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SENATE SELECT COMMITTEE ON SUPERANNUATION AND FINANCIAL SERVICES

FIRST REPORT ON INQUIRY INTO PRUDENTIAL SUPERVISION AND CONSUMER PROTECTION FOR SUPERANNUATION, BANKING AND FINANCIAL SERVICES

RECOMMENDATION	PROPOSED GOVERNMENT RESPONSE
Regulatory framework **Recommendation 1** **The Committee recommends that the regulators, especially APRA and ASIC, work together to develop a coordinated strategy to improve awareness in the community about their respective roles and responsibilities.**	Support. APRA and ASIC have already worked together on joint publications and industry seminars and will discuss how such programs can be expanded and improved. Implementation of the *Financial Services Reform Act 2001* will provide another opportunity for cooperation between the two agencies. APRA and ASIC also jointly conduct industry liaison meetings on matters of common concern. ASIC already expends resources educating not only industry groups but also the media and consumer organisations about its role and will continue to do so. Also, APRA will be examining opportunities to improve community awareness (see recommendation 2).
Recommendation 2 **The Committee recommends that an Office of Regulatory and Consumer Affairs be established within APRA to act as a first point of call for consumers and others unsure of which regulator to approach regarding a particular issue.**	Not supported. ASIC is the regulator responsible for consumer protection. Since acquiring this role in 1998, ASIC has expended considerable efforts promoting itself to both the general public and industry as the consumer protection regulator for all financial services (except credit). The ever increasing number of visits to its

	consumer site, FIDO, along with the increased number of calls to its Information Line, are evidence that this message is being heard. The creation of an Office of Regulatory and Consumer Affairs within APRA would be at odds with the respective roles of the two regulators and would blur the demarcation of responsibilities in the eyes of the public and industry. The referral role which the report seems to see as the primary focus of such an office is one already adequately undertaken by the staff of each of the four regulators - APRA, ASIC, the ATO and ACCC. In practice, the establishment of such an office would not stop calls being made to the wrong regulator nor the need for appropriate referral procedures to be in place. Should faults be found with referral processes at any stage, steps will be taken to rectify them. APRA already has a public information service that handles a large volume of calls from the general public (around 700 per day), mainly about superannuation. The Government has increased APRA's funding by $1.2 million to enhance APRA's education role. Together with improved co-ordination between APRA and ASIC, APRA's enhanced public education role should obviate the need for the establishment of such an office.
Recommendation 3 **The Committee recommends that ASIC and APRA establish an employee industry secondment scheme to provide opportunities for staff to gain practical experience in the financial services industry.**	In principle support. This is a matter for APRA and ASIC to determine. Both regulators recruit experienced staff from the financial services industry and are in the best position to determine the training needs of their staff.

Prudential supervision – trustees of superannuation funds **Recommendation 4** **The Committee recommends that APRA take steps to improve its performance in its oversight of trustees – whether they are trustees of small, medium or large funds – in particular by ensuring that trustees abide by the standards required to protect the best interests of fund members.**	Support. APRA has already made some progress in building up its enforcement capacity. The Government has increased APRA's funding by $3.1 million per year to improve its supervision of superannuation funds and trustees. The safety of superannuation funds is of great importance to the Government and to this end the Government commissioned the Superannuation Working Group (SWG) to undertake public consultation and develop legislative proposals to improve the safety of superannuation. The SWG has presented its report and the Government is now considering its recommendations.
Recommendation 5 **The Committee recommends that:** • **APRA act more quickly when matters come to its attention, and that APRA deals with those matters within its jurisdiction rather than passing them on to another regulator; and** • **APRA and ASIC work more closely together to ensure a timely and effective response when matters come to their attention.**	Support. APRA is working to improve procedures as far as possible. APRA and ASIC have protocols covering the referral of possible enforcement cases and information-sharing to supplement their high level memorandum of understanding. Those protocols have been revised in the light of experience and remain under ongoing review. New and existing staff will be trained in the operational requirements of those protocols.

Recommendation 6 **The Committee recommends that APRA work more closely with superannuation funds, the Australian Institute of Superannuation Trustees and others to ensure that an appropriate level of education and training is provided to trustees, including a mandatory minimum level of training prior to service.**	In principle support. APRA is happy to work with industry groups such as the AIST to help them develop training material for trustees. As mentioned in the response to recommendation 2, the Government has increased APRA's funding by $1.2 million to enhance this education role. Although only applicable to certain superannuation entities, the *Corporations Act 2001* requires licensed trustees to have an adequate level of training. Further work would need to be done to establish whether a mandatory minimum level of training should be done by all trustees in conjunction with the development of other requirements for trustees.
Recommendation 7 **The Committee recommends that APRA work more closely with the Australian Institute of Criminology to examine the best methods of crime prevention in superannuation funds administration.**	Support. APRA will establish contact with the Institute to identify areas where they could usefully work together.

