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**HOUSE OF
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STANDING COMMITTEE ON ECONOMICS, FINANCE AND
PUBLIC ADMINISTRATION

Reference: Review of the Australian Prudential Regulation Authority

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HOUSE OF REPRESENTATIVES
STANDING COMMITTEE ON ECONOMICS, FINANCE AND PUBLIC ADMINISTRATION

Monday, 4 September 2000

Members: Mr Hawker (*Chair*), Mr Albanese, Ms Burke, Ms Gambaro, Mrs Hull, Mr Latham, Mr Pyne, Mr Somlyay and Dr Southcott

Members in attendance: Mr Albanese, Ms Burke, Mr Hawker, Mrs Hull, Mr Latham and Mr Somlyay

Terms of reference for the inquiry:

To review and report on:

The Australian Prudential Regulation Authority's (APRA) supervision and prudential regulation of those areas of the financial services sector for which it has responsibility.

WITNESSES

**GRAY, Mr Brian, Executive General Manager, Policy, Research and Consulting Services,
Australian Prudential Regulation Authority 2**

**KARP, Mr Tom, Executive General Manager, Diversified Institutions Division, Australian
Prudential Regulation Authority 2**

**PHELPS, Mr Leslie John, Executive General Manager, Specialised Institutions Division,
Australian Prudential Regulation Authority 2**

**THOMPSON, Mr Graeme John, Chief Executive Officer, Australian Prudential Regulation
Authority 2**

Committee met at 10.03 a.m.

CHAIR—I declare open this public hearing of the Standing Committee on Economics, Finance and Public Administration and welcome everyone here today. Last year, the government provided the committee with a standing reference to inquire into and report on the Australian Prudential Regulation Authority's supervision and prudential regulation of those areas of the financial services sector for which it has responsibility. Today will be the Australian Prudential Regulation Authority's first appearance before the committee.

APRA became operational two years ago, in July 1998. This was as a result of the implementation of the Wallis inquiry recommendations. APRA has responsibility for regulating banks, insurance firms, superannuation funds, credit unions and building societies. In addition to regulating the financial services sector, APRA has been steadily changing the regulatory environment to reflect the outcomes of the Wallis inquiry. In particular, APRA has focused on the harmonisation of prudential regulations for organisations delivering like services, such as banks and credit unions, and developing prudential regulations for emerging areas of the financial services sector, such as financial conglomerates.

This public hearing will examine APRA's performance across a wide range of areas including APRA's administration, the supervision of authorised deposit taking institutions, insurance firms, superannuation funds and APRA's international activities. I call representatives from the Australian Prudential Regulation Authority.

[10.05 a.m.]

GRAY, Mr Brian, Executive General Manager, Policy, Research and Consulting Services, Australian Prudential Regulation Authority

KARP, Mr Tom, Executive General Manager, Diversified Institutions Division, Australian Prudential Regulation Authority

PHELPS, Mr Leslie John, Executive General Manager, Specialised Institutions Division, Australian Prudential Regulation Authority

THOMPSON, Mr Graeme John, Chief Executive Officer, Australian Prudential Regulation Authority

CHAIR—I welcome you to today's public hearing, and I remind you that the evidence you give at this public hearing is considered to be part of the proceedings of parliament. Any attempt to mislead the committee is a very serious matter and could amount to a contempt of parliament. Mr Thompson, I believe you would like to make a brief opening statement before the members of the committee proceed to questions.

Mr Thompson—I certainly welcome this first formal appearance of APRA before this important committee. In these opening remarks I would like very briefly to recount APRA's origins and purpose, since we are a relatively new agency. I will summarise some of the important elements of our work program and make some general comments on the health of the Australian financial sector that we supervise.

APRA's purpose is prudential supervision of Australia's financial institutions. This means that we promote prudent business behaviour by deposit takers, insurers and superannuation funds to maximise the likelihood that they remain in a sound financial condition so that they can meet their repayment obligations to depositors, policy holders or fund members, as the case may be. Our concern, therefore, is fundamentally with how these institutions control the risks in their activities. We are also responsible for managing the situation of any financial institution that has got into serious difficulty, so that the interests of its depositors, policy holders or fund members are protected as far as possible in that situation.

As the chair has noted, we were established on 1 July 1998 following a recommendation of the government's financial system inquiry conducted by the Wallis committee. We were established to be the single prudential supervisor of financial institutions in Australia. On 1 July that year we absorbed the prudential supervision functions of the Insurance and Superannuation Commission and of the banking supervision department of the Reserve Bank, covering prudential supervision of life and general insurance companies, superannuation funds and banks. On 1 July 1999, one year later, we took over the supervisory responsibilities of the Australian Financial Institutions Commission and eight state supervisory authorities that had prudential regulatory authority over credit unions, building societies and friendly societies.

The prudential supervisory responsibilities of 11 separate agencies were, therefore, combined in APRA. Not surprisingly, this has meant that we have had a good deal of work on internal management and organisational issues in our short life, while we have had to continue supervising the great bulk of Australia's financial system. While we inevitably lost some experienced people from predecessor agencies, in setting up and restructuring APRA, we have retained a very strong core of experienced and talented people across all of the industries that we supervise. We are also getting major benefits from mixing the skills, experience and ideas of staff from different professional backgrounds, and we are getting a big boost from the fresh ideas and energy of our new recruits.

In establishing our organisation structure and work programs, and in looking at supervisory processes and developing a culture in APRA, we have kept very much in mind the reasons for APRA's formation and the advantages that were envisaged over the old system based on specialist industry regulators. In brief, drawing on statements that the government made and from the Wallis committee's report, these advantages are, firstly, more flexibility in dealing with structural change in the financial system; secondly, a more consistent approach to supervising similar risks and activities wherever they occur in the financial system; thirdly, more effective supervision of financial conglomerates; fourthly, a clear focus on prudential supervision; and finally, reduced supervisory costs for industry through administrative economies.

We believe that in a relatively short time we have made a substantial start on achieving these outcomes. For instance, conglomerate groups now deal with a single relationship manager in APRA, rather than two or three different points of contact. Next week, as the chairman has noted, we will issue a single set of harmonised prudential standards covering all deposit-takers, from the smallest credit unions through to the largest banks.

The operating costs of prudential supervision for Australia's financial institutions have fallen in both nominal and real terms with APRA's formation. Under the pre-Wallis arrangements, about 540 people were engaged directly or indirectly in prudential supervision. Through administrative economies and more efficient methods, APRA is operating with a staff of around 420.

As our annual report to be issued tomorrow will show, the aggregate running costs of prudential supervision have fallen from over \$56 million in 1997-98 to a budgeted figure of \$51 million for APRA this year, and that is at a time the financial system has grown in complexity and has increased in size by about 35 per cent. Of course, it is not easy to measure exactly how well we are achieving some of the other outcomes that I listed. To some extent, those outcomes will always be difficult to measure and it is early days, but we have commenced a project to see what useful indicators can be developed in measuring the achievement of those objectives that the Wallis committee set. We are well aware that the government will be conducting an assessment of all of the Wallis reforms in 2003.

I should note that we recognise the need to work closely with other agencies to minimise duplication and inconsistencies in what we do and to share information and cooperate in taking action when necessary. We therefore put a lot of time and effort into building effective working relationships with ASIC, the Reserve Bank, the Taxation Office, Treasury and the ACCC.

Turning to processes and policies, much of APRA's work is devoted to day-to-day prudential supervision of financial institutions. Around half of our total staff are engaged in that activity. During 1999-2000, we completed a thorough review of the supervisory methods that we had inherited from predecessor agencies, and we are now introducing revised methods that, as far as practicable, will be streamlined and harmonised across industry groups. We are also aiming to concentrate our resources on institutions and activities where the risks are greatest. A risk based approach to supervision means making the most effective use of scarce resources and minimising the overall regulatory burden for industry.

APRA is also responsible for developing the policies and standards that underpin our frontline supervision work. I will just pick out four key areas that we have been working on over the past year or so. We have announced a comprehensive framework for supervising conglomerate groups that include banks, and the key innovation here was a set of criteria for accepting non-financial or commercial activities within such groups. As already mentioned, we are close to issuing one set of flexible harmonised prudential standards for all deposit takers—banks, credit unions and building societies.

We have embarked on a major project to review and modernise prudential supervision of the general insurance industry. This has been a neglected area and it is long overdue for reform. Finally, we have established a group to investigate the various operational risks incurred by financial institutions, and we are one of the first supervisory agencies around the world to have a team dedicated to operational risk.

We are also active in international work in upgrading prudential standards with such groups as the Basel Committee on Banking Supervision, the Joint Forum on financial conglomerates and the International Association of Insurance Supervisors, the IAIS. As an example of APRA's high international standing, we currently chair the important solvency subcommittee of the IAIS. I think it is also worth noting that we have begun a major project to revamp the statistics that are collected from financial institutions to make those more useful both for ourselves and for industry.

Having talked about what we are responsible for and what we do, it is probably worth clarifying what we are not responsible for. We are not responsible for policing competition in financial markets, for standards of disclosure about products and services or for how banks and others handle customer complaints and disputes. We are not responsible for fees, charges or interest margins, or for the representation of financial institutions in particular regional areas.

That is not to say that we are focused solely on prudential issues to the exclusion of all others. We have a statutory obligation, which is clearly spelt out in the APRA Act, to ensure that our prudential regulation is not so burdensome, frustrating or intrusive that we unduly interfere with competition, contestability, efficiency and competitive neutrality in the financial system.

