

EXPLANATORY STATEMENT

Banking Act 1959

Banking Executive Accountability Regime (Size of an Authorised Deposit-taking Institution) Determination 2018

The *Treasury Laws Amendment (Banking Executive Accountability and Related Measures) Act 2018* amended the *Banking Act 1959* (the Act) to introduce a new regime, the Banking Executive Accountability Regime (BEAR).

The BEAR imposes a heightened accountability regime on authorised deposit-taking institutions (ADIs) and people, known as accountable persons, with significant influence over the conduct and behaviour of an ADI. It requires these people to conduct themselves with honesty and integrity and to effectively carry out the business activities for which they are responsible.

The obligations set out in the BEAR begin to apply to large ADIs from 1 July 2018 and to small and medium ADIs from 1 July 2019.

A particular aspect of the BEAR is that ADIs must set remuneration policies which defer a specified proportion of the variable remuneration of accountable persons for a minimum period. This is intended to create an incentive for these individuals to make decisions taking account of the longer term effects. The proportion of an accountable person's remuneration which must be deferred depends on the size of the ADI where the person works.

The BEAR also includes civil penalties where an ADI fails to meet its obligations under the BEAR. The maximum penalty that may be applied by a court is also determined with reference to the size of the ADI.

Section 37G of the Act provides the Treasurer with the power to determine by legislative instrument the kinds of ADIs that are large, medium and small. The *Banking Executive Accountability Regime (Size of an Authorised Deposit-taking Institution) Determination 2018* (the Determination) sets out the methodology to determine the size of an ADI as small, medium or large. It considers the total resident assets of the ADI as reported to APRA. The Act provides that the subsidiary of an ADI takes on the size of the ADI and also the rules applying to an ADI in that size category.

The legislative instrument commences on 1 July 2018. However, the methodology set out in the Determination allows an ADI to calculate its size as at 1 July 2018 based on total resident assets reported to APRA in earlier financial years. An ADI will need to know its size on 1 July 2018 to know when the obligations in the BEAR apply to it, based on whether it is small, medium or large.

Consultation on an exposure draft of the Determination took place between 6 April 2018 and 20 April 2018. The exposure draft Determination and explanatory materials were made available on the Treasury website during that time.

A detailed explanation of the legislative instrument is at Attachment A.

The Statement of Compatibility is set out in Attachment B.

The Act does not specify any conditions that need to be met before the power to make the Determination may be exercised.

The Determination is a legislative instrument for the purposes of the *Legislation Act 2003*.

The Banking Executive Accountability Regime (Size of an Authorised Deposit-taking Institution) Determination 2018

Section 1 – Name

Section 1 provides that the name of the legislative instrument is the *Banking Executive Accountability Regime (Size of an Authorised Deposit-taking Institution) Determination 2018* (the Determination).

Section 2 – Commencement

Section 2 provides that the instrument commences on 1 July 2018.

Section 3 – Authority

Section 3 provides that the instrument is made under subsection 37G(3) of the *Banking Act 1959* (the Act).

Section 4 – Definitions

Section 4 sets out the definitions that are used in the legislative instrument. Terms such as ‘ADI’ and ‘APRA’ which are used in the instrument are defined in section 5 of the Act.

A brief explanation and summary of the new terms and definitions included in the Determination are set out below. A full explanation of how these terms are used in the Determination to calculate an ADI’s size is clarified as part of the explanations for sections 5, 6 and 7.

ARS 320.0 means Reporting Standard ARS 320.0 Statement of Financial Position (Domestic Books), which is set out in *Financial Sector (Collection of Data) (reporting standard) determination No. 14 of 2018* or the *Financial Sector (Collection of Data) (reporting standard) determination No. 30 of 2008*, whichever is applicable at the relevant time.

ARS 323.0 means Reporting Standard ARS 323.0 Statement of Financial Position (Licensed ADI), which is set out in the *Financial Sector (Collection of Data) (reporting standard) determination No. 23 of 2018*, or the *Financial Sector (Collection of Data) (reporting standard) determination No. 40 of 2008*, whichever is applicable at the relevant time.

final report means a report to APRA pursuant to ARS 320.0 or ARS 323.0 in relation to the final reporting period in a financial year.

financial year, in relation to an ADI, means the ADI’s financial year (see section 323D of the Corporations Act 2001) and includes financial years that begin before the commencement of this instrument.

threshold day is the day after a final report is given to APRA. Working out the size of the ADI is done with reference to the threshold day.

total resident assets value, is generally, the averaged amount of ‘total assets’ as reported to APRA. In ARS 320.0, total assets is at item 10 in Section A: Assets and in ARS 323.0, total assets is at item 11 in Section A: Assets.

lower threshold is the amount which determines whether an ADI is small or medium. When the instrument commences the lower threshold is \$10 billion. The amount is indexed annually on 1 January.

upper threshold is the amount which determines whether an ADI is medium or large. When the instrument commences the upper threshold is \$100 billion. The amount is indexed annually on 1 January.

Section 5 – Size of an ADI and Section 6 - Total resident assets value

Section 5 explains how the amount of an ADI's total resident assets is used to calculate its size as of the threshold day. Section 6 explains how to calculate an ADI's 'total resident assets value' which is the averaged amount of total assets reported to APRA.

