The Senate

Select Committee on Superannuation

Provisions of the Superannuation Industry (Supervision) Amendment Bill 2002 and the Superannuation (Financial Assistance Funding) Levy Amendment Bill 2002

March 2003

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Terms of Reference

On 5 February 2003 the provisions of the following bills were referred to the Select Committee on Superannuation for inquiry and report by 19 March 2003:

- Superannuation Industry (Supervision) Amendment Bill 2002
- Superannuation (Financial Assistance Funding) Levy Amendment Bill 2002

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List of Abbreviations

ACA	Australian Consumers' Association
APRA	Australian Prudential Regulation Authority
ASFA	Association of Superannuation Funds of Australia
ATO	Australian Taxation Office
CNAL	Commercial Nominees of Australia Limited
CSA	Corporate Super Association
DoFA	Department of Finance and Administration
EM	Explanatory Memorandum
FMA Act	*Financial Management and Accountability Act 1997*
IFSA	Investment and Financial Services Association
SAF	Small APRA fund
SEESA	Special Employee Entitlements Scheme for Ansett group employees
S(FAF)LA Bill	The Superannuation (Financial Assistance Funding) Levy Amendment Bill 2002
SIS Act	*Superannuation Industry (Supervision) Act 1993*
SISA Bill	Superannuation Industry (Supervision) Amendment Bill 2002
SMSF	Self-managed superannuation fund
SWG	Superannuation Working Group
The Levy Act	*Superannuation (Financial Assistance Funding) Levy Act 1993*

Chapter One

Introduction

Referral of the bills to the Committee

1.1 The Superannuation (Financial Assistance Funding) Levy Amendment Bill 2002 (the S(FAF)LA Bill) and the Superannuation Industry (Supervision) Amendment Bill 2002 (the SISA Bill) were introduced into the House of Representatives on 12 December 2002.

1.2 The provisions of the two bills were referred to the Senate Select Committee on Superannuation by the Senate Selection of Bills Committee on 5 February 2003, for inquiry and report by 19 March 2003.

1.3 In referring the provisions of the two bills to the Committee, the Senate Selection of Bills Committee noted that:

> Compensation against theft and fraud of superannuation (retirement) funds is a critical public policy issue. The compensation mechanism and level should be closely examined, particularly as this legislation is in response to the Commercial Nominees theft issue – the first so far.

Purpose of the bills

1.4 The levy collection process plays a central role in providing financial assistance to superannuation funds that have suffered losses due to fraudulent conduct or theft.

1.5 The S(FAF)LA Bill and the SISA Bill together aim to reform the imposition and administration of a levy on the superannuation industry under the *Superannuation (Financial Assistance Funding) Levy Act 1993* (the Levy Act).

1.6 The S(FAF)LA Bill amends the Levy Act in two ways:

a) It allows the imposition of one levy on superannuation funds at the end of the financial year to recoup grants of financial assistance made to funds that have suffered losses due to fraudulent conduct or theft. The Levy Act currently allows for a particular levy to relate to only one grant for financial assistance. When the Levy Act was introduced, it was not envisaged that a large number of funds would require assistance at any one time.

b) It allows for a minimum and maximum to be set when imposing the levy. Without a floor or a ceiling on the levy, the Levy Act in its

current form would require some funds to pay in excess of $400,000, far above the $65,000 maximum the funds pay for the purposes of Australian Prudential Regulation Authority (APRA) supervision, and smaller funds to have to pay as little as 20 cents (or less), which is not administratively sensible or cost effective to collect.[1]

1.7 The Explanatory Memorandum (EM) to the S(FAF)LA Bill indicates that the maximum and minimum levies are envisaged to be less than the levies imposed on superannuation funds for the cost of APRA supervision in any one year. For the 2002-03 financial year, the minimum and maximum levies for APRA supervision were $400 and $66,000 respectively.[2]

1.8 The purpose of the SISA Bill is to make some minor consequential amendments to section 237 of the *Superannuation Industry (Supervision) Act 1993* (the SIS Act) as a result of the amendments proposed in the S(FAF)LA Bill.[3]

1.9 Together the two Bills are designed to make the collection of levies more efficient, and the levy burden shared more equally across the superannuation industry.

1.10 An outline of the main provisions of the S(FAF)LA and SISA Bills is at **Appendix 1.**

1.11 The proposed levy is payable by all APRA-regulated superannuation funds and approved deposit funds, with the exception of:

- Funds in respect of which a determination under Part 23 of the SIS Act was made in the same financial year;[4] and
- Exempt public sector superannuation schemes (as defined by section 10 of the *Superannuation Industry (Supervision) Act 1993* and Schedule 1AA of the *Superannuation Industry (Supervision) Regulations*).[5]

1.12 Self-managed superannuation funds (SMSFs), which are regulated by the Australian Taxation Office (ATO), are also excluded from the levy.[6]

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1 S(FAF)LA Bill, Explanatory Memorandum, p. 4.

2 S(FAF)LA Bill, Explanatory Memorandum, p. 6.

3 Department of the Parliamentary Library, Bills Digest No 94 2002-03, p. 1.

4 *Superannuation (Financial Assistance Funding) Levy Act 1993*, section 6.

5 Submission 5, Treasury. Attachment A of the submission lists the current exempt public sector superannuation funds.

6 Under s.17A of the SIS Act, a SMSF is defined (with a small number of exceptions) as a fund with less than five members where all the members of the fund are also the trustees of the fund. Small funds with less than 5 members may also elect to be regulated by APRA if they replace their trustees with a trustee who had been granted approved trustee status by APRA under Part 2 of the SIS Act.

Background

The Levy Act

1.13 The Levy Act provides for regulations to impose a levy on superannuation funds and approved deposit funds for the purposes of funding financial assistance under Part 23 of the SIS Act. Although the Levy Act has not previously been used, the Government intends to use the Act to recoup the recent grants of financial assistance made since June 2002 under Part 23 of the SIS Act.

1.14 Under subsection 7(2) of the Levy Act, the size of the levy that can be imposed on superannuation funds in any one financial year is limited to 0.05 per cent of assets of that fund at the end of the financial year prior to the financial year in which the levy is to be raised.[7]

Part 23 of the SIS Act

1.15 Part 23 of the SIS Act enables a trustee of a superannuation fund to apply for financial assistance from the Government if the fund has suffered an 'eligible loss', subject to certain conditions. An 'eligible loss' is a loss that is suffered as a result of fraudulent conduct or theft. Upon the Minister being sufficiently satisfied that the fund has suffered an 'eligible loss', the Minister must determine whether the public interest requires that a grant of financial assistance be made to the fund.

1.16 Until recently, Part 23 of the SIS Act had never been used. However, on 20 June 2002, the Minister for Revenue and Assistant Treasurer made a determination for the first grant of financial assistance under Part 23. This determination related to 181 small superannuation funds previously under the trusteeship of Commercial Nominees of Australia Limited (CNAL), which suffered losses in the Enhanced Cash Management Trust account. A further 197 grants had been made up until 12 December 2002.[8] The Committee understands that, while one determination was made in respect of the Australian Independent Superannuation Fund, the remainder were in respect of CNAL. As a result, to date, the Minister for Revenue and Assistant Treasurer has made nearly 380 determinations, and the Government has paid out over $20 million.[9]

Anticipated revenue from the levy

1.17 Under the Levy Act, the Treasury anticipates collecting in the order of $11.1 million in 2002-03, to cover financial assistance paid out in 2001-02. In 2003-04, the Treasury anticipates collecting in the order of $20 million, to cover expected financial

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7 Department of the Parliamentary Library, Bills Digest No 94 2002-03, p. 2.

8 S(FAF)LA Bill, Explanatory Memorandum, p. 3.

9 S(FAF)LA Bill, Second Reading Speech.

assistance payouts in 2002-03. This represents an anticipated total of $31.1 million over two financial years.[10]

1.18 Treasury advised the Committee that the levy amounts in 2002-03 and 2003-04 will be less than 0.05 per cent of the assets of superannuation funds, in accordance with subsection 7(2) of the Levy Act, and as envisaged in the EM to the S(FAF)LA Bill. In addition, the levy amounts in 2002-03 and 2003-04 will each be less that the APRA supervisory levy in 2002-03, which was in the order of $30 million.[11]

The Superannuation Working Group

1.19 In October 2001, the then Minister for Financial Services and Regulation, The Hon Joe Hockey MP, established the Superannuation Working Group (SWG), which included representatives from APRA, the Australian Securities and Investments Commission and the Department of the Treasury. They were charged with conducting public consultations on ways in which the safety of superannuation could be improved. The SWG presented its findings to the Minister for Revenue and Assistant Treasurer in March 2002 in a report entitled *Options for Improving the Safety of Superannuation*.[12]

1.20 The Minister released the report of the SWG to the public on 28 October 2002. Recommendation 27 of the SWG report dealt with the issue of whether any amendments needed to be made to the financial assistance provisions in Part 23 of the SIS Act. Recommendation 27 stated:

> Given that the current provisions contained in Part 23 of the SIS Act have not yet been fully tested, the SWG recommends that the provisions not be changed at this time. However, the SWG recommends that the Government review the operation of Part 23 and consider possible amendments to it, in consultation with relevant stakeholders, once the first decision under Part 23 has been made.[13]

1.21 The Government issued a response to the SWG report on the same day, 28 October 2002. In that response, the Government included a number of proposed changes to the regulation of the superannuation industry, and supported Recommendation 27 of the SWG:

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10 Committee Hansard, 5 March 2003, p. 10.

11 Committee Hansard, 5 March 2003, pp. 10-11.

12 Department of the Parliamentary Library, Bills Digest No 94 2002-03, p. 3.

13 Superannuation Working Group, *Options for Improving the Safety of Superannuation – Report of the Superannuation Working Group*, 28 March 2002, p. 78. See http://www.treasury.gov.au/documents/457/RTF/options_super.rtf

> The Treasury will review the operation of these provisions, in consultation with key stakeholders.[14]

Conduct of the inquiry

1.22 The Committee advertised its inquiry into the provisions of the S(FAF)LA and SISA Bills in *The Australian* on 12 February 2003. In addition, the Committee contacted a number of organisations with a possible interest in the Levy Bills, inviting submissions. The Committee received seven submissions, which are listed at **Appendix 2**.

1.23 The Committee met in public to consider the bills on 5 March 2003. A list of those who gave evidence at the public hearing is at **Appendix 3**.[15]

1.24 The issues arising during the inquiry on the two bills are discussed in the next chapter.

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14 Government Response to SWG Recommendations, 28 October 2002, p. 13. See http://www.treasury.gov.au/documents/459/RTF/resp.rtf

15 References to the hearing in this report are to the proof hansard.

Chapter Two

Issues Arising During the Inquiry

Introduction

2.1 The Committee notes that all parties giving evidence to the inquiry were broadly supportive of the provisions of S(FAF)LA and SISA Bills, on the basis that the proposed single annual levy would be simpler to administer than imposing hundreds of separate levies.

2.2 This chapter initially examines the position of parties giving evidence to the inquiry. Subsequently, the chapter examines in detail:

a) The proposed operation of the levy under the amendments proposed in the S(FAF)LA and SISA Bills;

b) The operation of Part 23 of the SIS Act; and

c) The compensation mechanisms for parties not covered by the SIS Act.

The position of parties giving evidence

2.3 During the inquiry, the Committee received submissions from five financial industry and consumer parties: the Association of Superannuation Funds of Australia Limited (ASFA), the Corporate Super Association (CSA), the Investment and Financial Services Association (IFSA); the Australian Consumers' Association (ACA) and the Trustee Corporations Association of Australia. The position of these parties is summarised below:

a) ASFA supported the passage of the Bills without amendment, subject to an assurance that the superannuation sector would be consulted on what the levy rates should be in any given financial year.[1]

b) The CSA supported the Bills, on the basis that they improve the workability of the Levy Act by making the collection of the levy more efficient. However, the CSA suggested that the Federal Government should make some contribution towards the financial compensation of funds in difficulty out of consolidated revenue.[2]

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1 Submission 1, ASFA, p. 2.

