



Australian Government

Banking Executive Accountability Regime

Consultation Paper
July 2017

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CONTENTS

Consultation Process	iv
Chapter 1 — Introduction.....	1
Chapter 2 — Key features of existing accountability frameworks	3
Chapter 3 — Institutions to be covered by the BEAR	4
Chapter 4 — Individuals to be covered by the BEAR.....	5
Chapter 5 — Expectations of ADIs and accountable persons under the BEAR	7
Chapter 6 — Remuneration	9
Chapter 7 — Implementation and transitional issues.....	11
Appendix A — Key features of international responsibility and accountability frameworks	16

CONSULTATION PROCESS

REQUEST FOR FEEDBACK AND COMMENTS

Interested parties are invited to comment on the issues and options raised in this paper by 3 August 2017.

Submissions may be lodged electronically or by post.

PROVIDING A CONFIDENTIAL RESPONSE

All information (including name and address details) contained in formal submissions will be made available to the public on the Australian Treasury website, unless it is indicated that you would like all or part of your submission to remain confidential. Automatically generated confidentiality statements in emails do not suffice for this purpose. Respondents who would like their submission to remain confidential should provide this information marked in a separate document.

A request made under the *Freedom of Information Act 1982* for a submission marked 'confidential' to be made available will be determined in accordance with that Act.

Closing date for submissions: 3 August 2017

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CHAPTER 1 — INTRODUCTION

In recent years, there has been growing community concern regarding a number of examples of poor culture and behaviour in banks and the financial sector generally. There have been too many instances where participants have been treated inappropriately by banks and related financial institutions.

The House of Representatives Standing Committee on Economics *Review of the four major banks* (the Coleman Report) found that no individuals have had their employment terminated as a result of recent scandals, noting that:

‘The major banks have a ‘poor compliance culture’ and have repeatedly failed to protect the interests of consumers. This is a culture that senior executives have created. It is a culture that they need to be accountable for.’

The Australian financial system is the backbone of the economy and plays an essential role in promoting economic growth. In order for it to operate in an efficient, stable and fair way, it is imperative that participants have trust in the system. It 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. As the Financial System Inquiry noted:

‘Without a culture supporting appropriate risk taking and the fair treatment of consumers, financial firms will continue to fall short of community expectations.’

Banks, as authorised deposit-taking institutions (ADIs), play a critical role in the financial system, including through their deposit-taking, payments and lending activities. ADIs enjoy a privileged position of trust, with prudential regulation designed to provide consumers with confidence in the safety of their deposits.

In the 2017-18 Budget the Government brought forward a comprehensive package of reforms to address the recommendations of the Coleman Report and strengthen accountability and competition in the banking system. As part of this package, the Government announced that it will legislate to introduce a new Banking Executive Accountability Regime (the BEAR).

The Budget announcement outlined significant changes to be introduced under the BEAR, including:

- **Registration** — prior to the appointment of directors and senior executives, ADIs must register these individuals with the Australian Prudential Regulation Authority (APRA) and provide maps of their roles and responsibilities.
- **New powers and penalties** — APRA will have stronger powers to remove directors and senior executives from APRA-regulated institutions, subject to review; expectations of ADIs and their directors and senior executives will be established; where ADIs do not meet these expectations, there will be civil penalties; and APRA will have power to impose penalties on ADIs not appropriately monitoring the suitability of executives.
- **Remuneration** — variable remuneration for ADI senior executives will be deferred for at least four years; and APRA will have stronger powers to require ADIs to review and adjust remuneration policies.

This consultation paper outlines for comment the more detailed policy considerations involved in the design of the BEAR.

The intention is to enhance the responsibility and accountability of ADIs and their directors and senior executives. The BEAR will provide greater clarity in relation to responsibilities and impose heightened expectations of behaviour in line with community expectations. There will be strong incentives for arrangements to be put in place to improve the culture and behaviour within the ADI sector. However, where endemic poor behaviour continues there will be consequences.

The stronger powers for APRA complement the existing powers of the Australian Securities and Investments Commission (ASIC) for regulating market conduct. The ASIC Enforcement Review is examining the adequacy of ASIC's regulatory tools and powers.

This consultation paper is structured as follows:

Chapter 2 — Key features of existing accountability frameworks

Chapter 3 — Institutions to be covered by the BEAR

Chapter 4 — Individuals to be covered by the BEAR

Chapter 5 — Expectations of ADIs and accountable persons under the BEAR

Chapter 6 — Remuneration

Chapter 7 — Implementation of the BEAR, including:

- Registration
- Removal and disqualification
- Penalties

Appendix A — Key features of international responsibility and accountability frameworks

CHAPTER 2 — KEY FEATURES OF EXISTING ACCOUNTABILITY FRAMEWORKS

The objective of the BEAR is to apply a heightened responsibility and accountability framework to the most senior and influential directors and executives within ADIs, rather than replacing or changing the existing prudential framework or directors' duties.

