FSC FINANCIAL SERVICES COUNCIL

Financial Accountability Regime (FAR) draft Bill 2021

FSC Submission 13 August 2021

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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

Recommendations 3.9, 4.12, 6.6, 6.7 and 6.8 of the Financial Services Royal Commission recommended the extension of the Banking Executive Accountability Regime to all APRA-regulated entities, with joint administration from APRA and ASIC.

We note that the Government has released for consultation *the Financial Accountability Regime (**FAR**) draft Bill* (**Bill**). The Government has also released exposure draft explanatory materials (**EM**), an information paper on joint administration (**Information Paper***)*, a policy paper on prescribed responsibilities and positions (**Policy Paper**), and a Questions and Answers document for consultation (**Q&A**).

The FSC welcomes the opportunity to make a submission on these documents. Whilst we acknowledge the intent of the Bill and understand the recommendation from the Financial Services Royal Commission to increase executive accountability in APRA-regulated entities, we have some general concerns as follows:

1. **Timing**: we note that the Treasury has asked the FSC as to the feasibility of bring forward the effective date for certain entities from 1 July 2023. We would strongly advocate against bringing this forward given there are serious concerns whether industry and regulators would be ready;
2. **Reasonable steps to comply with financial services laws** (accountable person taking reasonable steps in conducting those responsibilities to ensure that the accountable entity complies with a list of specified financial services laws) is in our view potentially unduly onerous for a single person.
3. **Significant Related Entity:** this includes connected entities of an RSE Licensee, which in some group structures includes entities over which the accountable entity would not be able to exercise control;
4. **Complexity and double jeopardy**: the interaction of FAR with general law and statutory rules is not clear and misconduct could result in liability under both FAR and existing regimes;

5. **Regulatory arbitrage**: There are instances where the FAR regime overlaps existing regulatory regimes. This overlap would allow a regulator to arbitrage the different regimes and choose between the different regimes;
6. **FAR entities**: the extent to which the regime potentially applies to foreign entities and foreign executives should be limited;
7. **Overreach**: many more persons in an entity will likely be characterised as accountable persons (APs) than was the case under the Banking Executive Accountability Regime (BEAR). The cost and benefit of such an extensive reach is questionable;
8. **Unintended consequences**: we are concerned the FAR may operate as a disincentive to recruitment and adversely impact on talent retention strategies in the financial services sector, including attracting and retaining foreign nationals;

3. Key Comments and Observations

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

1. Timing

The FSC notes that it is challenging for entities to fully prepare for FAR, having regard to current timeline (let alone a bring forward). There will be extensive engagement for accountable entities with the regulators to approve accountability documentation, which should not be underestimated from a timing perspective. That underlines the question as to the timing of the revised legislation, rules and guidance, as well as systems and process preparedness of the regulators. The FSC has received feedback from some members that it is not feasible to bring forward the proposed commencement date from 1 July 2023. Whilst the amount of preparation time required will vary between licensees depending on their size, complexity and structure, for many it will be a very substantial exercise, including potentially involving changes to organisational structure as well as roles and responsibilities in order to implement the new regime in the most effective manner. Adequate time is also needed for the preparation of regulatory guidance to provide clarity on the new requirements early in the implementation timetable. In our view a shorter timeframe would lead to substantial implementation risk. The FSC recommends finalising any regulatory guidance well before the completion of APRA and ASIC's arrangement outlining their general approach to administration and enforcement (noting that APRA and ASIC's arrangement is to be completed within six months of the commencement of the FAR). We note that prior to BEAR implementation, individual entities had the opportunity to consult with APRA in the 6 months leading up to the implementation date to ensure readiness, which would be challenging for FAR implementation if the commencement date is to be brought forward.

2. Scope of the regime

Entities subject to FAR: clarification is required as to the extent to which foreign entities are subject to the regime and whether the intention is still for FAR to be extended to non-APRA regulated entities (and if so, what the current anticipated timing would be).

