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REPORT
ON THE PROVISIONS OF THE FINANCIAL SECTOR LEGISLATION AMENDMENT BILL (NO.1) 2000

SENATE SELECT COMMITTEE

ON SUPERANNUATION AND FINANCIAL SERVICES

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TERMS OF REFERENCE

On 28 June 2000 the provisions of the Financial Sector Legislation Amendment Bill (No. 1) 2000, in respect of proposed changes to the *Superannuation Industry (Supervision) Act 1993*, were referred to the Committee for inquiry and report by 16 August 2000. On 15 August the Senate agreed that the time for presentation of the report be extended to 30 August 2000.

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CHAPTER 1 - INTRODUCTION

Background to the inquiry

1.1 The Financial Sector Legislation Amendment Bill (No. 1) 2000 ('the Bill') was introduced into the House of Representatives on 13 April 2000 and into the Senate on 26 June 2000. On 28 June the Senate referred certain provisions of the Bill to the Select Committee on Superannuation and Financial Services for examination and report by 16 August 2000.[1]

1.2 In accordance with a recommendation in the Selection of Bills Committee Report, the Committee was required to review the proposed changes to the *Superannuation Industry (Supervision) Act 1993* (SIS Act) contained in Schedule 3 of the Bill.

1.3 In view of the necessity to hold a second public hearing into the provisions of the Bill on 14 August 2000, the Committee sought an extension of time in which to report. On 15 August the Senate agreed that the time for presentation of the report be extended to 30 August 2000.

Conduct of the inquiry

1.4 The inquiry was advertised in the *Australian* on 6 July 2000 and in the *Australian Financial Review* on 7 July 2000, inviting submissions.

1.5 The Committee received a number of submissions from superannuation industry bodies, service providers to the industry and from the regulators responsible for the administration of the SIS Act - the Australian Prudential Regulation Authority (APRA), the Australian Securities & Investments Commission (ASIC), the Australian Taxation Office (ATO) - and from the Treasury which is responsible for carriage of the legislation. A list of the submissions received is at **Appendix 1.**

1.6 The Committee met in public to consider the provisions of the Bill on 11 July 2000 in Sydney and again on 14 August 2000 in Canberra. A list of witnesses who gave evidence at the public hearings is at **Appendix 2**.

Background to the Bill

1.7 This Bill is a continuation of the previous and current Government's financial sector reform agenda, beginning with the 1995 review of the Criminal Code, and following on from financial sector legislation already implemented in response to recommendations of the 1997 Financial System Inquiry chaired by Mr Stan Wallis.

1.8 The Bill contains proposed amendments to the *Reserve Bank Act 1959*, the *Banking Act 1959* and the SIS Act and is aimed at updating and enhancing Australia's financial sector legislation, in particular by providing 'a more effective enforcement framework for the superannuation industry.'[2] The Committee did not consider the full range of measures

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1 Selection of Bills Committee Report No 10/2000.

2 Senator the Hon Christopher Ellison, Second Reading Speech, Hansard, p. 14624, 26 June 2000.

contained in the Bill. In accordance with its terms of reference, the inquiry concentrated on the proposed changes to the SIS Act contained in Schedule 3 of the Bill.

1.9 Schedule 3 makes a range of amendments to the SIS Act including amendments to enforcement powers and offence provisions. It contains substantive amendments to various offence provisions that change the nature of the offences in question, and also ensures that they are compliant with the Criminal Code (as set out in a Schedule to the *Criminal Code Act 1995)* and that they are consistent with similar provisions contained in the Corporations Law and in the *Managed Investments Act 1998*.

1.10 An explanation of the background to, and justification for, each of the proposed amendments is at **Appendix 3.**

1.11 It is important to note that the Bill does not represent a change in the penalty regime, in terms of increasing the penalties applicable; rather, the proposed amendments will have the effect of maintaining the status quo. A comparison of the current and proposed penalty provisions, which demonstrates that penalties remain unchanged for most offences, or have been reduced where a two-tier system of liability is introduced, is at **Appendix 4.**

1.12 The proposed amendments would affect the regulatory framework in the following specific areas:

- Amendments to facilitate the application of the Criminal Code to certain offence provisions;
- Conversion of fault liability offences to strict liability or two-tier offences;
- A new power to enable regulators to disqualify persons adjudged not 'fit and proper' from managing superannuation savings in certain circumstances;
- Power to allow regulators to accept enforceable undertakings from a superannuation fund trustee;
- Extension of the time limit in which prosecutions may be commenced;
- Removal of immunity from prosecution in relation to certain evidence;
- Measures to prevent persons holding themselves out to be auditors or actuaries without the requisite qualifications; and
- Measures requiring former trustees to assist Acting trustees.

1.13 According to the Explanatory Memorandum, the amendments are designed to:

> Provide the Regulators with various new or enhanced enforcement powers. These powers will strengthen the regulatory framework for superannuation and facilitate the prosecution of contraventions of the SIS Act. This in turn will assist in ensuring that superannuation entities are administered prudently and that superannuation savings are adequately protected.[3]

3 Financial Sector Legislation Amendment Bill (No. 1) 2000, Amended Explanatory Memorandum, p. 18.

Harmonisation of the legislative and regulatory regime

Compliance with the Criminal Code

1.14 As mentioned above, the Bill contains substantive amendments to various offence provisions that change the nature of the offences in question, and also ensures that they are compliant with the Criminal Code and that they are consistent with similar provisions contained in the Corporations Law and in the *Managed Investments Act 1998.*

1.15 The Criminal Code is set out in a Schedule to the *Criminal Code Act 1995.* Chapter 2 of the Criminal Code codifies common law principles built up over time by court decisions relating to criminal responsibility. (For example it defines the physical elements and fault elements of an offence). These principles are designed to be employed in the interpretation of criminal offences. The Code's application is designed to ensure clarity and consistency in the interpretation of Commonwealth criminal offences. The Code does not of itself impose any liabilities or penalties.

1.16 Chapter 2 of the Criminal Code is to be progressively applied to existing offences in all Commonwealth legislation to ensure consistent application of criminal law principles. It has been applied to all new offences since 1997. The SIS Act is the first of a series of Acts where the Code will be applied to existing offences.

1.17 Various offence provisions within the SIS Act need to be amended to ensure they are compliant with the Criminal Code. Since the Bill creates some new offences or amends existing offences under SIS, the opportunity is being taken to make changes to ensure those offences are compliant with the Code. Remaining offences against the SIS Act are addressed in another Bill (Treasury Legislation Amendment (Application of Criminal Code) Bill 2000, introduced into Parliament on 29 June 2000).

Harmonisation with other regulatory schemes

1.18 In keeping with the move to unify the interpretation of criminal offences, this Bill seeks to harmonise the various measures with other prudential regulation schemes.

1.19 This Bill converts certain fault liability offences to strict liability offences and also converts a number of other fault liability offences to two-tier fault and strict liability offences. The offences to be converted relate to duties and obligations that are fundamental to the protection of superannuation investments.

1.20 This shift towards strict liability is consistent with consumer protection measures contained in legislation regulating other areas of the investment industry, namely the Corporations Law and the *Managed Investments Act 1998*. For example, offences concerning lodgment of annual returns, the keeping of minutes and proper financial records, which are strict liability offences under the Corporations Law, will become strict liability offences under the proposed amendments to SIS Act.

CHAPTER 2 - ISSUES

2.1 The response to the Bill was mixed. Although a small number of groups welcomed the proposed amendments because they improved standards of stewardship by trustees and other superannuation managers and brought the legislative framework into greater harmony, others were concerned that there was no necessity for the Bill and that its impact could have serious adverse effects on the representative trustee system.

2.2 The background to, and justification for the proposed amendments, was not clearly articulated in the Explanatory Memorandum and that this may have contributed to the adverse reaction by some industry groups and service providers.

2.3 The most significant issues which emerged during the inquiry related to:

- **Consultation** with industry before and after the introduction of the Bill;
- The **policy rationale** for the changes to the SIS enforcement and penalty regimes;
- The changes to the **penalty regime**, especially the conversion of fault liability offences to either strict liability offences or two-tier offences;
- The potential impact of the changes on the **representative trustee system;**
- The perceived shift of **compliance cost** from regulators to trustees; and
- The creation of **legislative uncertainty** especially where the legislation is silent on criteria and guidelines for disqualification of trustees and other superannuation managers as being not 'fit and proper'.

2.4 These issues are discussed in turn below.

Consultation

Consultation prior to the introduction of the Bill

2.5 The lack of consultation by the policy department with responsibility for the legislation, Treasury, and the regulators, APRA, ASIC and the ATO, prior to the introduction of the Bill was one of the most significant issues raised during the inquiry.

2.6 Organisations representing the spectrum of superannuation trustees, including the Association of Superannuation Funds in Australia (ASFA), the Australian Institute of Superannuation Trustees (AIST), the Small Independent Superannuation Funds Association (SISFA), the Industry Funds Forum (IFF), the Corporate Super Association, and service providers, including the Institute of Actuaries of Australia (IAA), and the Institute of Chartered Accountants in Australia (ICAA) were critical of the lack of advance notice or consultation with industry prior to the Bill's introduction into Parliament.

2.7 ASFA, for example, pointed out that the Bill was introduced into parliament without any consultation with industry.[1] The AIST also informed the Committee that 'there was no consultation prior to [the legislation's] appearance in parliament, and that was quite shocking.'[2]

2.8 Pointing to the potentially serious consequences of the Bill's provisions for trustees and auditors, SISFA stated that:

> … it is extremely disappointing that it was introduced without any industry consultation or without the presentation of any evidence to highlight the insufficiencies in the current regime. Industry consultation should take place to discuss any of the problems, if any, being encountered by the regulators and to discuss appropriate solutions.[3]

2.9 The IFF also expressed surprise at the lack of consultation on the provisions of the Bill, given past practice:

> I would have thought that the industry would have been consulted and we would have worked in a consultative way to actually develop what was seen to be appropriate legislation, which is my understanding of what has occurred in the past on a whole range of issues.[4]

2.10 The Corporate Super Association also expressed its preference for consultation to have occurred prior to the Bill's introduction, describing the Bill as 'bolt out of the blue'.[5]

2.11 Service providers also raised their concerns on this issue which could have quite serious implications for practitioners. The ICAA noted that:

> … most practitioners would regard this as quite a serious imposition on their obligations as practitioners. There would be an expectation that the profession would be consulted where there are amendments that have application or implication for practitioners.[6]

2.12 Similarly, the IAA informed the Committee that they were seeking discussions with APRA to clarify provisions concerning actuaries, since they only became aware of the legislation after its introduction to Parliament.[7]

2.13 Representatives of the Investment and Financial Services Association (IFSA), the Australian Custodial Services Association (ACSA) and the Financial Services Consumer Policy Centre (FSCPC) were also critical, though to a lesser extent, of the lack of prior consultation with affected parties.

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1 Committee Hansard, p. 1.

