

## ADMINISTRATION

- 2.1 APRA has been supervising banks, insurance firms and superannuation funds for just over two years, and credit unions and building societies for just over 12 months. APRA is the single prudential supervisor of financial institutions in Australia. It brought together the prudential supervisory responsibilities of 11 separate agencies.<sup>1</sup>

### Wallis Committee recommendations

- 2.2 The Wallis Committee recommended the establishment of a new regulatory entity to undertake prudential regulation of the financial system, and made a number of further recommendations establishing the scope of the proposed regulator.<sup>2</sup> The specific aims of the new prudential regulator were to:
- reduce supervisory costs for regulated industries through administrative economies;
  - develop a harmonised approach to supervising similar risks and activities whenever they occur in the financial system;
  - apply a more flexible approach to dealing with structural change in the financial system; and
  - develop more effective supervision of financial conglomerates.<sup>3</sup>

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1 Evidence p 17.

2 Financial Systems Inquiry. *Financial Systems Inquiry Final Report*. 1997. Melbourne, FSI, pp 297-319. See also Australian Prudential Regulation Authority. *Annual Report 99*. 1999. Sydney, APRA, p 5.

3 Evidence p 3.

## Early indicators of APRA's performance

- 2.3 Gauging how well APRA has implemented the aims of the Wallis Committee is an important early indication of how effectively the organisation is operating. It is easier to assess APRA's progress in some of these aims than others.
- 2.4 According to APRA, in relation to administrative economies, the operating cost of its prudential regulation has dropped from \$56 million in 1997-98 to an estimated \$51 million in the 2000-01 financial year. This has been achieved at a time when financial institutions have grown in complexity and increased in size by about 35%.<sup>4</sup> APRA believes this is a reasonable administrative saving, and will be seeking to keep its costs steady in real terms in the future.<sup>5</sup>
- 2.5 Some advances have been made in the harmonisation of prudential regulation. These are dealt with in more detail in Chapter 3. However, the regulation of mutual institutions, such as credit unions, has exposed some difficulties in reconciling a more flexible approach to prudential regulation with the aim of developing a harmonised approach to regulation.
- 2.6 Recommendation 54 of the Wallis Committee report states that restrictions on the classes of debt and equity that may be issued by a mutual institution should be removed to the greatest extent possible on the basis that protection for depositors is enhanced by increasing funding from non-depositor sources, such as shareholders.<sup>6</sup> According to APRA, mutual institutions face some difficulties in retaining their mutual status when they issue these forms of debt. ASIC has issued a set of principles detailing how a mutual can raise capital from its members and preserve mutuality, and work is continuing in this area.<sup>7</sup>
- 2.7 Another concern for mutual organisations is the new capital standard, which restricts the portion of tier 1 capital<sup>8</sup> based on the issue of preference shares to 25%. Apart from capital raised through retail banking, mutual institutions are restricted to raising capital through preference shares, as other forms of capital raising threaten their

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4 Evidence p 3.

5 Evidence p 8.

6 Financial Systems Inquiry. *Financial Systems Inquiry Final Report*. 1997. Melbourne, FSI, pp 357-358.

7 Evidence p 12.

8 Tier 1 capital is the highest quality capital for the purposes of meeting capital adequacy standards.

mutuality. In relation to this issue, APRA recognises that within the harmonised approach there needs to be some flexibility.<sup>9</sup>

- 2.8 Credit unions have sought to have their members' shares recognised as tier 1 capital for the purposes of capital adequacy. On this question, APRA states it will look at the situation on a case by case basis. The issue is one of the permanence of the shares. The international definition of shares as tier 1 capital requires that the shares be permanent and that the people holding the capital should not have the right to withdraw it. According to APRA, a mutual institution needs to show that it remains in control of its members' shares in order for these shares to be considered as tier 1 capital.<sup>10</sup>
- 2.9 Overall, in relation to the difficulties faced in reconciling harmonisation and flexibility, APRA states:
- Harmonisation means a single look and feel to the prudential standard guidelines...But different parts and different approaches within those standards will be relevant to smaller, less sophisticated institutions than the parts that are relevant to the larger banks. We are talking about harmonisation rather than an identical set of requirements across the board.<sup>11</sup>
- 2.10 Reconciling flexibility and harmonisation will require further work by APRA before a sensitive and prudent solution is found to the problems posed by mutual institutions. The Committee will monitor this area of APRA's work in the future and looks forward to seeing progress in the current financial year.
- 2.11 With regard to dealing with structural change in the financial system, such as the growth in the number and complexity of conglomerate institutions, APRA indicates that the process of change is a continuing one, so it may never be possible to say that APRA's job is complete.<sup>12</sup> However, APRA has created a Diversified Institutions Division to regulate conglomerates and is in the process of developing a regulatory framework for conglomerates (see Chapter 3).<sup>13</sup>
- 2.12 Overall, in the opinion of Mr Graeme Thompson, APRA's CEO:

