SUBMISSION ON THE BANKING EXECUTIVE ACCOUNTABILITY REGIME

3 AUGUST 2017

SUMMARY

1. ANZ thanks Treasury for the opportunity to comment on the proposed Banking Executive Accountability Regime (the **Regime**).

2. 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.

3. We sanction executives for poor outcomes including through their compensation, promotion prospects and, ultimately, their future with the company.

4. The Regime offers opportunity to enhance current accountability arrangements. As with all complex changes, the challenge to seeing benefit from the Regime will be designing and implementing it carefully and with adequate dialogue between Government and stakeholders.

5. As Treasury prepares draft legislation, we have five key points concerning the design of the Regime for it to consider.

6. **First**, the concepts of 'accountable person' and 'responsibilities' could be approached with less complexity.

7. Instead of crafting a new concept of 'accountable person', we think it would be simpler to use the existing idea of 'responsible person' in APRA Prudential Standard CPS 520 (**CPS 520**). A subset of these people could be designated for the Regime's enhanced accountability. This would be cheaper and quicker to implement while still capturing the individuals for whom enhanced accountability is appropriate. Related to this, we think there is limited utility in applying the concept of 'accountable person' to each subsidiary of an ADI group. This would embrace a large number of individuals who lack the influence over the ADI group that is the focus of the Regime. Instead, relying on the responsible person concept of identifying individuals within the group who can affect the ADI, as a whole and including its subsidiaries, achieves the same policy intent with significantly lower implementation costs.

8. Further, we think that the 'responsibilities' to be allocated across this subset of responsible persons should be identified without reference to the United Kingdom regime. The UK regime's concept of 'prescribed responsibilities' uses bespoke concepts that would not translate well to Australia. Instead, Treasury should legislatively require that the responsibilities for the institution should be allocated, without gaps, across the subset of responsible persons. This will allow banks to specify the responsibilities in more detail and consult with APRA on the appropriateness of their specification.

9. **Second**, the conduct expectations imposed by the Regime would benefit from further consideration to ensure they are clear and well-aligned with existing regulatory and legal

frameworks. This would help ensure they are well understood and reduce implementation costs and legal uncertainty.

10. The delineation between APRA's focus on conduct that is of a 'systemic and prudential nature' and ASIC's remit concerning conduct related to financial services and credit needs mindful calibration. We are concerned that the consultation paper's articulation of the conduct expectations does not adequately make clear when conduct will rise to the level that the Regime seeks to address.

11. Further, applying the conduct expectations to those already covered by directors' and officers' duties under the *Corporations Act 2001* (Cth) (**Corporations Act**) will mean they are subject to overlapping obligations. These obligations should be aligned. For example, the objectivity and safe harbour in section 180 of the Corporations Act should be mirrored in the Regime.

12. **Third**, we are supportive of reward structures that encourage the right behaviour. We defer large portions of our executives' remuneration and have the ability to claw remuneration back. If Treasury is concerned that excessive deferral of variable remuneration could incentivise more fixed pay, it could allow part of the deferred portion of variable remuneration to vest on a pro rata basis. This would still ensure executives are subject to the right behavioural incentives, particularly as the unvested amounts accreted through their tenure, but minimise the relative attractiveness of fixed pay. It would also reduce any impact on banks' ability to recruit executives with transferrable skills from outside the industry, an issue that is becoming more acute as banking transforms digitally.

13. **Fourth**, we would urge the Treasury to consider carefully the proposal's current intent to apply to banks and their subsidiaries but not to other prudentially regulated entities (even when those entities own banks). For example, as recognised by the consultation paper, this will have the outcome that insurers owned by banks will be subject to the Regime while insurers without an ADI parent will not. This uneven scope of application will only fall into sharper relief if APRA is given prudential power over non-bank lenders (as Treasury is currently proposing).

14. **Fifth**, the Regime portends a significant implementation effort for Australian banks. We would hope that enough time is allowed for both consultation and implementation (as occurred in the UK). We would posit that APRA may take a number of months to adequately consult and prepare the Regime's prudential standards. Depending on the Regime's complexity, industry may benefit from 18 months to implement its changes.

