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James Kelly
First Assistant Secretary
Financial System Division
The Treasury

via email: FAR@treasury.gov.au

Dear Mr Kelly

Financial Accountability Regime – Exposure Draft Legislation

Thank you for the opportunity to provide comments on the Financial Accountability Regime (**FAR**) Exposure Draft.

This submission concerns the Exposure Draft - Financial Accountability Regime Bill 2021 (**Exposure Draft**) and Explanatory Materials - Financial Accountability Regime Bill 2021 (**Explanatory Materials**).

The Australian Institute of Company Directors' (**AICD**) mission 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's membership of more than 46,000 reflects the diversity of Australia's director community, comprised of directors and leaders of not-for-profits, large and small businesses and the government sector.

The AICD has a standing policy forum comprised of non-executive directors from APRA regulated entities that has advised us in the preparation of this submission. Were Treasury interested in further targeted consultation we would be pleased to convene the APRA-regulated entities forum for that purpose.

The AICD supports measures to strengthen governance and accountability practices across financial services industries, including implementing the recommendations of the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry (**Financial Services Royal Commission**).

Executive Summary

1. The AICD is supportive of the overall objectives of the FAR and we acknowledge the need for increased accountability and compliance within the financial sector. We also support Commissioner Hayne's recommendation to extend the BEAR to all APRA-regulated entities.

2. However, we raise the following concerns about the Exposure Draft:

    - the Exposure Draft seeks to not only extend but to expand the BEAR. We believe, in accordance with the recommendations of the Financial Services Royal Commission, the legislation should limit itself to extending the BEAR;

- sub-section s.76(2) of the Exposure Draft exposes individuals to accessorial liability under the FAR in contradiction to the stated policy intention of the legislation. It should be amended so that only accountable entities may be held liable for breaches of their obligations;
- the use of the word "ensure" in Part 2 of Chapter 2 of the Exposure Draft sets an extraordinarily high bar, requiring an accountable person (or indeed an entity) to guarantee compliance with all obligations including all obligations under Acts, regulations, determinations and orders. This wording is inappropriate and does not reflect the role of non-executive directors in governance and oversight, as opposed to management, of financial services entities;
- sub-section 20(d) should be deleted from the Exposure Draft;
- where the word "ensure" appears in Part 2 of Chapter 2 of the Exposure Draft it should be deleted and replaced with "support";
- sub-section 19(1)(d) exposes directors to unreasonable personal liability risk, is too broad in scope and complexity, is not aligned with the recommendations of the Financial Services Royal Commission and duplicates existing provisions. It should be deleted from the Exposure Draft;
- the new responsibilities relating to directors as accountable persons substantially and unfairly increase their risk of exposure to prosecution for breaches of directors' duties under the *Corporations Act 2001 (Cth)* (**Corporations Act**);
- the requirement to deal with the Regulator in an 'open, constructive and cooperative way', raises some concerns when extended to ASIC given its prosecutorial role, particularly in relation to directors' duties;
- we do not consider the broad proposed directions powers in the Exposure Draft are necessary;
- there should be greater alignment of the deferred remuneration obligations in the Exposure Draft with APRA's draft CPS 511. Where there is inconsistency on matters such as deferral amounts and periods, draft CPS 511 should be amended to align with the provisions in the Exposure Draft;
- the privilege against self-incrimination regarding civil penalties from the BEAR should be restored;
- the Exposure Draft should at least, in part, detail how the Parliament expects the Regulators to jointly administer the FAR. The proposed public arrangement concerning joint administration, while welcome, should contain sufficient detail, supported by regulator guidance, to allow accountable entities and accountable persons to sufficiently understand how the Regulators will administer the FAR; and
- the Exposure Draft should address the vague wording around joint liability and clarify responsibilities to ensure individual accountability.

