AUSTRALIAN BANKERS' ASSOCIATION INC.

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Mr Peter Hallahan
Committee Secretary
Senate Economics Committee
Department of the Senate
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Dear Mr Hallahan,

Financial Sector Legislation Amendment (Simplifying Regulation and Review) Bill 2007

On 21 June 2007, The Hon. Peter Dutton, Minster for Revenue and Assistant Treasurer introduced the *Financial Sector Legislation Amendment (Simplifying Regulation and Review) Bill 2007* into Parliament.

The Bill contains legislative amendments that implement many of the proposals contained in the *Streamlining Prudential Regulation: Response to 'Rethinking Regulation' Proposals Paper*.

The ABA has been working closely with the Treasury on the proposals, including participating in an industry roundtable held on 28 May 2007.

1. General observations

Australia's banking and finance sector is widely recognised as strong and Australia's financial regulatory and supervisory structure as sound. It is important for Australia to maintain an effective prudential framework to ensure the stability, efficiency and competitiveness of our financial system.

However, it is also important that prudential regulation does not place unnecessary regulatory burdens on business and thereby reduce the competitiveness of Australia's banking and finance sector. It is the ABA's view that the main ways to reduce regulatory burdens and compliance costs is to eliminate unnecessary regulation, remove legislative complexity and reduce regulatory inconsistency and/or duplication through assessment of regulation.

The ABA is pleased that the Government has given considered thought to the concerns raised by industry with the Regulation Taskforce. However, a number of the amendments in the Bill represent a significant shift more broadly in prudential policy and regulation.

The intention of the Bill is to cut red tape by streamlining and simplifying prudential regulation. However, we are concerned that a number of significant amendments contained in the Bill, if implemented, may have unintended consequences. It is the ABA's view that given the significance and breadth of a number of amendments, further consultation and rigorous regulatory and business impact assessment should be conducted to assess whether these widespread changes to prudential regulation are necessary, especially where these introduce new provisions into the law, rather than remove unnecessary regulatory burden.

Furthermore, we note that depositor protection and policy holder protection policy is still being resolved – both are likely to have a significant impact on the prudential framework in Australia. It is the ABA's view that any changes to the prudential framework should therefore not be made until these outstanding matters are resolved.

Having said that, there is benefit in simplifying and clarifying some operational matters, such as streamlining breach reporting. This amendment will make regulatory processes simpler and more consistent across APRA and ASIC regimes and reduce regulatory burden and compliance costs for the financial services industry.

2. Specific comments

The ABA focuses our comments on proposed amendments that would primarily affect authorised deposit-taking institutions (ADIs) and non operating holding companies (NOHCs) under the *Banking Act 1959*.

2.1 Breach reporting

The Regulation Taskforce's *Rethinking Regulation* report recommends that the Australian Government, in consultation with APRA and ASIC, should amend the breach reporting requirements to improve consistency and reduce compliance burden[1].

The Bill makes a number of changes to the breach reporting requirements contained in the prudential Acts[2] and makes the requirements broadly aligned to those as contained in section 912D of the Corporations Act.

The ABA supports improving consistency and reducing compliance burden with breach reporting requirements. In our initial submission we supported aligning the prudential Acts with the breach reporting requirements in section 912D of the Corporations Act, amending the criteria to acknowledge differences between the objectives of the prudential and conduct of business regulatory regimes.

The ABA supports the legislative amendments harmonising the timing for reporting breaches; eliminating the requirement for breaches to be reported twice; and introducing a 'materiality' test, where appropriate, so that only significant breaches need to be reported. These amendments, in particular the factors determining whether a breach is significant, are consistent with our comments. However, there are a number of areas that require further clarification.

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1 Recommendation 5.8.

2 The prudential Acts are the Banking Act 1959, Insurance Act 1973, Life Insurance Act 1995 and Superannuation Industry (Supervision) Act 1993.