15. Some of these points are elaborated on below in response to the consultation questions. Our responses often address several questions collectively and we have grouped the questions accordingly. We would be happy to discuss our points further if helpful.

RESPONSE TO QUESTIONS

1. Does the prescriptive element of the proposed definition of accountable persons capture the roles which, at a minimum, should be subject to enhanced accountability under the BEAR?

1.1. Are there any other roles which should be included at a minimum?

1.2. Should any of the roles be excluded?

2. Does the principles based element of the proposed definition of accountable persons provide sufficient flexibility to reflect differences in business models and group structures?

3. Should the definition of accountable persons apply to individuals in the subsidiaries of a group or subgroup with an ADI parent, including where the subsidiaries are not regulated by APRA?

1. We believe that the intent behind both the prescriptive and principles-based elements of the proposed definition of 'accountable person' is generally correct. The Regime should apply to the most senior people who can significantly influence the actions and stability of an ADI.

2. However, we believe that this application could be achieved without introducing a new concept of 'accountable person'. Subject to the comment below on subsidiaries, the individuals who would be 'accountable persons' are likely to be 'responsible persons' under CPS 520. It would be simpler, from both a legislative and an implementation perspective, to require banks to designate a subset of their responsible persons for the enhanced accountability of the Regime. This would avoid introducing a wholly new concept into law, APRA's regulation and banks' internal policies.

3. Responsible persons within banks under CPS 520 are the directors, auditors and senior managers. A senior manager is someone who is involved in decisions that affect the whole or a substantial part of the business of the bank, has the standing to affect significantly the bank's financial standing or who has significant responsibility for risk management or implementation of policies and strategy.

4. This definition of responsible person would capture all individuals who the consultation paper proposes would be accountable persons including:

   - The directors who chair the Board and the Risk, Audit and Remuneration Committees;
   - The CEO, CFO, CRO, COO, CIO and Head of Internal Audit; and

- Any other individuals who, in the language of the consultation paper, '…have significant influence over conduct and behaviour, and whose actions could pose risks to the business and its customers'.

5. We think that the consultation paper is correct in using both a prescriptive and a principles-based element in identifying relevant individuals.

6. We would largely endorse the prescribed roles as being appropriate for designation as responsible persons that should be subject to the Regime. However, we think it is important that Board members operate according to homogenous legal standards. If some Board members are subject to legal duties that others are not, then there is the risk that the collective responsibility of the Board for its decisions is undermined.

7. Respectfully, we think that the principles-based element proposed in the consultation paper would benefit from greater precision.

8. For example, by not specifying whose 'conduct and behaviour' is relevant, the definition could capture managers who have significant influence over relatively small teams. Similarly, there is no scale concept that illuminates the terms 'business' or 'its customers'. Thus, it is unclear if the definition intends to capture any risk to an ADI's business (or part thereof) or to any of its customers.

9. We think that an appropriate principles-based element for identifying relevant responsible persons would be the concepts expressed in paragraphs 25(a) and (b) of CPS 520. As currently drafted, these would capture anyone who is involved in decisions that affect the whole or a substantial part of the business of the bank or who has the standing to affect significantly the bank's financial standing.

10. We believe it may be more appropriate to focus on those who 'make' rather than are merely 'involved in' decisions (many individuals may be involved in executive-level decisions; only the most senior truly make them however).

11. We note that 'business' would likely be interpreted as extending to the conduct and behaviour of staff.

12. Further, to help achieve Treasury's policy intent to capture individuals with influence over the bank group, it could be made clear in the principles-based element that it is the business and financial standing of the bank and its subsidiaries that is relevant.

13. With these minor adjustments, using these ideas would capture the most senior people within the corporate group while allowing the industry and APRA to use existing, well-understood terms.

14. We note that the phrasing of paragraphs 25(a) and (b) is drawn from, and intended to be interpreted consistently with, the definition of 'senior manager' in section 9 of the Corporations Act.

15. Consistent with our position that the CPS 520 definition of responsible person should be used, we do not think it is appropriate that 'accountable persons' should be identified within each subsidiary of a banking group. Such an application would capture a large number of individuals who are responsible for running administrative or minor commercial functions of the bank and who lack the scale of influence over the organisation's culture, soundness and impact on customers that we understand is the target of the Regime.

