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3 August 2017

Mr Tony McDonald
Principal Adviser
Banking, Insurance and Capital Markets Unit
Financial Systems Division
The Treasury
Langton Crescent
Parkes ACT 2600

By email: bear@treasury.gov.au

Dear Mr McDonald,

SUBMISSION ON THE PROPOSED BANKING EXECUTIVE ACCOUNTABILITY REGIME

National Australia Bank Limited (NAB) welcomes the opportunity to comment on the Department of Treasury's consultation paper on the 'Banking Executive Accountability Regime' (the **Consultation Paper**). As a member of the Australian Bankers' Association (ABA), NAB has also contributed to and is supportive of the ABA's submission to this consultation process.

NAB appreciates that the Government is responding to the community's concerns in proposing to enact, among other things, the Banking Executive Accountability Regime (the **BEAR**). The objective of the BEAR is to apply a heightened responsibility and accountability framework to the most senior and influential executives in their Authorised Deposit-Taking Institutions (**ADIs**). It is proposed that this be achieved by enhancing the existing model, not by replacing or changing it.

NAB is concerned that the proposed BEAR might not fully meet its objectives and that there might be unintended consequences. Further, NAB is concerned by the very significant change the proposed legislation would make to our current legal and regulatory framework. We outline these concerns in this submission.

Our key concerns are as follows.

A. Changes to APRA's role and to ADIs' relationships with APRA

The BEAR has the potential to materially change the role of APRA as prudential regulator, and in doing so undermine its supervisory relationship with ADIs. To address this risk, the scope of the BEAR, and APRA's role in conduct regulation, needs to be clearly defined in any new legislation. NAB recommends that this is achieved by reference to matters of a systemic and prudential nature¹ that undermine the financial safety of, and public confidence² in, the relevant ADI group. This

¹ The term, 'systemic and prudential', is proposed on page 7, Chapter 5 of the Consultation Paper.

² The Treasury has indicated that, in carrying out its role, APRA will 'enhance public confidence in Australia's financial institutions through a prudential framework that balances financial safety and efficiency, competition, contestability and competitive neutrality' see: <http://www.treasury.gov.au/PublicationsAndMedia/Publications/2013/PBS-2013-14/Report/APRA>.

scope should operate as a gateway such that conduct not meeting this criterion is not subject to the BEAR. The Corporations Act will continue to regulate criteria for products and conduct at a more specific level.

NAB believes it should also be made clear that the BEAR does not increase existing directors and officers liability³ and this should be explicit in the legislation. Similarly, the BEAR should make clear that the sorts of defences and protections afforded to individuals accused of failing to comply with legal and regulatory obligations, as set out in the Corporations Act, are reflected in the new expectations.

B. APRA's powers in relation to removal and disqualification

The exercise by APRA of its enhanced powers based on the proposed new expectations under the BEAR could result in a fundamental and detrimental shift in regulation of the financial services industry in Australia. It could also mark a departure from Australian legal jurisprudence. Whilst NAB recognises the rationale for providing APRA with enhanced powers in certain circumstances, NAB believes that APRA should not be permitted to disqualify someone without a fair and clearly defined process, including judicial determination of breach, in line with the current requirement for APRA to apply to the Federal Court.

C. The individuals proposed to be covered by the BEAR

It is unnecessary for the BEAR to introduce a new definition of 'accountable persons' since the existing Prudential Standards provide a workable, effective and well understood definition of the most senior and influential executives in an ADI. NAB considers the current 'senior manager' definition in CPS 520 covers those with control and influence and sets an appropriate threshold of materiality in relation to risk. In addition, NAB does not consider it appropriate to include non-executive directors in Chair roles as accountable persons. This does not reflect governance practice/ board structures or the operation of board committees, and creates 'classes' of directors.

Further, NAB emphasises the critical importance – for individuals and ADIs – to have certainty (through the registration process proposed) as to who is an accountable person covered by the BEAR, and the serious undesirability of APRA revisiting the question as to who is an accountable persons with hindsight.

D. Further legislation on senior executive remuneration

An ADI, through its Board and Remuneration Committee, should retain responsibility for setting and reviewing remuneration, in line with strategy and performance, and in compliance with CPS 510 and the Australian Securities Exchange Corporate Governance Guidelines. NAB also considers that the application of the proposed changes to variable remuneration in the BEAR will not be workable if the definition of accountable persons is too broad.

E. Other prudentially regulated institutions

NAB believes the BEAR should apply to all prudentially regulated financial institutions, not just those controlled by an ADI. NAB is concerned that not adopting this approach could incentivise institutions to pursue regulatory arbitrage by seeking lesser-regulated structures, even if that is not in the interests of customers or the financial system. A failure by an ADI, a general or life insurance company, or a superannuation provider, to meet the proposed expectations under the BEAR, could equally undermine trust in (as well as the soundness and stability of) the financial system.

F. Application to foreign subsidiaries/ branches

It is not practicable for the BEAR to apply to foreign subsidiaries in Australia or branches of ADIs in other jurisdictions. This would result in foreign subsidiaries and branches being subject to multiple, potentially inconsistent, regulatory regimes.

