SUBMISSION

# Submission to Treasury — Financial Accountability Regime (FAR)

14 February 2020

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Manager
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Treasury
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Via email: FAR@treasury.gov.au

14 February 2020

Dear Sir/Madam

**Financial Accountability Regime (FAR)**

The Association of Superannuation Funds of Australia (ASFA) is pleased to provide this submission in response to Treasury's consultation on the Financial Accountability Regime (FAR).

**About ASFA**

ASFA is a non-profit, non-political national organisation whose mission is to continuously improve the superannuation system, so all Australians can enjoy a comfortable and dignified retirement. We focus on the issues that affect the entire Australian superannuation system and its $2.9 trillion in retirement savings. Our membership is across all parts of the industry, including corporate, public sector, industry and retail superannuation funds, and associated service providers, representing almost 90 per cent of the 16 million Australians with superannuation.

If you have any queries or comments in relation to the content of our submission, please contact Maggie Kaczmarska, Senior Policy Advisor, on (02) 8079 0849 or by email mkaczmarska@superannuation.asn.au, or Glen McCrea on (02) 9264 9300 or by email gmccrea@superannuation.asn.au.

Yours sincerely

Glen McCrea
Deputy CEO and Chief Policy Officer

# Executive Summary

ASFA supports the Government's intent to increase the overall accountability within RSE licensees. As Commissioner Hayne mentioned in the final report to the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry (Royal Commission), proper governance of a superannuation fund is critical to the fund's performance.

There are, however, a number of concerns ASFA would like to raise in relation to the proposed Financial Accountability Regime (FAR):

- ASFA remains concerned about the level of discretion the FAR will provide to regulators in determining the how the regime will apply to RSE licensees.
- The inconsistencies between APRA's proposed prudential standard CPS 511 and the proposed FAR legislative provisions.
- ASFA believes there should be more consideration of the practical implications of some of the proposals under FAR. This includes, for example, the need for organisational changes if FAR does not accommodate joint accountability and the significant deterrents FAR creates in attracting talent to the superannuation industry.
- There is need for absolute clarity in the use of powers that the FAR provides to regulators. For example, APRA's use of the veto power can have a significant impact on both the individual and the entity and, as such, transparency in its use is critical.
- The list of obligations largely replicates existing fiduciary duties and legislative obligations already executed by RSE licensees, creating unnecessary duplication.

## Scope of the regime

The metric used to classify RSE licensees as either core compliance entities or enhanced compliance entities differs from APRA's proposed prudential standard CPS 511. While the terminology differs between CPS 511 (significant financial institution) and the proposals paper (enhanced compliance entity), ASFA understands that the intent is largely similar. For consistency, and to reduce the differences between the legislative and regulatory provisions, the metrics used to identify an 'enhanced compliance entity' and a 'significant financial institution' should be identical.

The Minister, APRA and/or ASIC are proposed to have the power to exempt further entities or classes of entities from the regime. There is need for absolute transparency around the circumstances in which an entity would be exempt from all of the FAR's requirements, both legislative and regulatory. The steps in the decision-making process should be publicly available, as well as the reasons used in exempting particular entities from the regime.

Further clarity is required around the movement between a 'core compliance entity' and an 'enhanced compliance entity'. In the categorisation of entities, it would beneficial to understand:

- The transition period for movement between the 'enhanced compliance entity' to a 'core compliance entity' categories. Given the compliance requirements for an 'enhanced compliance entity' are more onerous, it would be valuable to have a longer transition period to move to the 'enhanced compliance entity' category rather than moving to the 'core compliance entity' category. For example, will a newly classified 'enhanced compliance entity' be required to immediately submit their accountability statements?
- The criteria regulators will use to determine when to re-classify entities. Similarly to what was mentioned above, it would be beneficial to align the criteria with APRA's CPS 511 classification of 'significant financial institution'.
- Where an entity has moved beyond the metric threshold for an 'enhanced compliance entity', is the onus on the entity to inform the regulators that they now need to be classified as an 'enhanced compliance entity'?

### Indicative list of particular responsibilities

Of the particular responsibilities listed in Attachment B, there are a number that overlap. There is need to clarify the differences between similar responsibilities. Additionally, some of the responsibilities listed may be attributed to more than one person. There is need for the regulators to provide practical descriptions of each responsibility to ensure entities are able to clearly identify the persons accountable for them.

For example, there is likely to be significant overlap between product responsibility and service responsibility. Another example is whether responsibility for an entity's operations refers to investment operations and/or member operations.

The responsibility for the setting of incentives is, generally, not accountable to one person. Outward facing and internal facing incentives tend to be the responsibilities of different areas within an RSE licensee. Internal incentives, for example, tend to be within the remit of the human resources function. Outward facing incentives could be within the remit of the distribution or product functions.

There is need for clarity as to whether responsibility for breach reporting refers to breaches of all regulatory obligations, and whether it is the responsibility to report breaches or to make the decision to report a breach under a licence.

