Governance Institute of Australia

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

By email: FAR@treasury.gov.au

Dear Director,

Exposure Draft: *Financial Accountability Regime Bill 2021* (ED) and related materials

Who we are

Governance Institute of Australia is a national membership association, advocating for our network of 40,000 governance and risk management professionals from the listed, unlisted and not-for-profit sectors.

As the only Australian provider of chartered governance accreditation, we offer a range of short courses, certificates and postgraduate study. Our mission is to drive better governance in all organisations, which will in turn create a stronger, better society.

Our members have primary responsibility for developing and implementing governance frameworks in public listed, unlisted and private companies, as well as not-for-profit organisations and the public sector. They have a thorough working knowledge of the operations of the markets and the needs of investors. We regularly contribute to the formation of public policy through our interactions with Treasury, ASIC, APRA, ACCC, ASX, ACNC and the ATO.

Our members support the overall intention of the Financial Accountability Regime (FAR), namely implementation of recommendations 3.9, 4.12, 6.6 – 6.8 of the Final Report of the Royal Commission into Financial Services (FSRC) and improving the risk and governance cultures of Australia's financial institutions – Explanatory Memorandum (EM) para 1.8.

We have not commented in detail on the ED but have confined our comments to issues of particular relevance and concern to our members.

Further guidance

There are a number of places in the EM where it is indicated there will be guidance to accompany the FAR legislation. This guidance will be important for industry when making the transition to the new regime. Governance Institute's members consider it would be preferable to consult on the guidance as soon possible. Our members who have been involved in implementing the Banking Executive Accountability Regime (BEAR) report that guidance was an important tool in the implementation process. They encourage release of the Guidance for consultation at the earliest opportunity to enable industry feedback. Settling the form of the guidance to the FAR regime sooner rather than later will better enable APRA-regulated entities make the transition to the new regime.

Governance Institute recommends consultation on the new Guidance to the legislation at the earliest opportunity to assist in a smooth transition to the new regime.

Alignment between FAR and *Prudential Standard CPS 511 Remuneration* (CPS 511) and role of ASIC and APRA

Our members consider it is important that the FAR and CPS 511 align. It will create a regulatory burden if remuneration calculations, timeframes, and periods do not align. Under the proposals entities may be required to maintain separate processes for a similar purpose, and may find roles meeting requirements under one regime but not the other.

As currently drafted the ED provides for deferred remuneration obligations and requires entities to defer at least 40 per cent of the variable renumeration of directors and most senior and influential executives for a minimum of four years, if the amount deferred is $50,000 or more. In addition, variable remuneration must be reduced where accountability obligations are breached. The EM indicates that the deferral period is 'intended to be consistent with APRA's proposed prudential standard to regulate remuneration in APRA-regulated industries' – para 1.94 of the EM.

The current BEAR requirement provides for mandatory deferral of variable remuneration for four years, so it remains at risk, and requires the forfeiture of variable remuneration proportionate to an 'accountable person's' failure to comply with their accountability obligations.

Our members welcome the more streamlined approach in the FAR regime which has reduced some of the complexity and clarified some of the ambiguities of the existing BEAR remuneration requirements. However, they note that the most recent draft of CPS 511 and the accompanying Guidance indicate that there should be a higher deferral of 60 per cent of the variable remuneration for CEO's of 'significant financial institutions' for a period of six years.

It increases the regulatory burden on entities for there to be differing requirements under the Remuneration Standard and the FAR regime. Practically it also increases the potential for confusion in an already complex and highly regulated and closely scrutinised area.[1]

The ED also indicates that APRA and/or ASIC may have a role in determining how equity-based remuneration is calculated for determining deferral – EM para 1.87. Our members would welcome clarification about how this would operate in practice. The EM para 1.87 also states that variable remuneration should be valued at the start of the minimum deferral period and based on maximum opportunity. This is not workable for some members that maintain arrangements that do not have a maximum opportunity, and may mean that more than 40 per cent of the actual incentive needs to be deferred where the outcome is less than the amount calculated at grant.

Section 26 of the ED sets out when the minimum deferral period for remuneration commences. Members consider that the drafting in CPS 511 is preferable, and that section 26 could be aligned by requiring section 26(2)(b) to apply only to the extent that the period is forward looking. Section 26(2)(a) is not aligned to CPS 511 and could be confusing in practice resulting in different forms of remuneration having different commencement dates, even when with respect to the same performance period.

