



FINANCIAL
SERVICES
COUNCIL

Financial Accountability Regime Draft Minister Rules 2022 Consultation

FSC Submission

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1. About the Financial Services Council

The financial services industry is responsible for investing \$3 trillion on behalf of more than 15.6 million Australians. The pool of funds under management is larger than Australia's GDP and the capitalisation of the Australian Securities Exchange, and is the fourth largest pool of managed funds in the world.

The Financial Services Council (**FSC**) is a peak body which sets mandatory Standards and develops policy for more than 100 member companies in one of Australia's largest industry sectors, financial services.

Our Full Members represent Australia's retail and wholesale funds management businesses, superannuation funds, life insurers and financial advice licensees. Our Supporting Members represent the professional services firms such as ICT, consulting, accounting, legal, recruitment, actuarial and research houses.

2. Executive Summary and Recommendations

The FSC is pleased to have the opportunity to provide feedback to the draft Financial Accountability Regime Minister Rules 2022 (**Minister Rules**).

The FSC welcomes the removal of the proposed “end-to-end product responsibility”, noting that this would have represented an unduly onerous and impractical measure, and it was not clear how the end-to-end product responsibility obligation would interact with the recently introduced design and distribution obligations (**DDO**) regime.

The FSC seeks clarification on behalf of our members and makes the following key points and recommendations.

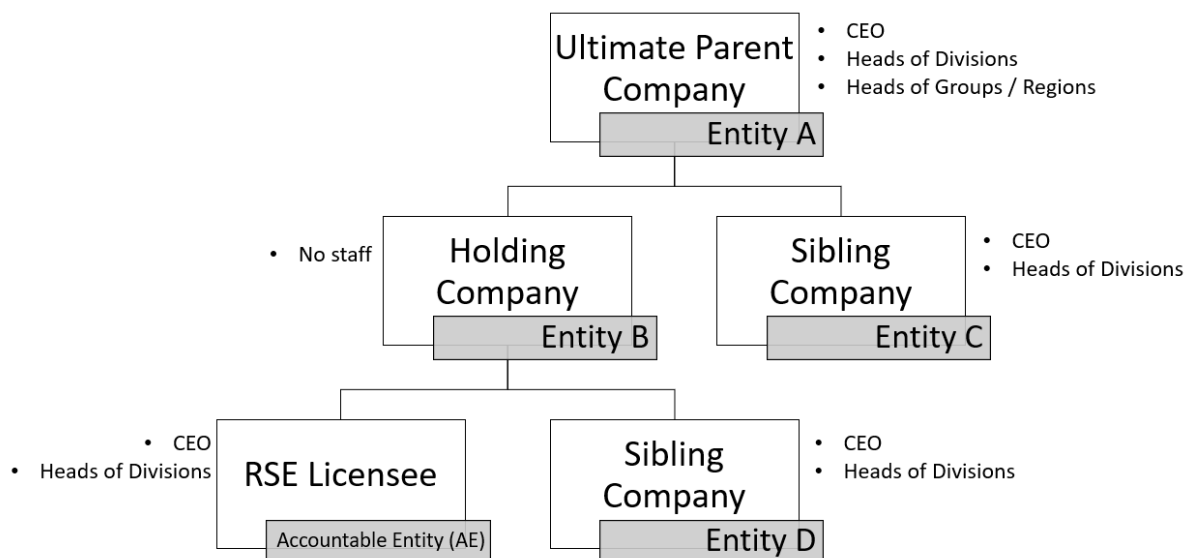
- 1 There is a lack of clarity regarding which person(s) within a significant related entity would be considered ‘accountable persons’ of an accountable entity for the purposes of the draft Financial Accountability Regime (**FAR**) Bill. Section 5(2)(g) of the Minister Rules prescribes that a person who has ‘senior executive responsibility for management or control of the business activities of a significant related entity of the accountable entity’ would be captured. We recommend that the drafting of section 5(2)(g) of the draft Minister Rules be clarified to include a nexus and significance to the operations of the accountable entity.
- 2 There is a lack of clarity regarding the impact of reporting lines for prescribed roles in an accountable entity. We recommend guidance or explanatory materials to clarify that when a senior executive in the accountable entity can be considered an accountable person based on the prescribed roles and the nature and extent of their management and control responsibilities, there will be no expectation to designate a more senior executive in other group entities notwithstanding the senior executive in the accountable entity has a reporting line to another senior executive in a related entity.
- 3 It is not clear how the approach to accountable persons will address the independent office of the superannuation trustee or “designated business unit” scenario and when persons working in such an office or unit would be considered to be accountable persons. We recommend guidance or explanatory materials to clarify the position.

