16 August 2021

Director
Regulatory Powers and Accountability Unit
Financial System Division
The Treasury
Langton Crescent
PARKES ACT 2600

By email: FAR@treasury.gov.au

Dear Ms Reeve

Financial Accountability Regime Exposure Draft Legislation

The Australian Financial Markets Association (AFMA) welcomes the opportunity to comment on the Financial Accountability Regime Exposure Draft Legislation.

AFMA members include Australian-owned banks, foreign subsidiary banks and branches of foreign banks who will be required to comply with the Financial Accountability Regime (FAR). AFMA was closely engaged with the issues arising for members with regard to the implementation of the Banking Executive Accountability Regime (BEAR) and its oversight by APRA and provided a submission to Treasury in response to the January 2020 FAR proposals paper. While detailed comments will be set out in our submission below, our main comments are as follows:

1. We strongly support the closer alignment of APRA's Remuneration Standard with FAR. Ideally this would be done through moving the 4-year deferral requirements out of legislation and into a single prudential standard. Alternatively, the deferral and vesting periods for FAR could be moved to Ministerial determination. This would allow FAR to be adjusted to keep FAR compatible with CPS 511. It should also facilitate incorporating a vesting schedule into FAR.
2. Additionally, AFMA suggests removal of certain elements of the individual accountability requirements on accountable persons, which are inconsistent with the fundamental aim of the amendments to the scheme. While we welcome amendments to the proposal that remove civil penalties for individuals who breach their accountability obligations, we remain concerned that the ancillary liability provisions effectively keep individuals personally exposed for potentially

extreme penalties. AFMA supports removal of these exposures to ensure consistency with the intention of the amendments.

3. We are also concerned to maintain a clear separation of the breach reporting obligations associated with the regime and those from other regulatory obligations. Minor or technical breaches of *mala prohibita* regulations should not trigger a requirement for an investigation into accountable persons. This would be a substantial, unwarranted and unhelpful regulatory intervention into the functions of the private sector for no public benefit.

In relation to foreign ADIs, AFMA is interested to confirm the exclusion of SREs and that Foreign ADIs have discretion to determine how the prescribed responsibilities will be addressed. We have identified a number of other issues requiring clarification, including matters such as the end-to-end product responsibility which are not a natural fit for foreign ADIs. We will continue to explore this and other matters in the upcoming consultation on the list of prescribed responsibilities and positions.

We thank you for considering our comments.

Please contact me via the Secretariat if further clarification or elaboration is desired.

Yours sincerely

Damian Jeffree
Senior Director of Policy

1. Accountability and key personnel obligations

1.1. Accountable entities – accountability obligations

FAR entities are required to take reasonable steps (s18) to comply with specified obligations which cover the way an accountable entity should conduct business, how it should engage with APRA and ASIC (in an open, constructive and cooperative way) and ensure accountable persons and significant related entities comply with obligations under the regime. We understand 'open, constructive and cooperative' which flows from BEAR to be a compendious phrase similar to Young J's view of 912A(1)(a). Its meaning has been the subject of some supposition. If our understanding that it does not compromise any substantive legal rights of firms is correct, then we do not raise objections at this time but do seek further guidance on what the obligation means in practice more generally.

Accountable entities are required to take reasonable steps to conduct business with honesty and integrity, with due skill, care and diligence, and in a manner that prevents adverse impact on prudential standing.

Detail on 'reasonable steps' is set out in s20 to include having appropriate governance arrangements in place, safeguards against inappropriate delegations of responsibility, and appropriate procedures for remediating problems, as well as taking appropriate action to ensure compliance and respond to non-compliance. AFMA suggests that clear guidance is provided to allow entities to understand how the 'reasonable steps' requirement can be met. We discuss concerns relating to s20 further below in relation to accountable persons.

1.2. Accountable persons – "reasonable steps"

AFMA has serious concerns about the proposed 'reasonable steps' provisions for accountable persons which, as currently drafted, are in places severe and can place unfair obligations on them. AFMA supports the removal of the specific obligation on an individual to ensure an entity complies with its licensing obligations but is opposed to the new requirement imposed on individuals to ensure that the entity complies with a number of specified laws.

