Law Council
OF AUSTRALIA

Financial Accountability Regime – Exposure draft legislation

Treasury

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Table of Contents

About the Law Council of Australia

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The Law Council advises governments, courts and federal agencies on ways in which the law and the justice system can be improved for the benefit of the community. The Law Council also represents the Australian legal profession overseas, and maintains close relationships with legal professional bodies throughout the world.

The Law Council was established in 1933, and represents 16 Australian State and Territory law societies and bar associations and the Law Firms Australia, which are known collectively as the Council's Constituent Bodies. The Law Council's Constituent Bodies are:

- Australian Capital Territory Bar Association
- Australian Capital Territory Law Society
- Bar Association of Queensland Inc
- Law Institute of Victoria
- Law Society of New South Wales
- Law Society of South Australia
- Law Society of Tasmania
- Law Society Northern Territory
- Law Society of Western Australia
- New South Wales Bar Association
- Northern Territory Bar Association
- Queensland Law Society
- South Australian Bar Association
- Tasmanian Bar
- Law Firms Australia
- The Victorian Bar Inc
- Western Australian Bar Association

Through this representation, the Law Council effectively acts on behalf of more than 60,000 lawyers across Australia.

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- Mr Greg McIntyre SC, Executive Member
- Ms Caroline Counsel, Executive Member

The Chief Executive Officer of the Law Council is Mr Michael Tidball. The Secretariat serves the Law Council nationally and is based in Canberra.

Acknowledgement

The Law Council is particularly grateful for the expertise of each of the Corporations Committee and the Financial Services Committee of its Business Law Section and the Superannuation Committee of its Legal Practice Section in leading the development of this submission.

Introduction

1. The Law Council makes this submission in relation to the exposure draft Financial Accountability Regime Bill 2021 (**Bill**) and related materials released for consultation by Treasury on 16 July 2021 (**Consultation Materials**) which propose to impose a financial accountability regime (**FAR regime**) on certain financial entities.

2. References to sections in this submission are to sections of the Bill unless otherwise indicated.

Overview

3. In summary:

   - the Law Council's primary submission is that the optimal way to achieve the dual objectives of implementing the recommendations of the Royal Commission into Misconduct in the Banking and Financial Services Industry (**Royal Commission**) and consistency with the Prime Minister's and Government's deregulatory agenda is to extend the Banking Executive Accountability Regime (**BEAR**) set out in Part IIA of the *Banking Act 1959* (Cth) (**Banking Act**) which currently applies to authorised deposit-taking institutions (**ADIs**) in its existing form to the other types of entity which are regulated by the Australian Prudential Regulation Authority (**APRA**);
   - if that primary submission is not accepted, the next best alternative would be to remove aspects of the proposals which would add cost, and divert effort from growth and job creation, without a proportionate regulatory benefit. It would also be necessary to resolve some inconsistencies between FAR and the superannuation and insurance legislation. The Law Council has detailed below some of these for registerable superannuation entity (**RSE**) licensees with the benefit of the expertise of our Superannuation Committee;
   - the respective roles of APRA and the Australian Securities and Investments Commission (**ASIC**) should be clarified well ahead of the initial implementation of FAR; and
   - as the statutory review of BEAR is due to be conducted, the Law Council considers that it would be beneficial for that process to be completed so that the development of the FAR legislation can be as well informed as possible.

Primary submission – optimal approach is to extend BEAR in its existing form to other APRA regulated entities

4. The Government committed in 2019 to implement all the recommendations of the Royal Commission. These included recommendations extending the BEAR to RSE licensees and APRA-regulated insurers.

5. Much has changed since early 2019, when the Government issued its response to the Royal Commission recommendations:

   - Banking culture has improved. BEAR itself – which was in place before the final report of the Royal Commission was issued – has been in place since 1 July 2018 (for large ADIs) and 1 July 2019 (for other ADIs). Both BEAR and other measures taken by the banks in the light of the Financial Services Royal Commission have had a positive impact on bank culture and behaviours.[1]

- The pandemic arose. This continues to pose substantial challenges for the community, business and the Government. The fact that Australian banks have been, and remain, in a position to accommodate customers affected by the pandemic underlines the importance of strong banks and other financial institutions to the Australian economy.
- Recognising the critical importance of rebuilding the economy following the pandemic, the Prime Minister's office has implemented Australia's Deregulation Agenda[2], directed to efficiently implementing regulation, reducing regulatory barriers to make it easier for business to grow and create jobs. Treasury's role is integral to the economic recovery plan.

6. In that context, the question arises how Treasury can best fulfil two key objectives:

   (a) the commitment to implement the Royal Commission recommendations; and

   (b) the Prime Minister's, and the Government's deregulation agenda.

7. The Law Council submits that the optimal way to fulfil both of these key objectives is to extend BEAR in its existing form to the superannuation and insurance entities contemplated in the FAR proposals.