I might say a few words about the state of the financial system that we supervise. Over the past year, Australian financial institutions have operated against a background of buoyant domestic economic growth and a more stable international environment than in other recent years. Growth in the financial sector was relatively rapid and profitability has generally been strong. Financial sector assets grew by about 11 per cent compared with around 13 per cent the year before. In the main, prudential supervision concerns have not been significant, although the

flow-on effects from natural disasters in 1999 have continued to strain the general insurance and domestic reinsurance sectors.

Rationalisation has continued as a feature of the financial sector, as in other industrial countries. Both large and small companies continue to seek the partnership of other financial institutions with a view to reducing their overheads, better allocating scarce capital and generally deriving synergies from the joint supply of financial services. The interest in the use of electronic and Internet commerce is still in its infancy but it is growing rapidly.

In the banking sector, profits have been high, despite continuing decline in interest margins. Asset growth of about 11 per cent and increases in non-interest income have generated after tax returns on equity averaging over 18 per cent. Impaired assets remain low by historical standards and aggregate provisioning against loans' deteriorating quality is strong. The capital ratio of the banking sector is 10 per cent, about the same as two years ago, and this compares with the standard regulatory minimum ratio of eight per cent.

Banks have become much more active in managing their capital. This is the product of their efforts to maintain their returns on equity in the face of stronger competition and also their ability to measure their internal capital requirements more accurately than in the past. As a result, we have seen share buybacks and securitisation programs become much more common and currently an amount equivalent to around seven per cent of banks' collective balance sheets has been securitised and on-sold to investors, which makes the Australian market for securitised assets one of the largest in the world in relative terms. It goes without saying that we are monitoring these sorts of trends very closely to ensure that banks continue to hold capital commensurate with their risks.

Building societies and credit unions experienced average growth of around five per cent over the past year. Consolidation remains a topical issue with those groups, with the number of institutions continuing to trend down and being much lower than five years ago. Credit unions and building societies were generally well capitalised through 1999-2000 with capital ratios for both groups currently at around 15 per cent.

The past year has been a difficult one for the general insurance sector. While profits there were on average flat—around a third of the 155 general insurers recorded operating losses while another third were only marginally profitable—this was a similar picture to the one the year before and partly reflected the continuing effects of the spate of natural disasters experienced around the world over the previous two years.

Following from that, problems were especially concentrated in the reinsurance segment of the market. This relatively small component of the local industry recorded aggregate losses in the order of \$3 billion. Overall, solvency levels within the industry remained well above statutory minimums and Australian policyholders were not affected by the difficulties of these companies.

This experience, nonetheless, underscores to us the continuing need for prudent underwriting and strong risk focused management, particularly in high risk areas such as reinsurance. It also, we believe, points to the need for reform of the supervisory framework for the general insurance sector and I have already noted that this is one of the priority items on our policy agenda.

The life insurance industry has had less exciting times. It has seen further restructuring with mergers between some of the larger players encouraged by increased competitive pressures in domestic and international financial services markets. Assets growth for the life insurance sector over the past year was around nine per cent, similar to the previous year.

In turning to friendly societies, declining assets and membership levels continue to be a feature of that sector. Some funds are seeking to diversify and expand into new areas of business to maintain their relevance. Overall, the assets of friendly societies declined by nine per cent over the past year and policy numbers fell by two per cent.

The superannuation sector has continued to grow rapidly. Growth in the past year was about 17 per cent, and there are now just over \$450 billion worth of savings in superannuation funds of various kinds.

In conclusion, might I say the obvious, that the financial sector continues to evolve rapidly in Australia and abroad, and this pace of change is set to continue. Factors such as increasing globalisation and competition in financial services, the growing focus of conglomerates on group activities as opposed to institutional activities, acceleration innovations such as electronic and Internet commerce, the growth of more sophisticated risk management techniques and the trend towards the outsourcing of important activities—all of these—carry challenges for both financial institutions and for their prudential supervisors. For APRA and other prudential supervisors, a key challenge, we believe, is to strike the right balance between facilitating these developments and these innovations in the interests of the general community and financial sector efficiency while at the same time protecting the safety and soundness of financial institutions through a strong regulatory framework. Thank you very much.

CHAIR—Thank you, Mr Thompson. I guess those last few words probably sum up what we like to hear. Thank you for a very comprehensive introduction. I think it certainly raises a whole range of areas that the committee would like to explore, but I would like to go back to some of the basics first. With the Wallis inquiry, how far have you really got in implementing everything and how much more work do you feel will have to be done in pursuing those earlier recommendations from Wallis?

Mr Thompson—I think the task of establishing the new institution, the new agency, is just about complete. There is still some work to be done on training and in bedding down some of the new organisation features, but we are getting to the end of that process. Our new organisation structure has now been in place since August last year and is bedding down quite well.

The task of achieving the broader challenges that the Wallis committee set is, in a sense, an ongoing one. The Wallis committee expected that an agency like APRA would be able to keep up with and, to some extent, anticipate the need for regulatory change in response to innovations and evolution in the financial system. That process of change of change and evolution is a continuing one, so it will never be possible for us to say that our job is complete.

I think, though, we have made some very significant steps towards achieving some of the objectives that Wallis talked about. I mentioned a couple of those on the way through. One is to have made a substantial start in defining a set of prudential supervision standards for

conglomerate groups. Before APRA was established, there was no such framework in place for dealing in an effective and efficient way with conglomerate groups. We have also made a substantial start on the task of harmonising the approach to financial regulation across industry groups as far as that is practical. To some extent, progress there will depend on legislative change—which is obviously not fully under our control—but particularly with the development of the harmonised standards across deposit-takers, we have made a substantial start on that task as well.

CHAIR—There is one area, specifically, that we would be very interested in following up. In talking about levies, the Audit Office report talked about the range of cost recovery from 63 per cent for non-excluded super funds up to 965 per cent for excluded super funds. You are obviously aware of all this?

Mr Thompson—Yes.

CHAIR—I am just wondering what progress you have made to make that somewhat more equitable, or do you see that as being a fair criticism?

Mr Thompson—There are a few points to make about the audit report. One is that levy rates are not set by APRA; they are set by the government. I guess the other point, in particular, in relation—

CHAIR—But you could recommend changes.

Mr Thompson—Yes, we do make recommendations but, at the end of the day, it is the Treasurer who determines the levy rates. In relation to the excluded superannuation funds, the particularly large overcollection that the ANAO report referred to in 1998 and 1999 was really a hangover from previous arrangements. Those funds were levied \$200 each under previous arrangements when they were regulated by the Insurance and Superannuation Commission, and that money flowed to consolidated revenue. It did not flow directly to the regulatory agency, whether that was the ISC or APRA. So, in that particular year, it is true that a very substantial excess was collected from that sector than was needed for prudential regulation, but that excess did not flow to APRA; it flowed to consolidated revenue and APRA received a very small proportion of what was collected from that sector for our regulatory requirements.

CHAIR—What about the question of the capturing of administrative costs? That is something that certainly is within your control.

Mr Thompson—I am sorry; I do not quite follow.

CHAIR—In terms of keeping the costs down, what progress has been made there?

Mr Thompson—As I said in my opening remarks, it is not possible to do an absolutely precise calculation of how the costs of prudential supervision have changed over the past few years, because previous arrangements involved 11 different agencies, and some of those did things beyond prudential regulation. But the rough calculations that we have been able to do suggest that the running costs, the operating costs, of prudential regulation have fallen in nominal terms by about 10 per cent between 1997-98 and the present year. We believe that is a

reasonable dividend from administrative savings and more efficient organisation of the regulatory function. It has also, as I said, occurred at a time when the financial sector that we regulate has continued to grow very rapidly by something like 35 per cent or 40 per cent over those years and has become more complex and more difficult to supervise.

CHAIR—Do you see that trend continuing? You talked about the nominal reduction; do you see that reduction continuing?

Mr Thompson—I think it might be asking a bit much for us to see a continuing reduction in nominal terms. We certainly would like to keep the costs steady in real terms, and we think that, in the absence of major developments in the financial system that require us to acquire new resources, it is probably achievable.

Ms BURKE—Given the answer that there was so much disquiet about the levy system that was put in place and that a review, which is now secret, was held by the minister, do you think you had adequate input into that review and can you broadly outline the findings? I do not want you to get yourselves into trouble with the minister, but what was the broad thrust of that, because certain aspects of the industry are unhappy about the levy arrangements that are in place?

Mr Thompson—I was not under the impression that the outcome of that review was secret. I thought that the industry groups had been informed of the broad outcome.

Ms BURKE—The broad outcome—but the report has not been made public.

Mr Thompson—Broadly, the outcome of the review has been to make only small changes to the framework that was originally put in place. Industry groups, generally, were in favour of staying with a sectoral arrangement for collecting levies, and that is continuing. I think there were views about the timing of collections, which are not to be changed. Broadly, the framework that was in place previously has been confirmed.

The main changes that were introduced were a concessional levy rate for branches of foreign banks in recognition of the lower intensity of supervision in those cases. There was recognition that, in the event of overcollection, it could be rebated to industry through lower collections in the following year. There were one or two other minor amendments in the area of pooled superannuation trusts. So the structure is very similar to what was there previously. The government has announced that it would like to do a further, more thorough review in 2003 when the whole range of Wallis reforms is reviewed. Most sectors of industry have benefited from a reduction, or no change, in levy rates this year. The only sectors that are seeing an increase are the larger general insurance companies and some of the smaller superannuation funds. The levy rate for deposit takers has actually come down slightly. There was no change as far as life insurance companies were concerned.

Ms BURKE—The ANAO report said that APRA was unable to accurately capture the administrative costs associated with particular levies. How then can APRA claim that the associated costs of the prudential regulation of the big four banks is no different from the minor banks, the million-dollar cap for the banks being one of the major sticking points in the levying

field? How can you make that assessment when you have just said you cannot accurately comment on how much it is costing you to regulate these institutions?

