SUBMISSION TO TREASURY

FINANCIAL ACCOUNTABILITY REGIME

AUGUST 2021

About Us

CHOICE

CHOICE is the leading consumer advocacy group in Australia. CHOICE is independent, not-for-profit and member-funded. Our mission is simple: we work for fair, just and safe markets that meet the needs of Australian consumers. We do that through our independent testing, advocacy and journalism.

Consumer Action Law Centre

Consumer Action is an independent, not-for-profit consumer organisation with deep expertise in consumer and consumer credit laws, policy and direct knowledge of people's experience of modern markets. We work for a just marketplace, where people have power and business plays fair. We make life easier for people experiencing vulnerability and disadvantage in Australia, through financial counselling, legal advice, legal representation, policy work and campaigns. Based in Melbourne, our direct services assist Victorians and our advocacy supports a just marketplace for all Australians

Financial Counselling Australia

Financial Counselling Australia (FCA) is the peak body for financial counsellors in Australia. Financial counsellors work in community organisations and provide advice and support to people experiencing financial hardship.

Super Consumers Australia

Super Consumers Australia (Super Consumers), formerly known as the Superannuation Consumers' Centre, is an independent, not-for-profit consumer organisation formed in 2013. Super Consumers was first funded in 2018. We work to advance and protect the interests of low and middle income people in the Australian superannuation system.

During its start up phase Super Consumers has partnered with CHOICE to deliver support services. CHOICE is the leading consumer advocate in Australia, established over 60 years ago, it is an independent voice, ensuring consumers get a fair go.

Contents

About Us 2

Executive summary 4

Summary of recommendations 6

Objectives should include preventing misconduct and ensuring that customers are treated fairly 7

Strengthen individual accountability 9

Expand accountability obligations 9

Civil penalties 10

Deferred remuneration 11

Expand the scheme to include senior managers 12

Disqualification powers 13

Strengthen corporate accountability 15

The regime should apply to APRA and ASIC regulated entities 15

Enhanced notification threshold 16

Executive summary

The Australian community expects that finance executives who make decisions that harm customers and break the law are held to account.

The Banking Royal Commission revealed that many decisions made by senior leaders of financial services firms have had a devastating impact on people across Australia. Their conduct has driven many members of the community into financial hardship, with serious results including the losses of family homes, the closure of small businesses, insolvencies, mental and physical ill-health, and relationship breakdown.

Australia's financial system is currently designed to reduce the personal legal accountability of finance executives when they break the law. This contributes to a corporate culture of prioritising short-term profits over customer wellbeing and compliance, at the expense of the interests of consumers and the Australian community.

If designed correctly, the Financial Accountability Regime (**'FAR'**) could be a game-changer in reforming corporate culture in Australia.

However, the Financial Accountability Regime Bill 2021 *(*'**the Bill**') is deficient in many important areas. As drafted, this law will be unlikely to hold finance executives to account for their actions, nor will it significantly improve corporate culture in Australia. Without amendment, members of the community remain vulnerable to decision-making that trades off consumer welfare for excessive profits, and we are likely to see a repeat of the same harmful corporate practices that resulted in the Banking Royal Commission.

CHOICE urges the Treasury to amend the Bill to address these deficiencies and help avoid history repeating itself.

The Bill needs to be strengthened in a number of key areas for it to have any meaningful impact on improving corporate culture:

1) **The scope of the regime needs to be expanded to include executives and senior managers.** While executives must be accountable for corporate decisions, senior managers regularly make operational decisions that affect their customers. Senior managers should be held to account. The United Kingdom's Senior Managers Regime, on which the Australian model was originally based, covers executives and senior managers. This will help promote lasting cultural change within financial services firms.

2) **There must be meaningful consequences for people who break the law.** It is disappointing the Government has backflipped on its proposal to have civil penalties of

over $1 million for leaders who break their FAR obligations. These penalties need to be reinstated. Individual penalties send a clear message to executives and managers that misconduct will have serious repercussions, and are necessary to deliver on the intent of this reform.

3) **The Bill's proposed deferred remuneration obligations need to be bolstered.** As drafted, they are currently weaker than the existing requirements in the Banking Executive Accountability Regime ('**BEAR**').This represents a step backward in that there are weaker financial incentives for senior executives to avoid misconduct and unfairness. Banking leaders should have all of their variable remuneration subject to clawback over a minimum seven year period. This will align the obligations with international best practice.