16. Accountability for the actions of subsidiaries (as defined in Division 6 of Part 1.2 of the Corporations Act) would ultimately rest with the responsible persons of the parent bank. Such subsidiaries are controlled by that parent and oversight of their actions would always rest with the senior management of that holding company.

17. Applying the Regime to subsidiaries will significantly increase its compliance burden without increasing accountability at the most senior level of the banking group; such accountability can be achieved through using the principles-based element we proposed above.

18. Further, we hold strong concerns about the consultation paper's position that subsidiaries would be subject to the Regime solely because of their parent, rather than what they do. The prospect of a bank-owned insurer being subject to the Regime, while an insurer without a bank parent is not, will create an uneven field for financial services in Australia. Insurers, like banks, hold positions of trust in the financial system; this much is recognised by their prudential regulation by APRA. We would urge Treasury to consider its position on prudentially regulated entities that are not owned by banks.

4. Do the options canvassed for the expectations of ADIs capture the behaviours that should be expected under the BEAR?

5. Do the options canvassed for the expectations of accountable persons capture the behaviours that should be expected under the BEAR?

19. The intent of the proposed conduct expectations for both ADIs and 'accountable persons' appears appropriate. To help improve the implementation of the expectations, we have four points for Treasury to consider.

20. **First**, the delineation between ASIC's conduct regulation and the Regime would benefit from being crisper.

21. As currently expressed, we are concerned that limited scale conduct that contravened standards within ASIC's remit would also appear to breach the Regime's expectations. This concern rests on two observations.

    a) The first observation is that it is not yet clear how the conduct expectations will be expressed to focus on 'systemic and prudential matters'. As articulated on

page 7 of the consultation paper, it would be possible to breach the expectations with a single instance of non-systemic behaviour.

We do not think that the term 'prudential matter' truly assists in articulating a heightened scale of conduct. This term is defined in section 5(1) of the *Banking Act 1959* (Cth) to mean matters relating to the conduct by an ADI of its affairs:

- To keep the ADI in a sound financial position or not to cause or promote instability in the Australian or New Zealand financial system; or
- With integrity, prudence and professional skill.

As is clear, the second limb of this definition does not help clarify when conduct would be caught by the Regime and when it would be within the remit of ASIC. A single instance of behaviour could lack integrity, prudence or professional skill. Additionally, for the reasons set out below, the concepts of integrity and professional skill are arguably already covered by ASIC-regulated rules concerning financial services and the provision of credit.

To focus the expectations on conduct that is unambiguously concerned with wide-spread behavioural or bank-stability issues, we think there needs to be a clear definition of 'systemic' which operates cumulatively with the definition of 'prudential matter'.

Together, these two terms should be applied to the conduct expectations to make clear that they operate at the level of conduct which jeopardises the ADI or the Australian or New Zealand financial system or which is otherwise pervasive through the ADI. By pervasive, we mean that it affects the whole or a substantial part of the ADI's operations, staff or customers.

Such a definition would be consistent with the scope of influence of responsible persons who, by definition, can affect the whole or a substantial part of the business of the bank or have the standing to affect significantly the bank's financial standing. Thus, there would be consistency between individuals covered and the conduct expectations that apply to them.

b) The second observation is that the proposed standards would seem to overlap with pre-existing behavioural requirements regulated by ASIC that apply to holders of Australian financial services licences and Australian credit licences (which all banks are) under section 912A of the Corporations Act and section 49 of the *National Consumer Credit Protection Act 2009* (Cth) respectively:

- The expectations to conduct business with 'due skill' and 'integrity' are cognate with the requirements to act 'efficiently' and 'honestly' in section 912A(1)(a) in relation to financial services and in section 49(1)(a) in relation to credit activities; and

- The expectation to take reasonable steps to act in a prudent manner, including by meeting all of the requirements of APRA's prudential standards, would already be covered by the requirement in section 912A(1)(c) to comply with the financial services laws (to the extent the relevant behaviour related to the provision of financial services).

For these reasons, it is important that the conduct expectations are focused on truly systemic issues.

