An update on the Financial Accountability Regime

What does this mean for Insurers

Overview

On 22 January 2020 Treasury released a Paper setting out the Government's proposed model to extend the Banking Executive Accountability Regime (BEAR) to all APRA regulated entities - the Financial Accountability Regime (FAR). This is in response to the Government's commitment to implement recommendations 3.9, 4.12, 6.6, 6.7 and 6.8 of the Financial Services Royal Commission. A link to the FAR proposal paper can be found here.

Similar to the BEAR, the FAR will impose the following:

- accountability obligations;
- key personnel obligations;
- accountability map and accountability statement obligations;
- notification obligations; and
- deferred remuneration obligations.

Timing

Treasury sought submissions and facilitated industry roundtables on the FAR Proposal Paper in February 2020. However, in response to COVID-19, APRA announced that consultations on FAR and other regulatory agendas would be postponed until at least 30 September 2020. Further, the Treasurer announced a six month deferral on the Financial Services Royal Commission Implementation Roadmap which includes FAR.

Given the postponements, it is anticipated that the draft FAR legislation Exposure Draft will be released in early 2021 and presented at the Winter 2021 Parliamentary sitting. While the implementation date remains unknown, it is possible that the implementation date could be 1 January 2022 and ideally align with CPS 511 Remuneration which is to be finalised.

For more information on CPS 511, please see the following link.

From the BEAR…

"By effectively implementing the BEAR, ADIs will genuinely enhance their governance and risk management through much clearer understanding and agreement on individual accountabilities."

Wayne Byres, APRA chairman

…to the FAR

The FAR intends to improve risk culture and governance for both prudential and conduct purposes and will be jointly administered by APRA and ASIC.

Scope of the FAR

Entities subject to the FAR

Beyond all Authorised Deposit-taking Institutions (ADIs) that are subject to the BEAR, the FAR will be extended to all other APRA regulated entities:

- **all general and life insurance licensees;**
- **all private health insurance licensees;**
- all Registrable Superannuation Entities (RSEs) licensees; and
- licensed non-operating holding companies.

Classification of entities

Under the FAR regime entities will be classified as *Core compliance entities* or *Enhanced compliance entities*.

The classification is based on the size and complexity of the entity, with total assets size used as a metric to determine Enhanced Compliance:

- **ADIs and RSE*** - > $10bn
- **Life insurance - > $4bn**
- **General insurance and private health insurers - > $2bn**

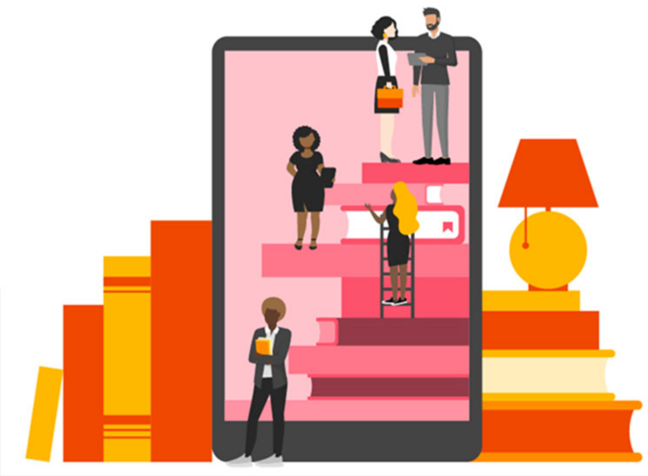
** for RSE, it's the combined total assets of all RSEs under the trusteeship of a given RSE licensee.*

This will replace the small, medium and large classification of ADIs under the BEAR. ADIs will transition to the FAR and be classified as core or enhanced compliance entities depending on size and complexity. Classification under the FAR will drive regulatory obligations.

What does the Financial Accountability Regime mean?

The FAR consultation paper released by Treasury follows similar provisions to BEAR. A summary of the proposed FAR provisions are set out below:

