2138.

2 Explanatory Memorandum, p. 9.

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

4 *Factsheet: Banking and Financial Services*, Budget 2017–18, http://budget.gov.au/2017-18/content/glossies/factsheets/html/FS_Banking.htm (accessed 6 November 2017).

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

Conduct of the inquiry

1.6 The committee advertised the inquiry on its website and wrote to relevant stakeholders and interested parties inviting submissions by 1 November 2017. The committee received 20 submissions, which are listed at Appendix 1.

1.7 The committee held two public hearings for this inquiry:

- 14 November 2017 in Canberra; and
- 17 November 2017 in Canberra.

1.8 The committee thanks all groups and individuals who took the time to make written submissions and attend public hearings.

Overview of the bill

1.9 The Australian financial system is the backbone of the economy and plays an essential role in promoting economic growth. For it to operate in an efficient, stable and fair way, all participants must have trust in the system.[6]

1.10 Banks have a special role within our society:

- First, it is virtually impossible for an Australian to go about their daily lives without a bank account.
- Second, banks benefit from an extraordinarily privileged regulatory environment. Virtually all depositors in Australian banks are protected by a government guarantee, the Financial Claims Scheme.
- Third, banks are fundamentally important to financial stability, and financial stability is fundamentally important to Australia's economic wellbeing. Crises that begin in the banking sector generally spread throughout the entire economy.[7]

1.11 Consequently, ADIs must operate at the highest standards and meet the needs and expectations of Australian consumers and businesses. Participants need to be confident that financial firms will balance risk and reward appropriately and serve their interests.[8]

1.12 A key objective of the BEAR is to improve the operating culture of ADIs and increase transparency and accountability across the banking sector. By setting out accountability obligations in the Banking Act and providing guidance about them, the bill makes clear and enhances the obligations of ADIs and reinforces the standards of conduct expected of them by the community.[9]

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6 Explanatory Memorandum, p. 9.

7 The Hon. Scott Morrison MP, Second Reading Speech, *House of Representatives Hansard*, 19 October 2017, p. 3.

8 Explanatory Memorandum, p. 9.

9 Explanatory Memorandum, p. 9.

1.13 The BEAR:

- imposes a set of obligations to be met by ADIs and 'accountable persons';
- introduces a definition of 'accountable person' and requires their registration with the Australian Prudential Regulatory Authority (APRA) prior to the commencement in an accountable person role;
- requires that ADIs give APRA accountability statements detailing the roles and responsibilities of each accountable person;
- requires that ADIs give APRA accountability maps allocating the roles and responsibilities of each accountable person across the ADI and its subsidiaries; and
- gives APRA new and stronger enforcement powers.[10]

1.14 A comparison of key features between the new law and current law are listed in Table 1 below.

An ADI's obligations under the BEAR

1.15 The BEAR imposes strengthened obligations on both ADIs and their accountable persons. The obligations cover conduct that is systemic and prudential in nature. Where an ADI or an accountable person breaches its BEAR obligations, penalties will be imposed (see below).[11]

1.16 The BEAR obliges an ADI to:

- comply with its accountability obligations, which cover the way an ADI should conduct itself and how it should engage with APRA;
- meet its key personnel obligations, by ensuring all areas of an ADI's operations and those of its group are attributable to accountable persons;
- give APRA accountability maps and statements, which explain who is responsible for all parts and aspects of the ADI; and
- defer the remuneration of accountable persons for a period of up to four years, have remuneration policies that allow for a reduction in remuneration in proportion to any failure to meet the BEAR obligations, and continue the deferral where there is a likely failure by an accountable person to meet the BEAR obligations.[12]

1.17 ADIs are responsible for their subsidiaries and are obliged to take reasonable steps to ensure that the subsidiaries within the ADI group meet the obligations under the BEAR.[13]

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10 Explanatory Memorandum, p. 9.

11 Explanatory Memorandum, p. 14.

12 Explanatory Memorandum, p. 14.

13 Explanatory Memorandum, pp. 15, 17.

Table 1: Comparison of key features of new law and current law

New law	*Current law*
Establishes the BEAR which places new obligations on an ADI, including for the conduct and operation of its subsidiaries.	No equivalent.
Accountable persons	
The Banking Act defines an 'accountable person' with respect to the responsibilities undertaken in the ADI and, where relevant, the ADI group. A list of prescribed responsibilities in ADIs is also included.	No equivalent.
Accountable person roles must be filled at all times and registered with APRA.	No equivalent.
Obligations under BEAR	
Obligations with regards to the prudential conduct of an ADI group and 'accountable persons' under BEAR are prescribed in legislation.	No equivalent.
ADIs must give APRA statements which detail the roles and responsibilities of each accountable person.	No equivalent.
ADIs must give APRA accountability maps which identify the lines of responsibility through the ADI group.	No equivalent.
Penalties under BEAR	
APRA may seek civil penalties of up to 1 million penalty units where an ADI breaches the obligations under BEAR.	APRA may seek civil penalties in specified circumstances.
APRA may disqualify an 'accountable person' for breaching the obligations of BEAR.	APRA may apply to the Federal Court to have a director, senior manager or auditor disqualified from being or acting in that position.
Deferral of remuneration	
An ADI must defer a proportion of the remuneration of an accountable person for a period of four years. The proportion to be deferred depends on the size of the ADI. There are circumstances where APRA may allow an ADI to defer a person's remuneration for a shorter period. An ADI must have a remuneration policy which is consistent with the requirements under the BEAR.	No equivalent.
Insurance	
An ADI must not take out insurance against the consequences of breaching the BEAR for itself or an accountable person.	No equivalent.
Examination powers	
Examination powers allow an APRA investigator to require a person to give information relevant to an investigation, set out how the person's lawyer may participate during the examination and how examination records must be kept and shared.	Section 61 allows APRA to conduct an investigation and require an ADI to give certain information.
Statements and evidence are admissible during a proceeding unless the evidence would self-incriminate an individual or the other party to the proceedings has not had sufficient time to examine the material. Section 52F is also expanded to apply to production of a book, account or document or signing of a record.	Section 52F sets out self-incrimination provisions in relation to information given by a person

Source: Explanatory Memorandum, pp. 11–13.

1.18 A foreign ADI is not subject to the BEAR for its offshore operations or for any locally incorporated non-ADI subsidiaries. However, its Australian branch operations are obliged to comply with BEAR to the extent required by their operations and presence in Australia.[14] The BEAR imposes a statutory obligation on an ADI (including its subsidiaries) to defer a percentage of an accountable person's variable remuneration. It ensures that accountable persons have clear incentives to make decisions which account for longer term effects. It also ensures that accountable persons are properly held to account for those decisions that have negative future consequences.[15]

1.19 If an accountable person engages in behaviour in breach of their BEAR obligations then the ADI is obliged to withhold all or part of the accountable person's variable remuneration that is deferred under the BEAR. The amount withheld is to be proportionate to the severity and consequences of the breach.[16]

1.20 An ADI must implement a remuneration policy that is consistent with an ADI's BEAR obligations. This updated remuneration policy will be required to be in effect by 1 July 2018. The ADI should defer the variable remuneration of accountable persons for all accountable persons for the minimum period (four years or a shorter period approved by APRA).[17]

1.21 The amount of an accountable person's remuneration to be deferred by an ADI will depend on the size of the ADI (see Table 2). ADI size is defined as:

- a large ADI would have greater than or equal to $100 billion of a three year average of total resident assets;
- a medium ADI would have between $10 billion and $100 billion of a three year average of total resident assets; and
- a small ADI would have less than $10 billion on a three year average of total resident assets.

