

PwC's summary of the Financial Accountability Regime Exposure Draft

July 2021



Overview and timing



Overview

On 16 July 2021, Treasury released the consultation package which included the Exposure Draft and Explanatory Memorandum for the implementation of the Financial Accountability Regime (FAR).

The FAR is the government's response to recommendations made by the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry to extend the Banking Executive Accountability Regime (BEAR) to strengthen the responsibility and accountability of the directors and most senior and influential executives of financial institutions.

The FAR follows many of the provisions of its predecessor, the BEAR.



Timing

Treasury is seeking feedback in relation to the FAR Exposure Draft by **13 August 2021**. Public consultations will commence in August and September, for an expected introduction and passage of the legislation into Parliament in the 2021 Spring sitting.

Proposed implementation dates:

- **Authorised deposit-taking institutions (ADIs) and their non-operating holding companies (NOHCs)** from the later of **1 July 2022 or 6 months** after the commencement of the FAR following Royal Assent
- **Insurers, their licensed NOHCs and registrable superannuation entity (RSE) licensees** from the **later of 1 July 2023 or 18 months** after the commencement of the FAR following Royal Assent

Timeline to the implementation of the FAR



Entities caught under the FAR

The intention of the FAR is to improve the operating culture of entities in the banking, insurance and superannuation sectors and to increase transparency and accountability across these sectors - in relation to both prudential matters and conduct-related matters.



Accountable entities under the FAR

- ADIs and their NOHCs
- General insurers and their NOHCs
- Life insurers and their NOHCs
- Private health insurers
- RSE licensees
- Australian branches of foreign accountable entities

Under the FAR, entities are classified as either core or enhanced, depending on their size. These classifications inform the entity's notification obligations.



Classification thresholds

The table below sets out the thresholds to determine whether an entity meets the enhanced compliance notification obligation.

Entity type	Total assets
ADIs	>\$10B
RSE licensees	>\$10B (total combined assets of all RSE's under the trusteeship of a given RSE licensee)
General & Private Health insurance	>\$2B
Life insurance	>\$4B
NOHCs	No metrics or thresholds specified - classified depending on whether another accountable entity within the group meets the enhanced threshold.



Entity classifications

Enhanced compliance entities

Subject to all the obligations under the FAR including the requirement to submit accountability statements and maps to the regulators and provide timely updates (within 30 days) when material changes occur.

Core compliance entities

Subject to the FAR obligations except the requirement to submit accountability statements and maps to the regulators. Core compliance entities are still required to identify their Accountable Persons and register them with APRA and ASIC.

More entities caught under the FAR - Significant Related Entities

FAR introduces the term “significant related entities” (SREs), which, for most entities are significant subsidiaries. Accountable entities must take reasonable steps to ensure that its SREs comply with certain accountability obligations under the Exposure Draft. Accountable persons of SREs must comply with the accountability obligations.



Significant related entity

An entity is a significant related entity of an accountable entity if the following apply:

- For ADIs and insurers it is a significant (material and substantial) subsidiary of the accountable entity
- It is a constitutionally covered entity
- It is not an accountable entity itself
- For RSE licensees this includes other related body corporates and entities with certain control relationships with the licensee (Connected Entities as defined by s10 of the Superannuation Industry (Supervision) Act). A connected entity can be an SRE of more than one SRE licensee.



Considerations

While the Exposure Draft does not provide a definition of *material and substantial effect*, it does list a number of factors that may be taken into account for the purposes of determining whether the SRE is material or substantial, such as the nature, scale and interdependencies of the entity. A significant related entity can only be related to one accountable entity, the closest parent accountable entity.

In addition, for an entity to be a SRE of the accountable entity, it must not itself be an accountable entity (meaning it will unlikely be an entity regulated by APRA), and will need to be “constitutionally covered” as defined by s12 of the Exposure Draft.

Firms will need to review their corporate structures as FAR widens the scope of the accountability obligations to broader than APRA regulated entities.

Who is an Accountable Person?

