

EXPOSURE DRAFT

TREASURY LAWS AMENDMENT (BANKING EXECUTIVE
ACCOUNTABILITY AND RELATED MEASURES) BILL 2017

EXPLANATORY MEMORANDUM

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Glossary

The following abbreviations and acronyms are used throughout this explanatory memorandum.

<i>Abbreviation</i>	<i>Definition</i>
AD(JR) Act	<i>Administrative Decisions (Judicial Review) Act 1977</i>
ADI	Authorised deposit-taking institution
APRA	Australian Prudential Regulation Authority
APRA Act	<i>Australian Prudential Regulation Authority Act 1998</i>
ASIC	Australian Securities and Investments Commission
Banking Act	<i>Banking Act 1959</i>
BEAR	Banking Executive Accountability Regime
Corporations Act	<i>Corporations Act 2001</i>

Chapter 1

Banking Executive Accountability Regime

Outline of chapter

1.1 This Bill amends the *Banking Act 1959* (Banking Act) to establish the Banking Executive Accountability Regime (BEAR). The BEAR is a strengthened responsibility and accountability framework for the most senior and influential directors and executives in authorised deposit-taking institutions (ADI) groups.

1.2 To support the BEAR, the Bill gives the Australian Prudential Regulation Authority (APRA) new and strengthened powers.

Context of amendments

1.3 The Australian financial system is the backbone of the economy and plays an essential role in promoting economic growth. For it to operate in an efficient, stable and fair way, all participants must have trust in the system.

1.4 ADIs must operate at the highest standards and meet the needs and expectations of Australian consumers and businesses. Participants need to be confident that financial firms will balance risk and reward appropriately and serve their interests.

1.5 The House of Representatives Standing Committee on Economics undertakes an annual inquiry into the performance and conduct of Australia's banks.

1.6 In response to the first report from the Committee the Government announced in the 2017-18 Budget a comprehensive package of reforms to strengthen accountability and competition in the banking sector. In doing this, the Government announced that it would legislate the BEAR.

1.7 The BEAR complements the existing regulatory framework. This includes the Australian Securities and Investments Commission's (ASIC's) role regulating market conduct, the duties placed on directors under the *Corporations Act 2001* (the Corporations Act) APRA's existing prudential framework and standards.

Summary of new law

1.8 The Bill amends the Banking Act to establish the BEAR: an enhanced accountability framework for ADIs and persons in director and senior executive roles.

1.9 The BEAR imposes a clearer accountability regime on ADIs and people with significant influence over conduct and behaviour in an ADI. It requires them to conduct themselves with honesty and integrity and to ensure the business activities for which they are responsible are carried out effectively.

1.10 It does this by creating a new definition of ‘accountable person’. An accountable person is a Board member or senior executive with responsibility for management or control of significant or substantial parts or aspects of the ADI group.

1.11 The general requirement placed on accountable persons is framed in the context of their particular responsibilities. These will be clearly defined in accountability statements for each accountable person and an accountability map for each ADI group.

1.12 Accountability maps and statements are designed to give APRA greater visibility of lines of responsibility. The maps will clearly allocate responsibilities throughout the ADI group, to ensure that all parts or elements of the group are covered.

1.13 An ADI must comply with its BEAR obligations. These include new accountability, remuneration and key personnel obligations. An ADI must ensure that it has a remuneration policy consistent with the BEAR, its accountable person roles are filled and it has given accountability statements and maps to APRA.

1.14 ADIs must set remuneration policies deferring an accountable person’s variable remuneration to ensure accountable persons do not engage in behaviours inconsistent with BEAR obligations.

1.15 APRA will have additional powers concerning examination and disqualification to let it implement the BEAR.

1.16 If an ADI breaches its BEAR obligations, significant civil penalties may be imposed by a court.

1.17 Recognising there are different business models and group structures in the banking industry, the Bill uses both high level principles as well as prescribed detail. The BEAR will work with existing legislative and regulatory frameworks.

Comparison of key features of new law and current law

<i>New law</i>	<i>Current law</i>
Establishes the BEAR which places new obligations on an ADI, including for the conduct and operation of its subsidiaries.	No equivalent.
<i>Accountable persons</i>	
The Banking Act defines an 'accountable person' with respect to the responsibilities undertaken in the ADI and, where relevant, the ADI group or parent. A list of prescribed responsibilities is also included.	No equivalent.
Accountable person roles must be filled at all times and registered with APRA.	No equivalent.
<i>Obligations under BEAR</i>	
Obligations with regards to the prudential conduct of an ADI group and 'accountable persons' under BEAR are prescribed in legislation.	No equivalent.
ADIs must give APRA statements which detail the roles and responsibilities of each accountable person.	No equivalent.
ADIs must give APRA accountability maps which identify the lines of responsibility through the ADI business.	No equivalent.
<i>Penalties under BEAR</i>	
APRA may seek civil penalties of up to 1 million penalty units where an ADI breaches the obligations under BEAR.	APRA may seek civil penalties in specified circumstances.
APRA may disqualify an 'accountable person' for breaching the obligations of BEAR.	APRA may apply to the Federal Court to have a director, senior manager or auditor disqualified from being or acting in that position.
<i>Deferral of remuneration</i>	
An ADI must defer a proportion of the remuneration of an accountable person for a period of four years. The proportion to be deferred depends on	No equivalent.

<p>the size of the ADI.</p> <p>There are circumstances where APRA may allow an ADI to defer a person’s remuneration for a shorter period.</p> <p>An ADI must have a remuneration policy which is consistent with its BEAR obligations.</p>	
<i>Insurance</i>	
<p>An ADI must not take out insurance against the consequences of breaching the BEAR for itself or an accountable person.</p>	<p>No equivalent.</p>
<i>Examination powers</i>	
<p>Examination powers allow an APRA investigator to require a person to give information relevant to an investigation, set out how the person’s lawyer may participate during the examination and how records examination must be kept and shared.</p>	<p>Section 61 allows APRA to conduct an investigation and require an ADI to give certain information.</p>

Detailed explanation of new law

1.18 The BEAR:

- imposes a set of requirements to be met by ADIs and accountable persons;
- introduces a definition of ‘accountable person’ and requires their registration with APRA prior to commencement in an accountable person role;
- requires that ADIs give APRA accountability statements detailing the roles and responsibilities of each accountable person;
- requires that ADIs give APRA accountability maps allocating the roles and responsibilities of accountable persons across the ADI and its subsidiaries; and
- gives APRA new and stronger enforcement powers.

