

Australia's proposed Banking Executive Accountability Regime: Regulatory panopticon or fail-safe?

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- When looking at banking regulation, disclosure, or standard form contracts, it is clear the self-regulatory system in Australia has failed.
- Under the BEAR proposed regime, Australia's bank executives would be required to take responsibility for their corporate culture.
- It is difficult to determine if the proposed BEAR would curb conduct risk of banks and bank executives as it is still too early to point to evidence from other jurisdictions.

It is difficult to ignore the widespread concern over the corporate culture of Australia's banking industry. This growing concern has led to close scrutiny of banks and subsequently triggered the Australian Securities and Investments Commission (ASIC) to regulate what it deems as bad corporate culture.

The resulting independent initiatives of the Australian Bankers Association (ABA) Code of Conduct reviews and recommendations have attempted to address the issue. The July 2017 Federal Treasury's consultation paper is currently seeking to introduce a Banking Executive Accountability Regime (BEAR) providing Australian Prudential Regulatory Authority (APRA) with powers to enforce a new regulatory regime. The August 2017 Commonwealth Bank of Australia (CBA) allegation of multi-million dollar money-laundering activity through intelligent bank deposit machines has sounded more alarm bells in relation to the alleged lack of cultural risk.

Under the BEAR proposed regime, Australia's bank executives would be required to take responsibility for their corporate culture. This is an attempt to restore the trust and integrity lost due to a number of financial organisations


behaving inappropriately.¹ It has been suggested that the erosion of trust in finance forces renewed reflection on how to mediate the relationship between state and market and the role to be played by the corporation.² Kingsford-Smith, Clarke and Rogers observes:

'[W]hilst lately more attention is being given to responsible persons or managers, the calibre of personnel, and 'risk culture' in regulatory standards, it is still mainly seen as an entity requirement to have proper capabilities and resources, not a question of individual ethical or legal responsibility. This concentration on entity regulation is one of the myriad structural features that act as obstacles to professionalism in banking.³

Analysis of Australian Banking Industry Report

The ABA's Independent Review of the Code of Banking Practice (the Code), along with its February 2017 amendments have been described as designed primarily to facilitate enhanced voluntary engagement rather than perform an investigatory or punitive function.⁴ This is evident in one of the Code's key recommendations:

- Signatory banks' websites should provide an easily navigable, clear link to the Code, with links from the obvious places such as customer service and complaints information. They should no longer be required to display the Code at branches.



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- In order to maximise the message of change to customers, signatory banks should look at ways of coordinating publicity and messaging about the implementation of the new Code.⁵

Given the historic failure of self-regulatory initiative codes (first introduced in 1996) it has been difficult to deter or prevent scandal. It is not surprising that the self-regulatory approach by the ABA is not enough to restore public confidence. Australia's bankers are not in a position to be professionalised,⁶ in the same way as lawyers and accountants. The ABA does not have powers similar to other professional bodies to bind their members or compel them to face disciplinary hearings or the possibility of expulsion and is by no means a body that can be left to measure and report its own failures moving forward. The Code would not, in our opinion, be enough of an initiative to restore public trust.

In the last few years there has been evidence of conduct involving calculated deceit and the intention to carry on in this manner has been the main motivating factor for the public's outcry.⁷ Prime Minister Turnbull's criticisms⁸ reflect a familiar litany of financial scandals in Australia characterised by poor, indeed sometimes deceptive and illegal, behaviour by financial professionals seemingly unfazed by the deterrent capacities of existing penalties. The roll call of infamy includes many well-known names.⁹ The government's support for the need to change has been public and vocal from the outset.

Whether looking at banking regulation, disclosure, or standard form contracts, the self-regulatory system in Australia has failed.

Commentators have remarked that the government and all political persuasions, both state and federal, have not adequately protected consumers from being abused by dishonest and unconscionable actions by the banks.¹⁰ The government has since announced in its 2017–18 Budget comprising a comprehensive package of reforms the need to address the recommendations of the Coleman Report. As part of this package, the government announced that it will legislate to introduce registration of directors and senior executives with APRA. The registration would be providing maps of their roles and responsibilities. These are new powers and penalties afforded to APRA allowing them to remove senior executives from the APRA-regulated institutions and powers to issue civil penalties and variable remuneration.

The proposed new Banking Executive Accountability Regime (BEAR)

On 15 September 2016, the Federal Treasurer requested the House of Representative's Standing Committee on Economics to undertake an inquiry into Australia's banks. In November that year the inquiry published a report (Coleman Report). In this report's chair's foreword states that:¹¹

'The culture of Australia's financial sector also needs to be reformed. While significant changes have been announced that will better protect consumers, not enough has been done to force banks' senior leaders to change their behaviour. When consumers are continually let down, senior executives should go.'