Enhanced compliance thresholds: 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 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 Bill. In particular:

(a) the extent to which foreign executives fall within the regime. We suggest unless they are holding a prescribed responsibility or position in relation to an Australian branch or other operations in Australia of an entity as specifically set out in the rules they should not be covered, given that such foreign executives would be subject to regulation in a home jurisdiction and there would be practical difficulties in seeking to apply the provisions of the FAR to them;

(b) the number of persons 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;

(c) 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;

(d) impacts for RSEs with designated business units, which disrupt senior executive influence and control within corporate groups, for designated persons and responsibilities requires consideration;

(e) 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?; and

(f) Double jeopardy concerns – an accountable entity or accountable person being potentially liable under multiple laws.

3. Accountability and reasonable steps

Accountability obligations: a concern we do have is the concept of an entity or accountable person 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 legislation or EM, or, in regulatory guidance into which industry has had input,

Reasonable steps to comply with financial services laws: we note the new obligation imposed on accountable persons to take reasonable steps in conducting

their responsibilities as an accountable person to ensure that the entity complies with certain financial services laws as set out in the Bill. This is potentially an onerous requirement, as it will require accountable persons to be able to demonstrate how they have exercised reasonable steps to ensure compliance with financial services laws. As it stands, many numerous accountable persons will have responsibility for compliance with the same pieces of legislation. This could add a significant compliance burden to the existing compliance frameworks which already address the financial institution's compliance measures in respect of the financial services laws. The burden of the new accountability obligation could outweigh the benefit of including this additional responsibility.

This imposes a new legislative obligation on accountable persons which is additional to the legislative obligation imposed by the financial services laws listed – an obligation on individuals which was not considered appropriate by the legislature when making the underlying FS law, and which is potentially inconsistent with the obligation under the FS law. This is contrary to first principles of legislative power

As a drafting comment the multiple references to "in conducting responsibilities" is duplicative and adds confusion and the words "to ensure" compliance creates a very high standard.

One way to address this would be (1) to change the obligation into a "framework" obligation so the obligation is to ensure that there is an appropriate framework for the accountable entity to comply with the financial services laws and (2) to include the obligation as part of the obligations associated with the compliance responsibilities.

Also, it is unclear whether each accountable person must take reasonable steps to comply with all the listed financial services, or just those relevant to their responsibilities. This should be clarified in the Bill.

Further, as currently drafted all accountable persons could be liable if the accountable entity breaches one of the financial services laws. That is completely inconsistent with the whole design of BEAR / FAR and should be specifically addressed.

4. **Deferred remuneration obligations:** further 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).

   The FSC also notes that under FAR, the deferral rules apply to all entities without regard to level of revenue, net assets or the like and would recommend consideration be given to a de minimis threshold being introduced.

   The FSC also notes that APRA is in the process of consulting on deferred remuneration rules in CPS 511. However, APRA's proposals are at times duplicative, at other times, contradictory to the proposed deferred remuneration rules in FAR.

5. **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 is

welcomed. Further, it should be prescribed in the Bill that having provided required information to that point of contact is deemed as having complied with a requirement to send to all relevant regulators. We note that the Information Paper states that prior to the implementation of the FAR, the regulators are expected to release joint regulatory guidance to guide and assist accountable entities in the implementation and registration processes. Any regulatory guidance should provide practical examples of material and non-material matters.

6. Disqualification for individuals and double jeopardy:

Given that the regulators have power to disqualify a person from acting as an accountable person, (subject to review and appeal rights), we express our concern as to the impact such a regime might have on appropriate recruitment and retention.

Again, the interplay of these provisions with other relevant legislative provisions is unclear and this requires clarification if this aspect were to proceed. There is a concern regarding double jeopardy and an individual being subject to overlapping and sometimes inconsistent requirements in different laws.

