FSC FINANCIAL SERVICES COUNCIL

Implementing Royal Commission Recommendations 3.9, 4.12, 6.6, 6.7 and 6.8 Financial Accountability Regime (FAR)

FSC Submission 14 February 2020

FSC FINANCIAL SERVICES COUNCIL

Contents

1. About the Financial Services Council

The FSC is a leading peak body which sets mandatory Standards and develops policy for more than 100 member companies in one of Australia's largest industry sectors, financial services.

Our Full Members represent Australia's retail and wholesale funds management businesses, superannuation funds, life insurers, financial advisory networks and licensed trustee companies. Our Supporting Members represent the professional services firms such as ICT, consulting, accounting, legal, recruitment, actuarial and research houses.

The financial services industry is responsible for investing $3 trillion on behalf of more than 15.6 million Australians. The pool of funds under management is larger than Australia's GDP and the capitalisation of the Australian Securities Exchange and is the fourth largest pool of managed funds in the world.

2. Introduction

The FSC welcomes the opportunity to make a submission on the Proposal Paper (**Paper**) of 22 January 2020 in relation to FAR. The Paper states that the purpose of FAR is to:

> *increase the transparency and accountability of financial entities in these industries and improve risk culture and governance for both prudential and conduct purposes.*[1]

The FSC and its members, as mentioned at the Sydney February roundtable support the focus on accountability and the need to demonstrate that these accountabilities are being met with a consequent improvement in risk culture and governance. We appreciate that at this stage of the process, it is difficult for specifics to be provided and much of the Paper necessarily is cast in general language. However, there are some broad observations we can make at this stage and these are as follows:

1. **Complexity**: the interaction of FAR with general law and statutory rules is not clear;
2. **FAR entities**: the extent to which the regime potentially applies to foreign entities is unclear;
3. **Overreach:** it seems to us that many more persons in an entity will be characterised as accountable persons (**APs**), than is the case under the metamorphosing Bank Executive Accountability Regime (**BEAR**). The cost and benefit of such an extensive reach is questionable;
4. **Unintended consequences:** we are concerned that the individual civil penalty regime may operate as a disincentive to recruitment and adversely impact on talent retention strategies in the financial services sector;
5. **"Reserve Powers":** we note the view expressed at the February roundtable that exercise of the individual civil penalty regime and the non-objections power, fall in a "last

[1] Paper. Page 2.

resort" category and that this could be addressed in an Explanatory Memorandum This is unsatisfactory-such a concept is properly expressed in the legislation itself.

We understand from our discussions with Treasury and the Australian Prudential Regulation Authority **(APRA**) and the Australian Securities and Investment Commission (**ASIC**),[2] at the recent February roundtable that Exposure Draft (**ED**) legislation will be released following consideration of submissions lodged during this consultation period. In addition, the Regulators will issue draft, high-level guidance at this stage.

The current intent is to introduce the relevant Bill(s) into Parliament in the Spring Session. We trust our comments will be of assistance in drafting the ED and of course would be happy to discuss any aspect of our submission further.

For convenience, in our submission we will adopt the substantive headings in the Paper in providing our detailed comments.

3. Key Comments and Observations

In summary, our key comments and observations are as follows:

1. Scope of the regime

Entities subject to FAR: clarification is required as to the extent to which foreign entities are subject to the regime;

Core compliance and enhanced compliance: there are some definitional issues in terms of defining which category an entity falls within and consideration does need to be given to "buffers" and/or grace periods where an entity moves from one category to another.

Accountable persons: the very broad definition or scope of this concept gives rise to a number of practical difficulties and we ask that our observations in this regard be considered for the purposes of formulating the ED. In particular:

(a) is it the intention that foreign executives fall within the regime? If so, we question the utility and practicality of such an approach;

(b) in the prescriptive part of the concept, Attachment B, there does appear to be some duplication and non-alignment with commercial practice, for example, an accountable person having end to end responsibility for a product; while an aspect of that accountability has been specifically drawn out in the one of the other sections of Attachment B, for example, remediation;

(c) the number of person likely to be characterised as accountable persons, depending upon the particular structure may be quite significant – we do question the ultimate cost/benefit analysis of such an outcome;

[2] Collectively, the **Regulators**.

(d) there are other issues as mentioned in our submission as to:

(i) executives advising trustees in the role or function of the Office of the Trustee-do these persons become accountable persons?

(ii) delegates - do they also become accountable persons?

(ii) interaction with prudential standards and the potential for duplication of processes and roles;

(e) in these circumstances, there appears to be the potential for a significant number of accountable persons attributable to a FAR entity or group of entities - which is unlikely to assist in either Regulator or business efficacy;

(f) further it is not clear to us how this responsibility interacts with the recently introduced design and distribution obligations legislation; and

(g) as outlined below, there is a plethora of general law and statutory obligations and duties currently applying to persons who might be characterised under the regime as accountable persons. The regime seems to operate as an overlay on these obligations and duties and there does not appear to be clarity as to how the obligations and duties and the regime interact. Further, what if there is a conflict or inconsistency between general or statutory law and the regime? Which is to have priority and what are the consequences for the relevant accountable person in acting in accordance with the regime but not in accordance with general or statutory law?

2. Accountability and key personnel obligations

Entity obligations
Accountability obligations

We note that these particular obligations are consistent with the BEAR regime. The concern we do have is the concept of dealing with a Regulator in *an open, constructive and cooperative way*. It seems to us that this is a concept which is easily expressed but capable of many different interpretations depending on one's perspective. This should be addressed, ideally in the ED, or, in regulatory guidance into which industry has had input;

Group entities: further consideration and guidance is required to explain the meaning of significant or substantial subsidiaries. Additionally, the position of a corporate group and its officers and senior executives is not clear where the group controls a number of subsidiaries some of which fall within the regime.