8. It is encouraging that, in the Bill Treasury has lessened some of the onerous features of the earlier FAR proposals in a way which is consistent with the deregulation agenda, including:

   - removing the proposal to impose civil penalties on individuals;[3] and
   - allowing flexibility for corporate groups to implement aspects of FAR on a group basis, which should help mitigate inefficiency and duplication in some respects.

9. However, there remain features of the FAR proposals which go beyond the requirements of BEAR and indeed the recommendations of the Royal Commission. The Law Council submits that those features, some of which are detailed below, would impose a significantly increased cost and regulatory burden for Australian business, without a corresponding proportionate incremental regulatory benefit.

10. The BEAR legislation itself is due for review mid this year under section 37KC of the Banking Act, being 3 years after it came into operation. That review has not yet occurred – and the Law Council encourages Treasury to undertake that review and consider the outcomes prior to introducing the FAR legislation. However, anecdotal and available empirical evidence suggests that BEAR has worked, together with other

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[1] This view is supported by independent empirical research. See for example: Sheedy, Elizabeth A. and Canestrari-Soh, Dominic, Regulating Accountability: An Early Look at the Banking Executive Accountability Regime (BEAR) (December 1, 2020). Available at SSRN: https://ssrn.com/abstract=3775275 or http://dx.doi.org/10.2139/ssrn.3775275.

[2] A speech delivered on 2 October 2020 to the Business Council of Australia by Ben Morton MP, the Assistant Minister to the Prime Minister and Cabinet, discusses the Deregulation Agenda. See https://ministers.pmc.gov.au/morton/2020/morrison-governments-deregulation-agenda

[3] The Law Council understands that Treasury is aware of concerns raised in relation to ancillary liability and a further proposal will be forthcoming for consultation. Our view is that where there is primary liability on accountable persons through their accountability obligations there should not be a "second go" through those provisions. This is consistent with the Government's direction in relation to no civil liability. The Law Council will comment further when a revised proposal is available.

measures taken by the banks, to implement cultural and behavioural change. Although suggestions have been made that BEAR may not be as "impactful as the comparable UK regime" [4], the Law Council is not aware of any apparent inadequacies or gaps in accountability which have emerged.

11. The Law Council submits that, particularly given no material shortcomings in BEAR have emerged and the Royal Commission recommended the application of BEAR to a wider range of institutions, it would best serve the dual objectives above to implement FAR as follows:

    - Before introducing FAR, conduct the review of BEAR this year (as required under section 37KC of the Banking Act); and[5]
    - Taking into account the findings of the BEAR review, apply BEAR - in substantively its existing form – to the other APRA-regulated entities. This could be done by including the existing provisions, with only necessary changes to fit within the relevant legislation (for example, to address any technical inconsistencies as detailed below in relation to RSEs), to the *Superannuation Industry (Supervision) Act 1993* (Cth) (**SIS Act**) and the applicable insurance legislation. Transitional provisions and regulatory guidance could make it clear that groups which have multiple APRA-regulated entities could implement FAR on a group basis in the same way as is contemplated in the consultation draft Explanatory Memorandum (**EM**).

12. The Law Council has addressed in our secondary submission below some specific new features of FAR and demonstrated how they would, if retained, add to the implementation burden and inefficiency without a corresponding proportionate incremental regulatory benefit.

13. Efficiencies from adopting this implementation approach would include the following:

    - ADI corporate groups which have already implemented BEAR would not need to change their existing implementation systems for the ADI itself – the first phase of implementation contemplated in the Consultation Materials. This would avoid the need for amendments to accountability statements, accountability maps and the creation of new accountability statements for the new accountabilities (noting that an ADI is already required to ensure that the responsibilities of the accountable persons of the ADI and its subsidiaries cover all parts or aspects of the operations of the group). Similarly, there would be no need to change or re-train people in respect of a large number of internal policies and systems which appear to be working well.
    - The second phase of implementation contemplated in the Consultation Materials envisages ADI groups which also have additional APRA-regulated entities applying FAR directly to their other APRA-regulated entities (as opposed to the indirect application of BEAR which already applies to the corporate group of an ADI by virtue of section 37D of the Banking Act). These ADI groups could leverage to a substantial extent off their existing templates, accountability statements, maps and policies, making only the necessary changes.

[4] Footnote 1, at p 35

[5] The Law Council also notes that there is limited time for entities currently regulated by BEAR to make adjustments required for FAR – effectively less than 4 months if the FAR bill is passed in December and drafts of new/ revised maps and statements need to be with the regulators by the end of April (following required Board approvals etc to allow for registration by 1 July).

