KING&WOOD MALLESONS
金杜律师事务所

Level 27
Collins Arch
447 Collins Street
Melbourne VIC 3000
Australia

T +61 3 9643 4000
F +61 3 9643 5999

www.kwm.com

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To Committee Secretariat
Senate Standing Committees on Economics
PO Box 6100
Parliament House
Canberra ACT 2600
By email: economics.sen@aph.gov.au

Submission – Financial Accountability Regime Bill 2021

King & Wood Mallesons is pleased to provide this submission to the inquiry of the Senate Economics Legislation Committee (the **Committee**) in relation to the *Financial Accountability Regime Bill 2021* (the **FAR Bill**) and related bills.

We have previously made a submission in relation to the exposure draft of the FAR Bill, and associated materials, presented by Treasury for consultation earlier this year. While the revised FAR Bill addresses some of the concerns raised in our previous submission, we remain particularly concerned that certain aspects of the FAR Bill give rise to unintended adverse consequences on entities and individuals who are not properly the subject of a financial services accountability regime, or which give rise to unnecessary ambiguity as to the potential liability position of affected individuals (namely, civil penalties for individuals due to ancillary liability). We are also concerned about the ongoing ambiguity as to which executives will be subject to the regime as "accountable persons", as well as regarding the proposed timing for implementation.

1 Extension of FAR to "significant related entities" of RSE licensees

At a high level, the FAR Bill provides that a body corporate will in most circumstances be a "significant related entity" of an RSE licensee where:

(a) it is a "connected entity" of the RSE licensee; and

(b) it has (or is likely to have) a material and substantial effect on the accountable entity or its business or activities,

in which case the "significant related entity" (and certain accountable persons associated with that entity) will indirectly be required to comply with various obligations under the FAR Bill. The "accountable entity" (i.e., the ADI, RSE licensee or insurer that is relevantly regulated by APRA) will bear an obligation to ensure compliance by the "significant related entity" and in some cases by its "relevant group".

In our view, the broad approach to "connected entities" and thus "significant related entities" of RSE licensees (including when combined with the extension of certain obligations to the "relevant group" of

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the accountable entity) will substantially increase the regulatory impact of FAR without achieving the regulatory benefits intended by the FAR Bill or the Financial Services Royal Commission.

These provisions will be particularly problematic for RSE licensees that are part of a larger corporate group. This is a common arrangement for businesses that operate have their own "in-house" superannuation fund for the benefit of their staff (and in some cases, other non-staff participants). The corporate groups in question are typically not financial services businesses and would not otherwise fall within the remit of FAR.

In these circumstances, while the RSE licensee is typically a separate entity, it often uses shared services from other entities within the corporate group (e.g., finance, accounting, human resources, and similar back-office functions). Entities that are involved in providing those services may, under the current drafting of the FAR Bill, be captured by the "connected entities" definition, including parent companies and related party service providers (e.g., sister companies), and may be "significant related entities" because of their involvement in the provision of those back-office services.

The proposed regime will therefore extend FAR well beyond its originally intended scope by applying accountability obligations to businesses and individuals who are not, in any meaningful sense, involved in a financial services business.

Further, the proposed legislative provisions have the consequence of subsidiaries (and potentially multiple subsidiaries) being responsible for ensuring their parent and sister companies comply with FAR – notwithstanding that they may have no ability to do so and that their parent entities are not regulated.

In addition, the senior executives of those service provider entities may be required to be registered as "accountable persons" and have their remuneration subject to regulation under FAR. This could affect, for example, the CFO, CRO or head of HR in a major corporate, which is not regulated by APRA and with no financial services business, but which has a corporate super scheme.

It could also affect senior executives of financial services groups that have subsidiary RSE licensees, but who are not otherwise required to be registered under FAR. The proposed regime therefore also creates a competitive disadvantage for RSE licensees who are part of a broader corporate group compared to stand alone RSE licensees.

In our view, this issue could be addressed by requiring one group executive with general management responsibility for the RSE licensee to be an accountable person, in addition to the directors and management of the RSE licensee itself to whom the FAR requirements would already apply. This would be directly analogous to the regime that applies to foreign banks, where the "senior officer outside Australia" is required by APRA to be an accountable person.

2 Civil penalties should not be imposed on individuals without fault

The FAR Bill no longer contains "direct" civil penalties for breaches by accountable persons – with the BEAR liability regime of potential disqualification and/ or remuneration consequences applying. It does, however, impose "ancillary" civil penalties on individuals involved in a contravention by the accountable entity (e.g., where a person attempts, aids, abets, procures, induces, conspires with others to effect, or is in any way knowingly concerned in, a contravention of a civil penalty provision).