Outsourcing arrangements: we assume, given recent APRA focus, that the reference in the Paper primarily is to RSE outsourcing arrangements. We also note that insurers have mirror standards under CPS231.This demonstrates the lack of clarity as to how the various items of legislation are intended to operate given that there are specific superannuation provisions and APRA Standards for RSEs and insurers governing this topic.

There also is a lack of clarity which arises where for example, the trusteeship of a superannuation fund is "outsourced" to an RSE licensee for hire.

Key personnel obligations: clarity is required as to what extent the regime applies to a person who temporarily, say for a period of 90 days, assumes the role of an accountable person.

Accountable person obligations

Accountability obligations

We have mentioned above our concerns with the concept of dealing with a Regulator in an open, constructive and cooperative way.

There is an additional issue here – there is a further obligation imposed on accountable persons to take reasonable steps in conducting their responsibilities as an accountable person to ensure that the entity complies with its licensing obligations. The ED and the draft guidance should clarify what connection will be needed between the person's responsibilities in any accountability statement and the relevant licensing obligations. Clarification is also required so that the reasonable steps will be measured by reference to that person's accountability.

3. **Deferred remuneration obligations:** clarity is required as to how these obligations might apply to foreign executives (and if so, what is the policy intent, particularly where those executives are subject to overseas prudential and conduct supervision).

   As we have mentioned, clarity also is needed as to how the provisions might operate in the circumstances of persons temporarily filling the role or function of an accountable person.

   The Paper notes that CPS 511 also will apply to prudentially regulated entities that are also subject to the FAR. The FSC suggests that there be an alignment between CPS 511 and the FAR on key terms such as 'variable remuneration' and 'deferral date' to avoid complexity for organisations.

   There also is an issue as to why there has been a change from the BEAR approach in FAR as to the level of deferral of deferred remuneration. Under BEAR, the level of deferral is dependent upon the size of the ADI whereas under the FAR proposal, the deferral rules apply to all entities without regard to characterisation as core or enhanced compliance entities, i.e., "size".

4. **Accountability maps and statements**: in the case of dual regulated entities from an entity's viewpoint and at a very practical level, one point of contact at one Regulator would be useful and should be prescribed. Further, it should be prescribed that having provided required information to that point of contact is deemed as having complied with a requirement to send to all relevant regulators. Any regulatory guidance should provide practical examples of material and non-material matters; drawing on any available learnings form the BEAR.

5. **Notification obligations**: relevant notification obligations will sit alongside existing statutory obligations. We suggest for efficiency that one notification to one Regulator, covering each relevant item of legislation would be appropriate.

6. **Penalties:**

Penalties for entities**:** we note that the penalty regime is consistent with the new penalty framework under the Corporations Act and other legislative items mentioned in the Paper.

Penalties for individuals: we understand from the round table that the purpose in introducing individual civil penalties was from a perceived neutrality perspective. Again, we understand that this will be practically administered as a reserve power and will be used only in the most extreme circumstances. If the latter is the case, then this should be expressed in final legislation and reference in the Explanatory Memorandum seems to us to be insufficient.

Given that the Regulators have power to disqualify a person from acting as an accountable person, (subject to review and appeal rights), we do question the need for such a regime. In a practical sense it seems to us that a disqualified person is extremely unlikely to ever again secure a comparable position in the financial services industry.

We also express our concern as to the impact such a regime might have on appropriate recruitment and retention and have provided below a reference to a United Kingdom study which is instructive in this context.

If the ED is to proceed with this proposal, then there are some definitional issues which should be addressed. Again, the interplay of these provisions with other relevant legislative provisions is unclear and this requires clarification if this aspect were to proceed.

7. **Non-objections Power:** we appreciate that this veto power over appointment was suggested by the APRA Capability Review. However, given the veritable armoury of powers conferred upon the Regulators, we do question whether it is in fact required. Again, we note that this is said to be a reserve power and a power which will be exercised only in the case of last resort. If this proposal proceeds, then this is of such significance and importance that the concept needs to be articulated in the legislation itself and not relegated to commentary in an Explanatory Memorandum.

Our detailed comments and observations follow.

4. Scope of the regime

Entities subject to the FAR

We note that in addition to ADIs already subject to the BEAR, the FAR will be extended to all other APRA regulated entities. This includes licensed non-operating holding companies (**NOHCs**). There are two issues here. The first is to the extent to which the FAR is intended to apply to foreign entities (i.e., non-Australian domiciled entities). The following statement appears for example at page 5 of the Paper:

> *Similar to APRA's ability under the BEAR, APRA and ASIC will be able to prescribe additional particular responsibilities over time and will also be able to prescribe particular responsibilities in respect of* ***foreign entities subject to the FAR****.* ***(our emphasis)***

This is extremely broad language and has given rise to some concern amongst our members who are subsidiaries of ex-Australian parents. We assume however that the better view is that this statement is to be read in the context of the overall regulatory scheme, both current and proposed. We believe the reference is intended to apply to FAR entities that are branches, i.e., in legal terms are local operations of a foreign entity. This seems to be developed further in the Paper with the following references applicable to branches:

(a) *senior executive responsibility for the conduct of all the activities of an Australian branch of the foreign ADI, Category C insurer or Eligible Foreign Life Insurance Company (EFLIC);*

(b) *the Senior Officer Outside Australia for an Australian branch of the foreign ADI or Category C insurer;*

(c) *responsibility for oversight of an EFLIC as a member of the Compliance Committee;*

(d) *agent in Australia of a Category C insurer; and*

(e) *any particular responsibility under items 1 or 3 that are determined by either APRA or ASIC to apply to the branch.*

Accordingly, we assume that the reference to foreign entities subject to the FAR is to be construed in the context of these "branch provisions". Could you please confirm or otherwise advise?