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**). We note that the Bill states that for a foreign accountable entity in the banking or insurance sectors, the accountable persons' responsibilities will relate to the Australian branch, rather than to the entity as a whole (Section 9(5)). In addition, Section 13(2) goes on to provide that the accountable entity obligations do not apply to (a) an accountable entity that (i) the Minister has exempted under section 14, or (ii) is included in a class of accountable entities that the Minister has exempted under section 14; or (b) a foreign accountable entity, except to the extent that it operates a branch of the foreign accountable entity in Australia. In this regard we would welcome further clarity regarding the contemplated exemptions provided for in (i) and (ii), and also confirmation that FAR is only intended to capture a branch or other operations in Australia.

This is issue is of particular concern in the context of overseas entities in a group (in particular, in relation to related bodies corporate or holding company entities). The FSC suggests that Section 13(2) of the draft Bill could be broadened to provide for additional carve-outs to ensure there are no unintended consequences for foreign related parties of accountable entities in this regard. We also suggest that regulatory guidance, or failing this the EM, should provide a clearer indication of the intent here.

For example, for locally registered companies that hold the relevant license (local subsidiaries of foreign owned financial services groups, particularly life insurers, investment managers and the like), is the nexus of control or influence sufficiently severed by an immediate parent company as 100% shareholder of the accountable entity? If not, where does it stop, given frequently complex global corporate structures? Diagram 1.2 in the EM does not directly assist with this issue. We would suggest perhaps multiple diagrams could be provided with relevant comments as to the likelihood of a particular entity/accountable person within an international group being caught by FAR.

Another example is where foreign entities are connected to an RSE licensee. Given the regulatory requirements applying to RSE licensees which require a strong Australian based governance structure (for example, SPS 510), it would be helpful to clarify in the EM and by way of illustrative examples when foreign connected entities (and their foreign executives) of an RSE licensee would be caught as Significant Related Entities and Accountable Persons, respectively. We suggest that one option would be to include a presumption that in this situation the foreign connected entity and foreign executive would generally not be caught if they are not materially impacting/controlling operations in Australia (in a similar way that the concept of an Australian branch is used in the context of foreign accountable entities). If not, the Bill could raise significant uncertainty and/or unintended consequences for foreign entities connected to an RSE licensee.

In addition, we note that Government announced as part of the implementation roadmap that the FAR would be extended to AFSL/ACL holders that are not prudentially regulated or

otherwise caught by the FAR. We would welcome clarity as to the latest thinking on this issue and an indication of anticipated timing.

Another point of note is that ADIs and their significant related entities have a different commencement date to RSE licensees and insurers. This would appear to bring forward the commencement date for RSE licensees and insurers who are part of a group with an ADI. This would produce an unfair advantage for those RSE licensees and insurers who do not operate in this type of corporate structure. It is recommended that the Bill clarify that the commencement date for all RSE licensees and insurers, regardless of their related parties, is 1 July 2023.

Core compliance and enhanced compliance threshold

We note that under the FAR, in addition to the core notification obligations, accountable entities that meet the *enhanced notification threshold* are required to provide the regulator with an *accountability statement* for each of its accountable persons and an *accountability map*. According to the table in the Q&A, exceeding a stated level of total assets is the determinant of whether an entity meets the enhanced notification threshold.

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.

We also note that the Bill provides that Minister rules may set out how to determine when an accountable entity meets the enhanced notification threshold. The Minister rules may specify a method for working out the enhanced notification threshold and/or specify different methods for working out the enhanced notification threshold for different circumstances. We would welcome greater visibility on what is intended at this stage.

The EM states that FAR is intended to reduce the regulatory burden and compliance costs by only requiring accountable entities that meet the enhanced notification threshold to prepare and submit accountability maps and statements "and to notify the Regulator of material changes to these documents". Any regulatory guidance on what constitute material changes should provide clear examples as well as cover the points raised above.

Accountable persons

Several points of concern arise as follows.

***Prescription*:** We note also that FAR obligations and responsibilities are proposed to apply to a materially wider-ranging list of functions than is the case under the BEAR.