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Notably, of the Bill provides that section 94 of the *Regulatory Powers Act (Standard Provisions Act) 2014*, which deals with a person's state of mind in relation to a contravention of a civil penalty provision, does not apply such breaches. Section 94 provides that in proceedings for a civil penalty order against a person for a contravention of a civil penalty provision, it is not necessary to prove the person's intention, knowledge, recklessness or negligence.

We understand the intention is that, in the absence of section 94, common law principles applicable to aiding, abetting, and similar should apply (in the same manner as these concepts apply to equivalent provisions under the Corporations Act); however, this is not clear from the Bill or associated explanatory materials.

We think this issue can be addressed if civil penalties could only be imposed on individuals who have been involved in a contravention by the accountable entity (in the circumstances as described in the FAR Bill), and who have also acted dishonestly, intentionally or recklessly. We think this is the intention and at the very least should be confirmed in the Explanatory Memorandum for the FAR Bill.

Put simply, civil penalties should not be imposed without intent and this should be put beyond doubt in the explanatory materials. Failures in skill (i.e., lack of due diligence) are dealt with under the existing FAR provisions and other applicable laws.

3 Continued overlap and 'stepping stones' risk with obligations on individuals to ensure compliance with financial services laws

The exposure draft legislation originally proposed a new "accountability obligation" which would require accountable persons to take "*reasonable steps…to ensure that the accountable entity complies with*" a long list of financial services laws, including FAR itself, the Banking Act, the Insurance Act, the Private Health Insurance (Prudential Supervision) Act and the Superannuation Industry (Supervision) Act, and other financial services laws including as specified under the Corporations Act.

The revised obligation, as set out in the current FAR Bill, is now to take "*reasonable steps in conducting those responsibilities to prevent matters from arising that would (or would be likely to) result in a material contravention by the accountable entity*" of the financial services laws.

The explanatory memorandum notes that "*occasional minor or technical contraventions*" are not intended to be caught, but repeat occurrences could indicate a systemic issue of non-compliance which could amount to a material contravention. The explanatory memorandum also notes that an accountable person would only be required to take reasonable steps to ensure compliance by the accountable entity in relation to the financial sector laws relevant to their area of responsibility.

While we welcome the changes that have been made to the original drafting, we remain concerned that this is essentially an obligation to comply with existing obligations. Accountable entities themselves are already required to comply with these laws by virtue of the underlying laws themselves, as well as by virtue of their Australian financial services licences and credit licences. Further, overseeing the entity's compliance with law is already a part of each accountable person's ordinary managerial responsibilities and their existing obligation to carry out their responsibilities with due skill, care and diligence, particularly in combination with sections 22(c) and (d) which expressly deal with identifying and responding to issues and non-compliance. Specific compliance accountabilities are also carried by the designated compliance Accountable Person.

While we note the expectation that accountable persons will oversee compliance with law within their respective areas of responsibility, we submit that this is already adequately captured by accountable persons' existing legal and managerial obligations and that the introduction of section 21(d) in its present form is redundant and does not achieve the FAR's objectives.

4 Prescribed "accountable person" roles continue to require clarification

The consultation materials released in July 2021 included the "Financial Accountability Regime – List of prescribed responsibilities and positions – Policy Proposal Paper", which set out the Government's proposal regarding the responsibilities and positions that should result in a person being an Accountable Person. The FAR Bill provides for these matters to be addressed in the Minister Rules, which have not yet been released for consultation. We understand the Committee is continuing to assess this approach.

Given the material concerns raised by businesses to date in connection with the prescribed responsibilities and positions, we recommend that the Minister Rules be released in draft for consultation prior to the passage of the Bill.

5 Timing

The FAR Bill is expressed to apply to ADIs from the later of 1 July 2022 or the date that is 6 months after the commencement of the Act. If the latter approach applies (due to a delay in the passage of the FAR Bill) then we note that there is a possibility that obligations could begin applying to ADIs mid-month. To assist in business certainty and smooth the transition, we would recommend that the obligations begin to apply from the first day of a calendar month.

We would be pleased to discuss any aspect of this submission further at your convenience. Our contact details are set out below.

Kind regards

Diana Nicholson | Partner
King & Wood Mallesons
[redacted]

Tim Bednall | Partner
King & Wood Mallesons
[redacted]

Rebecca Williams | Senior Associate
King & Wood Mallesons
[redacted]