If the intention is that there be a broader application to foreign entities, then we would wish to discuss the matter further with you. There are many legal and practical issues which we assume Treasury and Government is alive to if indeed the intention is for FAR to have a broader reach.

The second issue is whether it is intended the FAR apply to foreign executives which we discuss below.

Core compliance and enhanced compliance

We note that under the FAR, entities will not be classified as small, medium and large (as is the case under the BEAR) but rather divided into two categories: *core compliance entities* (who will not be required to submit accountability maps and statements) and *enhanced compliance entities* (who will have to do so). According to the table in the Paper, exceeding a stated level of total assets is the determinant of whether an entity is an Enhanced Compliance Entity.

At this stage, it is not clear whether total assets are calculated on a gross or net basis. Indeed, we wonder whether some other determinant might also be more appropriate, for example in the case of insurers, premium income in force.

In addition, consideration should be given to providing for a "buffer" where an entity in a particular period exceeds a core compliance threshold and/or a grace period during which an entity can progress to the enhanced compliance entity level. For completeness, we suggest that these considerations also apply in the reverse situation, albeit that it may be unlikely in a practical sense for an entity to move "downwards" from the enhanced compliance category to the core compliance category.

We also note that the joint regulators, APRA and ASIC will have power to re-characterise entities as core or enhanced. Additionally, core compliance entities may be required to submit accountability maps and statements if regulators form a view this would benefit the entity's governance accountability. These are very wide powers expressed in this fashion. We are hopeful that the ED will clarify some of the parameters of these powers and that draft regulatory guidance will be available for consideration.

Accountable persons

***General*:** The Paper indicates that:

> *An accountable person will be defined using a principles-based element and a prescriptive element. Similar to the BEAR, under the principles-based element, a person is an accountable person of a FAR entity or a subsidiary of a FAR entity if the person is in a senior executive position with actual or effective management or control of the entity, or the management or control of a substantial part of the operations of the entity and its significant and substantial subsidiaries. As with the BEAR, where the activities of a subsidiary of a FAR entity are significant, an accountable person should have responsibility for the operations of that subsidiary.*
>
> *For the prescriptive element, APRA and ASIC will prescribe a list of particular responsibilities. Attachment B provides an indicative list of particular responsibilities for each entity type.* [3]

We note that such a broad-based expression or definition of accountable person (**AP**) does raise many issues which we outline below:

[3] At page 5.

***Prescription*:** We note also that FAR obligations and responsibilities are proposed to apply to an extremely wide-ranging list of functions than is the case under the BEAR. The Paper in Attachment B outlines list of particular responsibilities that the Regulators may prescribe. The Paper states:

> *The following lists, under items 1-3, are indicative of the particular responsibilities that APRA and ASIC may prescribe under FAR. Guidance would be issued to emphasise the critical expected functions within each particular responsibility that relate to the prudential and conduct obligations set out in the FAR. Guidance would also be provided on the respective roles of APRA and ASIC in registering individuals for these roles.*[4]

The Paper notes that the Regulators will be able to prescribe additional responsibilities over time and will also be able to prescribe particular responsibilities in respect of foreign entities subject to the FAR.[5] The list in Attachment B is very extensive as it is, and is divided up into:

1. all FAR entities;
2. FAR entities that are branches of a foreign entity; and
3. FAR entities that insurers or RSE Licensees.

FAR thus appears to have a potentially wide reach numerically in terms of persons capable of being characterised as APs. There are issues as we explain below with the list itself and how these obligations interact with other relevant obligations.

Reach of the FAR: Foreign Executives as APs?

In our opening remarks, we questioned whether the intention was to extend the FAR at an entity level to ex-Australian entities, which did not otherwise have an Australian regulatory connection, such as being registered or licensed with APRA. In this section, we focus on the position of foreign executives as potential APs and question whether that is indeed the intention.

If it is, we ask what policy objective is met by this extension?

This issue is of some significance to certain groups of our membership. For example, some RSE licensees are subsidiaries of overseas entities and, given recent market changes, in the order of 80% of Australian life insurers are foreign owned.

We note that it is not uncommon for such Australian-based businesses owned by global entities to have matrix reporting structures under which:

(a) (i) Australia-based senior executives report to an offshore executive (for example, a global or regional head of IT) while having a dotted reporting line to the local chief executive; or

[4] At page 14
[5] At page 5.

(ii) Australia-based executives report to the local chief executive but have dotted reporting loan to an offshore executive.

(b) Local chief executives often report to a global or regional (e.g. an Asia-Pacific) executive.

The current BEAR regime is not explicit about whether individuals who are based overseas can be characterised as APs. However, the Explanatory Memorandum to the *Treasury Laws Amendment (Banking Executive Accountability and Related Measures) Bill* 2017 contains this statement:

> *1.121 If an accountable person of an ADI or a subsidiary may be placed in a position where compliance with the BEAR could place them in breach of a corresponding foreign law (such as the Manager in Charge regime in Hong Kong), and APRA is satisfied that this contravention could occur, APRA can give the accountable person a written notice specifying the obligation for the accountable person. This will ensure that accountable persons, as with ADIs, are not placed in a position where they breach a foreign law through complying with BEAR. This administrative decision is judicially reviewable under the AD(JR) Act and there is no merits review available for the same reasons set out in paragraph 1.40. [Schedule 1, item 1, section 37BC]*

This statement does imply that for BEAR purposes, an AP could be an individual who is neither based in Australia nor an Australian resident but resident of a foreign jurisdiction.

