



COMMONWEALTH OF AUSTRALIA

Official Committee Hansard

SENATE

ECONOMICS LEGISLATION COMMITTEE

ESTIMATES

(Budget Estimates)

WEDNESDAY, 1 JUNE 2005

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SENATE
ECONOMICS LEGISLATION COMMITTEE
Wednesday, 1 June 2005

Members: Senator Brandis (*Chair*), Senator Stephens (*Deputy Chair*), Senators Chapman, Murray, Watson and Webber

Senators in attendance: Senators Brandis, Chapman, Conroy, Fifield, Lundy, Murray, Sherry, Watson, Webber and Wong

Committee met at 9.05 am

TREASURY PORTFOLIO

Consideration resumed from 31 May.

In Attendance

Senator Minchin, Minister for Finance and Administration

Department of the Treasury

Dr Ken Henry, Secretary

Outcome 1: Sound Macroeconomic Environment

Output Group 1.1: Macroeconomic Group

Dr Martin Parkinson, Executive Director

Mr David Parker, Alternate Executive Director

Dr David Gruen, Chief Adviser, Domestic,

Mr Roger Brake, General Manager, International Finance Division

Dr Steven Kennedy, General Manager, Domestic Economy Division

Ms Meghan Quinn, Principal Adviser, Forecasting, Domestic Economy Division

Dr Gordon de Brouwer, General Manager, G20 and APEC Secretariat

Mr Adam McKissack, Manager, Macroeconomic Policy Division

Mr Peter Downes, Specialist Adviser, International Economy Division

Mr Luke Yeaman, Acting Manager, International Economy Division

Mr Brian Thomas, Acting Manager, International Economy Division

Mr Phil Garton, Specialist Adviser, International Economy Division

Outcome 2: Effective Government Spending and Taxation Arrangements

Output Group 2.1: Fiscal Group

Mr David Tune, Executive Director

Mr David Martine, General Manager, Budget Policy Division

Mr Matthew Flavel, Manager, Budget Policy Division

Mr Jason McDonald, Manager, Budget Policy Division

Ms Maryanne Mrakovcic, General Manager, Industry, Environment and Defence Division

Mr Rob Heferen, General Manager, Social Policy Division

Mr Michael Willcock, General Manager, Commonwealth-State Relations Division

Output Group 2.2: Revenue Group

Mr Mike Callaghan, Executive Director
Mr Bruce Paine, General Manager, Board of Taxation Secretariat
Mr John Lonsdale, General Manager, Superannuation, Retirement and Savings Division
Mr Nigel Ray, General Manager, Tax Analysis Division
Mr Phil Gallagher, Manager, Tax Analysis Division
Mr Colin Brown, Manager, Tax Analysis Division
Mr Peter Greagg, Manager, Tax Analysis Division
Mr Neil Motteram, General Manager, International Tax and Treaties Division
Mr Patrick Colmer, General Manager, Indirect Tax Division
Mr Colin Johnson, Business Tax Division
Mr Tony Regan, Manager, Business Tax Division
Mr Mark O'Connor, Acting General Manager, Individuals and Exempt Tax Division
Ms Marisa Purvis-Smith, Manager, Individuals and Exempt Tax Division

Outcome 3: Well Functioning Markets**Output Group 3.1: Markets Group**

Mr Jim Murphy, Executive Director
Mr Chris Legg, General Manager, Financial System Division
Ms Kanwaljit Kaur, Manger, Financial System Division
Ms Vicki Wilkinson, Manager, Financial System Division
Mr Iain Scott, Manager, Financial System Division
Mr Trevor King, Manager, Financial System Division
Mr Damien White, Manager, Financial System Division
Ms Kathryn McCrea, Financial System Division
Mr Mike Rawstron, General Manager, Corporations and Financial Services Division
Mr Matt Brine, Manager, Corporations and Financial Services Division
Ms Kerstin Wijeyewardene, Manager, Corporations and Financial Services Division
Ms Ruth Smith, Manager, Corporations and Financial Services Division
Mr David Love, Manager, Corporations and Financial Services Division
Mr Steve French, General Manager, Competition and Consumer Policy Division
Ms Sandra Patch, Senior Adviser, Competition and Consumer Policy Division
Ms Louise Seeber, Senior Adviser, Competition and Consumer Policy Division
Mr David Hall, Competition and Consumer Policy Division
Ms Suzanne Howarth, Senior Adviser, Competition and Consumer Policy Division
Mr Simon Vickery, Competition and Consumer Policy Division
Ms Jacky Rowbotham, Senior Adviser, Competition and Consumer Policy Division
Mr Brad Archer, Competition and Consumer Policy Division
Mr Gerry Antioch, General Manager, Foreign Investment and Trade Policy Division
Mr John Hill, Manager, Foreign Investment and Trade Policy Division
Ms Susan Antcliff, Senior Adviser, Australian Government Actuary
Mr Peter McCray, General Manager, Financial Literacy Foundation
Ms Sally Webster, Manager, Financial Literacy Foundation
Ms Gillie Kirk, Senior Adviser, Financial Literacy Foundation
Mr Grahame Crough, Manager, Financial Literacy Foundation

Mr John Riley, Financial Literacy Foundation
Mr Scott Rogers, Competition and Consumer Policy Division
Ms Jane Benson, Competition and Consumer Policy Division
Mr Chris Lyon, Competition and Consumer Policy Division

Australian Competition and Consumer Commission

Mr Graeme Samuel, Chairman
Mr Brian Cassidy, Chief Executive Officer
Mr Joe Dimasi, Executive General Manager, Regulatory Affairs Division
Mr Mark Pearson, Executive General Manager, Enforcement and Compliance Branch
Ms Lee Hollis, General Manager, Criminal Enforcement and Cartel Branch
Ms Rose Webb, General Manager, Enforcement and Co-ordination Branch
Mr Tim Grimwade, General Manager, Mergers and Asset Sales
Mr Scott Gregson, General Manager, Adjudication Branch
Mr Robert Antich, General Manager, Policy and Liaison Branch
Mr Nigel Ridgway, General Manager, Compliance Strategies Branch
Mr Michael Cosgrave, General Manager, Telecommunications Group
Ms Helen Lu, General Manager, Corporate Management Branch
Mr John Bridge, Chief Finance Officer
Ms Lisa-Anne Ayres, Executive Branch
Mr Chris Steger, Executive Branch
Ms Colette Downie, Director, Enforcement and Co-ordination Branch
Mr Sam Ceravolo, Director, Finance and Services

Australian Bureau of Statistics

Mr Dennis Trewin, Australian Statistician
Ms Susan Linacre, Deputy Australian Statistician, Population Statistics Group
Mr Peter Harper, Deputy Australian Statistician, Economic Statistics Group
Ms Kerrie Duff, Acting First Assistant Statistician, Corporate Services Division
Mr Paul Williams, Assistant Statistician, Census & Geography Branch

Corporations and Markets Advisory Committee

Mr John Kluver, Executive Director

National Competition Council

Mr John Feil, Executive Director
Mr Alan Johnston, Director, Government Businesses and Regulation

Productivity Commission

Mr Ian Gibbs, Assistant Commissioner
Mr Garth Pitkethly, First Assistant Commissioner

Australian Prudential Regulation Authority

Mr Ross Jones, Deputy Chairman
Mr Stephen Somogyi, Member
Mr Charles Littrell, Executive General Manager, Policy, Research and Statistics
Mr Wayne Byres, Executive General Manager, Diversified Institutions
Dr Darryl Roberts, General Manager, Enforcement, Supervisory Support
Mr Stephen Glenfield, General Manager, South West Region, Specialised Institutions

Australian Securities and Investment Commission

Mr Jeffrey Lucy, Chairman
Mr Jeremy Cooper, Deputy Chairman
Ms Jan Redfern, Executive Director, Enforcement
Mr Peter Clark, Senior Counsel

Australian Taxation Office

Mr Michael Carmody, Commissioner of Taxation
Mr Murray Crowe, Assistant Commissioner
Mr James O'Halloran, Assistant Commissioner
Mr Bill Gibson, Chief Information Officer
Mr Greg Farr, Second Commissioner
Ms Jan Farrell, Deputy Commissioner
Ms Erin Holland, Deputy Commissioner
Mr Mark Jackson, Deputy Commissioner
Mr Mark Konza, Deputy Commissioner
Mr Neil Mann, Deputy Commissioner
Ms Stephanie Martin, First Assistant Commissioner
Mr Michael Monaghan, Deputy Commissioner
Ms Donna Moody, Chief Finance Officer
Ms Tracey Nicholson, Assistant Commissioner
Mr Shane Reardon, Deputy Commissioner
Mr Greg Topping, Assistant Deputy Commissioner
Mr Graham Whyte, Assistant Commissioner
Ms Anne Ellison, First Assistant Commissioner

Inspector-General of Taxation

Mr David Vos, Inspector-General of Taxation
Mr Steve Chapman, Deputy Inspector-General of Taxation

Australian Office of Financial Management

Mr Neil Hyden, Chief Executive Officer
Mr Paul Power, Chief Operating Officer
Mr Pat Raccosta, Chief Finance Officer
Mr Michael Bath, Director, Financial Risk
Mr Gerald Dodgson, Head, Treasury Services

CHAIR (Senator Brandis)—Welcome to this resumed hearing of the Senate Economics Legislation Committee. We are resuming with officers from the Australian Bureau of Statistics. We will proceed with the sequence in the program as it is currently published, but I will try to give officers from other agencies a better idea during the morning as to when they will be required.

Australian Bureau of Statistics

Senator SHERRY—Firstly, I would like to note and acknowledge that it is the ABS's centenary year. Congratulations. It is a widely respected organisation and an apolitical one. Mr Trewin, I read your speech to the Press Club. I just want to touch on a couple of the issues you raised there. Firstly, could I go to the improved housing index. You flagged a new,

improved housing index at the Press Club. Could you please give us a brief summation of the problems with current statistics and how you are proposing to improve them?

Mr Trewin—The main problem with the current house price index is that it comes out too late for the needs of most users. It comes out roughly three months after a reference period. The way it is compiled, it refers to transactions that took place even a few months before that. We basically rely on the valuers-general in the states and getting data from them. By the time they collect all of that data and feed it through to us, it is not possible for us to do it much quicker than that. We are moving to a new methodology which revolves around getting data from the major banks. We have been in discussions with the major banks for the last six months. They are all cooperating. I guess there is a degree of self-interest as well as community interest in this, so they are cooperating with us. We have done some experimental studies of an index we will derive from data from the banks. It is all looking very promising. We are reasonably confident that we will be able to start a new house price index series, starting from the September quarter, that will be released about one month after the reference period. We will actually have a bit of historical data in the first release.

Mr Harper—Our aim is to put out an information paper prior to moving across to the new methodology so that people are aware. It will probably actually be about six weeks after the reference period that we will be able to put the index out, because it takes about a month or so to get the data out of the banks.

Senator SHERRY—Basically, we are looking at new data that will reference six weeks after the event rather than more than three months after the event?

Mr Harper—Yes.

Senator SHERRY—With historical data just to give us a bit of a comparison and an overview?

Mr Trewin—Yes, that is right.

Senator SHERRY—How are you finding the level of cooperation with the financial institutions?

Mr Harper—That has been excellent. We have asked them to provide us with back data covering, I think, the previous two years out of their systems, so that we could do some simulations to understand their data. In a number of cases they had to undertake some fairly extensive computer programming in order to provide us with that information, and they did it very cooperatively.

Senator SHERRY—So you have not found any difficulties in gathering data from anyone?

Mr Harper—Not from the banks, no.

Senator SHERRY—You say ‘banks’. Are there other financial institutions as well? I know there are other financial institutions, but are there any other financial institutions involved in the provision of data?

Mr Harper—Not at this stage. The major banks cover what we think is a sufficiently large proportion of the market for the purposes to which we are trying to put the data.

Mr Trewin—We include financial institutions in some of our collections, but for the house price index we are just using the five major banks.

Senator SHERRY—There is obviously a political and economic sensitivity about this type of data, as indeed there is about much of the data you release. Have there been discussions with Treasury and the Reserve Bank about the new data series?

Mr Harper—Yes, we have had ongoing discussions with Treasury and the Reserve Bank. Of course, they are major users of our house price index and they have been strong proponents of our making improvements. We have been keeping them informed of our developments. I think both institutions are pleased with what has been happening. We have also been keeping the broader economic statistics users informed of the developments.

Mr Trewin—We have an Economic Statistics User Group, which is a mixture of people from the financial sector, from Treasury, the Reserve Bank, state government agencies and industry associations. We meet about every six months with that group. I think there is a meeting next week. This is one of the prime items of discussion. One of the features of our index is that it is what we call price constant quality. It takes account of the shift in composition of house sales, if they vary from across areas within a city or if the mix between apartments and houses changes. We actually take account of this in our index whereas some of the private sector indexes do not. We are trying to create a gold standard index, if you like.

Senator SHERRY—Whilst we are on the issue of gathering data, you released, I think it was last Friday, a survey of funds management financial institutions. My office looked at this data on Monday. It consists of a vast number—in fact, it would have been too heavy for me to bring up here—of flow charts/models of financial cash flow in financial institutions. There is a range of issues that flows from that. Taking superannuation funds, which I will be asking some questions to APRA and ASIC about later on, I notice that, as a consequence of the release of that data on Friday, there was a report on the ABC news in the finance section that—I am not quoting it word for word but summarising the point that was made—that once this data was released it showed that financial institutions, particularly superannuation institutions, were doing very well in terms of cash flow, fees and charges and, as a consequence, their share price went up. That demonstrates the economic sensitivity of this data. I have to say, having downloaded and received a copy of the data in detail, it would be extraordinarily difficult for the ordinary punter, if I can use that term, to, firstly, access it and, secondly, understand it. It is obviously data that is useful for specialist economic writers and commentators. In gathering that data, have you had any difficulty with financial institutions, particularly superannuation funds, providing data when requested?

Mr Harper—Typically, no, we do not have difficulty with financial institutions. We are increasingly sourcing more and more of our data from financial institutions via APRA. That has been very successful in terms of eliminating duplication of reporting of information. Superannuation is a tricky area, because not all superannuation funds are regulated by APRA. Some are in fact regulated by the tax office and we need to use them as a data source for other aspects of superannuation. But overall we have a good deal of cooperation with both APRA and the financial institutions.

Senator SHERRY—Just on that point—and this is an issue I will raise with APRA in much more detail—for the collection of data do you have legal authority in statute, regulations and law to collect data requested?

Mr Harper—Yes. We have the Census and Statistics Act, which gives the statistician the power to ask businesses and people questions.

Senator SHERRY—What if they refuse to provide the data?

Mr Trewin—I have two powers. One is to request people to provide information, and that is what we do 99.99 per cent of the time. If someone objects and they are really important for the collection, we do have the power to direct, but we use it with discretion. I cannot recall having to do it for this particular sector.

Senator SHERRY—It is rarely used. If the power of direction is breached, presumably there is a penalty provision that could be imposed?

Mr Trewin—Yes, there is an offence created, so it gets referred to the DPP.

Senator SHERRY—Do you know what the penalty in the act is?

Mr Trewin—The penalty provides for a fine of up to \$500 per day in terms of an offence. When someone has been found guilty of such an offence, the fines vary. They have normally been in the \$200 to \$2,000 range. If it builds up, it could be a very big fine, but a fine of that level has never, ever been imposed.

Senator SHERRY—I assume if an institution being asked a question or questions is not clear about what it is being asked, it would contact you and seek clarification from the bureau and then you would expect that it would respond once the clarification is given?

Mr Harper—We try to work very cooperatively with all of the providers to our collections. We design our forms in a way that suits their internal record-keeping purposes. We provide a range of explanatory information on the forms. We provide contact officers for them to talk to the ABS if they are having any difficulties. If it is a large enough provider, we will send someone around to visit them if they are having problems. We do not like to rely on the provisions of the act to seek compulsory information; we prefer to rely on the cooperation of the data providers.

Senator SHERRY—You would accept that at least with some of your data in respect of finance markets, for example, it is highly sensitive in the sense that it can impact significantly on the market attitudes to pricing of financial institutions?

Mr Harper—We have very strict secrecy provisions under which we operate. All officers are bound not to divulge information about the businesses that they deal with. Information is only available on a need-to-know basis. There are significant penalties, jail penalties, for people who breach those secrecy provisions.

Senator SHERRY—What I was getting at is that you do recognise that data—I am assuming it is properly collected; I am not suggesting there are leaks or anything—once released can have a significant impact in the economic market and also in terms of consumers and their particular attitude to the reporting of data in the aggregate and their attitude to

particular financial institutions or services that are being offered. Do you accept that can be highly sensitive?

Mr Trewin—Yes, that is the case. We have a whole range of statistics that are market sensitive. The national accounts are just one example. We have very tight procedures revolving around the release of those statistics. They are well understood within the organisation, and we have lots of systems just to make sure that things are kept as tight as possible.

Mr Harper—Our aim is to make sure that everybody gets equal access to the information at the same time so that there is no market advantage to anybody.

Senator SHERRY—I do want to refer to what I would describe as a less than glorious episode, the retail trade data. The deputy governor, Mr Stevens, flagged a question mark over the retail trade data in a public speech in December. He made the statement at a time of virtually unprecedented public debate between the Treasurer and the RBA on the strength of the economy. The retail trade data was central to this debate. I notice at the Press Club you defended your calculations. You said they had been double checked, triple checked: ‘We have got real confidence in the numbers.’ That was the quote from your speech. How could you say that when—and I say this quite frankly—you had to admit that the calculations were seriously flawed?

Mr Trewin—The statement I made at that time was correct. They were double checked and triple checked. Unfortunately, we did not find the error that was there. Perhaps I can explain the source of it just to understand why it was a little bit peculiar.

Senator SHERRY—I was going to get to that detail, so by all means, yes.

Mr Trewin—In June last year we changed the sample for our retail survey. We have been getting access to business activity data from the tax office, and that enables us to design more efficient samples. We introduced a smaller sample in reducing the compliance costs on the small business end of the retail sector. As a consequence of that, we had to change our estimation systems. For June we did what we call a parallel run. We checked the old and the new, and everything checked out. The nature of the error was such that it was peculiar to the first month of the quarter. It first appeared in July. With hindsight, we should have checked both June and July. There was a lot of extensive checking. As I said, the statement I made at the Press Club was true; we had taken the comments very seriously all the way through and had spent a lot of time checking, but unfortunately we did not pick it up. As soon as we did pick it up, we thought the best thing to do was to get the revised figures out as soon as possible rather than waiting for the next retail release. I am highly embarrassed by the whole incident, particularly after making the public statements I did. I have commissioned an independent person to have a look at the whole episode to see whether there are any changes we should be making both in terms of our quality assurance procedures when we make changes like this from time to time but also to assess our checking procedures to find out why this error was not picked up when we were checking. But the point I want to assure you of is that we were taking the comments we are getting not only from the Reserve Bank but from financial commentators very seriously. We did not shrug our shoulders and say, ‘They are wrong.’ We did an awful lot of checking and did not pick it up until quite late in the piece.

Senator SHERRY—In terms of the size of the correction, can you give us an indication of the figures involved?

Mr Trewin—Each one in its own right was within the range for sampling errors. That was another thing that threw us off. It was an accumulation over the first month of three quarters, so over time it built up to be quite significant. We do not believe—and Treasury told us this, too—that it changed the overall shape or the overall assessment of what was happening with the economy, that retail sales were slowing down. It would have been far more embarrassing if the figures we had published originally were telling a completely different story to the ones that we ultimately released.

Senator SHERRY—I was looking for an indication of the figure. You might be getting to it. Was it not that ABS found that retail sales grew at a rate of 3.5 per cent over the past year, more than double the earlier reported 1.5 per cent?

Mr Harper—That sounds approximately right.

Senator SHERRY—That is a very major—

Mr Harper—The cumulative size of the error was about two per cent.

Senator SHERRY—Yes.

Mr Harper—It affected three months most significantly, and the impact on those months was about 0.5 to about 0.7 for the months concerned.

Senator SHERRY—At what point did you discover that the data was incorrect?

Mr Trewin—We discovered it internally about a week before we released the revised numbers.

Senator SHERRY—Which was on?

Mr Harper—We released them on 18 May. It was about 10 days.

Senator SHERRY—I have the press release here. Just so I am clear on this—

Mr Trewin—We thought we should work out what all of the new estimates were and whatnot before—

Senator SHERRY—Yes, I can understand that. Just so I am clear on this, you have referred to an examination of the cause of the problem. Was it because you were collecting data from a smaller number of retail outlets or was the problem the formula used to analyse and aggregate data from a smaller number of retail—

Mr Trewin—It was in the estimation system.

Senator SHERRY—Not the collection of the data?

Mr Harper—Can I clarify that? There was an incorrect file being called into the estimation system. The size of the errors on the incorrect file was not very large for any individual unit, but collectively it had the impact that we have just described.

Senator SHERRY—You referred to the issue of data collection from business. I must say from time to time I do get complaints from business. Can you just give me an indication of what the size of collection from retail outlets is now as a result of the change?

Mr Harper—I do not have the exact numbers, but it went from about 4,000 businesses to about 3,200—that order of magnitude.

Senator SHERRY—Okay. In this case, were the businesses you collected data from the same businesses over time, so as to ensure you have a like sample over time?

Mr Harper—The population is split into two. There is what we call the completely enumerated sector, which are the bigger businesses. They are in the survey all of the time. Then we have what we call a sample sector, where we take a selection of businesses. Once a quarter we rotate some of those businesses out and rotate some new businesses in.

Senator SHERRY—The press release on 18 May: were Treasury, the Treasurer's office and the Reserve Bank advised before the announcement occurred publicly?

Mr Trewin—We advised the Treasury and Treasurer's office I think about half an hour or an hour beforehand that we were going to be making a revision. They knew the day before, like everyone else, but slightly earlier than other people. It was a revision that is market sensitive and we are conscious of that, so that is why we try and keep it to ourselves for as long as it is sensibly possible.

Senator SHERRY—In the context of the size of the total revision, the issue of retail sales figures is one of a number of critical factors, for example, in respect of interest rates, that the Reserve Bank takes into account?

Mr Trewin—Yes, most certainly. Yesterday's figures, we knew, were going to be a bit of a surprise to some people, so we put even more effort than normal into explaining to people why the figure was lower than was expected. We are pleased we have done that, because the reporting of yesterday's figures, we think, has been quite good and sensible. It has told the story as it is.

Senator SHERRY—I want to refer to another area of revision, the capital expenditure numbers in the December quarter, 5625.0, 'Private new capital expenditure and expected expenditure in Australia'. There was a big upward revision in the capital expenditure numbers. What caused that?

Mr Harper—The majority of the revision was to machinery and equipment in the December quarter. That was caused by some updated information that became available to the ABS about the status of some aircraft. We had previously been advised that the aircraft concerned were owned by a foreign entity, and where they were being used by Australian entities they were under operating lease arrangements. In that case the capital expenditure is not recorded against Australia. We were advised subsequently that the aircraft were owned by an Australian entity and that that meant they were capital expenditure for Australia.

Senator SHERRY—So the purchase by the Australian owned entity—it seems logical to me—would transfer capital expenditure from the foreign entities into an Australian entity into the Australian accounts?

Mr Harper—Yes, that is the way it works.

Senator SHERRY—What was the figure, approximately?

Mr Harper—I think it was around about \$500 million.

Senator SHERRY—Just to be clear on this, were the ABS given information that they were held by a foreign entity up to the point when you compiled the figures.

Mr Harper—Yes.

Senator SHERRY—How did you subsequently find out, after the figures had been released, that the planes that you had not included were in fact owned by an Australian entity?

Mr Harper—The data provider gave us some additional information.

Senator SHERRY—Had ABS asked for that information or did they pass it to ABS? I am not quite understanding how this came about.

Mr Harper—I do not want to get into too much detail because of the confidentiality of the individual provider. There was a subsequent discussion with the provider about aircraft and, during that discussion, that was when the provider gave us revised information about the ones in the December quarter. Can I just make another point about those aircraft in the December quarter: we made an offsetting revision in our imports statistics, so there is no impact of that revision on gross domestic product, because of the netting out.

Mr Trewin—As you can imagine, the provider we are talking about is fairly significant; they are a good provider. We have got a good working relationship with them. We are in reasonably continual contact with them. They do not just get a form from us every now and then and fill it out.

Senator SHERRY—I suppose in this context, even though it is a small number of articles, planes, they have a huge value?

Mr Harper—We are very aware of that and we try and track every plane in Australia in the system to determine what arrangement it is under and get a consistency across our statistics. As you can appreciate, there can be some very complicated arrangements associated with civil aircraft.

Senator SHERRY—I cannot help thinking of a similar type of issue in the Department of Defence with missing tanks. You have got your missing planes, and you found them.

Mr Harper—These were not missing; we just—

Senator SHERRY—Failed to report?

Mr Harper—We knew about them. We just had the wrong information about their ownership.

Senator SHERRY—In terms of the two areas of concern I have touched on, can you give the committee an assurance, Mr Trewin, that this is not a sign of standards falling or problems with methodology within the ABS?

Mr Trewin—Yes, I can. In the last budget round we did get some extra funding from the government to help us add resources to a number of critical areas of statistics where we felt we were at some risk. We are much better placed today than we were 12 to 18 months ago to properly resource some of these critical areas for statistics. But I cannot give you an absolutely ironclad guarantee. Unfortunately, accidents do happen. In terms of the lesson we have had from retail trade, we will try and learn from that. As I mentioned, we have commissioned a study, so we will be having another look at our procedures. But the one thing

I can say confidently is that it is not a sign of a gradual deterioration in the quality of the ABS work.

Mr Trewin—It is an unfortunate incident that I hope will not happen again.

Senator SHERRY—I was not seeking a rock solid, ironclad guarantee. We have had enough of those in recent times. I have a couple of other brief questions. In respect of document 4130.0.55.000—

Mr Harper—Does it have an English name?

Senator SHERRY—I will give you the title. My office downloads every press release from the ABS. You are one of the more prolific releasers of material. It is titled ‘Mortgages up and people borrowing more’ and was released on 23 February. It comments:

More owner-occupied dwellings had a mortgage or loan secured against them in 2002-03 than seven years ago.

I was particularly interested in ‘loan secured against them’. You may not be able to answer this now. This may have been in the data and I may have been unable to find it. You may be aware that what are called equity drawdown loans have grown in use and popularity, it seems to me, enormously in recent times, and are a way of obviously increasing consumption expenditure by borrowing against your home.

You are much more readily able to do that now than, say, 10-20 years ago, when this did not seem to exist. I could not find detailed information on loans secured against mortgages. Does that exist? There is data about the proportion of owner-occupiers, median mortgages, the costs in real terms and all those sorts of things. But I could not find the data on loans secured against your home.

Mr Trewin—We will have to take that one on notice.

Senator SHERRY—Can you come back to me with an historical overview of this area?

Mr Trewin—Yes.

Senator SHERRY—Another press release, No. 3301.0, states that Australia’s fertility rate remains steady. I was a little interested in this, because there has been a bit of speculation in the press recently that there is some sort of baby boom going on. But apparently in 2003 the fertility rate of 1.75 babies per woman was similar to the rates of between 1.73 and 1.76 babies per woman recorded since 1998. Has your more recent data picked up any signs of a baby boom, an increase in the fertility rate?

Mr Trewin—I do not have the data at hand, but my understanding is that the latest assessment of the fertility rate is higher than that, it is in the 1.8 sort of range. So there are some tentative signs that the fertility rate may have bottomed and may be increasing again.

Senator SHERRY—For data of that type, is it the long-term data that we should be looking at? Can we make some immediate assumptions?

Mr Trewin—Statisticians are very cautious people. We normally would like to see a few more observations before making strong statements. But, as I said, there are signs that the fertility rate may at least temporarily have bottomed. From memory, the last two numbers were somewhat higher than the number three years ago.

Senator SHERRY—On another issue connected with fertility but at the other end of the scale, there has been some public comment about the life expectancy of Australians levelling off. There has been a steady increase in life expectancy probably since World War I—80 or 90 years. Do you have any data on life expectancy?

Mr Trewin—Yes, we do. I must admit I had not seen it levelling off. It seem to me it is on a fairly steady increase. The interesting thing is that there has been a slight narrowing of the gap between males and females in more recent years. I expect that comment may be a prediction of what might happen as a result of obesity and other things, because I understand in the United States there has been a levelling off in the life expectancy—

Senator SHERRY—It was in the context of obesity and related—

Mr Trewin—I think it is probably more in the nature of what might happen rather than what has happened.

Senator SHERRY—So there are no signs of that in our data as yet?

Mr Trewin—Not that I am aware of. I will have another look. If I am wrong, I will let you know.

Senator SHERRY—Also, document 6359.0 indicates that one in four people are working 45 hours a week or more. One in four, 24 per cent of the 9.6 million employed persons in Australia aged 15 years and over, in November 2004 worked for 45 hours or more in their main job, according to the survey results. How does that compare historically, say, with 10, 20, 30 years ago? Is this again a trend up?

Mr Trewin—Perhaps I should get a data series for you, because I am going on memory a little. I think there has been a slight trend up over the last decade. The more rapid increase was perhaps a little earlier than that. That is my recollection. It was a little bit different to the public perception. We can drag those figures out for you.

Senator SHERRY—Okay.

Mr Trewin—I know that Australia, in terms of hours worked, is one of the highest among the OECD countries. Our image of being laid back is not necessarily the case.

Senator SHERRY—Laid back when we are not at work. I would be interested in that international comparison as well, if you have relatively brief over time series data. Conversely, I notice from your release 6620 that one in four people are not in the labour force. Do you have any observations to make about the historical data over time for people who are not in the labour force?

Mr Trewin—There is a lot of interest in what we statisticians call the labour underutilisation rate. In recent years, we have been publishing another series as well as the official unemployment series, which is based on an ILO definition, an underutilisation series, which takes account of those people who are working part-time who would like to work more hours and also those who are not in the labour force who really do want to work if they can. This series basically runs in parallel with the unemployment series. It is higher, as you expect. If you look at the shape of the trends, they are pretty much in parallel.

Senator SHERRY—I notice, for example, when women were questioned in this survey the main reasons they gave for not actively looking for work were child care, 32 per cent, and attending an educational institution, 15 per cent. Has that been an upward trending reason for women not actively looking for work?

Mr Trewin—I am not sure. I would have to get that data for you.

Senator SHERRY—Perhaps you can give us some historical—

Mr Trewin—Is that the persons not in labour force publication you are referring to?

Senator SHERRY—It is titled ‘One in four people not in the labour force’.

Mr Trewin—It is a press release.

Senator SHERRY—It is No. 6220.0, of the 14th of the 3rd. How is work progressing on the census?

Mr Trewin—It is progressing well. We are having what we call a dress rehearsal next August, this coming August, in Melbourne, Adelaide and some rural areas in Victoria and South Australia. That will be the real proofing exercise. It literally is a dress rehearsal of everything we do. We have had financial support from the government to enable us at this time to introduce an electronic census form for those who want to do it that way. That is a very positive step, because we think that a lot of the people whom we find hard to contact because they are not home all that often will use that means to complete their census form. The census will also include some additional questions this time that there is a lot of public interest in. There are some questions on volunteering, some questions on paid care, not only of children but also of older people and people with disabilities. We also will have some questions on disability, on people who actually need support and services because of a long-term injury or illness. I think it will be a good census, and an interesting census with a few new features.

Senator SHERRY—You have mentioned that there will be additional questions. I am always a bit nervous when I hear about additional questions in terms of, firstly, the gathering of extra data and the ability of people to complete forms. Will there be questions that will be dropped out?

Mr Trewin—No. I share your sorts of concerns, and that is why we have thoroughly tested this with the population. Basically, we are adding an extra page to the census form. But the questions we are adding are tick-a-box. We are not talking about a huge amount of personal time. With our testing—and we do focus group work after we run tests—we have not had any negative reaction to the extra questions. In terms of the extra time involved, we are talking about perhaps a minute or two, not a large-scale change.

Senator SHERRY—What does your testing show about the time it would take to complete the census form?

Mr Trewin—I cannot answer that precisely. I can only talk to you about the additional time compared with previous censuses. As I said before, we are talking about an extra minute or two. It varies a lot depending on the size.

Senator SHERRY—Yes, of course. I was going to get to that. But a minute on top of the average what?

Mr Trewin—I think we say roughly about 45 minutes for an average household to complete a census form. So we are talking about adding a minute or two to that.

Senator SHERRY—But averages of course can be very misleading.

Mr Trewin—They can, yes.

Senator SHERRY—Do you have a breakdown based on your previous census collection and also your focus group research about average response times?

Mr Trewin—I am not sure that we have one. We could create a table like that quite easily from the work we have done. We may not be able to pick one out when I go back and photocopy it to you, but we could create it reasonably easily.

Senator SHERRY—If you could. There would be a considerable range of response times and I suspect difficulties based on education levels.

Mr Trewin—Yes, there are. Our field collectors, for most households, drop off a form, give a brief explanation and pick it up. But there are some people, particularly older people, and people where English may not be their first language, whom the collectors do help. And we also have help lines, too, particularly for people who do not speak English very well, to help them with the completion of the census.

Senator SHERRY—And functional illiteracy, which is at a reasonable level in Australia. When will the questions be finalised?

Mr Trewin—They may even be now. If it is not now, it will be soon. As you can imagine, this is a huge printing job. We have to have a long lead time. We finalise the questionnaires well before the actual census. We have got a dress rehearsal next August. If I just backtrack on that a little bit, I would say it is probably September when we absolutely finalise the questionnaire. Because even though in August we are running a dress rehearsal, there may be something that has gone badly amiss that we need to do more work on.

Senator SHERRY—There will be a couple more estimates in between now and when the census is done. Just one last issue on the census: you have data collection districts, don't you, that you allocate to the collectors?

Mr Trewin—Yes.

Senator SHERRY—You have a standard set of data collection districts, haven't you?

Mr Trewin—Yes.

Senator SHERRY—Do you know whether those have changed significantly for this coming census?

Mr Trewin—No, they will not have changed significantly. We try to keep them as constant as possible because they are used as a statistical output unit. But of course, particularly in areas with rapid housing development, we would send a census collector mad if we did not change the boundary. We split it into more manageable workloads. Occasionally we have to

do other things, if there is a new highway or something like that. But the changes are at the margin rather than starting from scratch.

Senator SHERRY—What about the additional resources in terms of money required for the census? Obviously, there is the preparation for this year, there are the additional resources for the collection period itself, and then obviously that data is used and has to be inputted et cetera.

Mr Trewin—The arrangements we have with the financing of the census is that there is an agreed formula that rolls over from one census to another. This time we need a bit of additional money to fund the additional questions, the extra page in the questionnaire, and we have got support from the government for that. We also need some extra funds to help with the development of the eCensus, and they provided us with support on that. Over successive censuses, as more and more people take up the Internet option, we would expect that our cost structure would reduce. But this being the first time there is some investment we have to make before we can actually start accruing those savings.

Senator SHERRY—There is in a sense an extra investment, for example, in the area of the eCensus, which is the first time—

Mr Trewin—Yes.

Senator SHERRY—But any long-term financial or efficiency gains will be longer term?

Mr Trewin—Yes.

Senator SHERRY—Thank you, Mr Chairman.

CHAIR—Thank you very much, Senator Sherry. As there are no further questions to the ABS, Mr Trewin and Mr Harper, you are excused; thank you. I invite to the table Mr Kluver from the Corporations and Markets Advisory Committee. Senator Wong?

Senator WONG—Mr Kluver, I wanted to ask some questions about some of your current or most recently released discussion papers and also the reference to you by Mr Pearce on 23 March in relation to CSR and directors duties. I just assume that both outputs that are relevant to your work are being engaged, or that the references are under both outputs?

Mr Kluver—Yes, one reference is in relation to the discussion papers and the other is in relation to reports.

Senator WONG—Can you tell me this: the discussion papers that you released on corporate duties for officers below the director level and also on personal liability for corporate fault, do these constitute part of the exploration of directors duties that was announced in March?

Mr Kluver—Sorry, do these?

Senator WONG—Constitute part of your exploration of the broader issue of directors duties that Mr Pearce announced in March, or are they separate?

Mr Kluver—My understanding is that, if we are referring to the statement of 22 March by Mr Pearce, his announcement was in relation to insolvency law. I understand that his announcement—

Senator WONG—The 23 March letter to you is what I am talking about.

Mr Kluver—The discussion paper on personal liability for corporate fault arises, as is indicated in our discussion paper, and the terms of reference came from a letter from the Senator Ian Campbell, who was then the Parliamentary Secretary to the Treasurer. As to the discussion paper, ‘Corporate duties below board level’, as indicated in our discussion paper, the terms of reference came from the then Parliamentary Secretary to the Treasurer, Ross Cameron MP, in May 2004, arising from the HIH royal commission report.

Senator WONG—So these are quite separate inquiries to the directors duties-CSR inquiry reference in March 2005?

Mr Kluver—The March 2005 report is a further reference that has been given to us. That is dealing with corporate social responsibility. That is currently a matter that we have under review.

Senator WONG—Yes, I understand that. What I am just clarifying is whether the two other matters we are talking about are quite separate references.

Mr Kluver—That is correct.

Senator WONG—To what extent will those investigations—that is, the personal liability and corporate duties below board level—inform the CSR-directors duties reference of March 2005? I am just trying to work out if they are part of the parameters of how you are going to approach something as broad as CSR?

Mr Kluver—The two papers—‘Personal liability for corporate fault’ and ‘Corporate duties below board level’—and our current reference on corporate social responsibilities all deal with various aspects of corporate governance. However, the corporate social responsibility reference arises out of the James Hardie matter, whereas the corporate duties below board level arises out of the HIH royal commission report. The personal liability for corporate fault arises out of a previous reference. So the commonality is they all deal with different aspects of corporate governance, but they are not arising all from the same source. In regard to the most recent reference—that is, to deal with corporate social responsibility—Chris Pearce has asked us to look at four specific questions. And they are, first—

Senator WONG—Yes, I do have a copy of the letter. There are a couple of questions arising out of that. The personal liability for corporate fault, you said, arose out of a different reference. What is the factual context to that? We know HIH and Hardie are related to the two other references we have been discussing. What was the factual circumstance that led to the corporate fault and personal liability reference?

Mr Kluver—The reference that was given to us raised the general question about whether the state of the law was such that it was creating a disincentive for persons to act as directors. The view of the advisory committee was that there had been some concern in the commercial community for some years about the nature of the liabilities that were arising for directors and other persons involved in corporate management under legislation outside of the Corporations Act.

Senator WONG—So not to CLERP 9 issues but beyond those?

Mr Kluver—Yes. This particular paper, ‘Personal liability for corporate fault’, does not focus on the corporations act. In fact, it focuses on a range of Commonwealth, state and territory legislation, in particular environmental protection, occupational health and safety, hazardous goods and fair trading, that impose what the paper describes as ‘derivative liability’—that is, liability that arises in consequence of corporate fault simply by virtue of the position a person holds in the corporation itself, without the requirement to establish any personal fault on that person’s part.

There has been a view in the commercial community for some time that the plethora of legislation at these different levels could have detrimental impacts on the ability of corporations to operate fully effective compliance systems because of the nature of the variations between state and state, particularly for corporations operating in one or more jurisdictions, and as well that could have some impact on the incentive for persons to be directors, given the nature of the personal liability that could be imposed. That was the background to the particular paper.

The paper itself has sought to identify patterns in the range of Commonwealth, state and territory legislation that impose derivative liability and, with a view to more effective compliance, put forward some possible templates for a form of legislation that may move towards a more uniform approach to liability in different jurisdictions, rather than at the current moment where corporations that operate within various jurisdictions in Australia have to take into account all of the fine subtleties and differences between one piece of legislation and another.

Senator WONG—I recognise the benefits of some sort of streamlining of regulatory processes there. What I was interested in is this: it seems to me that—and this is certainly how a number of people would understand CSR—this whole issue of the personal liability of directors and/or officers of companies is one aspect of how one might achieve that. What I am trying to work out is, if you are taking this approach in relation to the personal liability inquiry, how does that inform the way you approach or will approach your corporate social responsibility inquiry?

Mr Kluver—The questions in our corporate social responsibility inquiry are of a different nature to the questions that we raise in ‘Personal liability for corporate fault’. The questions in regard to corporate social responsibility are essentially what, if any, interests, other than the interests of the shareholders, may or should directors take into account in reaching their decisions in regard to their commercial decision making. This is an issue that arises under the Corporations Act itself—in particular section 181 of the Corporations Act—which requires directors to act in good faith and in the best interests of the corporation and for a proper purpose. An issue arose with the James Hardie—

Senator WONG—Yes, I am aware of the issue with James Hardie.

Mr Kluver—That is right.

Senator WONG—Is Professor Ramsay on CAMAC too?

Mr Kluver—Yes, he is; he is a member of our committee.

Senator WONG—There is an issue—and I assume CAMAC will be considering this—that there is a view that the law itself, in terms of the provision you are talking about, does not preclude directors having regard to stakeholder concerns in terms of assessing the long-term interests of the company.

Mr Kluver—One of the issues we will be looking at and have been specifically asked to look at is whether it is necessary to clarify the Corporations Act with regard to the extent to which directors may take into account a broader range of interests. There is a difference of view in the commercial community as to whether there is any requirement that the Corporations Act be clarified or whether the Corporations Act, as it stands, suffices to allow directors sufficient and appropriate discretion with regard to their commercial decision making to take into account this broader range of interests. This is one of the issues we have been asked to look at and it will certainly be one of the issues we will be focusing on in our forthcoming discussion paper.

Senator WONG—Have you considered an enabling provision as opposed to a substantive change—that is, something along the lines of the fact that this does not preclude consideration of broader stakeholder-community interests?

Mr Kluver—At this stage, the advisory committee is still working in the direction of a discussion paper. We have not yet settled on the ambit of that discussion paper or what policy options we will be looking at. However, in response to your question, the UK has recently put forward a model provision which suggests a broader definition of the concept of acting in the interests of shareholders. One of the options we will be raising in the paper is whether a provision on the same basis as the UK model provision—it is not yet enacted in the UK; it is simply a draft provision—would be appropriate in Australia. I would emphasise that our discussion paper will look to a range of policy options in this regard rather than just one or two.

Senator WONG—I am aware that you have not gone that far down the track in this inquiry, but certainly Mr Pearce's letter focused pretty specifically on the legal framework. The broader issue of corporate social responsibility obviously may include policy initiatives that go beyond specific legal changes to the Corporations Law. Would those things be within the ambit of your discussion paper and consideration or are you really focused on the legal framework?

Mr Kluver—If you look at the four questions that we have been asked specifically to deal with by Mr Pearce, the first, second and fourth are more focused on the Corporations Act, whereas question 3—'should Australian companies be encouraged to adopt socially and environmentally responsible business practices and, if so, how'—clearly goes well beyond the operation of the Corporations Act and is more in line with the sorts of questions that you are asking.

Senator WONG—Do you see your role as going beyond the legal aspects of personal and company responsibility to stakeholders?

Mr Kluver—The full ambit of and boundaries around what our discussion paper will cover have not yet been settled. However, we are aware that there is what one might describe as an energetic debate going on in the commercial community about the nature of corporate

social responsibility and how that might best be encouraged, be it through government initiatives or private initiatives, what is currently in operation and what further initiatives there might be. Question 3 allows us to look at this much broader ambit. Therefore, not only will we be looking at the Corporations Act, which is one of the essential issues, of course, but question 3 gives us the opportunity to go well beyond that.

Senator WONG—Are you actually going to attempt a definition of CSR? It seems that everyone that one talks to has a different view about what it means.

Mr Kluver—Yes, we have not yet drafted a definition of CSR. We are still at the stage of taking note of what other parties in the commercial community mean by that and how they see it being worked out. So we are still at what one might describe as a preliminary information gathering stage. At an appropriate point the advisory committee may seek to consider some sort of definition, but I suppose one would have to be very careful about moving towards something that looked like a statutory based legal definition of corporate social responsibility as opposed to a more generic type of commercially understanding of what it means or includes.

Senator WONG—Or multiple definitions?

Mr Kluver—Or multiple, yes.

Senator MURRAY—Will you consider in your discussion paper whether other law may be appropriate to carry that concept? I will give you this example: the trade practices law and indeed things like the Financial Services Reform Act all impose broader obligations towards consumers and towards society through other legislative instruments. It may be that issues like this could reside in other areas of law. I am not putting an opinion to you; I am just putting a proposition to you that you may choose to think of it as being sited elsewhere.

Mr Kluver—At this stage I would again emphasise that no decisions have been made by the advisory committee with regard to the full ambit of the discussion paper. Nor have we yet considered, if there were to be CSR initiatives, in what form they might take or under what form of legislation. Certainly the terms of reference have excited a high degree of interest amongst a broad range of social groups, and we have received a very large number of inquiries as to what our reference will be, what our timing will be and what we propose to do in terms of forthcoming papers. So I would again emphasise that we have not made any decision at this stage.

The first task is to get a full understanding of how the CSR concept is utilised and employed by different groups within our society and also in overseas jurisdictions, and at some stage we will be able to put together a discussion paper which will raise a whole series of policy options so that the debate can carry forward. We are a long way away from a final report and I would anticipate that there will be a lot of debate, and hopefully in the public sector, before we move in that direction.

Senator MURRAY—My point is simply that I have picked up an automatic belief that these things should only reside in Corporations Law, but if you look at other social responsibility laws—for instance, laws governing charities and philanthropy—you will see they largely reside within tax law. The laws governing environmental concerns and responsibilities are specifically separate. As I have outlined, the laws governing the way in

which you should behave within the ethics of good competitive behaviour and good consumer behaviour reside within the trade practices law and other laws. All those put obligations on directors and on companies to perform ethically, responsibly and in a socially considerate manner. I would be concerned if the discussion paper took a channelled view in response to this concept.

Mr Kluver—The advisory committee is aware that many of the issues regarding corporate social responsibility and the responsibilities of directors to a broader audience reside in legislation outside the Corporations Act. For instance, it resides in environmental legislation, occupational health and safety legislation and whatever as well as trade practices.

Senator MURRAY—Workplace relations is another one.

Mr Kluver—That is right. So there is already a range of statutory obligations which directors have to take into account in reaching a decision, and not necessarily a narrow perspective on what they might consider to be merely the duties to shareholders, because that includes compliance with a range of existing laws. We will certainly be taking that into account. And the mechanisms by which any CSR initiatives may be implemented, of course, will be a question in its own right and in that regard the types of comments that you are making, Senator, will be certainly at the forefront of the committee's thinking.

Senator WONG—What is your process in terms of engagement with non-business community interests in relation to the CSR reference?

Mr Kluver—At this stage our focus is on gathering together our information with a view to issuing a discussion paper which allows all interested parties, both commercial and non-commercial, to be able to comment on and debate the particular issues that have been raised. We would anticipate that any discussion paper we may produce would excite a fair degree of interest by a broad range of community groups, not just simply commercial groups, and we would hope that that would be the case. Our impression to date is that there is a high level of awareness amongst various community groups as to the nature of our particular reference or information about it and the reference itself, and our discussion and everything will all be published on our web site. We would anticipate therefore that there will be a very strong response by a variety of community groups to the process. It will not be a short reference. Normally there is a period in which we analyse all the material that we have received. After a discussion paper we anticipate there will be, I think, a large and voluminous response, and that will take a considerable time to do. But the purpose of the exercise is to make sure that at the end of the day the interests of all interested groups are fully taken into account, are recognised and responded to in our report in line with our practice in all previous documents.

Senator WONG—Just to clarify the process: you will release a discussion paper prior to substantive consultation with—let us use the term—stakeholders, whether they are commercial or non-commercial interest groups. Then there will be the opportunity for organisations and individuals to make written submissions based on the discussion paper. Is that a reasonable summary of the process?

Mr Kluver—That has been our process in the past. We have found that there is always a benefit in preparing what you describe as an issues paper or a discussion paper because it allows all interested parties to be able to communicate, focus and debate under a banner of

common language and discussion points. That is not to say that our discussion paper is definitive. In this area particularly, I think it will be hard to say that any paper will be able to fully take into account every possible consideration in such a broad and generic area as corporate social responsibility.

Senator WONG—I will be very impressed if you can do that.

Mr Kluver—We will do our best. We do not promise to be perfect but we have found in the past—and going right back to our experiences in the early 1990s when we reviewed superannuation and what was then called prescribed interest and managed investments—that releasing a paper is probably of the greatest assistance in terms of being able to get to a debate between groups that comes to grips with the issues in the most effective manner. Whether we will need a further supplementary paper is an open question. For instance, when we did our corporate group's report we released a discussion paper—

Senator WONG—Yes, I read it.

Mr Kluver—and we received a large number of submissions and there were some new ideas. We then released a second paper which set out our provisional views on a range of matters and asked for further comment. It may be that, depending upon the nature and the level of response we get to this particular discussion paper, that there may be a series of stages we need to go through, because we need to ensure at the end of the day that any advice we give to government has fully and effectively taken into account, dealt with and responded to all the particular viewpoints that have been put forward.

Senator WONG—Can I get some sense—and obviously I cannot hold you this—of approximate time frames? What is your current target for releasing your initial discussion paper?

Mr Kluver—We received the reference in March. The advisory committee has had one major meeting dealing with this particular reference. It was the meeting before the one that needed to settle the two discussion papers that we released in May—namely, 'Personal liability for corporate fault' and also 'Corporate duties below board level'. So the advisory committee has had one meeting. The Legal Committee, which advises the advisory committee, has also had one meeting. We are starting to formulate the basis of a discussion paper. I would anticipate that that process will probably continue throughout the rest of this year, but I cannot put a date on it because at the end of the day it depends on when the advisory committee is sufficiently satisfied that the paper is ready to be settled and published. But I think the end of this year would probably be the earliest that I would anticipate a discussion paper being released.

The advisory committee also needs to make a decision about what level of detail it wants in that particular discussion paper, because this can be a somewhat endless process, given both the importance and also the open-ended nature of corporate social responsibility. At some stage the members will make a decision about the content, the size and the publication date, but that I cannot anticipate at this stage. All I can say is that this particular reference is now the central focus of attention of both the advisory committee and the Legal Committee. When submissions on our previous two discussion papers, which were released in May, come in we

will also have to start looking at that as well. So we will have three major papers with which we will be dealing.

Senator WONG—So the discussion paper will come out at the end of the year or in the first half of next year. Is there a time frame for reporting to the minister?

