

23 August 2017

Insurance and Capital Markets Unit Financial System Division
The Treasury
Langton Crescent
PARKES ACT 2600
Via email: bear@treasury.gov.au

Attention: Ms Kate Wall
Manager Banking
Insurance and Capital Markets Unit Financial System Division

Dear Ms Wall,

Review of Banking Executive Accountability Regime

Thank you for the opportunity to provide a submission to Treasury on the Banking Executive Accountability Regime Consultation Paper (**BEAR**), and for your willingness to accept it after the submission deadline.

This Submission

This submission has been prepared through collaboration between the Financial Services Committee and the Corporations Committee of the Business Law Section of the Law Council of Australia.

Our primary submission is that, while we support the Government's desire to ensure that the law imposes high standards of accountability and behaviour, the BEAR is unnecessary and should not be introduced. We have explained our reasoning focused on the following three themes emerging from the *Banking Executive Accountability Regime Consultation Paper* (BEAR Paper):

- Policy considerations
- Co-regulatory issues and
- Competition law.

In considering the issues, we have also commented on safeguards and features which would be important if, contrary to our primary submission, the BEAR regime is implemented. These could partially mitigate, but would not eliminate, our concerns with the BEAR proposals.

In addressing these matters, we have identified (in the heading to each section), the relevance to the 17 questions posed in the BEAR Paper. We have not addressed all questions posed in the BEAR Paper.

1. Policy Considerations: BEAR Paper Questions 1, 2, 3 and 13

Over-arching policy concerns

The Bear Paper characterises the intention of the reforms as being to enhance the responsibility and accountability of ADIs, their directors and senior executives. However, the need for a new regime, focusing upon ADIs alone is not apparent. We submit that there is no evident regulatory gap justifying the impost of the BEAR.

In our view the existing legislative tools available to ASIC are sufficient to meet the underlying intent of the BEAR. We have material concerns about:

- the logic and anti-competitive effect of an additional regime, applied just to ADIs;
- potential inconsistency in interpretation and enforcement, and overlap between, the regimes under the *Corporations Act 2001* (Cth) administered by ASIC and the proposed BEAR to be administered by APRA.

The distinction between behaviour of a systemic and prudential nature to which the BEAR will apply, and other systemic conduct within ASIC's jurisdiction as the conduct regulator, is not apparent. For example, a systemic issue in relation to the assessment of insurance claims could be argued to impact an ADI's prudential standing, notwithstanding the substantial concerns such an issue would raise from a conduct perspective. ASIC is already well placed to regulate such conduct, by virtue of the complementary regulatory powers it already holds, as well as its mission, existing expertise and resources.

We suggest that imposing an additional regime on ADIs and their subsidiaries in the BEAR, would place financial services providers that are not part of an ADI-owned group at an undue competitive advantage, to the potential detriment of consumers.

Onerous obligations may deter high calibre candidates

A second key policy consideration raised by the paper is the incentive effects of the prescriptive requirements that are proposed. For example, designated accountable persons face considerable career risk for events which they may perceive they can not necessarily control or influence.

Our current anecdotal experience with the AFSL responsible manager regime suggests that individuals considering taking up such roles are acutely sensitive to mere perceptions of personal responsibility for the corporation's conduct. These are high risk positions, with a very small pool of people prepared to apply for them. We suggest that higher calibre candidates will not apply for such roles given the associated risks. The result may be a rise in remuneration for such roles, in order to attract candidates who may well not be of an adequate calibre to satisfy the underlying objective of the BEAR.

Civil penalty concerns: BEAR Paper Questions 13 and 14

The BEAR Paper proposes a civil penalty regime with two tiers of penalties for large and small ADIs respectively. The penalties proposed are very significant, so as to maximise the deterrent effect, by making the maximum penalty a substantial proportion of revenue. This measure, however, punishes shareholders rather than punishing those responsible for breach behaviour within the regulated ADI.

We suggest that the enforcement tools already available to ASIC under the Australian financial services licences (AFSL) regime in the *Corporations Act 2001* (Cth), including targeted enforceable undertakings and licence conditions, are sufficient to regulate the conduct of ADIs and their management teams. We understand that the penalties applicable to contraventions which are regulated by ASIC are under review. That is the appropriate forum to consider whether there are any inadequacies in the current penalty regime for the appropriate enforcement of the extensive liability regime which already exists.

2. Co-regulatory issues

Regulatory equity for industry participants

For the reasons explained above it is our strongly held view that the current regulatory regime is adequate and that a regulatory gap analysis does not justify the imposition of the BEAR on ADI groups or any financial services industry participants.