We note that the Policy Paper states that the Government will formally consult on the list of prescribed responsibilities and positions prior to the list being determined in the rules by the Minister. However, the Policy Paper also states:

"The full list of prescribed responsibilities and positions that would be set out in the rules determined by the Minister would comprise five sub-lists, namely the list of prescribed responsibilities and positions for:

- all locally incorporated ADIs, insurers, and registrable superannuation entity (RSE) licensees;
- all locally incorporated insurers (in addition to the first sub-list above);
- all locally incorporated RSE licensees (in addition to the first sub-list above);
- all Australian branches of foreign accountable entities; and
- all authorised/registered non-operating holding companies (NOHCs)."

FAR thus appears to have a potentially wide reach numerically in terms of persons capable of being characterised as APs by way of ministerial discretion (rather than being set out in the legislation, as was the case with BEAR (and which is to be preferred). The Policy 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 not welcome and 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.

We also query whether further consideration will be given to how the proposed FAR accountable person provisions align with the 'responsible person' requirements of APRA Prudential Standards CPS 520 and SPS 520.There are issues as we explain below with the list itself and how these obligations interact with other relevant obligations.

We also understand that in an ADI group structure, several of the prescribed responsibilities for RSE licensees and insurers (e.g. actuarial function, claims handling) may already be covered by the broad accountabilities of the accountable person responsible for the business unit within which the RSE licensees and insurers operate. We suggest that where an RSE licensee and/or insurer operates as a subsidiary of an ADI, the new prescribed responsibilities for RSE licensees and insurers should not apply to the extent that they are already covered in this way.

Reach of the FAR: Foreign Executives as APs?

The FSC advocates that the FAR should make it clear that foreign executives are not covered, unless they are holding a prescribed responsibility or position in relation to an Australian branch or other operations in Australia of an entity as specifically set out in the rules. In this regard we also note that the concept of "branch" is not defined in the Bill and the concept should be clarified and supplemented to cover other operations in Australia that may not fall within the definition of a branch.

This issue is of some significance to certain groups of our membership. For example, some RSE licensees are subsidiaries of overseas entities (who are not necessarily considered a foreign accountable entity) 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 entities owned by global entities to have matrix reporting structures which could impact the prescribed positions, for example:

(a) (i) Australia-based executives report to an *offshore executive,* often with functional responsibilities within global operating models (for example, a global or regional head of IT) while sometimes (but not always) having a dotted reporting line to the local chief executive; or

(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 executive* (e.g. an Asia-Pacific).

We further note that Table 4 of the Policy Paper specifically includes:

- The senior executive responsible 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); most likely the *Head of Branch or Country or similar*.
- *The Senior Officer Outside Australia* as defined under Prudential Standard CPS 510 Governance.
- *All members of the Compliance Committee* of an EFLIC as defined under Prudential Standard CPS 510 Governance.
- *Agent in Australia of a Category C insurer* as defined under Prudential Standard CPS 510 Governance.

In the circumstances we have outlined above, we feel there should be clarity that, unless they are holding a prescribed responsibility or position in relation to an Australian branch or other operations in Australia of an entity, foreign executives would not be covered, including in relation to the following matters:

(a) the position of foreign executives of entities who are 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;

(c) where there is direct operational accountability and decision-making at the Australian entity level (for example, if there is an Australian-domiciled executive who could be assigned as an accountable person, a foreign executive should not be assigned as an accountable person); and

(d) 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.

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.

The concept of proportionality does not seem to have been sufficiently addressed and is relevant to accountability (and, subsequently, deferred remuneration), not only for the achievement of group corporate goals but also for the foreign executive's personal

responsibilities and key performance indicators (for example, where the Australian business is a small component of the executive's responsibilities and driver of their rewards).

Difficulties with end-to-end product responsibility

The FSC submits that the concept of end-to-end product responsibility is impractical and often does not mesh with 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. In practical terms, this clearly covers many different teams and even cross-entities, so the idea of a single-point of accountability in our view, will be extremely challenging. Further, other prescribed responsibilities would appear to fall within the scope of end-to-end responsibility for product, such as dispute resolution, remediation and finance. It is unclear how these other responsibilities would interact with a broad view of a product responsibility.

