The Parliament of the Commonwealth of Australia

# PRUDENTIAL SUPERVISION AND CONSUMER PROTECTION FOR SUPERANNUATION, BANKING AND FINANCIAL SERVICES

# FIRST REPORT

SENATE SELECT COMMITTEE

ON SUPERANNUATION AND FINANCIAL SERVICES

August 2001

Commonwealth of Australia

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# TERMS OF REFERENCE

On 22 September 1999 the Senate resolved that:

(1) A Select Committee on Superannuation and Financial Services be appointed with effect on and from 11 October 1999, with the same functions and powers as the Select Committee on Superannuation appointed by resolution of the Senate on 5 June 1991, and reappointed on 13 May 1993 and 29 May 1996, except as otherwise provided in this resolution.

(2) The committee inquire into matters pertaining to superannuation and financial services referred to it by the Senate and inquire initially into:

(a) prudential supervision and consumer protection for superannuation, banking and financial services;

(b) the opportunities and constraints for Australia to become a centre for the provision of global financial services; and

(c) enforcement of the Superannuation Guarantee Charge;

and report on paragraphs (a), (b) and (c) by the last day of sitting in June 2000.*

(3) The committee have power to consider and use for its purposes the minutes of evidence and records of the Select Committee on Superannuation appointed in the previous three Parliaments.

(4) The committee consist of seven senators, three nominated by the Leader of the Government in the Senate, two nominated by the Leader of the Opposition in the Senate and one nominated by other parties or independent senators.

(5) The nomination of the final member to be determined by agreement between the other parties and independent senators and, in the absence of agreement, duly notified to the President, the question of representation on the committee of other parties or independent senators be determined by the Senate.

(6) The Senate, by subsequent resolution, appoint a member of the committee as its chair.

*(On 8 June 2000 the Senate granted an extension of time in which to report to 7 December. On 6 November 2000, the Senate granted a further extension of time in which to report to 15 March 2001. On 6 March a further extension was granted to 24 May 2001. On 23 May 2001 a further extension was granted to 27 September 2001.)

# TABLE OF CONTENTS

## CHAPTER 3



## CHAPTER 4



## CHAPTER 5

## CHAPTER 6



## CHAPTER 7

# LIST OF TABLES



# LIST OF FIGURES

# PREFACE

This report is the first report on the Committee's reference to inquire into prudential supervision and consumer protection for superannuation, banking and financial services. The Committee has been unable to present a report on this term of reference until now because, although it has had this reference since October 1999, the Committee has been required by the Senate to report on a number of bills and has also conducted a number of other inquiries. In the period since its establishment, the Committee has presented 13 reports.

In this first report, the Committee has reported at a broad level on the adequacy of the regulatory framework, the overall performance of APRA and ASIC, some regulatory issues which came to the attention of the Committee and some issues associated with the SIS legislation which require further consideration. Reference is also made at a generic level to a number of case studies which were chosen by the Committee as examples of poor management by trustees and as illustrations of where the regulatory framework, and the role of the regulators, play such a crucial part. The Committee will report separately on these case studies in a second report under the same term of reference.

In summary, the Committee has found that, in the wake of the Wallis Inquiry reforms, the current regulatory framework is complex and confusing. More needs to be done to improve awareness of the roles of the regulators, especially to clarify the role demarcation between APRA and ASIC, and to streamline the entry point for consumers and others by having a one-stop shop for regulatory and consumer affairs.

The Committee also found that there was scope for APRA, as the major prudential regulator, to improve its performance in some areas, especially in the prudential supervision of superannuation entities. While some sectors receive top class advice, assistance and oversight, there are other areas, especially in the small to medium superannuation fund environment where there are serious shortcomings. In particular, the Committee considers that there is a great deal of scope for APRA to assist trustees to perform their duties more effectively and in the best interests of fund members. The Committee has made a number of recommendations in this regard.

The Committee considers that, generally speaking, ASIC is operating effectively. However, more particularly for APRA, the Committee has some reservations about the timeliness and effectiveness of the regulators' enforcement activities in some areas. In the wake of recent corporate collapses and the mismanagement of funds by some trustees, the Committee has also commented on the adequacy of resources for both regulators.

During the inquiry, the Committee also found that there are a number of regulatory issues which need to be addressed. These include the system of financial sector levies, accounting standards and standards of auditing, as well as a number of aspects of the SIS legislation which require clarification or investigation.

I commend the report to the Senate.

**Senator John Watson**
**Chair**

# RECOMMENDATIONS

***Regulatory framework***

**Recommendation 1 (paragraph 2.34)**

**The Committee recommends that the regulators, especially APRA and ASIC, work together to develop a coordinated strategy to improve awareness in the community about their respective roles and responsibilities.**

**Recommendation 2 (paragraph 2.44)**

**The Committee recommends that an Office of Regulatory and Consumer Affairs be established within APRA to act as a first point of call for consumers and others unsure of which regulator to approach regarding a particular issue.**

**Recommendation 3 (paragraph 2.49)**

**The Committee recommends that ASIC and APRA establish an employee industry secondment scheme to provide opportunities for staff to gain practical experience in the financial services industry.**

***Prudential supervision – trustees of superannuation funds***

**Recommendation 4 (paragraph 3.44)**

**The Committee recommends that APRA take steps to improve its performance in its oversight of trustees – whether they are trustees of small, medium or large funds - in particular by ensuring that trustees abide by the standards required to protect the best interests of fund members.**

**Recommendation 5 (paragraph 3.48)**

**The Committee recommends that:**

- **APRA act more quickly when matters come to its attention, and that APRA deals with those matters within its jurisdiction rather than passing them on to another regulator; and**
- **APRA and ASIC work more closely together to ensure a timely and effective response when matters come to their attention.**

**Recommendation 6 (paragraph 3.51)**

**The Committee recommends that APRA work more closely with superannuation funds, the Australian Institute of Superannuation Trustees and others to ensure that an appropriate level of education and training is provided to trustees, including a mandatory minimum level of training prior to service.**

**Recommendation 7 (paragraph 3.53)**

**The Committee recommends that APRA work more closely with the Australian Institute of Criminology to examine the best methods of crime prevention in superannuation funds administration.**

**Recommendation 8 (paragraph 3.65)**

**The Committee recommends that, in relation to annual reports to fund members, the minimum information requirement be expanded to include identification of:**

- **any payments to trustees from the fund, broken down into directors' fees and other payments; and**
- **all significant administration fees, charges and commissions paid to both fund and investment managers.**

**Recommendation 9 (paragraph 3.73)**

**The Committee recommends that:**

- **a trustee, fund manager or administrator who has been convicted of fraud should not practice again in the business of superannuation until certain conditions are met. These conditions might include not practicing for a period of at least 15 years, and then proving to APRA's satisfaction that they are a fit and proper person; and**
- **APRA maintain a listing of trustees, fund managers and administrators of superannuation funds which have been defrauded, regardless of whether they are regulated or not.**

**Recommendation 10 (paragraph 3.78)**

**The Committee recommends that:**

- **the Minister act expediently and efficiently in making a decision under the SIS Act to grant financial assistance to a fund that has suffered as a result of fraud or theft, to minimise the hardship that superannuation fund members could otherwise potentially suffer; and**
- **the provisions for financial assistance to funds under Part 23 of the SIS Act be extended to include an appropriate range of pension and retirement annuity products.**

***Prudential supervision – operational effectiveness of APRA***

**Recommendation 11 (paragraph 4.32)**

**The Committee recommends that APRA review its approach to risk management to ensure that it has transparent procedures in place to detect early warning signals of impending institutional or fund failure or loss.**

**Recommendation 12 (paragraph 4.56)**

**The Committee recommends that APRA increase the attention it gives to the prudential supervision of superannuation entities, especially those in the small to medium sized fund environment.**

**Recommendation 13 (paragraph 4.66)**

**The Committee recommends that the Government review the resources allocated to APRA, to ensure that it is provided with the resources necessary to match its level of supervisory responsibilities.**

***Consumer protection***

**Recommendation 14 (paragraph 5.97)**

**The Committee recommends that the Government review the resources allocated to ASIC to ensure that it is provided with the resources necessary to enable it to perform effectively its broad and increasing range of regulatory functions.**

***Regulatory issues – levies and standards of auditing***

**Recommendation 15 (paragraph 6.29)**

**The Committee recommends that APRA review the rationale for determining the quantum of supervisory levies, in order to remove inequities and ensure that levy payments more closely match the level of supervision.**

**Recommendation 16 (paragraph 6.49)**

**The Committee recommends that APRA work more closely with the Institute of Chartered Accountants in Australia to identify ways to improve adherence by auditors to professional and ethical standards and ensure genuine auditor independence.**

***Superannuation regime***

**Recommendation 17 (paragraph 7.87)**

**The Committee recommends that the Government review those aspects of the *Superannuation Industry (Supervision) Act 1993* (the SIS Act) referred to in this report.**

# ABBREVIATIONS

| | |
|---|---|
| ACCC | Australian Competition and Consumer Commission |
| ADI | authorised deposit-taking institution |
| AIST | Australian Institute of Superannuation Trustees |
| ANAO | Australian National Audit Office |
| APRA | Australian Prudential Regulation Authority |
| ASC | the former Australian Securities Commission |
| ASFA | Association of Superannuation Funds of Australia |
| ASIC | Australian Securities and Investments Commission |
| ATO | Australian Taxation Office |
| Basel Committee | Basel Committee on Banking Supervision |
| CEO | Chief Executive Officer |
| CNA | Commercial Nominees of Australia Pty Ltd |
| CRIMP | control, risk management, investment, management and prudential management model (APRA) |
| CSA | Corporate Super Association |
| ECMT | Enhanced Cash Management Trust |
| EPAS | Employees Productivity Award Superannuation fund |
| FICS | Financial Industry Complaints Service |
| IAA | Institute of Actuaries of Australia |
| ICAA | Institute of Chartered Accountants in Australia |
| IFSA | Investment and Financial Services Association Ltd |
| ISC | the former Insurance and Superannuation Commission |
| LESF | Law Employees Superannuation Fund |
| MOU | memorandum of understanding |
| RBA | Reserve Bank of Australia |
| RMS | Risk Management Statements |

| | |
|---|---|
| RSA | Retirement Savings Accounts |
| SAF | small APRA fund |
| SCT | Superannuation Complaints Tribunal |
| SIS Act | *Superannuation Industry (Supervision) Act 1993* (Cwlth) |
| SMSF | self-managed superannuation fund (ATO administered) |
| UCCC | Uniform Consumer Credit Code |
| Wallis Report | Financial System Inquiry, *Final Report,* (Chairman S Wallis), AGPS, Canberra, 1997 |

# CHAPTER 1

# INTRODUCTION

## Background to the inquiry

1.1 On 22 September 1999 the Senate agreed to establish the Select Committee on Superannuation and Financial Services with effect from 11 October 1999. The Committee was given the same functions and powers as the previous select committees on superannuation, with the addition of some further inquiry functions in relation to the financial services sector.

*Terms of reference*

1.2 The Committee's terms of reference included inquiring into matters pertaining to superannuation and financial services referred to it by the Senate and initially, inquiring into:

(a) prudential supervision and consumer protection for superannuation, banking and financial services;

(b) the opportunities and constraints for Australia to become a centre for the provision of global financial services; and

(c) enforcement of the Superannuation Guarantee Charge.

1.3 This report relates to term of reference (a). The Committee has already reported separately on the other terms of reference.[1]

1.4 In preparing its report, the Committee was surprised to discover that, even though there had been major structural and legislative change in the meantime, many of the issues addressed repeated those identified in the first report of the former Select Committee on Superannuation in 1992.[2]

1.5 Given the wide nature of the issues under inquiry, the Committee agreed to present two reports under this term of reference. The Committee determined that the issues would best be highlighted in a first generic report on prudential supervision and

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1 The Committee's report on *The opportunities and constraints for Australia to become a centre for the provision of global financial services* was presented to the President on 22 March 2001 and tabled on 26 March 2001; and the report on the *Enforcement of the Superannuation Guarantee Charge* was presented to the President on 27 April 2001 and tabled on 22 May 2001.

2 Senate Select Committee on Superannuation, First Report, *Safeguarding Super – The Regulation of Superannuation*, 1992. For example, the need for certainty in the regulatory framework, coordination between regulators, resourcing of regulators, the role of trustees, investment strategies, the role of auditors, protections from fraud and management of fund surpluses.

consumer protection, and a second, more specific report covering a number of case studies.

1.6 While reference is made in this report to these case studies in general terms, the Committee will report separately on the following case studies in its second report. The first four case studies relate to superannuation funds, while the fifth relates to solicitors' mortgage schemes:

- Queensland Employees Productivity Award Superannuation scheme (EPAS);
- Queensland Hairdressers Association Superannuation Fund;
- Queensland Law Employees Superannuation Fund (LESF);
- Commercial Nominees of Australia Pty Ltd (CNA); and
- solicitors' mortgage schemes in Tasmania.

1.7 Although it was not an actual case study, the Committee has monitored the developments associated with the collapse of HIH Insurance as part of this term of reference. The Committee will continue to monitor with interest both the outcome of the investigation by the Australian Securities and Investments Commission (ASIC) into possible illegalities associated with the collapse, and the outcome of the Royal Commission, announced by the Prime Minister on 21 May 2001 to examine the collapse.[3]

1.8 Since its establishment, the Committee has presented 13 reports to the Senate. The Committee was originally required to report on this term of reference by the last sitting day in June 2000. However, because a large number of bills and other inquiries have been referred to the Committee since its appointment, it has been unable to meet this deadline. The Committee therefore sought a number of extensions of time in which to report.

*Conduct of the inquiry*

1.9 The three original terms of reference were advertised in The Australian and The Australian Financial Review on 26 October 1999 and again on 25 and 28 February 2000, inviting submissions from interested organisations and individuals. A number of organisations were also contacted directly seeking submissions.

1.10 The Committee received over 200 submissions in relation to its inquiry into term of reference (a). A list of these submissions is at **Appendix 1**. The majority of these submissions related to the two case studies undertaken in 2001 – CNA and solicitors' mortgage schemes.

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3 The terms of reference of the Royal Commission were announced on 18 June 2001 – see **Appendix 5.** The Royal Commission is expected to start on 1 September 2001 and report on 30 June 2002.

1.11 The Committee conducted the inquiry into the three terms of reference concurrently, holding nine public hearings in the period May to October 2000. Issues relating to term of reference (a) were raised at nearly all of the hearings. A further five public hearings were conducted in 2001. Details of all witnesses who gave evidence at all of these public hearings are at **Appendix 2**. A list of all tabled documents and exhibits is at **Appendix 3**.

1.12 In conducting this inquiry, the Committee was mindful of other concurrent parliamentary committee inquiries which had some bearing on the Committee's inquiry. For example, the House of Representatives Standing Committee on Economics, Finance and Public Administration conducted an inquiry into the Australian Prudential Regulation Authority (APRA), the Joint Statutory Committee on Corporations and Securities conducted inquiries into fees on electronic and telephone banking and the Financial Services Reform Bill 2001, and the House of Representatives Standing Committee on Employment, Education and Workplace Relations conducted an inquiry into issues specific to mature-age workers. Wherever possible, the Committee sought to minimise duplication where there were issues in common.

**Structure of the report**

1.13 In conducting the inquiry, the Committee examined broad and generic issues associated with prudential supervision and consumer protection for superannuation, banking and financial services. Most of the evidence received pertained to superannuation; more limited evidence was received on banking, and even less on insurance.

1.14 Chapter Two provides an overview of the regulatory framework and assesses how well the arrangements are working.

1.15 Chapter Three discusses issues associated with the prudential supervision of superannuation, with particular reference to APRA's role in oversighting trustees.

1.16 Chapter Four considers APRA's role in the overall prudential supervision of superannuation entities and other financial institutions.

1.17 Chapter Five examines issues associated with consumer protection and the operational effectiveness of ASIC.

1.18 Chapter Six discusses some regulatory issues which were drawn to the Committee's attention during the inquiry, including financial sector levies, and accounting standards and standards of auditing.

1.19 Chapter Seven identifies some issues associated with the *Superannuation Industry (Supervision) Act 1993* (the SIS Act) which were raised during the inquiry.

## Acknowledgments

1.20 The Committee is grateful to the many individuals and organisations which took the time to write to the Committee to express their views, make submissions and/or give evidence at the public hearings. Their cooperation and willingness to provide additional information to assist the Committee in its inquiry was much appreciated and gave refreshing insights into the many issues facing prudential regulation and consumer protection in Australia.

1.21 The Committee would also like to acknowledge the assistance it received from the Information and Research Service of the Department of the Parliamentary Library. In particular, the Committee is grateful to the Department for agreeing to release Mr David Kehl on two occasions to assist the Committee in progressing the inquiry and assist with the drafting of major sections of the report. Mr Kehl also facilitated the Committee's work by providing a useful background paper on the regulatory framework and providing technical advice on many aspects of the inquiry.

1.22 The Committee also acknowledges the assistance provided by other officers of the Department of the Senate. In particular, Dr Sarah Bachelard provided valuable assistance in April this year by progressing aspects of the Committee's report.

# CHAPTER 2

# REGULATORY FRAMEWORK

## Current regulatory framework

2.1 In 1996-1997 there was a major review of the Australian financial system. The *Final Report* of the review, known as the Wallis Report, led to a major program of restructuring and rationalisation in the regulation of the Australian financial sector.[1] The current regulatory framework reflects the changes made in the wake of the Wallis Report.

2.2 The Report recommended the establishment of a single prudential regulator - the Australian Prudential Regulation Authority (APRA) - for the entire financial system, the idea being that such a body would provide:

- integrated and consistent supervision;
- regulatory neutrality;
- economies of scale and lower costs in regulation; and
- more flexibility to cope with likely future changes in the financial system.

2.3 Another new regulatory body was proposed to oversee regulation of corporations, financial market integrity and financial consumer protection, and its powers supported by new legislation. The former Australian Securities Commission (ASC) was to be abolished and its current functions absorbed by the new organisation. The new body would also assume responsibility for the administration of financial consumer protection from the Australian Competition and Consumer Commission (ACCC) and take on some functions of the Insurance and Superannuation Commission (ISC), which would be abolished.

2.4 These recommendations were adopted by the Government, resulting in the tripartite regulatory arrangement consisting of APRA, the Australian Securities and Investments Commission (ASIC) and the ACCC. Under the new regime, which came into effect from 1 July 1998, policymaking for financial services moved to the Department of the Treasury, APRA became the new prudential supervisory body and assumed responsibility for policy implementation while ASIC assumed responsibilities for regulation, consumer protection for financial services and enforcement. The ACCC continued to cover overall consumer protection and some aspects of financial service regulation.

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1 Australian Financial System Inquiry, *Final Report* (Wallis Report), Canberra: AGPS, March 1997.

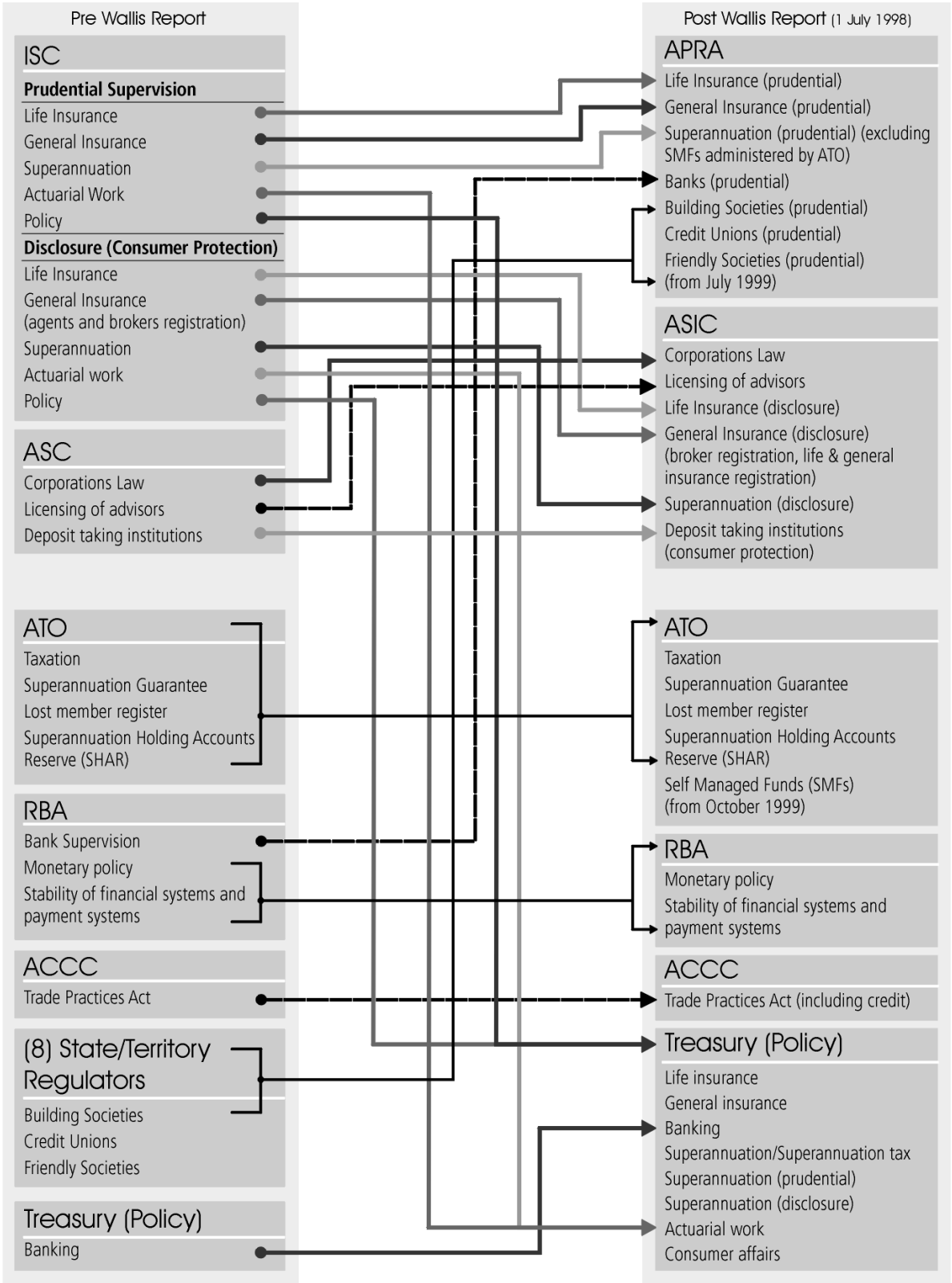
2.5 A number of significant changes to the banking sector were also adopted. The supervision of all banks was taken from the Reserve Bank of Australia (RBA) and given to the new single prudential regulator, APRA.

