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By email

Dear Director

## **Submission on Exposure Draft of Financial Accountability Regime Minister Rules 2022**

This submission is made by Herbert Smith Freehills in response to the Exposure Draft of the Financial Accountability Regime (**FAR**) Minister Rules 2022 (**Draft Rules**) and the Exposure Statement (**Draft ES**) released for consultation on 12 September 2022.

The Draft Rules will prescribe aspects that are central to the operation and implementation of the Financial Accountability Regime Bill (**FAR Bill**), including the prescribed responsibilities and positions that cause a person to be an accountable person for the purposes of FAR.

We are pleased to see that consultation on the Draft Rules is taking place at the same time as the FAR Bill is being considered by Parliament. It will be important for the final Minister Rules to be made available as soon as possible after the FAR Bill is passed by Parliament to provide potential accountable entities with sufficient time to comply with the FAR requirements.

We welcome this opportunity to make a submission on the Draft Rules and Draft ES.

### **1 Prescribed responsibilities and positions**

#### **1.1 General comments**

We are pleased to see that clarity has been provided on the following:

1. **Focus on management of, not undertaking, activities:** The Draft Rules make it clear that the 'accountable person' roles are intended to focus on persons with senior executive role or responsibility for management of specified activities or functions of an accountable entity rather than persons merely carrying out those activities or functions (section 5(3) of the Draft Rules and page 4 of the Draft ES).

While this was how we had interpreted the equivalent provisions under the Banking Executive Accountability Regime (**BEAR**), there was residual uncertainty in the banking industry about this.

2. **Multiple accountable persons for one prescribed responsibility:** The Draft ES notes that one prescribed responsibility may capture multiple individuals and accountable persons will only be held accountable to the extent of their involvement in and responsibility for any contravention, as if the position or responsibility were solely theirs (page 4 of the Draft ES).

Under BEAR, we understand that ADIs were expected to only nominate one person for each prescribed responsibility and that if more than one person was nominated, they were jointly accountable for the whole prescribed responsibility. We hope that this clarification in the Draft ES (together with proposed section 21(2) of the FAR Bill)



will result in more clearly defined responsibilities and hand-offs between accountable persons in practice.

**Submission 1: It would be helpful for Treasury to provide additional examples in the Explanatory Statement about where a prescribed responsibility could be divided between two or more accountable persons. This will guide accountable entities and the regulators with implementation of FAR.**

**1.2 Prescribed responsibilities for accountable entities other than foreign accountable entities and NOHCs (section 5 of the Draft Rules)**

We have set out below our comments and suggestions in relation to the prescribed responsibilities that apply to accountable entities other than foreign accountable entities and NOHCs:

Responsibility	HSF submission and comments
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**Operations:**  
Management or control of the accountable entity's operations (section 5(2)(a)(iii))

While 'operations' was a particular responsibility under BEAR, there was some confusion about what was meant by this term and ADIs grappled with the question of who to nominate as the accountable person with this responsibility. In multiple cases, this resulted in the CEO being nominated as having this responsibility. Even where an ADI had a designated 'Chief Operating Officer' (**COO**), it was not clear whether BEAR was intending to capture that person as the accountable person under the 'operations' limb of the definition or another person.

As this question will also arise under FAR, it would be helpful for Treasury to explain what is intended by the reference to 'operations' and we would suggest providing further guidance than what is provided in the Draft ES, which only refers to a COO role, as not all accountable entities will have this role. This would also promote consistency across the industry.

It would also be helpful for the Explanatory Statement to acknowledge that the CEO may be responsible for the management or control of the operations, without the need to have this role being performed by another person, if that reflects the way the entity is managed.