2 Committee Hansard, p. 19.

3 Committee Hansard, pp. 42-43.

4 Committee Hansard, p. 30.

5 Committee Hansard, p. 76.

6 Committee Hansard, p. 82.

7 Committee Hansard, pp. 23 and 35.

2.14 IFSA submitted that, while it agreed with the thrust of the proposals in the Bill and 'the desirability of increasing the level of harmonisation as between enforcement provisions under SIS and the Corporation Law', it was also of the view that 'some prior consultation with the superannuation industry would have been desirable.'[8]

2.15 The ACSA also advised that it was not consulted, and nor did it expect to be.[9]

2.16 The FSCPC observed that the lack of notice or prior consultation with industry 'may very well affect the provision of good public policy in superannuation.'[10]

Consultation after the introduction of the Bill

2.17 Industry representatives and officials subsequently advised the Committee that, following the introduction of the Bill, consultation had occurred. For example, the AIST advised that it had had two briefings from APRA, in the month following the introduction of the Bill.[11] The IFF also advised that it would be meeting with the Minister in the near future and that this would provide an opportunity for discussion on this issue.[12]

Role of the Treasury and regulators in consultation

2.18 All policy officials and most regulators agreed that there had been no consultation with industry prior to the introduction of the Bill, and that this may have contributed to a breakdown in communication. However, they also indicated that, in their view, there was no real need for consultation. For example, Treasury advised the Committee that it saw no need for consultation with industry prior to the introduction of the Bill as, in its view, the proposed changes were of a machinery or technical nature, and were not likely to have 'a major effect on the vast majority of diligent industry participants.'[13]

2.19 APRA advised that, as the legislation was being developed by Treasury, it believed that it was Treasury's responsibility to conduct appropriate consultations. APRA also advised that, like Treasury, it saw no real need for consultation because of the specialised and technical nature of the proposed amendments.[14]

2.20 ASIC advised that the Bill was largely driven out of APRA's needs. ASIC's representative told the Committee that: 'I am not aware of whether ASIC had any particular consultation.'[15] The Attorney-General's Department also advised that it had no consultation with industry, because its role is to advise various portfolios on how they might adjust their

8 Submission No 5, p. 2.

9 Committee Hansard, p. 95.

10 Committee Hansard, p. 49.

11 Submission Nos. 4 and 18.

12 Committee Hansard, p. 30.

13 Committee Hansard p. 140.

14 Committee Hansard, p. 137.

15 Committee Hansard, p. 103.

legislation and that 'at the end of the day it is the responsibility of each portfolio to deal with the various groups.'[16]

2.21 Treasury also advised that, in its opinion, the response from some sectors of industry was 'a bit over the top' and due to a lack of understanding and not looking at the detail of the Bill. A Treasury official explained that, in his view, 'A lot of it could have been cured by a closer examination of the measures in the Bill.'[17]

Policy rationale

Reasons for the amendments

2.22 The rationale for the proposed policy change, as described in the Explanatory Memorandum to the Bill, is that the amendments will 'facilitate the prosecution of contraventions of the SIS Act … and assist in ensuring that superannuation entities are administered prudently and that superannuation savings are adequately protected.' However, the Memorandum provided little in the way of detailed reasons for the proposed changes or their proposed implementation.

2.23 Noting that the policy rationale for the proposed changes was not apparent from the Explanatory Memorandum or the Minister's Second Reading Speech, ASFA called for the reasons for the change to be provided:

> ASFA is not aware of any real evidence to suggest a failure in the superannuation system that would warrant such a change in the penalties regime. Equally, any concerns of the regulator in relation to its enforcement powers have not been made public…
>
> Independent investigation by ASFA has indicated that APRA has experienced (unspecified) difficulties in taking action under the current provisions of SIS, particularly in prosecuting acts of omission. Despite the purported prosecution difficulties facing APRA, a convincing case had not been made for substantial changes to the penalty regime.[18]

2.24 Many other submissions to the inquiry, such as those from the ICAA, the IAA, AIST, William M. Mercer, SISFA and the NRMA also questioned the rationale for the proposed changes, and expressed the belief that the current legislation provides sufficient protection to fund members. For example, the AIST advised the Committee that in its view, there was 'no evidence of widespread wrongdoing by trustees' to justify the changes, and that despite further investigation and consultation with APRA, AIST 'remains convinced that the proposed changes are unnecessary.'[19]

2.25 In evidence to the Committee, Treasury, the Attorney-General's Department, and all of the regulators expressed their support for the amendments in order to provide for the proper regulation of superannuation entities, which is consistent with the Criminal Code.

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16 Committee Hansard, p. 104.

17 Committee Hansard, p. 141.

18 Submission No 8, p. 2.

19 Submission No 18, p. 1.

2.26 Treasury submitted that the amendments were considered necessary 'due to the experiences of the former Insurance and Superannuation Commission (ISC) and APRA, who have encountered considerable difficulty in bringing prosecution actions under the SIS Act, even in situations where the breaches seemed quite blatant and deliberate (and that) this difficulty is due to the requirement to prove a mental element or "state of mind", such as intention or recklessness, under fault liability offences.'[20] Both Treasury and the Attorney-General's Department also pointed to the need to apply the Criminal Code to the SIS Act as part of an overall reform of Commonwealth Acts and Regulations.

2.27 In its submissions to the inquiry, APRA pointed out that the ISC/APRA have only initiated one criminal prosecution and one civil penalty action since 1997, and that there were a number of other cases in which APRA (or the former ISC) wished to take prosecution action, but was constrained due to the difficulties in proving the elements of fault liability offences and the Director of Public Prosecutions (DPP) declined to prosecute in those cases. APRA contends that many fault liability offence provisions are virtually unenforceable, particularly in circumstances where the conduct that contravenes an offence provision involves a failure to act (for example, failure by a trustee to provide information to the regulator). The requirement to prove a mental element is a substantial impediment to proving such offences, due to the fact that evidence of intention or recklessness is often difficult to obtain.[21]

2.28 At the hearing APRA provided the Committee with a case study illustrating the nature of problems it had encountered:

> A trustee had, by my recollection, 33 superannuation funds for which it acted. It was associated with an accountancy practice. It was holding itself out as a professional in the area. It had the assets of all these funds pulled into an unregulated entity and then on-invested the money. Some of the money was invested into the parent of the trustee; some of the money was invested into very illiquid assets—a part share in a shopping centre, for example. The records of the individual funds were extremely poorly maintained. Annual returns of the various funds had not been filed. There were real questions about the proper valuation of the assets of these funds. Given our level of concern about those funds we sought the minister's approval and froze the assets of the funds while we investigated to see what a proper assessment of the asset valuation was.
>
> The freezing of the assets, in our view, constituted a significant event which members were entitled to know about under the legislation. We conveyed that view to the trustee orally and in writing. We had an officer of the trustee acknowledge to us that this was indeed a significant event and that the trustee did have an obligation to advise the members in the terms of legislation as soon as practicable and in not more than 90 days. The trustee failed to notify the members until such time, in fact, as we were perhaps stretching our legislated entitlements in seeking to convene a meeting of all of these funds. During this process the trustee resigned as trustee of the various funds.
>
> This was an instance where we did say this conduct is outrageous. It has put member benefits at significant risk. It was made the more outrageous by the fact

20 Submission No 17, p. 2.

21 Submission No 13, p. 4.

> that the trustee was holding itself out in the marketplace as professional. We went to the DPP on this matter. The DPP's advice was, 'You will not be able to succeed in a prosecution here.' It was not part of the written advice but the effect of the advice was that as long as the trustee can say with a modicum of plausibility, 'I thought I told one of my staff to do that,' then we would fail to prove beyond reasonable doubt that the trustee had been reckless or deliberate in failing to fulfil its obligations. That really is the nub of the difference between fault liability where we have to prove beyond reasonable doubt that there was recklessness or intent in actually carrying out an action or failing to carry out a required action as against strict liability where it is sufficient to prove, still beyond reasonable doubt, that the trustee had done or failed to do the thing.[22]

2.29 At the public hearing APRA advised that, if it had had the proposed powers in the last five years, it would have had the potential to prosecute a further five to six cases, where the interests of between 50 – 200 members, and assets of between $0.5 million and $10 million were at stake.[23]

2.30 APRA also pointed out that, although its need to resort to its formal enforcement powers has arisen in only a small minority of cases, demonstrated deficiencies in the current arrangements need to be addressed, including mechanisms to address recalcitrant trustees where necessary, and that this is why it sought legislative amendments.[24]

2.31 In APRA's view, examples of poor internal governance continue to be found. During the period 1995-1999, APRA reviews of funds identified shortcomings in between 31 and 50 per cent of funds. If not rectified, these shortcomings would have created a potential risk to members' interests. In addition, in the three year period 1995-1998, eight per cent, two per cent and four per cent respectively of funds reviewed had serious shortcomings which required a closely supervised rectification program, formal investigation or enforcement action. In the four year period, 1995-1999, four trustees and two corporate trustees were removed by APRA, and one approved trustee was revoked.[25] According to APRA, in most of these cases, the shortcomings were able to be addressed by a process of persuasion or negotiation of remedial programs with the relevant trustees. More detail about APRA's enforcement actions is attached at **Appendix 5.**

2.32 In their evidence to the inquiry, both ASIC and the ATO endorsed the arguments put by Treasury and APRA as to the need for the proposed amendments. In the case of the ATO, it expressed the view that 'it is important that the legislation we administer is able to be enforced where appropriate.'[26]

Application of the business judgment rule

2.33 Treasury, the Attorney-General's and the regulators all pointed to the place of the Bill in the Government's overall reform agenda, which includes ensuring that the SIS

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22 Committee Hansard, pp. 130-131.

23 Committee Hansard, p. 106.

24 Submission No 19.

25 Submission No 13, p. 1 and Submission No 19, pp. 1-3.

26 Submission No 16, p. 1.

provisions are compliant with the Criminal Code and consistent with similar provisions contained in the Corporations Law and *Managed Investments Act 1998.*

2.34 However, the AIST drew attention to the treatment of trustees under the proposed amendments which, in its view, is not consistent with the treatment of company directors found in breach of their duties. In particular, the AIST noted that a defence similar to the 'business judgment rule', which is available to directors (under recent amendments to Corporations Law), is not available to trustees.[27]

2.35 When questioned by the Committee about whether a mechanism similar to the 'business judgment rule' could provide protection, ASIC advised that the 'requirements we are talking about (in the Bill) involve no business judgment at all (and that) the business judgment rule is more to do with taking decisions that affect the assets or undertakings of a company.'[28]

Reactions to the proposed amendments

2.36 As mentioned above, the majority of evidence to the Committee was critical of the proposed amendments because they were seen to represent a complete change to the tone and direction of the penalty regime without any real evidence suggesting a failure in the superannuation system which would warrant such a change.

