



Submission – *Treasury Laws Amendment (Banking Executive Accountability and Related Measures) Bill 2017.*

Bank of Queensland Limited

29 September 2017

The Bank of Queensland (**BOQ**) is pleased to provide this submission in relation to the *Treasury Laws Amendment (Banking Executive Accountability and Related Measures) Bill 2017 (Draft Bill)*.

1. **APRA's role**

The Banking Executive Accountability Regime (**BEAR**) will expand the role and enforcement powers of the Australian Prudential Regulation Authority (**APRA**) in relation to authorised deposit-taking institutions (**ADIs**). APRA will become an enforcement regulator that will be required to work alongside other enforcement regulators, particularly the Australian Securities and Investment Commission (**ASIC**). BOQ wants to ensure it maintains a close and productive relationship with both APRA and ASIC but is concerned that the Draft Bill does not address how APRA's changing role and responsibilities will be managed with the roles and responsibilities of other regulators. There are a number of areas where the obligations of ADIs to APRA under the Draft Bill and the ASIC under existing legislation would overlap (for example, breach reporting).

It is therefore essential that there be clarity as to how the roles of APRA and ASIC will be managed efficiently and productively.

Recommendations

Further consideration should be given to whether the implementation of the Draft Bill could have unintended consequences arising from the change in APRA's role.

In addition to other recommendations made in this submission in relation to the clarification of the scope of the BEAR and APRA's role, BOQ strongly encourages APRA and ASIC to issue joint guidance on how the regulators will coordinate and respond to issues that may be the subject of dual regulation.

2. **Disqualification powers of APRA**

The Banking Act already contains provisions by which the Court can on application by APRA make an order disqualifying persons from being or acting as directors or senior managers of ADIs.¹

The Draft Bill proposes that APRA, without Court Order, have a separate power to disqualify a person from being or acting as an accountable person with effect not earlier than seven days after notice of the disqualification is given.²

The Draft Bill sets out a process requiring APRA to give the person and the relevant ADI an opportunity to make submissions before the disqualification, and permitting APRA to "*discuss any matter contained in the submission with such persons as it considers appropriate for the purpose of assessing the truth of the matter.*" APRA is almost entirely unconstrained by the Draft Bill as to how it conducts this process.

APRA's proposed powers in relation to disqualification fundamentally infringe on entrenched principles of fairness and could be considered to allow the arbitrary exercise of power in contravention of the rule of law. At the least, the provisions relating to APRA's proposed power to disqualify are deficient in relation to natural justice.

Recommendation

APRA should not have the power to disqualify accountable persons without Court order. The existing power of the Court to make orders disqualifying directors and senior managers on application of APRA should instead be extended to the disqualification of any accountable persons. If APRA is to have the power to disqualify an accountable person without Court order, then that power should be subject to a procedural process which affords natural justice to the ADI and the accountable person.³

¹ Section 21 of the Banking Act.

² Section 37J of the Draft Bill.

³ Such as those that apply to ASIC under section 920A(2) of the Corporations Act, Division 6 of Part 3 of the *Australian Securities and Investments Commission Act 2001* (Cth) and ASIC Regulatory Guide 8.

3. Examination powers of APRA

The Draft Bill proposes to give APRA powers to conduct examinations.⁴ Paragraph 1.138 of the EM states that it is not intended that the additional powers granted to APRA to conduct examinations be limited to use in respect of the BEAR only. This is a further issue which will inform the change in APRA's role.

The Draft Bill includes a provision which would permit APRA to provide copies of transcripts of examinations to potential private litigants.⁵

In the context of prudential supervision and the accountability obligations in the Draft Bill (a contravention of which would not itself give rise to any cause of action by private litigants), it is not appropriate or desirable for APRA to provide copies of transcripts to potential private litigants.