2.6 While the new regulatory agencies were designed to have substantial operational autonomy under a clear charter of objectives, the Government determined that there would be close cooperation between them, both bilaterally and through their participation in the Council of Financial Regulators, which was to be responsible for the coordination of their activities across a wide range of issues.[2]

2.7 A diagram showing how the arrangements have changed since the Wallis Report follows at Figure 2.1. More detail on the main players in the current regulatory framework is at Appendix 4.

2 'Reform of the Australian Financial System', Statement by the Treasurer, the Hon. Peter Costello, MP, House of Representatives, 2 September 1997, *The Treasurer Press Release No 102*, p. 3.

**Figure 2.1: Prudential supervision and consumer protection for superannuation, banking and financial services - the regulatory framework**



## Arrangements are complex and confusing

2.8 While some support was expressed for the current regulatory framework being functionally based rather than industry-sector based,[3] the Committee received evidence claiming that the current regulatory framework was complex and confusing. However, Dr David Knox of the Institute of Actuaries of Australia (and a Board member of APRA) stated that the roles of ASIC and APRA are evolving. He added:

> The process started only two years ago and there was always going to be a period of bedding down between those roles and a review of how they work together. I think the two bodies do work together, but that needs to be finetuned in some areas.[4]

*Industry groups*

2.9 William M Mercer Pty Ltd noted that even two years after the new regulatory arrangements were put in place, 'there is still much confusion over the various roles, particularly in regard to the division of duties between APRA and ASIC.'[5] William M Mercer added that:

> Superannuation funds (other than Self Managed Superannuation Funds) now have to deal with 3 regulators (ATO, APRA and ASIC). In addition to these regulators, the industry has to deal with Treasury on policy matters.[6]

2.10 The Corporate Super Association (CSA) echoed and expanded on how this confusion and complexity works out in practice. Mr Mark Cerche, the Chairman of CSA, recalled an instance where a member of his organisation had APRA and ASIC investigate the legality of a particular arrangement and the two organisations reached different conclusions. Despite the different opinions on the legality of the arrangement from each regulator, the CSA member had to comply with both decisions because if either regulator was wrong, a significant criminal penalty might apply. In the end, to avoid the risk of prosecution, the CSA member reluctantly unwound an investment arrangement and, as a consequence, had to increase the level of tax paid by the fund.[7]

2.11 While the issue of regulatory overlap and confusion was a concern for some regulated superannuation entities, it did not appear to be a concern for regulated general insurance entities. The Insurance Council of Australia stated that there had been no particular overlap problems that struck the general insurance industry as being difficulties. Mr Phillip Maguire, Deputy Chief Executive of the Council, said:

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3 For example, CPA Australia, Submission No 20, p. 1.

4 Committee Hansard, pp. 692-3.

5 Submission No 19, p. 3.

6 Submission No 19, p. 3.

7 Committee Hansard, p. 372.

> At this stage I would have to say that the lines of demarcation between APRA and ASIC have not really resulted in any substantial overlap problems for the general insurance industry. As you say, it is still reasonably early days as both the organisations are quite young, but we have found that the separation of market conduct as opposed to prudential regulation does seem to be working quite well.[8]

*Consumer groups*

2.12 Perhaps not unexpectedly, consumers and consumer groups have found the current arrangements confusing. For example, Care Inc advised the Committee that the split between ASIC and ACCC is not easy to understand for either consumers or consumer advocates, especially in the areas of credit and general financial services. They also stated that unrepresented consumers have difficulty in obtaining useful or understandable information from regulators, and that there are barriers in the manner in which consumers can make contact with regulators (including poor information about contact points). [9]

2.13 The Financial Services Consumer Policy Centre stated that there are some confusing overlaps in regulation which cause difficulties for consumers and advocacy organisations seeking policy direction or advice on matters where two or more regulators appear to have jurisdiction.[10] The Centre provided the Committee with the following examples of key overlaps in regulation:

- credit matters are regulated by State Government agencies under the Uniform Consumer Credit Code (UCCC), the ACCC, ASIC and various memoranda of understanding;
- electronic commerce matters are covered by the National Office for the Information Economy, the ACCC, and the ASIC; and
- direct marketing matters are regulated by bodies including the ACCC, ASIC, the Australian Consumers Association and a self-regulatory Code of Practice.[11]

2.14 The Centre also advised the Committee of the following gaps which it has identified in the regulatory framework:

- no regulation of bank fees and charges;
- no regulation of selling practices in superannuation;
- no regulation of some on-line financial intermediaries; and
- no national regulation of fringe credit (outside UCCC jurisdiction).[12]

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8 Committee Hansard, p. 250.

9 Submission No 10, pp. 1-2, Committee Hansard p. 721.

10 Submission No 26, pp. 4-5.

11 Submission No 26, p. 5.

2.15 Further discussion on the adequacy of the legislative and structural arrangements for consumer protection is in Chapter 5.

*Regulators' views*

APRA

2.16 APRA believes that the 1998 reforms are working well and meeting all reasonable expectation. The Authority argued that it was working to:

- integrate its prudential standards and supervisory approaches across all industry sectors;
- progressively improve the cost efficiency of supervision; and
- modernise its regimes in line with international regulatory trends and commercial practices.

2.17 APRA acknowledged that industry participants were bound to take some time to absorb the separation of responsibilities between APRA and ASIC and that both organisations have attempted to improve the industry's understanding of their respective roles.[13] APRA also stated that the regulators take considerable effort to co-ordinate their activities:

> There are regular high–level meetings and liaison meetings with all those agencies [Reserve Bank, APRA, ASIC and the Bureau of Statistics] which include Treasury and the APRA leadership. There is a lot of day-to-day contact; people know each other.[14]

ASIC

2.18 ASIC echoed APRA's comments about working closely with other regulators by explaining to the Committee its participation in the Council of Financial Regulators (with APRA and the Reserve Bank), and its close workings with APRA and the ACCC, which are facilitated through memoranda of understanding (MOU).[15]

2.19 ASIC acknowledged that problems arise from the jurisdictional overlap between the ACCC and ASIC, but stated that these issues have been at the margins and have been dealt with by goodwill and administrative arrangements. ASIC also has jurisdictional overlaps and matters of common interest with State and Territory consumer protection agencies, and has undertaken to establish MOUs with these agencies to cover matters of common interest. While the jurisdictional boundary is recognised by both ASIC and APRA, ASIC acknowledges that others may not be

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12 Submission No 26, p. 2.

13 Committee Hansard, p. 801.

14 Committee Hansard, p. 821.

15 Submission No 11, p.26.

aware of it. The Director of Regulatory Policy at ASIC, Mr Malcolm Rodgers, advised the Committee:

> …I am not sure that we have quite got to the stage where the divisions that I am saying are fairly clear to ASIC and APRA are necessarily as widely understood, either by industry or consumers, as they might be. It is a fairly hard task on which both ASIC and APRA have worked fairly hard to make it clear. But I must say that from time to time we do come up against situations where people express a bit of surprise that they are dealing with two regulators, and it is a slightly hard message to get across. We have by and large got it across fairly well, but I would not want to suggest that we have quite got to the end of that yet.[16]

ACCC

2.20 According to the ACCC, there is no jurisdictional overlap between it and other regulatory agencies. Mr Allan Asher, Deputy Chairman of the ACCC, informed the Committee that:

> The commission … meets regularly with members of ASIC. We have been doing that for many years and I do not believe there has been any evidence of overlap … In my experience of at least 13 years with the commission, I cannot think of a single case where it has been alleged that there was duplication of enforcement action. I do not think there is any issue there.[17]

2.21 According to the ACCC, there is no jurisdictional overlap because of the Commission's past experience in dealing closely with State and Territory agencies. The Commonwealth laws that the ACCC enforces are almost identical to State and Territory laws covering the same subject matter. For more than 20 years, the ACCC has had close relationships with those State and Territory agencies, enabling them to determine priorities and decide which agency would take regulatory action.[18]

2.22 The ACCC did acknowledge a number of gaps in current regulatory arrangements, mainly in financial services. For example, credit type products are regulated by the ACCC whereas debit and investment products are not.[19]

**One-stop shop for regulatory issues**

2.23 In light of the confusion over the jurisdictional boundaries between regulators, in particular between ASIC and APRA, the Committee was advised by groups such as the ACCC and others that a solution may be to establish a 'one-stop shop' for regulators.[20] For example, Mr Pat Hannan, the former State Director (Queensland) for

16 Committee Hansard, p. 776.

17 Committee Hansard, p. 858.

18 Committee Hansard, p. 858.

19 Committee Hansard, p. 857.

20 For example, the ACCC, Committee Hansard, p. 858 and Mr Pat Hannan, Submission No 57, p. 2.

APRA and previously the Insurance and Superannuation Commission (ISC), stated that the demarcation lines between prudential supervision and consumer protection remain blurred, a situation which was not fair to consumers or industry. He suggested that a 'one-stop shop' could be required for the regulator.[21]

2.24 CPA Australia also called for a more unified approach to prudential supervision.[22]

**Lack of practical experience in the regulators**

2.25 The Committee received evidence claiming that there is some lack of practical experience in the regulators, particularly in APRA, and that this might be due, in part, to the high turnover of staff and the reduction in staff numbers which occurred when the ISC ceased and APRA was established.

2.26 The Institute of Chartered Accountants advised the Committee that APRA has experienced a loss of staff:

> At the moment there is a real resource issue in APRA. On the positive side, a lot of the people who were in APRA have moved out into industry. So, with a lot of the knowledge, skills and experience that they have built up, they are now out in industry working on compliance monitoring and things like that. That is on the positive side; on the negative side, there are not a lot of resources left in APRA from a review point of view of the industry.[23]

2.27 Mr Mark Cerche of the Corporate Super Association (CSA) told the Committee that the Association was not happy with APRA. The CSA pointed to a contributing cause, namely the rebukes issued to trustees for omitting to take certain action when there was no legislative requirement for them to take the action APRA demanded. In the CSA's view, this pointed to inadequate training by APRA staff.[24]

2.28 Echoing these sentiments, Mr Kevin Casey, then Senior Strategy and Technical Adviser with the AMP, also voiced concern at the level of practical experience of operational level regulators, especially those involved in the supervision of the superannuation industry. Mr Casey informed the Committee that APRA staff have a good understanding of the law, but do not have a great feel for the financial system that they are overseeing.[25] He also claimed that, while APRA was professional and dedicated, its performance was inferior in terms of outcomes to that of the ISC, the organisation it replaced.[26] To improve interaction between regulators and industry,

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21 Submission No 57, p.2.

22 Submission No 20, p. 1.

23 Committee Hansard, p. 380.

24 Committee Hansard, p. 377.

25 Committee Hansard, p. 3, and Submission No 31, p. 5.

26 Committee Hansard, p. 7.

Mr Casey proposed the development of a program to enable secondments from ASIC, APRA and the industry, in order to give regulators a greater appreciation of the day-to-day difficulties faced by businesses, particularly in the superannuation industry.[27]

2.29 APRA disputed the criticism of its lack of practical experience, in the following terms:

> A new organisation with a new structure inevitably meant that some new faces turned up for meetings with regulated institutions. Inevitably, that has produced some negative comments along the lines that APRA does not understand some segments of the finance sector as well as its predecessors who had a responsibility for only one particular part of the financial industry. …The mixing up of 11 predecessor supervisory agencies was bound to produce some new approaches which would intrude into the comfort zone of some regulated entities.[28]

2.30 In addition, APRA officials advised the Senate Economics Legislation Committee that:

- APRA staff turnover is 15 per cent, which is about average for the finance sector; and
- APRA has been unable to fill 7-8 per cent of vacancies because of the competitive employment market.[29]

**Committee conclusions and recommendations**

*Improving awareness of the roles and responsibilities of the regulators*

2.31 The Committee notes the concerns expressed by industry and consumer groups about the complex and confusing nature of the current regulatory arrangements. The Committee is mindful that the arrangements have been in place now for nearly three years, and so finds it surprising that the regulators' roles and responsibilities are still unclear to stakeholders. The Committee considers it imperative to provide certainty and clarity in the regulatory framework. The Committee therefore considers that it is incumbent on the regulators to take all possible steps to ensure a better understanding of their respective roles, particularly in relation to clarifying the role demarcation between APRA and ASIC.

2.32 The Committee is aware from the case studies which have come to its attention through the inquiry that issues frequently require the attention of both regulators. In some instances, the demarcation in roles has resulted in a less than expeditious response by APRA and, to a lesser extent, ASIC, to serious matters

27 Submission No 31, p. 10.

28 Committee Hansard, pp. 801-2.

29 Senate Economics Legislation Committee, Budget Estimates, Hansard, Tuesday 5 June, p. 166.

associated with the regulation of some superannuation funds and institutions. This will be discussed in more detail in the Committee's second report.

2.33 The Committee is also aware from numerous items of correspondence it has received (although those items were not received as evidence) that some individuals in the community have been unclear about the respective roles of the regulators, and that this has led to uncertainty as to where they should go for assistance. People writing to the Committee have also been confused about whether issues fall within State or Commonwealth jurisdiction. Where appropriate, the Committee has referred these instances to the attention of the relevant regulators.

**Recommendation 1**

**2.34 The Committee recommends that the regulators, especially APRA and ASIC, work together to develop a coordinated strategy to improve awareness in the community about their respective roles and responsibilities.**

2.35 The Committee notes that MOUs have been established between APRA and the other regulators - ASIC, the ACCC and the ATO.

2.36 The MOU between APRA and ASIC sets out the framework for the two agencies to work together to achieve enforcement and compliance outcomes. It provides for the establishment of a coordinating committee, policy development, mutual assistance, information-sharing, and international representation on regulatory fora and training initiatives.

2.37 The MOU between APRA and the ACCC sets out the agreed basis for policy coordination and information sharing; while the MOU between APRA and the ATO sets out the framework for the two agencies to work together to achieve efficient administration and consistent application of the legislation, particularly the SIS Act.

2.38 The Committee urges the regulators to continue to work closely together to ensure that the regulatory framework is effective. In particular, the Committee encourages the more timely exchange of information between the regulators. As the case studies have shown, this is an area in which there appears to be room for improvement. In this regard, the Committee notes that ASIC has identified a need to document more specific protocols regarding referred matters, especially to designate clearly which agency has prime carriage of a matter.

2.39 The Committee is aware that in the United Kingdom, the Financial Services Authority is the sole financial services regulator. The Committee considers that while such a single regulatory model has some merit for consideration in Australia, the system of having two regulators is generally operating effectively. While problems have been identified with the Australian regulatory framework, they are not insurmountable and a number of measures are being taken to address some of the issues.

*One-stop shop*

2.40 The Committee notes the useful suggestion that a 'one-stop shop' approach might be required to simplify the complex and confusing arrangements. The Committee sees considerable merit in this suggestion, as it would overcome the difficulties people face in knowing whether their issue is a Commonwealth issue, a State or Territory issue, an issue of prudential supervision or an issue of consumer protection.

2.41 As is discussed in Chapter 5, the Committee notes that ASIC has already established an info line to provide a single entry point for consumer inquiries. This seems to be a useful development which could form a model for further expansion, such as the creation of an Office of Regulatory and Consumer Affairs. Such an Office, which could be located within APRA, could be jointly funded and administered by all regulators, including APRA, ASIC, ATO and the ACCC. Such an Office could serve as a first point of call for consumers and others unsure of which regulator to approach.

2.42 The Committee also considers that it would be useful if the websites of all of the relevant regulators, APRA, ASIC, ATO and ACCC, drew attention to the Office and provide an access link.

2.43 In the longer term the Committee also considers that there may be merit in exploring the concept of establishing an office of Superannuation Ombudsman. However, this would need to be considered in the light of broader consumer affairs mechanisms, such as the jurisdiction of the Superannuation Complaints Tribunal and the effectiveness of the proposed Office of Regulatory and Consumer Affairs.

**Recommendation 2**

**2.44 The Committee recommends that an Office of Regulatory and Consumer Affairs be established within APRA to act as a first point of call for consumers and others unsure of which regulator to approach regarding a particular issue.**

*The need for practical experience in the regulators*

2.45 The Committee notes that some in industry are concerned that the regulators, especially APRA, lack practical experience of the industry which they regulate. The Committee also notes the calls for secondment opportunities for APRA, ASIC and industry staff in order for each to gain a better understanding of the relative environments. The Committee supports any such endeavours.

2.46 While APRA claims that its new mode of operation[30] may have caused some negative comments from regulated entities, it has not refuted the claim made to the

30 See paragraph 4.46 for an explanation of APRA's new organisational structure.

Committee that the staff operating in the new framework lack the practical experience of their predecessors.

2.47 The Committee notes that this issue was considered by the House of Representatives Standing Committee on Economics, Finance and Public Administration, which found that:

> The bedding down of staff picture that APRA paints is not wholly supported by everyone. At this stage, the Committee is not in a position to reach a conclusion on the success or otherwise of APRA's staffing position. Accordingly, if this is seen as a problem when the Committee next meets with APRA, it will follow up with comments from APRA's staff and clients.[31]

2.48 The Committee is also unable to reach a conclusion on the experience of APRA's staff. Nonetheless, if APRA's clients continue to raise the issue with the Committee, it will pursue the matter with APRA.

**Recommendation 3**

**2.49 The Committee recommends that ASIC and APRA establish an employee industry secondment scheme to provide opportunities for staff to gain practical experience in the financial services industry.**

31 House of Representatives Standing Committee on Economics, Finance and Public Administration, *Report on the Review of the Australian Prudential Regulation Authority: Who Will Guard the Guardians*?, 6 November 2000, pp. 15-16.

# CHAPTER 3

# PRUDENTIAL SUPERVISION OF SUPERANNUATION – APRA'S OVERSIGHT OF TRUSTEES

## Introduction

3.1 While the Committee received some evidence on the prudential supervision of banking and financial services, most of the evidence it received related to the supervision of superannuation entities by APRA. Very little evidence was received on the small self-managed superannuation funds regulated by the ATO.

3.2 APRA was established on 1 July 1998 by the *Australian Prudential Regulation Authority Act 1998.* The Authority has a range of powers to assist its regulation of financial institutions. In relation to superannuation, APRA's main regulatory powers are over fund trustees, who have prime responsibility for the prudent management of the money entrusted to them by the members. This chapter examines APRA's role in improving the standards of stewardship by trustees of superannuation funds, including:

- examining methods to improve the levels of education and training of trustees;
- improving the accountability of trustees to fund members; and
- examining methods of detecting and dealing with fraud.

3.3 More general issues relating to APRA's approach to prudential supervision, including its supervision of other financial institutions, are considered in the next chapter. Further issues relating to the SIS Act are considered in Chapter 7.

## Which superannuation entities are regulated by APRA and the ATO?

3.4 The superannuation industry in Australia has increased significantly over the last decade. Currently there are nearly 220 000 superannuation funds with assets of nearly $500 billion. In the March quarter 2001, there were 22.8 million fund members.

3.5 The ATO is responsible for supervising the vast majority of those superannuation entities, following amendments to the SIS Act that resulted in responsibility for most small self-managed funds being transferred from APRA to the ATO in October 1999. Those funds must have less than five members, all of whom are trustees. It was estimated that 187 000 such funds (SMSFs) were transferred to the ATO in 1999/2000.[1]

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1 The number of SMSFs is somewhat uncertain. At 30 June 2000, the ATO reported that there were 165,000 SMSFs, accounting for 95 per cent of all superannuation funds (ATO, *Annual Report 1999-2000,* p. 38). On 25 June 2001, APRA advised the Committee that 187,000 funds had been transferred to

3.6 As well as comprising the bulk of all superannuation entities, the self-managed superannuation funds have a high average asset per account compared with other funds. Preliminary data from the ATO reveals that the average account balance of the funds it supervises is approximately $185,000. This is considerably higher than the average account balances for larger funds: for corporate funds the average is $54,000; for public sector funds, $41,000; for retail funds $13,000 and industry funds, $6,000.[2]

3.7 In its last annual report, APRA reported that it regulated over 3 500 financial institutions, including 2 930 superannuation entities.[3] However, there has been some uncertainty about the total number of superannuation entities that are subject to APRA's regulation. In addition to the 2 930 superannuation entities listed in its annual report, APRA estimated as at June 2000 that it had also retained responsibility for approximately 8 500 small superannuation funds with fewer than five members where not all of the members are trustees (known as 'small APRA funds'). Those funds were not eligible under the SIS Act for transfer to the ATO's supervision and are required by the Act to have an APRA-approved trustee.

3.8 In response to the Committee's request for further information to clarify the situation, APRA provided the following details of superannuation funds it regulates.[4] The numbers include all those funds which reported to APRA either as at June 1999 or June 2000.

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the ATO (Submission No 216, p. 2). On 6 July 2001 the ATO advised that the number of SMSFs had since increased to over 212,000.

2 M. Roberts, ATO, 'Self Managed Superannuation Funds – Preliminary Statistics', Paper presented at "Reform of Superannuation and Pensions", Ninth Annual Colloquium of Superannuation Researchers, Sydney, 9-10 July 2001. The data is preliminary as the first returns from the funds were only due on 31 March 2001.

3 'Superannuation entity' is a generic term which means a regulated superannuation fund, an approved deposit fund or a pooled superannuation trust (SIS Act s. 10).

4 Submission No. 216, p. 2.

**Table 3.1: Superannuation funds regulated by APRA**

| Type of fund | Number of funds | Amount invested ($m) | Number of members (000s) | Average size of fund ($m) |
|---|---|---|---|---|
| Funds with approved trustees of which: | **8 493** | **161 244** | **15 151** | **19.0** |
| Public offer funds | 399 | 154 403 | 12 363 | 387.0 |
| Small APRA funds | 7 654 | 2 278 | 10 | 0.3 |
| Other regulated funds | 440 | 4 563 | 2 778 | 10.4 |
| Employer-sponsored funds of which those with assets: | **2 940** | **130 588** | **4 450** | **44.4** |
| <$1m | 1 047 | 408 | 18 | 0.4 |
| $1m – 5m | 772 | 1 867 | 55 | 2.4 |
| $5m – 10m | 293 | 2 139 | 85 | 7.3 |
| >$10m | 828 | 126 174 | 4 292 | 152.4 |
| **TOTAL** | **11 433** | **291 832** | **19 601** | **25.5** |

3.9 APRA noted that these statistics included 323 funds which had not submitted the required annual return for 1999/2000, and that it was likely that a sizeable proportion of those 323 funds would have wound up during the year. APRA advised that it is continuing to pursue those funds.

