

Australian Regulators “BEAR” Down on Accountability

The Banking Executive Accountability Regime (BEAR) is scheduled to go live in Australia on July 1, 2018. This marks the Australian government’s latest response to improving accountability in the financial services industry. The new regulation aims to raise the bar for risk management and corporate governance standards and outline consequences for both institutions and responsible individuals who breach the required standards of the regulation.

The Australian Parliament officially passed the Treasury Laws Amendment (Banking Executive Accountability and Related Measures) Bill on February 7th, 2018. The government is introducing this legislation to hold banks and their senior executives accountable in order to ensure a high standard of corporate governance in the financial services sector.

BEAR applies to authorized deposit-taking institutions (ADIs) and their subsidiaries in Australia. For ADIs that do not meet their obligations, the Australian Prudential Regulation Authority (APRA) will have new powers to restrict and require specific incentive plan features for senior executive remuneration packages within ADIs. APRA will also be able to impose higher fines on institutions and individuals for failure to comply.

Large financial institutions will need to be BEAR compliant by July 1, 2018, while smaller and medium sized institutions will have an extra 12 months to meet the new standards.

“Where these obligations are not met, the Australian Prudential Regulation Authority will be empowered to seek substantial fines, more easily disqualify individuals, and ensure banks’ remuneration policies result in financial consequences for individuals.”

–Scott Morrison, Australia’s treasurer¹

What does this mean for remuneration policies? How should firms prepare? Below we’ve outlined more specifics on the requirements of BEAR, some recommendations, and observations that we have made from other markets.

The BEAR Requirements

There are several new obligations as a result of BEAR for Australian ADI firms to consider.

Remuneration Policies

- To begin, large ADIs² and foreign ADI Australian brand operations must have a remuneration policy in place by the proposed deadline of July 1, 2018 that complies with the bill's requirements. The deadline is exactly one year later for small and medium ADIs.

Registration of Accountable Persons, Board Members, and Responsible Senior Executives

- Accountable persons, board members, or senior executives responsible for management and control of significant aspects of the ADI group must be registered with Australian regulator, APRA.
- Examples of roles expected to be covered as accountable persons include: CEO, CFO, CRO, COO, Chief Information or Technology Officer, Head of Internal Audit, Chief People Officer / Head of Human Resources, Head of Compliance / Chief Compliance Officer, and Anti-Money Laundering Officer.

Provision of Accountability Maps and Accountability Statements

- Each ADI is also required to provide APRA with an accountability map to highlight responsibilities within the bank and reporting lines that cover all operations of the ADI group in Australia.
- ADIs will additionally be asked to provide APRA with accountability statements, which set out the responsibilities for each accountable person in the ADI group.
- It is necessary for ADIs and accountable persons to act honestly and work with APRA in an open, cooperative manner. The regulation states: the accountability obligations of an accountable person of an ADI, or of a subsidiary of an ADI, are to conduct the responsibilities of his or her position as an accountable person:
 - (a) *by acting with honesty and integrity, and with due skill, care and diligence*
 - (b) *by dealing with APRA in an open, constructive and cooperative way*
 - (c) *by taking reasonable steps in conducting those responsibilities to prevent matters from arising that would adversely affect the prudential standing or prudential reputation of the ADI³*

Deferral Arrangements

- It will be necessary for ADIs to defer 40% of accountable persons' variable remuneration for a minimum of four years, increasing to 60% for certain executives. It's important to note that these deferral requirements can be subject to adjustment based on size of the ADI and levels of total compensation for the individual role.

Impact for International Firms in Australia

While foreign ADIs are not subject to BEAR for its offshore locations, the regime *will* apply to foreign ADIs with branches operating in Australia, such as local branches of global banks. Importantly, APRA may also amend BEAR obligations for an ADI in the event that they may contradict with ADI requirements under a foreign law, such as the UK SMCR or Hong Kong Manager-in-Charge Regime.

How to Prepare

With the proper preparation, aligning your firm with the new requirements of BEAR should be simple. Here are some key items to address as soon as possible as the deadline quickly approaches.

- Revise your remuneration policy to ensure that it is in line with BEAR requirements.
- Register all senior executives and directors (who will be classified as accountable persons) with APRA
- For all senior executives and directors, prepare governance and accountability maps in line with APRA specifications.
- Update all policies and provide training for senior executives and directors on the requirements.