Recommendation

The transcripts of examinations conducted by APRA should be required to be kept confidential. APRA should not be permitted to provide copies of transcripts of examinations to potential private litigants.⁶

4. Scope of the BEAR obligations

The gateway to the expansion of APRA's role is the imposition of the accountability obligations on ADIs and accountable persons, which APRA will have the responsibility and powers to enforce.

The accountability obligations in the Draft Bill would require ADIs and accountable persons taking reasonable steps to prevent "*matters arising that would affect the prudential standing or reputation of the ADI*".⁷

It is not clear what is meant by "*prudential standing*" or "*reputation*" in this context and whether those terms are to be read conjunctively. There is also no requirement of materiality.

Consistent with the object of the BEAR and APRA's role, it is only the prudential "*reputation*" that should be the subject of an accountability obligation and there is no clear difference between "*prudential standing*" and "*prudential reputation*".

Recommendation

The requirement should be to take reasonable steps to prevent "*matters arising that would affect materially the prudential standing of the ADI*" and the term "*prudential standing*" should be defined.

5. Application to subsidiaries of ADIs

In the Draft Bill, the BEAR applies to subsidiaries of ADIs to the extent that accountable persons are defined by reference to subsidiaries and by requiring ADIs to take reasonable steps to ensure that their subsidiaries comply with the accountability obligations as if they were ADIs.

The definition of accountable persons in the Draft Bill would mean that any person with "*management or control of a significant or substantial part or aspect of ... a subsidiary's operations*" is an accountable person for the purposes of the BEAR irrespective of the significance or size of the relevant subsidiary to the ADI.

This definition is inconsistent with the intention described in the Explanatory Memorandum (EM) for the Draft Bill, being that accountable persons are to have responsibility where the "*activities of the*

⁴ Sections 61A to 61E of the Draft Bill.

⁵ Section 61D of the Draft Bill.

⁶ Section 61D of the Draft Bill.

⁷ Sections 37C(c) and 37CA(1)(c) of the Draft Bill.

subsidiary are significant”, that a person will be an accountable person if they have “*management or control of a substantial part of the ADI group’s operations*” and that “*it is not the Government’s intention that simply being in a management role in a subsidiary means the person is an accountable person*”.⁸

The definition is also unclear as to the test to be applied when determining whether a part or aspect of a subsidiary’s operation is “*significant or substantial*”.

Recommendation

BOQ supports the Australian Bankers’ Association’s (**ABA**) recommendation that the BEAR should apply to an ADI group and that accountable persons must have effective responsibility for the whole, or a substantial part of, the ADI group.

Alternatively, if the approach in the Draft Bill is maintained, then the definition of accountable person in section 37BA(1)(b) of the Draft Bill should provide that a person is an accountable person of an ADI or a subsidiary of an ADI if the person holds a position in, or relating to, the ADI or subsidiary and because of that position has actual or effective responsibility:

- “(i) for management or control of the ADI; or
- (ii) for the management or control of a part or aspect of the operations of the ADI or subsidiary, which part or aspect is significant or substantial to the ADI”⁹

and the terms “*significant*” and “*substantial*” should be clearly defined.¹⁰

6. **Standard for assessment of breach and taking reasonable steps**

The Draft Bill is silent as to the standard that will be applied in assessing whether an accountable person has failed to comply with the accountability obligation to conduct the responsibilities of his or her position as an accountable person with honesty and integrity, and with due skill, care and diligence.¹¹

The standard applied in assessing compliance with the accountability obligations under the BEAR should be consistent with the well-known and judicially considered standard that applies to existing duties imposed on directors and officers of ADIs under the *Corporations Act 2001* (Cth) (**Corporations Act**).

Further, the qualifications and defences applying to the duties imposed on directors and officers under the Corporations Act should be incorporated into the BEAR as “*reasonable steps*” that can be taken by accountable persons to comply with the accountability obligations.