**Standards of stewardship by trustees of superannuation entities**

3.10 Trustees of superannuation entities have both duties at common law and specific obligations under the SIS Act to act in the best interests of members and manage funds prudently. Under the SIS Act, it is the trustees' duty to develop and implement an investment strategy and to monitor and review investment performance.[5] The investments must be made and maintained on an arm's length basis. The need for diversification in investments is recommended consistent with contemporary risk and portfolio management theories; however, diversification is not

5 SIS Act s. 52 requires certain covenants by the trustee to be included in a superannuation entity's governing rules. Those covenants include covenants to act honestly; to exercise due care, skill and diligence; and to formulate and give effect to an investment strategy that has regard to the whole of the entity's circumstances (s.52(2)).

a requirement.[6] Trustees are generally not subject to direction;[7] however, because employer-sponsored funds are required to have equal numbers of employer and employee representatives as trustees, members are able to express their views about investment strategies through their trustee representatives.

3.11 Trustees have a duty to notify APRA of any event which has a significant adverse effect on the entity's financial position.[8] They must also seek information from an investment manager, where the entity's money has been placed under a manager's control, and establish arrangements for dealing with inquiries and complaints.

3.12 With the enactment of the *Financial Sector Legislation Amendment Act (No 1) 2000* in December 2000, as part of the process of aligning all Commonwealth Acts and Regulations with the Criminal Code, the standards required of trustees regulated by the SIS Act are now more consistent with the standards required of trustees under the Corporations Law.

3.13 Under the SIS Act APRA has various responsibilities which give it some power over trustees. These responsibilities include:

- approval of trustees for certain funds[9] and the replacement of trustees in certain circumstances, including where the trustee's conduct may result in the entity's financial position becoming unsatisfactory;[10]
- ensuring that trustees lodge an annual return;
- notifying trustees about complying fund status; and
- ensuring that standards for trustees, custodians and investment managers of superannuation entities are adhered to.

3.14 The Committee is aware that the majority of trustees are professional in their conduct, and take very seriously their duties and obligations under the SIS Act. Nonetheless, the Committee received a great deal of evidence about the low standard of stewardship by some trustees. This points not only to the need for improved stewardship to better protect fund members, but also for increased vigilance by the regulator.

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6 See APRA Superannuation Circular II.D.1 "Managing Investments and Investment Choice", April 1999, para 24.

7 SIS Act, s. 58. See also s. 52(4) re directions as to an entity's investment strategy.

8 SIS Act, s. 106. An event is defined as having a 'significant adverse effect' if, as a result, the trustee may or will not be able, prior to the next annual report, to make payments to beneficiaries as the obligation arises. Both civil and criminal penalties apply to a trustee's failure to comply with section 106.

9 APRA must approve the trustees of approved deposit funds, public offer superannuation funds and small APRA funds (that is, those funds with less than five members, other than the funds regulated by the ATO): SIS Act Part 2.

10 SIS Act Part 17.

*Trustee issues arising out of audit reports*

3.15 The Committee received a report from Mr Richard Rassi of Deloitte Touche Tomatsu titled *Top 10 Audit Issues From 1999–A Post Mortem Summary Report of Audit Findings*.[11] Mr Rassi prepared this report in his capacity as the approved auditor of approximately 600 superannuation funds.

3.16 According to Mr Rassi, the top 10 audit issues for 1999 were as follows:

- lack of meetings held by trustee boards;
- review of risk management statements not conducted on regular basis;
- outdated bank and investment signatories;
- lack of procedures to ensure trustees are not disqualified persons;
- incorrect calculation of benefit payments to members;
- member reporting not within the timeframe specified by the SIS Act;
- member contributions not remitted within 28 days of month end and employer contributions within 28 days of balance date;
- reconciliation of assets, key profit and loss items and membership not conducted on a regular basis;
- trustee equal representation requirements not satisfied; and
- financial statements not completed within the timeframe specified by the SIS Act.[12]

3.17 The report suggested three factors which summarise the causes of many issues raised in audit reports:

- a lack of experience and knowledge of the legislation governing superannuation funds;
- a lack of monitoring by trustees of the superannuation fund's operations; and
- a lack of appropriate internal controls to ensure that the fund is being managed in accordance with the SIS legislation and the fund's governing rules.[13]

3.18 The report suggested various tips to trustees and administrators for ensuring compliance. These are as follows:

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11 See Committee Hansard pp. 382-4.

12 Committee Hansard, pp. 382-3.

13 Committee Hansard, p. 383.

- proper planning of the year-end reporting cycle by trustees and their external administrators, which should include agreeing to a timetable and assigning responsibilities for tasks;
- adequate resources, including organising temporary contract staff to assist with compressed workloads where appropriate;
- completing all account reconciliations at an earlier cut off date to relieve the workload at the year end;
- completing a format of the draft accounts, preferably before year end and agreeing this with the fund auditor;
- anticipating potential processing problems/areas and addressing these with the trustee/employer–sponsor before year end;
- ensuring the filing of all fund documents is up to date and accessible well before the audit commences so as to not delay the audit process;
- involving the auditor in any problems at an early stage;
- holding regular status meetings among administration staff, detailing progress against client timetables and new issues or problems requiring resolution;
- communicating the new reporting deadlines to employer sponsors so that they understand the importance of timely information;
- ensuring that back-up facilities are in place and operational to enable processing of data/administration work to continue in the event of major systems failures; and
- monitoring the morale and motivation of the administration team, rewarding on a regular basis excellent performance.[14]

3.19 In evidence Mr Rassi expanded on some of the reasons why numerous issues were raised during superannuation fund audits:

> These audit issues reflect a number of things, but one of the key points is the fact that trustees have imposed on them a lot of regulation and I think a lot of trustees of corporate funds are lacking in the resources to properly carry out their role. On the other hand, there is also some inefficiency within some of the administration firms which those trustees have outsourced their administration to, which is leading to some of these problems.[15]

*Competence of trustees*

3.20 Mr Pat Hannan, the ISC's and APRA's former State Director for Queensland, made some pertinent comments about the performance of trustees:

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14 Committee Hansard, p. 384.

15 Committee Hansard, p. 385.

> When the issues of most significant concern found through audit/inspection activity were annually evaluated within ISC/APRA 'poor' trusteeship topped the list. Ignorance, whether it be innocent or mischievous, remains the greatest problem and threat to member's superannuation benefits. I have no doubt the same concern exists with stewardship responsibility across regulatory jurisdictions.[16]

3.21 The Committee was also advised by Dr Adam Graycar of the Australian Institute of Criminology that conference findings had shown that while there is not much fraud, there was a lot of incompetence and ignorance among superannuation fund trustees. He claimed:

> There were people at the margin taking risks that were not, on the face of it, fraudulent but could have ended up as losses. … In a lot of cases, it is ignorance and incompetence rather than malicious theft that causes problems.[17]

3.22 Dr Graycar stated that the key is to try to establish a set of early warning indicators, not only for fraud, but to make sure that funds had tight standards of accountability, safeguarding, recording and authorisation. Second-line activities such as reconciliation and verification, review and monitoring were also important.[18]

3.23 Dr Graycar indicated that the Institute would be willing to work with APRA to identify the criminological component of those cases where things have gone wrong, so that prevention mechanisms can be identified.[19]

*The regulator's view*

3.24 APRA does not believe that there is any indication of systematic 'under capacity' of the trustees, or systemic incompetence on the part of trustees of the superannuation funds that it supervises. According to APRA, the wide diversity of fund size and nature would make it difficult to devise an industry-wide 'certification' standard for trustees. APRA acknowledged that there is a general need to educate and inform trustees about their duties and responsibilities, and that some funds have put in place extensive training and induction programs.[20]

3.25 In response to the Committee's request for further information, APRA provided a list of the types of problems it had identified during its reviews of

16 Submission No 57, p. 3.

17 Committee Hansard, pp. 703-4.

18 Committee Hansard, pp. 703-4.

19 Committee Hansard, p. 705.

20 Submission No. 88, pp. 3-4.

superannuation funds, broken down into categories to reflect the size of the fund's assets.[21] Issues for the smaller funds of less than $1million in assets included:

- inadequate investment strategies and concentrations of risk in investment portfolios;
- inadequate title to assets, which are sometimes intermingled with assets of the employer sponsor or members;
- investment transactions that are not 'arm's length' or breach the in-house asset rules;
- inadequate documentation of service agreements, and inadequate fund records;
- lack of understanding of retirement income policy compliance issues;
- lack of equal numbers of member-elected and employer directors in employer sponsored funds; and
- lack of consideration of fraud control procedures (such as having dual signatories).

3.26 APRA's reviews found that issues common to all funds were inadequate documentation of service agreements (including inadequate performance criteria, indemnity provisions and reporting requirements) and inadequate documentation more generally. Some of the medium and larger size funds (those with assets of more than $1 million) also showed problems in failing to adequately monitor the service providers, having poor strategic planning and not adequately considering the "disqualified persons" provisions of the SIS Act. Delay in remitting contributions was also identified as a problem for those medium-sized funds with between $1 million and $60 million in assets.

3.27 APRA advised that problems were usually resolved through its discussions with trustees. When serious issues arose and were not able to be resolved, APRA pursued further action, including giving specific directions to the trustee or taking legal action. APRA noted:

> These serious issues often stem from trustee failure to exercise adequate control over the fund's operations, ranging from poor investment decisions resulting in large losses to members, to trustee directors' fraudulent use of fund assets for their own benefit. While such serious issues may arise in funds of any size, the greatest incidence of severe problems lies in the smaller funds with assets up to $5 million.[22]

3.28 APRA proposed a change in its approach, quoting from its recent submission to the Productivity Commission's review of superannuation legislation:

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21 Submission No. 216, pp. 3-4.

22 Submission No. 216, p. 5.

> … we believe that additional prudential requirements or guidelines covering portfolio strategy, asset selection and potentially large concentrations of risk should be introduced. Prudential policies on portfolio concentrations and large exposures form part of the prudential regime covering ADIs and the insurance sector. These industries have accepted the balance of advantage that such core prescription provides in obviating excessive risks …
>
> As a first step, therefore, we will be amending existing advice to trustees on asset and portfolio selection, to emphasize the need for funds to follow more diversified strategies where they do not already do so. Further, we intend to act more forcefully in requiring better portfolio balance in those cases where trustees have not take the spirit of the SIS requirements on investment strategy and portfolio determination into account.[23]

3.29 APRA also acknowledged that prudential reporting by superannuation funds was critical to effective supervision and that more could be done in this area:

> … it is fair to say that the quantity and quality of regulatory reporting is not high. At present, information received by APRA is neither timely nor comprehensive by comparison with the range of information collected from other entities supervised. Late reporting by some superannuation funds has become almost endemic. The case for a major upgrading of prudential reporting arrangements – across the full range of superannuation funds – is compelling.[24]

3.30 APRA stated that its key priorities in the immediate future were in five areas:

- targeted portfolio and investment guidelines, particularly focusing on asset concentrations;
- improved supervisory reporting and tightened reporting standards by superannuation funds;
- consideration of more structured capital requirements for approved trustees and possibly superannuation funds more generally;
- increased focus on improving governance standards; and
- more effective licensing of superannuation funds.[25]

3.31 APRA stated that it would also consider the case for legislative amendments to confirm its powers in these areas. In particular, a more direct power for APRA to impose a minimum capital requirement on approved trustees is likely to be one of

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23 Submission No. 216, p. 6. These comments were first made in APRA's submission to the Productivity Commission's National Competition Policy Review of the *SIS Act* and certain other superannuation legislation. The Productivity Commission is expected to report in late October 2001.

24 Submission No 216, p. 6.

25 Submission No. 225, p. 14, referring to APRA's submission to the Productivity Commission's National Competition Policy Review of the *SIS Act*, p. 11.

APRA's recommendations.[26] At present, approved trustees are required either to have $5 million in net tangible assets or guarantees from authorised deposit-taking institutions, or to agree to comply with any requirements imposed by APRA. Like the former ISC, APRA has to date required approved trustees who do not meet either of the first two tests to use an arm's length custodian with $5 million in capital. This requirement has been examined following the CNA matter, with APRA considering that an approved trustee should have its own capital. The issue will be discussed further in the Committee's separate report on the case studies.

*Committee conclusions and recommendations – trustees*

3.32 The Committee is aware that the vast majority of trustees are professional in their conduct and the performance of their fiduciary duties. However, as a result of its work inquiring into the four case studies involving trustees of superannuation funds, the Committee noted many examples of poor standards of stewardship by trustees, in particular through speculative, inappropriate and unsound investment practices and loan arrangements. In all four cases involving superannuation funds, this has resulted in financial losses and jeopardised the retirement incomes of fund members. The Committee notes that it is a requirement under the SIS Act for trustees to notify the regulator of a significant adverse event which might have 'a significant adverse effect on the financial position of the entity' and that this may not have occurred in all cases examined.

3.33 The Committee is also aware that some concerns were expressed about the transparency of APRA's procedures for appointing a replacement trustee. The Committee notes that APRA now claims to have in place a clearer and more transparent process for the appointment of replacement trustees.[27] However, as will be discussed in the separate report on the case studies, concerns have also been expressed about APRA's procedures for appointing a replacement trustee for CNA.

3.34 The Committee is greatly concerned by the apparent low standards of stewardship being exercised by some trustees and the consequent adverse impact their actions have on fund members, especially as a result of their investment activities.

3.35 The Committee considers it imperative to improve the standard of stewardship by trustees and for APRA to improve its performance in its oversight of trustees. This might include requiring more information from some funds, stricter guidelines on fund investment portfolios (including ensuring that trustees have diversified investments rather than large single assets in their portfolio) and wider powers for APRA to seek information directly from third party service providers. The Committee is pleased to note that APRA is already giving consideration to these issues.[28] The Committee particularly encourages efforts by the regulator to have stricter requirements for the

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26 Submission No. 225, p. 16.

27 Submission No. 225, p. 29 and Attachment E.

28 *The Australian Financial Review,* 6 June 2001, Submission No 197, p. 5 and Submission No. 216, p. 6.

spread of investments and more specific information in returns on fund performance, as this may mitigate investment risk and assist the regulator to identify any early warnings of possible fund failure.

3.36 The Committee is particularly concerned to ensure that members of all funds receive equal treatment by the regulator, as members of small regulated funds are entitled to the same degree of protection as members of larger funds. The Committee notes the concerns expressed by Mr Ian Macfarlane, Governor of the Reserve Bank of Australia about the adequacy of the regulatory arrangements applying to 10 000 [29] or so small funds with between 5 and 20, 50 or 100 members (many of which are company based).[30] While acknowledging that the majority of these are well run, Mr Macfarlane drew attention to some recent cases where, in his view, some very irresponsible financial transactions and related-party transactions had taken place. To address these issues, Mr Macfarlane suggested the need to consider reducing the number of such funds by adding licensing requirements and/or capital requirements to the existing requirement to submit an annual return to APRA six months after the end of the financial year. The alternative, he suggested, was to 'find a massive amount of new resources for APRA'. Mr Macfarlane acknowledged that, with current resources, APRA could not possibly make an inspection of each fund every year.

3.37 In response to these suggestions, APRA conceded that it had some concerns about funds with between 5 and 15 members and assets of less than $1 million. Of the 3 000 – 4 000 funds in this category, APRA said that only some might be at risk. Further the Association of Superannuation Funds of Australia (ASFA) has indicated that it would work with APRA to develop strategies and, if necessary, a legislative response to mitigate any risks to members in the smaller funds.[31]

3.38 APRA's CEO, Mr Graeme Thompson, advised the Committee that, in relation to smaller funds with assets of less than $5 million:

> It is an area where some sort of licensing criteria and possibly some capital requirements could improve the level of comfort that we have with them or force some rationalisation in the number of funds of that size.[32]

3.39 APRA subsequently advised that it intended to 'review the potential role of capital requirements for superannuation funds generally', but that more specific review for funds with approved trustees will be undertaken.[33]

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29 The Committee notes that this number appears to be an over-estimate, given APRA's estimate that it regulates approximately 11,400 superannuation funds in total, of which more than 7,600 are small APRA funds with less than five members (see Table 3.1). Hence there appear to be between 3,000 and 4,000 funds with more than five members.

30 House of Representatives Standing Committee on Economics, Finance and Public Administration, Hansard, Friday 11 May 2001, p. 85.

31 ASFA Media Release, 14 May 2001, *Few super funds at risk – ASFA and APRA agree*.

32 Committee Hansard, p. 1299.

3.40 The Committee is pleased to note that APRA is aware of the issue and that it will work with the industry to identify strategies to mitigate the risks for smaller to medium sized funds. The Committee is concerned to ensure that the community has confidence in superannuation savings at all levels of the spectrum, whether it is the larger industry, public sector and retail funds, or the smaller, medium sized corporate (employer-sponsored) funds.

3.41 The Committee emphasises that the ATO's regulation of approximately 187 000 self-managed funds, that is the funds with less than five members where all the members are trustees, is not an area of concern. Those funds are frequently used by individuals, couples and families. As Mr Daryl Dixon, a superannuation commentator, has observed, the trustees of self-managed funds are only dealing with their own money, so they will be the only losers if they attempt to defraud themselves.[34] However, the Committee notes that members of self-managed funds might need protection and access to appeal mechanisms.

3.42 While some sectors receive top class advice, assistance and oversight, there are other areas, especially in the small to medium size fund environment, where there are serious shortcomings. The Committee notes that the Government is aware of the need to improve the prudential regulation of the smaller funds, and welcomes the Prime Minister's assurance that the supervisory arrangements will be examined to see 'whether improvements can't be made.'[35]

3.43 The Committee also has some concerns about the role of auditors and the standards of auditing. These issues are considered in Chapter 6.

**Recommendation 4**

**3.44 The Committee recommends that APRA take steps to improve its performance in its oversight of trustees - whether they are trustees of small, medium or large funds - in particular by ensuring that trustees abide by the standards required to protect the best interests of fund members.**

3.45 However, as evidenced by the case studies, particularly CNA, the Committee also considers it imperative for APRA to act quickly on matters which come to its attention, and to deal with those matters within its jurisdiction rather than passing them on to another regulator. The Committee notes that ASFA has acknowledged that in the case of CNA, 'it appear(ed) that breaches of the SIS Act occurred, APRA had the necessary powers but failed to act in a timely way, allowing retirement money to be invested and lost.'[36]

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33 Submission No 225, p. 15.

34 *The Bulletin,* 12 June 2001, p. 58.

35 *The Age*, Friday 1 June 2001, p. 2.

36 ASFA, *ASFA's response to Macfarlane,* Media Release, 13 May 2001.

3.46 The Committee is also aware that better cooperation between the regulators would provide greater assurance that regulatory issues do not 'fall between the cracks' as appeared to happen in the case of CNA. The Committee considers it imperative that the regulators draw to the Government's attention any weaknesses or gaps in the regulatory framework, to avoid the problem which occurred with CNA.

3.47 The Committee also sees merit in APRA working more closely with ASIC to ensure a timely and effective response when matters come to its attention. As discussed in Chapter 2, the Committee notes that ASIC would like to document more specific protocols on matter referrals, in particular to identify the agency with primary carriage of a referred matter. The Committee understands that ASIC is currently progressing discussions with APRA on this issue.

**Recommendation 5**

**3.48 The Committee recommends that:**

- **APRA act more quickly when matters come to its attention, and that APRA deal with those matters within its jurisdiction rather than passing them on to another regulator; and**
- **APRA and ASIC work more closely together to ensure a timely and effective response when matters come to their attention.**

3.49 The Committee considers that one of the ways in which the standards of stewardship could be improved is by requiring all trustees to undertake a compulsory level of training before, as well as during, their period of service. This would ensure that individuals had minimum levels of competence prior to assuming the responsibility for managing other people's money. An additional benefit for the trustees is the assistance which such training would provide in performing their fiduciary duties to an appropriate standard.

3.50 The Committee notes that the mission of the Australian Institute of Superannuation Trustees (AIST) is to raise the standard of fiduciary performance by trustees through education, training and seminars. The Committee commends the efforts made by the Institute to date, but considers that much more could be done to improve the levels of trustee education and training. The Committee notes the Institute's recent comments calling for greater support and input from the regulators into its education programs.[37] While the need for education and training applies equally to larger and medium funds where the stakes are higher, it is especially relevant to trustees of small APRA regulated funds, where the trustees may be lay people, unpaid and without any particular skill or knowledge in managing a fund and its investments.

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37 AIST *Submission to the Productivity Inquiry into Superannuation Laws*, 11 May 2001, p. 3. The Institute also proposed 'that APRA establish an ongoing partnership with AIST for the purpose of providing trustees with accessible, up to date information on regulatory matters'. The Institute submitted that such activity 'could greatly strengthen the current system, more so than further legislative change'.

**Recommendation 6**

**3.51 The Committee recommends that APRA work more closely with superannuation funds, the Australian Institute of Superannuation Trustees and others to ensure that an appropriate level of education and training is provided to trustees, including a mandatory minimum level of training prior to service.**

3.52 The Committee notes that the Australian Institute of Criminology is willing to work with APRA to identify mechanisms to prevent 'things going wrong'. Although criminal activity is not yet a major issue in the superannuation industry, there is a risk that it will emerge in the future. For this reason the Committee considers that it would be worthwhile for APRA to work more closely with the Institute to examine the best methods of crime prevention.

**Recommendation 7**

**3.53 The Committee recommends that APRA work more closely with the Australian Institute of Criminology to examine the best methods of crime prevention in superannuation funds administration.**

**Improving the accountability of trustees to fund members**

*Members having same rights as shareholders*

3.54 It was suggested to the Committee that one way in which members of funds might be able to hold trustees more accountable is if fund members had the same rights as shareholders. This might include fund members participating in an annual meeting with trustees, similar to annual meetings held for shareholders with company directors. The Committee explored this idea with some witnesses.