All amounts, once finalised, will be indexed.[18]

14 Explanatory Memorandum, p. 15.

15 Explanatory Memorandum, p. 20.

16 Explanatory Memorandum, pp. 20–21.

17 Explanatory Memorandum, p. 21.

18 Explanatory Memorandum, pp. 22–23.

Table 2: Minimum amounts of remuneration to be deferred

If the accountable person is …	the amount is …
The CEO of a large ADI.	The lesser of 60 per cent of the CEO's variable remuneration for the financial year or 40 per cent of the CEO's total remuneration for the financial year.
An accountable person (other than the CEO) of a large ADI, or of a subsidiary of a large ADI.	The lesser of 40 per cent of the person's variable remuneration for the financial year or 20 per cent of the person's total remuneration for the financial year.
An accountable person of a medium ADI, or of a subsidiary of a medium ADI.	The lesser of 40 per cent of the person's variable remuneration for the financial year or 20 per cent of the person's total remuneration for the financial year.
An accountable person of a small ADI, or of a subsidiary of an ADI.	The lesser of 40 per cent of the person's variable remuneration for the financial year or 10 per cent of the person's total remuneration for the financial year

Source: Explanatory Memorandum, pp. 21–22.

Who is an accountable person?

1.22 A key objective of the BEAR is to ensure that an ADI allocates responsibilities to accountable persons across the ADI group. The bill inserts the term 'accountable person' into the Banking Act. 'Accountable person' is defined by reference to a general principle and by reference to listed functions or responsibilities. A person in an ADI will be an accountable person where the person is in a position that undertakes a particular responsibility as listed in the Banking Act. An ADI, particularly small and medium ADIs, may not necessarily have a separate person corresponding to each of the listed functions.[19] A table of listed functions and typical roles that may correspond to those functions is presented below (Table 3).

1.23 Unless exempt, an accountable person must meet their accountability obligations under the BEAR. The accountability obligations make clear the behaviour and conduct expected of an accountable person—they relate to conduct or behaviour that is systemic and prudential in nature both because of the seniority of accountable persons and because the content of the obligations relates to prudential matters, such as integrity, professional conduct and governance arrangements. While the obligation to have integrity and honesty, and be open with APRA is absolute, an accountable person has met their accountability obligations if they can show APRA they have taken reasonable steps to prevent other matters that could affect the prudential reputation or standing on an ADI.[20]

19 Explanatory Memorandum, pp. 24–25.

20 Explanatory Memorandum, pp. 28–29.

Table 3: Particular responsibilities covered by the BEAR

Particular responsibility	Typical role(s)
Responsibility for oversight of the ADI as a member of the Board of the ADI.	Chairman/Non-executive board member
Senior executive responsibility for management or control of the business activities of the ADI, including allocating to accountable persons responsibility for all parts or aspects of the ADI group and reporting directly to the Board of the ADI.	Chief Executive officer
Senior executive responsibility for the management of the ADI's financial resources.	Chief Financial Officer
Senior executive responsibility for the overall management of the risk controls and/or risk management arrangements of the ADI.	Chief Risk Officer
Senior executive responsibility for the management of the operations of the ADI.	Chief Operation Officer
Senior executive responsibility for the information management, including information technology systems in the ADI.	Chief Information/Technology Officer
Senior executive responsibility for the management of the internal audit function of the ADI.	Head of Internal Audit
Senior executive responsibility for the management of the compliance function of the ADI.	Head of Compliance/Chief Compliance Officer
Senior executive responsibility for the management of the human resources function of the ADI.	Chief Of People Officer/Head of Human Resources
Senior executive responsibility for the management of the anti-money laundering function of the ADI.	Anti-Money Laundering Officer

Source: Explanatory Memorandum, pp. 25–27.

Notification obligations

1.24 The BEAR obliges an ADI to give APRA accountability statements and an accountability map. These documents show the governance and management controls in an ADI and show the organisation's lines of accountability. The accountability maps and statements are intended to be viewed as tools of good governance which illustrate that the ADI has appropriate accountability checks and balances and accountable person roles are allocated appropriately according to the size, complexity and customer base of the ADI.[21]

21 Explanatory Memorandum, p. 32.

1.25 An accountability statement is a description of the areas of responsibility attributable to each accountable person, including a comprehensive description of that part of the ADI or its subsidiaries operations over which the accountable person has actual or effective management or control. An accountability statement should align with the accountable person's functions and responsibilities.[22]

1.26 All ADIs must complete accountability maps which accurately show lines of reporting and responsibility in the ADI. Accountability maps can assist APRA to identify accountable persons when an issue arises and may assist ADIs to show the reasonable steps it has taken to avoid any breach of its BEAR obligations.[23]

Consequences of breaching the BEAR

1.27 In addition to its existing powers, APRA may seek pecuniary penalties where an ADI has not:

- met its BEAR accountability obligations;
- met its key personnel obligations, including ensuring that each significant and substantial part or aspect of the ADI's operations are covered by an accountable person;
- met its obligations to register an accountable person and give APRA an accountability statement for that person;
- met its obligations to give APRA an accountability map; and
- met its remuneration obligations, including by deferring variable remuneration as required and having a remuneration policy that meets the BEAR requirements.[24]

1.28 A civil pecuniary penalty must be imposed by a court. The maximum penalty available will depend on the size of the ADI:

- for large ADIs, the maximum civil penalty will be 1 million penalty units (currently $210 million);
- for medium ADIs, the maximum penalty will be 250 000 penalty units (currently $52.5 million); and
- for small ADIs, the maximum penalty will be 50 000 penalty units (currently $10.5 million).[25]

1.29 If an accountable person breaches the BEAR, APRA may disqualify an accountable person from acting as an accountable person of an ADI or in a subsidiary, or a class or classes of ADIs or their subsidiaries. APRA can make this disqualification for a period that APRA considers appropriate. An accountable person

22 Explanatory Memorandum, p. 33.

23 Explanatory Memorandum, p. 34.

24 Explanatory Memorandum, pp. 35–36.

25 Explanatory Memorandum, p. 36.

has protections and rights to procedural fairness under the BEAR. APRA's powers concerning disqualification are subject to merits review.[26]

Examination powers

1.30 The bill gives APRA additional examination powers to investigate potential breaches of the BEAR and extends these powers to all of APRA's supervisory functions under the Banking Act. Applying these powers to the banking sector would mean it was regulated consistently with other industry sectors regulated by APRA.[27]

Indemnification of ADIs and accountable persons

1.31 Indemnification against the financial consequences of breaching the BEAR is prohibited to ensure that breaches of the BEAR have meaningful consequences on ADIs and accountable persons.[28]

Review of the BEAR

1.32 The Minister must initiate a review of the operation of the BEAR three years after the regime comes into effect. A written report must be tabled in Parliament 15 sitting days after the Minister has received a copy of the report.[29]

Financial implications

1.33 The 2017–18 Budget included additional funding for APRA of $4.2 million over the four years from 2017–18 to implement the BEAR. A further $1 million per year will be provided to APRA to enforce breaches.[30]

1.34 The cost of the additional funding to APRA is offset by an increase in the APRA Financial Institutions Supervisory Levies of $8.2 million over four years from 2017–18.[31]

1.35 The Budget also included $1.1 million in additional funding to Treasury to oversee the implementation of *A More Accountable and Competitive Banking System*, of which BEAR is a part.[32]

1.36 The regulatory impact statement indicates that the BEAR will increase compliance costs on ADIs by $11.5 million per year.[33]

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26 Explanatory Memorandum, pp. 37–38.