Mr Kluver—No, there is not.

Senator WONG—So that could be some time after the discussion paper, given the workload in relation to the other areas as well.

Mr Kluver—Agreed, and given the desire of the advisory committee to make sure that any report in this particular area is as thorough as it possibly can be. Given the broad ranging nature of it, it is not a term of reference that can be dealt with quickly, although it will be dealt with as expeditiously as possible, consistent with our responsibilities to the government and in terms of the nature of our report.

Senator WONG—One final area: remind me of your current membership. How many are on CAMAC?

Mr Kluver—We have 12 members of the advisory committee and 14 members of the Legal Committee. That takes into account some recent appointments.

Senator WONG—I was going to say that. Over the last two years, has that been a reasonably normal level of membership?

Mr Kluver—The membership varies depending upon when terms expire and when reappointments come on, but a size of 12 for the advisory committee and 14 for the Legal Committee is typically the largest size for an advisory committee. Any number greater than that becomes a little bit unworkable.

Senator WONG—My recollection is—and I could be wrong on this—that your membership was until recently a bit lower than would typically be the case. So, of the 12 on CAMAC, what were the most recent appointments? How many have been appointed in 2005?

Mr Kluver—In 2005 we have appointed three additional members, and their appointments took place in May this year.

Senator WONG—Were the remaining members on for a long period of time? Were a number of them appointed in the second half of last year?

Mr Kluver—There have been two tranches of appointments to the advisory committee this year. In the earlier appointments, five were reappointed. Members whose terms expired in the latter part of last year were reappointed this year and since then we have had three additional appointments, bringing our membership up to 12.

Senator WONG—And the Legal Committee?

Mr Kluver—We have had two additional appointments to the Legal Committee this year. Prior to that, the Legal Committee had 12 members. We had two additional appointments, which brought it up to 14.

Senator WONG—Your resourcing in the current budget: what is your allocation?

Mr Kluver—Our budget estimates vary slightly from year to year but are in the range of \$850,000 to \$870,000. I think our current budget is around \$860,000. That has been the pattern for quite a few years.

Senator WONG—Thank you.

Senator SHERRY—Following on from the questions Senator Wong was asking: there are 14 members on the body corporate advisory committee and a further 13 members on the Legal Committee. Are they the numbers as of today?

Mr Kluver—The numbers as of today are 12 members on the advisory committee and 14 members on the Legal Committee.

Senator SHERRY—I am looking at the annual report.

Mr Kluver—Yes, and that annual report is quite dated now. That was the annual report of last year, and since then terms have expired and reappointments have been made. The latest information about our membership is published on our web site.

Senator SHERRY—When appointments are made is there a press release issued?

Mr Kluver—We do not issue a press release, because we would be—

Senator SHERRY—No, I would not assume you would.

Mr Kluver—The Parliamentary Secretary to the Treasurer typically issues a press release.

Senator SHERRY—Do you know if has issued a press release for all of the appointments this last year?

Mr Kluver—I cannot answer that; I am not aware.

Senator SHERRY—Could you take it on notice?

Mr Kluver—I will take that on notice.

Senator SHERRY—One thing that did strike me was that we have a significant number of members of the body corporate advisory committee and the Legal Committee, but there are only two or three employees, I think.

Mr Kluver—That is correct.

Senator SHERRY—A very small number of employees.

Mr Kluver—That is absolutely correct.

Senator SHERRY—In fact, I have made a point of looking through the more than 900 range of instrumentalities in government, and I cannot find any organisation that has fewer than two or three employees. It just seemed to me to look a little odd, if you like, when you have got significant numbers of members on committees and only two or three employees.

Mr Kluver—We have three permanent employees. There is my assistant, Vincent Jewell, and me. We are both lawyers and our role is to prepare all the research, documentation and drafts as requested by the advisory committee and to publish the documentation and prepare drafts of the reports. We do all the research work and the drafting. Our third full-time employee does all the work on the administrative side of the committee and, in conjunction with ASIC, the accounting side, because even though we are a small organisation from an

accounting and reporting point of view we are in the same position as any other government agency and have all the responsibilities of any other government agency.

Senator SHERRY—Could I just go to an accounting issue. I note your financial assets are listed on pages 48 and 49 of your last annual report. You had a cash amount in the bank, in 2004, of \$659,174, earning a weighted average effective interest rate of 4.65 per cent. Is that correct—it is on page 49?

Mr Kluver—Yes, we had that amount of money in the bank. It is in the Reserve Bank.

Senator SHERRY—That was going to be my next question: which bank is it in?

Mr Kluver—It is in the Reserve Bank.

Senator SHERRY—Do you operate a separate bank account in the name of the body corporate or is it a pooled bank account with other instrumentalities?

Mr Kluver—No, it is a separate account. We have our own separate funding under the—

Senator SHERRY—Yes, I understand that.

Mr Kluver—It is a bank account that is operated in the name of the Corporations and Markets Advisory Committee.

Senator SHERRY—Wouldn't you get a higher rate of interest if you were operating a pooled bank account with other instrumentalities?

Mr Kluver—I have not explored that particular matter further, given our limited resources, as you pointed out earlier. There are just three of us full-time. I would not entertain that idea without first getting the advice of ASIC who are our financial advisers on these sorts of matters. Only if, say, ASIC and Treasury were happy with any such arrangement would I move from our current position, which is to have all our funds sitting in the Reserve Bank.

Senator SHERRY—In the context of your size with only three employees, the cash in the bank of \$659,174—it has obviously changed since then—is still a considerable amount of money. Where does that cash in the bank come from? Have there been accrued surpluses over a number of years?

Mr Kluver—That is correct. There have been some accrued surpluses over the years. Our expenditure varies from year to year and is in many ways dependent upon the size of the committees and the number of meetings of those committees, so that since the mid-90s we have gradually accumulated surpluses that are currently of the order of \$500,000. Given our current expenditure we have indicated to Treasury, and also to DOFA, that it is likely that that surplus will now be used up gradually as we move more towards some deficit funding. And at some stage in the future, although not immediately, the funding arrangements for the committee may need to be reviewed. This has been drawn to the attention of Treasury and DOFA and is currently under review.

Senator SHERRY—What struck me was that the size of your moneys at the Reserve Bank 'reserve' is not that far short of your total appropriation in a year. You apparently seem to be indicating in a fairly gentle way that this has come to the attention of the department of finance.

Mr Kluver—What has also come to the attention of the department of finance is that the days of surplus are probably now drawing to an end with our committee. The long-term trend is that our costs are increasing, particularly the cost of running meetings and all the additional costs invariably involved. It is likely that we will be now moving towards deficit funding and at some stage in the future there will be a correction.

Senator SHERRY—To return to my original question, that is why it struck me as a bit strange that we had so many members on a board, the advisory committee and the committee and only three employees. There is the efficiency of the organisation—and this is not a criticism of you and your other two employees—having such a significant number of board and committee members versus the number of employees.

Mr Kluver—The role of the employees—Vincent Jewell, the deputy, and me—is to prepare all the research documentation for both committees, and that arrangement seems to be working fairly well. Our general philosophy certainly has been until now, and continues to be, to operate the committee on the minimal staffing necessary.

Senator SHERRY—Section 148 of the ASIC Act deals with making recommendations on corporations legislation other than excluded provisions. What are the excluded provisions?

Mr Kluver—I cannot answer that, Senator. We have had no cause to look at what that particular matter means.

Senator SHERRY—We did, and we could not find the answer either, which is why I am asking you.

Mr Kluver—I am not aware that there are any excluded provisions.

Senator SHERRY—Could you take it on notice. If it is a general reference to excluded provisions, presumably the minister or parliamentary secretary—or both—at a particular point in time can exclude provisions. If that is the case can you let us know, and, if there have been excluded provisions to date, what they are.

Mr Kluver— Right.

Proceedings suspended from 10.30 am to 10.47 am

National Competition Council

ACTING CHAIR (Senator Watson)—Senator Sherry, would you like to start the questions.

Senator SHERRY—The NCC is aware that the arrangements for competition payments have been terminated. In light of that termination, what role do you envisage for the NCC after the cessation of competition payments in 2006?

Mr Feil—We have two roles in a broad sense. One of those is the area you are talking about, which is promoting national competition policy, conducting assessments and, on the basis of that assessment, making a recommendation regarding payments. We are in the process of doing our final assessment at this stage and that will carry us through the balance of this calendar year. The payments are for the year to 30 June 2006. Our other role is in gatekeeping regulation of access under part IIIA of the Trade Practices Act and the gas code. That role will continue and has conveniently increased in terms of the number of applications

in recent times. So there is some uptake of our resources in that area as we phase down some of our work on NCP.

We, like a number of other people, remain acutely interested in what is going to happen with future reform. The council have made a number of submissions to the Productivity Commission and produced a number of papers offering suggestions as to the ambit of a new reform agenda. We are only one participant, obviously, in that discussion. Our view is that there are, clearly, gains from reform in the past. If an appropriate reform agenda that involves coordination between the states, territories and the Commonwealth can be identified, then we think that the model that exists to date, where that is codified into an intergovernmental agreement and then carried forward over a period of years, has merit. We think it is important that, as well as the agenda, an assessment role and some form of appropriate incentives are also incorporated into that agreement. If that comes to pass, we would suggest—perhaps not particularly humbly—that the NCC or some similar operation might be carried forward. If there is no agenda, obviously there will be some reconsideration of the role and the scope of what we do. But at this stage we stand ready. We hope there is not too much of a loss of momentum or too much of a gap between the first agenda of reform and whatever comes afterwards, because clearly that would create some difficulties in retaining people and interest.

Senator SHERRY—I want to get to the future agenda shortly. Currently, you are preparing your last competition payment calculations. You have said you are winding back that area, for obvious reasons. What are the staffing levels in that area?

Mr Feil—We have a staff complement at the moment of around 12 or 13 full-time equivalents. That has been declining over the last couple of years because, among other things, in our assessment role there are getting to be shorter volumes—last year we went from three volumes to two and this year we will manage one. So our numbers have come back from the projections we normally operate at, which is at around 20. We have picked up some new staff and we have lost some staff. We have recently had a flurry of people move on. In my assessment they are generally moving on to jobs they would regard as promotions and enhancements, so we are not shedding people for the wrong reasons. But we are finding it somewhat difficult to recruit and so we tend to use a little bit more consultancy.

Senator SHERRY—The average staffing level for 2004-05 was 20, and it is still budgeted to be 20 for the next financial year.

Mr Feil—Yes.

Senator SHERRY—What is the NCC's position on WA retail shopping hours?

Mr Feil—In our last assessment we held that the Western Australia government had not met the obligations it entered into. The obligation, as you may be aware, is to remove all anticompetitive regulation unless you can provide a public interest justification for it. Governments agreed that public interest justification requires that an objective, transparent and independent assessment be provided to the government and us. If there is such a positive public benefit found then the arrangement can continue. If there is not then the obligation governments agreed to was to remove that restriction. There has been no public interest review that found that the continued restriction of trading hours was in the public interest.

Therefore, in our last assessment we found it was contrary to obligations the government had and we recommended a penalty.

Senator SHERRY—In this case there was a state referendum. Any government would find it very difficult—I would have thought almost impossible—to disregard the views of a referendum outcome.

Mr Feil—I understand that. We are in the process of doing our assessment for this year. However, there is no alternative means of evading the obligation to reform allowed in the agreement that rests on a referendum. Governments are, of course, free not to undertake the obligation, but that is likely to have consequences in terms of the payment recommendation we make.

Senator SHERRY—So, despite the referendum outcome in WA, which was opposed to changing retail shopping hours, a penalty will still be imposed on WA?

Mr Feil—The council has yet to formulate its recommendations—and they are recommendations—to the Commonwealth government. But if you track our previous assessment and recommendation and the fact that there is no clause that says, ‘If you conduct a referendum, you can continue with anticompetitive arrangements that have not been found to be in the public interest,’ that would logically take you to a continuation of the same recommendation.

Senator SHERRY—Which is a penalty imposition?

Mr Feil—Which is a penalty recommendation.

Senator SHERRY—Can you provide me with an update on issues relating to the compliance of pharmacists to NCC rulings?

Mr Feil—In our last assessment and in assessments prior to that, we pointed out that the obligation to undertake reform, unless there is a public interest justification to continue regulation, applies to the medical professions and pharmacies. There have been two reviews that found that some continuing restrictions were appropriate, and those concerned arrangements regarding operation of a pharmacy by pharmacists and ownership by pharmacists, but they did not support continuing limits on the number of pharmacies that any individual pharmacist can own. On that basis we have held in our past assessments that all states and territories did not comply because they had continuing restrictions on the number of pharmacies that pharmacists can own. We included pharmacy in a whole range of relatively more minor matters that led to a contravention of or a failure to meet obligations, and made recommendations on that basis.

There was an intervention from the Commonwealth government to indicate to states that there would not be penalties if states adopted measures that did not go as far as the reform requirements. As it turned out, in our last assessment we have held all the states and territories to continue to be in breach, but the council itself did not recommend a penalty. So in that sense the Commonwealth did not have a recommendation from us that they would have likely overturned. That was a decision we made based on the relative importance and on some progress being made. A number of states and territories have increased the number of pharmacies that a pharmacist may own from three, in some cases, to five or six. That is going

in the right direction, although in terms of the obligation that the states and territories have it does not go far enough because there is no public interest justification being produced for having any restriction on numbers of pharmacies that a pharmacist may own.

Senator SHERRY—But in the case of pharmacy, a breach has been found as to the ownership numbers cap by all states but the decision of the council is that no penalty will be applied. That came after Commonwealth intervention.

Mr Feil—In terms of timing, yes, but the council reached its own view. Our aim is to not have penalties because we would much prefer to see the obligations being complied with. We do not think it is productive to impose small penalties for small matters. Some years ago the council took the view that if penalties were to be imposed they were to be at significant levels, and matters below that would either be bundled as a group and a penalty imposed—as we have done over a couple of years—or else we would rely on the statements we make in the assessment and the fact that it is public to provide some persuasion for governments to meet the obligation they agreed to.

Senator SHERRY—But if the Commonwealth made its view clear as to pharmacists, it could do so in respect of anything else, couldn't it?

Mr Feil—Our reports provide recommendations. It is for the government to decide what they do with those. To date our recommendations have been accepted. That does not have to follow, although obviously we would prefer that.

Senator SHERRY—But in the one case of pharmacists that has not followed.

Mr Feil—In the case of pharmacists, in the last assessment the issue did not arise because we made no recommendation for penalty.

ACTING CHAIR—Although you did not make any recommendation for penalty, I hope you looked at what is happening in some overseas countries in terms of the health outcomes. In a sense if you follow this dictum of opening up competition, increasingly you are going to take away the close relationship between the pharmacist, who has an interest in the pharmacy, and the patient in the doctor-patient relationship. It has come to my notice that some of the worst practices in England are occurring as a result of the so-called opening up of competition. Instead of people getting their scripts almost on demand or maybe 10 or 15 minutes later at the most, they are having to wait a number of hours. In some parts of England you are told to come back in a week's time unless the medication is for a life-threatening condition or is an antibiotic or something like that.

I just raise the question that when an itinerant pharmacist tends to go to these sorts of places like corporate pharmacies—the Woolworths, though that comes under corporate—or multi-owned pharmacists, there is not that close relationship. Doctors tend to disregard the calls that come from the pharmacist because they know that the person will probably not be there in a week's time because there is a very high turnover of staff in these situations. None of this is very good in terms of patient health or a close relationship between the pharmacist and the doctor and between the pharmacist and his client.

In terms of the theoretics of trying to increase competition that is all very well, but in some cases, particularly in health, there are other strong consequences that I think, with respect,

need to be taken into account by your body in enforcing this concept of effective and fair competition. Some of the big stores in Britain are sourcing some pharmaceuticals from Third World countries where some are produced under circumstances which are not comparable with Western standards but are produced to a lower price. We get pills, for example, sourced from different countries to ease the same sort of problem which are even in different colours. All this raises problems particularly in the minds of older patients taking these prescriptions. If they are given, say, a yellow pill in a box with another box with a green pill, do they take them both together rather than one a day? It raises all sorts of health complications. I just feel, with respect, that there does need to be a pause from time to time by bodies such as yours in pushing the limits of what you call 'fair competition', because once the products get sourced from Third World countries I do not think we have the same sense of fair competition because you are very much in the hands of the multinationals.

Mr Feil—Can I answer that in increasing specificity. Firstly, there is no obligation to promote competition for all costs. The agreement that governments entered into was to review a whole range of anticompetitive legislation and where it was found to be in the public interest by all means it can be retained. The obligation is to systematically examine that. Competition is the default option but there are many occasions when it is entirely appropriate and consistent with national competition policy for regulation to be retained, and pharmacy is an example. There have been two reviews of pharmacy regulation that for—I assume and understand—a number of the reasons you have mentioned have agreed that pharmacists should remain the owners of pharmacies, that it should not be open slather to nonpharmacists to own them and that pharmacists should remain in control of pharmacies. No-one is questioning those, or at least under the agreements we are responsible for assessing the issue does not arise.

What I think does arise is the question of the cap on ownership limits, meaning how many a pharmacist can operate. It is not the council's role—in fact, we are precluded from undertaking these reviews. It is for state and territory governments, or on occasions the Commonwealth government, to conduct reviews that are open and transparent, hear all the interested parties, take into account the range of social and public interest issues, and balance those with competition. Our role is to ensure that those reviews are undertaken. In the case of pharmacy, two were and they were done on a national basis and made a set of recommendations that I think do take into account the issues you are trying to raise.

It is not the council's role to make judgments that are much better left to experts and to the political process. But once those reviews are done we are obliged to pursue government's implementation of them. If governments choose to retain regulation that there is not a public interest case for—and, as I say, two reviews have found that the cap on the number of pharmacists presumably does not assist with the objectives you are concerned about and does affect competition—then the obligation is to remove it. But there was no suggestion that open-slather ownership be put into place or that restrictions on appropriate quality controls for importation of medicines be interfered with. It is not uncommon for people to believe that the NCP and the council's role is to make competition at the cost of everything else. That is simply not the case.

ACTING CHAIR—I am pleased with those assurances. Perhaps I should declare an interest: my wife is a pharmacy examiner, an inspector and a locum pharmacist.

Senator SHERRY—Just to quickly summarise: you have indicated that you are struggling to maintain staff and recruit new staff and part of the work of the council will come to an end. Are these issues about the future and the future role important issues that need to be finalised in terms of the council's future?

Mr Feil—I think the most important thing is to make a decision on what is an appropriate agenda for going forward, and then issues of institutions and the like will follow. The original national competition policy agreements provided that during the last year of the arrangements there would be a review. Earlier in the year the Productivity Commission completed its role in that review, and the matter, I am clearly led to understand, will be before COAG later this week. Like a number of others, we wait to see what the next step will be, with a view to determining what, if any, future agenda is in place and, hopefully in conjunction with that, institutions and the like.

Senator SHERRY—You mentioned you had put forward some suggestions on the future agenda. Were these in discussion papers or issues papers?

Mr Feil—We provided two submissions to the Productivity Commission, and in conjunction with one of those we included three commissioned reports that we had had done. One of those was done for us by Allen Consulting Group and looked at how far Australia had come in a whole range of areas compared to other OECD countries. I think it is fair to say that the themes in that and in our submissions were pretty similar to what the Productivity Commission adopted in theirs as well.

Senator SHERRY—I just want to be clear on this: you put forward two documents to the PC.

Mr Feil—Yes.

Senator SHERRY—What are the titles of those documents?

Mr Feil—I think they are imaginatively called submission No. 1 and submission No. 2. They are all on our web site and I am happy to provide—

Senator SHERRY—They are on the web site.

Mr Feil—Yes, as are the discussion papers we had commissioned.

Senator SHERRY—Do any of those involve issues to do with infrastructure reform?

Mr Feil—It is pretty hard to deal with microeconomic reform these days without also dealing with infrastructure. We also have a role in infrastructure in respect of our gatekeeping to access arrangements under part IIIA. So there is some discussion of infrastructure and of regulatory reform generally.

Senator SHERRY—Has the NCC provided an outline of a work program to the Productivity Commission for possible inclusion?

Mr Feil—I do not think we would be right to say we had provided an outline of a work program. We provided a very broad range of things where it seems to us that there is an interface between the states and territories and the Commonwealth where reform might be

advanced by way of an agreement between those parties. That ranges very broadly. We certainly did not get down to the specifics of a work program because it has always been the council's role to act essentially as an assessor of progress against agreements that others have entered into. So we really are reluctant to get too involved in setting an agenda that we would then be subsequently assessing. We think the better model is for governments and their officials to come to an agreement as to what they will do, when they will do it and, to a degree, how they will do it and then to have us or somebody like us provide an annual transparent assessment of how well they are going, so that when they miss a target the target does not get adjusted.

Senator SHERRY—So, firstly, it is up to COAG, when it meets on 3 June—on that day or at subsequent meetings—to determine the 'work program' based on issues identified by the Productivity Commission and by the NCC?

Mr Feil—Certainly by the Productivity Commission and, maybe, broader agendas.

Senator SHERRY—There may be other issues as well—I do not know.

Mr Feil—The notion of an agreement that sets the agenda and an assessor and some incentive is a model that can be very broadly applied, as it has been to date. In the original agreement there were some quite specific things and there were some much broader targets with longer time frames associated with those, but the assessment layer and the payments layer were put across all of that. So we think it is a model that is worth replicating if there is a valid agenda. It is certainly not worth having the model with nothing to do.

Senator SHERRY—I have no further questions.

[11.11 am]

Productivity Commission

Senator SHERRY—Broadly, the Productivity Commission is Australia's principal advisory body in respect of micro-economic reform. Is my understanding correct?

Mr Pitkethly—That is correct.

Senator SHERRY—The commission's work covers all sectors of the economy and extends to public and private sectors and focuses on areas of Commonwealth as well as state and territory responsibility. Is that correct?

Mr Pitkethly—That is correct.

Senator SHERRY—There are a number of statutory functions of the commission; I will not go through those now. On the future work agenda, I understand that the Productivity Commission has given a report to all governments which will be delivered to COAG on 3 June.

Mr Pitkethly—Is that in relation to national competition policy?

Senator SHERRY—Yes.

Mr Pitkethly—That is correct.

Senator SHERRY—There or may not be decisions taken out of COAG that will determine flow-on of work programs, if any, as a consequence of those decisions?

Mr Pitkethly—Correct.

Senator SHERRY—You have mentioned competition policy. What about other areas?

Mr Pitkethly—Competition policy traditionally has been a focus of our work for some years but, increasingly, our workload has diversified. The genesis of the organisation was in the Tariff Board, which came into being in the twenties, and the question for decades was, ‘What’s the appropriate tariff for carpets, furniture and things like that?’ But we have now got to the stage where the sorts of issues we look at encompass not just economic issues but social and environmental issues. To give you some idea, at the present time we have five commissioned projects on hand. One is to do with the impact of advances in medical technology, and another is to do with measures to improve energy efficiency. Another project, which we have just got, is to do with the demand and supply side factors dealing with the health work force; another is to do with consumer safety; and the final one, which is different again, is to do with the pressures and factors which affect the handling of Australia’s built heritage. So, as you can see, it is a fairly mixed menu.

Senator SHERRY—So you carried out a review of national competition policy reforms; there is a report going out on 3 June—

Mr Pitkethly—By the way, Senator, that report is public.

Senator SHERRY—Are the departments that made submissions to the Productivity Commission’s review of national competition policy listed in the report?

Mr Pitkethly—In the report’s appendix we list the parties that have actually provided input in the form of submissions. We also list, I believe, the parties that we had discussions with. The submissions themselves are available on our web site, with the one minor caveat that a very small proportion of some submissions may have been accepted as commercial-in-confidence.

Senator SHERRY—Right. It appears that the future work program of the Productivity Commission—we have just heard from the NCC and certainly this is so in its case—to a substantial degree will be determined on the decisions that flow from COAG, if any.

Mr Pitkethly—I suppose the best way of answering that is to say that presumably COAG may see the need to have further work in a number of areas. It is then up to the government, or perhaps governments, to determine what body looks at these areas of work. We are not the only alternative.

Senator SHERRY—So there may or may not come a list of programs, and you may or may not be involved in those programs.

Mr Pitkethly—That is my understanding.

Senator SHERRY—The issue of infrastructure has been in public debate. I am sure you have observed the public debate around issues of investment in infrastructure and the economic and social impacts of that. Has the Productivity Commission put any submissions to COAG on issues relating broadly to infrastructure?

Mr Pitkethly—The short answer is no. I would see our contribution to that debate being the review of national competition policy reform report.

Senator SHERRY—Regarding further infrastructure reform, if it is adopted as an NCP item by COAG, how would you as a commission deal with issues relating to that?

Mr Pitkethly—Just to get a better understanding of the nature of your question, I think in the first instance it would depend on the government asking us through the Treasurer to look at particular parts of infrastructure. That request is typically embodied in a terms of reference which in itself points out the particular areas or aspects that the government may wish us to investigate.

Senator SHERRY—In April of this year the PC released a report on the review of national competition policy reforms, and within that was an entire chapter headed ‘Further infrastructure reform’, wasn’t there?

Mr Pitkethly—That is correct.

Senator SHERRY—I have a summary here. There were a significant range of issues raised.

Mr Pitkethly—Yes.

Senator SHERRY—They related to transport, communication, broadcast regulation—there was a very significant identification of issues that needed to be examined.

Mr Pitkethly—Certainly.

Senator SHERRY—Do you believe, if further infrastructure reform is identified by COAG and if the PC is given work in this area that it will be able to focus on it?

Mr Pitkethly—I would certainly hope so. We have done a lot of work over a lot of years, not in all areas of infrastructure, but as far back as 1988-89 we were looking at some of the government owned business enterprises and we laid out an agenda for reform in this particular area. So it is an area where, over the last decade or so, we have accumulated considerable experience and we would like to think that we have the capacity to add to public debate in this area.

Senator SHERRY—So you believe that this area of infrastructure is an important priority?

Mr Pitkethly—Certainly.

Senator SHERRY—Coming to the issue of the further infrastructure reform, when you released that report in April 2005 were you able to summarise or identify the barriers that exist to this?

Mr Pitkethly—We looked at certain areas, and I think we need to explain the nature of this report. The scope of it was incredibly broad, so the time available for us to do detailed analysis area by area was limited. Nevertheless, in many of the areas we looked at we endorsed some ongoing reforms—for instance, some of those which came out of the Parer report on energy and some of those associated with the National Water Initiative. In addition, in those and other areas we pointed to other aspects which we believed warranted further examination. For example, in the case of electricity there have been some ongoing issues about the transmission links between regions and jurisdictions.

Mr Gibbs—Running through all of those infrastructure areas in that report was a common theme. Our focus there was very much on infrastructure reforms that would require or benefit from coordinated action by governments. So it is not a complete infrastructure reform agenda.

Senator SHERRY—I understand that, but the observation you just made about the need for coordination by governments was made in that report.

Mr Gibbs—Correct.

Senator SHERRY—Has there been any response from Commonwealth departments to the release of that report into national competition policy?

Mr Pitkethly—I think there most certainly have been responses, but we have not been involved in the preparation of those responses or any subsequent action.

Senator SHERRY—I expect you would not be, but are you aware of any press releases or statements from any government departments in response to your release of that report?

Mr Pitkethly—We are not aware—there may have been one or two—but our media people are usually pretty good on those things.

Senator SHERRY—I assume you would look at this because you would obviously want to see what the reaction is.

Mr Pitkethly—Yes.

Senator SHERRY—Does it surprise you that there has been no response from Treasury?

Mr Pitkethly—We would not expect that any response from Treasury would be public at this stage.

Senator SHERRY—When would you expect it?

Mr Pitkethly—I would have thought that the Australian government would have put its position at the COAG meeting and that perhaps the reports that stem out of that meeting would then be in the public arena.

ACTING CHAIR—We will give Senator Murray the opportunity to ask some questions now.

Senator MURRAY—I did not mind waiting, but thank you for the courtesy. Mr Pitkethly, are you acquainted or familiar with a magazine called *News Weekly*?

Mr Pitkethly—No, I am not familiar with that.

Senator MURRAY—I refer you to an article written by Pat Byrne in *News Weekly* on 7 May 2005. It begins:

A major report on competition policy fails to explain why European countries not pursuing competition policies have much higher output per hours worked than countries pursuing these policies, such as Australia.

The glaring inconsistency appear in the just-released, 500-page Productivity Commission's *Review of National Competition Policy Reforms*. The same inconsistency was pointed out by the *Australian Financial Review* columnist, Brian Toohey, when the commission's draft report on National Competition Policy was floated for public discussion last year.

Brian Toohey is more familiar to me than Pat Byrne, although obviously he is a person who follows and assesses these matters in quite some depth. The point of the article is that the report failed to explain why European countries not pursuing competition policies have higher output per hours worked than countries, like ours, that are pursuing these policies. Have you looked at that comparison? Is there validity in those remarks?

Mr Pitkethly—I will make an introductory comment and then ask my colleague whether he wants to elaborate. If we talk in productivity terms, it is worth distinguishing between productivity growth and productivity levels.

Senator MURRAY—He has made that point, but he argues:

The Productivity Commission's defence of NCP is not that Australia has a higher actual productivity level than other developed countries but that Australia had one of the best improvements in productivity in the 1990s. This is like saying the student who moved from the bottom of the class to fourth from the bottom had shown the biggest improvement over the year.

So he does not much like that argument.

Mr Pitkethly—He may not like it, but I suppose it is comforting to know that we do have an improvement. In terms of growth, perhaps we started at the bottom of the class—and I do not know if I would agree with that—but we certainly have gone up in the class, and I think that is a comforting feeling. But this goes to the point about the validity of international comparisons: each country has its own unique sets of factors and conditions which contribute to growth and growth rates. To come back to productivity levels, if we compare ourselves with the US we are certainly a fair way below them pretty well across the board. However, I think some commentators would say, 'What does that mean?' It probably means that there is scope for further improvement in Australia. But America, with a population of something like 290 million—a huge economy—can reap economies that we could never hope to get. So we can aspire to head in that direction. I think it is quite reasonable for us to say, 'Have a look at what national competition policy has done in association with other factors over the last decade; we believe it is a promising outcome.' That is a roundabout way of saying that I think you have to look at both levels and growth rates. If the analogy you draw about the classroom and about our starting from the bottom and having moved to fourth from the bottom is correct—

Senator MURRAY—Not that I drew; he drew.

Mr Pitkethly—I stand corrected: Mr Toohey drew—I would say that at least we have got the movement going in the correct direction.

Mr Gibbs—Further to that analogy, I think you have a situation with Australia where we had moved from close to the top of the class and shuffled down through the ranks towards the bottom of the class and over the last decade and a half we started moving back up again. I guess there are a lot of people out there, including the Productivity Commission, who see the program of microeconomic reform over the last decade and a half as one of the contributing factors to that change.

ACTING CHAIR—Senator Murray, would you like to table the document?

Senator MURRAY—Yes, I do not mind doing so. I am sure that the paper concerned would be happy to accept a response from you.

Senator SHERRY—You might have to subscribe and boost their subscription levels.

ACTING CHAIR—Is it the wish of the committee that the document be tabled? There being no objection it is so ordered.

Senator MURRAY—I must point out that I am not a subscriber to *News Weekly*; I get it in the mail. They have strong criticisms of the Productivity Commission's report, which is to be expected—you are in a policy debate. Mr Byrne concludes:

The PC report is a whitewash. Methodologically it is deficient with no rigorous analysis of the range of factors affecting productivity and no proper assessment of the effects of competition policy across the economy. It is a mantra to the free market with blinkers on.

That may give you an idea. One could disagree with your analysis and one could disagree with your assessment, but I would never, even where I disagree with you, think you pursued your activities without rigour or real professional assessments. I raised the article with you because this area of debate is far from finished.

Mr Pitkethly—Thank you, Senator. We will be keen to have a look at it.

Senator MURRAY—I have some more questions unless you want to stay on the same issue.

Senator SHERRY—No.

Senator MURRAY—Thank you. I want to move briefly to negative gearing. The Productivity Commission report No. 28 into first home ownership on 31 March 2004 recommended on page XXV:

The Australian Government should, as soon as practicable, establish a review of those aspects of the personal income tax regime that may have recently contributed to excessive investment in rental housing. The focus of the review should be on the Capital Gains Tax provisions. However, it should also assess 'second best' options for addressing distortions in incentives to invest in housing and other asset markets, including: restrictions on negative gearing and changes to the capital works deduction provisions for buildings. Pending such review, it would not be appropriate to make housing-specific changes to negative gearing rules or to capital gains tax arrangements.

When the Productivity Commission recommended that review did you do any economic modelling on the impact of negative gearing and other tax concessions on the Australian economy, including the property and rental markets?

Mr Gibbs—No, our analysis was mainly a qualitative one, looking at the way the various aspects of the tax provisions impacted on decisions by investors.

Senator MURRAY—Would you suggest that a review such as you outlined should include the use of economic modelling?

Mr Gibbs—It may be of some value. It is a very complicated area. Perhaps the Treasury people may be better able to advise you as to what would be involved in doing that.

Senator MURRAY—The scale of the effects, as you know, has been estimated to be of the order of \$2 billion lost to revenue, but the social and economic impacts include asset inflation

and an overheated market in that area, with consequent distortions to the economy. I would have thought that, whilst you can do a qualitative analysis, when you get into large numbers you do need to try to quantify them.

Mr Pitkethly—We are not arguing with you at all about the significance of the issue, Senator Murray. We are saying that we are not very close to the modelling but one of the questions with modelling is that it needs to be fairly comprehensive and I suspect that some of the assumptions you would have to feed in would be subjective. A general question with modelling is: can we get some realistic data and realistic assumptions so that the modelling does assist the policy debate? And there is a question of how much work is involved to get to that. That is why we cannot say to you, ‘Yes, it would help,’ but we would certainly say that that is something Treasury could have a look at to see if it would add to the debate.

Senator MURRAY—When you did that study or subsequently, has the commission done any work on the impact of the removal or the reform of negative gearing and other tax concessions on the property and/or rental market?

Mr Gibbs—No. I should add that in that report we were careful to draw a distinction between the impact of negative gearing and the impacts of some of the other tax arrangements impinging on investment decisions. As was clear from the recommendation you read out, the commission’s conclusion was that the very strong growth in investment in investment housing may have had as much to do with the change in the capital gains tax arrangements and also the fact that investment in these sorts of areas tends to be cyclical. I think the commission concluded, basically, that tax structures at the moment favour whichever investment happens to be on top, so that while you had a declining equities market and a strong property market the combined effect of all these tax provisions was to reinforce that.

Senator MURRAY—I thought that the capital gains tax concessions and changes post 1999 were unwise, but particularly, if I had had the opportunity, I would have persuaded government to discriminate against short-term speculative gains and, if they were to offer incentives in that area, to focus on the medium to longer term. That is a view I have, but I recognise the interaction between the two. Do you have any view? Is it within your competence to pass an opinion as to whether reform or removal of the negative gearing concession—reform implies adjustment whereas removal takes away the concession—is better done when the market is quietening down? Obviously it should be done prospectively not retrospectively so that the impact is accommodated into the system.

Mr Pitkethly—It is not an issue that we have looked at. We have not done much work in the tax area in general over the last year. Housing would be one exception to that.

Senator MURRAY—Effectively interest rate changes have been used to affect that market, but the problem is that that hits just as hard on other productive activity which you would rather were not affected by interest rates. Rather than for the Reserve Bank to rely on a broad interest rate weapon, it would be better, in my view, to attack the policy problem. So the issue of when you do it is a core one. But you have not done any work to see how other countries have addressed that?

Mr Pitkethly—No. As I say, what we did in housing, which was only a very small part of the inquiry, has been the only venture into the tax area probably in the last four or five years, that I can recall.

Senator MURRAY—I remain of the view that it is a very unwise policy and the Labor Party were wrong to stamp on Mr Latham when he said so. Hopefully, some changes will be made. Are you proposing to do any further work in this area?

Mr Pitkethly—No. The housing inquiry came out of a terms of reference which was forwarded to us by the government. I guess the question would be up to the government not up to us.

Senator SHERRY—There was a report on this issue in yesterday's *Australian*. Are you aware of that report?

Mr Pitkethly—Yes. I think it referred to us and a couple of other bodies.

Senator SHERRY—Yes, it referred to the Reserve Bank and the Productivity Commission and said:

... all told the government in late 2003 that the generous tax breaks were fuelling a nationwide property boom.

It goes on in quite some detail. There is a paper obtained under freedom of information I think. It refers to a paper by the head of Treasury's domestic economic department, Mr Jim Hagan. Did the PC have any contact with Treasury or its officers in respect of preparation of reports or observations on reports on this issue that has been under discussion—the negative gearing and tax treatment of property investment?

Mr Pitkethly—That timing in late 2003 coincided with when we were finalising our draft report on housing. We certainly would have talked to Treasury about certain aspects. Perhaps my colleague may care to elaborate.

Mr Gibbs—We spoke with some officials from Treasury seeking clarification of how aspects of the taxation arrangements worked and to seek their views on some of the issues raised, in the same way that, during these inquiries, we talk to many government departments that have expertise in the areas we are looking at.

Senator SHERRY—That consultation occurred until the release of the report on 31 March 2004?

Mr Gibbs—Yes.

Senator SHERRY—Has there been any subsequent consultation with Treasury and/or the tax office since the release of the report?

Mr Gibbs—Not that I am aware of.

Mr Pitkethly—No, I think that our last association with Treasury would have been the briefing. That is it, I think. So the answer is no.

Senator SHERRY—Has the Productivity Commission been carrying out an R&D survey?

Mr Pitkethly—No, we have not been carrying out an R&D survey; I cannot quite think of anything close to that, to tell you the truth. We have been doing a research project which involves looking at the links between R&D and productivity, but there is—

Senator SHERRY—I think that is probably what is referred to in the notes I have been given.

Mr Pitkethly—Okay.

Senator SHERRY—That is a link between R&D and productivity.

Mr Pitkethly—Yes, it is basically looking at the extent, type and form of R&D that individual firms may undertake, and seeing how that links to the productivity outcomes of firms. It is quite a complicated piece of work. It involves a steering group drawing on people from other government agencies and academia.

Senator SHERRY—So the survey has not been made public yet?

Mr Pitkethly—I do not believe there was a survey.

Senator SHERRY—When is the examination—or whatever we call it—that you are carrying out going to be made public?

Mr Pitkethly—We hope to have a finished report out by July or August this year.

Senator SHERRY—Indicative date: July or August. You are not able to advise us in respect of any of the observations and findings of the survey to date?

Mr Pitkethly—I am not aware of the findings, no. I think they are still firming up. A lot of the exercise has been working very closely with the ABS to get our hands on the right data and doing fairly complex econometric analysis on that data.

Senator SHERRY—The document *Economic implications of an ageing Australia* was released. You are familiar with that, I assume?

Mr Pitkethly—Yes.

Senator SHERRY—How does that document describe the situation that Australia faces with respect to the ageing population? Does it describe it as an imminent crisis, a serious challenge or a serious problem? What is the view of the PC in respect of the overall description of the ageing of Australia?

Mr Pitkethly—The picture we are trying to paint there is that, looking out in 40 years time, Australia will face a very different situation compared to what it looks like now, caused by the ageing of the population. We were going to great pains to say: ‘This is not a crisis. However, there is a big problem looming and government has 40 years to think about steps to address the situation.’ We would only paint it as a crisis if governments did nothing over the next few decades.

Senator SHERRY—Do you have any observations to make about policies that increase significantly in cost as a consequence of the ageing population?

Mr Pitkethly—The big cost impact comes through health expenditure. We are looking at a situation where the distribution of the population changes quite dramatically. At present we have about 12 per cent of our population aged 65 or more. In 40 years time we are looking at

that 12 per cent growing closer to 25 per cent. We all know that our medical expenses are highest when we get old. We are going to have a much bigger proportion of old people in 40 years time.

Senator SHERRY—The report made some observations about the contribution that workers who are currently out of the work force—older Australians, if you like, who are in their 40s and 50s—could or could not make if they were convinced to rejoin the work force—

Mr Pitkethly—I cannot cite—

Senator SHERRY—Mature age Australians.

Mr Pitkethly—One of the difficulties we face with the ageing of the population is that our participation rates will drop, and I think one of the points the—

Senator SHERRY—Will drop?

Mr Pitkethly—Yes.

Senator SHERRY—Why will participation rates drop?

Mr Pitkethly—Because the distribution—

Senator SHERRY—But I am asking specifically about mature-age people who are currently in their 40s, 50s and early 60s. You made some observations about the contribution this group of people could make if they were convinced to move back into the work force.

Mr Pitkethly—It is a significant group of people—they have significant training and they are reasonably high-productivity workers. One of the points I was making is that, if some of these people were to elect to remain in the work force longer, that would obviously help—

Senator SHERRY—I am talking about people who are not currently in the work force.

Mr Pitkethly—I am trying to make the same point—obviously not very articulately. There are two ways of looking at it: there is the contribution people can make by remaining in the work force rather than retiring, and there is also the pool of people, possibly retired, who may wish to rejoin the work force. In both ways there could be a contribution to welfare more generally.

Senator SHERRY—Let us take the mature-age people aged 45 to early 60s who are not in the work force for whatever reason. What observation was made by the report in respect of their contribution if they could be convinced to move back into the work force?

Mr Pitkethly—I will have to take that on notice. I do not know exactly what the observation was. I can only respond in the general ways I have tried to.

Senator SHERRY—Would there be a cost for policies to convince this group to move back into the work force?

Mr Pitkethly—One of the things the press has picked up is related to disability pensions.

Senator SHERRY—That is one area.

Mr Pitkethly—I do not know if you are heading in that direction. That is an area in which we believe we have been misreported in the press. The press have been saying that getting people off the disability pension will bring no economic benefit. In our report we make the

point that getting people back into the work force is a good idea. It is of benefit to them and it also reduces taxpayers' costs. But, coming back to the ageing problem: even if you were successful in getting quite a significant proportion of people on disability pension back into the work force, it would not have a huge effect on the ageing problem as we have portrayed it. As I say, those comments have been misreported in some of the media.

Senator SHERRY—Are you saying it would not have a huge effect, a significant effect?

Mr Pitkethly—I do not want to debate words with you.

Senator SHERRY—The words are important.

Mr Pitkethly—I cannot tell you the exact adjective we used in the report. We say that getting people off the disability pension and into the work force is a good thing but, given the magnitude of the looming problem with ageing, it would not be a significant factor.

Senator SHERRY—So it is a small element of the future costs, the total formula?

Mr Pitkethly—Yes, a small element of the jigsaw puzzle.

ACTING CHAIR—Senator Sherry, you might recall that the Productivity Commission acknowledged that they drew reasonably heavily from the Senate superannuation committee's report on ageing, which addressed these sorts of issues.

Senator SHERRY—Isn't there going to be a new cost in payments to Australians over the age of 55 who are convinced to go back into the work force or who are currently in the work force? Let me give you an example. Are you aware of the mature age tax offset which is being introduced?

Mr Pitkethly—I do not know the details of that.

Senator SHERRY—It is a direct payment of up to \$500 to Australians over the age of 55 who continue in the work force. It is income tested; it is not paid to everyone. That is an example of a policy being adopted that costs extra money, isn't it?

Mr Pitkethly—Certainly.

Senator SHERRY—Do you believe it is valid to weigh up the costs of these new initiatives versus the benefit they brings in terms of participation in the work force?

Mr Pitkethly—For any policy measure I think it is valid to weigh up the benefits and the costs.

Senator SHERRY—Did the PC make any comment about direct funding of future cost arrangements?

Mr Pitkethly—I will have to take that on notice. I am not aware of whether we did make a direct comment on that.

ACTING CHAIR—Senator Lundy, who has had to leave us, has some questions that she will be placing on notice.

Senator SHERRY—I have a few more that I will place on notice, but in view of the time we will conclude there.

ACTING CHAIR—Thank you very much for appearing before us today. It was very informative.

[11.53 am]

Australian Prudential Regulation Authority

ACTING CHAIR (Senator Boswell)—Welcome. Do you wish to make an opening statement?

Mr Jones—I would like to make a couple of quick comments. Over the past couple of months since our last appearance we have been preparing ourselves and the institutions that we regulate for the more adverse economic circumstances or industry specific events which we think might develop. The credit environment is changing with the rapid growth in housing credit having peaked, and the regulatory environment is also changing. International initiatives are leading to the development of new accounting standards and APRA is upgrading its supervisory framework.

In the past few months we have emphasised three main areas: improved staffing, improved tools and techniques, and improved prudential rules.

In the past two years the government has substantially increased APRA's budget to support an expanded and much more experienced group of supervisors. We have gone from 488 staff at the end of the financial year in 2003 to 560 staff, and this is now close to our expected planned expansion of 580 staff. In particular the intensity of our supervision has been to increase the supervision in the complex and larger institutions. For the larger entities we have gone from having 59 supervisors to 86 supervisors—a fairly substantial increase—and the average experience of our staff has increased considerably as well. We now have specialist and support staff with an average of 16 years of relevant industry experience, of which six years are with APRA, so we have gone a fair way with our staffing.

Since 2002 we have also embarked upon a substantial refurbishment of our internal processes. Without going into detail, we have successfully implemented comprehensive risk assessment and supervisory response models. We have introduced and are bedding down a new APRA supervision framework. Our statistical collection and reporting tools have also improved in recent months. We have recommenced, on a more timely and more accurate basis, monthly publications on banking. We have introduced new and substantially expanded publications for the general insurance and superannuation industries. We are collecting, and we will shortly provide for industry use and, in the medium term, for public use, a substantial new database for policy and claims information in the longtail end of the general insurance sector.

We have also been fairly busy in prudential rule making. We have introduced new prudential standards on business continuity management for insurance and ADI industries and we have completed or are about to complete consulting in a number of areas, including the Basel II standard approach to credit risk; reforms relating to risk and financial management for general insurance; governance requirements for general insurers, ADIs and life companies; and amendments to reporting standards. We are working jointly with ASIC on unit pricing issues. Our approach to governance has actually been to develop prudential standards designed to promote strong and effective performance by the boards who actually have the

ultimate responsibility for prudential management. This prudential rule-making work is derived from the reform of the general insurance industry following the HIH royal commission. It has been our approach to take a harmonised governance standard across deposit-taking and insurance institutions.

I will mention a couple of challenges for us in the near future. The first is superannuation licensing. There are 13 months remaining for the transition period for the licensing of trustees of APRA-regulated superannuation entities and the registration of those entities. To date we have issued six licences and four entities have been registered. We expect to license around 400 trustees and around 9,000 entities. We hope and expect that the majority of the applications are going to come in the next six months. The licensing window actually extends to 30 June 2006, but in all probability APRA will have to close the window early to ensure that applicants coming through the door receive appropriate attention. Our superannuation licensing team has made over 200 presentations to trustees and industry groups. In fact, as I speak we are providing assistance to more than 100 potential applicants by reviewing their draft applications.

The second major area of interest for us at the moment is appropriate risk management practices. The excellent results in the banking and insurance industries owe a great deal to the sound economy, but competent and consistent risk management processes play a very important part in these results. APRA needs to continue to encourage industry to maintain and improve risk management processes to actively anticipate issues rather than react to problems on their doorstep. A short-term focus on cost control and revenue growth which led to overly severe cutbacks to risk management would be undesirable.

The third area of our focus continues to be to investigate examples of unsound practices involving direct insurance and reinsurance companies. For over a year APRA has been investigating practices from the past going back to the late 1990s. In recent months North American and European regulators have also commenced similar investigations, and there has been some degree of media attention on these practices. We are reasonably confident that unsound reinsurance practices are not widespread in Australia today, but we will continue to investigate and we would be extremely concerned if the regulated entities deliberately misled APRA about the nature of these arrangements. Linked to this, we are continuing to examine the behaviour of a number of individuals linked to past reinsurance arrangements, to determine whether these individuals are fit and proper and whether disqualification is the appropriate response. We are exchanging information, as appropriate within legal constraints, with our overseas regulators and we expect that these investigations will in fact continue for quite some time.

In conclusion, the APRA-regulated entities are in reasonably good shape. Our skill base and our capacity has expanded. There are areas for improvement but, given the improved quality of our staff, improved prudential tools and improved quality of the rules in which we operate, we think we are heading in the right direction. We look forward to your questions.

Senator SHERRY—You made comment about the statistical collection and I want to start with that. I want to congratulate APRA for the updated statistical collection in respect of superannuation performance. The new formatting, both the annual and the quarterly superannuation performance data released on 4 May, is a big improvement and very useful.

My understanding is that in terms of superannuation performance and overview, this is the most comprehensive and the only independent data collected by any government agency.

Mr Jones—Yes. We are the keeper of the official statistics.

Senator SHERRY—What is the legal requirement on financial institutions to respond to requests for data?

Mr Jones—There are specific legal requirements.

Senator SHERRY—There is a specific legal requirement to respond?

Mr Jones—Yes.

Senator SHERRY—Are you aware of any penalties if data is not provided?

Mr Jones—There are all sorts of penalties for nonprovision of information, yes.

Senator SHERRY—And you would agree that this data in respect of superannuation is useful, particularly in the context of superannuation choice beginning on 1 July? It does provide, not by individual firm, some very useful data about rates of return, funds under management and fees and charges that are useful to consumers in the aggregate form to help them make decisions.

Mr Jones—Certainly the objective of the collection of the statistics is designed to provide information out there. Some of the statistics that we collect are probably more useful for consumers than others, and some of them, because they are at more aggregate levels, are probably of less use to consumers.

Senator SHERRY—But you would agree that the information is useful for both commentators and consumers to examine, if they require it, in order to add to the information available to them in respect of superannuation choice, which starts on 1 July?

Mr Jones—I would hope so. I would hate to think that they were finding this material completely useless.

Senator SHERRY—I want to refer to a couple of specific issues in the data collected. I want to go to page 10 of the quarterly data set that was released on 4 May—and there is a similar table on page 18 in the yearly bulletin. Do you have a copy of that page?

Mr Jones—Mr Littrell has come prepared for that fight!

Mr Littrell—Are you at table 1 of the quarterly at the moment?

Senator SHERRY—Yes, ‘Financial performance by fund type’. Looking at this list, I see there is corporate, industry, public sector, retail; there is a whole series of data involving contributions, roll-overs, benefits and operating expenses. There is a subheading ‘Investment expenses’ and under that there are four subcategories and then ‘Total investment expenses’, and the total comes to \$270 million. Is that correct?