1.19 The Bill imposes strengthened expectations on ADIs and accountable persons in, or maintaining control over, an ADI and its subsidiaries.

1.20 As a result of the accountability maps and statements ADIs will provide to APRA, APRA will know who is responsible for relevant business lines and activities within an ADI group. This is an important element of the BEAR. It ensures accountable persons cannot avoid responsibility for problems which happen under their watch.

1.21 All references in this explanatory memorandum are to the *Banking Act 1959*, unless otherwise stated.

An ADI's obligations under the BEAR

1.22 As noted above at paragraph 1.19, the BEAR imposes strengthened obligations on both ADIs and their accountable persons. The obligations cover conduct that is systemic and prudential in nature. Breaches by an ADI or an accountable person are to be dealt with effectively and seriously.

1.23 APRA can apply to a court for the imposition of a civil penalty when there is evidence of a failure to comply with the BEAR relating to prudential matters. However, where there has been a minor breach, such as a failure to notify APRA of a change to an accountability map or statement (required under Division 5 of the BEAR), this may result in a direction from APRA under section 11CA of the Banking Act. [*Schedule 1, item 1, section 37G*]

Significant obligations under the BEAR

1.24 In summary, the BEAR obliges an ADI to:

- comply with its accountability obligations, which cover the way an ADI should conduct itself and how it should engage with APRA (for more information see paragraphs 1.39 – 1.50);
- meet its key personnel obligations, by ensuring all key areas of responsibility in ADI and its group are attributed to accountable persons (for more information see paragraphs 1.51 – 1.62);
- give APRA accountability maps and statements, which explain who is responsible for all parts and aspects of the ADI (for more information see paragraphs 1.116 – 1.122); and

- implement remuneration policies that defer the remuneration of accountable persons for a period of up to four years and allow for a reduction in remuneration in proportion to any failure to meet the BEAR obligations (for more information see paragraphs 1.63 – 1.76). [*Schedule 1, item 1, section 37*]

1.25 In summary, an ADI's BEAR accountability obligations require it to conduct its business with honesty and integrity, deal openly with APRA and ensure that it takes reasonable steps to prevent matters impacting negatively the prudential standing or reputation of the ADI. Accountability obligations are further explained below at paragraphs 1.39 – 1.50. [*Schedule 1, item 1, section 37C*]

1.26 An ADI's key personnel obligations require it to ensure that all parts or aspects of an ADI group are covered by an accountable person. This increases the transparency of responsibilities within ADIs so any breach of accountability obligations in an ADI group can be attributed to an accountable person. [*Schedule 1, item 1, paragraph 37D(1)(a)*]

1.27 Other key personnel obligations include ensuring that prohibited persons are not accountable persons and complying with APRA directions to reallocate responsibilities of accountable persons. [*Schedule 1, item 1, section 37JB*]

1.28 An ADI must take reasonable steps to ensure its subsidiaries meet the accountability obligations, obligations relating to key personnel and obligations around the deferral of remuneration of accountable persons. [*Schedule 1, item 1, paragraph 37C(e), 37D(1)(d) and 37E(1)(d)*]

Extent of obligations to an ADI's activities

1.29 The BEAR recognises consumers often associate the wide range of financial services and activities provided by subsidiaries under an ADI's brand. Poor behaviour in a subsidiary can have a negative effect on the ADI's brand and public standing and has the potential to undermine confidence in the ADI itself. Where the activities of a subsidiary are significant, then an accountable person should have responsibility for that subsidiary.

1.30 This is intended to capture, for example, large insurance or wealth management arms of an ADI. If an ADI's wealth management arm acts in breach of Bear obligations, then it may adversely affect the prudential standing or reputation of the ADI.

1.31 The BEAR applies to foreign ADIs. A foreign ADI is not subject to the BEAR for its offshore operations or for any locally incorporated non-ADI subsidiaries. However, its Australian branch

operations are obliged to comply with the BEAR. [Schedule 1, item 1, section 37]

1.32 To ensure that the BEAR can operate flexibly and is appropriately targeted the Minister has a power to exempt an ADI or its subsidiary from the application of the BEAR. If the Minister decides to grant an exemption, it does this by giving the ADI or its subsidiary a written notice. [Schedule 1, item 1, subsections 37A and 37KA(1)]

1.33 The Minister has a power to exempt a class of ADIs or a class of subsidiaries of ADIs from the application of the BEAR. To do this the Minister must make a legislative instrument. [Schedule 1, item 1, subsections 37A(2) and 37KA(2)]

1.34 This power recognises the importance of having a flexible system which lets the Minister consider the variety of ADIs in the Australian financial system and allows it to exempt a class or classes of ADI if it decides it is appropriate.

1.35 The Minister would use these powers where it is not necessary to include the particular ADI or class of ADIs to achieve the objectives of the BEAR.

1.36 A person adversely affected by the Minister's decision to exempt or refuse an exemption from the BEAR has the capacity to appeal the decision. That person or ADI may apply for judicial review by the Federal Court under the *Administrative Decisions (Judicial Review) Act 1977* (AD(JR) Act). A legal challenge concerns the lawfulness of the Minister's decision process, as required by the BEAR.

1.37 A ministerial decision to exempt, or not exempt, an ADI or its subsidiary from the BEAR is not subject to merits review. Not having merits review is justified because:

- The Minister must make a decision which balances a range of competing considerations and interests, which is informed by its unique position as the prudential regulator; and
- permitting a potentially protracted merits review process in circumstances where the Minister declined an application to exempt an ADI could undermine public and industry confidence in the prudential system and create uncertainty in financial markets.

