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Manager
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Financial System Reform Taskforce
The Treasury
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Via email: FAR@treasury.gov.au

Dear Sir/Madam

Proposal Paper: The Financial Accountability Regime (FAR)

Thank you for the opportunity to provide a submission on the Proposal Paper *Implementing Royal Commission Recommendations 3.9, 4.12, 6.6, 6.7 and 6.8 - Financial Accountability Regime* (**Proposal Paper**).

The Australian Institute of Company Directors (**AICD**) has a membership of more than 45,000 including directors and senior leaders from business, government and the not-for-profit sectors. The mission of the AICD is to be the independent and trusted voice of governance, building the capability of a community of leaders for the benefit of society.

The AICD support efforts to strengthen governance practices across financial services. We recognise that the Banking Executive Accountability Regime (**BEAR**) has had positive effects since its introduction to Authorised Deposit-Taking Institutions, including clarified responsibilities and accountability. We appreciate that the Government has taken steps in its Proposal Paper to simplify the regime and to reduce the regulatory burden on firms. We also commend the Government's approach to constructive consultation with industry through the roundtables it has held on these proposals.

Our main feedback relates to the proposal to introduce civil penalties for individuals who breach their accountability obligations and the importance of ensuring that the obligations that apply to non-executive directors are clear, appropriately framed and consistent with their existing duties. While the AICD supports individual liability for misconduct in appropriate circumstances, any reform in this area must be clear, balanced and fair in its application. From our discussions with the Government, we understand that the introduction of civil penalties is intended to give the regulators a tool allowing them to penalise individuals in a more 'graduated' manner, rather than resorting to disqualification as the only recourse.

With this in mind, and to ensure that the FAR extension meets its objective of increasing accountability and improving governance in financial services, we suggest the Government (and where appropriate, APRA and ASIC) consider the following:

- Providing guidance and explanatory materials to clearly set out the expected standard of conduct for the individual accountability obligations;

- Providing clarity around how and when the civil penalty will be imposed so that it reflects Government's stated intention of being a 'graduated' tool, and is proportionate to the relevant misconduct and the individual's position in the entity; and
- Clarifying how the civil penalty provisions under FAR interact with existing laws and enforcement regimes, and in particular its interaction with directors' duties.

We expand on these suggestions below.

Further guidance and explanatory materials needed

The AICD acknowledges that it is critical that individuals as well as corporations are held liable for misconduct and failings in accountability. However, any such reform in this area must be clear, consistent and fair in its application.

We are concerned that if the current drafting of BEAR is retained, the individual civil penalties will be unworkable and unfair. In particular, we emphasise the concerns raised at the time the original BEAR legislation was introduced that the accountability obligations are insufficiently definite for institutions and individuals to be able to meet their accountability obligations, as the legislation is not clear on the standard of conduct expected of them. The problem is made more acute by the proposed introduction of civil penalties.

This issue is relevant for non-executive directors, who have a monitoring, oversight and strategic role, distinct from management. As Commissioner Hayne commented in the final report of the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry, "the task of the board is overall superintendence of the company, not its day-to-day management." It is important that the accountability obligations imposed on directors are consistent with this oversight role, as well as their role in collective decision-making.

For example, the proposed new obligation to take reasonable steps to ensure that the entity complies with its licensing obligations risks blurring the line between non-executives and management. Requiring non-executives to 'ensure' certain matters that sit within the remit of executive management risks imposing an expectation that would be impossible to meet without the board embedding itself in operational and compliance functions and compromising the independent judgement and oversight their roles are meant to bring.

We also reiterate our previous submission that some of the accountability obligations, such as the duty to deal with APRA 'openly', 'cooperatively', and to act with 'integrity', are highly subjective and open to interpretation, without a legally clear meaning in Australia.

Clarity around what each accountability obligation entails is also important for the purposes of reporting breaches to APRA or ASIC. As under the BEAR, the FAR proposes that entities will be required to notify the regulators if the entity becomes 'aware' that it or one of its accountable persons have breached their accountability obligations. Further explanatory materials on the accountability obligations will promote consistency in reporting across industry, as well as provide individuals with greater comfort that they are afforded procedural fairness when an entity is determining whether a (reportable) breach has taken place. We would also be interested to understand how such a notification might be used in subsequent proceedings by the regulator, either under the FAR or under the *Corporations Act 2001 (Cth)* (the **Corporations Act**).