Mr Littrell—Yes.

Senator SHERRY—That is just for a quarter, isn’t it? The annual figure is in the annual data.

Mr Littrell—Yes, that is for three months.

Senator SHERRY—Then there is ‘Operating expenses’ with five subcategories, and that comes to a total of \$685 million. Is that a quarterly figure there too?

Mr Littrell—Yes.

Senator SHERRY—My assumption is that a year’s total expenses identified in these areas would be the four quarters added together.

Mr Littrell—That is correct, yes.

Senator SHERRY—Of the expenses identified.

Mr Littrell—Correct.

Senator SHERRY—Why weren’t you able to provide data in respect of small superannuation funds—because they are a particularly large and very rapidly growing segment of superannuation—and RSAs, retirement savings accounts?

Mr Littrell—The quarterly collection is from funds with more than \$50 million in assets, so small funds were precluded on the basis that very few, if any, of them would qualify. The RSAs are treated as a separate type of entity and do not normally feature on our main tables.

Senator SHERRY—But you do identify the total assets held by small super funds—that is correct, isn’t it? Looking at the self-managed funds, there are very substantial assets held in the self-managed funds, aren’t there?

Mr Littrell—Yes. That is a quarterly estimate, though.

Senator SHERRY—Yes. I understand that.

Mr Littrell—There is an aggregate estimate of assets at the quarterly level.

Senator SHERRY—Where is that information derived from? Where do you get that from?

Mr Littrell—For SAFs, small APRA funds, from our own resources; self-managed funds are regulated by the tax office.

Senator SHERRY—Yes. That is right. So you get the information from the tax office?

Mr Littrell—I would have to check. I believe the annual is from the tax office and there is some consultation with the ABS on the quarterly projection.

Senator SHERRY—I put it to you: given that self-managed funds contained, as at December 2004, assets of—we will use the approximate figure—\$152 billion of the \$693 billion, wouldn’t it be reasonable to have greater detail of their fees, expenses and operating costs in the same way that you provide that information for other types of funds?

Mr Littrell—We do not regulate self-managed funds.

Senator SHERRY—That is not what I am asking.

Mr Littrell—Sorry; are you asking more generally whether it would it be a good idea?

Senator SHERRY—Yes.

Mr Littrell—My answer is: we do not regulate them, so that would be a question better directed to government or Treasury.

Mr Jones—The dilemma for us is that we do not have a mechanism whereby we can require the collection of the information where things are not regulated by us.

Senator SHERRY—I understand that. But you provide very good data, in my view, on corporate, industry, public sector and retail and yet we have got a very major area of superannuation—and we are coming up to superannuation choice and presumably more or fewer people may be attracted into these things—and we do not have the aggregate fee data, other expense data and the other material that you present in respect of the other four main categories of fund type, do we?

Mr Jones—No. I think part of it is that with the self-managed funds, the members are the operators of the fund; the type of information we collect is particularly critical as we work with trustee relationships.

Senator SHERRY—Yes, but isn't the difficulty that this type of self-managed fund is heavily promoted generally? That happens, doesn't it? You can pick up any ad, any copy of the *Financial Review*, and you see self-managed funds and there is a promotion of these types of funds, isn't there?

Mr Jones—It certainly seems to be an area that is growing, yes.

Senator SHERRY—Yes. Your stats show it is growing. But the difficulty is we do not have aggregate detailed numbers in the same way that we do have for corporate, industry, public sector and retail. Wouldn't you agree that it would be useful to have that data? I accept that you cannot get it because you do not regulate the area, but would it be useful from a public policy position to have that sort of detail?

Mr Jones—At the general level maybe it would be useful, but from the perspective of the regulator, given that they are subject to a completely different regulatory environment, there is not much that is of interest to us in the self-managed super funds.

Senator SHERRY—What about the industry and the public who pick up a copy of this? There is useful information here about four main categories of superannuation fund, but there is virtually no detail about another area of major superannuation fund that they may wish to consider in the context of super choice, for example. The data are not here.

Mr Littrell—There are a couple of points to make. The ATO does collect tax returns on these funds. If you want to get into what data are available on those funds your question is better directed to the ATO. The relevant factor for APRA is this: would knowing more than we currently get in a data feed from the ATO help us supervise funds with trustees? Our assessment of that is that it might be mildly helpful, but in the context of doing what we do for the 2,000 big ones, for the several hundred thousand small ones, it is a heck of a lot of work and expense.

Senator SHERRY—I would not suggest that the data be gathered for all of them. That would be very difficult. I meant a representative sample. That is an issue I will take up with Treasury. The point I make is that when we talk about quarterly superannuation performance and annual superannuation performance, small super funds and RSAs are not included, are they?

Mr Jones—It is the regulated population.

Senator SHERRY—I have a couple of specific questions on page 12 of the quarterly statistics. Perhaps Mr Littrell is the most appropriate person here. There is a similar table on page 21 of the annual statistics. If we look at the entity ratios by type, which are on page 12 in the quarterly and page 21 in the annual, we have, and I think it is very useful, the return on assets for each category—corporate, industry, public sector, retail and total—and then we have the expense ratio. We have total investment expenses and total operating expenses, which I referred to earlier. My understanding is that the investment expense and the operating expense do not include commission payments. Is that correct?

Mr Littrell—The instructions on the June 2004 annual and December 2004 quarterly ask reporting entities to report their contributions gross and give instructions as to where to report deductions from those contributions, which would mainly be commissions. We felt that the actual returns we received had widespread noncompliance. We had a great many funds for which a casual reading of their—

Senator SHERRY—I want to get to that but you are jumping ahead a little. A request was made for the provision of, effectively, the identification of commission payments, wasn't it? It would have effectively largely identified the commission payments.

Mr Littrell—To be technical it was a request for deductions from gross contributions.

Senator SHERRY—Which are otherwise understood as commissions?

Mr Littrell—Very much so—the majority of those, yes.

Senator SHERRY—Financial institutions were requested to identify those. I was somewhat taken back when I looked at retail reporting and the expense ratio, which would identify this, wouldn't it?

Mr Littrell—That would be an element in the expense ratio.

Senator SHERRY—It would be a significant element, wouldn't it?

Mr Littrell—Material, yes.

Senator SHERRY—It is very material, isn't it, Mr Littrell?

Mr Littrell—For funds which collect commissions, yes, it is material.

Senator SHERRY—I was not just taken back, I was absolutely flabbergasted to see the expense ratio for retail funds, 'SNR'. The expense ratio for corporate funds is 0.2, for industry funds it is 0.2, for the public sector it is 0.1 and for retail it is SNR—what does 'SNR' mean?

Mr Littrell—SNR is 'statistically not reliable'.

Senator SHERRY—Why are the commissions statistically not reliable from those 133 entities and so have not been included in the report?

Mr Littrell—Essentially there has been widespread noncompliance with the instruction given in the return to report gross contributions and then indicate the amount deducted from those to create net contributions.

Senator SHERRY—Given that you say 'widespread noncompliance', approximately how many retail superannuation funds of the 133 have complied with the requirement to report what is effectively a large part of the commissions that are charged?

Mr Littrell—If we presume that trustees which operate via financial planners are charging commissions, then we would presume that trustees reporting zero—that is, reporting net commissions as gross—are not complying. That group would be the majority of the 133. There are some trustees reporting a number other than zero, so they are reporting some amount but it is much harder to work out if they are in compliance or not, because we have not got a basis unless we go on-site to work out if their number was correct or not.

Senator SHERRY—Can you identify if any retail entities of the 133 did meet the requirements in terms of the reporting standard?

Mr Littrell—On a reasonableness test between 10 and 20, we would say. I caution that we have not gone on-site and confirmed some of those.

Senator SHERRY—So on a reasonableness test only 10 to 20 of 133 retail funds which contain some \$210 billion complied?

Mr Littrell—That is our estimate.

Senator SHERRY—Of those 10 to 20 that complied, was there any indication from those retail funds—this small minority—whether they had any difficulty with the information? Did they seek clarification? Did they contact APRA and ask what information was required and in what format? Were you able to respond? Obviously they were able to provide the information.

Mr Littrell—There was an extensive industry education program provided in late 2003 and early 2004. I do not doubt that there were some questions on those particular items in the form. I am not aware of any subsequent inquiries from complying trustees around, for example, September or October 2004, when the annuals would have been topical, or later when the quarterlies would have been topical.

Senator SHERRY—So an extensive education campaign took place in 2003-04, yet the considerable majority of retail superannuation funds in this country did not provide, despite there having been an educational campaign, the details that were required?

Mr Littrell—On that particular item; that is correct.

Senator SHERRY—That is what stands out. This one particular item of what is effectively commission disclosure is the only item I can find in these documents that has SNR—statistically not reliable—next to it.

Mr Littrell—It is in fact the only SNR in the reports. If I could clarify this, the item you are referring to is not just commissions; it includes all forms of expenses and fees.

Senator SHERRY—But we are missing the commission element, if you like.

Mr Littrell—The defects leading to an SNR rating revolved around the apparent nonreporting of commissions, deductions from contributions and the zero reporting, if you will, of indirect expenses where funds were placed with other investment managers—which we think in fact was the larger of the two areas of nonreliability.

Senator SHERRY—Did the 10 to 20 you mentioned seem to have any particular problem in providing the information?

Mr Littrell—I am not aware that they did.

Senator SHERRY—What was the problem identified by the over 100 retail superannuation funds in this country as to why they could not provide the information required by law?

Mr Littrell—One of the disappointing aspects of that was that there were no queries, as far as I can ascertain, before the due dates for these returns. We simply received non-complying returns.

Senator SHERRY—What—blank?

Mr Littrell—In that particular item, zeroed. In the subsequent investigations into that—we have not gone to all 100-and-something odd funds but we have been to a subsample—we have typically been finding that it is difficult and in some cases allegedly impossible for those trustees to produce that number. We would have preferred to know that some time during the two years of industry consultation before we created these reporting forms, but that is water under the bridge.

Senator SHERRY—That was exactly the next question I was going to ask. Despite your going on an education campaign in 2003-04, none of them came back to you prior to the reporting deadlines with concerns about difficulties in meeting the reporting requirements.

Mr Littrell—Besides the education campaign, going back even to 2002 as well as 2003, there were substantial consultations, which we are required to do under the law and would do anyway. There was a great deal of industry and other public consultation and comment on what should be in the reporting forms and in the publication. Again, this is one aspect of a much larger collection, so there were some aspects of this raised, as well as other issues. The apparent inability of retail trustees to report on this item was not raised in this process—at least not effectively.

Senator SHERRY—Has APRA had any contact on this matter with IFSA, which is the representative organisation of retail and wholesale funds management in this country?

Mr Littrell—Not on this matter.

Senator SHERRY—In the lead-up to the deadline did they have any contact with APRA about any process difficulties in retail super funds providing this data?

Mr Littrell—IFSA was one of a great many parties submitting responses to our request for consultation. As well, my recollection is we met with them on more than one occasion to go through what was going to be in the new returns.

Senator SHERRY—I want to pass you up a copy of a media release from IFSA. There are enough copies for the committee members and maybe for Mr Jones as well. It was released on 18 March 2005 and it is called ‘Super fees and charges under the spotlight’. This is a release of an analysis conducted by Rice Walker Actuaries into superannuation fees and expenses by market segment. It is somewhat similar to the material that you have released. I noticed that on the attachment there is a breakdown of fees and expenses by superannuation segment in the year to 30 June 2004. Do you have any response to the observation that it appears that retail superannuation funds were able to provide details of fees, administration, investment and indeed commission payments across sectors to IFSA?

Mr Littrell—I am not picking up your question—

Senator SHERRY—You would agree that they were able to do that?

Mr Littrell—Yes. The information we were requesting was on a historic whole-of-fund basis, so the real dollars. I am not aware on what basis Rice Walker conducted its work. You would doubtless be aware that, under ASIC administration of product disclosure statements, funds from 1 July are required to produce a schedule of fees and charges, but that is done on a representative investor basis. So, if I am given a person of a certain amount in the fund and a certain activity pattern, what would be the fees and charges for that person? All trustees should be able to produce that sort of information. It turns out that that is an easier information set to produce than on an audited basis of ‘what did your fund charge in the last year’ to however many hundreds of thousands of members you have. We have not read the Rice Walker material. It is not a free document; it costs between \$1,000 and \$2,000, so we have not bought that.

Senator SHERRY—Notwithstanding that, IFSA, as the industry organisation, were able to identify—I do not know whether these figures are accurate or not—by category market segment as a percentage expenses of superannuation funds. They have been able to do it.

Mr Littrell—For a limited number of funds, on a limited question, for a limited period, using a somewhat restricted assessment, yes, they were able to do that.

Senator SHERRY—Subject to seeing the Rice Walker report in some detail.

Mr Littrell—But, having said that, we do not need to see the report to observe that. Because trustees statutorily must be able to produce this table for their PDS, they can produce a retrospective or prospective single investor fees and expense number. In our documents we are trying to collect at the fund level on the real dollar flow as opposed to the theoretical dollar flow that would be the subject of this sort of research.

Senator SHERRY—Could I suggest that the reason you have had mass noncompliance from the retail industry with the provision of the information required is that they did not want to disclose their commission levels in any shape or form.

Mr Littrell—That is your suggestion, not ours.

Senator SHERRY—But what is your response to it?

Mr Littrell—My response is that it is probably unduly harsh.

Senator SHERRY—How would you describe it?

Mr Littrell—I would say, in the first year of a new collection, for any of our industries when there is a substantial new collection, it is almost invariably the case that we get a hiccup in some lines of data. In this case we have reviewed our own instructions which, while they were clear enough for the great majority of equal representation funds to understand, evidently were not for retail. So there is an area that we have clarified. For the 2005 year we are expecting that this compliance item will be addressed. I also understand that several of the funds simply had a systems issue, in the sense that they did not understand the difficulties in reporting this item, and we hope that will be rectified in the future. I do not have any sense that there was some collective decision somehow to not report a number they had; they do not have the number.

Senator SHERRY—Or failed to generate the number.

Mr Littrell—Yes. It is not the case, as far as we can tell, that these non-complying funds have the number to hand and they decided not to give it to us; that they were not able or not willing to produce that number.

Senator SHERRY—Not willing to produce the number.

Mr Littrell—We do not know if they were not able or not willing.

Senator SHERRY—But we have a case of over 100 retail funds not complying.

Mr Littrell—Yes.

Senator SHERRY—I assume within that—I am not going to name particular retail funds because that would be a bit unfair—we are talking about the major retail funds in this country within that group?

Mr Littrell—The complying funds did not comprise the top 20 or 30 by assets. They were spread through the industry.

Senator SHERRY—But isn't the difficulty that we have super choice starting on July 1, we do not know from APRA the expense ratio for retail superannuation funds in this country in aggregate, and we will not know it until you release your next quarterly data set, which will presumably be in August sometime.

Mr Littrell—In fact, we are trying to fix the instructions for the June annual and then for the quarterlies from then on.

Senator SHERRY—But that will not be published until August, will it?

Mr Littrell—I will have to check the schedule, but the annuals will not be published until considerably later than that.

Senator SHERRY—I am referring to the quarterly. The next quarterly will come sometime in early August, presumably?

Mr Littrell—Yes, but that one will not have the instructions amended. It will still be an SNR.

Senator SHERRY—It will still be an SNR in August?

Mr Littrell—Yes.

Senator SHERRY—So at what point will we see the expense ratio by retail superannuation funds in this country? When do you think that is likely to be?

Mr Littrell—I believe we will correct for the commissions issue for the annuals as of June 2005. That is a collection that is due in October 2005 and the report will come out in early 2006.

Senator SHERRY—So the report comes out in early 2006. And on a quarterly basis?

Mr Littrell—The quarterlies will come out thereafter. I will have to check. The first will be on 30 September 2005 and then onwards from there. However, that will deal with the nonreporting of deductions from contributions. That will not cure the SNR problem, which has two components. One is the nonreporting of deductions and the other has to do with

indirect investment expenses. That fix will require us to amend our returns, which will require us to go through a public consultation process.

Senator SHERRY—So we will get a total fix on this issue in early 2006?

Mr Littrell—No. That is just the commissions aspect. The total fix will be no earlier than 2007.

Senator SHERRY—So, in respect of commissions, we can get an expense ratio figure in early 2006.

Mr Littrell—You will get a deductions from contributions number.

Senator SHERRY—We will get deductions for contributions commissions in early 2006, approximately?

Mr Littrell—Yes.

Senator SHERRY—We will have choice operating from 1 July 2005, yet we will not know in the aggregate—we will not know until six months later—what the retail superannuation fund is charging as an expense ratio. Do you think that is a satisfactory situation?

Mr Littrell—You will not know from this report—which is not the same as not knowing.

Senator SHERRY—Then how would I know?

Mr Littrell—You open up any PDS from 1 July.

Senator SHERRY—I am talking about in the aggregate.

Mr Littrell—That is a question you should direct to ASIC. My understanding is that they have in train some processes to produce a public report comparing these matters. But that is their bailiwick.

Senator SHERRY—That is right. But APRA's bailiwick is producing this sort of material which, as I have said, I think is very useful. The nonprovision, the SNR, would obviously increase the expense ratio of retail superannuation funds, wouldn't it?

Mr Littrell—If you go from zero to a number, yes. The other numbers—0.2, 0.2 and 0.1—are exact calculations from the data we have received. That does not make them exactly correct, but they are correct within the bounds of statistical acceptability. SNR essentially means that we did collect numbers and we can calculate something to put in the report, but that number is so inaccurate we feel it would do more harm than good to report it.

Senator SHERRY—It is not in the report. You said you calculated a figure. What was it, approximately?

Mr Littrell—Again, it is not a meaningful number, but it is approximately 0.8 on an annual basis. But that is a substantial understatement of the real number.

Senator SHERRY—That is a substantial understatement? So we know that the expense ratio for retail funds is 0.8 per cent plus.

Mr Littrell—Annually.

Senator SHERRY—Annually, yes. We do know that?

Mr Littrell—Yes.

Senator SHERRY—Yet the expense ratio for corporate and industry funds is 0.2.

Mr Littrell—That is quarterly.

Senator SHERRY—Quarterly, sorry; annually, 0.7, 0.9; public sector, 0.3. Where are we to get reliable data in the aggregate on the expense ratio of superannuation funds in this country by industry segment—corporate versus industry versus public sector versus retail? Can you show me any other data that is available?

Mr Littrell—If you want reliable data on performance—

Senator SHERRY—No, on expense ratio.

Mr Littrell—I will just observe that if I were a fund member I would rather know the fund's performance than what other people made out of it.

Senator SHERRY—I would prefer to know both.

Mr Littrell—In this report the great improvement over previous official comprehensive data is we can now report the net returns, so you can get that data from our reports. In terms of getting the expense data, we remain in this country unable to produce historic aggregate data by fund type.

Senator SHERRY—The net returns—which page is that?

Mr Littrell—You want to look at the annual or the quarterly?

Senator SHERRY—Let us look at the annual.

Mr Littrell—The annual, from memory, is table 10 on page 21. Above the expense ratio line, with the aforementioned SNR, you will see 'Return on assets', the one commencing 12.2. On the 10.0 we do not have an SNR. For argument's sake, let us say a retail fund earned 13 per cent and reported to us that they earned 10 and had expenses of zero, we would know the zero was wrong, hence the SNR on expenses with a 10 within the bounds of statistical acceptability was correct. The 10 is, in fact, mildly overstated for underreporting of deductions on contributions but does include the considerably larger deductions for other expenses, mainly investment management and administration expenses.

Senator SHERRY—Yes. But commissions paid?

Mr Littrell—Are not included in the 10.

Senator SHERRY—So if we are looking at return on assets—this is for the year ending June 2004—corporate 12.2, industry 12.5, public sector 12.4, retail 10—and that is an overstatement?

Mr Littrell—A slight overstatement.

Senator SHERRY—Depending on the level of unidentified SNR'd expense ratio.

Mr Littrell—Yes. Those numbers were not previously available in an official publication.

Senator SHERRY—I understand, and that is one of the reasons why I think this is a much better publication. We have actually got these figures, hard representative data, for the first time.

Mr Littrell—I should note from the APRA perspective—and remember that our focus is on administering the prudential aspects of this not the choice aspects—the net return figure and, separately, the volatility figures are far more important than the fees and expense figure. Without wishing to be too defensive on this subject, we do feel that we have broken through to being able to assess the net performance of trustees, which at the end—

Senator SHERRY—I think that is excellent. Those figures and whatever people make from them are excellent figures because we have got them for the first time, and I am not criticising APRA in any respect for the mass disobedience campaign we have had from retail superannuation funds.

Mr Littrell—Again, disobedience is your word. Our word is—

Senator SHERRY—Yes, it is my word.

Mr Littrell—Our word would be more inability.

Senator SHERRY—Inability?

Mr Littrell—Yes.

Senator SHERRY—You are going to tell me that the largest financial institutions in this country do not have the resources and ability, after more than a year's education campaign, to be able to report these figures to you accurately?

Mr Littrell—I am telling you that is the outcome we received on our statistical returns.

Senator SHERRY—To conclude: the outcome we got is that they had more than a year's notice to provide this; there was extensive consultation, education and liaison with the retail superannuation funds; they are amongst the largest financial institutions in the country; none of them apparently came back to you before the deadline and said that they could not provide the information—

Mr Littrell—Correct.

Senator SHERRY—and over 100 of them have not provided critical information.

Mr Littrell—Yes, with the caveat that this is not unusual in a new statistical collection. There are some issues there in that APRA, in hindsight, could have done a better job of explaining this. So we will fix this over time and rectify this section of the report.

Senator SHERRY—But, interestingly, it is the only area in your entire data collection where we have statistically non-reliable figures.

Mr Littrell—We are keenly aware of that.

Senator SHERRY—Yes, I am too. It just seems such a coincidence that it is the only area where we do not have statistically reliable data.

Mr Littrell—And if I could just emphasise that we at APRA are not suggesting it is anything other than coincidence. If you wish to put a different spin on it—

Senator SHERRY—But it is fact, isn't? It is the only area where they could not provide the information.

Mr Littrell—It is the only area where the provision of information was insufficient to the degree that we had to do an SNR.

Senator SHERRY—Yes.

Proceedings suspended from 12.41 pm to 1.45 pm

Senator SHERRY—I want to go back briefly to the issues we were discussing prior to the lunch break. Mr Littrell, I think you mentioned that there were approximately 10 to 20 superannuation funds that did comply.

Mr Littrell—That is our estimate, yes.

Senator SHERRY—Do you have the list of names of those that did comply?

Mr Littrell—No, and that would be behind our section 56 confidentiality wall.

Senator SHERRY—When we were talking about the expense ratio for retail superannuation funds, I think you mentioned a figure of a minimum of 0.8.

Mr Littrell—That is not actually a minimum; the true minimum is considerably higher than that. Again, the figure comprises a number that reported partially, a number that reported fully and a larger number that reported zero.

Senator SHERRY—So, for the 0.8 and above, my question is: was that a reference to quarterly or yearly?

Mr Littrell—That is annual, but, again, that number does not have any relevance at all; it is just an arithmetic artefact of a flawed collection process.

Senator SHERRY—During last year's budget estimates I asked about data collection in this area. I asked on notice:

Please send me the items now being collected on the expenses (fees and charges) of superannuation funds.

Through the Treasurer's office APRA provided an answer. It gives:

b) List of additional data items collected in the new returns—from 30 June 2004

From 30 June 2004 the additional items collected are:

Fees and charges earned by superannuation entities

Item 13—Fees and Commissions earned:

Item 13.1—Scrip Lending fees

Item 13.2—Underwriting activities

Item 13.3—Other fees—Includes (but is not limited to): Entry/exit fees earned, trailing commissions earned, ongoing fees/charges earned.

Then there is a considerable list of other detail. Is that the sort of detail that is listed on the data form that the funds are required to comply with?

Mr Littrell—Again, it depends somewhat on whom we are speaking about and if we are talking about the annual collection, the quarterly collection or the small fund collection.

Senator SHERRY—It is just that the answer is headed: ‘b) List of additional data items collected in the new returns—from 30 June 2004’. I do not think it specifies whether it quarterly, annual or small fund.

Mr Littrell—I have the list here but I do not have the reply to the question on notice in front of me. Sorry, what is your question?

Senator SHERRY—It is probably easier if you have the answer in front of you. While a copy of that is coming to you, was data on the issue of entry and exit fees requested?

Mr Littrell—I would have to take that on notice. There is a category in which we would collect data on entry fees per se, but I would have to check the form instructions to make sure. I think it is in directors or trustees fees. I will have to look.

Senator SHERRY—What about exit fees?

Mr Littrell—We are not confident that we have collected exit fee data appropriately. That is one of the items we are following up.

Senator SHERRY—So that is another issue. Is that included in the SNR, statistically not reliable?

Mr Littrell—Yes.

Senator SHERRY—So APRA does not have sufficient data on exit fees to come to any conclusive data publication as yet?

Mr Littrell—Our intent is to follow up with some non-complying reporters on the issues of indirect expenses, commissions, trails and exits. They are the ones where we theorise that we may not have got a good collection. But we need to do a fair amount of work to see what the outcome there was.

Senator SHERRY—Are we looking at a similar level of insufficient information in the sense of the number of funds in respect of exit fees?

Mr Littrell—Yes, but the dollar amount would be considerably lower.

Senator SHERRY—Yes. Does APRA have any idea of the number of superannuation fund members who are in a superannuation fund with an exit fee, and to what level?

Mr Littrell—No, we do not. We have not run that calculation that I am aware of, and I would have to check our statistical collections to see if that is possible to run.

Senator SHERRY—Could you take that on notice.

Mr Littrell—We will.

Senator SHERRY—It is claimed that exit fees are a legacy product, a historical anachronism. That is the description I often see people in the industry use in reference to exit fees. Are you able to identify whether, say from last year onwards, in a historical sense, there are any new members going into a fund where an exit fee applies?

Mr Littrell—I will have to take that on notice. Exit fees do exist in currently open products as well as sales price and bid and offer price spreads. I might editorialise slightly that cripplingly large exit fees tend to be a feature of legacy products, but exit fees per se or equivalent costs are still pretty routine.

Senator SHERRY—That was going to be my next question. I am sure you will have to take this on notice, given your previous answers. Can we identify the level of exit fees and the numbers involved? I think you have made the correct observation in your editorialisation that there are exit fees and there are exit fees. There are exit fees that cover administrative costs of \$40, \$50, \$60 or perhaps \$100 at the outside, but there are exit fees that I am aware of that take up thousands of dollars of the balance of the fund if a transfer occurs.

Mr Littrell—In terms of the question we are taking on notice, if you are asking us at an individual member level what is happening, we will not be able to answer that because we collect at the aggregate fund level. If you are asking us what proportion of funds charge exit fees, we will see whether we can do that.

Senator SHERRY—Yes.

Mr Littrell—In terms of the amount, again that is an area of current investigation. My conjecture at this point is that we have not collected that with much comprehensiveness.

Senator SHERRY—Because it is claimed that these are historical legacy products, it would be interesting to know whether in fact there are any products still being offered with, as you described them, cripplingly high exit fees and whether you can identify that.

Mr Littrell—We will undertake to look at it, but I do not hold out a great deal of hope on that score.

Senator SHERRY—You can only do your best. You have done well to date. I had some questions on the performance audit of APRA's prudential supervision of superannuation entities. Audit report No. 6, 2003-04 describes, on pages 34 to 36, how once a superannuation fund becomes eligible for tax concessions the law ensures it stays eligible pretty much until it winds itself up or until the minister appoints an acting trustee to wind it up. There is a second passage on pages 53 to 56 which shows that, at the time of the audit, the largest commercial superannuation funds had not been individually inspected, assessed and given a risk rating by APRA. Instead, APRA assesses such funds' approved trustee, or did so at the time of this audit anyway. What, if any, individual inspection and assessment of superannuation funds has been carried out after this audit report?

Mr Byres—Since the time of that audit we have had a fairly systematic process of working through all of our superannuation funds to assign them a risk rating. I think, as it currently stands, there is still a handful that are not risk rated, but it is a very small number.

Senator SHERRY—What is the number? Approximately; I am not going to hold you to it.

Mr Byres—In my division it is probably about 20 out of many hundreds. They are invariably small funds that are part of a larger financial group which already has a rating. In many cases they are also funds which are in the process of being wound up, so it has not been seen to be a priority to assign a rating to them. There has been a systematic process of going through and making sure that all significant funds and funds that are intended to continue to operate are rated. The one area where we have not assigned individual risk ratings is the small APRA funds. These are the small funds that are operating under an APRA-approved trustee. In those cases, we have certainly rated the approved trustee but we have not assigned an individual rating to each of the many thousands of small APRA funds.

Senator SHERRY—I note that paragraph 3.24—and I do not know whether you are familiar with it—details the woes of an unnamed fund which was mismanaging more than 5,000 small APRA funds. It is all very well to look at the major entity. What about the subsidiary entities or funds?

Mr Byres—In the case of those small APRA funds, as you said, there may be a trustee that manages literally thousands of funds. These are typically small, family funds. It is a physical impossibility to conduct a full review of each and every one of those funds. So usually we will conduct a thorough review of the trustee and its operations and then we will do a degree of sample testing on individual funds which that trustee is responsible for.

Senator SHERRY—That paragraph says:

ANAO fieldwork revealed that, in one instance, APRA's intervention to resolve the operational issues of an Approved Trustee found:

- almost 5 000 outstanding annual returns for SAFs ...
- more than 30 SAFs from which the trustee had borrowed ...
- more than 50 SAFs in which investments may not have been conducted on an arms length basis ...
- more than 20 SAFs without an investment strategy ... and
- more than 500 SAFs with investments outside their documented investment strategy.

That is a serious level of noncompliance with a variety of requirements. You seem to be suggesting that it is just a physical impossibility to adequately police these subsidiary funds.

Mr Byres—No. I think the way we have tackled that and made sure that those issues have all been addressed and rectified is by looking at the controls that the trustee has in place to make sure that returns are lodged, that investments are indeed in accordance with the investment objectives of the fund, and that borrowing is not occurring. It is a process of sampling and of testing, yes. It is not a thorough audit of every individual fund, but we do not undertake audits of individual funds.

Mr Jones—The primary responsibility is with the trustee. Our focus is ensuring that the trustee's behaviour is appropriate. So we focus on the trustee's activities and then do sample testing for the small APRA funds to see that the behaviour of the trustee is consistent in looking at those funds. That is how we pick up these things.

Senator SHERRY—Figure 3.5 on page 58 of the Audit Office report is an on-site review of superannuation entities, and there is a historical table there. The number of on-site reviews of superannuation entities excludes on-site reviews of self-managed superannuation funds. They include 54 reviews of approved trustees. The number does go up steadily in 1998-99 to 893. In 1999-2000 it dropped off to 333; in 2000-01, 622; and 2001-02, 1,073. Is there any more up-to-date information, for 2002-03 and 2003-04, on the number of on-site reviews of superannuation entities?

Mr Byres—I am not sure whether that information is actually in our annual report. We do publish some information in our annual report. If not, it is probably something we could take on notice.

Senator SHERRY—Another answer to a question on notice related to the adequacy of funding of defined benefit superannuation funds. The answer I received stated:

Out of a total defined benefit fund population of 491 (including hybrid funds) as at 30 September 2004, there are presently 68 defined benefit funds and sub funds supervised by APRA which are considered to be in an unsatisfactory financial position.

What is meant by ‘unsatisfactory financial position’?

Mr Glenfield—It is anything with a vested benefits index under 100 per cent.

Senator SHERRY—In other words, if for any reason the employer went under—

Mr Glenfield—Yes, if it wound up today, the vested benefit sits below the 100 per cent.

Senator SHERRY—It is below the 100 per cent. So full payment could not be made?

Mr Glenfield—Yes, at that time.

Senator SHERRY—As at that date. We are talking about 68 defined benefit funds. Approximately how many employees who are members of these 68 defined benefit funds are we talking about?

Mr Glenfield—Again, I do not have the numbers with me.

Senator SHERRY—Are we talking here about thousands of people? We would have to be, wouldn't we?

Mr Glenfield—Yes. It will depend on the size of the funds, yes.

Senator SHERRY—So it would be thousands of people in these 68 defined benefit funds.

Mr Glenfield—Yes. But we can take the number on notice, if you like.

Senator SHERRY—The answer also says:

APRA considers that 60 of these funds have a satisfactory rectification plan in place to address their financial position, and APRA is seeking improvements to the balance.

What do you mean by ‘satisfactory rectification plan’?

Mr Glenfield—Under the SI(S) Act they have to go to their actuary and come back with a plan to correct their vested benefits index position within five years, from memory. We have gone to each one of those funds and sought their rectification plan. As I said, it was 60 or so first up where we thought the plans were reasonable. We have gone back to the eight or so that we were not happy with to seek better plans from them.

Senator SHERRY—So you are seeking undertakings and information that over a period those funds will be fully able to meet the requirements?

Mr Glenfield—Correct.

Senator SHERRY—What sort of period are we talking about?

Mr Glenfield—The SI(S) Act allows five years. We generally push for two years. But, if push comes to shove, it is five years.

Senator SHERRY—What do you mean by ‘if push comes to shove’?

Mr Glenfield—We will encourage two years. If the position is such that the actuary is recommending over a period of five and the employer chooses to go down that route, that is what the law allows.

Senator SHERRY—That means the employer effectively making a higher contribution than they would otherwise be making?

Mr Glenfield—They make either a higher contribution or perhaps a one-off lump sum or payment to fix it.

Senator SHERRY—Will most of these funds be in a satisfactory position within the two-year period?

Mr Glenfield—I would say—I will talk on the portfolio that I have—most of them benefited from some fairly good markets over the last year. So the plans have actually been accelerated from the initial ones.

Mr Jones—The great advantage over the past couple of years has been that the share market has performed much better than it had when some of that stuff was done.

Senator SHERRY—We are talking here about private sector DBs, aren't we? We are not talking about public sector DBs. There are different requirements.

Mr Jones—Yes, they are all private sector.

Senator SHERRY—One specific issue that arose—I do not know whether you have looked at it—with respect to the Ansett superannuation fund was that the fund had insufficient assets in part because there was a redundancy benefit provision not in all of the Ansett super funds but in a couple of them, which meant that when Ansett went under, whilst the retirement benefit, if you like, was largely covered or fully covered depending on the fund, the fund was still short because the fund contained a component of redundancy payment, which seemed logical. Ansett was not going to fully fund a fund on the assumption that Ansett would collapse and all the redundancy moneys would be paid out in one hit. It seemed logical, but unfortunately, as events turned out, it happened. Do any of these defined benefit funds have such provisions for the payout of redundancy as part of the fund and therefore the fund would not at least theoretically have sufficient assets to meet the redundancy provision within the fund?

Mr Glenfield—Subsequent to the Ansett one, we did do a review of those defined benefit funds. From memory, we did not produce any that were in the format of the Ansett one. If they were there as part of a rectification plan, we would expect that the actuary would take that into account.

Senator SHERRY—So, as part of a rectification plan, if they are there, it is an issue which has to be rectified as well?

Mr Glenfield—The actuary would have to make their assessment on the likelihood of having to pay that. You made the comment that you are not going to assume that every company falls over tomorrow, but the actuary has to look at the environment that that company is working in.

Senator SHERRY—In a question on notice relating to diversification of superannuation fund assets I had asked for examples of ‘where you have not been successful in persuasion to ensure that trustees ensure members’ super assets are diversified, with an acceptable trade-off between risk and expected return’. The response says:

Within the retail superannuation segment a number of trustees believe that they have fulfilled their fiduciary and *Superannuation Industry (Supervision) Act 1993* “sole purpose” test responsibilities by ensuring that potential members may only enter the fund through an approved financial planner. The basis of this belief by trustees is that the financial planner is then responsible for advising on the member’s entire portfolio including assets outside the superannuation environment. This can give rise to highly concentrated superannuation holdings for the member which the trustee justifies on the basis of the financial planner having the ‘whole of member’ view. APRA is presently reviewing this advice before proceeding further on this particular matter.

Has APRA reviewed its advice, and how is it proceeding on this matter?

Mr Jones—We are in the final stages of the revision of the superannuation investment management circular. That circular was last revised in 1999 and is still going through our internal processes. It will be put out for public comment probably very soon.

Senator SHERRY—What do you mean by ‘very soon’? Do you mean the next few weeks or a number of months?

Mr Jones—I would think weeks, yes. In terms of our internal processes, it is up for discussion in fact at our next meeting.

Senator SHERRY—In answer to the question of whether this will be covered by the same circular, the next dot point says:

APRA also has experience of trustees of both retail and small APRA funds (SAFs) directly, or indirectly, facilitating asset concentrations of close to 100% within broad asset classes (equities, cash, property and so on) and over 90% to asset sub-classes ...

It also says APRA is presently reviewing the advice. Will this issue be covered in that circular?

Mr Jones—Yes, this issue will be addressed in that circular, and so will the issue of advice from investment planners and the notion of a whole of asset type of allocation. APRA is going to have a different view I think on some of these things.

Senator SHERRY—Then the next dot point states:

Superannuation funds on occasions service a group of individuals with a common linkage. One example is a fund formed for beneficiaries sharing a given religious background and where the belief (and/or associated risk tolerances) preclude certain types of investments ... APRA treats such instances with appropriate sensitivity.

Will this issue be addressed in that circular as well?

Mr Jones—No, that issue will not be part of that circular, I do not think.

Senator SHERRY—So you believe existing practice and appropriate sensitivity will continue?

Mr Jones—I hope it will. In response to your original question, I think there was a certain sensitivity about APRA’s approach to certain investments described as ethical investments.

We do not take a view one way or the other. Our view is solely with regard to prudential safety in these things.

Senator SHERRY—Yes, but you go on to say in that dot point:

Such beneficiaries with a common linkage may affect the ability of the trustee to ensure adequate investment diversification.

So you actually do balance where there is a group of individuals with a common linkage. Let us take the religious example. Taking those beliefs into account, we may in fact have funds that do not have an adequate investment diversification strategy.

Mr Jones—Our primary objective would be the diversification strategy would be paramount. Our objective would be to ensure there was no risk or minimising the risk.

Senator SHERRY—Yes, I understand that. But you seem to be saying that where you have a group of individuals with a common linkage, and a religious example is given, you are more tolerant with respect to adequate investment diversification than you otherwise would be because of those special circumstances.

Mr Jones—I am trying to think of a specific instance that I could give. I might have to take that on notice and come back to you.

Senator SHERRY—Okay, take it on notice. I also notice you released a press release about undertakings from the AXA Australia staff superannuation plan trustee.

Mr Somogyi—I need to leave the room while this item is being discussed. I have a personal interest in this issue.

CHAIR—Mr Somogyi, that is fine.

Senator SHERRY—It is actually APRA and ASIC accept undertakings.

Mr Jones—Yes.

Senator SHERRY—From the AXA Australia staff superannuation plan trustee. I note that this followed complaints from members of the DB fund; is that correct?

Mr Jones—Yes, I think that is correct. There were certainly complaints; I recall that.

Senator SHERRY—There were a number of complaints?

Mr Jones—There were a number of complaints, yes.

Senator SHERRY—It goes to a total of 288 deferred benefit members and an estimated \$9.2 million in adjustments, if I could describe it as that. That is correct, isn't it?

Mr Jones—Yes. Around \$10 million, I think it was.

Dr Roberts—I think there might be a mixture of two different areas there. The \$10 million I think deals with a larger category of members. I think it might be around 2,000. There were two issues, and the \$10 million refers to one of those issues.

Mr Jones—That is right. The \$10 million refers to 1,200 members.

Senator SHERRY—That relates to the smooth rate application; is that what the issue related to?

Mr Jones—Yes, to reinstating the former crediting rate.

Senator SHERRY—Which was a smoothing rating which they changed?

Mr Jones—Yes.

Senator SHERRY—Also, the 47 former members who accepted an offer by their employer to buy out their future pension entitlement—that relates to the employer offer. With respect to the employer offer, I note the press release says:

APRA and ASIC had expressed concern to the trustee that, at the time members were required to make a decision whether to accept the employer offer, members had not been given all the information they needed to make an informed decision.

What sort of information was missing?

Dr Roberts—We thought the trustee had an obligation. The trustee essentially said, if I can simplify it, 'Here is the employer offer; you should seek your own financial advice before you make a choice.' We believe that under section 52 of the SI(S) Act, which includes covenants for trustees such as always acting in the best interests of members and so on, the trustee needed to go a stage further. While it was not in a position to give financial advice to each member, which would have to be tailored to their circumstance, it should have had more diligence and provided more guidance to put those members in a better position to make a fully informed decision.

Senator SHERRY—And to seek further independent advice if necessary?

Dr Roberts—If necessary, yes. The trustee had already suggested that members should seek further advice, but we felt they needed to go a step further.

Mr Jones—It was our view that there was some additional information that could have been provided.

Senator SHERRY—To them?

Mr Jones—To the members.

Senator SHERRY—In order to help them make an informed decision.

Mr Jones—Yes.

Senator SHERRY—And also to be provided presumably to I hope not AXA advisers but other independent advisers so that they would be able to make a fully informed decision and give advice?

Mr Jones—Yes.

Senator SHERRY—With respect to the smoothed rating issue, was it a failure to provide adequate notice and information to members about the change in policy?

Dr Roberts—In our view, they introduced the policy retrospectively, in that in the course of the main year in question, 2001-02—the crediting rate does not actually have to be set until 30 June—members and members who left the fund and got a kind of interim crediting rate had a reasonable expectation that the smoothing policy would still apply to that year. It was some months after the end of the financial year that the trustee decided that the new formula would apply to the 2001-02 year. We felt that was in spirit a retrospective timing.

Senator SHERRY—So those members who had left had not actually been notified about this, because how would they have been notified?

Dr Roberts—The members who had left I think got the benefit of the smoothing rate, because it was the interim rate that applied until the trustee formally switched to the new formula.

Senator SHERRY—So, if someone left after 1 July, even though they had been told, they would have had the—in this case it was a lower rating, wasn't it?

Mr Jones—Yes, it was.

Dr Roberts—The adverse impact was on the members who stayed in the fund.

Mr Jones—The new rate resulted in members being credited a negative rate.

Senator SHERRY—Yes, 5.8 per cent.

Mr Jones—Whereas there had been an expectation up until then that they were in fact going to have a positive rate, yes.

Senator SHERRY—I think that is perfectly understandable in the circumstances. It is pretty rough retrospectively applying a negative 5.8 per cent credit rating.

Mr Jones—I think it would have been a surprise, yes.

Senator SHERRY—I think a lot of people would be surprised if that happened to them. Does it surprise you that a company of AXA's size and expertise could fail to provide information and in a sense apply a retrospective, in this case, negative credit rating to such a significant number of people? We are dealing here with one of Australia's largest superannuation funds.

Mr Jones—I think it is always the case that we are disappointed when we believe there have been some types of failures.

Senator SHERRY—It is a significant failing affecting a significant number of people by a significant superannuation fund.

Mr Byres—We do need to distinguish here between the trustees of the fund and AXA itself.

Senator SHERRY—Do we?

Mr Byres—They are two separate—

Senator SHERRY—I know they are.

Mr Byres—The AXA fund had member representatives on it. It was an equal rep board of trustees, and at the end of that day it was that board making the decision. It is a technical point, but we do need to distinguish that.

Senator SHERRY—It is an important technical point. How it works in practice is interesting. I do not want to explore this extensively, but do you know where the employer trustee representatives suddenly got this idea to initiate these actions? Were there any suggestions from AXA itself?

Dr Roberts—I think everyone understood that this was all in the context of this being a very generous scheme. In fact, the degree of generosity probably was in excess of community standards at the time. APRA was not concerned about the kinds of decisions that were ultimately made to adjust the scheme. We were concerned about in this case the manner in which it was done—in the one case, with the retrospective impact and, in the other case, without sufficient advice and recommendation. But we did not object to the changes themselves, if they had been introduced in a more careful manner.

Senator SHERRY—Your earlier comment opens up another interesting issue. You said a generous scheme in terms of the community standard. You would be hard pressed to find a defined benefit fund that effectively did not confer a benefit greater than the existing superannuation guarantee rate, wouldn't you? There would not be too many such funds around.

Dr Roberts—Yes. Other features of the fund were very generous.

Senator SHERRY—Such as?

Dr Roberts—We do not—

Senator SHERRY—Such as?

Dr Roberts—In relation to deferred benefit members there was an entitlement to stay in the scheme when they left AXA employment, provided I think that they had 10 years service there, and to retain a pensionary entitlement. They were the 47 members who were affected, potentially, by the offer. The crediting rate in the smoothing policy appeared to be working well when markets were really going well. But we could understand an intention to try to move to a new formula that took into account the fact that markets go up and down. It is a commercial matter for the employer and the fund as to how they adjust the terms of the fund and the trust deed, provided they comply with the SI(S) Act, over time. Our concern in this case was with the manner in which those changes were introduced, not with the changes per se.

Senator SHERRY—What was the effective average contribution from the employer to the fund, do you know?

Dr Roberts—I do not know. We would have to take that on notice.

Senator SHERRY—I have a couple of questions on General Re. Can APRA explain the process that it had undertaken when it began its formal investigations?

Mr Jones—The process we undertook when we began our formal—

Senator SHERRY—Let us go back in time. When did you begin your investigations?

Mr Jones—We began our investigations over a year ago. Our investigations began by looking at certain transactions involving Zurich. The other party involved in the Zurich transaction was General Re. So that is effectively the sequence.

Senator SHERRY—Did you receive complaints or was it a result of investigative action by officers of APRA? How did it come about?

Mr Jones—It was a result of an on-site investigation by APRA staff. That on-site investigation led to APRA having some concerns about certain transactions involving Zurich.

We appointed an inspector into Zurich. That work that had been done by the inspector then pointed to other issues, and those other issues involved Gen Re.

Senator SHERRY—When did those other issues involving General Re come to your attention, approximately?

Mr Jones—It is hard to say, but in all probability we saw that the two parties were involved in the transaction very early on. But our focus in the first instance was unwinding the arrangements. So our first focus last year in our investigation was primarily on the Zurich side. That is the work that was completed through much of last year and into this year, looking at the Zurich side of it. Now we are doing more on the General Re side of it.

Senator SHERRY—When do you anticipate completing the work with respect to General Re?

Mr Jones—That is fairly difficult to say. I do not think it will be all that soon, the reason being that we have only just begun the formal investigation of the General Re side. Our first focus was on the Zurich side of the transactions, and that is now largely complete. In fact, we took an enforceable undertaking from Zurich last week, I think it was. Now we have appointed an inspector into General Re. At the moment we are looking at effectively their side of a series of transactions.

Senator SHERRY—In looking at their side, are there any particular issues that make it more difficult to investigate General Re?

Mr Jones—At this preliminary stage I would have to say no, but also it is very early on.

Senator SHERRY—You said about a year ago with respect to Zurich; so it could be the end of this year?

Mr Jones—Yes, it could be.

Senator SHERRY—Perhaps next year?

Mr Jones—It could be. I would like to think that the expertise that we developed during the Zurich investigation will enable us to actually do some of this more quickly.

Senator SHERRY—During this investigation, Zurich and then identifying General Re, did communications go to the minister about investigations of this type?

Mr Jones—Yes.

Senator SHERRY—And did they in this case?

Mr Jones—I would imagine so.

Mr Somogyi—Yes, they did.

Mr Jones—Yes.

Senator SHERRY—On what dates did communications go to the minister?

Mr Jones—On Gen Re or on Zurich?

Senator SHERRY—Both.

Mr Jones—I might have to take some of that question on notice. We would have sent things to the minister in March and April this year specifically on Gen Re. On Zurich, I will probably have to go back and check the dates.

Mr Somogyi—We certainly informed the minister that we were starting an investigation of Zurich about this time last year and gave the minister some information. We then made a public announcement of the appointment of an inspector. So that became public information. At a couple of points along the path we gave the minister some updates to that initial information but nothing major.

Senator SHERRY—If you could take on notice the question of the dates on which the advices were given.

Mr Jones—We also put out a press release making our announcements for these things as well, announcing that we had appointed the inspector. So there will be a very specific date.

Senator SHERRY—I am aware of the press releases. I am interested in the date on which specific advices went to the minister—not the advices themselves, because I know I cannot get that. I do read your press releases. I have been going through mountains of press releases from APRA and ASIC. I must make the general observation that you do not issue quite as many as ASIC.

Mr Jones—Or the ACCC.

Senator SHERRY—Or the ACCC, although I do make the observation that the number of press releases from the ACCC seems to have declined markedly under the new chair. I digress.

CHAIR—It has not lessened the effectiveness of the agency.

Senator SHERRY—I do not think the fewer number of press releases has lessened the effectiveness of your agency. In fact, I can recall, Chair—I do not know whether it was in your time—a very famous case where the previous chair of the ACCC had to excuse himself for an appointment and I caught him giving a press conference during the committee hearing, much to my annoyance.

CHAIR—I do not remember it, but I do not doubt it either.

Mr Jones—I have to plead a conflict of interest, since I was there with him.

Senator SHERRY—You were there with him, were you?

Mr Jones—I was a commissioner at the ACCC at the time.

Senator SHERRY—That was just a touch beyond the pale. I have some questions about the use of drive-by valuations. Is APRA concerned about the use of drive-by valuations?

Mr Littrell—Are you referring to our recent report on valuation practices in the deposit taking industry?

Senator SHERRY—Yes. They are commonly known as drive-by valuations.

Mr Jones—I think they are misnamed nevertheless.

Mr Littrell—That work was one of a series of examinations of different sorts of lending practice around home lending. Previous reports, for example, included the use of brokers. The

valuation report looked at a number of issues and concluded that valuation practice was changing in many cases away from what might be termed a traditional valuation to other, cheaper and more streamlined methods, but not necessarily methods that had been properly tested in a downturn. In the specific case of drive-by valuations, that has been a colloquial term in the industry for many years, along with 'kerbside valuation'. That has always been shorthand for a sloppy valuation. To the extent that some ADI is relying solely on that sort of valuation, we would not view that with favour. However, having said that, the general tone of the report was that most of what was happening in valuation practice was reasonable from our point of view. There were some trends there that we will continue to watch and we will expect the users of those new sorts of services to watch even more closely. We hopefully will never have a downturn to test that. But, ultimately, the information versus cost savings benefit of streamlined valuations can only really be tested in a downturn.