1.38 A person adversely affected by the Minister's decision to exempt or refuse an exemption from the BEAR still has the capacity to appeal the decision. That person or ADI may apply for judicial review by

the Federal Court under the AD(JR) Act. A legal challenge concerns the lawfulness of the ministerial decision process, as required by the BEAR.

The accountability obligations of an ADI

1.39 The accountability obligations of an ADI are to:

- conduct its business with honesty and integrity and with due skill care and diligence;
- deal with APRA in an open, constructive and co-operative way. This does not displace legal professional privilege; and
- take reasonable steps to conduct its business to prevent matters arising which affect the prudential standing or reputation of the ADI. *[Schedule 1, item 1, section 37C]*

1.40 An ADI is responsible for its subsidiaries, and must take reasonable steps to ensure its subsidiaries meet the accountability obligations outlined at 1.39 – 1.50. *[Schedule 1, item 1, subsection 37(2) and paragraph 37C(1)(d)]*

1.41 An ADI is responsible for each accountable person it nominates, including those in a subsidiary or a parent company. The ADI must take reasonable steps to ensure each of its accountable persons meet his or her accountability requirements. *[Schedule 1, item 1, paragraph 37C(e)]*

1.42 Unless the Minister has exempted an ADI, the ADI must meet its BEAR accountability obligations. *[Schedule 1, item 1, paragraph 37(2)(a)(i)]*

1.43 A key objective of the BEAR is to improve the operating culture of ADIs and increase transparency and accountability across the banking sector. By setting out accountability obligations in the Banking Act and providing guidance about them, the Bill makes clear the obligations of ADIs and reinforces the standards of conduct expected of them by the community.

1.44 The steps by which an ADI complies with the BEAR are described as ‘reasonable steps’ in section 37CB. *[Schedule 1, item 1, section 37CB]*

1.45 A reasonable step may be setting up appropriate governance arrangements. It could cover setting clear lines of responsibility for each of an ADI group’s business activities. It is complemented by the BEAR requirement for ADIs to give APRA accountability maps and statements. An ADI’s accountability maps can show how it has fully considered the appropriate management structure for the ADI or broader ADI group and

how it attributes effective responsibility for key business activities to accountable persons.

1.46 A reasonable step may also be delegating responsibilities for key functions to appropriate persons. It could cover actions like having an effective process to determine whether a person has sufficient experience and judgement to undertake a particular responsibility.

1.47 The Minister can exempt an ADI from taking reasonable steps in relation to a subsidiary with respect to the subsidiary meeting the following obligations:

- accountability obligations under subsection 37C(d);
- key personnel obligations under subsection 37D(d);
- deferred remuneration obligations under subsection 37E(d); and
- notification obligations under subsection 37F(d). [*Schedule 1, item 1, subsection 37KA(1)*]

1.48 The Minister has a power to issue a legislative instrument to exempt ADIs from compliance with the obligations listed above, in relation to a particular class of subsidiaries of ADIs. [*Schedule 1, item 1, subsection 37KA(2)*]

1.49 The terms ‘honesty’, ‘integrity’, ‘due skill’ and ‘diligence’, ‘open, constructive and co-operative’ are not defined terms in the Banking Act. The ordinary meanings of each of those terms are generally well understood, and are used in other laws and considered by established case law.

1.50 The Bill sets out the steps an ADI may take to show it has taken reasonable steps to meet its accountability obligations. Section 37CB is not exhaustive in identifying a ‘reasonable step’. However, it does provide that a reasonable step can include situations where the ADI ensures there is appropriate governance, control and risk management about the particular issue, appropriate delegations of responsibility and appropriate procedures to identify and remediate problems about the particular issue. [*Schedule 1, item 1, section 37CB*]

The key personnel obligations of an ADI

1.51 The BEAR imposes key personnel obligations to ensure that all management functions in an ADI are covered by an accountable person. The size and complexity of an ADI or an ADI group will affect the

number of functions covered and the number of accountable persons nominated covering those functions.

1.52 Generally, an ADI would – in complying with the BEAR – be expected to ensure that the accountable person is the person whose responsibility it is to oversee a function. However, because different business structures may be used, the ADI has the discretion to determine the most appropriate allocation of accountable persons to its business activities.

1.53 It is the ADI's responsibility to ensure responsibilities are allocated appropriately. If an ADI does not or cannot do this, APRA has the power to direct an ADI or subsidiary with respect to the allocation of responsibilities. APRA can use this power if it is concerned that the ADI's allocation of responsibility (or failure to do so) is likely to give rise to a prudential risk. *[Schedule 1, item 1, section 37DB]*

1.54 This reflects the key BEAR obligation on an ADI to ensure it assigns all management and control responsibilities in an ADI group (the ADI, parent and subsidiaries) to accountable persons. *[Schedule 1, item 1, section 37D]*

1.55 The combination of key personnel obligations and the accountability maps will operate to let an ADI satisfy itself and show APRA that it has allocated all key personnel obligations to accountable persons and that those accountable persons can discharge their obligations under the BEAR.

1.56 An ADI must also ensure that persons who are prohibited from being an accountable person are not placed into an accountable person role. *[Schedule 1, item 1, paragraph 37D(1)(b)] [Schedule 1, item 1, section 37JB]*

1.57 A person will be prohibited from being an accountable person if they are not registered as an accountable person. The ADI can then simply register the person as an accountable person with APRA to overcome this restriction. *[Schedule 1, item 1, paragraph 37DA(1)(a)]*

1.58 To deal with the situation where a person unexpectedly becomes an accountable person without first being registered, such a person may be in the role for 21 days without being registered before they are prohibited from being an accountable person. *[Schedule 1, item 1, subsection 37DA(2)]*

1.59 This means that the person could be in the role for up to seven days before the ADI submits an application to APRA to have the person registered. As discussed at paragraph 1.114, registrations take effect 14 days after the application is made to APRA.