2.37 For example, William M. Mercer, a leading superannuation consulting firm, questioned not only the necessity for the changes, but also the effectiveness of the proposed changes in achieving any better result if they are enacted, and the appropriateness of the changes to superannuation legislation at this time.[29]

2.38 The AIST, which urged the Committee to recommend that the Bill be withdrawn, drew the Committee's attention to two alternative steps to the Bill that could strengthen the protection of retirement savings. These suggestions related to considering a regime of graduated financial penalties for breaches of the SIS Act, and the development and introduction of a trustee certificate of practice, independently assessed and acceptable across the industry and the regulator. In the view of the AIST this would be a practical and constructive step to raise the standards of stewardship and spread high standards further throughout the industry on a continuing basis.[30] ASFA also indicated its willingness to explore other ways of tightening any perceived weaknesses in the penalty regime without threatening the representative trustees platform on which much of SIS is based.[31]

2.39 Others, like IFSA, the FSCPC and the Australian Custodial Services Association welcomed the proposed amendments.

2.40 IFSA stated that it 'strongly supports legislative initiatives to maintain and improve the effectiveness of the prudential regulatory regime for financial products and services (and)

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27 Committee Hansard, p. 12.

28 Committee Hansard, p. 109.

29 Submission No 7, p. 1.

30 Submission No 18, p. 2.

31 Submission No 8, p. 4.

further ensuring the security of Australians' superannuation savings.'[32] Elaborating at the public hearing, IFSA explained that:

> Our members believe that those who look after other people's money should meet the higher standards regardless of whether that money is in super or non-super investments.[33]

2.41 IFSA further submitted that it supported the harmonisation between enforcement provisions under the SIS Act and the Corporations Law.[34]

2.42 Although somewhat critical of the suddenness of the proposed policy change, the FSCPC welcomed the move to boost APRA's enforcement powers as 'quite good in terms of enhancing consumer protection.'[35]

2.43 The ACSA also indicated to the Committee that it saw no issues in relation to the proposed amendments, as, in enhancing the regulators' powers, they (the regulators) are better able to perform their functions and in so doing protect the interests of superannuation assets of ordinary Australians.[36]

2.44 The IAA welcomed the inclusion in the SIS Act of a provision making it an offence to hold oneself out as an actuary.[37]

Use to be made of the enforcement powers

2.45 Some witnesses to the inquiry were concerned that regulators might make inappropriate use of the proposed new enforcement powers. For example, industry was concerned that these penalty provisions would be invoked to prosecute trustees for what industry regards as relatively minor breaches of the SIS Act, such the late submission of an annual report or failure to request a tax file number from a member, beneficiary or employer.

2.46 In evidence to the inquiry, APRA advised that the proposed amendments would 'not herald any change in (its) general supervisory approach' and that '(we) have no intention of enforcing more actively or aggressively than previously.'[38]

2.47 The ATO also advised, that, like APRA, it did not intend to adjust its compliance/enforcement strategy as a result of the amendments.[39]

2.48 ASIC, while acknowledging industry's concerns, felt that it was important to take a wider view of the issues. At the hearing, ASIC said that:

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32 Submission No 5, p. 1.

33 Committee Hansard, p. 58.

34 Submission No 5, p. 2.

35 Committee Hansard, p. 49.

36 Committee Hansard, p. 90.

37 Submission No 2, p. 2.

38 Submission No 13, p. 2.

39 Submission No 16, p. 1.

> From an enforcement perspective, I think that a regulator would very quickly lose any credibility it has in the market if it deployed a disproportionate amount of its resources to the prosecution of people for not providing tax file numbers or not providing annual returns. These provisions provide an essential part of the infrastructure for a system that we all take for granted. The brutal reality is that these offences are no more serious in their effect on people's personal lives than running through a red light, which is a strict liability. No-one asks you, 'Did you intend to run through that red light?' It is not a defence to say, 'I did not intend to run through that red light'—yet to do so can attract a fine not too much different from the fines we are talking about here today. Also, you put people's lives at risk.
>
> … these provisions are important. From an enforcement point of view, if there is poor record keeping, if there is poor minute taking, if people do not file their annual returns, then they are indicators of poor compliance with some bigger issues. The fact of the matter is that regulators have a discretion; we have a choice. Our first strategy in matters of this kind is to educate people to comply. We all run educational campaigns. We all support industry efforts to educate people who are required to comply with these provisions. Certainly, prosecution action is reserved for the more serious cases where there is some pattern or history where the people involved have come to the attention of the regulators with a frequency that makes taking action not a possibility but a reality. [40]

2.49 In the view of Treasury the amendments to the SIS Act proposed in the Bill represent an appropriate response to the difficulty experienced in bringing enforcement actions, and that the regulators 'can be expected to exercise their enforcement powers under the SIS Act responsibly and reasonably (and that) there are significant checks and balances on the regulators' use of enforcement and prosecution powers.'[41]

Penalty regime

2.50 Although the Bill does not represent a change to the penalty regime, in terms of increasing the penalties applicable, this was not clearly articulated in the Explanatory Memorandum. Consequently there appeared to be some misunderstanding within some elements of industry as to the impact of the proposed amendments.

2.51 Because of this apparent misunderstanding, much of the evidence to the inquiry, including that from the IFF, SISFA, William M. Mercer, ASFA, and the AIST, expressed concern about the changed penalty regime, that is the conversion of fault liability offences to either strict liability offences or two-tier offences, and the application of the Criminal Code to certain offences. Of particular concern was the application of the Criminal Code for inadvertent breaches, and the potential for this to adversely impact on trustees, and especially on representative trustees. In the view of groups like the IFF, these measures would impose an additional onus of proof on the trustees, and that 'people are guilty until they can prove themselves innocent.'[42]

2.52 However, IFSA advised that, in its experience, with the Corporations Law changes in the early 1990s and more recently with the Managed Investments Act, strict liabilities

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40 Committee Hansard, p. 133.

41 Submission No 17, p. 5.

42 Committee Hansard, p. 23.

clearly aimed at the individual involved, helped to focus attention on compliance matters. In the Association's view, 'strict liability turns the well intentioned into the well focussed.'[43]

2.53 In its submission, the Institute of Chartered Accountants in Australia expressed the view that the introduction of criminal penalties should be reconsidered, as the current legislation provides adequate protection to fund members. The ICAA was particularly concerned about the imposition of criminal penalties for the failure to provide an audit report within the required period.[44] The IAA also suggested that the proposal to change from fault liability to strict liability should be reconsidered, especially for breaches of standards where the trustee may be reliant on third parties.[45]

2.54 An additional concern to some witnesses was the concept of the two-tier system, which in their view, would give the regulator two chances at prosecuting a breach - both under the strict liability and the fault liability standard. According to ASFA, 'it seems that if APRA looks at a case it will decide which one to use. If it has not got the evidence to go for the reckless and deliberate action, then it could use the other provisions.'[46]

2.55 In its submission, Treasury pointed out that, in its view, there appeared to be some confusion as to the effect of the application of the Criminal Code to the SIS Act, that criminal offences already exist under the SIS Act, and that the application of the Criminal Code to existing offences under the SIS Act should be viewed as a separate exercise to the conversion of existing offences in the Act from fault to strict liability. In relation to the effect of conversion from fault to strict liability, Treasury further submitted that:

> While strict liability offences do not require the prosecution to prove fault elements (such as intent or recklessness), the prosecution nevertheless has a legal burden to prove beyond reasonable doubt the physical elements of the offence. Once this has been established by the prosecution, the onus shifts to the defendant to show why criminal responsibility should not apply (eg by raising a defence).
>
> The proof required by a defendant to establish a defence is much lower than the standard placed on the prosecution. [47]

2.56 ASIC too disagrees with the view that the Bill represents a change in the penalty regime. In ASIC's view, the Bill will have the effect of maintaining the status quo.[48] Like Treasury, ASIC further submitted that the onus of proof is not reversed in strict liability offences.[49]

2.57 In relation to concerns about the regulator having two chances to prosecute a breach, APRA advised that the regulator would have the choice of proceeding either under the fault liability of the offence if it considered there was adequate evidence of the required mental

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43 Committee Hansard, p. 58.

44 Submission No 1, p. 2.

45 Submission No 2, p. 2.

46 Committee Hansard, p. 2.

47 Submission No 17, p. 3.

48 Submission No 14, p. 6.

49 Submission No 14, pp. 9-10.

element, or under strict liability, if evidence of the mental element were not available. However, the regulator would not be permitted to proceed under both limbs of the offence (ie there would be no double jeopardy).[50]

2.58 In relation to concerns that trustees would be liable for breaches where they rely on third parties, the Attorney-General's Department outlined that there were specific defences in the Criminal Code to cover such situations. For example, there is a defence of 'mistake of fact' which would provide a trustee with the opportunity to raise explanations about the circumstances of the alleged breach. It would then be for the regulator to show that the explanation was not sufficient. [51]

2.59 Overall, Treasury advised that, under the current legislation, regulators have experienced difficulty in obtaining convictions for offences against the SIS Act, and that, in its view, the proposed penalty regime represents an appropriate response to the difficulties experienced in bringing enforcement actions.[52]

Representative trustee system

2.60 Because of the confusion and apparent misunderstanding surrounding the penalty regime, an additional reason given by many witnesses, including ASFA, AIST, the IFF, the IAA and the Corporate Super Association, for opposing the proposed legislation was that it had the potential to impact adversely on the voluntary, representative trustee system. ASFA for example commented that:

> One of the real problems is that the nature of representative trustees is seen by trustees at the moment as under threat. They see themselves as being potentially heavily penalised under this regime. The potential risk of criminal prosecution will be seen as a risk and a disincentive to employer and employee involvement.
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> …
>
> If passed in its current form, the Bill will be a strong disincentive for funds being able to source persons to serve as trustees, as well as a likely barrier to retaining those who serve in this capacity at present.[53]

2.61 Similarly, the Corporate Super Association submitted that, in its view, 'the proposed penalties are so unreasonable and so severe that they are likely to discourage voluntary trustees from agreeing to act as such.'[54]

2.62 The AIST also submitted that the proposed Bill would undermine the representative trustee system and that it had been advised by some of its members that in the event of the Bill becoming law they would withdraw from trusteeship.[55]

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50 Submission No 13, pp. 4-5.

51 Committee Hansard, p. 132.

52 Submission No 17, p. 5.

53 Committee Hansard, pp. 2- 3.

54 Submission No 9, p. 3.

55 Submission No 18, p. 2.

2.63 The Private Health Care Employees Superannuation Fund also submitted that the introduction of the legislation 'will discourage appropriate representatives from becoming trustees' and that the legislation therefore 'threatens to strike at the heart of the representative superannuation trustee principle.'[56]

2.64 However, not all witnesses shared this concern. For example, IFSA and the FSCPC advised that it was not likely to be a problem. In evidence to the Committee IFSA compared the reaction to changes proposed in the Bill to the reactions of company directors when similar changes were introduced to the Corporations Law:

> … there would still be a group of individuals who currently are super trustees, not because they get well paid but because they believe in what they are doing and they believe it is an appropriate contribution to make. Whilst there may be a certain percentage of those who think these liability provisions rule them out of that function, like Corporations Law, I believe there will still be a large number of people who will be prepared to contribute because that is what is important to them. That is why they are there now and they are already taking very big responsibilities on themselves even without these provisions. I believe we would see a similar experience that we saw in Corporations Law and you would still find a good number of people who are prepared to be trustees, albeit there will be some people who, like with the Corporations Law, decide that is not for them.[57]

2.65 The FSCPC indicated that, from a consumer perspective, the proposed amendments merely enforce good practice:

> We do not envisage there being a situation of that many trustees putting their hands up just as a result of this, because, as I said, this merely enforces good practice. If trustees are going to be scared off as a result of them being expected to do their job properly, that is fine; perhaps they are trustees that the industry can do without.[58]

2.66 In response to the concerns of some witnesses, Treasury submitted that it was not expected that the measures contained in the Bill would act as a significant disincentive to people volunteering to act as trustees. While acknowledging the contribution of voluntary trustees, Treasury pointed out that:

> … people considering taking on this role must appreciate and accept the responsibilities of the position. Superannuation members have the right to expect a certain minimum level of competence and skill from their trustees, whether those trustees are paid professionals or unpaid volunteers.[59]

2.67 APRA also advised that, in its view, it would be an 'overreaction' to say that 'honorary' trustees would be driven out. APRA advised that:

> I think they are definitely overreacting. … That same reaction was raised when the SIS legislation first came into place—that nobody in their right mind would ever

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56 Submission No 15.

