**11 August 2017**

Ms Kate Wall
Manager
Banking, Insurance and Capital Markets Unit
Financial System Division
The Treasury
Langton Crescent
PARKES ACT 2600

Email: bear@treasury.gov.au

Dear Ms Wall

# Banking Executive Accountability Regime

Governance Institute of Australia (Governance Institute) is the only independent professional association with a sole focus on whole-of-organisation governance. Our education, support and networking opportunities for directors, company secretaries, governance professionals and risk managers are unrivalled.

Our members have primary responsibility to develop and implement governance and risk frameworks in public listed, unlisted and private companies. They are frequently those with the primary responsibility for dealing and communicating with regulators such as the Australian Securities and Investments Commission (ASIC) and the Australian Prudential Regulation Authority (APRA). In listed companies, they have primary responsibility to deal with the Australian Securities Exchange (ASX) and interpret and implement the Listing Rules. Our members have a thorough working knowledge of the *Corporations Act 2001* (the Corporations Act). We have drawn on their experience in our submission.

Governance Institute of Australia welcomes the opportunity to comment on the *Banking Executive Accountability Regime* (BEAR) and we thank Treasury for allowing us an opportunity to meet with Treasury representatives on 24 July in order to discuss the proposed regime. We also thank Treasury for its forbearance in accepting our submission after the due date for lodgement. The tight deadline set by Treasury did not allow sufficient time for our policy committees to give proper consideration to the submission which is why we were not in a position to lodge it until today.

Due to the comprehensive nature of the proposed legislative regime and the timeframe given to provide a submission, we have not responded to each of the detailed questions set out in the consultation paper but have confined our comments to the following issues.

## Accountability framework

We note that the consultation paper states 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. We also note from our meeting with Treasury that the regime is intended to sit side by side with the existing framework of legislation, guidance and regulation.

The obligations to act with integrity, due skill, care and diligence mirror the existing statutory and common law duties of directors and officers. We consider that it is not helpful to replicate these in another statute and are concerned about the consequences of overlapping and slightly inconsistent regulatory provisions. ASIC has the responsibility of enforcing these duties and confusion is likely to arise if directors and officers are accountable to two regulators with potentially different interpretations and views on the meaning and content of these duties.

In addition, 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 non-executive directors to 'ensure' something occurs is different from that of management.

Governance Institute recommends that any proposed legislation clearly state how the new regime will interact with current provisions to ensure that the regime does not introduce another layer of prudential complexity.

By way of example, the consultation paper refers to the proposed requirement of accountability mapping of accountable persons within each ADI which is aimed to, amongst other things, promote a clear understanding of the responsibilities of accountable persons on an individual level and the allocation of responsibilities across an ADI group. This is aimed at making it easier to hold an individual to account if he or she does not meet new expectations within the activities or business of the ADI group for which he or she is responsible.

ADIs already have in place effective and comprehensive governance and risk management frameworks including delegations of authority which are designed by each ADI to suit their scale, size and complexity.

Governance Institute recommends that the proposed regime take into account existing requirements and avoid duplication of those with which ADIs are currently complying. To do otherwise, would result in further complexity being added to an already highly regulated sector. APRA will also need to consider issuing guidance as to how the new regime fits within existing requirements. Any new requirements must be able to be tailored by the ADI to suit its particular circumstances rather than be a 'one size fits all' prescriptive approach.

## The role of non-executive directors

Governance Institute notes that we raised our concerns at our meeting with Treasury as to how the role of non-executive directors would fit in with the proposed BEAR. As we stated at our meeting, non-executive directors are not involved in the day-to-day management of the organisation and are not employees of the ADI.

To illustrate this, the board of an ADI is responsible for the entity's risk management framework. As part of this role, the Board sets the risk appetite and risk management strategy, oversees the risk management framework and satisfies itself that the framework continues to be sound. It is the role of management to implement that framework and to ensure that the entity operates within the risk appetite set by the board.

As part of this framework, the board and its committees provide oversight of the ADI and the non-executive directors exercise independent judgment. The board also plays an important role in relation to constructively challenging and guiding management. Accordingly, we consider that precisely mapping the accountabilities of non-executive directors is not feasible given the collective responsibilities of the board and the board committees and any attempt to do so may in fact be counter-productive to the proper governance of the ADI. It should also be noted that the APRA Standards and ASX Corporate Governance Principles and Recommendations link the various board (or board committee) related responsibilities to the board (or board committee) itself and not to the individual non-executive directors.

In addition, it is not entirely clear from the consultation paper whether the concept of an accountable person includes all non-executive directors of an ADI or only those holding prescribed functions (the chairs of the board and board committees). If only some but not all non-executive directors are accountable persons, then it follows only 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. This creates unnecessary complexity and confusion.

