

February 2024

Will you be FAR ready by 15 March 2024?

Update on insurance implications

From 15 March 2024, the *Financial Accountability Regime Act 2023 (Cth)* (FAR Act) will come into effect, replacing the Banking Executive Accountability Regime (BEAR)¹ and apply to all authorised deposit-taking institutions (ADIs). Additionally, the *Financial Accountability Regime (Consequential Amendments) Act 2023 (Cth)* (FCA Act) will provide various transitional mechanisms for ADIs previously subject to the BEAR.

Further to our previous whitepapers, we provide below an update on how your professional indemnity (PI) and directors and officers (D&O) liability insurance may respond to the FAR Act and the FCA Act – together the **new financial accountability regime**.² This paper also provides guidance on potential amendments you may need to consider under your insurance policies to address the new financial accountability regime.

1. Cover for Accountable Entities

The FAR Act will apply to all APRA regulated entities namely:

- From 15 March 2024: ADIs
- From 15 March 2025: General and life insurers including to their non-operating holding companies (NOHC), private health insurers and registerable superannuation entity (RSE) licensees and Australian branches of foreign accountable entities

being 'accountable entities' for the purposes of the FAR Act.

The FAR Act applies directly to 'accountable entities'³ and indirectly to 'significant related entities'⁴ of 'accountable entities'.

Unlike PI policies, cover is generally not available under D&O policies for the 'accountable entity' in respect of its own liability with the limited exception of those D&O policies that include cover for securities claims. Separately, different considerations apply for management liability insurance policies held by non-profit or private for-profit companies.

2. Cover for Accountable Persons

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 position⁵.

The definition of 'insured persons' under both PI and D&O policies are generally quite broad and likely to already capture some 'accountable persons' as defined in the FAR Act. However, this definition should be carefully reviewed and tailored if necessary to ensure that all 'accountable persons' as defined in the FAR Act are expressly covered.

3. New FAR obligations and policy definition of Wrongful Acts

The obligations under FAR apply to everything that an 'accountable entity' does, including, for example, in relation to its arrangements relating to cyber security, data risk management, anti-money laundering, product governance, scams and hardship. The new financial accountability regime imposes broad obligations on 'accountable entities' and on 'accountable persons' in relation to the adequacy of these arrangements.

¹ As set out in Pt IIAA of the Banking Act 1959 (as in force up to and immediately before the commencement of Pt 2 of Sch 1 to the FAR Act).

² Passed in the Senate on 5 September 2023 and received royal assent on 14 September 2023.

³ Has the meaning given in section 9 of the FAR Act 2023.

⁴ Has the meaning given in section 12 of the FAR Act 2023.

⁵ Has the meaning given in s37BA and 37BB of Pt IIAA of the Banking Act 1959 (Cth) or s10 and s11 of the FAR Act as applicable.

'Accountable entities' must comply with four core sets of obligations:

1. **Accountability** – For example, in taking reasonable steps to conduct its business with honesty and integrity, and with due skill, care and diligence, and prevent matters from arising that would (or would be likely to) adversely affect its prudential standing or reputation. This also applies to 'significant related entities' (eg. subsidiaries) whose poor behaviour has the potential to adversely affect the prudential standing or reputation of the 'accountable entity' itself. 'Accountable entities' and 'significant related entities' must deal with both ASIC and APRA in an open, constructive and co-operative way.
2. **Key personnel** – For example, ensuring no 'accountable person' is prohibited from being an accountable person and in taking reasonable steps to ensure 'significant related entities' comply with key personal obligations.
3. **Deferred remuneration** – Being at least 40% variable remuneration for each 'accountable person' for a minimum of four years, if above A\$50,000; and
4. **Notification obligations** – to ASIC and APRA of certain events. For example, when a person ceases to be an 'accountable person' or is dismissed or suspended.

Similarly, 'accountable persons' are obliged to, among other things:

- act with honesty and integrity, act with due skill, care and diligence and in a manner that prevents adverse impact to the entity's prudential standing,
- deal with APRA and ASIC in an open, constructive and co-operative way, and
- take reasonable steps to ensure compliance by the entity with certain laws relating to the financial sector.