APRA's prudential framework already includes standards covering:

- *culture*: Prudential Standard *CPS 220 Risk Management* (CPS 220) requires the board of a bank to form a view on the ADI's risk culture and the extent to which that culture supports the ability of the ADI to operate consistently within its risk appetite, and ensure that the ADI takes steps to make desirable changes to its risk culture;
- *remuneration*: Prudential Standard *CPS 510 Governance* (CPS 510) requires the ADI to establish a Board Remuneration Committee and maintain a Remuneration Policy that aligns remuneration and risk taking;
- *governance*: CPS 510 sets out minimum standards for good governance of an ADI to ensure that it is managed soundly and prudently by a competent board;
- *risk management*: CPS 220 requires an ADI to maintain a risk management framework that is appropriate to its size, business mix, and complexity. Moreover, Prudential Standard *CPS 232 Business Continuity Management* requires an ADI to maintain a business continuity management policy that ensures it is able to meet its financial and service obligations to its depositors, policyholders and other stakeholders; and
- *fit and proper*: Prudential Standard *CPS 520 Fit and Proper* sets out criteria for determining the fitness and propriety of responsible persons. APRA may direct an ADI to remove directors or senior managers who lack the requisite fitness and propriety.

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

The design of the BEAR also seeks to draw on the elements of existing international responsibility and accountability frameworks. A number of overseas jurisdictions have been exploring ways to improve culture and increase accountability across their financial sectors. In particular, the United Kingdom has introduced the Senior Managers Regime (SMR) and Hong Kong has introduced the Managers-in-Charge (MIC) measures. Further detail on the SMR and the MIC is provided at Appendix A.

As international banking groups may be subject to a number of international frameworks, there is benefit in ensuring consistency as far as possible and practicable. Consequently, the proposals in this paper have particular regard to some elements of the SMR. On the other hand, as the particular circumstances of the Australian banking sector differ to those in the UK, the proposals in this paper do not adopt all elements of the SMR.

CHAPTER 3 — INSTITUTIONS TO BE COVERED BY THE BEAR

CONTEXT

In the 2017-18 Budget, the Government announced that the BEAR will apply to ADIs. This chapter provides further detail on the scope of ADIs to be covered by the BEAR.

POLICY CONSIDERATIONS

ADIs are in scope of the BEAR due to the critical role they play in the economy and in response to community concern regarding recent poor behaviour. It is imperative that they maintain the trust of financial sector participants and depositors in particular.

The scope of the BEAR is also intended to include all entities within a group with an ADI parent. This will include subsidiaries of ADIs, including those that provide non-banking services and those that are foreign subsidiaries. Where an ADI exists within a group with a non-ADI or overseas parent company, the scope of the BEAR is intended to apply only to the subgroup of entities for which the ADI is the parent.

This scope will apply for the purpose of the expectations and accountabilities of the BEAR, which are outlined further in Chapter 5. ADIs and their directors and senior executives will be responsible and accountable for taking reasonable steps to ensure that the expectations of the BEAR are applied and met throughout groups or subgroups with an ADI parent.

This scope could also apply to the individuals to be covered by the BEAR, to include the directors and senior executives of the subsidiaries within a group or subgroup with an ADI parent, including those subsidiaries that are not APRA-regulated. These individuals could be subject to the expectations of the BEAR, outlined in Chapter 5. They could also come within scope of the remuneration elements of the BEAR, requirements for registration and accountability mapping, and APRA's enhanced removal and disqualification powers, outlined in Chapters 6 and 7.

The rationale for including groups and subgroups with an ADI parent within the scope of the BEAR in this way is that consumers will often associate the wide range of financial services and activities that are provided by the subsidiaries with an ADI brand. Therefore, poor behaviour in the subsidiaries has the potential to undermine confidence in the ADI itself. Indeed, recent poor behaviour in the provision of insurance and financial advice by the subsidiaries of ADIs has raised community concerns.

The proposed scope would mean that the BEAR would apply in relation to a business (such as an insurer) that is part of an ADI group or subgroup, but not to its competitor that is not part of an ADI group or subgroup. This difference reflects the unique position of ADIs. ADIs enjoy a privileged position of trust in the financial system, with prudential regulation designed to provide consumers with confidence in the safety of their deposits.

