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Ms Ly Reeve
Manager, Redress and Accountability Unit
Financial Services Reform Taskforce
The Treasury
Langton Crescent
PARKES ACT 2600

By email: FAR@treasury.gov.au

Dear Ms Reeve,

Financial Accountability Regime (FAR)

The Australian Finance Industry Association (AFIA) welcomes the opportunity to provide a response to Treasury on the Proposals Paper for Implementing Royal Commission Recommendations 3.9, 4.12, 6.6, 6.7, and 6.8, to extend the Banking Executive Accountability Regime (BEAR) to all APRA regulated entities and provide joint administration to ASIC as the conduct regulator.

AFIA is committed to ensuring that all Australians have continued access to finance, while enhancements to consumer protections are made following the *Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry* (Royal Commission).

AFIA Background

AFIA represents over 100 providers of consumer, commercial and wholesale finance in Australia from retail banks, finance companies, credit card issuers, and Fintechs, including buy now pay later providers (for more information about AFIA, please see Annexure A to this submission).

AFIA's role as an industry body is to drive industry leadership and represent members' views, facilitate self-regulation through industry codes, and to work with the Federal Government, financial regulators and other stakeholders to promote a supportive environment for the industry.

Our guiding principles seek to build these settings in order to:

- Promote simple, convenient, innovative and affordable credit to finance Australia's future, including maximising access to credit for customers able and willing to service their commitments and minimising the likelihood or incidence of customers entering into unsuitable credit contracts;

- Foster competition and innovation in Australia's financial services industry, enabling our members to grow, expand and thrive as key participants in lending and other markets; and
- Generate greater financial and economic participation by consumers and small businesses in Australia's financial system and economy and improve social participation to create financial wellbeing.

To do so, we focus on the key drivers that provide positive customer outcomes, foster competition and innovation within industry, and facilitate financial, economic and social engagement by both customers and industry.

Our Submission

We support the Federal Government's commitment to improve governance practices and strengthen accountability of directors and senior executives in financial institutions. However, we are concerned about further expansion of the BEAR as it would be applied to authorised deposit taking institutions (ADIs) and therefore how this would be applied to other APRA regulated entities, including superannuation and insurance companies, as contemplated in the Proposals Paper.

We also do not support the blanket extension of the BEAR to ASIC regulated entities, which is beyond the scope for which these rules were designed.

We believe the Government's commitment to enhance the obligations of APRA regulated entities will improve the overall risk culture and governance of these entities. It is important to establish a clear framework of accountability for directors and senior executives. However, the proposed increase in organisational accountabilities, liabilities and penalties will impact on innovation by, and investment in, Australia's financial institutions and discourage domestic and international executive talent.

Furthermore, we note the Proposals Paper proposes the introduction of a legislative instrument to enable ASIC to administer the BEAR and extend the current proposed FAR to Australian Financial Services licensees and Australian Credit licensees, which are not APRA regulated.

The Government's roadmap indicates that this proposal will be consulted on and introduced by the end of 2020. We are concerned this timeframe is unrealistic and unreasonable, particularly given the cumulative impact of the vast array of changes underway in the industry, including legislative and regulatory changes, compliance system changes, technology changes and new industry standards voluntarily being adopted through codes of practice, and the likely significant impact across the different ASIC regulated entities.

If the Government proceeds with the extension of the FAR to ASIC regulated entities, it is critical that thorough consideration is given to the impact of extending the FAR to ASIC regulated entities and how to balance the objectives of strengthening governance, accountability and transparency without causing unnecessary compliance complexities and costs and impeding competition, innovation, customer choice and accessibility. Additionally, it is crucial that an adequate consultation period is provided and reasonable commencement, transition and compliance timeframes are identified and introduced.

Members are concerned that in the event the FAR is extended to ASIC regulated entities, especially to parts of the industry and emerging sectors where significant risks have not been evidenced to justify additional regulation, it will be detrimental to growth, competition, innovation, and create further barriers of entry to the market.