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9 Evidence p 11.

10 Evidence p 13.

11 Evidence p 14.

12 Evidence pp 6-7.

13 Australian Prudential Regulation Authority. *Annual Report 2000*. 2000. Sydney, APRA, p24.

...the task of establishing the new institution...is just about complete...<sup>14</sup>

- 2.13 Notwithstanding this APRA has commenced a project to see what useful indicators can be developed in measuring the implementation of the aims proposed by the Wallis Committee.<sup>15</sup> The Committee looks forward to the outcome of this investigation.

## Relations with other regulatory bodies

### National regulatory bodies

- 2.14 In order to effectively perform its regulatory functions, APRA must have close contact with the other organisations in the financial regulatory framework. To facilitate this, APRA has negotiated Memoranda of Understanding delineating lines of responsibility and methods of cooperation with: the RBA;<sup>16</sup> ASIC;<sup>17</sup> the Australian Taxation Office (ATO);<sup>18</sup> and the Australian Competition and Consumer Commission (ACCC).<sup>19</sup> APRA's Chair, Dr Jeffrey Carmichael, recognised that:

While APRA's role is, in principle, distinct, in practice it continues to overlap – or at least abut – the roles of the other financial regulatory agencies...<sup>20</sup>

- 2.15 Evidence from some of regulated industries indicates that the separation of responsibilities still requires some work. The Corporate Super Association has indicated that APRA and ASIC have applied different interpretations of the regulations concerning pooled superannuation

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14 Evidence p 6.

15 Evidence p 3.

16 *Memorandum of Understanding: The Reserve Bank of Australia and the Australian Prudential Regulation Authority*. Australian Prudential Regulation Authority Media Release, 12 October 1998. See also House of Representatives Standing Committee on Economics, Finance and Public Administration. *Review of the Reserve Bank of Australia Annual Report 1997-98: Interim Report*. 1999. Canberra, AGPS, p 30.

17 *Memorandum of Understanding: The Australian Securities and Investment Commission and the Australian Prudential Regulation Authority*. Australian Prudential Regulation Authority Media Release, 12 October 1998.

18 *Memorandum of Understanding between the Australian Prudential Regulation Authority and the Australian Taxation Office*. Australian Prudential Regulation Authority Media Release, 16 April 1999.

19 *ACCC/APRA Sign Memorandum of Understanding*. Australian Prudential Regulation Authority Media Release, 2 December 1999.

20 Australian Prudential Regulation Authority. *Annual Report 99*. 1999. Sydney, APRA, p 2.

trusts, and these differing interpretations are constraining the activities of superannuation funds.<sup>21</sup>

- 2.16 APRA indicates that part of the problem for the superannuation and insurance industries is that previously, the Insurance and Superannuation Commission (ISC) handled all regulatory activities in their sector. Under the current, functional, division of responsibility, prudential supervision resides with APRA, disclosure and market conduct is with ASIC, and the development of new legislation is the responsibility of the Department of the Treasury. Regulated industries are still coming to terms with this arrangement, and this may be the source of much of the frustration being expressed.<sup>22</sup>
- 2.17 APRA recognises the need to work closely with other regulatory agencies, especially ASIC, to minimise the duplication and inconsistencies and to share information and cooperate in taking action wherever necessary.<sup>23</sup>
- 2.18 APRA states that over the past year it has expended a large amount of time developing liaison and consultation processes with ASIC, and the two regulators meet often. Special focus groups discuss issues such as the consistency of legislative interpretations, identifying enforcement options, and surveillance programs and techniques.<sup>24</sup>
- 2.19 Effective relations between APRA and other national financial regulatory bodies is clearly a key to the success of the current regulatory structure. The Committee will monitor these relationships to ensure they remain sound.