- Those APRA-regulated entities which are not part of ADI groups would be able to rely on external advisers with experience acquired through assisting ADIs with BEAR for effective and efficient support, which could produce better policy outcomes; and
- Avoiding the particular inefficiencies identified below from the proposed new accountable person roles, which (if implemented in their current form) would require significant re-work of existing accountability statements and systems with the associated business disruption and cost to regulated entities, even though those statements and systems necessarily already cover all aspects of each ADI group's operations.

Secondary submission – removing features which would cause inefficiency without a corresponding proportionate regulatory benefit

14. There are particular features of FAR in its proposed form which would add substantial implementation cost without a corresponding regulatory benefit. The Law Council submits that, if our primary submission is not accepted, at least these features should be eliminated or substantially recast, based on the same reasoning. That is, to implement FAR without these features would still be consistent with achieving the separate objectives of implementing the Royal Commission recommendations and the Prime Minister's and Government's deregulation agenda. We discuss these particular features below.
15. The Law Council also identifies below some inconsistencies and anomalies identified by our Superannuation Committee in relation to how FAR would apply to RSEs.

New proposed individual accountability obligation – obligation to take reasonable steps to comply with laws

16. Perhaps the most onerous new aspect proposed for FAR compared to BEAR is the new accountability obligation imposed on individuals in section 19(1)(d) to take reasonable steps in conducting the responsibilities of their position as an accountable person to comply with a long list of laws - including all the financial services laws and any regulations, other instruments, directions or other orders made under each of them.
17. Regulated entities, of course, are obliged to comply with all those laws and regulations, not just to take reasonable steps to do so. Even for a sophisticated financial institution this is an extremely onerous task. The major banks, for example, have complex systems in place, employing specialists and engaging external legal and risk advisory expertise costing at least tens of millions of dollars each year, to identify and comply with them.
18. The complexity of the financial services laws alone has been recognised in the Australian Law Reform Commission's Review of the Legislative Framework for Corporations and Financial Services Regulation. See for example, Background Paper FSL1 to the ALRC's Review of the Legislative Framework for Corporations and

Financial Services Regulation[6], which notes consensus among stakeholders that corporations and financial services laws are too complex and difficult to locate:

> *There has been a level of consensus amongst stakeholders that the law in this area is 'too complex' and in need of simplification* ([5]).
>
> *Many stakeholders have identified navigability of the law to be a key concern – it is too difficult to locate relevant parts of the law, and even experienced lawyers cannot always be confident that they are taking into account all relevant provisions and instruments on a particular issue without 'missing something'* ([5]).

19. If this obligation is in fact imposed on individual accountable persons as proposed in section 19(1)(d), the Law Council assumes regulators would expect the individual to, at a minimum, know specifically what laws apply to the part of the business for which they are accountable and have a plan in place to ensure compliance with each of them. A prudent accountable person looking to mitigate their risk is likely to want that work to be done.
20. However, that would be simply impractical when there are likely to be (literally) thousands of applicable legislative provisions and regulatory instruments, directions and orders within the scope of the section, many of which need to be complied with across multiple accountable persons' businesses resulting in duplication and the need to identify minor differences between the different roles and accountabilities (further complicated where individuals may be registered as accountable for multiple entities within the same corporate group). Having robust systems in place to do this is already the subject of a specific accountability - compliance. The task is only magnified when the imperative to not only identify and map these obligations is considered, but also to keep these obligation maps up to date both with the constant changes both in the regulatory environment as well as in the business.
21. When legal experts struggle to stay on top of these constantly developing laws and regulations, the imagery that comes to mind for a person running a commercial business is one of a person attempting to roll a boulder up a hill. It is not hard to envisage that time and resources would need to be spent on simply identifying, let alone understanding and implementing the rules that apply, which could otherwise have been spent on building the business in a productive way which would benefit the economy in terms of generating growth and jobs.
22. It would, with respect, be more realistic for the accountable person to be able to rely on the regulated entity's systems to discharge their obligations. That is, to make sure that the accountable person is overseeing that the area for which he or she has primary responsibility is complying with the regulated entity's systems, with the entity also having designated accountable persons to oversee that those systems are appropriate. That is already likely to be required by the accountable person's accountability obligation to act with due skill, care and diligence in any event. Most accountability statements which the Law Council has reviewed recognise this.
23. There are existing, appropriate and proportionate measures to support compliance with applicable laws and regulations including:

[6] (accessed at: https://www.alrc.gov.au/wp-content/uploads/2021/06/FSL1-Initial-Stakeholder-Views.pdf)

- The legal obligation on the regulated entity itself to comply with law (and in some cases liability attaching to persons who have responsibility for supporting compliance or who are involved in a contravention);
- The fact that senior executive responsibility for the compliance function is an existing role which requires an accountable person (section 37BA(3)(h) of the Banking Act). Given the complexity of the applicable law, different accountable persons will have – and need - different areas of responsibility, backgrounds and expertise; and
- The obligation on an ADI and each accountable person to comply with the accountability obligation to act with due skill, care and diligence (sections 37C and 37CA of the Banking Act).