4) **The FAR should require executives and senior managers to treat customers fairly.** This should mirror the United Kingdom's conduct obligation of executives and senior managers to, 'pay due regard to the interests of customers and treat them fairly'.

Without these changes, the Bill fails in its primary objective of establishing an 'accountability regime'.

Summary of recommendations

The Federal Government should:

1. Amend s 3 of the Bill to state that the object of the legislation is "to provide for accountability obligations that will prevent misconduct and ensure that customers are treated fairly."

2. Add an accountability obligation in s 18 and s 19(1) of the Bill that requires accountable entities and persons to "pay due regard to the interests of customers and treat them fairly."

3. Impose civil penalties for individuals for breaches of accountability obligations in s 19. Penalties should be the greater of:
    - 5,000 penalty units (currently $1,050,000); or
    - three times the benefit obtained or detriment avoided.

4. Amend s 25 of the Bill to require 100% of an accountable person's variable remuneration to be subject to deferred remuneration obligations.

5. Amend s 26 of the Bill to require a deferral remuneration period of seven years, with the option of extending the period by three years if there is an outstanding regulatory investigation at the end of the normal seven-year clawback period.

6. Expand accountability obligations to include all executives and senior management of accountable entities.

7. Strengthen the legislation so that accountable persons banned for breaching accountability obligations in the FAR are prohibited from being employed in a leadership position in any AFSL or ACL-holding firm.

8. Legislate when the FAR regime will apply to AFSL and ACL holding firms. The new regime should commence by 1 January 2023 at the latest.

9. Grant only APRA and ASIC the power to exempt entities for the new regime.

10. Consider the risk of consumer harm, as well as the complexity of entities, to determine the benchmark for the 'enhanced compliance' classification."

1. Objectives should include preventing misconduct and ensuring that customers are treated fairly

As we transition from the BEAR to the FAR, it is important to reflect on what the Australian community needs the new regime to achieve. The Banking Royal Commission urged policymakers to clearly state the underlying norms and principles expected of financial services firms through applicable legislation. Commissioner Hayne concluded that the practice for statutory drafting is that:

> *"the first requirement will be to settle upon the principle or principles to which the law is to give effect."*[1]

The current objects of the Bill are:

> *a) to provide for accountability obligations for certain financial entities; and*
> *b) to provide for accountability obligations for persons who hold certain positions, or have certain responsibilities, related to those financial entities."*[2]

These objectives are deficient. They lack any reference to the underlying principle of why this legislation is necessary; namely, to protect members of the Australian community from misconduct and ensure that customers are treated fairly.

The objectives should reflect the fact that accountability obligations are in place to ensure executives and entities who employ them are to be held to account when misconduct occurs. Strong accountability obligations should improve consumer outcomes and reduce misconduct in the financial sector. It is important that the Government codifies this principle in the objectives of new FAR legislation. Doing so will signal to financial entities and their senior leaders the rationale for these measures and provide context for courts and regulators interpreting the law over time. This will help ensure that the focus of the FAR regime always remains on protecting people from harm, and not be a box-ticking, compliance exercise.

We encourage the Government to look at the *Competition and Consumer Act 2010* (Cth) for drafting guidance. This law states:

> *"The object of this Act is to enhance the welfare of Australians through the promotion of competition and fair trading and provision for consumer protectio*n"[3]

[1] Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry, Final Report, Volume 1, p486
[2] s3 Financial Accountability Regime Bill 2021
[3] Competition and Consumer Act 2010, s2,.

This is also consistent with the *Telecommunications Act 1997* (Cth), which states that the main object of the Act is to provide a regulatory framework that promotes:

> *"The long-term interests of end-users of carriage services or services provided by means of carriage services".*[4]

The Government currently has a clear opportunity to establish the principles and underlying norms of the FAR. This will help simplify and clarify the law for entities, regulators, and the broader community.

Recommendation 1

The Federal Government should amend s 3 of the Bill to state that the object of the legislation is "to provide for accountability obligations that will prevent misconduct and ensure that customers are treated fairly."

[4] Telecommunications Act 1997, s3

2. Strengthen individual accountability

It is important that regulators are empowered with a strong regulatory toolkit to investigate and prosecute individuals who break the law. As drafted, the range of options available at the regulator's disposal is too limited and will not be enough to punish executives when they break the law in a way that deters others from similar behaviour.

Expand accountability obligations

We support the accountability obligations being expanded to include a standard of fairness for accountable persons that reflects international best practice. Finance leaders and entities need to be held to account for failing to treat their customers fairly. This standard should mirror the obligations in the United Kingdom's Senior Manager Regime.