## International regulatory bodies

- 2.20 APRA has an active international presence providing technical assistance and training to supervisors in emerging economies, particularly in the Asian region. Supervisors from agencies in Fiji, India, Korea, Malaysia, New Zealand, and Papua New Guinea have spent time in APRA offices over the past year.<sup>25</sup>
- 2.21 APRA also participates actively in a number of international fora, such as the International Association of Insurance Supervisors (for which APRA

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21 Senate Superannuation and Financial Services Select Committee. *Hansard*. 15 June 2000. p SFS372.

22 Evidence p 19.

23 Australian Prudential Regulation Authority. *Annual Report 2000*. 2000. Sydney, APRA, p 33. See also Submission p S7.

24 Australian Prudential Regulation Authority. *Annual Report 2000*. 2000. Sydney, APRA, p 34.

25 Australian Prudential Regulation Authority. *Annual Report 2000*. 2000. Sydney, APRA, p 35.

currently chairs the solvency subcommittee); the Basel Committee on Banking Supervision; the Core Principles Liaison Group and the associated Capital Liaison Group; the Joint Forum (on cross sectoral financial regulation); the IMF; the World Bank and the OECD Insurance Committee. While the Committee supports APRA's activities in this area, it would not wish to see these international activities being undertaken at the expense of getting APRA fully operational at this early stage in its development.

## **APRA's funding - Levies**

2.22 APRA is funded by levies paid by regulated financial institutions based on a percentage of assets held by the entity, subject to minimum and maximum levy amounts. This system attempts to ensure that the levy paid by each class of entity reflects the actual cost of supervising those entities.<sup>26</sup> The administration and determination of levies has been an ongoing point of contention for APRA since its inception. At the outset of the discussions about levies during the hearing, APRA stressed that the levies are set by the government and not by APRA. However, APRA indicated it is able to make recommendations to the government on this matter.<sup>27</sup>

## **Differences in levies between sectors**

2.23 In April 1999, the umbrella Association of Super Funds Australia estimated that superannuation funds were paying about 40% of the running costs of APRA while ADIs were paying 16%.<sup>28</sup> In addition, based on asset value, large ADIs (banks) currently pay significantly less than other institutions towards the cost of running APRA. While the assets of the big four ADIs (banks) represent 60% of the capital under regulation, in 1998-99, they paid only 16% of ADI regulatory costs. The apparent anomaly occurs because there is a maximum levy for any institution of \$1 million, resulting in ADIs with asset bases of over \$90 billion paying the same amount as ADIs with asset bases around \$20 billion.<sup>29</sup>

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26 Department of the Treasury. 'Reform Of The Australian Financial System.' *Economic Round-Up*, Winter 1998. Canberra, AGPS, p 21.

27 Evidence p 7.

28 *Super funds rail against soaring fees*. Blue, Tim. *The Australian*, 15 April 1999.

29 *Small banks protest over big four's APRA fees*. van Leeuwin, Hans. *Australian Financial Review*, 25 March 1999.

- 2.24 At the hearing, APRA indicated that there are two reasons why the superannuation sector provides the bulk of levy funding. Firstly, there are more APRA staff involved in supervising superannuation than any other sector. Second, the number of institutions is large. APRA is supervising between 4,000 or 5,000 superannuation funds compared with 50 or 60 banks.<sup>30</sup>
- 2.25 With regard to minimum and maximum levies, APRA's view is that the current levy structure is logical. Minimum levy payments are imposed because there is a minimum level of expenditure required to supervise an organisation regardless of its size. Maximum levy payments are imposed because beyond a certain size the cost of supervising an entity does not increase regardless of the size of the asset base.<sup>31</sup>
- 2.26 In addition, APRA claims it is very difficult to develop an accurate measure of exactly how much regulatory effort goes into individual financial institutions or individual groups of financial institutions. Regulatory effort will also vary from one year to the next. APRA reported that:

The bottom line here is that it is virtually impossible to come up with a formula for calculating levy rates for cost recovery of an organisation like APRA that will satisfy everybody every year.<sup>32</sup>