CHAPTER 4 — INDIVIDUALS TO BE COVERED BY THE BEAR

CONTEXT

In the 2017-18 Budget, the Government announced that the BEAR will apply to directors and senior executives of ADIs (to be referred to as ‘accountable persons’). This chapter provides further detail on the meaning of accountable persons.

POLICY CONSIDERATIONS

An objective in defining accountable persons for the purpose of the BEAR is to provide greater clarity in relation to the responsibilities of the most senior individuals within an ADI. The BEAR should make it easier to hold senior individuals to account for their behaviour in carrying out their responsibilities.

The net should not be cast so wide that responsibility can be deflected and accountability avoided. The risk is that if everybody is responsible, nobody will be accountable. On the other hand, the definition of accountable persons should not be cast too narrowly so as to exclude individuals with effective responsibility for management and control.

The definition of accountable persons is intended to clearly identify the most senior directors and executives who will be held to a heightened standard of responsibility and accountability. It is intended to build on, rather than replace, existing concepts of responsibility and accountability, such as definitions of ‘responsible persons’, ‘directors’ and ‘senior managers’ under APRA’s Fit and Proper framework.

The definition of accountable persons will include new and existing individuals. As outlined in Chapter 3, the definition could also include directors and senior executives of the subsidiaries within a group or subgroup with an ADI parent.

It is proposed to define accountable persons by adopting a combination of prescription and principle. This would have the benefit of ensuring key functions are caught, while also providing sufficient flexibility to reflect differences between ADIs.

The prescribed element of the definition could leverage the SMR in the United Kingdom, as outlined in Appendix A. Prescribed functions could include both oversight functions (such as Chair, Chair of the Risk Committee, Chair of the Audit Committee, and Chair of the Remuneration Committee) and executive functions (such as Chief Executive, Chief Finance, Chief Risk, Chief Information and Head of Internal Audit), as defined in Table 1.

The principles-based element of the definition is intended to capture other individuals who have significant influence over conduct and behaviour, and whose actions could pose risks to the business and its customers. The extent to which ADIs would register accountable persons under this element of the definition would vary depending on differences in business models and group structures.

An example of a function that could be assumed to meet this criteria would include the head of a key business area. This function would be responsible for the management of a significant proportion of the ADI business or activity, based on its proportion of total gross assets, revenue or profit. This function could include directors or senior executives of subsidiaries within a group or subgroup with an ADI parent.

As detailed in Chapter 7, ADIs would be required to register individuals performing accountable person functions with APRA, and provide accountability statements to further detail their roles and responsibilities and accountability maps to outline roles and responsibilities across the group with an ADI parent.

Table 1: Proposed prescribed accountable persons functions

Descriptor	Function
Oversight functions	
Chair	Responsible for chairing and overseeing the performance of the Board.
Chair of the Risk Committee	Responsible for chairing and overseeing the performance of any committee responsible for the oversight of the risk management systems, policies and procedures.
Chair of the Audit Committee	Responsible for chairing and overseeing the performance of any committee responsible for the oversight of the internal audit system.
Chair of the Remuneration Committee	Responsible for chairing and overseeing the performance of any committee responsible for the oversight of the design and the implementation of the remuneration policies.
Senior Officer Outside Australia	Under the authority of the Board of a foreign ADI, outside Australia and responsible for overseeing the Australian branch operation of a foreign ADI. This function already exists under APRA's prudential standard CPS 510.
Executive functions	
Chief Executive	Under the immediate authority of the Board, responsible for carrying out the management of the conduct of the whole business (or relevant activities).
Chief Finance	Responsible for the management of financial resources and reporting directly to the Board in relation to financial affairs.
Chief Risk	Responsible for overall management of risk controls, including the setting and managing of risk exposures, and reporting directly to the Board in relation to its risk management arrangements.
Chief Operations	Responsible for the management of operations and for reporting directly to the Board on the operations function.
Chief Information	Responsible for the management of information technology and for reporting directly to the Board on the information technology function.
Head of Internal Audit	Responsible for the management of the internal audit function and for reporting directly to the Board on the internal audit function.
Head of a Foreign Bank Branch	Ordinarily resident in Australia and responsible for the conduct of the Australian branch operation of a foreign ADI. This function already exists under APRA's prudential standard CPS 510.

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?

CHAPTER 5 — EXPECTATIONS OF ADIS AND ACCOUNTABLE PERSONS UNDER THE BEAR

CONTEXT

In the 2017-18 Budget, the Government announced that the behaviour and conduct of ADIs and their accountable persons must meet the expectations of the community. New statutory expectations will require ADIs and their accountable persons to conduct their business consistently with good prudential outcomes, and will cover matters such as conducting business with integrity, due skill, care and diligence and acting in a prudent manner.