1.60 APRA has the power to determine another period of time that the person may be in the role before they are prohibited. APRA can exercise this power by giving a written notice to the relevant ADI. *[Schedule 1, item 1, paragraph 37DA(2)(b)]*

1.61 For example, a person may unexpectedly become an accountable person where the incumbent goes on sick leave or long-term leave.

1.62 A person is prohibited from being an accountable person if APRA has disqualified that person under the BEAR. Disqualification under the BEAR is discussed below at paragraphs 1.133 – 1.137. *[Schedule 1, item 1, paragraph 37DA(1)(b)]*

Deferred remuneration obligations of an ADI

1.63 The BEAR imposes a statutory obligation on an ADI or subsidiary to defer a percentage of an accountable person's variable remuneration. It ensures that accountable persons have clear incentives to make decisions which account for longer term effects. It also ensures that accountable persons are properly held to account for those decisions that have negative future consequences. *[Schedule 1, item 1, paragraph 37E]*

1.64 If an accountable person engages in behaviour inconsistent with their BEAR obligations then the ADI is obliged to withhold the accountable person's variable remuneration with the amount withheld to be proportionate to the severity and consequences of the breach. *[Schedule 1, item 1, paragraph 37E(1)(b)]*

1.65 Provision of deferred remuneration is a common practice in many ADIs and other companies. It rewards executives for actions which increase profitability or grow the business over time. However, when those actions negatively affect the business, or harm the community, the BEAR makes clear that executive remuneration should be reduced.

The ADI's obligations concerning remuneration policy

1.66 An ADI must implement a remuneration policy that is consistent with the ADI's BEAR obligations, that is, consistent with section 37E of the Banking Act. *[Schedule 1, item 1, section 37E]*

1.67 The ADI should defer the remuneration of accountable persons for all accountable persons of the ADI for the minimum period. The minimum period is defined as four years or a shorter period approved by APRA. The period starts on the day after the day on which the ADI made the decision that the person was granted variable remuneration. *[Schedule 1, item 1, section 37E] [Schedule 1, item 1, section 37EC]*

1.68 The amount of an accountable person’s remuneration to be deferred by an ADI will depend on the size of the ADI. For large and medium-sized ADIs, a range of deferred remuneration requirements apply. *[Schedule 1, item 1, section 37EB]*

Table 1.1 Minimum amounts of remuneration to be deferred

If the accountable person is the amount is
The CEO of a large ADI.	The lesser of 60 per cent of the CEO’s variable remuneration for the financial year or 40 per cent of the CEO’s total remuneration for the financial year.
An accountable person (other than the CEO) of a large ADI, or of a subsidiary of a large ADI.	The lesser of 40 per cent of the person’s variable remuneration for the financial year or 20 per cent of the person’s total remuneration for the financial year.
An accountable person of a medium ADI, or of a subsidiary of a medium ADI.	The lesser of 40 per cent of the person’s variable remuneration for the financial year or 20 per cent of the person’s total remuneration for the financial year.
An accountable person of a small ADI, or of a subsidiary of an ADI.	The lesser of 40 per cent of the person’s variable remuneration for the financial year or 10 per cent of the person’s total remuneration for the financial year.

1.69 For a smaller ADI, if the minimum amount of remuneration to be deferred, as calculated under the above table is less than \$50,000 a year, the ADI is not required to defer the remuneration. *[Schedule 1, item 1, section 37ED]*

1.70 The Minister has the power to determine what constitutes a small, medium or large ADI by legislative instrument. The Minister will make this decision based on advice from APRA. *[Schedule 1, item 1, subsection 37G(3)]*

1.71 The Government intends that the legislative instrument will provide that:

- a small ADI would have less than or equal to \$10 billion on a three year average of total resident assets.

- a medium ADI would have between \$10 billion and \$100 billion on a three year average of total resident assets.
- a large ADI would be any ADI with greater than or equal to \$100 billion on a three year average of total resident assets.
- all amounts, once finalised, will be indexed to GDP.

1.72 APRA has a power to agree to defer the remuneration of a specific accountable person for a period of time less than four years. APRA exercises this power by giving a written notice to the relevant ADI. *[Schedule 1, item 1, subsection 37EC(3)]*

1.73 The Government expects that APRA would exercise this discretion where an accountable person has died, or they are seriously incapacitated, disabled or seriously ill. APRA must also be satisfied that the ADI has satisfied itself that the relevant accountable person has complied with his or her BEAR obligations based on information that is available to the ADI at the time of applying to APRA for a shorter deferral period. *[Schedule 1, item 1, subsection 37EC(2)]*

1.74 To give full flexibility, APRA can also use the power for other reasons justifying a shorter deferral period. If the reason for using the power is not that the person has died, suffered a serious incapacity, disability or illness, then APRA may determine appropriate reasons by making a legislative instrument. *[Schedule 1, item 1, subparagraph 37EC(3)(a)(ii) and subsection 37EC(4)]*

1.75 A shorter deferral time is not intended to let a person avoid the consequences of breaches of BEAR obligations. It would be based on a situation where the ADI had satisfied itself and APRA that there were no emerging issues that would indicate a potential breach of BEAR in connection with that person. *[Schedule 1, item 1, subsection 37EC(2)]*

Who is an accountable person?

1.76 A key objective of the BEAR is to ensure that responsibilities are allocated to accountable persons across the ADI business. This can include its parent entity or subsidiaries so that where an issue arises, APRA can identify the responsible accountable person.

1.77 The Bill inserts the term ‘accountable person’ into the Banking Act. ‘Accountable person’ is defined by reference to a general principle and by reference to listed functions or responsibilities. *[Schedule 1, item 1, section 37BA]*

1.78 The definition of accountable person builds on existing concepts of accountability and responsibility, such as ‘responsible person’, ‘director’ and ‘senior manager’ which are defined in APRA’s existing prudential standards and the Banking Act.