2.1.1 Transition period

The Bill indicates that the new breach reporting requirements will take effect from 1 January 2008. Both regulators and regulated entities will require adequate time to implement any new procedures and update their systems accordingly. For example, the law requires a regulated entity to make a report when it 'becomes aware' that the entity has or will breach a provision of the law or regulations or prudential standards. Regulatory guidance on the new reporting obligations will be required. Regulators and regulated entities procedures and systems will need to be changed, especially those entities that decide to report breaches through APRA to ASIC.

The ABA suggests that the new breach reporting requirements should take effect from 1 July 2008.

2.1.2 Defining what breaches are reportable

Defining what breaches are reportable is not identical across all statutes. In section 912D Corporations Act, breach reporting applies if the licensee "breaches or is likely to breach". In the prudential Acts, breach reporting applies if the entity "has breached or will breach". We believe that the language should be consistent across the statutes so obligations are consistent and unambiguous.

The ABA suggests that the Corporations Act should be amended to remove the requirement to report "likely breaches".

2.1.3 Consistency of breach reporting

Breach reporting obligations pursuant to section 62A of the Banking Act applies not just to a bank, but also to its subsidiaries. For example, marketing material for investment schemes must clearly disclose that the investments are not deposits or other liabilities of the bank[3]. If a subsidiary issues marketing material inviting investment in investment schemes without that disclosure, it must consider whether to report the breach to APRA. The other prudential Acts require breach reporting by the relevant company, i.e. a life company, general insurer or superannuation trustee. The Corporations Act requires breach reporting by the licensee. We believe that the breach reporting obligations across the prudential Acts should be consistent.

The ABA suggests the law should be amended so that the requirement to report breaches in the Banking Act only applies to the bank.

2.1.4 Removing duplication of breach reporting

Duplication of reporting may still be an issue, because an auditor or actuary is not obliged to notify the regulated entity that it has made a breach report to APRA at the same time as the report is made to APRA.

The ABA suggests that the law should be amended to require the auditor or actuary to inform the regulated entity that they have made a breach report to the regulator about the regulated entity and the reason for the notification.

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[3] APRA Prudential Standard APS120: Funds management and securitisation.

2.1.5 Confidentiality of information

It is the ABA's view that documents produced for the purposes of complying with the breach reporting requirements should be made confidential and subject to privilege to assist the free flow of information between industry and the regulators. We believe that the law should be amended accordingly. We note that the matter of legal professional privilege and Federal investigatory bodies is the subject of an ALRC issues paper.

2.1.6 Regulatory guidance and reporting arrangements between the regulators

The ABA notes that the explanatory memorandum to the Bill highlights that it is envisaged that APRA and ASIC will:

- Provide guidance for entities in relation to how they meet their breach reporting obligations and that entities will be able to engage with APRA and ASIC in the development of regulatory guidance.
- Provide guidance as to how the single breach reporting mechanism will operate and that entities will be able to engage with APRA and ASIC in the development of regulatory guidance.

The new breach reporting obligations will require regulated entities to report breaches when the entity 'becomes aware' of the breach. Breaches relating to minimum solvency or capital adequacy must be reported immediately. Other breaches must be notified within 10 business days. Amendments to the Banking Act and Corporations Act are consistent with our comments.

It is the ABA's view that regulatory guidance will be necessary to clarify the intention of the law. The timeframe for when a breach must be reported should commence not at the point of the initial discovery, but when a 'person responsible for compliance' becomes aware of a breach and determines the breach to be significant.

The information sharing protocols, notification arrangements and single breach reporting mechanisms between APRA and ASIC at this stage are unclear. For example, it remains to be seen what breaches will be dealt with in the agreement between APRA and ASIC.

As it is assumed that APRA will make available any Corporations Act-related breach notifications to ASIC, it will be important to ensure:

- *Accountability of information sharing arrangements*: Protocols for information exchange and appropriate arrangements should be entered into between APRA and ASIC and adopted as part of the Memorandum of Understanding (MOU).
- *Requirement for APRA to notify the regulated entity*: APRA should be required to acknowledge that a breach notification has been received and indicate how that notification will be managed.
- *Limited dialogue between APRA and ASIC*: Information exchange should be contained simply to the provision of the breach notification.