By way of example, in the United Kingdom, the Financial Conduct Authority has detailed guidance (around 50 pages) in its Code of Conduct[1] (akin to the accountability obligations under BEAR) that gives examples of the type of conduct that could be considered a breach of the relevant rules. For

[1] See Code of Conduct (COCON) of the FCA Handbook: https://www.handbook.fca.org.uk/handbook/COCON.pdf

example, on the obligation to be open and cooperative with the regulators, the FCA Handbook provides a non-exhaustive list of examples of conduct that would be in breach of this rule, such as:

- Failing to report promptly in accordance with their firm's internal procedures (or, if none exist, direct to the regulator concerned), information in response to questions from the regulators;
- Failing without good reason to inform a regulator of information of which the approved person was aware in response to questions from that regulator or attend an interview or answer questions put by a regulator, despite a request or demand having been made; and
- Failing to supply a regulator with appropriate documents or information when requested or required to do so and within the time limits attaching to that request or requirement.

In addition, the FCA Handbook includes specific guidance on the role and responsibilities of non-executive directors.[2] This guidance recognises that non-executive directors do not manage a firm's business in the same way as executive directors and therefore the responsibilities for which non-executive directors are accountable are likely to be more limited. It states that the role of a non-executive director is to provide effective oversight and challenge and help develop proposals on strategy, and that they are neither required nor expected to assume executive responsibilities.[3]

This type of guidance will enhance the operation of the FAR by giving institutions and individuals a clear understanding of the behaviour expected of them. It will ensure that the FAR operates in a fair, consistent and proportionate manner, and give regulators and the court a better base for assessing whether there has been a breach. Such guidance is also necessary given the dual administration by ASIC and APRA of the FAR, so that the expectations of both regulators are consistent and clear.

With this in mind, we recommend that the Government consider:

- Tailoring or refining the accountability obligations as they apply to non-executive directors, so that they more appropriately reflect the role of the board as well as existing duties (discussed further below); and
- Providing further guidance that better articulates the standard of conduct and behaviour expected under the accountability obligations, and in particular how the guidance on 'reasonable steps' applies to non-executive directors and to clarify that the FAR is not intended to cut across collective responsibility or collective decision-making.[4]

The AICD would be pleased to consult with the Government and the regulators on drafting these explanatory materials, particularly in relation to the role of the board and non-executive directors, including perspectives from current practising directors.

Clarity around the use of the civil penalty provision and interaction with other regimes

Further clarity is needed around the purpose and use of the civil penalty provisions as they apply to individuals. At the consultation roundtable, the Government indicated that these provisions are

[2] COCON 1 Annex 1G of the FCA Handbook: https://www.handbook.fca.org.uk/handbook/COCON/1/Annex1.html It is also worth noting that under the Senior Managers Regime, only those NEDs who hold specific roles such as the Chair of the Board or of certain board committees are captured under the regime.

[3] It is also worth noting that the FCA and the Prudential Regulation Authority did not include all non-executive directors within the Senior Managers Regime as they agreed with concerns expressed during consultation that this could "encourage Standard NEDs to take on a more 'executive' role contrary to their purpose as independent members of the Board" and that this could lead to "further eroding the clarity of accountability sought by the regulators." See *Approach to non-executive directors in banking and Solvency II firms & Application of the presumption of responsibility to Senior Managers in banking firms: FCA CP15/5; PRA CP7/15,* https://www.fca.org.uk/publication/consultation/cp15-05.pdf

[4] We note that the explanatory materials that accompanied the original BEAR legislation made it clear that the BEAR is intended to apply to non-executive directors only in relation to their performance of an 'oversight function', rather than day-to-day executive and management functions (EM paragraph 1.83). However, the AICD remains concerned that the intent outlined in the explanatory materials has not been achieved in the legislation itself.

intended to provide a tool that can be used by the regulator in a graduated manner, rather than resorting to disqualification of an individual. Consistent with the Explanatory Memorandum that accompanied the original BEAR consultation, we also assume that the use of the civil penalty will be limited to *significant* breaches of the FAR. If this is the case, we recommend this materiality threshold be incorporated into legislation.