24. Particularly in light of these existing measures, the Law Council submits that this proposed new accountability obligation would create inefficiency without a corresponding regulatory benefit, and should not be introduced. The Law Council also submits that section 20(d) (setting out that reasonable steps includes “taking appropriate action to ensure compliance in relation to that matter”) has the same issues and should not be introduced.

25. In addition, the Law Council notes that in creating the regimes under each of the relevant financial laws the relevant legislature has turned its mind to who should be accountable (and exposed to liability in the event of a contravention) and to what standard. Applying an overarching obligation and standard disregards the legislative intention behind the relevant regimes without regard to the regulatory impact on the underlying law.

26. The Law Council understands from discussions during the consultation process that the intent of this new proposed individual accountability obligation is to cover the risk of misconduct in financial services, and that this would correlate with the areas of responsibility of ASIC, in parallel with the existing reasonable steps obligation with respect to prudential standing and prudential reputation which correlates with the responsibilities of APRA. The Law Council submits that the existing BEAR accountability obligation of due skill, care and diligence already performs this function.

27. The Royal Commission was a dramatic illustration of the impact misconduct in the financial services sphere can have on an entity. A leader applying due skill care and diligence will necessarily be taking reasonable steps to mitigate the risk of misconduct in their area of responsibility. Any accountable person on whose watch misconduct occurs would expect to come under regulatory scrutiny and that they will need to be ready to satisfy the regulator that this was despite them applying due skill, care and diligence. This is consistent with how ASIC views and applies section 180 of the Corporations Act 2001 (Cth) (**Corporations Act**).

28. If, on the other hand, this new, the Law Council submits over-reaching, accountability obligation is retained, there is a contagion risk where it would have the effect of broadening the risk under section 180 of the Corporations Act. This risk could arise by the development of a body of law suggesting what “reasonable steps” requires of each individual in relation to granular compliance with laws, which may then be extrapolated to set (similarly unrealistic) expectations of a director or officer under section 180 of the Corporations Act.

29. In addition, the combination of this new accountability obligation and the obligation under proposed under section 18(d) to take reasonable steps to ensure that its accountable persons meet their accountability obligations under section 19 risks indirectly substantially expanding on the civil penalties applicable to entities. Under BEAR, civil penalties are only applicable to the entity where the relevant breach concerns a prudential matter. Under this proposed form of FAR, if the entity breaches that requirement, it faces civil penalty liability even when the actual substantive provision is not a civil penalty provision and is not a prudential matter (for example, if it is a strict liability offence with a much smaller penalty or requires actual fault not just failure to take steps before it is breached). The Law Council understands this is an area that Treasury is reconsidering so have not provided detailed submissions, but will look to do so based on any revised version.

New accountable person roles unnecessary and detract from existing accountability structures

30. The Consultation Materials seek to establish new roles for which there is an accountable person, beyond those specified in the BEAR legislation, including:

- End-to-End Product Responsibility;
- Remediation;
- Dispute Resolution; and
- Breach Reporting.

31. It is important to note at the outset that there is not currently an accountability gap where no one in a BEAR-regulated entity has accountability for those matters in ADIs. BEAR requires there to be an accountable person with responsibility for all parts of aspects of the relevant group of bodies corporate that is constituted by the ADI and its subsidiaries (sections 37BA(3)(b) and 37D(1)(a)(i) of the Banking Act). Under those existing allocations, there may be several accountable persons who each have accountability for (for example) breach reporting and for remediation, each with respect to the area of the business that they manage.

32. The current accountability allocation made by ADIs in their BEAR implementation reflects considered thought by the regulated ADIs as to who should be accountable in order to best incentivise the people who have the relevant control and oversee operation of the relevant business to manage those exposures appropriately. A common philosophy which ADIs have applied since the Royal Commission is to address the “moral hazards” that arise where a person who receives credit for revenue generation from a particular product or service does not bear the direct consequences if the product or service later causes problems. So, for example, the existing accountability framework of an ADI may focus on making the accountable person who benefits from the performance of certain revenue-generating activity, also accountable for the consequences of that activity in terms of remediation and breach reporting. The ADIs have coupled this with ‘second line’ oversight from other accountable persons (who may have accountability for compliance for example) as further checks and balances providing assurance that the required remediation and breach reporting is occurring. Critically, these frameworks are structured in such a way that the

accountable person who oversees the business and is responsible for revenue cannot treat the remediation activity or breach reporting as “someone else’s problem”.

