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

Attention: Director

By email: FAR@treasury.gov.au

Dear Director

Introduction

1. On 16 July 2021, Treasury released the exposure draft legislation for the Financial Accountability Regime ("***FAR Bill***"). FAR will apply to all prudentially-regulated institutions (e.g., banks, insurers and super funds) and places institutional and personal liability on key executives for regulatory failures, based on new broad principles-based obligations.

Gadens

2. Gadens is a leading Australian law firm with 97 partners and ~880 staff across offices located in Adelaide, Brisbane, Melbourne, Perth and Sydney. With our history dating back to 1847, our vision is to be a preeminent, independent firm renowned for providing outstanding client service, innovative solutions and value.

3. We regularly undertake highly complex and day-to-day transactional legal work for a wide range of clients across multiple industry sectors. Our clients include major Australian and multinational organisations – we are advisors to more than a quarter of the Top 200 companies listed on the ASX – as well as many small to medium-sized businesses, and high-net-worth families and individuals.

4. Gadens have extensive experience with FAR's forerunners: the Australian BEAR, the Hong Kong Managers in Charge Regime and the United Kingdom Senior Managers & Certification Regime. The FAR is heavily based on these overseas regimes, which reflect the global shift to more principles-based regulation and personal accountability in the wake of the Global Financial Crisis.

5. Notably, Gadens has previously completed an in-depth analysis of the FAR regime based on the consultation paper released in 2020,[1] and have also completed a comparative analysis of the UK experience in applying these broad principles-based regulations to individual accountabilities.[2]

6. Gadens is delighted to provide a response to the consultation. We have had feedback from multiple large general insurer clients in preparing this response.

[1] See Gadens – Extension of the Banking Accountability Regime.
[2] See Gadens – Culture-Related Regulatory Enforcement: Where Might the Australian 'BEAR' Go Hunting?; See also Gadens Financial Accountability Regime – Key Facts 2021.

End-to-end Product Accountability Role

7. Gadens and its clients are concerned with the breadth of responsibilities allocated to the end-to-end product role.

8. Under s 9 *FAR Bill* 2021, an individual is an accountable person if the person holds a position in, or relating to the accountable entity, that is of the kind prescribed by the Minister rules. Minister rules are a legislative instrument per s 99 *FAR Bill* 2021,[3] and the current draft proposal policy paper (i.e., draft Minister rules) proposes that the responsibilities of the end-to-end product role will include design, delivery and maintenance of all products and services offered to customers; customer remediation; linkages to IT systems and data quality; outsourcing; and incentive arrangements of frontline staff.[4]

9. This is a challenging and arguably unrealistic responsibility given the number of products on offer at most financial services institutions, and the breadth of responsibilities allocated to the role.

10. Generally, for large financial services providers the product value chain is broken down by phase or divisional expertise, rather than by product. As such, previously, a Chief Product Officer role did not exist in most financial institutions. The *FAR Bill* requires financial institutions to modify corporate governance structures to include a role of that nature, which creates an unrealistic expectation that is beyond the original intent and purpose of the regime.

11. Therefore, we recommend that the full product life cycle is broken down into phases that are each allocated to accountable persons, which is a more realistic allocation of responsibilities and liability.

12. In the alternative, we suggest that the scope of the end-to-end product role is narrowed to include only the steps in the design, delivery and maintenance of products and services offered to customers.

Regulatory Directions Power

13. Under s 60 *FAR Bill* 2021, APRA and ASIC may give a financial institution a direction if they reasonably believe the firm or one of its accountable persons has breached FAR or is likely to breach FAR, and the direction is necessary to prevent the breach. For example, directions can include taking a specific action, making changes to internal systems and practices, or to reconstruct an entity's structure.[5]

14. ASIC has previously not had this broad unfettered power and it raises concerns of the usurpation of judicial power. For example, the directions power acts in the same manner as an order for specific performance.

15. Whilst noting this might not occur in practice, the draft legislation currently permits ASIC and APRA to direct a financial institution to pay another entity a sum of money merely because ASIC and APRA believe it is warranted.

16. In addition, ASIC and APRA can determine that the direction is covered by the secrecy provisions under s 63 *FAR Bill* 2021. This means that if the financial services firm or individual discloses the direction, they could be criminally liable (save for limited exceptions).

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[3] See Exposure Draft Explanatory Materials, Financial Accountability Regime Bill 2021 (Cth) 33 [1.212].
[4] See Commonwealth, *Financial Accountability Regime – List of Prescribed Responsibilities and Positions* (Policy Paper Proposal,16 July 2021) 4.
[5] S60(2) *FAR Bill* 2021.

17. It is our recommendation that this power is narrowed so that it is only exercisable when there has been a known specific breach that is imminent and harmful to the consumer, which requires immediate action to either mitigate or rectify.

Enforceable Undertakings/Actions & Regulator Procedural Advantages.

18. According to s 79 *FAR Bill* 2021, APRA and ASIC can accept undertakings in relation to the FAR regime and any matter which the regulators have a power or function under the draft exposure legislation. These undertakings are enforceable in the Federal Court. When combined with the direction's powers, this provides a very broad enforcement toolkit for the regulators quite outside the civil penalty regime.