In the circumstances we have outlined above, we feel there should be greater clarity in relation to the potential position of such ex-Australian persons to be APs. We seek clarity in relation to the following matters:

(a) the position of overseas executives of entities who are prudentially regulated in their home jurisdiction;

(b) whether they will be subject to the deferred remuneration arrangements even if their variable remuneration is based on goals of the global entity, to which the Australian business may contribute a very small percentage; and

(c) whether the Regulators will provide practical guidance to assist with what degree of decision-making authority is required for executives to meet the 'principles-based' test for accountable persons.

In any event, we do question the policy of the FAR extending to such executives as APs. In most instances, it seems to us that these executives would be subject to regulation in a home jurisdiction and there are practical difficulties in seeking to apply the provisions of the FAR in the circumstances we have outlined.

Interaction with other prudential tests and requirements?

There is a lack of clarity how these might interact with FAR. For example, *Prudential Standard CPS 520 Fit and Proper* and *Prudential Standard SPS 520 Fit and Proper* deal with the minimum requirements for APRA-regulated institutions in determining the fitness and propriety of individuals to hold positions of responsibility. For example, responsible persons and senior

managers in terms of these Standards are likely be characterised as APs under FAR. It is likely that there will be a duplication of processes and duplication of appointments and functions.

It would be useful if this could be clarified and indeed streamlined.

Difficulties with Attachment B

The indicative list in Attachment B of APs is problematic for several reasons. The primary issues here may be identified as follows:

(a) there is double-up in the list e.g. remediation is particularised separately at item 1m. but would also be included in end-to-end product at item 1n;

(b) the concept of an end-to-end AP accountable for product (item 1n) is, in our respectful opinion, quite impractical and ignores commercial reality. This item covers functions and tasks performed not just by a myriad of teams within the entity, but potentially, also by shared group services. We understand that in its 28 June 2019 letter to all ADIs, in relation BEAR, APRA indicated that it saw that end-to-end accountability being for design, delivery and maintenance, including remediation, linkages to IT systems and data quality, outsourcing, incentives etc. In practical terms, this clearly covers many different teams and even cross-entities (some of which may already be responsible under BEAR), so the idea of a single-point of accountability in our view, will be extremely challenging; and

(c) it is not clear from the Paper whether accountabilities for particular responsibilities can be joint or whether it is anticipated there will only be one Accountable Person for each responsibility. Identifying a single AP for a number of the responsibilities e.g. items 1n and 3a, would be problematic given the complexity of large organisations. We suggest that organisations have appropriate flexibility to determine the correct AP, or in certain cases, multiple APs, for these responsibilities.

Office of the Trustee?

We note that some RSEs maintain an independent office of the superannuation trustee or “designated business unit” with its own executive staff who may report to the Board of the superannuation trustee rather than to the CEO or other senior executives of the broader organisation. The superannuation trustee may also receive services from and/or be supported by executives of a related party or group entities. We also note that APRA recently has been requesting and intimating that all RSE licensees implement and maintain an independent office of the superannuation trustee or “designated business unit” with its own executive staff. In determining APs for such an RSE licensee, it is unclear how FAR will respond to and interrelate with that situation. It also seems to us to be an unusual and indeed odd outcome if executives of a related-party service provider, albeit acting at all times on an arm’s length basis in relation to the RSE, could be captured as APs.

Delegations?

As mentioned at the round table, it is not clear to us how the regime will interact with the common corporate and commercial practice of delegation.

What is delegation?

Delegation, considered in isolation, is the assignment of any authority to another person to carry out specific activities. It is one of the core concepts of management leadership and is a core tool in many Australian businesses for efficient business operations. However, the person who delegated the work remains accountable for the outcome of the delegated work. Delegation enables a subordinate to make decisions, i.e. it is a shifting of decision-making authority from one organisational level to a lower one. It is not uncommon in our experience for many businesses, especially in large corporate groups, to have one delegation to a multiplicity of persons.

Corporations Act

From a company law perspective, Section 198D of the Act allows boards to delegate some of their powers to a committee of directors unless the company's constitution disallows it. Generally, the directors remain responsible for the exercise of power by a delegate as if it had been exercised by the directors themselves. There is a limited exception available under section190(2) of the Act. Thus, delegating directors will not be liable if the relevant director believed:

(a) on reasonable grounds at all times that the delegate would exercise the power in conformity with the duties imposed by the Act and the company's constitution; and

(b) on reasonable grounds and in good faith (and after making proper inquiries if the circumstances so required) that the delegate was reliable and competent in relation to the power delegated.

Section 189 provides authority for the rest of the board to reasonably rely on the information or advice given by a committee so long as it is independently assessed by the board and is relied upon in good faith. However, this delegation of authority does not lessen the board's overall duties and responsibilities.

As you would know, the most common board committees in a listed entity are the audit, remuneration, nomination and risk committees. Some committees are subject to other requirements such as ASX Listing Rules and if the entity is prudentially regulated, APRA prudential standards. The nature and number of board committees will depend on the size of the company, its corporate status and the nature of its business.