A material issue with the imposition of an individual civil penalty is its overlap with existing duties and enforcement regimes. Again, this issue is particularly acute for directors, who already have duties under the Corporations Act that have a civil penalty attached to a breach. For example, in what circumstances would a director breach the statutory obligation to act with care and diligence, but not the accountability obligation to take due care, skill and diligence (or vice versa)? If the breach of one will always result in a breach of the other, how will enforcement action and penalties be coordinated and assessed? Will the defences and qualifications available under the directors' duties provisions, such as the business judgment rule and reasonable person test, also apply to the accountability obligation?

We are unclear what the policy rationale is behind applying duplicative, overlapping civil penalties to directors that arguably covers the same conduct. Australia's directors are already exposed to a unique civil penalty regime for directors' duties contraventions, and Australian courts may impose civil fines that rival criminal fines in other jurisdictions. [5]

We also find it curious that the Government is introducing a new civil penalty under FAR in the context of the Australian Law Reform's Commission (**ALRC**) inquiry into Corporate Criminal Responsibility. Relevantly, this inquiry found that there is a great degree of complexity and duplication in the current offence provisions,[6] consistent with Commissioner Hayne's observation that the volume, complexity, and deconstructed nature of much of the current regulation makes compliance difficult.[7] The ALRC noted that "where conduct is potentially caught by multiple legislative regimes, there is a risk that those regimes might provide for different methods of attribution and therefore, potentially different liability for the same conduct,"[8] and that "the variety of different models means that officers have different (and sometimes overlapping) responsibilities in relation to different legislation. The inherent complexity of this regime as a whole undermines the aim of corporate compliance."[9]

To overcome these issues and to harmonise the various overlapping regimes and obligations, we suggest:

- Tailoring or refining the accountability obligations as they apply to directors, so that they do not overlap with existing obligations and duties; and
- Incorporating the defences and qualifications that are available to directors under other provisions of the Corporations Act into FAR, so that there is consistency across legislation. In particular, we are concerned that the requirement of 'due skill, care and diligence' is without any form of defences, qualifications and relief for accountable persons. This is entirely inconsistent with the existing duty of care and diligence under section 180 of the Corporations Act, which provides directors with the business judgment rule.

[5] See AICD commissioned research on Australia's director liability environment as compared to other jurisdictions: https://aicd.companydirectors.com.au/-/media/cd2/resources/advocacy/policy/pdf/2020/aicd--advice-for-publication-including-organagrams.ashx
[6] Paragraph 4.9, ALRC Discussion Paper on Corporate Criminal Responsibility: https://www.alrc.gov.au/wp-content/uploads/2019/11/Corp-Crime-DP-87.pdf
[7] Ibid, paragraph 4.12.
[8] Ibid, paragraph 3.42.
[9] Ibid, paragraph 7.81.

Defining accountable persons

The Proposal Paper states that FAR will provide APRA and ASIC with powers to define 'particular responsibilities' for the purposes of defining an accountable person. The indicative list in Attachment B suggests that the number of 'particular responsibilities' will be significantly expanded. However, there is no detail in the Proposal Paper on how these responsibilities will be decided by the regulators.

We consider that the FAR should focus on the most senior decision makers in a firm who have the greatest potential to impact on market integrity, consumer outcomes or financial system stability. As stated in the Government's original consultation on BEAR, 'the net should not be cast so wide that responsibility can be deflected and accountability avoided. The risk is that if everybody is responsible, nobody will be accountable.' Again, based on the indicative list in Attachment B, the net appears to have been cast much wider than originally contemplated under BEAR.