The Policy Paper provides that where multiple accountable persons are registered to hold the end-to-end product responsibility "they will not be held jointly accountable to the extent that they are not holding that responsibility for the same product or service". The difficulty with this concept will likely give rise to definitional challenges around what constitutes "same product" and/or "same service" and artificial distinctions drawn by industry seeking to limit liability. We would request clarity on what would give rise to joint liability.

It is not clear to us how this obligation interacts with the recently introduced design and distribution obligations (**DDO**). Given the complexity of the interaction of DDO and other various recent legislative items we would welcome clarification in this regard.

Furthermore, the interaction between end-to-end product liability and prescribed responsibilities can be problematic. For example, remediation is listed as a prescribed responsibility and also an element of end-to-end product responsibility. We would welcome clarity on this, for example stating in the PP that the prescribed responsibility relates to frameworks/policies whereas the end-to-end product responsibility would be accountable for implementation.

The FSC notes that the Policy Paper also provides "at this stage, only very limited exclusion is proposed, e.g. road-side assistance services offered by some insurers". We submit that industry be given the opportunity to provide specific suggestions for additional exclusions.

The practical effect of the application of the joint responsibility rule in section 19(2) in the context of product end-to-end responsibility is unclear particularly given the EM outlines that accountable persons may be jointly and severally liable (see paragraph 1.68 of the EM).

Does FAR cover the Independent Office of the Trustee?

We note that many 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. Often, this has been required by APRA of RSEs. 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 that situation. It also seems to us to be an unusual and indeed odd outcome if executives of a related-party service provider, always acting on an arm's length basis in relation to the RSE with deliberate oversight and scrutiny by the designated business unit, could be captured as Aps, where the very purpose of the designated business unit is to disrupt undue influence on trustee decision-making.

In addition, we note that the Policy Paper states that the extended list of prescribed responsibilities is not intended to capture middle or lower management who may only have day-to-day responsibility for certain parts or aspects of the accountable entity or its significant related entities. However, the personnel working in an independent office of the superannuation trustee or "designated business unit" may be middle or lower management, yet often exercise significant influence or control (including over the flow of information informing trustee board decision-making). The FSC suggests that the legislation or Policy Paper makes it clear how the approach to APs will address this scenario for those RSEs and APRA's intentions for designated business units. This should follow in determinations by the Treasurer of designated roles and responsibilities.

Does FAR cover delegates?

it is not clear to us how the regime will interact with the common corporate and commercial practice of delegation.

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 of accountable entities will depend on the size of the company, its corporate status, its operating model (including within global operating models) and the nature of its business.

We reiterate our concern at the impact the regime may have on this common business practice. Given that the delegating party generally retains responsibility, will each individual delegate or member of a committee exercising delegated authority also becomes an accountable person? This is another area where the legislation should be clarified.

5. Accountability

Complexity

A key concern is 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 and APRA Prudential Standards; and

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

Consistency with regulatory framework

As a related matter, 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. These multiple pieces of legislation create a lack of clarity and we would appreciate regulatory guidance on how it is intended these interact with FAR and which will have priority in application from the perspective of an accountable person. See also Sections 7, 8 and 9 below.

Accountable person obligations

There is a new obligation imposed on APs by the Bill. An accountable person must take reasonable steps in conducting their responsibilities as an accountable person to ensure that "the accountable entity complies with any of the following that applies in relation to the accountable entity:

(i) this *Act*;
(ii) the *Banking Act 1959*;
(iii) the credit legislation (within the meaning of the *National Consumer Credit Protection Act 2009*);
(iv) the *Financial Sector (Collection of Data) Act 2001*;
(v) the financial services law (within the meaning of section 761A of the *Corporations Act 2001*);
(vi) the *Insurance Act 1973*;
(vii) the *Life Insurance Act 1995*;
(viii) the *Private Health Insurance (Prudential Supervision) Act 2015*;
(ix) the *Superannuation Industry (Supervision) Act 1993*;

(x) any regulations or other instruments, directions or orders, made under a law mentioned in subparagraphs (i) to (ix)."