Further, focusing upon ADIs and their subsidiaries alone in the BEAR, places financial services providers that are not part of an ADI-owned group at an undue competitive advantage, to the potential detriment of consumers. It has not been shown that the same concerns applying to ADI-owned financial services providers do not also equally apply to non-bank owned financial services providers, or indeed to other industries which deal with consumers.

The need for regulatory consistency – BEAR Paper question 4

We submit that care needs to be taken to ensure that the BEAR is consistent with existing regulatory regimes. This is fundamental to avoid creating a regime that creates confusion or double jeopardy.

We understand, as per Chapter 2 of the BEAR Paper, that 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. The BEAR Paper then notes various prudential frameworks from APRA and refers in passing to the duties of directors under the *Corporations Act 2001* (Cth).

In our view, the existing powers conferred upon ASIC under the Corporations Act (including sections 180 and 181 of the Corporations Act) suffice to meet the objectives of BEAR if they are appropriately enforced. As noted earlier, we have concerns that where such duties are repeated and/or overlapping in the BEAR, which is administered by another regulator, APRA, the two regulators may take differing or contradictory views on matters of compliance and enforcement. In addition, the risk of double jeopardy arises.

While this overlap could be partially addressed by way of an MOU, in our view even with an MOU a dual regulatory approach is inefficient and causes uncertainty, and it is not appropriate to introduce a legislative regime where double jeopardy can arise for individuals and companies and rely on informal agreement between regulators as the safeguard. To the extent that existing legislative provisions are difficult for ASIC to enforce successfully, imposing the BEAR does not facilitate better enforcement. Rather, it divides and therefore weakens regulatory responsibility for holding accountable persons liable for inappropriate conduct.

We submit further that all board-rooms and senior managers or company officers should be held to the same competence and conduct standards, whether they be accountable persons or not and in the boardroom of or senior officers of an ADI or other company not.

While referring in passing to directors' duties, the BEAR Paper fails does not address the comprehensive requirements for responsible managers to maintain the organisational competence required by holders of AFSL under chapter 7 of the *Corporations Act*. Under section 912A of the *Corporations Act*, a licensee must do all things necessary to ensure that the financial services are provided efficiently honestly and fairly. The BEAR Paper (Chapter 5) proposes similar concepts of integrity, due care, skill and diligence, and acting in a prudent manner. As the chapter 7 AFSL requirements apply to all ADIs, we submit that these AFSL regulatory requirements should also be considered when drafting the BEAR to ensure there is consistency across all frameworks.

The BEAR paper suggests that certain non-executive directors will be accountable persons – for example, the Chairs of the Risk and Audit committees. This suggests that such directors are to be held to a higher account than other directors. This is not consistent with governance standards – no one director can make a decision for such committees. All directors are required to discharge their duties and the collective skill set is applied.

In addition, we note that the application of BEAR to foreign branches and subsidiaries is of material concern as those business must in the first instance comply with the applicable “home” requirements. Compliance with multiple regimes would be costly and confusing, if practicable at all. We suggest that BEAR should apply only on a “group” basis to each ADI, and that in the unlikely event that an executive based in a foreign subsidiary or branch would be an “Accountable Person”, such a person in a foreign branch or subsidiary be exempt from BEAR – or at least in jurisdictions where like regimes apply.

Important partial safeguards if the BEAR regime is introduced:

To partially mitigate the issues we have raised, if (contrary to our submission), the BEAR regime is introduced:

- ***the BEAR legislation should expressly provide that the regime does not apply so as to increase directors' and officers' duties under the Corporations Act (for example, by requiring any higher standard of care. If it does not do so, there is a risk that directors and officers duties will be read as having been expanded by the regime with consequent increased exposure to directors and officers;***
- ***the BEAR legislation should expressly exclude double jeopardy: The regime seeks to penalise ADIs and not individuals. If a civil penalty is imposed against an ADI for conduct of an “Accountable Person”, that person should not be subject to civil penalties under the Corporations Act for the same conduct.***
- ***in setting out the expectations under BEAR, the principles recognised in the Corporations Act as reasonable should be reflected – for example, the concepts of reasonable reliance, the business judgement rule and the good faith standard.***

Scope of Executives affected

The BEAR paper proposes a principles based regime to identify affected persons. This aspect of the regime needs further exploration. It is understood that some flexibility is required to address the variations in structures in firms, however certainty of application is required and the regime must establish processes pursuant to which for a particular ADI the relevant persons are identified and registered so as to be certain for a particular period of time (subject to regular review if required). It would be unfair and contrary to the aims of the legislation to improve accountability if clarity does not exist and the relevant “Accountable Persons” are identified retrospectively. There is no point in deeming accountability after the event.