3.55 Mr Dan Scheiwe, of the Queensland University of Technology, explained the lack of accountability to superannuation fund members by highlighting the disparity in the legal status of information disclosure to company shareholders compared to superannuation fund members. He did so through an example:

> In the case of my own major superannuation fund, the shares in the corporate trustee are owned by the universities throughout Australia. Therefore, when the corporate trustee has its AGM [annual general meeting], the only persons invited along to the AGM are representatives of the universities, not the members. The annual general meeting of that corporate trustee then decides important things like the remuneration of the trustees. So basically, the corporate trustees are not accountable to any of the members.[38]

3.56 According to Mr Scheiwe, the lack of accountability is continued through the actions of trustees. First, information is provided to fund members at the discretion of the trustees. Second, if superannuation fund members request information beyond that

38 Committee Hansard, p. 539.

which is required by statute, then the information is supplied to individual members, not to all members.[39]

3.57 Dr Grabosky of the Australian Institute of Criminology noted that the proposal of annual general meetings for superannuation fund members might have some merit if the flow of information between trustees and fund members were equal. He added:

> I think that if there were an unequal flow of information, basically the members could get snowed if somebody wanted to snow them. If, on the other hand, it was a situation of having certain information sent out to members and members being able to comment on that information and having the questions thrown back rather than just a pretty bland balance sheet put out once a year, or if it was like a web site chat room where members could come back and forth asking questions, that, in a way, might be more useful – something interactive rather than a two hour meeting where people with all the information are on one side and people with not much information are on the other.[40]

3.58 ASIC also commented on the proposal. At the conceptual level, ASIC argued that there are important differences between being a member of a superannuation fund and a shareholder of a company. According to ASIC, being an ordinary shareholder provides rights to participate in the governance of the company. Those rights do not extend to unit holders in managed investments or members of superannuation funds, but do extend to the managers of managed investments and trustees of superannuation funds.[41] ASIC appeared to imply that with managed investments and superannuation funds, investors and members are indirect and beneficial owners and therefore do not possess the rights that come with ownership.

3.59 On the practical level, ASIC stated that it was not aware of any problems with trustees' accountability to fund members that would make annual general meetings an obvious solution.[42]

*Improving communication with members*

3.60 A submission from William M Mercer Pty Ltd stated that because superannuation had become extremely complex and was not well understood by the community, funds should be encouraged to improve their communication to members by providing them with material written in plain English and conveyed in different ways, such as via the internet. The submission recommended that legislation needed to take account of this issue. William M Mercer Pty Ltd also argued that '(t)he application of black letter law to, for example, the production of member information

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39 Committee Hansard, p. 539.

40 Committee Hansard, p. 709.

41 Committee Hansard, p. 787.

42 Committee Hansard, p. 787.

will inhibit a proper understanding of superannuation and hence will limit the effectiveness of superannuation benefits financing the needs of our aging population'.[43]

*Committee conclusions and recommendation – improving trustees' accountability to fund members*

3.61 The Committee considers that, in most cases, there are already sufficient mechanisms in place for fund members to hold trustees accountable for their actions. While the Committee sees merit in the concept of funds engaging their members in an annual general meeting, this would be entirely up to individual funds.

3.62 The Committee notes that certain industry funds already have meetings with members on a regular basis. The Committee welcomes this development, while also noting that there appears to have been a general improvement in the quality of information now being sent to members.

3.63 The Committee sees that the more urgent issue is developing better strategies to keep members informed. This would help to overcome the imbalance of information which currently appears to exist. As evidenced by the case studies, the lack of information provided by the trustees to members is a serious issue. In particular, the Committee considers that there is scope to increase the level of information provided to fund members in annual reports, to require identification of any payments to trustees from the fund, broken down into directors' fees and other payments, and disclosure of all significant administration fees, charges and commissions paid to both fund and investment managers. This requirement would also have the effect of harmonising the reporting requirements for trustees with those required under Corporations Law.

3.64 The Committee notes the difficulties in communicating complex issues to fund members in plain English. However, the Committee recognises that the regulators, trustees, custodians and fund administrators require sufficiently clear guidance in the legislation to enable them to do their jobs within the law. The challenge for legislators is to achieve a balance between complex black letter law, and that which is comprehensible in plain language to the broader community.

43 Submission No 19, p. 3.

**Recommendation 8**

**3.65 The Committee recommends that, in relation to annual reports to fund members, the minimum information requirement be expanded to include identification of:**

- **any payments to trustees from the fund, broken down into directors' fees and other payments; and**
- **all significant administration fees, charges and commissions paid to both fund and investment managers.**

3.66 Further discussion on means to improve the reporting of fund data is at Chapter 4. There is also further discussion on the need to standardise the definition of a fund's 'administrative expenses' at Chapters 5 and 6.

**Fraud in superannuation funds**

3.67 In its first report in 1992 on the regulation of superannuation, the former Select Committee on Superannuation drew attention to the need for safeguards to minimise the risk of fraud.

3.68 Although statistics on the amount of fraud committed in the superannuation industry are difficult to obtain, estimates over the past ten years or so range in the order of $20 million to $30 million.[44] As discussed earlier in this Chapter, the Director of the Australian Institute of Criminology gave evidence to the Committee that fraud was much less of a problem than trustee incompetence. However, according to Mr Richard Rassi of Deloitte Touche Tomatsu, the lack of reconciliation of assets with the member records increases the risk of fraud which he acknowledges is very small in terms of the total amount of money invested in superannuation, but is there nonetheless. Mr Rassi also noted that a lot of fraud is not reported or recorded by superannuation funds. In most instances, the matter is kept quiet and settled privately between the employer-sponsor and the insurance company, leading him to speculate that that the level of fraud exceeds the estimates put out by APRA. [45]

3.69 The Committee also received evidence concerning the fraudulent actions of a trustee of a superannuation fund not regulated under the SIS Act.[46] The trustees of the non–regulated fund were not required to comply with the trustee duties prescribed in the SIS Act. In this case, the fraudulent actions of the trustee cannot be explained by a shortcoming in the regulations or an action or omission by APRA, since APRA had no jurisdiction. While acknowledging this lack of oversight of non–regulated

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44 Committee Hansard, p. 385, together with estimates drawn from Adam Graycar (ed), Australian Institute of Criminology Research and Public Policy Series, *Protecting Superannuation from criminal exploitation,* 1996, p. vii.

45 Committee Hansard, p. 385.

46 Submission No 21, pp. 1-8.

superannuation funds, Ms Fiona Ogilvy-O'Donnell recommended to the Committee that:

> Where a superannuation fund is defrauded, the Trustees of that superannuation fund should have to show cause why they should not be prohibited from acting as Trustees in the superannuation industry thereafter. Serious financial penalties should apply. APRA should maintain a public listing of Trustees of superannuation funds which have been defrauded, regardless of whether these funds were regulated or not. This list of deregistered Trustees should be circulated to employers and employees via their superannuation fund managers. A similar regime applies to Directors of companies that become insolvent and leave creditors unpaid.[47]

*Committee conclusion and recommendations – fraud*

3.70 The Committee acknowledges that fraud is an issue with which the regulators may have to deal increasingly.

3.71 The Committee is particularly concerned about the potential for fraud in non-regulated funds. While the Committee sees merit in the proposal that trustees of a superannuation fund which has been defrauded should have to show cause why they should not be prohibited from acting as trustees in the superannuation industry thereafter, the Committee considers that the key issue is to ensure that that where a trustee, fund manager or administrator has been convicted of fraud, that they do not practice again in that capacity in the business of superannuation until certain conditions are met. These conditions might include not practicing for a period of at least 15 years, and then proving to APRA's satisfaction that they are a fit and proper person.

3.72 The Committee also sees merit in the proposal that APRA maintain a listing of trustees of superannuation funds which have been defrauded, regardless of whether or not they are regulated, and make this information publicly available as required.

**Recommendation 9**

**3.73 The Committee recommends that:**

- **a trustee, fund manager or administrator who has been convicted of fraud should not practice again in the business of superannuation until certain conditions are met. These conditions might include not practicing for a period of at least 15 years, and then proving to APRA's satisfaction that they are a fit and proper person; and**
- **APRA maintain a listing of trustees, fund managers and administrators of superannuation funds which have been defrauded, regardless of whether they are regulated or not.**

47 Submission No 21, p. 4.

3.74 The Committee notes that, under section 229 of the SIS Act, the trustee may apply to the Minister for a grant of financial assistance for a fund which has suffered a loss as a result of fraudulent conduct or theft. The Minister may grant assistance of an amount determined by him or her, if satisfied that to do so is in the public interest (s. 231). The Committee understands that these provisions have not been implemented before now, but is aware that, with the collapse of the funds for which CNA was the trustee, recourse through this means has been sought. The Committee has also been advised that the acting trustee of a Western Australian fund that has suffered loss through fraud, the Australian Independent Superannuation Fund, intends to pursue an application in the near future.[48]

3.75 As will also be discussed in the report on the case studies, the Committee is concerned to ensure that claims made under section 229 of the SIS Act are dealt with expeditiously by the relevant Minister, in order to minimise the hardship that fund members could otherwise suffer. The Committee notes that the Act does not specify that a criminal conviction for fraud or theft is a precondition for the Minister to form a view that a loss is an eligible loss. The Committee notes APRA's advice that the test is whether the Minister is satisfied on the balance of probabilities that the loss is attributable to fraudulent conduct or theft.

3.76 Once the Minister has determined that it is in the public interest to make a grant of financial assistance, the Committee seeks assurance from the Government that any such grants will continue to provide 100 per cent compensation, which includes both the return of the capital with applicable interest.

3.77 The Committee also notes that superannuation monies, collected as a lump sum by an individual when they retire, which are then reinvested in a range of financial products, are not necessarily protected by the fraud and theft provisions of the SIS Act. The Committee has been made aware of a growing number of cases of theft and fraud in respect to these funds. The Committee is therefore concerned to ensure that the provisions for financial assistance to funds under Part 23 of the SIS Act apply to a broader range of pension and retirement annuity products than is currently the case. This might require broadening the grounds under which applications could be made under section 229.

48 Submission No. 225, p. 26.

**Recommendation 10**

**3.78 The Committee recommends that:**

- **the Minister act expediently and efficiently in making a decision under the SIS Act to grant financial assistance to a fund that has suffered as a result of fraud or theft, to minimise the hardship that superannuation fund members could otherwise potentially suffer; and**
- **the provisions for financial assistance to funds under Part 23 of the SIS Act be extended to include an appropriate range of pension and retirement annuity products.**

3.79 The Committee notes that there is also scope under the SIS Act for a special levy to be raised where money has been lost through fraud and the Minister considers it to be in the public interest.[49] As will be discussed in more detail in the report on the case studies, the levy has not been used to date. The Committee considers that there may be merit in the Minister considering a two-tiered approach: invoking the levy in the case of those affected in the case of CNA, and considering an indemnity fund to provide a more expeditious vehicle for settlements.

3.80 The report on the case studies will also discuss whether the Minister should give consideration to seeking Cabinet approval to grant an Act of Grace payment to help alleviate the consequences for those affected by the failure of a statutory body to administer its responsibilities properly.

49 Under section 235 of the SIS Act, the Minister may order that assistance be paid either from consolidated revenue, or from a special reserve, in which case an additional levy of up to 0.05 per cent of a fund's total assets is imposed on each fund.

# CHAPTER 4

# PRUDENTIAL SUPERVISION OF SUPERANNUATION AND OTHER FINANCIAL INSTITUTIONS – THE ROLE OF APRA

## Introduction

4.1 As the prudential supervisory body, APRA's responsibilities extend to a wide range of financial institutions, namely authorised deposit-taking institutions (ADIs) (banks, building societies and credit unions), friendly societies, general and life insurance companies, and superannuation entities. Together these entities account for about 85 per cent of the assets in Australia's financial system.[1]

4.2 This chapter examines:

- APRA's approach to risk management;
- APRA's performance in prudential supervision;
- APRA's resources for prudential supervision; and
- APRA's and the ATO's data collection.

## What APRA regulates

4.3 In its last annual report, APRA reported that it regulated over 3 500 financial institutions, including 2 930 superannuation entities, as set out in the following table. (As noted in the previous chapter, the number of superannuation entities APRA regulates is actually over 11 000 when the 'small APRA funds' with less than five members are included.)

1 APRA, *APRA Insight,* Ist Quarter 2001, 2001, p. 2.

**Table 4.1: APRA-regulated institutions as at 30 June 2000[2]**

| | Number of Institutions | | Total assets ($billion) | |
|---|---|---|---|---|
| **Institution** | **Diversified Institutions** | **Specialised Institutions** | **Diversified Institutions** | **Specialised Institutions** |
| ADIs | 49 | 241 | 690 | 48 |
| Friendly societies | 1 | 53 | - | 6 |
| General insurers | 120 | 39 | 59 | 4 |
| Life insurers | 40 | 3 | 183 | 3 |
| Representative offices of foreign banks | - | 26 | - | 0 |
| Superannuation entities | 130 | 2,800 | 141 | 138 |
| **TOTAL** | **340** | **3,162** | **1,073** | **200** |

4.4 APRA has considerable powers to ensure that it can effectively pursue its prudential supervision task. In the areas of financial institutions, including ADIs and insurers, these powers include:

- licensing institutions that take deposits from the public or write insurance policies;
- establishing minimum capital requirements and operating standards to manage risk and minimise the likelihood of serious financial problems;
- directing institutions to comply with those requirements and standards or do other things necessary to protect the interests of their depositors and policyholders;
- collecting information from, and investigating, financial institutions;
- taking control of, or arranging to appoint an administrator or liquidator to, an institution that is in serious financial difficulty and whose capacity to meet its obligation is in doubt.

2 APRA, *Annual Report 2000,* p. 14.

## Risk management approach

*APRA's approach*

4.5 At the beginning of 2000, APRA introduced a broad-based approach to risk management. The aim was to widen risk management and internal audit beyond purely financial risk and compliance auditing. As a result, APRA has adopted a strategic risk management framework which has the principal aims of:

- assessing risks across all of APRA's business operations;
- specifying risk management strategies, policies and actions to mitigate risks, with particular focus on identified high and significant risks; and
- adopting and implementing a risk-based strategic internal audit plan.[3]

4.6 As prudential supervisor, APRA aims to see that financial institutions are measuring the risks in their business accurately and keeping them to manageable dimensions. APRA emphasises that, in its view, its supervision does not - and should not - provide an absolute guarantee against misadventure. Rather than pursuing safety at all costs, APRA aims to balance the objectives of financial safety and efficiency, competition, contestability and competitive neutrality. It describes its approach to supervision as being: 'forward looking, primarily risk-based, consultative, consistent and in line with international best practice'. By 'risk based' APRA says that it means putting most resources into areas of highest assessed risk and correspondingly fewer into areas of low risk. APRA is presently working to define more clearly what this means in practice, so it can deploy its people most cost-effectively.[4]

*The range of legislative risk controls*

4.7 As mentioned earlier in this chapter, a range of legislative risk protection mechanisms operate to ensure effective prudential supervision and that, as part of a global financial system, Australia does not become unduly exposed to the consequences of onshore and offshore financial market failure. IFSA provided the Committee with information about these risk management controls, as outlined in the following table:

3 Submission No 88, p. 3.

4 APRA, *APRA Insight,* 1st Quarter 2001, p. 3.

**Table 4.2: Risk management controls**[5]

*Superannuation*

- common law and legislative duties on a trustee to invest prudently;
- prohibitions on funds borrowing to leverage;
- Derivative Charge Ratio calculations to govern the operation of derivatives (which limits the extent to which derivative obligations can exceed the value of the fund's assets).

*APRA prudential regulation of banks, superannuation life and general insurance*

- licensing institutions and trustees;
- capital adequacy provisions;
- liquidity requirements and large exposure limits;
- regular reporting and disclosure requirements;
- institutions must prepare and have audited a detailed risk management statement which sets out policies and procedures for managing risk across all aspects of the business, with particular references to derivatives; and
- surveillance and monitoring.

*ASIC financial market integrity regulation of exchanges, clearing houses and institutions*

- licensing requirements for exchanges and clearing houses (such as capital adequacy, business rules, transparency of information, supervisory and reporting requirements);
- licensing requirements for intermediaries dealing in markets (such as financial resources, competence, skills and experience);
- regular reporting and disclosure requirements; and
- monitoring and surveillance.

*Improving the risk management systems*

4.8 The Committee was advised by IFSA that the risk management systems could be enhanced by appropriate liaison between APRA, ASIC and their international counterparts to:

5 Submission No 27, p. 6.

- keep pace with globalisation and electronic commerce developments;
- support the ongoing development of international standards and co-operation;
- support the ongoing development of standards and codes by industry associations which promote transparency, disclosure and best practice risk management systems; and
- support the development of technological platforms/software that will reduce risk and enhance risk management systems.[6]

V*iews on APRA's approach*

4.9 The Institute of Chartered Accountants in Australia (ICAA), whose members conduct many audits of superannuation funds, praised APRA's approach to superannuation fund risk management. The Institute stated that:

> We are well aware of their CRIMP model which covers the whole area of controls, risk management, investments, the management of the fund and the prudential management of the fund. We are quite encouraged by that. We think that APRA have the right approach there in terms of working with trustees to make sure that they are properly managing the funds.[7]

4.10 The ICAA also commented that the approach used by APRA to supervise conglomerates should also be applied to the supervision of funds with approved trustees and large funds that use an administrator. The ICAA argued that:

> This would involve a review of the processes applied by the administrator on a global basis with a reduced scope review of the individual funds administered. This will assist with keeping the costs of regulation down while ensuring members' assets are protected. We understand that this type of approach has been used by APRA in the past.[8]

4.11 The Institute of Actuaries of Australia (IAA) advised the Committee that it supported the following APRA proposals to improve the level of risk management control applying to general insurance:

- APRA's supervisory approach and the move to a more risk responsive regulatory regime;
- increased transparency in the general insurance market through greater disclosure;
- consistency with international best practice and competition principles;
- APRA's proposals on entry standards, asset risks, operational risks;

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6 Submission No 27, pp. 6-8.

7 Committee Hansard, p. 380.

8 Submission No 8, p. 2.

- APRA's new statutory solvency standard and statutory valuation standard for general insurers.[9]

4.12 The IAA did not support more stringent reporting requirements in insurers engaging in higher risk business.

*APRA's views*

Superannuation

4.13 In evidence to the inquiry, APRA addressed the issue of risk management controls with respect to superannuation funds. APRA argued that it accepted that diversification (that is, holding a broad spread of asset clauses) reduces investment risk, but did not favour mandating diversification for superannuation funds. APRA noted that it should be possible to strengthen the obligation on trustees to invest prudently, including through diversification, by expanding the scope of Risk Management Statements (RMS).

4.14 The RMS requirements were introduced by the former ISC in late 1995 in response to concerns about the possible imprudent use of derivatives for gearing and speculation. They ensure that trustees are aware of and focus on the impact derivatives can have on the investment profile of a fund, and that trustees of funds investing in derivatives are required to disclose the risk management practices and controls adopted for derivatives in a RMS. While APRA acknowledges that RMS worked very well in practice, it proposes to broaden the RMS requirements to encompass all aspects of a superannuation fund's investment strategy.[10]

4.15 As referred to in the previous chapter, APRA has also recently announced that it will be increasing its efforts to require superannuation funds to provide more timely and accurate information, in order to assist its prudential supervision:

> More rigorous processes have been introduced to reduce the incidence of late reporting of existing prudential returns. Furthermore, improved data returns and collection techniques, currently being developed, will lead to a significant improvement over time in the quality and detail of information provided by superannuation funds. A regular flow of such data is an integral part of building risk profiles of individual institutions which, in turn, is critical to a risk-based approach to allocating supervisory resources. These matters have been (and will continue to be) discussed with industry.[11]

9 Submission No 49.

10 Submission No 23, Attachment pp. 2-3.

11 Submission No 216, p. 6, quoting APRA's recent submission to the Productivity Commission's National Competition Policy Review of the SIS Act.

General insurance

4.16 APRA advised the Committee that it has been working over the past two years on reform of the *Insurance Act 1973*, the prudential legislation covering general insurance. There are currently 161 private sector companies authorised under the Act managing $63.1 billion in assets, and the prudential supervisory regime has been relatively unchanged since the 1973 Act came into force. APRA told the Committee that the Act should be modernised and that there was scope to develop more objective standards for risk measurement and management in general insurance, borrowing from more sophisticated approaches used in life insurance and banking.

4.17 Following consultations with industry, APRA released a revised policy discussion paper in March 2001 with draft Prudential Standards with which companies would be required to comply. A key proposal is the requirement for each insurer to appoint a valuation actuary to advise the company's board on the valuation of insurance liabilities. The board and senior executives will also be accountable for establishing risk management and internal control systems. APRA anticipated that the draft Prudential Standards and Guidance Notes would be finalised later in 2001.[12]

4.18 The Committee notes that the General Insurance Reform Bill 2001 which incorporates such policy changes was introduced by the Minister for Financial Services and Regulation on 28 June 2001, with a view to having the new regime commence on 1 July 2002.[13] The Bill's key objectives include ensuring the new prudential regime is more transparent and responsive to the risk profile of individual general insurers, and ensuring the regulatory regime is more consistent with APRA's other supervisory regimes.[14] The Bill gives APRA power to make, vary and revoke prudential standards, and proposes four prudential standards on liability valuation, capital adequacy, reinsurance arrangements and risk management. Risk weighted capital adequacy requirements similar to that used in banking regulation are to be introduced, and the minimum level of capital for general insurers is to be raised from $2 million to $5 million. As well as the requirement to appoint a valuation actuary, there will be obligations on auditors and actuaries to report to APRA on both a routine and non-routine basis.[15]

4.19 In evidence to the Committee, APRA's CEO elaborated on the value of the proposed new requirement for an evaluation actuary:

> In the event the company decided, for whatever reason, not to follow the advice of the appointed evaluation actuary, that fact will need to be reported to us and reasons for the company deciding to adopt a different evaluation

12 APRA *Prudential Supervision of General Insurance*, Policy Discussion Paper, APRA, March 2001; Committee Hansard p. 1272.

13 House of Representatives, *Hansard* 28 June 2001, p. 27200.

14 Explanatory Memorandum to the General Insurance Reform Bill 2001, cl. 1.5.

15 Second Reading Speech, 28 June 2001.

> approach will need to be set out in full for us … Beyond that, the appointed evaluation actuary will have a general reporting obligation to us – somewhat similar to the reporting obligation … for the external auditors of banks – to draw to our attention any developments in the company that might be putting or are likely to put at risk the interests of policyholders. And there will be the usual whistleblower protections available to the evaluation actuary who follows that course.[16]

4.20 APRA noted that during its on-site inspections APRA would also 'look first-hand at the process by which actuarial evaluations were conducted and form a view about the adequacy of those processes'.[17] APRA also referred to the new requirement 'for certain common assumptions to be fed into the valuation of insurance company liabilities':

> There will be a requirement for a prudential margin at a figure we specify. So the extent to which companies can adopt different approaches to the valuation of their liabilities will be considerably reduced compared with the previous regime … we believe there has been too much room for flexibility and evaluation of claims provisions of insurers in the past and that flexibility will be much reduced in the new regime.[18]

4.21 APRA's view is that if the proposed new regime had been in place, the collapse of HIH may have been avoided because of earlier and clearer warning to the regulator of the company's financial problems.[19]

Dedicated risk team

4.22 APRA provided evidence to another Parliamentary Committee on a recent initiative to improve operational risk management controls (as distinct from credit and market risks).[20] A dedicated team has been established to examine company operational risk from information technology, outsourcing and so on. The purpose of this team is to examine company responses to the threat of operational risk to attempt to heighten the awareness of the issue across all industry sectors regulated by APRA.