27 Explanatory Memorandum, p. 38.

28 Explanatory Memorandum, p. 41.

29 Explanatory Memorandum, p. 41.

30 Explanatory Memorandum, p. 7.

31 Explanatory Memorandum, p. 7.

32 Explanatory Memorandum, p. 7.

33 Explanatory Memorandum, p. 67.

Standing Committee for the Scrutiny of Bills

1.37 The Standing Committee for the Scrutiny of Bills reviewed the bill in *Scrutiny Digest 13 of 2017* which was tabled on 15 November 2017. That report identified a number of areas of concern with regard to the bill, including:

- reversal of evidential burden of proof;
- privilege against self-incrimination; and,
- procedural fairness.[34]

1.38 The Standing Committee for the Scrutiny of Bills sought responses on these concerns from the relevant Minister.

Human rights

1.39 According to the Explanatory Memorandum, the bill engages the following human rights and freedoms:

- the imposition of strict liability for an offence;
- the right against self-incrimination under article 14(3)(g) of the International Covenant on Civil and Political Rights (ICCPR); and
- the right to protection from arbitrary or unlawful interference with privacy under article 17 of the ICCPR.[35]

1.40 However, the bill is compatible with human rights because:

- the strict liability offences are appropriate and consistent with the requirements of the Government's Guide to Framing Commonwealth Offences, Infringement Notices and Enforcement Powers;
- the information gathering powers are consistent with the right against self-incrimination under article 14(3)(g) of the ICCPR; and
- the information gathering powers are consistent with the right to privacy under article 17 of the ICCPR.[36]

1.41 The bill is compatible with human rights because to the extent that it may limit human rights, those limitations are reasonable, necessary and proportionate.[37]

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34 Standing Committee for the Scrutiny of Bills, *Scrutiny Digest 13 of 2017*, 15 November 2017, pp. 50–55.

35 Explanatory Memorandum, p. 77.

36 Explanatory Memorandum, p. 81.

37 Explanatory Memorandum, p. 81.

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.
>
> …
>
> 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.
>
> '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.
>
> '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.
>
> …
>
> 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

Additional Comments by Labor Senators

1.1 At the outset of these additional comments, Labor Senators want to indicate that they are broadly supportive of this legislation.

1.2 This legislation however, is no substitute for a Royal Commission. This inquiry, in fact, has received evidence that strengthens the case for a holistic and considered review of the sector rather than the ad-hoc nature of reforms taken by this Government in order to pursue political outcomes.

1.3 Many stakeholders have also made it clear that this legislation is unlikely to change the culture in major financial institutions.

1.4 In fact, the inquiry received no conclusive evidence to suggest that this legislation would have either prevented the six scandals set out on page 49 of the explanatory memorandum had the BEAR legislation been in place beforehand or would have triggered the BEAR's penalties.

1.5 The inquiry also heard how there could be competition impacts in the insurance sector, where entities with a parent ADI would be covered by the BEAR and others without an ADI related entity would not be covered.

1.6 Labor Senators note that the United Kingdom (UK) conducted a lengthy, fulsome review of the regulation of its financial sector and note the benefits that such a review brings.

1.7 A Royal Commission can conduct a fulsome review in Australia and consider legislative and regulatory changes from a holistic perspective, resulting in a set of interconnected reforms that complement and enhance each other.

1.8 In contrast, this Government has adopted an ad-hoc approach with a short consultation process that failed to meet the best practice expectations of the Department of Prime Minister and Cabinet's Office of Best Practice Regulation. The committee views in the main body of this report, supported by Government Senators, are also a clear sign that the Treasurer has botched the policy process.

1.9 A number of other concerns have also been raised through the inquiry and have been noted below.

1.10 Labor Senators won't stand in the way of the bill and note Recommendation 1 set out by Government Senators to allow a proper time for implementation.

1.11 Labor Senators will seek an amendment that smooths the implementation burden on small and medium ADIs.

The Government in its piecemeal approach to reform has missed an opportunity to take real action

1.12 Labor Senators note the approach of the UK in reviewing their own regulatory arrangements after the Global Financial Crisis, resulting in the Senior Manager and Certification Regime (SMCR) and note the comments made by stakeholders such as Dr Wardrop and CHOICE on this issue:

> If you look at the UK position, the Financial Conduct Authority and the prudential regulator there—the twin peaks—work together on this type of stuff. They have codes of conduct that apply to all staff, from the top down, and then they have the code of conduct that applies to the senior managers, which is part of that. It seems like the regulators are working together on this idea in the UK, whereas what's happened here is that this has been put just into APRA's bailiwick at the moment.[1]
>
> Our take generally is that the UK system has been really constructive—that it has involved both regulators working together to define the limits of powers for each one and make sure that there aren't gaps. Because this was developed in tandem it just means that you don't end up with those awkward gaps between regimes that can happen when you split regulatory powers between a prudential and a consumer regulator.[2]

1.13 The UK harmonised the regulatory framework, making sure that the prudential regulator and the conduct authority were able to competently handle both prudential matters and non-prudential matters. The UK reforms ensured that there were no regulatory gaps and that regulatory responsibility was clear.

1.14 The Finance Sector Union (FSU) also made it very clear that UK rules also applied to all banking employees, from executives at the top of an organisation all the way through to frontline staff.

> It really goes to the situation that the introduction of BEAR will be seen as an opportunity lost if not done to the depth and level of perhaps—and I think the representative from the ABA touched on this—the rollout of the UK senior manager regime. It's undertaken a 12-month to two-year process to ensure that a regulated regime does cover the top executives of UK financial institutions all the way to a frontline worker. The UK system is integrated and ensures that the processes and accountabilities of executives, CEOs and directors is captured in the same system as the accountabilities of frontline workers—and that process is cleanly explained—that provides the security and the different thresholds and different accountability points are well understood. I think the introduction of BEAR is a small snippet of that piece of regime from the United Kingdom as well as other places. It's an opportunity lost, not to take the will of executive accountability and roll it out across the industry.[3]

1.15 In contrasting the UK's approach to this Government's approach, it is clear that the Treasurer has selected a small component of the UK scheme without the supporting elements. This risks the BEAR being less effective, particularly if there are regulatory gaps or overlaps that confuse enforcement of behaviour. The rushed development of this bill heightens such risks.