The Senior Managers Regime in the United Kingdom has the following conduct rules:

- Rule 1: You must act with integrity.
- Rule 2: You must act with due skill, care and diligence.
- Rule 3: You must be open and cooperative with the FCA [Financial Conduct Authority], the PRA [Prudential Regulation Authority] and other regulators.
- Rule 4: You must pay due regard to the interests of customers and treat them fairly.
- Rule 5: You must observe proper standards of market conduct.[5]

The proposed FAR accountability obligations are:

- acting with honesty and integrity, and with due skill, care and diligence; and
- dealing with the Regulator in an open, constructive and cooperative way; and
- taking reasonable steps in conducting those responsibilities to prevent matters from arising that would (or would be likely to) adversely affect the prudential standing or prudential reputation of the accountable entity.

The focus on the fair treatment of customers is a missing link in the current drafting of the legislation. Despite being a centrepiece of the Royal Commission's Final Report, and being an increasing focus of both the courts and regulators, fairness is missing from the proposed accountability regime. The Government should legislate an accountability obligation that mirrors Rule 4 in the UK's accountability framework.

[5] Financial Conduct Authority, 'COCON 2.1 Individual conduct rules' https://www.handbook.fca.org.uk/handbook/COCON/2/1.html

Recommendation 2

The Government should add an accountability obligation in s 18 and s 19(1) of the Bill that requires accountable entities and persons to “pay due regard to the interests of customers and treat them fairly.”

Civil penalties

It is extremely disappointing that the Government plans to renege on its proposal to include civil penalties for individual executives in the FAR regime.[6]

It is critical that finance leaders are personally liable for misconduct. The Banking Royal Commission revealed that executives had engaged in or turned a blind eye to misconduct but had rarely faced personal consequences. Australians need to be protected by a regime that meaningfully deters individual senior leaders from engaging in misconduct and unfair decision-making, including strong penalties and rigorous enforcement.

Implementing civil penalties for accountable persons would better reflect the concerns and expectations of the Australian community: 81% of Australians think there should be stronger laws that hold senior financial executives to account.[7]

The United Kingdom’s Senior Manager Regime includes civil penalties under its framework, and is viewed by the regulators as a wide-ranging success. For example, the FCA and Prudential Regulation Authority fined the CEO of Barclays Group over £600,000 for failing to act with due skill, care and diligence.[8] Barclays also clawed back £500,000 of his deferred remuneration for the breach.

The level of penalties under the FAR must be set at a level which deters non-compliance and is seen as more than the cost of doing business. We strongly support aligning maximum penalties for entities and accountable persons under the FAR with the newly-imposed maximum penalty framework under the *Corporations Act 2001* (Cth), *Australian Securities and Investments Commission Act 2001* (Cth), *National Consumer Credit Protection Act 2009* (Cth) and *Insurance Contracts Act 1984* (Cth). This was the Government’s proposal in January 2020 and should be retained. We urge the Government to put the interests of Australian consumers of financial services first and reinstate meaningful civil penalties for finance executives.

---

[6] Treasury 2020, Proposal Paper. Financial Accountability Regime (FAR)
[7] Polling was completed as part of the Dynata's weekly "Omnipulse" omnibus.The fieldwork was conducted on 11-16 November, 2020. 1,014 people completed the survey and data was weighed to the latest ABS census data so results are nationally representative.
[8] Financial Conduct Authority, 2018, ‘FCA and PRA jointly fine Mr James Staley £642,430 and announce special requirements regarding whistleblowing systems and controls at Barclays’.
https://www.fca.org.uk/news/press-releases/fca-and-pra-jointly-fine-mr-james-staley-announce-special-requirements

Recommendation 3

The Government should impose civil penalties for individuals for breaches of accountability obligations in s 19. Penalties should the greater of:

- 5,000 penalty units (currently $1,050,000); or
- three times the benefit obtained or detriment avoided.

Deferred remuneration

Deferred remuneration obligations can discourage inappropriate risk-taking that harms consumers and can help to eliminate a culture of 'short-termism'. This can be achieved through requiring 100% of an accountable person's variable remuneration to be subject to deferred remuneration obligations over a seven year period. We strongly support their application to the financial services sector.

However, the FAR proposes to legislate a model below international best practice and below the benchmarks of BEAR, particularly for larger entities. The deferred remuneration model adopted in the FAR needs to be significantly bolstered to reflect international best practice.