³ NAB proposes this approach to ensure there is no judicial or executive attempt to read in a broader scope to Corporations Act duties or the BEAR, and the defences and qualifications that apply under section 180 of the Corporations Act (such as, the business judgment rule (section 180(2)), the ability of directors to rely on expert advice (section 189) and delegations (section 190) are not eroded.

A more detailed discussion of these concerns is set out in Appendix A. Appendix B sets out NAB's response to the questions raised in the Consultation Paper, to the extent they are not already addressed in Appendix A.

NAB encourages further careful and detailed consideration of the design and implementation of the BEAR. We urge the Department of Treasury to allow sufficient time for further consultation with the industry and other interested parties including on the draft legislation and any related prudential standards.

NAB has appreciated our engagement to date with the Department of Treasury and would welcome further discussions to ensure the BEAR best meets its policy objectives and avoids unintended consequences.

Please contact me or Chris Venus, Manager, Government Affairs & Public Policy, 0477 306 694 or chris.venus@nab.com.au if you have any questions about this submission.

We look forward to hearing from you further.

Yours sincerely

A handwritten signature in black ink, appearing to read 'SC', is written over the typed name 'Sharon Cook'.

Sharon Cook

Chief Legal & Commercial Counsel
National Australia Bank Limited

APPENDIX A: DETAILED NAB SUBMISSION ON THE BEAR

1. Scope of the BEAR

1.1. *Institutions to be covered by the BEAR (Consultation Paper – Chapter 3)*

NAB agrees that the BEAR should apply to all ADIs, and their controlled entities. This is consistent with the application of the definition of an ADI, and the term ‘APRA-regulated institution’, in relevant prudential standards such as CPS 220 and CPS 520.⁴ Any reference to an ADI in the BEAR should adopt this definitional approach, so it covers the ADI and or any entity in the ADI’s sub-group. Given its entity structure, NAB and all entities in its group will be covered by the BEAR since NAB, as the ultimate parent, is an ADI.

The application of the BEAR to foreign subsidiaries and branches of an ADI is, however, of concern in that it may create overlapping and possibly inconsistent regulatory requirements within the same financial institution. For example, it raises the prospect that relevant accountable persons, employed in NAB’s London Branch, would be subject to both the BEAR and the SMR. The Consultation Paper acknowledges the benefits of ensuring consistency between international frameworks so far as possible and practicable. NAB considers it important to recognise that a foreign subsidiary or branch is obliged to comply with the law of its primary jurisdiction and limit the BEAR accordingly to avoid duplication and inconsistency.

The Consultation Paper also proposes that the BEAR not cover all prudentially regulated financial institutions, if those institutions are not controlled by an ADI. NAB believes that all prudentially regulated financial institutions, including life insurance, general insurance and superannuation providers, should be held to the same heightened standards of responsibility and accountability proposed in the BEAR. There are a number of reasons for this, including the following.

- Australia has been well served by the consistent national prudential regulatory regime introduced following the Wallis Inquiry. The Wallis Inquiry resulted in a significant simplification of the structure of financial system regulation⁵ and redefined the scope of regulation applying to particular types of financial products through the concept of ‘intensity of promise’⁶. Adopting a different regulatory approach to institutions with similar risk profiles will create a two-tier system and moves away from the regulatory approach adopted by the Wallis Inquiry and recently reaffirmed by the 2014 Financial System Inquiry. Over time, it is likely to incentivise institutions to pursue regulatory arbitrage by seeking lesser-regulated structures, even where that may not be in the interests of the financial system as a whole. For example, it makes no conceptual sense that a general insurer owned directly by an ADI would be treated differently under BEAR than a general insurer owned by a Non-Operating Holding Company (NOHC) which also owns an ADI.
- Not covering some prudentially regulated financial institutions has the potential to reduce the impact of the BEAR. Prudential Standard CPS 520 (which will remain as one of the key standards expected of responsible persons of an ADI) applies to all prudentially regulated institutions.

NAB recommends that the BEAR should apply to all prudentially regulated financial institutions, and NOHCs of such institutions. If not applying initially, NAB would encourage a phased approach to ensure the BEAR will, in time, apply to all prudentially regulated institutions in Australia (similar to the SMR in the UK).

⁴ CPS 520 and CPS 220 provide that where an ADI (or other APRA regulated entity) is the ‘head of a group’ it must comply with a prudential standard, in its capacity as an APRA-regulated institution, and by ensuring that the requirement is applied appropriately throughout the group, including in relation to institutions that are not APRA-regulated; and on a group basis.

⁵ Following the Wallis Inquiry, 11 separate Federal and State regulatory bodies were merged to create APRA, including parts of the RBA responsible for banking regulation, resulting in a far more uniform regulatory approach.

⁶ The concept is that “the higher the intensity of a promise [such as a deposit or life insurance obligation], the stronger the case for regulation to reduce the likelihood of breach”.

1.2. *Individuals to be covered by the BEAR (Consultation Paper – Chapter 4)*

NAB notes the intention of the BEAR to build on, rather than replicate, concepts and accountability in existing regulations and law. The Consultation Paper proposes that accountable persons to be covered by the BEAR will be determined based on a combination of prescription and principles. NAB agrees with the proposed list of prescribed roles in relation to executive functions, subject to a review of the specific responsibilities described as ‘Executive functions’ in the Consultation Paper⁷. However, NAB is concerned with the proposed inclusion of non-executive directors in oversight functions, for a number of reasons.