Extension vs Expansion of BEAR

3. Recommendation 6.8 of the Financial Services Royal Commission was to "extend" the BEAR:

> ***Recommendation 6.8 – Extending the BEAR***
>
> *Over time, provisions modelled on the BEAR should be extended to all APRA-regulated financial services institutions. APRA and ASIC should jointly administer those new provisions.*

4. The Exposure Draft for the FAR instead represents an expansion of BEAR. In our opinion, it is a material divergence to what was contemplated under the Royal Commission recommendations through the creation of a new accountability regime with expanded obligations on accountable persons, such as the provisions in s.19(1)(d).

5. Expansion of the BEAR, rather than extension, is contrary to the recommendations of Commissioner Hayne:

> *I do not otherwise consider there to be a need for the obligations in the BEAR to be expanded, although consequential changes may be necessary in light of what I have said above.*[1]

6. The BEAR has meant an increased focus from Authorised Deposit-Taking Institutions (**ADIs**) and their boards on compliance. This has been time and resource intensive for those ADIs. Notwithstanding their concerns around time and resources, in general their directors have advised the AICD that the BEAR has assisted in clarifying lines of accountability. APRA has also formed the view that it has been successful in driving improved accountability practices across ADIs as evidenced by their Information Paper on implementation of the regime at three large banks.[2]

7. The BEAR represents a settled, well understood and implemented legislative and regulatory framework. ADIs already subject to it should be allowed to continue to apply it and insurers and RSE licensees and other APRA regulated entities should be able to benefit from their experience.

8. We are particularly concerned about amendments to the obligations on accountable persons and how they will apply to directors. We anticipate that if legislated without amendment the obligations on accountable persons who are non-executive directors would drive or incentivise behaviour that is inconsistent with the role of the board as the key oversight governance body of an accountable entity.

9. Absent a policy decision to extend the BEAR unamended to all APRA regulated entities, we consider there are opportunities to refine the proposed accountability obligations under the FAR as they apply to non-executive directors to more appropriately reflect the role of the board.

Recommendation

10. The AICD recommends that the Exposure Draft be amended so that it is limited to the consequential changes in the BEAR.

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[1] Final Report of the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry, page.466

[2] APRA Information Paper, Implementation of the Banking Executive Accountability Regime (BEAR), 11 December 2020

Accessorial liability – s.76(2)

11. We note that the Treasury's Proposal Paper from 22 January 2020 *Implementing Royal Commission Recommendations 3.9, 4.12, 6.6, 6.7 and 6.8 - Financial Accountability Regime* (**2020 Proposals Paper**) discussed the FAR containing individual civil liability provisions for accountable persons. This has, ostensibly, not been pursued in the Exposure Draft and we understand that there has been a policy decision by Government not to impose individual civil liability on accountable persons, thereby limiting liability (except for certain named offences) to accountable entities. The drafting of the civil penalty clause in s.76(1)(2), with its reference to accountable entities, makes this policy intention clear.

12. Sub-section 76(2) however indicates that a "person" is liable to a civil penalty for contravening sub-section 1 and the note to sub-section 2 clarifies that '*Section 92 of the Regulatory Powers Act (which deals with ancillary contravention of a civil penalty provision) applies in relation to this subsection.*' Section 92 of the *Regulatory Powers (Standard Provisions) Act 2014 (Cth)* is an accessorial liability provision applying to persons, including individuals. It is in nearly identical terms to the accessorial liability provision contained in s.79 of the Corporations Act.

13. The effect, then, of s.76(2) of the Exposure Draft is to create an accessorial liability provision relating to conduct (such as appears in the Corporations Act), when an accountable entity is alleged to have failed to comply with an obligation.

14. Section 18(d) of the Exposure Draft states that the 'accountability obligations of an accountable entity are to take reasonable steps to… **ensure** that each of its accountable persons meets their accountability obligations under section 19.' (emphasis added) Where it was alleged that an accountable person failed to comply with their obligations under s.19 then this might mean the accountable entity has breached s.18(d). The accountable person might then be held liable for the accountable entity's breach under the accessorial liability provision in s.76(2). It is an odd outcome: an accountable person is accessorily liable because the accountable entity is liable for the accountable person's initial conduct.