2 Submission 2, CSA, p. 4.

c) IFSA offered broad support for the Bills, but also raised the issue of whether the Federal Government should cover financial compensation of funds in difficulty out of consolidated revenue. Failing that, IFSA suggested that the annual levy on superannuation funds be collected over a five-year period, to reduce the burden in any one year.[3]

d) The ACA welcomed the Bills, on the basis that access to compensation under the Levy Act is crucial for consumer confidence in the superannuation system. However, although not within the provisions of the Bills before the Committee, the ACA raised a number of issues connected with the efficiency and adequacy of the financial assistance provided under Part 23 of the SIS Act.[4]

e) The Trustee Corporations Association of Australia supported the proposed introduction under the Bills of a single annual levy to eradicate the need for multiple levies, but raised a number of issues with regard to the need for better preventative measures to strengthen the regulatory structure, the need for appropriate financial underpinnings for superannuation funds, the need to address the moral hazard issue, and the need for even-handed application of the levy structure.[5]

The proposed operation of the levy

Prudential supervision

2.4 The Committee notes evidence to the inquiry which highlighted the desirability of effective prudential supervision to prevent losses amongst superannuation funds due to fraudulent conduct or theft.

2.5 For example, IFSA stated in its written submission that effective prudential supervision is preferable to *post facto* compensation.[6] Similarly, the Trustee Corporations Association of Australia advocated in its written submission strengthening the current regulatory structure by expanded independent oversight of superannuation fund trustees:

> Genuinely independent and timely oversight of the trustee's compliance with a Risk Management Plan would improve governance and provide a powerful preventative measure to reduce the probability of serious problems

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3 Submission 3, IFSA, pp. 1-3. Committee Hansard, 5 March 2003, pp. 2-8.

4 Submission 4, ACA, pp. 1-3.

5 Submission 7, Trustee Corporations Association of Australia, pp. 1-4.

6 Submission 3, IFSA, p. 2.

> arising. This approach would also be consistent with overseas best practice for managed funds.[7]

2.6 The Trustee Corporations Association of Australia further advocated strengthening the prudential supervision of funds by:

- requiring those responsible for safeguarding other people's money to have appropriate levels of capital and/or insurance that could serve as a first source of funding for losses;
- requiring APRA to better utilise its resources by concentrating its prudential focus on the small APRA fund (SAF) trustees rather than the SAFs themselves; and
- reviewing the inequitable levy structure which currently exists and which provides a financial incentive for investors to by-pass SAFs and opt for SMSFs regulated by the ATO.

2.7 Given that a number of funds – both SAFs and SMSFs – have suffered losses due to fraudulent conduct or theft, the Committee notes a number of issues in relation to the proposed operation of the levy. These are examined below.

The funding of compensation

2.8 A number of submissions raised the issue of how grants of financial assistance should be funded.

2.9 The CSA argued in its written submission that the full burden of providing financial assistance to funds which have run into difficulty should not fall solely on those funds which have operated responsibly without loss or incident. The CSA observed that as it stands, funds that have gone to the trouble and expense of maintaining systems and procedures to minimise the likelihood of loss and underperformance are nevertheless expected to assist making good the damage suffered by funds which have, in many instances, made less effort to safeguard their members' interests or which, in a few instances, have simply been unfortunate.[8]

2.10 To address this issue, the CSA argued that as a major stakeholder in the superannuation system, the Government should be prepared to meet some of the costs of financial assistance to superannuation funds that have suffered losses due to fraudulent conduct or theft through a regular provision from consolidated revenue. The CSA observed:

> The Federal Government has a number of reasons for wishing to maintain the integrity of the privately funded superannuation system. Amongst these reasons is an interest in ensuring that there is a pool of funded savings to

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7 Submission 7, Trustee Corporations Association of Australia, p. 2.

8 Submission 2, CSA, p. 4.

> reduce community dependence on the Social Security system. Another is that although there may be a cost in providing tax concessions for superannuation, there are regular and increasing revenue streams arising from the funding of superannuation. Therefore the Government is a major stakeholder in the superannuation system. Given this, we believe that it would be not unreasonable for some of the burden of effectively providing a guarantee for the compulsory superannuation savings system to be shared by the Government.
>
> Our proposal for implementing this would be that there should be a regular provision from consolidated revenue to fund a financial assistance fund for superannuation funds in difficulty. This could be funded from the regular increases in revenue flowing from taxes on contributions.[9]

2.11 IFSA also argued in its written submission that the Government should use consolidated revenue to finance compensation to funds that have suffered losses due to fraudulent conduct or theft:

> … IFSA does not believe that superannuation investors would be well served by implementing broad compensation arrangements funded from other Australians' retirement savings.[10]

2.12 IFSA's position was reiterated by Mr Stanhope from IFSA in the hearing on 5 March 2003:

> There is an attraction in (implementing broad compensation arrangements) … from consolidated revenue. We are not advocating that as a firm position, but are simply pointing out that were you to recover amounts via consolidated revenue you would get a spread across all taxpayers based on income. … The attraction for not funding the levy from the superannuation industry itself is that it must fall on members in funds, and fund membership is uneven.[11]

The collection of a single levy

2.13 In its written submission, ASFA supported the proposed imposition of a single annual levy on superannuation funds to meet multiple instances of financial compensation in a given year, on the basis that it has the potential to substantially reduce the administration costs of both the regulator and funds. ASFA acknowledged that imposing separate levies for each instance of financial compensation would not be administratively efficient.[12]

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9 Submission 2, CSA, p. 4.

10 Submission 3, IFSA, p. 2.

11 Committee Hansard, 5 March 2003, p. 3.

12 Submission 1, ASFA, p. 1.

2.14 The ACA also supported the proposed imposition of a single levy at the end of the financial year, on the basis that levying in the order of 380 separate levies would clearly be costly and unwieldy.[13] The Trustee Corporations Association of Australia also supported the proposed single annual levy to minimise administrative costs for all parties.[14]

2.15 The general support for a single annual levy was reiterated by Mr Stanhope from IFSA in evidence on 5 March 2003. Mr Stanhope noted that the proposed imposition of a single levy is a 'sensible mechanism' to recover amounts paid under Part 23 of the SIS Act.[15] The Corporate Super Association also indicated that the proposed approach was sensible.[16]

2.16 APRA has responsibility for collection of the levy on behalf of the Commonwealth. In the hearing on 5 March 2003, Mr Venkatramani from APRA advised the Committee that APRA wished to ensure that the levy was clearly distinguished as a levy to replenish the Commonwealth public account as a result of a decision to issue a grant of financial assistance under Part 23 of the SIS Act, and was not part of APRA's normal supervisory role within the finance sector.[17]

The proposal to collect the levy over a five-year period

2.17 In its written submission, IFSA raised concern that if financial assistance is to continue to be funded by an industry levy rather than from Government consolidated revenue, then there will potentially be large annual fluctuations in the levy amount. Accordingly, IFSA recommended that the levy amount should be collected over a five-year period, to reduce the burden in any one year. IFSA suggested that an even spread of 20 per cent of the levy per year will dampen fluctuations quite significantly, and allow trustees to set fees with foreknowledge of greater than 60 per cent of the final levy amount in any one year.[18]

2.18 Mr Stanhope from IFSA reiterated these arguments for the collection of the levy over a five-year period in the hearing on 5 March 2003:

> As you know, IFSA's position is one of full and complete disclosure. So, in order to deal with this we suggest a refinement to the process that would do two things … One is to minimise the fluctuations (in the levy), and the other is to provide (trustees) with some foreknowledge of the annual levy

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13 Submission 4, ACA, p. 2.

14 Submission 7, Trustee Corporations Association of Australia, p. 4.

15 Committee Hansard, 5 March 2003, p. 2.

16 Submission 2, CSA, p. 4.

17 Committee Hansard, 5 March 2003, p. 9.

18 Submission 3, IFSA, p. 3.

> amount. We have suggested spreading the levy over five years, which, we think, would achieve both of these objectives.[19]

2.19 In its written submission, the Trustee Corporations Association of Australia also argued that if the levy would otherwise be particularly large, there should be provision for the Government to decide to fund it over more than one year.[20]

2.20 The Committee raised this issue with Mr Ray from the Treasury in the hearing of 5 March 2003. In response, Mr Ray indicated that the Government's policy is to collect the revenue on a year-to-year basis in the interests of administrative simplicity.[21] In addition, Mr Ray pointed out that any system whereby the Government paid out compensation up-front, but collected the levy up to five years in arrears, would obviously have implications for Commonwealth finances.[22]

Equity issues - individuals with multiple accounts and public sector funds

2.21 Issues about the equity of the proposed arrangements for the levy were also raised in evidence to the inquiry.

2.22 In its written submission, IFSA raised concern that individuals with multiple accounts will potentially have to pay the levy several times over, rather than just once. In addition, individuals in public sector superannuation funds will avoid paying the levy entirely:

> Currently, compensation could come from either consolidated revenue, or from a levy on superannuation funds. Compensation from consolidated revenue would represent a contribution from all Australians. On the other hand, levy-based compensation would fall unevenly, depending on which funds were levied and how the costs were passed on to fund members. For instance, people with multiple accounts could well pay more towards a levy than people with a single high balance account. Members of public sector (and unfunded) schemes might escape contributions altogether. [23]

2.23 In response to questions from the Committee about how trustees would apply the levy in an equitable way, APRA advised the Committee that it was up to the trustee to apportion the levy on a per capita basis between members of a fund, in accordance with general trust law as well as section 52 of the SIS Act.[24]

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19 Committee Hansard, 5 March 2003, p. 2.

20 Submission 7, Trustee Corporations Association of Australia, p. 4.

21 Committee Hansard, 5 March 2003, p. 15.

22 Committee Hansard, 5 March 2003, p. 16.

23 Submission 3, IFSA, p. 2.

24 Committee Hansard, 5 March 2003, p. 16.

2.24 In response to the exemption of some public sector superannuation funds from the provisions of the Bill, Mr Ray from the Treasury acknowledged that some public sector superannuation funds would not be required to pay the levy, but indicated that 'government's policy is that that is as it should be'.[25]

2.25 In a subsequent submission, Treasury clarified this position:

> Exempt public sector superannuation schemes (as defined by section 10 of the *Superannuation Industry (Supervision) Act 1993* and Schedule 1AA of the *Superannuation Industry (Supervision) Regulations*) are exempt from a levy imposed under the SFAFL Act. …
>
> Non-exempt public sector superannuation schemes that are regulated superannuation funds or approved deposit funds (as defined by the SIS Act) will be liable to a levy imposed under the SFAFL Act. For example, the Commonwealth Superannuation Scheme and the Public Sector Superannuation Scheme, superannuation schemes for employees of the Australian Public Service and other participating Commonwealth and Territory agencies, will be subject to any levy imposed under the SFAFL Act.[26]

Equity issues - the minimum and maximum levy amounts

2.26 During the inquiry, the Committee's attention was also drawn to the potential for the S(FAF)LA Bill to increase the financial burden on superannuation funds with small balances by allowing regulations that impose a levy which includes a minimum and maximum amount. The proposed imposition of a minimum levy, while ensuring that small funds are not levied ridiculously small amounts (for example, 20 cents or less), will place a proportionately heavier burden on small funds than large funds. As stated in the EM to the Bill:

> While the application of a minimum levy amount based on one levy means that smaller funds may incur a slightly higher burden, the saving in reduced compliance costs through the imposition of one levy, rather than around 200 potential levies, would offset to some extent a potential increase in the quantum imposed by setting a minimum levy amount. [27]

2.27 In its written submission, ASFA argued that there is a strong case for a minimum levy on efficiency grounds, in that it would not make sense to send out an invoice for a payment of just a few dollars.

2.28 Moreover, ASFA also argued that there is a case for a minimum levy on broader equity grounds. ASFA suggested that because small funds, many of them

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25 Committee Hansard, 5 March 2003, p. 10.