1. First, the designation of the Chair, and the Chair of relevant Board committees as an accountable person suggests that the Chair would be individually responsible for the decisions of an intentionally collective decision-making body. The role and importance of committees, to whom authority is delegated from the board of an ADI, is a critical cornerstone of corporate governance and draws on specific expertise and independence of all of its members.
2. Secondly, the substantive effect of this approach is that some non-executive directors would have a higher standard of care imposed on them, and potentially face greater personal liability, under general law than other non-executive and executive directors who do not hold such roles.
3. Thirdly, in selecting certain non-executive directors who Chair the Board and relevant committees, there is a suggestion that the Chair has control or makes decisions alone. Whilst this reflects the administrative role of the Chair of a committee, as flagged above, it does not reflect their decision making. Indeed, in relation to many matters before a committee, it recommends a proposal to the full board for its decision.

Together, these points reflect the long standing and well understood common law and Corporations Act principles in respect of directors’ duties, which impose the same very high standards to all directors and officers of a company. If it is proposed that the Chair, and the Chair of relevant committees nevertheless remain in scope of the BEAR, NAB recommends that the prescribed responsibilities for such roles in the ‘Oversight functions’⁸ only address their respective administrative responsibilities (in respect of the board and each relevant committee).

NAB supports the intent of including a principles-based component in the definition of accountable persons. However, as currently expressed, NAB believes the principles-based definition is very broad and lacks a risk materiality threshold to ensure that only appropriately senior and materially influential executives in the context of the ADI group are covered by the BEAR. Given the emphasis on seniority, influence over conduct, and behaviour and risk, and responsibility for management of a significant proportion of the ADI business or activity (based on gross assets, revenue or profit), NAB believes the definition of accountable person should substantially replicate the definition of senior managers in CPS 520.⁹ The definition of senior managers covers the most senior individuals in an ADI who have effective responsibility for management and control of the institution. NAB believes the adoption of an existing, prudential based definition is most appropriate and there is no need to add to or amend this definition to achieve the purpose of the BEAR. The current definition is broad but has the advantage of being well understood by ADIs and APRA.

The proposed application of the BEAR to an ADI group (and not other prudentially regulated institutions) may cause attraction, retention and succession issues for ADIs as senior executives may prefer to work for institutions that are not covered by the BEAR. This problem will be exacerbated if there is an extension of accountable persons beyond NAB’s recommended definition.

NAB also notes that it is critical that the BEAR allows an ADI to agree its accountable persons with APRA (based on the application of the principles-based component, and subsequent registration) so that APRA is precluded, on a post-incident review, from penalising an ADI for failing to hold an individual to account (where that individual was not covered by the BEAR as an accountable person). (This approach would not derogate from an ADI’s obligation to maintain the currency of its registered accountable persons.) This is particularly the case since in a post-incident environment APRA may be under significant pressure to identify and hold individuals accountable (relying on the BEAR). NAB therefore recommends that in assessing whether an accountable person has met the proposed expectations under the BEAR, the Federal

⁷ Table 1: Proposed prescribed accountable persons functions, page 6 of the Consultation Paper.

⁸ Table 1: Proposed prescribed accountable person functions, page 6 of the Consultation Paper.

⁹ As set out in CPS 520 paragraph 20(g) and paragraphs 25(a) and (b).

Court must retain the right to assess the incident based on a fair and objective test (please also see discussion under paragraph 2.1).

Consistent with this view, NAB does not believe that directors of subsidiaries should be included in the definition of accountable persons (unless they hold one of the other positions). The definition of accountable persons should be agnostic to the entity structure of an ADI group since the purpose of the definition is to capture the most senior individuals with responsibility for management and control. This is rarely the directors of subsidiaries – and if it were, they would, in any event, be covered by the definition of senior managers, if appropriate due to the nature of their role and responsibilities. There are more than 150 companies in the NAB group and over 100 subsidiary directors across these companies, many of whom would be classified as ‘middle management’ rather than ‘senior executives’. All directors, irrespective of their seniority within the organisation, are already subject to the directors and officers duties set out in the Corporations Act.

2. New expectations of ADIs and Accountable Persons under the BEAR

The proposed expectations for ADIs and accountable persons under the BEAR cover the types of behaviours and responsibilities that NAB would also expect of accountable persons¹⁰ and an ADI. However, NAB believes the scope and application of the expectations require further consideration to ensure they do not duplicate or conflict with existing laws or regulation in relation to directors and officers duties. Specifically, the BEAR should provide clarity on how the expectations will be applied (based on what standards), and by whom (APRA or a judicial body).

2.1. *Recommended structure of any new statutory expectation and prudential guidance*

The Consultation Paper provides that the new expectations of ADIs and accountable persons will only apply to ‘systemic and prudential matters’¹¹. Given the potential ramifications of enforcement under the BEAR, this scope should apply as the overriding criterion for when an ADI and/or accountable person has failed to meet a new expectation, and the scope should be clearly outlined in proposed legislation. NAB recommends that the definition is drafted by reference to the role of APRA in the Australian financial system and, in particular, its promotion of prudent behaviour by ADIs with the key aim of protecting the interests of their depositors and the underlying financial system. It could also clarify that the BEAR is focussed on the quality and operation of an institution’s systems for identifying, measuring and managing the various risks in its business.¹² This clarity of scope is essential in assisting to distinguish conduct covered by the Corporations Act and to avoid the creation of inconsistent overlapping regulatory regimes.