15. The effect is that the accountable person is exposed to individual civil liability for their compliance with their accountability obligations through these provisions, contrary to the Government's stated policy intention. Additionally, all individuals (including directors) are potentially liable for the accountable entity's compliance with its accountability obligations.

Liability environment for Australian directors

16. It is worth setting out the context in which this liability is being imposed. In 2020, the AICD commissioned the law firm Allens to research the frameworks for imposing criminal and civil liability on directors in Australia and comparative jurisdictions (the UK, New Zealand, Canada, Hong Kong and the USA). Allens concluded that Australia's director liability environment is unique - and in many regards, uniquely burdensome - as compared with other jurisdictions.[3]

17. While accessorial liability is also a feature of other comparator jurisdictions, Australia is unique in that it relies on public enforcement of duties (including as is proposed under the FAR). ASIC may seek pecuniary penalty orders payable to the Commonwealth, relinquishment orders payable to the

[3] The full research paper is available here.

Commonwealth, compensation orders payable to a company, and disqualification orders against individuals.

18. In contrast, comparator jurisdictions rely almost exclusively on private enforcement of directors' duties, be it through company actions, derivative actions or shareholder class actions. In particular, and relevant to the FAR, 'directors of UK public companies run virtually no risk of being sued for damages for breach of directors' duties.'[4]

19. This means that when accountability regimes are modelled on comparator jurisdictions (such as is the case with FAR based on UK regulatory arrangements) care must be taken noting the different approaches taken to enforcement. Australian directors are exposed to a higher likelihood of liability than directors in comparator jurisdictions. There are already means to hold them to account. Foreign Parliaments and regulators when drafting legislation and imposing regimes may not have the same arsenal of public enforcement mechanisms and may need to create bespoke industry-specific ones.

Liability risk under Exposure Draft

20. The accountable persons responsibilities under the FAR are broad and vague. As discussed in the section on "Distinction between management and the board" below, they are unclear about the responsibilities of directors as opposed to managers and what reasonable steps directors might need to take to ensure compliance.

21. There is also an increased risk of stepping stone liability discussed in "Increased liability risk for breaches of the Corporations Act" below.

22. Imposing individual liability, with public enforcement and serious consequences for breach, in circumstances where the extent of the obligation is unclear and open to many differing interpretations is, in our view, unreasonable and inappropriate. It is likely to have a chilling effect on boards and directors, discourage individuals from taking up roles at key financial institutions and lead to an understandable board preoccupation with compliance over other responsibilities such as oversight, strategy and innovation.

Recommendation

23. The AICD recommends that the Exposure Draft be amended by deleting the Note to s.76(2) and amending the sub-section as follows (new wording underlined):

> *A person <u>who is an accountable entity</u> is liable to a civil penalty if the person contravenes subsection (1).*

Use of the word "ensure"

24. Part 2 of Chapter 2 of the Exposure Draft uses the word "ensure" on multiple occasions, referring to obligations on accountable entities and persons. While some of these are drawn from BEAR - for example the provision in s.21(b) on an accountable entity to ensure that no accountable person of the accountable entity is prohibited - some are new and create new obligations. We have particular

[4] Jennifer Hill and Matthew Conaglen, 'Directors' Duties and Legal Safe Harbours: A Comparative Analysis' in DG Smith and AS Gold (eds), *Research Handbook on Fiduciary Law* (2017) 11.

concern with the use of the word "ensure" in sub-sections 19(1)(d) and 20(d) of the Exposure Draft. We deal with s.19(1)(d) in more detail in the section below.

25. Section 20(d) states that reasonable steps in relation to a matter includes taking appropriate action to ensure compliance in relation to that matter. The effect of that is to require an accountable entity to ensure compliance with all its obligations under s.18. It also requires an accountable person to ensure compliance when conducting their responsibilities to prevent matters from arising that would (or would be likely to) adversely affect the prudential standing or prudential reputation of the accountable entity under s.19(1)(c).