Please see below for further detail.

3. Senior Executive Responsibility in Corporate Group context

Set out below is a case study which seeks to illustrate the problem of the lack of clarity regarding: (a) the drafting of section 5(2)(g) of the Minister Rules and therefore the types of people caught as ‘accountable persons’ of accountable entities, and (b) reporting lines relating to prescribed roles.

Case Study – RSE Licensee within a group structure



For the purposes of this case study:

- Entities A, B, C and D are all considered connected entities of the AE according to the Superannuation Industry (Supervision) Act 1993 as they are related bodies corporate.
- Entity A is considered to be a significant related entity of the AE according to the FAR Bill (section 12(3)), as a part of their business activities (which is managed by the Head of Group / Region) is likely to have an effect on the accountable entity that is material and substantial.
- Entity D is considered to be a significant related entity of the AE according to the FAR Bill (section 12(3)), as it provides a number of services to the AE and those business activities (which are led by respective Heads of Divisions) are likely to have an effect on the accountable entity that is material and substantial.
- Entities B and C are not considered to be significant related entities of the AE.

Issue 1 – senior executive responsibility for management or control of the business activities of a significant related entity

In reading section 10(6) of the draft FAR Bill, a person is considered an accountable person of a significant related entity of an accountable entity if: (a) the person holds a position in the

significant related entity, and (b) because of that position, the person has actual or effective senior executive responsibility for (i) management or control of the accountable entity, or (ii) for management or control of a significant or substantial part or aspect of the operations of the accountable entity or the accountable entity's relevant group. A 'relevant group' means the accountable entity and its significant related entities. Therefore, under this section, the accountable persons of Entities A and D are senior executives who have responsibility over a significant or substantial part or aspect of the operations of the AE, or the AE and its significant related entities as one group. For Entity A, this would be the Head of Group or Head of Region (as it relates to the business activities that impact the operations of the AE), and for Entity D it would be the Head of Division (only for the services provided to the AE).

However, in reading section 5(2)(g) of the draft Minister Rules, the senior executive with responsibility for management or control of the business activities of a significant related entity of the accountable entity is considered to be an accountable person of the accountable entity. Per the Explanatory Statement to the Minister Rules, this could be interpreted to include the CEOs and the entire executive team of Entities A and D, even though those individuals may not have any nexus to the operations of the AE. So it could capture executives who are responsible for areas of business which have little to no impact or significance to the operations of AE.

Designating the senior executives in a significant related entity who have the accountability and responsibility for the day-to-day decision making in relation to the activities of the AE would be more consistent with the intent of the legislation which has a focus on operational accountability. For example, in the Explanatory Memorandum to the draft FAR Bill, the objective of the Bill is to:

- enhance the *operating culture* of accountable entities¹, and
- impose a strengthened responsibility and accountability framework for Australia's financial institutions which requires entities to nominate senior and influential executives to be responsible for all areas of their *business operations*.²

In addition, under section 21 of the draft FAR Bill, the accountability obligations of an accountable person, or of a significant related entity of an accountable entity, are to conduct the responsibilities of their position as an accountable person by, amongst other things:

- dealing with the regulator in an open, constructive and cooperative way;
- taking reasonable steps in conducting those responsibilities to prevent matters from arising that would adversely affect the prudential standing or prudential reputation of the accountable entity; and

¹ See section 1.3, Explanatory Memorandum, FAR Bill 2022.

² See sections 1.7 and 1.8, Explanatory Memorandum, FAR Bill 2022.

- taking reasonable steps in conducting those responsibilities to prevent matters from arising that would result in a material contravention by the accountable entity of a range of Australian laws.