57 Committee Hansard, p. 64.

58 Committee Hansard, p. 56.

59 Submission No 17, p. 4.

> want to be a superannuation trustee because the duties are too onerous and the penalties are too severe. That did not happen.
>
> …
>
> Broadly speaking, there are no new penalty provisions here. If the trustees are complying with the law now, they should already have processes in place to comply with the (proposed new) law ...[60]

Adequacy of trustee training, knowledge and skill

2.68 At the end of March 2000 there was in excess of $450 billion invested in superannuation in Australia. The SIS Act and Regulations establish a regulatory framework designed to ensure that this pool of savings is prudently administered. Under the SIS Act, primary responsibility for the prudent management of superannuation funds is placed on trustees. It is therefore the responsibility of trustees to ensure that this pool of savings is secure and that it is available to meet the purpose of providing an adequate level of retirement income for fund members.

2.69 The Committee notes that both ASFA and the AIST provide training for trustees, in order to assist them to perform their duties to the highest possible standard, and update their knowledge in keeping with the changing industry requirements.

2.70 The importance of adequate training and knowledge to fulfil those responsibilities was highlighted in evidence to the inquiry by groups such as IFSA and the AIST. For example, IFSA advised the Committee that, in its view:

> … the people who are taking on the role of trustee need to find a way to ensure that they know what their responsibilities are, that they have adequate training and knowledge to fulfil those responsibilities…[61]

2.71 During the course of the inquiry, the Committee attempted to ascertain whether the regulators were satisfied with the levels of training and skill of trustees.

2.72 In response to questions from the Committee, APRA advised that, in its view, the level of knowledge among trustees is higher now than it was five years ago. APRA also advised that that the level of expertise required to be a trustee of a ten-member employer sponsored fund is very different to that required by a trustee of a large industry fund. In this regard, APRA's view was that the level of knowledge is generally better at the 'big end of town' rather than at the 'small end of town' where the level of expertise required does not need to be as high.[62]

2.73 While acknowledging that there are many avenues for trustees to receive training, such as ASFA and AIST courses and IFSA conferences, APRA also observed that some funds and some trustees did need more training, particularly in relation to the application of knowledge about investment practices. APRA explained that, in its view:

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60 Committee Hansard, p. 111.

61 Committee Hansard, p. 70.

62 Committee Hansard, p. 115.

> Perhaps one of the issues where there might still be a weakness is in the understanding of how the generic knowledge they might have obtained about investment decision making actually relates directly to the particular fund that the person might be sitting on. [63]

Standards for trustees

2.74 The Committee notes that currently most offence provisions in the SIS Act are drafted as fault liability offences. Under the proposed amendments, superannuation trustees (usually voluntary or honorary trustees) would be subject to the same strict liability types of provisions which were introduced for trustees of collective investment vehicles under the *Managed Investments Act 1998* (usually paid, professional trustees).

2.75 A number of witnesses considered that the regime should not be so severe where trustees are voluntary. For example, the Corporate Super Association expressed the view that:

> If (the proposed Bill) were brought in … then it would definitely put off the not for profit, altruistic mutual basis of trusteeship and professionalise it. Essentially, this level playing field moves us into the area of professionalism which is money value. No longer will you have trustees who are doing this for the mutual benefit of their members.

2.76 However, IFSA's view was that it should not matter whether trustees are honorary or professional, 'they should apply the same due diligence and care and be held at the same standards.'[64]

2.77 APRA further expressed the view that it should not matter whether the trustee is honorary or professional, if people are managing other people's money, they should be subject to the same standard, and that, if two standards were to apply to public offer and non-public offer funds, there could be definitional difficulties in determining which fund should comply with which standard, as some funds are a hybrid of the two types. [65]

Compliance costs

2.78 Another significant concern to some industry groups, like SISFA, the IFF and the AIST, was the perceived shift of compliance costs from regulators to trustees, and the potential increases in those costs.

2.79 For example, SISFA submitted that, in its opinion, shifting the burden of proof and associated costs of enforcing the relevant provisions from the regulator to the trustees should be opposed. In its view, any attempt to shift this burden is contrary to the government's policy embodied in *Superannuation Legislation Amendment Act (No 3) 1999* that self-managed funds were to be subject to a less onerous and consequentially less costly prudential regulation regime.[66]

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63 Committee Hansard, p. 114.

64 Committee Hansard, p. 70.

65 Committee Hansard, p. 110.

66 Submission No 20, pp. 1-2.

2.80 The AIST submitted that, while it was not possible to provide a firm dollar amount, its members believed that their costs would increase. In the view of the members of the Institute, this reflects not only the increased costs of insurance and new procedures to ensure trustees were directly involved with decisions currently delegated to advisors, but also increased legal costs to prepare a defence where the onus of proof has been transferred to the trustee. The Institute further submitted that one large fund had advised that its current annual compliance costs are already in the vicinity of $300,000.[67]

2.81 ASFA was also concerned that the reversal of the onus of proof, while creating a cost saving for regulators, 'appears to be a move towards "user pays" and will be an added burden for superannuation funds who already pay for supervision by the regulator through the Supervisory Levy.'[68] The NRMA supported this view, stating that it already pays significant levies to APRA and as such any increase in NRMA's costs associated with increased compliance, and the collection of evidence should be reflected in the decrease in levies paid by the NRMA to APRA.[69]

2.82 The Institute of Actuaries of Australia submitted that, although it would be difficult to quantify the extent to which the changes proposed by the Bill would add to trustee/fund costs, there were some areas where increased costs could be expected. The Institute advised that indicative costs might range from $5,000 to $50,000 for a 'compliance' review; while indicative additional annual costs might range from $1,000 to $5,000.[70]

2.83 Treasury advised that, in its view, the argument that trustees would face increased costs in ensuring compliance with the SIS Act and in defending possible criminal prosecutions was based on a misunderstanding of the purpose of the amendments.[71] Further, Treasury submitted that trustees who are complying with existing requirements should not face an increase in compliance costs under the new provisions. Treasury advised that there would be no increase in compliance costs because the trustees should be complying already with these requirements. 'To the extent they are not, there may be an increase in compliance costs but they should be meeting the requirements already.' [72]

2.84 ASIC further submitted that the onus of proof is not reversed in strict liability offences, and that in its view, there is unlikely to be any significant cost saving to the regulator or the prosecution as a result of offences being made strict liability.[73]

Legislative uncertainty

2.85 Another issue of concern to some industry groups was the uncertainty associated with the absence of criteria for disqualification of trustees and other superannuation managers as being not 'fit and proper'.

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67 Submission No 21.

68 Submission No 8, p. 3.

69 Submission No 11, p. 2.

70 Submission No 10, p. 3.

71 Submission No 17, p. 3.

72 Committee Hansard, p. 143.

73 Submission No 14, pp. 9-10.

2.86 Currently the regulator has the power under section 120 of the SIS Act to disqualify a trustee, custodian, or investment manager where the person has been convicted of an offence involving dishonest conduct; or a civil penalty order has been made in relation to the person; or the person is an insolvent under administration. Under the proposed amendment to section 120 of the SIS Act, the regulator may now disqualify an individual if satisfied that the person has contravened the SIS Act on one or more occasions and that the nature or seriousness of the contravention/s provides grounds for disqualification. In addition, the regulator has a further power to disqualify an individual where it is satisfied that the individual is otherwise not a 'fit and proper' person to be a trustee, investment manager or custodian.

2.87 SISFA was one of several groups to express concern at the lack of guidance within the legislation as to when a person would be considered not to be 'fit and proper'.[74]

2.88 In answer to this concern, APRA advised that it intends to monitor the cases that fall within this category with a view to developing indicative guidelines at a later date. The regulator further submitted that it would be difficult to develop guidelines now without sufficient industry experience of the new legislation.[75]

2.89 APRA also advised that, while there are currently no international standards for the superannuation industry, there are international 'fit and proper' test standards for the banking and insurance industries, and that in developing indicative guidelines it would have regard for these standards in order to harmonise standards for insurance, life companies, superannuation and banks. [76]

2.90 In the meantime, APRA also submitted that it already has available to it a 'fit and proper person' test in relation to disqualification of auditors (which is already familiar to industry) and that any guidelines developed are expected to reflect similar criteria to the test for auditors. [77]

2.91 In response to a question about the availability of an appeal mechanism in relation to such a disqualification order, APRA advised that appeal mechanisms already exist through natural justice provisions and internal reconsiderations and that the regulators' decisions are reviewable by the Administrative Appeals Tribunal (AAT).[78]

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74 Submission No 6, p. 4.

75 Submission No 13, p. 6 and Committee Hansard, p. 126.

76 Committee Hansard, pp. 127-128.

77 Submission No 13, p. 6.

78 Committee Hansard, pp. 126-128.

CHAPTER 3 - CONCLUSIONS AND RECOMMENDATIONS

Consultation

3.1 The Committee notes that the Bill contains amendments which are mostly of a technical nature. The Committee considers that, even when proposed amendments to a bill are largely of a technical nature, it is good practice to consult with stakeholders likely to be affected. In the view of the Committee, some of the industry's uncertainties and fears of the proposed legislation may have been avoided if consultation had occurred at an earlier stage.

3.2 The Committee notes the absence of such consultation prior to the introduction of the Bill and considers that it is regrettable that such consultation did not occur. The Committee also notes that there appeared to be some confusion between policy officials and regulators over which area had the responsibility for such prior consultation.

3.3 The Committee considers that it would be helpful in future to clarify the roles and responsibilities of officials involved in preparing draft legislation so that it is clear which area is responsible for either consulting, or ensuring that appropriate consultation occurs, prior to the introduction of a bill. However, the Committee also notes that consultations have occurred since the Bill was introduced, and that industry has now had the opportunity to become better acquainted with the proposed amendments.