Recommendation

BOQ supports the ABA’s recommendations that the BEAR should provide that:

- (a) the responsibilities of an accountable person should be discharged to the standard a reasonable person would exercise subject to the circumstances of the relevant entity, role and scope of responsibility at the relevant time (consistent with the standard applied in section 180(1) of the Corporations Act); and
- (b) the “*reasonable steps*”¹² that can be taken to comply with the accountability obligations should include the defences and qualifications that apply under section 180 of the Corporations Act

⁸ See paragraphs 1.29, 1.30, 1.79 and 1.80.

⁹ This drafting is consistent with section 37D(1)(a)(i) of the Draft Bill.

¹⁰ It is noted that the terms “*significant*” and “*substantial*” are also used in sections 37BA(3)(b) and 37D(1)(a)(i) of the Draft Bill; definitions for the terms would also assist in the interpretation of those sections.

¹¹ Section 37CA(1)(a) of the Draft Bill.

¹² Sections 37CA(1)(c) and 37CB of the Draft Bill.

(such as the business judgment rule, the ability of directors to rely on expert advice and delegations).

7. **Responsibility for management of “financial resources”**

The Draft Bill provides that a person who has “*management of the ADI’s financial resources*” is an accountable person. The meaning of this phrase is unclear. It could mean overall responsibility for all of the ADI’s “*financial resources*”, or could mean responsibility for discrete areas of “*financial resources*” which could include for example debt, equity and human resources.

Recommendation

The responsibility for “*management of the ADI’s financial resources*” should be amended to make clear that the responsibility is for “**overall management of all of the ADI’s financial resources**” and by defining the meaning of “*financial resources*”.

8. **Joint responsibility**

The Draft Bill proposes that where more than one accountable persons have the same responsibility, those persons have the accountability obligations jointly in relation to that responsibility.¹³

The Draft Bill does not deal with how the provisions relating to the reduction of remuneration and disqualification consequent upon failures to meet accountability obligations operate in circumstances where the accountability obligations are held jointly.

Recommendation

The BEAR should provide that where more than one accountable persons have the same responsibility, those responsibilities are held individually and on the basis that each such accountable person is not liable for, and cannot have his or her remuneration reduced or be disqualified on the basis of, a failure by any such other person.

9. **Legal professional privilege**

The accountability obligations in the Draft Bill require ADIs and accountable persons to deal with APRA in an “*open, constructive and co-operative way*”.¹⁴

Whilst the EM states that the obligations to deal with APRA openly do not displace legal professional privilege, APRA could still seek to argue that the privilege is abrogated by these obligations despite authorities in relation to this issue in the context of other legislation. The argument could be supported by the proposition that the word “*open*” must be given some meaning beyond “*constructive and co-operative*”.

This issue is of particular concern as the Draft Bill does not expressly provide that persons in the legal function of an ADI, such as the general counsel, will be excluded from the definition of accountable persons.

The person with responsibility for the legal function of an ADI should be excluded from the definition of accountable person because that person should not be regarded as fulfilling a prudential function. The person with responsibility for the legal function is required to 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.

¹³ Section 37CA(2) of the Draft Bill.

¹⁴ Sections 37C(b) and 37CA(1)(b) of the Draft Bill.

Recommendation

The word “*open*” should be deleted from the accountability obligations relating to dealing with APRA.

The person with responsibility for the legal function of an ADI should be expressly excluded from the definition of accountable persons.

10. **Reduction in variable remuneration for “likely” failure to comply**

The Draft Bill proposes to require an ADI to have a remuneration policy that requires that if an accountable person has failed or is “*likely to have failed*” to comply with his or her accountability obligations, then the person’s variable remuneration is to be reduced.¹⁵ The Draft Bill also requires the ADI to ensure that the amount of the reduction is not paid to the person.¹⁶

The Draft Bill proposes to require decisions to be made about the reduction of variable remuneration based on failures or “*likely*” failures to comply, which may require reductions to be made at a time before a finding or determination can be made as to whether there has in fact been a failure.

