GRG Remuneration Insight 101

Are You Prepared for the BEAR?

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Introduction

The Banking Executive Accountability Regime (BEAR) is currently being considered by Parliament and it is likely to be passed early in 2018. It will apply to Authorised Deposit-taking Institutions (ADIs) including not only the major banks, but also credit unions and others. Initially it will not apply to insurers or super funds but its extension to such organisations is already being considered, thus it may be prudent for such organisations to be prepared.

BEAR may be seen as being composed of four streams of obligations. These streams are:

a) accountability obligations,
b) key personnel obligations,
c) deferred remuneration obligations, and
d) notification obligations.

Streams a), b) and d) are intended to come into effect on 1 July 2018. The other stream is intended to apply to variable remuneration paid on or after 1 January 2019. However, there are indications that these dates may be deferred for six months.

Unfortunately the legislation appears to be plagued by some clarity issues, particularly with regards to remuneration, that are likely to be highly problematic when theory meets practice. Some of these are described below, and Boards will be forced to make interpretive judgements in relation to policy and procedure that may expose them to the risk of breaching the BEAR requirements.

Accountable Person

A person is an ***accountable person***, of an ADI or a subsidiary of an ADI, if the person:

a) holds a position in, or relating to, the ADI or subsidiary; and
b) because of that position, has actual or effective responsibility:
    i. for management or control of the ADI or subsidiary; or
    ii. for management or control of a significant or substantial part or aspect of the ADI's or subsidiary's operations.

Persons filling accountable person roles must be registered with APRA, and such registrations are required after less than a month of an individual taking on an accountable role even temporarily. It should be noted that APRA may disqualify a person from holding an accountable person role.

Specifically mentioned roles that are accountable persons include:

a) directors;
b) senior executives including:

- CEO
- Head of Risk
- CTO
- Head of Compliance
- Head of Anti-money Laundering
- CFO
- COO
- Head of Internal Audit
- Head of HR
- Head of the Australian branch of a foreign ADI

Key Personnel Obligations

Governance Documentation

In addition to organisation charts which show the roles present in an organisation and their reporting relationships, the BEAR will require two additional forms of governance documentation that must be supplied to APRA. They are:

a) **accountability maps** that clearly and accurately show lines of reporting, delegation and responsibility and that the ADI is meeting its key personnel obligations, by ensuring all key areas of responsibility in an ADI and its group are attributed to accountable persons, and

b) **accountability statements** that describe the specific accountabilities for each accountable person.

It is the ADI's responsibility to ensure responsibilities are allocated appropriately. If an ADI does not or cannot do this, APRA has the power to direct an ADI or subsidiary with respect to the allocation of responsibilities. APRA can use this power if it is concerned that the ADI's allocation of responsibility (or failure to do so) is likely to give rise to a prudential risk.

Accountability Maps

Accountability maps will help APRA identify accountable persons where an issue arises in a particular area of an ADI or its subsidiary. They will also ensure that there are no gaps in accountable person functions across the ADI and that appropriate governance controls are in place. The accountability maps could also assist an ADI to show the reasonable steps it has taken to avoid any breach of its BEAR obligations.

Accountability Statements

Accountability statements include a comprehensive description of that part of the ADI or its subsidiaries' operations over which the accountable person has effective management or control. An accountability statement should align with the accountable person's functions and responsibilities.

Other Key Personnel Obligations

Other key personnel obligations include ensuring that:

a) prohibited persons are not accountable persons, and

b) APRA directions to reallocate responsibilities of accountable persons are complied with.

Comments

Many ADIs, insurers and super funds may not currently have in place the extent and quality of governance documentation required to fulfil their disclosure and reporting obligations to APRA. In some cases the organisation design may need to be changed so that key personnel obligation can be fulfilled to the satisfaction of APRA. Some commentary regarding the issue of complex matrix reporting structures has already emerged, and it is clear that such structures will result in the sharing of consequences for the misdeeds of individuals in ways that are unlikely to be acceptable to executives (see next section). GRG has the expertise to support ADIs, insurers and super funds to review their organisation design, allocation of accountabilities and development of accountability statements.

Accountability Obligations

The following table summarises the accountability obligations of ADIs and accountable persons.