Senator SHERRY—Has the use of kerbside or drive-by valuations increased in recent years?

Mr Littrell—I commenced my Australian banking career in 1984 and that was a prominent feature of the industry at that point. I do not believe that we felt that that particular practice had increased a great deal. The practices that had increased were, one might say, data based valuations—say, a comparable house in the same postcode. And also valuations based on the sales contract have increased. But, again, you do not typically get people reporting a proportion of kerbside valuations. But there is not much of a sense that they have increased.

Senator SHERRY—I wish to raise brief two constituency matters that I have had referred to me. The individuals do not mind my raising it here. I had a complaint from Mr Steve Huggett concerning his transfer as a member from the Telstra Superannuation Scheme, TSS, to the new division of TSS, known as NDC Super Advantage. In some respects, it is somewhat like the AXA issue. He claims he was disadvantaged and not fully informed when he transferred from the defined benefit to an accumulation fund. He believes that TSS were deceptive and misinformed him. I understand he has been in contact with APRA and a number of other agencies, including ASIC.

Mr Jones—The Superannuation Complaints Tribunal.

Senator SHERRY—I think the SCT, too. Can I request you to investigate this further. I did not give you notice of the individual case, but he believes that his case has not been appropriately investigated or actions taken that he believes are justified given what he believes is the lack of information he was given at the time.

Mr Jones—As a clarification, he has already complained to APRA, did you say?

Senator SHERRY—That is my understanding. APRA, ASIC and the Superannuation Complaints Tribunal have investigated this—to what level I am not sure—but certainly he is not satisfied that the matter has been investigated as thoroughly as he would wish. Perhaps you could have a look at that for me. I would not have expected anyone here to have had familiar knowledge of Mr Huggett's case. Does anyone have knowledge of the collapse of the so-called—a bit ironic in the current context—Freedom of Choice Monthly Income Fund? Perpetual Trustees took over the monthly income fund from AXA and National Mutual on 12 December 2000. Australian Unity notified investors of the collapse of the PAM/MIP on 16

November 2000. Specifically, it involves a Mr Jim Welch, who again believes that APRA and ASIC have not sufficiently investigated the case; nor in this case has he received sufficient remedy, or in fact any remedy, and compensation for what occurred in this instance.

Mr Glenfield—Australian Unity inherited the trusteeship of that one from a previous trustee. There were, from memory, about four divisions. In respect of the division that that fellow was in, the assets that came across to Australian Unity were worthless. Australian Unity had been negotiating with the previous trustee for an extended period of time to reach a solution. I do not think that has been reached as yet, but we will take it on notice and give you an updated response.

Senator SHERRY—It is just that Mr Welch's correspondence—and I do not want to go through huge detail on this—goes back to 2000. We are now five years down the track.

Mr Glenfield—We have corresponded with him before. It is like anything else, in that at times you are limited in exactly what you can say to him. I would only say that it is a very difficult one to reach a resolution on because there is not sufficient detail. From memory, from his case, he could not provide sufficient detail of what he was told at the time he invested.

Senator SHERRY—There does seem to be a degree of duckshoving between the original owner of the entity and the new owner of the entity. As you say, no assets or almost no assets were transferred over and there was a lack of documentation.

Mr Glenfield—I will take it on notice to give you more detail, but the level of documentation from Mr Welch has not given us enough detail to understand what it was he thought he was investing in at the time that he invested.

Senator SHERRY—But it is not unusual for an individual to not comprehend the extent of information that they are required to, if something goes wrong.

Mr Glenfield—But to understand what he went into we need to get documentation of the product that he actually invested in, which we do not have.

Senator SHERRY—But if he does not have sufficient documentation and the transmitting company does not have sufficient documentation it becomes very difficult, does it not?

Mr Glenfield—It does.

Senator SHERRY—Perhaps you would take another look at that for me. That is it for me with APRA.

CHAIR—Thank you, gentlemen.

Proceedings suspended from 2.39 pm to 2.46 pm

Australian Securities and Investments Commission

CHAIR—Welcome. Mr Lucy, do you want to make an opening statement?

Mr Lucy—Just a short one, if I may. Today ASIC is represented by me and the Deputy Chairman, Jeremy Cooper. For specific questions related to our HIH inquiry, we are joined by Executive Director, Enforcement, Jan Redfern, and our independent senior counsel, Peter Clark SC. ASIC Commissioner Professor Berna Collier is unable to join us today because of other commitments.

Since our last estimates hearing, one of the key outcomes for ASIC has been the launch of our five-year strategic plan entitled *Working together for fair and efficient markets and confident and informed consumers*. I have copies, gentlemen and Senator Wong, if you would like to take those later on. Externally, we have been very much focused on enforcement outcomes. I think that we have received indeed some quite significant outcomes. When I last came to this committee, Mr Rodney Adler had announced that he was going to plead guilty to the charges brought against him for his part in the collapse of HIH. He was subsequently jailed for a maximum of 4½ years, as was Mr Ray Williams, the former CEO of HIH. Former HIH Managing Director, Mr Terry Cassidy, has always been jailed for a maximum term of 15 months. Mr Abbott, another former director of HIH, is currently before the courts. ASIC has six further criminal briefs currently with the Commonwealth Director of Public Prosecutions in relation to HIH.

For James Hardie, if I can provide a very quick update, I should note that ASIC has begun investigating James Hardie Industries creation of a fund to compensate victims of asbestos related illnesses. We have now formally established a dedicated task force to conduct inquiries and focus on the disclosure and conduct of the directors and senior management of James Hardie. Although these two cases are obviously ASIC's most high-profile matters, I would ask the committee to remember that they are just two of 328 investigations involving 473 actions against over 1,000 individuals or companies that we currently have on the go. In addition, we have currently 146 litigations under way. To date, ASIC has successfully completed 92 per cent of our litigations, entered into 22 enforcement undertakings, including with several large companies, been successful in seeking over \$47 million in compensation paid to consumers and investors—that is a conservative estimate—and taken action against the operators of illegal investment schemes involving around 1,000 investors and over \$100 million.

One of the key challenges for ASIC this year is undoubtedly the introduction of super choice. At the outset, I would like to mention the excellent working relationship that we have with the Australian Taxation Office and Treasury on this very important issue. ASIC's key role in this initiative is to monitor switching advice and to ensure that financial product advice is given in accordance with the FSR regime. Of course, we are also playing our part in the government's educational campaign, particularly in designing the messages for consumers on how they should approach choice. It will, however, be incumbent upon the superannuation industry to ensure that the consumers' rights are not abused when choice is introduced. ASIC will be monitoring this area very closely.

The FSR regime provides the regulatory framework within which super choice will operate. The Parliamentary Secretary to the Treasurer recently launched the FSR refinements consultation paper to assist with the practical implementation of FSR. ASIC is working closely with the government on this issue and the preliminary feedback to me from senior industry figures suggests that industry is generally pleased with the proposals and the consultation process established.

Over the first half of this year we have been active in the area of audit regulation, specifically reviewing compliance with the CLERP 9 auditor independence requirements by auditors of Australia's publicly listed companies. Our first round of reviews is currently under way and focuses on compliance with auditor independence by the major firms, that is,

PricewaterhouseCoopers, KPMG, Deloitte and Ernst and Young. The review program will expand in scope and will include several mid-tier firms in the next financial year. Under our memorandum of understanding with the FRC, we will provide broad-level findings and any systemic issues we identify to the FRC to assist that organisation with its oversight of auditor independence arrangements in Australia.

In conclusion, we are an active regulator not only in the enforcement area but also in the areas of compliance and providing guidance and education and ultimately contributing to the ongoing confidence in Australia's financial markets. As an agency, we continue to work hard, and I believe that we are working effectively, but there are many challenges we still face.

At the last estimates hearing there was a lot of interest in HIH and in particular in the matters dealing with Adler and Williams, but because they were before the court awaiting sentence it was not appropriate for us to comment any further. There was discussion as to whether or not there might be a specific hearing, but that has not eventuated. But we thought that we would take the opportunity today to bring Jan Redfern and Peter Clark to this hearing to provide senators with the opportunity of inquiring of them any particular issues that they have in relation to HIH.

CHAIR—And Ms Redfern and Mr Clark are here just for that, are they?

Mr Lucy—They are.

CHAIR—That makes sense, because I did get a message that it suited the commission to deal with HIH first. Now I understand why.

Mr Lucy—Thank you.

CHAIR—Have you finished your opening statement?

Mr Lucy—I have. With your permission, could Jan Redfern just introduce the topic of HIH?

CHAIR—Certainly, Ms Redfern, and if you want to add anything, Mr Clark, as well.

Ms Redfern—On the last occasion we were asked to give a briefing on our investigations to date, and it seems like an appropriate time to talk about a number of the issues that have yet been finalised. I should mention, though, that one of the matters that is finalised is the sentencing of Mr Williams, although it is not finalised in the sense that Mr Williams has actually appealed the sentence. I might just make that comment in passing.

We are here to give a briefing on our investigations to date and to answer questions in relation to those matters. I thought I might just start by giving a brief overview of the royal commission referrals, our investigations to date and the outcomes to date. I have asked Mr Peter Clark, who is our independent senior counsel assisting our task force, to come today in case there are particular technical issues that you want some answers on. But, just in general terms, there were 56 referrals from the royal commission. All save for one matter that was statute barred at the time that we received it have been and are currently being investigated by ASIC. The referrals covered 19 individuals and entities. They were transaction based referrals covering four key areas. The referrals were both civil penalty and criminal matters. As at today, we have not taken any civil penalty actions other than those that we commenced within the first three months of the collapse of HIH, which I will refer to later. Where we have taken

action on a civil penalty referral from the royal commission, it actually has resulted in a criminal prosecution. We have used the referrals as a basis for our investigations. In some cases our investigations have led us to take action on matters that were not actually referred by the royal commission. An example of this is in relation to the charges that we laid against Mr Williams on the prospectus of fundraising for HIH back in 1998.

We are very proud of our outcomes to date, although I hesitate to add that we have not yet finished. As the chairman has mentioned, we do currently still have six briefs with the DPP, not relating to six individuals but six transactions on a number of individuals, and we do have some further investigations to undertake. But to date we have taken action, either criminal, civil penalty or administrative action, against 15 individuals and entities. We have taken action against 10 former executives and directors of the HIH group of companies, three executives of reinsurance company GRA, and we have also taken action against two companies, GRA and Adler Corporation.

As a result of those actions, we have brought to account nine former executives, involving 31 charges. Four of those matters have in fact been concluded, and I will talk about that in a little more detail and you may want to ask some questions about those matters. In addition, we have obtained compensation orders or actions or refunds by GRA—General Reinsurance Australia—and Adler Corporation for in the vicinity of \$36 million, which has returned that money to the creditors of HIH. As I said, we have taken administrative action against three former officers of GRA. Since we commenced our investigation we have had a fairly steady flow of outcomes since 2001. We commenced the civil penalty action that I referred to earlier against Mr Ray Williams, Mr Rodney Adler and Mr Dominic Fodera within three months of the collapse of HIH. Within a year of the collapse those proceedings were finalised, with penalty orders, disqualifications of two of the directors, and compensation.

The particular outcomes that we have achieved since the commencement of our investigation involve the significant matters in the sentencing in April of Mr Ray Williams, Mr Rodney Adler and Mr Terence Cassidy. Those matters—with the exception of the issue I have talked about with Mr Williams: the appeal—concluded our investigations in relation to those people. As I have said, we have ongoing investigations, six briefs with the DPP. We have prepared a bit of a summary of some of the things that we have done in terms of a chronology, with the charges laid, the pleas obtained and the orders obtained and the sentencing, which I am happy to provide the committee. Apart from that and my opening statement, I am open to questions you may wish to ask on those matters.

CHAIR—Thank you, Ms Redfern. Thank you for the copies of that chronology. Mr Clark, did you want to add anything?

Mr Clark—No, I do not wish to.

CHAIR—You are just available for questions. In view of the fact that Ms Redfern and Mr Clark have come specifically to deal with this matter, and to meet their convenience, I propose to take questions specifically on HIH first and then we will proceed to other questions. Senator Wong?

Senator WONG—Do you have any involvement in the James Hardie issues as well, Ms Redfern?

Ms Redfern—As the Executive Director, Enforcement, I have oversight of the James Hardie matter.

Senator WONG—Just for your convenience, I am indicating that I am happy to go to those issues after HIH, if the concern is that Ms Redfern and Mr Clark would like to leave after questions dealing with their matters. You said in your opening statement, Ms Redfern, there is an appeal, I understand, on sentence by Mr Williams. Is that right?

Ms Redfern—Yes, there is.

Senator WONG—There is obviously no prejudice associated with questions at these hearings, given the appeal is only on sentence. I assume there is no additional evidence suggested to be adduced on appeal?

Ms Redfern—Not as I understand it.

Senator WONG—You would be familiar with the issues I raised on the last occasion, I presume. I suppose what we are interested in is getting some feel as to the basis of the decision to pursue some charges and not others. Could you firstly take me through the process by which those decisions were made and then I might turn to some specific examples.

Ms Redfern—In relation to all of the people I have mentioned or just generally on our investigation?

Senator WONG—In relation to Mr Williams and Mr Adler.

Ms Redfern—As I said, we had been investigating the matter prior to the referrals. Clearly that informed our views of the matters we should investigate, but we considered the referrals from the royal commission and used that as a base for our investigations. We investigated all the issues raised in the referrals very thoroughly. To the extent that there was sufficient evidence to warrant a prosecution, we referred those matters to the DPP.

Senator WONG—Who makes the decision as to sufficient evidence?

Ms Redfern—We have quite a close working relationship with the DPP, so there is a number of issues that we raise with them along the way. When we investigate we collate the evidence. In this case we referred it our counsel who assisted us with that process. Then we referred those issues to the DPP.

Senator WONG—What I am trying to clarify in relation to Messrs Williams and Adler is: was the decision not to proceed with some aspects of the matters referred a decision within ASIC, or a decision within the DPP, or a mutual decision? Or were different decisions taken in relation to different aspects?

Ms Redfern—I think it is the latter. In some cases, the DPP itself formed particular views. In some cases, we had discussions with them. In some cases, we formed the view that there was not sufficient to even refer the matter to the DPP.

Senator WONG—How many matters fall into that last category—that is, issues raised on the royal commission's recommendations that ASIC determined not even to refer to the DPP?

Ms Redfern—In relation to Mr Williams there were, I believe, about seven referrals. The majority were civil penalty referrals. There were about three criminal referrals. One of them was the subject of a specific issue raised by the royal commission, loosely speaking. One was

a new issue—the prospectus issue that I referred to earlier—and one was an issue that arose out of one of the referrals but not precisely on the same issue. We investigated all of those matters. The civil penalty matters we did not refer to the DPP—because they were civil penalty matters; they were not criminal prosecutions. In our view there had been sufficient regulatory impact already achieved by the findings and disqualifications. In relation to Mr Adler—

Senator WONG—Can we just stop there. Were there matters relating to potential criminal proceedings which ASIC determined to not refer to the DPP in relation to Mr Williams? As I understood your earlier evidence—and I may have misunderstood it—you said there were three categories of decisions in relation to criminal matters. We are dealing only with criminal matters now.

Ms Redfern—Yes, that is right.

Senator WONG—The first category is where the DPP gives you advice about the strength of the evidence for your prosecution case, so there is a decision made at that end. The second category is the mutual decision—discussion between ASIC and the DPP. The third category, as I understood your evidence, was matters where ASIC determined not to refer the issue to the DPP.

Ms Redfern—Yes.

Senator WONG—I am asking: were there criminal matters in relation to Mr Williams which fall into that last category?

Ms Redfern—There was one matter that was a criminal referral. We did not formally refer it to the DPP, although, from recollection, we did confer with the DPP about the particular issue. There were two civil referrals relating to Home Security International and one criminal referral for breach of directors duties. Mr Clark is reminding me: we certainly investigated it extensively. We obtained advice from both senior and junior counsel in relation to it. My recollection is that we actually did confer with the DPP, although we certainly did not refer a formal brief to the DPP on the matter.

Senator WONG—This is in relation Home Security International and a breach of directors duties?

Ms Redfern—Yes. One of the other criminal referrals relates to Hanover Re and the accounts for HIH for 1999. That was specifically the subject of one of the charges.

Senator WONG—Was that one of the charges that was proceeded with or one of the charges that was dropped?

Ms Redfern—Yes.

Senator WONG—My recollection from your web site was that there were three charges of breaching the Corporations Law. The first related to the letter from HIH to note holders who had purchased FAI notes, the second was the prospectus issue you have raised and the third was the statement in the 1998-99 report which was knowingly misleading.

Ms Redfern—Yes.

Senator WONG—The issue of Hanover Re: is this the concealment of a reserve shortfall in 2000?

Ms Redfern—Yes.

Senator WONG—Was that the subject of criminal proceedings?

Ms Redfern—That is the matter that was the subject of the referral to the DPP and, ultimately, the charges. There were some broader issues raised in the matter that went to the DPP, but the precise charge that was preferred was the issue in relation to the 1999 accounts that overstated the profit for the financial year by around \$92 million—\$92.6 million, I think it was.

Senator WONG—Was there a guilty plea in relation to that specific charge?

Ms Redfern—Yes.

Senator WONG—That is what I am confused about, because I just read the three findings on your web site and I did not understand that any of those related specifically to the 1999 \$55 million shortfall in the statements.

Ms Redfern—No, the last one that you referred to related to the 1999 accounts.

Senator WONG—I see.

Ms Redfern—And the referral related to the Hanover reinsurance issue. I think the particular suggestion of the royal commission was 1309, in terms of lying to directors or misleading directors. The charge that was actually preferred was false accounts.

Senator WONG—Which has a lower penalty?

Ms Redfern—No.

Senator WONG—What is the penalty?

Ms Redfern—It is exactly the same.

Senator WONG—One year's imprisonment?

Ms Redfern—Two years. It is exactly the same. Since HIH, the legislation has been amended so that those provisions carry a five-year penalty.

Senator WONG—Anything more before I move on to the next issue?

Ms Redfern—No.

Senator WONG—Anything else on Mr Williams that you want to tell me?

Ms Redfern—No.

Senator WONG—Can you tell me about the NESS Security Products issue in relation to Mr Williams?

Ms Redfern—It might be best since Mr Clark was very much involved in that—he was the senior counsel that I was referring to—if he provided some more detail on this issue.

Mr Clark—The essential allegation was that Williams had used HIH funds to purchase an interest in NESS, which was a manufacturer of security alarm systems. The purchase price did not adequately reflect the value of the asset. We investigated the matter very thoroughly—

indeed, we went to the extent of engaging expert accountancy assistants to determine whether or not we could identify criminal conduct on the part of any person who had been engaged in that particular transaction, including Mr Williams. At the end of the day, we were satisfied that we are unable to assemble sufficient admissible evidence which would justify a recommendation that criminal charges be preferred. The simple fact was that we just could not maintain sufficient material that would justify a recommendation of criminal charges.

Senator WONG—Can I just clarify: did the lack of evidence relate to the transaction or to the valuation?

Mr Clark—In a criminal investigation not only does one need to go out and attempt to collate evidence which will establish the relevant elements of the criminal offence that you have in mind but also you need to be able to negate any innocent explanation and, by so doing, one needs to identify any commercial explanation that a defendant could put forward to justify the particular transaction. Williams had put forward a number of explanations to justify his decision to enter the transaction. We were unable to assemble sufficient evidence to negate those explanations. Indeed, the expert whom we engaged was of the view—certainly a preliminary view—that one of his explanations was quite sound from a commercial perspective.

Senator WONG—What was the charge? Was it a breach of 184?

Mr Clark—It was a breach of a director's duties, yes.

Senator WONG—What is the maximum penalty on that?

Mr Clark—Five years, I think.

Senator WONG—Yes, I thought so. And this was a transaction involving Mr Cooper as well?

Mr Clark—Mr Cooper was the vendor of the company. He managed to get himself a good deal.

Senator WONG—That is one way of putting it. Was the decision to not proceed the subject of discussion with the DPP or was that an internal position for ASIC?

Mr Clark—We have regular liaison, as you can imagine, with the DPP and certainly the matter had been discussed from time to time. Ultimately, it was a matter on which we advised them of our views and they did not disagree.

Senator WONG—Would it be correct to characterise that decision as being primarily an ASIC decision?

Mr Clark—I think so, yes, and I would have to say that I will take the blame: it was primarily my decision. I think I wrote a 40- or 50-page opinion on the matter.

Senator WONG—Very assiduous of you. Obviously, with litigation, you always have to make some sort of judgment as to the prospects of success. On the last occasion it was put that a better than 50 per cent prospect of success would be required. Is that your understanding of the directions to you from the commission about the way in which you should be assessing the prospects of success before pursuing a matter?

Mr Clark—The commission's instructions to me are to examine the prosecution policy of the Commonwealth. The prosecution policy of the Commonwealth is a fairly comprehensive document published by the Office of the Commonwealth Director of Public Prosecutions. It is a document that sets out in some detail the process which they go through when exercising the decision to prosecute. It is our guideline, as it were, to determine whether we should make a recommendation to prosecute. The fundamental test, apart from many others, is whether there are reasonable prospects of success.

Senator WONG—Which is what most right-thinking lawyers, I would hope, would take to a litigation decision.

Mr Clark—Being a criminal matter of course, the decisions are harder than they are in a civil matter. You simply do not have a go. You need to be satisfied that the jury is likely to convict.

Senator WONG—Would you agree that 50 per cent is perhaps an inaccurate way to describe—

Mr Clark—I think that it should be more than 50 per cent, a lot more.

Senator WONG—Do you want to tell me about Mr Adler?

Ms Redfern—With Mr Adler there were essentially four categories of referral or four transactional bases. One related to FAI underreserving and there were three other referrals—one civil and two criminal relating to the same issue. They related to the argument that there had been material omissions about underreserving in relation to claims. We have actually laid charges on the subject of this against three former executives of FAI and those matters are before the court in September. Those people are Mr Wilkie, who was the former CEO; Mr Mainprize, who was the chief financial officer; and Mr Burroughs, who was another executive.

The second transaction that was referred to was, again, the Home Security International transaction that Mr Clark has just mentioned. There were two civil referrals and a criminal referral, again on the same issue. The third subject matter was around payments to Mr Cooper, and there was a combination of both civil and criminal referrals—that is, on similar conduct but different provisions: provisions of the Crimes Act, including the director's duty provision. The last one was Business Thinking Systems, which were both actually civil referrals.

Perhaps I can pre-empt the question you are going to ask me: which of those did we refer to the DPP in a formal sense and for which did we make decisions along the same lines. I can say that we actually referred the Business Thinking Systems matter to the DPP as a criminal prosecution and it was the subject of the charges that Mr Adler pleaded guilty to and was sentenced for on 14 April. Considerations of the HSI transaction were very similar to those that Mr Clark has just been talking about. It was a director's duties issue: failure of an officer to act in good faith in the interests of the corporation. There were the same considerations and we went through the same process that Mr Clark just described with Mr Adler as we did with Mr Williams.

The first topic was the FAI underreserving. As I have indicated, we did not send a formal brief to the DPP in relation to this issue on Mr Adler. We did in respect of Mr Wilkie, Mr Mainprize and Mr Burroughs, and charges were laid in 2003, I believe. All three were

committed for trial last year in the matter. The hearing is before the court in September. In relation to the FAI underreserving, we went through a similar process to the one that has been described in the sense that we investigated it and we referred a number of issues to our senior counsel for advice on whether a brief should be sent to the DPP. We also consulted quite extensively with the DPP on this issue because we currently had a brief with the DPP. I might ask if Mr Clark would like to add anything in relation to this matter.

Mr Clark—I think one point that might assist senators is this: in both the matters that Ms Redfern has been discussing with you—

Senator WONG—Williams and Adler?

Mr Clark—For both Williams and Adler, the same principle applies. To accept a plea of guilty is seen to be very much in the public interest because it avoids the cost of a trial, it ensures a successful outcome for the prosecutorial effort and it ensures that the person is before the court and that the appropriate punishment is by way of sentence.

Senator WONG—It depends what you give away in order to achieve it, though.

Mr Clark—That is the very point I want to address. The key test that one must apply in considering whether the plea be accepted is whether the charges to which the person is going to plead guilty adequately reflect the criminal culpability of that person as we find it as a result of the investigation. In other words, we could not have accepted the pleas of guilty by either of these two persons at the beginning of the investigation because we would not have been able to make any assessment as to the full extent of their criminal conduct. But, by the stage that we had reached when the pleas were finally offered and given, we were satisfied that the charges to which they were pleading guilty adequately reflected the criminal conduct that we could prove or establish in a court if we had to proceed to trial. Of course, the DPP is the final arbiter as to whether or not the plea is accepted in the public interest. The test that the DPP applies is the same one—that is, does the criminal conduct which is reflected by the charges before the court adequately reflect that person's involvement as we understand it to be and could prove it to be? So, whilst there may be some matters that fall off along the way, those matters fell off simply because we could not assemble sufficient admissible evidence to be able to say charges were appropriate.

Senator WONG—So there was a plea entered to four charges in relation to Mr Adler. Remind me of the total number of criminal charges which were investigated in relation to Mr Adler.

Ms Redfern—We investigated all the matters that were heard. Under the four headings, there is FAI underreserving. In terms of criminal referrals or suggestions for criminal referrals, there were two referrals with different sections but relating to the same conduct on FAI. On HSI there was one referral, which was a director's duties referral. In relation to the payments to Mr Cooper, there were three referrals relating to exactly the same conduct but different sections were referred to. For instance, there were Crimes Act and Corporations Act offences in relation to the same conduct.

Senator WONG—So there were three categories of referral but obviously a substantially greater number of potential criminal breaches?

Ms Redfern—More than for Mr Williams, yes.

Senator WONG—Yes, because one referral could comprise a potential or alleged breach of a number of provisions of either the Corporations Law or other legislation?

Ms Redfern—Yes.

Senator WONG—What was the total number of potential criminal transgressions that these three matters comprised in relation to Mr Adler?

Ms Redfern—What I was trying to convey was that it was relating to the same conduct but they were alternatives. So, for instance, in relation to the payments to Cooper, there were three. It was a director's duties issue, a director's duties breach or a Crimes Act breach relating to two particular provisions of the act.

Senator WONG—That is in relation to Cooper. What about the FAI underreserving?

Ms Redfern—It is the same issue. One was a breach under 1309, which—

Senator WONG—Why do you say it is the same issue?

Ms Redfern—They were in the alternative.

Senator WONG—The payments to Mr Cooper and the FAI?

Ms Redfern—Sorry, the FAI. It is in the alternative.

Senator WONG—I understood that.

Ms Redfern—So in relation to FAI there were two and they were proposed as alternatives in relation to the same conduct.

Senator WONG—And the HSI issue?

Ms Redfern—There is one—a director's duties breach.

Senator WONG—One of the issues that has had some discussion is an allegation of the backdating of a document in 2001 to bolster Mr Cooper's claims to a share in Data Advantage. Was that matter investigated?

Mr Clark—At first blush that was an exciting prospect. Unfortunately, the result of the investigation was that again we just could not get into a position where we could recommend criminal prosecution. For example, we could not find the original document to even be able to prove that it was backdated. The originals had disappeared. Mr Adler had given an explanation before the royal commission as to how it had come about that that document appeared to be backdated. We could not negate that.

Senator WONG—But the document was before the commission, wasn't it?

Mr Clark—That is right.

Senator WONG—How could it have disappeared after the commission?

Mr Clark—No, only a photocopy of the document was.

Senator WONG—And it was regarded as not being sufficient?

Mr Clark—That is correct, because we needed the original to demonstrate when it had been sent—one with a fax imprint, for example, that sort of issue. We could never negate a suggestion that the document may well have been correct.

Senator WONG—In whose possession was the original document?

Mr Clark—We do not know. It was a document that was faxed.

Senator WONG—Was it faxed to Mr Adler?

Mr Clark—We made every endeavour we possibly could to try and find the document.

Senator WONG—Was the possibility that the document had been improperly destroyed canvassed?

Mr Clark—That certainly was a possibility, or it had been hand-delivered from Mr Adler's office to Mr Cooper's office. That particular claim made by Mr Cooper is the subject of one of the charges that he is before the court, and his trial commences in August.

Senator WONG—There is a maximum penalty on that of 10 years—and that is Crimes Act?

Mr Clark—Yes, Crimes Act. It would be no more than 10 years—I cannot recall the amount but most of those offences are approximately five to 10.

Senator WONG—And the FAI underreserving—this is the allegation that Mr Adler failed to inform the FAI board of the FAI reserve shortfall.

Mr Clark—Yes.

Senator WONG—Why was that not proceeded with—or was that proceeded with?

Mr Clark—No, it was not proceeded with.

Ms Redfern—Not in relation to Mr Adler.

Senator WONG—Why was that?

Ms Redfern—The issue was that we investigated it and we did not have sufficient evidence to establish that that was the case—that there was knowledge. Again, I am happy to defer to Mr Clark on the particular issues and the detail of it.

Mr Clark—We could not prove that Adler knew that it was in fact false. It is very easy to get these sorts of cases up if one is proceeding civilly or even by way of civil penalty, but in a criminal environment one needs to be able to establish a case beyond reasonable doubt. We were very keen to try and pursue every possible avenue and did so. Whilst I am putting my own name forward, I can assure you that if we had thought that we could have got a case up, that case would have been referred to the DPP with a recommendation for prosecutorial action.

Senator WONG—This issue was a significant one, as I understand the commentary around the royal commission—

Mr Clark—We could not use the evidence, of course, that Mr Adler—I beg your pardon, Senator; I interrupted you.

Senator WONG—The concern that has been raised in the public's view is that the underreserving of FAI was a significant causative factor in the collapse of HIH. For ASIC not to have proceeded with a prosecution or other proceedings in relation to that issue has been the subject of some criticism.

Ms Redfern—I might just interject here to say that we did proceed in relation to Messrs Wilkie, Mainprize and Burroughs in relation to a core issue—

Senator WONG—But not in relation to Mr Adler.

Ms Redfern—Not in relation to Mr Adler. We had sufficient evidence to establish that all of those people knew of the circumstances of the accounting issue and the financial reinsurance and the letter. In relation to the underreserving issue, we did not have such evidence in relation to Mr Adler.

Senator WONG—You did not have evidence that he knew of the underreserving?

Ms Redfern—No—not sufficient to a criminal standard and in admissible form.

Senator WONG—Was that a decision made in conjunction with the DPP?

Ms Redfern—It was certainly an issue we discussed in quite a lot of detail with the DPP at the time, because that was one of the first briefs that we referred to the DPP, back in 2003. The precise nature of the discussions I cannot recall now.

Senator WONG—Was the decision to not proceed with that aspect of the prosecution on the advice of the DPP, or was it a decision within ASIC?

Ms Redfern—It may have fallen into the category of those matters that we discussed, and it was more a joint decision, but I would have to take that aspect on notice because it goes back to 2003.

Senator WONG—Is the case as part of the plea arrangements with Mr Adler that he is not required to testify in cases against other HIH executives?

Mr Clark—It was not a question of 'not required'. The law recognises that people get discounts when they plead guilty.

Senator WONG—I am aware of that.

Mr Clark—He did not get a cooperation discount because he was not able to be produced as a credible, reliable witness in any other prosecution. So he did not get a discount for that. We did not seek that requirement because we did not believe he could be used as a credible, reliable witness in any other case.

Senator WONG—The absence of evidence from Mr Adler: is that going to have any detrimental impact upon the prosecution of other HIH executives?

Mr Clark—We rather thought, with respect, it was the other way around: if you had Mr Adler you would jeopardise any prosecution because you could never be sure what he was going to say.

Senator WONG—If his credibility was such an issue, I wonder why the proof on a number of the issues we have raised, including the backdating of the document, was determined to be so difficult.

Mr Clark—We could not use any of the evidence he gave in the royal commission against him, of course, by reason of the provisions of the Royal Commissions Act.

Senator WONG—It depends what evidence he gave in chief in prosecution, I suppose.

Mr Clark—Insofar as the evidence he gave in the royal commission, we could not lead that against him in any prosecution.

Senator WONG—No, but you could if he gave inconsistent evidence. That would be admissible.

Mr Clark—You may be able to use it for the purpose of cross-examination, but you have still got to get your case up in the first place and you have got to get the case to a sufficient level where he would be required to go in the witness box in defence of any criminal charges. The DPP does not determine as part of the prosecutorial discretion what action a defendant is likely to take. The DPP needs to see evidence which stands up on its own to be satisfied that it should commence a case.

Senator WATSON—I have a couple of brief questions. Given the scale of the failure and its flow-on effects to innocent people, were you surprised, Mr Lucy or Ms Redfern, at the lightness of the penalties and did you ever consider appealing the sentences?

Mr Lucy—You directed the question to me. I was not surprised at the severity of the sentences. The sentences were within the range of what I understood was likely to be forthcoming. As to the matter of appeal, could I pass that to Jan Redfern.

Ms Redfern—From our point of view and, as I understand it, from the Commonwealth DPP point of view there is no consideration of appealing against those sentences, although Mr Williams, who believes his sentence was too severe, has appealed.

Senator WATSON—Have the penalties increased since then as a result of the HIH decision?

Mr Lucy—Yes.

Ms Redfern—Yes, they have.

Senator WATSON—By how much?

Ms Redfern—From two years to five years in relation to one of the key issues that the court found was the most serious one, which was the accounts issue: misleading and deceptive accounts. The penalty at the time of the commission of the offence was two years. The court found that Mr Williams's conduct was at the high end of the scale and I think as part of the sentencing there was one year and three months, which is very close to the two-year limit. I guess the issue is that if this had happened today—post some amendments to the Corporations Act, where the penalty for that offence has gone up to five years—you probably would have seen a far stiffer sentence.

Senator WATSON—What recoveries of moneys have taken place against individuals as opposed to corporations?

Ms Redfern—I know that the liquidator has been pursuing a number of recoveries; he has a number of actions on foot. I cannot tell you the people who he has sued. I believe they are a

number of the directors of FAI and HIH and some of the auditors. I just do not have the detail on that. From our point of view, we have—

Senator WATSON—Can you take that on notice. I know it is not directly your responsibility; it is the liquidator's. But we are interested to see what sort of recovery action has been taken against some of these people as opposed to some of the corporations, from which quite a considerable amount of money has been recovered.

Ms Redfern—We did sue Mr Williams, Mr Adler and Adler Corporation for compensation back in 2001. Compensation of some \$8 million was ordered, and in fact was paid by Mr Adler and Adler Corporation back in 2001. But, as I said, I am aware that the liquidator certainly has actions on foot against a number of individuals.

Senator WONG—One of the issues that has been in the public arena is that the financial consequences of the conduct that was the subject of prosecution were quite small compared to the arguable financial consequences of matters which were not prosecuted. The concealment of the true financial state of FAI caused about \$591 million—I think that was the amount the royal commission articulated. The charges you have obtained a guilty plea to are worth around \$12 million. Can you understand from the public's perspective that, in terms of the amount of money that Adler's actions arguably—or perhaps patently—cost the company and therefore its policyholders and shareholders—

Ms Redfern—I think the issue in relation to FAI is that we actually have preferred charges on the issue of the financial reinsurance and the accounts being dressed up. Those matters are currently before the court and they have not been finalised, but I think that is one of the core issues in the FAI issue. In relation to Mr Williams, I think the charge I have referred to on the accounts, with the overstating of the profit of \$92.6 million, goes to the heart of some of those issues.

CHAIR—There are no further questions on these matters. Mr Clark, you were here only for HIH related matters, so you are excused. Ms Redfern, are you here for other matters as well?

Ms Redfern—I was not going to be.

Mr Lucy—No, that was not the intention, Chair.

CHAIR—Then you are excused too, Ms Redfern. Mr Lucy, I want to ask a few questions about James Hardie. There has been some speculation in the media recently about James Hardie being released from civil liability, and some of ASIC's views have been reported. Can you tell us about that, please?

Mr Lucy—I would suggest that the views are more particularly to deal with the civil penalty as distinct from the civil liability. The discussion that has recently been in the media follows, I guess, the leadership of the New South Wales government and the ACTU to strike an arrangement with James Hardie for an ongoing compensation arrangement for parties that have been associated with asbestos related diseases. The basis of that agreement was that there would be essentially a waiver of any civil actions undertaken. That is an approach which we at ASIC felt comfortable with on the basis that the compensation for the asbestos victims was very much part of the entire transaction or proposed transaction, and therefore we felt

very comfortable with civil actions being withdrawn. The more recent discussion, though, suggests that the New South Wales government is considering removing civil penalty provisions, and it is that area that we at ASIC have particular anxiety about.

CHAIR—How would a civil penalty arise?

Mr Lucy—I will provide a bit of background. In the first instance, it needs to be a serious offence undertaken by an officer or a director and essentially dealing with their responsibilities to the company and the shareholders. It is not dealing with their responsibilities to third parties such as the creditors and indeed the people suffering the asbestos related diseases. It is typically areas of, for example, lack of duty of care and omissions. But again, as I mentioned earlier, they need to be serious elements of omission and duty of care. And again, as I said, the obligation is back to the companies not to third parties. The outcome of a civil penalty proceedings being successful is typically a fine, which could be substantial—\$200,000 for any event—and disqualification, which could be essentially for an unlimited period, subject to the court.

CHAIR—Can a state government release individuals from liability under the Corporations Act?

Mr Lucy—The advice which we have received to date is not complete. There is a suggestion that the opportunity for a state government to so legislate really falls into two categories. In the first instance it applies to transactions that took place before July 2001 and, in that instance, there is a suggestion that a government, in this case the New South Wales government, would be successful in passing legislation that would affect our position. The other area is where they might pass legislation which deals with an activity post July 2001. I have received advice that that would be an approach that could be set aside by the federal government if it chose to.

CHAIR—That being the date of the Corporations Act?

Mr Lucy—That is correct.

CHAIR—What effect would it have on the Corporations Act if the New South Wales government were to pass legislation purporting to release individuals from any liabilities under the Corporations Act?

Mr Lucy—In our opinion it would have a very materially negative consequence. The laws are quite clear. We at ASIC have a responsibility to uphold the laws of the Commonwealth. To the extent that a government or parliament specifically chose to release directors and/or officers from any civil penalty responsibilities, in our opinion is very difficult to justify.

CHAIR—If the New South Wales government were to pass legislation through the state parliament purporting to release James Hardie's directors and officers from liability for civil penalties, what will that mean for ASIC's investigation into James Hardie and its directors and officers?

Mr Lucy—Again, we are at the early stages of that. I have sought senior counsel advice and I have not received that complete advice as yet. But the preliminary advice is that obviously it would materially affect any investigations in respect of civil penalty but it would almost certainly materially prejudice any actions for criminal liability.

CHAIR—So if the New South Wales government were to do this, it is your evidence that it could be potentially seriously prejudicial to ASIC's future investigations of James Hardie?

Mr Lucy—That is the preliminary advice that I have received.

CHAIR—Do you accept that advice?

Mr Lucy—It is given in the form that it is preliminary advice. This is an issue that has come to us very recently. I understand the background to it. I understand the difficulties of witnesses that would be giving evidence in a court that would come to the court with a level of taint. I understand that background and therefore the preliminary advice that I have received is logical and consistent with what I expect to be the case. I am waiting for complete formal senior counsel advice.

CHAIR—How soon do you expect to receive that?

Mr Lucy—I am hopeful it will be by the end of the week.

CHAIR—The Premier of New South Wales, Mr Carr, has said in the press that ASIC would still be able to pursue directors for criminal liability. Are you aware of Mr Carr's press statements to that effect?

Mr Lucy—I have read a number of newspaper articles. I have not actually read his press releases as such but I am aware that the press has reported such comments.

CHAIR—Can you explain to us how ASIC pursuing the directors for criminal liability is different from ASIC pursuing them under the civil penalty provisions?

Mr Lucy—The discussion that we had earlier in relation to HIH I think provides a fair glimpse as to the difficulties as far as prosecution at the criminal level. The purpose for the civil penalty provisions is very much to provide an opportunity for the regulator and the courts ultimately to find directors and officers guilty of particular offences in the Corporations Act. They are serious offences and, apart from the fine, the most important aspect of the consequences of being found guilty is the suspension of being a director ongoing. Therefore that opportunity, we think, is a very important piece of our armoury. We feel very strongly about having that denied.

CHAIR—Can you provide us with some other examples of the sorts of penalties that would not be able to be applied if civil penalty liability were extinguished for James Hardie's directors and officers by an act of the New South Wales parliament?

Mr Lucy—Much of the area of disclosure, continuous disclosure, would be denied to us—certainly actions of directors and officers. Their diligence and care as officers and directors would be denied to us, as would acts of omission. We have only commenced our investigation in a very preliminary manner. I think we have some 200 boxes of information. We are in the process of trying to make arrangements for access to electronic information. It could potentially take us between one and two years to receive all the electronic information. It is very early days as yet as far as our investigation is concerned, but it is clear that it is important for us to have the opportunity to look at the civil penalty opportunities for prosecution as well as at the criminal areas.

CHAIR—Has ASIC been involved in the compensation agreement negotiations with the New South Wales government and James Hardie?

Mr Lucy—Not directly. We have had close dialogue, particularly with the New South Wales government and to a lesser extent with the ACTU, but we have not been a party to those discussions.

CHAIR—When was ASIC first made aware by the New South Wales government that it was proposing to extinguish civil penalty liability for the directors of James Hardie?

Mr Lucy—We have not formally been advised by the New South Wales government that that is indeed their approach. We have received a letter from the solicitors acting for James Hardie—I think on around 9 May this year. That was the first indication we had that there were discussions between James Hardie and the New South Wales government to seek to achieve the removal of civil penalty but, at this stage, we have not received formal advice from the New South Wales government.

CHAIR—Are you seriously telling us that the New South Wales government has announced an intention to legislate to remove a liability which will potentially seriously prejudice your investigations without so much as notifying you of its intention to do so?

Mr Lucy—In a formal sense, that is correct.

Senator WONG—‘In a formal sense’—what does that mean? Does that mean there has been informal contact?

Mr Lucy—Since 9 May we have had officer-level discussion around the fact that this is something the New South Wales government are looking at, but they have not come to us to say, ‘We are proposing to pass legislation.’ My observation about the attitude of the New South Wales government is essentially what I read in the newspapers.

CHAIR—Let us indulge you here. What is your view as to the way in which the New South Wales government have gone about this and what they propose to do?

Senator WONG—Chair, aren’t you asking him for an opinion?

Mr Lucy—As I said earlier, I think that the New South Wales government have provided a significant leadership role in getting the negotiations to where they were at Christmas. Since then, as far as we were aware the discussions were rolling forward to convert the heads of agreement into something which was binding, ultimately requiring the approval of the company and its shareholders. As I said, early in May we received advice from the James Hardie lawyers that they were in discussions with the New South Wales government to seek specific release of civil penalty provisions. I wrote to the Premier and subsequent to that there have obviously been articles in the press, which you referred to. My reading of those articles, as they are attributed to the Premier of New South Wales, indicates that he has some sympathy for the withdrawal of the civil penalty provisions.

CHAIR—Has the Premier replied to your letter?

Mr Lucy—I have not received a reply.

CHAIR—When did you write to him?

Mr Lucy—I believe it was last week.

CHAIR—It has been reported that the New South Wales government always envisaged the extinguishment of civil penalty liability for James Hardie directors and officers. Is that ASIC's understanding of the position?

Mr Lucy—No, it is not.

CHAIR—What is your understanding of the position?

Mr Lucy—Our understanding is that it was always contemplated that civil action would be excluded but not civil penalty.

CHAIR—Is it correct that the heads of agreement neither contemplates nor requires the release of civil penalty liability?

Mr Lucy—That is our reading of the heads of agreement, and senior counsel has confirmed that.

CHAIR—Is there any link between the extinguishment of civil penalty provisions for directors and officers of James Hardie and funding for asbestos victims?

Mr Lucy—In our view there is no link.

CHAIR—Thank you.

Senator MURRAY—I have a question.

CHAIR—Arising out of that?

Senator MURRAY—Yes.

CHAIR—Then Senator Fifield has some questions.

Senator MURRAY—Mr Lucy, I wish to amplify this matter because it confuses me a little. New South Wales law affects only New South Wales, doesn't it?

Mr Lucy—Yes, it does.

Senator MURRAY—So why is it not possible to prosecute these directors for actions taken in Victoria, for instance, in Victorian courts?

Mr Lucy—The place of incorporation is the key. James Hardie was incorporated in New South Wales.

Senator MURRAY—But if the events which affect complainants—the people affected by asbestos poisoning—occur in all the jurisdictions of Australia, which they do, surely you are still able to pursue them in those other states?

Mr Lucy—No, because what we are talking about in the civil penalty area is the action of directors and officers.

Senator MURRAY—Which results in this poisoning?

Mr Lucy—No. It was the company transactions that resulted in the poisoning. That is why the civil penalty provisions or the compensation are very much part of that.

Senator MURRAY—That is right. It is a chain of events.

Mr Lucy—No, the likelihood is that the actions of the directors and officers, in undertaking activities which would be relevant for civil penalty, would not necessarily be

traced down to the actual sale of asbestos. It would be more to do with market issues, directors' issues, compliance issues and financial accounting type issues, as distinct from the actual sale of the asbestos.

Senator MURRAY—So you cannot take the link to the affected persons who will be in those jurisdictions?

Mr Lucy—It is not our expectation that we could.

Senator FIFIELD—Mr Lucy, did the government provide additional resources for the James Hardie investigations to ASIC in this year's budget?

Mr Lucy—Yes, it did. In the additional estimates for the 2004-05 current financial year we received in aggregate \$4.28 million. In the budget announced in May for the 2005-06 year we received specific funding of \$3.4 million.

Senator FIFIELD—The parliament passed special legislation to allow full investigation of the group's directors and its officers. You mentioned, in response to previous questions, that your investigations would be seriously compromised if New South Wales did extinguish civil penalty liability for directors and officers. Are there any additional public policy problems with extinguishment, from your point of view? Are there any additional issues that would arise?

Mr Lucy—Jeremy Cooper will make a comment on that. I will just say that indeed there were two pieces of legislation: there was legislation passed in the New South Wales parliament as well as the legislation passed in the federal parliament. They are both dealing with privilege and access to documents.

Mr Cooper—The two public policy issues are, firstly, that the passage of state legislation effectively to exclude matters from the Corporations Act is a fairly serious step. It seriously affects the national operation of the scheme and raises a number of uncertainties particularly as to whether other states have to follow suit in order to make the coverage complete.

CHAIR—Sorry to interrupt, Mr Cooper, but is it unprecedented for a state to legislate specifically in relation to a particular corporation to exclude civil penalty liabilities for directors and officers?

Mr Cooper—I believe not.

Mr Lucy—I think we will have to take that on notice. I am not aware of any other incidents. It has certainly not been brought to my attention that there is such a precedent. We need to take that on notice to be categorical.

CHAIR—Please take that on notice.

Mr Cooper—That in fact leads to the second point I was going to make: the concerning precedent that in future, in the case of a corporate collapse or wrongdoing by directors, one possible way that companies would approach this would be by seeking to effectively do deals with state governments to withdraw themselves out of the Corporations Act specifically in relation to civil penalties.

Senator FIFIELD—So it is a shocking precedent for a state government to set?

Senator WONG—That is asking the witness for an opinion.

Mr Cooper—I support what the chairman said, in that obviously the New South Wales government has shown the initiative and gone a very long way down the track. Our position is that we see no logical reason for the directors to be given relief in this respect. It does not, in our view, affect the ongoing viability of the company. We are not talking about large sums of money, so we are not affecting the viability of the company going forward. We are simply wanting to keep our jurisdiction to punish wrongdoing by directors if in fact that has happened.

Senator FIFIELD—ASIC's investigation and the potential outcomes will be a significant test of current provisions and measures dealing with corporate disclosure, accountability and responsibility. If ASIC's investigation is restricted, as proposed by New South Wales, will this undermine the test of the current provisions of the Corporations Act?

Mr Lucy—It will mean that ASIC will not take forward civil penalty proceedings against the directors and officers of James Hardie. So to the extent that the community does not get the benefit of that precedent and that airing, then of course it does prejudice the act.

Senator FIFIELD—Would community confidence in the Corporations Act be undermined if the law did not apply equally to those who have breached civil penalty provisions?

Mr Lucy—Our role as a regulator is to deal with the law as it is provided to us. Clearly, the area of confidence in the financial markets is a matter that we are entitled and obliged to have a keen interest in. Anything that undermines that confidence obviously will have a negative effect—and arguably not just in Australia, because the markets these days are essentially international. Such a consequence would almost certainly have a ripple effect around the world.

CHAIR—I find it extraordinary, Mr Lucy, that a state government could legislate in a manner which constrains and compromises the capacity of a law enforcement agency or regulator to enforce the law without so much as consulting the regulator at an early stage to attempt to explain to it the special circumstances of why in its eyes such legislation was desirable. What do you say to that?

Mr Lucy—I cannot speak for the New South Wales government.

CHAIR—You are in charge of the regulator whose investigative powers, on your evidence, have been compromised.

Mr Lucy—Potentially. That is exactly the background to the reason why I wrote to the Premier. Obviously I was extremely concerned. We considered it at length within our agency and looked at alternatives, and we felt that there was no alternative but to write in a formal sense to the Premier.

CHAIR—I do not want to labour the point too much. There is obviously a merits issue, but there is a process issue as well. If your capacity to investigate serious corporate fraud is being undermined by a state government acting for reasons which presumably are persuasive to them, you would think that at least they would have engaged you before they proceeded to attempt to do this?

Mr Lucy—I guess the only clarification is that at this stage, to the best of our knowledge, they have not proceeded to do it. They have been encouraged to do it, and the Premier and

others within the New South Wales government have made indications in the press that they propose to do it; but, whether or not that is going to be their final determination we are yet to see.

CHAIR—It is a shame that you had to read about it in the newspapers.

Senator MURRAY—This would be retrospective legislation, wouldn't it?

Mr Lucy—In effect it would be, because we are looking at transactions that have occurred many years back; therefore by taking out the provisioning from 2001 it effectively is retrospective.

CHAIR—It is a retrospective excusal.

Mr Lucy—Yes.

Senator WONG—There are a number of issues there, Mr Lucy. The first is that, from your first answer, I take it that you are comfortable with the extinguishment of civil liability in the broader context of the package?

Mr Lucy—Yes.

Senator WONG—You are aware that the agreement reached between James Hardie, the New South Wales government, victims groups and the ACTU is for in excess of \$1.7 billion in compensation?