Generally:

A small ADI is a kind of ADI that has 'total resident assets value' less than or equal to the lower threshold on the threshold day.

A medium ADI is a kind of ADI that has 'total resident assets value' greater than the lower threshold but less than the upper threshold on the threshold day.

A large ADI is a kind of ADI that has 'total resident assets value' greater than or equal to the upper threshold on the threshold day.

[Subsections 5(1), 5(2) and 5(3) – Size of an ADI]

On 1 July 2018, the lower threshold is \$10 billion and the upper threshold is \$100 billion. These amounts are indexed annually (see *Section 7 – Indexation*).

If an ADI does not have a threshold day, for example it has never reported its total assets to APRA the ADI will be a small ADI. An example of when an ADI may not have reported its total assets to APRA is when it is a newly authorised ADI.

[Subsection 5(4) - Size of an ADI]

Working out an ADI's size relies on two new terms: threshold day and total resident assets value.

Threshold day

Subsection 5(5) of the Determination sets out how to work out the threshold day for the financial year for an ADI.

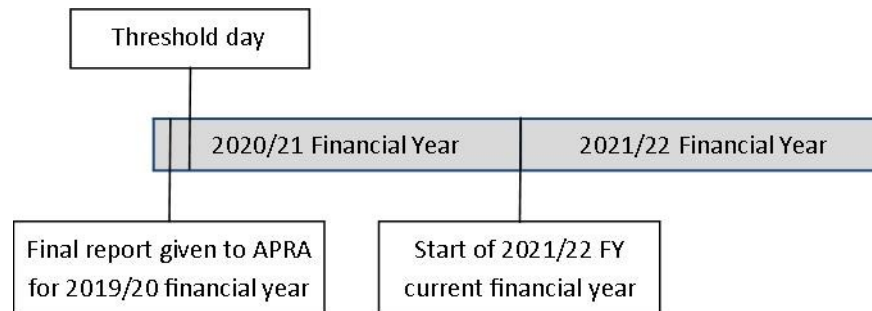
The threshold day for a financial year is the day after the ADI gave the most recent final report to APRA. The threshold day falls before the first day of the current financial year. Subsequent revisions of these reports are ignored. For the purposes of working out its size for 1 July 2018, an ADI's threshold day will necessarily be a day before the Determination commenced.

A report given under ARS 320.0 or ARS 323.0 for the final reporting period of a financial year is defined in the Determination as a 'final report'. *[Section 4 – Definitions]*

Example 1

An ADI is required to submit its ARS 320.0 report for the final reporting period in a financial year 10 business days after the end of the financial year.

The ADI is currently in its 2021-22 financial year. The threshold day for that financial year was in the 2020-21 financial year, the day after the ADI submitted its final report for the 2019-20 financial year.



The methodology recognises that an ADI will have its own financial year. Section 323D of the *Corporations Act 2001* shows how to work out a financial year for an ADI. In most circumstances a financial year for an ADI will be a period of 12 consecutive months, with its first financial year commencing on the day the ADI is registered or incorporated.

Being able to use its own financial year minimises the regulatory burden on an ADI and ties in with its existing reporting obligations to APRA, the contents of which will be used to calculate an ADI's total resident assets. It also assists the ADI to more easily transition to the BEAR.

Total Resident Assets Value

The second new term needed to determine the ADI's size is total resident assets value. *[Section 4 – Definitions and Section 6 – Total resident assets value]*

The total resident assets value is an average of the total assets reported to APRA.

For ADIs that are banks, 'total assets' are defined in ARS 320.0, item 10 in Section A: Assets.

For ADIs that are credit unions or building societies, 'total assets' are defined in ARS 323.0, item 11 in Section A: Assets.

As discussed above, these reports are defined as 'final reports' for the purpose of the Determination.

General Rule

The general rule applies where the ADI has submitted at least three final reports to APRA before the current financial year. The amount included in those final reports as total assets is averaged and the result is the 'total resident asset value'.

Example 2

The 3-year average would be calculated as:

- Year 1: \$30 billion
- Year 2: \$38 billion
- Year 3: \$37 billion

Total resident assets value is:

$$\frac{\$30 \text{ billion} + \$38 \text{ billion} + \$37 \text{ billion}}{3} = \$35 \text{ billion}$$

Two-years of final reports

If an ADI has not submitted three-years of reports, but has submitted two years, then the total resident assets value is the average of the total assets included in those two final reports.

Example 3

An ADI has only been in operation for 3 years (it is currently in its 3rd year of operation). Its averaged total resident assets would be calculated based on the total assets reported for these two years.

- Year 1: \$57 billion
- Year 2: \$80 billion

Total resident assets value is:

$$\frac{\$57 \text{ billion} + \$80 \text{ billion}}{2} = \$68.5 \text{ billion}$$

One final report

Where the ADI has only submitted one final report to APRA, the 'total resident assets value' is the amount included in that report as total assets.

Calculating the size of an ADI: Applying the threshold day and the total resident assets value

The threshold day is the point in time at which the ADI's size is determined.