Importantly, we support:

1. Regulation where there has been a market failure and when it is used to foster an appropriate environment, where intervention is required to achieve optimal outcomes for customers, businesses, the financial system and the broader economy, and where those interventions are deemed economically necessary and beneficial. The purpose of the BEAR is to establish clear and heightened expectations of accountability for ADIs, their directors and senior executives, and to ensure there are clear consequences in the event of a material failure to meet those expectations¹.
2. Reforms that are intended to reduce harm to consumers caused by misconduct, and strengthen risk management and market integrity by making individuals more accountable for their conduct and competence. However, we believe that the operational and compliance costs of extending FAR to ASIC regulated entities will outweigh the benefits of the proposed FAR and introduce unnecessary and unreasonable regulatory and compliance burden on entities with very different business models and financial activities to APRA regulated entities.

We note that while the structure of the proposed FAR is similar to the BEAR, it does differ in a number of respects. In particular, the civil penalties for breach of FAR obligations will be larger and will apply to both entities and potentially a broader category of individuals. APRA and ASIC currently have numerous powers available to them to take regulatory actions and impose penalties, and it is unclear from the Proposals Paper on how penalties imposed under the FAR will work alongside these existing powers. It is important that clarity on this issue is provided, as it would be unjust for ASIC and APRA to have the power to separately pursue a penalty for the same offence.

Members are concerned that the imposition of civil penalties under the FAR will detrimentally affect a firm's ability to compete both domestically and internationally for executive talent. Furthermore, it is likely that as a result of imposing civil penalties on individuals, FAR regulated entities will see increased remuneration and insurance costs across multiple levels, in order to protect and compensate for the increased liability.

At a high level we support increased accountability and transparency for directors and senior executives in financial institutions. However, there is doubt that the requirement to defer 40 per cent of variable pay for four years will achieve this outcome. The current proposals do not take into account the size of entity, nor the seniority of the individual, as is currently the case under the BEAR. This is likely to have a negative impact on growth as it will mean granting higher fixed pay (i.e. salaries) to compensate for these deferrals and could be detrimental for smaller FAR regulated entities to compete for executive talent.

¹ http://www.apra.gov.au/sites/default/files/information_paper_implementing_the_bear.pdf

We support ASIC and APRA being joint administrators of the FAR, however, it is important that a clear governance framework is established, and that an adequate consultation period is provided, in order to ensure certainty and consistency in the expectations set by both regulators. We note the importance of examples and guidelines to be included in the framework to clearly outline the approach both regulators will take when administering the FAR. Further guidance is also needed to be provided in the governance framework for scenarios where ASIC and APRA may have divergent views.

Recommendations

In establishing the FAR, Treasury should consider:

1. The impact on Australia's financial institutions with the approach contemplated in the Proposals Paper, particularly where this goes well beyond the existing BEAR and where the FAR would be imposed inappropriately across entity types. We encourage Treasury to examine:
 - The UK Senior Managers Regime and experience with the application and extension of that regime in terms of definitions, categories, requirements, commencement, transition and compliance timeframes, etc.
 - Research and organisational psychology that concludes more regulation, rules and procedures leads to a decline in clarity and employee accountability, which in turn lowers the quality of professional judgement and commitment to living up to ethical standards.
2. Whether there is evidence of the need to extend the FAR to ASIC regulated entities, and if so, for each sector to be considered individually, taking into consideration the nature, scale, complexity and size of the entities.
3. Providing further guidance and examples on how individual civil penalties will be imposed, and the methodology to be used when deciding the penalty amount, and how the application of penalties will apply and be administered by both regulators. In particular, further guidance and examples are needed on "how the court can determine – the benefit derived, or detriment avoided because of the contravention, multiplied by three". We recommend that when deciding on the appropriate size of the penalty, factors such as mitigating steps the individual and/or financial institution has taken, and the disciplinary actions taken (i.e. remuneration adjustment, employment/role adjustment, etc) should be taken into account.
4. Providing further guidance and examples on how both regulators will co-administer the FAR, especially where an entity is regulated by both APRA and ASIC. We recommend in particular that clarity is provided on how both regulators will conduct surveillance activities, monitor compliance, pursue enforcement action (both regulators should not be able to pursue enforcement action for the same offence), and the process to be undertaken for instances where both regulators have divergent views.
5. The costs associated with deferring variable pay and implementing systems that can track the variable remuneration model so that there can be appropriate tracking.