22. **Second**, the conduct expectations may benefit from further definitional work.

23. For example, organisations would likely appreciate guidance on what 'reasonable steps' would constitute. This would help provide certainty around compliance systems and thus reduce costs. Similarly, concepts like 'prudence' and 'culture' may be well understood in everyday language but, without more statutory or regulatory elaboration, risk vagueness and imprecision when used as legal thresholds. Treasury may like to employ terms that are well understood in Australian jurisprudence when crafting the conduct standards (for example, from the directors' duties in the Corporations Act).

24. One aid to comprehension would be to introduce a degree of objectivity into the expectations (again, such as exists for directors' duties). This could be done by making clear that the standard of conduct expected of 'accountable persons' is that which would be shown by a reasonable person occupying the same position in the organisation with the same responsibilities as the individual whose conduct is being assessed.

25. We also note that, as currently proposed, the conduct expectations risk articulating the same norms of behaviour in overlapping and conflicting ways. For example, the expectations state that an ADI is expected to conduct its business with due skill, care and diligence. This expectation is expressed absolutely and without reference to taking reasonable steps. In contrast, a different expectation is that ADIs take reasonable steps to organise and control its affairs responsibly and effectively. Ignoring the predication of the latter expectation on taking reasonable steps, it is difficult to see what substantive difference there is between these two expectations. Failure to organise and control a bank's affairs would clearly involve a failure to conduct business with due skill, care and diligence.

26. Taking the predication into account, however, means that conduct is judged accordingly to whether reasonable steps were taken to prevent the conduct, rather than simply whether the conduct occurred. A conflict thus arises between the two expectations as, while they ostensibly capture the same behaviour, they apply different normative standards to that behaviour. This type of issue would merit resolution before the expectations are reduced to law or prudential standard. In

particular, we would ask Treasury to consider providing clarity about the corporate and individual states of intent that are relevant for breach of the conduct expectations.

27. **Third**, we note that the conduct expectations risk setting a higher bar of conduct for directors and officers of banks than currently applies to them under the Corporations Act's directors' duties. For example, section 180 imposes very similar obligations on directors and officers of a corporation to act with care and diligence. However, section 180(2) provides for the business judgment rule that sets out when directors and officers can be taken to have acted with care and diligence.

28. We believe that the conduct expectations should align with section 180 and other directors' and officers' duties, including by making clear the circumstances in which the expectations will be considered met.

29. **Fourth**, while we support the expectation of being open and honest with APRA, we would ask for comfort that this expectation not derogate from existing rights, such as legal professional privilege and, for individuals, the privilege against self-incrimination.

6. Would deferring variable remuneration be likely to result in a shift from variable to base remuneration? Would this be problematic and, if so, can anything be done to prevent this outcome?

30. If banks were required to defer the full 40% or 60% of variable remuneration for four years then there may potentially be pressure for a shift towards an increased level of base remuneration.

31. If Treasury were concerned about this, it could achieve substantially similar policy outcomes concerning appropriate behavioural incentives by allowing banks to vest the deferred portion of the variable remuneration on a pro-rata basis across the four years. For example, of the deferred portion, 25% could vest in year one, 25% in year two, 25% in year three and the remainder in year four. Banks already defer substantial amounts of variable remuneration and a pro-rata deferral structure would be unlikely to incentivise migration towards more fixed remuneration.

32. The optimal balance between fixed and variable remuneration will vary with each organisation. Organisations use variable remuneration to align the performance of staff members with customer, shareholder and organisational interests. Variable remuneration awards can also be subject to malus prior to vesting. That said, contingent remuneration with long vesting periods may be less valued by executives than more immediate reward. It may thus have reduced influence over their behaviour.

7. What are the complexities in defining variable remuneration, including in relation to non cash remuneration?

8. Does the proposed principles based definition of variable remuneration provide sufficient clarity as to the application of the BEAR to current and potential future remuneration structures?

33. The main complexity in defining variable remuneration concerns quantifying it. For example, should the remuneration be valued at the time of award or the time of vesting? We would submit it is easiest to value such remuneration at its face value at the time of award.