This chapter provides further detail on the new expectations under the BEAR.

POLICY CONSIDERATIONS

The new expectations are intended to make clear the expected conduct of ADIs and their accountable persons. The objective is to improve conduct by setting a standard of behaviour and deterring inappropriate conduct that falls outside the new expectations.

The new expectations are intended to identify a heightened standard of conduct or behaviour rather than replacing existing concepts such as contained in APRA's Fit and Proper framework.

The BEAR will apply where there is poor conduct or behaviour that is of a systemic and prudential nature.

ASIC will remain responsible in its role as conduct regulator.

One potential approach in identifying the new expectations for ADI groups and accountable persons is to draw upon the expectations of behaviour contained in the SMR and the Fundamental Rules in the United Kingdom, as outlined in Appendix A, but keeping the focus on systemic and prudential matters.

Using this approach, an ADI would be expected to:

- conduct its business with integrity;
- conduct its business with due skill, care and diligence;
- deal with APRA in an open and cooperative way; and
- take reasonable steps to:
 - act in a prudent manner, including by meeting all of the requirements of APRA's prudential standards, and maintaining a culture which supports adherence to the letter and spirit of these standards;
 - organise and control its affairs responsibly and effectively; and
 - ensure that these expectations and accountabilities of the BEAR are applied and met throughout the group or subgroup of which the ADI is parent.

An accountable person would be expected to:

- act with integrity, due skill, care and diligence and be open and co-operative with APRA; and
- take reasonable steps to ensure that:
 - the activities or business of the ADI for which they are responsible are controlled effectively;
 - the activities or business of the ADI for which they are responsible comply with relevant regulatory requirements and standards;
 - any delegations of responsibilities are to an appropriate person and those delegated responsibilities are discharged effectively; and
 - these expectations and accountabilities of the BEAR are applied and met in the activities or business of the ADI group or subgroup for which they are responsible.

QUESTIONS

4. Do the options canvassed for the expectations of ADIs capture the behaviours that should be expected under the BEAR?
 - 4.1. Are there any other behaviours which should be included?
 - 4.2. Should any of the behaviours be excluded?
5. Do the options canvassed for the expectations of accountable persons capture the behaviours that should be expected under the BEAR?
 - 5.1. Are there any other behaviours which should be included?
 - 5.2. Should any of the behaviours be excluded?

CHAPTER 6 — REMUNERATION

CONTEXT

In the 2017-18 Budget, the Government announced that:

- a minimum of 40 per cent of an ADI executive's variable remuneration — and 60 per cent for certain ADI executives such as the CEO — will be deferred for a minimum period of four years; and
- APRA will have stronger powers to require ADIs to review and adjust remuneration policies when APRA believes these policies are producing inappropriate outcomes.

This chapter provides further detail on these remuneration elements of the BEAR.

POLICY CONSIDERATIONS

Remuneration policy should be aligned with sound and effective risk management and should not incentivise a short-term focus or excessive risk-taking. Deferring variable remuneration is aimed at providing an appropriate period of time for risks to crystallise and for variable remuneration to be adjusted downwards as a result. The intention is to better align the realisation of risk with reward.

A potential consequence of requiring variable remuneration to be deferred is that firms may adjust pay structures, shifting the balance of payment from variable to base remuneration. As a result, individuals may face reduced incentives to engage in, or create a culture of short-term excessive risk taking. This raises the question as to whether a shift from variable to base pay is problematic and, if so, what, if anything, should be done to prevent this outcome.

The remuneration elements of the BEAR are specifically intended to enhance accountability for executive accountable persons by ensuring there are financial consequences for conduct that does not meet the new expectations of the BEAR. The BEAR is intended to build on rather than replace APRA's existing prudential standards on remuneration. These prudential standards will continue to apply more widely than to executive accountable persons and APRA is currently undertaking further work in this area.

Executive Accountable Persons

The remuneration elements of the BEAR will apply to accountable persons that perform executive functions only. Accountable persons that perform oversight roles are not covered because, under the ASX Corporate Governance Council *Corporate Governance Principles and Recommendations*, they should not receive variable remuneration.

Variable remuneration

The objective in defining variable remuneration is to provide sufficient clarity as to whether current remuneration structures are within scope for the purposes of the BEAR. In addition, the aim is to future-proof the definition. It needs to be sufficiently principles-based so as to provide clarity as to the BEAR's application to future remuneration structures.

