The Senate

# Standing Committee on Economics

## Financial Sector Legislation Amendment (Simplifying Regulation and Review) Bill 2007 [Provisions]

August 2007

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# Senate Standing Committee on Economics

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# Chapter 1

# Introduction

## Background

1.1 The Financial Sector Legislation Amendment (Simplifying Regulation and Review) Bill 2007 was introduced into the House of Representatives on 21 June 2007 by the Parliamentary Secretary to the Treasurer, the Hon. Chris Pearce MP.

1.2 On 21 June 2007, on the recommendation of the Selection of Bills Committee, the Senate referred the provisions of the bill to the Standing Committee on Economics for inquiry and report by 31 July 2007.

## Conduct of the inquiry

1.3 The committee advertised the inquiry in the *Australian* newspaper on 27 June 2007 and invited written submissions by 9 July 2007. Details of the inquiry were placed on the committee's website. The committee also wrote to a number of organisations and stakeholder groups inviting written submissions.

1.4 The committee received four submissions. These are listed in Appendix 1. A public hearing was held in Melbourne on 27 July 2007, at which Treasury officers gave evidence by teleconference. Witnesses who presented evidence at this hearing are listed in Appendix 2.

1.5 The committee thanks those who participated in this inquiry.

# Chapter 2

# The bill

## Introduction

2.1 This is an omnibus bill containing a range of measures, including proposed changes intended to streamline and simplify prudential regulation of the financial sector, and changes intended to ensure that where a superannuation fund has suffered loss as a result of fraudulent conduct or theft, financial assistance is made available on a more equitable basis. An overview of the bill's four schedules follows.

## Schedule 2 – Streamlining prudential measures

2.2 Schedule 1 of the bill implements the Government commitments relating to prudential regulation in response to the Regulation Taskforce report (*Rethinking Regulation*: *The report of the Taskforce on Reducing Regulatory Burdens on Business*).[1] The Government released this report on 7 April 2006 and announced its final response to the report on 15 August 2006.

2.3 The Government accepted all of the recommendations that were relevant to prudential regulation in the report. The Explanatory Memorandum (EM) advises that the bill also contains additional measures to streamline and simplify the prudential Acts[2] in a manner that is consistent with the Regulation Taskforce's findings.[3]

2.4 The measures in the bill have been subject to extensive consultation[4] through the release of a proposals paper on 4 December 2006,[5] an exposure draft of the bill on 11 May 2007,[6] and an industry roundtable discussion on the draft bill which was held on 28 May 2007.

2.5 Significant measures in the bill include the following:

- Changes to breach reporting requirements;

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1 The Regulation Taskforce report can be found at: http://www.regulationtaskforce.gov.au/

2 The prudential Acts are the *Banking Act 1959*, the *Insurance Act 1973*, the *Life Insurance Act 1995* and the *Superannuation Industry (Supervision) Act 1993*.

3 Explanatory Memorandum (EM), p. 3.

4 Parliamentary Secretary to the Treasurer, the Hon. Chris Pearce MP, Second reading speech.

5 The proposals paper can be found at: http://www.treasury.gov.au/contentitem.asp?NavId=037&ContentID=1199

6 The exposure draft of the bill can be found at: http://www.treasury.gov.au/contentitem.asp?NavId=037&ContentID=1259

- Consistent protection for whistleblowers[7];
- Changes to APRA's exemption powers;
- APRA to gain powers in relation to discretionary decisions under prudential standards;
- Simplified requirements in relation to APRA consultation on general insurance prudential standards;
- New APRA power to accept court enforceable undertakings;
- Powers to appoint actuaries and auditors relegated to boards;
- APRA will have the power to refer matters relating to actuaries and auditors to their professional bodies; and
- other changes, as described in the table below.