Banking capital adequacy: future reform

4.23 The Committee also notes that banks risk management controls may be the subject of reform in the near future. On 17 January 2001, APRA welcomed proposals released by the Basel Committee on Banking Supervision for the reform of

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16 Committee Hansard, p. 1272.

17 Committee Hansard, p. 1274.

18 Committee Hansard, p. 1275.

19 Comments by APRA's CEO reported in 'Planned new law might have saved HIH', *Australian Financial Review*, 29 June 2001, p. 70.

20 House of Representatives Standing Committee on Economics, Finance and Public Administration, Inquiry into the Australian Prudential Regulation Authority, Committee Hansard pp. 26-28.

international capital adequacy guidelines for banks.[21] The Basel Committee's current guidelines, set out in the 1988 Basel Capital Accord, have become the global benchmark for banks' capital adequacy. In Australia, APRA applies the framework to all ADIs – banks, building societies and credit unions.

4.24 APRA's CEO, Mr Graeme Thompson, said:

> APRA supports and welcomes the Basel Committee's reforms. Though more complex than existing requirements, the proposed new rules will give depositors better protection against the risks in banking. They will also be flexible to suit institutions of varying levels of sophistication – a range of capital calculation options will be available.[22]

4.25 Implementation of the revised framework is envisaged in 2004 to give institutions and supervisory agencies sufficient time to consult and prepare for the new system.

*Committee conclusions and recommendation – risk management approach*

4.26 The Committee notes that APRA has many competing objectives and that it is not possible to guarantee with absolute certainty that there will not be serious failure in either a financial institution or a superannuation fund. However, the Committee believes that it is APRA's role to ensure that it minimises the risk of a financial institution failing by taking a rigorous approach to its prudential regulatory functions.

4.27 The Committee is concerned that there may not be sufficient early warning signals of institutional or fund failure, and that those signals which do occur appear to be overlooked at times by the regulator. In these circumstances it is the fund members who suffer the financial losses, many of them very severe. As will be reported separately in its report on the case studies, the Committee considers that, for example, the early warning of problems with EPAS and CNA appear to have been overlooked by the regulator. Although it was not one of the Committee's case studies, the collapse of HIH Insurance is yet another example where early warning signals seem to have been ignored by the regulator.

4.28 The Committee considers that it would be appropriate for APRA to review its approach to risk management to ensure that it has transparent procedures in place to detect early warning signals of impending institutional or fund failure or loss.

4.29 The Committee was particularly concerned to note that APRA was not routinely sending insurance company reports to the Australian Government Actuary, as had been the practice of the former ISC some years ago. However, APRA's CEO

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21 The Basel Committee comprises the central banks and bank supervisory agencies of the G10 countries. It formulates broad supervisory standards and guidelines and recommends best practice in banking supervision.

22 Mr Graeme Thompson, *APRA Welcomes Revised Proposals On Capital Adequacy*, APRA Media Release 01.01, 17 January 2001.

stated that the ISC had stopped the practice 'well before APRA was established', probably in 1996-97:

> This was done because the ISC concluded that the practice was not useful. It was not done to save money. The practice did not involve full-scale actuarial investigations but merely reviews of each company's own working papers. APRA can commission actuarial reports from internal sources from the actuaries office or elsewhere whenever we assess that to be necessary.[23]

4.30 Nevertheless, the Committee considers that such regular scrutiny may provide early warning of problems and may well have been of use in the HIH matter.

4.31 The Committee notes that the proposed new prudential standards for general insurance companies will require companies to have an appointed valuation actuary with statutory reporting obligations to APRA. The Committee welcomes the introduction of the proposed new regulatory regime.

**Recommendation 11**

**4.32 The Committee recommends that APRA review its approach to risk management to ensure that it has transparent procedures in place to detect early warning signals of impending institutional or fund failure or loss.**

4.33 The Committee did not receive many submissions on the risk management controls applicable to banking, life insurance and financial services. However, the Committee notes that new risk management controls for life insurance were introduced with the passage of the *Life Insurance Act 1995*.

4.34 Notwithstanding APRA's claim that new prudential requirements may have avoided the collapse of HIH insurance, the Committee also notes that APRA already has considerable powers to prudentially regulate general insurers. These powers, contained in the *Insurance Act 1973,* pertain to:

- valuation of assets;
- reinsurance arrangements;
- statements of accounts;
- appointment of auditor;
- actuarial investigation; and
- liabilities.

4.35 The Committee notes that questions have been asked about whether APRA made effective use of its powers under the Act in its regulation of HIH insurance. However, it is beyond the Committee's role to make findings in respect of these

23 Committee Hansard, pp. 1262, 1272.

matters, as they are the subject of both an ASIC investigation and a Royal Commission and the Committee would not want to jeopardise any proceedings which may eventuate.

4.36 The Committee also notes that the Australian National Audit Office (ANAO) carried out a recent performance audit of APRA's prudential supervision of banks.[24] The ANAO concluded that while APRA complies with most aspects of the Basel Committee's Core Principles for Effective Banking Supervision, APRA could take steps to improve its supervisory practices, including:

- strengthening its risk management approach; and
- maintaining closer adherence to international standards for prudential supervision issued by the Basel Committee.

4.37 In particular, the ANAO's report noted that despite APRA's program of on-site visits to assess bank risk management systems, regular visits to all banks had not been undertaken. Consequently APRA was unable to meet the Basel Committee's best practice recommendation of periodic verification of banks' adherence to required standards.[25] The report also recommended that APRA consider the merits of a structured program of visits to the offshore operations of Australian banks.[26] APRA agreed to that recommendation.

4.38 In relation to APRA's risk management approach, the ANAO recommended that APRA review its risk rating process to ensure risk ratings provide sufficient basis for prioritising supervisory actions.[27] The ANAO noted evidence that APRA's approach had 'not been universally successful', in that one bank had breached various Prudential Standards and 'appeared to treat ongoing compliance … as a burdensome imposition that may be dispensed with …'.[28] APRA agreed with the ANAO's recommendation, commenting that its risk assessment process was subject to ongoing refinement. The ANAO also noted that APRA's lack of staff had limited some of its supervisory duties to date.[29]

4.39 The Committee notes that the House of Representatives Standing Committee on Economics, Finance and Public Administration is currently reviewing the ANAO's report and investigating the arrangements associated with APRA's supervision of banks.

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24 Australian National Audit Office, *APRA – Bank Prudential Supervision,* Performance Audit Report No 42, 2000-01.

25 ibid, p. 12.

26 ibid, Rec. 3, p. 67.

27 ibid, Rec 2, p. 53.

28 ibid, p. 52.

29 ibid, pp. 49, 62.

4.40 The Committee also notes that, as part of its ongoing performance audit strategy, the ANO is continuing to review APRA's prudential supervision of the superannuation and insurance sectors, and that reports on these areas are expected to be presented over the next two years.

**APRA's performance in prudential supervision**

4.41 The Committee requested APRA to provide information about its performance in fulfilling its statutory obligations in prudential regulation. In accordance with its powers under the SIS Act, the *Insurance Act 1973,* the *Life Insurance Act 1995* and the *Banking Act 1959*, the Committee sought information on APRA's activities in reviewing, monitoring, investigating, examining and prosecuting supervised entities. To provide an historic perspective which would enable some comparison to be made between the level of activity of the former ISC and APRA, the Committee requested that this information be provided over the last five years, that is from 1994/95 to 1999/2000.

4.42 APRA provided a detailed response which was very informative and helpful. However, the response pointed out that 1999/2000 was the first full financial year in which APRA had all of its new responsibilities. APRA also pointed out that it was not always possible to provide consistent information over the period requested, as, amongst other reasons, the categories used by the different regulators might have changed and the various State-based supervisory agencies had their own ways of defining activities such as inspections and detection of breaches of prudential requirements.[30]

4.43 The historical information provided by APRA about the supervision, rehabilitation and enforcement activity of the former ISC (to 1997/98) and APRA (1998/99-1999/2000) in relation to the superannuation industry is as follows:

30 Submission No 90, p. 1.

**Table 4.3: ISC and APRA – Superannuation reviews by fund type 1994/95 to 1998/99[31]**

| Review Type | Fund type | 1994/95 | 1995/96 | 1996/97 | 1997/98 | 1998/99 |
|---|---|---|---|---|---|---|
| Onsite | APRA fund | 293 | 515 | 786 | 999 | 893 |
| | SMSF | 100 | 391 | 389 | 482 | 174 |
| | All | 393 | 906 | 1175 | 1481 | 1067 |
| Desk | APRA fund | 44 | 21 | 39 | 36 | 200 |
| | SMSF | 109 | 39 | 46 | 42 | 167 |
| | All | 153 | 60 | 85 | 78 | 367 |
| **TOTAL** | **APRA fund** | **337** | **536** | **825** | **1035** | **1093** |
| | **SMSF** | **209** | **430** | **435** | **524** | **341** |
| | **All** | **546** | **966** | **1260** | **1559** | **1434** |

4.44 As APRA noted in its submission, the statistics show a steady build-up in the number of reviews of superannuation funds over the past five years.

31 Submission No 90, p. 1.

**Table 4.4: ISC and APRA — Rehabilitation and enforcement activity in relation to superannuation entities 1994/95 to 1999/2000[32]**

| Type of action taken | 94/95 ISC | 95/96 ISC | 96/97 ISC | 97/98 ISC | 98/99 APRA | 99/00 APRA | Total |
|---|---|---|---|---|---|---|---|
| Refer to police/ ASIC/DPP | 3 | 3 | 5 | 2 | 8 | 10 | 31 |
| Refer to ATO | 0 | 4 | 1 | 3 | 5 | 5 | 18 |
| Show cause letter issued | 1 | 4 | 2 | 3 | 5 | 2 | 17 |
| Wind up | 2 | 3 | 1 | 1 | 4 | 6 | 17 |
| Replace trustees[33] | 1 | 2 | 0 | 3 | 2 | 5 | 13 |
| Transfer of assets | 3 | 3 | 0 | 3 | 5 | 7 | 21 |
| Payment of benefits due | 1 | 2 | 0 | 1 | 5 | 2 | 11 |
| Investigator/ liquidator/inspector appointed | 2 | 6 | 1 | 3 | 2 | 3 | 17 |
| Disqualify auditor/ exit industry/ refer to industry body | 1 | 2 | 7 | 4 | 6 | 3 | 23 |
| Fund made non-complying | 0 | 3 | 3 | 5 | 5 | 1 | 17 |
| Other* | 3 | 7 | 4 | 7 | 4 | 3 | 28 |
| **TOTAL** | **17** | **39** | **24** | **35** | **51** | **47** | **216** |

* Other includes: revoke approved trustee, issue notice to produce books, freeze assets, direct trustees not to accept contributions, and meet with board.

4.45 As the table shows, the number of formal enforcement actions taken is relatively small compared with the number of superannuation funds supervised.

4.46 APRA provided the following information about its supervision, rehabilitation and enforcement activity in 1999/2000, the first full year of its operation with all its current responsibilities. Rather than adopting separate structures for regulation of each

32 Submission No 90, p. 2.

33 There appears to be some inconsistency in the number of replacement trustees in material made available to the Committee. APRA provided further details of such instances in Submissions No. 216, p. 7, and 225, p. 29. Those details revealed that one trustee was appointed in 1994/95, one in 1995/96, and following APRA's establishment, four were appointed in 1998/99, one in 1999/2000 and four in 2000/01. APRA explained that the reason for the discrepancy was that the figure of five noted for 1999/2000 in the table above referred to the number of trustees active at the end of the 1999/2000 financial year, rather than the number of new appointments in that year (Submission 225, p. 29).

of the different financial sectors, APRA has adopted an organisational structure where two of its four Divisions, comprising around 60 per cent of its staff, are devoted to day-to-day supervision, and where necessary, to enforcement actions. The Diversified Institutions Division is responsible for the supervision of functionally diversified financial institutions and those with international connections, and hence is concerned with mainly larger organisations. The Specialised Institutions Division supervises institutions whose activity is mainly in one of the traditional categories of deposit-taking, insurance, fraternal benefits or superannuation. These organisations tend to be smaller and greater in number.

**Table 4.5: APRA – Number of visits to financial institutions 1999-2000**[34]

| | **Specialised Institutions Division** | **Diversified Institutions Division** | | | |
|---|---|---|---|---|---|
| **Financial institution** | **Total visits** | **Total visits** | **Consultations** | **On-site reviews** | **Tripartites** |
| ADIs | 143 | 80 | 36 | 12 | 32 |
| Friendly societies | 46 | 0 | 0 | 0 | 0 |
| General insurers | 18 | 15 | 14 | 1 | 0 |
| Life insurers | 2 | 6 | 3 | 2 | 1 |
| Representative offices of foreign banks | 3 | 0 | 0 | 0 | 0 |
| Superannuation entities | 322 | 11 | 10 | 1 | 0 |
| **TOTAL** | **534** | **112** | **63** | **16** | **33** |

4.47 APRA commented that on-site reviews of general insurers had not been carried out regularly prior to APRA assuming that responsibility.[35] In addition to the on-site work, APRA noted that it had carried out around 300 'desk reviews' of superannuation funds, as well as detailed reviews of the quarterly information supplied by ADIs and insurance companies.

4.48 The following table shows APRA's enforcement actions for 1999-2000.

34 Submission No 90, p. 4.

35 Committee Hansard, p. 1262.

## Table 4.6: APRA's rehabilitation and enforcement activity 1999/2000[36]

| Type of action taken | ADIs | Super | General insurance | Friendly Society | Section 66 Banking Act | Bank/ Foreign Rep offices | Total |
|---|---|---|---|---|---|---|---|
| Refer to police/ ASIC/DPP | 0 | 10 | 4 | 0 | 0 | 0 | 14 |
| Refer to ATO | 0 | 5 | 0 | 0 | 0 | 0 | 5 |
| Show cause letter issued | 0 | 2 | 1 | 0 | 0 | 0 | 3 |
| Wind up/ liquidated/ terminated | 4 | 6 | 2 | 11 | 0 | 0 | 23 |
| Breach of prudential standards | 3 | 0 | 4 | 5 | 0 | 1 | 13 |
| Replace trustees[37] | 0 | 5 | 0 | 0 | 0 | 0 | 5 |
| Transfer of assets | 5 | 7 | 0 | 5 | 0 | 0 | 17 |
| Payment of benefits due | 0 | 2 | 0 | 0 | 0 | 0 | 2 |
| Investigator/ liquidator/inspector appointed | 1 | 3 | 1 | 0 | 0 | 0 | 5 |
| Lack of strategic plan | 10 | 0 | 0 | 0 | 0 | 0 | 10 |
| Start up institution | 2 | 0 | 0 | 1 | 0 | 0 | 3 |
| Low profits/ delinquent loans | 19 | 0 | 1 | 0 | 0 | 0 | 20 |
| Disqualify auditor/ exit industry/ refer to industry body | 0 | 3 | 0 | 0 | 0 | 0 | 3 |
| Fund made non-complying | 0 | 1 | 0 | 0 | 0 | 0 | 1 |
| Other* | 10 | 3 | 3 | 0 | 4 | 2 | 22 |
| **TOTAL** | **54** | **47** | **16** | **22** | **4** | **3** | **146** |
| **No. of institutions** | **31** | **34** | **6** | **15** | **4** | **3** | **93** |

* 'Other' includes: revoke approved trustee, issue notice to produce books, freeze assets, direct trustees not to accept contributions, and meet with board, managers and external auditors.

36 Submission No 90, p. 5.

37 There appears to be an error in APRA's reporting of the number of replacement trustees appointed in 1999/2000: see footnote 28.

*Deficiencies in APRA's enforcement powers*

4.49 During the inquiry, APRA informed the Committee that in the course of conducting its core activities some of its enforcement powers were found to be deficient and ineffective in certain circumstances. These were:

- an inability to use discretionary disqualify certain persons from becoming trustee in the same manner that ASIC uses its power under the Corporations Law to prohibit persons being involved in a company;
- an inability to accept enforceable undertakings from trustees (ASIC and the ACCC have such a power in remedying certain contraventions); and
- shortcomings in certain offence provisions.

4.50 To rectify the deficiencies in APRA's enforcement powers, the Government introduced the Financial Sector Legislation Amendment Bill (No 1) 2000. The Bill, which was amended in the Senate, received Royal Assent on 21 December 2000. Both Treasury and APRA advised the Committee that the Act 'will go some way towards addressing identified deficiencies'.[38] APRA envisages a need to make further additional amendments to its enforcement powers through a proposal for a single and consistent enforcement regime across all APRA regulated entities.

*APRA's communication strategy*

4.51 The Committee notes that much of the communication APRA has with regulated entities is by way of circulars. As at June 2001, there appear to have been 27 circulars issued pertaining to superannuation, and a further 24 pertaining to life insurance and general insurance. The Committee notes that these areas, especially superannuation, are very complex, and it is useful for the regulator to clarify statutory and regulatory issues through this means. The Committee notes, however, that there is the potential for confusion about the status of the circulars which could give rise to trustees and others taking action or not taking action on the basis of reliance on APRA circulars. The Committee notes that APRA includes a range of disclaimers in its circulars, such as that the circulars have no legal status whatsoever. The challenge is for APRA to ensure that its circulars are updated regularly to reflect legislative change and provide the most accurate advice, in plain English, to trustees and others on the prudential oversight of funds and institutions.

*Committee conclusions and recommendation – APRA's performance*

4.52 The data presented by APRA is, of necessity, heavily qualified. Bearing that in mind, the Committee notes that APRA's supervisory, rehabilitation and enforcement activities appear to be many and varied. APRA's responsibilities extend to six types of institutions, of which superannuation is just one. The Committee notes that approximately 32 per cent of APRA's rehabilitation and enforcement activity

38 Submission No 87, p. 5 and Submission No 88, p. 4.

centres on superannuation entities, while 45 per cent of APRA's visits to financial institutions were in relation to superannuation entities.

4.53 Notwithstanding this level of activity, the Committee also notes that there are nearly 220 000 superannuation funds, with assets totalling nearly $500 billion, representing the retirement savings of 22.5 million members. These figures are expected to grow to $1 000 billion by June 2010 and $1 700 billion by June 2030.

4.54 Although the majority of these funds are ATO regulated self-managed funds, APRA directly or indirectly regulates about 11 000 superannuation funds. About 3 000 of the APRA regulated superannuation entities have assets approaching $300 billion. Because of the significant amounts involved, and the importance of safeguarding retirement savings and incomes, the Committee considers that APRA should be doing more in the area of prudential supervision of superannuation funds. The Committee has commented earlier in this chapter that one area in which APRA could concentrate is the small to medium sized funds, in order to mitigate the risks associated with these types of funds.

4.55 The Committee also notes (as is discussed in Chapter 6) that as the superannuation sector provides a large part of APRA's funding through supervisory levies, it should therefore receive a large proportion of APRA's supervisory attention.

**Recommendation 12**

**4.56 The Committee recommends that APRA increase the attention it gives to the prudential supervision of superannuation entities, especially those in the small to medium sized fund environment.**

**Resources for prudential supervision**

4.57 As is discussed in more detail in Chapter 6, APRA is funded almost entirely by levies collected from the various financial sectors.

4.58 As at 30 June 2000, APRA had 425 staff.[39] According to APRA, only around 200 of the approximately 600 staff of its predecessors remained with APRA (with departures due to restructuring and normal turnover since July 1998). This has required APRA to undertake not only recruitment action but also extensive training and retraining.[40]

4.59 The Committee has noted elsewhere in the report that some in the industry consider that with the loss of staff during the changeover in 1998 and since, APRA's resources have not only been depleted, but its staff now lack practical experience, especially in the supervision of the superannuation industry (see Chapter 2).

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39 APRA, *Annual Report 2000*, p. 93.

40 Submission No 90, p. 3.

4.60 In the wake of recent corporate disasters such as the collapse of HIH and CNA, the Committee considers that APRA has received a number of severe wake-up calls and therefore faces some significant challenges. These are to:

- ensure that it has adequate resources to perform its task of prudential supervision, within budgetary constraints, of all the institutions and entities for which it has responsibility;
- ensure that all staff are appropriately trained; and
- ensure that resource deployment is appropriate to meet the challenges of effective supervision within a framework of risk based assessments.

4.61 While it is a matter for the regulator to deploy its resources in the way in which it sees fit, the Committee considers that APRA has not devoted sufficient resources to the prudential supervision of some superannuation funds, and that this is the reason that problems have occurred in cases like EPAS. The Committee notes that many of the 'problem' funds appear to be located in Queensland. The Committee considers that it may be useful for APRA to review the reasons behind this apparent trend, and if necessary, consider the allocation of resources.

4.62 The Committee is also aware that, in the wake of the HIH collapse, the resources of APRA have been stretched. As the Australian National Audit Office identified, APRA may also need to devote more attention to supervision of the banking sector. This, together with the need for APRA to monitor more closely the performance of smaller and medium sized funds, may place additional strains on its capacity to provide effective prudential supervision.

4.63 The Committee is somewhat concerned about the narrow and legalistic approach which has sometimes been taken by the regulator. The Committee sees considerable scope for APRA to broaden its narrow view of its statutory responsibilities so that it can provide more effective prudential supervision of the sectors for which it is responsible.

4.64 With these additional responsibilities in mind, the Committee therefore considers that it may be timely for the Government to review the resources allocated to APRA, to ensure that it is provided with the necessary resources to perform effectively as the prudential regulator, and thereby to ensure that the community has confidence in the regulation of superannuation, banking and financial services, including the insurance sector. This may include giving APRA more resources from government funds rather than imposing additional charges on funds and members through higher levies.

4.65 The Committee considers that such a review should also consider the adequacy of APRA's resources and the adequacy of APRA's skills in particular areas of the financial services industry, including reinsurance arrangements, hedging and Internet security.