Potential Impact of FAR

We express our concern at the impact the regime may have on this common business practice. Given that the delegating party generally retains responsibility, we acknowledge that they are likely to be characterised as APs. However, does the regime mean that each delegate also becomes an AP? This will give rise to an even larger cohort of APs and it seems to us to diffuse the concept of accountability. This is another area where Regulator guidance and consultation will be required.

Complexity

Moreover, it is apparent from this that the FAR regime has the potential to be complex and to compound complexity in an already crowded regulatory landscape. Thus, we appear to have an overlay of obligations imposed on an already diverse framework. For example, the following matters are of significance to entities and especially potential APs in this context:

(a) application of the general law relating to company directors, officers and employees and the specific Corporations Act provisions; for example, duties to exercise due care, skill and diligence;

(b) application of the general law relating to trustees, trustee directors and employees and the specific statutory provisions of the Superannuation Industry (Supervision) Act 1993 and Regulations made under that Act;

(c) application of the general law relating to life insurers and specific statutory provisions under the Life Insurance Act 1995 and APRA Prudential Standards; and

(d) the role of statutory offices such as the Appointed Actuary, the Company Secretary and indeed a company Director and the interaction with the AP rules.

Consistency with regulatory framework

The differing regimes outlined above, coupled with FAR, may impact upon and apply to the same individuals, potentially leading to confusion and inefficiencies. This unnecessary complexity is not helpful in supporting the overall intent of these regimes, which would benefit from being simplified. In summary, as we said, the FAR includes several elements that could be considered to duplicate and overlay obligations under the general law, Corporations Act, the *Superannuation Industry (Supervision) Act* 1993 and other key pieces of legislation. (including prudential standards and regulatory guides which relate to licensing obligations). These multiple pieces of legislation create a lack of clarity and we would appreciate guidance in the ED or further consultation how it is intended these interact with FAR and which will have priority in application from the perspective of an AP.

Similarly, with FAR being jointly administered, it is important that APRA and ASIC work together, to ensure that this is effective and efficient. We suggest that a set of joint principles would be a useful framework for industry and provide some clarity, and given the additional complexity with joint regulation, suggest that Treasury allow sufficient time for consultation with both Regulators when determining an implementation timeframe.

Product responsibility

As noted above, the concept of an end-to-end AP accountable for product (item 1n) of Attachment B, in its current formulation is, in our respectful opinion, quite impractical and ignores commercial reality. This does require some further rethinking and review and definitions of what is meant by key concepts such as ‘products’ and ‘services’ should be consulted on with industry.

As mentioned, at the roundtable, it is not clear to us how this obligation interacts with the recently introduced design and distribution obligations (**DDO**). We note Treasury comments

that there is no necessary inconsistency. However, in our view, this demonstrates the complexity of the interaction of various legislative items.

5. Accountability and key personnel obligations

Entity obligations

Accountability obligations

The obligations imposed on APs are to be compared with the entity obligations, i.e., those imposed on a FAR entity, as distinct from APs. These obligations are not dissimilar from those currently contained in the BEAR. In summary, an entity must take reasonable steps to:

- conduct its business with honesty and integrity, and with due skill, care and diligence;
- deal with APRA in an open, constructive and cooperative way;
- deal with ASIC in an open, constructive and cooperative way;
- for APRA regulated entities, in conducting its business, prevent matters from arising that would adversely affect the entity's prudential standing or prudential reputation;
- ensure that each of its APs meets their accountability obligations (confirming at this stage our previous comments that the number of roles and responsibilities in the list prescribed by regulators for the purposes of defining an AP has been expanded significantly under the FAR); and
- ensure that each of its significant or substantial subsidiaries that are not subject to the FAR, comply with all of the other obligations as if the subsidiary were subject to the FAR (to the extent that the obligations are relevant to the subsidiary).

Group entities

According to the Paper:

> *A significant or substantial subsidiary in this context refers to subsidiaries that have a material impact on the activities of the FAR entity.*[6]

This clearly is an area where further consideration and guidance is required. For example, what is the position where a corporate group contains several FAR entities each operating in different financial services streams? For example, it is not impossible for such a group to consist of an ADI, an RSE licensee or a FAR insurer. How is the legislation intended to operate in such circumstances and where do the entity responsibilities lie? Given the number of entities that the FAR will apply too, we would suggest that sufficient flexibility is permitted to organisations to structure their operations in a way that best reflects accountability.

[6] Page 6.

Outsourcing arrangements

In a similar vein, the Paper indicates that FAR entities with outsourcing arrangements need to ensure the FAR entity and APs have adequate control and oversight of activities covered by the FAR.[7]

We assume this comment is intended to highlight concerns APRA has expressed with outsourcing in the context of RSE licensees. Again, there is an issue as to how this comment is to be taken and interpreted considering the specific superannuation provisions and APRA Standards governing this topic.

As mentioned previously, insurers have mirror obligations as RSE licensees in relation to outsourcing. Accordingly, any clarification in this context should consider the position of both insurers and RSE licensees.

There also is a lack of clarity which arises where for example, the trusteeship of a superannuation fund is "outsourced" to an RSE licensee for hire.

Key personnel obligations

We note that in similar vein to the BEAR, the key personnel obligations of an entity will be to:

1. ensure that the responsibilities of APs cover all aspects of the operations of the entity and its significant or substantial subsidiaries;
2. ensure that none of the APs are prohibited under the FAR;
3. comply with Regulator directions to reallocate responsibilities; and
4. take reasonable steps to ensure that each of the entity's subsidiaries that is not a FAR entity complies with obligations (2) and (3) above.