Section 19 (1) (d) in particular, which was not in BEAR, should be deleted. The requirements as drafted require accountable persons to "ensure" compliance by the accountable entity:

> (d) by taking reasonable steps in conducting those responsibilities to ensure that the accountable entity complies with any of the following that applies in relation to the accountable entity:

> …[various specified financial services laws including the *Banking Act*, credit legislation, and other laws relating to the provision of financial services.]…
> (x) any regulations or other instruments, directions or orders, made under a law mentioned in subparagraphs (i) to (ix).

"Reasonable steps" is defined under 20 (d) to require "taking appropriate action to ensure compliance in relation to that matter".

In the event limb (d) remains, which we oppose, then in the final version at a minimum the drafting in section 19(d) should change. The language used of requiring individuals to 'ensure' compliance is unfair. This type of drafting was traditionally preferred by ASIC as it makes prosecutions straightforward as whenever there has been a breach of an obligation by an entity then by definition it follows prima facie that compliance has not been 'ensured' by the associated individual. This is regardless of how reasonable the steps taken were. It is an unfair methodology that approaches strict liability and ignores the challenges in operating complex businesses.

A fairer approach would be to require individuals to take reasonable steps to 'enable compliance', as would typically occur, for example, through the implementation of the accountable entity's compliance framework in the relevant part of its operations.

In any event, section 20(d) should be deleted.

Section 20 (d) effectively defines "reasonable steps" to include taking "appropriate action to ensure compliance". In practice this means what constitutes 'reasonable steps' can only be understood a posteriori, as events (such as a breach) can render any preparation as 'insufficient to ensure compliance'. This is not a definition compatible with ordinary notions of 'reasonable steps' which is generally understood to be a set of risk management activities that can be known and acted on in advance and that are sufficient, under a reasonable assessment, to be likely to prevent a negative outcome. 'Reasonable steps' as a defence is typically used where the outcome the steps were intended to prevent *has occurred* despite the steps. The steps remain 'reasonable steps' even though they were not, in hindsight, sufficient.

Should sections 19(1)(d) and 20(d) be included in the FAR, there would be a circularity in their application such that there would be an absolute requirement on an accountable person to ensure compliance by the accountable entity. Any failure by an accountable entity to comply with a relevant law or regulation would necessarily result in a failure by an accountable person to comply with his or her accountability obligation to ensure the accountable entity complies. This is notwithstanding how reasonably an accountable person has acted to minimise the risk of non-compliance.

The introduction of section 19(d) is unnecessary as currently there is adequate coverage under BEAR in respect of compliance with laws. Currently, the accountabilities of accountable persons typically cover the following:

- development and maintenance of the entity's compliance framework (typically held by the Chief Compliance Officer or Chief Risk Officer); and
- implementation of the compliance framework in the relevant parts of the entity's operations (typically held by each other executive accountable person).

Accountable persons are already required to discharge their respective responsibilities relating to compliance, as outlined above, by acting with 'due skill, care and diligence'. The introduction of section 19(d) simply introduces an additional, absolute requirement to ensure compliance, rather than to minimise the risk of non-compliance.

The proposed addition in section 20(e) of the definition of reasonable steps to "taking appropriate action in response to non-compliance, or suspected non-compliance" is unnecessary as it is duplicative of section 20(c). The procedures referred to in section 20(c) for "identifying and remediating problems that arise or may arise" cover the identification and remediation of instances of actual or suspected non-compliance. The new proposed section 20(e) should be deleted.

2. Deferred remuneration obligations

One of AFMA's main priorities in relation to deferred remuneration requirements is, consistent with the Government's stated intention in the Explanatory Materials, to seek greater alignment between the deferred remuneration obligations forthcoming APRA Remuneration Standard CPS 511 and FAR.

Currently the two regimes are duplicative and a poor fit for each other. The extent of alignment at this point in the proposed drafting is that the effective minimum period until vesting can occur is consistent for Senior Managers and CEOs.

The requirements for total deferral for CPS 511 for CEOs and Senior Managers exceeds that set by FAR, and are not competitive with our regional competitor jurisdictions Hong Kong and Singapore. We strongly encourage the Government to align the total deferral periods for CPS 511 to the four year limit set by FAR. We note we no longer have concerns about the regional competitiveness of the requirements for Highly Paid Material Risk Takers (HPMRT) under the latest CPS 511 draft which requires four year deferral vesting from two.