26. The Shorter Oxford English Dictionary defines "ensure" as:

> *…4. Guarantee, warrant…6. Make certain the occurrence of (an event, situation, outcome, etc.)*[5]

27. It is an extraordinarily high bar to require an accountable person (or indeed an entity) to guarantee compliance or make certain it occurs. There may be occasions, despite intention or systems, where the ability to guarantee compliance is beyond the span of control or sphere of influence of the accountable person. This drafting does not seem to allow for that nuance.

Distinction between management and the board

28. It is critically important that the FAR legislation appropriately reflect the distinct roles of senior executive management and the board. The current drafting does not appropriately distinguish the governance and oversight role of non-executive directors from the day-to-day direct management accountabilities of senior executives. Current drafting requiring directors to guarantee compliance or ensure that certain management functions occur will necessarily result in a blurring of the line between the board and management. This is consistent with our previous submissions and feedback from AICD members on the Exposure Draft.[6] The AICD strongly urges redrafting to address these concerns.

29. Commissioner Hayne in considering the role of boards focuses on ensuring the board obtains the right information in order to discharge its functions and challenge management:

> *In particular, boards must have the right information in order to challenge management on important issues including issues about breaches of law and standards of conduct, and issues that may give rise to poor outcomes for customers.* [7]

30. He then goes on to stress that boards should not be involved in the decision making of management (emphasis added):

> *Boards cannot, and must not, involve themselves in the day-to-day management of the corporation. Nothing in this Report should be taken to suggest that they should. The task of the board is* ***overall superintendence of the company, not its day-to-day management****.*[8]

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[5] Brown, L (ed.), *The New Shorter Oxford English Dictionary*, Oxford University Press, 1993 at p. 827.
[6] AICD submission Proposal Paper: The Financial Accountability Regime (FAR), 13 February 2020. Available here.
[7] Final Report of the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry, page 400.
[8] Ibid.

31. A director who has a legal duty to "ensure" compliance with all aspects of complex financial services regulation must necessarily involve themselves in the day to day running of a company. They must consider whether it is prudent to work around the key management personnel and potentially provide instructions to lower-level employees in contrast to usual delegated decision-making arrangements. They must directly intervene in matters that are properly the responsibility of management, which will create confusion, duplication and potentially lead to sub-optimal decision making.

32. We note that the reference to the accountable person's 'responsibilities of their position' may be used to argue that the clause distinguishes between the role of the board and management and recognises that directors and executives have different responsibilities. However, the view of where that distinction lies may differ between Treasury, the Parliament, the entity in question and the Regulators. Unlike the UK, there is no guidance to assist directors in determining where the regulator regards that line as being drawn (see "Joint administration and regulator guidance – s.34" below). In those circumstances, the prudent and cautious director, may feel that, to manage liability risk and demonstrate reasonable steps, they need to directly intervene to guarantee compliance or make sure it occurs.

33. If Treasury is minded to retain these provisions then the word "support" could be substituted for "ensure". This would recognise some positive duty on accountable persons without requiring them to guarantee compliance.

Recommendation

34. The AICD recommends that s.20(d) be deleted. It does not appear in BEAR and is unnecessary and unreasonable.

35. Further, the AICD recommends that the word "ensure" be deleted from sub-sections 18, 19 and 20 (if s.20(d) has not been deleted and subject to our recommendation on s.19(1)(d) below) and the word "support" inserted.

Accountable person obligations – s.19(1)(d)

36. This section responds to section 19(1)(d) of the Exposure Draft.

37. We consider section 19(1)(d) of the Exposure Draft as unduly onerous, counterproductive to the objectives of the FAR and importantly inconsistent with the Royal Commission recommendations. Further, in combination with the use of "ensure" as set out above we are concerned that this obligation is inconsistent with the governance role of the board as providing oversight of the decision making and actions of management.