The period where an individual may temporarily fill the position of an accountable person if they are not registered will be set by Regulator. We understand from the roundtable that this period is likely to be 90 days. We also understand that whilst there will be no obligation to register these persons, the individual is taken to be the accountable person. Specific issues which seem to arise here include:

(a) Does such a "temporary" AP become subject to the FAR remuneration rules?

(b) What is the position if the "temporary" AP fills the same or different AP roles over different periods of time, specifically in terms of application of the FAR remuneration rules?

(c) What is the position if the appointment period extends over two different accounting and therefore remuneration periods?

[7] Ibid.

Accountable person obligations

Accountability obligations

We have outlined some of the issues we see with the **definition of APs** above and the obligations imposed on APs (under the heading ***Accountable persons)***. We do note that APs, in a manner reminiscent of the BEAR, must:

- act with honesty and integrity, and with due skill, care and diligence;
- deal with APRA in an open, constructive and cooperative way (noting that this will not displace legal professional privilege);
- deal with ASIC in an open, constructive and cooperative way (noting that this will not displace legal professional privilege); and
- take reasonable steps in conducting those responsibilities to prevent matters from arising that would adversely affect the prudential standing or prudential reputation of the entity.

There is a further obligation imposed on APs. An AP must take reasonable steps in conducting their responsibilities as an accountable person to ensure that the entity complies with its licensing obligations. This obligation extends beyond the current BEAR obligation to take reasonable steps to prevent matters from arising that would adversely affect the entity's prudential standing or reputation. The ED and the draft guidance must clarify what connection will be needed between the AP's responsibilities in any accountability statement and the relevant licensing obligations. We also need clarification that the reasonable steps will be measured by reference to that person's accountability.

In addition, as mentioned at the roundtable, the concept of dealing with Regulators in an *open, constructive and cooperative way* is extremely unclear and open to many differing interpretations. On one view, a direct response to a direct question satisfies the requirement. However, on another view, if there is further unrelated information which may have some bearing on the matter, is a failure to disclose that a failure to satisfy the obligation? What if other privileges are available to the person such as privilege against self-incrimination?

Scope of the additional AP obligation and implications

As noted above, the FAR imposes an additional obligation on *APs to take reasonable steps in conducting their responsibilities as an accountable person to ensure that the entity complies with its licensing obligations* This additional obligation extends beyond the current BEAR obligation to take reasonable steps to prevent matters from arising that would adversely affect the entity's prudential standing or reputation.

This additional obligation appears to have a very broad application and, in our view, has the potential to include all the licensing obligations under s 912A of the Corporations Act. This requires licensees *to do all things necessary to ensure that the financial services covered by the licence are provided efficiently*, *honestly and fairly*. It is not clear to us how this obligation interrelates with the additional FAR obligation-and indeed other statutory and general law obligations.

If the additional obligation is intended to add to existing licensing and other obligations of APs, clarity is required on the standard of conduct expected of APs in conducting their responsibilities.

We note that the requirement to take reasonable steps to "ensure" compliance is considerably broader than the corresponding requirement relating to prudential standing which requires the executive to take reasonable steps to "prevent matters from arising" that would adversely affect prudential standing and reputation.

With individual civil penalties at the level set out in the Proposal Paper, the impact of this new obligation is to create a new category of liability equivalent to directors' and officers' duties, that only applies in FAR-regulated industries.

An obligation to "ensure" compliance with an entity's licensing obligations would appear to require an executive to take positive steps to ensure compliance, and this seems likely to oblige an executive to take actions that are outside that executive's area of responsibility. This issue is made particularly acute by the expansion of listed APs to include persons who do not have significant influence or control over an entity's operations (e.g. senior executives with responsibility for an RSE licensee's actuarial function). This makes it particularly likely that there will be a misalignment of a person's responsibilities within an entity and that person's responsibilities and obligations under the FAR regime.

We note that the BEAR regime's objective was to increase transparency and accountability across the banking sector (Explanatory Memorandum 1.44) and to ensure that responsibility for all parts of an ADI group were covered by an accountable person (EM 1.56). It is consistent with this purpose that accountable persons under the BEAR regime are Board members and senior executives responsible for management or control and that the obligations imposed on accountable persons cover conduct that is 'systemic and prudential' in nature (EM 1.25). The executive responsibilities that are specified in the BEAR legislation are responsibilities that give those executives management or control over significant functions across the group (e.g. management of an ADI's operations, internal audit, compliance function). The Proposal Paper significantly expands the list of responsibilities to include executives who have specific responsibilities that do not give them management or control over the entity or the group (e.g. actuarial functions). This is likely to have an effect that is contrary to the legislative purpose of ensuring that key executives are accountable for key functions across a regulated group.

6. Deferred remuneration obligations

We note the observations in the Paper. As mentioned previously, we have concerns as to how these practically might apply to:

(a) "temporary" APs; and

(b) Foreign executives.

We have an additional issue here. The BEAR differentiated between regulated entities based on scale (small, medium or large) for the purposes of deferral of variable remuneration. There is no such increasing proportion of deferral based on increased scale of the regulated entities in the FAR proposals. It would be useful if we could understand the policy behind this apparent shift in intent.

7. Accountability maps and statements

We note that the Paper refers to Accountability Maps and Statements submitted to either APRA or ASIC being shared in the case of dual regulated entities. The Paper also notes that:

(a) An updated accountability map will only need to be provided to a Regulator upon any material changes, e.g. changes in the accountabilities of an accountable person.

(b) If immaterial changes have occurred to accountability maps and statements over the course of the year, entities will need to submit a revised copy on an annual basis.