Mr Thompson—The maximum levy rate for deposit-taking institutions of \$1 million is written into the legislation. That is a given in the absence of legislative change. It is very difficult to accurately measure exactly how much regulatory effort goes in to individual financial institutions or individual groups of financial institutions. It will also vary from one year to the next. 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.

Our main concern, alluding to my earlier remarks, is to contain our overall costs—and I believe we have done that—and to seek efficiencies in the way we regulate industry wherever possible. The actual formulas for recovering costs from individual companies and industry groups will always be imprecise for the reasons that I mentioned, and also because of the way that APRA has organised itself. Encouraged by the Wallis committee, we have organised ourselves in ways which are not focused as much on the traditional industry sectors as in the past, but which aim to integrate prudential regulation across industry boundaries. Increasingly, as we go forward, it will be more difficult to allocate costs to the traditional industry groups. We would 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 rate across all industry groups. But, in the meantime, we live with a system that is probably inevitably going to have some groups satisfied in one year and others unsatisfied, and the reverse situation the following year.

Ms BURKE—To expand on that, how would you have a single rate? Are you going to ensure that you can capture your administrative costs?

Mr Thompson—We measure our administrative costs. The difficulty in going forward will be allocating those costs accurately to different sectors of the financial system. We must do that imperfectly at present because the legislative arrangements are based on collections from different sectors.

Ms BURKE—How will you do that, given that the sectors are blurring so much—part of your stuff is about conglomerates? I could not work through this, for example: Suncorp-Metway is two distinct entities; will you levy them once or twice? What is happening with them at the moment?

Mr Thompson—Under the legislation as it is at the moment, levies are applied to each licensed entity. I am not sure exactly how many licences a group like Suncorp-Metway has.

Ms BURKE—It has more than one.

Mr Thompson—It clearly has a banking licence and probably two or three insurance licences.

Mr Karp—A general insurance licence and a life insurance licence and superannuation.

Ms BURKE—Superannuation has heaps.

Mr Thompson—So, under the present arrangements, an amount is levied on each of those licensed entities. That illustrates why, over time, we would like to move to a system that levied a similar, if not identical, rate on assets across the whole financial system regardless of which particular institution they might sit in.

Ms BURKE—The Association of Superannuation Funds of Australia have estimated that they are paying about 40 per cent of the levies versus ADIs, which they claim are paying about 16 per cent. Do you think that is fair, given that those levies come out of people's take-home superannuation pay? The funds move it as a fee against the superannuation that you pay as an individual. ADIs can cost shift a lot better than superannuation funds. Do you think that is fair and is it something that you would like to see reviewed in the long run?

Mr Thompson—We are operating on the principle—which the Wallis committee recommended—of a cost recovery model from all sectors. The ideal is a reasonably equitable arrangement for cost recovery. One reason the superannuation sector might appear to be carrying a larger share of the burden than you would expect is simply that there are so many superannuation funds. We have more staff time involved in supervising the superannuation sector than any other sector. If you look at aggregate assets in that sector, it may not look much different from the domestic assets of the Australian banks—they are probably less—but the number of institutions is immensely larger. Even after we have transferred most of the very small funds to the tax office, we will be supervising something like 4,000 or 5,000 superannuation funds compared with 55 or 60 banks. So it is not just the size of the assets base but the number of institutions that is relevant to the cost allocation.

Ms BURKE—But do you think it is fair? Don't answer that. It is all right; I understand.

Mrs HULL—I want to touch on that point. I probably received most representations from superannuation funds who believed they were unfairly levied by APRA. Their levies then almost halved. I listened to you say that it is impossible to strike a levy that will please everybody or that will encapsulate all industry activity fairly. You say that some years they might go up and some years they might go down. Are you indicating that superannuation levies may increase, because they have been reduced significantly?

Mr Thompson—No, I am certainly not forecasting that. In doing our cost allocation and making recommendations about levy rates, we have introduced an averaging formula, one of the objectives of which is to avoid volatility in rates from one year to the next. So we expect that there will not be sharp movements in levy rates from one year to the next. What happened with the bulk of superannuation funds this year is that we were able to recommend a levy rate on assets equivalent to the levy rate for most other sectors. We think that objective is desirable, so we are basically levying a consistent rate across the whole financial system.

I cannot see, in the absence of some sudden change which requires us to devote additional resources to manage some crisis or in the absence of additional responsibilities given to us by the government, our need for funds fluctuating dramatically from one year to the next. The formula that we have adopted for allocating our total costs among industry groups is designed to avoid fluctuation in the levies applying to particular industry groups.

Mrs HULL—You have explained why superannuation appears to have the highest proportion of levies, because there are so many, et cetera. I find it hard to understand why the levy was so high in the first place. Was there just a thought that, because there were so many of them, the time taken and the process would be even more difficult than it turned out to be? I cannot quite understand why they were so different and why they have now fallen so much.

Mr Thompson—Mr Karp may be able to help here, because he is probably more familiar with the history. The starting levy rate for superannuation that APRA had was, I believe, basically the rate that had been inherited from previous arrangements with the Insurance and Superannuation Commission.

Mr Karp—Yes, that is correct. The levy rates that applied for super funds in the ISC regime were not full cost recovery. As Mr Thompson pointed out, the revenue from those levies went straight into consolidated revenue, and the ISC was on budget and had to get allocations from government. So it was not a full cost recovery model; it was a minimum levy, maximum levy and rate in between, and we inherited that levy structure to start with. That levy structure was also struck at a time when the number of very small funds was actually much less than the 200,000-odd that we have got to now; it was struck at a time when there were more like 40,000 to 50,000 smaller funds. Over the second half of the nineties, the number of funds grew dramatically and so, in that sense, there was an ability to cut that rate back.

We inherited a levy structure which was not cost recovery; it was very broad and, in essence, a move from that to what we currently have was a move in the right direction, but without upsetting arrangements and equality between the groups too dramatically.

Mrs HULL—So obviously, because it was over and above, it was quite broad. I have the same problem as the deputy chair in that I would hate to think that superannuation funds were a milking cow for revenue.

Mr LATHAM—I have another question about superannuation funds. Recently there has been a debate about so-called ‘ethical investments’: the prospect of superannuation funds being used for socially responsible investment rather than necessarily seeking the highest financial return. Is this a policy, a trend, a development, on which APRA has a particular attitude?

Mr Thompson—I am not aware that APRA has an official view on this. Our responsibility is to ensure, as far as possible, that—and this is not always easy in the case of superannuation, given the number of funds—trustees of funds are managing the money that is entrusted to them prudently and for the purposes for which superannuation exists, which is retirement income. That broad policy approach or responsibility is not necessarily inconsistent with introducing some ethical component into the funds management policies of particular funds, but one could imagine that, in extreme circumstances, it might be.

Mr LATHAM—Is it something you would look at on a case by case basis?

Mr Thompson—I believe so. I do not know if Mr Phelps has anything to add to that.

Mr Phelps—The important process here is that the trustees must have an investment strategy which is documented. That must be conveyed to members through disclosure to members. That

is a very important part of this process. If a fund were to embark on this, its members should be adequately informed.

Mr LATHAM—I have got a particular interest in mutual organisations. I noticed that Wallis recommended at No. 54 that restrictions on the classes of debt and equity that may be issued by mutual institutions should as far as possible be removed. What sort of progress have you made with the implementation of that recommendation?

Mr Phelps—The important needle that needs to be threaded here is for people to be able to issue this sort of debt and retain mutuality. ASIC has been given responsibility for what you might call the corporate structures of building societies, credit unions and friendly societies. It has come out with a set of principles, in which it is trying to say, ‘Here is what we see as mutuality, which your members would expect you to preserve. And here is how you would define somebody who is continuing to be a mutual. If you wish to issue subordinated debt, capital raisings from your members, then you need to do it in a way which preserves this mutuality.’ From a prudential supervisory point of view we are very encouraging of mutuals issuing capital and raising capital. It provides more protection to the deposit takers. The negotiations which occur are primarily with ASIC and these mutuality preservation rules. There was one credit union that found its way through that but for reasons of its own aborted the issue late. There are one or two more who are getting close to finding their way through that and they will be able to issue some subordinated—effectively preference—shares.

Mr LATHAM—On that, what about the new draft capital standard which is restricting the portion of tier one capital to 25 per cent, given that credit unions, building societies and friendly societies have only got the preference shares available to them for raising capital? Is it a bit unfair to bring them into the general restriction of 25 per cent? Should they not have some sort of flexible arrangement where they can go above the 25 per cent while still maintaining prudential security?

Mr Gray—That is a problem for those institutions. Where we are at in relation to that is having discussions with the industry about how that can be alleviated. It is very difficult. When we were doing the harmonised standards, as Graeme said at the start, we were trying to cover institutions here from the mutuals right through to your largest banks and we were trying to put in a consistent approach. We do recognise that within the consistent approach there has to be some flexibility. That is one of the outstanding issues.

Mr LATHAM—And you are hoping through discussions with the industry that you can arrive at those flexible arrangements?

Mr Gray—This model of harmonised standards is—we keep using this expression, but it is not a one size fits all model—a matter of trying to meld these arrangements to fit different institutional characteristics.

Mr LATHAM—Wallis did recommend some sort of flexibility to accommodate differences in the operation of deposit taking institutions. On that the credit unions sought to have their member shares recognised as capital. Is that something you are happy to facilitate? I understand it happens in Canada, France, Germany, Netherlands and the rest of Europe that the membership ownership or proportion is counted in as capital.