Increased Liability Risk

38. The extensive obligations under this sub-section significantly increase director liability risk, both under accessorial liability provisions and because they may ground a case for ASIC alleging the director breached their director duties (see section below). The scope and complexity of these provisions make compliance with this obligation very difficult and further enhance risk.

39. We have already specified why the director liability environment is in many regards, uniquely burdensome as compared with other jurisdictions. Increasing personal liability risk for directors may cause directors not to seek out board roles in major financial institutions and lead boards into

involvement in day-to-day management of an organisation as well as prevent directors' necessary focus on strategy, growth and innovation.

Scope and complexity of provision

40. The scope and complexity of the obligation on directors is very significant. There are a multitude of obligations on accountable entities under legislation and regulations or other instruments, directions or orders, likely in the order of thousands. It is very hard to see how a director, working part-time with broad oversight of a large and complicated entity, could guarantee that that entity complies with every single obligation. Such an expectation is clearly impractical.

41. As already noted in the section earlier on "Distinction between management and the board" the effect will be to encourage, if not require, the director to interfere in the day-to-day management of the entity.

Misalignment with Financial Services Royal Commission

42. We understand from the 2020 Proposal Paper that the policy intent of this new obligation was to broaden the scope of the accountable person obligations from the 'prudential standing and reputation focus' under the BEAR to one that also encompasses 'conduct that affects entities complying with obligations under each of the respective licensing regimes.'[9]

43. In our view, the drafting of this obligation is an expansive reading of this policy intent and more importantly inconsistent with the Financial Services Royal Commission that found that the BEAR already had a conduct element as noted by Commissioner Hayne:

> *The BEAR, therefore, has both a conduct and prudential outlook. So much is clear from the second reading speech, which emphasised that when community expectations are not met, appropriate consequences should follow for those accountable.*[10]

44. In our opinion, the addition of this new obligation goes beyond the consequential changes that were envisaged by Commissioner Hayne in expanding the BEAR to all APRA regulated entities and allowing for joint administration with ASIC. The structure of the BEAR accountable persons' obligations already provides sufficient scope for ASIC to pursue consumer protection and conduct matters and the inclusion of this new obligation is unnecessary.

Duplication of existing duties and obligations

45. The proposed accountability obligation is also largely unnecessary and either duplicates or potentially conflicts with duties and obligations already held by officers, including directors and key management personnel.

46. For directors, these obligations are either broad, as is the case for director duties under the Corporations Act, or industry specific, for example the trustee covenants relevant to directors of RSE licensees under the *Superannuation Industry (Supervision) Act 1993*. As such, the new obligation is duplicative and would create significant complexity and confusion about how the obligation aligns or interacts with the existing director obligations.

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[9] Treasury Proposals Paper, *Implementing Royal Commission Recommendations 3.9, 4.12, 6.6, 6.7 and 6.8 - Financial Accountability Regime*, 22 January 2020, page 6.
[10] See footnote 7, page 456.

Recommendation

47. The AICD strongly recommends that this clause be deleted from the Exposure Draft.

Increased liability risk for breaches of the Corporations Act

48. We are concerned that some of the additions to the Exposure Draft, such as s.19(1)(d) and the new limbs in s.20(d) effectively creates provisions where, when the director as an accountable person is alleged to have failed to comply with one of their accountability obligations, or the accountable entity itself fails to comply with its accountability obligations, the director can be charged by ASIC for breaching a directors' duty under the Corporations Act.

49. This liability risk, also known as stepping stone liability, is an emergent form of direct liability involving a 'two-step process', whereby 'directors and officers may be personally liable for failure to prevent contraventions of law by their corporation.'[11]

50. When alleging stepping stone liability, ASIC generally invokes the 'catch-all' duty to act with care and diligence to 'piggy back' director civil liability on to the Corporations Act and *Australian Securities and Investments Commission 2001 (Cth)* breaches by a corporation. If a director's conduct has been particularly egregious, ASIC also invokes directors' duties to act in good faith and in the best interests of the company, and to not misuse their position.