To do this, NAB recommends the introduction of a two part statutory test. The first element of the test could be to determine whether there is a matter of a systemic and prudential nature that has the effect of undermining the financial safety of an ADI, and public confidence in the institution. If this threshold is not satisfied, then the second part of the test would not be considered. This is consistent with NAB’s understanding, that the BEAR is only intended to operate in severe circumstances. NAB believes the BEAR should not create a new liability for accountable persons in the absence of any systemic and prudential matter impacting on the relevant ADI.

If the first test is established, then it is a question of whether the ADI and/or the accountable person has met the new expectations under the BEAR (which NAB expects to be set out in legislation, including appropriate qualifications and defences). Having established in legislation an appropriate objective test as to the reasonableness of the behaviour, NAB recommends that APRA then provide guidance in prudential standards. For example, guidance in relation to compliance and control of an ADI as set out in the Consultation Paper.¹³ By providing guidance, there would be a basis on which the court, or APRA, will objectively assess whether an accountable person has failed to meet the expectations in the particular circumstances and recognising that what is ‘reasonable’ in any instance must depend on the circumstances.

¹⁰ All references in this letter to ‘accountable person’ assume that the BEAR defines this term as ‘senior managers’ under CPS 520 paragraph 20(g) and paragraphs 25 (a) and (b).

¹¹ Page 7, Chapter 5 of the Consultation Paper

¹² Please refer to APRA Portfolio Budget Statements 2013-14, Section 1.1 Strategic direction statement at <http://www.treasury.gov.au/PublicationsAndMedia/Publications/2013/PBS-2013-14/Report/APRA>

¹³ Pages 7-8, Chapter 5 of the Consultation Paper

2.2. *Expectations of an accountable person (Consultation Paper – Chapter 5)*

The Consultation Paper proposes that an accountable person will be expected to 'act with integrity, due skill, care and diligence and be open and co-operative with APRA'. NAB notes that very similar (if not the same) standards of behaviour are required of senior managers, directors and officers through a combination of existing statutory obligations in the Corporations Act, Banking Act and prudential standards. On this basis, it is strongly recommended that any new legislation either relies on existing concepts and definitions, or mirrors them, as discussed further below.

The expectation is similar, but broader, than the existing duty of care and diligence in section 180 of the Corporations Act, which applies to both directors and officers of a company.¹⁴ The duty of care and diligence in the Corporations Act is well understood and is supported by a large body of case law. It is NAB's view that the equivalent duty of care and diligence proposed in the BEAR should be consistent with the existing duty under the Corporations Act. To the extent that the expectation proposed under the BEAR is invoking the same duty as section 180, it should be made clear¹⁵ that the BEAR does not impact the Corporations Act duties in any way and that the relevant defences and qualifications that apply to section 180¹⁶ must also be available under BEAR.

As an example, NAB believes it would be inappropriate for a director or officer who is subject to a duty of care and diligence under the BEAR and the Corporations Act to be able to avail themselves of the business judgment rule in the Corporations Act to show that they had discharged their duties, but not avail themselves of a similar defence to the expectation under the BEAR. NAB strongly recommends that the legislation to introduce the BEAR specifically provides that it does not in any way affect the duties imposed on directors and officers under the Corporations Act or common law and applies only in relation to APRA's powers under the BEAR in respect of registration and remuneration of accountable persons. NAB also considers that the defences available under the Corporations Act should be reflected in the expectations under the BEAR as these are clearly considered "reasonable steps" under the Corporations Act.

The proposed expectations also include a requirement for an accountable person to 'be open and co-operative with APRA'. Whilst this behaviour is consistent with NAB's current relationship with APRA, and NAB welcomes the recognition of its importance, the introduction of a statutory duty to this effect could be problematic. In particular, any such expectation should be subject to the usual protections afforded to individuals accused of failing to comply with legal and regulatory obligations (such as in relation to legal professional privilege), especially when a failure to meet the expectation may in itself bring serious consequences, irrespective of the underlying issue (see also discussion below in relation to Chapter 7). This is heightened where the link to civil and criminal liability under the Corporations Act is not express, and where deregistration is the 'remedy' because of the lifetime effect such action is likely to have on an individual's employability.

Finally, the proposed new expectation requires an accountable person to act with 'integrity and due skill'. Again, these are familiar standards, utilising the language contained in CPS 520 criteria of 'fit and proper' and the definition of 'prudential matter' in the *Banking Act*. If used in a statutory duty, however, NAB recommends that there is an appropriate definition of the terms, or reliance on existing or enhanced prudential guidance as to how they will be objectively assessed.