Mr Lucy—Yes.

Senator WONG—You would agree also that that is a far greater amount of compensation than ASIC is ever likely to get through any civil proceeding against the directors, given the history of how much money you generally get through such processes?

Mr Lucy—Against the directors—I think that is a fair comment.

Senator WONG—And against the company, presumably, you would also have the issue if you achieved that kind of settlement—which, in my recollection of this area, would be unprecedented—of the ongoing viability of the company, which is important for the income stream for compensation for victims. Correct?

Mr Lucy—Correct.

CHAIR—I want to clarify something. When you say civil proceedings by ASIC you mean civil penalty proceedings?

Mr Lucy—No. I do not think—

Senator WONG—Both.

CHAIR—Both?

Mr Lucy—Yes.

CHAIR—The difference between criminal proceedings, civil penalty proceedings and civil proceedings is very important to this discussion and I think the distinctions should be made as plain as can be in the questions.

Senator WONG—But you would agree that, in terms of the history of litigation in these sorts matters, you would be unlikely to achieve that kind of recovery, of \$1.7 billion, through civil proceedings?

Mr Lucy—Certainly the quantum that has been potentially secured is manifestly greater than any compensation we have previously been able to recover.

Senator WONG—That is right. You would also be aware that when this matter was debated in this parliament, in relation to legislation on the removal of privilege, one of the issues that concerned all parliamentarians in this place was timeliness. A great many victims of asbestos related diseases are dying every month.

Mr Lucy—Regrettably, that is the case.

Senator WONG—So the timeliness of compensation for the victims and their families is obviously an issue of great priority, is it not?

Mr Lucy—Clearly.

Senator WONG—You also made the comment that you have preliminary advice, and by that I assume you do not have advice that you would make public or make any statements about yet regarding the effect of the heads of agreement.

Mr Lucy—No, I have formal advice about the heads of agreement. The preliminary advice that I was referring to was specifically as to how that might prejudice any action for criminal.

Senator WONG—Have you forwarded that formal advice to the New South Wales government?

Mr Lucy—No.

Senator WONG—Are you intending to?

Mr Lucy—I have offered to meet the Premier.

Senator WONG—Are you intending to forward the legal advice?

Mr Lucy—I would take the advice with me. I would not forward it in advance of any meeting.

Senator WONG—Are you aware at whose insistence the issue of civil liability was included in the heads of agreement?

Mr Lucy—When you say ‘included’ do you mean included by specific reference that it was not to apply?

Senator WONG—Correct.

Mr Lucy—No, we were not a party to that. So I am not able to answer at whose insistence it was.

Senator WONG—But surely you would be aware from the public discussion of this and from the fact that you have correspondence from the solicitors for James Hardie that this issue was put very strongly by the James Hardie directors.

Mr Lucy—I accept the point you are making. I am not able to respond.

Senator WONG—Whilst I do not agree with the position they took, this is what they put on the table as one of their significant and key demands for what is a very large sum of money that goes to victims' families.

Mr Lucy—I want to restate that our attitude at ASIC is that we warmly support the agreement that was struck around Christmas and we continue to. We have no ambition to do anything or put up anything that might prejudice that going forward. ASIC did not disagree with the contemplation for the separation of civil liability in the original heads of agreement.

Senator WONG—You are saying that civil liability is different from civil penalty?

Mr Lucy—I am.

Senator WONG—The agreement refers to civil liability—

Mr Lucy—It does.

Senator WONG—so I assume there would be an argument, including about what was agreed, that what was actually sought by the James Hardie directors was extinguishment of penalty provisions—not criminal, but civil—in addition to civil liability claims.

Mr Lucy—That may be something the James Hardie directors now state, but that is certainly not our understanding of what the heads of agreement contains nor of subsequent discussions and comments made by the New South Wales government.

Senator WONG—That is one of the reasons I am asking whether the legal advice that you have has been sent to the New South Wales government because, given how strongly that government have been critical of James Hardie and how much work they undertook to ensure that money was actually made available for victims, I cannot see that they would easily extinguish something they did not have to.

Mr Lucy—I think that is the point. They did not extinguish civil penalty; they only extinguished civil. And we are totally comfortable with the logic of extinguishing civil on the basis that there is adequate compensation provided in the long term.

Senator WONG—But I understood your suggestion and the suggestion that Senators Brandis and Fifield are making is that there is a proposition to extinguish civil penalties. I have not seen legislation to that effect or any indication other than what is in the media, but my suggestion to you is that, obviously, if that is the case there is an alternative legal view about what flows from the heads of agreement and the reference to civil liability.

Mr Lucy—If there is we have not seen it. All I am able to refer to is what we have seen and what has been communicated to us, and that was quite clear that there was a contemplation of civil but not civil penalty.

Senator WONG—You said you had a letter from the solicitors for James Hardie on 9 May. Was that matter referred to the Treasurer or any other member of the government?

Mr Lucy—To the best of my knowledge, no, but I should take that on notice to make sure that I give you a definitive answer.

Senator WONG—Has there been any contact by ASIC with the Treasurer regarding this issue in the last month?

Mr Lucy—Yes. The letter that I sent to the Premier of New South Wales I copied to the Treasurer and marked on my letter to the Premier of New South Wales the fact that I was forwarding it to the Treasurer.

Senator WONG—When was that—last week?

Mr Lucy—Yes, the same day.

Senator WONG—Was that the only contact—

Mr Lucy—I am reminded it might have been Friday the week before.

Senator WONG—Was that the only contact you have had with the Treasurer's office about this?

Mr Lucy—They have sought clarification as to what some of the issues are associated with this and what the consequences would be for our agency, but that is the extent of the communication.

Senator WONG—In your correspondence to the Premier did you put the view that your legal advice is that the heads of agreement does not require the extinguishing of civil penalties as opposed other civil claims?

Mr Lucy—Yes, we endeavoured to make my letter to the Premier as explicit but as carefully framed as possible.

Senator WONG—In terms of your advice as to the prejudicing of criminal proceedings, I have to say I did not quite understand your answers about that. On what basis is it asserted that the extinguishment of civil liability generally, including civil penalties, would prejudice criminal proceedings?

Mr Lucy—I think I have mentioned that at this stage we have only received preliminary advice. The commission have sought formal senior counsel's advice, which we are yet to receive, but the preliminary advice indicates that almost certainly it will cause prejudice against any criminal follow-up that we might undertake, and in discussions—

Senator WONG—Criminal follow-up, did you say?

Mr Lucy—Yes.

Senator WONG—Meaning a criminal prosecution subsequent to civil proceedings?

Mr Lucy—Yes.

Senator WONG—That is just not having a test run, isn't it?

Mr Lucy—The explanation I have received is that if we were taking criminal action against a particular party then the witnesses which we would almost certainly need to bring forward to prove the criminal conduct would be parties that may well have been specifically quarantined because of any removal of civil penalty provisions. In that event, the parties in which we would be taking criminal action would then have cause to suggest that those people were tainted and so therefore the evidence that they would provide would be materially adjusted in the court. That is the preliminary advice that I have received and I am not able to say to you categorically that that is the firm position. In anticipation for today I have sought

clarification as to whether or not the formal advice is likely to be consistent in that regard and I am advised that it is, but I am yet to receive it.

Senator WONG—I have to say there is nothing in terms of the legal documentation which would preclude ASIC from pursuing criminal proceeding against the James Hardie directors and officers.

Mr Lucy—At the end of the day what we need to do is to be sure—

Senator WONG—But that is the case, isn't it, in terms of what is in the heads of agreement?

Mr Lucy—If there is criminal conduct there, it is a question of what we need to be able to do to successfully prosecute it or that the DPP would need—indeed, in the first instance, they would need to be willing to take on the matter and then successfully prosecute it in court.

Senator WONG—Is your concern more that your preference would be to take civil proceedings which obviously bear an easier standard of proof rather than criminal proceedings?

Mr Lucy—No. ASIC have not historically demonstrated any convenience in our approach. Our attitude is that if people are capable of being prosecuted criminally, we do so. In particular, in an area such as this where officers and directors have direct responsibilities to the company then invariably they are an area of prosecution which we look to.

Senator WONG—Obviously the issue of what was actually agreed is something that still needs some investigation. I cannot comment on that. I do not know what the New South Wales government's view is and I have not seen your legal advice, I only have your evidence today. But obviously the concern for victims would be that there is a very substantial amount of money which, if the agreement is not proceeded with, will not flow in to the families of those who are dying or who have died.

Mr Lucy—We have a very clear understanding of that and totally accept the perspective that you are bringing. The advice that I have received is that the civil penalty possibilities should not in any event, in any manner, set aside the ongoing asbestos arrangements.

Senator WONG—And that is the basis on which ASIC is proceeding—

Mr Lucy—Correct.

Senator WONG—to try and preserve the integrity of the heads of agreement. As I understand your evidence, Mr Lucy, you are very aware of the benefit of the agreement.

Mr Lucy—And the importance of it.

Senator WONG—That is clear. I presume there is no indication from the federal government that they are going to stomp up \$1.7 billion if the agreement does fall over?

Mr Lucy—I cannot answer for the government.

CHAIR—I want to ask a couple of questions arising from Senator Wong's questions. What is the maximum civil penalty available under your act for directors and officers?

Mr Lucy—To my recollection, the fine is \$200,000 per event and suspension. The suspension is unlimited so, for example, it could be a lifetime.

CHAIR—I mean in monetary terms. What is the maximum single penalty?

Mr Lucy—It is \$200,000 per event.

CHAIR—That is the fine.

Mr Cooper—As with things legal, there is one slight twist there. There is also the ability to seek compensation through the civil penalty system. Consistent with the philosophy of the agreement, ASIC would, depending on the mechanics, not seek to come through the backdoor and collect compensation under that regime. So we are talking about banning and the \$200,000 fine.

CHAIR—The reason I asked that is to illustrate the point that the civil penalty is not meant to be compensatory. It is limited by a statutory ceiling.

Mr Cooper—Yes, the High Court has told us that it is punitive rather than compensatory.

CHAIR—That is the point I was going to make. It is punitive not compensatory, so comparisons between civil liability and civil penalty are inapt, are they not, because a civil liability *ex hypothesi* is designed to compensate whereas a civil penalty *ex hypothesi* is designed to punish?

Mr Cooper—That is our view.

Senator MURRAY—On the heads of agreement arrangement, the understanding that they have arrived at: is it the intention of the company to put that to its shareholders for approval?

Mr Lucy—Yes, that is the case.

Senator MURRAY—Depending on how they present it of course—it could be broken up into its constituent parts—it is perfectly possible for the shareholders, recognising their financial liability, to reject the directors' claim for the civil penalty waiver, isn't it?

Mr Lucy—I do not believe that is the case, in that if the New South Wales government successfully passed legislation then I think it beyond—

Senator MURRAY—Let us assume that the New South Wales government did not put the legislation forward.

Mr Lucy—Then that would not be put to the shareholders at all.

CHAIR—Because it would not arise.

Mr Lucy—No.

Senator MURRAY—But my point is that the shareholders could be asked prior to the legislation going through. As you know, legislation takes some time to present and to be passed. It would seem to me that the missing element in this discussion is what the shareholders think of this proposed arrangement. They might find that the behaviour of directors representing them affronts them as much as it does the community at large and would not want to see them have a waiver.

Mr Lucy—Certainly it is not usual for those sorts of questions to be put to the shareholders for them to determine because amongst the myriad of shareholders you would have different interests and different expectations. Indeed, James Hardie now is a company resident in the

Netherlands. So the attitude of the shareholders is something that frankly I do not think anyone could predict.

Senator MURRAY—Does ASIC have any powers when a proposal is put to shareholders to require or to influence how that is presented?

Mr Lucy—It needs to be clear and concise.

Mr Cooper—I think that is the only answer. We have a power to compel that the information given to shareholders is clear, concise and effective, but really no further than that.

Senator MURRAY—I would just be surprised, given the community attitudes, if shareholders did not share them. They are up for the 1½ billion whatever happens but they might not want to let off those who led them into this.

CHAIR—I gather from what you said earlier, Mr Lucy, that your principal concern about this is not so much that ASIC's opportunity to chase a civil penalty may be lost but the potential consequences of that for criminal prosecutions that ASIC might bring and the risk posed to the success of those prosecutions. Is that right or is it both?

Mr Lucy—I think that both are relevant. ASIC's view is, and we think that the community would expect, that if directors and officers have undertaken activities such that they would breach civil penalty requirements they would be prosecuted and fined and/or suspended. That would be a reasonable community expectation.

CHAIR—So you would be deeply concerned about any special act of a state parliament which hazarded the success of a criminal prosecution?

Mr Lucy—Yes, we would.

Mr Cooper—Not so much hazarding the criminal prosecution but potentially—and, again, this is completely hypothetical—it may have the effect that there is really no consequence whatsoever. If, in fact, the conduct that was the subject of the Jackson committee inquiry and our investigations is entirely civil under the penalty regime and not criminal, this may have the effect of neutralising the entire investigation and the outcome. That is completely hypothetical. But, if you read the Jackson report and look at the sort of conduct that is talked about, it is more likely—and I am speaking very generally here—to be in the breach of duties sort of camp than the outright dishonest. That has to be taken into account.

Senator WONG—There are two issues. As I understand your position, Mr Lucy, you are saying you feel comfortable with the extinguishing of civil liability in the interests of the benefits of the agreement, particularly to victims and their families?

Mr Lucy—Yes, and indeed the certainty that it also frankly provides to the company.

Senator WONG—Correct.

Mr Lucy—And the sustainability of the company.

Senator WONG—Yes, but your concern is really predicated on legal advice that says that the agreement does not require the extinguishing of the civil penalty provisions?

Mr Cooper—That is correct.

Senator WONG—I note that the New South Wales government has talked about civil liabilities generally, so I am not sure to what extent that extends to the civil penalty provisions. But, if that issue were resolved, and if the legal advice was that the head of agreement does extend to civil penalties, would your desire to hold the agreement together be retained or would you change your position?

Mr Lucy—We have not considered it in that light.

Senator WONG—It is another hypothetical, but Mr Cooper seems to be willing to deal with them.

Mr Lucy—I am not quite so anxious to look at the hypothetical because my initial reaction is that I would be very loath to do anything that would put at risk the achievement of the outcome of the settlement for the asbestos victims. But the advice I have received to date is very clear that that is not a risk.

CHAIR—It strikes me as strange, given the magnitude of money involved in the settlement of the potential civil claims of the victims, that an extinguishment of the civil liability of the directors was an element of the agreement at all. Do you have a view about that?

Mr Lucy—My understanding is that the civil liability essentially is with the company. It is a civil penalty that is with the officers and the directors. So, to the extent that there was waiver of civil liability on the basis that the victims were to be compensated over a 50- or 60-year period, that sits very comfortably with us. We see no lack of logic with that.

CHAIR—I understand that, but my point is: why did the directors have to be looked after in this way if it is a straight-up settlement between the company and the victims?

Mr Lucy—I guess that is the hub of our point.

CHAIR—It seems very strange indeed to me.

Mr Cooper—One important point to make is that, when we talk about the directors—

CHAIR—And the officers too.

Mr Cooper—The point I am making is that a number of them are former directors, who have nothing whatever to do with the ongoing running of the company.

Senator MURRAY—Exactly—which is why the shareholders should be asked their opinion.

CHAIR—And why the regulator's views should be had regard to, too, I would have thought. Are there no other questions on this topic? Then we will move to other topics.

Senator SHERRY—My question concerns the impact of FSR, where advice is given by a non-licensed adviser. What is your understanding of the penalties that apply?

Mr Cooper—There are really two regimes, I suppose—one under the ASIC Act and one under the Corporations Act. The penalties under the ASIC Act are considerably higher than under the Corporations Act.

Senator SHERRY—What are they?

Mr Cooper—Under the Corporations Act I believe we are talking about \$220,000. Are you talking about pure and simple unlicensed advice or unlicensed advice that is misleading? It depends which camp the breach falls into.

Senator SHERRY—Let us deal with both camps. What are the penalties for each camp of advice?

Mr Cooper—If we are going into the specifics and going into each act, I guess I would have to take that on notice to make sure I give you absolutely the correct answer.

Senator SHERRY—My understanding is that it is two years in jail and/or a \$22,000 fine.

Mr Cooper—That will be the Corporations Act; when you move to the ASIC Act, it increases.

Senator SHERRY—So it is higher under the ASIC Act?

Mr Cooper—Yes.

Senator SHERRY—Has ASIC considered the implications where an employer gives advice to an employee about superannuation choice of fund which is outside the terms of the choice of superannuation fund act?

Mr Cooper—Is this advice about the employer's own fund?

Senator SHERRY—Any sort of advice about superannuation that an employee asks of an employer that is outside the terms of the choice of funds superannuation legislation.

Mr Cooper—And the employer is unlicensed?

Senator SHERRY—And the employer is unlicensed.

Mr Cooper—There is a proposal as part of the FSR refinements that a product issuer is able to give advice about its own product. So, where you have members of a fund seeking advice from the trustee, that is dealt with.

Senator SHERRY—But that is not the employer in most circumstances.

Mr Cooper—I think employers have quite clearly been told that, unless they have a licence, they should not be giving advice about superannuation.

Senator SHERRY—And if they do they face the series of penalties that we discussed earlier.

Mr Cooper—Correct.

Senator SHERRY—This fund choice will involve some hundreds of thousands of employers and approximately five million employees. After 1 July, what will be the circumstance if an employee asks an employer for advice about which fund they believe is best that is not within the terms of the superannuation choice legislation? Prima facie, that would be a breach if the employer responds and gives advice, wouldn't it?

Mr Cooper—No, not really, because we have to look at whether the employer is getting a reward for that. Is the employer being remunerated? I imagine not.

Senator SHERRY—No, I mean if they are.

Mr Cooper—That would be a very unlikely circumstance.

Senator SHERRY—We do not know that, but if they are.

Mr Cooper—With respect, I think we are moving into hypotheticals.

Senator SHERRY—You volunteered a mighty big hypothetical earlier.

Senator WONG—You set the rules, Mr Cooper.

Mr Cooper—It would be unusual for an employer to charge an employee for superannuation advice, but let's assume they do. If they are carrying on the business of giving advice without a licence, then they are potentially in breach. Our position is going to be quite generous in this area. There is absolutely no way in the world it assists us or the system to be seeking to cart employers off to jail for trying to help their employees. The provisions say that, but there is no way—

Senator SHERRY—Sorry, the provisions say that—

Mr Cooper—We talked about the two-year jail sentence, didn't we?

Senator SHERRY—Yes, and the fine.

Mr Cooper—There is no way we would spend taxpayer money on carting genuine employers off before the courts under those sorts of circumstances.

Senator SHERRY—Shouldn't the law be changed to ensure that this does not happen?

Mr Cooper—Ultimately, when the system beds down, I think there will be very limited situations where employers are in that zone. Clearly, as we move into the phase, I imagine there will naturally enough be situations where that does occur. But do not forget: where an employer does that without reward and not as part of carrying on a business, strictly speaking they are not technically within the regime.

Senator SHERRY—Don't you think it is likely that, of the millions of employees who are receiving information about choosing a fund, at least some of them are going to ask employers for advice?

Mr Cooper—Yes, I do. That would be only natural.

Senator SHERRY—And at least some of the advice they ask for will be outside the terms of the choice of funds superannuation legislation.

Mr Cooper—Again, that is reasonably likely, particularly in the early stages.

Senator SHERRY—I put to you a situation where an employer has entered into some sort of arrangement—I will get to the legality of such an arrangement, but I believe some arrangements are legal, and we will explore that later—where the employer receives a benefit from a superannuation fund that is legal. Granted there are arguments about what is legal and what is not. What if the employer then gives advice to the employee and the employer has received a benefit from the giving of that advice which is outside the FSR Act?

Mr Cooper—Again, without wanting to prejudge our position in any particular case, I guess that is moving more into an area where some form of enforcement action might be appropriate.

Senator SHERRY—If an employee comes to you in a year or two and says, ‘I was given this advice to go into this particular fund,’ and there is some form of legal inducement to the employer, would you view that at a more serious level?

Mr Cooper—I think we would be expected to, yes. But, as you know, we have jurisdiction to monitor what Peter called the kickback provisions.

Senator SHERRY—I am going to get to the kickback issues more generally later. I am just looking at the issue where, not unnaturally, some employees at least are going to seek advice from the employer. What about when in a year or two—maybe even longer—the employee comes to ASIC and says, ‘I was given advice by the employer. There is no inducement but the rate of return and/or the fees are now clearly to my disadvantage.’ Do you regard that as a more serious level of advice?

Mr Cooper—It would be. However, you need to look at the steps in between that advice and what actually happens. Typically, the employee would go off and be given a product disclosure statement and there would be a number of intervening steps between some form of recommendation that the employer might give and the actual entering into a switch or an investment in a particular fund. What we are saying to consumers is that there are any number of sources of advice—coming from government and advisers and individual product issuers—and they are to do the best they can to consider all of those things rather than just what someone might tell them.

Senator SHERRY—Until recently at least, there was some confusion—in fact, I believe outright denial by ASIC, APRA and the tax office—as to who precisely was to enforce the third line forcing provisions in choice of fund. I am aware of statements being made by all three regulators at one time at a conference in Hobart all denying responsibility for this. Are you aware of the confusion that caused?

Mr Cooper—I am aware of the issue because we have talked about this on previous occasions. The ASIC view is that third line forcing is an exclusive dealing matter that really comes from the Trade Practices Act and is the ACCC’s responsibility. There is a slight gloss on that in the sense that we have a MOU with the ACCC and they can ask us to provide information about third line forcing that might be happening in the financial services sector.

Senator SHERRY—Isn’t it true that the latest amendments to the choice of fund legislation shortly to come before the parliament specifically nominate you, ASIC, as responsible for enforcing this provision?

Mr Cooper—If it does I must admit I am not aware of it.

Senator SHERRY—I must say I am a bit shocked if you are not!

Mr Cooper—That surprises me in the sense that it has never been our jurisdiction before and, as I say, conceptually it is a competition law matter. It is not something that really is on our horizon. But if you are telling me that it is in some not-yet-passed law then I am not aware of that.

Senator SHERRY—So ASIC was not consulted about the latest amendments to the law in this regard?

Mr Cooper—It has obviously been the subject of the Dawson inquiry and potential changes to the Trade Practices Act, but I was not aware that it had come into our jurisdiction.

Senator SHERRY—I must say I am a bit taken aback that we have a bill before parliament that gives you the power and you do not know about it yet.

Mr Lucy—We should take that on notice.

Mr Cooper—We will have to take that on notice.

Senator SHERRY—It leads to a whole series of questions about your preparation to enforce the third line forcing provisions, about your resourcing, and about what inspection you are carrying out at the present time in respect to third line forcing in the context of superannuation choice. If you do not know that you are going to be doing it, how are you going to enforce it?

Mr Cooper—We will have to take that one on notice.

Senator SHERRY—Minister, can you throw any light on this?

Senator Minchin—I cannot, Senator. I will seek some further information if you like, but I do not have it to hand.

Senator SHERRY—We touched earlier on what I would call legal third line forcing arrangements. I want to deal with a particular issue that I have written to ASIC about, and a particular case which involves the retail industry superannuation fund in Tasmania. Are you aware of that case?

Mr Lucy—I am aware of a couple in Tasmania, so if you would go a bit further that might help us to identify which one.

Senator SHERRY—I will give you a very brief summary. The retail association has an arrangement with a master trust whereby, using Australian workplace agreements, the employees—they have no option; there is no choice—are required to join the Retail Traders Association's superannuation fund, which is a master trust arrangement. I do not know the company that is providing the master trust service. In return, the Retail Traders Association receives a part of the commission that the planner receives for this arrangement. It seems to me that this arrangement is probably legal. There is a requirement for the employees under the AWA to join that fund; there is no choice. The financial adviser who has arranged the arrangement with the retail master trust receives a commission, and part of that commission is rebated to the employer organisation. I wrote to ASIC and APRA about this about seven or eight weeks ago. I have received an acknowledgment; I am not expecting a response. But would the situation that I have described be, in your view, a legal arrangement—for a commission payment to an employer?

Mr Cooper—Firstly, I do not think it is third line forcing.

Senator SHERRY—I think it is a form of third line forcing, but—

Mr Cooper—I guess that is a difficulty with third line forcing: it is somewhat esoteric and does not always—

Senator SHERRY—It is a general description, but—

Mr Cooper—I guess it is a matter of disclosure. Are the employees being told where this commission is going? Who in this scenario has got the financial services licence? It becomes quite quickly complex to determine.

Senator SHERRY—But, in a circumstance where an individual is denied choice, and under choice of fund legislation there is a range of carved-out categories—I will not go to the others; they are known—it is not a total choice situation; there are carved-out categories. Indeed, a trade union could have the same arrangement. Is it appropriate for another party to receive a commission payment in return for the granting of a non-choice arrangement?

Mr Cooper—It would depend on how that commission was made up, why it was being paid and what level of disclosure had been made. It sounds unusual; I will grant you that.

Senator SHERRY—I look forward to the conclusion of your investigation. It seems to me that the principle of a commission going to any organisation that has some form of authority to override choice is an undesirable approach. You are nodding; I take it you agree?

Mr Cooper—No. As a broad concept, I accept that.

Senator SHERRY—Good. At the last meeting, Mr Lucy, I raised the issue of self-managed superannuation funds and the role of accountants. You indicated words to the effect that ASIC had no jurisdiction in this area—not so much no interest but no legal jurisdiction. Since then, I have noticed a press statement on Monday, 16 May—not that long ago—headed ‘ASIC to keep a close eye on accountants’ advice about self-managed superannuation funds’. It seems to me to be somewhat of a shift in ASIC’s view about the role of accountants giving advice about superannuation.

Mr Lucy—I will initially respond and then Jeremy can take over. It is fair to say that we have had somewhat of a shift, in that it became apparent to us that there were accountants giving advice about self-managed superannuation funds that fell outside their exemption and very much went to the heart of the products themselves. So we decided two things: firstly, that we would issue press releases through Jeremy that specifically addressed that issue and had a very clear focus about it, including involvement with the professional accounting bodies. Separately, the Commissioner of Taxation and I have also issued some fairly precise advice to the community broadly as to what we think are some of the issues that should be considered by persons contemplating investing in self-managed super funds. We think it is a very important area and that there needs to be perhaps a greater focus on it than there might have been in the past.

Senator SHERRY—I noticed that the latter advice to the community—‘Four key questions about self-managed super funds’—was issued on Sunday, 22 May. Is that what you are referring to?

Mr Lucy—Yes.

Senator SHERRY—There are hundreds of thousands, if not millions, of Australians who are going to accountants who may or may not be given advice about superannuation and the possibility of setting up a self-managed superannuation fund. How is this going to be communicated to those consumers in the context of super choice?

Mr Lucy—Like all of these areas it is a matter of public awareness. We and the government, particularly through the tax office, are being very forthright in providing advice to consumers—

Senator SHERRY—I am not criticising your lack of forthrightness in this case. I am actually concerned about your forthrightness and your communications getting through to consumers, many of whom go to accountants.

Mr Lucy—That was really the point which we picked up on—and you are right. Our concern was that accountants were giving advice for people to establish self-managed superannuation funds where the quantum of the investment was blatantly inadequate to justify the ongoing costs and provide a decent return. So, in that instance, notwithstanding the fact that the accountant may not necessarily breach FSR specifically, we felt that they had a duty of care to their clients, and we said that if we came across such instances we may well prosecute—and that remains our position.

Senator SHERRY—How are you going to enforce this? Are you going to be inspecting something which, on the face of it at least, seems to us very unreasonable? I am talking about someone who is in a small self-managed superannuation fund involving a balance of, say, \$20,000, \$30,000, \$40,000 or \$50,000, which I think, on all the available data—and you may agree—is simply too small. How is this going to be checked and enforced? On the last APRA statistics, we are dealing with 289,000 funds growing at an exponential rate.

Mr Lucy—But not all of that number are necessarily inappropriate funds.

Senator SHERRY—I accept that.

Mr Lucy—Coming back to your point about how we are going to enforce, the first area is through complaints. It is inevitable that we will be receiving complaints from parties who have established self-managed super funds and determined very quickly that the advice they received from their accountant was inappropriate and the ability to attract adequate returns is not really there. In those cases, we will investigate and may well take action against the accountants.

Senator SHERRY—How would the everyday consumer know that the return is inadequate, the fees are too high or some combination of the two?

Mr Cooper—Generally speaking, they would not know. I guess that is why—

Senator SHERRY—That is what concerns me.

Mr Cooper—Unfortunately, superannuation is a complex topic. The reason for making that particular release was that we wanted to put pressure on the professional advisers to remind them what they have to do when they talk to consumers.

Senator SHERRY—I was going to get to the shadow-shopping exercise. Are you including accountants in that shadow-shopping exercise you announced?

Mr Cooper—I must say the trend whereby ASIC is in a position where it has to broadcast all of its surveillance tools, when it is going to be doing things, what outcomes and so on is perhaps not always in the best interests of our surveillance and enforcement activities.

Senator SHERRY—It may not be, and therefore I may have to pull some more questions that I have on the issue later on, but, given that this is an identified risk area, will accountants be included in the shadow-shopping exercise?

Mr Cooper—I think it is a potential risk area. We wanted to make clear in the release that it was not as if we were aware of huge breaches in this area.

Senator SHERRY—I see them advertised. I see advertisements in the financial press, such as ‘Take control of your own destiny’, ‘Take ownership of your super with a small superannuation fund’—I see them time and time again.

Mr Cooper—I have seen those ads, but I must say that generally speaking it is our experience that they are not coming from the accounting professions but from businesses that are specifically in that area and typically they will have to have licences. They are a concern, but, going back to where we started, Mr Lucy was right in the fact that for an accountant it stays specifically within the exemption. We do not regulate those people unless they start giving misleading advice, and that was the pitch for the media release.

Senator SHERRY—You were stating a concern earlier about flagging the details of the shadow shopping exercise, and we will get to that in some detail a bit later. But I did ask specifically twice whether accountants would be included as part of the shadow shopping exercise. Is that going to happen?

Mr Cooper—I think that is proposed, but I guess our position in relation to accountants is that they are professionals. We want to give them a strong reminder in this fashion, but I do not think we are prefacing that we are going to be marching around looking at accountants more than other people. I think they will be included, but I would like to think that they will perhaps be on the lighter side. Given that they are generally members of professional bodies and have a fairly strict range of professional duties, we should not have to be calling on too many accountants.

Senator SHERRY—I thought financial planners regard themselves as professionals and have an overarching planning association that is out there providing firm advice about a range of issues on super.

Mr Cooper—That is true, but certainly accountants can point to a longer and more stable professional structure than perhaps other participants, if I could put it that way.

Senator SHERRY—Yes, although I just noticed in your voluminous press release that there are quite a few planners who are running into a bit of trouble lately.

Mr Cooper—Indeed. Our surveillance activities will certainly be heavily concentrated on financial planners because, depending on the count, there is anywhere between 9,000 and 12,000 of them.

Senator SHERRY—You licence them though, don’t you?

Mr Cooper—Yes.

Senator SHERRY—How many are there? I did ask this last time and you—not you individually—did not know, and I do expect a regulator to know how many people are operating that it is actually licensing.

Mr Cooper—There are roughly 4,700 financial services licences out there. Within the number will be the financial planner licensees, but of course the human beings that actually give the financial planner advice do not hold licences; they are in turn authorised by the licensees, so doing the count at any particular time of how many financial planners sit under a financial services licence is actually quite complex. The Financial Planning Association has 9,000 members, but there are planners outside that organisation.

Senator MURRAY—It is correct, is it not, that in contrast to accountants who are members of professional associations—there are three of them—financial planners do not have to be. So only some of them are members of a professional association, with the result that it is more difficult to communicate to them formally and professionally from the perspective of ASIC?

Mr Cooper—That is correct. It is fair to say that a majority of financial planners are members of the Financial Planning Association. There are other bodies, but I think the point we are making is that it is an evolving profession, if you like.

Senator SHERRY—How it is evolving will be interesting to watch. Just for the record, PDSs—disclosure of fees and charges—do not apply to self-managed superannuation funds, do they?

Mr Cooper—No.

Senator SHERRY—And therefore it would be much more difficult for an individual to identify what may or may not be an unreasonable fee?

Mr Cooper—Correct.

Senator SHERRY—Therefore, in respect of self-managed superannuation funds my contention would be that we have a greater level of risk in this area than in other areas.

Mr Cooper—We do not disagree with that, and I guess that is why we took a somewhat aggressive position in relation to the accountants. And we also stuck our necks out and indicated that we thought that a fund with less than \$200,000 was *prima facie* something that could be called into question.

Senator SHERRY—I actually agree with your observation. It may even be a little bit higher, but that is an issue for another time. On the issue of fees and charges, APRA produce a very useful statistical bulletin. Are you aware of the APRA statistical bulletin? It is now issued in a revised form.

Mr Cooper—Yes, we are.

Senator SHERRY—If we want to analyse superannuation by industry segment there is a whole range of data about assets, fund flows, categories of expenses—with one important exception which we will get to a little bit later. Have you had a look at the APRA fees data in the APRA superannuation bulletin?

Mr Cooper—Are you citing a particular issue?

Senator SHERRY—I am going to get to a couple of particular issues.

Mr Cooper—I mean a particular issue of the bulletin.

Senator SHERRY—I am going to get to the particular issues. Have you had a chance to look at the APRA bulletin?

Mr Cooper—Briefly, yes.

Senator SHERRY—One issue that I think is particularly useful in the context of fee disclosure, expenses and returns is that they break it down by industry segment, so we have corporate, industry, public sector and retail. Do you think that information is useful?

Mr Cooper—I guess it is useful to sophisticated people who understand the industry and the issues involved, yes.

Senator SHERRY—In terms of its ongoing use by consumers or commentators is it useful information?

Mr Cooper—I must admit I would not have thought it was all that useful for your average consumer.

Senator SHERRY—We will see. But isn't the provision of this information useful in the context of the public debate on superannuation? As far as I can find, it is the most detailed and comprehensive and the only truly independent statistical gathering in aggregate form on superannuation.

Mr Cooper—Let us assume that is correct.

Senator SHERRY—Can you name another?

Mr Cooper—I was going to point to ASIC's approach to dealing with this issue, which is to have a superannuation fees calculator.

Senator SHERRY—That is a calculator, though.

Mr Cooper—It is, but I am not convinced that a consumer would find useful such detailed and industry-wide information in that form.

Senator SHERRY—But, for example, a consumer might find it interesting to know the return on assets as a percentage by fund sector.

Mr Cooper—I would not have thought so. In the sentence that you have just spoken are a number of complicated concepts that I do not think the average consumer would really understand or be interested in.

Senator SHERRY—We have information on corporate, industry, public sector and retail but we do not have information on small superannuation funds or RSAs. I cannot obtain similar material—it would not have to be identical—on RSAs or small superannuation funds. Do believe that would be useful?

Mr Cooper—I do.

Senator SHERRY—Are you aware of where commentators or consumers who want to look at issues such as the return on assets could obtain such information?

Mr Cooper—Not so much on return on assets—but certainly ASIC itself has done work on the costs of running a self-managed super fund, which we propose to release because we do think that, for the reasons you identified earlier, there is a dearth of information about those products.

Senator SHERRY—I was not aware of that. When are you planning to release that?

Mr Cooper—In the next few weeks.

Senator SHERRY—Good. And that will include return on assets, expenses, costs and the like?

Mr Cooper—It will not deal with return on assets. I guess it is trying to explain perhaps not to consumers but to a wider market the sorts of factors that went into our nomination of \$200,000 as a benchmark.

Senator SHERRY—What about return on assets? This category of small superannuation funds is advertised as a category, as indeed some other categories are advertised—but let us just deal with small super funds at the moment. It is advertised as a category. Isn't it useful to know what the rates of return are for this particular category in the context of the ongoing debate we are having on super?

Mr Cooper—Yes.

Senator SHERRY—That is information you are not gathering. I am not criticising you for that; it is a matter of fact.

Mr Cooper—As a conduct and disclosure regulator, we are not well geared up to create that kind of information.

Senator SHERRY—The tax office regulate this area. Are you aware of whether they are gathering that information?

Mr Cooper—I am not aware.

Senator SHERRY—I will deal with them on that. Do you think that would be useful for RSAs as well? I am not aware of anyone doing it. Other than on individual bank sites, which I have done some work on, there is no aggregate information published which breaks down the sorts of issues we have discussed on RSAs.

Mr Cooper—Yes, I think that would be useful.

Senator SHERRY—What I found interesting was that the APRA data do give us some information on RSAs and small superannuation funds. You would be aware that they have the data on the number and the funds under management. But they cannot go the next step—which is understandable because they are not the regulator—in producing, in the same way, the information that they have published. Do you understand that that is the case?

Mr Cooper—Yes.

Senator WONG—I want to go back briefly to your prosecutions approach, generally. I am aware from your most recent annual report that your prosecutions target is 70 per cent. Is that right?

Mr Lucy—Do you mean success?

Senator WONG—Yes; I am sorry. The percentage of successful litigations target is 70 per cent.

Mr Lucy—Yes.

Senator WONG—That has been the case for some time. Is that right?

Mr Lucy—Yes.

Senator WONG—You achieved well in excess of that—93, 94 and 92 per cent—over the three financial years reported in that annual report?

Mr Lucy—Correct.

Senator WONG—Can I suggest that that would indicate a reasonably conservative attitude to prosecution, in the sense that you are achieving over 20 per cent greater success than your target? In other words, you are taking fewer risks in terms of your prosecution strategy than your target would imply.

Mr Lucy—Sitting alongside that is the fact that we might also be doing our job very well, in that we are endeavouring to be thorough and speedy, and reach conclusions. We are certainly finding that there is an increasing number of people who are choosing to plead.

Senator WONG—Yes, but we had evidence today—I accept that Mr Clark has his professional advice—that substantial actions by Mr Adler which resulted, on the basis of the royal commission, in very substantial losses to HIH were not proceeded with. That was not proceeded with, as I understand Mr Clark's evidence, on the basis that there was insufficient evidence to negate Mr Adler's explanation for the backdating of a document. I am just making the point that, in terms of the weighing up of a prosecution strategy, one would have thought that, with an action which led to such substantial losses, perhaps there would have been some merit in proceeding with the prosecution.

Mr Lucy—I would not use the word 'conservative' as you have. Certainly the commission is anxious to ensure that we do not embark on any form of prosecution—be it in criminal law or even administrative law—unless there are proper grounds. In the case of HIH, the first thing was to make sure that the investigations we undertook were vigorous and that there was no suggestion of holding back any application of resources to get to the right outcome. But having completed a rigorous investigation, we needed to look at the facts we had in front of us to determine whether or not we would be successful in prosecution. In particular, in the area of criminal prosecution, there is a dialogue, and the final decision is that of the DPP.

Senator WONG—No, that was not the evidence, Mr Lucy. The evidence was that there were a number of decisions made in-house not to proceed with the prosecution.

Mr Lucy—Certainly, that is a fair point. It does not get to the point of being referred to the DPP; quite so. But again, in almost every instance—certainly with anything of any significance—we would obtain independent advice, as distinct from making determinations within the ASIC investigating team itself. So whether or not the 90 per cent or the 70 per cent is the right figure, my view as chairman of ASIC is that it is wrong for people to criticise our success. I do not think that the regulator should be undertaking any investigative activity, or in particular enforcement activity, unless we are satisfied as to the grounds of success. We are using taxpayers' money to bring prosecution and to bring charges. The consequences of our actions are significant and—

Senator WONG—There is also the message sent to the markets, though, isn't there?

Mr Lucy—I think that the market is receiving a sound message from ASIC as to the fact that we are an energetic regulator. I mentioned earlier that we have some 300 matters in front of us which we are currently investigating. We are obtaining again quite a high number of enforcement undertakings—much higher than previously was the case, so that also distorts the statistics. We are looking at outcomes that are not necessarily running matters through the courts.

Senator WONG—Can I turn now to ASX and the discussion that has been made public about the ASX seeking to limit its supervisory role. You have also made some public comments about that, I think to the AICD.

Mr Lucy—Yes, I have.

Senator WONG—It is the case, isn't it, that in terms of the CLERP 9 legislation and the associated discussions about the corporate governance changes in Australia there was some reliance by the government on the ASX taking up a number of regulatory functions for the supervision of share market operations?

Mr Lucy—Yes.

Senator WONG—And our legislative scheme to some extent is predicated upon that role being undertaken by the ASX?

Mr Lucy—And undertaken effectively.

Senator WONG—You would agree that there has been a reasonably clear indication from the ASX that it wants to step back from some aspects of that role?

Mr Lucy—I am not sure that that is indeed what the management of the ASX are indicating. Certainly from my discussions with the chief executive officer, Tony D'Aloisio, he is looking at the whole range of activities that the ASX currently undertakes. His commentary to me is that in a number of areas to do with supervision he is indeed increasing the level of activity within the ASX. There is no doubt that he understands the legislative obligation of the ASX. To the best of my awareness, there is no suggestion that he is seeking to move outside that obligation—indeed, if there were to be any change that again comes back to government and to the parliament.

Senator WONG—But there have already been changes. The Corporate Governance Council has lapsed, and there has been some public discussion of the disinclination of the ASX to require companies to report on or in relation to the corporate governance guidelines. There has been an indication from the ASX that it is expressing some disinclination to continue to proceed with some of what I suppose would be described as its regulatory functions.

Mr Lucy—I think the Corporate Governance Council requirements are certainly areas they are looking at. But my reading of that is that they are looking at whether or not they need to be refreshed and whether there needs to be another review as to the sorts of issues that companies are reporting against. The ASX continues to be committed to that council as it exists at the moment; it continues to chair it.

Senator WONG—Regarding the General Property Trust bid—it is a bit current and I do not want to comment on the actual bid—as I understand it the ASX was of the view that the

way the proposal was being presented did not accord with the corporate governance guidelines of the council but it was not concerned to ensure that there was compliance. So is that not one indication of its regulatory functions not being exercised?

Mr Cooper—I guess that is a matter for the ASX. There has been some slightly misinformed press on that. I think the issue is that the ASX has the discretion to treat a unitholder in this case as sufficiently associated that they cannot vote. On this occasion the ASX, for reasons we are not aware of—and I am not criticising those reasons—has decided not to exercise that discretion, and this has been described in the press as a breach of some vague corporate governance principles.

Senator WONG—These were not vague corporate governance principles. The argument, as I understand it, is that these were guidelines issued by the ASX's Corporate Governance Council.

Mr Cooper—Correct. They are, firstly, not binding—

Senator WONG—So that is okay?

Mr Cooper—No. If you read those articles, you will see that they do not specifically say which one of those principles has been breached. It is just a broad allegation of 'this is legal, but we do not like it from a corporate governance point of view'—which is good press rhetoric but does not actually impinge on the ASX principles.

Senator WONG—But I think Mr Lucy conceded that there was a role for the ASX in terms of the way in which our legislation was framed. I can recall a number of exchanges in the chamber about whether or not the legislation might have taken a different approach on some of the issues associated with sharemarket operations. There was reliance by the government and, to some extent, by the parliament on ASX exercising a certain role.

Mr Cooper—Quite so, but I am not quite sure how the GTT example bears that out.

Senator WONG—What do you understand the announcement of the ASX to be? They are reviewing their supervisory functions—correct?

Mr Cooper—Yes. But they were reviewing their broad role.

Mr Lucy—They were reviewing everything

Mr Cooper—Yes, they were reviewing broad areas of their activities.

Senator WONG—Have you discussed the issue of the supervision of sharemarket operations in light of the ASX reviews with the government? Has that been the subject of discussion with the government?

Mr Lucy—Would you be kind enough to restate that question.

Senator WONG—In terms of the ASX's review—

Mr Lucy—Our review or the ASX's review?

Senator WONG—The ASX's review and some of the public commentary expressing concern about the impression—which, I understand, you do not agree with—that there is a stepping back from some of its supervisory functions. Has that been a matter of discussion with government by ASIC?

Mr Lucy—Not with government, but certainly with Treasury. I have not had discussions—I beg your pardon, I have had discussions with the parliamentary secretary. So, yes, I have raised it with the government.

Senator WONG—Did you discuss with the parliamentary secretary your view that ASIC ought not step into the breach, as it were?

Mr Lucy—No. It was more about the fact that there was interest in some of the commentary in the press as to what the ASX were looking to do. I passed on the fact that we meet regularly with the ASX—and indeed I meet regularly with the CEO of the ASX. I do not have any anxiety or concern that they are walking back from anything they should not be walking back from. So it was in that context that I had discussions with the parliamentary secretary. With the Treasury it was more in the context that this is a very important area and, to the extent that there may or may not be dialogue in the future, that it is an area that needs to be given full consideration.

Senator WONG—Should I understand your position to be that you agree that the supervisory aspects of ASX's role are important—

Mr Lucy—Yes.

Senator WONG—and that it would be detrimental to transparency and disclosure in the market if that role were not properly undertaken?

Mr Lucy—That is correct.

Senator WONG—But you do not think it is ASIC's role to do that?

Mr Lucy—No. We have our role, as provided for by the law, which includes, for example, our annual assessment of the ASX. But it seems to me it is really two areas being complemented together with both the ASX and ourselves.

Senator WONG—Which is why you would not have any provision in your budget to take on that sort of market supervisory function?

Mr Lucy—Quite so.

Senator WONG—Is it a view that has been put by ASIC to the ASX that its supervisory functions are an important part of our regulatory framework?

Mr Lucy—Yes.

Senator WONG—Are you confident that, as a result of the review, an appropriate supervisory function will still be maintained by the ASX?

Mr Lucy—Yes, I am.

Senator WONG—On what basis?

Mr Lucy—The ASX fully appreciate their responsibilities to the extent that they have any appetite yet to be determined; but, if they were to have any appetite to shift regulatory functions from themselves to us, then that would be a matter for them to raise with the government and, ultimately, for legislation to be passed. But we are not in that space.

Senator WONG—Is it not the case that the ASX, in discussing its review, has indicated a view that it wanted to reduce its market supervisory role?

Mr Lucy—I believe that has only been in the press; that has certainly not been communicated to me by the ASX itself.

Senator WONG—Given it has been in the press, have you raised that with the ASX?

Mr Lucy—Yes.

Senator WONG—And put a view that that is not appropriate?

Mr Lucy—It has not come to the fact that I need to show that it is inappropriate. The ASX have always indicated to me that they fully understand their responsibilities and are not shirking them.

Senator WONG—Do you think there is a case for making reporting against the governance guidelines a requirement under the Corporations Law?

Mr Lucy—That is a matter of government policy.

Senator WONG—Do you think there is a case for it?

Mr Lucy—We have not considered it sufficiently to form a view.

Senator WONG—What about making reporting against them enforceable by ASIC, which would be a logical consequence of that?

Mr Lucy—Again, that is a matter of government policy. We have not been asked to consider that.

Senator WONG—Have you been asked to consider any alternative regulatory mechanism in the event that the ASX do not continue to undertake the supervisory role?

Mr Lucy—No.

Senator WONG—You have not been asked?

Mr Lucy—No, we have not.

Senator WONG—I have one question about the James Hardie task force funding. I want to clarify the funding both in terms of your answer earlier today and in terms of the additional estimates and the budget measures. I think that, in the 2004-05 additional estimates, it was an additional seven point—

Mr Lucy—Five.

Senator WONG—Seven point seven million for the HIH task force being reprofiled to 2005-06. Is that right? That is on page 102 of the additional estimates document.

Mr Lucy—Are you talking about James Hardie or HIH?

Senator WONG—Sorry, can we do HIH first?

Mr Lucy—The original allocation for HIH was \$17.5 million for 2003-04 and \$10.7 million for 2004-05, totalling \$28.2 million. We sought for that to be spread over three years as distinct from two years. The allocations were then \$8 million for 2003-04, \$12.5 million for 2004-05 and \$7.7 million for 2005-06. As to our actual expenditure against that, in 2003-04 we overspent by \$1,000. In 2004-05 our best estimate is that we will underspend by approximately \$4 million. Our best estimate in respect of 2005-06 is that again we will materially underspend.

Senator WONG—In the additional estimates the amount of \$7.7 million appropriated in 2004-05 was reprofiled to 2005-06.

Mr Lucy—Yes.

Senator WONG—Is that restated in the PBS?

Mr Lucy—I would have to take that on notice.

Senator WONG—You are not able to refer me to—

Mr Lucy—Regrettably, I am not. It is certainly my understanding that 2005-06 is indeed \$7.7 million, but where—

Senator WONG—It is on page 102 of the additional estimates statement, but I am not clear where it is in the PBS. If you have to take it on notice, obviously I cannot object. It is a technical issue.

Mr Lucy—Would you mind if I did take that on notice? I can then let you know exactly.

Senator WONG—Turning to James Hardie, there was an announcement by the Treasurer in May this year of additional funding of, I think, \$3.1 million. That is the same amount as in budget paper No. 2, but on page 183 of the PBS it is described as \$3.426 million. I just wanted to check the reason for that.

Mr Lucy—The figure I have is about \$20,000 different from the figure you are referring to.

Senator WONG—Maybe you could take that on notice.

Mr Lucy—Yes.

Senator WONG—The announcement by the Treasurer in May was \$3.1 million and in the budget it was \$3.436 million. The figure you have is \$3.2 million, did you say?

Mr Lucy—No, \$3.405 million.

Senator WONG—Perhaps we can work out which it is.

Mr Lucy—Yes.

Senator WONG—That would be good.

Mr Lucy—There is some capital expenditure.

Senator WONG—I assumed that was what the difference was.

Mr Lucy—I think that is where it is.

Senator WONG—In the statement to which I have been referring the Treasurer referred to the fact that the \$3.1 million was to fully fund the dedicated James Hardie task force. Do I understand that to mean that that is the entirety of the funds that ASIC will require to finalise the James Hardie litigation?

Mr Lucy—The James Hardie investigation. That is what we understand the position to be. That is the basis under which we made our submission, yes.

Senator WONG—That was to fully fund the dedicated James Hardie task force?

Mr Lucy—Yes.

Senator WONG—So additional funds would need to be appropriated for prosecutions or proceedings?

Mr Lucy—At this stage we do not know what—

Senator WONG—If there were such proceedings.

Mr Lucy—If there were such proceedings, an additional appropriation would potentially be required, yes.

Senator WONG—This is only the investigation stage?

Mr Lucy—Yes.