26 Submission 5, Treasury, p. 1.

27 Explanatory Memorandum, Superannuation (Financial Assistance Funding) Levy Amendment Bill 2002, p. 6.

with relatively high average member account balances, have been the primary beneficiaries of financial assistance under Part 23 of the SIS Act (ultimately to be funded by the levy), it would be inequitable if small funds were only required to pay a levy of say $10 or $20, while the large industry and retail funds might have to pay a levy of, say, $400,000 or more.[28]

2.29 In its written submission, the Trustee Corporations Association of Australia argued that there was no reason why the levy should be capped at a maximum, on the basis that doing so unfairly subsidises larger funds, for which the per-member cost of an uncapped levy would normally be trivial. The Trustee Corporations Association of Australia continued in relation to very small funds:

> If the financial assistance levy that otherwise would apply is uneconomic to collect (eg. the 20 cents mentioned in Treasury calculations), it would be more equitable simply to waive levies below a certain level, than to unfairly raise the minimum levy on smaller funds – this would have the added advantage of saving the administrative costs of processing very small levies.[29]

2.30 In the hearing on 5 March 2003, the Committee Chair raised with Mr Ray from Treasury whether 'very small' funds should be excluded from the requirement to pay the levy. In response, Mr Ray reiterated the argument that it is primarily the small funds that had benefited from Part 23 compensation.[30]

2.31 The Committee also questioned Mr Ray as to the likely maximum and minimum payments that Treasury anticipates levying in 2002-03. In response, Mr Ray reiterated that Treasury aims to collect in the order of $11.1 million in 2002-03. Based on this figure, Mr Ray argued that the levy payments in 2002-03 will be less than the minimum and maximum levies for APRA supervision in 2002-03 ($400 and $66,000 respectively), given that the APRA supervision levy collected in the order of $30 million.[31] However, Mr Ray refused to speculate further as to the precise level of the minimum levy, on the basis that this is a matter for the Minister for Revenue and Assistant Treasurer within the restrictions imposed by the Levy Act.[32]

2.32 The Committee also raised with Mr Ray the likely number of funds which would be required to pay the proposed minimum levy. In response, Mr Ray noted that a minimum levy of the order of $400 would be paid by approximately 8,000 of the approximately 10,000 superannuation funds in Australia. He also noted that the number of funds paying the maximum levy would 'be in the hundreds and not in the

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28 Submission 1, ASFA, p. 1.

29 Submission 7, Trustee Corporations Association of Australia, p. 4.

30 Committee Hansard, 5 March 2003, p. 13.

31 Committee Hansard, 5 March 2003, p. 11, 15.

32 Committee Hansard, 5 March 2003, p. 12.

thousands'. Accordingly, the vast majority of funds paying the levy will be covered by the minimum levy provisions proposed in the S(FAF)LA Bill.[33]

Consultation with the industry on the minimum and maximum levy

2.33 ASFA sought in its written submission an assurance that the superannuation sector would be consulted by Treasury on what the proposed levy rates would be in any given financial year:

> The actual minimum and maximum rate will need to be determined in the light of those being compensated, the amount of compensation, and the industry structure at the time compensation is paid. ASFA would expect that the superannuation sector would be consulted on what the levy rates should be in any given case, and it would be helpful if the Committee sought from the Government an assurance that such consultation will be undertaken.[34]

2.34 During the hearing on 5 March 2003, the Committee sought an assurance from the representatives of Treasury that the superannuation sector would be consulted on what the levy rates should be. In response, Mr Ray from the Treasury gave the Committee an assurance that Treasury proposes to consult with the industry in the development of the draft regulations pertaining to the levy.[35]

The operation of Part 23 of the SIS Act

2.35 During the inquiry, parties raised a number of issues not directly related to the drafting of the S(FAF)LA and SISA Bills, but more generally relating to the granting of financial assistance under Part 23 of the SIS Act. These issues are discussed below.

Delays in the granting of financial assistance

2.36 In its written submission, ASFA noted that the current process for assessing and deciding on applications for financial assistance under Part 23 of the SIS Act has, in a number of instances, involved unsatisfactory delay and uncertainty for applicants. Accordingly, ASFA suggested that it would be desirable for that process to be made more efficient and transparent.[36]

2.37 Similarly, the ACA also argued for reforms to ensure the most expeditious restitution of capital to fund members where funds have suffered losses due to fraudulent conduct or theft. According to the ACA, those reforms should include a

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33 Committee Hansard, 5 March 2003, pp. 13, 20.

34 Submission 1, ASFA, pp. 1-2.

35 Committee Hansard, 5 March 2003, pp. 9-10.

36 Submission 1, ASFA, p. 2.

review of the role of Ministerial discretion with respect to the awarding of financial assistance in the public interest.[37]

2.38 In support of this argument, the ACA noted that while financial assistance under Part 23 of the SIS Act can compensate for loss of funds, it cannot make up for accumulation and growth time lost through the delay in administering any compensation:

> With the overwhelming number of Australian super fund members in accumulation schemes, the consequences of any delay in restitution effectively compounds any loss, as they lose the time to grow their superannuation which would have been available had the breach not occurred.[38]

2.39 In his evidence to the Committee on 5 March 2003, Mr Ray from the Treasury acknowledged that this issue, including the 15-month delay in some cases in providing compensation to eligible funds, falls within the scope of the review of Part 23 of the SIS Act currently being conducted by the Treasury.[39]

Additional grants for trustee fees

2.40 In response to concerns raised by the Committee, Mr Ray acknowledged that at the time of the first ministerial determinations for financial compensation to failed superannuation funds in 2001-02, the acting trustees of those failed funds had in some instances not finalised their own fee, in some cases up to $10,000 or more. Mr Ray indicated that under the SIS Act, the new trustees of those funds are entitled to apply for further compensation to cover those amounts of up to $10,000 or more through an additional Part 23 determination.[40]

2.41 The Committee is also aware of a small number of APRA regulated funds where CNAL was trustee that, while not suffering investment losses through fraud or theft, have incurred higher than normal trustee fees following the appointment of Oak Breeze as acting trustee. The Committee notes in this context that where funds have suffered losses through fraud or theft, acting trustee fees have been included in the eligible losses for the purpose of financial assistance.

The definition of an 'eligible loss'

2.42 In its written submission, the ACA questioned whether financial assistance under Part 23 of the SIS Act should be limited to compensation for eligible losses suffered through fraud and theft. The ACA noted that there are other breaches equally capable of occasioning substantial losses. As an example, the ACA suggested that

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37 Submission 4, ACA, p. 3.

38 Submission 4, ACA, p. 3.

39 Committee Hansard, 5 March 2003, pp. 15, 16.

40 Committee Hansard, 5 March 2003, p. 14.

fund members that suffer breaches through in-house dealing should also be able to seek financial assistance.[41]

2.43 By contrast, in its written submission, IFSA noted that the provision of financial assistance to funds which have suffered losses raises the moral hazard that superannuation contributors might be less likely to select a scheme carefully if there is ready access to 100 per cent compensation.[42]

2.44 The Committee asked Mr Stanhope from IFSA to elaborate on this argument in the hearing of 5 March 2003. Mr Stanhope reiterated IFSA's position that offering compensation without strong regulatory supervision, including better compliance and universal licensing, raises moral hazards:

> If you do not do the regulatory behaviour—the regulatory supervision—and you have broad compensation, the moral hazard risk is obviously that people will feel that, if they enter a slightly risky product, they will be compensated. You might have people feeling a little more comfortable than perhaps they should be in those parts of the market.[43]

2.45 Mr Stanhope also noted that the Superannuation Working Group recommended that the definition of eligible losses suffered through fraud or theft should not be extended. That said, Mr Stanhope acknowledged that the Working Group's decision not to extend the definition of eligible loss occurred prior to the determinations made in relation to Commercial Nominees of Australia Limited, and that the issue could be readdressed in the light of these developments.[44]

2.46 The Committee notes that in his evidence on 5 March 2003, Mr Ray from the Treasury acknowledged that reviewing the definition of an 'eligible loss' falls within the scope of the review of Part 23 of the SIS Act currently being conducted by the Treasury.[45]

Part 23 coverage for post-retirement products

2.47 In its written submission, the ACA supported the extension of financial assistance coverage to other retirement products where appropriate, such as annuities and pensions.[46]

2.48 The Committee again raised this issue with Mr Ray from the Treasury in the hearing on 5 March 2003. The Committee questioned whether Part 23 compensation protection should also be extended to protect post-retirement products.[47]

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41 Submission 4, ACA, p. 3.

42 Submission 3, IFSA, p. 2.

43 Committee Hansard, 5 March 2003, p. 5.

44 Committee Hansard, 5 March 2003, p. 4.

45 Committee Hansard, 5 March 2003, p. 16.

46 Submission 4, ACA, p. 3.

2.49 In response, Mr Ray indicated that post-retirement products are not covered by Part 23 compensation, but again noted that there is the possibility that the Treasury may receive submissions on this issue as part of its review of Part 23 of the SIS Act.[48]

Level of compensation

2.50 The ACA noted in its written submission that the current policy of the Minister for Revenue and Assistant Treasurer is to provide financial assistance under Part 23 of the SIS Act at the rate of 90 cents in the dollar. The ACA argued that there appears to be little reason not to guarantee the full restitution of an eligible loss:

> Consumer confidence in a mandatory superannuation system demands appropriate safeguards, and fund members who have lost their superannuation through the failure of trustees and regulatory processes have every right to expect they will not be penalised through inadequate restitution.[49]

2.51 However, the Committee notes that Mr Stanhope from IFSA, in his evidence to the Committee on 5 March 2003, argued that less than full compensation, whether 90 cents in the dollar or otherwise, goes some way to overcoming the moral hazard issue. Mr Stanhope argued that there are risks that individuals need to be cognizant of when they are choosing a super fund. At the same time, however, Mr Stanhope acknowledged that IFSA did not wish to push this argument in this context.[50]

2.52 The Trustee Corporations Association of Australia also supported financial assistance under Part 23 of the SIS Act at less than 100 cents in the dollar in order to reduce moral hazard. It argued that financial assistance at less than 100 cents in the dollar:

> … would reduce the incentive for investors to choose more risky superannuation vehicles than they otherwise might if they could expect to be completely bailed out for any losses due to fraud or theft.[51]

2.53 Once again the Committee notes that in his evidence on 5 March 2003, Mr Ray from the Treasury acknowledged that the SIS Act provides for up to 100 per cent compensation for eligible losses, but that the level of compensation is at the discretion of the Minister. The Committee was assured that this issue falls within the scope of the review of Part 23 of the SIS Act currently being conducted by the Treasury.[52]

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47 Committee Hansard, 5 March 2003, p. 18.

48 Committee Hansard, 5 March 2003, p. 18.

49 Submission 4, ACA, p. 3.

50 Committee Hansard, 5 March 2003, pp. 6 - 8.

51 Submission 7, Trustee Corporations Association of Australia, p. 2.

52 Committee Hansard, 5 March 2003, p. 17.

Compensation mechanisms for parties not covered by the SIS Act

2.54 In addition to APRA regulated funds which suffered losses as a result of fraud and theft associated with the collapse of CNAL, the Committee is aware that some SMSFs also suffered financial loss as a result of fraud and theft associated with the collapse of CNAL. SMSFs are excluded from the protection afforded by Part 23 of the SIS Act.

2.55 The Committee notes evidence from the Department of Finance and Administration (DoFA) that the Commonwealth has other discretionary compensation 'schemes' or mechanisms available to it. One of these is the request for an act of grace payment to be made under the provisions of the *Financial Management and Accountability Act 1997* (FMA Act).

2.56 In its submission, DoFA advised that sub-section 33(1) of the FMA Act provides authority for the Minister for Finance and Administration (or his delegates) to approve a payment in special circumstances.[53]

2.57 DoFA further advised the Committee that:

> The existence of special circumstances may lead to the decision-maker concluding that … the Commonwealth has a moral obligation, rather than a legal obligation, to make an act of grace payment to an individual or an organisation.
>
> …
>
> The Parliamentary Secretary to the Minister for Finance and Administration … is responsible for exercising sole discretion as the decision-maker in considering requests for act of grace payments.[54]

2.58 DoFA further submitted that:

- the decision-maker's powers in relation to providing act of grace assistance will usually only be applied when all other avenues of redress have been examined; and
- in its view, it was more appropriate for the Department of the Treasury to address the proposal that compensation for losses suffered by superannuation funds as a result of fraudulent conduct or theft should be funded from consolidated revenue.[55]

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53 Submission 6, DoFA, p. 1. 'Special circumstances' are specified in Attachment B of Finance Circular 2002/01, *Commonwealth compensation 'schemes', debt waiver and write-offs*. The full text of the DoFA Circular is included at **Appendix 4.**

54 Submission 6, DoFA, pp. 1-2.

55 Submission 6, DoFA, p. 2.

Chapter Three

Conclusions and Recommendations

Overview

3.1 The Committee notes that all parties giving evidence to the inquiry were broadly supportive of the provisions of S(FAF)LA and SISA Bills, on the basis that the proposed single annual levy would be simpler to administer than imposing hundreds of separate levies.