These references indicate that the legislation is intended to focus on those senior executives that have a level of involvement and day to day influence as it relates to the operations of the accountable entity. In the case of entities A and D, this would be the Head of Group/Region or the Head of Division, respectively. The CEOs (and other senior executives) of entities A and D in this example do not have management or control of a significant or substantial part of the AE but instead have management or control for the significant related entity's business. In the context of senior executives in particular, we note that not all aspects of the business and functions of a significant related entity will be relevant to the operations of the accountable entity. The executive team of Entities A and D may have responsibilities that only tangentially relate to the AE to the extent that the AE is an entity in its corporate group, but not in a manner that is material or significant to the operations of the AE. Designating them as accountable persons would lead to illogical outcomes – in particular, accountability statements and maps would cover activities that are not relevant to the accountable entity's operations. In addition, certain measures in the FAR Bill such as the deferral of executive remuneration will be disproportionate to the involvement of these senior executives in the activities of the accountable entity.

This would likely result in an increase of legal, HR and administrative costs, for no consumer benefit. In addition, the overreach of the legislation may deter corporate groups from participating in the industry, which could reduce overall competitiveness.

Recommendation: the drafting of section 5(2)(g) of the draft Minister Rules should be clarified to include a nexus and significance to the operations of the accountable entity. Commentary should be put in the Explanatory Statement to the Minister Rules explaining the need for such nexus before an executive in a significant related entity is considered an 'accountable person' for the purposes of the FAR legislation.

Issue 2 – reporting lines in prescribed roles

In reading section 5 and section 8 of the draft Minister Rules, we understand that the intention is to capture senior executive responsibility, as opposed to execution of an activity or function. In a group reporting situation, the definition of a 'senior executive' may be open to interpretation.

Using section 5(2)(b) as an example, the AE Head of Risk would be interpreted as having a senior executive responsibility for management of the AE's overall risk controls or overall risk management arrangements. However, if the AE Head of Risk has a group reporting line to Entity A's Head of Risk, it is unclear as to whether the interpretation of 'senior executive' would cover Entity A's Head of Risk.

We would suggest that the Explanatory Statement be updated to confirm that where 'senior executive responsibility' of a certain function sits in a certain individual, the fact that this individual has a 'reporting line' to another executive in another entity does not of itself capture

that other executive. Instead, the focus should be on the individual that performs the substance of the prescribed role.

Recommendation: guidance or explanatory materials to clarify that when a senior executive in the AE can be considered an accountable person based on the prescribed roles, there will be no expectation to designate a more senior executive in other group entities.

4. Independent Office of the Superannuation Trustee.

The FSC notes that many Responsible Superannuation Entity licensees (RSEs) maintain an independent office of the superannuation trustee or “designated business unit” with its own executive staff who may report to the Board of the RSEL rather than to the CEO or other senior executives of the broader organisation. Often, this has been required by APRA of RSEs. The RSEL may receive services from significant related entities, with their own senior executives of the broader organisation. It is unclear how FAR is intended to respond to that situation in order to determine accountable persons.

It also seems to us to be an unusual and indeed odd outcome if senior executives of significant related entities, always acting on an arm’s length basis in relation to the RSEL with deliberate oversight and scrutiny by the designated business unit, could be captured as accountable persons, where the very purpose of the designated business unit is to disrupt undue influence on RSEL decision-making (unless, of course, the RSEL delegates authority to a senior executive of a significant related entity to make a decision).

In addition, we note that Section 5(3) of the draft Minister Rules clarifies that the prescribed responsibilities are intended to capture senior executive responsibility for management of an activity or function, distinct from a (typically lower level) responsibility for carrying out or executing the activity or function.

However, the personnel working in an independent office of the superannuation trustee or “designated business unit” may be less senior, yet often exercise more influence (including through the flow of information that informs RSEL decision-making).

Further, the fiduciary obligations of a RSEL, as trustee of a superannuation fund (including proscriptions on being directed and delegating certain responsibilities), further limit the ability for senior executives of significant related entities to influence or control the RSEL.

Recommendation: we recommend guidance or explanatory materials to clarify the position.