2.6 The following table showing the changes and comparing the new law with the old law is derived from the EM.

## Table 2.1: Comparison of key features of new law and current law

| *New Law* | *Current Law* |
|---|---|
| Only significant breaches need to be reported under the prudential Acts. A written report on significant breaches needs to be made to APRA as soon as practicable, and in any event, no later than 10 business days after the entity becomes aware of the breach. Some breaches will need to be notified in writing to APRA immediately. | All breaches need to be reported under the prudential Acts.<br><br>There are inconsistent and ambiguous timing requirements under the prudential Acts and the Corporations Act for the reporting of breaches. |
| Where an actuary or auditor identifies a breach and is required to notify APRA and the regulated entity of a breach, the ADI, general or life insurer or superannuation trustee is not also required to report the breach to APRA. The reverse also applies. | Overlapping reporting requirements between responsible persons and officers, actuaries and auditors may be creating the need for multiple reporting of breaches. |
| Where a breach was previously reported to APRA and ASIC, the breach is only required to be reported to APRA. | There may be unnecessary breach reporting where a breach is required to be reported to both APRA and ASIC. |

7 See also report of the Parliamentary Joint Committee on Corporations and Financial Services, *CLERP (Audit Reform and Corporate Disclosure) Bill 2003, PART 1 - Enforcement, executive remuneration, continuous disclosure, shareholder participation and related matters*, 4 June 2004, Chapter 2 - Whistleblowing. http://www.aph.gov.au/senate/committee/corporations_ctte/completed_inquiries/2002-04/clerp9/clerp9p1.pdf

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| Consistent protection is provided for whistleblowers and persons who report information under the prudential Acts. These persons enjoy 'use immunity' in relation to reported information. | Inconsistent protection for whistleblowers and persons who report information. |
| APRA's exemption powers have been expanded under the SIS and Life Acts while reduced under the Banking and Insurance Acts. It is clarified that decisions relating to classes of persons are legislative in nature while those relating to a particular person are administrative in nature and are reviewable decisions. | There is lack of a flexibility in the prudential regime which may impose unnecessary compliance costs. |
| APRA will gain the power under the Banking and Life Acts to make discretionary decisions under its prudential standards. It is clarified that decisions relating to classes of persons are legislative in nature while those relating to a particular person are administrative in nature and are reviewable decisions. | APRA's ability to tailor prudential requirements to particular circumstances under prudential standards is limited, and these requirements are not transparent. |
| Section 33 of the Insurance Act has been repealed, so APRA only needs to comply with the consultation requirements under *Legislative Instruments Act 2003.* | APRA currently must comply with two sets of legislative requirements with respect to consultation on general insurance prudential standards. |
| APRA has the power to accept court enforceable undertakings under the Banking and Life Acts. | APRA is unable to enforce cooperative agreements made with entities to address prudential concerns under the Banking and Life Acts. |
| The Board will have responsibility for the appointment of the actuary or auditor of the entity. There will be no requirement for APRA approval. Under the Insurance and SIS Acts, APRA can direct a regulated entity to remove the auditor or actuary who does not meet the fit and proper requirements or has been disqualified. Under Life Act, APRA can declare the auditor or actuary ineligible for appointment. | Entities are required to seek APRA approval for the appointment of its actuaries and auditors, which is inconsistent with a principles based legislative framework. |
| APRA has the power to refer matters relating to actuaries and auditors to their professional bodies under the Banking, Insurance and Life Acts. This will improve industry self-regulation and enhance co-operation between APRA and industry professional bodies. | APRA does not have the power to share information regarding actuary and auditor conduct with appropriate professional bodies under the Banking and Life Acts and its power under the Insurance Act is limited. |
| Prudential rules will be phased out by 30 June 2011. | Prudential rules add prescription and unnecessary complexity to the prudential framework |
| The LIASB will be abolished. The requirements currently found under actuarial standards in the Life Act will be prescribed under prudential standards. | The Life Act provides that APRA may determine standards on prudential matters for life companies under section 230A but grants actuarial standards-making powers to the LIASB under section 101. |
| The eligibility requirements for appointed actuaries under the Life Act will be replaced by principles based legislation, with further requirements prescribed under prudential standards. | Requirements with respect to actuaries in the Life Act are prescriptive and inflexible. |

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| Duplication in reporting requirements has been removed and replaced by a process of information sharing between APRA and ASIC. | Duplication in reporting requirements under the Life Act. |
| Sections 123 and 125 of the Life Act, relating to reinsurance contracts, have been repealed. | Reinsurance reporting requirements are under the Life Act rather than responsibility of the Board of the life company. |
| Subsections 20(2), (3) and (4), sections 25 and 28 of the Life Act and Part 3 of the Life Regulations have been repealed. Section 21 of the Life Act has been amended so that APRA would no longer issue a certificate but would provide 'authorisation in writing'. | The Life Act and Life Regulations contain prescriptive requirements with respect to registration of life insurers, and requirements to notify changes to information provided in a registration application. These requirements overlap with other information gathering processes. |
| ABNs will become a uniform business identifier. All RSE licensees and superannuation entities are required to obtain and display an ABN. | There is a requirement under the SIS Act to display RSE licence and registration numbers on certain documents. |
| The obsolete provisions have been repealed from the Life and SIS Acts. | Several transitional arrangements in the Life and SIS Acts are obsolete and add to complexity. |

