3 August 2017

Financial System Division
The Treasury
Langton Crescent
PARKES ACT 2600

By email: bear@treasury.gov.au

Dear Mr McDonald

Bank Executive Accountability Regime

The Financial Services Council (FSC) welcomes the opportunity to provide a submission in relation to the Bank Executive Accountability Regime.

The FSC has over 100 members representing Australia's retail and wholesale funds management businesses, superannuation funds, life insurers, financial advisory networks and licensed trustee companies. The industry is responsible for investing more than $2.7 trillion on behalf of 14 million Australians. The pool of funds under management is larger than Australia's GDP and the capitalisation of the Australian Securities Exchange and is the fourth largest pool of managed funds in the world.

The FSC submission is restricted to those issues relevant to the organisations we represent, which does not include Authorised Deposit-Taking Institutions (ADIs). The FSC also notes that the views expressed in this submission reflect the majority view of our membership, particularly in relation to the scope of the regime, and some organisations may express different positions on some issues.

Please contact me with any questions in relation to this submission on (02) 9299 3022.

Yours sincerely,

Blake Briggs
Senior Policy Manager

Policy Considerations

The FSC understands that the Bank Executive Accountability Regime (BEAR) is partially modelled on the regime implemented by the Prudential Regulation Authority and the Financial Conduct Authority in the United Kingdom.

The UK regime had a similar policy objective, to promote individual accountability within the financial sector, however the policy originated from a different context to the Australian experience. During the financial crisis the UK experienced multiple bank failures and Government bail-outs.

Bank failures and bail-outs were not a feature of the Australian experience of the financial crisis. The Australian banking system remained stable and worked closely and effectively with Government and regulators to navigate the crisis.

It is therefore not immediately apparent what purpose the BEAR is intended to serve in the Australian context. As a matter of principle, however, the FSC supports measures to make the financial services industry more transparent and accountable to consumers, and for this reason the FSC does not oppose the BEAR, but have serious concerns about its design that we outline below. The FSC also recommends an implementation timeframe that reflects the significant complexity of the new regime.

Scope of the BEAR

The regime is named the Bank Executive Accountability Regime. If the regime is to be made into law we believe it ought to apply true to label.

The FSC understands that the proposed scope in Treasury's consultation paper is as a result of the increased scrutiny proposed by the House of Representatives Standing Committee on Economics Review of the four major banks (Coleman Report):

> 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…
>
> 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.

The FSC supports the scope of the BEAR as outlined in the consultation paper. To the extent that additional regulatory oversight is required to prevent misconduct, the FSC submits that this oversight should be restricted to responding to public concerns identified in the Coleman Report from the direct connection to ADIs.

The proposed scope is an effective solution in the context of the complex network of corporate structures that exist in the financial services system. It avoids unnecessarily capturing structures that have no direct connection, or only a tangential relationship, to ADIs.

The proposed scope also navigates, insofar as this is possible, the existing delineation of powers between ASIC and APRA. It would complicate the operation of Australia's established and effective 'Twin Peaks' regulatory framework if new measures blurred the responsibilities of the two regulators.

The FSC submits that a clear delineation of powers between the regulators should be maintained wherever possible.

The FSC submits that for these reasons it is appropriate for life insurance, superannuation, funds management and advice businesses that are not owned by ADIs to be excluded from the scope of the BEAR.

Feedback on Specific Issues

'Accountable person'

The FSC submits that, instead of using the new concept of 'accountable person', it wold be simpler for APRA to adopt the existing idea of 'responsible person' in its Prudential Standard CPS 520. A subset of persons could be designated for enhanced accountability.

These requirements are robust, widely understood and embedded by the industry. Rather than creating a new framework, these requirements should be enhanced to include the relevant components of BEAR.

This proposal would be cheaper and quicker for businesses to implement, while still capturing appropriate individuals.

Non-executive directors

Non-executive directors should be provided a broad based exemption from the scope of the BEAR. Their inclusion risks driving a conversion between their roles and responsibilities and those of management.

Non-executive directors are covered by well-established legal principles governing director's responsibilities and duties. The overall BEAR regime, and as well as the independence and standing of non-executive directors, would be promoted through maintaining the important distinction between them and management.

Obligation to act with integrity, due skill, care and diligence

The obligations to act with integrity, due skill, care and diligence mirror the existing statutory and common law duties of directors and officers. It does not seem helpful to replicate these again in another statute.
ASIC has the responsibility of enforcing these duties and it will be quite confusing if directors and officers are accountable to two regulators with potentially different interpretations and views on the meaning and content of these duties.

Obligation to "take reasonable steps"

The proposed obligation to "take reasonable steps to ensure…" is the same for all accountable persons. However, this fails to recognise that the roles of the Board and Management are different and that the capacity of part-time external non-executive directors to "ensure" something occurs is different from that of executives.

It is not entirely clear whether the concept of an accountable person includes all directors of an ADI (on the basis that they "have significant influence over conduct and behaviour, and whose actions

could pose risks to the business and its customers") or only those holding prescribed functions (the Chair of the Board and the Chairs of the Audit, Risk and Remuneration Committees). This should be clarified in the final legislation.

Further, if only some but not all directors are accountable persons, then some Board members will be held accountable to a higher and different standard than other Board members in relation to the performance and conduct of an ADI, which would be quite unusual.

Conduct expectations

The FSC is concerned that the conduct expected of captured employees is not clear. The FSC would support more information relating to 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.

Further, the enhancement of conduct expectations should be accompanied by longstanding procedural safeguards, such as maintenance of the burden of proof on the regulator and legal recourse to challenge administrative action.

We note that the UK SMCR legislation initially provided for a 'presumption of responsibility' which required individuals to prove to the regulator that they had not broken the rules, rather than the regulator having to prove wrongdoing. However, this presumption reversing the burden of proof was removed by the UK Government prior to the commencement of the UK regime and replaced by a practical 'duty of responsibility'.

Vesting of variable remuneration

The FSC supports the reforms being amended to allow part of the deferred portion of variable remuneration to vest on a pro rata basis in order to minimise relative attractiveness of fixed pay.

Implementation timeframe

The proposed regime is broad and complex. The FSC supports providing affected businesses sufficient time for the regime to be implemented.

The FSC understands that the implementation of the UK regime demonstrated that the allocation of senior management functions and responsibilities to specific individuals, including the development of a comprehensive accountability map, was a complicated process and required adequate transition provisions.

In particular, implementation required a careful review of governance structures and reporting lines, manager remits and bank policies and procedures. In order to ensure individuals understood and had the capability to be accountable to their revised remits and duties, significant engagement with individuals was necessary. This included training for managers designated as senior managers, as well as other employees across the office, to fully embed the requirements.

The FSC would support a two year implementation period from when the requirements are finalised.