33. Similarly, in the case of particular products, it was recognised by the ADIs that there could be a disconnect between the manufacture of a product, its distribution and the ultimate customer outcomes, and that this had caused problems. Therefore, the ADIs in their BEAR implementation carefully considered how best to allocate accountability to mitigate the risk that someone who runs one part of the business is dis-incentivised to achieve positive ultimate customer outcomes from that product. While there may be superficial appeal from a regulator’s perspective in having one individual with “End-to-End Product Responsibility” accountability who can be held accountable if anything goes wrong with that product, it could potentially (and unintentionally) deflect accountability from other individuals overseeing businesses with key roles in relation to the relevant product. In our experience, ADIs, in designing their BEAR implementation, have been demonstrably conscious of the need to provide accountability in a way which incentivises all key people in the product chain to do the right thing to mitigate the risk of adverse customer outcomes.

34. The Law Council is not aware of any suggestion that the above approach to accountability has not worked well. Similarly, since the implementation of BEAR, the Law Council is not aware of any suggestion that BEAR has any accountability gaps or issues with respect to dispute resolution or breach reporting and remediation. This is something which could be further tested by (as the Law Council has recommended) undertaking the BEAR review ahead of finalising the FAR legislation.

35. Given that there do not appear to have been any problems or gaps with accountability based on the BEAR system and how ADIs, to mitigate their own liability risk, have allocated accountability between accountable persons, there does not appear to be any benefit in requiring a different allocation of accountabilities under FAR. Joint accountability is not a solution, since that involves the “blunt instrument” of joint and several liability and may ironically give individuals less ownership than is necessary and ideal.

36. The Law Council submits that FAR ought not require the ADIs to undo any decentralisation of accountabilities they have assigned to the businesses which create the relevant issues. It would be inconsistent with the measures ADIs have taken to incentivise all those who ultimately have an impact on customers to keep their own houses in order because they will have accountability for cleaning up any “mess” that arises from their businesses. Research on the effectiveness of BEAR detected that executives were “grasping the concept that if there is a problem in their area of accountability, they alone will be answerable” and that this was driving a more proactive risk culture. Requiring ADIs to reverse compliance arrangements which were only implemented a short time ago, in the absence of a strong and clear justification, would be also inefficient and contradict the objectives of the Government’s deregulation agenda.

37. The Law Council notes that Treasury has indicated it is revisiting the concept of joint accountability and did not intend that where two persons may have responsibility for, or impact upon, a matter, they necessarily have joint culpability nor should they necessarily be subject to the same ramifications. There is significant confusion as to joint accountability and its consequences. The Law Council supports the clarification of

how joint accountability applies, in a way which does not in any circumstances penalise an accountable person who has complied with their own accountability obligations, and look forward to the further proposal on this topic.

Significant related entities in the RSE context

38. The definition of “significant related entity” of an RSE, unlike the definition that applies to other accountable entities, will capture entities that are not subsidiaries of the RSE, are not prudentially regulated, and may not operate in the financial services sector at all. A listed industrial company with an “in house” superannuation fund and RSE is likely to be caught by this definition. The directors and senior executives are likely to become accountable persons, and be subject to the registration and remuneration provisions of FAR. The RSE would be obliged to take reasonable steps to ensure that its ultimate holding company, in communications, or mining, or retailing, complies with the FAR including the accountable persons provisions. This is practically impossible and is likely to be inconsistent with the RSE’s “best financial interests” obligations as a trustee under the SIS Act. This is clearly not the intention of FAR.
39. The rationale for having a potentially broader range of significant related entities for superannuation, compared with other industries, is unclear. For other industries an entity can only be a significant related entity if it is a subsidiary of the accountable entity (section 11(1)(a)). For superannuation, an entity can be a significant related entity of an RSE licensee if it is a 'connected entity' (section 11(3)(a)), which traces through to the Corporations Act definition of 'associated entity', and it would seem possible it could catch a shareholder in an RSE licensee, including an employer association or a union. The stated rationale for the different approach for superannuation is at paragraph [1.39] of the EM:

> *Different related entities are covered by the Regime for registrable superannuation entity licensees as they may have a different operating structure to other types of accountable entities. In particular, a connected entity of a registrable superannuation entity licensee could have a material and substantial impact on the licensee but may not be a subsidiary of the licensee. These connected entities can be significant related entities of registrable superannuation entity licensees. Additionally, unlike other accountable entities, a related entity can be a significant related entity of more than one registrable superannuation entity licensee.*

40. However, the Law Council suggests that the rationale for taking a different approach for superannuation should be more specifically clarified to ensure there is no over-reach.
41. A related point is that many of the provisions concerning significant related entities proceed on the assumption that the accountable entity has at least some ability to influence the significant related entity. This assumption may be justified where a significant related entity is a subsidiary, but it does not seem accurate where a significant related entity is, say, a parent entity. If a significant related entity of an RSE licensee can be a parent entity, then a number of the provisions that apply to the accountable entity should be adjusted to reflect the fact that the accountable entity may, in fact, have no ability to influence the significant related entity. For example,

under the Bill as it currently stands, a regulator could give a direction to an accountable entity, and the direction could relate to the significant related entity (and not to the accountable entity itself), and yet the accountable entity would be under an unqualified obligation to comply with the direction (sections 60(1)(d) and 62(1)(b)). In other provisions, the accountable entity's obligation in relation to a significant related entity is a reasonable steps obligation, which partially addresses the concern, but that approach has not been taken consistently throughout the Bill.