In addition to the specific expectations, the Consultation Paper provides that an accountable person must take reasonable steps in executing other responsibilities for compliance and control of an ADI (eg 'take reasonable steps to ensure that the activities or business of the ADI for which they are responsible are controlled effectively' etc).¹⁷ NAB recommends that the specific expectations discussed above are set out clearly (and with appropriate qualifications) in any legislation and it recommends that the additional elements of the expectations are set out in prudential guidance from APRA, which would serve as examples of discharging the statutory duty of care and diligence rather than operating as separate duties in themselves. This would also provide an opportunity for

¹⁴ The officers of a company include senior executives who (amongst other things) participate in making decisions that affect the whole or a substantial part of the business of the corporation. This includes many senior executives that are likely to be 'accountable persons' under BEAR. Note that this is different to the position in the UK, where directors' duties do NOT apply to officers. This made the introduction of the SMR in the UK more necessary than in Australia, because there were no pre-existing duties applicable to such persons.

¹⁵ So that there is no judicial or executive attempt to read in a broader scope to either section 180 or the BEAR.

¹⁶ Namely, the business judgment rule (section 180(2)), the ability of directors to rely on expert advice (section 189) and delegations (section 190).

¹⁷ Pages 7 and 8, Chapter 5 of the Consultation Paper.

APRA to clarify how the new expectations may be linked to existing prudential standards as referred to in the Consultation Paper.¹⁸

2.3. *Expectations of an ADI (Consultation Paper – Chapter 5)*

The expectations of an ADI under the BEAR are expressed in very similar terms to the expectations of an accountable person. Accordingly, NAB's comments on the expectations of an accountable person apply equally in this context.

NAB believes the BEAR should make clear how the expectations of an accountable person are linked to the outcomes or the impact for the ADI, and its consequent failure to meet expectations on it. Whilst the intention of the BEAR is to ensure that senior bank executives are accountable, it should not create a separate and independent basis for senior management liability. In this case, NAB supports adopting a similar approach to the SMR where the senior manager's duty of responsibility (and their liability) is linked directly to the impact of their behaviour on the ADI. This is because the senior manager's statutory duty is in essence a duty to act reasonably as a manager to prevent the firm from contravening a relevant requirement.¹⁹ This approach is important to ensure an accountable person is not liable just because the ADI has breached a requirement – it is because they have personally failed to meet an expectation (based on a reasonableness test in the circumstances) with the relevant impact on the ADI. In other words, the regime should not make the accountable person vicariously or strictly liable for misconduct that occurs within or by an ADI. Instead, the onus of proof should be on the regulator to prove (before a court) that the accountable person did not act reasonably.

3. **Enhanced powers of APRA in relation to removal and disqualification**

3.1. *Removal and Disqualification (Consultation Paper – Chapter 7)*

The Consultation Paper contemplates that APRA will have enhanced powers in circumstances where an ADI and/or an accountable person has failed to meet expectations of the BEAR, (on NAB's recommended construction) in a systemic and prudential manner, so as to undermine the financial safety and community confidence in the ADI. Whilst NAB acknowledges the rationale for providing APRA with enhanced powers in certain circumstances, the exercise of these powers – based on the proposed new expectations under the BEAR – could result in a fundamental shift, in regulation of the industry. It could also mark a very material departure from Australian legal jurisprudence.

NAB has the following two primary concerns with these proposed enhanced powers for APRA.

- APRA will be placed in the role of both supervisor and enforcement agency. If APRA can enforce actions (and impose very material civil penalties), this could change the way ADIs and APRA interact with each other.
- APRA will determine when an accountable person is removed or disqualified. That is, the regulator, interpreting the statutory expectation, can impose a very material, and potentially career ending, enforcement action on an individual. This differs to an enforcement action by ASIC, or another interested party, on the failure by a director or officer to satisfy their directors' duties, when ASIC must prove that there has been a failure and the director can avail themselves of statutory defences. This is a fundamental reversal of the onus of proof. Even with prudential standards or guidance, NAB does not believe that it is fair or appropriate for APRA to have the ability to disqualify an industry participant without applying to the Federal Court. NAB believes an application to the Federal Court (or another independent body) should be required before APRA can exercise this disqualification power.

3.2. *Insurance*

NAB believes that it is important that accountable persons under the BEAR be entitled to appropriate insurance. This would include availing themselves of legal costs cover under directors and officers liability insurance to enable them to defend or challenge decisions of removal or disqualification. The Corporations Act already contains appropriate restrictions on the provision of indemnities or payment of insurance for directors and officers of companies.

¹⁸ Page 3, Chapter 2 of the Consultation Paper.

¹⁹ "The expanding scope of individual accountability for corporate misconduct", Mark Steward, Director Enforcement and Market Oversight at the Financial Conduct Authority, United Kingdom at: <https://www.fca.org.uk/news/speeches/expanding-scope-individual-accountability-corporate-misconduct>

3.3. *Civil penalties*

NAB agrees that the three types of circumstances identified in the Consultation Paper are appropriate as the triggers for APRA to apply to the Federal Court to seek civil penalties against an ADI. However, NAB strongly recommends that the circumstances are more clearly defined. NAB supports the adoption of an appropriate threshold of materiality for their application and detailed guidance (through existing and new prudential standards) as to what is expected of an ADI in monitoring and holding to account its accountable persons. For example, if a material issue is identified in an ADI, such as a systems error impacting customers, arising from a single incident of failing to monitor²⁰, the ADI should not be required to remove the accountable person to satisfy APRA that a civil penalty is not applicable. This outcome could be unfair and inappropriate for both the accountable person and the ADI.