3.2 However, during the inquiry, a number of issues were raised in relation to the proposed operation of the levy under the amendments proposed in the S(FAF)LA and SISA Bills, the operation of Part 23 of the SIS Act, and the compensation mechanisms for parties not covered by the SIS Act. These issues are discussed below.

The proposed operation of the levy

Prudential supervision

3.3 The Committee notes and acknowledges the desirability of effective prudential supervision to prevent losses amongst superannuation funds due to fraudulent conduct or theft. In the view of the Committee, effective prudential supervision is preferable to *post facto* compensation.

3.4 However, when prudential supervision fails to protect the interests of fund members, then the Committee considers that it is important to have mechanisms for accessing compensation.

The funding of compensation

3.5 The Committee notes suggestions that funding for grants of financial assistance should come wholly, or in part, from consolidated revenue in order to spread the burden of compensation more evenly.

3.6 The Committee acknowledges that the Government has a key stake in maintaining the integrity of the privately funded superannuation system through the provision of financial assistance under Part 23 of the SIS Act because superannuation, unlike other financial products, is compulsory.

3.7 However, the Committee considers that financial assistance to superannuation funds that have suffered losses due to fraudulent conduct or theft should be funded by the superannuation industry through the provisions of the Levy Act, and not out of consolidated revenue and ultimately the Federal Budget. The Committee considers that this is one way to address the moral hazard issue as the levy arrangement transfers

some of the market risk to the superannuation population which is the population that can benefit from the compensation scheme.

3.8 The Committee notes that for the ten-year period since the passage of the SIS Act, the total compensation paid will be $11.1 million for 2001-02 and about $20 million for 2002-03. With approximately 8.8 million employees in Australia, this represents around $1.26 and $2.27 per fund member in those respective years or an average of around 35 cents per fund member per year over ten years. This is a very low cost for the important protection provided by Part 23.

3.9 The Committee notes that, based on the Government's decision to provide 90 per cent compensation, the levy amount represents total losses due to theft and fraud of over $31 million over ten years. Compared to total fund assets of $505.7 billion[1], this level of theft and fraud is very small.

3.10 The Committee also notes that, a decade ago, the Levy Act, together with the SIS Act, was developed as part of a suite of legislative reforms designed to improve the prudential supervision of the superannuation industry, strengthen the security of superannuation savings, and protect the rights of members. In the development of that package of prudential measures, the government of the day indicated that it needed to have regard to the possible 'moral hazard' risk associated with measures such as levy arrangements, and that measures having high levels of 'moral hazard' risks attached to them could be counterproductive.[2] The Committee notes that when the Levy Act was drafted, it was not envisaged that a large number of small funds would require assistance at any one time.

3.11 The Committee draws an analogy with the Government's Special Employee Entitlements Scheme for Ansett group employees (SEESA), under which the Government has met certain entitlements such as unpaid wages and leave of former Ansett employees whose employment was terminated as a result of their employer's insolvency. An important feature of SEESA is that advances to former Ansett employees are recoverable by the Commonwealth under the *Air Passenger Ticket Levy (Imposition) Act 2001*.

The collection of a single levy

3.12 The Committee notes the support for, and endorses, the proposed imposition of a single annual levy on superannuation funds to meet multiple instances of financial compensation in a given year. The Committee considers that it is a sensible approach which has the potential to substantially reduce the administration costs of both the regulator and the funds.

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1 APRA, *Superannuation Trends, September Quarter 2002*.

2 The Hon John Dawkins, MP, Treasurer of the Commonwealth of Australia, *Security in Retirement – Planning for tomorrow today*, 30 June 1992, p.30.

The proposal to collect the levy over a five-year period

3.13 The Committee notes the suggestion to collect the levy over a five-year period. However, the Committee does not support this proposal as this would introduce additional administrative complexity and uncertainty, and potentially affect Commonwealth finances.

Equity issues - individuals with multiple accounts and public sector funds

3.14 The Committee acknowledges that there may be some equity issues associated with the proposed arrangements for the levy, including that individuals with multiple funds may be required to pay the proposed levy several times over. The Committee notes that this problem would persist regardless of whether funds had to pay a single levy or multiple levies. The Committee notes that a number of proposals have been put forward to encourage or require the consolidation of accounts that would, to varying degrees, address this issue if implemented.

3.15 The Committee also notes that there are procedures in place to ensure that trustees apply the levy equitably to fund members.

3.16 The Committee acknowledges that some of the public sector superannuation funds will not be required to pay the levy, but recognises that there will be others that will be required to pay the levy.

Equity issues - the minimum and maximum levy amounts

3.17 The Committee notes that the proposed imposition of a minimum levy, while ensuring that small funds are not levied ridiculously small amounts (for example, 20 cents or less), places a proportionately heavier burden on small funds than the larger funds. In this regard, it was indicated to the Committee that around 8,000 of approximately 10,000 superannuation funds in Australia would likely be charged the minimum levy. However, the Committee notes that the proposed minimum levy is likely to be relatively small. In addition, the Committee notes that it is small superannuation funds, that is with account balances of less than $1.5 million, that have largely benefited from financial assistance from the Commonwealth to date under Part 23 of the SIS Act.

Consultation with the industry on the minimum and maximum levy

3.18 The Committee notes calls for consultation with industry when setting the proposed minimum and maximum levy rate. The Committee has been assured by Treasury that such consultation will take place. The Committee understands that considerations when setting the minimum and maximum levy are likely to include those being compensated, the amount of compensation, and the industry structure at the time compensation is paid.

Conclusion

3.19 The Committee notes that there are some equity issues associated with the two bills. However, the Committee considers that the bills offer a more streamlined approach to the collection of the levy than would otherwise be the case. The Committee also considers that, with appropriate consultation on the amount of the levy to be determined, none of the issues raised are of sufficient importance to delay the passage of the bills.

Recommendation

3.20 The Committee recommends that Superannuation (Financial Assistance Funding) Levy Amendment Bill 2002 and the Superannuation Industry (Supervision) Amendment Bill 2002 be agreed to.

The operation of Part 23 of the SIS Act

3.21 The Committee notes that during the inquiry, a number of issues were raised relating to the granting of financial assistance under Part 23 of the SIS Act.

Delays in the granting of financial assistance

3.22 Various parties suggested that the current process for assessing and deciding on applications for financial assistance under Part 23 of the SIS Act has involved unsatisfactory delay and uncertainty for applicants in some instances, and accordingly should be made more efficient and transparent.

3.23 The Committee notes that at the time of the first ministerial determinations in 2001-02, acting trustee fees had not been finalised for some funds. The Committee considers that Treasury and the relevant acting trustees must act expeditiously to ensure that any compensation payable, or potentially payable, in relation to acting trustee fees is paid.

The definition of an 'eligible loss'

3.24 Various parties suggested that the financial assistance under Part 23 of the SIS Act should not be limited to compensation for eligible losses suffered through trustee fraud and theft, and that other breaches that occasion substantial losses such as in-house dealing should warrant financial assistance.

Part 23 coverage for post-retirement products

3.25 Proposals were also made that financial assistance under Part 23 be extended to other post-retirement products such as annuities and pensions.

Level of compensation

3.26 A number of parties, including some members of the Committee, have expressed concern at the level of compensation being paid. The Committee notes that the current policy of the Minister for Revenue and Assistant Treasurer is to provide

financial assistance under Part 23 of the SIS Act at the rate of 90 cents in the dollar, rather than 100 cents in the dollar.

3.27 The Committee understands that the SIS Act provides for up to 100 per cent compensation for eligible losses, although the level of compensation is up to the Minister to determine. However, the Committee notes the argument that provision of 100 per cent compensation raises the moral hazard that superannuation contributors might be less likely to select a scheme carefully under that scenario.

Conclusion

3.28 The Committee notes that a number of the issues which arose during the inquiry do not bear directly on the drafting of the S(FAF)LA and SISA Bills, but are relevant to the operation of Part 23 of the SIS Act. At the hearing Treasury acknowledged these issues and indicated that they could be addressed as part of its review of Part 23 of the SIS Act.

Recommendation

3.29 The Committee recommends that, at the very least, the issues raised in this report in relation to Part 23 of the SIS Act be considered during the review of Part 23 of the SIS Act currently being conducted by Treasury.

Compensation mechanisms for parties not covered by the SIS Act

3.30 The Committee notes that some funds, such as SMSFs, also lost money through the collapse of CNAL, and that SMSFs are excluded from the protection afforded by Part 23 of the SIS Act. The Committee notes that discretionary compensation mechanisms, such as an act of grace payment under the FMA Act, are available for trustees of those funds to seek compensation in such circumstances, once other avenues for redress, such as the courts, have been examined.

3.31 The Committee accepts that SMSFs, as internally managed superannuation entities, are not eligible for grants of financial assistance under the SIS Act. However, the Committee notes that some SMSFs, which invested in the Enhanced Cash Management Trust administered by CNAL, invested money in what they believed to be an Australian Prudential Regulation Authority badged fund. The Committee considers that APRA needs to be very conscious of its responsibilities when approving trustees and supervising the industry, as any poor performance on its part can have serious repercussions for trustees making investment decisions. The Committee also considers that, where approved trustees operate superannuation investment vehicles that are not regulated under the SIS Act, in addition to their responsibilities as superannuation trustees, they should make this distinction and its consequences clear to potential investors.

3.32 The Committee considers that the Australian Taxation Office and any financial advisors or other intermediaries involved in the establishment of SMSFs should be specifically required to inform current and prospective trustees of SMSFs

that they are not covered by the provisions of Part 23 of the SIS Act, and to highlight the consequences or potential consequences of that exclusion.

3.33 In the event that any court action by the SMSFs is unsuccessful, the Committee urges the relevant Minister, or his delegate, the Parliamentary Secretary, to give careful and due consideration to requests for compensation from SMSFs which suffered financial loss due to the collapse of a fund administered by an APRA approved trustee.

Recommendation

3.34 The Committee recommends that the Australian Taxation Office and any financial advisors or other intermediaries involved in the establishment of self-managed superannuation funds (SMSFs) should be specifically required to inform current and prospective trustees of SMSFs that they are not covered by the provisions of Part 23 of the SIS Act, and to highlight the consequences or potential consequences of that exclusion.

Senator John Watson
Committee Chair

Additional Comments by Labor Senators

Labor Senators support the Committee's recommendations and the passage of the Bills, however, we believe urgent steps should be taken to strengthen the protections under Part 23 of the SIS Act.

Labor Senators note the Government's intention to review Part 23 of the SIS Act. In light of previous attempts by the Government to water-down the protections in Part 23, including amendments proposed in the Financial Sector Reform (Amendments and Transitional Provisions Bill (No. 2) 1999, the Government's motives in reviewing the arrangements in Part 23 are questionable. Any review of Part 23 should be conducted with a view to strengthening protections for the millions of Australians with superannuation.

In contrast to the Government's past attempts to water-down Part 23, their failure to provide full compensation where theft and fraud has occurred and their vague plan for a review, Labor has put forward a number of proposals to strengthen protections for fund members:

- Legislate for full compensation in the event of theft or fraud;
- Expand the definition of an 'eligible loss' beyond theft and fraud to include losses resulting from other serious breaches of the SIS Act; and
- Extend compensation provisions to certain post-retirement products.

Labor Senators were pleased to see that these issues received extensive consideration by the Committee and that the Committee was able to reach a consensus that these proposals must, at the very least, be considered by the Government's review. However, the time for reviews and inquiries has passed and urgent action is needed to protect the retirement savings of all Australians.