19. Gadens is concerned how procedurally advantaged ASIC and APRA are in terms of enforcement actions. For example:

- privilege against self-incrimination is not an excuse to refuse to provide documents or information (though it will not be admissible in court proceedings);
- there are novel penalties against lawyers for refusing to provide details which are legally privileged (but only if the person to whom it relates consents);
- to establish the state of mind of the financial services firm, it is sufficient to show that an employee, agent or an individual engaged in the relevant conduct had the relevant state of mind. That appears to apply irrespective of seniority or collective consciousness.

20. The regime is based on broad principles-based obligations which give APRA and ASIC wide scope to achieve its mandate. Additional procedural advantages are unnecessary for the regulators to achieve its goal.

21. In particular, we recommend that to establish the state of mind of a financial services firm, the *FAR Bill* should be amended to require collective consensus at the senior executive level.

Double Jeopardy

22. Gadens and its clients are concerned that liability will be automatically attributed to the corporation upon an accountable person breaching their duty and being held liable. It would seem inconsistent with the regime that the corporation and the accountable persons both be held liable, when the objective of the regime is to attach penalties to individuals for failing to meet mandated corporate governance and culture requirements. Gadens would argue that there are already sufficient civil penalty provisions for financial institutions that address these concerns.

23. In addition, it is concerning that that an entity or individual could be found to be in breach of multiple pieces of legislation for one action/event with different liabilities and penalties under each legislation. For example, there is significant overlap between the *FAR Bill* and the general obligation under s 912A *Corporations Act 2001* (Cth) to provide financial services efficiently, honestly and fairly. If one event amounts to breaches of different regimes, multiple penalties differing in size can be levied against accountable persons and entities.

24. Therefore, it is our recommendation that if an action is to be brought by the regulator, multiple penalties cannot be imposed for the same cause of action.

Application to Material Subsidiaries – Extension of the FAR Regime

25. Under the FAR Regime, accountable entities must also take reasonable steps to ensure their “significant related entities” comply with certain FAR obligations (including the “accountability obligations”). This can extend the impact of FAR to non-APRA regulated entities within a corporate group, resulting in increased compliance obligations. For most entities this will mean subsidiaries with business activities that are material or substantial to the accountable entity.

26. We are concerned that FAR extends beyond the objectives of the regime into business activities that do not require regulation. For example, businesses providing non-financial products through a separate legal entity should not be subject to the regulatory and compliance requirements of financial services firms. The application to material subsidiaries is beyond the intention of the FAR Regime and is not necessary to achieve the regime's objectives.

27. We suggest that the application to material subsidiaries be limited to only include subsidiaries that are material to the offering of financial services and products.

Direction on how the Regulators interpret "Reasonable Steps"

28. It is unclear how ASIC and APRA will interpret the phrase "reasonable steps" in ss 18 and 19 *FAR Bill* 2021 with respect to accountable entities and person's obligations.

29. We seek clarification on how senior executives can be assured that they are meeting the "reasonable steps" requirement. We believe that the requirement should be outlined in regulations, regulatory guides and further ancillary material.

30. In addition, we believe that it is appropriate to include a safe harbour provision given the breadth of duties and personal liability allocated to the accountable persons.

Direction on how the Regulators interpret Accountable Persons obligations

31. It is uncertain how ASIC and APRA will interpret the requirement for accountable persons and accountable entities to act "with honesty and integrity, and with due skill, care and diligence". Drawing from UK case law and regulator action, numerous questions arise as to the interpretation of accountable person obligations which need to be clarified into law to give certainty to senior executives.

32. For example, can an accountable person lack integrity without being dishonest? Is a failure to contradict the truth of a statement a lack of integrity? Will behavioural misconduct in a personal capacity be a breach of the "integrity" requirement? Will accountable persons be responsible for failures to adequately prevent bullying, discrimination or sexual harassment in their division?

33. We seek clarification on how the regulators will interpret the meaning and scope of the accountable persons obligations, including the "integrity" requirement. It is our recommendation that this issue be addressed in regulations, regulatory guides and other ancillary materials.

The Misalignment of FAR and CPS 511

34. In April 2021, APRA released a revised draft Prudential Standard CPS 511 on renumeration, with the intention to regulate the incentive structures of all APRA-regulated entities. This objective notably overlaps with the FAR Regime and has resulted in inconsistencies. For example, the deferral period under FAR and CPS 511 differs. Under CPS 511, a CEO for a significant financial institution must defer variable renumeration for at least six (6) years from the inception of the total renumeration component. This differs from FAR, which requires an accountable person's deferral period to be at least four (4) years.

35. It is our recommendation that the deferral period, and other inconsistencies in CPS 511, be removed for financial institutions that are required to comply with FAR. This removal will align the two regulatory regimes and create a consistent streamline approach that lessens the regulatory burden on the financial services industry.

Joint Administration by ASIC and APRA

36. Gadens and its clients are concerned as to how ASIC and APRA will administer the regime efficiently and fairly. Importantly, we are concerned with the regulatory burden already imposed

upon the industry, and the potential for multiple identical requests for documentation (e.g., reporting requirements) from ASIC and APRA.

37. We therefore suggest ASIC and APRA having clear publicised mandates that are well understood and articulated. In addition, we would suggest regular reviews of the FAR Regime to ensure it meets policy objectives.

Conclusion

38. We thank you for consideration of our submission in relation to the draft *Financial Accountability Regime Bill* 2021. If you wish to discuss our submission, please contact Liam Hennessy, Partner at liam.hennessy@gadens.com or Cameron Simpson, Solicitor at cameron.simpson@gadens.com.

Yours faithfully,

Liam Hennessy
Partner

Cameron Simpson
Solicitor