As discussed above, the Consultation Paper indicates in the context of the new expectations that APRA's role in regulating conduct will be triggered by a matter which is of a systemic and prudential nature so as to undermine the financial safety and public confidence in the ADI group. We recommend that, with some guidance as to what constitutes such a matter,²¹ this should be the extent of the circumstances in which a civil penalty applies. This is also consistent with NAB's recommendation that the new expectation is framed as a two part test, with the initial threshold for its application requiring that the matter is of a systemic and prudential nature, applicable to the ADI as a whole.

NAB welcomes the reference in the Consultation Paper to a court having jurisdiction to determine whether there has been a contravention of a civil penalty provision and discretion to impose a proportionate penalty having regard to the seriousness of the contravention.

NAB also welcomes the approach outlined in the Consultation Paper to require that ADIs retain responsibility for the management of their business, including breach reporting and monitoring. NAB would expect to consult with APRA, and to maintain a co-operative and transparent relationship in the context of its supervisory relationship, but there must be clear guidance as to when and how an ADI is entitled to report to APRA.

4. **Registration, roles and responsibility mapping and accountability statements**

There are currently effective and comprehensive requirements on ADIs under existing prudential standards to notify APRA of appointments of responsible persons, and changes to their roles and responsibilities.²² NAB therefore recommends that only those matters required by APRA in addition to the existing regime are required to be actioned.

NAB also strongly supports the proposed accountability statements and process of registration (rather than seeking approval) of accountable persons with APRA. We note the process of registration and maintenance of the register may require some additional guidance from the Australian Securities Exchange regarding continuous disclosure requirements of the most senior roles, following registration.

In relation to the scope of mapping roles and responsibility at an ADI, NAB understands that the BEAR is intended to cover the entire business of an ADI, including governance mechanisms, risk frameworks, internal systems and procedures, and compliance with prudential standards. NAB's strong preference is that the BEAR adopts an approach similar to the Hong Kong managers in charge regime where NAB understands an organisational chart must be provided to the regulator, setting out the licensed corporation's governance and management structure, business and operational units, key human resources and their reporting lines, including all managers in charge and their roles and responsibilities. NAB prefers this approach (in addition to the provision of accountability statements) to the responsibility mapping adopted in the SMR, on the basis that it appears to serve the purpose intended by the regulator without imposing an unnecessary administrative burden on institutions.

²⁰ In instances where appropriate monitoring and oversight was in place.

²¹ For example, by reference to section 5 of the Banking Act.

²² CPS 520.

5. Remuneration

5.1. *Variable remuneration*

The remuneration of senior executives is complex and NAB does not believe that prescriptive legislation about it will be effective.

NAB believes that Boards and Remuneration Committees are best placed to determine the most appropriate remuneration arrangements (including the quantum and timing of variable remuneration) in line with corporate strategy and performance. In doing so, (listed) ADIs must comply with CPS 510 and the Australian Securities Exchange Corporate Governance Guidelines. Importantly, ADIs must also obtain shareholder approval of certain remuneration arrangements. On top of all this, APRA already has the power to review and adjust an ADI's remuneration policies (see 5.2 below).

If, in spite of these views, it is decided to legislate on the issue of remuneration, NAB believes that the proposed principles based approach is preferable. NAB recommends that the BEAR adopt or build upon the approaches taken in other jurisdictions, rather than create a new definition.

5.2. *APRA's remuneration powers*

NAB believes that APRA's existing powers to direct ADIs to review and adjust remuneration policies is appropriate. More detail is required on the proposed enhanced powers and when such powers can be exercised. In particular, NAB would welcome guidance on what constitutes 'inappropriate outcomes'. As with other measures proposed in the Consultation Paper, NAB believes that the BEAR should provide for a process of either consultation or appeal before APRA reaches a final determination as to when and how inappropriate outcomes have occurred.

APPENDIX B: NAB RESPONSES TO QUESTIONS IN THE CONSULTATION PAPER

CHAPTER 4 — INDIVIDUALS TO BE COVERED BY THE BEAR

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?*

NAB considers that the prescriptive element of the proposed definition of accountable persons is appropriate, subject to reviewing the final detail in Table 1: Proposed prescribed accountable persons functions. Please also refer to discussion in paragraph 1.2, 'Individuals to be covered by the BEAR' of Appendix A.

- 1.1. *Are there any other roles which should be included at a minimum?*

NAB does not consider there are any other roles which should be included at a minimum. Please also refer to discussion in paragraph 1.2, 'Individuals to be covered by the BEAR' of Appendix A.

- 1.2. *Should any of the roles be excluded?*

NAB considers that non-executive directors acting as Chairs of committees should be excluded as accountable persons. Please also refer to discussion in paragraph 1.2, 'Individuals to be covered by the BEAR' of Appendix A.

Whilst it is not referred to in the prescribed executive functions, NAB is of the view that the head of legal should not be covered by the BEAR. It is an advisory function, rather than a control or management function, and – critically – must remain independent from commercial decisions of the organisation. In addition, the legal function must retain the ability to claim legal professional privilege, where appropriate. Its ability to do so may be compromised if it is subject to certain obligations under the BEAR.