1.79 Under the general principle, a person is an accountable person if the person is in a senior executive position with actual or effective management or control of the ADI, or the management or control a substantial part of the ADI group’s operations. The group would include a non-ADI parent, the ADI and its subsidiaries. [*Schedule 1, item 1, subsection 37BA(1)*]

1.80 It is not the Government’s intention that simply being in a management role in a subsidiary means the person is an accountable person. The application of the principle is intended to capture persons performing functions in addition to those in the prescribed list in appropriate circumstances. Under the general principle, a person having significant influence over the conduct and behaviour of the entity where that person’s behaviour or conduct could pose risks to the business and its customers will be an accountable person. This could include the head of a business line or a position in the parent entity if the parent is not an ADI. Similarly, an accountable person could also be a senior executive responsible for an ADI’s subsidiary or a major business activity in that subsidiary.

1.81 An accountable person is also defined by reference to a list of particular responsibilities. A person in an ADI will be an accountable person where the person is in a position that undertakes a particular responsibility as listed in the Banking Act. [*Schedule 1, item 1, subsection 37BA(2)*].

1.82 An ADI may not necessarily have a separate person corresponding to each of the functions listed in the table at section 37BA. In particular, small ADIs could liaise with APRA to determine the appropriate representation for their size, business operations, customer base and presence in the Australian market.

Table 1.2 Particular responsibilities covered by the BEAR

Particular responsibility
Responsibility for oversight of the ADI as a member of the Board of the ADI.
Under the immediate authority of the Board of the ADI, responsibility for carrying out the management of the ADI, including allocating to accountable persons responsibility for all parts or aspects of the ADI and reporting directly to the
Responsibility for the management of the ADI's financial resources..
Responsibility for the overall management of the risk controls and/or risk management arrangements of the ADI
Responsibility for the management of the operations of the ADI
Responsibility for the information management, including information technology systems in the ADI
Responsibility for the management of the internal audit function of the ADI
Responsibility for the management of the compliance function of the ADI
Responsibility for the management of the human resources function of the ADI
Responsibility for the management of the anti-money laundering function of the ADI

1.83 The Government would generally expect non-executive directors to be accountable persons, reflecting their oversight role for the ADI and its group. However, their BEAR obligations will apply to their performance of an oversight function, rather than day-to-day executive and management functions. Executive directors' BEAR obligations would cover both their oversight roles and their executive and management functions.

1.84 Some organisations will provide the occupants of senior executive and management roles with different titles, but the business practice in relation to the position descriptions is reasonably standard. Typically, people with the following role titles would be within the scope of the BEAR, subject to individual business circumstances:

- Chief Executive Officer – responsible for key management functions, including allocating responsibility for all parts or aspects of the operations to accountable persons;
- Chief Financial Officer - responsible for management of the financial resources of the ADI;

- Chief Risk Officer - responsible for overall risk controls and risk management arrangement for the ADI;
- Chief Operations Officer – responsible for management of the ADI's operations;
- Chief Information or Technology Officer - responsible for an ADI's information technology systems;
- Head of Internal Audit - responsible for management of the internal audit function of the ADI;
- Chief People Officer/Head of Human Resources - responsible for human resources functions
- Head of Compliance/Chief Compliance Officer - responsible for management of the compliance function of the ADI;
- Anti Money Laundering Officer – responsible for anti-money laundering obligations, although this function is sometimes performed by the Executive General Manager of Risk or the Executive General Manager of Security depending on the title assigned to the person managing of this function.

1.85 Regardless of specific role titles, the purpose of the general principle, combined with the list of position descriptions provides a clear set of broad responsibilities that are covered by the BEAR. Changing role titles or breaking up functions will not avoid BEAR obligations. Recognising that there are different business structures and that businesses change over time, APRA has a power to include additional responsibilities in the prescribed list. APRA exercises this power by making a legislative instrument. *[Schedule 1, item 1, subsection 37BA(4)]*

1.86 APRA also has a power to exclude responsibilities performed in a specific ADI or its subsidiaries from the prescribed list of responsibilities by issuing a written notice to the ADI or its subsidiaries. Where APRA issues a notice anyone in that ADI or its subsidiaries conducting those responsibilities is not considered an accountable person. *[Schedule 1, item 1, section 37BB]*

1.87 This power ensures APRA can respond flexibly to changes in business practices. It also recognises that there may be specific circumstances in particular ADIs may justify a different approach to defining accountable responsibilities.

1.88 APRA also has a power to exclude specified responsibilities for a particular class of ADIs or subsidiaries so that persons with those

responsibilities are not accountable persons. APRA exercises this power by making a legislative instrument. *[Schedule 1, item 1, paragraphs 37BB(1)(b) and 37BB(3)(b)]*

1.89 In exercising these powers, APRA must take into account whether including these responsibilities is necessary to achieve the objectives of BEAR.

1.90 As part of its accountability obligations (see paragraphs 1.39 – 1.50) an ADI must take reasonable steps to ensure that each accountable person meets his or her accountability obligations. *[Schedule 1, item 1, paragraph 37C(d)]*

1.91 An ADI must ensure that responsibility for all business and activities in the ADI and its subsidiaries is allocated to an accountable person or persons. *[Schedule 1, item 1, subsection 37C(e) and section 37FB]*

The accountability obligations of accountable persons

1.92 Unless an accountable person works in an ADI or class of ADIs that the Minister has exempted from the BEAR, an accountable person must meet his or her accountability obligations under BEAR. *[Schedule 1, item 1, sections 37B and section 37CA]*

1.93 The accountability obligations make clear the behaviour and conduct expected of an accountable person – they relate to conduct or behaviour that is systemic and prudential in nature with the obligations of accountable persons being a function of their role, the systemic nature of reasonable steps, and relating to prudential matters.

1.94 These obligations complement existing conduct and behaviour expectations which are already in place under APRA's *Prudential Standard CPS 520 Fit and Proper*. APRA may update CPS 520 to reflect the new and strengthened BEAR expectations as appropriate.

1.95 ASIC will continue to regulate instances of poor conduct or behaviour that are not prudential in nature, and consequently do not result in a breach of the BEAR accountability obligations. APRA and ASIC currently work together to oversee and regulate the financial sector and this is unchanged by the BEAR.