The SIS Act should be amended immediately to provide for 100 per cent compensation if retirement savings are stolen or defrauded. Once a determination is made as to the value of the eligible loss – the loss due to theft and fraud – that loss should be compensated in full, without delay and without the capricious exercise of ministerial discretion we have seen in the case of Commercial Nominees and the Australian Independent Superannuation Fund.

Labor Senators reject the argument, presented by the Government, in some submissions and in paragraph 3.27 of the report, that providing 100 per cent compensation would create 'moral hazard'. This argument is simply inappropriate in the case of theft or fraud and ignores the basic realities of superannuation.

Superannuation, unlike other financial products, is compulsory as well as being very complex. Furthermore, it fulfils the fundamental goal of providing retirement incomes for millions of Australians.

The nature of theft and fraud, be they essentially random or systematic, is such that it is impossible to predict in advance if and when they will occur. The implied suggestion that fund members whose savings were stolen or defrauded should have known this was going to happen is both ridiculous and unfair. The Commercial Nominees case demonstrates that where serious fraud occurs it is often concealed from fund members until it is too late and the consequences too damaging to repair without adequate compensation arrangements. An argument predicated on 'moral hazard' may have merit in the context of well-informed investors making choices as between investment vehicles carrying different risks. It is not applicable to circumstances where superannuation savings are lost through theft or fraud.

Labor is not suggesting that the Government can or should guarantee superannuation outcomes against market fluctuations or poor judgements made honestly within the regulatory framework but Australians have a right to know that their superannuation savings are safe – that the trustees, investment managers, administrators and custodians in control of their money are behaving honestly and that the regulator is supervising them adequately. The thankfully rare occasions that those charged with looking after superannuation act dishonestly and the regulator fails represent a fundamental breach of trust and the victims should be fully compensated.

Of course it is preferable that the circumstances where compensation is payable never arise but the only way to avoid them is through strong regulation and by punishing the perpetrators of theft and fraud, not by punishing the victims with less than adequate compensation.

The relatively rare occurrence of theft and fraud in the superannuation sector make full compensation in such circumstances affordable. There are also significant policy arguments for ensuring the safety of Australians' retirement savings, and obvious devastating consequences for individual victims of theft and fraud. Accordingly, Labor Senators consider that it is imperative that full compensation be provided to individual fund members suffering loss as a result of theft or fraud.

The Labor Senators therefore recommend that the Superannuation (Industry) Supervision Amendment Bill 2002 be amended to require 100 per cent compensation where APRA regulated funds have suffered an eligible loss. These amendments should apply to determinations previously made under Part 23 and to all future determinations.

While the other proposals put forward by Labor and examined by the Committee require more detailed consideration, Labor Senators consider it imperative that these be implemented in the medium term.

Labor Senators therefore recommend that the *Superannuation Industry (Supervision) Act 1993* be amended to:

- **Expand the definition of an 'eligible loss' beyond theft and fraud to include losses resulting from other serious breaches of the SIS Act; and**
- **Extend compensation provisions to certain post-retirement products.**

Senator the Hon Nick Sherry (Deputy Chair)

Senator Geoffrey Buckland

Senator Penny Wong

Appendix 1

Main Provisions of the Bills

Main Provisions of Schedule 1 of the Superannuation (Financial Assistance Funding) Levy Amendment Bill 2002

Item 1 – Section 6

1.1 Item 1 of the S(FAF)LA Bill amends section 6 of the Levy Act to insert two new sections:

a) Subsection 6(1A) allows regulations to impose a levy to cover more than one determination of financial assistance made under Part 23 of the SIS Act.

b) Subsection 6(1B) specifies that if a regulation imposes a levy in respect of more than one grant for financial assistance, the regulation imposing the levy must specify all the determinations to which the levy relates and the proportion that each individual determination represents of the aggregate levy.

Item 2 – Section 6

1.2 Item 2 adds a new subsection that enables regulations imposing a levy in respect of one or more determinations to impose either or both a maximum and minimum amount of levy that is payable.

Item 3 – Subsection 7(1)

1.3 Item 3 repeals subsection 7(1) and inserts a new subsection. The inserted provision ensures that the rate of any levy made under Part 23 is set in such a manner that the amount of revenue raised does not exceed the amount that was granted as financial assistance.

Item 4 – Subsection 8(1A)

1.4 Item 4 inserts a new subsection 8(1A). It requires that where a maximum amount is stated in the regulations, a fund whose levy amount calculated using the formula in subsection 8(1) is greater than the maximum amount will only be required to pay the maximum amount. Similarly, where a minimum amount is stated in the regulation, a fund whose levy amount calculated using the formula in subsection 8(1) is less that the maximum amount will only be required to pay the minimum amount.

Main Provisions of Schedule 1 of the Superannuation Industry (Supervision) Amendment Bill 2002

1.5 Schedule 1 of the SISA Bill proposes minor amendments to section 237 of the SIS Act that are consequential to changes proposed in the S(FAF)LA Bill.

1.6 The proposed amendments in items 1, 2 and 3 alter subsection 237(2) of the SIS Act to ensure that it applies to more than one determination. If the total amount of funds raised by the levy exceeds the amount of financial assistance granted under the determination the levy applies to, then the excess is applied in a manner determined by the Minister.

Appendix 2

Submissions

1	Association of Superannuation Funds of Australia Limited
2	Corporate Super Association
3	Investment & Financial Services Association Ltd
4	Australian Consumers' Association
5	Department of the Treasury
6	Department of Finance and Administration
7	Trustee Corporations Association of Australia

Appendix 3

Public Hearing

Wednesday, 5 March 2003, Canberra

Department of the Treasury

Mr Nigel Ray, General Manager, Financial System Division

Ms Joanne Evans, Manager, Prudential Policy, Superannuation and Insurance Unit

Mr Aaron Broughton, Analyst, Superannuation and Insurance Unit

Investment & Financial Services Association

Mr Bill Stanhope, Senior Policy Manager

Australian Prudential Regulation Authority

Mr Senthamangalam Venkatramani, General Manager, Diversified Institutions Division

Appendix 4

Finance Circular 2001/01 – *Commonwealth Compensation 'Schemes', Debt Waiver and Write-Offs*

FINANCE CIRCULAR
No: 2001/01

DEPARTMENT OF FINANCE AND ADMINISTRATION

To All Departments of State, Parliamentary Departments and Prescribed Agencies

COMMONWEALTH COMPENSATION 'SCHEMES', DEBT WAIVER AND WRITE-OFFS

KEY POINTS

- This Circular provides a consolidated overview of Commonwealth compensatory 'schemes', debt waiver and write-off provisions. It also provides detailed guidelines for agencies on the following schemes for which the Department of Finance and Administration (Finance) has policy responsibility:
  - *Compensation for Detriment Caused by Defective Administration* (CDDA scheme);
  - act of grace payments; and
  - waiver of debts owed to the Commonwealth under the *Financial Management and Accountability Act 1997* (FMA Act).
- The Circular updates and replaces the (then) Department of Finance Estimates Memorandum 1995/42 which advised on the original establishment and operation of the CDDA scheme.
- There are no changes in the existing policy intent of any of the schemes covered in this Circular.

BACKGROUND

In December 1995, the (then) Department of Finance issued Estimates Memorandum (EM) 1995/42 providing advice and guidelines for agencies on the establishment and operation of the CDDA scheme. Since that time, two developments have occurred which have necessitated a revision of the guidelines:

- the introduction of the FMA Act and the *Public Service Act 1999* (PS Act); and
- the October 1999 Commonwealth Ombudsman's report: '*To compensate or not to compensate*'. The report highlighted that agencies are seeking a more integrated explanation of the existing rules relating to Commonwealth compensatory 'schemes', in order to understand and apply the current arrangements more comprehensively.

CONTENTS

Attachment A to the Circular provides a general overview of the Commonwealth 'schemes' for considering compensation, namely:

- *Legal Services Directions on Handling Monetary Claims against the Commonwealth* (ie for legal liability);

- *Compensation for Detriment Caused by Defective Administration* (CDDA scheme);
- Act of grace payments; and
- Payments in Special Circumstances (which relate to APS employment).

In addition, Attachment A includes an overview of write-off and waiver provisions which provide two other forms of financial 'relief'.

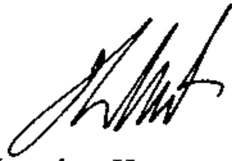
Attachments B–D provide guidance on the schemes for which Finance has policy responsibility:

- CDDA at Attachment B;
- Act of grace at Attachment C; and
- Waiver of debts at Attachment D.

This Circular will be maintained on the Finance website at: http://www.finance.gov.au/finframework/discretionary_payments.html.

CONTACTS

Any inquiries on the advice provided in this Circular can be directed to the Special Financial Claims Section, Finance, on (02) 6215 2560 or 6215 2561.



Jonathan Hutson
Group Manager
Financial Framework Group
23 July 2001

Attachment A to Finance Circular 2001/01

Overview of Commonwealth 'Compensatory Schemes'

<table>
<tr><th>'Scheme'
Application/Key criteria</th><th>Legislation
Head of Power
Delegate</th><th>Guidance</th></tr>
<tr><td>Legal Services Directions on Handling Monetary Claims

The Directions apply where a claim for monetary compensation is made against the Commonwealth or an agency (other than claims that need to be determined under a legislative mechanism (eg, social security benefits) or under a mechanism provided by contract (eg, an arbitration of a disputed contractual right)).

For such claims, agencies in the first instance must consider whether a <u>legal obligation exists</u> to pay the compensation sought. If it does, the claim must be settled in accordance with the Directions (even if the claimant may have initially sought compensation under CDDA or an act of grace payment).

Claims covered by the Directions are to be <u>settled in accordance with legal principle and practice</u>. That criterion requires at least a meaningful prospect of liability being established. Settlement is not to be effected simply on the basis of the cost of defending what is clearly a spurious claim. If there is a meaningful prospect of liability, the factors to be taken into account in assessing a fair settlement include: likely success of claim in court; costs of defending the claim; and any prejudice in defending the claim.</td><td>s.55ZF Judiciary Act 1903

Agency CEOs or their authorised officers</td><td>• A-G's Legal Services Directions on Handling of Monetary Claims (para 4.4 and Appendix C)
• A-G's Legal Services Directions on the Commonwealth's Obligations to Act as a Model Litigant (para 4.2 and Appendix B)</td></tr>
<tr><td>Compensation for Detriment Caused by Defective Administration (CDDA)

CDDA is an administrative scheme providing Commonwealth agencies with a <u>discretionary authority</u> to compensate persons who have suffered detriment due to the 'defective' actions or inaction of such agencies and where the claimant has no legal or statutory right of redress. Defective administration refers to:
• a specific and unreasonable lapse in complying with existing administrative procedures; or
• an unreasonable failure to institute appropriate administrative procedures; or
• an unreasonable failure to give the proper advice that was within the official's power and knowledge to give (or reasonably capable of being obtained by the official); or
• the provisions of advice that was, in all the circumstances, incorrect or ambiguous.</td><td>Provided under the Government's inherent Constitutional powers and a specific Government decision, Oct 1995.