Senator WONG—Turning to the administrator's reports, you may recall that ASIC's investigation of the administrator's reports was raised in the insolvency inquiry of the parliamentary joint committee.

Mr Lucy—Yes.

Senator WONG—I think there were some witnesses—I will not put it any higher than that—who raised a concern as to the extent to which ASIC investigated such reports. Do you have figures for the past financial year on how many such reports have been investigated?

Senator MURRAY—You might need more than the previous financial year.

Mr Lucy—It might be most expedient if I took that on notice. You are looking for a fairly precise response.

Senator WONG—Senator Murray raises a good point. We are interested in the trend, so perhaps you could give us the figures for three financial years.

Mr Lucy—Okay.

Senator WONG—Can I ask you about Ion Ltd?

Mr Lucy—Yes.

Senator WONG—Are you aware of that matter?

Mr Lucy—Yes.

Senator WONG—I understand that deeds of the company arrangement have now been executed. Has Ion been the subject of an ASIC investigation?

Mr Lucy—Yes, it has.

Senator WONG—Did that result from the administrator's report?

Mr Lucy—Yes. Again, I would like to take that on notice. Our recollection is that we were looking at it earlier than that. To be accurate, we should take that on notice.

Senator WONG—Has the investigation concluded?

Mr Lucy—I do not believe so.

Senator WONG—What is the status of the investigation?

Mr Lucy—Typically, we would not respond to that question, on the basis that it is an ongoing investigation.

Senator WONG—No, I am not asking for an exact response. Is it ongoing?

Mr Lucy—It is ongoing.

Senator WONG—Is there a particular staff complement working on that?

Mr Lucy—Yes. They would not necessarily be dedicated solely to it, but there would be a team.

Senator WONG—When do you expect that investigation to be concluded?

Mr Lucy—I would have to take that on notice. I could not give you an accurate response to that.

Senator WONG—Is the investigation relating to the conduct of directors?

Mr Lucy—It includes that, yes.

Senator WONG—Thank you, Mr Lucy.

ACTING CHAIR (Senator Watson)—I have several questions in relation to Rio Tinto. I notice that, according to a report, not only the tax office but also ASIC have actually authorised Rio directors to redistribute franking credits to traditional shareholders. What was the reasoning for your directive in relation to this? What was the background to it? That seems somewhat harsh to ordinary shareholders.

Mr Cooper—Perhaps I could answer this question. In the case of the Rio Tinto transaction, you are quite right; there was a buyback in which franking credits were distributed as part of the buyback. ASIC does not have any jurisdiction over franking credits. That is entirely a matter between Rio and the tax office. Significantly, in the case of Rio Tinto, that buyback transaction was in fact approved by shareholders of Rio Tinto Ltd, the Australian company, as well as the shareholders of Rio Tinto PLC. We have looked at the statistics of the voting and it has been a signal message to ASIC in its deliberations about the whys and wherefores of off-market buybacks. In fact, it was almost a unanimous vote. In other words, the meeting had a number of resolutions, and in many cases there were a fairly significant number of shareholders voting against. In the case of the buyback, it was, I would have to say, minuscule. A fully informed shareholder meeting approved that transaction almost unanimously. But I do stress that ASIC has no jurisdiction over franking credits.

ACTING CHAIR—It was primarily the Australian Taxation Office, but you did have an involvement.

Mr Cooper—Strictly, no.

ACTING CHAIR—Collectively, you decided to ensure the redirection of the franking credits held within the company.

Mr Cooper—With respect, I disagree with that. We have no say over what they do with franking credits and we made no decision one way or the other in the case of Rio because they did not come to us asking for anything. As far as we were concerned, they had complied with the Corporations Act provisions and put the matter to shareholders.

ACTING CHAIR—Last Senate estimates I raised a question as to whether the expenditure of a large amount of money for industry advertising programs by the 19 industry

funds breached the sole purpose test. After some reflection, Dr Laker subsequently replied. He said:

The approach we are taking seeks to balance the desire by trustees to showcase the features of their funds in a choice environment and the need for trustees not to fritter away member balances in activities that may not be in their best interests.

Further, APRA went on at the time, referring to ‘taking action where advertising practices and expenditure may not be primarily to inform and to educate existing shareholders’. That is where you are concerned. Since that time, the matter seems to have become a consumer protection issue and has appropriately been taken up by ASIC. I note that the TV commercials have recently been withdrawn. The question I ask is: what is the reason—a breach of the sole purpose test or problems associated with certain projections in the program?

Mr Cooper—ASIC’s view is that the sole purpose test is really not part of our regulatory jurisdiction. The case of the industry super fund ad that you are talking about is an ongoing investigation on our part in that it is very current and in fact there has not been a final resolution of that matter, but suffice it to say it emanated from concerns we had that the advertisement was misleading.

Senator SHERRY—In what way?

Mr Cooper—In three respects. The first was that it used past performance as a predictor of future performance without a sufficient warning or disclaimer that that was not an accurate predictor. Secondly, we were concerned that the particular advertisement in question purported to show figures a very great way out into the future down to the very last dollar. We felt that on national television a rotating dial that purported to show that you could make a comparison to that extent, to the nearest dollar, was again inherently misleading.

Senator SHERRY—Was that based on returns or fees or a combination of both?

Mr Cooper—It was a composite. As we understand it, it was intended to be a composite outcome. The third and perhaps most important element that we had concerns with was that there was an underlying assumption in those two numbers that the current cost and fee differential between your average retail fund and average industry fund would continue. Those were the three areas of concern.

ACTING CHAIR—You indicated that you do not have responsibility for the sole-purpose test. In these sorts of issues we have some problems with dual regulators to ensure that there is consistency and transparency in what is happening. What is the position on the sole-purpose test? You are saying we should have waited to ask APRA that question?

Mr Cooper—I am afraid so. In our view the sole-purpose test is primarily a tax issue, in the sense that a superannuation entity is in some ways a tax entity, and if you breach the sole-purpose test you potentially lose the taxation status of the vehicle. Similarly, APRA have a role there, but we do not.

ACTING CHAIR—Have you determined how this advertising was funded, or is that an APRA issue?

Mr Cooper—That is not an issue we are concerned with.

ACTING CHAIR—In terms of an advertising campaign, are you really being challenged by a number of problem people such as Greg Combet from the ACTU who, in a recent speech to the ACTU superannuation trust forum, commented on the need for industry funds to inform members of commercial matters and have a marketing campaign to attract members? Are you concerned about those sorts of challenges in that that could well be a signal of intention to breach the sole-purpose test? We really need a common approach, because it is part sole-purpose test and, as you pointed out, part future projections—which is in your domain. But, when we have a situation which involves some dual responsibility, I think you need something of a unified approach; otherwise we may not be getting a very clear message. I understand that APRA have not acted on or said anything on this, certainly not in the public domain. What we are reading in papers like the *Australian Financial Review* is the reaction of one regulator but not of the other, whereas the sole-purpose test, if we are not careful, could be a major reason of concern.

Mr Cooper—I guess that our position, being responsible for consumer protection in financial services, is that we prefer a landscape where there are perhaps advertisements and different types of information available, so long as it is not misleading. That is the extent of our position.

ACTING CHAIR—You say it is misleading—

Mr Cooper—In this instance we thought it was, yes.

ACTING CHAIR—In another article, in the *Sydney Morning Herald* on 23 May, noted luminary the former Reserve Bank Governor Bernie Fraser, who is currently trustee of at least three industry funds, projected that retirement savings would be 30 to 50 per cent higher for an industry fund than a retail fund. Have you sought to ascertain the accuracy of this statement or the information on which it is based?

Mr Cooper—I will answer your questions in turn. There has been a very large number of comments in the press from a number of participants in this industry. We do not seek to verify every statement that might be made in the press. If, as you say, Bernie Fraser made that comment, I guess it would be based on things as they currently are. It is a well known fact that the costs—the fee burden—in the retail sector are higher than in the industry sector, but there is nothing to say that that will continue to be the case. I guess we have a concern about projecting that in the future.

Senator SHERRY—What is to say that that will change?

Mr Cooper—I guess it is a feeling that competition will level out the landscape.

Senator SHERRY—It is based on a feeling?

Mr Cooper—No. It is based on the fact that if you want to make an assertion you have to have a reasonable basis for making it.

Senator SHERRY—But you are making an assertion that the long-term fees may change. On what basis can you make that claim?

Mr Cooper—No, it is slightly different. We are saying that if you make an assertion that they are not going to change, that is not reasonable or justifiable.

Senator SHERRY—So it would be permissible to say, with a disclaimer at the end, that the fees may change—may go down—over time?

Mr Cooper—That is the territory. We are certainly not seeking to stop industry fund advertisements. Without prejudicing where this might be heading I can tell you that that may well be the way in which some of these issues are resolved.

Senator SHERRY—An advertisement that compares the impact of fees in one segment of the superannuation industry with another, per se, is not wrong as a concept?

Mr Cooper—No. In fact, the advertisement in question is the second in a series done by industry super funds. The first one was a print advertisement that sought to show past performance by way of a graph. It was run along similar lines. We looked at that very carefully and decided that that was acceptable.

Senator SHERRY—That was based on historic performance over a number of years—five or 10 years?

Mr Cooper—It was based on performance over a five-year period and it sought to show that you would have been quite a number of times better off in an average industry fund than you would have been in an average retail fund. That advertisement generated quite a lot of debate but it was our view that that was acceptable.

Senator SHERRY—So that is an advertisement that has gone back in time and come up to the present time, whereas the TV advertisement—I think I have seen it a couple of times; it shows the dials clicking over—starts at the present and moves forward in time.

Mr Cooper—More overtly, do not forget that the implication of the first advertisement was that that would be a trend likely to continue. It was not quite as ‘in your face’—if I can put it that way—as the two dials turning around. Certainly, the reason for pointing to past performance is to create an implication that that will continue—otherwise, why point to it? The specific facts of each ad need to be look at.

ACTING CHAIR—Under Corporations Law it is much more certain what is required and what is legitimate when projecting figures forward; as opposed to the superannuation area, where some people feel there is a much more discretionary element. I think that is unfortunate. I think we have to get some certainty so that we know where the boundaries lie. You have clarified that to some extent this afternoon by saying that past graphs are acceptable, but you have certain concerns about the status quo remaining the same in terms of future projections.

Senator SHERRY—Doesn’t an advertisement of that type create pressure on the uncompetitive product?

Mr Cooper—Yes, I think it probably does.

Senator SHERRY—Presumably, in a rational market, there is only one thing they can do to survive.

Mr Cooper—That is what I meant when I referred to competition. Over time, it is a relatively reasonable assumption that if all of those products are available to a market there will be a levelling of the costs.

ACTING CHAIR—But in the meantime you have to set some rules.

Mr Cooper—Yes.

Senator FIFIELD—What was the process by which you found out about the industry fund advertising? Did you stop the ads before they actually appeared?

Mr Cooper—No, we did not. People do not need to seek our permission to place an advertisement. In the case of the one in question I think it first started running on a Sunday morning during the business programs.

Senator SHERRY—I think Senator Minchin drew our attention to that in a TV interview. I think he held it up as a glowing example of competitive advertising in action. I will have to look at the transcript, Senator Minchin. I thought you appreciated the ad.

Senator Minchin—That is unfair.

Senator SHERRY—I do not think it is. I will have to look at your remarks on that occasion.

Senator FIFIELD—Senator Minchin is ever-vigilant.

Senator Minchin—That is right.

Senator FIFIELD—How was the ad drawn to the attention of ASIC? Did ASIC officers themselves notice it or did another party?

Mr Cooper—For some time we have had a very strong feeling that this period leading up to super choice would see advertisements of that type. In fact, we have perhaps seen rather fewer of those advertisements than we thought. We have a team that are looking. We even use an external service of some sort to bring these sorts of ads to our attention. They get looked at and we make a quick decision as to whether there are issues with it or not.

Senator FIFIELD—Would it be fair to say that the view of ASIC was that those ads gave an impression that the industry based funds would provide a better net return than other funds?

Mr Cooper—Yes.

Senator FIFIELD—Whereas that is not necessarily the case.

Mr Cooper—Going forward, not necessarily.

Senator SHERRY—Going forward, but it is the case at the moment, though, isn't it?

Mr Cooper—Quite so, yes. We make no secret that that is our view.

Senator FIFIELD—In light of the problems with this particular set of TV ads, has ASIC taken any steps to see if there are other misleading ads at the present time?

Mr Cooper—The point I am making is that in this period we are generally looking at all of those sorts of ads. It just so happens that the retail sector at the moment seem not to be making specific advertisements. They seem to be just reinforcing their brands. That seems to be the strategy that they have adopted.

Senator FIFIELD—It would be fair to say that what you are driving at is transparency. You do not necessarily have a position of trying to see fees as low as possible, because fees are sometimes there for legitimate purposes. A particular fund may provide a particular

service or a particular benefit, so fees do not in and of themselves indicate that one fund provides a better return than another fund. So to focus exclusively on fees can misrepresent the actual return that a member of a particular fund would get.

Mr Cooper—Yes. If I can just ascertain what you are asking, if you look at an overall benefit such as the availability of certain types of insurance or other benefits, then maybe fees are not the be-all and end-all, but I guess the way these ads are cast is that, in terms of net dollars, fees do have a fairly major part to play, particularly over such a long term.

Senator FIFIELD—But you agree that the nominal value of overt fees is not the defining characteristic of a good investment.

Mr Cooper—I would not say that so much, but our landscape is such that, in this context, we are very much a disclosure regulator. If you wanted to have a superannuation fund that had ridiculously high fees, so long as that was properly disclosed, certainly going into the new template coming in on 1 July, we would not have an issue with that.

Senator FIFIELD—Could I just draw your attention to something from the ‘ACTU worksite for schools’ web site. I know we are trying to steer away from hypotheticals, so I might present an actual example.

ACTING CHAIR—Do you publicly give reasons behind your decision to require the advertisements to be withdrawn?

Mr Cooper—Not yet, because as I stressed earlier—

ACTING CHAIR—Don’t you think you have, in terms of transparency and for the whole community, to be aware of how you interpret the rules?

Mr Cooper—Correct. The point I am stressing is that this is an ongoing matter. We have not reached the final conclusion on this. Quite often we would come out with a release to explain, because it has certainly been commented on quite widely in the press as to what we are doing and what is happening, so there is clearly an interest at a certain level in the financial community. I would imagine that when we do get to a resolution we will be clarifying our position.

ACTING CHAIR—Obviously, the ads are no longer running. People need to know whether they are going to be infringing any laws if they unilaterally decide to run those ads. So I think the funds themselves, their competitors and the community at large are entitled to know at an early opportunity.

Mr Cooper—I think that at that professional level, in terms of the funds themselves, they well know what the rules are. Certainly our position on this will become—

ACTING CHAIR—So you are being challenged, are you?

Mr Cooper—It is difficult—this is an ongoing matter that we have with the industry super funds so I would prefer not to speak specifically.

ACTING CHAIR—If they decided next week to continue those, would you take action?

Mr Lucy—We would consider it.

Mr Cooper—We would certainly consider it. I think the answer to that is yes.

ACTING CHAIR—On the basis of?

Senator SHERRY—Continue it in the same form. I think that we are starting to take hypotheticals—

Mr Cooper—Correct. We are getting a little bit—

ACTING CHAIR—It is a practical situation. If you are a trustee of a super fund you want to know what the risks are of running an advertisement or not running an advertisement.

Mr Cooper—But the law is as it is. We are taking a particular stance in relation to a particular advertisement. The law is fairly well-known—

Senator SHERRY—Have you taken legal advice? How do you know that your actions are in fact legal?

Mr Cooper—Yes, we have taken legal advice.

ACTING CHAIR—You have to have some sort of synergy between Corporations Law and superannuation law. You cannot have projections in a situation under Corporations Law much more constrained than under superannuation law because people's money is at risk, or may be.

Senator FIFIELD—Referring to the document that Mr Lucy and Mr Cooper referred to, which is an extract from the ACTU's web site, and the section 'ACTU worksite for schools', I have a concern that there is an emerging impression that lower fees automatically equal a better investment. It says:

You're probably wondering at this point what the difference is between an industry superannuation fund and a normal superannuation fund.

Industry superannuation funds return the 'profits' to your account instead of their shareholders. This means that their fees are generally lower and the returns are generally higher.

Below that statement there is a table which is the industry funds comparison of industry super funds and large insurance corporations. There it makes the categorical statement the industry super funds charge lower fees and large insurance corporations charge higher fees. Is that categorical statement something that ASIC believes is misleading?

Mr Cooper—No. In the broad context of these sorts of statements that is pretty well the lay of the land right now. Our issue with the ads is that there are possible historical reasons why there is a lack of uniformity between those two industry groups, but here and now that is not an unfair thumbnail sketch summary of the industry. It may not stay the same.

Senator FIFIELD—So in terms of the industry super fund ads which were pulled it was more the assumption that the fee differential would remain indefinitely?

Mr Cooper—That and a quite strong and quite graphic representation that past performance was also going to be a predictor of future performance down to the last dollar.

Senator FIFIELD—Are you confident that the industry funds are not disguising their fees by, say, offsetting costs against other investment returns?

Mr Cooper—Not as far as we are aware, no.

Senator FIFIELD—So you are happy with the ACTU web site? You do not think that those statements are too categorical?

Mr Cooper—Regulators do not get happy; we are just not unhappy.

Senator SHERRY—Isn't it a fact that IFSA, which represents retail superannuation funds, has issued a press release showing that retail superannuation funds are almost twice the cost of industry superannuation funds? The retail organisation itself has disclosed that its personal retail superannuation cost total expenses are 2.3 per cent. In industry funds the total expenses are 1.17 per cent. Do you recall seeing the press release from IFSA?

Mr Cooper—I do not recall seeing that, but this issue is something that ASIC have looked at in great detail. We have discussed with APRA also the broad message that you are currently reflecting, and that would be consistent with our understanding. That is why I so confidently answered the question as to whether we have a problem with what is said on the ACT web site, and the answer is no.

Senator SHERRY—Did IFSA complain about the ads to ASIC?

Mr Cooper—Yes.

Senator SHERRY—Don't you think it is a bit rich to complain about the ads when they put out a press release themselves on 18 March which shows that their fees are almost double with respect to retail those in the industry sector?

Mr Cooper—It is very much part of ASIC's landscape that we receive numerous representations from industry associations of one sort or another and we play with a very straight bat. We receive all sorts of submissions about things and we just do our work. We take our own counsel.

Senator SHERRY—Did you hear the earlier conversation with APRA on their annual superannuation bulletin?

Mr Cooper—I heard quite a bit of it.

Senator SHERRY—Is it not a matter of fact that on page 21 of APRA's annual superannuation bulletin the return on assets—it takes into account fees—for corporate super funds is shown as 12.2 per cent for the year ending 2004, 12.5 per cent for industry, 12.4 per cent for public sector and 10 per cent for retail? It is a matter of fact, isn't it?

Mr Lucy—All we can do is note that; it is not for us to confirm that that is a matter of fact. They are APRA's figures. We note the figures and they are consistent with what we would anticipate.

Senator SHERRY—In this context of informed choice and informing individuals, commentators and markets, does it concern ASIC that most—not all—the retail superannuation funds failed to provide the statistics required by law on their commission fee levels to APRA?

Mr Cooper—That really is an APRA matter. The first we became aware of it was watching the previous hearing. It is really a matter between those funds and APRA.

Senator SHERRY—In the context of choice, for which you have responsibility, isn't it useful to have factual information gathered by an independent regulator that commentators and consumers can make an informed choice about?

Mr Cooper—It depends how that information is presented. We are confident that the new fee disclosure template will substantially address that, along with our own super web site calculator.

Senator SHERRY—The APRA statistics, in this context, would be useful information to have.

Mr Cooper—I imagine so, yes.

ACTING CHAIR—Is the ASIC fee calculator concept consistent with ASIC's view about projections?

Mr Cooper—It is. That is a very good question. There are a lot of these calculators around. You see them on bank web sites. They relate to credit card repayments, mortgage repayments and so on. They are very much a part of the landscape. ASIC has done a lot of work to ensure that when you use the ASIC calculator you are very clear on the assumptions that go into it. It prompts you and you are made aware of how these sorts of assumptions over time can have a very great impact on the numbers. There are lots of variables—inflation rates, return rates, expenses and so on. A 30-second TV ad with two dials showing you down to the last dollar does not make clear all those underlying assumptions to the person sitting on the couch watching that advertisement.

ACTING CHAIR—But in your own rules you say that one must look at the whole picture not just a snapshot of one particular element, important though that may be. As for the concept of an ASIC calculator, despite the fact that you do set out the assumptions under which your projections under the calculator are put forward I seem to see an inconsistency about the whole-picture approach, looking at all the factors, rather than just an asset calculator, although it is true you say these are the assumptions on which the projections are founded.

Mr Cooper—I partly agree with what you are saying. When you go to the ASIC web site you see a number of warnings and qualifications. All it is really showing you, if you have two different superannuation funds with the same assumptions, is what the potential effect of different fees and charges is going to be over time. It is just a tool that tells you that; it does not purport to do more than that.

ACTING CHAIR—So it does not tell you anything about the importance of the level of insurance, your insurability or anything like that.

Mr Cooper—No, it does not.

ACTING CHAIR—This is the weakness of too much reliance on calculators and projections.

Mr Cooper—It is just one tool in quite a complex landscape.

Senator SHERRY—Forgive me, Senator Watson and Senator Fifield, but I thought one of the government's stated primary intentions for super choice was to drive down fees and

charges in this industry. That was up there in lights, but now we have complaints about this fact being highlighted. But that is true, isn't it, Mr Lucy? Isn't that one of the stated aims of this entire policy?

Mr Lucy—It is certainly one of the expectations—absolutely so.

Senator FIFIELD—The concern is that fees and charges are not the only determinant of what constitutes a good superannuation fund and what determines a good return for those in those funds. Mr Cooper, I am wondering if you might tell us what are some of the other things that employers and employees should consider in relation to super funds.

Mr Cooper—These have been mentioned before: typically, whether the fund carries life insurance and what sort of insurance that is, because at particular points in time it will be very important that superannuants understand what insurance they are receiving, and —

Mr Lucy—Qualification periods is another.

Mr Cooper—Yes—whether exit fees are payable, the various mechanics of how the fund works, and what sort of track record the fund manager has—that is a factor. Obviously, fees and charges are part of that equation as well.

Senator FIFIELD—For the record, government senators are interested in only making sure that consumers have full information. They do not have a biased view as to one particular element when considering superannuation.

Senator SHERRY—But isn't it perfectly legitimate for a fund or a group of funds to advertise the particular competitive advantages that they have, whether they be as to fees, rate of returns, insurance, cost of insurance, service levels or the different forms of choice of investment available? Aren't they all perfectly legitimate aspects that a superannuation fund can advertise?

Mr Cooper—Yes.

Senator Minchin—Yes, but not in a fashion that is misleading, which was the assertion in this case.

ACTING CHAIR—If I were a construction worker and a high risk, surely I would be very interested in the level of disability or death insurance payable in the event of injury or death? As a worker in the early years of my life with a young family, knowing about disability insurance and the level of that insurance is perhaps more important to me than knowing what I might get if I were to retire.

Mr Cooper—I quite agree.

ACTING CHAIR—So how are we going to ensure that there is a better balance in this advertising so that people get the whole picture?

Mr Cooper—I made an observation before that there are a number of elements in the process between first thinking about superannuation and ultimately acquiring a product. Do not forget that product disclosure statements will always be a part of that chain as will licensed advice.

Senator SHERRY—On the calculators issue, did ASIC do a review of the various calculators that were put up on the web sites of superannuation funds?

Mr Cooper—Yes.

Senator SHERRY—Did it check them?

Mr Cooper—It did.

Senator SHERRY—That was my understanding. I understand a very large number of them came down when you started to express concerns, but now they are back up.

Mr Cooper—You might be thinking of the mortgage brokers.

Senator SHERRY—I was told that it was the superannuation funds.

Mr Cooper—We have certainly done that work and we are about to release the fruits of that work. We used some very basic inputs: a 35-year-old male who had \$55,000 in superannuation savings, who was going to retire at 65 and who was on \$50,000-odd a year. We put that very basic data into a range of calculators and we came up with a quite a divergence of outcomes. Because of the sorts of assumptions that were either made or not made there was a very great range of outcomes.

Senator SHERRY—The calculators have not gone back up yet?

Mr Cooper—I believe they are up, yes.

Senator SHERRY—I am informed, although I have to get the details, that one of the calculators up there is in fact based on illegal assumptions; they are totally incorrect. I will get the information. So the calculators are back up. Have those that were potentially misleading—I am not going to put it any harder than that at the moment—been corrected?

Mr Cooper—Not yet, no. There are a number of different approaches that we could take in this area. We certainly do not want to ban them. I guess we are setting an example with our calculators by having a very deep set of assumptions and showing the industry how it all works.

Senator SHERRY—I know you are setting the example, but are others following your example with the required degree of accuracy?

Mr Cooper—I think it is fair to say ‘not yet’.

Senator SHERRY—When do you think that they will be doing this?

Mr Cooper—We are about to release the results of that work and really drive a campaign to get the industry to lift its game.

Senator SHERRY—That is fine, but people out there are starting to make superannuation choices, presumably using calculators, and to date we have not got an accurate calculator system—or at least one that satisfies you as the regulator.

Mr Cooper—It is an inherently difficult area because there will always be a range of opinions as to what is a reasonable assumption on any measure—for example, if we all asked ourselves what we thought the inflation rate was going to do over a period. It is a question of boundaries. You are never going to have a set of calculators that always come up with the same answer.

Senator SHERRY—It sounds like the simpler solution, and the only practical one, is to prohibit them.

Mr Cooper—We see these calculators as pretty much a fact of life on the internet. As the internet is global it would be very difficult. We formed the view that that would be a very hard step, and perhaps a retrograde step.

Senator SHERRY—Just like advertising is a fact of life too?

Mr Cooper—Correct.

Senator FIFIELD—I have going around in my head your comment that the reason for taking the industry super fund ads off TV was the assumptions going forward. The ACTU 'Worksite for schools' web site says:

Industry superannuation funds return the 'profits' to your account instead of their shareholders. This means that their fees are generally lower and the returns are generally higher.

That is making the statement that not-for-profit equals lower fees and, clearly, that is implying that that is going forward and is just like the laws of physics: returning the profits to the account instead of to shareholders equals lower fees. That is a statement looking forward. It is saying 'not-for-profit equals lower fees'. I read that as: 'It is just like the law of gravity; it is a fact of life.' To me, that clearly implies that it goes forward onwards and forever, which I think is misleading.

Mr Cooper—These things are always a question of degree. I would have thought that was describing the current state of affairs. I certainly would not be confident about running a case that said that was making a projection.

Senator FIFIELD—It is saying 'not-for-profit equals lower fees'.

Mr Cooper—Correct, and certainly the structure—

Senator SHERRY—It is a statement of fact.

Mr Cooper—Absent a major change in structure, it will still be the case that there is not an intermediate party seeking to take a profit out of running a superannuation fund. It is really the fund and the members.

Senator FIFIELD—I am just seeking to follow the logic in the TV ads which is assuming fee differentials go forward.

Mr Cooper—It is a balancing act.

Senator FIFIELD—This is saying that not-for-profits will forever have lower fees; that not-for-profit equals lower fees.

Mr Cooper—I would not put it as strongly as that. There may be some degree of forward-looking statement inherent in that statement but it is quite minor.

Senator FIFIELD—Not-for-profits would be capable of doing something, one would think, that could result in higher fees. Therefore, saying not-for-profit equals lower fees is more than a statement of what currently occurs. It is just stating that that is the way it is—it is like a definitional thing.

Mr Cooper—As I said, it is a question of degree in each case. I think this is one that would not attract our regulatory attention, based on what we know now about the industry.

Senator FIFIELD—I know you are not happy, because regulators are never happy or sad, but you are comfortable with the assertion that for-profit equals higher fees and therefore that not-for-profit equals lower fees?

Mr Cooper—That is not quite what is said here. We are not unhappy with the way this language is used.

Senator FIFIELD—That you ‘return the “profits” to your account instead of their shareholders. This means ...’?

Mr Cooper—‘This means that their fees are generally lower’—I think we are happy with that—‘and the returns are generally higher.’ Based on what we know, what APRA tells us and our own work, we are comfortable with those statements. There is some element of suggestion that that will continue, but it is not—

Senator FIFIELD—I have ringing in my head that you are concerned about assumptions about things going forward.

Mr Lucy—If they were to provide a calculator going forward which provided \$329,226, that is when we would start to have a real interest in it, because then that clearly is (a) going forward but also (b) indicating a level of conciseness that just is not realistic.

Senator SHERRY—But doesn’t a calculator do that? If you input X amount—

Mr Lucy—But then you are putting in the assumptions.

Mr Cooper—It specifically takes you through the assumptions at each point—certainly ours does.

Senator SHERRY—But it will come up with the nearest dollar.

Mr Cooper—It will, and it will warn you that this is all a bit of a game in the sense that it is not—

Senator SHERRY—If the spinning dial cut off at \$300,000 rather than \$300,625, and it cut off at \$300,000 ‘approximately’—

Mr Lucy—That would have eased it for us.

Senator SHERRY—That eases your concern?

Mr Cooper—It could do, because it conveys a slightly different message.

Senator SHERRY—I am sure you will sort it out. I have some other issues.

ACTING CHAIR—Perhaps Senator Murray has some questions.

Senator SHERRY—Can I just clarify something in the second reading speech of the Superannuation Legislation Amendment (Choice of Superannuation Funds) Bill 2005. It is about the sixth paragraph.

ACTING CHAIR—Is that another question?

Senator SHERRY—No, it is not a question. It is just so that the shocked and surprised ASIC officials do know—

Mr Cooper—I think we are talking about the same thing here.

Senator SHERRY—This is the second reading speech of the minister. It has already been given. It says:

The choice legislation ensures that fund trustees do not try to inappropriately induce employers to move their employee's contributions to the trustee's fund by offering them personal incentives. This bill will make the Australian Securities and Investment Commission the agency that administers this provision.

Mr Cooper—Yes. Just to correct the record—thank you, Senator—we are well aware of that. This was a confusion between us and you in relation to the third line forcing language which, I must say, we have had before. Third line forcing is very much a creature of competition law. In fact in the material I have, the explanatory memorandum, it is described as the 'employer kickback rule', which we are well familiar with. We know what our role is there and we have some ideas about how we are going to administer those provisions.

Senator SHERRY—I will return to questions on that shortly, after Senator Murray has had his go.

Senator MURRAY—Mr Lucy, because I have been part of the interrogation through the Joint Committee on Corporations and Financial Services, I do not have a long list of things to talk to you about. I do want to ask you, though, if you could just update us on the effect that the death of Mr Rivkin may or may not have had on your ongoing inquiry.

Mr Lucy—It has essentially had no effect, in that our investigation is ongoing.

Senator MURRAY—It will neither lengthen it nor shorten it?

Mr Lucy—No.

Senator MURRAY—I will not ask you any more questions for the usual reasons. I want to turn to your staffing and budget situation. The budget press release and the budget papers say that ASIC will receive additional funding of \$13.4 million over four years for the James Hardie task force, which is \$3.1 million for OneTel, \$4 million for Offset Alpine investigations and \$6.3 million for the United States-Australia audit regulation program, so that is the total of \$13.4 million. On page 1,030 of Budget Paper No. 1, it says that your average staff numbers will fall in 2005-06 to 1,534 from 1,571 in the current financial year. It seems odd that you have this money for these investigations, which are quite resource intensive by their nature, but your staff numbers are to fall. Can you tell us why that is happening?

Mr Lucy—The staff reductions are a net reduction. Because of the fact that our core activities, which we undertake day in day out and are not subject to special purpose funding, are subject to a cap which is adjusted because of the efficiency dividend, it is in that area that we need to continue to ensure that we are running our business effectively and efficiently. We think that there are areas in which we can continue to be more effective and so therefore we will be reducing staff numbers in certain areas.

Senator MURRAY—Which areas and why does that not affect your capabilities?

Mr Lucy—There is no particular area in which we are looking to reduce numbers—it is really across the board. We have an obligation to run our affairs within the budgets which we

are provided. We feel that we are capable of doing so. In the 2005-06 year it will mean that there will be a net reduction in staff.

Senator MURRAY—Cutting through that, you have been forced to cut your staff by a government imposed policy—is that right?

Mr Lucy—No. We did not seek additional funding in that regard. For example, for the area of enforcement activities we received the full amount of money which we sought. We have an obligation, as I said earlier, to run our affairs efficiently and effectively and we think that there are areas in which we can be more effective than we have been.

Senator MURRAY—But your tasks have not diminished. There is this whole super choice area and there is still bedding in of the FSR stuff. You are still very active on all the new accountancy effects, the new systems. There are these investigations. There are demands which, quite properly, you have met requiring you to be more active in areas like the phoenix area, which you have addressed much more over the past year. There is a lift in compliance activity. There is a lift in both civil and criminal activity. You are a busy outfit with, I think, increasing responsibilities. Frankly, your answer that you can accommodate staff reductions does not fit.

Mr Lucy—It is certainly fair to say that there are increases or greater demands in almost all areas of activity. But, having said that, I think there are areas in which we can continue to do our job better and more effectively. For example, in one area we are looking to staff training to bring our people further as to their own capabilities. The other part of it is a greater level of delegation. There are many organisations, including ASIC, that need to see whether they are making decisions at the right level and whether or not they can force decisions down the line. In the area of enforcement, for example, we have categorised matters into A to D. The A and B matters essentially present themselves, so we do not have a choice as to whether or not we take them on. With respect to the D matters, we very definitely have a choice. In particular, we are looking to see whether or not we can have those undertaken essentially within the branches or within the state offices in a manner whereby the decisions are being taken within those offices and are not necessarily matters continually referred back up through committee structures.

Senator MURRAY—That sounds to me as if you are reducing supervisory activity which you do not think is necessary, where the staff member can take their own decisions without being supervised.

Mr Lucy—We do not think that there is a risk in reducing supervision. We think that in the modern world people expect, and are required, to take responsibility for their actions and be accountable. We think that there is a possibility for ASIC to further devolve responsibilities within our organisation. We have looked not only at other regulators but at Treasury. Treasury went through a phase several years ago where they looked at how they conducted their operations, and we think there are examples in that for us.

Having said that, it would be fair to say that the 2005-06 year is getting to the point where we really will be driving the business hard. We will reach a point where it will be very difficult to accommodate further such efficiencies. In 2004-05 we think we have run the business hard and effectively. We expect to come up with a financial result which will

essentially be a break-even. In 2005-06 we are looking again to run the business hard and make some decisions and we believe we can come up with a financial result which will be within our limitations.

Senator MURRAY—I must tell you frankly that I am not convinced. I am of the opinion that you have been pushed to this. I just hope it does not affect what I regard as a very high-quality, professional body which has been producing increasingly better outcomes.

Mr Lucy—Thank you.

Senator SHERRY—From my observation yours is virtually the only agency—or bureau or department or however they are termed—which is putting in the forward estimates that staff numbers are going to go down.

Senator MURRAY—It is the only regulator where that is the case, yes.

Senator SHERRY—That is the case almost right across the board in the entire government.

Senator MURRAY—I recall what happened to ATO when they reduced numbers because they were told to. There was a terrible outcome and now, thankfully, they are back to—

Senator SHERRY—And in the department of finance, with all the spillover from the great theoretical approach.

Senator MURRAY—If you come under stress will you ensure that you advise government and the parliament of that at an early stage, because we rely heavily on ASIC to do the job we have delegated to you through legislation?

Mr Lucy—The commission are really aware of the point that you make and we are certainly aware of our obligations. We are attuned to the fact that we have to meet parliament's and the community's expectations.

Senator MURRAY—The reason I put the question like that is that my impression of the situation with the ATO is that they did not squeal early enough. As soon as they saw the problem they should have alerted both the parliament and the government, and I do not think they did so early enough.

Senator SHERRY—I note your press release of Wednesday, 11 May, where you announced the closure of four regional business centres.

Mr Lucy—That is right.

Senator SHERRY—Those centres were at Townsville, Gold Coast, Newcastle and Geelong. You say:

The ASIC Service Centres located within capital cities across Australia will continue to operate as normal.

Is this a response to the rationalisation, cost pressure and efficiency issues? My final point is that I hope Hobart does not become one of the regional centres that are shut down. How many staff are involved in the closure of these centres?

Mr Lucy—The decision to close down the service centres was made for a number of reasons. I will just give you some examples and I am looking at the same periods—that is,

comparing 2004 with 1999. The numbers of documents lodged have dropped in Geelong from 14,000 to 1,500; in Townsville, 14,000 to 900; on the Gold Coast, 22,000 to 3,000; and in Newcastle, 38,000 to 2,800. So we are really responding to the realities of what has happened in the business.

Senator SHERRY—What about inspectors on the ground—do they work out of these offices?

Mr Lucy—No.

Senator SHERRY—None at all?

Mr Lucy—No.

Senator MURRAY—Let us hope it does not become a desktop operation with respect to some areas. I want to ask you briefly about the AXA Australia Staff Superannuation Plan. You put out a media release last week detailing a forcible undertaking concerning AXA's Australia staff superannuation scheme. If I understand the situation correctly from your press release, AXA had changed its method of calculating superannuation benefits, with a consequent detriment to its members—which you woke up to. The result is that members will be reimbursed to the tune of \$10 million for the incorrect crediting rate. Are there perhaps more of these incidents elsewhere to which you have not been alerted? Do you intend to do a sample audit of similar schemes to see whether there have been any changes of this kind?

Mr Lucy—The short answer is yes. We are anxious as to whether or not there might be others. It is a complex area, and experience has shown us that a number of companies such as AXA—major companies and respected companies—have come to us and volunteered the fact that there are problems that need to be addressed. They have been addressed to date through enforceable undertakings. Again, we have been transparent and have made it clear that these issues have been dealt with and investigated by us and that proper accommodation has been dealt with for those people who have been affected. It is part of our surveillance activity going forward because we are mindful that these issues are presenting themselves fairly regularly, and we are looking to see whether or not they are more systemic than might otherwise be the case.

Senator MURRAY—I must compliment you on the outcome, because it is terrific for the members concerned. Was there mala fides in the legal sense of that? Is the company or any officers likely to be punished?

Mr Lucy—No. To the extent that we will achieve an enforceable outcome, that would not be achieved if there was malfeasance and we felt that there needed to be other action undertaken. AXA is a very good example of where the two regulators, namely APRA and ASIC, have worked extremely well together, both at officer level and at commission level to achieve a single outcome. I think you are right, that this is a good outcome. I think it is an appropriate outcome. It was done expediently. I think the right message has been sent to not only AXA but the industry more broadly. Again, I think the right message has been sent to Australian consumers, that the regulators are vigilant.

Senator MURRAY—If you took it at its worst, you could sit here and say that some bright managerial spark said: 'I know how we can save ourselves \$10 million. We'll introduce a new

calculation rate. The mug members won't pick it up, the regulators are unlikely to find out about it and we can put it in the pockets of the company.' The alternative view is that it was just an accidental change. I subscribe to the view that it would have been a profit-making opportunity. After achieving this enforceable undertaking and publicising it to the market, will you move to punish somebody else who does it and does not come to you and say: 'Look, we did it. We own up. We'll fix it on the same basis you have outlined'?

Mr Lucy—The likelihood is that, if it was not brought to our attention on a voluntary basis but we found out about it through, for example, surveillance or complaints, we would not accept enforceable undertakings.

Senator MURRAY—So you will punish future transgressors of this kind?

Mr Lucy—Yes.

Senator MURRAY—That is what I wanted to hear.

Senator SHERRY—Given the nature of AXA's work force, I would have thought it quite extraordinary that it could believe that it could take any actions in any way detrimental to its members without fully informing them, given that the work force work in the superannuation industry. You would not have more highly informed—not necessarily fully informed—members of a superannuation fund, I would not have thought.

Mr Lucy—I think that is a fair statement. We were obviously listening to the discussion that you had with APRA on this very matter.

Senator MURRAY—The point Senator Sherry is making—and, I must say, it occurred to me—is that members of another company's staff fund, say one dealing with transport, are not going to have the professional education—

Mr Lucy—They may not be so astute.

Senator MURRAY—which would enable them to blow the whistle.

Senator SHERRY—I did not ask APRA earlier whether, when you are doing a joint exercise like this, officers in APRA and ASIC work on the same project, presumably at some sort of coordinated team level.

Mr Lucy—Correct.

Senator SHERRY—What do they do? Do they physically relocate?

Mr Lucy—Not necessarily. I think the most important thing is that there is a very high level of dialogue and that, when we start an investigation plan, we put on the table our expectations and what we are going to be looking at to get us to a position where we can form a view as to what should be the right remedial action. That is really the point: to make sure we get the facts. It is one thing for the company to tell us the facts; we need to independently satisfy ourselves that their representations are reliable.

Senator SHERRY—The point I am getting at is that you would not want, on the same case, an officer of APRA going down one day and an officer of ASIC going down, looking at probably similar types of material, on another day.

Mr Lucy—No. I would like to think—and I am sure I am able to have this reliable view—that our people do work sensibly together. It would be reasonable to assume that, if they were not, we would be getting complaints very quickly from organisations that were being investigated by different organisations—and that is not the case.

ACTING CHAIR—I refer you to a case on another matter that is in litigation—Unity Eleven Pty Ltd v Sharp Partners Pty Ltd—where there is a claim for losses allegedly suffered as the result of a breach of duty by the auditor; that is the allegation. My interest in the case is that it highlights, I believe, a lack of transparency and accountability to members in certain superannuation fund arrangements. By way of background, Unity Eleven appears to be an investment management company of the Transport Workers Union Superannuation Fund and two of its directors are also trustees of transport workers super. It then goes to a situation whereby there is another trust—and an arts investment trust—of which Unity Eleven Pty Ltd is the trustee of a related trust of transport workers super. Is this really subject to the in-house tests of part 8 of the superannuation industry provisions? It raises questions, particularly if you look at the 2005 transport workers super FSG in the PDS. Could that be deemed to be misleading? Whilst the attention of members and potential members is drawn to the remuneration and the potential conflicts of interest, no disclosure is made in the documents as to the potential conflict arising from the trustee directors also being directors of an investment manager appointed by the trustee. Could you throw some light on this, because I think this is an issue?

Mr Lucy—Not in this form, I am afraid. We will take that on notice, look at it closely and come back to you.

ACTING CHAIR—I think there are real transparency issues here. We are entitled to know where the regulator sits and what he has done.

Mr Lucy—It is a specific matter which neither Jeremy nor I are aware of.

ACTING CHAIR—You are not aware of the litigation?

Mr Lucy—Not that one—no, we are not.

ACTING CHAIR—It has been around for a little while.

Mr Lucy—I guess that what we are not sure about is whether or not ASIC is the party to it—perhaps it might be APRA. We will need to look at it specifically and advise you accordingly.

ACTING CHAIR—You have taken it on notice but, in terms of your response, I am concerned that superannuation funds do not appear to be subject to the same level of disclosure as other public investment vehicles. You might like to take that on; I probably do not need to coax you in that area. This has raised some important gaps, which I do not think should exist in the system, whereby the disclosure requirements for super funds appear to be a lot less, superficially, than those under Corporations Law.

Senator SHERRY—Could you take two other cases on notice? I know there has been correspondence, but I would not expect you to have knowledge of it today. I asked APRA because the first one involves Mr Steve Huggert and it is the same principle as the AXA issue.

Mr Lucy—The Telstra employee?

Senator SHERRY—Yes. It involves an employer offer. He was convinced to shift from a DB fund to an accumulation fund—that is the first one. He has corresponded with ASIC, APRA and SCT and is not satisfied and not happy. Could you have a look at that one? The second one involves Mr Jim Welch and the collapse of a fund called Freedom of Choice, a monthly income fund. This goes back almost five years to December 2000. APRA were able to give a bit of information on the record—not about Mr Jim Welch particularly—but the matter has been outstanding now for almost five years and Mr Welch is getting a little aggravated, and I do not say I blame him, because of the moneys issue and the compensation issue. Could you take those on notice?

Mr Lucy—Yes.

ACTING CHAIR—I seek a little guidance. I refer you to *Options for improving the safety of superannuation*, the report of Superannuation Working Group, recommendation No. 26, which required trustees to disclose ‘non-investment transactions entered into with related parties’. I think that goes to the core of some of my concerns.

Senator FIFIELD—Mr Lucy, I draw your attention to an article in the *Financial Review* today, which I am sure you will have seen: ‘Industry funds in new tangle with ASIC’, which says:

Mr Weaven revealed that, in a separate exercise, ASIC had told IFS that its rollover service, which advises savers on switching out of commercial super funds, maybe in technical breach of ATASIC’s regulations ... ASIC was understood to be concerned that the IFS advisory service failed to analyse other aspects of commercial funds, or master trusts, such as insurance and the range of investment products.

I just want to check that that is correct, that ASIC is concerned that there is a technical breach and that the concerns as stated in the article are the concerns of ASIC.

Mr Cooper—In the last couple of days there has been a lot of comment on this subject, but that specific complaint does not ring a bell. That may reflect that somewhere within ASIC very recently this issue has been taken up, but I must admit that I am very close to the IFS issue and I am not aware that we have made those statements. A lot of people are attributing motivations and comments to ASIC and they have not spoken to us at all. There is a lot of information flowing around and I am just not aware of that specifically.

Senator FIFIELD—So you can take that on notice?

Mr Lucy—Yes.

Senator SHERRY—On the so-called ‘refinements’ that were announced to the financial services regulations that were issued earlier in May—or it might have been April—there is the specific issue of the amount of information to be disclosed in PDSs. What was the intention in terms of reducing the size of PDSs? Is it going to happen as a consequence of these refinements?

Mr Cooper—Senator, I guess there are two key proposals. One is to try and drive the clear, concise and effective campaign harder, and the second one specifically deals with what might be called ‘short form’ product disclosure statements where more detailed information that would not necessarily be of interest to every consumer would be available either on a web site or upon request—

Senator SHERRY—An option—two levels.

Mr Cooper—Yes. That is the proposal.

Senator SHERRY—Okay. Here we are, super choice is coming in on 1 July and PDSs are being issued. There are so many of them flying around that I cannot keep up with them at the moment. I would like to have a look at various samples that are being issued—or maybe it is too early—but I am looking at 50- to 80-page PDSs and the average consumer has got very little opportunity to understand all of that.

Mr Cooper—ASIC has made no secret of the fact that it has been disappointed that the documents continue to be of that length.

Senator SHERRY—Now we are in a situation where presumably these companies, the providers, are going to have to get more legal advice and reissue these PDSs. Do you know of any that have been reissued? I have not seen any.

Mr Cooper—No.

Senator SHERRY—How is this going to be handled in the context of super choice, which starts on 1 July? PDSs are very important documents when making a decision. We have documents which by your own admission are unreadable but have not been reissued yet.

Mr Cooper—I am not sure about ‘unreadable’. They are certainly too long. The average PDS is still too long.

Senator SHERRY—So do we have an indication from providers as to when new PDSs—hopefully much clearer and concise ones with a much smaller number of pages—will be issued?

Mr Cooper—Don’t forget that these are only proposals and they will take time. There are 25 proposals and some of them involve making regulations and some of them involve guidance from ASIC. They, as part of an overall package, will be implemented as quickly as possible, but that will not be done overnight.

Senator SHERRY—But this is the very point: choice of funds starts on 1 July and the PDS regime will not be completed in time. That regime is fundamental to fund choice. I am not blaming you: they are the government’s regulations, not yours.

Mr Cooper—The strict answer to that is that the regulation was right but the industry has not followed through with sufficient take-up. There are a number of reasons for that.

Senator SHERRY—Do you know of any providers that have provided clear, concise PDSs? I have not found one yet.

Mr Cooper—They do exist. I do not want to give any of them a free kick by reading their names into the record.

Senator SHERRY—Maybe you could send me one.

Mr Cooper—They are out there but they are certainly in the minority.

Senator SHERRY—Mr Lucy, does it concern you that one of the fundamental disclosure documents that underwrite superannuation choice will not be finalised by 1 July?

Mr Lucy—I would not use the word ‘worry’. I think that it is disappointing. But, as Jeremy has said, at this stage the default is that the PDSs are overproviding information, as distinct from underproviding it. Therefore the proposed adjustments indeed streamline it, as distinct from making it more bulky. At least we are going into 1 July with overstatement, as distinct from understatement.

Senator SHERRY—But it is unreadable overstatement in many cases.

Mr Lucy—I am not sure that it is unreadable. I think it is bulky—

Senator SHERRY—Is it understandable?

Mr Lucy—The concern is that some consumers are just simply choosing not to read them because of their bulk.

Senator SHERRY—I refer to superannuation fund exit fees. Mr Lucy, you put out a release on Monday, 21 March that identified at least 550,000 Australians who have old style or legacy superannuation accounts. Isn't it true that if the fees are not waived in some form these individuals are very unlikely to exercise choice as (1) it would simply be impractical and (2) the financial penalties for transferring to another fund, if they wished to do so, are substantial?

Mr Lucy—Your comments are right. We did point that out and we are encouraged by the fact that a number of the major companies have reached an accommodation whereby they are able to deal with some of these exit fees so that people are not disadvantaged.

Senator SHERRY—We still have 550,000. Are you able to identify the number that has been let go, so to speak?

Mr Lucy—No. We would not be able to look at it with that level of preciseness. Indeed, in many instances the companies have allowed members to retain a small interest in those funds, not trigger the exit fees and therefore take the bulk of their investments out without incurring exit fees. There is quite a level of flexibility being provided.

Senator SHERRY—By some.

Mr Lucy—Yes, by some.

Senator SHERRY—We still have a very substantial number of people in these things.

Mr Lucy—Quite so.

Senator SHERRY—Substantial exit fees are a barrier to choice, aren't they?

Mr Lucy—They are certainly a barrier for moving within choice.

Senator SHERRY—I was interested in your comment that people going into a new fund today also need to understand the different fee options available and that ASIC has found that one-third of people going into new superannuation products are choosing an exit fee option rather than paying entry fees. That frankly astounded me. The one-third are still out there. I thought these products were extinct, long gone, dead and buried for good.

Mr Lucy—They are materially smaller in quantum.

Senator SHERRY—That was my next question. What do you mean by that? Are we talking about 50 to 100, or the old style of thousands and massive percentage penalties?

