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Strong banks – strong Australia

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Mr Mark Fitt
Committee Secretary
Senate Economics Legislation Committee
PO Box 6100
Parliament House
CANBERRA ACT 2600

Dear Mr Fitt

Inquiry into the Financial Sector Legislation Amendment (Crisis Resolution Powers and Other Measures) Bill 2017 [Provisions]

The Australian Bankers' Association (**ABA**) appreciates the opportunity to provide comments on the *Inquiry into the Financial Sector Legislation Amendment (Crisis Resolution Powers and Other Measures) Bill 2017 [Provisions]* (**the Bill**) and the associated draft Explanatory Memorandum (**EM**).

With the active participation of its members, the ABA provides analysis, advice and advocacy for the banking industry and contributes to the development of public policy on banking and other financial services. The ABA works with government, regulators and other stakeholders to improve public awareness and understanding of the industry's contribution to the economy and to ensure Australia's banking customers continue to benefit from a stable, competitive and accessible banking industry.

The ABA recognises the fundamental importance of maintaining a sound and stable financial system. Our members stand at the heart of that system and are committed to stable and competitive banking and delivering high quality services to the Australian community in a prudent and responsible manner. The strength and prudence of our institutions, overseen by the Australian Prudential Regulation Authority (**APRA**) and other regulators, are the foundations of that stability. If, despite all precautions, an Authorised Deposit-taking Institution (**ADI**) is on the point of failing to meet its financial obligations, we recognise that enhanced legislative powers of the kind proposed in the Bill may be needed in order for regulators to resolve the ADI with the least loss and disruption to the system.

Commencing in 2012, the process to strengthen APRA's crisis management powers has been a large and complex piece of reform. The ABA would like to state that the short three-week consultation period provided to industry in September 2017 to comment on the Bill (284 pages) and EM (170 pages) is an unnecessary haste. The ABA is in full agreement with the statement of APRA's Chair that this legislation is "vital infrastructure for the well-being of the financial system"[1]. Given industry and regulator support for this reform it is most regrettable that only three weeks were allowed to comment on the complexities of the Bill and EM. This cannot be the acceptable standard for Australian Public Service (**APS**) policy design and development envisaged by the PM&C.[2] This is important legislation, it deserves appropriate consultation and consideration.

[1] Opening statement of Wayne Byres, Chairman, Australian Prudential Regulation Authority – Appearance before the Senate Economics Legislation Committee, Canberra, (26 October 2017)
http://www.apra.gov.au/Speeches/Documents/Senate%20Economics%20Legislation%20Committee%20opening%20statement%20Oct2017.pdf
[2] PM&C letter to ANAO, https://www.anao.gov.au/work/performance-audit/design-and-monitoring-national-innovation-and-science-agenda#24-0-appendices

In our September 2017 (attached) review of the draft legislation the ABA highlighted a number of concerns with the way in which a number of the proposed powers have been formulated. The ABA made a significant number of recommendations, some of which have been adopted, and others where we continue to recommend changes.

Stability is a product of confidence. An important contributor to confidence is the certainty of parties' rights and obligations. If rights and obligations are to be modified or overridden by regulatory action, it should be reasonably clear when and to whom that can happen; what the regulator is entitled to do; for what period it can intervene and what rules guide its exercise of those powers. This is not the case for a number of the powers. The less certainty in key concepts, the greater the potential for disputes.

It is also important in resolving a crisis that an ADI, authorised Non-Operating Holding Companies (**NOHC**) and related entities, as well as their officers and employees, not be burdened with conflicting duties under different laws. Certain aspects of the powers have the potential to create these issues. That will inhibit decisive, well-informed actions when speed and experience are essential.

The ABA asks the Committee to consider and ultimately adopt the following four recommendations in relation to the Secrecy provisions[3] and Resolution planning as envisaged in the EM[4].

1. Secrecy provisions

The Committee needs to give serious consideration to two important practical issues, which the ABA had previously raised, but remain unaddressed.

First, where an ADI, NOHC or other group member operates or raises funds in markets outside Australia, there are fundamental issues with secrecy orders in the context of resolution proceedings. These ADIs have disclosure duties under foreign laws, e.g. to foreign securities exchanges on which their shares or bonds are listed, or to foreign prudential regulators in countries where they carry on business. Protections given to them under Australian law, such as section 70AA will not be effective in giving immunity from liabilities and proceedings under those laws. To allow disclosure as required by foreign laws, while withholding disclosure in Australia, is impractical. Where this is an issue, as it will be in the case of the resolution of any ADI or NOHC with an offshore business or fundraising, orders requiring secrecy contrary to those laws should not be made.

The ABA requests that the Committee recommend that:

> *The legislation be amended, expanding the direction power given to APRA in section 11CH(5) such that APRA have regard to the obligations an ADI, NOHC or other group member and its officers may have under any applicable laws, including foreign laws, before making any secrecy order.*

Second, if a direction is made secret, immediate issues will arise as to who in the ADI the direction may be shown. Some sharing of the direction is essential. It cannot, in practice, remain known only to the immediate addressee. The ABA anticipates that the direction to APRA (section 11CH(5)) to consider the class of person to whom disclosure is allowed under section 11CK is intended to contemplate some necessary dissemination among officers of the corporation who need to be aware of the direction. At the very least, it would be preferable to require APRA to specify the class of person(s) as a condition of making the direction.