Policy rationale – need for a better Explanatory Memorandum

3.4 The Bill makes a range of amendments to the *Superannuation Industry (Supervision) Act 1993* (SIS Act) including amendments to enforcement powers and offence provisions. It contains substantive amendments to various offence provisions that change the nature of the offences in question, and also ensures that they are compliant with the Criminal Code and that they are consistent with similar provisions contained in the Corporations Law and in the *Managed Investments Act 1998*. The Committee considers that the amendments to the SIS Act proposed in the Bill represent an appropriate response to the difficulty experienced by regulators in bringing enforcement actions.

3.5 The Committee notes that reactions to the Bill were mixed and that although the majority of evidence initially opposed the Bill, this appears to be because of a misunderstanding about the policy rationale of the Bill – the purpose of the proposed amendments, including the changes to the penalty regime, and the way in which the proposed amendments would be implemented, including the way in which the new enforcement powers are intended to be used.

3.6 The Committee notes that many witnesses were critical of the absence of information in the Explanatory Memorandum which would have explained the reasons for the proposed amendments and the way in which they were proposed to be implemented.

3.7 The Committee considers that much of the initial adverse reaction to the Bill could have been overcome if there had been an appropriate level of detail in the Explanatory Memorandum and appropriate consultation. The Explanatory Memorandum should be sufficiently informative as a users' guide to the Bill and should make clear the intent of the Bill in the event that the Bill itself is not sufficiently clear.

3.8 The Committee finds that the existing Explanatory Memorandum, as amended by the House of Representatives, did not provide the appropriate level of information to users who wished to understand the meaning of the proposed legislation and the way it was proposed to be implemented.

3.9 In order to ensure that the Explanatory Memorandum clarifies not only the reasons for the Bill but also clarifies the implications of the proposed amendments, the Committee considers that it would be appropriate for Treasury to prepare a new Explanatory Memorandum for this Bill.

Penalty regime

3.10 The Committee notes that the proposed penalty regime is designed to make the SIS Act compliant with the Criminal Code and to overcome the difficulties experienced by regulators in taking enforcement action under the SIS Act.

3.11 The Committee notes that criminal penalties already exist under the current legislation and that the Bill does not represent a change to the penalty regime, in terms of increasing the penalties applicable. The Committee also notes that those trustees already complying with the current regime have no need to fear the proposed new regime, because there is no increase in the penalty regime.

3.12 The Committee notes that the need for regulators to resort to invoking formal enforcement powers has arisen in only a small number of cases to date and that the regulators would lose credibility if they deployed a disproportionate amount of resources to the prosecution of minor or inadvertent breaches of the SIS Act.

3.13 As mentioned above, it appears that much of the concern about the proposed penalty regime, and the fear concerning the inappropriate use of enforcement powers by the regulators, has arisen because of apparent misunderstandings by industry about the content and intent of the Bill. As also mentioned above this could have been avoided by an improved Explanatory Memorandum and consultation with industry prior to the introduction of the Bill. In order to ensure that inappropriate use of their powers is not made, the Committee will continue to monitor the use made by the regulators of their enforcement powers.

Representative trustee system

3.14 The Committee acknowledges the role of the voluntary, representative trustee system but considers that it is appropriate for the same standard to apply to voluntary or honorary trustees as applies to professional trustees. The Committee welcomes the consistency which the proposed legislation brings.

3.15 The Committee considers that people who manage other people's money must appreciate and accept the responsibilities of the position and that superannuation fund members have a right to expect a certain minimum level of competence and skill from their trustees, whether those trustees are paid professionals or unpaid volunteers.

3.16 The Committee is aware that when the SIS Act was first introduced, some trustees opted out, and that it is therefore not surprising that some may wish to reconsider their future under the proposed new regime.

Trustee education and training

3.17 The Committee recognises the increasing complexity of trustee responsibilities in an environment characterised by the continual and rapid growth of superannuation assets and the need to diversify investments to maximise returns to members. Given that there is now in excess of $450 billion in superannuation assets, the prudent management of such funds by trustees with appropriate levels of training and skill is essential.

3.18 Within this environment, the Committee believes that there is a new awareness among some of the representative groups of the need for enhanced and on-going training for trustees, especially for those managing larger funds.

3.19 The Committee welcomes any moves to ensure that there is an adequate level of training, knowledge and skill level among trustees and supports efforts designed to improve the standards of stewardship by trustees in the performance of their duties.

3.20 As part of APRA's role in monitoring overall fund performance, the Committee considers that it would be useful for APRA to monitor whether trustees are receiving appropriate training, commensurate with their responsibilities.

Compliance costs

3.21 The Committee notes that several submissions referred to the potential for increased costs of compliance. However, it concludes that this issue is not likely to be as onerous as thought, because those already complying will have no need for additional costs.

Criteria and guidelines

3.22 The Committee notes the calls from some parts of the industry for the identification of criteria and guidelines which would be applied by the regulators when seeking to disqualify a person as being not 'fit and proper'.

3.23 The Committee notes that APRA is considering the development of such guidelines, and considers that the development of such guidelines would alleviate any uncertainty surrounding the definition of 'fit and proper'. The Committee considers that it would be useful for APRA to develop the criteria and guidelines in consultation with industry.

Overall conclusion and recommendations

3.24 The Committee concludes that the Bill represents a significant step in further aligning all Commonwealth Acts and Regulations with the Criminal Code, and harmonising the SIS legislation with the Corporations Law. The proposed Bill will provide a more consistent standard for those who undertake the responsibilities of trusteeship, and for those who provide services to the superannuation industry, including auditors, actuaries, investment managers and custodians.

3.25 The Committee appreciates the concerns expressed by some industry participants at the commencement of its inquiry. Given the lack of consultation and the inadequacy of the Explanatory Memorandum which accompanied the Bill it is not surprising that the Bill initially received such an adverse reaction from many industry participants.

3.26 In order to ensure that the Explanatory Memorandum clarifies not only the reasons for the Bill but also clarifies the implications of the proposed amendments, **the Committee recommends that Treasury prepare a new Explanatory Memorandum for this Bill.**

3.27 The Committee considers that it has fulfilled an important role in obtaining evidence which has clarified both the rationale for, and implications of, the proposed amendments and that this new information should allay many of the fears previously expressed. **The Committee therefore recommends that the Bill be agreed to.**

Senator John Watson
Committee Chair

SUPPLEMENTARY STATEMENT BY LABOR SENATORS

SENATOR NICK SHERRY
Labor Senator for Tasmania

28 August 2000

Senator John Watson
Chair of the Senate Select Committee on
Superannuation and Financial Services
S1.42
Parliament House
Canberra ACT 2600

Dear Senator Watson

As you would be aware the Labor Members of the Senate Select Committee on Superannuation and Financial Services have agreed with the report of the Committee on the Financial Sector Legislation Amendment Bill (No. 1) 2000.

There are a number of statements Labor Senators wish to make however, which do not appear in the report.

In this light I would request that the following Labor Senators' Statement be printed along with the report.

Yours sincerely

Senator Nick Sherry

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Labor Senators' Statement

Government failure to consult

The Committee has already discussed the issue of the lack of industry consultation in some detail. However, it is again disappointing that both the Treasury and APRA considered that the changes proposed in this bill would not cause major concern within the industry. That judgement proved to be completely inaccurate and wrong. The changes in this bill caused major concern amongst key industry bodies and Treasury's assessment that the bill implemented changes that were considered to be 'machinery or technical in nature' showed poor judgement. Labor Senators strongly support the Committee's consideration that it is good practice to consult with stakeholders likely to be affected, even if the amendments are considered to be technical in nature.

The case for change

Much evidence was provided to the Committee about the efficiency and effectiveness of the existing laws relating to trustee liability and penalties. While the APRA was not able to provide specific and detailed statistics relating to breaches of SIS and prosecutions, the evidence provided suggests that the current system works well.

However, APRA strongly argued that the legislative changes in this bill would have assisted it in taking action against some five or six trustees representing around 50-200 fund members and some $0.5-$10 million were under risk. While these figures represent a small part of the growing superannuation funds under management and fund members, they are of major significance for the retirement incomes of individual fund members; particularly if Governments are required to outlay funds for retirement income support that would not otherwise have occurred. Governments should make protecting the interests of fund members a top priority. The continued growth of superannuation, albeit at a much slower pace than would have occurred under a co-contribution policy and without a surcharge tax, will require even better vigilance against theft and fraud or bad risk management practices.

APRA appears to have a good record in using its judgement to assist trustees to comply with the requirements of SIS and other regulations, rather than heading down the road of formal prosecution. The statistics provided by APRA show that, in most cases, the regulator has used persuasion and negotiation to remedy problems trustees have experienced in complying with the superannuation laws. This practice of itself needs to be closely monitored by the Parliament to ensure that it is not abused. However, APRA's track-record of judicious use of its existing powers should allay some of the fears industry participants have that this new bill will give the regulator new enforcement powers that will be wielded with abandon. Labor Senators welcome APRA's assurances that it will continue to exercise judgement in assisting trustees to comply with the superannuation laws. This will be particularly relevant where the bill gives the regulator the option of utilising 'two-tier' offences.

The case proposed by the Australian Institute of Superannuation Trustees for a system of graduated financial penalties could be given further consideration and should certainly be part of a comprehensive retirement incomes review.

Preservation of the representative super trustee system

An integral part of Australia's world-class retirement income system – and a part that attracts great international interest – is the system whereby ordinary fund members can become a member of the trustee board and directly influence the decisions of the fund.

Some evidence to the Committee suggested that this bill undermines the representative trustee system to such an extent that ordinary fund members will no longer want to be trustees for fear of onerous penalties.

Labor Senators accept the evidence of the Attorney General's Department, Treasury, APRA and ASIC that this bill does not change the penalty provisions applying to breaches of SIS (two new offence provisions are included; holding oneself out as an actuary or auditor and requirements of former trustees to provide information to acting trustees – these are considered to be beneficial and are not opposed). Trustees will have no change to the penalties that apply to them and this should not act as a disincentive to ordinary fund members wishing to become trustees.

The bill does, however, change the system of liability, from fault to strict, and the defences available for breaches of SIS have also changed. This is of significant concern to many industry participants who appeared before the Committee.

Those trustees who comply with the SIS and other requirements need not worry about any type of liability, whether fault or strict. Those who inadvertently breach the superannuation laws may be subject to the new forms of liability although Labor Senators have noted the APRA's assurance that it will not act in a heavy handed way against accidental or inadvertent breaches. In the event that a trustee is prosecuted under the new liability provisions, a defence is available that should provide trustees with a legitimate way of avoiding prosecution. However, the new liability provisions should be closely monitored by the Parliament to ensure that they are effective and efficient in meeting their policy intention of better protecting workers' retirement incomes.

The representative trustee system should remain a cornerstone of the superannuation system and provide ordinary fund members with much confidence and opportunity. While Labor Senators take very seriously concerns that this bill will undermine that system, we are not convinced that on the face of it, this bill will do that. Labor will closely monitor the system for any significant impact on the representative trustee system and will respond quickly to the Parliament if required.

Compliance costs

The Committee received evidence from a number of industry players that the bill will significantly increase compliance costs for trustees. Any change that significantly increases costs must be taken very seriously as such an increase can only result in lower retirement incomes for fund members. The balance between ensuring appropriate prudential supervision and risk management against possible higher compliance costs is difficult.

