

## The Banking Executive Accountability Regime: Getting your BEARings around the new obligations!

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The commencement date of 1 July 2018 for the Banking Executive Accountability Regime (**BEAR**) is fast approaching at least for the large ADIs. Whilst the commencement date of the BEAR for most customer-owned ADIs (**Mutual ADIs**) is not until 1 July 2019 it is useful to take stock and see where we are at with the BEAR.

The BEAR of course has been implemented by the *Treasury Laws Amendment (Banking Executive Accountability and Related Measures) Act 2018 (Act)* (Cth). The purpose here is quite clear. Those people who have significant influence over the conduct of an ADI are to be more accountable for the conduct and actions of the ADI, that occurs under their watch.

The Act received royal assent on 20 February 2018. Prior to the Act being enacted, it was subject to a review by the Economics Legislation Committee in November 2017, a consultation process and various proposed amendments by stakeholders and players in the political arena. The Act does reflect the result of some of the outcomes of the review process.

Given the extent of some of the revelations that have emerged from the current Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry one question could be whether, if the BEAR was in place earlier, it could have prevented some of the conduct or misconduct that have arisen. As for the Mutual ADIs which, it is argued, have worked very hard to earn and maintain the trust of their customers and members, this can be where they are subject to further regulatory burdens by the actions of the major ADIs.

### WHAT IS BEAR?

The BEAR creates obligations on all authorised deposit-taking institutions (**ADI**) to comply with four primary pillars:

- (a) accountability obligations;
- (b) key personnel obligations
- (c) deferred remuneration obligations; and
- (d) notification obligations.

### ACCOUNTABILITY OBLIGATIONS

#### ***Obligations of an ADI***

Each ADI must “take reasonable steps” to:

- (a) conduct its business with honesty and integrity, and with due skill, care and diligence;
- (b) deal with APRA in an open, constructive and cooperative way;
- (c) prevent matters from arising that would adversely affect the ADI’s

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prudential standing or reputation;

- (d) ensure that each of its accountable persons meets his or her accountability obligations; and
- (e) ensure that each non-ADI subsidiary complies with the above-mentioned obligations as if they were an ADI.

***Obligations of an Accountable Person***

All “accountable persons” of an ADI must comply with the accountability provisions. An accountable person of an ADI must conduct the responsibilities of his or her position as an accountable person by:

- (a) acting with honesty and integrity, and with due skill, care and diligence;
- (b) dealing with APRA in an open, constructive and cooperative way; and
- (c) taking reasonable steps to prevent matters from arising that would adversely affect the prudential standing or reputation of the ADI.

A point to note here is that the reasonable steps test does not apply to the first two obligations and they will take their ordinary meaning as informed by other laws and established case law. In other words being reasonable may not be enough here.

If more than one accountable person have the same responsibility, those accountable persons have the obligations jointly. As a result one accountable person may become responsible for the conduct of another.

***Who is an accountable person?***

An “accountable person” is defined in s 37BA to mean:

- (a) a person with actual or effective senior executive responsibility for management or control of the ADI (or of a significant or substantial part or aspect of the operations of the ADI);
- (b) the members of the Board of an ADI;
- (c) senior executives with responsibility for management of the ADI’s business activities (CEO), financial resources (CFO), risk management (CRO), operations (COO) information technology systems (CIO);
- (d) senior executives responsible for management of the ADI’s internal audit, human resources or anti-money laundering functions.

In relation to foreign ADIs, the person with senior executive responsibility for all activities of the *Australian branch* of the ADI would (without limiting the above) also be an accountable person.

What appears quite clear, particularly for the Mutual ADIs is that the majority, if not all in some cases, of the senior management of a Mutual ADI will be an accountable person.

All accountable persons must be registered with the Australian Prudential

**REASONABLE  
STEPS TEST**

Regulatory Authority (**APRA**). APRA has a discretion to exempt certain ADIs (or classes of ADIs) as well as particular accountable persons from their accountability obligations.

The ADI must maintain a register of accountable persons which must include details of any disqualification and APRA directions upon the person.

There is currently very little guidance as to what constitutes “taking reasonable steps” for the purposes of meeting accountability obligations. However s 37CB provides that it must include having:

- (a) appropriate governance, control and risk management;
- (b) safeguard against inappropriate delegations of responsibility; and
- (c) appropriate procedures for identifying and remediating problems that arise or may arise.

It is expected that APRA will, in the months following BEAR’s commencement, provide further guidance on the meaning of reasonable steps, with existing APRA guidelines possibly being a useful base line to consider.

**KEY PERSONNEL  
OBLIGATIONS**

An ADI must ensure that the responsibilities of the accountable persons (as well as the accountable persons for its subsidiaries) cover all parts or aspects of the operations of the ADI and its subsidiaries.

The intention here is that an ADI will have, at all times, an identifiable person responsible for each aspect of its business, and that such responsibilities are allocated appropriately. It should also be noted that APRA has a power under the Act to direct an ADI (or subsidiary) to allocate responsibilities in a particular way if it is concerned that an ADI’s allocation gives rise to a prudential risk.