**Recommendation 13**

**4.66 The Committee recommends that the Government review the resources allocated to APRA, to ensure that it is provided with the resources necessary to match its level of supervisory responsibilities.**

4.67 As mentioned in Chapter 2, the quality and experience of APRA staff is also an issue which the Committee will monitor.

**Data collection by APRA and the ATO**

4.68 During the inquiry the Committee experienced considerable difficulty in obtaining data that was consistent over time, accurate and up to date, particularly in relation to superannuation entities. For example, there are discrepancies in the data provided by APRA regarding the number of superannuation funds which exist and which it regulates.

4.69 The Committee acknowledges that APRA faces many difficulties in collating data, including:

- late lodgement of or failure to lodge annual returns;
- discrepancies in data sources;
- the rapid growth in the superannuation industry, with an average growth of 14 per cent per annum; and
- the transfer to the ATO of responsibility for the supervision of self-managed superannuation funds in 1999/2000.

4.70 However, the Committee considers that it would be helpful to standardise the data collected in order to provide a more consistent framework which will allow more meaningful comparisons over time. This might include developing a more consistent definition of what constitutes small, medium and large superannuation funds. It also might include giving more attention to the application of fund classification. Under the SIS Act superannuation funds are classified into functional categories such as corporate, industry, public sector, retail and small funds. However, a recent APRA paper has pointed out that one of the difficulties with data collected is that funds may classify themselves according to how they wish to be seen rather than how they operate in commercial reality, and that this might lead to a distortion of statistics.[41]

4.71 As discussed in Chapter 3 and noted in Chapter 6, the Committee also considers that there is scope to standardise the definition of 'administrative charges' in returns provided by funds to APRA.

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41 R O'Donohue, APRA, 'Review of APRA Superannuation Statistics', p. 4, Paper presented at "Reform of Superannuation and Pensions", Ninth Annual Colloquium of Superannuation Researchers, Sydney, 9-10 July 2001.

4.72 The Committee notes that APRA is currently reviewing the method by which it obtains data and is working with the Australian Bureau of Statistics to improve data reported by large funds. In line with that project, APRA is developing new superannuation returns, expected to be in place for the 2002/03 financial year.[42]

4.73 The Committee welcomes APRA's review as it promises to provide more robust data which will greatly assist policy makers, researchers and others to have a better and more accurate understanding about Australia's superannuation industry. As part of this review, the Committee also sees merit in APRA and the ATO working closely to ensure accurate statistics for all small superannuation funds.

4.74 The ATO is currently developing data on the self-managed superannuation funds for which it assumed responsibility in 1999/2000, as was mentioned in Chapter 3.[43] The income tax returns now show a more detailed asset allocation than that previously required by APRA.

4.75 The Committee considers that there is a great opportunity for the ATO, as the regulator, to identify the data that should be required from those funds. For example, researchers have suggested that the ATO might consider adding investment returns to the data being captured. This might provide assurance about fund performance and give early warning signals to the regulator if the fund is getting into difficulty. Given that the failure of a self-managed superannuation fund has a potential impact on the taxpayer, improving the effectiveness of the supervision would be helpful.

4.76 As mentioned in Chapter 3, the Committee also considers that APRA's data on superannuation funds would be improved if more specific information in returns on fund performance were required. This may mitigate investment risk and assist the regulator to identify any early warnings of possible fund failure.

4.77 The Committee considers that in order to ensure a more consistent data framework, it would be useful for the ATO to continue to work closely with APRA to identify data required in returns. The Committee notes that concerns have been expressed about the different reporting requirements for ATO funds and small APRA funds, and addresses this issue in Chapter 7.

4.78 As noted in the previous section of this chapter, APRA is also aware of a number of discrepancies in the data it has collected on its enforcement activities. The Committee considers that, as part of its project to review superannuation statistics, it would be timely for APRA to review its own data collection on its enforcement activities. More accurate and consistent data collection will enable APRA to

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42 ibid, p. 7.

43 M. Roberts, ATO, 'Self Managed Superannuation Funds – Preliminary Statistics', Paper presented at "Reform of Superannuation and Pensions", Ninth Annual Colloquium of Superannuation Researchers, Sydney, 9-10 July 2001. The data is preliminary as the first returns from the funds were only due on 31 March 2001.

demonstrate more clearly than is currently the case how effective APRA has been in prudentially regulating the various financial institutions for which it has responsibility.

4.79 The Committee has recommended in Chapter 3 that APRA require more specific detail in annual returns about fees, charges and commissions.

# CHAPTER 5

# CONSUMER PROTECTION – THE ROLE OF ASIC

## Introduction

5.1 Financial markets cannot work well unless participants act with integrity and provide adequate disclosure to allow consumers to make informed judgements. Such conduct and disclosure are achieved through regulation which ensures that markets are orderly and transparent, and the price formation process is reliable. Markets must also be free from misleading, manipulative or abusive conduct, and retail customers must have adequate information, be treated fairly and have adequate avenues for redress.[1]

5.2 As outlined in Chapter 2 and Appendix 4, conduct and disclosure regulation of different types of financial institutions was formerly undertaken by several Commonwealth agencies, including the ISC, the ASC and the ACCC. Under current arrangements, and in accordance with the recommendations of the Wallis Report, responsibility for ensuring Commonwealth regulation of corporations, financial market integrity and financial consumer protection across the financial sector as a whole now belongs primarily to ASIC.[2]

5.3 This Chapter examines the adequacy of this legislative and organisational framework for financial consumer protection, as well as ASIC's operational effectiveness.

## Legislative and structural arrangements

5.4 ASIC began operations on 1 July 1998. It is charged with the regulation and enforcement of laws designed to promote honesty and fairness in the following areas:

- investments, superannuation, insurance, deposit-taking and financial advice to Australian consumers;
- buying and selling shares, debentures, options, futures contracts, managed investments and other securities in Australian markets; and
- directing and managing companies, company financial reports, raising money from investors and takeovers.[3]

5.5 ASIC's legislative underpinning is the *Australian Securities and Investments Commission Act 1989*, which was amended in the light of the Wallis Report to mirror

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1 See Appendix 4.

2 The ACCC has retained responsibility for consumer protection in relation to credit products. See Committee Hansard, p. 857.

3 Submission No 11, p. 96.

the consumer protection provisions relating to financial services in the *Trade Practices Act 1974*. At the same time, the Trade Practices Act, whose enforcement is the responsibility of the ACCC, was amended to exclude financial services (as defined) from its jurisdiction, with the exception of matters relating to credit, foreign exchange, GST, unconscionable conduct and electronic commerce.[4]

5.6 At its establishment ASIC also gained responsibility for existing legislation and codes of conduct covering general insurance, life insurance, superannuation and banking.[5]

**Adequacy of legislative and structural arrangements**

5.7 The Committee received evidence which raised concerns about aspects of the legislative and structural arrangements for ensuring consumer protection in the financial services area. These concerns may be summarised under the following headings:

- adequacy of disclosure regime;
- gaps in regulatory regime;
- adequacy of redress mechanisms; and
- representation of consumer affairs in government.

5.8 The Committee will discuss these matters in turn.

*Adequacy of disclosure regime*

5.9 Criticisms of the disclosure regime were targetted at three levels, as follows:

- the regulatory regime itself;
- disclosure of bank fees and charges; and
- disclosure of commissions for financial advice.

5.10 In its submission to the Committee, ASIC noted that the regulatory regime it inherited for consumer protection was fragmented and did not ensure consistent disclosure across different parts of the financial sector.[6] ASIC said that this made it difficult for consumers to compare products and services and hence to make fully informed choices.[7] ASIC noted that the implementation of a consistent disclosure

4 Committee Hansard, pp. 856-857.

5 Submission No 11, p. 98.

6 Appendix A of ASIC's submission lists a plethora of legislation, regulation, policy and codes of practice which apply variously to products and services offered by different institutions (banks, credit unions, insurers, superannuation funds, financial advisers, share markets and so on). Submission No 11, pp. 151-153.

7 Submission No 11, p. 93.

regime was one of the recommendations of the Wallis Report, and requires enactment in legislation.[8]

5.11 A number of other witnesses, including the Australian Society of Certified Practising Accountants, now CPA Australia,[9] the Institute of Chartered Accountants in Australia,[10] the NRMA,[11] and the Investment and Financial Services Association,[12] raised similar concerns and endorsed the introduction of legislation to ensure consistency in the disclosure regime across the finance sector.

5.12 The second set of criticisms levelled at the disclosure regime focused on bank fees and charges. Within this set, two matters must be distinguished. The first concerns criticism of the *cost of banking* and the *lack of monitoring of the level of bank fees and charges*. The Financial Services Consumer Policy Centre, for example, claimed that the issue of bank fees is 'the most prominent issue in consumers' minds in financial services and the one which has the greatest impact on the lowest income and most vulnerable consumers, and yet Australia has no monitoring of fees and charges'. Mr Chris Connolly, Director of the Centre, said that the consequence of the lack of monitoring is that:

> … the government at any one time does not know what fees and charges apply to the bank accounts of, say, pensioners; they do not know how quickly those fees and charges are increasing; they have no idea whether a new fee or charge is being introduced; there is no general monitoring. In addition, there is no regulation of fees and charges in that a fee and charge could increase by 300 per cent today or tomorrow and there would be no trigger for that to be reviewed by the government at all. There would be no comeback for consumers who believe that that rise was unfair.[13]

5.13 Mr Connolly went on to note that the government's approach to this issue 'has been to let the market look after fees and charges' with the result that ASIC has no power to 'take complaints or make inquiries about the level of fees and charges'.[14] While the ACCC has power to act if bank fees or charges are anticompetitive, Mr Connolly claimed that 'it does no monitoring of fees and charges so it can never know whether a fee or charge is anticompetitive or not'.[15]

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8 Submission No 11, p. 93.

9 Submission No 20, p. 271.

10 Submission No 8, p. 73.

11 Submission No 18, p. 246.

12 Submission No 27, p. 379.

13 Committee Hansard, pp. 34-35.

14 Committee Hansard, p. 35.

15 Committee Hansard, p. 35.

5.14 Similarly, Ms Louise Petschler, Senior Policy Officer, Financial Services, Australian Consumers' Association, expressed concern that:

> … there really is no effective government monitoring of fees, per se, at the moment and no mechanism by which consumers can get redress for what they perceive to be an unfair or undue fee increase for a particular service, unless you can show that it breaches competition law, essentially.[16]

5.15 ASIC acknowledged that its role in this area was limited but noted that any expansion of its responsibilities to include the monitoring of the level of bank fees and charges would involve a change of government policy.[17]

5.16 The second kind of criticism pertaining to bank fees and charges focused specifically upon the issue of the *disclosure* of those fees. Ms Petschler told the Committee that:

> We think that disclosure of fees is a fundamental consumer protection issue in banking and it is something that consumers tell us that they want. They do not understand the fee regimes that are imposed upon them. Our survey results show us that more than half of our respondents find it difficult to tell which bank account is best for them because they do not understand or are not informed about the fees and charges that they will pay on those accounts. Research by the Financial and Consumer Rights Centre in Melbourne … also showed that most of the consumers that were surveyed were unaware of the costs that they were being charged for electronic banking services, including ATM, EFTPOS transactions, Internet and telephone banking.[18]

5.17 While acknowledging that 'there will be a lead time in terms of some of the technology', Ms Petschler argued that disclosure of bank charges to consumers should ideally occur 'at the point of transaction'.[19]

5.18 Questioned on its role in ensuring the adequate disclosure of bank fees to consumers, ASIC informed the Committee that as part of its contribution to the review of the banking industry's code of conduct it has recommended that fee disclosure be improved. In the context of Internet banking, ASIC recommended that an Internet banking site have a clear link to information about fees and charges. It further recommended that this information be more readily available on statements and in telephone banking transactions. Ms Delia Rickard, Director, Office of Consumer Protection, ASIC, told the Committee that:

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16 Committee Hansard, p. 672.

17 Committee Hansard, p. 779.

18 Committee Hansard, p. 672.

19 Committee Hansard, p. 672.

> ASIC is also chairing a working party consisting of industry, consumer groups and some government representatives. The product of that working party is likely to be an ASIC guide to good disclosure practices for transaction accounts. I think it is fair to say that we have achieved a fair amount of consensus so far about the recognition that there is a need to improve fee disclosure and the basics of how to do that.[20]

5.19 She went on to note that:

> There are several categories of fee disclosure … I think we will see immediate improvements in statements, Internet banking et cetera. In terms of real time disclosure of fees – that actual costs of a particular transaction at the time of the transaction or where you are up to in terms of the number of free transactions – because of the sorts of costs and system changes involved, those sorts of reforms will take a bit longer.[21]

5.20 The Committee notes that the issue of fee disclosure specifically in relation to electronic and telephone banking has been discussed in detail in a recent report by the Parliamentary Joint Statutory Committee on Corporations and Securities titled *Report on Fees on Electronic and Telephone Banking* (February 2001).

5.21 Finally, the third set of concerns raised about the disclosure regime related to the disclosure of commissions for financial advisers or agents.

5.22 As explained by Mr Malcolm Rodgers, Director, Regulatory Policy, ASIC, the current financial services regime requires that financial advisers disclose any commission or financial incentive they receive as a result of selling particular financial products.[22] The policy of disclosure assumes that if consumers are informed about the extent to which advisers may be influenced by self-interest in recommending particular financial products, they are then in a position to make a more independent assessment of the merits of particular suggestions. This information is deemed to be sufficient to allow consumers to take steps to protect themselves.

5.23 Evidence to the Committee argued, however, that the disclosure of commissions and other benefits may provide insufficient protection for consumers on two grounds. Mr Anthony Starkins, Managing Director, First Samuel Ltd, argued that the disclosure regime is founded upon the false premise that the relationship between financial adviser and investor is a relationship between equals.[23] It wrongly assumes, according to Mr Starkins, that an investor is in a position to assess whether the advice provided is in the investor's best interests, notwithstanding the fact that the adviser stands to benefit if the advice is taken. When the level of expertise is unequal, however, simply knowing that the adviser stands to gain from the transaction does not

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20 Committee Hansard, p. 779.

21 Committee Hansard, p. 779.

22 Committee Hansard, p. 799

23 Submission No 74, p. 7.

help the investor to make an objective assessment of the merits of the particular proposal.[24]

5.24 Furthermore, the requirement to disclose does not require the adviser to inform the investor of the opportunity cost of particular proposals. For example, an adviser who is employed by a bank and who recommends one of the bank's products is required to disclose that he or she will receive, say, a 60 per cent commission on that product. The adviser is not required to disclose, however, that he or she could have recommended a similar product from another bank, on which the adviser would only make a 20 per cent commission.[25]

5.25 Mr Starkins argued that the retail investor 'should be able to have independent and disinterested advice. However, the presence of commissions and other benefits as part of the decision regime considerably qualifies that advice'.[26] He concluded that financial services legislation should be amended to recognise a fiduciary relationship between financial adviser and client, such that the adviser has a duty to act for the sole benefit of the client and that the payment and receipt of commissions or other benefits, whether disclosed or not, should be made illegal.[27]

5.26 Finally, some evidence to the Committee expressed concern about the ways in which commissions or benefits to advisers are funded and about the capacity of investors to understand the significance of different arrangements. For example, Industry Fund Services maintained that the commissions paid to agents who sell superannuation fund membership may be disclosed, but in such a way as to hide from investors the real impact of the commission on their ultimate savings.[28] Following an analysis of a range of commission recovery arrangements, the Industry Fund Services's submission stated:

> Even in a regulatory environment in which a promoter is required to advise a consumer of the quantum of fees levied on their savings, there would still not be any disclosure of the impact of those fees on the consumer's ultimate retirement benefits. If the consumer is an average person, it is unlikely that they will be able to translate the quantum of fees into an understanding of the amount they will be paying in commission and other fees … For example, the average person is likely to believe that a fee of '5% of all contributions ever paid into their superannuation fund' is more disadvantageous than '1% off the top of their fund earnings each year'. In fact, the second fee has a far greater impact on the end benefits …[29]

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24 See Submission No 74, p. 8.

25 Committee Hansard, pp. 797-800.

26 Submission No 74, p. 11.

27 Submission No 74, p. 2.

28 Submission No 45, p. 536.

29 Submission No 45, p. 540.

5.27 Accordingly, the submission argued that:

> Disclosure must be structured to allow people to make informed decisions and the best way to achieve that is to ensure that people are clearly shown the impact of the structure of a fund on their savings, and not simply told the quantum of the fees and charges.[30]

5.28 In a similar vein, the Financial Planning Association of Australia Ltd argued that:

> Critical to the effectiveness of disclosure and the ability of consumers to make an 'apples and apples' comparison of different funds is the development of a standardised industry-wide disclosure regime that requires disclosure of all fees, commissions and bonuses.[31]

Committee comments – adequacy of disclosure regime

5.29 In relation to the question of the consistency of the disclosure regime as it applies across the financial industry, the Committee notes that reforms to that regime are now in the process of being legislated. In his second reading speech for the Financial Services Reform Bill 2001 on 5 April 2001, the Minister for Financial Services and Regulation, the Hon. Joe Hockey MP, drew attention to the Wallis Report recommendation that 'a single licensing regime for all financial sales, advice and dealing and the creation of a consistent and comparable product disclosure framework' be introduced. He maintained that 'the comprehensive package of reforms proposed in the Financial Services Reform Bill 2001' will 'introduce a harmonised regulatory regime for market integrity and consumer protection across the financial services industry'.[32]

5.30 The Committee notes that the proposed bill has been generally welcomed by the financial sector.[33] The Committee also notes that the bill is currently the subject of an inquiry by the Joint Statutory Committee on Corporations and Securities.

5.31 In relation to the issue of government monitoring of the level of bank fees and charges, the Committee notes the concerns that have been expressed. The Committee is pleased to note ASIC's work with industry, consumer groups and some government representatives aimed at producing a guide to good disclosure practices for bank fees, including telephone and internet transactions.

5.32 Finally, on the issue of disclosure of commissions for financial advisers, the Committee has noted with interest Mr Starkins's proposal that the relationship

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30 Submission No 45, p. 540.

31 Submission No 72, p. 3. This recommendation is endorsed also by the ACTU, Submission No 29, p. 413, and the Financial Services Consumer Policy Centre, Submission No 26, p. 346.

32 Hon. Joe Hockey, Second Reading Speech, Hansard, 5 April 2001, p. 25635.

33 'Thumbs-up for finance sector reform bill', *The Australian Financial Review*, 9 April 2001.

between financial adviser and investor be deemed a fiduciary relationship. At the same time, it notes the advice of ASIC that the 'rules in the Corporations Law about disclosing commissions or other things that might affect the giving of advice … make it very clear that the law contemplates that there will be commissions that can be paid to advisers'.[34] The Committee is not persuaded of the need to implement such a radical change to financial regulation as envisaged by Mr Starkins, as long as the disclosure regime is rigorous and consistent.

5.33 On the issue of whether the disclosure of commissions informs consumers *in practice* of the relative suitability of particular products, the Committee notes that the Financial Services Reform Bill 2001 introduces measures which should assist in this area. The Bill aims to have commissions, fees and benefits described in a standardised format that will allow consumers to compare 'apples with apples', and hence to be in a better position to exercise genuinely informed choice.

*Gaps in regulatory regime*

5.34 As reported in Chapter 2, the Committee received some evidence suggesting that the split in responsibility for consumer protection between ASIC and the ACCC is difficult for both consumers and consumer advocates to understand.[35]

5.35 The ACCC advised that a consequence of this split is that there are gaps in coverage of certain areas. Mr Allan Asher, Deputy Chairman, ACCC, commenting on the issue of regulatory gaps and overlaps arising from the post-Wallis Report division of responsibilities said:

> I am not really aware of any overlaps, but I think there are a number of gaps and tensions that arise. That is because, in the way that the law was implemented, the Trade Practices Act was amended to exclude certain financial services, as defined, but remained with jurisdiction in some other areas. Put most generally, credit type producers were left within our jurisdiction while debit type products, investment products, were taken out. But as any observer could readily note, the distinction between those sorts of products is a fairly historical one and increasingly you get debit cards that have some credit card facility or you might buy bundled goods and financial services. So there are a number of areas where the jurisdiction is not all that clear.[36]

5.36 Mr Asher went on to say that this issue, as well as the issue of the ACCC's role in consumer protection in health insurance, has 'been dealt with through a memorandum of understanding with ASIC and certain cross-referrals of powers'.[37]

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34 Committee Hansard, p. 797.

35 Submission No 10, p. 82; Submission No 26, p. 339.

36 Committee Hansard, p. 857.

37 Committee Hansard, p. 857.

5.37 The Committee also notes that, at the organisational level, ASIC has established an infoline which provides a single entry point for consumer inquiries. ASIC said: 'We think an effort should be devoted to ensuring that line serves that purpose and that it is able to refer people on to the appropriate ADR [alternative dispute resolution] scheme, the ACCC or a state fair trading agency, if needed; or internally to ASIC'.[38]

Committee comments – gaps in the regulatory regime

5.38 The Committee considers that the combination of inter-agency memoranda of understanding and the central referral infoline for consumers should mitigate any confusion experienced over the different roles of ASIC, the ACCC, state agencies and industry schemes in delivering effective consumer protection.

5.39 However, as the Committee has recommended in Chapter 2, the regulators need to do a lot more to develop a coordinated strategy to improve awareness in the community about their respective roles and responsibilities.

5.40 In that Chapter, the Committee also recommended that an Office of Regulatory and Consumer Affairs be established to act as a first point of call for consumers and others unsure of which regulator to approach regarding a particular issue.

*Adequacy of redress mechanisms*

5.41 Consumer protection requires both that consumers have access to dispute resolution mechanisms and to appropriate redress for harm suffered. Mr Peter Kell, Coordinator, Office of Consumer Protection, ASIC, informed the Committee that:

> The sort of process that we look for across the finance sector is that normally someone would be asked or advised to try and deal with [a] problem with the individual firm or adviser in the first instance. If that does not provide them with a satisfactory solution, they are referred to an appropriate dispute resolution body or possibly ASIC.[39]

5.42 Mr Kell went on to say that ASIC is currently working to ensure that all licensees, all financial advisers and securities dealers listed under the Corporations Law belong to an approved dispute resolution scheme which can deal with consumer complaints.[40]

5.43 In relation to superannuation, the major current mechanisms for dispute resolution involve the following:

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38 Committee Hansard, p. 777.