The draft legislation outlines an obligation to defer 40% of variable remuneration for at least four years, where the amount to be deferred is greater than $50,000. This is a considerable change from that adopted by the BEAR. The BEAR operated under a tiered arrangement that set different benchmarks for CEOs and Senior Managers, depending on the size of the entity and the sum of the variable component.[9] Under BEAR, for example, the CEO of a large authorised deposit-taking institution would be required to defer the lesser of 60% of variable remuneration or 40% of total remuneration for four years. The deferred remuneration model currently proposed in the FAR therefore requires a smaller sum of money to be deferred and represents a step backward as there would be even less financial incentive for senior executives to avoid misconduct and unfairness.

By comparison, the UK's FCA and Prudential Regulatory Authority (PRA) requires that firms apply deferral periods of no less than seven years to all variable remuneration of Senior Managers, and to defer all variable remuneration for three to five years for Risk Managers and Material Risk Takers. In addition, regulators can extend the period by up to three years where there are outstanding internal or regulatory investigations at the end of the normal seven-year clawback period.

[9] s37E(1)(a)(ii), *Treasury Laws Amendment (Banking Executive Accountability and Related Measures)* Act 2018

It is important that the Government gets the parameters of the deferred remuneration obligation right. Financial institutions must employ senior executives who are motivated by the highest standards of integrity, not those who are shopping around for the biggest bonuses.

The Government should amend s 25 of the Bill to require all of an accountable person's variable remuneration be subject to deferred obligations. The Government should also amend s 26 of the Bill to require a deferral period of seven years, with the option of extending the period by three years if there is an outstanding regulatory investigation at the end of the normal seven-year clawback period.

Recommendations 4 - 5

4. The Government should amend s 25 of the Bill to require 100% of an accountable person's variable remuneration to be subject to deferred remuneration obligations.

5. The Government should amend s 26 of the Bill to require a deferral remuneration period of seven years, with the option of extending the period by three years if there is an outstanding regulatory investigation at the end of the normal seven-year clawback period.

Expand the scheme to include senior managers

Consumer advocates support a broad application of the FAR that defines accountable persons to include executives and senior managers. This is the current structure in the United Kingdom, of which the Australian legislation was originally based upon. It is concerning that the Explanatory Memorandum for the legislation states that the accountability regime does not apply to "lower level executives.[10] In practice, the FAR may only apply to a few senior executives. This is not wide enough coverage to improve corporate conduct nor drive positive cultural change.

Financial institutions are large and complex corporate entities. Ultimately, accountability rests at the executive level. We support senior executives being held to the highest standards. However, many day-to-day operational decisions are made at a senior management level and carving out senior management from the regime will weaken the efficacy of the legislation.

By extending the FAR regime to senior managers, there will be greater accountability and responsibility for misconduct across the industry. As the Financial Conduct Authority recently noted:

[10]Financial Accountability Regime Bill 2021, Exposure Draft Explanatory Materials, 1.45

> *"A robust individual accountability regime can reinforce acceptable standards of behaviour and be a critical factor in deterring misconduct. Ultimately, its main aim is to drive culture change by making Senior Managers accountable and by applying baseline standards to all financial services staff."*[11]

Crucially, the United Kingdom regime requires managers to take reasonable steps to prevent regulatory breaches in the areas of the bank for which they're responsible and requires senior managers to act with integrity, pay due regard to the interests of customers and treat them fairly. These components are missing from the Australian regime.

It may be appropriate for obligations for senior managers to be different from executives, given they have different responsibilities within the organisation. However, senior managers should still be held to account for decisions that they make or that are otherwise within their control that lead to poor consumer outcomes.

Recommendation 6

The Government should expand accountability obligations to include all executives and senior management of accountable entities.

Disqualification powers

We welcome ASIC and APRA having the power to disqualify an executive if they breach their accountability obligations.

As drafted, the disqualification powers prevent a person from being an accountable person in another accountable entity. This is a relatively narrow disqualification power. We have concerns that financial institutions may be able to shift disqualified persons within the corporate group away from the narrow range of accountable persons - thereby avoiding the spirit of the regime and its aim of improving corporate cultures. The Government should consider anti-avoidance measures to ensure that the intent of this power can be achieved.

Regulators should have the power to ban an individual from being employed in a leadership position in any company holding an AFSL or ACL in Australia. The repercussions of being disqualified need to be severe enough to encourage compliance.