This is potentially an onerous requirement, as it will require accountable persons to be able to demonstrate how they have exercised reasonable steps to ensure compliance with financial services laws. This could add a significant compliance burden to the existing compliance frameworks which already address the financial institution's compliance measures in respect of the financial services laws. The burden of the new accountability obligation could outweigh the benefit of including this additional responsibility. We suggest that the legislation be clarified to provide that the reasonable steps will be assessed in relation to that person's position, the circumstances at the time, the person's prescribed responsibility and level of expertise. The proposal means going beyond existing directors' and officers' duties and accessorial liability and potentially imposing multiple overlapping layers of liability for the same conduct.

In addition, the FSC believes that the risk of assessing "reasonable steps to ensure compliance" with hindsight bias is material and it should be clarified that reasonable steps must be assessed from the perspective of the person taking those steps at the relevant time, not after the fact. We suggest that regulatory guidance or failing this relevant commentary in the EM should be given added attention in this regard. The use of relevant examples for members would be helpful to provide further clarity as to the intent.

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. As it is drafted, the use of the word "ensure" also potentially makes this a strict compliance provision. The potential impact of this provision on accountable person and entities is substantial and the FSC would suggest the provisions be amended so that this is not a strict compliance provision or failing which further regulatory guidance or discussion in the EM would be valuable.

An obligation to "ensure" compliance 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 or accepted corporate governance (for example, a blurring of the duties between board and management accountable persons). 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, or claims handling in the context of insurance). 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.

Section 20 of the Bill provides that the taking of reasonable steps in relation to that matter includes: (a) having *appropriate* governance, control and risk management in relation to that matter; (b) having *safeguards* against inappropriate delegations of responsibility in relation to that matter; (c) having *appropriate* procedures for identifying and remediating problems that arise or may arise in relation to that matter; (d) taking *appropriate* action to ensure compliance

in relation to that matter; and (e) taking *appropriate* action in response to non-compliance, or suspected non-compliance, in relation to that matter.

We suggest that the regulatory guidance should further clarify this section e.g. by providing examples and further explanation on what is "appropriate", and what are "safeguards" in this context. Clarification is also required so that the reasonable steps will be measured by reference to that person's specific accountability and position.

In addition, we submit that the concept of dealing with regulators in an *open, constructive and cooperative way* is 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?

Key personnel obligations

Regarding temporary vacancies, specific issues which seem to arise here include:

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

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

These situations would be relevant for example in the context of temporary cover for maternity or paternity leave or short secondments from other group entities.

6. Deferred remuneration obligations

We note that 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. Under FAR, the deferral rules apply to all entities without regard to level of revenue, net assets or the like and would recommend consideration be given to a de minimis threshold being introduced. It would be useful if we could understand the policy behind this apparent shift in intent.

We would also welcome specific clarification on whether the deferred remuneration provisions of FAR would apply to "sign on" bonuses or "buy out" awards, where a buy out award recognises awards forfeited by a new hire on resignation from the former employer. Given buyout awards generally replicate the awards forfeited from the previous employer a like for like basis, the FAR deferral requirements would mean that a like for like arrangement could not be achieved and this could make it difficult to attract talent.

We also note that based on the current drafting, it appears that any form of variable remuneration would be subject to the four year deferral requirement even in a change of control which raises a number of practical challenges in such situations.

The EM notes that the deferral period is intended to be consistent with provisions of APRA's proposed prudential standard to regulate remuneration in APRA regulated industries (Prudential Standard CPS 511 Remuneration) that would also require deferral of variable remuneration for an overlapping class of persons in those industries. It will be important to make sure the final prudential standard is properly aligned in this respect. We assume that the deferral periods in CPS 511 will be aligned to that within FAR.

Similarly, we also note that the APRA Prudential Standards dealing with Governance (CPS 510 and SPS 510) include (inter alia) detailed requirements for a Remuneration Policy that aligns remuneration and risk management. We request that consideration be given to ensuring alignment and minimising overlap of CPS 510/SPS 510 and FAR.