Variable remuneration could be defined to include that part of total remuneration that is discretionary and conditional upon performance and the delivery of results, including individual and business performance and results. The definition could clarify that it is

intended to reward performance and the delivery of results in excess of that required to fulfil a job description.

Deferral of 60 percent of variable remuneration

The intention in deferring 60 percent of the variable remuneration of certain executive accountable persons is to enhance the accountability and financial consequences for those individuals whose decisions can have the largest impact on the ADI sector and its customers. It is important to ensure that these individuals in particular are focused on longer-term outcomes.

It is proposed to apply 60 percent deferral to all CEOs of ADIs. One option would be to borrow from the UK approach outlined in Appendix A and also apply 60 percent deferral to the most senior accountable persons performing executive roles in the domestic systemically important banks (D-SIBs).

APRA's remuneration powers

The existing APRA prudential standards on remuneration require APRA-regulated entities to have remuneration policies which provide for the downwards adjustment of performance-based remuneration if necessary to protect the financial soundness of an institution or to respond to significant unexpected or unintended consequences. APRA can already direct APRA-regulated firms to change their remuneration policies to provide for this downward adjustment in variable remuneration.

APRA will be given enhanced statutory powers to direct ADIs to review and adjust remuneration policies when APRA believes these policies are producing inappropriate outcomes. In particular, the enhanced power should apply so that the variable remuneration of an executive accountable person will be reduced where he or she does not meet the new expectations of the BEAR and is consequently removed and/or disqualified.

QUESTIONS

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?
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?
9. Is the proposal for deferring 60 percent of the variable remuneration of certain executive accountable persons appropriate?
10. Are the proposed enhancements to APRA's remuneration powers appropriate?

CHAPTER 7 — IMPLEMENTATION AND TRANSITIONAL ISSUES

REGISTRATION AND ACCOUNTABILITY MAPPING

CONTEXT

In the 2017-18 Budget, the Government announced two mechanisms to clarify responsibilities and enhance oversight of accountable persons — registration of accountable persons with APRA and accountability mapping of accountable persons within each ADI.

This section canvasses options for designing an effective registration and accountability mapping system.

POLICY CONSIDERATIONS

The purpose of the registration and accountability mapping mechanisms is to:

- help ensure that if an individual is not suitable or has been found not to have met the expectations of an accountable person in the past, he or she is not registered as an accountable person;
- promote a clear understanding of the responsibilities of accountable persons on an individual level and the allocation of responsibilities across an ADI group or subgroup; and
- make it easier to hold an individual to account if he or she does not meet new expectations within the activities or business of ADI group or subgroup for which he or she is responsible.

Registration

ADIs will be required to register accountable persons with APRA. This mechanism will operate by requiring ADIs, prior to appointing an individual as an accountable person, to advise APRA of the potential appointment and provide APRA with information regarding the candidate's suitability.

Upon notification, APRA would consult its register of accountable persons and advise the ADI if the candidate has previously been removed or disqualified by APRA, or if APRA is aware of any other issues that could affect the candidate's suitability for the role. It is not intended that ADIs be able to consult the register themselves. In order to ensure that the register is internal to APRA it may be necessary to provide exceptions from information law regimes, such as the Freedom of Information Act and the Privacy Act.

Under this notification and registration system, ADIs will maintain responsibility for assessing suitability and appointing accountable persons. This responsibility will not shift to APRA. However, the prior notification requirement will help ensure that APRA has visibility of accountable persons and enable APRA to advise ADIs of its concerns prior to an appointment being made.

An appropriate transition period will need to be provided for the registration of accountable persons.

Accountability mapping

ADIs will also be required to provide APRA with accountability statements to detail the roles and responsibilities of each accountable person. These individual accountability statements should also be consolidated into a clear and comprehensive accountability map to detail the allocation of roles and responsibilities across the ADI group or subgroup.

These accountability statements and maps should be provided at the time of registration of an individual and on an ongoing basis as roles and responsibilities of accountable persons change.

The accountability maps should cover a sufficient range of responsibilities to take into account all aspects of an ADI group's or subgroup's operations, including but not limited to its governance mechanisms, risk frameworks, internal procedures and systems, compliance with prudential standards, and activities and businesses. There should be a sufficient nexus between the responsibilities assigned to an accountable person and the role they perform in order for accountability mapping to be effective in identifying the right person to hold accountable where issues arise in a particular area of the ADI group or subgroup.

One potential approach for developing the accountability mapping mechanism is to leverage the Senior Managers Regime in the United Kingdom, as outlined in Appendix A, by prescribing a minimum set of responsibilities across an ADI group or subgroup that must be allocated to accountable persons. The prescribed responsibilities would not necessarily have to be exhaustive, with ADIs having discretion to allocate additional responsibilities.