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 or 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

The FAR Act will be jointly administered by ASIC and APRA (except for those entities that do not hold an AFSL or 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 new financial accountability regime, including:

- information gathering including orders for production,
- conducting investigations and examinations,
- issuing directions relating to non-compliance,
- seeking orders for injunctions,
- agreeing enforceable undertakings, and
- powers to disqualify an 'accountable person'.

Most D&O and PI policies include some form of 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) would 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. Cover for Prosecution Costs

A 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 D&O policies cover this. Does yours?

6. Cover for Fines and Penalties

Under FAR, the maximum civil penalty that may be imposed on an 'accountable entity' for failing to comply with the regime is the greater of:

- 50,000 penalty units (A\$15.65 million), or
- three times the benefit derived or detriment avoided from the contravention, or
- 10% of the entity's annual turnover up to 2.5 million penalty units for each contravention (A\$782.5 million).

While the FAR Act did not implement a previous proposal that 'accountable persons' also be subject to *direct* financial penalties for breaches of *their own accountability obligations*, civil penalties can still potentially be imposed on individuals in certain circumstances under the ancillary liability provisions, whichever is the greater:⁶

- in the amount of up to 5000 penalty units (A\$1.565 million), or
- if the court can determine the benefit derived and detriment avoided because of the contravention multiplied by three

if they are directly or indirectly, knowingly concerned in, or party to a contravention of the FAR Act by the 'accountable entity'. Further, individuals may be disqualified from holding an 'accountable person' role under the FAR Act or other senior roles in an APRA regulated institution if they breach their obligations under the FAR Act or have their variable remuneration reduced for failure to comply with their obligations under the FAR Act.

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.

Cover for fines and penalties has been a longstanding contentious area of the law on public policy grounds. Even where cover is provided, qualifications apply. For example, some policies may stipulate that cover *'is provided unless the insurer is legally prohibited from doing so or the matter is deemed uninsurable at law'*.

⁶ Refer to section 81 of the FAR Act.

7. Insurance policies and prohibitions on indemnification

Under the FAR Act, a 'significant related entity'⁷ (or body corporate in the same corporate group⁸) of an 'accountable entity' (e.g. a subsidiary) is **prohibited from indemnifying and paying premiums** for an insurance contract that would insure the 'accountable entity' against the consequences of breaching FAR⁹. 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 insurance policies to address this issue.

The FAR Act does not appear to address whether an 'accountable entity' can insure against the consequences of breaching FAR by an entity that is not a 'significant related entity'.

Pleasingly, there is no prohibition relating to indemnification of or payment of insurance premiums for an accountable person's breach of FAR¹⁰. Another positive point is that most D&O and PI policies include an advance payment promise in relation to defence expenses, and the better policy wordings include final adjudication language in relation to the application of the conduct (dishonesty) exclusion.

⁷ Refer to the FAR Act sections 8, 12 and Explanatory Memorandum for what constitutes a 'significant related entity' for the purposes of banks, insurers and RSE licensees. See also section 50 of the Corporations Act 2001.

⁸ Refer to Explanatory Memoranda to FAR 1.257.

⁹ Refer to section 97 of the FAR Act.

¹⁰ Refer to Explanatory Memoranda to FAR 1.260.

Marsh Pty Ltd (ABN 86 004 651 512, AFSL 238983) ("Marsh") arrange the insurance and is not the insurer. This is a general overview of the Financial Accountability Regime (FAR) and D&O and PI policies. We recommend you read your policy wording or request a copy, so you have an understanding of the policy terms, conditions and exclusions before you decide whether this policy suits your needs and/or what amendments you may require to address FAR. Any statements concerning actuarial, tax, accounting, or legal matters are based solely on our experience as insurance brokers and risk consultants and are not to be relied upon as actuarial, accounting, tax, or legal advice, for which you should consult your own professional advisors.

Take action now

While most D&O and PI policies will provide some level of protection and comfort for the new financial accountability regime, policy wordings can vary significantly. If you are an APRA regulated entity or believe the FAR Act may impact your organisation, you should take proactive steps in reviewing and understanding your existing PI and D&O policies, and tailoring coverage to ensure that the maximum protection is available.

For more information, or if you need help reviewing your existing coverage, please contact your Marsh broker or visit our website at [marsh.com](https://www.marsh.com).



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