

Financial Accountability Regime (FAR)

Draft legislation proposed for 2020



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Introduction

In an effort to further increase transparency and accountability and improve risk culture and governance the Financial Accountability Regime (FAR) will replace the Banking Executive Accountability Regime (BEAR).

FAR will extend the responsibility and accountability framework to all APRA regulated entities (including insurers, Registrable Superannuation Entity licensees and Banks (already subject to BEAR)¹ as well as to their directors and senior executives.

While the Government has not yet proposed, a commencement date for FAR, legislation is expected by the end of the year.

Background

On 22 January 2019, Treasury released a proposal paper (the Paper) on extending BEAR to all APRA-regulated entities.

On 1 February 2019, the Final Report of the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry (Royal Commission) recommended extending the scope of and administrative responsibility for BEAR.

The new regime will be called the Financial Accountability Regime (FAR). The Paper proposes that FAR will mirror BEAR, subject to some differences, which are set out below. Submissions on the proposal paper (Paper) closed on 14 February 2020.

FAR to apply to all APRA-regulated entities

The following entities will be subject to FAR (unless the Minister, ASIC or APRA grants an exemption):

- authorised deposit taking institutions² (ADI);
- registrable superannuation entity (RSE) licensees;
- general and life insurance licensees;
- private health insurance licensees; and
- licensed non-operating holding companies.



On 1 February 2019, the Final Report of the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry (Royal Commission) recommended extending the scope of and administrative responsibility for BEAR.

¹ Followed by extension to solely ASIC regulated entities

² Already subject to BEAR. Transitional arrangements are proposed to deal with the two potentially overlapping regimes.

Similar to BEAR, FAR will impose the following obligations:

- **Accountability obligations:** such as the obligation for entities to:
 - take reasonable steps to prevent matters that would adversely affect the entities' prudential standing or prudential reputation;
 - ensure that each of its accountable persons meet their accountability obligations; and
 - ensure significant or substantial subsidiaries not subject to FAR comply as if they were to the extent relevant.

Entities with outsourcing arrangements will also need to ensure adequate control and oversight of activities covered by the FAR.

- **Accountable persons:** who have actual or effective senior executive responsibility will need to be identified. Accountable persons will be required to individually meet their own accountability obligations including acting with honesty and integrity, and with due skill, care and diligence, taking reasonable steps in conducting those responsibilities to prevent matters from arising that would adversely affect the prudential standing or prudential reputation of the entity. FAR entities will be required to apply to APRA or ASIC to register a person as an accountable person.
- **Key personnel obligations:** such as the obligation to ensure that the responsibilities of the accountable persons in the entity covers all aspects of the operations of the corporate group and to ensure that none of the accountable persons are prohibited under the FAR;

- **Accountability map**³: which will need to explain the reporting lines and lines of responsibility for the accountable persons in the entity. There are some proposed exemptions for smaller APRA-regulated entities that have total assets of less than a threshold prescribed by APRA and ASIC. Entities will be required to update the relevant regulator within 30 days of any change occurring.
- **Accountability statement obligations:** will need to be produced for each accountable person and will need to include information such as the aspects of the entity for which the accountable person has a responsibility to manage or control. There are some proposed exemptions for smaller APRA-regulated entities;
- **Notification obligations:** entities will be required to notify APRA or ASIC of:
 - a person ceasing to be an accountable person;
 - the entity becoming aware that it has breached its accountability or key personnel obligations, or an accountable person has breached their accountability obligations;
 - the dismissal or suspension of an accountable person because the person has failed to comply with their accountability obligations; and
 - the reduction of the variable remuneration of an accountable person by the organisation, because the accountable person has failed to comply with their accountability obligations; and
- **Deferred remuneration obligations:** it is proposed FAR entities defer 40% of the variable remuneration of any accountable persons for at least four years unless⁴ an exception applies. Further, entities must have remuneration policies that allow for a reduction in variable remuneration in the event that an accountable person breaches their FAR obligations.

