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Banking Executive Accountability Regime

Summary of consultation paper

July 2017

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What is BEAR?

Foreshadowed in both the Sedgwick inquiry and recent banking sector parliamentary inquiries, the 2017 Federal Budget included a proposed Banking Executive Accountability Regime (BEAR). The proposed regime will be administered by the Australian Prudential Regulation Authority (APRA) and will include a number of measures that are similar to the UK's Senior Manager Regime (SMR).

Whilst there are still a number of key questions to be clarified, a consultation paper was released on 13 July 2017, submissions are due on 3 August 2017.

The spirit of BEAR is to improve accountability through a sound risk culture, effective corporate governance and impose stronger consequences. The regime recognises that leadership is key to driving cultural change, and offers many opportunities to empower people to do the right thing. The impact to ADIs and the extent of work required will vary depending on previous programs undertaken in this space for implementation.

What does this mean for ADIs?

To both implement and administer the regime, different areas of the business will need to work together in a way they may not have previously – Human Resources will be further brought into the regulatory picture and we foresee the need for increased interaction with Compliance, Risk, Legal, Internal Audit and CoSec.

Considered decision-making through increased accountability and transparency will likely lead to a reduction in costly compliance mistakes, therefore improving shareholder confidence and consumer trust.

If seen as more than a compliance or legal exercise, the measures implemented as part of BEAR could help ADIs achieve real benefits to not only their risk culture, but their business as a whole.

What is BEAR? (cont'd)

Proposed measures announced in the Budget

New measure	Detail
Executive registration with APRA	All current senior executives and directors of ADIs will be required to be registered with APRA, and APRA will need to be advised prior to any future senior appointments. APRA will have the power to deregister and disqualify senior executives who fail to meet expectations.
Accountability mappings	ADIs will be required to provide APRA with accountability maps of senior executives' roles and responsibilities across all business areas.
APRA powers over remuneration policy	APRA will be given stronger powers to require ADIs to review and adjust their remuneration policies when APRA believes these policies are not appropriate.
Remuneration deferral	ADIs will be required to defer a minimum of 40% of bank executives' variable remuneration for a minimum of four years, increasing to 60% for certain executives.
Increased expectations and penalties for executives	Conduct standards for executives and directors - covering matters such as conducting business with integrity, due skill, care and diligence and acting in a prudent manner. Introduction of civil penalties for ADIs who fail to meet the new expectations (e.g. hiding misconduct), or do not appropriately monitor suitability of executives to hold senior positions. Executives may no longer be able to be registered or employed in senior roles if they are found to have breached their accountabilities.
Penalties for ADIs	APRA will be able to impose civil penalties of up to $200 million for large ADIs and $50 million for smaller ADIs that do not appropriately monitor the suitability of their executives to hold senior positions.

Lessons learnt from the UK's SMR

ADIs can benefit from the UK experience in terms of considerations for developing new processes, leveraging what has worked well, and anticipate challenges that may not come to pass.

The biggest challenge cited by the UK banks was obtaining clarity from the UK regulators around expectations on ambiguous requirements, along with ensuring sufficient lead time and the right resources for the significant amount of work to implement the new requirements. Many UK banks had underestimated how much work was involved. Some banks also initially treated it as a legal exercise, and spent significant time and wasted effort on technical design that did not consider practical implementation.

Other anticipated challenges in the UK have not yet been realised – such as banking executives either leaving the UK or the banking industry due to the increased personal risk involved, or executives being overly conservative in decision making to the extent this negatively impacts company financial performance. Whilst there have not yet been any prosecutions, there is debate whether the SMR will underline (or be undermined by) company law if cases are brought to trial.

Another major change for the UK banks has been for governance structures and committees – however not always in the same way. Some UK banks sought to simplify as individual accountability came to the fore, whilst others have created new committees to plug gaps identified.

Australian ADIs should consider…

01

Ownership of the implementation project

In the UK, there were different approaches with some organisations driving the changes from the first line, and others from Compliance / CoSec / Legal / HR. Whichever approach is taken, the crucial factor for success will be first line engagement and "buy in" to the changes.

