Why the new banking laws won’t be the slam dunk the government is expecting

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The federal government is set to enact new laws covering Australian banks, senior executives and directors. Called the Banking Executive Accountability Regime (BEAR), it imposes new legal obligations on banks and their senior management and empowers the banking regulator, the Australian Prudential Regulation Authority (APRA), to take action against banks and senior personnel who fail to comply with these obligations.

However, APRA does not consider itself to be a legal enforcement agency. APRA prefers to operate through consultation and co-operation with the organisations that it regulates, not enforcement action.

APRA’s chairman, Wayne Byres, has stated that APRA does not intend to change the nature of its supervision as the banking regulator. If that remains the case, APRA is unlikely to make much use of its new powers.

So we shouldn’t expect a fresh wave of legal action against banks, senior executives and directors because of BEAR. However, there is some reason to hope that the legislation will gradually change the culture within banks, through new accountability obligations and their impact on banking executives and directors.

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BEAR is a response to growing anger at poor culture and behaviour (including alleged money laundering and interest rate rigging).

The legislation follows a federal parliamentary review of the four major banks. It found that the banks had repeatedly failed to protect the interests of consumers and that senior executives had created this banking culture. The importance of having a culture that supported fair treatment of consumers was reinforced by the earlier findings of the Financial Systems Inquiry.

BEAR seeks to address these concerns by imposing new accountability obligations on banks, their senior and most influential executives and directors. The new law obliges them to: act with honesty and integrity, due skill, care and diligence; to co-operate with APRA; and to take reasonable steps to prevent matters that adversely affect the “prudential standing” of banks.

Prudential standing in essence refers to the financial stability of banks. The laws greatly increase the standards of behaviour required of senior bank executives. These go beyond the existing standards under APRA’s so-called prudential framework.

The impact on culture

Critical to the success of BEAR is APRA’s increased powers to disqualify senior executives and/or directors from being able to act in their positions and to sue banks for civil penalties up to A$200 million.

Since APRA is not willing to use its new enforcement powers except in rare cases, you might wonder how these laws will lead to cultural change. Wayne Byers has stated that “the goal must be that, with clear boundaries and obligations set out … boards and executives conduct their affairs in such a manner that intervention by APRA is not needed”.

In singling out the senior executives and directors of banks and imposing new legal duties on them, the BEAR adopts a “top-down” or hierarchical approach to managing bank behaviour. Boards and executives will be expected to conduct their bank's affairs in a manner that meets the standards implied by their new accountability obligations and to account for poor outcomes.

Given the size of banks, this will require senior management to establish systems for monitoring the conduct of personnel at lower levels of the organisation. While top-down approaches are a common feature of APRA's risk-management strategies and policies, the heightened accountability of banking executives and directors under BEAR is the first of its kind.

Through the process of co-operation APRA will be able to encourage and cajole banks and their senior personnel to adopt higher standards of behaviour, which in turn will gradually lift standards across the organisation. The experience of the UK, where a similar set of laws is already in place, points to the likelihood of its success.