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1 Dr Ann Wardrop, *Committee Hansard*, 14 November 2017, p. 29.

2 Ms Erin Turner, *Committee Hansard*, 17 November 2017, p. 3.

3 Ms Alicia Clancy, *Committee Hansard*, 14 November 2017, p. 23.

Criticism of the consultation process and the influence of the major banks

1.16 Some stakeholders criticised the short consultation process for the Treasury draft legislation.

1.17 Australian Bankers' Association chief executive Anna Bligh stated that:

> The seven-day consultation period announced by the federal government on new banking executive accountability laws is grossly inadequate and playing fast and loose with a critical sector of the economy.[4]

1.18 Dr Wardrop and Dr Wishart also raised concerns:

> **Senator KETTER:** I go back to the policy development process for this bill. I'm not sure if you have any comments to make about that. Other stakeholders have suggested it's been somewhat truncated.
>
> **Dr Wishart:** I think we'd agree—
>
> **Dr Wardrop:** We'd agree with that.
>
> **Dr Wishart:** We worked very quickly.
>
> **Dr Wardrop:** Yes. In fact, our views about it change, depending on the time that we've had to look at it. So, yes, we would say it's been a very quick consultation time.
>
> **Dr Wishart:** Yes, and I think our comments about some of the words that are used imply, without stating directly, that they might be a result of the swift development process of the bill.[5]

1.19 Even the Office of Best Practice Regulation raised concerns that best practice was not followed, stating that:

> The Office of Best Practice Regulation (OBPR) assessed the Regulation Impact Statement (RIS) prepared by the Department of the Treasury as compliant with the Government's RIS requirements, but the process undertaken was not consistent with best practice. The OBPR considered that to only provide one week for affected stakeholders to consider and comment on draft legislation was a significant departure from best practice.[6]

1.20 Labor Senators' concerns about consultation were exacerbated when learning about secret discussions between the Government and the major banks before the policy was announced in the budget.

> The Government also met with regulators in the UK to discuss the experience to date of the Senior Managers Regime – with follow-up

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4 http://www.afr.com/business/banking-and-finance/financial-services/treasurer-unveils-bear-trap-for-bank-boss-pay-20170922-gyn2ur

5 Dr Ann Wardrop & Dr David Wishart, *Committee Hansard*, 14 November 2017, p. 29.

6 Department of Prime Minister and Cabinet, *Banking Executive Accountability Regime*, 15 November 2017, accessed via http://ris.pmc.gov.au/2017/11/15/banking-executive-accountability-regime

> discussions following the Budget announcement. Options to address accountability gaps were also canvassed in discussions with the Chairs of the major ADIs in February 2017.[7]

1.21 It is not clear whether these discussions had any bearing on the policy options considered in the lead up to the budget announcement, such as limiting the scope of BEAR to prudential matters or to not harmonise the BEAR legislation and the ASIC enforcement review.

1.22 Labor Senators are concerned that the Government is selling an image of being tough on the banks, when in fact it appears that the major banks are the only stakeholders who get early access to policy discussions on banking accountability.

1.23 The explanatory memorandum and the inquiry process indicates that small and medium ADIs were not afforded the same access, despite the Treasurer's comments about wanting to promote competition in the sector.

> **Senator KETTER:** The explanatory memorandum includes a discussion about the fact that the government was in talks with the major banks from around February on the issue of heightened accountability, not necessarily specifically in relation to the BEAR proposal. What was the involvement of your organisation in any of those discussions prior to the budget?
>
> **Mr Lawler:** None.[8]

1.24 Labor Senators also note reports that Mr. Gonski was instrumental in the introduction of appeal rights into the legislation, further raising concerns that the major banks have a significant influence over this Government.

> The provision of an appeal mechanism in the BEAR comes after Treasurer Scott Morrison called ANZ Banking Group chairman David Gonski, a well-respected voice in Canberra who helped broker the deal on behalf of the banking sector.[9]

Concerns that the bill has flaws which reflect the rushed process

1.25 The ABA raised concerns that the policy intent set out in the explanatory memorandum was not the same as the text set out in the bill:

> From the start—and the ABA has done three submissions—we have always asked for clarity on these terms and some level of materiality. The threshold question if you go to prudential reputation is: what exactly is meant by that term? The legislation doesn't give that answer yet, so it is now given to APRA to answer that question, and I'll get to the implementation time frame in a while. APRA, the first agency in Australia and the first agency in the world, now have to sit down and say: what do we mean by 'prudential standing' and 'prudential reputation'? And then also test the question of materiality. The legislation itself is very much silent on materiality. One

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7 Paragraph 2.75 of *Explanatory Memorandum.*

8 Mr Luke Lawlor, *Committee Hansard,* 14 November 2017, p. 6.

9 http://www.afr.com/news/scott-morrison-makes-bear-concession-after-david-gonski-intervention-20171010-gyxvgm

> bad tweet could impact the prudential reputation of a bank, and I don't think that is what the explanatory memorandum intended. The explanatory memorandum does talk about behaviour that is systemic and prudential in nature that does have a material impact on the ADI. That's reflected in the EM; it's not reflected in the legislation.[10]

1.26 Dr Wardrop raised similar concerns:

> There is, at the moment, a dissonance in the explanatory memorandum, which seems to say that the conduct which is being directed by this legislation has to be prudential and systemic, implying that there's some difference between the two. Then, when you look throughout the legislation, you see that, for example, in the enforcement provisions, an ADI will only ever suffer a civil penalty if they have not complied with their obligations and it relates to a prudential matter.[11]

1.27 Dr Wishart went further and indicated that uncertainty about key words included in this legislation were signs of a rushed process. This may lead to confusion and uncertainty about how the BEAR will operate when the scheme starts:

> **Senator KETTER:** If I'm reading between the lines correctly, are you suggesting that there are some things that haven't been properly thought through in this bill?
>
> **Dr Wishart:** You could think that, yes.[12]

1.28 The highest volumes of concerns raised were about how this bill would operate alongside the Corporations Act. The inquiry received submissions which made statements such as:

> Moreover, how such obligations interface, both practically and theoretically, with similar duties under the Corporations Act 2001 (Cth) is not clear.[13]

27. Labor Senators believe that the rushed nature of the bill has heightened uncertainty and that it is incumbent in the Government to clearly explain to the industry how the new obligations will operate alongside existing legislation such as the Corporations Act and other regulatory standards.

Concerns about the short implementation timeframe

1.29 Many stakeholders remain concerned about the short implementation timeframe, given the proposed 1 July 2018 start date. A wide range of stakeholders raised this concern, from the banks themselves as well as stakeholder groups and the regulator APRA.

1.30 APRA noted that:

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10 Mr Aiden O'Shaughnessy, *Committee Hansard*, 14 November 2017, p. 10.