Determination of breach

The BEAR paper proposes that determinations will be made by APRA while still requiring institutions and individuals to relate to APRA in a frank and open fashion. We consider that any breach decisions should be judicially determined, as under the current regime. This is essential in order to preserve fairness and proper process in decisions which could have career ending impact and in any event material reputational effect. In summary:

- contraventions of the BEAR carry extremely serious ramifications and proper process is essential;
- giving APRA power to make a determination in the first instance would reverse the onus of proof in these most significant matters such that the executive is forced to prove their “innocence” on appeal. This undermines basic Australian jurisprudential principles;
- parties must be able to rely on usual jurisprudence principles of privilege/ no requirement to self-incriminate;
- APRA has to date engaged very constructively with prudentially regulated bodies to effect material change - this form of constructive engagement with the “judge” would be extremely difficult to maintain. If APRA however only resorts to court proceedings as a last resort continued constructive engagement may be able to be maintained;
- Just as the Courts have steered clear of making business judgments on behalf of directors, it would not be appropriate to charge APRA with making what would effectively be business decisions regarding the termination and remuneration of members of the management teams of the entities it regulates.

The current proposal carries a significant risk that the BEAR will deter frank communication with APRA. To be effective in driving cultural and conduct change, the BEAR must take account of learnings of behavioural science and business practicalities for corporate groups of the scale of large ADIs. In particular, the BEAR should recognise that the identification of conduct concerns, even systemic conduct concerns, does not necessarily represent a failure on the part of an executive to take reasonable steps. The identification of a concern, and prompt and constructive engagement to remedy the concern, should be regarded as part of taking reasonable steps. Without clear guidance on this, the BEAR risks driving the very conduct that it seeks to deter.

To partially mitigate the issues we have raised, if (contrary to our submission), the BEAR regime is introduced:

- ***the BEAR should only apply in the most serious of cases – as the BEAR paper recognises its application is to matters of a prudential and systemic nature – it is important to be clear that only such matters are subject to the BEAR regime within the purview of APRA, with the Corporations Act and ASIC continuing to police product and conduct matters. Further clarity is required to ensure this distinction applies - that is, the core “test” requires further detailed examination so that it is clear that the matter must be of a prudential and systemic nature so as to have a materially detrimental impact on the financial system or the relevant ADI and then fall short of the relevant expectations, which as noted above need to recognise what is reasonable, the usual governance principles and the sorts of “defences” set out in the Corporations Act – see above;***
- ***In relation to the requirement that an ADI conduct its business with integrity and with due skill, care and diligence: We submit that the legislation should clarify that only APRA can take action against the ADI in this regard. Absent that qualification, class actions by investors and shareholders would likely result.***

3. Competition issues

The impact upon competition for ADI executives

One of the stated policy objectives underlying the BEAR, is to ensure that senior executives and directors of ADIs are held responsible and accountable for the actions of their organisations, and are appropriately qualified. However, we believe that in implementing these objectives, there is a material risk that senior banking management and executive roles will become comparatively unattractive. The consequence of this may be:

- That the best corporate talent shies away from banking roles (which would be detrimental to the sector) and in turn would result in
- A lower rate of movement into the banking and financial services sector of senior people with more diverse life and corporate experience outside of banking (which is contrary to the underlying intent of the regime). We submit that if ADI culture is to be better aligned with community expectations and generally improved, steps should be taken to encourage more senior people into the sector, from outside of the financial services industry. The BEAR reforms should not dis-incentivise such movement of talent.

Providing a comparative advantage to non-ADI financial services providers

As noted earlier in this submission, the BEAR is intended to regulate ADIs and their affiliated and subsidiary businesses (including credit providers, insurance companies and seemingly

the charitable enterprises run by the larger ADIs). However the BEAR is not proposed cover other participants in the financial sector of equal importance and functionally similar to ADIs activities in many respects, or to industries outside financial services. We note that this would provide those non-ADI affiliated businesses with a competitive advantage over their ADI-affiliated competitors, and provide both non-ADI financial services businesses and other industries with a competitive advantage in the competition for talent over ADI businesses.

Concluding comments

The Committees would be pleased to discuss this submission if that would be helpful. In the first instance, please contact the Acting Chair of the Financial Services Committee, Justi Tonti-Filippini or via email: [REDACTED], Chair of the Corporations Committee, Rebecca Maslen-Stannage, on (02) 9225 5500 or via email: Rebecca.Maslen-Stannage@hsf.com.

Yours sincerely

A handwritten signature in black ink, appearing to read 'Teresa Dyson', with a stylized flourish at the end.

Teresa Dyson
Chair, Business Law Section, Law Council of Australia