The FAR is intended to capture the **directors and most senior and influential executives** within the entity. An individual is an Accountable Person if they hold a position in either the accountable entity or the significant related entity and they:



An individual can be an Accountable Person if they hold a prescribed responsibility or position per below. Accountable Persons may also cover multiple accountable entities within a group. In our experience, the prescribed responsibilities are typically allocated across the Board and senior executive team but includes internal audit. Prescribed responsibilities for locally incorporated accountable entities are listed below.

The individual has actual or effective senior executive responsibility:

- For management or control of the accountable entity
- For management or control of a significant or substantial part or aspect of the operations of the accountable entity or the accountable entity's relevant group

Oversight of the entity as a member of the Board , all directors	Control of all business activities , most likely Chief Executive Officer	Financial resources , most likely Chief Financial Officer
Risk management , most likely Chief Risk Officer	Operations , most likely Chief Operating Officer or similar	Information management , most likely Chief Information or Technology Officer
Internal Audit , most likely Head of Internal Audit	Compliance*	Human resources , most likely Head of Human Resources
Anti-money laundering*	Dispute resolution*	End-to-end product , likely CEO of a small entity or Head of a business division of a larger, complex entity
Client/ member remediation*	Breach reporting*	

End-to-end product: Two options

Responsibility	Joint accountability
One individual with end-to-end product responsibility allocated by product (e.g. retail, wholesale)	No
Multiple individuals with responsibility for components of the value chain for the same product (e.g. all steps in the design, delivery and maintenance of all products and services, customer remediation, linkages to IT systems and data quality, outsourcing and incentive arrangements of frontline staff)	Yes



*the senior executive responsible for the development, maintenance and review of the framework

Who is an Accountable Person? (cont.d)

The table below identifies the particular prescribed responsibilities specific to different types of financial institutions.

	ADIs	Insurers	RSEs	NOHCs	Australian branches
Locally incorporated accountable entity prescribed responsibilities	Yes - as set out on page 5	Yes - as set out on page 5 and below	Yes - as set out on page 5 and below	No - limited to the below	No - limited to the below
Prescribed responsibilities that are additional or separate	N/A - covered by the locally incorporated accountable entity prescribed responsibility listing	Actuarial function [^]	Member administration operations [^]	Oversight of the entity as a member of the Board, all directors	Conduct of all activities of an Australian branch, most likely Head of the Branch
		Claims handling function [*]	Investment function [^]	All business activities, most likely Chief Executive Officer	Senior Officer Outside Australia (ADI or insurer only)
			Financial advice services [^]	Financial resources, most likely Chief Financial Officer	All members of the Compliance Committee of an Eligible Foreign Life Insurance Company
			Insurance offerings [^]	Risk management, most likely Chief Risk Officer	Agent in Australia of a Category C insurer as defined under CPS 510
			Internal Audit, most likely Head of Internal Audit		

[^]the senior executive responsible for that function/ service/ offering

^{*}the senior executive responsible for the development, maintenance and review of the framework

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Deferred remuneration obligations under the FAR

The requirement to defer Variable Remuneration (VR) seeks to ensure that Accountable Persons have incentives to promote effective risk management when making decisions, and allows for Accountable Persons to be held to account should those decisions have negative future consequences.

Deferral

Requires accountable entities and their significant related entities to defer 40% of VR for each of their Accountable Persons for at least 4 years.

Remuneration consequence

Requires an accountable entity:

- To have a Remuneration Policy that requires the VR of Accountable Persons to be reduced if they breach their accountability obligations
- not to pay VR that has been reduced
- to take reasonable steps to ensure that their significant related entities comply with the above

The amount of an Accountable Person's VR that is reduced is determined by the accountable entity or significant related entity. The amount reduced must be proportionate to the failure to comply with the person's obligations. It does not need to relate to the period in which the failure occurred, and the Accountable Persons may not have any VR left after the reduction.