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

12 Dr David Wishart, *Committee Hansard*, 14 November 2017, p. 29.

13 Ann Wardrop, David Wishart and Marilyn McMahon, S*ubmission 14*, p. 3.

> Following passage of the legislation, both APRA and the banking industry will have a great deal of work to do to implement the accountability regime by the scheduled commencement date of 1 July 2018. APRA expects that this timeframe will be challenging; for this reason, the legislation provides some additional transition arrangements in some areas.[14]

1.31 The ABA noted that:

> 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.[15]

1.32 The Australian Shareholder's Association said that:

> While we acknowledge the government's desire to implement the legislation as soon as possible, we are of the view that ADIs will need time to undertake changes to policies, contracts and systems.[16]

1.33 The AICD said that:

> We reiterate our view that the BEAR's implementation date should be deferred, so that it commences on 1 January 2019. This will enable all ADIs to prepare their affairs to be in full compliance with the BEAR, and enable APRA to provide the industry with sufficient guidance.[17]

1.34 During the inquiry, concerns were raised by Customer Owned Banking Association (COBA) about the problems of the 1 July 2018 start date when the Senate is inquiring into these bills this month, given the substantial amount of work required by both APRA and ADIs between possible passage of the legislation and 1 July 2018.

> In order to effectively and efficiently implement the BEAR there are a number of things that must happen prior to the implementation date. APRA must develop its initial expectations in the form of draft standards and guidance. APRA must then consult with the industry on those expectations. APRA then must communicate its finalised expectations. ADIs need to understand those expectations, the impact they'll have on their businesses, and ADIs will then have to implement compliance with the standards and guidance through changes to policies, procedures, training, IT systems and so on. 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. Six months is clearly insufficient time to do this.[18]

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14 APRA, *Submission 11*, p. 6.

15 ABA, *Submission 10*, p. 6.

16 ASA, *Submission 2*, p. 2.

17 AICD, *Submission 16*, p. 2.

18 Mr Luke Lawler, *Committee Hansard*, 14 November 2017, p. 2.

1.35 Labor Senators note these concerns and believe that they have merit. It is important that the implementation of this BEAR regime is carried out correctly. Labor Senators note these concerns are shared by Government Senators as set out in Recommendation 1 of the main body of this report.

This legislation is likely to do little to address consumer outcomes

1.36 The Consumer Action Law Centre (CALC) and CHOICE made it clear that the legislation would do little for consumer outcomes:

> We've one clear ask of the committee, and that is to give this BEAR real teeth. Treasury has restricted the application of the proposed BEAR so that it will apply to poor conduct or behaviour that is of a systemic and prudential nature. This misses the crucial element of the United Kingdom model that ties accountability measures to poor consumer outcomes, not just prudential matters.[19]

> We hope that the requirement for accountable persons to pay due regard to the interests of consumers and treat them fairly can be added to the BEAR. As it stands, what we've got is a bit of a teddy bear. We need something much more powerful. I will leave that with the one request we are making today of the committee: please consider extending the regime so that it goes beyond prudential matters and considers consumer outcomes.[20]

1.37 When the basic question of whether this legislation would have made a material difference to the scandals set out on page 49 of the explanatory memorandum, both APRA and Treasury were unable to give a definitive answer:

> We haven't back-tested any of those examples or any others you could mention, again, on the basis that without interrogating and investigating the situation through the lens of BEAR, we cannot definitely say what the outcome would be. What I can say of those ones listed and some others is that they were certainly matters of prudential concern that we were investigating and so would have been investigated through the lens of BEAR. But it would be inappropriate for me to say what the outcome was, without an investigation having taken place.[21]

> I don't think Treasury's in a position to do an analysis and to look back as to whether a law would have applied in particular circumstances, I think for the same reason that Mr Brennan indicated when you were talking with APRA-you look at conduct matters in relation to the law you have available at the time and assessing whether it will apply and a different law that applied in the future is very challenging.[22]

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19 Ms Katherine Temple, *Committee Hansard,* 17 November 2017, p. 1.

20 Ms Erin Turner, *Committee Hansard,* 17 November 2017, p. 2.

21 Mr Pat Brennan, *Committee Hansard,* 17 November 2017, p. 20.

22 Ms Diane Brown, *Committee Hansard,* 17 November 2017, p. 30.

1.38 Paragraph 2.86 of the main report is a clear indication that even Government Senators wish for heightened accountability to be extended to consumer outcomes and note that the BEAR legislation is insufficient in this regard.

1.39 Labor Senators understand the difficulty in advising on the impacts of legislation had it been in place during the time that events occurred. However, when this issue is considered alongside concerns that the BEAR's remit will be limited to 'prudential' matters, it raises concerns that this legislation might not be targeted at policy outcomes.

The effect of this legislation on small and medium ADIs

1.40 COBA raised concerns that this legislation might introduce significant additional regulatory costs and make it more difficult to challenge the major banks:

> The Treasurer's second reading speech says that in addition to enhanced accountability the government also wants a robustly competitive banking system. To meet the twin objectives of an unquestionably accountable banking system and a robustly competitive banking system, it's critically important to minimise the regulatory compliance burden on smaller ADIs. 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. In the case of the BEAR, reducing the regulatory compliance burden 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.[23]

1.41 COBA in its submission also noted other reforms that its members are trying to implement at the same time as the BEAR legislation, and the pressure it puts on some internal departments:

> 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.[24]

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23 Mr Luke Lawlor, *Committee Hansard*, 14 November 2017, p. 1.

24 COBA, *Submission 13*, p. 7.

1.42 Bendigo bank also raised concerns that:

> In addition to the issues highlighted in the ABA's submission, the Bank believes that section 37G of the Bill sets out disproportionate penalty unit maximums for medium and small sized ADIs, in comparison to large ADIs.[25]

1.43 Paragraph 2.84 of the main report confirms that Government Senators hold this same view.

1.44 Labor Senators are concerned about the impact of this legislation on small and medium ADIs and support COBA's request to smooth the implementation cost and burden by delaying the commencement date for small and medium ADIs. Labor Senators note that paragraph 2.87 of the main report indicates that Government Senators share these same concerns.

The cultural divide between frontline workers and executives when it comes to accountability

1.45 The FSU made it very clear that the current approach to accountability reform in the financial services sector was ad-hoc at best and not in line with the UK's approach:

> But the process of banning senior managers is, again, another snapshot out of the UK regime that's trying to be bolted together without the systematic review processes that led to the senior manager regime in the UK. So we have BEAR that's come out through this process, through APRA, through ASIC, looking at filling that partial hold between executives and frontline workers, as part of the UK system, and then the other part of the UK system being plugged by the ABA through their conduct of the background check process.[26]

> As I said, the difference between our first submission to Treasury and now was particularly the ASIC enforcement review of the senior managers ban. That shed a light that saw a potential third element of accountability throughout the industry. It saw APRA with some accountability, ASIC with some accountability for different people, and then the industry having an accountability regime underneath it. And we were just concerned that the speed with which this was being undertaken was going to leave us in a position that meant that the true accountability that we're calling for across the industry was going to be lost in what were becoming very complex, very overladen systems.[27]

1.46 The FSU went further to say that these different schemes could worsen cultural divides in banking organisations:

> It is possible that by only providing an administrative appeals process to executives through BEAR, a cultural and accountability divide is created

25 Bendigo Bank, *Submission 18*, p. 1.

26 Ms Alicia Clancy, *Committee Hansard*, 14 November 2017, p. 23.

27 Ms Alicia Clancy, *Committee Hansard*, 14 November 2017, p. 20.

> between executives and frontline workers, who do not have such an appeal process and are therefore potentially exposed as scapegoats for poor outcomes.[28]

1.47 Labor Senators support the intent of the FSU's recommendation to have a coherent accountability framework from top to bottom. At the very minimum Labor Senators believe that frontline staff included in the ABA's conduct background check be afforded a similar appeals process to the appeals mechanism that banking executives fought for, and received as a concession, during the consultation process on the BEAR legislation.