It is the ABA's view that APRA and ASIC should establish a memorandum of understanding (MOU) containing mechanisms for administering the transfer of notifications between regulators and the creation of standardised reporting forms for regulated entities, especially where APRA would be acting as agent on behalf of regulated entities.

The ABA acknowledges that regulated entities will be able to decide whether they adopt streamlined reporting practices (i.e. reporting breaches through APRA to ASIC) or whether

they will continue to report breaches to both APRA and ASIC, due to a number of practical issues associated with reporting just to one regulator.

If industry does not have confidence in the administration of the single breach reporting arrangements between APRA and ASIC (i.e. information exchange is contained simply to the provision of the breach notification and regulated entities are notified by APRA when the breach notification has been passed to ASIC, etc), then it is unlikely that regulated entities will take advantage of the simplified arrangements.

2.2 Exemption powers

APRA decisions should be fair, accountable and transparent and the law should enable flexibility to be able to maintain the legislative intent without imposing unnecessary compliance costs on a person or class of persons.

The ABA notes the explanatory memorandum to the Bill highlights that it is not appropriate for APRA to have the power to exempt certain persons from fundamental provisions of the Banking and Insurance Acts, and consequently APRA's exemption powers are reduced. In our initial submission we did not support a broad exemption power.

It is the ABA's view that APRA should not be able to override the law, for example, the Banking Act, and enable an entity to carry on a banking business, for example, without having to meet the prudential obligations applicable to other ADIs.

There are existing mechanisms available to APRA to deal with matters in a flexible manner. Therefore, the ABA believes that along with other substantive amendments to shift the prudential regulatory framework, further consultation with industry is required to clarify the practical aspects of APRA exemption powers, especially the review procedures by APRA and the Administrative Appeals Tribunal (AAT).

Where the Government decides to proceed with this amendment, the Bill should be amended so that it does not apply to the authority to carry on a banking business. Furthermore, APRA should be required to publicly disclose their determination, whether it be a variation or a variation is varied or revoked, in relation to a person or class of persons.

The ABA notes that it is intended for this amendment to commence from the date of Royal Assent.

2.3 Discretionary decisions

Prudential standards specify how the regulatory framework is intended to operate in practice and APRA's expectations in administering the law and overseeing the prudential framework. It is essential that there is stability in the prudential framework and confidence in APRA's decision making. Discretionary decisions can undermine the certainty of the prudential framework, as prudential standards become the exception, rather than the norm. Discretionary decisions can also make the prudential framework more complex.

While the ABA acknowledges that in certain circumstances APRA should have the ability to reduce, refine or remove regulatory obligations from all regulated entities to ensure compliance with the regulatory objectives (e.g. in the event of a crisis), APRA should not be granted a broad discretionary power to approve, impose, adjust or exclude specific prudential requirements in relation to a particular regulated entity.

Any such APRA power to make discretionary decisions under its prudential standards should be limited and clearly defined. Therefore, the ABA believes that along with other

substantive amendments to shift the prudential regulatory framework, further consultation with industry is required to clarify the practical aspects of discretionary decisions, especially scrutiny of variations and transparency of APRA decisions.

Where the Government decides to proceed with this amendment, APRA should be required to publicly disclose on a quarterly basis the interpretations of its discretionary decisions for that period, including an explanation of the grounds for its prudential decisions, especially where APRA has exercised its discretion. APRA should explain why the decision was necessary to achieve compliance objectives and how the decision balances the objectives of financial safety and efficiency, competition, contestability and competitive neutrality[4].

Scrutiny of variations should be available and therefore any discretionary decisions made by APRA should be accountable and transparent. The ABA has made comments on the revised proposal on merits review as contained in the *Review of Prudential Decisions Consultation Paper*.

The ABA notes that it is intended for this amendment to commence from the date of Royal Assent.

2.4 Court enforceable undertakings

Administrative sanctions should be used for matters where other sanctions, such as criminal offences or civil penalties, are inappropriate. APRA should have the ability to administer and enforce the law to ensure that regulated entities meet their obligations. However, serious breaches of prudential obligations should be addressed through existing provisions.