**Submission 2: We suggest a definition and/or guidance be provided in the Draft ES on what is meant by 'operations' in section 5(2)(a)(iii) of the Draft Rules.**

**Anti-money laundering (AML):**  
Management of the accountable entity's AML function (section 5(2)(d)(iv))

While nominating AML as a particular responsibility under BEAR made sense given the application of AML/counter-terrorism financing (**CTF**) laws to ADIs, we note that the provision of general insurance is not currently a 'Designated Service' under the AML/CTF laws. In our view, it would make sense to limit this prescribed responsibility to ADIs only. Alternatively, the prescribed responsibility could be framed as applying to those entities which are required to be registered with AUSTRAC under the AML/CTF laws.

Having a prescribed responsibility for general insurers (who may or may not be required to be registered with AUSTRAC) may cause confusion

since the AML/CTF laws may not in all cases apply to these entities and ambiguity as to what would be required of those entities.

**Submission 3: We suggest that the reference to responsibility for the AML function in section 5(2)(d)(iv) be limited to applying to ADIs only, or alternatively, apply only to those entities that are required to be registered with AUSTRAC.**

**Dispute resolution function:**

Management of the accountable entity's dispute resolution function (whether internal or external, or both) (section 5(2)(d)(v))

It is not currently clear what is meant by the responsibility relating to the 'dispute resolution function' and this is open to a wide interpretation – for example, it could cover disputes with service providers, disputes between employees (which would be a human resources matter), customer complaints (which may or may not include matters capable of referral to AFCA), regulatory investigations and enforcement activity, as well as a wide range of other possible types of disputes.

We note there are particular statutory obligations in relation to internal and external dispute resolution set out in the *Superannuation Industry (Supervision) Act 1993* (Cth) for registrable superannuation entity (RSE) licensees, in the *National Consumer Credit Protection Act 2009* (Cth) for credit licensees and in Chapter 7 of the *Corporations Act 2001* (Cth) (Corporations Act) for Australian financial services (AFS) licensees. Further, there are legally binding elements of ASIC's Regulatory Guide 271 (Internal dispute resolution).

In our view, to promote consistent and effective implementation of the FAR by accountable entities, this prescribed responsibility should be defined by reference to the internal and external dispute resolution obligations under existing laws.

**Submission 4: We suggest the prescribed responsibility in section 5(2)(d)(v) in relation to the dispute resolution be defined by reference to the obligations in s912A(1)(g) and 1017G(1) of the Corporations Act, s47(1)(h) and (i) of the National Consumer Credit Protection Act 2009 (Cth), s101(1) and (1A) of the Superannuation Industry (Supervision) Act 1993 (Cth) and s47(1) and (2) of the Retirement Savings Account Act 1997 (Cth).**

**Remediation programs & hardship arrangements:**

Management of the accountable entity's client or member remediation programs (including hardship arrangements) (s5(2)(e) of the Draft Rules)

Treasury may want to consider separating the responsibilities for 'remediation programs' and 'hardship arrangements' (rather than including the latter as a subset of the former) because for these are typically distinct areas that would likely be allocated to different accountable persons.

By way of background:

- client or member remediation programs relate to reimbursing customers when something has not operated as intended within an accountable entity; and
- hardship arrangements relate to putting processes in place for customers when circumstances mean they are unable to meet their commitments to accountable entity.

The linkage between these two areas is not clear on the face of the Draft Rules or Draft ES.

While the Draft ES acknowledges that one responsibility can be divided between accountable persons, given the differing nature of the responsibilities, in our view, it would make sense to separate these.

**Submission 5: We suggest separating the responsibilities that deal with remediation programs and hardship in section 5(2)(e) of the Draft Rules into two separate responsibilities.**

**Significant related entities (SREs):**  
Management responsibility or control of the business activities of an SRE (section 5(2)(g) of the Draft Rules)

Under the FAR Bill, there are multiple references to an accountable person of the accountable entity 'or a significant related entity', including under section 10(6) of the FAR Bill, which includes a definition for an accountable person of an SRE.

We interpret these provisions in the FAR Bill to mean that an SRE must have an accountable entity with responsibility for it. However, the Draft Rules also include a prescribed responsibility of this nature. It is not clear to us what is intended by the prescribed responsibility relating to SREs under section 5(2)(g) that is over and above what is already provided for in the FAR Bill and this could potentially lead to confusion about what this means for the practical implementation of the requirements relating to SREs.