Mr Phelps—Just to retreat a second on the earlier question, while the discussion is about that 25 per cent limit, this is a potential problem for credit unions rather than a pressing problem. They have, as Graeme said, close to 15 per cent capital and almost all of that is tier 1. So they have got almost 14 per cent of tier 1. Twenty-five per cent of that would mean that their capital could go up to something like 17 or 18 per cent, and the capital would still be recognised as tier 2. Our limit of eight per cent is expressed in terms of tier 1 plus tier 2. So there is time for these sorts of discussions to be worked through before that is likely to be something which is actually limiting the ability of a credit union to raise capital.

On the question of recognition of member shares, I think we have got to the situation where it is really a matter of looking at issues credit union by credit union. The main question there has been the permanence. One of the things that comes out of the international definitions of capital is that tier 1 capital should be permanent and the people holding the capital should not have the right to withdraw it. It is okay for the regulator to approve a buyback, because then the institution is in control of the process but if the person actually subscribing the capital can come in and say, 'I want it back at any time,' generally, globally, that does not get recognised. So what you need to do is have some sort of mechanism in place for recognising that the institution stays in control of that capital so that if members that subscribe to the capital want their capital back because they are leaving the credit union, there has to be some way that that might be limited so that all the capital could not be withdrawn in one six-month period or something like that. That is the sort of mechanism that we are trying to agree on—that they might have something like an APRA approval for withdrawals of up to 10 per cent of the capital in any one year or something like that. That is the type of thing which, if it is in the individual deeds and members' understandings, could get recognised as tier 1.

Mr LATHAM—I know you have got a big charter and a lot of work to do. Do you feel that you have got the resources to look after the particular needs of credit unions and mutuals? It is an awkward thing in a way because these are organisations that have had a long tradition and have played a very important role, particularly in regional Australia. I think they are at the point where they are trying to reinvent themselves in the global capital environment but still keep their traditional features and to revive their role, particularly in regional development. Do you find it awkward to manage such a wide charter of organisations and are credit unions and mutuals being looked after with sufficient resourcing and attention?

Mr Thompson—The task has to challenge us but I think we have the resources. We recognise that there are special considerations to be taken into account in dealing with some of these smaller regional institutions. It was for that reason that we decided not to centralise regulation of regional institutions all in Sydney. Our offices in Perth, Brisbane, Adelaide and Melbourne supervise the institutions in their regions, which are largely credit unions and superannuation funds and some of the smaller insurers.

But more generally, yes, I think we do recognise that there are trade-offs to be struck between a one size fits all model, on the one hand, which may look more efficient and more tidy and, on the other, a more flexible arrangement that accommodates a range of different styles of institution. Our aim, when we talk about harmonising prudential standards across the deposit-takers, is not a one size fits all model. Harmonised means a single look and feel to the prudential standards guidelines, which are all in one place so that any deposit taker can go to and find the relevant parts that apply to it. But different parts and different approaches within

those standards will be relevant to the 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.

Mr LATHAM—I was reading somewhere that the credit union industry have established a depositor protection certification system. They have got 196 of their members in, but 20 are outside this industry self-regulation model. I think the 20 are saying, ‘APRA has not said much about this system. What is the point of going in?’ Is this something that you plan to authorise or make some statement about, that it is good for the industry to have a depositor protection system that all of its members belong to and in which they seek certification?

Mr Thompson—We have certified that arrangement. It was certified last year. We have not thought it appropriate to say to all credit unions that they must belong to that arrangement, as we feel that is a choice for them to make. There may be alternative arrangements that other, non-member credit unions could put in place which would be equally satisfactory from the point of view of providing comfort to their depositors. But we have certified that particular arrangement—which means, obviously, we think it is a viable and sensible arrangement. Another reason for certifying it was that certification means that, in the event that the arrangement needed to be called on and some of the members were reluctant to meet their obligations, then we would have the power to direct them to meet those obligations.

CHAIR—I know that it is not your role to foster development in this area, but in a number of other countries the credit unions, mutuals and so on take a much larger sector of the deposit-taking institution part of the market. Given the attitude of some of the major banks, it is interesting that we do not seem to have that growth in the credit unions to fill what could be seen as a bit of a gap, if not something more. What restrictions do you see that are holding back that growth?

Mr Thompson—I will let Mr Phelps make a comment, but I think the figures for the share of household deposits in different institutions show that the credit union share has been growing over recent years if you just look at net retail deposits. They are not as significant as they are in some other countries. Subject to what Mr Phelps has to say, I do not believe there is anything in our requirements which is actually inhibiting them from becoming more significant. I would see it as largely a matter of market forces: the difficulty of small institutions in competing with those that are already large and well established.

CHAIR—What about restrictions on capital raising?

Mr Thompson—We encourage capital raising, rather than restrict it.

Mr Phelps—But, to imagine that capital was an inhibiting factor on their growth: if you look at the industry you see that for the credit unions together the capital ratio is around about 14 per cent. Individual credit unions are quite different within that—some are down close to 8 per cent and some are up at 20—but the average is around about 14 per cent. The industry as a whole does not grow at 10 per cent rather than 20 per cent in assets, because they have not got enough capital. They grow at that rate because they are in a market where deposits of the household sector are growing and have been growing for perhaps the last 10 years, just in line with GDP,

whereas all the growth in people's assets is in superannuation, shares and all those sorts of things.

The main market of the credit unions is something that is just growing in line with the economy. So if the financial system grows at seven per cent or eight per cent, and they grow at seven per cent or eight per cent, they would need to have some sort of advantage to actually take market share if they were to build up to the sort of prominence that they have in some other countries. But it is not an inability to raise capital—a lack of capital—that stops them from doing that. It is difficult to see what is in our rules that actually restricts them except that anybody that wants to grow twice as fast as the market will find it difficult to find enough people to lend to without lending to some people that they should not lend to.

Mrs HULL—Following on from Mr Latham and the chairman, do you think that the term 'authorised deposit-taking institutions' is well understood by the Australian public? I come back to credit unions specifically and the role that they play in regional Australia. I wonder whether APRA is playing the role in fostering an understanding that they are as safe as a bank. Is that your role? I want to know whether you think that the Australian public understand that they have the same type of regimen and security that banks do.

Mr Thompson—I suspect probably not. It takes time for the general community to understand changes in arrangements of the kind that we have seen since the Wallis committee reported. On the material that we produce we are trying to promote the term, 'authorised deposit-taking institution' and discuss the various groups that come under that heading in an even-handed way on our web site and in our publications. We are trying to avoid any presentation or suggestion that there are first-class ADIs and second-class ADIs.

One of the difficulties that the credit unions and to some extent the building societies have is that they still want to promote themselves as being different from banks as well as being able to sell themselves as being as good as banks. So there is a marketing challenge there which they have themselves. The most that we can do is avoid giving the impression in any of our material that there are first-class ADIs and second-class ADIs, and we are doing that. One of the reasons we gave priority to developing a harmonised set of prudential standards for ADIs was to send that message—that there is one set of prudential standards that the smallest credit union and the largest bank now fit within and, at the end of the day, the same depositor protection provisions of the Banking Act apply to them all.

Mrs HULL—The fact that they have gone through this APRA process, and it has taken them 18 months or two years to get this far, is a great part of the Elders Bank spiel in opening the Bendigo Bank. In essence, is it up to credit unions as well to promote themselves with respect to this process or are they expecting too much in order to think that perhaps they would be given that context of equity by APRA?

Mr Thompson—I think we are doing all we can reasonably do to give them that context. It is up to them. There is nothing to stop them doing more than they have done to promote the fact that they are now regulated under the same regime as the banks and that they are covered by the same depositor protection provisions of the Banking Act as the banks. I am not sure whether they have done that as energetically as they might have. As I say, part of the challenge for them is that, while they want to portray that feature, they also want to present themselves for other

reasons—other purposes—as being different and special. They certainly do not want to adopt the generic term ‘ADI’. They want to protect and promote the terms ‘credit union’ and ‘building society’.

Mr Phelps—It is their choice to want to call themselves credit unions, which they do, and they see that as an advantage in promoting themselves. We probably use the term ADI more than people in the community—that is probably the truth of the matter. Banks obviously call themselves banks, and credit unions want to call themselves credit unions and with building societies it is the same. As far as us superimposing that they are all authorised deposit taking institutions, we can only really do that in our own material. Otherwise you might have to do things like insisting that they use that term in promoting themselves in their promotional material which is not what we would like to do; we would rather not have that sort of imposition on people. That is about where I would see it.

Mr Gray—I would like to add something on the ADI standards. It is same point that Graeme made. When these standards come out in the next month that will be the first time you have ever had a consistent, seamless set of standards, irrespective of whether you are a building society, a credit union or a bank. It is really about drawing distinctions between those institutions that have relatively simple operations and a spectrum of those institutions that have very complex operations, irrespective of what they call themselves. From a regulatory perspective, you could argue that under the old regulatory system there were distinctions just by virtue of the fact that different regulators regulated them. That certainly is not there now. Maybe it is a question of time as well—it is very early days for the new set of arrangements. But at least from a regulatory perspective we will be able to look at this system and say there are no differences.

Mr Thompson—Another point worth emphasising is that we have only had the supervisory responsibility for the credit unions and building societies since July last year, so, even though we are two years old, it is only just over a year that we have had the state based institutions. It is early days. I think community recognition of the change will come in time. That sort of thing does not happen overnight.

CHAIR—We might move on to a couple of other things. Four months ago when AMP appeared before the Senate Superannuation and Financial Services Select Committee, they were critical on the basis that there was a good understanding of law, and well intentioned, but not a good feel for the industry. I am sure they are remarks you would be well aware of. I was wondering what steps have been taken to address this in terms of getting people who you feel have a good feel for the industry so that hopefully we can get a better relationship going there.