Portfolio Ministers
Agency delegate(s) (ie, as specifically appointed by their Minister)</td><td>• Finance Circular 2001/01 Attachment B

• Agency specific guidelines</td></tr>
</table>

'Scheme' Application/Key criteria	Legislation Head of Power *Delegate*	Guidance
The four steps in determining a claim for CDDA are: • consider whether the scheme applies – that is look at the general limitations on its operation; • consider whether the actions complained of fall within the definition of defective administration; • if there is defective administration in a claim, then determine if the claimant suffered 'detriment' as defined by the scheme (see Attachment B page 4); and • if it is accepted that there was detriment directly caused by defective administration, then quantify that detriment.		
Act of grace Compensation by way of a special discretionary payment where there is no other viable avenue of redress available and the Minister or delegate considers the payment is appropriate because of 'special circumstances'. Whilst claims are determined on a case by case basis, the conditions under which claims are determined can broadly be characterised as where the decision-maker considers there is a moral rather than a legal obligation to provide redress to an individual or organisation where: • the Commonwealth's direct role, act or omission in relation to the particular case has resulted in an unintended, inequitable or unfair effect on the individual or organisation concerned; • the application of Commonwealth legislation has produced an unintended, anomalous, inequitable or otherwise unacceptable result in a particular case; or • the matter is not covered by legislation or a specific program, but it is intended to introduce such legislation or program and it is considered desirable in a particular case to apply the benefits of the relevant provisions prospectively.	s.33(1-4) FMA Act (& s.59) Minister for Finance and Administration or the Parliamentary Secretary to the Minister for Finance and Administration *Specified Finance officers*	• Finance Circular 2001/01 Attachment C
Payments in Special Circumstances relating to APS employment Payments authorised in special circumstances that arise out of, or relate to, Commonwealth employment matters. All such cases, should be considered under s.73 of the PS Act rather than under the FMA Act act of grace provision. Payments in Special Circumstances may be specific amounts or periodical payments and may be authorised even though the payments would not otherwise be authorised by law or required to meet a legal liability.	s.73 *Public Service Act 1999* Public Service Minister *Agency CEOs*	• PSMPC's *Advice No.30: Payments in Special Circumstances.*
Waiver of debts owing to the Commonwealth and postponement of the right of the Commonwealth to recover a debt in priority to another debt A waiver is a special concession granted to a person or	s.34(1)(a), (2), (3), (4) FMA Act (& s.59) Minister for Finance and Administration and	• Finance Circular 2001/01 Attachment D

'Scheme' Application/Key criteria	Legislation Head of Power *Delegate*	Guidance
organisation that <u>*expunges* the debt</u> owed to the Commonwealth. That is, the debt is wiped out so the Commonwealth cannot pursue the debt at a later date should that person's or organisation's financial circumstances improve. There are also specific waiver provisions under some program related legislation (eg s.1237 *Social Security Act 1991* or s.43A *Student Assistance Act 1973)* and specific review provisions under the Tax Relief Board arrangements under the *Income Tax Assessment Act 1936*. These specific provisions have precedence over the more general waiver provision under the FMA Act. Under the FMA Act, the decision-maker has an unfettered discretion to consider each request for waiver on a case by case basis. The most common condition under which a waiver may be granted is where, due to the particular circumstances of the case, the decision-maker concludes that there is a <u>moral obligation</u>, rather than a legal obligation, on the Commonwealth to extinguish the debt due to <u>equity</u> or <u>ongoing financial hardship</u> considerations.	the Parliamentary Secretary to the Minister for Finance and Administration as well as the Chief Executive Officer of certain other bodies in relation to acts they administer *Specified Finance officers* Powers under s.34(1)(b) in relation to postponement of the right to be paid in priority to another debt have not been delegated. s.34(1)(c-d) relates to payments of debts by instalments and deferring payments. These powers have been delegated to all CEOs.	
Write-off of debts owing to the Commonwealth The write-off of a debt owed to the Commonwealth merely <u>defers recovery</u>; it does not wipe out the debt at law. As such, an agency can pursue the debt at a later date should the person's financial circumstances improve. Under s.47 of the FMA Act, an Agency CEO must pursue recovery of a debt unless: • the debt can be written off as authorised by an Act; • the CEO considers it is not legally recoverable; or • the CEO considers it is uneconomic to pursue. There are specific write-off provisions under some program related legislation (such as s.1236 *Social Security Act 1991*, s.43 *Student Assistance Act 1973*) or the specific relief provisions available under the Tax Relief Board arrangements as a result of the *Income Tax Assessment Act 1936*. Specific write-off and review provisions have precedence over the FMA Act provision. Write-off of debts should not be seen simply as an alternative remedy to waiver. If there are equity or financial hardship considerations in the recovery of the	s.47 FMA Act Minister for Finance and Administration *Agency CEOs*	• Individual Agency CEIs

'Scheme' **Application/Key criteria**	**Legislation** Head of Power *Delegate*	**Guidance**
debt, an agency should refer the case to Finance for waiver consideration. A decision under s.47 of the FMA Act to defer recovery of a debt must be disclosed in an agency's financial statements as a write-off of a debt.		

COMPENSATION FOR DETRIMENT CAUSED BY DEFECTIVE ADMINISTRATION (CDDA): GUIDELINES FOR AGENCIES

1. Commonwealth agencies have a duty of care to administer legislation and policy responsibly and reasonably and to provide accurate, appropriate and unambiguous information.

2. When a Commonwealth agency has acted unreasonably or provided wrong or ambiguous information which leads to a financial (and sometimes non-financial) loss, it is reasonable to expect that the agency should provide compensation for the loss even if its actions do not amount to a liability to the other party.

What is the CDDA scheme?

3. CDDA is an administrative scheme, established in October 1995, to enable Commonwealth agencies to compensate persons who have been adversely affected by the 'defective' actions or inaction of such agencies, but who have no other avenues to seek redress.

4. These guidelines encompass the Government approved framework (ie definitions, criteria and limitations) for CDDA as originally set out in Estimates Memorandum (EM) 1995/42. As such, these guidelines repeal and replace EM 1995/42 with effect from the date of the covering Finance Circular 2001/01.

5. These guidelines describe the CDDA scheme and set out the steps that a decision maker should take in considering whether to compensate a claimant. Factors described in the guidelines to be taken into account when making a decision are not checklists and each case must be determined on its own merits. Care should be taken to ensure that the principles of natural justice are applied to CDDA matters to ensure that claimants are treated equitably.

Who can apply?

6. Any individual, company or other organisation can submit a claim for CDDA, either directly to the relevant agency or through a third party.

Determining a claim for CDDA

7. There are four steps in determining a claim for compensation for detriment caused by defective administration:

    - consider whether the scheme can apply – that is look at the general limitations on its operation (see below paras 8 to 10);
    - consider whether the actions complained of fall within the definition of defective administration (see below para 11 to 21);
    - if defective administration exists, the next step for the decision-maker to determine is whether the claimant suffered any actual 'detriment' (see below paras 22 to 27); and

- if it is accepted that detriment directly caused by defective administration exists, the decision-maker should then quantify the extent of the loss involved (see below paras 28 to 41).

Limitations of the scheme

8. The CDDA scheme is available to provide compensation in respect of defective administration in respect of all Commonwealth agencies. It is not available for Commonwealth authorities and companies that have a separate legal identity to the Commonwealth and operate under the *Commonwealth Authorities and Companies Act 1997.*

9. The CDDA scheme does not obligate the decision-maker to approve a payment in any particular case. However the decision – whether to approve or refuse a payment – must be publicly defensible, having regard to all the circumstances of the case.

10. The scheme does not apply:

    - to any claims for monetary compensation where it is reasonable to conclude that the Commonwealth would be found liable if the matter were litigated. Such claims should be settled in accordance with the criteria prescribed by the Attorney General's *Legal Services Directions on Handling Monetary Claims* (para 4.4 and Appendix C); or

    - where it is reasonable to conclude that a legislative mechanism (eg. a right of review under the *Social Security (Administration) Act 1999)* will provide a remedy to the person; or

    - to overcome the effects of specific legislative provisions that are found to be flawed;

        - Legislative problems or anomalies should be overcome via statutory remedies – either by seeking amendment of the relevant legislation (if appropriate, with retrospective effect to bestow the benefit on the claimant), or by resort to the act of grace powers; or

    - generally, to meet claims which had previously been determined and declined under the act of grace provisions of the FMA Act; or

    - to offset the payment of any recoverable debt owed to the Commonwealth – even if the debt arose because of defective administration. Such claims should either be considered under the relevant specific legislative provisions or, if none apply, be considered by the agency for deferral of recovery (ie write-off) under s.47 of the FMA Act, or be referred to Finance for waiver consideration under s.34 of the FMA Act.

Criteria for defective administration

11. If a Minister or an official authorised by the Minister to approve payments under the scheme, forms an opinion in respect of a claim that an official of the agency, acting, or purporting to act, in the course of duty, has directly caused the claimant to suffer detriment, or, conversely, prevented the claimant from avoiding detriment, by virtue of one of the following reasons:

    - a specific and unreasonable lapse in complying with existing administrative procedures; or

    - an unreasonable failure to institute appropriate administrative procedures; or

- an unreasonable failure to give to (or for) a claimant, the proper advice that was within the official's power and knowledge to give (or reasonably capable of being obtained by the official to give); or
- giving advice to (or for) a claimant that was, in all the circumstances, incorrect or ambiguous,

then this scheme applies, subject to the "Limitations" specified above.

When are actions 'unreasonable'?

12. In relation to the first three criteria, a lapse in complying with existing procedures, failure to institute procedures or failure to give advice will only amount to defective administration where that lapse or failure is 'unreasonable'.
13. An unreasonable lapse or failure is one whereby the actions of the officer(s) involved are considered to be contrary to the standards of diligence that the agency expects to be applied by reasonable officers acting in the same circumstances with the same powers and access to resources.
14. Circumstances may arise where instances of administrative omissions or errors may not be regarded as unreasonable when considered in isolation from each other, but may be considered as constituting defective administration when considered in totality in the context of the full impact of these omissions or errors on the client involved. Each assessment of whether there has been defective administration is dependent on the facts of a particular claim.
15. In relation to the fourth criterion, where advice or information given to a claimant was incorrect or ambiguous, it is not necessary for an element of unreasonableness to be present for the action to fall within the definition of defective administration.

Standards of Conduct

16. In assessing whether defective administration has occurred, consideration should be given to compliance with the values and code of conduct as set out in s.10 and s.13 of the *Public Service Act 1999* respectively. The general thrust of s.13 requires Australian Public Service employees to:
    - behave honestly and with integrity, care, and diligence, and treat everyone with respect and courtesy;
    - comply with all applicable Australian Acts;
    - deliver services fairly, efficiently, impartially, and courteously, and
    - use Commonwealth resources in a proper manner.
17. The Public Service and Merit Protection Commission can provide further guidance on standards of conduct.

Evidence of defective administration

18. Determining whether or not defective administration has occurred in individual cases can be difficult because:
    - there may be lengthy delays between the date of the alleged defective administration, the date its effect became apparent, and the date the complaint was lodged;
    - there may be insufficient written evidence available to support or refute the claimant's allegations; and

- the claimant's assessment of financial loss may appear unfounded and unreasonable.

19. Each case must be decided on its own merits. Where insufficient evidence of defective administration exists, a judgement must be made in regard to the plausibility of the claimant's account of his or her actions and allegations against the agency. In making such a judgement the following guidance is offered:

    - the likelihood that wrong advice could have been given in the particular situation - taking into account the experience of the staff involved and whether the particular statutory provisions/procedures were well known or new;
    - whether the officer's and claimant's account of events seem plausible (eg. whether the claimant's subsequent actions were consistent with the advice he or she alleges was provided by the agency);
    - the consistency of the allegations made;
    - whether the passage of time could have distorted the officer's and/or claimant's recollection of events; and
    - whether there has been confusion or misinterpretation of advice rather than defective administration per se.

20. Documentary or incontrovertible proof of defective administration should not be an essential requirement: the fact that a record of a telephone or counter inquiry is not present on a claimant's file or payment record, that documents may have been destroyed or misplaced in the normal course of events, or that an officer cannot recall the case, is unlikely in itself to constitute justification to refuse CDDA.

Ombudsman's role

21. Where the circumstances of a case do not clearly fall within the exact criteria for defective administration, but the agency concerned agrees with the Ombudsman that detriment has occurred as a result of defective administration and the agency is inclined to compensate a claimant, a recommendation by the Ombudsman supporting compensation is sufficient basis for payment.

Definition of detriment or loss

22. According to the 1995 Government decision which established the CDDA scheme, "detriment" is defined as:

    - the amount of quantifiable financial loss, including opportunity costs, that a claimant can demonstrate would be suffered despite having taken reasonable steps to minimise or contain the loss. If, for some reason, it is impracticable for a claimant to demonstrate all or part of the quantifiable loss, the decision-maker may make whatever assumptions as to amount, including with respect to the actions of the claimant to minimise or contain the loss, that are necessary and reasonable in all circumstances; and
    - non-financial damage (for example, arising from severe stress, pain and suffering, inconvenience or other 'qualitative' elements of that nature).

Is there a loss at all?