The regulatory responsibilities of ASIC and APRA are further confused in this legislation

1.48 This legislation further blurs the lines of responsibility between ASIC and APRA. Labor Senators believe that a Royal Commission should include in its scope whether the powers, regulatory approach and responsibility of each regulator is fit for purpose in addressing the misconduct and poor consumer outcomes that have occurred in the industry.

1.49 Dr Wardrop, Dr Wishart and Associate Professor McMahon note the differences in regulatory approach currently:

> APRA prides itself on employing a regulatory approach which is forward-looking, primarily risk-based, consultative, consistent and consistent with international best practice. It actively supervises by maintaining continuing conversations with institutions as to the matters with which it is concerned. ASIC, on the other hand is a much more traditional regulator, albeit one still adhering to the regulatory compliance pyramid based on the Ayres and Braithwaite model.[29]

1.50 This legislation will change the relationship between APRA and ADIs:

> **Senator GALLAGHER:** I accept that, but doesn't the BEAR change that? This is not about behind-the-scenes quiet chitchats telling people they need to change what they're doing, that APRA has some level of concern; the BEAR is very different. They're moving into a much more of an enforcement arrangement, which would seem to me to align much more logically with ASIC.
>
> **Mr Kirk:** That's true for at least some of the elements of the BEAR-that they would more likely involve public action and look more like enforcement action-but that sort of tool is already available to APRA under its existing legislation.[30]

1.51 It is also unclear whether any case would not involve concurrent investigations by both APRA and ASIC:

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28 FSU, *Submission 19*, p. 3.

29 Ann Wardrop, David Wishart and Marilyn McMahon, *Submission 14*, p. 6.

30 *Committee Hansard*, 17 November 2017, p. 27.

Senator GALLAGHER: For incidents that get covered under this regime as outlined in the legislation, can you think of any situation that wouldn't involve ASIC, where you wouldn't have dual investigations going on? If an incident triggered BEAR, wouldn't it also trigger some ASIC investigation?

Mr Saadat: Potentially, where there's a situation of misconduct that doesn't impact consumers or investors.

Senator GALLAGHER: Isn't that what it's about? I'm trying to think of a situation where you wouldn't have to be running a concurrent investigation under your responsibilities.

Mr Kirk: We were suggesting there may be instances of conduct which trigger the BEAR but do not translate into particular bits of misconduct impacting consumers. It may be about the broader management of their risk management systems and failures in management of a significant nature at that level. Those sorts of things are beyond ASIC's reach. For those sorts of risk management type systems arrangements, there is a clear exemption from some of the things that we look at. They're the purview of APRA. Whilst I would acknowledge there will be cases, as there are now, where we're both interested, there are potentially cases where it's only APRA.

Senator GALLAGHER: Perhaps once your senior management banning regime-I don't know what it's going to be called-is put in place, it would be even more likely that an accountable person penalised under BEAR would also trigger some response from ASIC.

Mr Kirk: The senior management regime is not yet designed or legislated, but I think that would have to be one of the things considered in that process.[31]

1.52 ASIC made it clear during the inquiry that they requested additional powers to heighten accountability well before the idea of BEAR was first announced:

Senator GALLAGHER: The first I heard of it was a couple of estimates ago. It's over a year.

Mr Kirk: It's in that sort of order, yes. But during that time there have been a large number of issues looked at.

Senator GALLAGHER: Yes, I'm aware of that. When did ASIC first become aware of the work underway on the BEAR regime? And did it fall into the work that was being done around assessment of ASIC's tools and capability?

Mr Kirk: Again I can't give you a date, but I think it was probably in the early months of this year. We had discussions with Treasury about a desire to increase accountability. They talked to us about what were the limitations in ASIC's existing regime in terms of holding managers to account, and a bit about what could be done within that regime, particularly things that might be able to be done by ASIC in terms of new licence conditions and the like, and we explained some of the limitations of that. Then there was a

31 *Committee Hansard*, 17 November 2017, p. 27.

> decision by government to go with the sort of approach that they have taken, and we have had less to do with that since, because it has been focused on APRA and on prudential issues. At that point, we saw the vehicle for getting greater accountability around conduct issues to be the enforcement review and that's been our focus subsequently.[32]

1.53 The decision to implement the BEAR regime and to put it in APRA's scope of responsibility was a decision of government:

> **Senator KETTER:** Can you tell us who made the decision to give responsibility for BEAR to APRA?
>
> **Mr McDonald:** That would be a government decision
>
> **Senator KETTER:** And to focus on prudential aspects of banking behaviour rather than-
>
> **Mr McDonald:** That's a government decision.[33]

1.54 Labor Senators remain concerned that decisions for the BEAR regime to cover prudential matters only and to have APRA be responsible for its enforcement have not been clearly outlined by the Government. Given ASIC requested additional powers to hold managers to account, it seems strange that the BEAR would be developed with little consideration for ASIC's role in managing conduct as well.

The impacts on the insurance market

1.55 Evidence received by the inquiry confirmed that some entities in the insurance market will be covered by the BEAR regime, while others will not be covered:

> **Senator GALLAGHER:** Are we going to be in a situation where-because Commonwealth Bank have off-loaded CommInsure-the new owner of CommInsure won't be covered by this legislation?
>
> **Mr Brennan:** To the extent that they're not an ADI, they won't be covered. I'm not completely familiar with the terms of the agreement. It is possible that even when an ADI off-loads a subsidiary they have some involvement. It might be selling or supporting the products, even if they're not taking the insurance risk. It depends on the cases, but your first point is correct-some insurance companies will be covered; some won't be.
>
> **Senator GALLAGHER:** It seems a bit in consistent to me. I can't see how CommInsure will be covered, because it's been bought out entirely, in my understanding, by a global insurer, but Westpac's BT, for example, which is owned by Westpac, will be covered. Those businesses are in direct competition.[34]

1.56 ASIC in evidence to the PJC on Corporations and Financial Services committee also confirmed their view that other parts of the financial sector should be covered, including the insurance:

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32 *Committee Hansard*, p. 25.

33 *Committee Hansard*, p. 29.

34 *Committee Hansard*, p. 20.