## Schedule 2 - Financial assistance for certain superannuation entities

2.7 Part 23 of the *Superannuation Industry (Supervision) Act 1993* (the SIS Act) provides a grant of financial assistance for certain superannuation entities that suffer loss as a result of fraudulent conduct or theft, subject to certain conditions. Pooled superannuation trusts (PSTs) and self managed superannuation funds (SMSFs) are not eligible for Part 23 financial assistance.

2.8 In 2004, the Government released the outcomes of a review conducted the previous year into Part 23.[8] The amendments in Schedule 2 of the bill implement the Government's response to the review. They are intended to expand eligibility for financial assistance under Part 23 and provide it on a more equitable basis.

2.9 The bill amends the *Financial Institutions Supervisory Levies Collection Act 1998* and the *Superannuation Industry (Supervision) Act 1993* to:

8 The review of Part 23 was undertaken in response to a recommendation in the Final Report of the Superannuation Working Group (SWG) into an Issues Paper released by the Government, *Options for Improving the Safety of Superannuation*, in October 2001. The SWG recommended that the Government should review the operation of Part 23 and consider possible amendments to it once the first decision under Part 23 had been made. The first decision to grant financial assistance under the provisions of Part 23 was made in June 2002.

The review and the outcomes can be found at:
http://www.treasury.gov.au/contentitem.asp?ContentID=858&NavID=037

- allow a superannuation fund that was eligible for financial assistance under Part 23 at the time an eligible loss was suffered to make a Part 23 application despite subsequently restructuring to a SMSF;
- allow former beneficiaries of a fund who suffered an eligible loss to obtain financial assistance;
- provide equitable access to financial assistance under Part 23 irrespective of whether the fund is a defined benefit fund or an accumulation fund;
- clarify the definition of 'eligible loss' so that any deficit in a superannuation fund arising from the failure to pay contributions is not covered under Part 23;
- allow the Minister to delegate certain administrative functions to reduce the length of time taken to consider applications; and
- abolish the Special Protection Account which was established to pay grants of financial assistance to superannuation funds which suffer losses due to theft or fraud, and to hold funds collected from the superannuation industry. In practice, the account has never been used as all grants of financial assistance made under the Part 23 framework are firstly paid by the Government from consolidated revenue. The amount paid is then recovered from the superannuation industry through the imposition of the Financial Assistance Levy on all APRA-regulated superannuation funds.

## Schedule 3 - Accounts, audit and reporting obligations

2.10 The *Superannuation Industry (Supervision) Act 1993* (the SIS Act) is the principal legislation establishing the prudential framework for the regulation of the superannuation industry, including the prudential reporting requirements of superannuation entities.[9] These requirements are located in four Parts of the SIS Act and associated regulations. According to the EM, this creates complexity and is potentially confusing. Additionally, by referring to 'superannuation entities', the SIS legislation can make it difficult to determine which reporting obligations relate to SMSFs and which relate to APRA-regulated superannuation entities. The distinction is important as the reporting obligations of these two types of superannuation vehicle differ.

2.11 Schedule 3 of the bill consolidates and rationalises the prudential reporting requirements in the SIS Act. It repeals the current Part 4 and replaces it with a new Part 4 which integrates the reporting obligations for registrable superannuation entities (RSEs) and self managed superannuation funds (SMSFs) that were previously found in Parts 4 and 13 of the SIS Act.

2.12 The new Part 4 includes requirements for superannuation entities:

- to keep accounting records;

9 EM, p. 92.

- to prepare reporting documents/accounts and statements; and
- to lodge annual returns and audit reports.

It also contains requirements for trustees of superannuation entities to appoint an approved auditor to report on the operations, and the RSE licensee (if any), of the entity.

2.13 Additionally, Part 4 clarifies which reporting requirements apply to RSEs and which apply to SMSFs.

2.14 Schedule 3 of the bill also amends the SIS Act to close the regulatory gap that currently exists for the reporting of contraventions of the market conduct and disclosure provisions in the *Corporations Act 2001*.