23. Financial loss should be distinguished from financial disappointment: eg where a formal assessment results in the amount of an entitlement being less than a 'ballpark' figure given to a person at the time he or she made inquiries.

Has a loss arisen as a result of the defective administration?

24. Compensation for loss suffered by a claimant is only available where it arose as a direct consequence of the defective administration. Claims for compensation for loss must be considered on their own merits on a case by case basis.

What sort of losses will give rise to compensation under CDDA?

25. There are two categories of losses which are compensable:

- Quantifiable financial losses; and
- Non-financial losses payable according to legal principle and practice.

Quantifiable financial losses

26. Quantifiable financial loss may be associated with costs incurred such as legal costs, out-of-pocket expenses, travel costs, medical expenses, accrued mortgage interest, or loss of wages for necessary time off work. This is not an exhaustive list.

27. If a claimant has relied on incorrect information to alter their circumstances to their detriment, it may be appropriate to consider compensation for financial loss actually suffered. In such cases it would be necessary to consider whether it was, on balance, reasonable for the claimant to have accepted in good faith, and to have acted upon, the incorrect information provided.

Non-financial losses

28. Claims for compensation for non-financial loss resulting from defective administration may be associated with:

- gross inconvenience resulting from persistent error made over a protracted period of time; or
- gross embarrassment, humiliation or unnecessary personal intrusion; or
- stress.

29. Where compensation is considered for non-financial damage, the decision-maker must have regard to relevant legal principle and practice in arriving at the appropriate amount of payment.

30. Legal principle and practice is not static and decision-makers should be careful to ensure that they are applying current principle and practice to the determination of any claim for non-financial loss.

31. According to current legal principle, a claim for non-economic loss must be related to other loss, that is, a claimant cannot claim for non-economic loss as the only loss suffered. A claim for stress or irritation which is not a claim for personal injury cannot stand alone. There must be some other loss from which the aggravation or stress flows. For example, where compensation is sought for stress, a claimant must show that the stress flowed from the suffering of the financial loss caused by the defective administration.

Stress as psychological injury

32. Note that a legal distinction is drawn between a psychological or psychiatric injury and a 'stress' claim. A 'stress' claim based on an assertion that the claimant suffers from a psychological condition as a result of defective administration, is, in effect, a claim for personal injury and the losses will not be limited to non-economic loss. The law in this

area of psychological damage is not clear, but it would seem that a claimant in such a case must show that he or she suffers from a psychological disease or condition.

33. A stress claim will be treated as a psychological injury if medical evidence supports the existence of such injury.

Stress as personal injury or 'distress'

34. Whilst the terms of the claim made by the claimant may give some indication about whether the claim is for a stress 'injury' or a claim for 'distress' or annoyance, medical evidence will almost always be necessary to identify which claim is being made.

Determining the level of compensation

35. Offers of compensation to claimants should be calculated on the basis of what is fair and reasonable in the circumstances and in consideration of the fact that the Commonwealth should not take advantage of its relative position of strength in an effort to minimise payment.

36. The overarching principle to be used in determining the level of compensation is to restore the claimant to the position he or she would have been in had defective administration not occurred.

Quantifying financial loss

37. In general, financial loss must be substantiated. In considering the type and amount of evidence required to substantiate the claim, the nature and size of the expenses involved should be taken into account. Where expenses are low, then a reasonable estimate may be appropriate; eg routine telephone calls, postage costs, photocopying or travel costs. It may not be necessary for the costs to have been incurred through dealing directly with the agency. It is possible that they may have been incurred as a result of obtaining professional or similar advice (eg. travelling to or from meetings with solicitors, or contacting them by phone).

38. If, for some reason, it is impracticable for a claimant to demonstrate all or part of the loss, the decision-maker should make a reasonable judgement about the level of the loss, taking account of all relevant factors.

Interest payments

39. In some cases interest may be payable where it forms part of the damages suffered (interest as damages), but not in general because of a delay in paying those damages (interest on damages). In regard to the latter, an exception may be where the agency's actions and/or notification of defective administration were unreasonably protracted. In determining this, consideration should be given to any agency service standards on timeliness.

40. The inclusion of any interest in a CDDA payment is a matter for the discretion of the decision-maker, having regard to the specific circumstances of each claim.

Quantifying non-financial loss

41. If it is decided that a claim for non-economic loss is payable, evidence of the distress and inconvenience suffered by the claimant will be needed. Generally, damages payable for non-economic loss should be arrived at by considering the amounts that have been paid in previous cases with similar facts.

Claimant's own actions

42. The actions of a claimant in regard to whether he or she contributed to the detriment suffered may have an impact on determining the appropriate level of compensation.

43. Each case should be considered on its own merits when deciding whether the claimant:

- acted reasonably in relation to their dealings with the agency; or
- to what extent, if any, the claimant contributed to the loss; or
- what steps they took to minimise or contain that loss.

44. The following factors are provided as a guide only in deciding if the amount of compensation for the loss should be reduced because of the actions of the claimant:

- the claimant's age, health and knowledge of dealing with such issues, including knowledge of English;
- whether the claimant gave false, misleading, or incomplete, information which the agency could not have been expected reasonably to challenge or clarify;
- whether there was any unreasonable delay between receiving and acting on the administrative error. Where repeated delays were experienced because of a claimant's inaction, the cumulative effect should be considered.

45. In considering a claimant's actions, it is important to take into account the claimant's specific circumstances and the factors that influenced his or her actions, rather than adopting an assumed normative model of 'usual' behaviour.

46. If it is considered the claimant contributed to his or her situation then, depending on the extent of the claimant's contribution to the loss, this may justify a reduction in the level of compensation.

Taxation implications

47. The taxation implications (if any) of payments should be taken into account when determining the quantum of the payment so as to place the claimant in the position he or she would have been in but for the effect of the defective administration.

48. As a general rule, where any component of a compensation payment relates to loss of an amount that would have been assessable for income tax purposes, that component will be assessable income. The claimant should be advised that he or she is obliged to declare such income. However, in many cases it may be difficult to estimate the taxation impact and it may be advisable to consult the ATO. The ATO contact point for these matters is the Legal Policy and Coordination Unit in National Office.

Settlement of claims

49. Each claimant should be provided with an adequate explanation of the reasons for a decision to accept, partially accept, or reject his or her claims.

50. Advice on the right to review by the Ombudsman should be provided to all claimants.

51. In order to protect the interests of the Commonwealth, compensation under the scheme should only be paid where the claimant agrees in writing not to pursue legal action in relation to the circumstances of the claim. In some circumstances it may be considered necessary to seek an indemnity from the claimant in relation to any legal action by any other person in relation to the circumstances of the claim. This agreement should be in the form of a deed of release. It is recommended that legal advice be sought in relation to the drafting of deeds of indemnity.

52. Where only part of the claim is settled by a payment under the scheme, claimants should provide a deed of release (and indemnity if appropriate) in relation to that part of the claim.

Decision-makers under the scheme

53. Where an authority is given by a Minister to an agency official to approve payments under this scheme, that authority is to be conferred expressly – ie, separately from the Minister's general authorisations to incur expenditure.

    - This requirement is in recognition of the special and potentially sensitive nature of decisions that may be made under the scheme, for which the agency and its Minister may be held accountable.

Funding and reporting

54. In general, CDDA payments should be funded through Departmental Appropriations and reported under an appropriate agency outcome. However, if any part of a CDDA payment can be settled under statutory entitlement provisions, then it should be paid from the relevant Administered Appropriation and reported under the associated outcome.

Contacts

56. The Special Financial Claims Section, Finance, can be contacted for assistance in relation to these guidelines. Advice on specific cases should be directed to the agency concerned.

Attachment C to

Finance Circular 2001/01

ACT OF GRACE PAYMENTS: GUIDELINES FOR AGENCIES

1. The authority for act of grace payments is provided by s.33 of the *Financial Management and Accountability Act 1997* (the FMA Act), under which the Minister for Finance and Administration, or the Minister's Parliamentary Secretary, may authorise a payment if he or she considers it appropriate to do so because of special circumstances.
   - The Minister has delegated this power to particular officers of the Department of Finance and Administration (Finance) according to specified financial delegation limits.
2. All act of grace requests received by agencies must be referred to the Special Financial Claims Section, Finance, for consideration.
3. These guidelines provide agencies with an outline of the general act of grace principles and the process for referral, notification, funding and reporting.

What is act of grace?

4. The act of grace power is a unique discretion given to the Minister for Finance and Administration to make payments to persons who may have been unintentionally disadvantaged by the effects of Commonwealth Government legislation, actions or omissions and who have no other viable means of redress.
5. Act of grace payments are not specifically sanctioned by Parliament in an Appropriation Act. For this reason, the act of grace power should not be seen as an alternative to other viable avenues of redress but rather as a remedy that may only be applied in special circumstances to ensure consistency and equity in the impact of Government activities.
6. Section 33(1) of the FMA Act provides:

   If the Finance Minister considers it appropriate to do so because of special circumstances, he or she may authorise the making of any of the following payments to a person (even though the payment or payments would not otherwise be authorised by law or required to meet a legal liability):

   a) one or more payments of an amount specified in the authorisation (or worked out in accordance with the authorisation);

   b) periodical payments of an amount specified in the authorisation (or worked out in accordance with the authorisation), during the period specified in the authorisation (or worked out in accordance with the authorisation).

Conditions under which requests for act of grace are considered

7. Act of grace payments can arise from any sphere of Commonwealth administration. As implied by s.33(1) of the FMA Act, the Minister has an unfettered discretion to determine each act of grace request on a case by case basis and as such, it is not appropriate to specifically define special circumstances.
8. However, the conditions under which act of grace claims are determined can broadly be characterised as where the Commonwealth considers it has a moral obligation, as opposed to a legal obligation, to provide redress because:

- the Commonwealth's direct role, acts or omissions in relation to the particular case has caused an unintended or inequitable result for the individual or entity concerned;
- the application of Commonwealth legislation has produced a result that is unintended, anomalous, inequitable or otherwise unacceptable in a particular case; or
- the matter is not covered by legislation or specific policy, but it is intended to introduce such legislation or policy and it is considered desirable in a particular case to apply the benefits of the relevant provisions prospectively.

9. Equity is an important element in consideration of act of grace requests. While an individual's private circumstances may impact on whether the application of a Commonwealth law or policy has produced an inequitable result in his or her case, act of grace payments are not provided where a request has arisen from circumstances outside the sphere of Commonwealth administration or application of Commonwealth law.

Scope of act of grace

10. The act of grace power is available to provide a remedy in respect of all Commonwealth Agencies that operate under the FMA Act. It is not generally available in respect of Commonwealth authorities and companies which have a separate legal identity to the Commonwealth and operate under the *Commonwealth Authorities and Companies Act 1997*. Exceptions to this may be where:
    - a Commonwealth Authority administers payments on behalf of the Commonwealth, such as the Health Insurance Commission; or
    - an act of grace request involves a Commonwealth Authority and has broader government policy implications.

11. The act of grace power does not apply:
    - to any claims for monetary compensation where it is reasonable to conclude that the Commonwealth would be found liable if the matter were litigated. Such claims should be settled against the criteria in the Attorney General's *Legal Services Directions on Handling Monetary Claims* (para 4.4 and Appendix C);
    - where it is reasonable to conclude that a legislative mechanism (eg. a right of review under the *Social Security (Administration) Act 1999)* will provide a remedy to the person;
    - to a claim for compensation relating to the defective administration of a Commonwealth agency, as defined in the *Compensation for Detriment Caused by Defective Administration* (CDDA) guidelines, which led to the claimant's financial detriment. Such claims should be considered by the agency concerned under the CDDA provisions; or
    - to the write-off or waiver of debts owed to the Commonwealth. As appropriate, such claims should either be considered under the relevant program specific legislative provisions or administrative review mechanisms, or if none apply, be considered by the agency for write-off in accordance with s.47 of the FMA Act, or be referred to Finance for waiver consideration under s.34 of the FMA Act.

12. The act of grace arrangements should not be seen as a means of circumventing legislative or policy provisions that are operating as intended, or establishing a payments scheme to remedy major legislative or major program deficiencies.