## Levy reviews

- 2.27 The Australian National Audit Office (ANAO) performance audit into the *Management of Commonwealth Non-primary Industry Levies*, tabled in February 2000, found that APRA was unable to accurately capture the administrative costs associated with the particular levies, and had significantly overcharged and undercharged on particular levies.<sup>33</sup>
- 2.28 In response to these concerns, on 3 August 1999, the Minister for Financial Services and Regulation announced a review of financial sector levies to determine whether existing levy arrangements were providing an effective funding mechanism for the supervision of prudential regulation.<sup>34</sup>

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30 Evidence p 10.

31 Senate Economics Legislation Committee. *Estimates Hansard*. 31 May 2000. p E320.

32 Evidence p 9.

33 Australian National Audit Office. *Audit Report No. 32: Management of Commonwealth Non-primary Industry Levies*. 2000. Canberra, AGPS, p 13.

34 House of Representatives Standing Committee on Economics, Finance and Public Administration. *Review Of The Reserve Bank Of Australia Annual Report 1997-98: Interim Report*. 1999. Canberra, AGPS, p 31.

- 2.29 The Minister indicated that industry groups were widely consulted during the levy review. The review found that the government should:
- continue imposing levies on a sectoral basis;
  - provide the ability to rebate excess levies back to industry in the event of overcharging;
  - recognise the lower level of demand placed on Australia's regulators by foreign bank branches in Australia; and
  - require regulators to provide more detailed specific activity cost information to assist with the levy setting process.
- 2.30 Broadly, the review has resulted in only small changes to the original levy framework.<sup>35</sup>
- 2.31 The outcome of the review contributed to the determination of the new financial sector levy structure for the 2000-01 financial year, released in June 2000. Total revenue collection from the financial sector during the financial year will reduce from \$66.6 million to \$61 million. This amount funds both APRA and ASIC. The levies will change in the following ways:
- superannuation levies will be halved to 0.02% of assets because of excess levy collections over the previous financial year;
  - the maximum levy payable by superannuation entities has increased by \$5 000 to \$46 000;
  - ADIs will have a slightly reduced levy rate because of overcollection in the previous financial year; and
  - general insurers will face an increased maximum levy, up from \$75 000 to \$100 000, because of increased supervisory work in this sector.<sup>36</sup>
- 2.32 APRA has also developed an averaging system for the determination of levy rates, which is aimed at preventing volatility in rates from one year to the next.<sup>37</sup>

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35 *Financial sector levies for 2000-01*. Minister for Financial Services and Regulation Media Release, 9 June 2000.

36 *Financial sector levies for 2000-01*. Minister for Financial Services and Regulation Media Release, 9 June 2000.

37 Evidence p 10.



## Future changes to levy arrangements

2.33 APRA admits that it is not comfortable with the current levy framework:

...increasingly as we go forward it will be more difficult to allocate costs to the traditional industry groups.<sup>38</sup>

2.34 While APRA does measure its administrative costs, it has difficulty in allocating those costs accurately to different sectors of the financial system. The measurement of administrative costs is done imperfectly at present because the legislative arrangements are based on collections from different sectors while APRA's work is organised on a risk basis.<sup>39</sup>

2.35 Another reason why APRA would like the levies changed is the growing number of conglomerate entities. Under the present arrangements, a levy is made under each licensed entity in a conglomerate, while the conglomerate is supervised as a single entity.<sup>40</sup>

2.36 In 2003 there will be a review of the effectiveness of the changes recommended in the Wallis Committee report. At that review, APRA hopes that the levy arrangements will change:

We hope that, when we get to 2003 and the whole framework is looked at afresh, we might be able to move to a single framework with a single levy across all industry groups.<sup>41</sup>

2.37 While the Committee sees merit in the concept of a single levy system, APRA must continue to work on methods for measuring the actual costs of supervising the individual entities to ensure that each entity is appropriately levied.

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38 Evidence p 9.