2.15 Finally, Schedule 3 makes consequential amendments to the SIS Act, the *Superannuation (Self Managed Superannuation Funds) Taxation Act 1987* and the *Income Tax Assessment Act 1936*.

## Schedule 4 - Technical amendments relating to legislative instruments

2.16 Schedule 4 of the bill makes amendments to various Acts that are consequential on the enactment of the *Legislative Instruments Act 2003*. The Legislative Instruments Act was assented to on 17 December 2003. Certain provisions of the Act commenced on that date but the bulk of provisions were to commence on a date to be fixed by proclamation which was 1 January 2005.

2.17 The amendments in the bill replace various references and requirements that relate to the Acts Interpretation Act, with the relevant references and requirements of the Legislative Instruments Act.

2.18 Some amendments also specify that a legislative instrument may take effect before it is registered on the Federal Register of Legislative Instruments (the FRLI), notwithstanding section 12(2) of the Legislative Instruments Act which, in certain circumstances, prevents a legislative instrument from taking effect before it is registered.

# Chapter 3

# Issues

## Evidence to the Committee

3.1 The committee received a total of four submissions on this bill. Submissions focussed on:

- whistleblower protection;
- breach reporting;
- Review of decisions in relation to prudential standards;;
- APRA's exemption powers;
- APRA's power to make discretionary decisions;
- Court enforceable undertakings; and
- Responsible officers and responsible persons.

### *Whistleblower protection*

3.2 The bill introduces a consistent framework of protection for whistleblowers across the prudential Acts. IFSA supports the extension of the whistleblower provisions but considers that they should be aligned with the relevant existing requirements under the Corporations Act. Part 9.4AAA of the Corporations Act gives protection to whistleblowers who have reasonable grounds to suspect that the information they disclose indicates a contravention of the Corporations legislation. IFSA states that this is objective test and allows a company to determine with some certainty whether such protection will apply.[1]

3.3 By contrast, IFSA submits that the proposed equivalent provisions in the bill purport to attract the same level of protection to a person who discloses information to one of the named persons (eg APRA, the auditor, the actuary, a director or senior manager) but the two tests to be met introduce subjectivity into the prudential Acts. These tests are:

- the information concerns misconduct, or an improper state of affairs or circumstances in relation to the regulated entity; and
- the discloser considers that the information may assist [the person to whom the disclosure is made] to perform the person's functions or duties in relation to the regulated entity.

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1 IFSA, *Submission 1*, p. 2.

3.4 IFSA argues that these tests create serious unintended consequences and recommends that:

- the provisions be aligned with the Corporations Act requirements;
- should be an objective test;
- should relate only to significant and materially damaging conduct; and
- should relate only to a potential breach of the legislation in which it appears.[2]

3.5 IFSA also maintained that the bill provides the Parliament with the opportunity to improve the drafting of the existing whistleblower provisions in the Corporations Act and recommends that a change be made both to these proposals and the Corporations Act to allow the organisation a reasonable discretion to disclose certain information for the fair and reasonable purposes of investigating the issues, provided due care is taken to protect the identity of the discloser.[3]

3.6 The ABA expressed general support for the proposed protections for whistleblowers in the prudential Acts. However, the ABA considered that the amendment creates some uncertainty in the operation and application of the provisions and poses some practical problems relating to the disclosure of information and subsequent response by recipients of the confidential information. Like IFSA, the ABA sought an amendment to the bill to ensure that the relevant whistleblower provisions are aligned between the Corporations Act and the prudential Acts.[4] A late submission from the Law Council supported the ABA view.[5]

3.7 The Chartered Secretaries Australia (CSA) submission also addressed aspects of the whistleblower provisions. CSA noted that in the bill, the recipients for the company include a director or senior manager or person authorised to receive disclosures. It noted that as it will depend on the facts whether a company secretary comes within the definition of senior manager, disclosure to a company secretary may result in the whistleblower not being protected.

3.8 CSA expressed the view that the failure to expressly include company secretaries in the relevant classes of persons is 'odd', given that their position within a company, and governance role, may make them likely recipients for disclosures.

3.9 The CSA made a number of recommendations, as follows:

- the provisions being inserted to the prudential Acts in relation to whistleblowing be amended to provide for a company secretary to

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2 IFSA, *Submission 1*, p. 2.