1.96 The accountability obligations of an accountable person are similar to those of an ADI. The accountable person has met these obligations if they can show APRA he or she has taken reasonable steps. *[Schedule 1, item 1, paragraphs 37CA(1)(c) and 37CB]*

1.97 Accountable person obligations, in an ADI, its parent or its subsidiary, include that the accountable person:

- in performing this role, must conduct him or herself with honesty and integrity and with due skill care and diligence;
- deal with APRA in an open, constructive and co-operative way (this does not displace legal professional privilege);
- in performing this role, take reasonable steps to comply with the law and prevent other matters which could affect the prudential standing or reputation of the ADI. [*Schedule 1, item 1, section 37CA*]

1.98 The terms ‘honesty’, ‘integrity’, ‘due skill’ and ‘diligence’, ‘open, constructive and co-operative’ are not defined terms in the Banking Act. They are not defined because these terms have a well understood common usage and, in some cases, legal application.

1.99 When an accountable person can show he or she has taken reasonable steps to meet his or her accountability obligations then he or she would not be in breach of those obligations. Section 37CB is not exhaustive in identifying what is a ‘reasonable step’.

1.100 Given the seniority of the role of accountable persons, reasonable steps are systemic in nature. An accountable person has taken reasonable steps where appropriate governance, control and risk management and policies and systems are in place; delegations are appropriate given the scope of responsibilities; and there are mechanisms for dealing with problems that arise or might arise.

1.101 The reasonable steps that a person could take to meet their accountability obligations should be considered in terms of that person’s functions or responsibilities. For example, a non-executive director in an oversight role may have in place different delegations to an accountable person in a management position.

1.102 Following appropriate consultation, APRA may issue further guidance on what factors it would consider to be reasonable steps and the behaviour and conduct it expects will meet the accountability obligations.

1.103 Where accountable persons share responsibilities, all of those people are equally responsible for meeting the accountability obligations. This is designed to prevent accountable persons from shifting blame between accountable persons. Each person who is responsible for a function listed in an accountability statement and map given to APRA, will be held as an accountable person for that role and those functions. [*Schedule 1, item 1, subsection 37CA(2)*]

Remuneration

1.104 The bill inserts definitions of ‘remuneration’ and ‘variable remuneration’ into the Banking Act. *[Schedule 1, item 1, subsection 37E(3) and section 37EA]*

1.105 Remuneration is a well understood concept.¹ This generally understood concept applies for the purposes of the BEAR. For example, it is based on the principle that remuneration is all of what is paid or payable to an accountable person for the performance of their duties in the course of their employment or their role as a director or officer. *[Schedule 1, item 1, subsection 37E(3)]*

1.106 Variable remuneration is defined at section 37EA as so much of an accountable person’s total remuneration that is not guaranteed because it is conditional on the achievement of pre-determined objectives and can be forfeited if these objectives are not met. *[Schedule 1, item 1, section 37EA]*

1.107 APRA has a power allowing it to adjust the scope of both ‘remuneration’ and ‘variable remuneration’ to account for new approaches to remuneration that may emerge. APRA exercises this power by making a legislative instrument. *[Schedule 1, item 1, subsection 37EA(4)]*

1.108 APRA also has the power to adjust the scope of variable remuneration in respect of one or more accountable persons of a particular ADI or subsidiary. APRA exercises this power by giving the ADI or subsidiary a written notice. *[Schedule 1, item 1, subsection 37EA(3)]*

1.109 Variable remuneration is valued at face value, rather than fair value for the purposes of calculating an amount to be deferred.

Accountable persons – registration requirements

1.110 Accountable persons must be registered with APRA prior to being appointed to that position. An application must be in writing in a form approved by APRA to include all information required by APRA as a part of the registration process. *[Schedule 1, item 1, subsections 37HA(1) and 37HA(2)]*

¹ See for example the *Remuneration and Allowances Act 1990* which sets the remuneration of holders of judicial offices, secretaries of Commonwealth departments and Senators and Members of the House of Representatives without defining the term ‘remuneration’.

1.111 A registration should also be accompanied by a signed declaration that the ADI is satisfied the person is suitable to be an accountable person. *[Schedule 1, item 1, paragraph 37HA(2)(c)]*

1.112 An accountability statement in respect of the person, as required by section 37F, should also be provided at this time. *[Schedule 1, item 1, paragraph 37HA(2)(d)]*

1.113 APRA must maintain a register of the ‘accountable persons’ of an ADI or its subsidiaries. The register is not public.

1.114 A person’s registration will take effect 14 days after APRA is notified, unless the ADI withdraws the registration beforehand. *[Schedule 1, item 1, section 37HA]*

1.115 While it is the responsibility of an ADI to determine the suitability of an accountable person, the period between the time at which an ADI registers a person and that registration taking effect gives APRA the opportunity to discuss with the ADI relevant information held by APRA. This information could include whether the person has previously been removed or disqualified as an accountable person, senior manager, director or auditor of an ADI.

Notification obligations

1.116 The BEAR obliges an ADI to give APRA accountability statements and an accountability map. These documents show the governance and management controls expected of an ADI and show the organisation’s lines of accountability. The accountability maps and statements are not intended to be viewed as compliance documents, but rather tools of good governance which illustrate that the ADI has appropriate accountability checks and balances and accountable person roles are allocated appropriately according to the size, complexity and customer base of the ADI. *[Schedule 1, item 1, sections 37F, 37FA and 37FB]*

1.117 ADIs must notify APRA if a person ceases to be an accountable person. This includes situations where the person ceases in that role because he or she has been dismissed or suspended because of a failure to comply with accountability obligations under BEAR. *[Schedule 1, item 1, paragraphs 37FC(a) and (b)]*

1.118 An ADI must notify APRA if the variable remuneration of an accountable person has been reduced or will be reduced as a result of that accountable person failing or being likely to have failed their accountable person obligations. *[Schedule 1, item 1, paragraph 37FC(c)]*

Accountability statements

1.119 An accountability statement is a description of the areas of responsibility attributable to management roles in an ADI and its subsidiaries. Each accountable person must have an accountability statement that outlines the areas over which they have effective management and control. *[Schedule 1, item 1, section 37FA]*

1.120 Accountability statements include a comprehensive description of that part of the ADI or its subsidiaries operations over which the accountable person has effective management or control. An accountability statement should align with the accountable person's functions and responsibilities. *[Schedule 1, item 1, section 37FA]*

Accountability maps

1.121 All ADIs will complete accountability maps which accurately show lines of reporting, delegation and responsibility in the ADI. The accountability map is a governance document. Many ADIs would already have some form of accountability map, in the form of an organisational structure and position descriptions.