An accountable entity must notify the regulator in the event of a reduction of the VR of an Accountable Person

- The FAR applies to VR. That is, remuneration that is conditional on achieving certain objectives (e.g. performance measures, service requirements)
- There is no requirement to include VR in the remuneration package for an Accountable Person
- The requirements apply regardless of which entity in the corporate group pays the remuneration to the Accountable Person
- The deferred remuneration obligations do not apply to an Accountable Person:
 - whose deferred VR is less than A\$50,000
 - while the person is filling a temporary or an unforeseen vacancy, who is not registered or required to be registered under the Regime because they hold the position for <90 days
- The deferral period is intended to be consistent with APRA's proposed prudential standard on remuneration (CPS 511).

Accountability obligations

The FAR imposes the following accountability obligations on both the accountable entity and Accountable Persons. The obligations relate to both conduct-related and prudential matters. Failure to meet these obligations may result in a FAR breach.



Accountable entity

Take reasonable steps to	Conduct its business with honesty and integrity, and with due skill, care and diligence
	Deal with APRA and ASIC in an open, constructive and cooperative way
	In conducting its business, prevent matters from arising that would (or would be likely to) adversely affect the accountable entities prudential standing or prudential reputation
	Ensure that each of its Accountable Persons meets their accountability obligations
	Ensure that each of its significant related entities complies with these obligations



Accountable person

Conduct the responsibilities of their position as an Accountable Person by	Acting with honesty, integrity, and with due skill, care and diligence
	Dealing with APRA and ASIC in an open, constructive and cooperative way
	Taking reasonable steps in conducting those 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
	Taking reasonable steps to ensure the accountable entity complies with the applicable laws

Key personnel and notification obligations

Accountable entities are also required to meet certain key personnel obligations to ensure that all areas of their operations and those of their group are attributed to directors and the most senior and influential executives regulated by the FAR. Accountable entities are also required to notify the Regulators of key changes under the FAR.



Key personnel obligations

Accountable entities must:

- Ensure that the responsibilities of their Accountable Persons collectively cover all aspects of their business including business of their significant related entities. This includes having Accountable Persons who are responsible for all of the applicable prescribed responsibilities
- Ensure that Accountable Persons have not been prohibited by the Regulators
- Ensure that each of its Accountable Persons is registered with the Regulators prior to occupying an Accountable Person role
- Take reasonable steps to ensure that each of its significant related entities complies with the key personnel obligations as if the significant related entity were an accountable entity



Notification requirements

Accountable entities are required to notify the Regulators of the following:

- A person ceasing to be an Accountable Person
- An Accountable Person failing to comply with accountability obligations resulting in the dismissal or suspension or reduction of variable remuneration
- Reasonable belief that an Accountable Person or the entity has breached its key personnel obligations
- A material change occurs to information on the register of Accountable Persons about an Accountable Person (e.g. the registration of a new Accountable Person)



For temporary or unforeseen vacancies, accountable entities will have up to 90 days to register an Accountable Person after that Accountable Person commences their role.



Generally, notifications must be provided within 30 days of the event occurring using the forms approved by the regulator.

Regulatory powers and indemnities

The Regulators have a variety of tools to administer and enforce the FAR. This includes the power to conduct investigations into possible contraventions of the FAR and issuing civil penalties to accountable entities for non-compliance.



Investigation powers

The Regulators have powers to investigate an accountable entity if it believes the entity has contravened the FAR legislation. It is considered an offence to conceal or not provide information relevant to the investigation.



Maximum penalties

The maximum penalties for an entity under the FAR will be the greater of the following:

- 50,000 penalty units (currently \$11.1m)
- 3x the benefit derived and detriment avoided because of the contravention, as determined by the court
- 10% of annual turnover of the body corporate, to a maximum of 2.5m penalty units (currently \$555m)

There are no civil penalties against the individual Accountable Persons, however a civil penalty can be issued against an accountable entity.



Indemnification and privilege

Indemnification

A related body corporate of an accountable entity is prohibited from indemnifying the entity against the consequences of breaching the FAR and from paying insurance premiums to insure the entity from those consequences.