The Draft Bill does not, however, permit any restitution to the person who has had their remuneration reduced as a result of a “*likely*” failure in the event that it is subsequently found or determined that there was in fact no such failure.

Recommendation

The Draft Bill should remove the requirement that there be any reduction of variable remuneration in respect of “*likely*” failures.

Alternatively, the Draft Bill should allow for a person who has had his or her remuneration reduced as a result of a “*likely*” failure to receive the amount of the reduction in the event that it is subsequently found or determined that there was in fact no such failure.

11. **Determination of a reduction in variable remuneration that is “proportionate”**

The Draft Bill would require that the reduction in variable remuneration payable to an accountable person be “*proportionate*” to that person’s failure or likely failure to comply with accountability obligations.¹⁷

Other than providing that the reduction need not be a reduction of variable remuneration relating to the period in which the failure or likely failure occurred¹⁸, the Draft Bill does not provide any guidance on how an ADI is to determine what is a “*proportionate*” reduction.

Recommendation

The Draft Bill should provide guidance on how an ADI is to determine what is a “*proportionate*” reduction, particularly whether it is to be determined by reference to part or all of the deferred variable remuneration not yet paid to the person, variable remuneration that may be payable to the person in future years (part of which may be deferred under the BEAR) or a combination.

¹⁵ Section 37E(1)(b) of the Draft Bill.

¹⁶ Section 37E(1)(c) of the Draft Bill.

¹⁷ Section 37E(1)(b) of the Draft Bill.

¹⁸ Section 37E(2) of the Draft Bill.

12. Indemnification and insurance

The Draft Bill proposes to prohibit ADIs (and their related bodies corporate) from indemnifying, or paying a premium for a contract insuring, accountable persons against the “consequences” of breaching their obligations.¹⁹

The Corporations Act already contains well understood and applied provisions in relation to the circumstances in which a company is prohibited from indemnifying, or paying a premium for a contract insuring, a person who is or has been an officer.²⁰ The directors and insurers of ADI’s understand those provisions, and the proposed additional regime in the Draft Bill would require extensive and careful consideration. There is no policy reason for different provisions to apply to ADIs, particularly in the uncertain terms proposed.

In addition, the extent to which the proposed prohibition in the Draft Bill would operate is unclear due to the use of the word “consequences” which could arguably cover collateral consequences (such as subsequent civil actions, reputational damage and loss of earning capacity).

Recommendation

The ADIs the subject of the Draft Bill should continue to be subject to the same provisions relating to indemnification of officers, and payment of insurance premiums for officers, as other large companies under the Corporations Act.

BOQ notes that a period of seven days has been provided for submissions in relation to the Draft Bill and that it is proposed that the Draft Bill take effect from 1 July 2018.

In the United Kingdom, the legislation that gave effect to the Senior Managers Regime (the *Financial Services (Banking Reform) Act 2013*) was passed in December 2013, but the regime did not begin to apply until March 2016 after extensive consultation between the industry and regulators.

The proposed short period for implementation of the BEAR will burden small and medium ADIs particularly heavily, as the costs of implementation (and compliance) will be largely independent of an ADI’s size. Small and medium ADIs will incur higher costs relative to their total revenue or assets and, with more limited existing resources than large ADIs, will be under significant pressure to implement fully the BEAR within a short time period.

BOQ encourages the Government to engage in consultation with the industry with the aim of introducing a fair and balanced regime which will effectively and efficiently address its objectives. BOQ supports the position of the ABA that the implementation date of the BEAR be extended to allow for this to occur and to allow for proper implementation by ADIs.

BOQ is also hopeful that the relatively larger costs of implementation and compliance that are faced by small and medium ADIs can be addressed by the favorable exercise of the Minister’s powers to grant exemptions in appropriate circumstances.²¹

End of submission

¹⁹ Section 37KB(2) of the Draft Bill.

²⁰ Sections 199A and 199B of the Corporations Act.

²¹ Sections 37A and 37KA of the Draft Bill.