42. Section 21(1)(a)(i) provides that the key personnel obligations include ensuring that the responsibilities of the accountable persons of the accountable entity and its significant related entities cover all parts or aspects of the operations of the accountable entity's relevant group. When all the defined terms are taken together, this is drafted extremely broadly, and the Law Council queries whether it is intended to affect all aspects of the group. This concept is included in the BEAR legislation and makes sense when the accountable entity is a parent company within the group (as would be case for, say, a listed entity). However, in any other case, the ability to comply with the requirement is heavily dependent on the accountable entity's ability to influence other entities within the group. For example, there could be an accountable entity which is within a much larger financial services entity, each with quite distinct businesses and products. It may not be possible or even appropriate for the accountable entity to alter the operations of other entities (and, thereby affecting their clients). For purposes of these obligations, there needs to be some quarantining in relation to the parts or aspects of the broader group's business which correlates directly to the accountable entity.

43. Further as a result of the 'connected entity' concept for superannuation, it is not sufficiently clear how the regime applies when an accountable entity has related entities in other jurisdictions outside Australia. For example, is FAR intended to apply to a foreign executive of a foreign company, which company is the ultimate owner of a superannuation fund trustee? Although section 21(3) deals with situations where the accountable entity is a foreign accountable entity, the situation of the connected entity being a foreign entity does not seem to be dealt with. This matter should be clarified and, if it is intended to apply to foreign connected entities, then there needs to be provision for the extent of the connection that it is necessary to have with the operations of the Australian accountable entity.

44. Subsections 11(3) and 11(4) set out a number of criteria that go towards determining whether a body corporate is a significant related entity. These criteria include if the body corporate's business or activities has (or is likely to have) a material or substantial effect on the accountable entity, or the business or activities of the accountable entity. This particular criterion is extremely broad and open to varying interpretations in its application.

45. At one extreme, it is potentially broad enough to capture passive investment vehicles established by the RSE licensee solely for the purpose of holding a particular asset or assets on behalf of the RSE licensee. These 'investment vehicle entities' do not generally have decision making power nor do they have a substantial operational impact on the RSE licensee outside of holding the asset - rather decisions as to whether to invest or divest in those assets are generally made by the Board, an Investment Committee or the staff of the RSE licensee. Capturing these entities adds

a significant and unnecessary administrative and compliance burden on the RSE licensee (particularly if it has multiple investment vehicles) given that the overarching intention of the FAR regime is to drive better decision making.

46. The Law Council suggests that the definition of “significant related entity” that applies to other accountable entities should also apply to RSEs, with a possible additional provision for RSEs that requires the executive in a holding company of the RSE who is responsible for the RSE to also be an accountable person. This would have a parallel with APRA’s requirement under BEAR that the Senior Officer Outside Australia of a foreign ADI be an accountable person.

Lack of clarity regarding respective roles of ASIC and APRA

47. The Prime Minister’s and Government’s deregulatory agenda statements have noted the importance from an efficiency perspective of avoiding duplication between regulators or regulation that is hard to understand.[7] The regulated community needs certainty and transparency around the roles and responsibilities of the various regulators, particularly given the volume and complexity of the laws to which they are subject.

48. In that context, it is important that the respective roles of ASIC and APRA in relation to the administration of FAR are clear. The Bill does not provide for a clear assignment of the roles of ASIC and APRA leading to potential duplication between regulators and uncertainty not only on the part of regulators but also on the regulated. It is therefore important that this be clarified in the legislation and not left to the regulators themselves to determine over time (creating a vacuum in the interim) and that the definition of “Regulator” in section 7 be revised accordingly.

49. In addition, the Law Council queries the appropriateness of expecting individuals to cooperate with ASIC in circumstances where there is any prospect that ASIC will prosecute them under sections 180 – 184, 1308 or 1309 of the Corporations Act, or for involvement liability for breach of civil penalty provisions of the financial services and product sales laws (by virtue of sections 1317E(4)(b) of the Corporations Act, s 12GBCL(b) of the *Australian Securities and Investments Commission Act 2001* (Cth), s 194 of the SIS Act and s 174 of the *Anti-Money Laundering and Counter-Terrorism Financing Act 2006* (Cth)) is not fair. The individual and the entity may have opposite interests in an enforcement situation.