One of the recommendations in the report states that:¹²

'The committee recommends that, by 1 July 2017, the Australian Securities and Investments Commission ASIC require Australian Financial Services License holders to publicly report on any significant breaches of their licence obligations within five business days of reporting the incident to ASIC, or within five business days of ASIC or another regulatory body identifying the breach.

This proposed report should include:

- a description of the breach and how it occurred
- the steps that will be taken to ensure that it does not occur again
- the names of the senior executives responsible for the team/s where the breach occurred
- the consequences for those senior executives and, if the relevant senior executives were not terminated, why termination was not pursued.'

The government's response in May 2017 was to introduce the legislation on what it calls the Banking Executive Accountability Regime (BEAR).¹³ According to the consultation paper released by the Australian Federal Treasury the aim of BEAR is, '[t]o

apply a heightened responsibility and accountability framework to the most senior and influential directors and executives within authorised deposit taking institutions (ADIs), rather than replacing or changing the existing prudential framework or directors' duties.¹⁴ BEAR is expected to improve conduct by setting a standard of behaviour and deterring inappropriate conduct.¹⁵

Furthermore, it will require key senior personnel to be registered and the accountability of these individuals to be mapped.¹⁶ The purpose according to the consultation paper is as follows:¹⁷

- to help ensure that if an individual is not suitable or has been found not to have met the expectations of an accountable person in the past, he or she is not registered as an accountable person
- to promote a clear understanding of the responsibilities of accountable persons on an individual level and the allocation of responsibilities across an ADI group or subgroup
- to make it easier to hold an individual to account if he or she does not meet new expectations within the activities or business of ADI group or subgroup for which he or she is responsible.

More important accountable persons are expected to:¹⁸

- 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.

To ensure that this new regime has 'bite', it is proposed that APRA should be able to seek a civil penalty, if an ADI fails to meet the new expectations of banks, and hold accountable persons to account if they do not appropriately adhere to the expectations of 'accountable persons' under BEAR.

In comparison with ASIC, APRA's track record in enforcement is not strong. It is expected that stronger powers for APRA will build on their existing prudential regulatory framework in addition to ASIC's existing powers for regulating market conduct. There is no doubt, however, that the implementation of this new regime will be challenging. Under questioning during Senate estimates, APRA chairman, Wayne Byres confirmed the challenges confronting the regulator in seeking to implement the new regime announced by the Treasurer, Scott Morrison in the Budget. Byres said he did not believe the process was likely to be straightforward, 'Like all of these things, the devil is in the detail. You are dealing with individuals' employment arrangements and there will be all sorts of complexities associated with things that are already in train that people have entitlements to.'¹⁹

Even more challenging will be the bank executives registered under BEAR. It would be like navigating in the dark because there is no equivalent in Australia. The only jurisdiction around the world is the United Kingdom. Therefore, it is imperative we examine SMR to appreciate and foretell the expectations of BEAR.

Expectations under the United Kingdom's SMR

The Senior Managers Regime (SMR) came into effect on the 7 March 2016 and is applicable to all banks and insurance companies. However, like all new regulatory regimes with no enforcement record, it is difficult to come to terms with what SMR encompasses. As a guide, the Financial Conduct Authority published its own version of how the SMR is applied to their senior managers. The document is 102 pages long.

...the time is ripe for a more robust method of dealing with poor corporate culture.

SMR, at its heart, is an attempt to guide banks and other financial institutions, '[t]o raise standards of governance, increase individual accountability and help restore confidence in the banking sector.'²⁰ It does so by providing recommendations of role and structure — a series of Management Responsibilities Maps; senior manager statements of responsibilities delineated by senior management function (SMF). Each of these SMFs have a series of allocated, prescribed and overall responsibilities. The FCA have also mined this down to examine details of:

1. individuals and their roles. For example, the Director of Strategy and Competition; to whom he/she reports to; their employment status; and other FCA Directorships
2. governance and management arrangements. For example, committees and committee structures
3. statements of responsibility. For example, role titles, such as Executive Committee Director, Enforcement and Market Oversight; their SMF; the main purpose of the role; and the key committees of which they are members.