51. Stepping stone liability is a unique feature of the Australian director liability environment because similar jurisdictions (e.g. Canada, Hong Kong, New Zealand, the UK and the USA) utilise private, rather than public, civil enforcement of directors' duties. Thus, these jurisdictions' regulators are not able to 'step' from an enforcement action against a company to a civil penalty application against a director in the manner ASIC can, as such stepping stone liability places a unique burden on Australian directors.[12]

52. The risk for Australian directors is furthered by the lack of protection provided by the business judgment rule, contained in s.180(2) of the Corporations Act. The purpose of the business judgment rule is to protect the authority of directors to make bona fide commercial decisions, acknowledge that directors make decisions with imperfect information, and avoid an unreasonable level of risk aversion and encourage sensible commercial risk-taking.

53. The AICD has commissioned law firm Allens to research the scope, operation and effectiveness of Australia's business judgment rule as compared with other jurisdictions. This is intended to complement the report on criminal and civil liability for directors already referred to in the section on "Liability environment for Australian directors".[13]

54. The report notes that, despite common policy objectives, Australia's business judgment rule operates differently, has a narrower application and provides less protection to directors than comparator jurisdictions' business judgment rules. Australia's business judgment rule has never been successfully pleaded by a defendant director, and has been the subject of more critical commentary than the comparator jurisdictions' business judgment rules.

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[11] Jennifer Hill, 'Legal Personhood and Liability for Flawed Corporate Cultures' (European Corporate Governance Institute (ECGI)-Law Working Paper 431, 2018) 27.

[12] This issue is covered in more detail in the Allens report referred to in footnote 3.

[13] The Allens report, which was released only this week, is available here.

Recommendation

55. The recommendations in "Use of the word "ensure"" and "Accountable person obligations – s.19(1)(d)" above, if implemented, would address these concerns.

Dealing with the Regulator – s.19(1)(b)

56. We are concerned about the requirement on accountable persons in s.19(1)(b) to deal with the Regulator in an open, constructive and co-operative way. While we note the similar provision in s.37CA(1)(b) of the *Banking Act 1959* (**Banking Act**) from the existing BEAR arrangements, the Exposure Draft extends this obligation to dealings with ASIC.

57. There are differences, in our opinion, in how entities may approach relationships with APRA and ASIC. ASIC is a conduct regulator, part of ASIC's mandate is deterring poor conduct through the use of public enforcement. Where ASIC is prosecuting an individual or an entity, or considering prosecuting, individuals and entities are entitled to defend their position. Requiring an entity or an individual to be "co-operative" with a regulator attempting to prosecute them, potentially restricts their ability to mount a robust defence.

58. Additionally, as already noted, ASIC is a public regulator of directors duties, unlike regulators in other jurisdictions. For example, Rule 3 of the UK's Financial Conduct Authority Handbook, on which this sub-section is clearly based, states 'You must be open and cooperative with the FCA (Financial Conduct Authority), the PRA (Prudential Regulation Authority) and other regulators.'[14] None of those regulators are able to charge UK directors for breach of their director duties.

59. It is unclear whether this provision would require an accountable person to provide to the Regulator material that is subject to legal professional privilege. It should be clarified in this sub-section that it is not intended to override legal professional privilege.

Directions power – s.60

60. We understand from the Explanatory Materials that the proposed general directions power under section 60 of the Exposure Draft largely replicates existing powers under the Banking Act and other industry acts administered by APRA. Our reading is that the power provides the Regulator with a largely unfettered ability to direct an accountable entity to address non-compliance, or likely non-compliance, of the FAR requirements by an accountable entity or accountable person.

61. It is not apparent what the policy rationale is for a new broad ranging power with a low threshold when APRA has existing directions powers under the industry acts. That is, it is difficult to envisage a situation where a breach or likely breach by an accountable entity or accountable person is not also relevant or within scope of APRA's administration of the industry acts. If there are specific examples or scenarios that directly concern the FAR requirements and where this power is necessary, then this should be clearly detailed in the Explanatory Materials.