Recommendation 8 **The Committee recommends that, in relation to annual reports to fund members, the minimum information requirement be expanded to include identification of:** • **any payments to trustees from the fund, broken down into directors' fees and other payments; and** • **all significant administration fees, charges and commissions paid to both fund and investment managers.**	Noted. As part of the FSR regime, regulations require a financial product provider to disclose information about costs associated with the holding of the product in periodic reports. These costs include details of amounts paid in respect of the product throughout the period and any amounts deducted by way of fees, expenses or charges. The Government supports the increased disclosure of information to fund members. It is noted that the SWG is also examining proposals to enhance disclosure. The Government is now considering the SWG's recommendations.

Recommendation 9 **The Committee recommends that:** • **a trustee, fund manager or administrator who has been convicted of fraud should not practice again in the business of superannuation until certain conditions are met. These conditions might include not practicing for a period of at least 15 years, and then proving to APRA's satisfaction that they are a fit and proper person; and** • **APRA maintain a listing of trustees, fund managers and administrators of superannuation funds which have been defrauded, regardless of whether they are regulated or not.**	More work required. There are existing legislative provisions relating to disqualified persons and these would need to be reviewed. Part 15 of the *Superannuation Industry (Supervision) Act 1993* governs the eligibility of trustees of superannuation funds, including provisions for the treatment of a trustee who has been disqualified. Section 120 of the SIS Act defines when an individual or body corporate is a disqualified person and section 120A outlines the circumstances where the regulator may disqualify an individual, ie for a contravention of the Act that is serious enough to provide grounds for a disqualification, as determined by APRA. These circumstances give the regulator significant powers where a person has contravened the Act, and the nature of the contravention is of a serious nature, for the regulator to disqualify the person. Although not applicable to all superannuation entities, under the Financial Services Reform regime, Part 7.6 Div 4, Subdivision C, ASIC may suspend or cancel an Australian financial services licence in specified circumstances such as insolvency, conviction of serious fraud or not carrying on a financial services business. Section 915I of the *Corporations Act 2001* outlines special procedures in the case of APRA-regulated bodies, such as public offer superannuation funds, which may have their licenses suspended or cancelled. Part 7.6 Div 8 contains procedures for banning or disqualifying persons from providing financial services. Further, Part 2D.6 of the Corporations Act provides for a range of measures to disqualify persons from managing corporations. The disqualification can be automatic and for a period of five years (for example for offences concerning breach of the Act, dishonesty, offences concerning participation in decision

	making affecting the business, or significantly affecting the corporation's financial standing). The Court can disqualify persons from managing corporations for breaches of the Corporations Act civil penalty provisions (disqualification for any period of time), insolvency and non-payment of debt (disqualification for up to ten years), or repeated contraventions of the Corporations Act (disqualification for any period of time). ASIC has the power to disqualify for up to five years in circumstances involving the management of at least two corporations that have become insolvent in the last seven years. The applicability of these provisions to the superannuation industry would need to be considered, and whether they could be used as a model for disqualification from operating generally in the superannuation industry. Specific issues that require consideration are whether the disqualification should be automatic, or whether it should be imposed by the Court or a regulator (or a combination of all three), and the means of appeal. Under paragraph 922A(2)(c), ASIC may keep a register of person against whom a banning order or disqualification order is made. Regulation 7.6.06 currently deals with the requirements of this register.
Recommendation 10 **The Committee recommends that:** • **the Minister act expediently and efficiently in making a decision under the SIS Act to grant financial assistance to a fund that has suffered as a result of fraud or theft, to minimise the hardship that superannuation fund members could otherwise potentially suffer; and** • **the provisions for financial assistance to funds under Part 23 of the SIS Act be extended to include an appropriate**	Noted. Since June 2002, the Government made determinations granting financial assistance to 197 small APRA funds that suffered losses in the Enhanced Cash Management Trust, with further determinations to be made. A grant was also made to members of the Australian Independent Superannuation Fund. The Government is concerned to minimise hardship suffered by fund members that suffered losses as a result of fraudulent conduct or theft.

range of pension and retirement annuity products.	There are a number of conditions for an application under Part 23 that must be met before a determination can be made, including: • the fund must suffer an eligible loss. That is, a loss as a result of fraudulent conduct or theft (a conviction is not required); • the loss must have caused a substantial diminution of the fund leading to difficulties in the payment of benefits; and • the application must be in writing and be accompanied by such information as the Minister determines. The Minister may also request any additional information as the Minister considers necessary for an application to be determined. The Minister must also seek APRA's advice on the application. Further, if a grant is made, it can be funded out of consolidated revenue or a levy on other superannuation funds. Any extension of Part 23 of the SIS Act to encompass some pension and retirement annuity products would require further examination.