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?*

NAB considers that the principles-based element of the proposed definition of accountable persons provides flexibility. However, it is critical that the BEAR allows for ADIs to agree with APRA the precise list of individuals who will be covered by the BEAR as accountable persons. In addition, APRA should not have the ability to revisit this list with the benefit of hindsight. This does not derogate from an ADI's obligation to maintain the currency of registrations of accountable persons and or its accountability map. Please also refer to discussion in paragraph 1.2, 'Individuals to be covered by the BEAR' of Appendix A.

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?*

The definition of accountable person should rely on the existing definition of a senior manager in CPS 520, and should be agnostic as to structure. NAB does not believe that the directors of subsidiaries of a group should be included in the definition of accountable persons (unless they would otherwise fall within the principles-based definition). Please also refer to discussion in paragraph 1.2, 'Individuals to be covered by the BEAR' of Appendix A.

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

4. *Do the options canvassed for the expectations of ADIs capture the behaviours that should be expected under the BEAR?*

NAB considers that the expectations of ADIs cover the types of behaviours and responsibilities that NAB would also expect of an ADI. However, NAB believes the scope and application of the expectations requires further consideration to avoid duplication or conflict with existing legal and regulatory regimes. Please also refer to discussion in paragraph 2, 'New expectations of ADIs and accountable persons' in Appendix A, in respect of all elements of Question 4.

- 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?*

NAB considers that the expectations of accountable persons cover the types of behaviours and responsibilities that NAB would also expect of a senior manager (and or accountable person). However, NAB believes the scope and application of the expectations requires further consideration to avoid duplication or conflict with existing legal and regulatory regimes.

The Consultation Paper provides that the new expectations of ADIs and accountable persons will only apply to 'systemic and prudential matters'²³. Given the potential ramifications of enforcement under the BEAR, this scope should apply as the overriding criterion for when an ADI and/or accountable person has failed to meet a new expectation, and the scope should be clearly outlined in proposed legislation.

To do this, NAB recommends the introduction of a two part statutory test. The first element of the test could be to determine whether there is a matter of a systemic and prudential nature that has the effect of undermining the financial safety of an ADI, and public confidence in the institution. If this threshold is not satisfied, then the second part of the test would not be considered. This is consistent with NAB's understanding, that the BEAR is only intended to operate in severe circumstances. NAB believes the BEAR should not create a new liability for accountable persons in the absence of any systemic and prudential matter impacting on the relevant ADI.

If the first test is established, then it is a question of whether the ADI and/or the accountable person has met the new expectations under the BEAR (which NAB expects to be set out in legislation, including appropriate qualifications and defences). Having established in legislation an appropriate objective test as to the reasonableness of the behaviour, NAB recommends that APRA then provide guidance in prudential standards. For example, guidance in relation to compliance and control of an ADI as set out in the Consultation Paper.²⁴ By providing guidance, there would be a basis on which the court, or APRA, will objectively assess whether an accountable person has failed to meet the expectations in the particular circumstances and recognising that what is 'reasonable' in any instance must depend on the circumstances.

Please also refer to discussion in paragraph 2, 'New expectations of ADIs and accountable persons' in Appendix A, in respect of all elements of Question 5.

5.1. *Are there any other behaviours which should be included?*

5.2. *Should any of the behaviours be excluded?*

CHAPTER 6 — REMUNERATION

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?*

The impact on remuneration will depend on more than the introduction of minimum deferral requirements. The definition of accountable persons, the definition of variable remuneration, the valuation methodology (especially for equity), the timing of the deferral testing and the level of prescribed deferral are all elements that need to be fully understood to assess the impact on the individual accountable person's remuneration.

The introduction of a requirement for a 4 year mandatory deferral period could result in an increase in fixed and/or variable remuneration which may also impact the percentage of fixed remuneration compared to variable remuneration. Any shift in remuneration would be in order to ensure NAB is able to retain and attract talent for accountable person roles from both the financial services and other industries.

Provided the definition of accountable persons is consistent with NAB's recommended definition in Section 1.2 of Appendix A, the public disclosure of 'key management personnel' remuneration would be likely to limit any significant shift from variable to fixed remuneration or significant increases in variable remuneration.

²³ Page 7, Chapter 5 of the Consultation Paper.

²⁴ Pages 7-8, Chapter 5 of the Consultation Paper.

7. *What are the complexities in defining variable remuneration, including in relation to non-cash remuneration?*

Defining variable remuneration is complex and without detailed guidance companies may adopt inconsistent approaches. NAB recommends that the BEAR adopts a similar approach to that detailed in the European Banking Authority's (EBA) Guidelines on Sound Remuneration policies under Articles 74(3) and 75(2) of Directive 2013/36/EU and disclosures under Article 450 of Regulation (EU) No 575/2013. Section 7 of this Directive defines fixed remuneration and states that variable remuneration is anything that cannot be classified as fixed remuneration based on the specified criteria.