The ABA requests that the Committee recommend that:

> *The legislation be amended to require APRA to consider the class of person to whom disclosure is allowed under section 11CK.*

Generally, the ABA would suggest that the exception to the secrecy obligation should countenance disclosure to directors, officers and employees of various entities within the group of the entity subject to the direction, to the extent reasonably necessary in the circumstances. When dealing with corporate

[3] Section 11CH(5) of the Banking Act & Schedule 1, Part 1, Item 56 of the Bill
[4] Explanatory Memorandum, para 1.45

groups, we note that employees may be employed in different entities and not always the entity subject to the direction (as well as their advisers). We would suggest that disclosure should also be afforded to the entities within the group itself. The ABA also requests an inclusion in the EM illustrating what kind of specifications might be made.

2. Protection of an ADI itself (and related bodies corporate) and its officers

In the ABA's view, in order for the resolution regime to work with certainty and confidence it is critical to provide comprehensive protection for the ADI and its officers from consequences under the many laws that may affect it or them if they are subject to direction by APRA.

For instance, APRA may give the ADI a direction and require it be kept secret under the proposed secrecy provisions in Pt II Division 1BA Subdivision D. Disclosure contrary to those provisions is a criminal offence.

It is conceivable that the direction will be material to the price of the ADI's securities. A listed ADI is under a legal duty to make disclosure and failure with this duty to comply, as duty may have both civil and criminal consequences under the Corporations Act.

Section 70AA offers protection against civil and criminal proceedings. There is an existing protection from liability in section 70A, but it does not apply to criminal proceedings, and whether it applies to a directed ADI itself is not clear.

The ABA requests that the Committee recommend that:

> *Clarity in key concepts is critical - the Commonwealth should include a statement in the EM clarifying the manner in which section 70A is intended to apply.*

3. Resolution planning

The ABA notes the proposed provisions for the setting and enforcing of appropriate prudential requirements for resolution planning, in particular the proposed definition of "prudential matters", the definition of "resolution" and the new direction powers proposed in section 11CA(2)(p) and (q).

We agree that there is merit in ADIs and/or NOHCs formulating plans to facilitate resolution, as well as recovery.

However, the ABA remains concerned that a requirement for a reasonable measure of resolution planning not expand into an extensive requirement for an ADI or NOHC to re-order its business at the direction of APRA to pre-position it (or parts of it) for disposal in circumstances which should be very remote, given all the other strengths of the Australian financial system and the way in which it is regulated. Pre-positioning for the remote event of resolution can impose immense regulatory costs on each ADI or NOHC for a circumstance which, with prudent management and vigilant regulation, should never arise. Further, if the need for resolution does arise, properly crafted legislative resolution powers can address issues that may arise in separating businesses and ensuring their continued operation. Resolution planning should not be a back-door Volcker rule or other similar rule for the structural separation of businesses and the duplication of systems and personnel, or for prescribing common or compatible systems among all ADIs. This would impose very real costs on the community with no commensurable benefit.

The powers proposed to be conferred on APRA create an apprehension that such measures may be in prospect. An ADI or NOHC must comply with whatever is in the prudential standard (proposed section 11AAA). Non-compliance, or the likelihood of non-compliance entitles APRA to give a direction under section 11CA. The direction may be to make changes in the ADI's systems, i.e. its business structure, its organisation or to its subsidiaries. By amending the definition of prudential matters to include "resolution", APRA is given very broad powers to introduce prudential standards, which must be complied with by subsidiaries of ADIs and authorised NOHCs of ADIs, in areas that would, typically,

only be relevant in the case of resolution (such as on systems, business structures and organisation structures). It would be costly, and in at least some cases may be inappropriate for an ADI or NOHC to be required to make extensive structural changes, or duplicate systems, in anticipation of a remote outcome. This is particularly the case where there is no requirement that such directions be made only as part of resolution or when it is imminent, or that they be reasonably appropriate to a legitimate end, such as the protection of depositors or the stability of the financial system. Consideration should be given to the cost and complexity of the proposed resolution requirement relative to the remoteness of the risk and the level of benefit in resolution that may be derived.

The ABA requests that the Committee recommend that:

a) The Bill and associated EM be revised to make clear that the new powers are exercisable in more clearly defined circumstances and must be appropriate for more clearly defined ends. The ABA recommends that the exercise of resolution powers needs to be reasonable and proportionate to legitimate prudential matters such as protection of depositors or the stability of the financial system. This may ultimately be a matter for the prudential standards, but will need to weigh the cost and complexity of the proposed resolution requirement against the remoteness of the risk of resolution and the level of benefit in resolution that may be derived. Proposed changes are included below.

Section 11CA(2)(p) and (q)

(p) to make changes to the body corporate's systems, business practices or operations as is reasonably necessary for one or more prudential matters relating to the body corporate;

(q) to reconstruct, amalgamate or otherwise alter all or part of any of the following:

i) the business, structure or organisation of the body corporate;

ii) the business, structure or organisation of the group constituted by the body corporate and its subsidiaries,

in each case as is reasonably necessary for one or more prudential matters relating to the body corporate.

b) The Commonwealth articulate its policy in relation to resolution planning and its approach to pre-positioning in greater detail. The ABA would welcome a statement in the EM to the effect that these powers are not intended to authorise extensive requirements for structural separation, duplication of systems, prescribing common or compatible systems or other pre-positioning; and

c) A statement should be included in the EM to the effect that any planning that affects foreign subsidiaries should be conducted in consultation with the relevant foreign regulator.

If you would like any further information, please contact me on 02 8298 0408.

Yours sincerely

Signed by

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Encl.