³ Submitted to ASIC or APRA will be shared in cases of dual regulated entities.

⁴ unless the deferred amount is equal to or less than \$50,000 or if variable remuneration is not a feature of the person's remuneration structure

In contrast to BEAR, FAR will contain some additional features and obligations, including:

- **Joint administration by APRA and ASIC:** Entities and accountable persons will be required to deal with both ASIC and APRA in an open, constructive and cooperative way in respect of FAR⁵;
- **Stronger penalty frameworks:** Penalties on regulated entities and accountable persons for breaches of FAR will be larger and aligned with the revised penalty framework in the Corporations Act 2001 (Cth) and other financial services legislation⁶. For all FAR entities, it is proposed that the maximum penalties will be the greater of the following either a) \$10.5million (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 \$525million or 2.5million penalty units). Courts will be required to consider the impact that the penalty has on the viability of prudentially regulated entities and on fund members when setting a penalty in respect of RSE licensees. Notably, the Paper states that RSE licensees will be prohibited from using trust assets to pay a civil penalty arising from breaching an obligation under the FAR. Unlike BEAR, Accountable persons will also be liable for civil penalties under FAR. It is proposed that the maximum penalties will be the greater of the following: either a) \$1.05m (5,000 penalty units) or; b) the benefit derived or detriment avoided because of the contravention, multiplied by three (where the court can determine it)⁷.
- **Power to veto appointment of accountable persons:** APRA will have a non-objections power⁸ to veto the appointment or reappointment of directors and senior executives of regulated entities if APRA holds existing information that conflicts with the obligations that the accountable person will need to perform.
- **Additional prescribed⁹ responsibilities and personal conduct obligations:** A senior executive will now be regarded as an accountable person if they hold a responsibility that is prescribed by APRA and ASIC. Further, accountable persons will also now have an obligation to take reasonable steps in conducting their responsibilities to ensure that the entity complies with its licensing obligations. Finally, persons who become an accountable person by filling a temporary vacancy will need to be notified to APRA or ASIC before the end of a longer time period prescribed by the regulator likely to be 90 days);
- **Introducing and linking obligations to the concepts of Core Compliance v Enhanced Compliance Entities¹⁰,** which are based on size of total assets and entity type, the former referring to smaller entities and the latter for all other entities. APRA and ASIC will however have the power to reclassify entities as either a core compliance or enhanced compliance entity;
- Updated accountability maps and statements will only need to be sent to APRA or ASIC when material changes are made, or annually if immaterial changes are made¹¹;
- **Notification obligations:** Regulated entities must notify APRA or ASIC if they become aware that it has breached either their accountability or a key personnel obligation.

5 This will not displace legal professional privilege.

6 Australian Securities and Investments Commission Act 2001 (Cth) (ASIC Act), National Consumer Credit Protection Act 2009 (Cth) (Credit Act) and Insurance Contracts Act 1984 (Cth) (Insurance Contracts Act)

7 This is in line with newly introduced maximum penalties for individuals under the Corporations Act, ASIC Act, Credit Act and Insurance Contrasts Act.

8 The Paper suggests this will be exercised as a reserve power.

9 By ASIC and APRA including in respect of foreign entities subject to FAR.

10 ADI and RSE licensees (combined all RSA's under trusteeship of a given RSE licensee) with total assets >\$10billion; general insurers and private health insurers with total assets >\$2billion and life insurers with total assets >\$4billion

11 BEAR does not distinguish between material and immaterial changes

Conclusion

FAR rewrites the mandatory requirement for corporate governance, culture and accountability risks and attaches larger penalties not only for entities **but also individuals who fail to meet the new standards.**

According to Treasurer Josh Frydenberg the proposed changes 'will ensure that senior executives of these financial entities will be more accountable for the activities of the organisation for which they are responsible and impose strict consequences for those who fail to perform their roles with competence, honesty or integrity'.



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MELITA SIMIC
Head of FINPRO Technical – Marsh JLT Specialty, Pacific
+61 405 005 274
melita.a.simic@marsh.com

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