Any principles-based definition should clarify how variable remuneration (especially for equity based remuneration) is valued for the purpose of determining the deferral amount. In this respect, NAB recommends the approach where variable remuneration is valued at the market price (or face value) at the time of granting the award. This approach is consistent with the PRA Rulebook (Part Remuneration)²⁵ and will assist in ensuring consistency across organisations with operations in different jurisdictions. The use of market price is also consistent with how shareholders value the award and the current trend in Australia to allocate long term incentive awards at face value. In addition this recognises the full potential value of the award to the accountable person.

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?*

NAB is concerned that a principles-based definition of variable remuneration provides sufficient clarity and recommends that the BEAR adopt or borrow from the well understood concepts of fixed and variable remuneration applied in other jurisdictions such as the United Kingdom and Europe. Please refer to NAB's response to question 7.

9. *Is the proposal for deferring 60 percent of the variable remuneration of certain executive accountable persons appropriate?*

NAB would expect that this is a responsibility of boards and remuneration committees subject to APRA and ASX oversight. Please also refer to paragraph 5.1, 'Variable remuneration' in Appendix A.

10. *Are the proposed enhancements to APRA's remuneration powers appropriate?*

NAB believes that APRA's existing powers to direct ADIs to review and adjust remuneration policies is appropriate and that no further powers are necessary. Please also refer to paragraph 5.2, 'APRA's remuneration powers' in Appendix A.

CHAPTER 7 — IMPLEMENTATION AND TRANSITIONAL ISSUES

REGISTRATION AND ACCOUNTABILITY MAPPING

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?*

NAB is supportive of the introduction of a requirement for ADIs to map the allocation of prescribed responsibilities; however, as discussed in paragraph 4, 'Registration, roles and responsibility mapping and accountability statements' in Appendix A, NAB recommends that the BEAR adopts an approach to mapping similar to that employed under the Hong Kong managers in charge regime.

11.1. *Are there any other prescribed responsibilities which should be included?*

NAB expects that once there is more clarity as to the nature of the responsibility map required by the BEAR, it will (probably) be necessary (for the document to make sense, and to be applied by APRA) for it to cover some responsibilities, in addition to the prescribed responsibilities. However, NAB would seek certainty from APRA that, having agreed the form and content of a responsibility map, APRA would not have the ability to revisit it with hindsight and suggest that it was deficient having regard to a failure of an ADI or an individual accountable person to meet the relevant expectations of the BEAR.

²⁵ Refer to Chapter 16.8 which states that where remuneration is subject to any condition, restriction or other similar provision which causes the amount of the remuneration to be less than it otherwise would be that condition, restriction or provision is to be ignored in arriving at its value.

11.2. *Should any of the prescribed responsibilities be excluded?*

As discussed in Appendix A, certain responsibilities (eg for decision making) of oversight functions should be excluded from the prescribed responsibilities.

12. *Should ADIs have discretion to add to the prescribed list of responsibilities?*

NAB would expect that this is a necessary discretion for ADIs but would be subject to agreement with and/ or approval of APRA. Please also refer to our response to Question 11.1.

REMOVAL AND DISQUALIFICATION

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

NAB does not consider that the options for enhancing APRA's removal and disqualification powers are appropriate. In particular, NAB believes an application to the Federal Court (or another independent body) should be required before APRA can exercise this disqualification power. Please also refer to discussion in paragraph 3.1, 'Removal and disqualification' of Appendix A.

CIVIL PENALTIES

14. *Are the proposed circumstances in which the civil penalties should apply appropriate?*

NAB strongly recommends that the proposed circumstances in which civil penalties apply are more clearly defined (than is currently proposed in the Consultation Paper) and that an appropriate measure of materiality is applied. Please also refer to paragraph 3.3, 'Civil Penalties' of Appendix A.

15. *Is the proposed definition of large ADIs appropriate?*

NAB considers that the proposed definition of large ADIs is appropriate.

GENERAL IMPLEMENTATION AND TRANSITION ISSUES

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

The time (and cost) for NAB to implement the BEAR will depend, in large part, on the approach taken by the Treasury on a number of the matters raised in this submission.

NAB strongly encourages the Federal Government to allow sufficient time between when any legislation is passed by Parliament and when the BEAR comes into effect. This may also include consideration of how any transitional provisions will apply. If legislation is passed by the Parliament by the end of calendar 2017, the BEAR should not come into effect before 1 January 2019. This timing also assumes that any new prudential standards are introduced by APRA at least six months before 1 January 2019. In addition, NAB believes that any new requirements introduced by the BEAR in relation to remuneration should only apply to the first full financial year after 1 January 2019.²⁶

A longer period of implementation of the BEAR will help to reduce implementation costs and to avoid unintended consequences.

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?*

The cost for NAB to implement the BEAR will depend, in large part, on the approach taken by the Treasury on a number of the matters raised in this submission. In particular, the approach taken on registration, accountability statements and roles and responsibility mapping would have an impact on cost, including in relation to contractual arrangements and systems changes. NAB believes these general areas are the most significant components of the BEAR which will determine implementation costs. The utilisation of existing requirements and definitions, under prudential standards or the Corporations Act, will help to contain costs.

²⁶ NAB and two of the other major ADIs have a financial year that runs from 1 October to 30 September. NAB tries to align significant changes to remuneration policy to its financial year to minimise impact on affected employees.