It is undesirable to have two competing and incongruous standards for remuneration applying to overlapping classes of persons within the prudential regulatory space. The UK has a cleaner arrangement whereby persons captured under their Senior Manager Regime (the inspiration for BEAR) are referenced by prudential rules and thereby brought into the one consistent set of requirements for prudentially regulated firms.

The existence of two incompatible schemes locally is an unfortunate accident of their separate developmental histories. The transition from BEAR to FAR presents a rare

opportunity to address the undesirable incongruity in current arrangements locally, before inconsistencies and inflexibilities are once again locked into legislation. Consideration should be given to adopting a structure with a single prudential deferral standard that also captures persons defined by FAR. Such a structure would be more agile and responsive and would be relatively easy to implement at this point in time, but very difficult to progress in future.

While reconstructing the two schemes into a logical, consistent and unitary whole is strongly preferred, at a minimum we suggest that the details of the deferral be moved to be matters of Ministerial determination rather than legislation so that maintenance of alignment between the schemes is at least possible.

AFMA supports the Government's intention to create consistency between the schemes in relation to deferral periods in the FAR with the APRA Remuneration Standard.

While we understand the intention is for FAR to create a minimum standard that CPS 511 can overlay increased requirements, there is a risk that adjustments to the CPS 511 scheme now (it is yet to be finalised) or in the future (potentially to make it more competitive regionally) could render the inflexible legislated FAR requirements that do not contain a vesting option effectively the sole determinant of deferral requirements.

Clarification in the form of guidance is also needed to explain what is meant by remuneration "wholly or partly" relating to responsibilities under FAR. In particular, it is unclear what this means for accountable persons of foreign ADIs that do not spend all their time in Australia, and whether remuneration payable for activities outside of Australia is exempt from inclusion. AFMA strongly supports having the ability to pro rata for time not spent on the ADI in line with the guidance given on BEAR.

We remain concerned about the coverage of non-financial services related accountabilities under the regime, given that entities not subject to FAR will not be subject to the same obligations. In particular, the deferred remuneration obligations for FAR entities will result in firms finding it more difficult for ADIs to attract suitable individuals to senior roles in human resources and information technology. Treasury should seek to create as level a playing field as possible for ADIs.

We note there are various other technical questions around implementation in relation to edge cases around terminations and change of role for which an ongoing dialogue will be of assistance.

3. Scope of the regime

We note that section 8 of the exposure draft legislation and the explanatory materials provide for the application of the FAR to APRA-regulated entities only (including ADIs, super funds, insurers and licensed NOHCs). We welcome and support this scope for the

regime, which is fully consistent with the recommendations of the Hayne Royal Commission that BEAR should be extended to all APRA regulated entities. Like BEAR, FAR requires the resources and structures of larger APRA regulated entities. It is entirely inappropriate for smaller firms.

3.1. Categorisation

The supplementary materials with the Exposure Draft legislation provide that the Minister will have the power to set out the rules to determine the enhanced notification thresholds for the purposes of accountability maps and statement requirements. While the rules for categorisation will be consulted on in coming months, AFMA notes that the indicative $10 billion threshold total assets for enhanced notification. We read this as total resident assets (as with BEAR). AFMA has argued for the APRA Remuneration Standard's Significant Financial Entity threshold set at $15 billion total assets to also use the resident assets test. While we have argued elsewhere that $15 billion is too low for a range of reasons, AFMA would support the raising of the FAR threshold to the same figure as the APRA standard but for resident assets.

We flag our support for a rolling average approach to the calculation rules for the threshold under the Ministerial powers.

3.2. Definition of accountable person

AFMA is supportive of plans by Treasury to consult further with industry on the prescribed list of responsibilities for accountable persons. The regime will need to be able to appropriately account for collective decision-making that takes place across the range of different organisational structures. Given the broad range of responsibilities that will be included in the list (as provided in the policy paper) the implementation of the compliance frameworks associated with the FAR will have a significant administrative burden on industry.