34. While we agree, in principle, with the definition that variable remuneration is '…that part of total remuneration that is discretionary and conditional upon performance and the delivery of results, including individual and business performance and results', we do not think the subsequent sentence in the consultation paper is helpful.

35. This sentence refers to a potential clarification that variable remuneration is 'intended to reward performance and the delivery of results in excess of that required to fulfil a job description'. In contrast, many organisations adopt 'target' remuneration for roles. This target remuneration will include a fixed and conditional component. The conditional component may be awarded when the individual meets or exceeds a performance hurdle.

9. Is the proposal for deferring 60 percent of the variable remuneration of certain executive accountable persons appropriate?

36. Depending on how the deferral operates (whether the full amount is deferred for four years, or pro-rated across the period), this proposal could be appropriate. ANZ defers 50% of its CEO's short-term variable remuneration on a pro-rated basis over one to four years. All of the CEO's long-term variable remuneration is deferred for three years.

37. We would also be interested in understanding further which executives would be considered the 'most senior accountable persons' for domestic systemically important banks.

10. Are the proposed enhancements to APRA's remuneration powers appropriate?

38. We appreciate the policy intent behind the proposed enhancements to APRA's remuneration powers. It is important that remuneration consequences flow from poor conduct.

39. However, we question whether involving APRA so closely in setting and influencing remuneration risks undermining the responsibility of Boards for appropriate remuneration standards and the role of shareholders in holding Boards to account.

40. Boards are already subject to rigorous oversight of bank remuneration standards. We think it is appropriate that bank Boards continue to be ultimately accountable for the pay standards that they set and enforce. Moreover, we note that under current corporate governance arrangements, it is shareholders who are entitled to opine on and vet the adequacy of remuneration arrangements.

41. We would ask Treasury to consider whether the policy intent could be achieved by requiring bank remuneration policies to include a mechanism to allow the Board to reduce (potentially down to zero) the:

- variable remuneration; and/or
- unvested component of previously awarded deferred variable remuneration,

of an executive who does not meet the expectations of the Regime and is consequently removed and/or disqualified by APRA.

42. This mechanism would allow the sanction to be applied to accountable executives but ensure Boards continue to be responsible for remuneration.

11. Should ADIs be required to map the allocation of prescribed responsibilities, similar to the approach under the Senior Managers Regime in the United Kingdom?

11.1. Are there any other prescribed responsibilities which should be included?

11.2. Should any of the prescribed responsibilities be excluded?

12. Should ADIs have discretion to add to the prescribed list of responsibilities?

43. We agree that it is appropriate that banks map or set out responsibilities. Such an exercise could aid in the governance of a bank.

44. We note that the proposed list of prescribed responsibilities in Table A2 of the consultation paper is drawn directly from the United Kingdom regime. Obviously, for that reason, it does not align with the prescribed accountable person roles that are suggested on page 6 of the consultation paper.

45. For example, many of the prescribed responsibilities have a compliance orientation and would, under the suggested Australian prescribed accountable person taxonomy, fall under the Chief Risk Officer. In contrast, the UK regime appears to prescribe more granular functions underneath the CRO (eg Head of Compliance and Money Laundering Reporting Officer).

46. We believe that the allocation of responsibilities within the Australian regime should be aligned with the 'accountable persons' that each bank identifies.

47. Rather than identifying the prescribed responsibilities at this stage of the policy development, we would suggest that the industry, in consultation with APRA, undertake this process once the universe of accountable persons is more certain.

48. At present, we would suggest that Treasury consider adopting the principle that there is an accountable person allocated to each of the activities, business areas and management functions of the organisation.

13. Are the options canvassed for enhancing APRA's removal and disqualification powers appropriate?

49. The options are generally appropriate.

50. Our major concern is that if banks are required to report the commencement of disciplinary processes, then banks could be reporting individuals to APRA who are ultimately exonerated of any wrongdoing.

51. We would submit it would be fairer and more efficient if banks were required to notify APRA once disciplinary processes are complete, contravention of the conduct standards has been proven and a consequence has been applied to the relevant person.