Concerns also relate to how breaches of the "reasonable steps" lead to use of the consequence management framework and the fact that both areas have significant amounts of guidance still required from Treasury and the regulatory bodies.

7. Regulator approach

Implementation and registration

Prior to the implementation of the FAR, we note that the regulators are expected to release joint regulatory guidance to guide and assist accountable entities in the implementation and registration processes. Given the importance of this regulatory guidance to enable entities to prepare for FAR implementation, we would welcome some clarity as to when this will be released, and whether there will be any consultation on this regulatory guidance.

In addition, the regulators expect to support implementation and registration through:

- establishing a single portal to receive applications for registration of accountable persons;
- establishing a single point of contact for accountable entities to raise any queries or requests they may have; and
- determining the appropriate form for registration.

We would submit that the single portal be tested with industry before it enters full operation and the FSC would also welcome early sight of draft guidance so that timely discussion and feedback from members can be obtained.

Single portal and single point of contact

We note that the Information Paper states that information submitted by accountable entities through the single portal would be made available to APRA and ASIC for the purposes of administering the FAR and that entities are not expected to submit the same information to each regulator individually. We would suggest that the legislation includes an express provision stating that information provided through this portal is deemed to be submitted to both regulators.

Facilitating regulatory arbitrage

There are instances where the FAR regime overlaps existing regulatory regimes. For example, under the Superannuation Industry (Supervision) Act 1993 (**SIS** Act), the regulators have powers to:

- Conduct investigations;
- Conduct examinations;
- Request information;
- Issue directions;
- Request enforceable undertakings;
- Issue injunctions.

However, there are misalignments between the legislation. For example, APRA's directions power under the SIS Act permits APRA to give a direction where APRA "has a reason to believe" the RSE licensee has contravened a provision of the SIS Act. Under FAR, APRA may give a direction where it "reasonably believes". The FAR wording imposes an objective test (which is arguably stricter) whereas the SIS Act test is subjective. The FSC recommends that other regimes be amended to ensure alignment with the FAR regime.

Otherwise, a regulator could arbitrage the different regimes and choose between the different regimes.

8. Notification obligations

Our understanding is that the FAR notification requirements coexist with existing breach reporting requirements. Thus 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 30 days, although the regulator can provide for a longer period than 30 days for compliance. The legislation should be aligned as much as possible, such that for example only 'significant breaches' are to be reported under the FAR,

It would be useful to have guidance on how these obligations will interact and the extent to which the rules will clarify any longer or shorter periods. 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 accountable person have to report it in any event under FAR? We would also appreciate guidance on how the regulators contemplate entities may comply with the requirement to notify in circumstances where an entity "reasonably believes that it or its accountable person has breached" when the entities are likely to be undertaking processes to determine a breach has occurred.

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

There is also the question about the extent to which regulators will have sufficient capacity and systems ready to properly deal with the large volumes of notifications that may potentially ensue.

9. Penalties

FAR will provide APRA and ASIC with the power to disqualify an accountable person 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.

There are number of observations we have on this aspect:

1. The concern here is that there are multiple avenues for various regulators to impose penalties, with different Acts containing similar prohibitions having different penalties, and a lack of clarity on how this would apply in the FAR regime. For example, the civil penalties that can be imposed on RSE licensees would differ depending on whether action is taken against them for breach of the standard of care in SIS, the efficiently, honestly and fairly obligation in the Corporations Act and the honesty, integrity and standard of care obligations in FAR. 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 to the extent possible, expressed in the ED.

2. The concern that firms will find it more expensive to recruit for senior roles given the increased risk that will apply has not gone away. We anticipate there may be a detrimental 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, especially with respect to the Accountable Person obligations discussed above.
3. The concern that the accessorial/ancillary liability provisions in the BEAR capped individual penalties to 1/5 of the penalty that would apply to a corporation, however the drafting of the FAR has relied on cross referencing the Regulatory Powers Act which does not include such caps. If the intention is that individuals may be subject to penalties in respect of ancillary liability, we submit that the FAR include specific limits for individuals.

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

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