> A third aspect to this is that at the moment it is restricted to banks, while in the UK it extends to insurance companies. That might be an area to be thinking about as a next phase.[35]

1.57 CHOICE also supported this view:

> **Senator KETTER:** Okay. To both organisations, my question is in relation to APRA's submission, which sort of postulates that this regulation could be extended at a later date to other parts of the finance industry. Do you have any views about that-firstly Ms Turner and then Ms Temple?
>
> **Ms Turner:** I don't disagree with them. If it's not extended at the moment, we'd certainly want it to be extended in future. We know in the United Kingdom it has been extended to insurers, and I think, given that a lot of concerns that consumers have about the finance sector have related to insurance scandals, that seems very appropriate.[36]

1.58 Labor Senators note these comments, and that paragraph 2.86 of the main report states that Government Senators endorse this view. Labor Senators will monitor any policy developments in this area should the Government seek to extend the scheme to cover other parts of the industry.

Labor Senators position on this bill

1.59 The legislation is no substitute for a Banking Royal Commission.

1.60 Stakeholders made it clear that the UK conducted a lengthy, fulsome review of the regulation of its financial sector. A Royal Commission into this sector in Australia can conduct a fulsome review in Australia and consider legislative and regulatory changes from a holistic perspective, a set of interconnected reforms that complement and enhance each other.

1.61 Many stakeholders raised concerns about the ad-hoc approach taken by this Government. Concerns were raised about the differences in intent set out in the bill as opposed to the explanatory memorandum, that the ASIC enforcement review was not considered alongside this legislation and that the BEAR regime included an appeal mechanism when frontline staff covered by the ABA conduct background check process would not be given a similar mechanism. Labor Senators believe that these issues are caused in part by the rushed process to develop this legislation, legislation which seeks political outcomes more than policy outcomes.

1.62 Labor Senators remain concerned that the legislation will not have a major impact on culture in this industry. No clear answers were offered to say that the BEAR regime would have had any impact on recent banking scandals had the BEAR legislation been in place at the time those events occurred. On this basis, it is difficult to believe that this legislation will have a major impact on the culture within the banking and financial services sectors. More will have to be done.

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35 Mr Greg Medcraft, *PJC Corporations and Financial Services Hansard*, 11 August 2017, p. 30.

36 *Committee Hansard*, 17 November 2017, p. 4.

1.63 Labor Senators are also concerned about this legislation further blurring the responsibilities of APRA and ASIC in regulating conduct within the banking sector.

1.64 The inquiry confirmed that some entities in the insurance market will be covered by the BEAR while others will not be covered. Labor Senators will monitor any policy developments in this area should the Government seek to extend the scheme to cover other parts of the industry.

1.65 Labor Senators are also concerned about the 1 July 2018 start date and the impact of this start date on small and medium ADIs.

1.66 Labor Senators also note that many of the same concerns raised in these additional comments are shared by Government Senators.

1.67 Labor Senators won't stand in the way of the bill, but will seek an amendment to reduce the implementation burden on small and medium ADIs.

Recommendation 1

1.68 To amend the bill in the Senate so as to have a commencement date for small and medium ADIs of 1 July 2019.

Senator Chris Ketter

Deputy Chair

Senator Jenny McAllister

Senator for New South Wales

Greens Additional Comments

Putting some meat on the BEAR-bones

1.1 Australian banks deserve their current poor reputation amongst the majority of the Australian people. They have failed to protect consumers from bad advice and unethical behaviour, failed to report breaches of corporate and consumer law, and have donated to political parties and lobbied Canberra to stack the system in their favour. They have also failed to properly manage systemic risks and prevent the build-up of household debt to perilous heights. As custodians of the financial system, most importantly they failed to meet the 'higher standards of accountability and integrity' that are expected of them. Fundamentally, banks failed to respect that their very existence is a privilege, not a right.

1.2 A bank's privilege is that which is granted to them by the Commonwealth in the form of a banking license. This is the privilege of being able to operate in an industry in which every individual and business is a customer; and, given the importance of the industry, being able to operate a business which is insured by the government.

1.3 But having a rock solid customer base and getting a government guarantee for free was not enough. The banks failed to resist the temptation of ever greater profits. The very existence of the BEAR implicitly acknowledges this fact. There would be no BEAR if the banks had properly balanced their responsibilities to their shareholder with their social licence to operate.

1.4 The Australian Greens support the introduction of the BEAR. However, we propose a number of amendments to strengthen the Bill and to ensure it better meets its stated aims. Irrespective, we in no way see the BEAR and other measures being put forward by the government as being a substitute for a Royal Commission—or similarly constituted Parliamentary Commission—to fully explore the failure of the banks.

Executive pay caps – changing culture from the top.

1.5 Implicit in the BEAR is that the remuneration paid to executives has been a central component of the market failure of the banks, and a key contributor to the poor culture that has let the public down. This poor culture has been consistently recognised and publicly acknowledged by commentators, and the even the former Chair of ASIC Greg Medcraft, who has said that remuneration is 'clearly a driver, particularly in finance, because finance is money'.[1]

1.6 A profit at all costs or profit before people culture at the banks and big financial services companies is directly linked to executive pay and the expectations of some shareholders. Consistently cutting staff, services and branches, overcharging

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1 Mr Greg Medcraft, Chairman, Australian Securities and Investments Commission, *Committee Hansard*, Economics Legislation Committee, Supplementary Budget Estimates, 26 October 2017, p. 20.

fees, cross selling of products, a culture of conflicted remuneration and meeting sales targets, unethical and illegal conduct are just some of the costs of such a culture. Others costs include the duress and loss of life for victims of financial crime, and systemic risks that could lead to economic meltdown and market contagion.

1.7 The Greens have often stated that any organisation's culture starts at the top. It makes sense that if senior executives are remunerated based on profit or return, then there will pressure on those below to make as much money as possible. This is the culture that has let the banks down. A simple way to address this is to cap executive pay, and set this remuneration at levels that better reflect community expectations. It may be heresy for some, but it would solve one of the biggest problems facing this sector.

1.8 The Treasurer says in his Second Reading speech that measures requiring the part deferral of executive remuneration will 'increase incentives for these people to focus on the long-term outcomes of their decisions'. The corollary is that the current unregulated approach encourages a focus on short-term gain for executives and some shareholders, at the expense of both customers and the nation.

1.9 The public knows this. We have all witnessed the spectacle of bank CEOs getting multi-million dollar pay packets while pushing the bounds of the law and common sense. Some senior bank executives earn over 100 times what the average Australian earns in a year. And we all know that this is wrong. It has not improved the lot of customers, it has not made for a more stable economy and it is eroding the social compact upon which banks depend.

1.10 Well, we do not need to tolerate it. We can take control. We can use the BEAR to reign in the fat-cats.

1.11 There is simply no justification for bank CEOs, who run a business that is embedded into society and that has a clear social responsibility, to be paid the ridiculous salaries that they have been paid. Excessive banker pay is emblematic of a system that has got its priorities wrong. It is encourages the pursuit of profit above all else and undermines the financial services industries social licence. The part deferral of executive pay that exists in the BEAR is not enough. It is time to establish pay caps in the banking sector.