The policy paper provides some welcome clarity on which individuals would be responsible for certain functions, with senior executives in charge of the development, maintenance and review of compliance, risk management, AML, dispute resolution and breach reporting related functions held responsible, rather than those overseeing execution of those functions. We have previously outlined the need for guidance to clarify how responsibility in relation to a product related service is to be applied in practice, and ensure obligations align with the detail of Product Design and Distribution Obligations (PDDO) of the *Corporations Act 2001*. AFMA acknowledges that the policy paper provides for multiple people to hold responsibility for end-to-end product responsibility (with joint accountability where responsibilities overlap) and notes that it is not necessary for an individual holding end-to-end product responsibility to have the technical expertise on every stage of the product value chain. However, we note that the end-to-end approach

remains an unnatural fit for most business models which often efficiently allocate responsibilities based on technical competence.

The end-to-end responsibility requirements are a particularly unnatural fit for foreign ADIs for whom many products have multiple elements associated with product creation based offshore, often in the head office jurisdiction. A carve-out of foreign ADIs from the end-to-end requirements would be the cleanest approach. If Treasury is not minded to provide such an exception, then extensive guidance should be provided on how foreign ADIs should approach the requirement.

While the Explanatory Materials have been helpful in elucidating matters, AFMA flags that we will be seeking more information on the end-to-end product responsibility in the upcoming consultation on the list of prescribed responsibilities and positions.

3.3. Foreign accountable entities

AFMA understands that the exposure draft legislation provides for the FAR regime to apply to foreign ADIs only to the extent that it operates a branch of the foreign ADI in Australia, which would align with the previous operation of the BEAR.

However, it is also provided that the obligations apply “to the operations of the foreign accountable entity’s branch in Australia”, with obligations applying to the same extent to an accountable person of such an entity or any of its significant related entities (see sections 13(2)(b) + 16(2)). This inconsistency needs to be clarified, as the extension of the applicability of the obligations to SREs of Foreign ADIs is a material issue that will create a significant administrative burden for affected entities.

AFMA is supportive of an approach, consistent with the drafting intention as we understand it, that ensures the scope of the regime does not extend to offshore operations or locally incorporated non-ADI subsidiaries.

While the consultation on the list of accountable person responsibilities is subject to future consultation, we note that the policy paper provides that the accountable persons’ responsibilities for foreign ADIs relate only to an entities’ Australian branches. We propose that the responsibilities that can be prescribed to foreign ADIs remain limited to the indicative list provided in the policy paper, being the Senior Officer Outside Australia (SOOA), and the senior executive responsibility for the conduct of all the activities of an Australian branch of the foreign ADI. We will welcome with the next consultation further confirmation that, as with BEAR, foreign ADIs through their appointment of the senior executive responsibility for the conduct of all the activities of an Australian branch (Head of the Branch) and the Senior Officer Outside Australia (SOOA) can themselves determine how to cover the longer list of “prescribed responsibilities/positions”.

AFMA also supports the introduction of provisions sections 15 and 17 to the Exposure Draft legislation (equivalent to sections 37AA and 37BC of the *Banking Act 1959)* to handle inconsistency with corresponding foreign laws, which provides for deference where the regulation has extra-territorial effect.

4. Accountability maps and statements

Enhanced notification entities will be required to provide accountability maps and statements for each accountable person that describe the responsibilities of accountable persons and set out reporting lines and lines of responsibility, alongside statements by each accountable person declaring the accuracy of the statement and their understanding of the obligations. This information will be kept in a register by the regulators.

The accountability map must be provided to the Regulator within 30 days of the commencement of the FAR. Enhanced notification entities will also be required to notify regulators of material changes in accountability maps and statements within 30 days. We note that the requirement to notify only material changes is a welcome adjustment, given that the BEAR required notification of all changes. That said, AFMA recommends guidance is released to explain what is meant by 'material changes' as this is not made explicit in the legislation.

5. Notification obligations

Both core and enhanced compliance entities are required to notify changes in accountable persons (including where that change is from dismissal or suspension due to a failure to comply with related obligations), reductions in variable remuneration, breaches of accountability obligations, and 'material changes' to information relating to an accountable person, within 30 days.

Under s30(d) of the Exposure Draft legislation with respect to breach reporting, accountable entities are required to notify regulators within 30 days of when the entity 'reasonably believes' that the accountable entity has breached its accountability or key personnel obligations, or an accountable person of the entity has breached their accountability obligations.