Referring to a threshold day before the current financial year means that the size worked out for the ADI applies almost one year after the information needed to make the calculation is available to the ADI.

Example 4

An ADI's financial year runs from 1 July to 30 June. It usually submits its final report to APRA within 10 business days after the end of the financial year.

The current financial year is 2018-19.

Step 1: Work out the threshold day

The threshold day for the financial year is 11 July 2017, the day after the ADI submitted its final report for the 2016-17 financial year.

The ADI has submitted at least three final reports.

Step 2: Work out the total resident assets value

- \$30 billion: Total assets reported on 11 July 2017 for the last reporting period for 2016-17.
- \$38 billion: Total assets reported on 9 July 2016 for the last reporting period for 2015-16.
- \$37 billion: Total assets reported on 10 July 2015 for the last reporting period for 2014-15.

Total resident assets value is:

$$\frac{\$30 \text{ billion} + \$38 \text{ billion} + \$37 \text{ billion}}{3} = \$35 \text{ billion}$$

Step 3: Calculate the ADI's size

The 'total resident assets value' is calculated as \$35 billion. While the lower threshold is \$10 billion and the upper threshold is \$100 billion, this ADI is a medium ADI.

This size applies from the beginning of that ADI's 2018-19 financial year and for the duration of that year.

Section 7 – Indexation

The upper and lower thresholds, which are the thresholds that the 'total resident assets value' is compared against to determine the ADI's size, are indexed annually beginning on 1 January 2020 and each subsequent 1 January. *[Subsection 7(2) – Lower and upper thresholds and indexation]*

On 1 July 2018 the lower threshold is \$10 billion and the upper threshold is \$100 billion.

The thresholds should be indexed by multiplying the amounts by the indexation factor and rounding the result down to the nearest multiple of \$1,000,000,000.

[Subsection 7(3) - Lower and upper thresholds and indexation]

The indexation factor is calculated as:

$$\frac{\text{relevant GDP number}}{\text{base GDP number}}$$

‘Base GDP number’ is the annual estimate of the Gross Domestic Product: Current Prices-Original series, most recently published by the Australian Statistician (ABS) for the financial year ending on 30 June 2018. This is included in Catalogue 5204.0 – Australian System of National Accounts. ‘Base GDP number’ uses the most recently published amount, which means that it will take into account any revisions subsequently published by the ABS.

‘Relevant GDP number’ is the first-published annual estimate of the Gross Domestic Product: Current Prices-Original series for the financial year that precedes the 1 January when the indexation will be applied. This is included in Catalogue 5204.0 -Australian System of National Accounts. For this number, any subsequent revisions published by the ABS in the relevant year should be ignored. *[Subsection 7(5) - Lower and upper thresholds and indexation]*

The threshold amount is not indexed if the indexation factor is 1 or less. *[Subsection 7(4) - Lower and upper thresholds and indexation]*

The indexation factor is rounded to three decimal places (rounding up if the fourth decimal place is five or more). *[Subsection 7(6) - Lower and upper thresholds and indexation]*

Statement of Compatibility with Human Rights

Prepared in accordance with Part 3 of the Human Rights (Parliamentary Scrutiny) Act 2011

Banking Executive Accountability Regime (Size of an Authorised Deposit-taking Institution) Determination 2018

This Legislative Instrument is compatible with the human rights and freedoms recognised or declared in the international instruments listed in section 3 of the *Human Rights (Parliamentary Scrutiny) Act 2011*.

Overview of the Legislative Instrument

The *Treasury Laws Amendment (Banking Executive Accountability and Related Measures) Act 2018* amended the *Banking Act 1959* (the Act) to introduce a new regime, the Banking Executive Accountability Regime (BEAR).

The BEAR imposes a heightened accountability regime on authorised deposit-taking institutions (ADIs) and people, known as accountable persons, with significant influence over the conduct and behaviour of an ADI. It requires these people to conduct themselves with honesty and integrity and to effectively carry out the business activities for which they are responsible.

The obligations set out in the BEAR begin to apply to large ADIs from 1 July 2018 and to small and medium ADIs from 1 July 2019.

A particular aspect of the BEAR is that ADIs must set remuneration policies which defer a specified proportion of the variable remuneration of accountable persons for a minimum period. This is intended to create an incentive for these individuals to make decisions taking account of the longer term effects. The proportion of an accountable person's remuneration which must be deferred depends on the size of the ADI where the person works.

The BEAR also includes civil penalties where an ADI fails to meet its obligations under the BEAR. The maximum penalty that may be applied by a court is also determined with reference to the size of the ADI.

Subsection 37G of the Act provides the Treasurer with the power to determine by legislative instrument the kinds of ADIs that are large, medium and small. The Banking Executive Accountability Regime (Size of an Authorised Deposit-taking Institution) Determination 2018 sets out the methodology to determine the size of an ADI as small, medium or large. It considers the total resident assets of the ADI as reported to APRA. The Act provides that the subsidiary of an ADI takes on the size of the ADI and also the rules applying to an ADI in that size category.

Human rights implications

This Legislative Instrument is compatible with human rights as it does not raise any human rights issues.