This is a highly intricate and guided attempt to govern the structure and activities of senior managers. However, there is very little detail concerning how the SMR might even begin to modify leader behaviour and subsequently change corporate culture. Jonathan Davidson the Director of Supervision of the FCA comments that,

'Changing culture is very difficult and we know it takes time. Why is this? It's

because culture comes from the past. CEOs, boards, programmes, systems and controls come and go regularly. Mindsets are developed and reinforced over years and even decades and are passed down from one generation to the next... So, the stakes are high and we are and will be paying very close attention to the culture of firms and what boards and management are doing to shape the culture, of which governance is a key factor.²¹

However, in both the UK and Australian context we need to be clear that what drives leaders and the climate in which they operate are far more fluid than the law envisages and stipulates. It is clear that the FCA views culture as a contributing factor to why banks behave badly. Andrew Bailey, who was then the chief executive of the Prudential Regulation Authority said in his speech in May 2016 that, 'Culture has thus laid the ground for bad outcomes, for instance where management are so convinced of their rightness that they hurtle for the cliff without questioning the direction of travel.'²² However, before adopting and adapting how the SMR could regulate the culture of banks in an Australian context, it is pertinent to discuss what this banking culture is and whether it can be regulated. Similarly, the role of leaders needs to be more deeply analysed. For example, Liu argues that,

'Despite the relative buoyancy of the local economy and strong performance of the major banks in Australia, the findings show how some banking chief executive officers were able to exploit the GFC by co-constructing with the media vivid, compelling narratives of their leadership in delivering their banks from "crisis".'²³

Conclusion

The initiatives proposed to be adopted to clean up the purported bad culture in Australia's banking industry are entering new territory, from a regulatory and political perspective. However, it appears that the time is ripe for a more robust method of dealing with poor corporate culture. The CBA case study with AUSTRAC and other Federal agencies is heavily relying upon the role of the media and of the chair of the board and CEO to explain the lack of culture.

In reality it is difficult to determine if the proposed BEAR would curb conduct risk of banks and bank executives without much evidence from the UK. One thing is certain, the regulatory proposals, place considerable burdens on bank executives to ensure compliance is achievable.

APRA appears to be extending its regulatory reach watching over the bank executives' control over the conduct of the those who work for the organisation. In short, APRA is 'watching the watchers' through a set of rules acting as an invisible panopticon. Getting the balance correct is the real achievement — the evidence is clear that self-regulation does not work due to self-interest, but over-regulation, such as the US response in Sarbanes-Oxley type legislation is a huge cost to business and regulation. Let us hope that the Australian government will learn from other jurisdictions and get the balance optimal. ■

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Notes

- 1 On discussions about the lead up to this new proposal see Michael Adams, Grace Borsellino and Angus Young, 'Leading From The Top: The Missing Piece In Nurturing Good Corporate Culture?', 2017, 69(4) *Governance Directions* 203.
- 2 Justin O'Brien, 'A Question Of Trust: Post-Truth Paradigms And The Challenge To Financial Regulation', 2017, *Law and Financial Markets Review* 1.
- 3 Kingsford Smith D, Clarke Ts and Rogers J, 2017, 'Banking And The Limits Of Professionalism', 40 UNSWLJ 411. 418.
- 4 O'Brien, above n 2, p 6.
- 5 Khoury P, February 2017, 'Australian Bankers Association Independent Review Code of Banking Practice', 42 <<http://cobpreview.crkhoury.com.au/wp-content/uploads/sites/2/2017/02/Report-of-the-Independent-Review-of-the-Code-of-Banking-Practice-2017.pdf>>.
- 6 Kingsford Smith, Clarke and Rogers, above n 3.
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- 8 'Malcolm Turnbull Slams The Big Banks For Unethical Behaviour', *Australian Financial Review* <www.afr.com/news/politics/malcolm-turnbull-slams-banks-saying-they-have-not-always-treated-customers-right-20160405-gnzcm3>.
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- 13 House of Representatives Standing Committee on Economics, 'Government Response', 9 May 2017 <www.aph.gov.au/DocumentStore.ashx?id=4b25cb5a-1612-4b96-8544-83d56423802b>.
- 14 Australian Government — Federal Treasury, 'Banking Executive Accountability Regime: Consultation Paper', July 2017, 3 <www.treasury.gov.au/~media/Treasury/Consultations%20and%20Reviews/Consultations/2017/BEAR/Key%20Documents/PDF/BEAR_cp.ashx>.
- 15 Ibid, 7.
- 16 Ibid, 11.
- 17 Ibid.
- 18 Ibid, 18.
- 19 Taylor M, *APRA Confirms Complexity In Banking Executive Regime* <www.moneymanagement.com.au/news/policy-regulations/apra-confirms-complexity-banking-executive-regime>.
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- 22 Bailey A, 'Culture in financial services — a regulator's perspective' (Speech at the at the City Week 2016 Conference on 9 May 2016) <www.bankofengland.co.uk/publications/Pages/speeches/2016/901.aspx>.
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