02

Ongoing co-ordination and oversight of requirements

Many UK banks have set up a small team, often under the CEO, to ensure requirements are properly embedded and remain fit for purpose. ADIs here will need to consider whether this model is the "right fit" for their organisation. On the one hand, a dedicated team will relieve pressure on already stretched teams across a business, but on the other, it may mean the relevant executives may not see the new requirements as "their responsibility".

03

How executives should approach their accountabilities

Whilst substantial effort will be required to determine the right accountabilities are mapped to the right executives, an overly legalistic and process-heavy approach may be counterproductive. There are examples in the UK of how senior executives did not know what was really going on 'under the bonnet' because they were putting too much faith in their dashboard reports and not asking searching questions.

04

The personal impact of the new regime

In the UK, the SMR implementation has highlighted internal politics, particularly with regard to interpreting "reasonable steps" as being accountable versus being informed. Further, it heightened the need to clarify responsibilities, as people typically do not like having the status quo or their authority challenged, as well as accepting responsibility for business decisions that they do not control.

Summary of proposed BEAR

What are the existing accountability frameworks in Australia?

APRA's prudential framework already includes standards covering:

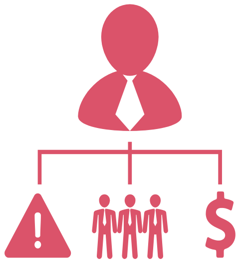
Culture	Prudential Standard *CPS 220 Risk Management* (CPS 220) requires the board of a bank to form a view on the ADI's risk culture and the extent to which that culture supports the ability of the ADI to operate consistently within its risk appetite, and ensure that the ADI takes steps to make desirable changes to its risk culture
Remuneration	Prudential Standard *CPS 510 Governance* (CPS 510) requires the ADI to establish a Board Remuneration Committee and maintain a Remuneration Policy that aligns remuneration and risk taking
Governance	CPS 510 sets out minimum standards for good governance of an ADI to ensure that it is managed soundly and prudently by a competent board
Risk management	CPS 220 requires an ADI to maintain a risk management framework that is appropriate to its size, business mix, and complexity. Moreover, Prudential Standard *CPS* 232 *Business Continuity Management* requires an ADI to maintain a business continuity management policy that ensures it is able to meet its financial and service obligations to its depositors, policyholders and other stakeholders
Fit and proper	Prudential Standard *CPS 520 Fit and Proper* sets out criteria for determining the fitness and propriety of responsible persons. APRA may direct an ADI to remove directors or senior managers who lack the requisite fitness and propriety.

These standards apply in addition to the duties of directors under the Corporations Act.

The objective of the BEAR is to apply a heightened responsibility and accountability framework to the most senior and influential directors and executives within ADIs, rather than replacing or changing the existing prudential framework or directors' duties.

Summary of proposed BEAR (cont'd)

Who does BEAR apply to?



ADIs, and subsidiaries of ADIs, including those that provide non-banking services and those that are foreign subsidiaries. Where an ADI exists within a group with a non-ADI or overseas parent company, the scope of the BEAR is intended to apply only to the subgroup of entities for which the ADI is the parent.

The directors and senior executives of the subsidiaries within a group or subgroup with an ADI parent, including those subsidiaries that are not APRA-regulated, are included.

Individuals to be covered by the BEAR – accountable persons

The definition of accountable persons is intended to clearly identify the most senior directors and executives who will be held to a heightened standard of responsibility and accountability.

The definition of accountable persons will include new and existing individuals.

It is proposed to define accountable persons by adopting a combination of prescription and principle.

Prescribed functions could include both oversight functions (such as Chair, Chair of the Risk Committee, Chair of the Audit Committee, and Chair of the Remuneration Committee) and executive functions (such as Chief Executive, Chief Finance, Chief Risk, Chief Information and Head of Internal Audit), as defined in Table 1 on the following page.

The principles-based element of the definition is intended to capture other individuals who have significant influence over conduct and behaviour, and whose actions could pose risks to the business and its customers. The extent to which ADIs would register accountable persons under this element of the definition would vary depending on differences in business models and group structures.

An example of a function that could be assumed to meet this criteria would include the head of a key business area. This function would be responsible for the management of a significant proportion of the ADI business or activity, based on its proportion of total gross assets, revenue or profit. This function could include directors or senior executives of subsidiaries within a group or subgroup with an ADI parent.