1.122 Accountability maps will help APRA identify accountable persons where an issue arises in a particular area of an ADI or its subsidiary. They will also ensure that there are no gaps in accountable person functions across the ADI and that appropriate governance controls are in place. The accountability maps could also assist an ADI to show the reasonable steps it has taken to avoid any breach of its BEAR obligations. *[Schedule 1, item 1, section 37FB] [Schedule 1, item 1, section 37C] [Schedule 1, item 1, section 37CB]*

Consequences of breaching the BEAR

1.123 APRA has an established approach to prudential supervision which is set out in the *APRA Supervision Blueprint* and is supported by enforcement powers under the Banking Act and laws concerning insurance and superannuation.

1.124 These existing powers include:

- a direction power in section 11CA of the Banking Act which lets APRA compel a regulated entity to take specific action to address particular identified prudential issues;
- the making of prudential standards under section 11AF of the Banking Act, in which APRA can impose different requirements to be complied with;

- revoking a banking license under section 9 of the Banking Act;
- removing or disqualifying a director, senior manager or auditor under Division 3 of Part II of the Banking Act; and
- seeking an injunction and other orders from a court.

1.125 APRA can continue to use its informal and formal powers in implementing the BEAR. It also has stronger powers to support the BEAR. APRA has administrative authority to issue guidance for ADIs in complying with the BEAR.

1.126 The Government expects that APRA would only seek a civil penalty for significant breaches of the BEAR. [*Schedule 1, item 1, subsection 37G(1)*]

Consequences of breaching the BEAR for an ADI

1.127 APRA may seek civil penalties where an ADI has not:

- met its BEAR accountability obligations; [*Schedule 1, item 1, section 37*]
- met its key personnel obligations including ensuring that each significant and substantial part or aspect of the ADI's operations are covered by an accountable person; [*Schedule 1, item 1, section 37D*]
- met its obligation to register an accountable person and give APRA an accountability statement for that person; [*Schedule 1, item 1, sections 37F and 37HA*]
- met its obligation to give APRA an accountability map; [*Schedule 1, item 1, sections 37F and 37FB*] and
- deferred the remuneration of certain accountable persons. [*Schedule 1, item 1, section 37E*]

1.128 The maximum penalty available will depend on the size of the ADI. For large ADIs the maximum penalty will be 1 million penalty units, (currently \$210 million), for medium ADIs the maximum penalty will be 250,000 penalty units (currently \$52.5 million) and for small ADIs the maximum penalty available will be 50,000 penalty units (currently \$10.5 million).

1.129 The amount of the penalty must be determined by a court, and would be set with regard to the seriousness of the breach. The maximum

penalties represent the seriousness of these breaches, reflecting the potential harm to consumers and other financial market participants. The maximum penalties also reflect the damage to public confidence in the financial system resulting from a failure by an ADI and its senior officers to meet its BEAR obligations, such as maintaining fundamental standards of honesty and integrity, which result in prudential and systemic harm.

1.130 The Minister will determine by legislative instrument the kinds of ADIs which will be considered as small, medium or large. [*Schedule 1, item 1, subsection 37G(3)*]

1.131 When considering whether to impose a civil penalty, the Federal Court must consider the impact a potential penalty might have on the ongoing viability of the ADI. Existing schedule 2 to the Banking Act also includes factors that the Federal Court must consider. This includes the seriousness of the contravention and the harm caused by that contravention to the community. These factors reflect the application of the BEAR to situations when an ADI or an accountable person takes action which results in a serious contravention of the law, including the BEAR, or there is harm caused to the community. [*Schedule 1, item 1, subsection 37G(4)*]

1.132 Existing schedule 2 to the Banking Act also sets out the timeframe in which APRA may start court proceedings. Consistent with the current law APRA will have six years from the date of the misconduct to start court proceedings for a breach of the BEAR.

Consequences of breaching the BEAR – an accountable person

1.133 If an accountable person breaches BEAR, APRA may:

- disqualify an accountable person in an ADI or in a subsidiary.
- disqualify an accountable person in relation to a class or classes of ADIs or their subsidiaries. [*Schedule 1, item 1, section 37JJ*]

1.134 The BEAR is designed so that APRA has sufficient information from the ADI upon which to make a decision about accountability of an individual for a breach of that individual's accountability obligations from the accountability map and statements. For example, before taking an action concerning an accountable person, APRA would consider the person's accountability statement and the accountability map of the ADI to confirm whether responsibility points to the accountable person in question.

1.135 APRA must be in a position to justify a decision to disqualify an accountable person. Generally, the Government expects that such a decision would only be justified in serious cases. This approach is consistent with APRA's approach to the disqualification of senior managers, directors or auditors under the Banking Act. Minor breaches or incursions would be unlikely to result in a disqualification. *[Schedule 1, item 1, paragraph 37J(1)(b)]*

1.136 APRA can administer the disqualification provisions with flexibility. It can vary or revoke a disqualification. *[Schedule 1, item 1, section 37JA]*

1.137 APRA's powers concerning disqualification are reviewable under the AD(JR) Act. This allows an adversely affected person to seek judicial review of the lawfulness of APRA's decision. It is not a merits review process.