(c) An accountability statement will only need to be updated upon any changes in accountability.

(d) The materiality thresholds are designed to minimise the administrative burden of updating accountability maps and statements.

(e) Entities will be required to inform the relevant regulator of changes to the accountability maps or statements within 30 days of the change occurring.

(f) Guidance on what is meant by material changes is to be provided in regulatory guidance.[8]

In our view:

(i) there are inherent issues in a joint regulator regime; such as matters "falling between the cracks". In addition to any statutory obligations then in force to co-operate and share information, there will need to be effective protocols within the Regulators in place to ensure this risk is minimised;

(ii) from an entity's viewpoint and at a very practical level, one point of contact at one Regulator would be useful; and

(iii) it would be useful if the proposed regulatory guidance gave practical examples of material and non-material matters; drawing on any available learnings form the BEAR.

[8] At page 7.

8. Notification obligations

We note that as under the BEAR, a reasonable steps qualification will apply to all the accountability obligations **other than** an AP's obligations to act with honesty and integrity, and to deal with the Regulators in an open way. However, the FAR notification *coexist with existing breach reporting requirements and the proposed FAR notification requirements will not alter existing requirements.*[9]

There is a potential misalignment between an entity's existing reporting obligations and the FAR. Entities are obliged to report significant breaches of the Corporations Act to ASIC and to APRA under individual pieces of legislation depending on the entity. There is a 10-day time limit for reporting a significant breach. The FAR appears to require that **all** breaches of the obligations be reported, and the timeframe is unclear. It would be useful to know how these two obligations will interact. For example, if an entity assesses a breach of one of the prudential standards for APRA and does not report it because it is not significant, do they/the AP have to report it in any event under FAR?

This again is an example of a potential multiplicity of notification requirements. It would be useful if in a practical sense, consideration could be given to streamlining requirements so that for example a Corporations Act notification could also operate as a FAR notification.

9. Penalties

Penalties for entities

We note that maximum penalties under FAR are quite significant, as a result of alignment with other penalty regimes.[10] These penalties are to be the greater of:

(a) $10.5m (50,000 penalty units);

(b) the benefit derived/detriment avoided by the entity because of the contravention multiplied by three (where this can be determined by the court); or

(c) 10% of the annual turnover of the body corporate (capped at $525m or 2.5m penalty units).

The Paper states that when considering whether to impose a civil penalty, the court will be required to consider the impact that the penalty has on the viability of prudentially regulated entities.

Interestingly, in the case of RSE licensees, it is noted that RSE licensees will be prohibited from using trust assets to pay a civil penalty arising from breaching an obligation under the FAR. In addition, the Paper notes that provision will be made for the court to have regard to

[9] Paper, at page 8.
[10] Corporations Act; *Australian Securities and Investments Commission Act* 2001, *National Consumer Credit Protection Act* 2009 and *Insurance Contracts Act* 1984.

the impact of the penalty on the trustee's superannuation fund membership.[11]

Given the consistency with other penalty regimes, it is difficult to contend the penalties are disproportionate or unfair.

The more contentious issue however does arise under the individual civil penalties aspects of the proposal.

Penalties for individuals

As is the case with the BEAR, FAR will provides APRA and ASIC with the power to disqualify an AP if they fail to comply with their accountability obligations. These will be reviewable by the Administrative Appeals Tribunal, with questions of law being capable of appeal to the court.

However, individuals will be subject to civil penalties for breaches of their accountability obligations. These civil penalties will be consistent with the newly introduced maximum penalties for individuals under the Corporations Act, and other legislative items.[12] The maximum penalties will be the greater of the following:

1. 5,000 penalty units (currently $1.05 million); or
2. if the court can determine – the benefit derived or detriment avoided because of the contravention, multiplied by three.

As with the BEAR, entities will be prohibited from indemnifying or paying the cost of insuring accountable persons against the consequences of breaching the FAR. Interestingly, the Paper notes:

> *However, the reforms will not prevent executives from obtaining insurance that they would otherwise be permitted to obtain to cover the financial loss arising as a result of a civil penalty being imposed against them for a breach of the FAR.*[13]

There are number of observations we have on this aspect:

1. the Paper indicates that one determinant of the potential penalty is the benefit derived or detriment avoided. We would appreciate guidance on how this will be calculated and how these terms will be defined. For example, will the benefit be calculated in relation to the remuneration received by that individual, and if so, we would appreciate clarification on how this would interact with any remuneration impact that may also be internally imposed by an entity. We would submit that any remuneration impact should be considered as a mitigating factor when determining any civil penalty.
2. As we have indicated previously, guidance is required on how these penalties are intended to apply with existing legislative regimes that have similar avenues of enforcement, for example section 912A of the Corporations Act. We would appreciate confirmation as to whether each of these regimes will both be available as an option to the Regulator, and how these legislative regimes will interact. The concern here is that

[11] Pp.8-9
[12] See footnote 10.
[13] At page 9.

there are multiple avenues for various Regulators to impose penalties and a lack of clarity on how this would apply in the FAR regime. Finally, in this context, it is unclear whether ASIC and APRA can each seek civil penalties under the FAR regime, and we would submit it would be appropriate for one regulator to 'front run' pursuing a civil penalty on behalf of both regulators. An example of when a civil penalty would apply and how this would be administered by APRA and ASIC would be useful to include in the Explanatory Memorandum. Ideally however, we would prefer to see the relevant principles however to the extent possible expressed in the ED.