ADI	Accountable Person
(a) to conduct its business with **honesty** and **integrity**, and with **due skill, care and diligence**;	(a) conduct the responsibilities of his or her position as an accountable person with **honesty** and **integrity**, and with **due skill, care and diligence**;
(b) deal with APRA in an open, constructive and co-operative way;	(b) deal with APRA in an open, constructive and co-operative way;
(c) take reasonable steps in conducting its business to prevent matters from arising that would **adversely affect the ADI's prudential standing or reputation**;	(c) take reasonable steps in conducting those responsibilities to prevent matters from arising that would **adversely affect the prudential standing or reputation** of the ADI:
(d) take reasonable steps to ensure that each of its accountable persons meets his or her accountability requirements;	*Note: If more than one of the accountable persons of an ADI or a subsidiary of an ADI have the same responsibility mentioned in section 37BA in relation to the ADI or subsidiary, all of those accountable persons have the accountability obligations jointly in relation to that responsibility.*
(e) take reasonable steps to ensure that each of its subsidiaries that is not an ADI complies with paragraphs (a), (b), (c) and (d) as if the subsidiary were an ADI.	

Variable Remuneration Deferral

BEAR will require part of variable remuneration to be deferred for at least four years. Thus, if an accountable person does not receive variable remuneration there will be no deferral requirement. Further, if the total of variable remuneration in a financial year does not exceed $50,000 then there is no deferral requirement.

Key aspects to be noted from the Explanatory Memorandum include:

1. remuneration is all of what is paid or payable to an accountable person for the performance of their duties in the course of their employment or their role as a director or officer.
2. variable remuneration is part of an accountable person's remuneration that is not guaranteed because it is conditional on the achievement of pre-determined objectives and can be forfeited if these objectives are not met, and
3. variable remuneration is valued at face value, rather than fair value for the purposes of calculating an amount to be deferred.

Once the amounts of total and variable remuneration for a financial year are ascertained it will be possible to calculate the minimum amount of variable remuneration required to be deferred, if any. The minimum amounts to be deferred are:

Role	Deferral of the Lower of the Amounts Calculated as a % of Remuneration	
	Variable Remuneration	Total Remuneration
CEO of large ADI	60%	40%
Accountable persons (other than the CEO of a large ADI) in large and medium ADIs and their subsidiaries	40%	20%
Accountable persons in small ADIs and their subsidiaries	40%	10%

Note that if variable remuneration is less than the specified percentage of Total Remuneration, but more than $50,000 (less than which is exempted), then 100% will need to be deferred. Also, the following classification of ADIs will be applied:

Small	<$10 billion in total resident assets based on 3 year average
Medium	$10 billion to <$100 billion in total resident assets
Large	≥$100 billion in total resident assets

The required period of deferral is 4 years "*starting on the day after the day on which the decision was made granting the accountable person the variable remuneration*". This wording is exceptionally unclear and may be interpreted in a number of different ways particularly for equity grants. There is a potential range of dates spanning years (e.g. date remuneration review signed off, up to vesting) that may be taken as the day of the "decision" and this is likely to be problematic. Similar issues occur when considering short term variable pay subject to deferral.

It should be noted that termination of employment does not shorten the deferral period. APRA may reduce the deferral period if a person is no longer an accountable person because the person has died, is seriously incapacitated, disabled or seriously ill, subsequent to an application being made in respect of that person. Also if an accountable person changes employers and a new ADI employer buys-out the deferred variable remuneration then APRA may apply the same deferral period to the buy-out amount.

Comments

For ASX listed entities the deferral aspect may be addressed (in full or in part) through equity grants as currently often occurs in relation short term incentive (STI) deferral and long term incentive (LTI) grants. However, plan designs will need to be reviewed and updated to enable compliance with the BEAR variable remuneration deferral requirements, and it appears that the periods during which access to variable remuneration must be restricted will need to be extended in many cases.

Entities that do not have share capital or have shares that are not listed on a stock exchange will need to develop plans to address the variable remuneration deferral requirement. For small ADIs the use of variable remuneration may cease to be a viable way of remunerating senior executives, other than within the $50,000 limit for exemption to the variable remuneration deferral. However, APRA has indicated that it would "take a dim view" of any such moves to reduce variable remuneration, though the consequences of that are not clear. For those that seek to retain variable remuneration and comply with BEAR, "bonus banks" based on deferred cash payments can be set up. GRG is well placed to provide pragmatic alternatives that will assist organisations to develop variable remuneration plans that are appropriate to the organisation and comply with BEAR.