An appropriate transition period will need to be provided for the production of accountability statements and maps.

QUESTIONS

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?

REMOVAL AND DISQUALIFICATION

CONTEXT

In the 2017-18 Budget, the Government announced that APRA will be given enhanced powers to remove and disqualify senior executives and directors. These enhanced powers will apply to all institutions regulated by APRA. Persons removed or disqualified under these powers will have a right of appeal.

This section details options for enhancing APRA's removal and disqualification powers.

POLICY CONSIDERATIONS

The new powers will enhance APRA's existing powers to remove and disqualify persons from APRA-regulated institutions.

- APRA already has the power to direct an ADI or authorised non-operating holding company (NOHC) to remove a director or senior manager if APRA is satisfied that the person is disqualified from acting in that position, or does not meet the fit and proper criteria set out in the prudential standards. A similar power exists in relation to other APRA-regulated institutions.
- This is in addition to a broad power for APRA to issue a direction to an ADI or authorised NOHC in a range of circumstances, including to remove a director or senior manager. A similar power exists in relation to other APRA-regulated institutions.
- APRA may also apply to the Federal Court to disqualify a person from being a senior manager, director or auditor of an ADI or authorised NOHC where the Court is satisfied the person is not a fit and proper person for such a role. A similar power exists in relation to other APRA-regulated institutions.

Enhanced powers are intended to make it easier for APRA to ensure that individuals who do not meet standards of competency and conduct cannot remain in their position, whilst ensuring those persons receive due process and have appropriate mechanisms to seek review. Enhanced powers will apply to all APRA-regulated institutions in order to maintain consistency in APRA's processes across regulated institutions.

One potential approach for enhancing powers is to permit APRA to disqualify a person without applying to the Federal Court. APRA could have the power to disqualify a person from being a senior manager, director or auditor of an APRA-regulated institution or NOHC where it is satisfied the person is not a fit and proper person for the role, subject to appeal.

The scope of individuals to whom the removal and disqualification powers should apply, and the test for its application, should be enhanced. While APRA already has powers in relation to directors, senior managers and auditors, it should be given power in relation to accountable persons. In particular, APRA should be given the power to remove or disqualify an accountable person where it is satisfied an individual does not meet the new expectations under the BEAR.

To help it enforce the enhanced powers, APRA may require ADIs to inform it where individuals have been subject to internal disciplinary proceedings, including where they have been subject to dismissal, suspension or a reduction in variable remuneration for not meeting the new expectations under the BEAR. Exceptions from information law regimes, such as the Freedom of Information Act and the Privacy Act, may be helpful.

It is important that the prospect of removal and/or disqualification of individuals should have a deterrent effect against poor behaviour. In order to achieve such a deterrent effect, it may be necessary to prevent individuals from taking out insurance against removal and/or disqualification.

QUESTIONS

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

CIVIL PENALTIES

CONTEXT

In the 2017-18 Budget, the Government announced a new civil penalty for ADIs that fail to meet the new expectations of the BEAR, with a maximum penalty of \$200 million for larger ADIs and \$50 million for smaller ADIs. There should also be penalties for ADIs that do not appropriately monitor the suitability of accountable persons.

This section details options for designing these new civil penalties for ADIs.

POLICY CONSIDERATIONS

The application of civil penalties is primarily intended to deter ADIs and their groups and subgroups from acting in a way that does not meet the new expectations of the BEAR. The prospect of civil penalties should provide a strong motivation for ADIs and their groups to act appropriately.

It is proposed that APRA should be able to seek a civil penalty in a range of circumstances, including where:

- an ADI fails to meet the new expectations of an ADI under the BEAR;
- an ADI fails to hold accountable persons to account under the BEAR; and
- an ADI does not appropriately monitor the suitability of accountable persons.

The distinction between civil penalties for small and large ADIs is intended to enhance the deterrent effect. The quantum of the penalty should be large enough to impact the ADI given its size and should consequently create an incentive for the ADI to avoid the penalty. It is proposed that an appropriate threshold for defining large ADIs is total liabilities greater than \$100 billion.

In order to enhance the deterrent effect, it may be necessary to prevent ADIs from taking out insurance against civil penalties.

The civil penalties are maximums. It is proposed that a court would determine whether there has been a contravention of a civil penalty provision and would have discretion as to what penalty to impose up to the maximum. It is intended that there should be proportionality between the seriousness of the contravention and the quantum of the penalty.