Mr Cooper—I understand that with the modern product you get a choice between paying the usual entry fee, which is a buy-sell spread or some sort of fee, or not paying that and merely rolling that to the back end of the transaction.

Senator SHERRY—Which is what?

Mr Cooper—We are talking way smaller than the sorts of numbers that we have previously looked at.

Senator SHERRY—Are there still some of the so-called older style of products about? Are they still being offered?

Mr Cooper—No, not as far as we are aware.

Senator SHERRY—You would have seen the evidence earlier when I was asking APRA about the retail industry failing to provide in sufficient detail information on exit fees, as they were requested. Are you aware of that?

Mr Cooper—Exit fees or commissions?

Senator SHERRY—Commissions as well. You may not have seen—

Mr Cooper—We saw the commission part.

Senator SHERRY—The request included other things—exit fees and entry fees. There was a failure to provide sufficiently detailed information. How did you get your information?

Mr Cooper—We saw it as a consumer issue. We got it on a voluntary and confidential basis by going and talking to, on our calculation, about 50 per cent of the total market by major managers.

Senator SHERRY—I notice that the aggregate exit fees total almost \$1 billion. That is a massive amount of exit fees, isn't it?

Mr Cooper—It is. I suppose you need to put that in perspective—it is a nearly \$700 billion industry. But, yes, if you run the percentage it is still a large number.

Mr Lucy—It is also on the assumption that everybody was to exit.

Senator SHERRY—I understand that. They are obviously there so no-one exits—or very few people. Regarding the Tower superannuation, there was a press release on Thursday, 10 March on the account balance errors. What was the approximate number of people that were to be compensated?

Mr Lucy—We will take that on notice.

Senator SHERRY—Earlier I touched on the new role for ASIC. Now we know what we are talking about in the sense of responsibilities. Then again, this seems to be a new responsibility that ASIC has been given, and in the context of your workload, budget and staffing it is a concern. What will you be doing in this area?

Mr Cooper—As I understand it, we have already started getting this message out there as part of our super choice campaign—reminding people that it is not acceptable for kickbacks to be paid. We are communicating with both employees and employers to let us know when this happens. We are confident that we will get a reasonable flow of information via those

channels. It has already formed part of our normal compliance plan that we have this kind of activity under surveillance.

Senator SHERRY—What type of activity are you looking for? What type of activity do you believe may be a possibility?

Mr Cooper—I suppose, at the extreme end of the market, any number of ways of trustees transferring value to employers. It could be kindred to the sorts of activities that we saw in our soft dollar surveillance: things that, on the face of it, are quite hard to track, but our experience with the soft dollar will give us a head start in this area.

Senator SHERRY—Let us use what may be a difficult area: a provider gives a discount on insurance or superannuation arrangements or some other financial discount to an employer. How do you prove that the concession has been given to the employer in return for the employer ensuring through any of a variety of legal or illegal ways that the employee's superannuation goes into a specific fund?

Mr Cooper—I suppose that the more artful the kickback, the more difficult it is to locate. But certainly, again coming back to soft dollar, we were able to track down and do things about all manner of arrangements.

Senator SHERRY—Except soft dollar is, I think, relatively easy to identify. A financial provider saying, 'Look, I'll give you a cheap home loan or cheap life insurance'—how do you prove the connection between that and the outcome in respect of the superannuation?

Mr Cooper—In subtle cases it would be difficult. But, as I say, in the cases where, surprisingly, people are going on overseas holidays that they did not go on before and all those sorts of things we see in soft dollar, we will be able to detect those things that look out of the ordinary, where discounts are being given that other comparable players are not getting, and where things are unusual and do not otherwise have an explanation. That is what we will be targeting.

Senator SHERRY—The area that worries me the most is the RSAs. RSAs are a shocker of a product: high fee and low return. Rationally, no-one would be in them. They are the worst performers of the lot. Say an employer uses a default fund in a bank with an RSA product. They have low returns for high fees, and all the surveys show that; there is no disagreement about that. How do you show that the bank has said to the employer, 'I am giving you a discount rate on insurance, bank products or whatever'? I think it is very difficult to show a connection in those sorts of circumstances. Frankly, I have no doubt it will go on. Let's take the RSA example, which you may not know, or on which you may not accept my claim that it is a poor product in terms of fees and returns. If there were a significant increase in RSA use by the employees of a particular employer, would you examine that to see what the rationale for that is, when it is seemingly irrational?

Mr Cooper—That could certainly be something that would be on our radar screen because, as you say, it has been a relatively unattractive product. If we suddenly saw take-up increasing with no obvious explanation: that would be the sort of thing we would be looking for.

Mr Lucy—So much of our activity is driven by complaints, where we get intelligence from people coming to us and bringing to our attention undesirable practices. Clearly, this is an area that we will be looking at, particularly in the area of complaints, and responding to very quickly.

Senator SHERRY—I understand that complaints are a useful basis for action, but proactive inquiry is also a useful basis for action.

Mr Lucy—Yes, absolutely.

Senator SHERRY—Heading off a problem before it starts to blow up—

Mr Lucy—Clearly.

Senator SHERRY—in any significant way, particularly in this area.

Mr Cooper—It is really not too different from a lot of the work that we look at in a range of different markets and irregularities in a range of areas. There is nothing unique about this particular element of our tasks.

Senator SHERRY—The selection of a default fund by an employer seems to me very important in terms of fees, returns et cetera. Are you examining this issue at all? There will be substantial numbers of people who remain in or enter into a default fund.

Mr Cooper—There will, but there will be all the usual processes, product disclosure statements and, of course, the regime on kickbacks that we have just been talking about to make sure that—

Senator SHERRY—Sure, the fees are disclosed—it is a default fund—but what in law requires an employer to act in the best interests of a member or potential member in respect of the selection of a default fund on those issues? There is not anything in law which requires them to do that, is there?

Mr Cooper—No. But it is the other protections; it is the fact that there is a product disclosure statement and that a number of employees will get advice.

Senator SHERRY—The point I am getting at is that a person who defaults, by their nature, is not being proactive. They are not making active comparisons.

Mr Cooper—They have not made a choice. Correct.

Senator SHERRY—It is a default. There is inertia amongst that group of people—and it is a very substantial number of people, whatever happens to—

Mr Cooper—In many cases it will be what they already have—in the sense that they did not make a choice about where they are at the moment.

Senator SHERRY—That is right. So what is the safeguard to ensure that the employer delivers a good value default fund when they select it?

Mr Cooper—Apart from the obvious answer of ‘a very unhappy work force if it is the wrong decision’, it is really the other protections around the system—the fact that there will be a PDS and the fact that many employees might ask a licensed adviser: ‘Hey, I really don’t want to make a choice and I am going to be put into this fund. What do you think?’ There will be a range of things.

Senator SHERRY—Do you think they are appropriate, given the nature of the default fund? Let me give you an example. Why shouldn't the law require competitive tendering for default funds? The law does not even require that, does it?

Mr Cooper—No. This comes down to an interesting philosophical question about what is the best fund. Even at licensed adviser level, the obligation really is only to advise whether a fund is appropriate or not—which is a slightly different standard. I also think that imposing this sort of obligation on the average employer is probably not the solution.

Senator SHERRY—I agree with that. Super fund choice—this model—is enough of an imposition anyway. Why should the onus be put on the employer to pick the default fund?

Mr Cooper—I guess that in many cases it replicates what has gone before—in the sense that, in many cases, where superannuation has gone has been the employer's decision. So it is not too dissimilar from that environment in many cases. Of course, even when someone has gone into a default fund, the system freely allows them to make a choice to do something else at any time they like.

Senator SHERRY—Will the examination of default fund selection be an issue you will be looking at in the context of super fund choice?

Mr Cooper—Definitely, and we have made that clear. That is a message we are definitely going to get out into the marketplace because, in some cases, it is clearly an area where there might be abuses.

Senator SHERRY—And there may not even be deliberate abuse; there may be just ignorance. Frankly, a lot of employers do not want to be involved in these sorts of issues—that is the feedback I get—and that is perfectly understandable. Some will go out and pay for advice to find out what is the best default fund and perhaps even go through a contract, a tendering service, where there are service criteria matched against price. That goes on, to some extent, already. There seems to me to be real potential not just for abuse but for inadvertently poor selection by employers, simply because they do not have the knowledge of or particularly want to make a selection of a default fund.

Mr Cooper—I think that is partly true, but it is certainly not too different from the current situation where, for many years, employers have, for one reason or another, been in a position of making those sorts of decisions.

Senator SHERRY—Yes, but, at least until the industrial laws of this country change, the default fund/s in the majority of cases are determined by the industrial commission.

Mr Cooper—That is true.

Senator SHERRY—That change means that the onus on the default fund comes back to the employer in all cases, doesn't it?

Mr Cooper—That is true.

Senator SHERRY—My suggestion is: watch that space. I think that is as much a worry as the individual churning that may or may not occur.

Mr Cooper—We will certainly take that on board.

ACTING CHAIR—Thank you very much Mr Lucy and Mr Cooper. We appreciate your frankness and the depth of your answers. We look forward to your responses in due course.

Proceedings suspended from 6.50 pm to 8.03 pm

Department of the Treasury

CHAIR—Order! The proceedings are resumed. I welcome to the table officers of the Treasury. Senator Sherry.

Senator SHERRY—I would like to start with some questions on the drought. Does Treasury do any analysis on the impacts of drought on the economy?

Dr Parkinson—I will pass that question to my colleague Ms Quinn. Before she answers that, I would like to indicate that the secretary to the Treasury had been here since four o'clock this afternoon. He waited until the committee arose. He sends his regrets that he is unable to join us tonight.

CHAIR—Thank you, Dr Parkinson.

Ms Quinn—The Treasury does examine the impact of weather on the rural sector. However, in the budget forecasts, as I think you are aware, we assumed the return to average normal seasonal conditions for the 2005-06 budget forecast period. There has been a question raised about that assumption. I would like to clarify that at the time of the publication of the budget, which is in May each year, there is a window of opportunity for rains for winter crops in particular. At the time the budget was put together, the information we had from the Bureau of Meteorology and the Australian Bureau of Agricultural and Resource Economics forecasts suggested that there was the possibility of a return to average seasonal conditions. That was the assumption that both those organisations were using. That is the assumption that we used in this year's budget. However, we did highlight that there were risks about the actual timing and distribution of rainfall through 2005 having an important influence on rural production and exports.

It is still too early to call the implications for the lack of rainfall in the intervening time between the budget forecast being finalised and today. The window of opportunity for planting winter crops is still open until some time around the end of June. So until that time and until we get more information from some of the experts in this area which we called upon, such as the Australian Bureau of Agricultural and Resource Economics, who are producing their next June crop report on 7 June, we have not done analysis on the precise implications of the current weather conditions for the 2005-06 period.

Senator SHERRY—Would you say the drought can have a significant impact on the economy? What economic variables can it impact?

Ms Quinn—It depends obviously on the timing, distribution and severity of the drought. It can have significant economic implications, as it did in 2002-03. It has an impact on rural production, rural employment and rural incomes and subsequently exports in the economy.

Senator SHERRY—So it can have a major impact on the economy?

Ms Quinn—Yes. It could do.

Senator SHERRY—Have you been able to analyse the impact of the drought on the economy in recent years?

Dr Parkinson—Senator, could you clarify the question, please?

Senator SHERRY—Well, there has been a drought over the last couple of years in large parts of the country. Hasn't that already impacted on our economy?

Dr Parkinson—It has. In previous meetings of this committee we have talked about it. For example, a couple of years ago we saw an almost 30 per cent fall in agricultural output. That is about three per cent of GDP. In normal conditions, that would be equivalent to taking close to one percentage point off GDP growth. After that, we had a very significant contribution to growth. So it depends on what is happening. As Ms Quinn said, how the current drought impacts on the economy is still up in the air.

Senator SHERRY—What is Treasury's forecast for farm sector growth in 2005-06?

Ms Quinn—We do not provide precise advice. Farm product is expected to fall eight per cent in 2004-05 in year average terms from a significant growth of 36.2 per cent in 2003-04, which was the recovery that Dr Parkinson was talking about. We are forecasting production on average over 2005-06 of five per cent.

Senator SHERRY—In the relationship between the earlier figure, the forecast of minus eight per cent, I think you said, and then the average five per cent growth over 2005-06, you have used the figure of minus eight and then a figure of forecasted plus five. What relationship is there? Why is one so significantly negative and the other positive?

Ms Quinn—Because in 2005-06 we were basing the five per cent growth in production on average seasonal conditions. So we are also looking at the implications. There were some areas that were still being affected by low subsoil moisture from the previous dry period. There are also issues about stock rebuilding and herd rebuilding and assumptions about decisions that agricultural producers make in terms of the acreage of planting they put in and what their assumptions are about production and so forth in terms of area. So we use information from a variety of sources, including a quite heavy reliance on the Australian Bureau of Agricultural and Resource Economics, who have more detailed research in this area.

Senator SHERRY—You have already touched on this; obviously Treasury consults directly with ABARE. Does Treasury consult directly with the Bureau of Meteorology?

Ms Quinn—Yes.

Senator SHERRY—In your consultations in the lead-up to the budget both with the Bureau of Meteorology and ABARE, you used their advice at the time of the cut-off date for the calculation of the impact in this area?

Ms Quinn—Yes.

Senator SHERRY—So does Treasury today stand by its forecast?

Ms Quinn—At the time of the budget, the Bureau of Meteorology was predicting above average rainfall in the eastern states. Conditions in parts of Australia have been drier recently and the Bureau of Meteorology have downgraded their analysis of the possibility of above

average rainfall or average rainfall. So it is true that since the budget the risks to the rural outlook have become greater than those highlighted at the time of the budget. However, it is still too early to have an analysis of the impact on the winter crops in particular because, as I said, the planting window has not yet closed and it is still possible that rainfalls between now and the end of June will result in the significant planting of the wheat crop and other cereal crops. There have been significant rainfalls in Western Australia which have allowed planting of the cereal crops to date. Western Australia is a significant proportion of the whole Australian production in this area.

Senator SHERRY—How important is that five per cent farm product growth to achieving other economic forecasts—for example, gross domestic product growth, the export of goods and services and the current account balance? What is the relationship between farm product growth and those sorts of economic issues I touched on?

Ms Quinn—It is important. It does contribute to GDP growth. As an indication of the size, in the latest national accounts, farm GDP has fallen 16 per cent through the year to the March quarter. With the gap between total GDP growing at 1.9 per cent and non-farm GDP growing at 2.6 per cent, it can have a significant impact on the overall output.

Senator SHERRY—And exports of goods and services?

Ms Quinn—Exports of goods and services to date? Is that your question?

Senator SHERRY—Both to date and also in the future if things do not eventuate as forecast.

Ms Quinn—Exports are around 20 per cent of the economy, so they are also a significant contributor to growth. We are forecasting exports to grow two per cent in 2004-05 and to grow seven per cent in 2005-06.

Senator SHERRY—So a continuation of the drought would impact on those forecasts?

Ms Quinn—Yes, they would, although there is an issue of timing in that the exports in 2005-06 are largely off the production of grains the year before. So there would be a large impact from any delay or reduction in the crop size in 2005-06 into exports for 2006-07.

Senator SHERRY—And would the same issue arise with the current account balance—a lag effect?

Ms Quinn—Yes. Although it would depend also on the price received for the products. It may be the case in some areas that Australia's exports, being wheat, may have an implication for the price received by producers.

Senator SHERRY—Does Treasury do a sensitivity analysis about different farm output scenarios?

Ms Quinn—We have not at the moment. At various times we do examine implications for different outcomes.

Senator SHERRY—Would they best be described in respect of farm product growth as projections?

Dr Parkinson—They are forecasts. We draw a distinction between forecasts and projections. Projections go beyond 2005-06. When we talk about the aggregate numbers, we

are talking about the attainment of trend. So it would be reasonable to treat the 2005-06 numbers, even though they are part of an overall set of estimates, as akin to projections because we have nothing else upon which to forecast out that period. I go back to what Ms Quinn said earlier. When we know that the window of opportunity has closed or we are aware that the carryover effects from a previous drought are so significant that even with normal seasonal conditions you would not get reasonable farm product outcomes, we would factor that in. As she earlier, when we put the budget together, we still have a window of opportunity and that window of opportunity has about another month to five weeks or so to run. Indeed, the Wheat Board has cautioned that people can plant wheat certainly up to the end of June. It is not too late. So that just reinforces the point that while it is clearly a situation that requires close monitoring, there is no reason at this stage to move away from our forecasts.

Senator SHERRY—In statement 11 in the budget, I understand the status of the fiscal risk of drought is referred to. Is that correct?

Dr Parkinson—You have me at a disadvantage, but I am sure that would be the case. That is the statement of risks document?

Senator SHERRY—Yes.

Dr Parkinson—Yes.

Senator SHERRY—In that statement of risks document, why wasn't that carried over to statement 3 of Budget Paper No. 1 on the economic outlook?

Dr Parkinson—I am sorry, but it was. In fact, the causality goes the other way. It would not be in the statement of risks unless it was seen in statement 3 as a potential risk. As Ms Quinn said earlier, the text of statement 3 explicitly mentioned the risk.

Senator SHERRY—What involvement and responsibility does Treasury have for the material in the blue budget books—for example, *Taking stock: positioning our rural and food industries for the future 2005-06* and *Building stronger communities 2005-06*?

Dr Parkinson—As you know, there are numerous documents produced at the time of the budget. I personally—and I suspect none of my colleagues here—have not seen any of those documents.

Senator SHERRY—They are part of the budget papers.

Dr Parkinson—Are they formal budget papers or are they budget supporting documents?

Senator SHERRY—Are they government spin?

Dr Parkinson—I have been advised by Mr Tune there is no Treasury involvement in those documents.

Senator SHERRY—None at all?

Senator Minchin—Every department produces its own set of supporting documents that are not official budget documents in the sense they are produced by Treasury and Finance.

Senator SHERRY—They are released with the budget?

Senator Minchin—Yes.

Senator SHERRY—So they are government spin, if you like?

Senator Minchin—Well, no. They are various departments demonstrating their own contributions to the working of the country.

Senator SHERRY—They are departmental spin. So you do not classify them as budget documents even though they come with the package?

Dr Parkinson—The white ones and the glossies are the official budget documents.

Senator SHERRY—What about the yellow ones?

Dr Parkinson—They are the portfolio budget statements, yes.

Senator SHERRY—Do you include those as official budget documents?

Dr Parkinson—Yes.

Senator SHERRY—So we have the white ones, the yellow ones and the blue ones.

Dr Parkinson—You may have the blue ones. I have not seen them.

Senator SHERRY—Then we get into press releases. That is real spin. These blue budget books seem to suggest there is a drought and it would continue in 2005-06. It says:

With many parts of the country still gripped by drought, the Coalition Government continues to make a major commitment to both drought preparedness and support to farmers.

That is in *Taking stock: positioning our rural and food industries for the future*. It goes on:

Before this drought is over, it is expected that the Australian Government will have contributed about \$1 billion on drought assistance measures for farmers.

That is without taking the latest announcement into account, obviously. That is *Taking stock: positioning our rural and food industries*. In *Building stronger communities*, it says:

With many parts of the country still gripped by drought, the Australian Government continues to make a major commitment to both drought preparedness and support to farmers.

It seems to me to be a different emphasis in message than the budget papers.

Dr Parkinson—Put aside the absence of rainfall for a moment. Even with normal rains, you would still likely have what we have referred to in the past as an irrigation drought—that is, low levels of water storage even after normal rains—which would impact on farm production and hence on farm incomes in various parts of the country. Similarly, there have quite clearly been patches of the country where there has not been ongoing drought. But what we are doing when we put together macroeconomic forecasts is making a decision in aggregate about the entire economy. We do not say, for example, that we expect above average production in Western Australia and below average production in New South Wales. If those things wash out in aggregate because seasonal conditions are on average reasonably around normal, we are just going to use the term ‘average seasonal conditions’. Indeed, page 3-6 of the budget papers state:

As is normal practice, the forecasts for the rural sector are predicated on an assumption that average seasonal conditions will prevail in 2005-06. The actual timing and distribution of rainfall through 2005 will have an important influence on rural production and exports in 2005-06, as will the lingering effects of dry weather in recent years.

Now I do not see there is any distinction between that and the government saying that it is committing money to deal with the ongoing effect of the drought and drought-proofing.

Senator SHERRY—You say drought-proofing.

Dr Parkinson—If you go back and read what you read out to us earlier, part of that is actually about helping farmers prepare themselves for drought, often referred to colloquially as drought-proofing. It does not prevent the absence of rain.

Senator SHERRY—I am just surprised you use the term ‘drought-proofing’ because I do not think even the government does. Certainly in the quotes I read it talks about drought-preparedness but not drought-proofing.

Dr Parkinson—I am prepared to use either ‘drought-proofing’ or ‘drought-preparedness’, whichever you prefer, Senator.

Senator SHERRY—I think there is a pretty major distinction. I do not have any more questions on the drought unless Senator Murray has.

Senator MURRAY—Dr Parkinson, you and I have had discussions about estimates and calculations of these sorts before. I just want to confirm this for the record, particularly in view of the remarks immediately after the budget by the Deputy Prime Minister and the immediate inference of its effect on GDP and other figures. Was anyone within Treasury or outside Treasury instructed to suppress the sorts of views that the Deputy Prime Minister seemed to be expressing?

Dr Parkinson—I am not aware of anyone in Treasury being instructed or suppressed on views on any issue. But I assume you are talking about the Deputy Prime Minister’s comments immediately afterwards that suggested that the drought could knock the forecasts off-track.

Senator MURRAY—That is right. The theory, of course, is that you knew that and it was too far down the budget process to change all your material. By you, I mean the Treasury.

Dr Parkinson—Let me assure you there is absolutely no substance to anybody suggesting that we suppressed anything at all. As Ms Quinn explained in detail earlier—

Senator MURRAY—I was listening on the television.

Dr Parkinson—we still have a window of opportunity that will not close until around the end of June. If we get good rains—and we have to get good rains—we can still get a reasonable outcome. As to where we were when the budget numbers were put together, we would have settled two weeks before the budget.

Ms Quinn—There is also an opportunity if there was a large set of information to adjust.

Dr Parkinson—Even within the last weeks.

Ms Quinn—Even within the last few weeks. But certainly at the time that we finalised our forecast the information we had from the Bureau of Meteorology was that they were predicting above average rainfall in the eastern states. There was also ABARE’s information that they were using average seasonal conditions in their outlook at that time. That was the information we used.

Senator MURRAY—And they did not advise you of the changed view until after the budget?

Dr Parkinson—No. We were not advised.

Ms Quinn—ABARE has not published new information as of yet. Their next published information is on 7 June. The Bureau of Meteorology is still actually talking about predicting average rainfall over winter for much of the country. So, while there are issues about the localised lack of rain, there is rain in other areas. So they still are expecting average rainfall across the economy as a whole.

Senator MURRAY—I have heard the Bureau of Meteorology in the west—that is where I am from—stating that they expect good early rains and poor later rains. It is that sort of environment. I do not criticise you for not knowing anything about the weather. Quite frequently I am in Perth and I am told by the Sydney newsreader that it is raining or it is hot when it is actually neither. They do not even know the day's weather sometimes, so I do not criticise you for that. All I wanted to be sure of on the record is that there was no instruction from inside the Treasury or from without to not to change the budget forecasts.

Dr Parkinson—Let me be absolutely categorical: no instruction of any sort was received by me or by any of my staff.

Senator SHERRY—I want to follow on from those questions from Senator Murray. The comments of the Deputy Prime Minister and Leader of The Nationals were strong—that is how I would characterise them—and came a very, very short time after the budget. It would seem to me to be unlikely that you formulated that opinion within that last two weeks. It begs the question of whether the National Party has any input into the budget at all.

Senator Minchin—That is not a fair question to Treasury.

Senator SHERRY—To you then, Senator Minchin. Does the National Party have—

CHAIR—I do not think it is a fair question to Senator Minchin.

Senator Minchin—It is an odd question to ask in estimates. But the National Party is a fundamental part of our government and is well represented in the cabinet. The cabinet decides the budget at the end of the day. The National Party has the Deputy Prime Minister and other ministers in cabinet; so, yes, it plays an appropriate role in budget formulation.

Senator SHERRY—But they were not under the doormat, as they usually are, on everything on this occasion again?

Senator Minchin—Normally you argue the converse—that the National Party has far too much influence on our government.

Senator SHERRY—No. I have not argued that. Some others might have, but I have not.

Senator Minchin—Some of your colleagues have.

Senator SHERRY—We will see from future activities in the Senate. On the issue of inflation, I note from the ABS CPI release for the March quarter of 2005 that the house price index rose in all capital cities 'driven to a large extent by increasing labour costs as a result of a general shortage of skilled tradesmen and rising material costs'. Has Treasury undertaken an

analysis on skills shortages in the construction sector? If not, who have you relied on for analysis? Where have you sourced such analysis, if in fact it has been carried out?

Ms Quinn—We do look at the labour market. We look at what is happening to the different components of the labour market in terms of employment. In terms of skills shortages, we have information from business surveys and industry liaison and information in the public domain from various industry organisations. We can look at the distribution of wages and employment. It is difficult to distinguish the difference between strong demand and a lack of supply in particular sectors, but it is true that there is particular pressure in particular industries in particular geographical locations in some areas for increases in wages. But there is no generalised or aggregate wage pressure or skill shortages that we are aware of at that aggregate level other than the specific locations.

Senator SHERRY—You referred to particular industries, particular occupations and particular localities. What are those that Treasury has been able to identify?

Dr Parkinson—We have talked about this in times past, most recently at the last estimates hearing. Clearly, the housing construction sector has been for some time experiencing price rises in material inputs and in wage rates. You can see that in the data and you can see it anecdotally if you try to get a bricklayer or a plumber. In addition, we have talked about there being particular types of skills shortages: for example, around engineering activities in some geographic areas but not necessarily broadly across the country or even across that entire sector. The other key area more recently, and not surprisingly, has been the mining sector.

Can I just go back for a moment, though. You made a comment about house prices increasing. The Residex series has data available for June 2005. It has virtually no growth in either March or June—

Senator SHERRY—Yes, I was going to get to that.

Dr Parkinson—in Sydney, very little in Melbourne and slightly more in Brisbane. That is consistent with the pattern that we have been seeing overall in the way the housing market took off first and where it has begun to soften first. So, while it is true that house construction costs have risen, I think we will see the shortages in the housing construction sector begin to ease as activity eases.

Senator SHERRY—Just before I leave the skill shortages issue, what about the health sector? It seems very difficult to be able to procure a local GP and nurses in parts of the country.

Dr Parkinson—You are asking me to go to a level of detail that I can't. I cannot get into a discussion with you on each and every sector or occupation or profession.

Senator SHERRY—I understand that. But you identified engineering, mining and areas of the housing sector.

Dr Parkinson—Engineering skills in some areas. For example, for some time there has been a suggestion of that in the Hunter, but there was a shortage in the Hunter long before there was any suggestion there might be a shortage more generally.

Senator SHERRY—Having identified that, I am asking about medical and health services, in which I am suggesting there are shortages.

Ms Quinn—Looking at the wage price index, which is a measure of wages, and looking at the sectors that have experienced the above average growth rate, construction has recorded over the last 12 months the largest increase in wages, followed by the education sector. Health and community services, which are lumped together as a group, have grown very, very slightly above the oil industry average. Similarly, right down at the bottom you have accommodation, cafes and restaurants and transport and storage. So there is a very large distribution between the different sectors experiencing wage increases over the last 12 months.

Senator SHERRY—You mention one that I was going to ask about next, which is education, which you have identified for wage growth. What are the factors in respect of education?

Ms Quinn—Education is obviously related to public sector wages. They are subject to agreements between the workers and employers. It is difficult to know precisely what is behind that. I do not have those details.

Senator SHERRY—And the private sector as well, I assume. It does not just cover the public education sector.

Ms Quinn—Yes. This covers both public and private.

Dr Parkinson—Can I just go back for a moment to the issue of health professionals. In our business liaison, we have contact with state treasuries and health service providers. The only category that has been reported to us—this does not mean it is the only category—is radiologists.

Senator SHERRY—In the context of inflation, some of the components of the CPI such as clothing and footwear have been experiencing deflation. Do you expect that to continue? Are there some unusual factors there or are they one-off factors?

Dr Parkinson—Are you asking me to forecast the price of clothing per se? I am sorry, but I am not going anywhere near it. I have no idea.

Senator SHERRY—I would not take the shirt off your back. There are some differences that have emerged with clothing and footwear. Do we know the reasons for that?

Senator Minchin—Tariff reductions. We reduced tariffs on 1 January.

Dr Parkinson—And the global textile restrictions having been removed is also probably going to contribute to downward pressure in trend terms on clothing prices.

Senator SHERRY—Do you expect that to continue?

Dr Parkinson—It would depend very much on how global producers respond. In that respect, it is in a sense quite disturbing that the Chinese have felt it necessary to impose export tariffs on textiles. Like all tariffs, whether you are applying them as an importer or whether you are applying them as an exporter, the people who ultimately get hurt by tariffs are the poor. Consumers get hurt and the poor tend to get hurt more.

Senator MURRAY—So do you prefer currency adjustment by the Chinese?

Dr Parkinson—I think the Chinese government understands fully that it is in its own interests to engage in currency adjustment. It believes—

Senator SHERRY—What observations do you base that on?

Dr Parkinson—Sorry, but I am answering Senator Murray's question, if that is okay. Going back to it, I think the Chinese government has a very clear view that it would benefit from greater exchange rate flexibility. It has a difficulty in its mind as to how it introduces that flexibility and the degree of flexibility. There is pressure coming from the US to introduce greater flexibility and to do it as quickly as possible. The politics of that I will not go into about whether that is productive or counterproductive, but it is clearly the case that it is in China's interest that it introduce greater flexibility over time. That will allow it to run an independent monetary policy. It will allow it to focus more on domestic drivers for growth. Indeed, in budget statement 3, we have a comment that any feasible exchange rate adjustment in the near term is unlikely to deal with the global current account imbalances, which is in a sense the proximate cause of US pressure on China.

Senator MURRAY—My apologies, Senator Sherry. My interjection was really that, faced with the two policy choices, you are saying that the currency adjustment policy is a better process to deal with that problem than the problem that is being dealt with by tariffs. That is right, isn't it?

Dr Parkinson—Absolutely. The tariff adjustment is unfortunate in the sense that what we have is proximate causes and concern in the US heartland about job losses to China and the extent of competition whereas the ending of the multifibre agreement is really leading to a readjustment throughout the global textile producers about where textiles are going to come from. In fact, you actually see this massive spike in Chinese textile exports to the US, but textile exports to the US do not move anywhere near like that spike. So it is basically the Chinese taking market share from other producers. But the whole issue of trade with China has taken on such a political hue—indeed, you have seen within the US congress bills proposed that would impose a 27½ tariff on all Chinese exports.

Senator MURRAY—Which they will not do if there is a currency adjustment. That is the threat, isn't it?

Dr Parkinson—The threat is, 'We will do this unless you have a currency adjustment.' Our view has been all along—and the Treasurer has articulated this and we have said it publicly numerous times—that it is actually in China's own interest to engage in a currency adjustment to introduce greater flexibility over time. But you have to be careful when you do that. You do not want to do that in an environment where there could be unfortunate consequences. The Chinese government basically is arguing that the banking system is not fully ready to cope with increased flexibility. It is clearly the case that the banking system is not ready to cope with an open capital account and perhaps even a free float. It is less clear that they could not start a process in the near term that would allow for greater flexibility.

Senator MURRAY—Which is a managed float.

Dr Parkinson—It could be a managed float. It could be the adoption of wider bands rather than a fixed point to the US dollar. Sorry, Senator Sherry.

Senator SHERRY—What evidence from any Chinese statements is there that they are going to do that any time soon? We are wandering into the international area now, but perhaps we can just finish off on this issue.

Dr Parkinson—I think we have seen contradictory statements from Chinese officials. You see numerous times references to a commitment to greater flexibility when the circumstances are appropriate. At times, statements by Chinese officials have been interpreted as suggesting such action will occur immediately. At other times, there have been quite explicit statements suggesting that any such decision will be off into the future. But clearly you would not want to telegraph too clearly that you are going to do something.

Senator SHERRY—Clearly you would not want to telegraph too clearly?

Dr Parkinson—You would not want to telegraph that you were going to introduce flexibility in the future at some point where people could guess you were going to do it if what that did was lead to an opportunity for people to pile in, buy your currency now and sit back and wait for what was effectively a one-way bet. As you will recall in December 1983, we suspended trading in the Australian dollar before we announced the shift to the float. No-one wants to have a policy whereby you are telegraphing every step of the process of changing your exchange rate regime in an environment where it looks like a one-way bet. That is just a recipe for speculation.

Senator SHERRY—I do not want to go any further into the international area, where we have digressed to at the moment. I return to the issues around the ABS labour price index for the March quarter 2005. It shows the seasonally adjusted through-the-year movement to the March quarter had picked up to 3.9 per cent compared to 3.5 per cent or 3.6 per cent for each of the preceding quarters. Can you explain the reasons behind this acceleration in wage inflation?

Ms Quinn—As you mentioned, the wage price index did increase from 3.5 per cent through the year to the December quarter to 3.9 per cent in the March quarter. In terms of the split between the private sector and the public sector, the private sector wage price index increased from 3.4 per cent to 3.7 per cent and the public sector increased from 4.1 per cent to 4.5 per cent. So both the public and the private sectors picked up in the March quarter. In terms of the components, we have already mentioned that some sectors are growing quite strongly—construction and education—but other sectors, such as transport and storage and accommodation, cafes and restaurants, are growing below that. In terms of the underlying economic factors determining wages, on average, we think about wages being determined by productivity and inflation and by conditions in the labour market. It is not surprising with the unemployment rate at a 28-year low that we would get some modest increase in wages. We were expecting this in the budget forecasts. There was no surprise in that increase from 3.5 per cent to 3.9 per cent.

Senator SHERRY—So do you expect the acceleration to continue?

Ms Quinn—We expect the wage price index on average to grow at four per cent in 2005-06, so we would expect wages to move slightly higher from where they are now but to not continue the slope of increase that we have seen recently.

Senator SHERRY—And beyond that?

Ms Quinn—We do not do forecasts beyond 2005-06.

Senator SHERRY—You do not publish forecasts?

Ms Quinn—We do not publish forecasts and we do not produce forecasts. We produce projections, which are based on average trend conditions in the economy rather than precise forecasts.

Senator SHERRY—But those projections beyond that year are not published, are they?

Ms Quinn—No. The wage price index is published in statement 1.

Senator SHERRY—But they become a projection?

Ms Quinn—Yes, they do.

Senator SHERRY—What is it for those projected years?

Dr Parkinson—Out to 2008-09, in which case it becomes four.

Senator SHERRY—So a slight dip, then a slight increase again?

Dr Parkinson—It is only a dip in the sense that we are going from a forecast to a projection. A projection is just the long-run average. But, if we maintain that 3¾ per cent that we have used for the projections, you get a declining wage share in GDP. As we argued in changing the projection for GDP growth in 2008-09, that is the period where we begin to think the ageing of the population begins to bite. So it would be unreasonable to assume that the wage share would not at least flatten there. So the way that is then manifest in the projections is that you get year wage growth of four per cent.

Senator SHERRY—I am a little puzzled about your comment that the effect of the ageing population begins to bite at that time. How do you mean?

Dr Parkinson—In the sense that inflows into the labour market begin to ease off so employment growth begins to slow. As a result, we anticipate that the reality of the attractiveness of labour as against capital will move in labour's favour. So the wage share will not fall.

Senator SHERRY—So that is the total number—I do not know what the raw number is—moving into the work force each year. At that point in time, it starts to drop?

Dr Parkinson—Around the end of this decade is when you begin to see the tailing off.

Senator SHERRY—All other conditions being equal?

Dr Parkinson—Everything else being equal, yes.

Senator MURRAY—Your only counter to that is a higher participation rate or a switch from part-time and casual to more hours worked and more productivity.

Dr Parkinson—You are both right. It takes us back to the whole three Ps issue. If you want to maintain GDP growth in per capita terms, you need to increase participation, and that basically comes about by keeping people who are in the work force in there for longer and encouraging people who are out of the work force in.

Senator MURRAY—More work in more hours.

Dr Parkinson—Or getting people who are part time to move to full time or, to take Senator Sherry's point, boosting it through productivity growth. As we have again discussed here in the past, the desirable approach is to do all of those things.

Dr Gruen—I was just going to add a small amount to that. The basis on which these calculations are done is an updating of the methodology used for the *Intergenerational report*. So at the time the *Intergenerational report* was written there were projections by age and gender of participation rates by full time and part time all the way out to 2040. On the basis of history since the *Intergenerational report* was written, we are now somewhat more optimistic about what aggregate participation will look like over that period. In other words, participation has turned out to be slightly stronger in several age groups—particularly, if my memory serves, older people. That has led us to suspect that the peak in participation will occur a couple of years later than we previously thought it would. The details are actually in statement 3 of the budget.

Senator SHERRY—I had not read that. Doesn't it just highlight the difficulty of making long-term forecasts when assumptions can shift, in this case in a reasonably short period of time?

Dr Gruen—Absolutely. With the best will in the world one wants to do these projections to inform sensible policy, but one does them with one's eyes open, realising that the assumptions on which they are based are precisely that.

Dr Parkinson—Which takes you into the realm of wanting a no-regrets policy change, encouraging improved productivity and encouraging greater participation—things that, if we do them, we will not regret. If we do not do it and things pan out as we anticipated, we will see a quite significant slowdown in the growth of living standards in Australia.

Senator MURRAY—The upside is greater wealth than you would otherwise expect.

Dr Parkinson—Absolutely.

Dr Gruen—And less fiscal pressure.

Dr Parkinson—I have one thing to add to what Dr Gruen said. It is true that these things are sensitive to changes in the assumptions around participation. There are uncertainties in different areas. For example, subject to a static immigration flow, population numbers will not vary by much. In other words, you will not get them dramatically wrong because, even if fertility increases in a way you have not anticipated, it is such a small inflow into the total population it is not going to change things. On the other hand, if we get productivity wrong by half a percentage point either way, it would have a dramatic impact on what we did in the *IGR*.

Senator SHERRY—I have even seen an emerging debate about whether or not the relatively constant increases in life expectation since World War I are going to continue because of some issues around health and obesity and diabetes—not necessarily new diseases but diseases that seem to be emerging much more strongly—and, therefore, we may see a levelling off of that growth.

Dr Parkinson—The issue of what you might euphemistically refer to as lifestyle diseases is actually picked up in budget statement 4. One of the reasons for covering it in there is that it is actually relevant to the issue of sustainability of growth.

Senator SHERRY—So, on the one hand, increased participation, presumably meaning a higher income for certainly some people, could have an adverse consequence and impact on, say, obesity levels amongst elderly people more significantly. It counteracts it.

Dr Parkinson—In the sense that people who work less are inclined to be obese?

Senator SHERRY—That may be an impact.

Dr Parkinson—It is plausible. I do not know if there is any relationship between—

Senator SHERRY—One factor that helps may in fact lead to an adverse consequence on the other side of the ledger.

Dr Parkinson—Or it may turn out to be complementary.

Senator SHERRY—Or they both—

Dr Parkinson—Yes. At page 4-26 of statement 4, chart 8 actually shows labour force participation rates by health status. So the better your health status the higher your participation. But it is not at all clear that the causality is one way or the other. We think it goes both ways. We think that in fact participation in work and participation in community activities is positively correlated with health. Again, which way does causality go? We suspect it probably goes both ways. One of the things that I find quite plausible is the idea that, if you can help people remain actively engaged in society, you will actually go a long way to addressing potential social problems and their own health and engagement.

Senator SHERRY—Dr Gruen, you referred to the adjustment of that factor earlier in the context of the intergenerational model. I suspect we will get into some more detailed questioning of this tomorrow with probably Mr Gallagher.

Dr Gruen—He would be the person to ask.

Senator SHERRY—I will leave it until then. He is always a mine of information.

Dr Parkinson—We have the same view.

Senator MURRAY—And he is always conveying it.

Senator SHERRY—Overwhelming.

Dr Parkinson—It may sound an odd thing to say, but he is actually a national living treasure. We would not find someone like Mr Gallagher if he was not around.

Senator SHERRY—I think that is probably right. I regard him as an estimates treasure anyway, even though I have the occasional sharp word with him. We touched on the participation rate. There is also the issue of welfare to work changes. Has there been any long-term modelling or modelling at all about the impact of the proposed welfare to work changes?

Dr Parkinson—There has been some. I might suggest that you direct that question to Mr Tune, who is the relevant officer.

Senator SHERRY—Is there any modelling on welfare to work changes?

Mr Tune—Yes. There was some modelling done for the government in the context of developing the package.

Senator SHERRY—Has that been released?

Mr Tune—No.

Senator SHERRY—Why is that? I would have thought in the case of an important public policy issue the modelling of impacts would be useful for the public debate.

Mr Tune—The only figures that have been released are the figures that the Treasurer has used, which indicates an increase in the participation rate of about 1.1 percentage points or about 190,000 people over the course of the first three years of the Welfare to Work package. The other material was prepared in the context of providing material to the cabinet and, therefore, has not been released.

Senator SHERRY—What other aspects have been modelled?

Mr Tune—In the Welfare to Work glossy, as we call it, you will notice there were some references there to the possible impact not just on participation but on employment and also unemployment. The document talks about the possibility of a short-term increase in unemployment perhaps as a result of the measures. But over time that will dissipate as those people who are participating move into employment. We talked about it in a general sense without putting numbers against it.

Senator SHERRY—Was that modelled?

Mr Tune—Yes. There was some modelling done in the Treasury, yes.

Senator SHERRY—What other aspects of it were modelled?

Mr Tune—The main area we were involved in was to look at some of the impacts on effective marginal tax rates of various options being considered.

Senator SHERRY—Again, you can provide more detail later. There is a mature age worker allowance for over-55s. Was that included in the modelling impact in terms of cost?

Mr Tune—No. That was a separate measure from last year.

Senator SHERRY—I know it was a measure announced last year. We now have a new package, Welfare to Work. It would seem logical that Welfare to Work would impact on the policy that was announced last year.

Mr Tune—I am not aware of that. That is probably one you should ask the revenue group about.

Senator SHERRY—We have had the announcement of some industrial relations changes, at least in principle. The specific detail of the legislation has not been released yet. Has the department recently carried out any modelling on various scenarios that eventuate from industrial relations changes?

Mr Tune—Yes, there was some modelling done.

Senator SHERRY—When was that done?

Mr Tune—Over the course of about the last month or month and a half.

Senator SHERRY—That has not been released?

Mr Tune—No.

Senator SHERRY—What issues was that looking at?

Mr Tune—It was trying to think through the implications for employment in particular of the options the government had under consideration.

Senator SHERRY—‘Trying to think through’. Can you be a bit more specific than that?

Mr Tune—Trying to model the impacts.

Senator SHERRY—What about the impact on wages over time? Has that been examined as part of that exercise?

Mr Tune—No. It would have been implicit in the modelling, I suppose. You work through the impact on wages and then the impacts on employment.

Senator SHERRY—Has that modelling been concluded?

Mr Tune—Yes.

Senator SHERRY—Has the modelling been passed on?

Mr Tune—To whom?

Senator SHERRY—To the minister or ministers?

Mr Tune—Yes.

Senator SHERRY—Which ministers?

Mr Tune—The Treasurer in particular.

Senator SHERRY—What about the industrial relations minister?

Mr Tune—I do not think so. We provided the information we had to the Treasurer.

Senator SHERRY—Was that a totally internal modelling exercise or were there external advisers or consultants used on that exercise?

Mr Tune—No. It was internal to Treasury.

Senator SHERRY—It was totally internal. Would that have involved—we have already touched on the ‘treasure’—Mr Gallagher?

Mr Tune—No. He was not involved.

Senator SHERRY—In that modelling, was there any examination of the sectorial impact on an industry specific basis?

Mr Tune—I do not think so, no.

Senator SHERRY—Any other aspects of that modelling?

Mr Tune—No. It was fairly broad-brush macro modelling, as I indicated.

Senator MURRAY—No participation rates consequences?

Mr Tune—We were trying to look at the impact on employment, so there was an impact there, which is only part of the participation rate, of course. But most of the work that was done on the participation rate was in the context of the Welfare to Work package.

Senator SHERRY—What about economic growth?

Mr Tune—No. I do not think that was done.

Senator SHERRY—Was that overseen by you, not directly but indirectly?

Mr Tune—My group was providing advice to the Treasurer and the government on the industrial relations policy aspects. The modelling was actually done by my colleagues here on the macro-economics side utilising information that we provided to them.

Senator SHERRY—What model was used? Was it designed specifically for this purpose, or did you go back to a previous modelling exercise?

Mr Tune—I stand confirmed, but I think it was the TRYM model that was used.

Senator SHERRY—The TRYM model?

Mr Tune—Yes. That is the background model that is used by the Macroeconomic Group.

Senator SHERRY—Is there any private sector modelling of a similar, like or same nature that you are aware of?

Mr Tune—I have to defer to my colleagues.

Ms Quinn—In terms of a similar model to the Treasury macro-economic model, TRYM, there are other models available in the private sector. Access Economics has one. The Murphy model is another that I am aware of. There are other types of models that are part of international modelling efforts. The Oxford Economic Forecasting group has an Australian component to its international model that is also of a similar order. There are various other organisations.

Senator SHERRY—But are you aware of this modelling exercise, Ms Quinn?

Ms Quinn—The Welfare to Work analysis I am.

Senator SHERRY—No. The industrial relations work.

Ms Quinn—I am not aware of the industrial relations work.

Senator SHERRY—Has there been any announcement by the Treasurer—I am not aware of any—that that will be released?

Mr Tune—No, not that I am aware of.

Senator SHERRY—Minister, you do not recall any announcement to release that modelling?

Senator Minchin—I have not seen such an announcement.

Senator SHERRY—The Treasury Business Liaison Program in the autumn 2004 Economic Roundup reported the key themes for this program for February 2004, stating:

A number of contacts noted that it was becoming more difficult to attract and retain skilled labour in some sectors.

Does ‘a number of contacts’ refer to a number of contacts from the same or different sectors?

Mr Miners—Generally they are the same sectors, the sectors that were discussed earlier—namely, the construction sector in particular has found it difficult to attract skilled labour.

Senator SHERRY—The report goes on to say:

There was concern that they—

skill shortages—

did have the potential to put pressure on wage costs in certain sectors...

So are you talking about more than one?

Mr Miners—Yes, where there were skill shortages. At that stage, the construction sector was one. There was some difficulty in the accounting sector, mainly changes to the accounting standards, so there was pressure there as well.

Senator SHERRY—The accounting sector was not one we discussed earlier. I think the Audit Office did mention in passing during their evidence the difficulty they have at the moment of holding and attracting new staff in the current financial environment because of eight to 10 per cent wage salary increases in the sector. I am not sure of the exact figure.

Mr Miners—I am not aware of the Audit Office raising that. We have certainly come up against some issues, there being more difficulty attracting them. That usually results in higher wages being offered to attract staff.

Senator SHERRY—It also noted:

Several contacts also indicated that these difficulties could become more marked in the medium term as a result of a shortage of new apprenticeships.

Is the reference to the shortage of new apprenticeships a general reference across the board or a specific sectoral reference?

Mr Miners—I am just trying to recollect exactly what was said. My recollection is that it was mainly in specific sectors, not across the board. It related again to those sectors where there were existing shortages of skilled labour. I do not recall it being widespread across all areas of apprenticeships.

Senator SHERRY—What about cooks? We always seem to see a significant number of cooks coming into the country. Is that indicating some sort of apprenticeship shortage in that area?

Mr Miners—I cannot recall the shortage of cooks ever being mentioned to us.

Senator SHERRY—You cannot recall?

Senator Minchin—There were too many cooks.

Senator SHERRY—Following that February 2004 Business Liaison Program, has been there any research carried out by Treasury in an attempt to identify and understand any emerging skill shortages issues already known or emerging?

Ms Quinn—We continue to monitor what is happening in the labour market in our continuous Business Liaison Program through, as I said before, business surveys and looking at the data available from the Australian Bureau of Statistics. DEWR also produces information on trades and apprenticeships and skill shortages. So we continue to monitor it as part of our general economic outlook. There has not been a specific project in my area of Treasury examining this.

Senator SHERRY—Any area of Treasury?

Ms Quinn—Not that I am aware of. But there could possibly have been elsewhere.

Senator SHERRY—So it is continual monitoring work in progress at this point in time?

Ms Quinn—Yes.

Senator SHERRY—Just to recap on this, we had an earlier discussion where we touched on housing; the labour force, although that would appear to start easing off; engineering skills; mining; education; and radiologists in the case of the health sector. You have kindly added to that list accounting. Are there any other areas that come to mind before I conclude this area? It seems to be a bit of a growing list.

Dr Parkinson—I want to make a general comment. We have an economy that has 5.1 per cent unemployment at a 28-year low. Were we not to have people saying that it is harder to get particular types of skills and employees than in the past, I would be very, very surprised. As Dr Gruen has just mentioned, I would mistrust the data. I know you have not done this yet, but were you to take what we had said and then say, ‘This is evidence that we think there are generalised skill shortages,’ I think we would say we had been verballed.

Senator SHERRY—Dr Parkinson, I think you are getting a bit ahead of yourself. I have not asked the question or even made the point yet. With respect, I think I am asking the questions in a respectful way. I do not think you need to get that far ahead. The anticipation is very significant on your part.

Senator Minchin—He is just keen to ensure you do not misunderstand some of the answers being given.

Senator SHERRY—I do not think I have made any outrageous or unreasonable assertions or allegations to date.

Dr Parkinson—I am more than happy to take your commitment that you would not take anything that we have said as evidence of generalised skill shortages.

Senator SHERRY—I am getting to the point where we are trying to establish where there are particular shortages.

Dr Parkinson—But that is a serious point. I am not in any way attempting to belittle the question. I reiterate that in an environment where you have had uninterrupted growth since the early 1990s, where you have a 28-year low in unemployment, it would be absolutely astounding were you not to be able to identify areas where there are skill shortages. We can go through every single occupation you can think of—

Senator SHERRY—I understand that perfectly, but there may be an issue around what the appropriate policy response is—

Dr Parkinson—Yes.

Senator SHERRY—in a whole range of areas—

Dr Parkinson—Absolutely.