In light of the above matters, the Governance Institute recommends that any mapping of accountabilities be linked to the board and each of the board committees and not to the individual non-executive directors. This approach is consistent with current requirements and any departure from this will create confusion and complexity in relation to the role of non-executive directors.

## Director liabilities under the BEAR

The Corporations Act contains provisions for the delegation of responsibility by directors to others in an organisation. Section 190(2) limits a director's responsibility for the exercise of power so delegated where a director:

- Believes on reasonable grounds at all times that the delegate would exercise the power in conformity with directors' statutory duties and the company's constitution; and
- The director believed on reasonable grounds, in good faith and after making proper enquiry if the circumstances indicated the need for inquiry, that the delegate was reliable and competent in relation to the power delegated.

The Corporations Act also contains the business judgement rule which provides that a director is taken to have met their obligations of care and diligence if they satisfy the provisions of the section.

Any heightened standards of conduct and behaviour imposed on directors, as accountable persons, under the BEAR must take into account the limitation of a director's liability under section 190 and the provisions of the business judgement rule in section 180 of the Corporations Act.

## Transition period

Governance Institute recommends that there be an adequate transition period which would allow ADIs to be able to comply with the regime in the time provided. We consider that compliance will be challenging for smaller ADIs who are resource constrained, particularly as regards the preparation of the accountability statements and matrices. Developing these documents would be a large and time consuming undertaking and we recommend that these smaller entities be given additional time before the accountability statement and mapping requirements apply to them.

A period of transition will be required for all ADIs to comply with the proposed changes to remuneration, which for listed ADIs will likely require shareholder approval at the AGM. If the regime were enacted by the end of 2017, ADIs would require a period of at least 12 months to allow them to put an amended remuneration policy before shareholders at their AGM with the result that the provisions should not come into operation until the end of 2019.

## Variable remuneration

We note the intention of the legislation to provide that a minimum of 40% of an ADI executive's variable remuneration, and 60% for certain ADI executives such as the CEO – will be deferred for a minimum period of four years in order to ensure that remuneration policy is aligned with sound and effective risk management.

Variable remuneration has not been defined in the consultation paper and the Governance Institute recommends that clarity be provided to avoid confusion and complexity.

Further, as discussed in our meeting with Treasury, the application of a 'one size fits all' approach to remuneration may not be appropriate for small ADIs such as mutual banks, building societies and credit unions which are unlisted and have no shareholders. Executives in these ADIs cannot benefit from awards of shares in the entity or an increase in share value. Variable remuneration in their case is a cash only component.

Governance Institute recommends that the Government implements a proportionate approach to remuneration and take into account the particular scope of role of an individual and the size and complexity of the ADI. We suggest that the Government consider applying a threshold of $500,000 in variable remuneration for small ADIs such as mutual banks, building societies and credit unions.

## Removal and disqualification of senior executives and directors

We note that APRA will be given enhanced powers to remove and disqualify senior executives and directors and that consideration is being given to permitting APRA to disqualify a person without applying to the Federal Court. We also note that APRA currently has the power to:

- Direct an ADI to remove a director or senior manager in certain circumstances; and
- Apply to the Federal Court to disqualify a person from being a senior manager, director or auditor.

We question why APRA requires the power of immediate removal and disqualification where it already has the power to apply to the court for such an order. We query whether APRA has applied to the court in the past to remove a director or senior manager and had such an application refused. Governance Institute has concerns about whether natural justice is being served in circumstances where APRA has the power to remove and disqualify persons rather than apply for the court to do so. We consider that the removal and disqualification of a director or senior executive of an ADI would be a measure conducted as a last resort and in extreme circumstances bearing in mind the reputational damage to the affected person which would flow from such an action. Any right of appeal referred to in the consultation paper would be of little comfort to a senior executive or director removed in a blaze of publicity and could only be exercised by incurring the considerable costs of legal action.

We also raise the following issues which would arise in the event APRA removed and disqualified a director or senior executive:

- The test APRA would apply in making its determination to remove and disqualify a director or senior manager and the steps involved. We note that although ASIC has the power to disqualify a director under section 206F of the Corporations Act, the power only arises in specific circumstances and is subject to the steps set out in the section. A director served with a notice of disqualification has an opportunity to present their case before an ASIC delegate as to why they should not be disqualified and section 206F(2) sets out the matters which ASIC must and may take into account when forming its decision whether the disqualification is justified;
- Whether a director or senior executive removed by APRA would be stood down on paid leave while awaiting the outcome of any appeal of APRA's decision or whether their contract with the ADI would be automatically terminated; and
- In removing the CEO of an ADI, APRA is arguably supplanting the role of the board.

Governance Institute does not recommend that APRA be given the power of removal and disqualification and that APRA be required to apply to the Federal Court for orders removing and disqualifying senior executives and directors as is currently the case.

Governance Institute would welcome the opportunity to be involved in further deliberations.

Yours sincerely

Steven Burrell
Chief Executive