Summary of proposed BEAR (cont'd)

Table 1: Proposed prescribed accountable persons functions

Descriptor	Function
Oversight functions	
Chair	Responsible for chairing and overseeing the performance of the Board.
Chair of the Risk Committee	Responsible for chairing and overseeing the performance of any committee responsible for the oversight of the risk management systems, policies and procedures.
Chair of the Audit Committee	Responsible for chairing and overseeing the performance of any committee responsible for the oversight of the internal audit system.
Chair of the Remuneration Committee	Responsible for chairing and overseeing the performance of any committee responsible for the oversight of the design and the implementation of the remuneration policies.
Senior Officer Outside Australia	Under the authority of the Board of a foreign ADI, outside Australia and responsible for overseeing the Australian branch operation of a foreign ADI. This function already exists under CPS 510.
Executive functions	
Chief Executive	Under the immediate authority of the Board, responsible for carrying out the management of the conduct of the whole business (or relevant activities).
Chief Finance	Responsible for the management of financial resources and reporting directly to the Board in relation to financial affairs.
Chief Risk	Responsible for overall management of risk controls, including the setting and managing of risk exposures, and reporting directly to the Board in relation to its risk management arrangements.
Chief Operations	Responsible for the management of operations and for reporting directly to the Board on the operations function.
Chief Information	Responsible for the management of information technology and for reporting directly to the Board on the information technology function.
Head of Internal Audit	Responsible for the management of the internal audit function and for reporting directly to the Board on the internal audit function.
Head of a Foreign Bank Branch	Ordinarily resident in Australia and responsible for the conduct of the Australian branch operation of a foreign ADI. This function already exists under APRA's prudential standard CPS 510.

Expectations under the BEAR

ADIs would be expected to:

- conduct its business with integrity
- conduct its business with due skill, care and diligence
- deal with APRA in an open and cooperative way; and
- take reasonable steps to:
  - act in a prudent manner, including by meeting all of the requirements of APRA's prudential standards, and maintaining a culture which supports adherence to the letter and spirit of these standards
  - organise and control its affairs responsibly and effectively
  - ensure that these expectations and accountabilities of the BEAR are applied and met throughout the group or subgroup of which the ADI is parent.

An accountable person would be expected to:

- act with integrity, due skill, care and diligence and be open and co-operative with APRA
- take reasonable steps to ensure that:
  - the activities or business of the ADI for which they are responsible are controlled effectively
  - the activities or business of the ADI for which they are responsible comply with relevant regulatory requirements and standards
  - any delegations of responsibilities are to an appropriate person and those delegated responsibilities are discharged effectively
  - these expectations and accountabilities of the BEAR are applied and met in the activities or business of the ADI group or subgroup for which they are responsible.

Summary of proposed BEAR (cont'd)

Remuneration

- A minimum of 40 per cent of an ADI executive's variable remuneration — and 60 per cent for certain ADI executives such as the CEO — will be deferred for a minimum period of four years
- APRA will have stronger powers to require ADIs to review and adjust remuneration policies when APRA believes these policies are producing inappropriate outcomes.

The remuneration elements of the BEAR will apply to accountable persons that perform executive functions only. Accountable persons that perform oversight roles are not covered because, under the ASX Corporate Governance Council *Corporate Governance Principles and Recommendations*, they should not receive variable remuneration.

It is proposed that variable remuneration be defined to include that part of total remuneration that is discretionary and conditional upon performance and the delivery of results, including individual and business performance and results.

It is proposed to apply 60 percent deferral to all CEOs of ADIs. However, the regime could borrow from the UK approach and also apply 60 percent deferral to the most senior accountable persons performing executive roles in the domestic systemically important banks (D-SIBs).

The existing APRA prudential standards on remuneration require APRA-regulated entities to have remuneration policies which provide for the downwards adjustment of performance-based remuneration if necessary to protect the financial soundness of an institution or to respond to significant unexpected or unintended consequences. APRA can already direct APRA-regulated firms to change their remuneration policies to provide for this downward adjustment in variable remuneration.