3. The practical impact of such a regime should not be underestimated. We note that a self-assessment of the United Kingdom (**UK**) Senior Managers and Certification Regime (**SCMR**) was jointly conducted by UK Finance and Ashurst; see: https://www.ukfinance.org.uk/policy-and-guidance/reports-publications/smcr-evolution-and-reform

   This is a useful tool for considering potential impacts of the FAR regime. The self-assessment noted that a number of firms found it more expensive to recruit for senior roles given the increased risk that applied as a result of the SCMR regime. We anticipate there would be a similar impact to the Australian industry following the introduction of the FAR regime. The industry may see increased remuneration costs to compensate for risk at multiple levels of the organisation or alternatively a reduced talent pool in relation to second line roles such as IT or Human Resources due to the increased risk associated with financial services businesses. We would appreciate Treasury's consideration of this concern.

4. We understand from the roundtable that this is "reserve power" and only to be used in the most extreme cases. It was volunteered that perhaps this could be mentioned in the Explanatory Memorandum (**EM**). If that is indeed the case and the proposal in this regard proceeds, it should appear in the legislation itself and not in the EM. There are only limited circumstances where an EM can be used to interpret a policy or intent of a statute or aid in interpretation. Moreover, the legislation should expressly state and limit the circumstances in which this power to pursue individual civil penalties can be used.

5. It is not clear to us whether in terms of general law or the proposed regime whether individuals may obtain insurance for civil penalties under the FAR regime and/or be indemnified by a policy. We do have concerns that even if permitted by the legislation, this type of insurance would not be readily available in the market. We would suggest that, if Treasury does propose to introduce a civil penalty regime (noting our concerns above), Treasury works closely with the insurance industry to ensure that the penalties are framed in a way to allow for appropriate insurance. We have concerns that if this was not available, there would be significant impacts on talent in the industry. We are happy to consult further with Treasury on this matter.

10. Non-objections Power

Again, we understand that this is to be a "reserve power" to be exercised in the most extreme circumstances. If so, for the reasons we have given in relation to the proposed individual civil penalty regime, this must be expressed in the legislation. The circumstances in which such a power is capable of being used must be strictly circumscribed and stated.

11. Extending the regime to solely ASIC regulated entities

We note the observations in the Paper and will provide comment when appropriate and when consultation commences on these aspects.

12. Timeframes for implementation

We note the observations in the Paper and will provide comment when appropriate and when consultation commences on these aspects.

However, we do note at this stage for completeness and to foreshadow what we are likely to say subsequently that a minimum period of 12 moths and ideally 24 months is at the forefront of thinking on this point. We say this given that the implementation of FAR is not simply a matter of transferring BEAR, but rather represents a significant change for non-BEAR institutions. Accordingly, appropriate time should be allowed for organisations to implement the changes and to consult with the Regulators (particularly in circumstances where significant matters are being left to the Regulators to determine).

Other observations

We have some other more general observations which we make in this section.

Joint regulation – it is currently unclear how the joint regulation between ASIC and APRA would apply. Historically, ASIC as a conduct regulator has demonstrated a different enforcement appetite to APRA. We would submit that a set of joint principles around operating and enforcement should be agreed between the regulators and shared to provide clarity and alignment. Additionally, there is additional complexity that will arise from the joint administration between the two regulators. The UK has adopted a model of 'single point of contact' for administrative purposes and we would suggest this model is adopted between APRA and ASIC.

Regulator Determination Power- There needs to be a distinction between what will be enshrined in legislation, and what will be left to the regulators to determine. For example, we would submit that the legislation should be clear on the thresholds for 'core' and 'enhanced' entities, so that this is not left to the Regulators to determine and is not subject to ongoing modification.

Need for ongoing consultation and guidance- Without wishing to repeat that which we have said before, we confirm that areas where increased guidance would be helpful include:

(a) making suit clear that potential penalties are proportionate, and reserved for material, exceptional items;

(b) defining the materiality of subsidiaries to be included within the scope of FAR;

(c) clarifying the interplay between executives accountable for end-to-end product management, and components of that related to underwriting, claims, disputes and remediation;

(d) we note that there is likely to be confusion concerning accountability and roles and we suggest that an organisation may be best placed to determine whether accountability sits at the say Executive Committee level or at a specific role level, for example an executive claims manager role;

(e) in vertically integrated businesses, making it clear whether multiple accountability statements and maps will be required for each APRA regulated entity;

(f) guidance on the intended additional obligation for all AP roles relating to "entity licences"; and

(g) clarity on defining the intended level of APs and a clearer definition of all regulated roles under different regulatory regimes.

Potential for unintended consequences-The final legislation should ensure that any penalties are proportionate, and are reserved for material, exceptional items.

The broader regulatory framework should continue to ensure that executives and directors can be reasonably compensated for the role having regard to the skill and experience required. There should be ongoing review as to whether those objectives are being met, as there is a risk that overly prescriptive requirements will be viewed as a compliance exercise, that does not support the proactive risk-aware management of the business.

Amongst other things, companies should have flexibility to consider the extent to which they encourage collaboration and enterprise leadership, and the minimum standards expected in demonstrating accountabilities are fulfilled. Similarly, the size and circumstances in which personal civil penalties are levied, if at all, should not discourage the transparent reporting and escalation of breaches.

Consistently with some industry observations on the CPS 511 proposals, there is a potential that this results in executives discounting the value of incentives, impacting retention as executives exit the industry. It is highly likely that these requirements will result in a need to increase base salaries, in order to retain and attract the right talent.

In turn, this could effectively water down the effectiveness and validity of a reward framework, and the encouragement of high performance.

Should you wish to discuss further, please do not hesitate to contact us.

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