QUESTIONS

14. Are the proposed circumstances in which the civil penalties should apply appropriate?
15. Is the proposed definition of large ADIs appropriate?

GENERAL IMPLEMENTATION AND TRANSITION ISSUES

It would be desirable to legislate and implement the BEAR as soon as possible. This would benefit ADI customers. However, it is recognised that in order to implement the BEAR, ADIs will need time to undertake changes to systems, structures, policies and contracts. In addition, ADIs will need time to register existing accountable persons with APRA and develop accountability statements for these individuals and accountability maps for the ADI group.

QUESTIONS

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

APPENDIX A — KEY FEATURES OF INTERNATIONAL RESPONSIBILITY AND ACCOUNTABILITY FRAMEWORKS

This Appendix outlines the key features of the:

- United Kingdom’s Senior Managers Regime and other elements of the UK regulatory framework that relate to the BEAR; and
- Hong Kong’s Managers-in-Charge measures.

SENIOR MANAGERS REGIME (SMR) AND OTHER ELEMENTS OF THE UK REGULATORY FRAMEWORK THAT RELATE TO THE BEAR (UNITED KINGDOM)

In March 2016, the Prudential Regulation Authority (PRA) and the Financial Conduct Authority (FCA) introduced new measures to increase individual accountability within the UK financial sector. The key elements are as follows:

- The SMR prescribes a set of Senior Management Functions (SMFs). Individuals performing SMFs are subject to regulatory approval. A list of SMFs is at Table A1.
- The SMR also specifies Prescribed Responsibilities (PRs) which must be allocated between individuals performing SMFs within an entity. A list of prescribed responsibilities is at Table A2.
- Entities are required to complete Statements of Responsibilities for each SMF, detailing that SMF’s areas of responsibility within the entity, including any PRs. Regulated entities are also required to record the allocation of PRs across the entity in a Management Responsibilities Map.
- Conduct rules set out high level standards and behaviours, as follows:
 - Individuals must act with integrity; due skill, care and diligence; and be open and cooperative with the FCA and the PRA and other regulators; and
 - SMFs must:
 - : take reasonable steps to ensure that the business of the firm for which they are responsible is controlled effectively;
 - : take reasonable steps to ensure that the business of the firm for which they are responsible complies with the relevant requirements and standards of the regulatory system;
 - : take reasonable steps to ensure that any delegation of their responsibilities is to an appropriate person and that they oversee the discharge of the delegated responsibilities effectively; and
 - : disclose appropriately any information of which the FCA or PRA would reasonably expect notice.
- Employees who are not subject to SMR but who are significant risk takers are subject to a certification regime, under which entities must assess their fitness and propriety.

- The SMR applies to banks, building societies, credit unions, large investment firms, branches of foreign banks operating in the UK. A similar regime applies to insurance firms. The SMR will be extended to all remaining financial services firms by 2018.

Separate to the SMR but relevant to the BEAR, regulated entities are subject to:

- Fundamental rules which require them to:
 - conduct their business with integrity;
 - conduct their business with due skill care and diligence;
 - act in a prudent manner;
 - at all times maintain adequate financial resources;
 - have effective risk strategies and risk management systems;
 - organise and control its affairs responsibly and effectively;
 - deal with its regulators in an open and cooperative way and disclose to the PRA anything of which the PRA would reasonably expect notice; and
 - prepare for resolution so, if the need arises, it can be resolved in an orderly manner with a minimum disruption of critical services.
- Remuneration rules which require that at least 60% of variable remuneration must be deferred where:
 - it is £500,000 or more; or
 - it is payable to the director of a firm that is significant in terms of its size, internal organisation, and the nature, scope and complexity of its activities.

MANAGER-IN-CHARGE (MIC) MEASURES (HONG KONG)

In April 2017, Hong Kong's Securities and Futures Commission (SFC) introduced MIC measures which aim to: clarify which individuals should be regarded as the senior management of a licensed corporation; promote awareness of the regulatory obligations and potential liabilities of senior management; clarify that certain members of senior management should seek the SFC's approval to be responsible officers (ROs); outline the roles and responsibilities of a licensed corporation's Board of Directors; and provide guidance on the submission of information in respect of human resources and organisational structures.