APRA will be given enhanced statutory powers to direct ADIs to review and adjust remuneration policies when APRA believes these policies are producing inappropriate outcomes. In particular, it is proposed that the enhanced power would apply so that the variable remuneration of an executive accountable person will be reduced where he or she does not meet the new expectations of the BEAR and is consequently removed and/or disqualified.

Summary of proposed BEAR (cont'd)

Registration and accountability mapping

Registration

ADIs will be required to register accountable persons with APRA. This mechanism will operate by requiring ADIs, prior to appointing an individual as an accountable person, to advise APRA of the potential appointment and provide APRA with information regarding the candidate's suitability.

Upon notification, APRA would consult its register of accountable persons and advise the ADI if the candidate has previously been removed or disqualified by APRA, or if APRA is aware of any other issues that that could affect the candidate's suitability for the role. It is not intended that ADIs be able to consult the register themselves.

ADIs will maintain responsibility for assessing suitability and appointing accountable persons.

Accountability mapping

ADIs will also be required to provide APRA with accountability statements to detail the roles and responsibilities of each accountable person. These individual accountability statements should also be consolidated into a clear and comprehensive accountability map to detail the allocation of roles and responsibilities across the ADI group or subgroup.

All aspects of an ADI group's or subgroup's operations, including but not limited to its governance mechanisms, risk frameworks, internal procedures and systems, compliance with prudential standards, and activities and businesses.

One potential approach for developing the accountability mapping mechanism is to leverage the Senior Managers Regime in the United Kingdom (outlined in Table 2 on the following page), by prescribing a minimum set of responsibilities across an ADI group or subgroup that must be allocated to accountable persons. The prescribed responsibilities would not necessarily have to be exhaustive, with ADIs having discretion to allocate additional responsibilities.

Summary of proposed BEAR (cont'd)

Table 2: Prescribed responsibilities – UK SMR

All firms	
Responsibility for the firm's performance of its obligations under the senior management regime	
Responsibility for the firm's performance of its obligations under the employee certification regime	
Responsibility for compliance with the requirements of the regulatory system about the management responsibilities map	
Overall responsibility for the firm's policies and procedures for countering the risk that the firm might be used to further financial crime	
Responsibility for the allocation of all prescribed responsibilities	
All firms except small firms	
Responsibility for: (a) leading the development of; and	(b) monitoring the effective implementation of; policies and procedures for the induction, training and professional development of all members of the firm's governing body
Responsibility for monitoring the effective implementation of policies and procedures for the induction, training and professional development of all persons performing designated senior management functions on behalf of the firm other than members of the governing body	
Responsibility for overseeing the adoption of the firm's culture in the day-to-day management of the firm	
Responsibility for leading the development of the firm's culture by the governing body as a whole	
Responsibility for the internal audit function: • safeguarding the independence of and oversight of the performance of internal audit	
Responsibility for the compliance function: • safeguarding the independence of and oversight of the performance of the compliance function	
Responsibility for the risk function: • safeguarding the independence of and oversight of the performance of the risk function	
Responsibility for overseeing the development of, and implementation of the firm's remuneration policies and practices in accordance with SYSC 19D (Remuneration Code)	
Responsibility for the independence, autonomy and effectiveness of the firm's policies and procedures on whistleblowing, including the procedures for protection of staff who raise concerns from detrimental treatment	
Management of the allocation and maintenance of capital, funding and liquidity	
The firm's treasury management functions	