Mr Thompson—We just do not accept the criticism that was made by that one individual, who is no longer with AMP. I think the background to that was one particular issue which he was unhappy with the exact way APRA handled and he saw it as appropriate to elevate that to a representation to a Senate committee. We believe that we are not a legalistic black letter law regulator. Our approach is to be consultative and flexible, but to draw a firm line when we need to, and I think we have the resources, the talent, the experience to supervise in that mode. I do not believe that sort of criticism is typical of what you would hear from industry.

Ms BURKE—I have got one that says, ‘By far the most frustrating and disappointing aspect has been its inability to retain decent staff who know anything about super versus insurance.’ I

have had the same comments from insurance people. It also says, 'All the knowledge officers have left and this has been a real and dramatic effect on service levels. It means that you now cannot get appropriate compliance advice out of its officers and they prefer to work on audit checklists rather than develop policy initiatives for Treasury.' You can dispute the stuff before the Senate inquiry, but I understand, from speaking to people within the super industry in particular who are very disappointed and feel very frustrated, and also from some other insurance areas, that you just do not have the level of staff with the level of experience to do the role that you currently have to do.

Mr Thompson—It is certainly true that we lost some experienced people, and that was inevitable, when the government decided that APRA would be headquartered in Sydney rather than in Canberra where the Insurance and Superannuation Commission had its headquarters. That is one factor. We also expect our people to operate across industry boundaries, so industry had to get used to new faces in some cases. And we have decided to regulate regional institutions out of the regions rather than, as had been done in the case of insurance previously, all from Canberra. So there is no doubt that industry has had to get used to some new faces, and we have had to bring some of our people up to speed as they have had to get on top of unfamiliar issues and unfamiliar industries. I think we are very well advanced in resolving those issues. We certainly do not get a general view from industry that service levels are as poor as suggested by that quotation.

Ms BURKE—The next one says, 'Generally responses are prompt, but only of a routine inquiry. Anything of a complex nature and you just do not get a response.' That is the comment I have received.

Mr Thompson—That is useful feedback, obviously; and we invite feedback of that kind. We do not pretend that these new arrangements can be bedded down perfectly overnight, but I would be very surprised if that sort of comment was felt across the board with the industries that we regulate. There is a tendency for regulated industries who hear something that they do not particularly like from a regulator to resort to the argument that they do not understand us. In some cases that is true, but I think quite often it is not true and it is just a rationalisation of their view on hearing what they would prefer not to hear. Les is closer to the frontline supervision of superannuation than I am so he might like to add something.

Mr Phelps—In superannuation there has not been any important change. There was an Insurance and Superannuation Commission office in Perth and Adelaide, et cetera, and we retained a lot of the people from those offices in our present offices. To that extent they are not even new people, they are the same people. I would think that their access to advice on technical matters has been similarly catered for. There are people in Canberra, people in Sydney and people in the policy areas where advice is only an email away. We have a cross-divisional group. Having set ourselves up basically as specialised institutions and diversified, we recognise that there would be questions which would be industry specific and we had to make sure we did not start giving different answers to different people on the same question.

There is a superannuation cross-divisional committee which has people from the policy area, people from my division and people from Tom's division where any issues of a controversial nature or difficult-to-interpret things go to to make sure that we get the one answer from APRA. I cannot think of the specifics of it. There may have been some questions which have come up

which have taken a couple of meetings of that committee to respond to, but I am not aware of people saying they just cannot get any answer.

On general insurance there was a change. As Graeme said, that was all done from Canberra and now my people in Perth, Brisbane, Adelaide and Melbourne cater for that. So certainly there were some new faces. But the advantage there is that now they have somebody on the ground in their state centre who they can talk to. In fact, we have had some appreciation of having someone local expressed by various bodies. They say that it is easier to deal with our Perth office people who can then get immediate access to head office, rather than trying to get through to somebody in Canberra. So there are pluses and minuses.

In this past two years there has been an awful lot of effort put into internal administrative restructuring. We have acknowledged in all our work that not dropping the ball during that period was an important aim for us. We do not think we have dropped it in any substantive way. We have not let the financial system run riot while we have been doing this. I guess we just have to take as valuable feedback the fact that some people do not think we are providing the level of service they got previously.

Ms BURKE—Two other things came out of the Senate inquiry from AMP. One was the feeling that a simple question was being shunted up the line and it was the stuff that comes from a Senate inquiry. Previously you would go and ask an officer for clarification and you would get a simple answer. Now it seems that everything is becoming a regulatory nightmare and is going through Treasury or to Canberra. There does seem to be this notion that the policy direction is more out of Treasury at this point in time than APRA. That is one thing to consider.

The other thing was that there does seem to be a view from particularly the super industry that you have adopted a different approach in your focus—that you are looking more at the risk for the particular fund rather than the overall systemic questions within the industry as a whole. That is putting more pressure back on the funds. Instead of just doing one look, you seem to be drilling down into the one fund a lot. The industry funds are the ones that have had less difficulty with regulation versus the smaller corporate funds where there do seem to have been some systemic problems recently. It seems to me that you are concentrating on the large funds, which are probably industry funds, and not looking at some of those smaller ones. There are those two issues.

Mr Thompson—I might ask Les to comment on the second part of that. On the first part, if industry is interested in legislative change or regulatory change, it will need to deal with Treasury. APRA's role is administering the SIS legislation and specifically those parts of the SIS legislation to do with prudential supervision.

I think the part of the problem that some industry sectors have had with the new arrangements—and probably superannuation has been the most affected—is that under the previous arrangements they could talk to the Insurance and Superannuation Commission about virtually everything to do with regulation of their sector. Under the Wallis model, we have moved to a functional division of responsibility for financial system regulation which means that prudential supervision is with APRA, disclosure and market conduct are with ASIC, and the development of new legislation is clearly with Treasury. There are some issues where no doubt the ACCC would have an interest. I think industry is still coming to terms with that

rearrangement of responsibilities. I am sure that is the source of some frustration that you are hearing, particularly the first point you raised. Les, do you want to say a bit more about the risk-based approach to regulating super?

Mr Phelps—I think that it is true that over the last five or six years there had been a concentration on larger funds. The decision had been taken some time ago that the great bulk of super funds was in the 360 bigger funds. With resources for someone like the Superannuation and Insurance Commission, which was given this charter, they would go first to the bigger funds and try and get the broadest coverage of the most amount of money most efficiently.

That was also complicated by the fact that there were 215,000 funds. The number of do-it-yourself funds was growing astronomically. The decision had been taken that they would go to the tax department and so resources had not been put into trying to visit. There are still a lot of issues coming out of those smaller funds. People getting divorced ring up and ask what happens to the money. Our phone service that operates out of Canberra gets just on 1,000 telephone calls a day on superannuation matters. We have had to work hard to make sure they are all answered within the regulatory 10 seconds.

We say, all right, all these thousands of funds have gone to the tax office and what is left is something that we can actually get our heads around. How do we decide which funds we ought to visit this year compared to next year? We get quarterly information from the other institutions but from a super fund we only get the one return a year. So we have not got as much information off-site, if I can put it that way, in the office on which to make selections. So we tend to say we will look at those that have grown quickly. We do have systems for following company failure, because if a company has failed and you have got a super fund, it is a good time to go and make sure that the super fund gets isolated as much as possible from the failure of the company.

So the task for the year ahead is to improve this risk based approach. You could imagine just having your inspectors and going alphabetically through all the super funds or something like that. We will not want to do that. We want to say that we will try and have some method for picking those that are likely to be riskier than others, and go and see those. And that ought to mean that those well-managed funds which have been visited previously will be unlikely to be visited—but you still need to make sure they are still there and that what was happening three years ago is still happening properly how. It is true that the problems that have come to light in recent years have tended to be with the smaller funds, and we will be doing our best to get around to see as many of those as we can.

CHAIR—We will have a short break.

Proceedings suspended from 11.22 a.m. to 11.28 a.m.

CHAIR—We were talking about superannuation. I turn first to the question of audit. You made some comments about the quality of auditing: you felt they were not fulfilling their responsibilities. Is that still the case and do you want to expand on that point?

Mr Thompson—I am not sure whether we were pointing to that as being a system-wide problem. There are certainly cases where we find that governance of superannuation funds is

not as strong as it should be. Sometimes that relates to the auditors and sometimes to the trustees. Would you like to elaborate, Les?

Mr Phelps—I do not think it is an issue of whether it has been any worse or any better. The sheer numbers of funds require large numbers of auditors to be involved. We have powers to discipline auditors that we see as not fulfilling their job. We have done that in certain cases, but it is not a new, alarming trend.

CHAIR—Is there still a problem?

Mr Phelps—I do not see it as a particular problem. We have powers to do something about the auditors, and I do not think we see our powers as being deficient there. No, I do not see it as one of our special problems. When you have fraud, for example, a whole lot of people have failed—the original trustees, the accountants and the auditors. If somebody sets out to deliberately deceive, it is traditional that you can go a long way without being caught even though you tend to get caught eventually. There have been some cases of fraud, but I do not see that as particularly discrediting auditors generally.

Ms BURKE—What do you think the level of fraud is? There are different claims by different people at the moment.

Mr Phelps—The actual ones that have been discovered—which, by definition, are the only ones we know about—have not been great. It was only this time last year that I got responsibilities in the area of superannuation, and there has been only one in that time.

Ms BURKE—There has been a lot of criticism about the level of expertise amongst trustees in this current legislation before parliament—looking at enforcing penalties and even criminal charges on the basis of trustees' failure to do this. Do you have a view on how you are going to regulate those sorts of things, because it actually comes back to APRA to regulate it? Do you have any comments about the actual level of education that trustees are getting? Do you think there should be something more put down in regulation about the prudential responsibility that these funds have to ensure that their trustees are actually up to scratch?