- Act of grace requests will not be considered in cases where legislative changes simply reflect the evolving nature of Commonwealth policy interpretation and analysis, including incremental modifications to the regulatory regime which operates to meet the Government's aims.

13. Where major legislative or program deficiencies are found to exist, agencies should implement procedures to amend the relevant legislation. In such situations, if there is any compensation proposed in the interim that involves a very large number of individuals and significant outlays, it may be more appropriate for it to be considered under ex gratia arrangements. This enables the Government to consider and agree to the payment of compensation for the group as a whole, rather than considering individual claims on a case by case basis for act of grace payments. The Special Financial Claims Section, Finance, can provide further advice on this.

Who can apply?

14. Any individual, company or other organisation can request an act of grace payment, either directly or through a third party.

15. All requests for act of grace payments must be referred to Finance for consideration. Where requests for act of grace come either directly to the Minister for Finance and Administration, the Parliamentary Secretary, or Finance, the relevant agency will be notified and consulted on the case.

Referral of requests to Finance

16. The Special Financial Claims Section, Finance, is responsible for coordinating all act of grace requests to ensure the Minister or delegate has sufficient information and evidence to make an informed decision.

17. In referring a request for act of grace payments to the Special Financial Claims Section, agencies are requested to provide sufficient information to enable an informed and independent assessment of the case, including as appropriate:

    - details of the relevant section(s) of legislation to which the claimed disadvantage may relate and details of the claimant's circumstances in relation to that legislation;
    - specific details of the Commonwealth's role, if any, that may have directly contributed to the claimant's situation;
    - any history/background to the case, including any consideration of the case under CDDA or by way of settlement of a legal claim;
    - if there is a perceived anomaly in the law or policy, an estimation of the likely number of people affected and overall cost;
    - whether or not the responsible agency supports the act of grace request and supporting reasons; and
    - any other information that may be relevant to the decision-maker in determining whether special circumstances exist.

18. The Special Financial Claims Section may seek additional information from the relevant agency or elsewhere, including directly from the claimant as appropriate.

19. If a proposed authorisation is likely to involve a total payment of more than $100,000, s.33(2) of the FMA Act requires that the Minister must first consider a report of an Advisory Committee.

- In practice, the Committee comprises the Chief Executive Officer, or their delegate, of: the Department of Finance and Administration; the Australian Customs Service (ACS); and the agency that is responsible for the matter on which the Committee has to report. Should the matter relate to Finance or to ACS, the third member of the Advisory Committee should be a delegate of the Attorney-General's Department.

Determining the level of an act of grace payment

20. The Minister or delegate will determine act of grace payments on the basis of what is fair and reasonable in the circumstances. The Commonwealth will not take advantage of its relative position of strength in an effort to minimise payment.

21. The overarching principle in determining the actual level of payment will be based on trying to restore the claimant to the position he or she would have been in had the special circumstances not arisen.

22. Issues that will be taken into account in determining the level of compensation include:
    - any benefit the claimant may have been entitled to had the special circumstances not arisen;
    - any claimed financial loss;
    - the extent, if any, to which the claimant contributed to the loss, or what steps they took to minimise or contain that loss; and
    - any interest and taxation implications.

Loss must have arisen as a direct result of Government actions

23. Compensation for loss suffered by a claimant is only available where it arose as a direct consequence of the actions or decisions of a Government agency. Claims for compensation for loss must be considered on their own merits on a case by case basis.

24. Two categories of losses are compensable:
    - Quantifiable financial losses; and
    - Non-financial losses payable according to legal principle and practice.

Claimant's own actions

25. Each case will be considered on its own merits when deciding whether the claimant acted reasonably in relation to their dealings with the agency or to what extent, if any, the claimant contributed to the loss, or what steps they took to minimise or contain that loss.

26. In considering how reasonable or otherwise the claimant's actions were, the claimant's specific circumstances and the factors that influenced their actions, will be taken into account.

Interest payments

27. In some cases interest may be payable where it forms part of the damages suffered (interest as damages), but not in general because of a delay in paying those damages (interest on damages). However, the inclusion of any interest in an act of grace payment is at the discretion of the decision-maker having regard to the specific circumstances of each claim.

Taxation implications

28. The taxation implications (if any) of payments will be taken into account when determining the quantum of the payment so as to place the claimant in the position he or she would have been in but for the effect of their special circumstances.

29. As a general rule, where any component of a compensation payment relates to loss of an amount that would have been assessable for income tax purposes, that component will be assessable income. The claimant should be advised of his or her obligations in this regard.

Settlement of claims

30. Claimants will be provided with adequate information on the details of the decision on their claim, including a summary of reasons for the Commonwealth's acceptance, partial acceptance or rejection of their claim.

31. Under s.33(3) of the FMA Act, conditions may be attached to act of grace payments. In circumstances where conditions are specified the claimant may be requested to release the Commonwealth from any legal action in relation to the circumstances of the act of grace claim. In certain circumstances the claimant may also be required to indemnify the Commonwealth from other claims arising out of the circumstances of the claim. A deed may provide that if conditions are breached, the payment may be recovered by the Commonwealth as a debt in a court of competent jurisdiction.

Funding and reporting

32. Although act of grace payments must be authorised by the Minister for Finance and Administration or a delegate, payments are funded and reported under an appropriate appropriation and outcome of the agency to which the act of grace case relates.

33. In general, payments should be made from Departmental Appropriations. However, if any part of an act of grace payment can be settled under statutory entitlement provisions, then it should be paid from the relevant Administered Appropriation and reported under the associated outcome.

34. Once an act of grace payment has been authorised by the Minister or a delegate, the Special Financial Claims Section will notify the relevant agency so that payment can be arranged.

Contacts

35. Inquiries on these act of grace guidelines can be directed to the Special Financial Claims Section.

WAIVER OF DEBTS: GUIDELINES FOR AGENCIES

1. In dealing with the Commonwealth a person or organisation may incur a debt which they are obligated to repay. For example, a debt may arise from:
   - an overpayment of income support; or
   - a customs duty debt on the importation of goods.
2. A waiver is a special concession granted to a person or organisation that "expunges" the debt owed to the Commonwealth. That is, the debt is completely wiped out so the Commonwealth cannot pursue the debt at a later date should that person's or organisation's financial circumstances improve.

Authority for waiver of debts

3. For a limited number of Commonwealth programs, specific waiver provisions are set out in the legislation governing the program. For example:
   - some debts in circumstances specified in s.1237 of the *Social Security Act 1991*, s.43A of the *Student Assistance Act 1973* and s.96 of *A New Tax System (Family Assistance) (Administration) Act 1999*; or
   - some debts waived under the *Income Tax Assessment Act 1936* by the Tax Relief Board to provide relief from a tax liability in specific cases of financial hardship.
4. These specific legislative waiver provisions have precedence over the general waiver provision under s.34 of the *Financial Management and Accountability Act 1997* (the FMA Act).
5. These guidelines relate specifically to the authority to waive debts owed to the Commonwealth under s.34 of the FMA Act. Under this section, a Minister of the Finance and Administration portfolio, including the Parliamentary Secretary, may:
   - waive the Commonwealth's right to payment of an amount owing to the Commonwealth;
   - postpone any right of the Commonwealth to be paid a debt in priority to another debt or debts;
   - allow the payment by instalments of an amount owing to the Commonwealth; or
   - defer the time for payment of an amount owing to the Commonwealth.
6. *Amount owing to the Commonwealth* includes an amount that is owing but not yet due for payment.
7. The Minister has delegated his waiver powers under section 34(1)(a) to particular officers of the Department of Finance and Administration (Finance) according to specified financial delegation limits.
8. If a proposed waiver involves, or is likely to involve, a total amount of more than $100,000, s.34(2) of the FMA Act requires that the Minister must first consider a report of an Advisory Committee. The Committee comprises Chief Executive Officers of: the Department of Finance and Administration; the Australian Customs Service (ACS); and the agency that is responsible for the matter on which the Committee has to report.

- Should the matter relate to Finance or to ACS, the third member of the Advisory Committee should be a delegate from the Attorney-General's Department.

9. Powers under section 34(1)(c) & (d) have been delegated to all Chief Executive Officers. Powers under section 34(1)(b), however, have not been delegated.

Conditions under which a waiver may be granted

10. Under the FMA Act, the Minister or delegate has an unfettered discretion to consider each request for a waiver on a case by case basis. However, the most common condition under which a waiver is granted is where, due to the particular circumstances of the case, the Minister or delegate concludes that there is a moral obligation, rather than a legal obligation, on the Commonwealth to extinguish the debt.

    - A moral obligation may be considered to have arisen due to continuing financial hardship or equity reasons, ie:
    - There are sound reasons supporting the view that the person's financial circumstances will not improve to the point where they could not repay the debt in full by instalments without suffering genuine and significant financial hardship. In determining such cases, a person's assets, future income earning capacity, health and family circumstances will be taken into consideration; or
    - a direct act or omission of a Commonwealth agency, or impact of a Commonwealth law - whether or not it arose from defective administration - has caused a person or entity to incur an unintended debt to the Commonwealth, the recovery of which would result in an overall loss to the person or entity concerned – ie, it would result in an inequity because they would be worse off than if the debt had not arisen.

Scope of waiver powers

11. There must be an amount owing or an amount that is expected to become due in the future for waiver under the FMA Act to operate. An amount which is not liquidated, for example, a court order for costs which has not been taxed, is not an 'amount owing' under s.34 of the FMA Act. Agencies have a general duty to attempt to pursue recovery of an order for costs, however, and may need to show there is a good reason not to (refer Director-General Social Services v Hale 47 ALR 281 at 319-320).

12. The waiver power under the FMA Act relates only to debts owed to Commonwealth Agencies. It does not apply to debts owed to Commonwealth authorities and companies which have a separate legal identity to the Commonwealth and operate under the *Commonwealth Authorities and Companies Act 1997*.

13. The waiver power does not obligate the decision-maker to waive a debt in any particular case.

14. Waiver should not be seen as a means to circumvent legislative or policy provisions that are operating as intended, or to provide remedies for major legislative or program deficiencies.

15. The FMA Act's non-recovery (write-off) and waiver provisions are separate and discrete provisions. As such, non-recovery (write-off) should not be seen simply as an alternative remedy to waiver. If there are equity or ongoing financial hardship considerations in the recovery of the debt, an agency should refer the case to Finance for waiver consideration.

16. Equity is an important element in consideration in waiver requests. The waiver powers are therefore intended to be used in a limited number of cases to ensure equity in the impact of Government activities.

Who may claim?

17. Any individual, company or other organisation can request a waiver, under the FMA Act, either directly or through a third party.

18. All requests for waivers must be referred to Finance.

19. Where requests for waiver come direct to the Minister for Finance and Administration or the Parliamentary Secretary or Finance, the Department (Finance) will notify and consult the relevant agency about the case.

Referral of requests to Finance

20. The Special Financial Claims Section, Finance, is responsible for coordinating all waiver requests to ensure the Minister or delegate has sufficient information and evidence to make an informed decision.

21. In referring a request for waiver to the Special Financial Claims Section, agencies are requested to provide sufficient information to enable an informed and independent assessment of the case, including as appropriate:

    - details of the relevant section(s) of legislation to which the debt may relate and of the debtor's circumstances in relation to that legislation;
    - specific details of the Commonwealth's role, if any, that may have directly contributed to the debtor's situation;
    - any history/background to the case, including any available information on the person's assets, income, future income earning capacity, other debts, health and family circumstances; and
    - any other information that may be relevant to the decision-maker's consideration of the particular circumstances.

22. The Special Financial Claims Section will seek additional information from the relevant agency or directly from the claimant as appropriate.

Notification of decision

23. Claimants will be provided with adequate information on the details of the decision of their claim, including a summary of reasons for the Commonwealth's acceptance, partial acceptance or rejection of their claim.

24. A copy of the letter advising the claimant of the decision will be forwarded to the relevant agency for information and action.

Reporting

25. Waiver of debts must be reported in the annual report of the agency concerned in accordance with the policy requirements set out in the Finance Minister's Orders: Financial Reporting Requirements for Commonwealth Agencies and Authorities.

Contacts

26. Inquiries on these guidelines can be directed to the Special Financial Claims Section, Finance.