As proposed in our previous submission, AFMA recommends the introduction of a materiality threshold for breach reporting under the FAR regime. Given ADIs are expected to expend significant effort to review breach governance processes in order to implement changes under the new breach reporting regime for AFSLs and ACLs administered by ASIC, it is important that there is no confusion as to what entails a 'breach' of the FAR by an

accountable entity or accountable persons. Clarity is also required to explain what is meant by 'reasonably believe', as it is somewhat unclear when such a 'belief' arises.[1]

For example, an accountable person with responsibility for overseeing that the entity complies with obligations may have taken reasonable steps to conduct their FAR related responsibilities even where an instance of non-compliance has been identified. One would expect that an incident on its own may not be indicative of an entity failing its obligations to take reasonable steps to conduct business with due skill, care and diligence and ensure accountable persons comply with FAR obligations. Evidently, further internal examination within the entity would be necessary to determine this. Guidance should stipulate that an accountable entity would only need to report a breach of the FAR until after investigation into the cause of non-compliance, once the severity of the situation is evident.

More generally AFMA would like to see a clear distinction between the breach reporting obligations under FAR and those arising from ASIC and other regulator obligations. The prudential nature of FAR's breaches must be differentiated from the typically less impactful technical breaches that are reported to ASIC. The nature of the two breach reporting regimes are quite different. A lack of clear separation between the two regimes could result in minor breaches reported to ASIC resulting in regular investigations to determine whether an accountable person or persons has breached their responsibilities under the FAR regime. This would be an undesirable outcome from any number of perspectives and would not appear consistent with the policy intent. We would like to work with Treasury to remove these risks through additional drafting refinements and guidance.

6. Penalties

6.1. Penalties for entities

The potential maximum penalty for breaches of the FAR by accountable entities set out in s78(c)(ii) of the Exposure Draft aligns with the *Corporations Act* penalties of 2.5 million penalty units or $555 million. In AFMA's previous submission, we emphasised the need to ensure proportionality between seriousness of a contravention and the quantum of penalty.

This penalty regime was copied ultimately from the *Competition and Consumer Act* but without the benefit of the 10% of annual turnover penalty maximum being limited to cases where "the Court cannot determine the total value of those benefits" (CCA s 76 (1A)

[1] See e.g. *George v Rockett* (1990) 170 CLR 104, which determined that 'a reasonable belief requires the existence of facts that are sufficient to induce the belief in a reasonable person. Belief requires something more than suspicion'.

(aa) (iii). This requirement was dropped when the ASIC Penalty Regime review increased penalties in 2018, fundamentally changing the scale of penalties in Australia.

AFMA suggests that in light of the changed economic circumstances and the Government's interest in improving the business environment that the penalty scheme is moderated, made proportionate to offences, and consistent with similar offences under the general law.

The Murray Financial System Inquiry advised against introducing "extremely high penalties", yet the penalties at up to over half a billion dollars could reasonably be considered to fit this description. International businesses pay close attention to these types of jurisdictional risks and they directly impact business decisions to locate and invest in Australia.

AFMA maintains the view that clear guidance is required to set out how the civil penalties power will be used and outline the expected penalty ranges for different categories of breaches.

6.2. Removal of penalties for individuals and ancillary liability

AFMA is supportive of the removal of individual civil penalties for breaches of their accountability obligations from the FAR legislation.

As previously argued, there were a number of concerns with introducing civil penalties for individuals for breaches of their obligations under the FAR, not least of which that the move would have extended beyond the policy scope of the applicable Royal Commission recommendations and created conflicts of law with existing duties and obligations of company officers under the *Corporations Act*.

AFMA remains concerned, however, that the ancillary liability provisions in the scheme create significant liability and the risk of extreme penalties for individuals. This would appear contrary to the policy intent of not applying penalties directly on persons. Increasing personal risk and liability would affect the attractiveness of Australia as a destination for international talent.

AFMA notes the removal of the requirement for matters to be in relation to 'prudential matters' (s37G(1)b) increases the exposure of accountable persons to being (or accused of being) knowingly concerned in a contravention.

We recommend that consideration be given to excluding accountable persons from the ancillary liability provisions in the absence of a policy justification for their inclusion given the intention not to include direct penalties on individuals. At a minimum, additional protections against prosecutions should be put in place and the applicable penalties should be suitable for individuals rather than for corporations.

