17 September 2020

Department of Home Affairs
Critical Infrastructure Centre

By email: ci.reforms@homeaffairs.gov.au

Protecting Critical Infrastructure Consultation

The Financial Services Council (**FSC**) provides this submission in response to consultation by the Department of Home Affairs (**The Department**) about proposed changes relating to Protecting Critical Infrastructure and Systems of National Significance (**the Proposals**).

About the Financial Services Council

The FSC is a leading peak body which sets mandatory Standards and develops policy for more than 100 member companies in Australia's largest industry sector, financial services. Our Full Members represent Australia's retail and wholesale funds management businesses, superannuation funds, life insurers, financial advisory networks and licensed trustee companies. Our Supporting Members represent the professional services firms such as ICT, consulting, accounting, legal, recruitment, actuarial and research houses.

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.

FSC response to Consultation

We thank the Department for the opportunity to provide comments to this consultation. The FSC is also closely involved in the current Foreign Investment Reforms and is keenly interested in how these two changes will interact, as they will potentially have large impacts on the financial services sector and our members including superannuation funds, fund managers and life insurers.

The Proposals will have a broad-ranging impact on the financial services sector – an already highly regulated sector. We raise a number of issues below and outline already existing APRA and ASIC regulation relating to risk management, cyber security, data security and IT management. In addition, the interaction between the Proposals and the foreign investment reforms relating to the definition of a national security business may result in significant impediments to investing should the proposed sectors all be classified as critical infrastructure.

The FSC's response below largely relates to the presentation of the Proposal provided at a workshop for the finance industry on 21 August 2020. Any reference to slides refers to the slides presented at that workshop. The FSC has not had an opportunity to develop comments on the related consultation paper, but we trust the Government will be discussing the details in the consultation paper during the co-design process with industry (discussed further below).

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General comments

The FSC submits that any changes made to the regulation of financial services should, to the greatest extent possible, use existing financial regulators (particularly ASIC and APRA) to minimise additional compliance costs on firms, and avoid duplication of intervention. The FSC notes that this view was expressed by the Department at the finance industry workshop.

In some cases, there are existing regulations that have similar goals of protecting financial infrastructure. The FSC submits that, wherever possible, the presumption should be that these existing regulations can address the goals of the current proposals and no additional or amended regulation is required.

In particular, life insurers and superannuation funds in Australia are already prudentially regulated and APRA has relevant Standards in place. APRA's supervisory functions include undertaking assessments of risks including IT and information security. ARPA's CPS 234 Information Security already aims to ensure that an APRA-regulated entity takes measures to be resilient against information security incidents (including cyber-attacks) by maintaining an information security capability commensurate with information security vulnerabilities and threats.

This CPS only came into force on 1 July 2019 (and certain sections after that date); firms committed material resources and costs to comply with CPS 234 so any additional requirements beyond CPS 234 should be commensurate with relevant risks, given many businesses have already just reached compliance with CPS 234. Other relevant regulations include CPS 220 (Risk Management), CPS 231 (Outsourcing), CPS 232 (Business Continuity Management). Regulations also apply to corporate groups that include regulated entities.

More generally, financial regulators, including Treasury, APRA, ASIC and the RBA can and do already intervene, consult and engage with financial firms on the topics and issues covered in the proposals. Oversight by another Department into board/governance, IT and data would be a duplication and add to the compliance and cost burden of an already heavily regulated sector.

The FSC strongly supports the proposed sector-specific co-design approach with industry, particularly for the government assistance and intervention powers which need to be carefully designed to minimise the risk of being highly disruptive to business. We submit that the relevant financial services regulators, particularly APRA and ASIC, should be involved in this co-design process. The FSC recommends a detailed regulatory impact analysis should occur on the proposals, with this analysis being published in full.

The FSC supports in principle the proposals to improve Australia's situational awareness by establishing a capability to facilitate information sharing. Superannuation funds in particular would benefit from an industry-wide information exchange enabling the real-time reporting of threats and suspected fraudulent activity.

The FSC submits that the Government needs to provide more information about the proposed changes to the potentially affected businesses, using industry regulators, media, and industry associations such as the FSC, as the likely knowledge about these changes in most businesses would be low. We submit this information should make it clear which businesses are (potentially) impacted and the exact way they would be impacted, as the current proposals are not fully settled. It is particularly important for businesses to be aware about any proposals for Government to intervene directly in a company's processes in 'exceptional circumstances' (slide 8).