6. Providing for scalability of the deferment of variable pay to take into account the size of the entity, and seniority of the individual, as is the case currently under the BEAR.
7. The Australian Law Reform Commission (ALRC) research and consultation regarding liability for corporate crime and ensuring the law does not impose undue and unreasonable liabilities on individuals².
8. Additional risk culture and risk management reforms to accompany the introduction of the FAR, including:
 - Revised licensing criteria to lift standards and ensure consistency across Responsible Managers.
 - Revised regulatory guidance to ensure AFS licenses and AC licensees met their general obligations, including acting efficiently, honestly and fairly, being competent to provide financial products and services and/or engage in credit activities, managing conflicts of interest, having adequate resources, compliance systems, risk management systems, complaint and dispute handling processes and compensation arrangements, etc.
 - Improved industry standards through a structured and integrated framework for improving risk culture and redesigning strategy and risk controls, including customer and stakeholder governance, product, service and channel customisation, data and risk analytics, integrity, etc.

Should you wish to discuss our feedback further, or require additional information, please contact Chalisa Parekowhai, Associate Director, Policy at chalisa@afia.asn.au or on 02 9231 5877.

Kind regards,



Diane Tate
Chief Executive Officer

² <http://www.alrc.gov.au/inquiry/corporate-crime/> and <http://www.alrc.gov.au/news/when-should-officers-be-liable-for-corporate-crime/>

Annexure A

The Australian Finance Industry Association (AFIA) is the voice of a diverse Australian finance sector. AFIA represents over 100 providers of consumer, commercial and wholesale finance in Australia which includes:

- Major, regional and mutual/community owned banks,
- Providers of consumer finance, including home loans, personal loans, consumer leases, credit cards, buy now pay later services, and debt purchasers,
- Providers of land finance, including residential and commercial mortgages and bridging finance;
- Equipment financiers, including commercial equipment financing ranging from agri-equipment to small ticket equipment financing,
- Motor vehicle financiers, including consumer motor finance, novated motor finance, small business motor finance and heavy vehicle finance,
- Fleet leasing and car rental providers, and
- Providers of commercial finance, including secured and unsecured loans and working capital finance to businesses, including small businesses.

AFIA's members range from ASX-listed public companies through to small businesses providing finance, which operate via a range of distribution channels, including through 'bricks and mortar' premises (physical branches and other outlets), via intermediaries (including finance brokers, dealerships, retail suppliers), and through online access or platforms (traditional financial institutions and fintechs).

AFIA's members collectively operate across all states and territories in Australia and provide finance to customers of all demographics from high to low-income earners and to commercial entities ranging from sole traders, partnerships and across the corporate sector in Australia.

AFIA's members provide a broad range of products and services across consumer and commercial finance, a snapshot of these include:

- consumer: home loans, personal unsecured loans, revolving products (including credit cards and interest free products coupled with lines of credit), personal secured loans (secured by land or personal property); consumer leases of household assets (including household goods, electrical/IT devices or cars) and buy-now, pay later services.
- commercial: land, asset or equipment finance (finance/operating lease, secured loan or hire-purchase agreement or novated leases); business finance and working capital solutions (secured loans, online unsecured loans; debtor and invoice finance; insurance premium funding; trade finance; overdrafts; commercial credit cards), together with more sophisticated and complex finance solutions.

For further information about AFIA, please see [here](#).