Senator SHERRY—that I may or may not get to. I am just trying to have a look at where Treasury is up to in terms of a factual analysis at this point of time. That is what we are dealing with at the moment.

Dr Parkinson—I am happy to carry on.

Senator SHERRY—The July-August 2004 liaison program with its contacts noted engineers, which we have covered; mechanics, and I am not sure whether that is covered in what has been mentioned so far; and specialist drivers. What was the reference to specialist drivers all about?

Dr Parkinson—Can I suggest you have us at a disadvantage. You have gone back 15 months.

Senator SHERRY—July-August.

Dr Parkinson—A moment ago, you were in February 2004. Now you are in mid-2004. We actually came to talk about the budget. We are more than happy to talk about the results of the business liaison program, but I am not aware that any of us actually have the detailed information in front of us.

Senator SHERRY—You just have to tell me that. We are dealing with macro domestic economic policy advice and forecasting. These are aspects that I think are relevant at least to aspects of domestic economic policy forecasting.

Dr Parkinson—Let me be clear. I am more than happy to have a discussion with you about any of these issues. But you are quoting back to us documents that we do not have in front of us. So all I am saying—

Senator SHERRY—I accept that.

Dr Parkinson—Mr Miners has conducted the liaison. But we are asking him to recall details of conversations that he had at that time, which I think is a bit unfair. He may well be able to do it, but I think we have to be cautious about what we are asking.

Senator SHERRY—I am not asking for his specific conversations. But the reports were written.

Dr Parkinson—Stephen, can you clarify what the reference to specialist drivers might have meant?

Mr Miners—I have to say from my recollection I cannot recall exactly which specialist drivers we would normally refer to. It could well have been drivers in the mining sector. That is quite a likely one.

Senator SHERRY—Yes. I looked at it and I thought, ‘Specialist drivers. What drivers are we talking about? Truck drivers or construction drivers?’

Dr Parkinson—Stephen, correct me if I am wrong, but we would try to give a bit of a rundown by industry. That sounds like a reference to the mining industry. There is a reason why I inject a note of caution—because we do not have it in front of us. You have it; we do not. I do not want us to make a comment that—

Senator SHERRY—It is the one time of the year when we might have a slight advantage on this side of the table in terms of access to information. Is that what you are suggesting, Dr Parkinson?

Dr Parkinson—Well, it is somewhat ironic that—

Senator SHERRY—You have all the information in the world over there with all the public servants and material on specialist advisers. It is the one time of the year we might have a possible advantage.

Dr Parkinson—And what disturbs me about it is that it is the information that we have released publicly.

Senator SHERRY—Yes. That is right. You cannot blame us for asking a few questions about it.

Dr Parkinson—No. We would encourage you to ask us questions about it.

Senator SHERRY—I understand Senator Murray had some questions.

Senator MURRAY—I will give you a bit of relief if you need it. I want to go back to currencies. I might have told you before that John Edwards from HSBC is one of the economists I keep an eye on. I think he makes some interesting remarks. Very recently, in the week commencing 30 May 2005, the *HSBC Australia and New Zealand Weekly* opened this way:

Tuesday's Australian first quarter balance of payments will add another \$15 billion or so to net foreign liabilities, which have swiftly increased this decade to a level which will sooner or later require big changes in Australia's economic structure. Neither Australia nor New Zealand can continue to run up liabilities over the next five years as they have over the last three years. The implacable arithmetic of these liabilities suggests both countries must begin running serious and continuing trade surpluses—and this probably means both will need spectacular falls in their exchange rates.

Need is one thing. Whether it happens is quite another thing when you have a float, as we do. Do you agree with that analysis in the broad? Do you agree with the view that in due course there must be a fall in the exchange rate or there will need to be a fall in the exchange rate?

Dr Gruen—I would not want to speculate on the direction of the currency. I would make the point that Australia has been running a current account deficit on average of about 4½ per cent of GDP since the early 1980s. The average for the 1980s is about 4½ per cent of GDP. The average for the 1990s is about 4½ per cent of GDP. The average since 2000 is about 4½ per cent of GDP. You might well have written such a commentary at various stages through that period. Certainly there were commentaries around 1990 that made those sorts of claims that Australia would not be able to go on running current account deficits of the size we had run them in the 1980s. The past 15 years has been a period of extremely good macroeconomic performance combined with current account deficits of that sort of order of magnitude.

It is true that over an extended period of time we have increased net external liabilities as a fraction of GDP. It is also true that we cannot go on forever increasing net external liabilities to GDP. But it is also true that with open capital markets, a government sector that is in surplus, private decisions that are based in an environment of low inflation and an extremely sound banking system, arguably we are in a very strong position to continue to run significant current account deficits.

Senator SHERRY—At this level?

Dr Gruen—I do not know the answer to that question. Certainly you could in principle go on running account deficits of 4½ per cent of GDP forever and the net external liabilities to

GDP ratio will stop rising at some point. In fact, it will stabilise at about something like 80 per cent of GDP. We are currently at about 66 per cent. Compare our situation to other countries which have very large current accounts. The one that comes to mind is the United States. Most of the commentary that I have seen about the United States has made the strong suggestion that the United States needs to get its fiscal house in order. A series of suggestions has been made about the things the United States should do, all of which we have done in Australia. So I think we are in a much stronger position to run current account deficits than we were in the past.

Although it appears convincing to make claims that we will have to do something over the next three years, my suspicion is you could have said that in 1990 or 1995 and it would have appeared to have been a very plausible prediction at the time. It turned out to be wrong. I do not know whether you are aware, but there is a big literature on exchange rate forecasting which suggests that the current level is about the best guess you can make any time, with the best will in the world, over the next 12 to 18 months. There are no economic models that do better than a no-change forecast over that sort of horizon. So I am not completely answering your question but I hope that I am at least giving you something.

Senator MURRAY—Dr Gruen, as you would expect, I read as much as I can around this field. I remain absolutely puzzled and perturbed as to any solution. I will readily confess I do not have an answer to problems that people put to me with respect to these issues. But I have asked my question because, of course, the budget papers, Treasury forecasts and Treasury projections do not assume a shift in the exchange rate.

Dr Gruen—That is right.

Senator MURRAY—Yet there is an assumption from most economists that an exchange rate change, probably downwards, is likely. That is my reading of it. You may disagree. It seems to me that the only lever you have almost with respect to exchange rates in the modern open economy is interest rates. There is not much else you can do. The market will decide, in other words. You can influence the market through interest rates. I am inclined to believe that past projections of doom that have been pushed away mean that you should not forecast doom in the future. Nevertheless, I am also of the view that a decline in our exchange rate would probably be advantageous for the country. With that in mind and with Edwards's remarks in mind, at the back of my question is really whether you think there is any policy adjustment which the government, as distinct from the independent Reserve Bank, can look to to influence this area.

Dr Gruen—It was the case that in the late 1980s and early 1990s there was a debate about whether monetary policy should be used to influence the current account. It was decisively decided by all players that monetary policy should not do that. In fact, a statement was made late last year by the deputy governor, Glen Stephens, along the lines that we had that debate in Australia and it was resolved and monetary policy has a role to achieve the inflation target and not to try and influence the current account. So monetary policy has come to that decision and I think that is exactly right.

One way to look at the current account is via a savings investment balance framework. In that framework, the statement you can make is that the government is making no net draw on

foreign savings because the government is running fiscal surpluses. Along that line, Treasury had a submission to a Senate inquiry into the links between current accounts, housing—

Senator MURRAY—And household debt. I am on that committee.

Dr Parkinson—We have made a submission.

Dr Gruen—In that submission is quite a revealing analysis which looks at the saving and investment balances of the various parts of the Australian economy—the government sector, corporate sector and household sector. That demonstrates that it is an excess of investment over savings in the household sector that explains virtually all the current account at the moment. That is associated with a very big rise in house prices and the lift in dwelling investment as a share of GDP. Even though dwelling investment has been coming off in the last few quarters, it is still at a very high level as a proportion of GDP. Household saving is low, as you would be aware. So the current account in a kind of arithmetic sense is explained by the household sector at the moment. I guess if your view is that the housing sector is cooling, which I think the evidence suggests it is, that suggests there are forces under way that are likely to reduce the extent to which the household sector's investment exceeds its savings in the future.

Senator MURRAY—The difficulty is that if you address issues which have led to asset inflation and consumption, which has ridden off the back of the asset inflation coupled with the usage particularly of home equity and so on to fuel current consumption, if you were to introduce policy measures to address that and dampen the demand for foreign funds, which effectively is feeding it, as you have just described, then you face the danger of putting recessionary pressures into the economy. So it is a very difficult policy conundrum, I think, to face. It seems to me that to date the government has given no clear indication of a policy path because they have relied on the Reserve Bank essentially to deal with these issues, which it pursues to address issues of increasing production and decreasing consumption through adjusting the relationship between the household sector and the business sector, effectively.

Dr Parkinson—This is not an answer in the way you just posed it then. It goes back to what Dr Gruen said in response to the earlier part of your question. The common way to think about the current account is as a trade issue—exports, imports and net income deficit. The better way conceptually, as Dr Gruen said, is to think about it in terms of the saving-investment balance. Let us go back and think about it from an issue of improving international competitiveness. You made a comment consistent with what John Edwards said, which is that you need a fall in the nominal exchange rate to improve the trade account. You can actually get the depreciation you are looking for through structural reform. That is, it works through the real exchange rate. The nominal exchange rate is what everybody focuses on.

Senator MURRAY—You are talking about relativities?

Dr Parkinson—Yes. It is actually not the nominal exchange rate that is important. It is the real one. You can affect the real exchange rate through the pursuit of structural reform. One of the things is that you cannot ever, even by changing the nominal exchange rate, know exactly how you will impact on the real one. So you have a multiple set of policy issues. First, does it make sense for you to think about using exchange rate policy to deal with the current account deficit? I would say no, it does not because it is a saving and investment issue. Let us say you

were convinced that was the way to go. Second, can you influence the nominal exchange rate? Even if you can, does that influence the real exchange rate? Why bother going down that route. Why even bother thinking about trying to influence an asset market where you have no idea what the outcome will be. Work to address the real exchange rate through structural reform and not with any idea about how you will affect it in terms of the magnitudes but on a no-regrets basis. This takes you back to the idea that structural reform is a good thing to pursue in its own right. It just happens to have the implications that it can enhance international competitiveness.

Senator MURRAY—Let me conclude this line of questioning with this question. Your *Intergenerational report* in my view most of all addressed issues of revenue and expenditure and the relationship with the population. Do you think that Treasury should put its mind to a similar sort of long-term approach with respect to the issues we have just been discussing—in other words, a long-term perspective? I very much doubt you can forecast very accurately how we as a country should be assessing ourselves in terms of our international trade and competitive relationships, the structure of our financial interrelationships, the nature of exchange rates and that sort of area? It seems to me that in this area, in contrast to what I would refer to as the more social matters you have addressed in the *Intergenerational report*, most of the work done is of a silo nature. Somebody writes a paper or assesses that particular area but there is not an integrated assessment.

Dr Parkinson—I think that is an interesting idea. You can see in fact elements of what you would want to cover there in our budget statement No. 4 this year and last year. You are right; it is not comprehensive of the form that you propose. It does not attempt to quantify the impacts of various things. You cannot quantify the impact in a very credible way of, for example, changes to your financial system or any particular type of structural reform. It is very hard ex post to work out what contribution has been made. Ex ante you know broadly how it is going to impact on the economy but to then quantify it is very, very difficult.

I hesitate in going down that sort of route because if your motivation is a concern about the current account, we are approaching the issue from the wrong way. The current account is simply the outcome of a whole variety of other issues. It is the other issues that are important for our future—economic performance and prosperity and living standards. That takes us back to issues around the achievement of international competitiveness and productivity gains and how you structure an economy to achieve those. You balance them against the various social objectives and redistributive objectives society may have. The current account is just a manifestation of how all those forces are playing out at any point in time. It is therefore going to have a structural element to it and a cyclical element. The magnitude of those at any point in time is also going to be influenced by what is happening globally. I think that would be the wrong objective to set for ourselves.

The objective is really going back and saying, ‘What sort of society do we want to see; what do we need to do to get there?’ That first question is a question for the political realm, not for us as economists. But as economists we can talk about the benefits of pursuing different types of policies if you want to achieve particular outcomes. They are very much the sorts of things we did in statement 4 last year and this year. Indeed, the theme of this year’s statement 4 is sustainability.

Senator MURRAY—Yes. I accept the way in which you have been moving. I welcome its inputs. If you accept my proposition to you, which is the long-term perspective and analysis which Treasury has been doing, most notably with the *Intergenerational report*, which is pretty well a 40-year look-through, it is incomplete. It does not yet cover the full range of areas which in my view Treasury is competent and able to take a perspective on. What I was really leading to is that if you accept that view, will Treasury try and address that in a more developed sense than you have been doing in your budget papers, particularly with respect to the longer term?

I draw your attention back to Dr Gruen's remark in the interchange he had with me, which is a remark heard often. Once we can go on as we have been, nobody can really say, 'We could go on like that forever.' It is a philosophical question about infinity. There is a longer time frame in which we will need to adjust our policy settings in quite considerable ways. All I am asking is whether Treasury is likely to develop that side of the work you have been doing for a longer term perspective.

Dr Parkinson—When we do the next *Intergenerational report*, we clearly will want to see to what extent we can enrich some of that analysis. How far we will be able to go is an open question at this stage. But I take your point about the value of thinking of some of these issues, even if you cannot quantify them. I will take it, in a sense, on notice for us to continue to think about. Mr Downes wants to add something.

Mr Downes—Both the OECD and the IMF do what we call medium-term projections. In the case of the OECD, the medium-term baseline goes out to 2010. One of the reasons that those organisations do that is exactly to bring out tensions that might be in the international outlook in terms of imbalances between different countries and what that might imply for policy. But it is very difficult to take those numbers out further because the normal projection methodology is to assume a fixed exchange rate. Once you go out a few years, increasing it becomes untenable. It becomes very difficult to make projections of trade balances going out 40 years and that sort of thing. The numbers would not mean a lot if you were trying to do that.

Senator MURRAY—Which is why I couched it the way I did—that it is a perspective that you are seeking. The alternative government, the opposition and the government, have to address it. In my view, there is not a clear enough picture forward on these fronts. I will leave it there, Chair.

CHAIR—We usually take a short break at about this time just to give people a breather. We will suspend for about 10 minutes.

Proceedings suspended from 9.41 pm to 9.55 pm

CHAIR—We will now resume.

Senator MURRAY—I have a brief question, Dr Parkinson. Senator Sherry, either earlier today or yesterday, questioned the Australian Bureau of Statistics about an error in their calculations on the retail growth, which was quite significant relative to that sector at least. I had noted it, but Senator Sherry ran through it all. I would have thought it would affect people like the Reserve Bank more in their monthly consideration of issues and where they would go.

My brief question to you is whether that sort of error has any really adverse effects for the Treasury. Does it raise alarm?

Dr Parkinson—It causes us concern whenever the credibility of the bureau's data comes under question. That was an instance where it was quite unfortunate what happened. But the statistician has gone public. The fact is you appoint an independent reviewer and he will make public what he is doing in response to that review. That said, with the exception of the CPI, every piece of data that we deal with is subject to revisions. So we are used to data moving around on us. It makes life much more difficult, but most of the time it is a function of the fact that the bureau or other data collectors are undertaking sample surveys. They are not conducting a full census or a complete enumeration. In this instance, though, while it was significant in terms of the retail sales numbers, retail sales are a relatively small proportion of consumption. Consumption is around 60 per cent of GDP. So the impact on the aggregate GDP numbers was relatively small—about 0.1 per cent per quarter.

Dr Gruen—They were 0.2 per cent for the December quarter. Revisions were brought in from the December quarter national accounts to the March quarter national accounts. The December quarter was revised by 0.2 per cent and the previous two figures were not revised. So that is the size of the revision that it introduced. There were other things that led to the revisions as well. But the size of those revisions is not big by historical standards.

Ms Quinn—I might clarify that the revisions to retail trade in themselves added slightly less than 0.1 percentage point to GDP if nothing else had changed. But once the Australian Bureau of Statistics had taken into account all the new information they had for the GDP estimates, the September quarter was not in fact revised at all in aggregate. The December quarter was revised up by 0.2 per cent, which is more than would be implied by the retail sales numbers themselves.

Senator MURRAY—I guess in my mind I am wanting comfort from you. If there were a sudden shift in a significant indicator that was quite different from the trend, you would not automatically think, 'We had better do something about this.' You would first automatically think, 'Well, there might be a mistake in the figures.'

Dr Parkinson—Let me assure you without going into our conversation with the bureau that the first thing we did was wonder whether there was a mistake in the figures.

Senator MURRAY—Good.

Dr Parkinson—The second thing was to ask whether this was real. I think we are comforted by the statistician's response.

Ms Quinn—The other thing to add there is that we do not take any piece of information in isolation. We take a composite picture trying to pull together information from different sources—both the Australian Bureau of Statistics and other private sources of information.

Senator MURRAY—My next question relates to the budget surplus. When the Senate Finance and Public Administration Committee had its estimates session, Senator Sherry and I were both in attendance there, as was the chair. I asked a series of questions around the budget surplus. I quoted Senator Minchin saying on *Meet the Press* on 13 March:

I would reject the story this week that we've got a \$10 billion surplus coming down the track. We have no evidence of that. We are sticking by the forecasts in our mid-year economic and fiscal outlook and we'll update that in the budget itself.

My question was whether his department had left him sitting like a bunny in the spotlight because by then it was known to someone—and I thought perhaps Finance—that there would be a \$10 billion surplus. Of course, there would have been more than that if there had not been the tax cuts. We know the tax cuts decision, from all the media stories, came late in the budget piece. So the question then is: what did you know and when did you know it? The finance department said they knew nothing and they were not responsible for leaving their minister in the air. They said to ask the question of Treasury. So here we are. I am asking the question of Treasury. When did you know that there would be a substantially greater surplus than that announced at MYEFO and then forecast at the election with the Charter of Budget Honesty? When were key people in the government advised? It appears that Senator Minchin, who I regard as one of the most senior ministers, was not advised.

Senator Minchin—Certainly not at the time of that interview.

Senator MURRAY—At the time of the interview.

Senator Minchin—I was there speaking with all honesty. You may be assured of that.

Senator MURRAY—That is right.

Dr Parkinson—Senator—

Senator MURRAY—It is time to fess up that you knew and you did not tell anyone.

Dr Parkinson—Let me start again. There are a number of stages in the budget process. Part of what will influence your expectation as to the future budget balance will be the pace of collections today. That depends very much on the different heads of revenue. It varies. So you can get quite large chunks of revenue come in at particular times. You then have additional issues, the complicated things more recently, which have been around the issue of growth in the nominal economy, where it is true that we have underestimated the extent of the terms of trade increase and nominal GDP growth in aggregate. It is nominal GDP growth that is important for revenue collections. At the last estimates, you very gently but quite fairly took us to task about the fact that we seem to be chasing the revenue estimates upwards.

Senator MURRAY—Incidentally, if I may compliment you, I was pleased to see that you in fact have adjusted your revenue modelling subsequent to that.

Dr Parkinson—That is what was occurring. We had undertaken a review of how effective we had been in forecasting the nominal economy and had concluded that we had been caught somewhat short. Much of it revolved around the terms of trade increase. There had been no deterioration in our forecasting around the real GDP growth, but we had underestimated the terms of trade shock, which is not in a sense surprising if you see the terms of trade because they have effectively gone vertical. But we also were conscious that, even taking account of that, there were still some areas in which we could improve our revenue forecasting methodologies. That work was underway. I cannot tell you whether we knew at that stage what the likely bottom line would be. I am not trying to handball this, but Mr Tune might be in a better position to answer that question as in exactly what time. But this was work that

involved our revenue group and our colleagues in fiscal group. Without knowing exactly what Senator Minchin was told at what time, I would be surprised if we had had enough information to tell Senator Minchin at the time where we thought the revisions to the revenue estimates would be going.

Senator MURRAY—My difficulty is the same difficulty I had before. If either senior members of the Public Service or senior members of the government make statements on significant fiscal matters that are shortly afterwards found to be incorrect, it just feeds cynicism from the media and from the public and from politicians that are you not being told the truth. That is not a good outcome for anyone. The difficulty was that Senator Minchin's interview in March was just two months prior to the budget. It was shorter than two months. You immediately think, 'Well, you know, Treasury is a very clever outfit with very good people feeding it information. Somebody must have known somewhere.' Finance said they did not know, and I believe them. Senator Minchin says he did not know, and I believe him. That only leaves you, you see. I have not said I disbelieve you.

Dr Parkinson—It is entirely true that we were the ones who were reviewing our forecasting methodologies and were thinking very carefully about the nominal economy. So you are entirely correct not to blame Senator Minchin or the Department of Finance. We are the ones responsible for the revenue estimates. If they are wrong, they are our fault. We were at the time actively attempting to review and consider how we might respond.

As I said earlier, you were very gentle with us at the time of the last estimates. We were already conscious of the fact that there was serious work that needed to be done. I cannot recall whether we had initiated the work at that stage. With this sort of stuff, because it can be contentious and easily politicised, we would be very careful to make sure we understood exactly what was going on and what needed to be done before we would, in a sense, share that information more widely.

Senator MURRAY—The flipside is in recent years we have been fortunate in that—the government would say it is good economic management and so on—as a country most of the mistakes have been on that side. There was more of a surplus than you expected, better growth than you expected and so on and so forth. Come the day when it is the other way around and the government is forced to tell the population to tighten their belts because times are getting tough, people will believe collective actions are taken too late. I am sure you understand the issues I am raising. I do think it is important that the Treasury message to our senior economic spokespersons, which is the Minister for Finance and the Treasurer and the Prime Minister and perhaps the Minister for Trade, is right up to date and they do not walk into a situation such as Senator Minchin did, when it was quite clear that the surplus was going to be—it was not clear then, but it was clear afterwards—substantially more than he was saying.

Dr Parkinson—To be fair, there was speculation from some parts that the surplus would be larger than we had anticipated at MYEFO.

Senator MURRAY—But it was informed speculation. It was from people who are good at that sort of thing.

Dr Parkinson—I would hazard that their revenue estimates, to the extent that they were higher, were higher by good luck rather than better methodology. Let me assure you that we are very conscious of the need—this sounds like a platitude—to keep the Treasurer, Prime Minister and the finance minister with the very best and most accurate forecasts we can provide. That is whether we are talking about the economy or revenue. We undertake regular evaluations of our forecasting performance. We have talked again in this room in the past about some of what we have done with our real economy forecasts. We concluded that we needed to go back and re-evaluate both our performance on the nominal economy and on revenue. It was not just a case that we had got the nominal economy wrong. The consequence of that review is reflected in the budget papers.

Senator MURRAY—I want to stay with tax cuts but move in a different direction. I assume the \$21.7 billion of tax cuts over four years in the budget papers have been modelled with respect to the impact on the economy.

Ms Quinn—Yes. The budget information, both the expenditure and the tax information, was factored into the economic outlook in the budget statements.

Senator MURRAY—So all the effects on GDP, employment, wages growth and all that sort of thing are all interconnected with these tax cuts?

Ms Quinn—Yes. Insofar as we did a forecast for 2005-06. The projections years beyond that are based on average trend assumptions so they do not incorporate major changes in policy. But the forecasts definitely do for 2005-06.

Dr Parkinson—When we do the 2006-07 for the first time in MYEFO, Obviously we will factor into that the second lot of tax cuts.

Senator MURRAY—Is there a view that because the tax cuts were weighted towards high-income earners the effects mostly will be on savings?

Ms Quinn—It is a case that with the distribution of the tax cuts, depending on the income, different consumers have different marginal to actually consume the increase in real disposable income. We have a rough rule of thumb that the average marginal propensity to consume is about 0.6 per cent. It is the case that the analysis suggests that high income earners will spend less of the tax cuts than low income earners.

Senator MURRAY—Does the Treasury fear at all that in that case asset inflation may lift again, particularly with respect to people using negative gearing and working away at additional housing investment?

Ms Quinn—The information that we have in terms of monitoring consumption and savings decisions in the economy is that consumers in aggregate appear to be looking at their balance sheets. We are seeing that the savings rate has stabilised in recent quarters. So we are expecting consumers to rebuild their balance sheets in aggregate over the forecast period. So we are expecting consumption to grow less strongly than income. In aggregate, it may be the case that some particular consumers spend above and others below. But in aggregate for the whole economy, we expect consumption to grow less than income.

Senator MURRAY—When you refer to household balance sheets in that sense, are there particular quartiles of income earners whose balance sheets you think will most be addressed?

Ms Quinn—We have not done that detailed analysis. It is difficult to get very recent information on the distribution of income so we have not done the analysis at that detailed level yet. As soon as the information becomes available, we will do it. We are looking at the aggregate consumer, so it is difficult to break it down at the moment.

Senator MURRAY—My instinct from my reading is that households, not tax earners, below perhaps \$100,000 gross are those where the balance sheet phenomenon is most apparent. But of course there is a substantial number of households above that \$100,000 who would use that money for investment, essentially.

Ms Quinn—Consumers have a choice between spending it or saving it. So if they are not consuming it, they are saving it in a variety of different assets.

Senator MURRAY—I understand the economics, but I am particularly concerned with restarting a cycle of asset inflation. That is why I asked you about modelling because I do not have the means to assess whether this kind of flow-back into the better-off community will in fact kick-start asset inflation again.

Ms Quinn—We are not anticipating a reflation in house prices. House prices have stabilised in recent times. They have fallen in some areas and they have risen modestly in others. We have seen a continued fall in housing approvals and a slowdown in the rate of housing finance. So we are expecting in the housing sector for there to be a muted slowdown in housing investment and for house price inflation to remain broadly flat over the forecast horizon. So when we did the analysis of the implications of the tax cuts through consumption and savings and GDP and employment, we did not anticipate significant pressure on house prices at that time.

Senator MURRAY—I suppose this is a difficult question because we move into policy. But one option if the asset inflation cycle starts up again is for the government to address the view of the Productivity Commission and the Reserve Bank that negative gearing tax concessions should be reviewed—I think that was their recommendation. Are you aware of that recommendation in Treasury from the Reserve Bank and the Productivity Commission?

Ms Quinn—I have seen the reports of that recommendation, yes.

Senator MURRAY—You would agree it is one policy possibility which could be considered if there were asset inflation again, particularly in the housing sector.

Dr Parkinson—I think we need to be very cautious when we talk about negative gearing. Your question is about the risk of asset price reflation. I think that is a legitimate question to ask.

Senator MURRAY—And how you address that. There is either a fiscal or monetary response, as you know.

Dr Parkinson—If you think this is an issue.

Senator MURRAY—Which is why I asked the modelling question.

Dr Parkinson—Yes. But in a sense—again, we have had this discussion here with your colleagues in the past—in an environment where you see a decrease in inflation and a decrease in interest rates, you will get an increase in asset prices. It is a repricing phenomena.

You get a permanent fall in inflation and a permanent fall in interest rates of the sort we saw earlier in the 1990s. What that does is it manifests itself in a real increase in other asset prices, such as house prices. We saw that. We saw that house prices took off in 1998 or thereabouts and rose about 80 per cent in real terms between 1998 and 2004.

Senator MURRAY—Materially assisted by the capital gains tax changes.

Dr Parkinson—Well, that is your judgment call. A moment ago, I took it you were suggesting that negative gearing was responsible.

Senator MURRAY—I think the interaction between the two is material. As you know, I have said that my concern with capital gains tax is not necessarily the quantum but the stepping. I would seek to attack speculative gains which most commonly are evidenced in the first couple of years of investment activity.

Dr Parkinson—There have been house price increases through many countries over the same period that have dramatically different tax systems which have not changed their capital gains tax, some of which I think do not have negative gearing. But the issue is that we did not change our negative gearing system during that period.

Senator MURRAY—That is right. I was not all that keen on it then either.

Dr Parkinson—That is okay. I am simply saying to attribute all of the increase in house prices in Australia to a tax change, the capital gains tax, with or without any interaction, without negative gearing at a time when comparable countries but with dramatically different tax systems and no change to their capital taxation regimes had similar phenomena seems to me to be drawing a very long bow.

Senator MURRAY—But I have not drawn that bow. I said if the tax cuts result in what you call reflation—I will refer to it as asset inflation—will you as Treasury go back and—as one of the things you might do—look at the Productivity Commission and Reserve Bank recommendations that that area be reviewed?

Dr Parkinson—Were we to think there was an issue here, we would look at a whole variety of aspects. We would advise the Treasurer and the government accordingly.

Senator MURRAY—You do not rule it out is what I am asking.

Dr Parkinson—I am not going to rule anything in or out. It is a question in terms of tax policy that is better addressed to our colleague Mr Callaghan as to what he might or might not want to do. But I go back to the analytic issue, which is I think you need to be very careful in attributing as the proximate cause something which is seen globally as being a change in the Australian capital gains tax regime. Even were that to be the case, I think you would need to think very carefully about whether there was anything you could do.

Clearly, there is an excellent paper by a very eminent Australian economist on the appropriate approach to monetary policy in an environment of asset price inflation. It suggests that you do not want to go there because you cannot actually have much impact. Were you to think about areas that fall under the heading of fiscal policy, you would want to think very carefully about the costs and benefits of those too. For example, where you decide to eliminate negative gearing, what impact would that have on rents? What impact would it have on activity in the sector? Were you to in fact reverse past capital gains tax changes, what

impact would that have? On negative gearing, there is a fairly fundamental tenet in our whole approach to taxation. We do not rule out negative gearing for the purchase of assets that generate income streams. Why should we do it specifically for housing?

Senator MURRAY—Let me just step you back through to my question so that we get it in perspective. I asked if you had done modelling. My question is whether the substantial tax cuts—because they are substantial—will have the effect of restarting the housing boom.

Dr Parkinson—Our judgment is the answer is no.

Senator MURRAY—Exactly. We know that if that occurs the Reserve Bank is likely to raise interest rates, which I do not think is in the interests of Australia given our current—

Dr Parkinson—I am sorry, but I am not sure we do know that the Reserve Bank will raise interest rates.

Senator MURRAY—No, we do not know that. But there is a danger they will.

Dr Parkinson—That is why I—

Senator MURRAY—Because they have in the past. Let me just finish, if I may, Dr Parkinson, so you understand my thinking. We get to a stage where the Reserve Bank might respond—I accept it is a might—to that situation with higher interest rates. The alternative to that, of course, is finding some other policy mechanism to dampen down housing again if it restarts. The whole basis of my question is just to make sure that the Productivity Commission's recommendation is not automatically excluded by Treasury if they have to look at alternatives if that situation arose.

Senator Minchin—Senator Murray, that is a policy question. The Treasury has already, I think in response to the Productivity Commission, ruled that out as a policy option for the government. The clear policy of the government is to retain negative gearing in the housing market. So I do not think it is fair on Treasury to press them on the matter.

CHAIR—The minister is right. You cannot ask them about the area of policy.

Senator MURRAY—I have done my best. Do you want to carry on, Senator Sherry?

Senator SHERRY—There is one issue relating to Senator Murray's concern about asset inflation. He has raised the issue of capital gains tax. One of the consequences of the budget tax changes is to shift the relative appeal away from negative gearing, I would have thought, because the surcharge is abolished for high-income earners. If we are looking at modelling behavioural change in high-income earners, who obviously benefit to the greatest degree, the abolition of the surcharge shifts the relative appeal away from negative gearing, I would have thought, notwithstanding that the policy may be, in my view, bad for other reasons. But it seems to me that superannuation for that level of income earner—earning \$100,000 a year—is going to have much greater appeal and, therefore, there is less likelihood that that group will increase their investment in negative gearing into housing.

Dr Parkinson—I think that is a reasonable starting point for thinking about the issue. To that I would add that, to the extent the proposed tax changes lower the marginal rate faced by individuals, that will also reduce the attractiveness of negative gearing. But we should also

remember that—I am going to get caught out here—60 per cent of all negative gearing is by households with incomes under \$70,000.

Ms Quinn—It is the other way around. In 2000-01, 70 per cent of people who held negative geared property had incomes less than \$60,000.

Senator SHERRY—Which I thought was quite an amazing figure when I saw it. In logic, I was quite surprised at that figure.

Ms Quinn—It is one issue, looking behind the distribution of assets, wealth, incomes and savings, that is quite important to understand.

Senator SHERRY—But there may be other appeals for saving in the form of housing other than the logic of a pure economic return.

Ms Quinn—There are many factors that people take into account in their investment decisions.

Senator SHERRY—Yes. They are not necessarily economically rational. But that decision is for individuals to make. Whether it is a good or bad call, it may not necessarily be economically rational. An example is investment in housing. Time and time again I have raised with me by people of relatively modest incomes the fact that they are negative gearing an investment property to set themselves up for retirement. When I ask them whether they are aware they are assets tested out of the age pension, I find that they have absolutely no understanding of the consequences—the loss on one side versus the gain on the other.

Dr Parkinson—As we have discussed here in the past, we have seen the phenomenon of people continuing to buy into areas where it is quite obvious there is going to be significant oversupply and, hence, very real risks of capital loss. I do not think economics says that individuals as individuals are necessarily rational, but in aggregate we hope they are.

Senator SHERRY—After a few get burnt on the way through.

Senator MURRAY—They are not perfectly informed.

Dr Parkinson—No. That is right.

Senator SHERRY—Who is? Just briefly coming back to that earlier discussion you had about the size of the surplus—I think this may be more appropriate for the Fiscal Group in Budget Policy Advice and Coordination—what is your role specifically in coordinating actual revenue versus estimates of revenue coming in? There would obviously be a regular reporting of actual revenues coming in versus estimates of revenue vis-a-vis finance, which records program by program but obviously in the aggregate actual expenditure against estimated expenditure. Do you have a role in coordinating those two?

Dr Parkinson—The Macroeconomic Group, do you mean?

Senator SHERRY—Yes.

Dr Parkinson—No. Our role is basically to try and understand where the economy is going. Let me put aside all the policy issues that we might deal with. In a very narrow sense around the economy and revenue, our role is to attempt to forecast where the economy is going in aggregate to draw out what we think will be occurring in a whole variety of parameters that are relevant to individual tax bases. We provide that to our colleagues in the

Revenue Group. They have information on actual collections to date. They marry that with what they can see happening and with the growth rates that we are giving them based on where we think the economy is going. From that, they derive their revenue estimates. That is a very simplified version because it is quite iterative. They provide us with, in a sense, a real-time cross-check on some of the things that we think are happening. They, for example, can tell us, ‘GST revenue seems to be growing much faster than you are anticipating,’ and that gives us an idea where we want to start to look at individual things.

Senator SHERRY—That is as I understood your role to be. I just was not sure whether in fact you or your division were involved in the actual correlation, matching up actual expenditure against actual revenue.

Dr Parkinson—No.

Senator SHERRY—I suspected not. I suspect that is more an issue for Budget Policy Fiscal.

Dr Parkinson—It is a Fiscal Group issue in terms of bringing everything together. It is a Revenue Group issue in thinking about the specifics of the revenue estimates.

Senator SHERRY—The issue of the lack of infrastructure has had a considerable public airing in recent times. There have been a number of reports and observations referring to issues relating to capacity constraints and infrastructure. I will not read all of the quotes from various documents I have, but there have been a number of references by the RBA and the Treasurer himself. I notice that Treasury, in Budget Paper No. 1, commented:

Given its nature, infrastructure often requires some form of government involvement—this may be in the form of direct provision, planning and coordination of networks...

But there are a whole raft of comments. We know from the previous round of estimates that Treasury is conducting a review of infrastructure constraints. What is the status of that inquiry?

Dr Parkinson—I do not know that we said we were conducting a review of infrastructure constraints. We were looking at what was going on. What I responded to was the word ‘review’.

Senator SHERRY—That may have been the context. I do not have the quote in front of me.

Dr Parkinson—We have looked at those sorts of issues and advised the Treasurer on what we thought was relevant. That has been a matter of policy advice to the Treasurer.

Senator SHERRY—Approximately when did that advice go? I am not going to what was in it.

Dr Parkinson—I have not handed anything off to our colleague Mr Murphy from Markets Group, and this is one for him. His group basically has taken the running on that.

Senator SHERRY—So Markets?

Dr Parkinson—Yes.

Senator SHERRY—Did your area of Treasury have any input into the Prime Minister’s Export and Infrastructure Taskforce, which I understand reported today?

Ms Quinn—Not directly, no.

Senator SHERRY—So I would refer that to Markets, if indeed they had any input, which they probably did?

Dr Parkinson—I do not know whether they had any input. In the earlier part of it, we obviously were closely working with Markets Group to ascertain where some of the restrictions were.

Senator SHERRY—So if I ask Markets tomorrow, they are not going to, in the early part of it, pass me back to you?

Dr Parkinson—I hope not.

Senator SHERRY—So do I. I might have to bring you back. I will leave that for Markets. COAG's meeting on 3 June, which must be Friday—

Senator MURRAY—All day.

Senator SHERRY—We are meeting all day and all night—that is why I am losing touch with the time frames at the moment. Has Treasury provided an input submission to the National Competition Commission?

Dr Parkinson—I think, again—

Senator SHERRY—There is a review of national competition policy reforms.

Dr Parkinson—Yes. Again, I think you want to direct that to Mr Murphy.

Senator SHERRY—I have a few questions on the current account deficit that we may not get done by 11 o'clock. In respect of the composition of foreign debt, can the difference between short-term and long-term foreign debt be outlined? Is there a commonly understood or an economically understood difference between short-term and long-term foreign debt?

Dr Parkinson—Normally, 'term' is a reference to term to maturity rather than the initial maturity of the debt. Take a bond that had been issued in 1996. It would today be defined as short-term debt because it is under one year to maturity. When it was issued in 1996 right up to 12 months and one day out from its maturity date, it would be regarded as long-term debt.

Senator SHERRY—Has there been any analysis or are there any statistics on Australia's level of short-term foreign debt vis-a-vis the level of other countries?

Dr Parkinson—We do not have the data at hand but it is available. The Bureau of Statistics reports on the maturity structure of debt. The IMF publishes material for individual countries. The Bank of International Settlements and at least one private sector entity collects data on debt maturity. So that information is commonly available. We would not have it here.

Senator SHERRY—Perhaps you could take that on notice. I am informed that our level of short-term debt is at a higher volume comparatively to other countries'. Do you have any knowledge of that?

Dr Parkinson—I would be surprised.

Ms Quinn—The last set of information I am aware of was that more than half of both our debt and equity liabilities were classed as long term.

Senator SHERRY—Do you have any idea whether that is less than or higher than that of comparable economic countries?

Ms Quinn—I do not have that information here.

Senator MURRAY—The other side of that question on notice would be whether short- or long-term debt has increased in Australia over the last 10 years in proportion to the other.

Dr Parkinson—We are happy to take that one on notice. I would reference back, though, to something that Professor de Brouwer said at the last estimates hearing when he was talking about the structure of our debt. The percentage is predominantly to the tune of something in the high 90s in terms of the responsibility of the private sector. About one-third is issued in Australian dollars, and the rest that is issued in foreign currency is predominantly swapped back into Australian dollars. So it would not be a clear indicator of vulnerability were our level of—just take this as an example—short-term foreign debt to be higher than another country's where its foreign debt was all issued and remained in foreign currency terms. We can actually reference that. It was page E122 of the transcript of the last hearing where he actually went into it.

Senator MURRAY—Didn't he also say that because it is private sector debt a great deal of it is processed through the banks? In other words, public sector debt is not through the bank system automatically whereas private sector debt almost always is. That means, because of the intermediate nature of a bank, you are not sure of the actual term of the debt because the bank is financing it on a short-term basis. Didn't he say something of that sort?

Dr Parkinson—No. He talked about the issue in terms of vulnerability around the nature of the liabilities. He indicated:

...they turn on whose liabilities they are—

that is, public or private; here they are predominantly private—

what the currency denomination of those liabilities is—

that is, whether it is foreign or domestic; ours are domestic—

and whether they are short term or long term—

that is, the maturity structure of the liabilities. He went on to point out:

... around half or more of the maturity is long term ...

Overall, he was saying that that, combined with the currency composition being one-third issued in Australian dollars with no currency exposure and the other two-thirds swapped immediately back in so that currency movements do not impact on the liability, all acts to reduce the vulnerability associated with any given level.

Senator MURRAY—Which is a sign that the banks are continually refinancing their books.

Dr Parkinson—It need not be the banks. You are right—the banks have been heavy borrowers. But many large corporates actually issue corporate bonds on their own behalf in dollar A and in other currencies. In those other currency terms, my understanding—and I stand to be corrected—is that it has been very common for them to immediately swap it into dollar A and bring it back. That is if they want it onshore. If they want it offshore because they

want to, for example, establish a subsidiary or buy a mine or something, they often have a natural hedge. So even if it still remains in, say, US dollars, the income flow associated with the investment is also in US dollars. So there can be a natural hedge there.

The reason why I have gone into this is that if we go back to the period immediately after the Asian crisis, part of our initial reaction was to look at the maturity structure and say, 'Well, these countries got themselves'—South Korea being a prime example and Thailand was another—'into trouble because they were borrowing very short term but lending in their domestic systems long term.' But as we have spent more time really looking at where the vulnerability has come about, I think we see the IMF and others take the view that the maturity structure is important but it is the composition in terms of the currency and structure of the liabilities and their interaction which is more important as an indicator of vulnerability.

Senator SHERRY—I accept the validity of your comments about the composition of the short-term debt. I am interested—I understand you have to take this on notice—in the short-term, long-term split of Australia's foreign debt in terms of, firstly, whether there has been a shift historically and, secondly, its comparability with other economies.

Dr Parkinson—We are happy to do that.

Senator SHERRY—Briefly, before I get to another related issue, I note earlier, Ms Quinn, you referred to our private savings having stabilised; I think 'stabilised' is the word you used. But it has stabilised in the negative, hasn't it?

Ms Quinn—As measured by the household savings rate in the national accounts. But, as has been raised before, the measurement of the savings rate is a residual in the way the Australian Bureau of Statistics calculate that measure. There are many issues related to what that represents in the real world. If you look at the growth in nominal disposable income and the growth in nominal consumption over the last 12 months, it is clear on that measure in terms of flows that consumption has been less than income growth. On that measure, people are saving in dollars and cents. What that does not take into account is depreciation of housing, which is included in the household savings rate as measured by the Australian Bureau of Statistics. So there are many different ways to measure savings. That is why I said stabilised. The issue about negative savings rates versus what that represents is a slightly separate question.

Senator SHERRY—Yes. But the issue with the household savings ratio, which is a commonly used parameter, is that it is at negative 3.3 per cent.

Ms Quinn—That is correct.

Senator SHERRY—So in terms of it stabilising, we are not necessarily drawing great comfort from stabilising at negative territory ongoing, are we?

Ms Quinn—That is right. Essentially, people are eating their house.

Senator SHERRY—Yes. I could not have put it better. They cannot keep eating their house forever.

Ms Quinn—No.

Dr Parkinson—We have talked about this. For as long as I have been coming to Senate estimates this has been an issue. There are two points that I would reiterate. One is that the measure of household savings in the national accounts is purely a national account measure. So, as Ms Quinn says, it takes into account the depreciation of assets. That means that people may be saving in cash terms out of their income flows, but that is not sufficient to offset the depreciation. Even though you and I do not see the depreciation on our house, if that is not sufficient, we are effectively eating our house. But equally it does not take account of capital gains, which we will think of, as individuals, as real additions to our lifetime wealth and our capacity to consume.

The second point goes back to the point Ms Quinn made about this being something that is a residual and hence it is subject to revision. As long as I can remember, and I have been in this game for a very long time, the pattern of the household savings ratio looks like that. Periodically, what happens is that the whole thing just moves up. The pattern stays the same. So we go from, in the past, down here to finding out in a number of years time that the bureau tells us it was actually up there. The pattern was still the same. That is an issue.

CHAIR—Just so the *Hansard* is not too opaque, I should mention that you are indicating an upward constant trend.

Dr Parkinson—An upward constant adjustment, yes, in the revisions over time.

Senator SHERRY—A downward trend line, but the line is adjusted upwards.

Dr Parkinson—A constant downward trend—I apologise to *Hansard* for waving my hands around—with an almost continual set of revisions that, over time, adjust the levels up but leave the trend continuing downwards. That then says it is clear that, over time, the household savings ratio has fallen. But the question is: what has it fallen to? Is it really a negative? Is it really a positive? That is where it comes down to the fact that there are a range of estimates of saving which do different things. But the message out of them is that things appear to have stabilised more recently.

Senator SHERRY—Stabilised in the negative territory. I take you back to the 1996 budget. I can remember pages of material on the household savings debt. There were a couple of pages of graphs in the overview summary. They have all disappeared. I am not talking about household debt but reference to it. It has largely disappeared, not totally. There was lots of emphasis on this back in 1996. When you look at the budget papers now, the level and the degree and the degree of coverage have contracted dramatically.

Dr Parkinson—Again, we have talked about that.

Senator SHERRY—Is that because are you less concerned about the issue or simply because you do not want to focus on to it any significant degree now because the figures are not looking particularly flash?

Dr Parkinson—If you are talking about the household debt to income ratio, it became almost a standing question from Senator Conroy each time we came to estimates. He would ask, 'Are you worried about the level of the household debt to income ratio yet?' All I would say is that it cannot continue to rise forever. But we are not alone in terms of where we are as a ratio.

Senator SHERRY—You mean internationally?

Dr Parkinson—Internationally.

Senator SHERRY—I am aware of that. We are down with the US and UK, I think. I am not sure about other economies.

Ms Quinn—The Netherlands.

Dr Parkinson—New Zealand. The Netherlands is significantly above us.

Ms Quinn—Denmark.

Dr Parkinson—Denmark is above us.

Mr Downes—A point to be made on this is that countries with falling household savings ratios also tend to be the countries that have had a lift in productivity growth. There is some economic theories that would say that if your productivity growth lifts then your lifetime expectation of income increases; hence, you will tend to dissave when you are younger and that sort of thing.

Senator SHERRY—That is an interesting observation. Are there any comparative observations, say, with the asset value of housing? Is there any linkage?

Mr Downes—There is also that linkage as well. The countries which have high income growth, like the US, Ireland and us, have had very strong rises in house prices. If you look at Germany, Japan and countries which have not had any increase in productivity growth, you find that their house prices are falling. Correlation is not causation, but I think there is something in that observation. As Martin was saying before, there are fundamentals going on. Prices overshoot. Markets tend to overshoot. But underlying some of these movements are fundamental changes. That is reflected in the international pattern that you see.

Senator SHERRY—I think there has been discussion about this at previous estimates as well. It comes back to the phrase about literally eating your house. Look at the prevalence of equity drawdown for consumption compared to 10 or 15 years when it virtually did not exist; you could not get that form. Your house has become almost like a bankcard at a cheaper rate in recent years.

Senator MURRAY—There is a huge proportion of the housing market which is mortgage and loan free. There is a massive percentage. I think it is 30 per cent or something. If you are talking behavioural economics, children are saying they do not have to save as much because their mum and dad are living in a debt-free house and they will get that return when they are older.

Ms Quinn—It is the case that in recent quarters the amount of equity in aggregate that has been withdrawn from houses has substantially been reduced. So, depending on slightly different measures, it is back around broadly neutral. That is one indication that households are looking at their balance sheet over and above the savings rate.

Senator SHERRY—But you would expect that, if housing prices are levelling off or dropping in certain areas, people are going to be slightly less optimistic about the level of drawdown they can engage in. They might be slightly more concerned, perhaps, or cautious as a consequence. You would expect that, wouldn't you?

Ms Quinn—The fact that house prices have levelled off in recent times and are expected to stay broadly stable over the forecast horizon is built into our outlook for consumption. One of the reasons we expect consumption to grow more modestly over the forecast period relative to the recent history is a stabilisation in the increase in wealth.

Dr Parkinson—And, going back to the national accounts, it would be manifest over time in an improvement in the household saving ratio. They are drawing down their wealth through mortgage equity withdrawals and then buying consumption goods—that is showing up as consumption. So that increases consumption relative to the aggregate level of income. So the aggregate level of income has not changed. Consumption has gone up because they are withdrawing from the house bank. As they stop doing that, you will get this recalibration of consumption vis-a-vis income. That is one of the reasons why in the budget papers we suggested that over time the gap between the growth in consumption and income will close up. We think that the wealth effect will dissipate because house prices have stabilised. People will actually slow their consumption patterns. That is what we mean when we talk about households beginning to consolidate their balance sheets.

Senator SHERRY—I will make this the last question. I have some other issues on the current account tomorrow. On that issue, though, have you done any economic modelling of the impact, given the ageing population—we touched on it earlier—of the decreasing total number of people coming into the work force and the increasing total number of people retiring? Have you done any economic modelling on the consumption impact of people who are retiring and spending their lump sum superannuation, which must be occurring in increasing quantities? Have you done any modelling on that?

Dr Parkinson—No. We definitely have not.

Senator SHERRY—It would seem to me logical.

Dr Parkinson—I do not imagine that anybody else in the department has approached the issue.

Ms Quinn—I am not aware of a study that looks at that outside Treasury either.

Senator SHERRY—It would seem to me it would increase for two reasons. One is an increase in the raw numbers actually retiring. The other is that their level of superannuation saving as a lump sum is significantly greater than in the past. Those two factors would lead to an increase in consumption expenditure given—the reality is that for the majority of people the level of lump sum is not worth converting to an annuity anyway—they will purchase whatever it may be based on an entirely rational decision, it would seem to me.

Ms Quinn—It is also due to people living longer, so they have to spread their larger superannuation lump sum over a longer period.

Senator SHERRY—With some people certainly I would agree. But with the majority of people who have only had super since the late 1980s, you are looking at only very modest amounts. I think the latest average level is about \$50,000. For the majority of people it will be less than \$50,000. There is no rational reason why you would put it into any sort of annuity. It is relatively very small; therefore you would spend the lump sum. It seems to me to be a financially logical thing that you would do. You just purchase whatever you need to do to set

yourself up for retirement. I am just interested to know whether there have been any economic studies on the impact of that coming through the system.

Dr Parkinson—I think it is an interesting question, but we definitely have not done any work on it.

Senator SHERRY—Tomorrow I have some issues to raise that I did not get to on the current account, terms of trade and some issues relating to exports. Surprise, surprise, I actually have a reference to a speech you gave on that, Dr Parkinson. You are definitely referred to in those questions. I also have some issues relating to investment.

Committee adjourned at 11.04 pm