Examination powers

1.138 APRA has additional examination powers to investigate potential breaches of the BEAR. These powers extend to all of APRA's supervisory functions under that Act. *[Schedule 2, item 4, section 61A]*

1.139 APRA can require a person to appear before an investigator where the investigator reasonably believes the person has information relevant to an investigation. The person must either swear or affirm that the information they give APRA is true and must answer questions relevant to the investigation. A person commits a criminal offence and will be liable to a penalty of 30 penalty units (\$6,300) if the person fails to appear before the investigator, fails to make the required oath or affirmation or refuses to answer questions put to them. *[Schedule 2, item 4, sections 61A, 61B and section 61E]*

1.140 The examination must take place in private. In addition to the APRA investigator and the person being examined, only the person's lawyer, an APRA staff member approved by APRA and a person directed by the investigator to be present may be at the examination. *[Schedule 2, item 4, section 61C]*

1.141 A person who is at an examination but should not be there commits a criminal offence and is subject to 30 penalty units (\$6,300). *[Schedule 2, item 4, section 61C]*

1.142 Where a person's lawyer participates in the examination, the APRA investigator may determine when the person's lawyer may speak to the investigator and when the person may be examined by their lawyer. An investigator may stop an examination or line of enquiry if the

investigator believes the person's lawyer is obstructing the examination. *[Schedule 2, item 4, section 61C]*

1.143 APRA must make a written record of a person's statements made during an examination. The investigator may require the person under examination to read the record, or have it read to them, and sign it. It is a criminal offence for a person not to comply with these requirements, with a penalty of 30 penalty units (\$6,300). *[Schedule 2, item 4, section 61D] [Schedule 2, item 4, section 61E]*

1.144 The investigator must give a copy of the record to the person, without charge. However, the investigator may impose conditions on the record. For example, the investigator may impose a condition limiting the capacity of the person to share the record with other persons. If the person fails to comply with the conditions the person has committed a criminal offence and is subject to a term of 6 months imprisonment. *[Schedule 2, item 4, section 61D]*

1.145 If APRA is satisfied that the person is considering court proceedings concerning matters covered by the examination, APRA may also give a copy of the written record to the person's lawyer. *[Schedule 2, item 4, section 61D]*

1.146 If APRA shares the record in these circumstances, the copying or further dissemination of the record must only occur in relation to the proceedings. Failure to comply is a criminal offence, with a penalty of 6 months imprisonment. *[Schedule 2, item 4, section 61D]*

Indemnification of ADIs and accountable persons

1.147 To ensure that breaches of the BEAR have meaningful consequences on ADIs and accountable persons, indemnification against the financial consequences of breaching the BEAR is prohibited. *[Schedule 1, item 1, section 37KB]*

1.148 The prohibition against indemnification for loss associated with breaching the BEAR does not cover any insurance obtained with respect to legal costs that may be incurred in a BEAR related legal action. *[Schedule 1, item 1, subsection 37KB(3)]*

1.149 The purpose of the BEAR would be undermined by:

- allowing an ADI to obtain insurance to cover financial loss as a result of a civil penalty imposed on it; or
- allowing an accountable person to be indemnified for financial loss if an accountable person's variable remuneration is reduced or for civil penalty or fine.

Other amendments

1.150 The Banking Act is amended to include new definitions in section 5(1) of the Act. *[Schedule 1, item 2, subsection 5(1)]*

1.151 APRA is provided with the general administration of Part IIAA of the Banking Act. General administration provisions reinforce the principle that an administrator or regulator is authorised to do whatever may be fairly regarded as incidental to, or consequential upon, the things that they are authorised to do by the law. *[Schedule 1, item 1, section 37K]*

Scrutiny of legislative instruments

1.152 The Minister has powers by making legislative instruments to:

- determine what constitutes a small, medium or large ADI. *[Schedule 1, item 1, subsection 37G(3)]*
- exempt a class of ADIs or a class of subsidiaries of ADIs from the application of the BEAR. *[Schedule 1, item 1, subsections 37A(2) and 37KA(2)]*
- exempt ADIs from compliance with the obligations listed above, in relation to a particular class of subsidiaries of ADIs. *[Schedule 1, item 1, subsection 37KA(2)]*

1.153 APRA has powers to do or define things by making legislative instruments:

- justifying a shorter deferral period for variable remuneration, if the reason for using the power is not that the person has died, suffered a serious incapacity, disability or illness. *[Schedule 1, item 1, subparagraph 37EC(3)(a)(ii) and subsection 37EC(5)]*
- including additional responsibilities in the prescribed list of accountable person responsibilities. *[Schedule 1, item 1, subsection 37BA(4)]*
- exclude specified responsibilities for a particular class of ADIs or subsidiaries so that persons with those responsibilities are not accountable persons. APRA exercises this power by making a legislative instrument. *[Schedule 1, item 1, paragraphs 37BB(1)(b) and 37BB(3)(b)]*
- adjusting the scope of both ‘remuneration’ and ‘variable remuneration’ to account for new approaches to

remuneration that may emerge. *[Schedule 1, item 1, subsections 37EA(4)]*

1.154 Those decisions are of a legislative character and are not, therefore, subject to administrative review. However, those powers are the subject of scrutiny of the Parliament under section 42 of the *Legislation Act 2003*, which provides that those instruments are disallowable.

Application and transitional provisions

1.155 The BEAR provisions will apply from 1 July 2018. An ADI must update its remuneration policies to comply with the BEAR deferred remuneration provisions from 1 July 2018. *[Item 2 of the table in subsection 2(1) of the Bill]*

1.156 Division 4 remuneration requirements apply to the variable remuneration of an accountable person if the decision granting the variable remuneration to that person was made on or after 1 January 2019. *[Schedule 1, Part 3, item 3(1)]*

1.157 If an employment contract is in place on Royal Assent, the ADI should update that contract to reflect the ADI's BEAR compliant remuneration policy and the BEAR's deferred remuneration requirements by 1 January 2020. *[Schedule 1, Part 3, item 3(2)]*

1.158 To the extent that updating a contract existing on the date of Royal Assent of this Bill is found by a court to be an acquisition of property on other than just terms in breach of section 51(xxxi) of the Constitution, the BEAR's requirement for that contract to be compliant by 1 January 2020 will not apply. *[Schedule 1, Part 3, item 3(3)]*