Privilege regarding self-incrimination

50. The Law Council notes that section 83 departs from section 52F of the Banking Act regarding the availability of privilege against self-incrimination in the context of civil penalties. Civil penalties are a live issue under a range of financial services laws – including the Corporations Act. If it is intended to remove this privilege, the Law Council submits that is not an appropriate approach. Privilege against self-incrimination is a fundamental protection and there is nothing in the policy underpinning FAR that should be sufficient to over-ride it. If it is intended to preserve this privilege, the Law Council requests that the wording be clarified.

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[7] See footnote 2 above.

Legal professional privilege

51. Paragraph 19(1)(b) requires an accountable person of an accountable entity or a significant related entity to conduct their responsibilities by, amongst other things, dealing with the Regulator in an open and constructive and cooperative way. Given the broad nature of this obligation, it raises the question of this would require an accountable person to provide to the Regulator material that is subject to legal professional privilege. Further to the High Court decision in *Daniels Corporation International Pty Ltd v Australian Competition and Consumer Commission* [2002] HCA 49; 213 CLR 543, this section should be amended to clarify that it does not require an accountable person to give information or a document that is the subject of a claim of legal professional privilege by the accountable person or the accountable entity or significant related entity.

52. Subsection 50(5) provides that a statement made at examination of a person is not admissible if it discloses a matter in respect of which 'the person' could claim legal professional privilege. However, this section seems to assume it is the person who is being examined that owns or holds the privilege. At law, the holder of the privilege in each case is always the client which is more likely to be the accountable entity or another body corporate within the group, but rarely if ever the actual individual being examined. Accordingly, this section should be redrafted so that it also applies where a person is required to give information or a document that is a privileged communication given to the person (or, more likely, to the relevant accountable entity) where it is the entity that has sought the legal advice.

53. Section 84 regarding legal professional privilege seems to provide that legal professional privilege is protected and provides a basis on which a requirement to disclose information or a document under the Act can be refused, which the Law Council supports. However, it seems to have been drafted on the misconception that it is only if the request for disclosure is made to the lawyer that the question of privilege arises. However, at law, the holder of the privilege in each case is always the client (not the lawyer). Accordingly, this section should be redrafted so that it also applies where a person (not the lawyer) is required to give information or a document that is a privileged communication given to the person (or, more likely, to the relevant accountable entity where it is the entity that has sought the legal advice) by a lawyer.

Double (or triple) jeopardy and overlapping obligations

54. The Law Council remains concerned that there is no recognition that accountable persons are exposed to double jeopardy, including from the same regulator, and particularly once ASIC has powers with respect to FAR. There is nothing in FAR that recognises that any accountable person could be held to liability under other legislation without the benefit of mitigating factors such as exist under the Corporations Act and the general law – such as the business judgement rule, reasonable reliance, and delegation. It would be manifestly unjust for an officer to be pursued by ASIC or APRA for multiple breaches for the same conduct, applying different standards. FAR, and the regulators, need to expressly recognise this issue and explain how they intend to appropriately address issues of double jeopardy.

55. There are numerous aspects of the Bill where its provisions would overlap with existing provisions of the SIS Act. This is not limited to the overlap between the obligations under FARand the covenants imposed on RSE licensees and their directors under sections 52 and 52A of the SIS Act. Instead, the overlap extends to a range of other matters, including regulatory investigations, giving directions and disqualification. However, the Bill does not include any amendments to the SIS Act provisions (or for that matter to the Corporations Act provisions) to remove the overlap. This matter should be dealt with in the Bill to avoid unnecessary overlap.

56. As a related specific example, section 30(d) sets out a breach notification obligation for accountable entities, and this would appear to add to (and overlap with) existing significant breach reporting obligations in the SIS Act and the Corporations Act.

57. Similarly, an action by an accountable entity or an accountable person which constitutes a breach under the FAR regime may also constitute a breach of the general conduct provisions under the SIS Act (for example, the covenant in section 52(2)(b) to act with care, skill and diligence), and possibly also under the Corporations Act (for example, the duty in section 912A(1)(a) as licensee to do all things necessary to ensure that the financial services covered by the licence are provided efficiently, honestly and fairly). There is significant regulatory overlap and the potential for 'triple jeopardy' if the one action could lead to breach of FAR, the SIS Act and the Corporations Act, each with their own penalties.

Indemnification of accountable entities by related bodies corporate

58. Section 91 regarding indemnification of accountable entities by related bodies corporate seems to have been based on somewhat similar provisions in sections 199A to 199C of the Corporations Act. However, the prohibition in section 91 of the Bill against indemnifying an accountable entity only applies to a related body corporate – ie, a related body corporate cannot indemnify the accountable entity and cannot pay for insurance premiums for a policy designed to provide coverage for such liability. If the drafting is intended as it appears, the rationale for the provision is unclear.