3 IFSA, *Submission 1*, p. 3.

4 ABA, *Submission* 2 (supplementary), p. 3.

5 Law Council of Australia, *Submission 4*.

discuss a disclosure with other senior officers for the purpose of investigating or remedying the matters raised, provided that the recipient does not disclose without the whistleblower's consent the identity of the whistleblower or information that is reasonably likely to lead to the identification of the whistleblower;

- a similar amendment be made to Part 9.4AAA of the Corporations Act;
- the Bill be redrafted to clarify that the recipients for the company authorised to receive disclosures include the company secretary.[6]

***Breach reporting***

3.10 IFSA maintained that as drafted, the provisions have the potential to result in uncertainty and confusion as to which if any breaches need to be separately reported to ASIC.

3.11 IFSA also raised an issue in relation to the timing of breach reports. It noted that the Bill amends the Corporations Act so that the current period of 5 business days within which to report a breach to ASIC under section 912D is extended to 10 business days. IFSA maintained however that the actual commencement time/date of the obligation to report is unclear and recommended that the time for the obligation to report commence from the date on which the breach is first notified to the most senior decision maker responsible for such matters and determined to be material.[7]

3.12 The Australian Bankers Association (ABA) welcomed the simplification and clarification of some operational matters, but said that others required clarification and further regulatory guidance. The ABA sought a number of changes in the bill in relation to breach reporting in its submission, including:

- new breach reporting provisions to come into effect from 1 July 2008 to allow both regulators and entities to implement new procedures and update systems;
- the definition of what breaches that are reportable obligations to be consistent across statutes, the requirement to report 'likely breaches' to be removed from the Corporations Act;
- breach reporting across the prudential statutes to be made consistent, and the requirement tor report breaches in the Banking Act to apply only to the bank, not subsidiaries;
- breach reporting duplication of reporting may still be an issue, and accordingly, the auditor or actuary should be required to inform the regulated entity of a breach report in addition to APRA; and

6 Chartered Secretaries Australia, *Submission 3*.

7 IFSA, *Submission 1*, pp 3-4.

- documents produced for the purposes of complying with the regulations to be confidential.

3.13 The ABA also expressed the view that regulatory guidance will be necessary to clarify the intention of the law in relation to a number of aspects of the new breach reporting requirements. The detail of the ABA's concerns in this regard is elaborated in its submission.[8]

***Review of decisions in relation to prudential standards***

3.14 IFSA noted that the proposed amendment (Items 56-59) extends APRA's ability to make prudential standards to a single entity or groups, and sought a change to the provision so that it would be a reviewable decision.[9]

***APRA's exemption powers***

3.15 The ABA sought an amendment to the Bill so that it does not apply to the authority to carry on a banking business; and for APRA to be required to publicly disclose its determination, in relation to a person or class of persons.

3.16 The ABA also noted that the depositor protection and policy holder protection policy is still being resolved and expressed the view that any changes to the prudential framework should therefore not be made until these outstanding matters are resolved.[10]

***APRA's power to make discretionary decisions***

3.17 The ABA maintained that APRA should not be granted a broad discretionary power to approve, impose, adjust or exclude specific prudential requirements in relation to a particular regulated entity.

3.18 The ABA said that if the Government wished to persist with this amendment, APRA should be required to publicly disclose on a quarterly basis the interpretations of its discretionary decisions for that period, including an explanation of the grounds for its prudential decisions, especially where APRA has exercised its discretion.[11]

***Court enforceable undertakings***

3.19 The ABA considered that further consultation on this issue was needed. They said that if the Government decides to proceed with this amendment, APRA should be required:

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8 ABA, *Submission 2*, p. 3.

9 IFSA, *Submission 1*, p. 4.

10 ABA, *Submission 2*, p. 5.

11 ABA, *Submission 2*, pp 5-6.

> …to work with regulated entities and industry representatives in relation to how APRA will use its new powers, especially how APRA envisages accepting enforceable undertakings and working with regulated entities cooperatively to develop mutually agreed solutions to an enforcement issue.[12]

### *Responsible officers and responsible persons*

3.20 The ABA noted that the Bill does not contain amendments to align the regime in the prudential Acts with that of the Corporations Act and expressed the view that the three regimes should be harmonised as much as possible to reduce unnecessary duplication and differences.[13]