An ADI must also ensure that no accountable person is prohibited under s 37DA of the Act (i.e. if the person is not registered with APRA, or disqualified by APRA for non-compliance).

**DEFERRED  
VARIABLE  
REMUNERATION  
OBLIGATIONS**

The BEAR also focuses on remuneration of accountable persons which is based upon the achievement of specified objectives. This has become quite a topical issue for the financial sector given some of the revelations from the Royal Commission.

Variable remuneration is defined as remuneration which is “conditional on the achievement of objectives”.

Importantly, the deferred remuneration obligations do not apply to an accountable person if his or her variable remuneration for that financial year is less than \$50,000 (or such other amount as determined by the Minister).

The deferred remuneration obligations of an ADI are to:

- (a) ensure that a certain minimum portion of the variable remuneration of an accountable person is deferred for a minimum of 4 years (unless a shorter period is approved by APRA) (further details are provided

below);

- (b) have a remuneration policy which reduces an accountable person's variable remuneration if he or she fails to comply with the accountability obligations, by a proportionate amount, and acting in accordance with that remuneration policy;
- (c) taking reasonable steps to ensure that any non-ADI subsidiaries also comply with the deferred variable remuneration obligations as if they were an ADI.

The minimum amount of variable remuneration which must be deferred, varies with the position of the accountable person as well as the size of ADI. These are:

- *CEO of a Large ADI*: The lesser of either (a) 60% variable remuneration. or (b) 40% total remuneration
- *Accountable person of a Large ADI (or subsidiary), other than the CEO*: The lesser of (a) 40% variable remuneration. or (b) 20% total remuneration
- *Accountable person of a medium ADI (or subsidiary)*: The lesser of (a) 40% variable remuneration, or (b) 20% total remuneration
- *Accountable person of a small ADI (or subsidiary)*: The lesser of (a) 40% variable remuneration, or (b) 10% total remuneration.

The issue for Mutual ADIs here of course is which category they fit in. The different categories are determined as follows:

- (a) *small ADI*: less than or equal to \$10 billion on a 3-year average of total resident assets;
- (b) *medium ADI*: between \$10 billion and \$100 billion on a 3-year average of total resident assets; and
- (c) *large ADI*: greater than or equal to \$100 billion on a 3-year average of total resident assets.

Other than in the case of one or two exceptions it would appear that the Mutual ADIs are all small ADIs.

These provisions are proposed as an incentive for accountable persons to comply with BEAR, as well as provide a financial penalty to those who breach their obligations under the Act.

## NOTIFICATION OBLIGATIONS

There are three branches to an ADIs notification obligations under BEAR. The ADI must (a) provide APRA with an accountability statement, (b) provide APRA with an accountability map and (c) notify APRA of certain events. APRA also has general powers of examination to facilitate its supervisory role.

It must also ensure that non-ADI subsidiaries comply with these obligations as if they were an ADI.

**Accountability Statements**

An accountability statement is a document, which describes the role and responsibilities of each accountable person, including details of any part or aspect of the ADIs operations that the accountable person has actual or effective responsibility for its management or control.

**Accountability Maps**

The accountability map is a list of all accountable persons in the ADI (and its subsidiaries), detailing all reporting lines and lines of responsibility. The accountability map must include sufficient information so as to allow APRA to identify each accountable person.

APRA may prescribe, by way of legislative instrument, further information to be included in the accountability statement or accountability map.

**Notification of Events**

Where there is a change of accountable person, reduction of variable remuneration or the ADI becomes aware of a breach of BEAR (by the ADI or an accountable person), the ADI must notify APRA within 14 days.

The ADI will also have to notify APRA of any changes to the accountability statement or accountability map within 14 days of such change.

**CONSEQUENCES  
FOR BREACH**

Contravention of BEAR obligations by an ADI is a civil penalty provision which may attract a pecuniary penalty of:

- (a) 1 million penalty units (\$210 million) for a large ADI;
- (b) 250,000 penalty units (\$52.5 million) for a medium ADI; and
- (c) 50,000 penalty units (\$10.5 million) for a small ADI.

Clearly the imposition of a civil penalty on a Mutual ADI may have a catastrophic effect upon them depending upon their size and is clearly a significant deterrent. While there is no personal liability imposed on accountable persons who breach their BEAR obligations, APRA may disqualify the accountable person from acting in that capacity for a period that APRA considers appropriate. As discussed above, there may also be implications in terms of their deferred variable remuneration.

Although the BEAR does not apply to the Mutual ADIs until another year, the Mutual ADIs should over time implement steps so that they are able to comply with the BEAR in a timely manner and also to try and learn from the experience of the large ADIs over the next year.

The BEAR will be reviewed 3-years from the date it comes into operation and hopefully any lessons learned can be implemented.

**DISCLAIMER:** This communication is intended to provide commentary and general information only. It is not intended to be a comprehensive review of all aspects of the matter referred to. It should not be relied upon as legal advice as to specific issues or transactions.

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