Prudential supervision – operational effectiveness of APRA **Recommendation 11** **The Committee recommends that APRA review its approach to risk management to ensure that it has transparent procedures in place to detect early warning signals of impending institutional or fund failure or loss.**	Support. An essential element of APRA's prudential supervision is formal risk rating of financial entities with a view to identifying the potential for serious problems to develop. APRA's internal risk rating system and all other aspects of its supervisory approach are being refined and improved continuously. The SWG is also examining proposals that would assist APRA in supervising the superannuation sector. These include a proposal for universal licensing requirements to operate a superannuation fund and risk management plan requirements.
Recommendation 12 **The Committee recommends that APRA increase the attention it gives to the prudential supervision of superannuation entities, especially those in the small to medium sized fund environment.**	Support. APRA is responsible for determining how best to supervise superannuation entities. APRA has indicated that it has increased its vigilance in supervising these types of superannuation funds. Additional funding of $3.1 million per year has been provided to APRA to expand its superannuation investigation and enforcement capability.

Recommendation 13 **The Committee recommends that the Government review the resources allocated to APRA, to ensure that it is provided with the resources necessary to match its level of supervisory responsibilities.**	Support. The Government has agreed to increased funding of $3.1 million per annum to APRA to improve superannuation supervision. The Government will also be reviewing APRA's funding for the next financial year as part of the public levy setting process that occurs each year in March - May. In addition, a formal review of levies involving industry is scheduled to commence later this year.
Consumer protection **Recommendation 14** **The Committee recommends that the Government review the resources allocated to ASIC to ensure that it is provided with the resources necessary to enable it to perform effectively its broad and increasing range of regulatory functions.**	Support. ASIC has already undertaken a pricing review to assess its own resource needs and the Government continuously reviews ASIC's resource allocation through the budgetary process.

Regulatory issues – levies and standards of auditing **Recommendation 15** **The Committee recommends that APRA review the rationale for determining the quantum of supervisory levies, in order to remove inequities and ensure that levy payments more closely match the level of supervision.**	Support. APRA and the Government will continue to consult with industry, to ensure that as far as possible, levies are set at a level that matches the cost of supervision and that avoids cross-subsidisation between sectors. Further, industry will have an opportunity to comment on the rationale for determining levies during the review of the levy setting process commencing later this year.
Recommendation 16 **The Committee recommends that APRA work more closely with the Institute of Chartered Accountants in Australia to identify ways to improve adherence by auditors to professional and ethical standards and ensure genuine auditor independence.**	Support. The Government commissioned a comprehensive review of audit independence in Australia, undertaken by Professor Ian Ramsay. It would be appropriate for APRA to work not just with the ICAA but with the accounting profession as a whole (including CPA Australia, the National Institute of Accountants and the staff of the Australian Accounting Research Foundation) to this end. There is already close collaboration between APRA and the profession on these issues. For example, The AARF Audit Guide, 'The Audit of Superannuation Funds', developed at the direction of the Auditing and Assurance Standards Board and endorsed by APRA, has a chapter on the qualifications and independence of the auditor.

Superannuation regime **Recommendation 17** **The Committee recommends that the Government review those aspects of the *Superannuation Industry (Supervision) Act 1993* (the SIS Act) referred to in this report.**	
Employer-sponsors Raiding Surpluses It was recommended to the Committee that there should be a prohibition against the surplus of a defined benefit fund being used for any purpose other than the best interest of defined benefit fund members.	**Employer-sponsors Raiding Surpluses** The Government notes that there have been situations in which some employers contributing to defined benefit superannuation funds are using an actuarial surplus - the amount above that needed to meet their future obligations, in lieu of contributions. The Government has asked Treasury to review the standards that apply to defined benefit funds, including undertaking public consultation to ascertain whether alternative arrangements are necessary to safeguard member interests.
Impact of Severe Financial Hardship Claims on Funds The Committee was advised by some industry representatives that severe hardship provisions in the SIS Act are cumbersome, costly, time consuming, and open to abuse by members.	**Impact of Severe Financial Hardship Claims on Funds** An important part of the Government's retirement income policy is to ensure that all members of the community have an adequate level of income in retirement. Consequently, restrictions are placed on the early withdrawal of superannuation savings to ensure that they provide for genuine retirement income. The Government recognises, however, that these restrictions may cause undue hardship for some people because of their personal circumstances. The legislation therefore provides for the early release of superannuation benefits in certain limited circumstances, such as retirement due to incapacity, severe financial hardship and in a limited number of compassionate circumstances. The final decision as to whether a release is permitted on any of these grounds