Overall, there is need for guidance in situations where there may be joint accountability for a responsibility as listed in Attachment B.

### Product responsibility

The responsibility for end-to-end management of a given product or product group is very broad. Generally, end-to-end product responsibilities are not aligned to one single senior executive. Each product has a number of components. Each component may have a single accountable person with the requisite expertise and decision-making authority allocated to it. If joint accountability for products is not accepted by the regulators, it will require RSE licensees to make significant changes to their entire organisational structure.

As with all accountabilities, there are handoff points. So long as these points are clearly identified, it is difficult to understand the need to assign end-to-end accountability for products to a single person. This change will require organisations to completely restructure, even when their current business structure is delivering member outcomes.

Given products are responsible for providing a significant number of members with retirement savings, it would potentially remove the opportunity for checks and balances on decision making if only one person was accountable for a product. Joint accountability is required not only because an effective product requires consideration of a number of components, and the requisite expertise in each component, but also because it provides governance checks and balances in the management of the product.

Given the FAR will capture roles that are accountable for the operations of an organisation, product accountability will be captured by FAR already without the need for one person to be accountable for a product.

If the decision is made to continue with the end-to-end product responsibility, it would be beneficial to align the obligations of the responsibility to the design and distribution obligations (DDO) that are expected to come into effect in April 2021. As mentioned in the Proposals Paper, the Royal Commission's concern centred on adverse customer experiences and outcomes. The DDO regime requires financial product firms to develop products that meet the needs of the consumers in their intended target market. Given the FAR is intended to be a dual regulated regime, it would create efficiencies to align the obligations for the responsibility to the existing DDO.

## Accountability and key personnel obligations

RSE licensees are already subject to a number of existing legislative obligations and fiduciary duties. The fiduciary role of a superannuation trustee requires trustees to broadly:

- Comply with the trustee deed governing the superannuation fund
- Act in the best interests of fund members
- Resolve conflicts of interest or duty by giving priority to members' interest, and
- Exercise a prudent degree of care in investing the fund assets.

In addition to these, superannuation trustees are subject to mandatory covenants under the *Superannuation Industry (Supervision) Act 1993* (SIS Act). For example, section 52A of the SIS Act identifies the duties that apply to individuals who are directors of corporate trustees of RSE licensees. Some of these duties include the duty to act honestly in all matters concerning the entity and to perform directors' duties in the best interests of the beneficiaries. Both the duties under general law and the SIS Act are an essential part of the environment in which a superannuation trustee's governance framework must operate and differentiates Trustee Boards from public company boards.

The proposed FAR obligations largely duplicate existing duties that RSE licensees currently execute. Where the FAR obligations replicate what is currently required of RSE licensees, ASFA recommends the same language be used to outline obligations to avoid confusion in interpreting another set of duties. Alternatively, direct reference to existing duties (as opposed to a new list of duties/obligations) would preferable.

How the accountability obligations interact with the existing obligations as a Responsible Manager and/or director requires clarity. Wherever possible, it would create significant efficiencies and decrease unnecessary duplication to refer or replicate exactly already existing duties/obligations/responsibilities.

Clarity is also required on the interpretation of the obligation to deal with the regulators 'in an open, constructive and cooperative way'. Under current obligations trustees are required to cooperate with regulators and fulfil their regulatory functions in order to operate as an RSE licensee. It is a part of their licensing requirements. It would be beneficial to understand how this differs from existing obligations.

In the fourth accountable person obligation, the terms 'prudential standing' and 'prudential reputation' are not defined. It would be beneficial to understand what these terms mean. The terms 'prudential standing' and 'prudential reputation' can be difficult to measure. To judge whether this is adversely affected requires significant subjectivity and judgement.  Additionally, it would be beneficial to specify that the obligation only extends to a person's operations/accountability remit (i.e. what is in their capacity to influence/control).

In the fifth accountable person obligation, mention is made to ensuring that an entity complies with its licensing obligations. This largely replicates the first obligation which, in turn, replicates similar obligations already enshrined in law. While it is important that every accountable person complies will all licensing obligations, penalties for breaching this accountability might be overly punitive if there is no materiality threshold. They may be a breach of a licensing obligation that may not be significant, but the accountable person took reasonable steps to prevent the breach from happening. There would still be a possibility that the accountable person would be liable for a penalty and possibly disqualified.

ASFA welcomes the extension of the timeframe to register individuals filling temporary vacancies from the current 28 days to 90 days.

## Deferred remuneration obligations

There are a number of proposals relating to deferred remuneration that do not align with the requirements in APRA's proposed CPS 511. While ASFA understands that there is general acceptance that complying with CPS 511 would be considered complying with FAR legislative obligations, this needs to be absolutely clear both in regulation and legislation.

There are also different categories within CPS 511 compared to the proposed FAR provisions. As mentioned above, it would be beneficial to have one 'enhanced' compliance category for entities that is used across both prudential regulation and legislation. There is merit in removing the category of 'senior managers' in CPS 511 and leaving accountable persons as the only category in both CPS 511 and legislation to minimise complexity.