Key area	Requirement under FAR
Executive **Registration** with APRA and ASIC	FAR will be governed by both **APRA and ASIC**. All current **'Accountable Persons'** (APs), which include certain senior executives and all Board members, **are required to be registered with APRA or ASIC**, and need to be advised prior to any future senior appointments. APRA will be able to veto the appointment or reappointment of senior executives and directors.
Obligations: Increased expectations	There are heightened obligations for both the organisation and Accountable Persons. Accountable Persons obligations include: • Act with **honesty and integrity**, and with due **skill, care and diligence**; • Deal with APRA and ASIC in an **open, constructive and co-operative** way; • Take **reasonable steps** to prevent matters arising that would **negatively impact the organisation's 'prudential standing'** or **'prudential reputation'**; and • **Take reasonable steps** in conducting their responsibilities as an accountable person to ensure that the entity complies with **its licensing obligations**.
Accountability mapping	Only **enhanced compliance entities** will be required to provide APRA and ASIC with an **accountability map and individual accountability statements**, showing which Accountable Person is responsible for the various activities of the entity's business. Although **core compliance entities** will not be required to submit accountability statements and maps, APRA and ASIC can request these at any time. It is expected that the core compliance entities undertake a process to identify and register their accountable persons to cover all aspects of their business.
Particular responsibilities	The FAR Proposal Paper includes an **indicative list of particular responsibilities**. Entities **need to allocate the particular responsibilities to their Accountable Persons population.** The particular responsibilities form the basis for drafting the accountability map and individual accountability statements.
APRA powers over **Remuneration** policy and Remuneration deferral	All **core compliance and enhanced compliance entities will be required to defer 40% of executives variable remuneration for at least four years**. All entities will be required to have a **remuneration policy that allows for a reduction in variable remuneration**. It is unclear at this stage whether there will be a prescriptive requirement around the reduction that should be applied. Further, under CPS 511, all entities will need to comply with the heightened requirements including for deferred remuneration arrangements. For a deeper look into the impact FAR will have on remuneration please see our separate publication here.
Sanctions: Penalties for the organisation and individual Accountable Persons	**The maximum penalties for an entity under the FAR** will be the greater of the following: • 50,000 penalty units (currently $10.5m) • 3x the benefit derived or detriment avoided by the body corporate because of contravention • 10% of annual turnover of the body corporate, to a maximum of 2.5m penalty units (current $525m) Similar to BEAR, **APRA has disqualification power to remove an individual from their role** and in extreme cases, prevent them from taking any similar role in the industry in the future. Unlike BEAR, **Accountable Persons will be liable for civil penalties** under the FAR. The **maximum penalties** will be the greater of: • 5,000 penalty units (currently $1.05m); and • 3x the benefit derived or detriment avoided because of the contravention.



Regulatory investigations

APRA announced on 17 June 2020 that it commenced an investigation in December last year into possible breaches of the Banking Act 1959 (including the BEAR) by Westpac, its directors and senior executives following allegations by AUSTRAC that Westpac failed to monitor and report millions of international fund transfer instructions. This is the first publicly announced investigation under BEAR. ASIC is also investigating certain conduct in connection with the matters alleged by AUSTRAC in its proceeding against Westpac. ASIC will consider whether the conduct that it is investigating also gives rise to contraventions of the accountability obligations under the BEAR and standards of fitness and propriety under the Banking Act. The investigations further reinforce the importance of Reasonable Steps and the need to have an effective framework in place to support an Accountable Person(s) in discharging their accountability obligations.

Calls to action – Financial Accountability Regime

In the absence of draft legislation and implementation timeframes, below are some ‘no regrets’ activities that insurers should consider to ensure they are well prepared for the implementation.

What does COVID-19 mean for FAR?

What does the FAR look like in a post COVID-19 environment? How does this align with the broader strategy or the organisational changes you may be implementing? What impact does the new way of working have on the FAR, governance arrangements, risk and control processes, delegation and supervision and the demonstration of reasonable steps? A strategic review should incorporate FAR as it clarifies roles and responsibilities even within agile and dynamic environments.

Move now, get ahead

Have you considered what the FAR will mean for your organisation? Have you reviewed the entity structure and governance arrangements? Experience from implementing the BEAR suggests the effort should not be underestimated.

Identify Accountable Persons population

Have you considered who your accountable person population could be? Where does accountability and authority reside? This could be beyond the Directors and Executive level.

Accountability Statements and Maps

Drafting Accountability Statements and an Accountability Map to utilise the benefits of FAR - including clarifying accountability, roles and responsibilities. You do not need to wait for FAR to be implemented to start this.

Reasonable steps framework

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

Consider your remuneration consequence framework

Have you considered how your remuneration framework allows you to enforce accountability via outcomes? For example, reduction to in-year outcomes or adjustments to future unvested awards / past awards.

Communicate effectively

How are you engaging and setting expectations with your key stakeholders to support FAR? How will FAR be communicated across the entity? Consider establishing a FAR project team to help obtain Executive buy-in and sponsorship.

Managing risk through controls

Have you considered who is giving assurance as to the design and operating effectiveness of key controls that mitigate risks that you are responsible for?

Effectiveness review

How will you measure success?

Develop the framework for an effectiveness review focused on: Framework design, outcomes - leader/employee experience and oversight / governance.

Contacts

Please reach out to any of the below contacts should you wish to obtain further information on the proposed FAR.

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