Mr SOMLYAY—Can I add to that question, David?

CHAIR—Yes.

Mr SOMLYAY—When you said before that fraud is discovered, what would be the most common method of discovering fraud; is it through the auditors?

Mr Phelps—I think the most common method—and this is not restricted just to superannuation—is when the auditors come across something which disturbs them, they start asking questions and somebody usually confesses. That is the normal process. That has happened with internationally operating banks as much as it has happened with small superannuation funds.

Mr SOMLYAY—Is that internal audit or external audit?

Mr Phelps—External audit. Normally, the fraudster has thought about internal audit and has found some way of circumventing the normal arrangements. It is when a curious or inquisitive external auditor comes across something that does not tally and starts asking questions that it is normally uncovered.

CHAIR—How much fraud is discovered; how many cases would you come across in a year?

Mr Phelps—As I just mentioned, in the last 12 months there has just been the one.

Mr Thompson—Indications are that it is very small, but that is not to understate the seriousness of it when it does occur. There are \$455 billion or so sitting in superannuation, and we are aware of one case of fraud in the past year which was a \$1 million fund.

CHAIR—It sounds too good to be true.

Mr Thompson—Let us hope not.

Mr Phelps—As I said, we only know about the ones that have been discovered.

Ms BURKE—Could I get some comments on the trustee question?

Mr Phelps—It is a general question in financial circles, for all sorts of financiers, whether there should be education or training requirements for people that hold senior positions. It comes up right through from superannuation trustees to people that operate in dealing rooms or trade derivatives or something like that: should they have to have a degree in physics to understand the mathematics that they are coping with? It generally gets rejected, on the basis that regulating people's individual competency to do their job is not something that a regulator is really well prepared to do, and an alternative is that there has to be some sort of industry standard which people reach through going to exams and so on.

There has been a lot of work done in that area by the industry associations—a lot of important work is done there. We encourage and help that wherever we can, but we have not seen it as our role to run courses for trustees or anything of that nature. The fact that there are now quite a lot fewer super funds than there used to be means that there is a demand for a smaller number of trustees, so almost by definition the pool of people that is available to do these jobs must result in less stress and demand than there was three or four years ago.

We do not see this as something that we need to put special efforts into. We do try to be helpful to trustees and others involved with the superannuation industry by running this call centre. We thought a lot of the calls might have been being run by the transfer of the tax office, but we are still getting nearly 1,000 telephone calls a day. That is a very valuable service for people involved in the industry and we would be encouraging the various industry associations to continue their work in providing educative material. We do not have a general view that trustees are generally not up to the mark. They vary but so do the tasks that they have got; they vary tremendously from a little fund to a big one.

Ms BURKE—What about independent information for trustees, say at ANZ Bank, where my experience is—getting the employer input at the table because the employer is represented there

and the trustees are there, and the actual ability to get some external advice? Should there be regulations around that when we are dealing with *My Money* Ralph type stuff?

Mr Karp—I might just come in there. In those sorts of situations where we do have trustees of funds, whether they are connected with banks or other large institutions, one of the things that we do is to look very carefully at how the particular fund or the regulated entity that we are looking at actually operates within a conglomerate. So while we are doing things from a conglomerate perspective, we are also making sure that the separate fund is actually being looked at appropriately. We do look quite carefully at how the trustees of that fund are actually getting their advice—whether they actually are getting advice in a professional way and not totally from within the group. It is an important issue from the conglomerate's point of view.

Leading on to education for trustees: what we are finding, especially for the medium to larger funds, is that it is now more common for many of the trustee boards, with the help of professional advisers, to actually have developed some training packages for their trustees so that when a new trustee is actually coming onto the board—because someone else has left and is being replaced—there is a process by which that new trustee can actually get trained. As Mr Phelps said, we do not set any standards there but it is something that we actually see as we go about our work.

Mr ALBANESE—I have a question on credit card debt. Can you comment on whether you are concerned about the rapid growth in credit card debt which has occurred in the last few years as a major component of private household debt—which is a problem in and of itself. Does this have supervision implications?

Mr Thompson—We have certainly been conscious of the growth of household debt generally to the banking system over the past few years. I guess it is fair to say that it is probably one of the areas that we focused on in our consultations with the banks to ensure that they had systems in place to monitor that debt and not overextend it. If interest rates begin moving around, it could cause repayment difficulties for borrowers. I do not think we have seen or heard anything to suggest that we should be seriously concerned about that. But it is a situation that we will continue to watch against a background of interest rates moving up and household debt certainly being higher than it was some years ago.

Mr Karp—Yes, that is entirely correct. While there has been that sort of growth, it has not yet translated into any problems in terms of high default rates or high levels of losses that the banks have had to cover. That has not shown through yet. Looking at the level of outstandings on credit cards, there is some suggestion that some of that is also driven by people's changing habits. While the outstandings levels have gone up, a lot of it is driven by the convenience of having these cards and the Fly Buys numbers attaching to them. People are churning a lot more through their cards so, at any particular point in time, the level of outstandings now is higher than it was before. But it is being repaid; the growth is there. It is an indicator for us and we are watching it, but it has not been demonstrated as yet that there are any concerns in terms of putting pressure on the banks' financial position or the borrowers.

Mr ALBANESE—Isn't there potential for problems down the track because of the growth in the number of cards issued and the level of debt attaching to those cards? Isn't it dangerous that we no longer have the warning signs that were there a few years ago? Couldn't a potential

increase in interest rates exacerbate problems down the track—which might occur anyway—such as high bankruptcy rates or a large number of defaults on credit card debts? You imply in your answer that people are borrowing more but paying it off. From the figures I have seen, that is true of a section of the population who have the finance to manage their payments from month to month. Surely there are many people now who are not in that situation and who have access to instant credit for the first time.

Mr Karp—There clearly is the potential for problems down the track. All we are saying at this stage is that those problems are not coming through yet. We have had that growth for a few years now and we have seen kick-ups in interest rates. We regard it as an indicator and we will be keeping a watch on it, but there is nothing at the moment to indicate that there is a problem.

Mr ALBANESE—Are you monitoring the level of debt? For example, how much is 12 months outstanding, six months outstanding or one month outstanding? Are you doing that? Do you see that as one of your roles in monitoring that potential problem?

Mr Karp—We do not monitor it across the whole system in that particular way; we expect the individual institutions to monitor it. We look at their whole credit systems when we examine them in detail. So we monitor it in that sense—at individual institutional level—but we do not monitor it right across the system.

CHAIR—While we are still on superannuation—the treatment of over 65s seems extremely onerous. Is it really necessary to have people reporting every month about whether they are employed?

Mr Thompson—Are we still requiring that?

CHAIR—That was in the earlier report.

Mr Phelps—I would have to take that on notice. Our primary focus is on the prudential running of the superannuation funds themselves and on the legislative changes we have inherited in, what you might call, some of the retirement incomes policies functions. I just do not know whether we are still requiring information on that.

CHAIR—You will get back to the committee on that?

Mr Phelps—Yes.

Mrs HULL—This is not on superannuation, but this committee did the report on the regional banking services, and one of the recommendations from that committee was that information and data be gathered on community access to financial services. It is my understanding that the government directed APRA to include recommendation 2 in their data collection. I just want to know how APRA intend to collect information on community access to financial services.

Mr Thompson—I will ask Mr Gray to respond as he is overseeing the new statistics project.

Mr Gray—Let me step back a minute and talk a little bit about our statistics project and that might help. We are spending a lot of time reviewing the sorts of statistics that we collect right across the financial sector and one of the sets of data that we will be looking to collect relates to your question. That is something that will happen over the next couple of years because the project itself has quite a long life—it is about getting rid of old collections that do not make much sense any more and introducing new collections that do. So that is the simple answer.

One of the more difficult things that arises from that is exactly how far you take that. We are interested in more quantitative information on the banking and financial sector as opposed to qualitative things. Concerning community access, there are a lot of aspects to that, from the number of outlets that people can go to to get their banking services conducted around the community—that is one aspect—to a whole range of qualitative issues about whether people feel that they are getting enough access to banking, are they happy with the services that they are getting, and so forth.

So while the new collections that will be put in place within two years are certainly going to be covering that first aspect, they will not be covering a lot of the range of those more qualitative things that I think a lot of people are interested in when they raise that sort of question. I guess the reason we are not doing that is that really it sits outside our brief as a prudential regulator.

Mrs HULL—So could you just answer how you go about collecting information data on these particular areas? What is the process?

Mr Gray—In simple terms, under old collections you would ask the simple questions: how many branches are there in the community; where do they reside—things like that. The problem has been that in the last five or 10 years the mechanisms used to distribute banking services have changed dramatically. So just as a branch might close in a certain area you find other mechanisms opening that give people access to banking in different ways. So what we are doing is really exploring the sorts of things, the range of means, that are becoming available for people to conduct banking—automatic teller machines, and all that sort of thing. The more complicated thing is banking via the Internet, and the like, and it is very complex to determine how many people have access to that.

But in the last five years and more recently the breadth of potential ways that people can get into banking services has just increased so dramatically. What we are doing is looking at that, thinking about that range and how you can measure it, and some of those things are not determined yet. One of the things we are doing is speaking to the industry about what has been done and how to go about measuring it. A lot of the issues in banking are to do with access and have not been decided yet, but that is what this process of the revision of the statistical collection is all about really—talking to people about how better measures can be got of those sorts of things.

Ms BURKE—Will you be giving us something, as part of the report, about face-to-face banking? I think that that is what we are getting to. Obviously, you still need, regardless of all the wonderful technology, to deal with a human being. Will we be able to pinpoint, face-to-face, by postcode, by—

Mr Gray—Yes, you will.