Are There Similarities to the United Kingdom?

BEAR will include a number of measures similar to the UK's Senior Managers and Certification Regime (SM&CR). The SM&CR, which launched in 2016 and initially covered the banking sector, is now being extended to the rest of the financial services industry. The goal of the SM&CR is to reduce harm to consumers and strengthen market integrity by making individuals more accountable for their conduct and competence. As part of this, the SM&CR encourages a culture in which staff at all levels take personal responsibility for their actions, ensuring that firms and staff clearly understand and can demonstrate where responsibility lies.

In the UK, there are three elements to consider:

1. **Senior Managers Regime:** This impacts most senior executives and non-executives, and involves allocating a list of prescribed responsibilities. Individuals sign up for a statement of responsibilities and statutory duty of responsibility.
2. **Certification Regime:** This requires firms to annually certify the fitness and propriety of key employees in *significant harm* functions, who are not pre-approved by regulators as senior managers.
3. **Conduct Rules:** This is a set of principles that applies to all employees.

One key difference between BEAR and SM&CR is that BEAR only applies to poor conduct or behavior that is of a systemic and prudential nature. This is an important distinction given that it does not include the element of the SM&CR that also links accountability measures to poor consumer outcomes.

In addition, while BEAR covers senior executives and directors only, the Conduct portion of SM&CR applies more broadly across the firm, requiring substantially more communication, training and monitoring. Also, deferral periods under SM&CR are considerably longer than those required by BEAR.

Lessons Learned from the United Kingdom

Prior to the introduction of the SM&CR, pay approaches amongst banks in the UK had already undergone significant change through the introduction of the CRD bonus cap (through which variable pay is limited to two times fixed pay) and mandatory three to five year deferrals. These requirements impacted fixed pay levels, either through salary adjustments or introduction of role-based allowances.

Following the introduction of SM&CR, those individuals covered by the Senior Managers Regime are subject to extended deferral periods of seven years and clawback periods of ten years for incentive awards. While the full influence of the new regime on people and pay is yet to be seen, we have observed the following impacts to date:

- Further upward pressure on fixed pay levels (due to increased deferral and clawback provisions)
- Recruitment and succession planning challenges around senior manager roles covered
- Heightened pressure and additional cost for implementation among medium sized and smaller firms, given that less senior levels of management are now subject to the same rules as those that apply to the most senior levels of management at the largest firms

As the group of covered firms becomes wider across the financial services sector, we expect this will have ongoing impact to reward design.

The Bigger Picture

Looking ahead, what does this mean for banks and financial services in general? Since the global financial crisis, Australian banks have among the highest returns on equity for global financial institutions. After addressing a range of issues over the last 24 months, regulatory bodies are focused on risk, conduct and culture, and ensuring Australian financial institutions operate to the highest standard. APRA is now empowered to impose civil penalties and enforce both accountability and adjustment of executive pay. This new regulation is just another pivotal step towards improving accountability, trust, and good governance within financial institutions around the world.

The Australian financial services industry remains aligned with the global financial services industry, which continues to focus on [restoring trust and shaping a more resilient and consumer-oriented industry](#).

As the financial services regulatory environment continues to also evolve across Asia Pacific, we expect other regulators in the region to watch closely Australia's adoption of this new requirement and consider whether this is relevant and appropriate for their own market.

For more information on BEAR or the SM&CR, and how to prepare your firm for these required changes, please [contact our team](#).

¹ treasury.gov.au: media release-Feb 7, 2018

² The current proposed definition of ADI size is based on the 3-year average of total resident assets: Large (\$100Bn or more), Medium (\$10Bn to 100Bn) and Small (\$10Bn or less). There is expected to be a formal definition provided of this.

³ 37CA, Part IIAA—The Banking Executive Accountability Regime, Treasury Laws Amendment (Banking Executive Accountability and Related Measures) Act 2018

Author Contact Information

Belinda Armenta

Associate Partner, McLagan
Aon
1.852.2917.7901
barmenta@mclagan.com

Joel Davies

Associate Partner, McLagan
Aon
+44 (0)20 7086 5107
joel.davies@mclagan.com

Tim Blackham

Director, McLagan
Aon
1.612.9253.7111
tim.blackham@mclagan.com

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