The key elements of the MIC which relate to the BEAR are as follows:

- Licensed corporations should appoint at least one individual to each of the following MIC core functions:
 - Overall Management Oversight;
 - Key Business Line;
 - Operational Control and Review;

- Risk Management;
 - Finance and Accounting;
 - Information Technology;
 - Compliance; and
 - Anti-Money Laundering and Counter Terrorist Financing.
- In determining whether an individual is an MIC of a core function, licensed corporations should take into account the individual’s authority and seniority and ensure the individual is fit and proper and qualified.
 - MICs who perform the Overall Management Oversight and/or Key Business Line core functions are required to be approved as ROs.
 - Licensed corporations are required to submit the names, core functions and reporting lines for each MIC to the SFC. Licensed corporations should also submit organisational charts to illustrate all MICs identified for core functions, their reporting lines and the personnel reporting directly to them.

Table A1 — Senior Management Functions*

PRA-designated functions	FCA-designated functions
Chief Executive	Executive Director
Chief Finance	Head of Compliance
Chief Risk	Money Laundering Reporting Officer
Head of Internal Audit	Other Overall Responsibility
Head of Key Business Areas	Chair of the Nomination Committee
Group Entity Senior Manager	Overseas Branch Senior Manager
Credit Union Senior Manager	Notified Non-Executive Director
Chair	
Chair of the Risk Committee	
Chair of the Audit Committee	
Chair of the Remuneration Committee	
Senior Independent Director	
Head of Overseas Branch	
Chief Operations	

* The functions applicable depend on the type of firm in question.

Table A2 — Prescribed Responsibilities

All firms
Responsibility for the firm's performance of its obligations under the senior management regime
Responsibility for the firm's performance of its obligations under the employee certification regime
Responsibility for compliance with the requirements of the regulatory system about the management responsibilities map
Overall responsibility for the firm's policies and procedures for countering the risk that the firm might be used to further financial crime
Responsibility for the allocation of all prescribed responsibilities
All firms except small firms
Responsibility for: (a) leading the development of; and (b) monitoring the effective implementation of; policies and procedures for the induction, training and professional development of all members of the firm's governing body
Responsibility for monitoring the effective implementation of policies and procedures for the induction, training and professional development of all persons performing designated senior management functions on behalf of the firm other than members of the governing body
Responsibility for overseeing the adoption of the firm's culture in the day-to-day management of the firm
Responsibility for leading the development of the firm's culture by the governing body as a whole.
Responsibility for: (a) safeguarding the independence of; and (b) oversight of the performance of; the internal audit function in accordance with SYSC 6.2 (Internal Audit)
Responsibility for: (a) safeguarding the independence of; and (b) oversight of the performance of; the compliance function in accordance with SYSC 6.1(Compliance)
Responsibility for: (a) safeguarding the independence of; and (b) oversight of the performance of; the risk function in accordance with SYSC 7.1.21R and SYSC 7.1.22R (Risk control)
Responsibility for overseeing the development of, and implementation of the firm's remuneration policies and practices in accordance with SYSC 19D (Remuneration Code)
Responsibility for the independence, autonomy and effectiveness of the firm's policies and procedures on whistleblowing, including the procedures for protection of staff who raise concerns from detrimental treatment
Management of the allocation and maintenance of capital, funding and liquidity
The firm's treasury management functions
The production and integrity of the firm's financial information and its regulatory reporting in respect of its regulated activities
The firm's recovery plan and resolution pack and overseeing the internal processes regarding their governance
Responsibility for managing the firm's internal stress-tests and ensuring the accuracy and timeliness of information provided to the PRA and other regulatory bodies for the purposes of stress-testing
Responsibility for the development and maintenance of the firm's business model by the governing body
Responsibility for the firm's performance of its obligations under Fitness and Propriety (in the PRA Rulebook) in respect of its notified non-executive directors

Specific types of firms

If the firm carries out proprietary trading, responsibility for the firm's proprietary trading activities

If the firm does not have an individual performing the Chief Risk function, overseeing and demonstrating that the risk management policies and procedures which the firm has adopted in accordance with SYSC 7.1.2 R to SYSC 7.1.5 R satisfy the requirements of those rules and are consistently effective in accordance with SYSC 4.1.1R

If the firm outsources its internal audit function taking reasonable steps to ensure that every person involved in the performance of the service is independent from the persons who perform external audit, including

- (a) Supervision and management of the work of outsourced internal auditors and
- (b) Management of potential conflicts of interest between the provision of external audit and internal audit services

If the firm is a ring-fenced body, responsibility for ensuring that those aspects of the firm's affairs for which a person is responsible for managing are in compliance with the ring-fencing requirements.

Overall responsibility for the firm's compliance with CASS

Small firms only

Responsibility for implementing and management of the firm's risk management policies and procedures

Responsibility for managing the systems and controls of the firm

Responsibility for managing the firm's financial resources

Responsibility for ensuring the governing body is informed of its legal and regulatory obligations