Ms BURKE—When do you think we will be able to get some of that information?

Mr Gray—Probably by next year.

CHAIR—On that same question, are you going to continue to collect those types of statistics? You were talking about reviewing your statistics base. Are you still going to collect that type of information?

Mr Gray—Yes. It is about getting better data and broadening but that will happen within a year or so. The project that is taking place at the moment is about getting statistical forms that we can get in place within about the next 12 months—July next year or thereabouts—and then working on beyond that. So it is in the foreseeable future, yes.

Ms BURKE—Do you, therefore, in that review, see that the banks have some form of social responsibility?

Mr ALBANESE—Nodding does not turn up in the *Hansard*.

Mr Thompson—We do not have to have a view on that to collect very useful information on points of delivery on banking services. That is the objective of this exercise.

Mr ALBANESE—I thought we were the politicians.

Mr SOMLYAY—It is not their function.

Ms BURKE—As you outlined at the beginning, you said that there were a whole lot of things that were not your function.

Mr Thompson—Yes.

Ms BURKE—Competition, fees and charges but it gets back to the data collection; it gets back to banking. I would say that the banks have a social responsibility and I am quite happy to say that but whose responsibility, in a prudential sense, is it for fees and charges and things like mergers? I do not know if you made a comment—I did not see anything—when the Colonial and Commonwealth banks merged. Certainly the ACCC did, in a competitive sense, but where in a regulatory prudential sense does this lie? Who has got the prerogative on it? Who is looking at that issue of risk associated with it and this overall notion of social responsibility to offer the service that the community has to have?

Mr Thompson—If it is prudential, it is ours. Prudential is about, at the end of the day, maximising the likelihood that banks will be able to pay their depositors back. When there is a proposal for a merger or takeover in the banking system, we assess that from a prudential point of view: will this merger, in any way, damage the interests of or reduce the protection available to the depositors with either of the institutions involved? If we come to the view that that is not an issue we would advise the Treasurer to that effect and, obviously, if we came to the view that

it was an issue we would advise the Treasurer to that effect. That would be one of the factors taken into account in decisions by the government about mergers and acquisitions.

We went through that process in the case of the Colonial-Commonwealth exercise and, obviously from the outcome, our recommendation was that we did not see any damage likely to flow to the depositors with either institution or to the policyholders with the insurance parts of the group from that merger going ahead.

Ms BURKE—If the wonderful Wallis went from the six to the four pillars, has APRA formed a view about the systemic risks, the prudential requirements of the disintegration of the four-pillar policy?

Mr Thompson—It is fairly hypothetical.

Ms BURKE—Yes, it is a hypothetical currently but—

Mr Thompson—If there were a proposal for amalgamation among the big four banks we would look at that proposal from the perspective that I described: if this goes ahead, is it likely to damage the interests of depositors of either bank? Is its going forward likely to make our job of prudential supervisor more difficult? They would be the questions we would be asking ourselves and advising the government accordingly.

CHAIR—Mr Thompson, in your opening remarks, you talked about setting up a team to look at operational risk. I was wondering whether you could talk about that a bit more. Is it all coming out in tomorrow's annual report? Following on from that, how are you going to handle the question of Internet commerce because, rightly or wrongly, there is a perception that it does leave itself open to a greater deal of risk, particularly in fraud—identity fraud?

Mr Thompson—I will ask Mr Gray to say a few words on that. No, we will not be unveiling much more about our work on operational risk in tomorrow's annual report. It is an area of risk which has not, until recently, been focused on extensively by prudential supervisors. Because of developments such as electronic commerce, the use of the Internet and the greater reliance of banks on computing systems, it is becoming more of an issue. It is for that reason that we established, last year, an operational risk team as part of our new structure. That team sits under Mr Gray. I might ask him to say some more about exactly what it is doing.

Mr Gray—Traditionally, I think regulators have always focused on the more traditional risks—credit risk and market risk. I think, pre-APRA but in our predecessor organisations, we were one of the first agencies to put in place dedicated risk based teams which looked at those sorts of risks. We felt that, when APRA came into existence, the growth in interest in operational risk issues were such that it really warranted a special team to look at the activities of institutions right across the spectrum, from banks to insurance companies and smaller ADIs, just to assess the sorts of things they are doing and the sorts of methods they are employing to address operational risk—and that is everything from what they are doing to address IT risk or outsourcing risk and so forth.

We have a small team of about half a dozen people, which is not big by any standards. Over the past 12 months—because they were put in place only about 12 months ago—the members

of that team have been going out looking at institutions and trying to draw some conclusions about what they have been seeing in much the same way as we have done, as I have said, in our other teams which look at market and credit risks. The thing that drives us in doing that is a realisation that, when you look around the world, lots of the failures that have occurred, particularly in banking but I think elsewhere, have been operational in nature as opposed to traditional market and credit risks. So, when we look at the Barings failure, I think our conclusion is that it is much more an operational risk problem than it is a market risk problem of someone getting the Nikkei index wrong. It is about someone creating fraudulent transactions and an institution not having an appropriate risk management process in place.

So, really, this operational risk team is about looking at those sorts of issues. In time, what we hope to be able to do is get some benchmarking done across the industry so that we can look at institutions and say, 'How do you stand in relation to those sorts of issues? How are you addressing operational risk issues within your institution?' At the moment, most of that work has been internal. I suppose what we are hoping to do in a reasonably short time is to put out some sort of discussion paper on that. We can circulate it freely and have the industry debate it and discuss it in pretty much the same way as we have done with a lot of the other issues that we have confronted in the last year. The whole purpose of this, as much as our finding out what is happening in relation to operational risk, is about getting some debate going on that topic within the industry. They are looking to us, to some extent, and saying, 'What are you finding? What do you think are important issues?' And we are doing the same to the industry: 'You tell us what you're thinking about operational risk.' Somehow, the two should meet there. So that is what we are doing. It is an active program. At the present time, we have done visits to something like—this will be a reasonable estimate—15 institutions with probably another 15 to 20 institutions scheduled for the next six to 12 months. Once we have done that, I think we will have a pretty good handle on the sorts of issues that are out there.

You mentioned Internet commerce, and that is a tricky one. There have been a number of papers issued by some of the international regulators recently as well, the Basel committee amongst others. They are international issues; they are not ones that any single regulator is going to deal with. They are the sorts of issues we are thinking about and looking at. It involves trying to get some sort of sense of the extent to which people are trying to engage in financial activities that would require authorisation in the normal course but somehow they are getting past those normal arrangements through Internet. I am not sure that there is a lot of that. There have been a few instances we have seen of people putting sites up, usually from overseas, touting for business. We have had some communication with one or two of those. Les, I think you had something to do with that.

The issue there is very complex. Traditionally, we always thought that authorisation was a domestic thing, but now that the world is becoming more and more global through the Internet all regulators are trying to figure out how you deal with that. There are no ready answers to that. What I do think is that to date we have not seen much of that. We have seen instances of people putting up sites that indicate that there are financial services available in other countries, but you can pick up magazines today that come from the States or come from the UK that have ads in the back of them. In a sense, the Internet is no different from that. But we are pretty alert to that. As for the particular issue of that group that was putting some advertisements on the Internet and touting for business, I think ASIC got on to that very quickly. They put out some papers on

Internet banking as well. It is an emerging issue. I do not have any sort of ready answer to that, but all regulators are trying to deal with it in one way or another.

Mr Thompson—The chair mentioned the possibility of fraud through the Internet. In looking at operational risk in this area, one of the things that we will be looking at is what protections banks have in place against fraud that could weaken their financial position. Clearly, the banks themselves have as much interest in that as we have. That would be one of the things that our operational risk people will be concerned about, the protections that banks have in place against fraud. Over time, we would be aiming to develop our own views about what adequate standards there are for that sort of protection. In other words, we will be aiming to develop benchmarks for good practice in control of operational risk.

ACTING CHAIR (Ms Burke)—In another area of risk, securitisation, which is the flavour of the month, can APRA explain to the committee what benefits accrue to a bank in terms of balance sheets of securitisation lending and why are banks doing it?

Mr Thompson—Mr Gray can answer any complicated technical questions, but the short answer is that securitisation, if it is done in a clean way, removes the assets from a bank's balance sheet and absolves the bank of the need to hold capital against those assets.

ACTING CHAIR—Do you see that as having a positive or negative impact on the risk associated with that, and the prudential regulation of it?

Mr Gray—I think it is positive. It has been a tremendously positive innovation. One of the problems with banking is that if you think of a bank, the liabilities side of the bank's balance sheet, people put money in and they come and take it out. The problem on the assets side of a bank's balance sheet is that they tend to lend for longer term, so they are less liquid. When you look overseas and determine what the prime cause of banking problems are, it has often been that the assets side has been too illiquid compared with the deposits side. Thank goodness we have not had those banking problems in Australia to any extent. What securitisation has done is to make the assets side much more liquid than it has ever been before. That is a good thing for banks because it means that they can, if they need to, get rid of assets quite simply. It gives them an alternative funding source if they need it. So that is positive from their perspective.

From our point of view, it is a good thing, because, as I said, it does make the supervisor's job easier if you have got a liquid balance sheet as opposed to an illiquid one. And in recognition of that, if we recognise that banks have got assets off their balance sheet in that way, we do not charge capital.

ACTING CHAIR—Is that leading to some of your thinking behind the reduction of the 50 per cent risk weighted asset for housing loans at this point in time—some of the discussions you have been having on the international stage?