---

[11] Financial Conduct Authority, 2017, 'Individual Accountability: Extending the senior managers and certification regime: cost-benefit analysis' p. 33 https://www.fca.org.uk/publication/research/cba-extension-senior-managerscertification-regime.pdf

Recommendation 7

The Government should strengthen the legislation so that accountable persons banned for breaching accountability obligations in the FAR are prohibited from being employed in a leadership position in any AFSL or ACL holding firms.

3. Strengthen corporate accountability

The regime should apply to APRA and ASIC regulated entities

Consumer groups strongly support the FAR regime applying to all APRA and ASIC-regulated entities.

The misconduct of superannuation fund senior executives was well highlighted during the Banking Royal Commission. Colonial First State executives were responsible for their continued use of related party CommInsure insurance products after management was made aware of their uncompetitive premiums. Suncorp admitted to waiting until the last minute before transferring its eligible members to a cheaper low-cost product boosting its profits at members' expense. Despite their overriding duty to act in the best interests of members. It is entirely appropriate that superannuation senior executives also be held accountable for the part they play in misconduct. In the context of the retirement savings scheme, the impact of their decisions can compound across decades leaving people materially worse off in retirement.

APRA regulated firms do not have a monopoly on misconduct. Executives from ASIC-regulated firms have also engaged in misconduct in the Australian financial sector. Examples of ASIC regulated firms that would be exempt from this regime include non-bank lenders, mortgage brokers and financial advice licensees .

In its response to the Banking Royal Commission, the Federal Government made a commitment that a:

> *"new ASIC-administered accountability regime will apply to AFSL and ACL holders, market operators, and clearing and settlement facilities."*[12]

Consumer groups welcomed this Government commitment. However, the draft legislation makes no mention of regulating ASIC-regulated entities. We encourage the Government to set out in the legislation when the FAR regime will apply to AFSL and ACL holders. The new regime should commence by 1 January 2023. This will provide certainty to businesses, consumers, and the community. It will allow good industry players to begin operationalising the FAR principles and will likely drive some preemptive improvements in corporate conduct.

The Explanatory Memorandum also states that the Minister will have the power to exempt entities or classes of entities from the regime.[13] We do not think it is appropriate to allow

[12] Australian Government, 2019, 'Restoring trust in Australia's financial system The Government response to the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry', https://treasury.gov.au/sites/default/files/2019-03/FSRC-Government-Response-1.pdf

[13] Financial Accountability Regime Bill 2021, Exposure Draft Explanatory Materials, 1.55

ministerial discretion to exempt an entity from the regime. If this power was established, there is a risk of unreasonable political influence in a scheme which could, for example, determine whether or not a CEO has to defer a multi-million dollar pay packet. The political influence of the financial services industry over political parties in Australia has been well documented. The FAR ought to operate under the high standards of transparency and accountability that it expects of the entities it regulates, and this is best delivered by APRA and ASIC alone.

Recommendations 8 - 9

The Government should legislate when the FAR regime will apply to AFSL and ACL holding companies. The new regime should commence by 1 January 2023 at the latest.

The Government should grant only APRA and ASIC the power to exempt entities for the new regime.

Enhanced notification threshold

It is appropriate for the FAR to utilise a tiered compliance model as it expands to all APRA- and ASIC-regulated entities. The higher regulatory burden should lie with the entities who are at greater risk of failing to meet the objectives of the FAR, because of either their complex organisational structure, or the risk of harm to consumers created by products and services the entity offers.

The "Exposure Draft Legislation Q&A – Financial Accountability Regime" outlines a model based solely on asset size to determine which APRA-regulated entities must comply with the enhanced compliance framework.[14] Yet the Royal Commission showed that entities of all sizes were found to be engaging in inappropriate behaviour, particularly where, for example, they were targeting vulnerable consumers or selling inappropriate products. The Government should consider whether other measures may be better suited to determine the benchmark for higher regulatory obligations. For example, the complexity of an organisation may be better reflected in the number of employees, and risk of harm may have geographic or product dimensions. The risk of harm could be calculated by AFCA complaints data or number of investigations by a regulator into a firm.

Recommendation 10

The Government must consider the risk of consumer harm, as well as the complexity of entities, to determine the benchmark for the 'enhanced compliance' classification.

[14] Treasury 2021, 'Exposure Draft Legislation Q&A – Financial Accountability Regime' https://treasury.gov.au/sites/default/files/2021-07/c2021-169627_questionsandanswers_2.pdf