Governance Institute recommends that the deferred remuneration requirements for APRA-regulated entities in FAR and CPS 511 should align and that there be greater clarity around the operation in practice of Regulators' involvement in determining remuneration calculations.

Significant related entities

[1] See Governance Institute submission *Strengthening Prudential Requirements for Remuneration*, 11 February 2021.

Our members acknowledge the objective of the provisions in relation to 'significant related entities' is to recognise in legislation the fact that related operations can be significant to an accountable entity's business and that consumers will associate a wide range of services and activities with the accountable entity – EM para 1.35.

Our members consider that there are likely to be implementation issues with the proposals as currently drafted. This could arise in a group with a wide variety of operations, some of which are APRA-regulated and some of which are not. There could be a situation where there is an impact on the accountable entity for a related entity's activity which is completely separate and unrelated to its financial services operations and do not go to its prudential soundness or its fitness to operate in the financial services sector. For example, a provider of insurance products which also operates holiday accommodation receives significant negative publicity. In the superannuation sector it is also possible for a trustee of a subsidiary to be liable for the completely unrelated activities of one of the trustee's shareholders which is presumably not what is intended.

Our members consider that as currently drafted the requirements are likely to create significant and increased compliance obligations with no appreciable benefit to the prudential soundness or operating culture of the APRA-regulated entities. The considerations of these issues will also to a large extent involve a 'hindsight test' which is difficult to administer in practice.

Our members also consider that as currently drafted the provisions relating to significant related entities are overly complex and create a number of unintended consequences. They consider the approach in the most recent draft of CPS 511 relating to groups is clearer, imposes less regulatory burden and has fewer unintended consequences. Our members would also welcome clarity about whether entities will be required to self-assess whether related entities are within scope of the regime.

Governance Institute recommends review of the drafting of the provisions relating to significant related entities to improve the clarity and reduce the regulatory burden on APRA-regulated entities. They consider the provisions of the most recent draft of CPS 511 are a preferable approach.

Accountability obligations – scope and reasonable steps

FAR imposes new obligations on accountable entities and persons that extend beyond those in the BEAR. In particular, accountable persons are required 'to take reasonable steps in conducting their activities to ensure the accountable entity complies with certain laws relating to the financial sector', in particular, various laws administered by APRA or ASIC, including regulations and instruments made under those laws - EM para 1.68, section 19(1)(d) ED.

Whilst our members acknowledge that the 2020 Treasury proposals referred to the taking of reasonable steps to comply with licensing obligations they are concerned that this has been widened to the broad range of legislation administered by ASIC and APRA. Of particular concern is that this potentially subjects accountable persons to duplicative liability for the same conduct.

Our members also have concerns about the potential breadth of the phrase 'reasonable steps to ensure'. In their experience the term 'ensure' is not used lightly as it implies a level of 'assurance' similar to that undertaken when carrying out an audit. Similarly, notwithstanding the elaboration of what 'reasonable steps' might involve set out in section 20 of the ED, our members consider the phrase sets too high a standard. For example, how would an executive determine what is 'reasonable'? It might be 'reasonable' to set up a particular system which would 'ensure' a particular outcome but there may be insufficient budget or resources to justify taking the particular step in light of the complexity of the system required to 'ensure' the outcome. For this reason, our members consider 'ensure' should not be used in the legislation.

Governance Institute recommends review of the drafting of the scope of the breadth of the obligations created by the ED.

Joint administration by ASIC and APRA

As part of implementation of the FSRC recommendations the consultation material includes the Information Paper on joint administration of the FAR regime by the regulators APRA and ASIC. From a practical perspective our members consider this will be one of the most important aspects of the new regime which will require careful thought. For this reason, our members encourage early release and consultation on more detail about how the joint administration will operate in practice.

Governance Institute recommends consultation on the joint administration of the new regime by APRA and ASIC at the earliest opportunity to assist in a smooth transition to the new regime.

If you wish to discuss any of the issues raised in this letter, please contact Catherine Maxwell.

Yours faithfully,

Megan Motto
CEO