## Treasury response

3.21 Several of the issues raised in submissions related to variations in provisions from those in the Corporations Act. Treasury officers advised the committee that wherever appropriate, the requirements for entities operating under the prudential acts are harmonised with the Corporations Act, but there are necessarily some differences. Officers explained that this is because there are differences between the objectives for prudential regulation and for consumer protection and accordingly, differences between the regulatory approaches adopted. Treasury representatives said that the whistleblower provisions are an example of this.[14]

3.22 Responding to IFSA's concerns about the whistle blowing provisions, officers said that the first principle Treasury had sought to apply is to make it as easy as possible for potential whistleblowers to convey information to the regulator or to senior managers and be confident that they will be covered by the whistleblower provisions if the disclosure is made in good faith. Mr Legg of Treasury also noted that the prudential regulator, unlike the market conduct regulator, needs to be able to identify problems fairly early, before they come to a head:

> They are not just identifying issues that might lead to a breach of the law but addressing problems in the way that risk management operations operate within a regulated entity—problems which may just be concerns about management practices. The prudential regulator needs to be able to identify those issues and have information brought to him fairly early in the process. The thinking behind the difference here is to facilitate that difference in the underlying process of prudential regulation relative to market conduct regulation.[15]

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12 ABA, *Submission 2*, p. 6.

13 ABA, *Submission 2*, p. 7.

14 *Committee Hansard* , 27 July 2007, p. 43.

15 *Committee Hansard* , 27 July 2007, p. 44.

3.23 In relation to the issue raised by Chartered Secretaries Australia, Treasury advised that it was possible that whistleblower disclosures could be made to company secretaries if they were included as responsible office holders or senior managers with prudential responsibility within the regulated entity.[16]

3.24 Officers indicated that Treasury is open to further consideration of the ABA's concerns about breach reporting, Officers said, however, that it would be necessary to give full consideration to suggestions for further amendments to ensure that the impact of any new proposals were properly considered and that accordingly it would not be possible to consider the ABA's requested amendments in the context of the current bill.[17]

3.25 Responding to questions about an apparent lack of certainty about the intended operation of some provisions, for example when the clock might start ticking in relation to breach reporting, officers indicated that further guidelines would be provided after the legislation is enacted.[18]

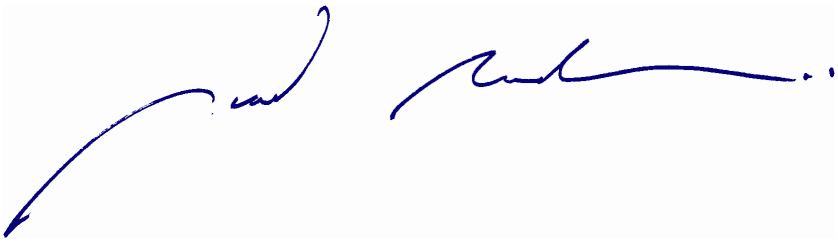
## Committee comments

3.26 The committee is satisfied that there are sound reasons for the differences in approach between corporations law and the amendments resulting from this bill, such as in relation to the whistleblower provisions. The committee also accepts that it is important that prudential regulators receive adequate warning of breaches to maximise the possibility of a timely intervention before problems become serious.

3.27 The committee nonetheless considers that it would be desirable to evaluate the operation of the new provisions after an adequate period, to ensure they are operating as intended. The committee notes Treasury's expressed willingness to continue dialogue with the industry in relation to possible future regulatory changes, if needed.

**Recommendation 1**

**3.28 The committee recommends that the bill be passed**



Senator the Hon. Michael Ronaldson

Chair

16 *Committee Hansard* , 27 July 2007, pp 44-5.

17 *Committee Hansard* , 27 July 2007, p. 43.

18 *Committee Hansard* , 27 July 2007, pp 43-4.

# APPENDIX 1
## Submissions Received

| Submission Number | Submitter |
|---|---|
| 1 | Investment & Financial Services Australia (IFSA) |
| 2 | Australian Bankers' Association (ABA) |
| 3 | Chartered Secretaries Australia (CSA) |
| 4 | Law Council of Australia |

# APPENDIX 2

## Public Hearing and Witnesses

**Friday, 27 July 2007 – Melbourne**

LEGG, Mr Chris, General Manager
Department of the Treasury

MOORE, Mr André, Unit Manager
Department of the Treasury