39 Evidence p 9.

40 Evidence p 10.

41 Evidence p 9.

## Staffing and service standards

- 2.38 APRA has 425 staff, half of whom are located in Sydney with the other half spread between Canberra, Melbourne, Brisbane, Perth, Adelaide and Hobart.<sup>42</sup>
- 2.39 As part of the restructuring process and the consolidation of APRA's head office operations in Sydney, a number of experienced staff previously based in Canberra left the organisation.<sup>43</sup> The lack of experienced staff appears to have had a noticeable impact on relations between the superannuation and insurance industries and APRA. Criticism from the insurance and superannuation sectors have included that APRA is unable to retain good staff, that all the knowledge officers have left, and that this has had a real and dramatic effect on service levels.<sup>44</sup> On the whole, APRA rejects such criticism:
- ...We certainly do not get a general view from industry that service levels are as poor as suggested...<sup>45</sup>
- 2.40 However, in response to a claim by some regulated entities that inquiries of a general nature were responded to promptly, while it was difficult to get a response to inquiries of a complex nature, APRA indicated that:
- That is useful feedback...We do not pretend that these new arrangements can be bedded down perfectly overnight...<sup>46</sup>
- 2.41 The prudential supervisory responsibilities of 11 separate agencies were combined in APRA. That has meant a good deal of work on internal management and organisational issues in APRA's short life. In addition, APRA also expects its staff to operate across regulatory boundaries, and has decided to regulate regional institutions in the regions.
- 2.42 A related problem is the fact that, under the ISC, insurance and superannuation organisations could talk to one organisation about virtually any regulatory matter to do with their sector. This has now been replaced with a functional separation between regulators. A situation which the industries may not yet have adapted to. As a result, regulated industry have had to get used to new staff and new administrative

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42 Australian Prudential Regulation Authority. *Annual Report 2000*. 2000. Sydney, APRA, p 94.

43 Australian Prudential Regulation Authority. *Annual Report 2000*. 2000. Sydney, APRA, p 3.

44 Evidence p 17.

45 Evidence p 17.

46 Evidence p 17.

arrangements, and APRA has had to train a number of its staff on their new responsibilities.<sup>47</sup>

- 2.43 APRA reports that it has invested over \$823 000 on learning and development activities during the 1999-2000 financial year. This was distributed through a studies support scheme and a learning and development program. The studies support scheme covered applications for post graduate qualifications, while the learning and development program covered technical cross skilling training, management, communication, and information technology skills development. The cross skilling program was designed to meet the immediate technical needs of staff as they were selected for their new cross functional roles in APRA's new structure. In-house APRA experts delivered the training.<sup>48</sup>
- 2.44 APRA now believes it has adequate staff numbers and professional people to carry out its functions. When questioned about the morale of staff, Mr Thompson indicated that, although it was difficult to generalise, he believes staff morale was good.<sup>49</sup> In its submission, APRA also indicates that its Board is regularly informed of staff issues.<sup>50</sup>
- 2.45 Currently, APRA states that there are some pockets of staffing where there are gaps to fill, and APRA is going to the market to fill those gaps. The jobs are in the Sydney market, and are therefore hard to fill. However, across the board staffing is no longer a major issue for APRA.<sup>51</sup>
- 2.46 APRA has advised that there are some relativity issues in relation to staff pay. These stem from the different pay structures APRA inherited from previous organisations. APRA has not yet solved all the anomalies and distortions that were inherited from that process.<sup>52</sup>
- 2.47 On the whole APRA claims its standard of service in a number of areas is high. To demonstrate this, APRA quoted its national superannuation call centre, which operates at world's best practice, answering 900 calls a day with 90% being answered within 10 seconds.<sup>53</sup>
- 2.48 It is a cliché that the staff of any service organisation are its lifeblood. The bedding down of staff picture that APRA paints is not wholly supported

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47 Evidence pp 17-19.

48 Australian Prudential Regulation Authority. *Annual Report 2000*. 2000. Sydney, APRA, p 37. See also Evidence p 30 and Submissions p S5.

49 Evidence p 30.

50 Submissions p S5.

51 Evidence p 30.

52 Evidence p 32.

53 Australian Prudential Regulation Authority. *Annual Report 2000*. 2000. Sydney, APRA, p 19.

by everyone. At this stage the Committee is not in a position to reach a conclusion on the success or otherwise of APRA's staffing position. Accordingly, if this is seen as a problem when the Committee next meets with APRA, it will follow up with comments from APRA's staff and clients.