However, there is no restriction applied to the indemnification of or payment of insurance premiums relating to Accountable Persons.

Privilege

A person is unable to refuse to give information or to provide documents on the basis of the privilege against self-incrimination or exposure to a penalty.

However, a lawyer can refuse to comply with the requirement to provide information or to produce a document if doing so would breach legal professional privilege.

Joint administration of the FAR between APRA and ASIC

The Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry recommended to have the extended accountability regime **jointly administered by APRA and ASIC**. The Treasury and Regulators consider that efficient and effective joint administration of the FAR between the Regulators would need to be underpinned by robust collaboration and coordination.

Implementation and registration

Prior to the implementation of the FAR, the Regulators are expected to release joint regulatory guidance to guide and assist accountable entities in the implementation and registration processes and its joint administration. In addition, the Regulators expect to support implementation and registration through:

- Establishing a single portal to receive applications for registration of Accountable Person
- Establishing a single point of contact for accountable entities to raise any queries or requests they may have
- Determining the appropriate form for registration

Decisions that require joint agreement

Powers exercisable at accountable entities level by written notice

- Exemption for inconsistency with corresponding foreign laws
- Any directions powers including direction to reallocate responsibilities
- Disqualification of Accountable Persons

Powers exercisable at class of accountable entities level by legislative instrument

- Extension of time for notification obligations
- Determine content of accountability statements and maps

Powers exercisable at accountable entities level by written notice OR at class of accountable entities level by legislative instrument

- Exclusion of responsibilities from the definition of an Accountable Person
- Extension of time before an Accountable Person is required to be registered for temporary or unforeseen vacancies
- Determination of whether a kind of remuneration is variable remuneration or the valuation of variable remuneration
- Circumstances in which shorter periods for deferred remuneration will be possible



The administration of the FAR over accountable entities that do not hold an Australian financial services licence (AFSL) or Australian credit licence (ACL), their significant related entities and all associated Accountable Persons would generally be exercisable by APRA only.

Things you can do now

Many accountable entities have started to prepare for the implementation of the FAR. We suggest the following:



Move now, get ahead

Have you considered what the FAR will mean for your organisation? Experience from implementing the BEAR suggests the effort should not be underestimated. A great start is APRA's Information Paper on its BEAR post-implementation review.



Multidisciplinary project team

Establish a multidisciplinary team to support the implementation of the FAR. Consider representation from People and Culture, Risk and Compliance, Legal, Company Secretary and the business. Define clear roles and responsibilities.



FAR objectives

What does the organisation want to get out of the FAR? The FAR can be used as more than a compliance exercise with broader business benefits including driving a culture of accountability across the business.



FAR readiness

Have you considered the organisation's readiness? Experience from the BEAR highlighted that ADIs weren't ready. Review key artefacts including organisational and legal entity structures, governance frameworks and executive job descriptions.



Identify accountable entities and persons

Have you reviewed your enterprise-wide legal corporate structure to identify all accountable entities? Have you considered who your Accountable Person population could be? This could be beyond the Directors and Executive level.



Accountability Statements and Maps

Draft Accountability Statements and an Accountability Map to utilise the benefits of FAR - including clarifying accountability, roles and responsibilities. Scenario workshops are effective to explore hand-offs.



Reasonable steps framework

Develop a reasonable steps framework which supports Accountable Persons in the discharge of their accountability obligations and identify gaps to remediate, through the review key policies, processes, frameworks and charters.



Consider remuneration consequences

Does the Board have remuneration adjustment 'tools' to properly hold Accountable Persons to account? Has the Board established frameworks and processes that result in proportionate, timely and consistent financial consequences where warranted?



Communicate effectively

How are you engaging and setting expectations with your key stakeholders to support the FAR? The FAR is a personal regime. Have you considered what support APs will need throughout the implementation to get comfortable?



Managing risk through controls

Have you considered how you will monitor and obtain assurance over the design and operating effectiveness of key controls that mitigate risks that you are responsible for?

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