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Financial Accountability Regime proposals paper

Treasury published 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) on 22 January 2020. This is in response to the Government's commitment to implement the recommendations 3.9, 4.12, 6.6, 6.7 and 6.8 of the Financial Services Royal Commission.

The proposal paper sets out the principles to be implemented under FAR but the regulatory text has not yet been released.

In terms of next steps, the Government will:

- seek submissions on the proposals set out in its proposal paper, by **14 February 2020**,
- introduce legislation by the **end of 2020** (no effective date specified), and
- separately consult on extending the regime to entities solely regulated by ASIC, in line with the further commitment the Government made in response to the Royal Commission.

A link to the FAR proposal paper can be found here.

Overall, the proposal provides clarity on the requirements to be implemented and how FAR intends to improve risk culture and governance for both prudential and conduct purposes - through an increase in the number of roles and responsibilities required to be identified as Accountable Person (AP). In addition, this intent will be supported through the deferred remuneration obligations, that ADIs will need to again consider as part of the transition to FAR, given the differences between the proposal model and the current BEAR obligations.

The FAR will be jointly administered by APRA and ASIC. There are penalties for both entities and individuals if they contravene their FAR obligations.

Proposed FAR remuneration requirements

The table below sets out a summary of the key remuneration requirements proposed under FAR and our observations:

	Summary of FAR requirements	PwC's observations
Entities in scope of FAR	- all ADIs that are already subject to the BEAR; - all general and life insurance licensees; - all private health insurance licensees; - all RSE licensees; and - licensed non-operating holding companies (NOHCs).	The wording in the consultation paper suggests that ultimately FAR will replace the BEAR. Given the differences in requirements between FAR and BEAR (see below), it is proposed that transitional arrangements will apply to ADIs. In addition, the organisations in scope of FAR extend further than the Royal Commission's initial recommendations, i.e. private health insurance licensees and NOHCs.
Classification of entities	FAR entities will be split into 2 categories - Core and Enhanced Compliance for accountability statements and map obligations. This replaces the small, medium and large classifications of ADIs under the BEAR. The classification is based on the size and complexity of the entity, with total assets size used as a	The number of categories has reduced from 3 under BEAR (large, medium, and small) to 2. For ADIs, this essentially means there will be no differentiation between small, medium and large ADIs. No definition of "total assets" was included in the proposal paper and it is unclear whether the criteria under BEAR continues to apply, namely: - total assets are measured as 3-year average - only resident assets are in scope of the definition.

	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.*	
Deferred remuneration obligations	All entities will be subject to the same deferred remuneration obligations, regardless of their classification. 40% of the variable remuneration for at least 4 years, if the amount that would be deferred under the FAR is greater than A\$50,000.	The key changes between the proposed requirement and that under BEAR are: - the removal of the total remuneration test (i.e. lesser of 40-60% of variable remuneration or 10-40% of total remuneration; - the simplification of deferral proportion requirements with the same deferral % now required across all FAR categories; and - for large ADIs, removal of the differentiated % deferral requirements between CEO and other APs. Although the requirement is simpler, this will likely have an impact on ADIs (mostly smaller ADIs) who have relied on the total remuneration test to determine the deferred amount - deferring the equivalent of 10% of their total remuneration as it was typically less than 40% of variable remuneration. In addition, removing the total remuneration test may mean that organisations have more options in how they implement longer deferral periods and compete for talent. For example, it may lead to an upward pressure on remuneration quantum and/or changes to the pay mix with a shift towards fixed pay.
Remuneration consequence	Requirement for companies to have remuneration policies that allow for a reduction in variable remuneration if an AP breaches their FAR obligations.	Although the requirement to apply remuneration consequence is consistent to BEAR, it is unclear, in the absence of proposed regulatory text, whether the prescriptive requirement around reduction in variable remuneration, i.e. to be proportionate to the failure, and may be down to zero, as set out under BEAR will remain.
Interaction with APRA's draft Prudential Standard CPS 511	Entities will need to comply with the requirements set out under CPS 511, including deferred remuneration obligations.	The proposal acknowledged the heightened remuneration requirements set out in the draft CPS 511 and made clear that the relevant entities (i.e. significant financial institutions) will be required to comply with these (including deferral).

Implementation

The proposal does not set out an effective date for FAR. However, it notes that the Government intends to introduce legislation by the end of 2020 and intends to consult on timeframes as part of the consultation on the exposure draft legislation.

If the legislation is introduced by the end of 2020, it is possible that the application date of FAR will align to that proposed for CPS 511 **- 1 July 2021**. And if the implementation approach follows that of BEAR (i.e. legislation applies to all payments on or after the application date), this will likely require companies to ensure the remuneration policies comply with FAR so that payments from 1 July 2021 satisfy the requirements.

How can PwC help?

To have a deeper discussion about these issues, please contact:

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