Trustees who appropriately comply with the law should not incur any significant cost increases as a result of the bill. Those trustees who inadvertently breach the SIS Act and who are treated appropriately by the APRA (as they appear to have been in the past using persuasion and negotiation to remedy problems) should also not incur significant cost increases. However, those trustees who are required to make a defence under the strict liability provisions may incur some cost increases. Labor Senators again expect that this type of action will be used judiciously by the APRA and should not affect a large number of well functioning funds. This should be closely monitored and the Parliament advised if the case is different.

SUPPLEMENTARY STATEMENT BY THE AUSTRALIAN DEMOCRATS

PARLIAMENT OF AUSTRALIA • THE SENATE

SENATOR LYN ALLISON
Australian Democrat
Senator for Victoria

29 August 2000

Senator John Watson
Senate Select Committee on Superannuation & Financial Services
Parliament House
Canberra ACT

Dear Senator Watson

FINANCIAL SECTOR LEGISLATION AMENDMENT BILL
SUPPLEMENTARY STATEMENT

The Democrats broadly agree with the conclusions in the Committee's report. However, I did want to place a number of observations on the record.

The Senate has long been concerned about the increasing propensity of Governments to impose "strict liability" and the associated reversal of the onus of proof into offences in Federal law.

The new offences proposed remove the elements of recklessness and intent from the statutory formulation of the offences, and transform them expressly into strict liability offences, wherein the prosecution bears no onus of proving the mental element. If the prosecution can prove the factual requirements of the offence, the *accused must then show* that he or she did *not* have a blameworthy intent; the accused must prove statutory defences available in the Crimes Act (Cth) which generally involve proving he or she was under a mistaken but reasonable belief regarding the acts of the offence.

Dixon J in *Proudman v Dayman* (1941) 67 CLR 536 at 540, stated that "As a general rule an honest and reasonable belief in a state of facts which, if they existed, would make the defendant's act innocent affords an excuse for doing what would otherwise be an offence."

It has been argued that placing the onus of proving a reasonable belief on the defendant is justified only where he or she is best placed to know what those beliefs would have been. The Scrutiny of Bills Committee has warned that problems arise for accused persons proving such a defence in instances where there is an element of "reasonableness" which must be proved, as in the case of the FSLA Bill. This is an *objective* element and evidence must be brought to *prove* reasonableness on the balance of probabilities. A defendant who innocently believed their actions were within the law might not be able to bring sufficient evidence to establish a *reasonable* belief.

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Strict liability offences with a reversal of onus of proof regarding a defence are often said to be acceptable where the legislation adopts penal measures in an effort to cast responsibility upon an individual to carry out their affairs so that the general welfare, for example, public safety, is not prejudiced. It is argued that a mental element should not be necessary in offences of this type, which are generally known as regulatory offences.

Some submissions have argued that the new defence on the Corporations Law to strict liability afforded by the "business judgement rule" should apply to alleviate the effect of these provisions. As APRA pointed out in its evidence, this is not relevant to these regulatory offences as:

"These are provisions that very specifically impose obligations to do certain things, compliance with which is required." (Hansard 14/8/00 p.109)

The business judgement rule is not available as a defence to criminal offences under the Corporations Law, although criminal offences under the law do require evidence of recklessness or intentional dishonesty (Corporations Law s. 184).

In terms of the SIS offences, the regulator is still also required to prove beyond reasonable doubt the existence of the factual situation before the strict liability applies. If the further element of intent is proved then under some provisions a higher level of penalty is applied.

As such, the provisions under the SIS Act are similar to those under the Corporations Law and Managed Investments Act, but not identical.

It is a difficult judgement as to whether strict liability laws should be allowed to be extended, even for regulatory offences. We note that these provisions do not change the penalties under the SIS Act nor the general scope of the offences.

On balance, the Democrats conclude that it is reasonable for a similar level of penalty regime to apply to superannuation as it applies to other elements of the financial sector. However, we believe that these sections will need to be very carefully monitored.

In evidence, APRA stated that it had no intention of pursuing inadvertent mistakes, pointing to only half a dozen or so cases it was proposing to prosecute in the last three years. APRA assurances are important, its previous behaviour even more important. If APRA fails to act properly with respect to these offences, I believe that the extension of strict liability and the defences to it should be reviewed again.

The Democrats believe that a lot of the concern across the superannuation industry about this bill flows from the lack of consultation with Treasury in the drafting of the legislation. This is frankly unforgivable. The problem is complicated by the inadequacies of the explanatory Memorandum outlined in the Committee's report.

We are concerned that this bill may result in undue concern among voluntary trustees about their duties being too onerous and reduce the pool of available candidates. Similar concerns were raised in 1993 when the SIS law came into effect and failed to

be realised. The onus is on APRA to ensure that adequate training and support is provided to trustees on how obligations can be met with a reasonable level of prudence.

In conclusion, I join with other members of the Committee in being critical of the way in which APRA and Treasury have developed and presented this bill. The Democrats are concerned about how it may operate in practice and are determined to ensure that the assurances of the regulator, in respect of trustees' performance, are kept.

Yours sincerely

Senator Lyn Allison
Australian Democrats spokesperson for Superannuation

APPENDIX 1

SUBMISSIONS

1. The Institute of Chartered Accountants in Australia
2. Institute of Actuaries of Australia
3. Corporate Super Association
4. Australian Institute of Superannuation Trustees (AIST)
5. Investment & Financial Services Association Ltd (IFSA)
6. Small Independent Superannuation Funds Association Ltd (SISFA)
7. William M. Mercer Pty Ltd
8. The Association of Superannuation Funds of Australia Ltd (ASFA)
9. Corporate Super Association (Supplementary)
10. Institute of Actuaries of Australia (Supplementary)
11. NRMA Limited
12. The Institute of Chartered Accountants in Australia (Supplementary)
13. Australian Prudential Regulation Authority (APRA)
14. Australian Securities & Investments Commission (ASIC)
15. Private Healthcare Employees Superannuation Fund
16. Australian Taxation Office
17. The Treasury
18. AIST (Supplementary)
19. APRA (Supplementary)
20. SISFA (Supplementary)
21. AIST (Supplementary)
22. APRA (Supplementary)

APPENDIX 2

LIST OF WITNESSES

Tuesday 11 July 2000, Sydney

Association of Superannuation Funds of Australia
Dr Michaela Anderson, Director, Policy and Research
Mr Zein El Hassan, Partner, Corrs Chambers Westgarth, Solicitors

Australian Institute of Superannuation Trustees
Ms Susan Ryan, President

Industry Funds Forum
Ms Ann Byrne, Convenor

Institute of Actuaries of Australia
Mr Anthony Coleman, Senior Vice President
Mrs Helen Martin, Vice President

Small Independent Superannuation Funds Association
Mr Graeme McDougall, Chief Executive Officer
Mr Robert Jeremiah, Chair, Technical Committee

Financial Services Consumer Policy Centre
Mr Khaldoun Hajaj, Researcher

Investment and Financial Services Association
Ms Lynn Ralph, Chief Executive Officer
Mr Philip French, Senior Policy Manager

Corporate Super Association
Mr Nicholas Brookes, Secretary

Institute of Chartered Accountants in Australia

Mr Richard Rassi, Member, National Superannuation Taskforce

Mr Keith Reilly, Technical Consultant

Australian Custodial Services Association

Mr Bryan Gray, Chairman

Ms Joanne O'Callaghan, Legal Adviser

Monday 14 August 2000, Canberra

Australian Securities and Investment Commission

Mr Joe Longo, National Director, Enforcement

Australian Prudential Regulation Authority

Mr Keith Chapman, General Manager, Specialised Institutions Division

Mr Christopher Fogarty, General Counsel

Mr Roger Brown, Senior Manager, Rehabilitation & Enforcement

The Treasury

Mr Steve French, General Manager, Financial Institutions Division

Ms Karen Whitham, Manager, Superannuation & Insurance Unit

Mr Dave Maher, Analyst, Financial Institutions Division

Attorney-General's Department

Mr Geoff McDonald, Senior Adviser, Criminal Law Reform Unit

Australian Taxation Office

Mr David Diment, Assistant Commissioner, Compliance, Superannuation

Mr Nigel Murray, Manager, Superannuation Legislation

APPENDIX 3

BACKGROUND TO THE PROPOSED ENFORCEMENT AMENDMENTS

(Source: APRA Submission No 13, Attachment A)

Application of Criminal Code

It would appear that the application of the Criminal Code to certain offence provisions within the SIS Act has been misinterpreted by some industry commentators. Importantly, the Criminal Code does not itself impose any penalties or create any offences. Rather, it codifies common law principles built up over time by Court decisions relating to criminal liability (eg it sets out defences, the burdens and standards of proof that apply to the prosecution and defence, definitions of the elements of an offence etc).

The Criminal Code is to be progressively applied to all Commonwealth legislation to ensure consistent application of criminal law principles. It has been applied to new offences since 1997. The SIS Act is not being singled out in this regard; the Bill is merely the first of a series where the Code will be applied to existing offences.

Various offence provisions within the SIS Act need to be amended to ensure they are compliant with the Criminal Code. Where new offences are being created or existing offences amended within the Financial Sector Legislation Amendment Bill (No. 1) 2000 (the Bill), the opportunity is being taken to make changes to ensure those offences are compliant with the Criminal Code. Remaining offences against the SIS Act are being addressed in another Treasury Bill (Treasury Legislation Amendment (Application of Criminal Code) Bill 2000).

It is important to note that the nature of the offence provisions contained in Division 2 of Part 2 of Schedule 3 of the SIS Act is not being changed. These technical amendments are, as required by the Criminal Code, merely clarifying that the existing offences are 'strict liability'.

Conversion of Fault Liability Offences to Strict Liability or Two Tier Offences

Background

Many contraventions of the SIS Act occur when a trustee (or another party such as an auditor) fails to perform specified obligations, many of which go to the core of the prudent operation of a superannuation fund. Examples include advising members of a significant event, keeping proper accounts of the fund, having the fund audited by an approved auditor, lodging annual returns with APRA, and keeping minutes of trustees' meetings.

Most offence provisions in the SIS Act are currently drafted as fault liability offences, where the prosecution must establish beyond reasonable doubt the existence of a state of mind or mental element such as intention or recklessness in order to prove the offence.

The experience of APRA, and previously the ISC, is that many fault liability offence provisions are virtually unenforceable, particularly in circumstances where the conduct that contravenes an offence provision involves a failure to act (eg failure by a trustee to provide information to the Regulator). The requirement to prove a mental element is a substantial impediment to proving such offences, due to the fact that evidence of intention or recklessness is often difficult to obtain, in the absence of admissions (ie, confessions) or independent evidence. This in turn reduces the effectiveness of using the prospect of prosecutions as a deterrent to imprudent behaviour or an incentive to negotiate a rectification plan.