	rests with the trustees of the applicant's superannuation fund, subject to the fund's governing rules. That is, individual funds have the discretion as to whether they will make such access available to their members. There has been significant interest from both the public and the superannuation industry in relation to early release of benefits and the Government believes that the existing arrangements be reviewed. Accordingly, the Government referred the issue of the effectiveness and efficiency of the current rules governing early access to superannuation benefits on existing compassionate and severe financial hardship grounds to the Senate Select Committee on Superannuation and Financial Services. The Committee has now reported and the Government is considering its recommendations.
Rules Governing Successor Funds The Committee found that the existing rules had two complications: where a successor fund transfer was to take place but was effectively blocked; and in the difficulty in determining whether benefits in the old and new funds are equivalent.	**Rules Governing Successor Funds** The current arrangements enable bulk transfers between funds without the consent of the members so long as equivalent rights between the respective funds are conferred, and this is agreed by the trustees of both funds in writing. These arrangements require trustees to act in the best interests of members. The Government does not consider that the issues raised in this Senate Committee report warrant a review of the successor fund rules. To allow trustees to be directed to agree to a successor fund arrangement without concern for the impact on members is contrary to this approach and may adversely impact upon retirement incomes. Moreover, the Government's policies in favour of choice and portability of superannuation are its preferred methods for enhancing mobility in superannuation. The Government reaffirmed its commitment to these policies in its 2001 election statement *A Better Superannuation System* and the 2002-03 Budget. Choice and portability will increase mobility between superannuation funds and provide individuals with the freedom to choose who

	is responsible for managing their superannuation.
Definition of 'Dependant' The Committee noted that the definition of 'dependant' could lead to misunderstandings, unintended consequences or introduce an element of discrimination.	**Definition of 'Dependant'** APRA Circular I.C.2, Payment Standards for Regulated Superannuation Funds issued in September 2000, defines a dependant to include: • a spouse regardless of whether they were financially dependant on the member. A spouse includes a person who although not legally married to the member, lived with the person on a genuine domestic basis as the member's husband or wife at the time of death; • a child of the person including an adopted child, a step-child or an ex-nuptial child, regardless of whether they were financially dependant on the member; • any person who was financially dependant on the member at the time of the member's death. This may include a partner who does not meet the definition of a spouse. It is the trustee's responsibility to decide whether such a person was financially dependant on the member at the time of death. The Government does not believe that the current arrangements are discriminatory. The Government does not propose to amend the definition of 'dependant' in the SIS legislation at this time but has noted the Committee's discussion of the issue.
Binding Death Benefit Nominations The SIS Act was amended recently to allow superannuation funds to structure their governing rules to accept binding death benefit nominations. As a result, where a binding death benefit nomination	**Binding Death Benefit Nominations** The Government notes the Committee's interest in this matter and its view that the SIS regime provides an appropriate outcome. The Government's priority at this time is to implement its election commitments announced in *A Better*

stands, a trustee would automatically pay the death benefit to the person nominated on the beneficiary nomination form. The Committee sees merit in the suggestion that binding death benefit nominations stay in force in a manner similar to a will.	*Superannuation System* and the 2002-2003 Budget and it does not intend to review the operation of binding death benefit nominations.
Arrangements for People over 65 years of age The Committee noted that superannuation arrangements for older Australians are less flexible where people over 65 wish to continue to make superannuation contributions.	**Arrangements for People over 65 years of age** Noted. Issues relating to superannuation and mature age workers were considered by the Productivity Commission in its examination of the SIS Act and certain other superannuation legislation. Furthermore, as part of the 2002-03 Budget, the Government delivered on its 2001 election commitment to allow working members of superannuation funds aged between 70 and 75 to continue to make personal superannuation contributions provided they are working at least 10 hours per week. The Government has also asked Treasury to review the monitoring requirements for superannuation funds in respect of the 10 hours per week employment test for persons aged between 65 and 75 years.
Preservation Rules Too Restrictive The Committee notes moves to improve the portability of superannuation benefits by non-residents departing Australia permanently and reiterates the views expressed in its earlier reports that there may be a case to review the preservation rules to facilitate such portability.	**Preservation Rules Too Restrictive** The Government has amended the preservation rules to allow eligible temporary residents who have permanently departed Australia to access their superannuation from 1 July 2002.

Trustees' Power to Delegate Investment-Related Functions to an Investment Manager The Committee noted its concern at the issue of superannuation funds outsourcing certain functions, and the importance of maintaining appropriate controls over these functions.	**Trustees' Power to Delegate Investment-Related Functions to an Investment Manager** The Government notes that the SWG, established to make recommendations on issues relating to the safety of superannuation, examined existing structures for contractual arrangements of outsourced functions. The Government is currently considering the SWG's final recommendations with a view to ensuring the appropriateness of these arrangements.