6.1. Disqualification power

As per the BEAR, under the FAR the regulator will have the power to disqualify a person from being an accountable person for a period if satisfied that "the accountable person has breached their accountability obligations" under the regime, and that disqualification is justified based on the seriousness of non-compliance. We suggested in our previous submission that guidance should prescribe that the removal and disqualification powers will only be exercised where there is a systemic failing that will have a material impact on the entity, and outline the procedural fairness arrangements that should be put in place to consider such matters.

We note that s41 of the Exposure Draft legislation makes it an offence for an accountable entity to allow a disqualified person to act as an accountable person.

We note that this is an improvement from the suggestion made in the January 2020 proposals paper to give regulators the power to veto appointments of senior executives and directors, based on an opinion that a person is not suitable to hold a position as an accountable person. This kind of subjective vetting process would have interfered with internal decision making and is not necessary in an environment where entities would seek to avoid the consequences of not having appropriate management in place.

6.2. Insurance

Under the exposure draft legislation, accountable entities will be able to indemnify themselves against breaches of the regime, however related body corporate of an accountable entity cannot indemnify nor pay costs to insure the accountable entity against the consequences of breaching regime.

We note that the previous proposals paper prohibited entities from indemnifying or paying the cost of insuring accountable persons against the consequences of breaching the FAR, however this is not part of the Exposure Draft legislation given the removal of civil penalties for individual accountable persons.

7. Timeframes for implementation

We note that the proposed commencement date for ADIs and NOHCs no earlier than 1 July 2022 (other APRA regulated entities have until at least 1 July 2023). Our previous submission proposed a staggered approach to implement the regime in phases across an at least 18-month period. We highlighted that requirements affecting foreign ADIs should be implemented at a later stage, to ensure these entities have sufficient time to make

required changes to accountability frameworks, given the complexities associated with implementing changes across a global organisation with multiple branches.

Feedback from industry suggests that the timings for implementation programs are still tight for ADIs and associated NOHCs. As BEAR is already in operation for ADIs there should be no urgency to rush implementation. At this point there is substantial uncertainty around the schemes final design elements which will not be completed until further consultations are finalised. Implementation of the scheme could well take until the end of calendar year 2021. This would leave the minimum 6 months to commencement which would not be appropriate for an important prudentially linked scheme. Consistent with our earlier representations we believe an 18-month implementation period is appropriate.

8. Joint administration of FAR by APRA and ASIC

AFMA notes that details on the joint administration are set out in an information paper accompanying the exposure draft legislation, and that arrangements for joint administration are subject to change prior to the commencement of the regime. We acknowledge that some concerns raised by AFMA with respect to the powers exercisable by regulators have been accounted for in the Exposure Draft, with key decisions around the categorisation of entities as enhanced or core notification entities to be set by the Minister. We support this change.

The Exposure Draft requires that ASIC and APRA agree before decisions can be made in relation to exemptions for inconsistency with foreign laws, directions powers to reallocate responsibilities, disqualifying accountable persons, extending time for notification and content of accountability maps and statements, as well as excluding certain responsibilities from accountable person definitions, extending time for temporary vacancy related registrations and determinations related to remuneration deferral.

We note that the arrangements for a number of other important decisions, such as decisions related to information requests, civil penalty powers, and investigation and examination powers, are to be provided for in due course. From an administrative standpoint it is important that information requests related to FAR obligations are streamlined, i.e. through the single data collection portal or single point of contact noted in the paper.

With respect to investigation and enforcement powers, while ASIC and APRA will exercise powers independently, AFMA understands that regulators would not pursue separate enforcement actions for the same breaches, although this does not prevent either regulator from taking enforcement action where a matter giving rise to the breach of FAR entails a breach of other statutory obligations in applicable legislation (e.g. the *Corporations Act* or *Banking Act*). The information paper notes that only APRA can

undertake enforcement action against entities that do not hold an AFSL/ACL, although APRA may delegate its power to commence proceedings to ASIC.

It is expected that joint regulatory guidance will be released prior to the commencement of the regime. Clear guidance outlining how entities are to comply with obligations under FAR should be made available and updated on both APRA and ASIC websites to minimise industry confusion around where relevant information is located.