This was highlighted in a case where the Director of Public Prosecutions (DPP) rejected the former ISC's recommendation to prosecute a trustee that had flagrantly breached numerous rules, including those relating to the provision of information to members. The DPP advised that for regulatory offences relating to the lodgement of documents or the provision of documentary information, it would be more appropriate if the legislation imposed a strict liability. The conversion of such offences to strict liability would mean that prosecutions could be more easily commenced and convictions more quickly obtained where the seriousness of the breach warranted action by the regulator.

On a number of other occasions, APRA/ISC has experienced similar difficulties and has not pursued in the first instance, or has ultimately abandoned, prosecution actions. As an illustration, APRA had a case where an accounting practice held itself out as a superannuation specialist and acted as trustee for 32 superannuation funds. The investment practices of the trustee led the then ISC to conclude that the assets of the fund members could be at risk. The trustee was then advised both orally and in writing on five separate occasions that this action constituted a "significant event" and as such was required to inform members as soon as practicable (in any event within three months). The trustee acknowledged its obligation but failed to meet the requirements within the required time. The assets of all the affected funds were subsequently frozen.

Proposed offence provisions

This Bill converts certain fault liability offences to strict liability offences. Strict liability does not require proof of a mental element but rather that a particular outcome occurred as a matter of fact. The offences to be converted relate to duties and obligations that are fundamental to the protection of superannuation investments. The shift towards strict liability is consistent with consumer protection measures contained in the *Corporations Law* and the *Managed Investments Act 1998*.

This Bill also converts a number of other fault liability offences to two-tier offences. The Regulator will have the choice of proceeding under the 'fault liability ' limb of the offence, if it considers that there is adequate evidence of a requisite mental element, or under the strict liability limb, if evidence of the mental element is not available or is insufficient. As the strict liability limb will place a lower burden of proof on the prosecution in relation to the offence, the penalty will be lower than for the fault liability limb.

The Regulator will not be permitted to proceed under both limbs of the offence. If the fault liability limb of the offence is pursued and a conviction is not secured, the Regulator will not be permitted to pursue a prosecution under the strict liability limb (ie, there will be no double jeopardy).

Under the Criminal Code, strict liability offences are subject to statutory defences of mistake of fact, intervening conduct or event, duress, sudden or extraordinary emergency and self-defence.

Issues

It has been argued that the conversion of the offence provisions, as outlined above, will shift the burden of proof from the Regulator to the Trustee. It is important to note, in this regard, that the prosecution in a criminal case will still have to prove beyond reasonable doubt that a particular act or omission occurred.

As the burden of proof on a defendant is an evidential burden, the defendant will only have to point to evidence that suggests a reasonable possibility that the defence applies. This is a considerably lower standard of proof than for the prosecution.

Further, a concern has been raised that there is no certainty as to when fault liability as opposed to strict liability may apply under two-tier offence provisions and it has therefore been suggested that guidelines should be prescribed. We would not like to see the flexibility of a two-tier structure undermined by rigid guidelines. Further, the existence of guidelines may give rise to manipulation by trustees. The superannuation industry is fragmented and diverse, and as such we consider enforcement needs to be tailored to the circumstances at the time on a case-by-case basis.

Disqualification

The SIS Act currently prohibits persons who have been convicted of offences involving dishonest conduct, or subject to civil penalty orders, or who are currently subject to external administration from acting as trustees, investment managers or custodians of superannuation entities.

APRA does not, however, have any discretion to disqualify other unsuitable persons from being involved in the management of superannuation savings. The need for a discretion to disqualify certain persons from managing superannuation savings was illustrated when action by the former ISC to remove a trustee of a mismanaged fund was circumvented through the establishment of another fund by officers of the former trustee. This fund was then marketed back to employers involved in the former fund.

In this instance and in others of which we are aware, the trustee is effectively acting as the "puppet" of an administrator. The Regulator currently has no credible preventative tools to address these prudential risks.

It is proposed therefore that the Regulator have the discretion to disqualify certain persons from acting as Trustees, Investment Managers or Custodians of Superannuation Entities where those persons:

- have contravened the SIS Act on one or more occasions and APRA is satisfied that the seriousness or frequency, or both, of the contraventions warrants the making of a disqualification order; or

- are otherwise not a fit and proper person to be a trustee, investment manager or custodian.

APRA would not be permitted to have regard to spent convictions under Part VIIC of the *Crimes Act 1914* when applying the fit and proper person discretion.

It is intended that the Regulator may revoke a disqualification order on application by the disqualified individual or on its own initiative. The decision to make a disqualification order or to refuse to revoke a disqualification order by the Regulator is reviewable both internally and by the Administrative Appeals Tribunal (AAT).

The question has been raised whether APRA will be issuing guidelines as to when a person would not be considered to be a 'fit and proper' person to be involved in the management of superannuation savings. APRA intends to monitor the cases that fall within this category with the view to developing indicative guidelines at a later date. However, it should be noted that the 'fit and proper' test is an international standard for banking and insurance regulators, and always includes both a competency element (relevant expertise) and a probity element (demonstrable integrity in business).

APRA already has available to it a 'fit and proper person' test in relation to the disqualification of individuals as approved auditors of superannuation funds. A total of thirteen auditors have been disqualified on this basis over the past five years. A further six have been asked to show cause why they should not be disqualified. They subsequently satisfied APRA that no action should be taken.

Enforceable Undertakings

To date, voluntary undertakings by trustees to remedy problems within certain time-frames have proved a cost effective and valuable supervisory tool for APRA. However, the usefulness of these undertakings is limited as they are not legally enforceable.

Currently, the Regulator's only option in the event of trustee's failure to comply with an undertaking is to impose administrative penalties or instigate enforcement action. Such enforcement/administrative remedies are often not timely, do not deal with the specific problem at hand, can be unduly harsh or difficult to pursue because of cost and evidence requirements. They can also significantly undermine the cooperative relationship the Regulator has with trustees and perhaps more importantly have a potentially adverse effect on members' interests.

The proposed amendments will ensure that written undertakings obtained from a trustee of a superannuation fund are enforceable through a direction from a Court. An undertaking may be withdrawn or varied at any time with the Regulator's consent.

The amendments mirror provisions that provide for enforceable undertakings in the *Trade Practices Act 1974* and the *Australian Securities and Investments Commission Act 1989* (ASIC Act).

Use Immunity and Derivative Use Immunity

A person subject to an investigation under the SIS Act can claim privilege in respect of the production of books ('use' immunity) or any information, document or other evidence obtained as a direct or indirect consequence of that person making an oral statement or signing a record of interview ('derivative use' immunity).

The current immunities, in certain circumstances, make it arduous for the Regulator to pursue prosecutions. Information provided by the Regulator in the course of a prosecution may be challenged as having been acquired directly or indirectly as a result of the privileged information. The Regulator has to then prove (on the balance of probabilities) that this is not the case. This places an unnecessary and costly burden on the Regulator.

It is important to note that the DPP has advised that the Regulator will have difficulties in achieving criminal prosecutions without this amendment.

Similar changes were made to the Corporations Law and the ASIC Act in 1992 following a recommendation by the Joint Parliamentary Committee on Corporations and Securities.

Time Limit on Prosecutions

Currently there are a number of significant SIS Act provisions where criminal proceedings must be commenced within one year of the commission of the offence. This time limit is commonly impractical as the Regulator would not have identified the offence within one year nor gathered evidence sufficient to initiate a prosecution. Specifically, sufficient time is required for investigation, preparation of briefing material to the DPP and for the DPP to commence the prosecution.

In gathering this evidence the Regulator may rely on the APRA annual returns provided by superannuation funds. The argument to extend the time limits on prosecutions has more weight as these returns are due four months after the end of the financial year, which can be sixteen months from when the offence was first committed.
The Bill proposes to amend the time limits, so that prosecutions can be commenced within five years after the date of the offence, or with the Ministers consent at any later time.

The proposed provisions are based on section 1316 of the Corporations Law.

Approved Auditors and Actuaries

Currently there is no effective sanction to prevent persons from holding themselves out to be an approved auditor/actuary without the requisite qualifications. We have identified several occurrences a year of this behaviour.

Such action increases the prudential risk to member benefits of the affected fund. It also disadvantages trustees who are acting in good faith when seeking the services of professionals to assist them in the discharge of their roles and responsibilities.

Assisting an Acting Trustee

When an acting trustee is appointed to a superannuation entity, APRA is required to make a written order vesting the property of a superannuation entity in the acting trustee.

Currently, there are no obligations imposed on the former trustee to assist the acting trustee in the location and transfer of the superannuation entity's property. In one instance, an acting trustee has had to take possession of an administrator's office to obtain records of the fund's membership and assets.

The proposed amendment will impose an obligation on a former trustee to provide the books and records of a superannuation entity to an acting trustee and to assist the trustee with the

transfer of property of that entity. It will reduce costs and legal risk for acting trustees, so helping them maximise the assets of members already disadvantaged by the behaviour of the former trustees.

APPENDIX 4

COMPARISON OF THE CURRENT AND PROPOSED PENALTY PROVISIONS

(Source: APRA Submission No 13, Attachment B)

ATTACHMENT B

FINANCIAL SECTOR LEGISLATION AMENDMENT BILL (NO.1) 2000
PROPOSED AMENDMENTS TO OFFENCE PROVISIONS CONTAINED IN THE SIS ACT

FAULT LIABILITY TO STRICT LIABILITY OFFENCE

SIS Section	Description	Current penalty	Proposed penalty	Administering Body
36(2)	Lodgement of annual returns and information to accompany annual return, to APRA	Criminal; 50 p/u; fault	Criminal; 50 p/u; strict	APRA
36A(7)	Trustee of self-managed superannuation fund to lodge annual returns	Criminal; 50 p/u; fault	Criminal; 50 p/u; strict	ATO
103(3)	Duty to keep minutes and records for at least 10 years	Criminal; 50 p/u; fault	Criminal; 50 p/u; strict	ASIC ATO
104(2)	Duty to keep records of changes of trustees	Criminal; 50 p/u; fault	Criminal; 50 p/u; strict	APRA ATO
105(2)	Duty to keep reports for 10 years	Criminal; 50 p/u; fault	Criminal; 50 p/u; strict	ASIC
122(2)	Investment manager must not appoint or engage custodian without the trustee's consent	Criminal; 50 p/u; fault	Criminal; 50 p/u; strict	APRA ATO
124(2)	Trustee to appoint investment manager in writing	Criminal; 50 p/u; fault	Criminal; 50 p/u; strict	APRA ATO
254(4)	Trustee required to give prescribed information to regulator	Criminal; 50 p/u; fault	Criminal; 50 p/u; strict	APRA ATO ASIC

SIS Section	Description	Current penalty	Proposed penalty	Administering Body
299C(3)	Employer must inform trustee of TFN	Criminal; 10 p/u; fault	Criminal; 10 p/u; strict	APRA ATO
347A(6)	Reporting statistical information to Regulator	Criminal; 50 p/u; fault	Criminal; 50 p/u; strict	APRA ATO ASIC