Guidance is required to understand how remuneration obligations may differ for temporary/acting accountable persons. For example, will remuneration obligations be commensurate with the amount of time a temporary accountable person has been in the role? To decrease the administrative burden, a time threshold could be used to determine whether the remuneration should be deferred. For example, if a person has been an accountable person in a particular role for less than six months then their remuneration does not need to be deferred.

How remuneration deferrals are to be calculated will also require clarity. For example, it may be that an accountable person has accountabilities across a number of entities. Will this impact how remuneration deferral is to be calculated for this individual? The date at which the deferral of variable remuneration is calculated will also require clarification. It would be an efficient outcome for FAR to allocate the start of the financial year as the calculation date for all variable remuneration.

Also, if an accountable person were to breach FAR, there is need for guidance on the amounts of their variable remuneration that should be reduced. That is, the factors that the entity will need to consider in calculating the reduction and case studies that step through how it is to be calculated.

Broadly, there needs to be alignment between the legislative provisions and prudential regulation in all aspects. This includes, for example, the definition of 'variable remuneration' and categorisations.

## Accountability maps and statements

ASFA welcomes the requirement for joint regulatory guidance on the preparation and content required for accountability maps and statements. This will help ensure consistency and decrease the need for duplicative efforts of entities.

ASFA also welcomes the change from 14 days in the current BEAR to 30 days for the regulators to be notified of any material changes. Where an entity is regulated by both ASIC and APRA, it would create efficiencies to only submit the updated statement and/or map once to either regulator.

## Notification obligations

In relation to breach reporting, ASFA understands that Treasury will be considering feedback received from the current consultation on strengthening breach reporting arising from recommendations made in the Royal Commission.

ASFA recommends there be a materiality threshold for the reporting of breaches to avoid significant compliance costs for entities and the relevant monitoring costs. There is potential that APRA will be flooded with relatively minor breach reports.

It would be valuable to have case studies and examples within FAR's Explanatory Memorandum identifying what a breach of FAR looks like and whether it will be required to be reported.

## Penalties

While having individual consequences for breaches of FAR could encourage individual accountability, it may have a significant impact on the ability of APRA-regulated entities to attract talent. This will include talent from entities that sit outside the regulatory remit of APRA, as well as global talent that may find the possible imposition of penalties, as well as the restrictions around the awarding of remuneration, as reasons not to take a role within the Australian financial services sector.

The proposed penalties are also not dependent on an individual's remuneration. Perhaps for higher earning accountable persons, the penalties might not be such a deterrent from undertaking a position. For other roles that do not have a high salary, the possible imposition of individual penalties is likely to strongly deter individuals from taking those roles.

A clear decision procedure to determine when a penalty will be imposed, and the amount of penalty, will help identify the principles in which the regulators will apply in determining a penalty. This will allow entities to understand exactly what compliance risks to look out for.

The imposition of individual penalties could have consequences on the remuneration expectations of accountable persons and could, by extension, be a cost to members. Individual penalties could also have the consequence of stifling innovation and reducing the desire of individuals to drive taking measured business risks. Many might not want to 'rock the boat' for fear that an innovation may not be as effective as imagined and will therefore result in the imposition of individual penalties.

In the first instance, ASFA recommends penalties be applied to entities for FAR breaches rather than individuals. Individual penalties could be considered at a later stage if the FAR is not having the impact that was intended. There is no question that RSE licensees should, and are, accountable to their members. The comprehensive duties RSE licensees have to their members is already enshrined in law and regulation and the FAR provisions applying to RSE licensees should be considered in this context.

## Non-objections power

As APRA is proposed to have the non-objections power to veto, there is a question as to how this will interact with ASIC's 'fit and proper' test. For example, will the same test be applied, a similar test, or the fit and proper test as well as additional assessments as determined by APRA. Clarity is required on exactly how APRA will determine when to use this power.

Where APRA exercises the power to veto, there is need to provide clear reasoning to both the entity and the individual in question. The use of the veto power can have a significant impact on both the individual and the entity and, as such, absolute transparency in its use is critical.

There is also a question as to whether the non-objections power applies to temporary vacancies / appointments and the re-appointment of the same individual person as an accountable person.

## General comments

ASFA remains concerned about the level of discretion the FAR will provide to regulators in determining the how the regime will apply to RSE licensees. While the proposed legislation will provide a general framework in which the FAR will be developed, APRA and ASIC will largely be responsible for both administering and designing the details of FAR.

Legislation is subject to debate as part of the Parliamentary process before it becomes law. While the regulators do consult before publishing regulation, it is not subject to the same vigorous debate that occurs in Parliament. ASFA is concerned that the decisions made by the regulators in the exercise of their powers as conferred under FAR will not be transparent. Given decisions will be made around such matters like whether an entity is subject to FAR or whether a person can be registered as an accountable person, it is absolutely vital that these decisions are made transparently and in accordance with a clear, publicly available criteria.