62. Further, the Exposure Draft already provides the Regulators with an extensive toolkit of regulatory powers, including directing the reallocation of responsibilities, enforceable undertakings, disqualifications, injunctions and general information gathering, investigatory and enforcement

[14] See: https://www.handbook.fca.org.uk/handbook/COCON/4/1.html

powers. Taken together these powers should be sufficient for the Regulators to appropriately administer the FAR.

63. We are also concerned that ASIC will, for the first time, be able to issue directions under this provision. It is important that the Regulators set out how they intend to use this directions power in any joint administration guidance. Ideally this should be subject to some legislative direction.

Recommendation

64. The AICD recommends that s.60 be removed from the Exposure Draft. Were it to be retained then we would welcome additional drafting that clearly set parameters and a higher threshold for its use in the primary legislation and Explanatory Materials.

Alignment with CPS 511

65. This section responds to Part 5 of the Exposure Draft.

66. We reiterate our previous support for regulatory settings in respect of remuneration that seek to promote positive executive behaviour and disincentivise misconduct. Further, we welcome changes to the deferred remuneration obligations in the Exposure Draft from those under the BEAR, particularly the simplification of the deferral amounts and deferral periods by role and size of entity.

67. We note that APRA is progressing with finalising a significant set of new cross industry prudential requirements on remuneration under draft Prudential Standard CPS 511 Remuneration (**draft CPS 511**). We anticipate that were CPS 511 to be finalised without consideration of the final form of the FAR legislation, then there would be several areas of misalignment. This would create significant industry uncertainty and complexity in interpreting the requirements.

68. We note the following areas of potential misalignment or uncertainty between the Exposure Draft and draft CPS 511:

    - divergence in the deferral amounts and deferral periods, for example a CEO of a significant financial institution would, under draft CPS 511, be required to defer 60 per cent of their variable remuneration for a period of six years whereas under the Exposure Draft it would be 40 per cent for a period of four years;

    - definitions of the 'relevant deferral period' and 'financial year' under sections 25 and 26 of the Exposure Draft as compared to the respective use of these terms under draft CPS 511;

    - treatment and calculation of equity based variable remuneration under draft CPS 511 and separately under the FAR; and

    - whether in-period downwards adjustments or use of malus under draft CPS 511 would trigger or be aligned with a reduction in variable remuneration under section 23 of the Exposure Draft and by extension a notification to the regulator under section 30 of the Exposure Draft.

69. We encourage the Government and APRA to work together to ensure greater alignment between the proposed prudential requirements and the FAR, including in the areas listed above. Our suggestion is that where there is inconsistency on matters of substance such as deferral amounts and periods, that draft CPS 511 be amended to align with the FAR. We remain concerned with the

lengthy deferral periods that are proposed to apply to all APRA-regulated entities under the draft CPS 511, which continues to remain out of step with international practice.

70. For smaller accountable entities that may have limited variable remuneration practices the FAR and draft CPS 511 would represent, in totality, a significant expansion of the regulatory burden as it relates to their remuneration arrangements. We anticipate that for the boards and board remuneration committees of these entities there will be significant challenges in understanding the respective requirements and obtaining the right information to be satisfied of compliance.

71. It may be appropriate for APRA to pause finalisation of CPS 511 until the FAR legislation is considered by Parliament. In addition, we expect that the remuneration obligations under FAR and how the relate to CPS 511 is an area where industry will require significant regulatory guidance.

Recommendation

72. The AICD recommends that APRA and Treasury correct any misalignment between the FAR and the draft CPS 511. Where there is inconsistency on matters such as deferral amounts and periods, draft CPS 511 should be amended to align with the provisions in the Exposure Draft.