52. We would also reiterate the importance of allowing for procedural fairness in relation to any APRA decisions concerning the exercise of its removal and disqualification powers. Removal of APRA's need to go first to the Federal Court for disqualification is a significant step. Whether such removal is warranted needs to be assessed by the gravity of disqualification and the relative infrequency with which the power is (hopefully) to be exercised. If referral to a court is removed as a precondition, then Treasury may like to consider alternative procedural fairness protections for affected individuals.

Registration

53. We note that no questions are posed on the registration process. However, we would ask Treasury to consider how it sees this registration process working in practice. For example, will banks be able to make employment offers in advance of notifying APRA on the proviso that such offers are contingent on no adverse response from APRA?

14. Are the proposed circumstances in which the civil penalties should apply appropriate?

54. We note that the proposed circumstances extend beyond contravention of the conduct expectations to include:

a) Failure to hold an accountable person to account; and

b) Failure to appropriately monitor the suitability of accountable persons.

55. If these are to be new civil penalty provisions then we would ask that they be accompanied by sufficient explanation to allow banks to understand what they will require. The imperative of clarity is made particularly acute by the quantum of fines proposed.

56. For example, how would APRA (and a court) assess whether a bank has failed to hold an accountable person to account? Would this involve an assessment of the adequacy of any disciplinary process or sanction applied? If so, then the provision may invite regulatory involvement in the disciplinary processes of banks. While this may be the policy intent, it will be important that clarity is provided around what constitutes adequate processes and sanctioning outcomes.

57. Further, the requirement to monitor the suitability of accountable persons would seem to have overlap with existing requirements under CPS 520. Paragraph 45 of CPS 520 requires that a 'Fit and Proper Policy' must require annual fit and proper assessments for each responsible person. Would adherence with paragraph 45 be sufficient to avoid contravention of the new civil penalty provision?

58. We also note the reference in the consultation paper to prohibiting ADIs from taking out insurance to indemnify them against the civil penalties (and individuals in respect of disqualification). We would like to understand more about these potential prohibitions before we comment on them. They would benefit from further consultation if Treasury is minded to embed them in law.

15. Is the proposed definition of large ADIs appropriate?

59. Yes, the definition appears appropriate.

16. What would be a reasonable period of time after the passage of legislation for ADIs to implement the BEAR?

60. The Regime has multiple elements that will each require careful consultation between Government, industry and other stakeholders and will then take time to implement effectively.

61. We note that the Regime will likely be constituted by both legislation and prudential standards. The development of the latter instruments would benefit from thorough dialogue between APRA and interested parties. Ideally, such dialogue would occur over a number of months. APRA may then benefit from an adequate period of time to draft the prudential standards. Obviously, what is adequate is at APRA's discretion but it is feasible that such drafting may, again, take several months.

62. Depending on the ultimate complexity of the Regime and its alignment with existing law and standards, industry may benefit from a further 18 months to implement adequate systems and processes to comply with the Regime, including any required

changes to remuneration arrangements. The implementation process could be expedited by adopting some of the recommendations we make in paragraph 65.

17. How significant are the costs associated with implementing the BEAR? How can these costs be mitigated consistent with the policy intent of the BEAR?

63. In the time allowed to respond to the consultation paper, ANZ has not been able to perform a detailed cost analysis of implementing the Regime. In any event, the scale of costs associated with the Regime will vary significantly with its design.

64. Key anticipated costs will be reviews of management controls, information frameworks, legal analysis and remuneration restructuring.

65. To help constrain implementation costs, we would suggest:

a) Using existing regulatory concepts, like 'responsible persons', to allow banks to adapt, rather than create anew, policies and processes

- Similarly, the conduct expectations could align existing expectations, such as those in the Corporations Act, to minimise legal analysis and uncertainty

b) Not extending the Regime to all subsidiaries of banks by focusing, instead, on any individual that can affect the ADI group as a whole

c) Allowing enough time for thorough consultation to provide clarity around the behavioural expectations, again minimising legal analysis and uncertainty

d) Allowing enough time for implementation to allow any required changes to be scoped and worked through in a considered manner, which will avoid the risk of mistakes and the need for rework

e) Minimising the degree of overlap between APRA and ASIC to reduce duplication of regulatory engagement

ENDS