Recommendation 1

1.12 That absolute limits be established on the remuneration payable to accountable persons at ten-times the average national wage for base remuneration; and a further five-times the average national wage for variable remuneration.

1.13 Australia would not be a pioneer in this field. In 2016, Israel agreed to establish a cap on executive pay in the banking and insurance sector at 44 times the wage of the lowest paid worker in the company.

Penalties

1.14 The penalty regime, as proposed, does not adequately reflect the difference in size between the big-four banks, smaller regional banks, and the customer-owned

banking sector. As noted in the Chair's report, the three-tiered penalty regime could have a disproportionate impact on smaller banks.

1.15 Instead of the proposed three-tiered structure, maximum penalties should be pegged to the value of the resident assets of covered entities: the bigger the bank, the bigger the risk, the bigger the penalty. This reflects one of the purported aims of the BEAR being to discourage activity within banks that gives rise to prudential risk.

Recommendation 2

1.16 That maximum penalties for breach of the BEAR be set at 10 penalty units for every $1,000,000 in resident assets.

Scope

1.17 As is detailed in the Chair's report, a number of submitters have raised issues with the scope of the BEAR. In particular: the BEAR is restricted to banks and does not cover the broader financial sector; and the BEAR is restricted to prudential matters and does not provide regulations aimed at directly protecting consumers.

1.18 These issues are too large to be addressed through amendments to this Bill at this time. However the government should commit to expanding the scope of BEAR to include them in the future.

Recommendation 3

1.19 That the government commit to broadening the scope of the BEAR to include the entire financial sector, and to provide regulation to directly protect consumer outcomes.

Senator Peter Whish-Wilson

Senator for Tasmania

Liberal Democratic Party Dissenting Report

1.1 This bill imposes a new layer of regulation and supervision on the banking sector, overseen by APRA.

1.2 Its purpose, as stated by the Treasurer in his Second Reading speech, is to ensure that where community expectations of accountability and integrity of banking directors and executives are not met, “appropriate consequences will follow”.

1.3 The bill is opposed on the following grounds:

(a) It is not a legitimate exercise of government authority to seek to ensure particular businesses meet community expectations. This is a matter for the market.

(b) The bill makes no provision for discovering or addressing community expectations. The only expectations to be met are those held by APRA.

(c) The bill will not prevent a repeat of the problems in the banking sector which were listed in the Explanatory Memorandum. That is, it will have no impact on the manner in which banks serve their customers.

(d) APRA will become a de facto additional board of directors, with a supervisory role in the appointment of senior executives, their responsibilities and remuneration.

1.4 Of particular concern are S37C and S37CA, which require banks and accountable persons "to take reasonable steps to prevent matters from arising that would adversely affect the ADI's prudential standing or prudential reputation."

1.5 APRA will have complete discretion, with no reference to community or any other external standards, to determine whether a bank is complying with this. The only consideration will be its own view of prudential standing and reputation.

1.6 APRA will have the authority to disqualify a person from acting as an accountable person, depriving them of their ability to remain employed. While an affected person will be able to appeal to the AAT, this amounts to a reversal of the onus of proof.

1.7 The bill requires banks to defer the remuneration of accountable persons for a period of up to four years, with policies that allow for a reduction in remuneration for failure to meet BEAR obligations. The bill also gives APRA the power to direct a bank with respect to the allocation of management responsibilities.

1.8 These are extraordinary intrusions into the management of a private sector business by public servants.

1.9 The merits of deferred remuneration are contested in management theory and entrenching the policy in law amounts to significant over-reach by the government. It also amounts to serious conceit to believe APRA has the expertise to direct a bank as to how to allocate its responsibilities.

1.10 The cost of complying with the legislation is likely to drive small ADIs from the market and reduce competition. This is likely to adversely affect consumer choice.

1.11 The bill will increase Executive risk, potentially making it more difficult and expensive for banks operating in Australia to recruit talented personnel. This has the potential to adversely affect the international competitiveness of the Australian banking sector.

1.12 Finally, the intended date on which the bill is to take effect (1 July 2018) is absurd, given such a significant departure from free market liberalism should be subject to considered scrutiny in the Senate.

1.13 If there are failures in the banking sector that are not being addressed by current regulations or market factors, this bill will do nothing to address them.

Recommendation 1

1.14 That the bill not be passed.

Senator David Leyonhjelm

Senator for New South Wales

Appendix 1
Submissions and additional documents received

Submissions

1. Mr Damien Morris
2. Australian Shareholders' Association
3. New Zealand Bankers' Association
4. Consumer Action Law Centre and CHOICE
5. MyState Limited
6. Westpac
7. Governance Institute of Australia
8. ANZ
9. Herbert Smith Freehills
10. Australian Bankers' Association
11. Australian Prudential Regulation Authority (APRA)
12. Bank of Queensland
13. Customer Owned Banking Association (COBA)
14. Dr Ann Wardrop, Dr David Wishart, Associate Professor Marilyn McMahon
15. Macquarie Group Limited
16. Australian Institute of Company Directors (AICD)
17. Financial Services Institute of Australasia (FINSIA)
18. Bendigo and Adelaide Bank Limited
19. Finance Sector Union of Australia
20. Mr John Colvin

Answers to questions on notice

1. Customer Owned Banking Association: Answers to questions take on notice at a public hearing in Canberra on 14 November 2017 (received 21 November 2017).
2. Australian Prudential Regulation Authority: Answers to questions take on notice at a public hearing in Canberra on 17 November 2017 (received 21 November 2017).

Appendix 2
Public hearings and witnesses

14 November 2017, Canberra ACT

Members in attendance: Senators Hume, Ketter, McDonald

CLANCY, Ms Alicia, National Industrial Officer, Finance Sector Union Australia

LAWLER, Mr Luke, Director, Policy, Customer Owned Banking Association

MacKENZIE, Ms Sally, Director, Engagement and Stakeholder Relations, Customer Owned Banking Association

O'SHAUGHNESSY, Mr Aidan, Director, Policy, Australian Bankers' Association

REES, Mr Nathan, National Assistant Secretary, Finance Sector Union Australia

WARDROP, Dr Ann, Private capacity

WISHART, Dr David, Private capacity

17 November 2017, Canberra ACT

Members in attendance: Senators Gallagher, Hume, Ketter, Leyonhjelm, Macdonald

BRENNAN, Mr Pat, Executive General Manager, Policy and Advice Division,

Australian Prudential Regulation Authority

BROWN, Ms Diane, Division Head, Financial System Division, Treasury

KIRK, Mr Greg, Senior Executive Leader, Australian Securities and Investments Commission

McDONALD, Mr Tony, Principal Adviser, Financial System Division, Treasury

SAADAT, Mr Michael, Senior Executive Leader, Australian Securities and Investments Commission

SCOTT, Mr Warren, General Counsel, Australian Prudential Regulation Authority

TEMPLE, Ms Katherine, Senior Policy Officer, Consumer Action Law Centre

TURNER, Ms Erin, Director, Campaigns and Communications, CHOICE