FAULT LIABILITY TO TWO-TIER OFFENCE

SIS Section	Description	Current penalty	Proposed penalty	Administering Body
64(3)	Remittance of deductions by employer to trustee	Criminal; 100 p/u; fault	Criminal; 100 p/u; fault Criminal; 50 p/u; strict	APRA ATO
107(3)	Establish and publish rules for procedures for appointment of member representatives (employer sponsored funds)	Criminal; 100 p/u; fault	Criminal; 100 p/u; fault Criminal; 50 p/u; strict	APRA
108(3)	Establish and publish rules for procedures for appointment of additional independent trustee/director of corporate trustee (employer sponsored fund)	Criminal; 100 p/u; fault	Criminal; 100 p/u; fault Criminal; 50 p/u; strict	APRA
111(3)	Accounting records to be kept for 5 years	Criminal; 100 p/u; fault	Criminal; 100 p/u; fault Criminal; 50 p/u; strict	APRA ATO
112(5)	Accounts and statements to be prepared for each year of income	Criminal; 100 p/u; fault	Criminal; 100 p/u; fault Criminal; 50 p/u; strict	APRA ATO
113 (1) and (2)	Trustee must appoint an approved auditor to give the trustee a report in the approved form. Trustee must give the auditor any document that the auditor requests in writing	Criminal; 2 years; fault	Criminal; 2 years; fault Criminal; 50 p/u; strict	APRA ATO
113(4) and (5)	Approved auditor to give report to the trustee in the specified period	Criminal; 6 months; fault	Criminal; 6 months; fault Criminal; 50 p/u; strict	APRA ATO

SIS Section	Description	Current penalty	Proposed penalty	Administering Body
154(2)	Trustee obligations re: commissions and brokerage (public offer funds)	Criminal; 100 p/u; fault	Criminal; 100 p/u; fault Criminal; 50 p/u; strict	ASIC
169(3)	Trustee to comply with requirements of the regulations in relation to money	Criminal; 1 year; fault	Criminal; 1 year; fault Criminal; 50 p/u; strict	ASIC
260(2)	A person appointed to investigate and make s.257 report must provide report to APRA.	Criminal; 100 p/u; fault	Criminal; 100 p/u fault Criminal; 50 p/u; strict	APRA
262	Trustee must comply with requirements imposed under ss, 257, 258 and 259.	Criminal; 100 p/u; fault	Criminal; 100 p/u; fault Criminal; 50 p/u; strict	APRA
299F(4)	Trustee must request person who is beneficiary at commencement to quote TFN	Criminal; 100 p/u; fault	Criminal; 100 p/u; fault Criminal; 50 p/u; strict	APRA ATO
299G(4)	Trustee must request person becoming beneficiary after commencement to quote tax file number	Criminal; 100 p/u; fault	Criminal; 100 p/u; fault Criminal; 50 p/u; strict	APRA ATO
299H(6)	Use of TFNs for certain purposes- beneficiaries of eligible superannuation entities	Criminal; 100 p/u; fault	Criminal; 100 p/u; fault Criminal; 50 p/u; strict	APRA ATO

FAULT LIABILITY TO TWO-TIER OFFENCE (CONTINUED)

SIS Section	Description	Current penalty	Proposed penalty	Administering Body
299J(6)	Use of TFNs for certain purposes- beneficiaries of regulated exempt public sector superannuation schemes	Criminal; 100 p/u; fault	Criminal; 100 p/u; fault Criminal; 50 p/u; strict	APRA
299K(6)	Use of TFNs for certain purposes- applicants to become beneficiaries of eligible superannuation entities	Criminal; 100 p/u; fault	Criminal; 100 p/u; fault Criminal; 50 p/u; strict	APRA ATO
299L(6)	Use of TFNs for certain purposes- applicants to become beneficiaries of regulated exempt public sector superannuation schemes	Criminal; 100 p/u; fault	Criminal; 100 p/u; fault Criminal; 50 p/u; strict	APRA
299M(4)	Trustee of eligible superannuation entity must inform RSA provider or other trustee of TFN for certain purposes	Criminal; 100 p/u; fault	Criminal; 100 p/u; fault Criminal; 50 p/u; strict	APRA ATO
299Y(2)	Trustee of former regulated exempt public sector superannuation scheme to destroy records of tax file numbers	Criminal; 100 p/u; fault	Criminal; 100 p/u; fault Criminal; 50 p/u; strict	APRA

NEW OFFENCE PROVISIONS

SIS Section	Description	Current penalty	Administering Body
131B	Offence of holding oneself out as an actuary or auditor	Criminal; 50 p/u; strict	APRA ATO
141A	Former trustee obligation to give acting trustee books Former trustee obligations relating to the identification of property and transfer of property	Criminal; 50 p/u; strict Criminal; 50 p/u; strict	APRA ATO

NEW OFFENCE PROVISIONS

SIS Section	Description	Current penalty	Proposed penalty	Administering Body
18(7BA)	Trustee to notify APRA of breach of condition	Criminal ; 30 p/u; strict	Criminal; 30 p/u; strict	APRA
29(4)	Trustee to notify APRA of change in circumstances or breach of conditions	Criminal; 250 p/u; strict	Criminal; 250 p/u; strict	APRA
63(7A)	Trustee contravention of Regulator direction not to accept employer contributions	Criminal; 100 p/u; strict	Criminal; 100 p/u; strict	APRA ATO
63(10A)	Trustee contravention of Regulator direction to refund employer contributions and notify employer-sponsor	Criminal; 50 p/u; strict	Criminal; 50 p/u; strict	APRA ATO
121(4)	Trustee to inform the Regulator if it becomes disqualified	Criminal; 50 p/u; strict	Criminal; 50 p/u; strict	APRA ATO
123(4) and (5) 123(6)	Custodian fails to notify APRA in writing of its eligibility to be custodian. Failure to make arrangements for orderly dismissal of custodian.	Criminal; 50 p/u; strict Criminal; 100 p/u; strict	Criminal; 50 p/u; strict Criminal; 100 p/u; strict	APRA
140(3A)	Acting Trustee to notify appointment to beneficiaries	Criminal; 50 p/u; strict	Criminal; 50 p/u; strict	APRA

SIS Section	Description	Current penalty	Proposed penalty	Administering Body
163(3)	Trustee to keep copy of consent of expert	Criminal; 10 p/u; strict	Criminal; 10 p/u; strict	ASIC
201(4A)	Person to give the Regulator reasonable assistance in connection with application for civil penalty order	Criminal; 5p/u; strict	Criminal; 5 p/u; strict	APRA ATO
265(4)	Person to return identity card upon ceasing to be an inspector	Criminal; 1 p/u; strict	Criminal; 1 p/u; strict	APRA ATO ASIC
303(1A)	Incorrectly keeping records	Criminal; 40p/u; strict	Criminal; 40p/u; strict	APRA ATO ASIC
331(1A)	Person not to contravene conditions to which exemption is subject	Criminal; 5 p/u; strict	Criminal; 5 p/u; strict	APRA ATO ASIC
377(3A)	New trustee to notify appointment to members	Criminal; 250 p/u; strict	Criminal; 250 p/u; strict	APRA ASIC

APPENDIX 5

APRA'S ENFORCEMENT ACTIONS

(Source: APRA Submission No 19)

Subject: FINANCIAL SECTOR LEGISLATION AMENDMENT BILL (NO.1) 2000

We refer to your request to APRA for additional quantitative information above that contained in our submission of 4 August 2000 to support the enforcement provisions contained in the Financial Sector Legislation Amendment Bill (No.1) 2000 (FSLAB).

APRA has not specifically tracked the number of breaches or prudential concerns that we have for each particular offence provision contained in the SIS Act.

As noted in our submission, as a result of the DPP's advice, the ISC and APRA have been deterred from considering prosecution as a serious option. Importantly, only one criminal prosecution and one civil penalty action has been initiated by ISC/APRA since 1997 .

We have compiled some general enforcement data for the period 1 July 1994 to 30 June 1999 that may be of interest to the Committee

1998-99

- 4 trustees were removed.
- In 2 cases, concern about the fund led to the freezing of fund assets.
- 24 funds were made non-complying with resultant loss of their concessional tax status.

1997-98

- 31% of funds reviewed had shortcomings which would have created a potential risk to members' interests if not rectified.
- 4% of funds reviewed had serious shortcomings which required a closely supervised rectification program, formal investigation or enforcement action.
- In 2 cases, concerns about the fund led to the freezing of assets.
- The ISC applied for 6 warrants to search premises under SIS as part of a continuing investigation that commenced during 1996-97 into the affairs of 57 superannuation funds.
- The ISC issued a non-compliance notice under section 40 of the SIS Act to a fund on the basis of contravention of the in-house asset rules.
- The ISC referred 9 breaches by a trustee, relating to acting as a trustee of a superannuation fund while a disqualified person, to the Victorian DPP.

1996-97

40% of funds reviewed had shortcomings that would have created a potential risk to members' interests if not rectified.

2% of funds reviewed has serious shortcomings which required a closely supervised rectification program, formal investigation or enforcement action.

- ISC declared 2 funds to be non-complying, resulting in each losing all tax concessions.
- 31 freezing asset directions were issued.
- Investigators were appointed to 2 funds.

1995-96

- 50% of funds reviewed had shortcomings which would have created a potential risk to members' interests if not rectified.
- 8% of funds reviewed had serious shortcomings which required a closely supervised rectification program, formal investigation or enforcement action.
- The ISC appointed inspectors to investigate the affairs of 33 superannuation funds.
- 2 corporate trustees were removed.
- 1 approved trustee was revoked.
- 30 funds were affected by freezing directions issued by the ISC.
- 3 funds affected by a direction to a trustee not to accept contributions.
- Of all the investigations, three investigation reports were submitted and enforcement action was taken in relation to one fund.
- The ISC detected some instances of fraud and misappropriation of assets in superannuation funds. Of the cases of fraud identified over the period 1988 to 1996, total known losses are in the order of $17 million. However, many of these cases pre-dated SIS.

We have also attached an outline, as at 30 June 2000, of those superannuation matters that have been referred to our Rehabilitation and Enforcement (R&E) area from our supervisory areas for appropriate remedial action.

As part of APRA's new supervisory processes we attach a risk rating to each of the superannuation funds that we supervise. . This rating system is currently being revised and we will move from the alpha rating shown in the attachment to one of extreme, high, medium and low in future. These ratings are for internal purposes only and assist in us following the correct supervisory process for each institution.

In the time available to us we have not been able to produce a summary of current superannuation cases being handled by our R&E area with commentary on the advantages APRA would see as a regulator if we had the proposed powers. However, we will be happy to discuss such matters in more detail on Monday evening.

Regards

Keith Chapman

General Manager

Specialised Institutions Division

TOTAL CASES REFERRRED TO R&E

RE: SUPERANNUATION AND AUDITORS

As at 30 June 2000

Total Number	33
Total Assets (approx)	$146.7 million
Total Members (approx)	58,655 (excluding members in industry funds)

CASES GRADED AS 'E'

As at 30 June 2000

Total Number	18
Total Assets (approx)	$54.6 million
Total Members (approx)	31,109 (excluding members in industry funds)

CASES GRADED AS 'C' or 'D'

As at 30 June 2000

Total Number	15
Total Assets (approx)	$92.1 million
Total Members (approx)	27,546 (excluding members in industry funds)