39 Committee Hansard, p. 778.

40 Committee Hansard, p. 778.

- the Superannuation Complaints Tribunal (SCT) whose role is to enable superannuation fund members to resolve complaints about decisions or conduct of trustees, insurers, Retirement Savings Accounts (RSA) providers, superannuation providers and certain other decision makers in relation to regulated superannuation funds, approved deposit funds, life policy funds, annuity policies and RSAs;
- the Award system, which currently provides a mechanism through the Australian Industrial Relations Commission to resolve some disputes between employer and employee, including disputes over superannuation; and
- the Financial Industry Complaints Service (FICS) which is authorised under its constitution and by ASIC to conduct alternative dispute resolutions between companies, which are its members, and consumers of superannuation products. FICS's jurisdiction over superannuation complaints intends to extend to all matters involving members and consumers which do not fall within the jurisdiction of the SCT.[41]

5.44 For consumer complaints relating to the banking industry, the Australian Banking Industry Ombudsman is the first port of call. The Committee notes that the banking and credit union codes of conduct are currently under review by ASIC, as are the terms of reference of the Banking Industry Ombudsman.[42]

5.45 The Committee also notes that the SCT has addressed the backlog of some 320 cases which accumulated since 1996 during the hiatus caused by the Federal Court in the *Wilkinson v CARE* and *Breckler v Leshem* decisions. The Tribunal reported in June 2001 that it had commenced its disposition of the 2000-2001 cases.

5.46 On the issue of redress for harm suffered, the Committee received some evidence expressing concern about the level of protection for consumers' funds. For example, the Association of Independent Retirees Inc. criticised the Financial Services Reform Bill for failing to provide for the restoration of capital sums which are lost through misappropriation. The Association contended that merely strengthening the licensing and disclosure regime does not impose a sufficient 'duty of care' upon the finance industry and hence leaves one of the most vulnerable sectors of the community at risk. Accordingly, it recommended that:

> The finance industry be obligated by a provision in the Finance Services Reform Bill to enforce participation in a contributory *Default Indemnity Provision Fund* to be administered by the government as a first preference, specifically for the purpose of restoring equity to those defrauded by

41 Senate Select Committee on Superannuation and Financial Services, *Roundtable on Choice of Superannuation Funds*, March 2000, p. 49.

42 Committee Hansard, p. 780.

> members of the industry in established circumstances such as misappropriation or other criminal activity.[43]

5.47 Other evidence before the Committee also expressed concern at the vulnerability of older investors and at the difficulty faced by superannuation fund members in obtaining information about suspected fraud or theft by trustees.[44]

Committee comments – adequacy of redress mechanisms

5.48 The Committee is concerned to ensure that consumers have adequate access to complaint mechanisms. The Committee notes that the United Kingdom has established a Financial Services Ombudsman as a single entry point for consumers with complaints. In Australia ASIC has sought to establish a consumer info line, but this is only a small step towards achieving a one-stop shop approach to consumer affairs.

5.49 The Committee considers that there is merit in the idea of a single complaints body that is adequately resourced.

5.50 The Committee is pleased to note that the Superannuation Complaints Tribunal, one of the principal complaint mechanisms, appears to have addressed the backlog of cases which had accumulated during the hiatus caused by a Federal Court decision which effectively removed all of the Tribunal's powers to make determinations.

5.51 The question of protection for capital sums is an issue which the Committee takes very seriously, especially in the light of the recent collapse of HIH and the failure of a CNA fund. In its second report on this term of reference, the Committee will report on a number of case studies including CNA, and, accordingly, will discuss the issue in that report.

*Representation of consumer affairs in government*

5.52 The final set of issues raised in relation to the legislative and structural arrangements for consumer protection in the financial services area concerned the adequacy of the representation of consumer issues in government itself.

5.53 The Financial Services Consumer Policy Centre said that the 'consumer movement as a whole' is concerned that there is no longer a Federal Minister for consumer affairs. It maintained that the 'downgrading' of the former department of consumer affairs to a division of Treasury has inhibited public policy development in the area and has meant that a consumer perspective on significant issues, such as tax reform, has been lacking. The Centre continued, saying:

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43 Submission No 44, p. 528.

44 See, for example, Submission No 48, Submission No 21, and Committee Hansard, pp. 9-10.

> The downgrading of the Minister was accompanied by the de-funding of the Consumers' Federation of Australia which at the time was the peak consumer organisation in Australia. The de-funding of the CFA has effectively marginalised the consumer movement from general policy input … We believe that this has a very adverse affect on public policy. This is particularly problematic in financial services where so much of our policy perceptives are informed by grass roots case work experience.[45]

Committee comments – representation of consumer affairs in government

5.54 The Committee notes that the question of the representation of consumer affairs in government is a general question, and is not confined simply to consumer protection in relation to superannuation, banking and financial services. The issue, then, goes beyond the Committee's terms of reference.

5.55 With regard specifically to consumer protection in the financial services area, the Committee considers that ASIC's Office of Consumer Protection should help to ensure both a high profile and the maintenance of strategic thinking in consumer affairs in this industry. Recognising the importance of the consumer perspective in the finance industry, however, the Committee considers that if the Government implements its recommendation to establish an Office of Regulatory and Consumer Affairs, this Office would enhance the profile given to consumer affairs.

**ASIC's operational effectiveness**

5.56 ASIC has overall responsibility for consumer protection in the financial services area. It informed the Committee that it had taken action to ensure that a consumer protection perspective is incorporated into all of its activities, enforcement, compliance, education and policy work.[46] To help it achieve this goal ASIC established the Office of Consumer Protection, which has the following functions:

- providing advice on consumer protection issues within ASIC, including strategic consumer protection advice;
- identifying current and future consumer protection risks and developing effective strategies to deal with them;
- ensuring effective links with ASIC and key consumer stakeholders; and
- ensuring ASIC's communications strategies adequately address the needs of consumers and are appropriately targetted.

5.57 Ms Delia Rickard, Director, Office of Consumer Protection, informed the Committee that in its two years of operation ASIC has put in place a number of structures designed to deliver effective consumer protection. These include:

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45 Submission No 26, p. 351; Committee Hansard, p. 36.

46 Submission No 11, p. 35.

> 'developing collaborative partnerships through … establishing structured liaison with consumer groups, including forming the Consumer Advisory Panel; establishing memoranda of understanding and cooperative arrangements with other areas of government, such as APRA, the ACCC and state consumer protection agencies … It also involves supporting self-regulation through means such as developing and implementing our policy for approving external dispute resolution schemes and assisting industry with the development and review of their codes of conduct'.[47]

5.58 ASIC has also undertaken a number of consumer education projects in collaboration with industry associations. For example, in conjunction with the Financial Planning Association, ASIC produced a guide for consumers for choosing the right financial adviser. It produced a booklet, *Super Decisions*, with the Association of Superannuation Funds of Australia and has begun work with the Securities Institute of Australia to provide an online directory of financial services consumer education material.[48]

5.59 Mr David Tennant, Director, Care Incorporated, Financial Counselling and Consumer Credit Legal Service, remarked also upon an ASIC discussion paper on educating consumers about financial services products 'that opens the possibility of partnerships with community based organisations to not only deliver education services that suit low income consumers but actually try and get some dialogue going with low income consumers about what they need and the manner in which that information would be most useful'.[49] He said: 'We are extremely encouraged by some of the efforts that the ASIC Office of Consumer Protection are taking at the moment in this regard'.[50]

5.60 This acknowledgement notwithstanding, the Committee received evidence which raised concerns about some aspects of ASIC's performance. The evidence covered the following matters:

- ASIC's communication with consumers and industry;
- ASIC's oversight of industry codes;
- adequacy of mechanisms for selecting consumer representatives;
- adequacy of consumer education programs;
- adequacy of handling of complaints and conciliation; and
- enforcement.

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47 Committee Hansard, p. 775.

48 Submission No 11, p. 111.

49 Committee Hansard, p. 723.

50 Committee Hansard, p. 723.

*ASIC's communication with consumers and industry*

5.61 Care Incorporated reported that its clients have difficulties in their direct communications with regulators. The submission stated that:

> The general impression is that unrepresented consumers have difficulty in obtaining useful or understandable information, or intervention. There are also barriers in the manner in which consumers make contact with regulators. From our experience these include poor information about contact points, over formalising the manner in which complaints must be communicated, little or no follow up, etc. These barriers are exacerbated for the most vulnerable consumers, who lack the skills or resources to take action on their own behalf.[51]

5.62 In oral evidence, Care Incorporated further reported that even it 'found it extraordinarily difficult to get any feedback from the regulators on what was happening'[52] in relation to a case it had referred.

5.63 The SCT also told the Committee that it was dissatisfied with the level of communication from ASIC about cases that the Tribunal referred to the regulator. Mr Graham McDonald, Chair of the Tribunal, said:

> I received the first report back from ASIC on our complaints to them about breaches – it arrived on my desk yesterday … I am not happy because they do not report to me necessarily what the outcome is. I do not know whether our reporting is having much effect or any effect or whether it is worth while or not worth while, because I cannot see the results.[53]

5.64 From the industry perspective, representatives of the AMP likewise expressed concern at ASIC's capacity to commmunicate effectively with stakeholders. The AMP's former Senior Strategy and Technical Adviser, Mr Kevin Casey, was of the view that because of 'the lack of feel for the industry that they [ASIC] are managing, they adopt very much a legalistic approach. Therefore, it puts everything onto a semiconflict basis, where it is the regulator versus the trustees, rather than trying to work together to resolve the issue'.[54] He expressed the hope that ASIC's understanding of the financial services and superannuation areas 'will come over time as they get more experience' and said:

> … we are seeking ways in which to try and expedite that experience. Certainly, from AMP's point of view, we have sought to meet with our

51 Submission No 10, p. 83.

52 Committee Hansard, p. 725.

53 Committee Hansard, p. 221.

54 Committee Hansard, p. 7.

> representatives from APRA and ASIC to ensure that there is an appropriate regular exchange of ideas and information.[55]

*ASIC's oversight of industry codes*

5.65 Mr Chris Connolly, Director, Financial Services Consumer Policy Centre, made the point that 'because we have pursued in Australia a self-regulatory regime for financial services based largely on codes of conduct and alternative dispute resolution processes, there is a greater need for effective oversight of that regime than if it was all based on legislation'.[56] Unfortunately, he suggested, this oversight is not as stringent as it should be. In particular, Mr Connolly claimed that codes were not reviewed in a timely manner, that problems identified in codes were often not rectified quickly enough and that there is no general oversight of codes of conduct.[57]

5.66 A more specific complaint about the adequacy of aspects of the banking and credit union codes was raised by Mr David Tennant, Director, Care Incorporated. He reported that it can be extremely difficult for consumers to 'navigate' the complaints processes of large financial institutions and to ensure that different parts of the institution communicate adequately with each other. Mr Tennant said that in one case 'we were dealing with the one institution but in three other jurisdictions and the ACT and it was impossible for us to get a straight answer from the institution'.[58]

5.67 Mr Tennant recommended that, as part of its review of industry codes of conduct, ASIC require that institutions provide a single internal point of conduct for complaints. He noted that this 'is certainly something we have drawn attention to in our responses to the review of the banking code and the credit union code'.[59]

5.68 ASIC itself expressed some dissatisfaction with the current state of industry codes. Its submission to the Committee stated:

> At present there is an issue about the proliferation of self-regulatory schemes – both codes of conduct and dispute resolution schemes. ASIC believes that it is time for some rationalisation, especially in the dispute resolution area. We also believe that attention needs to be paid to whether issues are best dealt with on a functional or industry basis and that present gaps and overlaps between financial services self-regulatory schemes need to be addressed.[60]

5.69 In order to assist with this process of rationalisation and reform, ASIC informed that Committee that it is:

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55 Committee Hansard, p. 8.

56 Committee Hansard, p. 36.

57 Committee Hansard, p. 36.

58 Committee Hansard, p. 725.

59 Committee Hansard, p. 725.

60 Submission No 11, p. 133.

> producing a draft policy statement on how we will exercise our codes approval role. This draft will be the subject of public consultation. Our aim is to ensure consistent standards in the processes for developing, promoting, reviewing and monitoring financial services industry codes and codes which effectively address the main consumer protection problems associated with the various industry sectors.[61]

*Adequacy of mechanisms for selecting consumer representatives*

5.70 The Financial Services Consumer Policy Centre has drawn attention to the importance of consumer representation on boards or committees which oversee industry dispute resolution schemes and on panels which make decisions on consumer complaints.[62] The Centre has expressed dissatisfaction, however, with the integrity and transparency of some of the processes for appointing consumer representatives, particularly in relation to alternative dispute resolution scheme boards and panels.

5.71 Specifically, the Centre has criticised the process followed by the Consumer Affairs Division of Treasury when appointing consumer representatives who are nominees of the Minister. Mr Connolly, Director of the Centre, told the Committee that:

> Prior to 1996, the process was that, in order to appoint a consumer representative, ads would appear in the national press and a merits based appointment process would be used in consultation with the consumer movement to appoint a consumer representative to those panels. However, in recent years there has been no national advertising; there is no merits based appointment process; and there is no consultation with consumer organisations about the appointment of consumer representatives. They are chosen by the minister … We are often concerned about the results of that appointment process and the lack of confidence that that gives to consumers who then have to go before these people with a complaint.[63]

5.72 ASIC advised that its policy statement on the appointment of consumer representatives requires the selection process to be transparent. ASIC stated, however, that it does not prescribe how the process must be conducted 'because each of the schemes generally has a different process'.[64] In relation to the Minister's role, ASIC stated:

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61 Submission No 11, p. 133.

62 Submission No 26, p. 355. The submission notes that the importance of consumer representation is widely acknowledged in government documents such as 'Fair Trading Codes of Conduct – Why Have Them, How to Prepare Them' (1996), 'Benchmarks for Industry Based Customer Dispute Resolution Schemes' (1997), 'Codes of Conduct Policy Framework' (1998) and 'Prescribed Codes of Conduct' (1999).

63 Committee Hansard, p. 37.

64 Committee Hansard, p. 792.

> Where the terms of reference indicate the participation of the federal minister responsible for consumer affairs in the appointment of consumer representatives, the minister has the role and should decide how he or she will go about appointing these consumer representatives … It is not necessarily the case that all schemes have the minister playing that role of appointing the consumer representatives; some do, some do not … [W]e have flagged very clearly that the appointment of people who are able to represent consumers on the overseeing body is a critical factor in ensuring that the scheme is both independent and perceived to be independent.[65]

*Adequacy of consumer education programs*

5.73 ASIC told the Committee that it is adopting 'a comprehensive education strategy' which is designed to provide consumers with accessible and relevant information. ASIC said that: 'As a priority we have development material which helps consumers choose a financial adviser and understand their superannuation objectives'.[66]

5.74 ASIC's education strategy has included the following elements:

- surveying the range of education materials already available, identifying gaps and consumer needs;
- establishing a website for consumers, which includes alerts and tips about finance and investing, and which covers topics on superannuation, shares, insurance, the Internet, managed investments, rural investment schemes, scams and illegal schemes;
- developing an online database of educational material;
- conducting investor forums;
- giving talks to community groups, groups of retirees and others;
- holding ad hoc public seminars;
- media releases and alerts; and
- publishing consumer education material.[67]

5.75 A number of organisations, without criticising ASIC's overall education strategy, argued that in relation to superannuation advice there also needs to be an independent resource centre for consumers. The Financial Services Consumer Policy Centre, the Australian Consumers' Association and the Financial Planning Association of Australia all endorsed the establishment of an independent

65 Committee Hansard, p. 792.

66 Submission No 11, p. 144.

67 Submission No 11, pp. 144-146.

Superannuation Consumer Resource Centre which would provide advice and, where necessary, legal assistance and advocacy for consumers of superannuation products.[68]

5.76 The Financial Services Consumer Policy Centre maintained that evidence of the need for such a centre is provided by the fact that community legal centres and Legal Aid offices receive around 40 000 inquiries from consumers each year about financial services, a significant proportion of which relate to superannuation. According to the Centre, the advice and information required by consumers includes:

- financial and legal information and advice at the point of purchase or entry, to explain the appropriateness of different products;
- financial and legal information, advice and assistance throughout the term of the product, relating to potential insurance claims, fees and charges, the costs and benefits of switching products, and the exercise of consumer choice;
- financial and legal advice on the termination of employment and/or the withdrawal of superannuation monies; and
- assistance in resolving disputes.[69]

*Adequacy of handling of complaints and conciliation*

5.77 Under a self-regulatory regime, consumer complaints must be addressed in the first instance to industry dispute resolution schemes. ASIC has released policy statement 139 which establishes the following standards for alternative dispute resolution schemes in the financial sector:

- independence of schemes;
- wide coverage so that most consumer complaints can be heard by schemes;
- low cost access to schemes by consumers;
- effective reporting by schemes of complaints trends and problems;
- adequate public promotion of schemes; and
- regular independent reviews of how each scheme is operating.[70]

5.78 Despite the existence of these in-principle standards, a potential difficulty with consumers' practical access to such schemes was identified by Mr David Tennant, Director, Care Incorporated. He said that, in his experience, some consumers

68 Submission No 26, p. 348; Committee Hansard, p. 684; and, Committee Hansard, pp. 664-666.

69 Submission No 26, p. 349.

70 Submission No 11, p. 135.

may not have the capacity to communicate their complaint effectively to the relevant industry scheme. He observed:

> Our concern is that many people appear to receive initial rejections. For example, after they make the banking ombudsman their first port of call, they receive what they perceive to be a rejection. Yet when they obtain information about the way that they should perhaps of presented their complaint or the issues that would be relevant to the terms of reference, those things can often progress with the assistance of an advocate – whereas, without an advocate, they would not.[71]

5.79 In other words, Mr Tennant said that consumers sometimes need help to prepare their complaint in such a way that it can be understood by the relevant complaints body as falling within its purview. He was concerned that, given the lack of funding for consumer advocacy organisations, the legitimate complaints of some consumers could not be heard or provided for under the current regime.

5.80 The Committee questioned Mr Tennant as to whether he considered that the industry schemes were not communicating adequately with complainants about the form their complaints should take. He responded that he did not necessarily think that the problem lay with, in this case, the banking industry ombudsman:

> To me, that is the philosophical divide between what is an independent alternate dispute resolution process and taking on the role of advocacy. There must be a line in the sand between those two roles. To maintain a credible level of independence, the banking ombudsman cannot be seen to be advocating on behalf of one party over another in a dispute. The role of an advocate is to present the person's complaint or situation in a way that would allow that alternate dispute resolution scheme to consider the issues. It is not the role of the scheme to investigate with the person or to prepare their complaint for them.[72]

Committee comments – consumer education and complaints mechanisms

5.81 The Committee considers that there is a need for a coordinated approach to develop a financial services education plan. This might include the Government working with industry bodies, regulatory bodies and consumer representatives to establish such a plan.

5.82 The Committee also considers that the success of a self-regulatory scheme requires that consumers are sufficiently empowered to lodge complaints with the relevant bodies.

5.83 It notes ASIC's advice that its Complaints Schemes Roundtable, which examines the effectiveness of the ADR schemes and which comprises managers of all

71 Committee Hansard, p. 724.

72 Committee Hansard, p. 724.

the schemes as well as two consumer representatives, is currently investigating the kind of assistance provided to complainants by different schemes.[73] The Committee considers that the issue of consumer access to schemes which has been raised by Mr Tennant should be considered carefully in that investigation.

**ASIC's enforcement activities**

5.84 The final plank of consumer protection is the capacity of regulators to prosecute offenders and to enforce the legislation.

5.85 The Committee requested ASIC to provide information about its performance in consumer protection in superannuation, banking, and financial services. In response, ASIC provided the following information drawn from its annual reports.

5.86 In relation to complaints, in the period between 1 July 1998 and 30 September 2000, ASIC received 1839 financial services consumer protection complaints. Of these, 802 were referred for surveillance and 27 were approved for investigation. Further detail is included in the following tables.

73 Submission No 11, p. 136.

**Table 5.1: ASIC – consumer protection complaints lodged, 1 July 1998 – 30 September 2000**

| Service Provider | 2000/01 (to 30 Sept) | 1999/2000 | 1998/1999 |
|---|---|---|---|
| - Bank | 9 | 31 | |
| - Building society | 2 | 6 | |
| - Credit union | 2 | 10 | |
| - Friendly society | 5 | 7 | |
| - Insurance agent | 13 | 24 | |
| - Insurance broker | 27 | 92 | |
| - General insurance company | 54 | 67 | |
| - Life insurance company | 13 | 37 | |
| - Superannuation adviser | 16 | 56 | |
| - Superannuation trustee | 29 | 85 | |
| - Not classified* | n/a | 260 | 994 |
| **Grand Total** | **169** | **676** | **994** |
| **Product** | | | |
| - Bank/ building society/ credit union products | 13 | 62 | 30 |
| - Friendly society products | 5 | 7 | 0 |
| - General insurance products | 79 | 146 | 132 |
| - Life insurance products | 28 | 105 | 104 |
| - Superannuation products | 44 | 208 | 285 |
| - No product specified | n/a | 148 | 443 |
| **Grand Total** | **169** | **676** | **994** |

* Includes complaints previously categorised as ACCC type, ISC type, such as licensee and insurance broker.

**Table 5.2: ASIC – surveillance, education and enforcement 1 July 1998 – 30 September 2000**

| Activity | 2000-2001 | 1999-2000 | 1998-1999 |
|---|---|---|---|
| ***Surveillance*** | | | |
| Insurance company | 5 | 35 | 59 |
| General agent | 1 | 7 | 20 |
| General broker | 10 | 76 | 46 |
| Life agent | 2 | 13 | 6 |
| Life broker | 3 | 5 | 4 |
| Mixed | 2 | 19 | 15 |
| Superannuation | 9 | 44 | 144 |
| Targeted surveillance | 31 | 163 | 338 |
| **Total Surveillance** | **63** | **362** | **632** |
| ***Education*** | | | |
| Advice to external parties | 26 | 37 | 1 |
| Liaison – external parties | 10 | 23 | 7 |
| Presentations | 8 | 4 | 0 |
| Publications | 2 | 0 | 0 |
| **Total Education** | **46** | **64** | **8** |
| **Total Enforcement** | **0** | **18** | **9** |

**Table 5.3: ASIC completed prosecutions 1 July 1997 – 30 September 2000**

| Investment advisers | 2000-2001 | 1999-2000 | 1998-1999 | 1997-1998 | 1996-1997 |
|---|---|---|---|---|---|
| Gaoled | 2 | 8 | 7 | 4 | 1 |
| Banned (incl. Permanently) | 5 | 50 | 17 | 18 | 21 |
| Banned permanently | 4 | 16 | 4 | 10 | 5 |

*Committee comment – ASIC's enforcement activities*

5.87 The Committee notes that, at present, ASIC has over 80 criminal proceedings underway; 35 civil actions, and almost 200 active investigations are being resourced. Major investigations include those into solicitors mortgage schemes, HIH Insurance, the Harris Scarfe retail organisation, and One.Tel.

