

August 2021

# Financial Accountability Regime (FAR) – Draft Legislation 2021 Update

Further to our [August 2020 White Paper](#), Treasury has now released consultation draft legislation for the proposed Financial Accountability Regime (FAR)<sup>1</sup> and has indicated that legislation is expected to be passed by the end of 2021.

Significantly and fortunately, accountable persons will not be subject to penalties for breaches of their FAR obligations as was previously foreshadowed. Unlike the Banking Executive Accountability Regime (BEAR), there will no longer be any prohibition in respect to indemnification or insurance cover for an accountable person's breach of FAR.

This paper focuses on how your professional indemnity (PI) and directors and officers (D&O) liability insurance may respond to the proposed new accountability regime.

## 1. Cover for Accountable Persons

The definitions of 'Insured Persons' under both PI and D&O policies are generally quite broad and are likely to already cover some 'accountable persons'. However, this definition should be carefully reviewed and tailored if necessary to ensure that all 'accountable persons' are expressly covered.

A person is an 'accountable person' if they have senior executive responsibility for a significant or substantial part of the entity or hold a prescribed responsibility or position.

## 2. Cover for Accountable Entities

FAR will apply to all Australian Prudential Regulation Authority (APRA) regulated entities – namely, authorised deposit-taking Institutions (ADI) and general and life insurers (including to their non-operating holding companies (NOHC)), private health insurers and registerable superannuation entity (RSE) licensees).

Unlike PI policies, cover is generally not available under D&O policies<sup>2</sup> for the entity in respect of its own liability, with the limited exception of those D&O policies that include cover for securities claims.

## 3. New obligations and the definition of Wrongful Act

Accountable entities must comply with their accountability, key personnel, deferred responsibility and notification obligations.

Relevantly, accountable entities will be required to, amongst other things, conduct its business with honesty and integrity, due skill, care and diligence. They will also be required to prevent matters from arising that would (or would be likely to) adversely affect its prudential standing or reputation, including in relation to 'significant related entities' (for example subsidiaries) whose poor behaviour has the potential to adversely affect the prudential standing or reputation of the entity itself. They must deal with both Australian Securities and Investments Commission (ASIC) and APRA in an open, constructive and co-operative way.

Similarly, accountable persons are obliged to, amongst other things, act with honesty and integrity, due skill, care and diligence and in a manner that prevents adverse impact to the entities prudential standing. Accountable persons are also required to deal with APRA and ASIC in an open, constructive and co-operative way. Unlike BEAR, accountable persons under the draft FAR legislation are obliged to take reasonable steps to ensure compliance by the entity with certain laws relating to the financial sector, which are within their area of responsibility.

<sup>1</sup> Also released is the *Financial Accountability Regime Bill 2021 Exposure Draft Explanatory Memorandum, Joint Administration of the Financial Accountability Regime between APRA and ASIC: Information Paper* dated 16 July 2021 and *Financial Accountability Regime - List of Prescribed Responsibilities and Positions: Policy Proposal Paper* dated 16 July 2021

<sup>2</sup> Different considerations apply for management policies issued to non-profit or private for profit companies.

An accountable entity is also required to take reasonable steps to ensure its accountable persons and significant related entities comply with their respective accountability obligations.

D&O policies generally provide cover for claims against insured persons arising from any wrongful act or omission committed in their insured capacity, unless the wrongdoing is specifically excluded from coverage.

PI policies are similar except that the wrongful act will typically tie back to any actual or alleged act, error, omission in the performance of or failure to perform 'Professional Services' by any 'Insured' or any other person for whom an 'Insured Company' is legally liable.

The definition of 'Wrongful Act' in both PI and D&O policies is typically broad enough to capture statutory breaches of APRA and ASIC administered legislation.

## 4. Cover for Regulatory Investigations

FAR will be jointly administered by ASIC and APRA (except for those entities that do not hold an Australian Financial Service Licence (AFSL) or Australian Credit Licence (ACL) who will be regulated by APRA only). This is to ensure the FAR is enforced from a prudential perspective as well as from a conduct and consumer outcomes based perspective.

Both APRA and ASIC have a number of powers to administer the regime, including information gathering and investigation powers, power to issue directions relating to non-compliance, and powers to disqualify an accountable person.

Most D&O and PI policies include cover for regulatory investigations. Typically, the reasonable fees, costs and expenses incurred by an insured person in preparing for, attending or producing documents at an investigation by an official body (such as ASIC or APRA) will be covered. However, cover can vary significantly and can be sub-limited and subject to additional exclusions. This cover typically does not extend to investigations of an insured entity.

## 5. Definition of Claim

Failure to comply with an obligation under FAR may enable enforcement actions to be taken such as disqualification of the accountable person.

While the better D&O policies include cover for Prosecution Costs, allowing an insured person to bring proceedings to challenge an order disqualifying them from holding office as a consequence of a claim or regulatory investigation not all do. Does yours?

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## 6. Cover for Fines and Penalties

If an accountable entity fails to comply with any of their obligations under the proposed FAR, it may be subject to a civil penalty the greater of 50,000 penalty units, 3x value of the benefit derived/detriment avoided or 10% of annual turnover up to 2.5 million penalty units.

The draft legislation has not taken up a previous proposal that accountable persons also be subject to penalties for breaches of their obligations.

While the better D&O policies include cover for fines and penalties for insured persons, this cover does not extend to fines or penalties imposed on insured entities. Further, most PI policies exclude cover for fines and penalties.

## 7. Insurance Policies

Like BEAR, a related body corporate of an accountable entity is prohibited from indemnifying and from paying premiums for an insurance contract that would insure the accountable entity against the consequences of breaching FAR. Anything that purports to provide such indemnity or insurance is void. This prohibition does not apply to legal costs. A special exclusion has been added to policies to address this issue.

Pleasingly and unlike BEAR, there is no prohibition relating to indemnification of or payment of insurance premiums for an accountable person's breach of FAR. Another positive note is that most D&O and PI policies include an advance payment promise in relation to defence expenses and the better ones include final adjudication language in relation to the application of the conduct (dishonesty) exclusion.

## Next Steps

Interested parties have until 13 August 2021 to make submissions on the proposed draft legislation. At this stage, FAR is proposed to gradually come into force during the course of 2022 and 2023. While most D&O and PI policies will provide some level of comfort for the proposed new accountability regime, policy wordings should be reviewed and tailored if necessary to ensure that the maximum protection is available.

**For further information, please contact your Marsh broker or visit our website at [marsh.com](https://www.marsh.com).**



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