It is the ABA's view that enforceable undertakings for financial services regulation as it relates to particular licensing, conduct or disclosure obligations are appropriate. However, it is unclear whether such sanctions are appropriate for prudential obligations. Furthermore, it is unclear whether enforceable undertakings in the Banking Act are necessary given the breadth of the directions power.

Introducing enforceable undertakings for prudential regulation is likely to adversely impact on the open dialogue that is a critical part of APRA's approach to working with banks to administer the law and oversee the prudential framework. Furthermore, it is unclear the basis for the amendment and whether the regulator has been unable to administer the law within the existing provisions.

Therefore, the ABA believes that along with other substantive amendments to shift the prudential regulatory framework, further consultation with industry is required to clarify the practical aspects of enforceable undertakings, especially confidentiality of undertakings.

Where the Government decides to proceed with this amendment, APRA should be required to work with regulated entities and industry representatives in relation to how APRA will use its new powers, especially how APRA envisages accepting enforceable undertakings and working with regulated entities cooperatively to develop mutually agreed solutions to an enforcement issue.

The ABA notes that it is intended for this amendment to commence from the date of Royal Assent.

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[4] Section 8 of the APRA Act.

2.5 Responsible officers and responsible persons

The Regulation Taskforce's *Rethinking Regulation* report recommends that the Australian Government, in consultation with APRA and ASIC, should review the "responsible officer" and "responsible person" regimes with a view to achieving greater consistency, to the extent that this is consistent with the underlying policy objectives[5].

Differences between the responsible person and responsible officer regimes results in unnecessary administrative costs for regulated entities.

The ABA notes that the Bill does not contain amendments to align the regime in the prudential Acts with that of the Corporations Act. We believe that the three regimes[6] should be harmonised as much as possible to reduce unnecessary duplication and differences.

It is the ABA's view that:

- A single term should be used in the prudential and financial services laws to refer to a "responsible officer". The laws should be amended to remove the requirement for responsible officers to be "officers".
- A responsible officer in the context of prudential regulation may include additional persons (or 'senior managers') involved in risk management and fraud control beyond those persons considered to be a responsible officer in the context of financial services regulation. However, tests, checks and reporting requirements should be standardised as much as possible.
- All responsible officers should have adequate skills, knowledge, experience and competency commensurate with the nature, scale and complexity of the business operations as well as reflective of the objectives of the regulatory regime. Competencies for responsible officers may differ across the prudential and financial services laws.
- Fitness of all responsible officers should be considered against harmonised criteria across prudential and financial services laws, with the appropriate prudential emphasis. This should not result in more onerous probity requirements for ASIC ROs.
- Reporting and notifications on responsible officers should be harmonised across prudential and financial services laws.

The ABA suggests that to ensure consistency it will be necessary to:

(1) Amend the various laws to contain a consistent definition of a "responsible officer";

(2) Amend the law to remove the requirement for responsible officers to be "officers"; and

(3) Amend the applicable regulatory documents (prudential standards, practice guides, policy statements, regulatory guides, etc) to ensure consistent administration of the law.

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5 Recommendation 5.9.

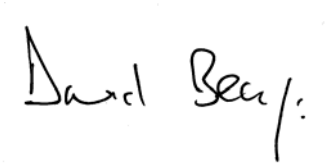
6 The three regimes refer to the ASIC responsible officer regime (Corporations Act) – ASIC RO; the APRA Super responsible officer regime (SIS Act) – APRA RO; and the APRA responsible person regime (Banking Act) – APRA RP.

3. Concluding remarks

While the ABA generally supports a number of the amendments in the Bill as streamlining prudential regulation, and we acknowledge that our comments have been taken on board with respect to a number of the less substantive amendments, we remain concerned with the more substantive amendments. These amendments along with a number of proposals contained in the *Review of Prudential Decisions Consultation Paper* represent a significant shift in prudential policy and regulation.

The ABA would be happy to discuss any of the issues raised in our submission with you further. Please contact me or Nick Hossack, Director, Prudential, Payments & Competition Policy on (02) 8298 0408: nick.hossack@bankers.asn.au or Diane Tate, Director, Corporate & Consumer Policy on (02) 8298 0410: diane.tate@bankers.asn.au.

Yours sincerely



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