In addition, many SREs will be part of a corporate group and operated in this context rather than as a stand-alone entity. In practice, this means that there may not be one individual who has management responsibility for an SRE, but instead, various accountable persons may have responsibilities relating to the SRE in the same way as they do for the accountable entity e.g. the CRO's responsibilities in relation to risk management may cover both the accountable entity and the SRE in the same way. In this context, having a prescribed responsibility that specifically picks up SREs could cause duplication.

**Submission 6: We suggest the prescribed responsibility in section 5(2)(g) relating to SREs be removed, or if it is retained, the Draft Rules and/or Draft ES should clarify what is intended by prescribing this responsibility in addition to what is provided for in the FAR Bill itself and how this should be applied in a corporate group context.**

Currently, the FAR Bill proposes a staged commencement of the FAR in that ADIs will first be required to comply 6 months after commencement of the FAR Act whereas insurers and RSE licensees will be required to comply 18 months after commencement of the FAR Act.

In the case of ADIs that have an insurance or superannuation business, as the FAR Bill and the prescribed responsibility in section 5(2)(g) of the Draft Rules are currently drafted, it appears that an insurer or an RSE licensee will be captured as an SRE, even though the insurer or an RSE licensee would not otherwise be an accountable entity until 12 months later.

This creates an anomaly between those RSE licensees that are part of an ADI group and those that are not. In our view, if this prescribed responsibility is retained, it should only cover SREs that will not of

themselves be accountable entities when FAR commences for insurers and RSE licensees 18 months after commencement of the FAR Act.

**Submission 7: If section 5(2)(g) is retained, we suggest that it be amended to make it clear that an accountable person only needs to be nominated for an SRE that will not itself be required to comply with FAR when the legislation commences for RSE licensees and insurers 18 months after commencement of the FAR Act.**

The definition of a SRE in the FAR Bill for RSE licensees will, in most cases, extend to capture employer-sponsors of superannuation funds, which appears to be an unintended consequence of the drafting.

We note that carving out employer-sponsors from the definition of SRE accords with the public policy rationale for a range of existing exemptions for employer-sponsors (including from the AFS licensing regime and from the financial services regulatory regime generally). This includes that imposing such obligations on employer-sponsors is disproportionate and represents no regulatory benefit given the existing regulation of the product issuers and superannuation fund trustees.

In our view, to reflect the Parliamentary intent of the FAR Bill, there should be a clear and express exemption from the definition of SRE for RSE licensees that applies to employer-sponsors of superannuation funds.

**Submission 8: If section 5(2)(g) is retained, we suggest that it be amended to provide that employer-sponsors of superannuation funds are not SREs of RSE licensees for the purposes of the FAR Act.**

## 2 Prescribed responsibilities for NOHCs (section 10 of the Draft Rules)

In our view, the prescribed positions and responsibilities for NOHCs do not reflect the practical reality of a NOHC (being, that it has no operations) and would impose obligations on the NOHC which are likely to be entirely duplicative. By definition, a NOHC is non-operating and its oversight activities of the broader group are undertaken by the NOHC's board of directors. The operational activities of the broader group are undertaken by the management team (all the other accountable persons) of the operating accountable entities that sit beneath the NOHC. Therefore, it does not make sense to require the NOHC itself to have executive accountable persons in each of the categories included in section 10 of the Draft Rules.

We suggest that the NOHC only be required to have Board members as accountable persons. To the extent those same individuals are also accountable for operating businesses, they will be accountable persons of other accountable entities in the group.

**Submission 9: We suggest that the prescribed responsibilities and positions for the NOHC in section 10 be limited to the members of the board of directors of the NOHC to reflect the holding company nature of a NOHC and that it does not have separate operations to the accountable entity that is its subsidiary.**



We are grateful for the opportunity to make this submission and would be happy to discuss this further. If you have any questions about our submission, please do not hesitate to contact us.

Yours sincerely

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