All firms except small firms (cont'd)
The production and integrity of the firm's financial information and its regulatory reporting in respect of its regulated activities
The firm's recovery plan and resolution pack and overseeing the internal processes regarding their governance
Responsibility for managing the firm's internal stress-tests and ensuring the accuracy and timeliness of information provided to the PRA and other regulatory bodies for the purposes of stress-testing
Responsibility for the development and maintenance of the firm's business model by the governing body
Responsibility for the firm's performance of its obligations under Fitness and Propriety (in the PRA Rulebook) in respect of its notified non-executive directors
Specific types of firms
If the firm carries out proprietary trading, responsibility for the firm's proprietary trading activities
If the firm does not have an individual performing the Chief Risk function, overseeing and demonstrating that the risk management policies and procedures which the firm has adopted in accordance with SYSC 7.1.2 R to SYSC 7.1.5 R satisfy the requirements of those rules and are consistently effective in accordance with SYSC 4.1.1R
If the firm outsources its internal audit function taking reasonable steps to ensure that every person involved in the performance of the service is independent from the persons who perform external audit, including a) Supervision and management of the work of outsourced internal auditors; and b) Management of potential conflicts of interest between the provision of external audit and internal audit services
If the firm is a ring-fenced body, responsibility for ensuring that those aspects of the firm's affairs for which a person is responsible for managing are in compliance with the ring-fencing requirements.
Overall responsibility for the firm's compliance with CASS
Small firms only
Responsibility for implementing and management of the firm's risk management policies and procedures
Responsibility for managing the systems and controls of the firm
Responsibility for managing the firm's financial resources
Responsibility for ensuring the governing body is informed of its legal and regulatory obligations

Summary of proposed BEAR (cont'd)

Removal and disqualification

It is proposed that APRA will be given enhanced powers to remove and disqualify senior executives and directors. These enhanced powers will apply to all institutions regulated by APRA. Persons removed or disqualified under these powers will have a right of appeal.

The new powers will enhance APRA's existing powers to remove and disqualify persons from APRA-regulated institutions.

APRA already has the power to direct an ADI or authorised non-operating holding company (NOHC) to remove a director or senior manager if APRA is satisfied that the person is disqualified from acting in that position, or does not meet the fit and proper criteria set out in the prudential standards. A similar power exists in relation to other APRA-regulated institutions.

This is in addition to a broad power for APRA to issue a direction to an ADI or authorised NOHC in a range of circumstances, including to remove a director or senior manager. A similar power exists in relation to other APRA-regulated institutions.

APRA may also apply to the Federal Court to disqualify a person from being a senior manager, director or auditor of an ADI or authorised NOHC where the Court is satisfied the person is not a fit and proper person for such a role. A similar power exists in relation to other APRA-regulated institutions.

Enhanced powers are intended to make it easier for APRA to ensure that individuals who do not meet standards of competency and conduct cannot remain in their position, whilst ensuring those persons receive due process and have appropriate mechanisms to seek review.

APRA could have the power to disqualify a person from being a senior manager, director or auditor of an APRA-regulated institution or NOHC where it is satisfied the person is not a fit and proper person for the role, subject to appeal.

To help it enforce the enhanced powers, it is proposed that APRA will require ADIs to inform it where individuals have been subject to internal disciplinary proceedings, including where they have been subject to dismissal, suspension or a reduction in variable remuneration for not meeting the new expectations under the BEAR.

Summary of proposed BEAR (cont'd)

Civil penalties

New civil penalty for ADIs that fail to meet the new expectations of the BEAR, with a maximum penalty of $200 million for larger ADIs and $50 million for smaller ADIs

It is proposed that APRA should be able to seek a civil penalty in a range of circumstances, including where:

- an ADI fails to meet the new expectations of an ADI under the BEAR
- an ADI fails to hold accountable persons to account under the BEAR
- an ADI does not appropriately monitor the suitability of accountable persons.

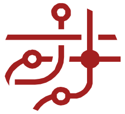
It is proposed that an appropriate threshold for defining large ADIs is total liabilities greater than $100 billion. It is also being considered that ADIs will be prevented from taking out insurance against civil penalties.

How PwC can help

Whilst BEAR has not yet been legislated, we can support you in understanding the implications of the regime. We can also assist in your response to the consultation paper, as it closely resembles the UK regime. The PwC international network ensures we bring the firm's experience advising leading global institutions on their response.

As you begin to consider the new measures, we can help by:

Assisting Regulatory Advocacy teams with feedback to Treasury and APRA especially on lesson learnt from the UK SMR



Designing and facilitating workshops to bring stakeholders across the business up-to-speed and help them understand the implications of BEAR

Defining what "good" looks like and how it will be measured, particularly with regard to the new accountability mapping requirements and conduct expectations

Reviewing maturity and operating of existing remuneration deferral and clawback policies

Reviewing maturity and operation of existing governance structures, along with monitoring and oversight measures

Identifying the likely gaps to the new regime that you will need to address, and prioritising activity to prepare for the new regime

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