The FSC submits that the proposals, as they are intended to apply to financial services, should acknowledge the very high rate of regulatory change in the financial services industry, with CPS 234 only recently implemented (see above), and numerous significant changes all occurring in the next year and a half, particularly the Design and Distribution Obligations, due to start in October 2021, and the implementation of the numerous recommendations of the Financial Services Royal Commission.

The FSC also considers the changes should also acknowledge the significant business disruption due to COVID-19, particularly for businesses based in Victoria. The Government and regulators have delayed many regulatory changes due to COVID-19. We note the Protecting Critical Infrastructure Proposals would be adding regulations at a time when other regulatory changes are being delayed in a whole-of-government approach.

Proposal specifics

The workshop slides state the proposals are that "regulated critical infrastructure assets" include insurance, reinsurance, and "specific" registerable superannuation entity (**RSE**) licensees (see slide 13), while "critical infrastructure assets in the banking and finance sector are proposed to be those assets associated with the delivery of services involved in the provision of, and facilitating the provision of, financial services" (slide 12).

The FSC requests clarification and more detail about which financial services entities of various types are intended to be regulated by the proposed changes.

In respect of RSE licensees, the FSC requests clarification of which RSE licences are to be included in the proposals, including the reasons why it is proposed that specific RSEs would be included while other RSEs would not. We understand the Gateway Network Governance Board (**GNGB**) is making a submission on some superannuation issues.

The proposals are likely to result in all businesses in financial services being classified as "critical infrastructure assets" (see slide 12). The FSC submits the Government should clarify why there is a need for "critical infrastructure assets" to cover a broad range of services including:

- smaller financial service businesses, such as a small financial advice business, or a boutique fund manager that does not manage significant funds.
- fund managers that do not internally provide any custody services.
- businesses that do not handle money, such as a business that provides financial/accounting/actuarial advice only without directly managing client money.

Page 12 of the consultation paper states that the framework "will apply to owners and operators of relevant critical infrastructure regardless of ownership arrangements". However, we query whether the proposals should apply to fund managers that are owners of critical infrastructure but do not also operate the infrastructure. Where a fund or Separately Managed Account is the owner of the asset and the investment manager might either be the responsible entity and/or investment manager, it is unclear why the Proposals should separately apply to the owner.

We understand why the proposals will be applied to infrastructure operators. However, having a separate obligation on the owner to comply with the proposals would result in overlapping and duplicative regulation, and change the nature of the funds management relationship. It is also unclear how an infrastructure owner that is not also an operator would comply with some parts of the proposals given the owner would not be involved in the day-to-date operational issues that are the focus of the proposals. In addition, it is not clear how this would work for infrastructure that is

owned by more than one entity. These issues imply the obligations better sit with the operator who has the day to day responsibility of running the asset.

We also note that if the proposal applied to both fund managers and custodians that are the legal owners of the investments made by the fund managers, this will mean duplication of regulation in relation to the same investments.

We request the Government provide clarity about how the obligations will apply to contracted third party service providers. APRA's CPS 234 makes its application to third parties clear.

It appears that the Government has not proposed any assets in financial services be classified as "systems of national significance". The negative impact on a business from being included in this classification would be quite material. Given this, if any financial service businesses are proposed to be included in this classification, we would request public consultation and close co-design with the industry, as this classification would have substantial regulatory burden on the affected businesses.

The proposals mean that a foreign company (including local companies with a foreign parent) starting a financial services business in Australia would potentially be a 'notifiable national security' action. New entrants to the financial services industry would then be regulated and need to seek approvals from FIRB, Department of Home Affairs, ASIC and APRA just to obtain a licence. This would be an impediment to competition, innovation, financial technology and start-ups.

Concluding comments

I have copied this letter to the Treasurer, the Hon Josh Frydenburg MP; the Assistant Treasurer, the Hon Michael Sukkar MP; the chair of ASIC, James Shipton; and the chair of APRA, Wayne Byres.

The FSC would be happy to discuss this submission further – please contact my assistant Regina McCulla on [redacted] or [redacted].

Yours sincerely

[redacted]

Sally Loane
Chief Executive