Privilege against self-incrimination - s.84(3)

73. Section 84(3) of the Exposure Draft amends the BEAR provisions contained in s. 52F of the Banking Act and removes the privilege against self-incrimination when an individual may be liable to a penalty. The effect appears to be that any information or document provided may be used as evidence in a civil penalty proceeding. We have already noted the extensive risk of individual civil penalties that may apply to persons, especially directors, under the FAR.

74. If this is an intentional amendment, it is unclear what policy justification there is for removing the privilege against self-incrimination for civil penalties. There was no reference to it in the 2020 Proposals Paper. There has been no evidence provided that the arrangement under BEAR has caused problems for regulators and that this represents a necessary step in enforcement proceedings.

Recommendation

75. The AICD recommends that s.83 be deleted and replaced with the wording in s.52F of the Banking Act (with consequential amendments).

Joint administration and regulator guidance – s.34

76. This section responds to section 34 of the Exposure Draft and the Information Paper *Joint administration of the Financial Accountability Regime between APRA and ASIC*.

77. We welcome the proposal that the Regulators will be required to enter into an arrangement that details how they will jointly administer the FAR. Effective coordination between the Regulators will be key to the FAR achieving its objectives in a manner that minimises the regulatory burden on accountable entities and accountable persons. To this end, we believe that the legislation should at least in part specify how the Parliament expects the Regulators to jointly administer the FAR rather than leaving it entirely up to ASIC and APRA.

78. To be useful to accountable entities and accountable persons the arrangement should provide specific detail on how the regulators will cooperate, including the decision making on regulatory

powers. This detail should cover decision making around the use of specific powers, including directions and disqualifications.

79. This complexity of the FAR and the expanded population of entities and accountable persons to which it will apply justifies a comprehensive and timely approach by the Regulators to guidance. Guidance will be key to successful implementation and ongoing compliance with the FAR requirements by accountable entities and accountable persons, including directors.

80. To date, APRA has provided limited guidance on the BEAR with a focus on its administrative aspects. While the APRA Information Paper released in 2020[15] noted certain best practices associated with implementation at three large banks, it stopped short of setting out APRA's regulatory expectations in a manner consistent with prudential practice guides.

81. For AICD members, regulatory guidance will be key to interpreting and meeting the accountable person obligations. This will be particularly the case if subjective elements of the obligations are retained, such as 'reasonable steps' and dealing with the regulator in an 'open, constructive and co-operative way'. The AICD is prepared to work with regulators on the development of guidance on the FAR as it relates to directors meeting the accountable person obligations.

Joint liability – s.19(2)

82. We are concerned by the vague wording in s.19(2) of the Exposure Draft providing that all accountable persons have accountability obligations jointly in relation to their responsibility. In the case of the board there is clear joint responsibility and accountability however the situation is less clear for management and prescribed accountable persons.

83. We are, for example, unclear how this provision will sit alongside the proposed requirement for prescribed accountable persons with end-to-end product responsibility. Where an accountable person may have some responsibilities for some part of the product in the product value chain, say in relation to human resources, it is unclear whether they would be jointly liable for all responsibilities for that product.

84. From the perspective of the board this has the potential to cause confusion both between management and in the board's oversight of non-financial risk and compliance. The principal benefit of BEAR has been the clearer allocation of responsibilities between executives. This has also allowed for easier board oversight and more direct accountability to the board (including through board sub-committees). Confusion caused by joint accountability risks hampering that board oversight.

Other matters

85. We have had the benefit of sighting the Law Council of Australia's submission to Treasury dated 12 August 2021.

86. The AICD endorses the Law Council's submissions on Significant related entities in the RSE context (paras 39 to 45), Double (or triple) jeopardy and overlapping obligations (paras 54 to 57), Indemnification of accountable entities by related bodies corporate (paras 58 to 60), Examinations (para 61), Fund mergers and Civil penalties (para 63).

[15] See footnote 2.

Next steps

We hope our response will be of assistance. If you would like to discuss any aspects further, please contact David McElrea at dmcelrea@aicd.com.au or Simon Mitchell at smitchell@aicd.com.au.

Yours sincerely,

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