59. Even if the drafting is intended and a rationale for the section can be supplied, some problems seem to have been introduced in changing sections 199A to 199C of the Corporations Act to produce section 91. For example, section 91(3) is copied from section 199C(2). Both refer to exemption in addition to indemnification. However, the reference to exemption in section 91(3) does not make sense, because while there is a provision concerning exemption in section 199A(1) of the Corporations Act, there is no provision concerning exemption earlier in section 91. Section 91 would benefit from careful reconsideration.

60. Further, in the context of superannuation, an RSE licensee cannot be indemnified from the fund's assets for a breach of the FAR regime because of section 56 of the SIS Act; so this section 91 would mean that trustees with their own capital can pay for any monetary consequences of breaching the FAR regime, but trustees without capital would seem to have no options at all (because they have no resources of their own outside the fund and they cannot have a related entity pay because of section 91). As a result, any penalty imposed will necessarily and directly result in the insolvency of

the RSE licensee which has the effect of automatically disqualifying the RSE licensee from continuing to act as the trustee of any superannuation entity, even if the penalty was not large. In the event that an RSE licensee became insolvent in such circumstances, there is a real risk that community confidence in the superannuation industry (being a cornerstone of the industry) would be compromised with even a possibility of there being a run on the fund by members who may have become alert to, and alarmed about, the situation. The mechanics of this provision, and its possible application to different types of RSE licensees needs to be reconsidered.

Examinations

61. Section 47 regarding examination of individuals appears quite heavy handed given the matters being examined concern financial accountability of entities and not, for example, crimes connected with terrorism or the like. Specifically, section 48 which deals with the written record of the examination includes provision for the investigator to require the examinee to read the written record and may require the examinee to sign the record else commit an offence. The compulsion to sign the document applies even where section 48 does not provide any opportunity for the individual to correct the record if the individual disagrees with what has been recorded. Failure to sign the record constitutes an offence which carries a penalty of 30 penalty units. Once a person has been compelled into signing the record, that signed record becomes admissible in a proceeding as prima facie evidence of the statements it records (subsection 50(7)). Whether this approach is consistent with the approach taken in other similar Australia legislative regimes must be queried and, if not, whether it is necessary, reasonable and proportionate to require a person to sign a document they may or may not agree with under threat of committing an offence, in order to achieve the objectives of the proposed legislation.

Fund mergers

62. The superannuation industry is undergoing an almost continual process of consolidation, which is likely to accelerate with the new APRA performance assessments due to commence under the 'Your Future, Your Super' reforms. In anticipation of the application of FAR r to superannuation funds in mid-2023 and thinking about funds which may at that time be in the process of merging, there should be a process by which the accountable entity (and its accountable persons) should be 'excused' from the application of the regime – perhaps on application to APRA. This would ensure that the costs of anticipating and complying with the regime ahead of its likely commencement on 1 July 2023 do not result in a waste of the fund's resources (member money) in circumstances where the fund is expected to cease to exist within say 12 months of the commencement of FAR. The Law Council suggests that a transitional disapplication of the regime should be specified in the legislation for this purpose.

Civil penalties

63. As a general observation, the civil penalties for breach of the regime can be very large potentially. Although this is not unexpected, for RSE licensees without their own capital, the potential application of civil penalties exacerbates the existing issue

whereby indemnification is not permitted from the superannuation fund's assets under section 56(2)(b) of the SIS Act (see the point above).

Other issues

64. The definition of 'this Act' in section 7 includes 'the Minister rules' and 'the Regulator rules'. It should be queried whether the 'Act' itself (strictly understood as an Act of Parliament) should be defined in this way to include rules made by the executive arm of government and a regulatory agency. The Law Council notes that the rationale for this approach is not explained in the EM and the Law Council notes that if this approach is to be maintained, a clear and specific rationale should be included in the final EM.
65. As a related comment, while 'Minister rules' and 'Regulator rules' are legislative instruments, it is not clear whether they are disallowable as they would be if the matters were to be dealt with by Regulations. Given that key matters will be determined through such rules, this matter should be clarified.
66. In sections 18 and 19 the term 'would be likely to' is used in relation to matters adversely affecting prudential standing or reputation. It must be queried if it is sufficiently clear as to who is required to determine likelihood.
67. Section 20 sets out what constitutes reasonable steps and turns on the concept of 'appropriateness', which is used in each one of the five matters specified. It appears, therefore, that there will be considerable subjectivity involved in determining whether an accountable entity or an accountable person has taken reasonable steps in discharging the entity's or the person's obligations set out sections 18 and 19. In other words, views about what is 'appropriate' will vary, and may well be assessed in retrospect with a negative bias once there has been an allegation that something has gone wrong. Similarly, to the point raised above, the concept of what constitutes reasonable steps in this section 20 for a particular accountable person should be expressly confined to those matters which correlate with the accountable person's particular responsibilities.

Questions

If you have any queries in relation to this submission, please feel free to contact Rebecca Maslen-Stannage either at Rebecca.Maslen-Stannage@hsf.com or on 0419 767 709.