We are concerned that the indicative list of particular responsibilities does not appear to have a clear policy objective or rationale underpinning them. Given the proposal for APRA and ASIC to have greater scope to define who will be an accountable person, it is important that legislation set out the parameters of how APRA and ASIC can exercise this power. It may be useful to look to the FCA's approach to defining 'Overall Responsibility' under the Senior Managers Regime as a benchmark for how accountable persons are defined. Under the overall responsibility test, this means a senior manager:

- has ultimate responsibility or accountability for managing or supervising a relevant function (as opposed to simply 'senior executive responsibility');
- briefs and reports to the governing body about their area of responsibility; and
- puts matters for decision about their area of responsibility to the governing body.

A threshold like the example above will ensure that accountable persons are always the most senior person responsible for managing the area overall, be sufficiently senior and credible, and with the resources and authority to be able to exercise their management and oversight responsibilities effectively.

We also note that Attachment B suggests that APRA and ASIC will issue guidance on the 'critical expected functions within each particular responsibility'. We would caution against any guidance that limits or defines how companies organise themselves and the roles within them, as this is the role of the board and the CEO rather than the regulators. This would also run counter to the stated intention that the FAR be able to adapt and reflect different governance structures. If this course was nonetheless taken, it will be critical that the governance role of the board, as distinct from management, is appropriately recognised.

Related to this, the Proposals Paper states that an entity will need to comply with ARPA and ASIC directions to reallocate responsibilities. Under the current BEAR legislation, this power can only be exercised by APRA if it has reason to believe that the current allocation of the responsibility is likely to give rise to a prudential risk. Further elaboration and clarity on how this power could be used by ASIC is needed, as it is not clear what circumstances would warrant the conduct regulator reallocating responsibilities within an organisation.

Non-objections power

The AICD remains concerned that the proposed 'no objections' power could create a potential moral hazard, with a risk that APRA might be considered responsible for the quality of the board and management of regulated entities. These are accountabilities that should remain with individual entities, their boards and shareholders or members (as appropriate). We remain of the view that the existing prudential framework, which includes a proactive obligation on entities to impose (and

be accountable for) a fit-and-proper person test for board and executive roles, in addition to the regulators' disqualification powers, is sufficient.

If, however, the Government proceeds with the non-objections power, it is critical that the legislation clearly defines the limited circumstances in which APRA can exercise this power. We understand from industry consultations that the power is intended to be exercised rarely (such as where an individual has been banned by an overseas' regulator). The Proposals Paper, however, seems to contemplate that it could be used in broader circumstances, including where, for example, a person has failed to deal with APRA in an open, constructive and cooperative way. We consider that this is unacceptably broad, and again raises issues with the lack of clarity around the accountability obligations. Given the impact that would stem from a person being prevented from being appointed as an accountable person, it is important the legislation clearly articulates the (limited) circumstances in which APRA can exercise this power.

The AICD supports the inclusion of an appeal mechanism and we look forward to further consultation on how the non-objections power and the right of review will operate.

Implementation and coordination

We understand that the Government is considering a staggered timeframe for implementing the FAR, recognising the significant compliance and operational impact this will have on firms. We support the Government's approach to giving firms an appropriately long period of implementation to transition to the regime to ensure that it works effectively and achieves the right outcomes for firms and consumers.

We also note that it will be critical for the Government to work closely with APRA and ASIC to ensure that firms are given sufficient clarity around their obligations. The Proposal Paper contemplates that APRA and ASIC will be given significant powers to prescribe details around many aspects of the FAR, including who will be subject to the regime as accountable persons, and it may be that the regulators are also best placed to develop further guidance and explanatory materials around accountability obligations and the approach to civil penalties. With this in mind, we commend the Government and regulators' commitment to date to closely working together on the regime, and request that, where possible, the full package of regulation and explanatory materials be consulted on within similar timeframes so that there is as much time and clarity as possible.

Conclusion

We hope our comments will be of assistance to you. If you would like to discuss any aspect of this submission, please contact Sophie Stern, Senior Policy Adviser, on (02) 8248 8428 or at SStern@aicd.com.au, or Christian Gergis, Head of Policy, on (02) 8248 2708 or at CGergis@aicd.com.au.

Yours sincerely

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