Mr Thompson—No, that is really a different point. That is looking at how much capital is desirable for a lending institution to hold against housing loans, and we came to the judgment that the 50 per cent risk weight is excessive if you look at the historical experience of losses on mortgage lending. So in a submission we made to the Basel committee about its reform of the capital adequacy rules we suggested that it would make sense to review that 50 per cent risk

weight and to reduce it. Whether that is accepted internationally remains to be seen. If it is not, then there is an issue for us as to whether we vary from an international standard and introduce a lower rate. It is a slightly different issue from securitisation which is actually about getting the assets off the balance sheet altogether.

Mrs HULL—I have had an upswing in the number of people who have been applying to have some of their super released in order to purchase housing. An incredible number of people are now looking at trying to get that release. They are generally knocked back. Have you noticed a surge in people wanting to access some of their superannuation funds? It may be a little lower than—

Mr Thompson—We would probably be steady. Les was talking about our call centre applications. A proportion of inquiries that come into our call centre relate to the release of benefits.

Mr Phelps—Yes, it is of the order of 250 to 300 calls a day from people trying to get access to their superannuation money. Probably about 40 actual applications are received as a result of the initial call. The rules—they are not our rules, they are laid out in the legislation—are quite stringent and people can really only get access to it if they are in life-threatening situations and/or they are in a situation where their only place of residence is likely to be lost. They are quite tough rules, but I do not think there has been—

ACTING CHAIR—Do you think that will have to change, because it is actually only the mortgage—

Mrs HULL—That is the reason I am asking the question now.

ACTING CHAIR—The difficulty is that it is only the mortgage and not if you are in a renting situation. We can all tell you, because we have all had constituents with this problem: it is only if you own the property that you can actually get the damn thing. And I have had people evicted—

Mrs HULL—Yes, I have too.

ACTING CHAIR—because it does not actually cover the rental situation. That is still your principal place of residence—you just do not own it.

Mrs HULL—I guess that is the reason why I am asking this question, because more and more I am having the principal place of residence being somewhere that they have rented for 20 or 30 years—honestly. Now their circumstances are changing, they want access so as to purchase a home or purchase the home that they have rented for all of that time. They are being knocked back all the time. That is the reason why I asked whether there was an upswing in this type of request.

Mr Thompson—It is pretty constant and there is quite a lot of it but there is not an upswing, no.

ACTING CHAIR—I am about to lose a quorum because unfortunately everybody has got to be on a plane. I want to get a couple of questions on the record. Then I am going to ask if it is all right, seeing as we are about to lose a quorum and there are some other questions, if we submit written questions to you in the future.

Mr Thompson—Certainly.

ACTING CHAIR—For the record, I want to go to staffing. What would you believe the morale of your staff is at this point in time?

Mr Thompson—That is always something that is very difficult to generalise on. I think morale is good.

ACTING CHAIR—Do you think you have got adequately trained individuals to carry out the roles that are currently your prudential requirements? Do you think you have got adequate staff numbers and the people with the professionalism to carry out those roles?

Mr Thompson—On the whole, yes. There are some pockets where we have got some gaps to fill and we are in the market trying to fill those. When these jobs are in Sydney the market is a difficult one for recruiting. We do have some vacancies at the moment but across the board that is not a major issue for us. It is certainly an issue that needs to be addressed but it is not a major issue inhibiting us doing our work.

We have put enormous resources into training over the past year or so, partly because we have had some inexperienced people joining the organisation and partly because we have been asking people to work outside of their traditional areas of expertise. I think we are pretty well through that basic training phase. By and large, I think our staff are extremely professional and well trained. But as I said earlier, because of the pace of change and innovation in the financial system, it is a continuing challenge. It is not something about which we will ever be able to say, 'Yes, we have done that,' and tick it off.

ACTING CHAIR—Would you share the staff's view that the senior management has not been as involved in the training, and see it as a second order issue—that it is being pumped out, but senior management has not been involved or seen it as an issue?

Mr Thompson—I am not aware of that view being held; I am surprised to hear it expressed.

ACTING CHAIR—I am not about to tell you where that view comes from. I have spoken to the staff—through speaking to the unions, obviously. Funnily enough, I have spoken to the unions that are responsible, and they are indicating the issues that they are getting from the staff at this point in time. That is the view that they have put to me from the discussions they have had.

Mr Gray—One of the issues that some of the very senior people in APRA raise is that such a lot of their time is spent on training that they are there literally 24 hours in a day. That goes to very senior levels in APRA. I am surprised at that comment. I think all of us have been involved in training in various ways over the past year. I have never seen a commitment to training in the way that I have seen it in the last 12 months in APRA.

Mr SOMLYAY—Do you think the pace of training has kept up with the pace of change in the people you supervise?

Mr Gray—Yes, I do. We have put in place some particular training courses. Training covers an enormous variety, but I will give an example: we have training courses that we have developed within APRA, covering various parts of banking and various parts of insurance. We have had requests from other countries, including parts of Asia, to give those courses. Some of our staff have been asked to give training courses to the Basel committee, for example, on aspects of conglomerate supervision. I see an enormous flow of requests for training from us. I take that as some indication that, certainly internationally, people feel our training is of a pretty high standard.

ACTING CHAIR—Yes, but one of the other comments is the concern that there has been a concentration on the overseas and not on the internal. ‘Nero fiddled while Rome was burning,’ is the comment I have received—that there has been a looking to that overseas angle at the expense of the internal requirements.

Mr Thompson—I would reject that view. We could be doing a lot more internationally. We have to say no to a number of requests, simply because we do not have the resources. In our formative stage internal development must take priority, and I think it has.

Mr Gray—Not only has it done so but, as a very practical indicator of that, you can virtually not make a booking in any large conference room in APRA, because there is training going on in every one of them virtually every day.

ACTING CHAIR—Current staff who came from the various organisations and who are now training new recruits who are on a lot higher salaries than them say that there is an issue about skilling up the new people at the expense of themselves. They say the salary issue across the board is one of the big issues at the moment, and has been one of the reasons that so many staff have left the organisation—that the salaries really are not keeping pace with the requirements and the industry out there. Any comments on those issues?

Mr SOMLYAY—That problem is not restricted to APRA.

ACTING CHAIR—No.

Mr Thompson—It is true to say there are some relativity issues in our salary structures which basically flow from how APRA was established and the fact that we inherited structures. Some of them were Public Service structures, some of them were Reserve Bank type structures and some of them came out of state agencies. I would not say that we have sorted out all of the anomalies or distortions that we inherited from that process, but it is certainly on our agenda and we have been doing some of that recently. I do not accept that we are expecting people who have joined us from the predecessor agencies to train up new recruits at the expense of their own development.

ACTING CHAIR—There is just one other thing I will ask, because these people want to run away on me even though I have three pages worth, so you are lucky that I did not ask these first. It is on the issue of AWAs. Why is APRA so absolutely going down the path of insisting that

AWAs are offered and so resistant to the underlying award being made? What is driving that? Don't you think that has had some detrimental impact on staff morale and issues in the organisation?

Mr Thompson—That was a contentious issue about 18 months ago, but all of our staff, with the exception of about 15, have been on AWAs or contracts since the middle of last year. I do not believe it is a contentious issue any more. We are in the process of trying to have a safety net award made. That is proving not to be straightforward. As you would be aware, the FSU decided to take its bat and withdraw from the game when we were aiming to negotiate an award with it.

The reason we decided to go with AWAs in the first instance was that we felt it was extremely important that we integrate, as far as possible, the constituent parts joining us and do that quickly. We made the judgment, which I believe was a correct judgment, that if we had attempted to tackle that integration on the basis of a collective bargaining approach with the two unions involved it would have been a lengthy and drawn out process and we would not have achieved what we needed to achieve in the time frame that our board had set for us.

ACTING CHAIR—You do not think that decision has impacted upon staff morale and staff leaving the organisation?

Mr Thompson—I am not aware of anybody who left the organisation as a result of that issue.

ACTING CHAIR—Going to something completely different—and I promise this will be my last, even though we were scheduled to go to 1 o'clock—where are you at with determining the notion of 'fit and proper' and the test for banking licences?

Mr Gray—The notion of fit and proper is something we have never had on the banking side, up until currently. Where it is at is that there will be a fit and proper requirement introduced. Before I talk about the notion I should step back a bit first because it is complicated to say there will be one introduced when, in the various things we are doing—our conglomerates proposals, our general insurance proposals and so forth—we are trying to introduce this notion into those things over time. In time, we would like to see a general fit and proper standard introduced.

Where it is going is very much an approach that relies on the institutions themselves having effective fit and proper standards in place. So it is not a question of APRA putting in place a prescriptive approach that will have it vetting management in any way. It is more about requiring institutions to have good systems in place so that they are sure that the sort of people they are getting in fall under this heading of fit and proper, and about us talking to the institutions about the systems they have in place. In a sense, we do not see fit and proper as any different from having good risk management systems, more broadly defined. It is just all part and parcel of the one thing.

ACTING CHAIR—What about someone seeking a new licence, particularly a new banking licence? Is there anyone out there currently seeking one?

Mr Thompson—We have got a number of applications in the pipeline for ADI authorities.

ACTING CHAIR—My next question—because it is fun to end on this one—is how are you going to determine that Ron Walker is a fit and proper person to get a banking licence?

Mr Thompson—It is very hypothetical.

ACTING CHAIR—It is very hypothetical—well, it is and it is not.

Mr Thompson—I am not aware that we have an application from a Mr Walker to actually hold a banking authority.

ACTING CHAIR—I thank all the witnesses who appeared before the committee today.

Resolved (on motion by **Mrs Hull**):

That this committee authorises publication, including publication on the parliamentary database of the proof transcript of the evidence given before it at public hearing this day.

Committee adjourned at 12.21 p.m.