5.88 The Committee is pleased to note the level and variety of ASIC's enforcement activities. In particular, the Committee commends ASIC for the level of its prosecutions, as it is only by taking such serious steps that those who would commit breaches of the law can be called to account. The Committee notes, however, that ASIC is required to prioritise the matters it examines and balance them against available resources.

5.89 Acknowledging that ASIC is not the enforcement arm of the prudential regulator APRA (which has its own enforcement framework), the Committee is also pleased to note that under the guidance of the current Chairman, Mr David Knott, ASIC appears to be adopting an even more purposeful direction in enforcement.

5.90 ASIC is currently taking civil action against EPAS, its directors and the 1995/96 auditors of the superannuation fund for which EPAS acted as trustee. While this development is highly commendable, the Committee received some evidence suggesting that ASIC may not be acting to enforce its legislation in a timely enough manner. In addition to the EPAS case, questions have been raised about whether ASIC could have acted earlier to prevent the consumer losses sustained as a result of the collapse of CNA and the failed solicitors' mortgage funds in Tasmania.

5.91 As noted earlier, the Committee is intending to report on these cases separately, at which time it will consider in detail the adequacy and timeliness of ASIC's enforcement strategies.

5.92 In the meantime, the Committee emphasises a recommendation that it made in Chapter 3 of this report, namely that the two regulators, APRA and ASIC, work more closely with each other to ensure a timely and effective response. Additionally the Committee notes calls from ASIC for the regulators to develop protocols which identify which regulator has the primary carriage of a matter referred.

**Resources for consumer protection**

5.93 At its inception in 1998, ASIC had a budget of $137 million, and 1 225 full time equivalent staff at 30 June 1999. In the 1999/2000 financial year this figure dropped to $132 million and 1 219 full time equivalent staff. In 2000/2001, the budget has increased to $141 million, which included $9 million for extra programs such as those introduced by the Financial Services Reform Bill. At 30 June 2001, ASIC had 1 190 full time equivalent staff.

5.94 The Committee notes that ASIC has administrative responsibility for the budget of the SCT. ASIC has advised that the Tribunal currently costs more to operate than ASIC receives in budgetary allocations. However, the Committee notes that in the 2001/2002 Budget, the Government has made an additional allocation of $700,000 to the SCT.

5.95 The Committee also notes that with the HIH collapse, other corporate disasters like One.Tel and Harris Scarfe, and the national investigation into solicitors mortgage schemes, ASIC's resources are stretched to the limit. This calls into

question whether there are adequate resources allocated to police the Corporations Law, especially in the light of the major changes foreshadowed in the Financial Services Reform Bill and the additional role for ASIC to supervise the compliance by the Australian Stock Exchange, as a listed entity, with the Stock Exchange listing rules. In addition under the Managed Investments Act, ASIC will assume responsibility for the regulation of certain solicitors' mortgage schemes from 31 October 2001.

5.96 The Committee therefore considers it timely for the Government to review the resources allocated to ASIC to ensure that it is provided with the resources necessary to enable it to perform effectively the broad and increasing range of responsibilities outlined above. In particular, the Committee seeks an assurance from the Government that ASIC's resources will not be diminished in the wake of the establishment of the Royal Commission inquiring into the collapse of HIH Insurance.

**Recommendation 14**

**5.97 The Committee recommends that the Government review the resources allocated to ASIC to ensure that it is provided with the resources necessary to enable it to perform effectively its broad and increasing range of regulatory functions.**

**Conclusion**

5.98 The Committee is generally satisfied with most of the current legislative and structural arrangements for consumer protection. Although some concerns have been expressed about aspects of these arrangements, the Committee does not consider that these point to insuperable problems. In particular, the Committee notes that the Financial Services Reform Bill aims to address if not all, then the majority of problems identified in the finance sector's disclosure regimes. This should enable consumers to make more effective comparisons between products and services.

5.99 The evidence of gaps in the regulatory coverage of consumer protection and of confusion among consumers and consumer advocates about the role of different agencies does cause the Committee some concern. However, the Committee considers that the combination of inter-agency memoranda of understanding, joint committees and a central referral point for consumers should be capable of addressing these matters effectively.

5.100 The Committee endorses the view that consumer protection should be a matter of high priority for Government, and has recommended that the Government establish an Office of Regulatory and Consumer Affairs within APRA, but with links to the other relevant regulators.

5.101 The Committee likewise considers that most of the evidence received indicates that ASIC is generally operating effectively. In particular, it is building links with key consumer stakeholders, developing a targetted consumer education strategy,

working with other regulatory agencies to develop a coherent and comprehensive consumer protection environment, and undertaking appropriate enforcement activity.

5.102 More detail on the regulator's role in the case studies will be discussed in a separate report.

# CHAPTER 6

# REGULATORY ISSUES – LEVIES, ACCOUNTING STANDARDS AND STANDARDS OF AUDITING

## Introduction

6.1 During the course of the inquiry various regulatory issues were drawn to the Committee's attention. These issues related especially to the levels of the supervisory levies which apply to regulated entities, the adequacy or relevance of certain accounting standards for superannuation funds and the role of auditors. These issues are discussed below.

## Levies

*The current system*

6.2 Prior to the establishment of APRA, different authorities with separate funding mechanisms regulated the different financial sectors. This system created significant disparities between the nature and level of funding of each regulator.

6.3 The Wallis Report recommended that regulatory authorities should collect amounts from financial entities they regulate to the extent required to cover the cost of regulation.[1] The Government endorsed this recommendation, stating that its aim was:

> To establish an administratively simple and uniform scheme based on the principle of full cost recovery from the institutional categories that are regulated.[2]

6.4 APRA is primarily funded by levies collected annually from the financial institutions it regulates.[3] In broad terms, all industries regulated by APRA are levied on a similar basis. The revenue collected through levies is applied in two ways under section 50 of the APRA Act:

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1 Recommendation 104 (p. 532) stated 'The regulatory agencies should collect from the financial entities which they regulate enough revenue to fund themselves, but not more. As far as practicable, the regulatory agencies should charge each financial entity for direct services provided, and levy sectors of industry to meet the general costs of their regulation.'

2 Treasurer, Second Reading Speech on the Company Law Review Bill 1997, *Parliamentary Debates*, 26 March 1998, p. 1160.

3 APRA *Annual Report 2000*, p. 46. The Report stated that other sources of funds included interest earnings on funds invested and revenue from sales of publications. Until 2002/03, levies also fund APRA's repayment of its $20 million Government loan for establishment costs. Levies are raised under the *Financial Institutions Supervisory Levies Collection Act 1998* and six Acts applying to different sectors of the financial system.

- The Treasurer must determine for each financial year the amount of levy money received that is to be available to cover the costs to the Commonwealth of providing market integrity and consumer protection functions for prudentially regulated institutions. That amount is retained in the Consolidated Revenue Fund until allocated to ASIC and the ATO, which perform those functions.
- The balance of the levy money is to be paid to APRA.

6.5 Following consultations with industry, APRA and the Treasury make recommendations to the Treasurer on levy rates and minimum and maximum amounts sufficient to raise the necessary funds.

6.6 In APRA's first year of operation, a levy on authorised deposit-taking institutions (ADIs), which include banks, building societies and credit unions, was not imposed.[4] Even though banks were regulated by APRA from 1 July 1998, the cost of their prudential regulation was funded by the interest forgone on non-callable deposits held by the Reserve Bank in the first financial year. This form of funding was abolished from 1 July 1999, the same time that credit unions and building societies came under APRA's prudential control.

6.7 In response to a request from the Committee, APRA provided information on levies collected over the last three financial years and the amounts distributed to the ATO, ASIC and APRA.[5] That information is set out in Figure 6.1, which shows that APRA has received most of the funding.

6.8 Figure 6.2 sets out the contributions of the different financial sectors to APRA's share of the levies over the last three financial years (once the amounts for the ATO and ASIC have been deducted). As can be seen, contributions from superannuation entities comprise a large proportion of APRA's funding.

4 The Treasurer has the power to determine the levy for ADIs under the *Authorised Deposit-taking Institutions Supervisory Levy Imposition Act 1998* (s. 7).

5 Submission No. 225.

**Figure 6.1: Total levies received 1999/2000 to 2001/02 (estimated)**

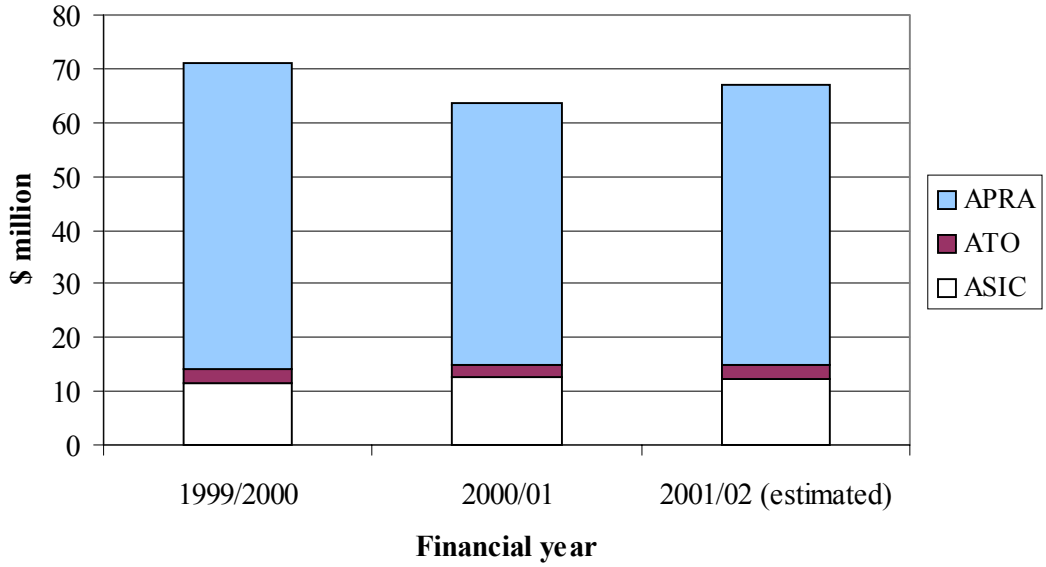
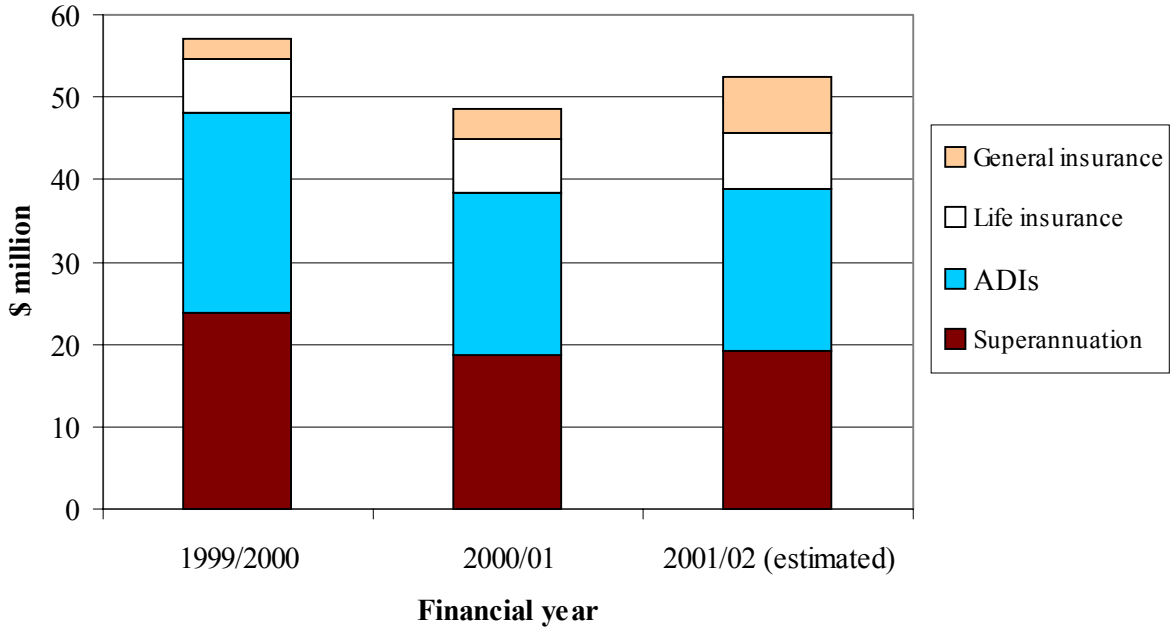



**Figure 6.2: Levies received by APRA 1999/2000 to 2001/02 (estimated)**




Notes: 1. The levy collected reflects cash received, including significant amounts collected for prior years. Amounts under or over collected to plan are carried forward to the following year.

2. This does not include amounts collected in 1999/2000 for excluded (self-managed) superannuation funds ($25.6 million) which were transferred to the ATO.

6.9 In April 1999, the Association of Superannuation Funds of Australia estimated that superannuation funds were paying about 40 per cent of APRA's running costs while ADIs were paying 16 per cent. In addition, based on asset value, large ADIs (that is, banks) currently pay significantly less than other institutions towards APRA's running costs. While the assets of the big four banks represent 60 per cent of the capital under regulation, in 1998-99 they paid only 16 per cent of ADI regulatory costs. This result was due to the statutory maximum levy of $1 million for any institution, so that ADIs with asset bases of over $90 billion paid the same levy as ADIs with asset bases around $20 billion.[6]

*Industry views*

6.10 The Australian Association of Permanent Building Societies (AAPBS) advised the Committee about the adverse impact of the supervisory levy on its members. According to the AAPBS, the supervisory levy applicable to ADIs punishes building societies and medium-sized regional banks. AAPBS made the following observations:

- The four major banks hold 65 per cent of total bank assets and pay 16 per cent of the levy;
- Because of the statutory upper limit of the levy, middle-sized ADIs must pay in full any exceptional costs incurred by APRA;
- The statutory upper limit of the levy, which applies to the ten largest banks in Australia, requires small and medium–sized institutions such as building societies and regional banks to meet in full the levy shortfall. This would occur where bank mergers reduce the levy from, say, $2 million (two supervised ADIs) to $1 million (one supervised entity created out of two);
- Recent bank mergers could result in an estimated reduction of ADI levy income to APRA/ASIC of some $2.6 million. This amounts to a decrease of 10 per cent of all ADI levy income;
- The ADI levy is likely to grow faster for building societies and small to medium-sized institutions than it will for major banks. This is because the statutory upper limit for banks is indexed to inflation, while building societies and other smaller ADIs pay according to asset growth that is typically higher than inflation;
- Foreign banks received a 50 per cent reduction on their ADI levy on the basis that they were also subject to prudential supervision in their home country;
- Building societies do not need the level of supervision given to major banks since they are relatively simple organisations. APRA has not provided any

6 House of Representatives Standing Committee on Economics, Finance and Public Administration, *Review of the Australian Prudential Regulation Authority: Who will guard the guardians?*, 6 November 2000, p. 10.

analysis of which sector of ADI supervision occupies the greater part of their time, building societies or the many activities of the large four banks.[7]

6.11 AAPBS called for the removal of the statutory upper limit on levies and for improved accountability of the regulators, APRA and ASIC, to the bodies that pay the levies.[8]

6.12 The Investment and Financial Services Association (IFSA) made a similar point in arguing that the current levy structure results in large institutions cross-subsidizing smaller institutions and certain sectors cross-subsidizing others. IFSA argued that there was no rationale for the determination of the levies and that the method used should change. IFSA recommended the following changes:

- increase the minimum levy rates to reflect the actual base cost of supervision and remove cross-subsidies;
- provide an explicit rationale for the determination of the quantum of the levies (such as matching levy payments more closely to the level of supervision);
- ensure that there is no double counting of assets in determining the levy;
- establish a single levy for the entire entity (or conglomerate) rather than separate levies for each line of business within the entity;
- amend the APRA legislation to allow for a continuing annual review of levies; and
- charge fees for discrete services (such as licensing applications, corporate restructures mergers and transfers of business) directly to the financial institution concerned.[9]

*Regulator's views*

6.13 APRA informed the Committee that the cost of prudential supervision should fall over time. It argued that a rough indicator of the reduced running costs of prudential regulation could be seen in the number of people employed by APRA (in the low 400s) compared with its predecessor agencies (close to 550).[10]

6.14 In response to Committee questions about the equitability of the levy structure, APRA advised that it 'puts a good deal of effort into calculating the industry sector expenditure figures needed for levy determination'. APRA provided details of its process for calculating the figures and advised that when industry amounts have

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7 Submission No 16 and Committee Hansard pp 739ff. AAPBS raised similar concerns in subsequent correspondence to the Committee dated 4 July 2001 in relation to the announcement of the 2000/01 levies, and called for 'urgent change' to the approach to funding APRA's supervision of ADIs.

8 Submission No 16, p. 3.

9 Submission No 27, pp. 8-13.

10 Submission No 23, p. 3.

been estimated, APRA, ASIC and the Department of the Treasury conduct a round of consultations with industry before making a recommendation to the Treasurer.[11]

6.15 In responding to Committee questions about APRA's accountability to levy payers, APRA submitted that there were numerous ways in which it was accountable for its expenditure. They include:

- industry consultations as part of the annual levy determination process;
- the Treasurer's role in determining levy rates each year;
- APRA's regular appearances before Parliamentary committees;
- performance and financial audits by the Australian National Audit Office; and
- APRA's annual report to Parliament.[12]

6.16 APRA also advised that the Government had conducted a review of financial sector levies in late 1999, and apart from minor modifications, had confirmed the arrangements introduced at the time of APRA's formation. The Government has announced that a further review will be conducted in 2003.[13]

6.17 The Committee notes that the House of Representatives Standing Committee on Economics, Finance and Public Administration also inquired into APRA's levies in 2000. APRA had advised that Committee that there were two reasons why the superannuation sector provides the bulk of APRA funding:

> First, there are more APRA staff involved supervising superannuation than any other sector. Second, the number of institutions is large. APRA is supervising between 4000 or 5000 superannuation funds compared with 50 or 60 banks.[14]

6.18 On the issue of minimum and maximum levies, APRA argued that the structure was logical. Minimum levies were required because a minimum level of expenditure was needed to supervise an organisation regardless of its size. Maximum levies were required because beyond a certain size the cost of supervising an entity did not increase, regardless of the size of the asset base.[15]

6.19 The amount of regulatory effort that goes into each institution is hard to calculate, and varies from year to year. According to APRA:

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11 Submission No 88, p. 2.

12 Submission No 88, p. 2.

13 Submission No 88, p. 3.

14 House of Representatives Standing Committee on Economics, Finance and Public Administration, *Review of the Australian Prudential Regulation Authority: Who will guard the guardians?*, October 2000, p. 11.

15 ibid, p. 11.

> The bottom line here is that it is virtually impossible to come up with a formula for calculating levy rates for cost recovery of an organisation like APRA that will satisfy everybody every year.[16]

6.20 APRA has also been reported as finding it 'increasingly difficult to justify levies it charges superannuation funds to recover the cost of supervising the superannuation industry.'[17]

6.21 The House of Representatives Standing Committee on Economics, Finance and Public Administration commented that, while it saw merit in the concept of a single levy system, APRA must continue to work on methods for measuring the actual costs of supervising the individual entities to ensure each entity is appropriately levied.[18]

6.22 The Committee notes that in its recent performance audit of APRA's prudential supervision of authorised deposit-taking institutions, the ANAO recommended that APRA improve its administration of the ADI supervisory levy by periodically reviewing the basis of its cost estimation approaches, and publicly reporting on the actual cost of supervision for each industry.[19]

*Committee conclusions and recommendation*

6.23 The Committee notes the concerns expressed by industry over the level of levy payments and the need for increased accountability of the regulators to those bodies paying the levy.

6.24 The Committee is concerned to note the adverse impact of the current arrangements on building societies and medium-sized regional banks, and that within this framework, a degree of cross-subsidization occurs.

6.25 The Committee regards the current arrangements, whereby the four major banks hold 65 per cent of total bank assets but pay only 16 per cent of the levy, as inequitable. For this reason, the Committee sees merit in the proposal that the statutory upper limit on levies be removed. Further, the Committee considers that levy rates should be more reflective of the level of supervision.

6.26 The Committee also notes the mechanisms by which APRA is accountable to those who pay the levies and that the levies collected by APRA cover some consumer protection costs of ASIC and the ATO. However, the Committee considers that more attention could be paid by the three regulators to accounting to levy payers in a more

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16 ibid, p. 11.

17 *Super Review*, December/January 2001, p. 6.

18 House of Representatives Standing Committee on Economics, Finance and Public Administration, *Review of the Australian Prudential Regulation Authority: Who will guard the guardians?*, October 2000, p. 13.

19 ANAO, *APRA – Bank Prudential Supervision,* Performance Audit Report No 42, 2000-01, Rec 1, p. 40.

direct way. This might include annual meetings with levy payers, and a separate arrangement for reporting directly to them on the expenditure of the levies.

6.27 Noting that a further review by Government is not due to take place until 2003, the Committee considers that in the meantime APRA should review the rationale for determining the quantum of the levies, in order to remove inequities and ensure that levy payments more closely match the degree of supervision.

6.28 The Committee notes with interest correspondence from the Australian Association of Permanent Building Societies, commenting that: '… the British Government is making genuine efforts to work out a fair system of levies. They may not be able to play cricket very well but they seem to be able to cobble together a rational basis for funding their Financial Services Authority.'

**Recommendation 15**

**6.29 The Committee recommends that APRA review the rationale for determining the quantum of supervisory levies, in order to remove inequities and ensure that levy payments more closely match the level of supervision.**

**Adequacy of accounting standards for superannuation funds**

6.30 Australian Accounting Standard AAS 25, entitled *Financial Reporting by Superannuation Funds*, sets out what should be in a general purpose set of financial statements of a superannuation fund. The Standard sets out the manner in which superannuation funds should account for particular transactions and events, including a fund's administrative expenses. It also specifies the format of superannuation fund financial statements and requires disclosure of certain information in the financial reports of superannuation funds.

6.31 In 1993 AAS 25 was revised and issued by the Public Sector Accounting Standards Board and the Australian Accounting Standards Board.

6.32 The Committee received evidence from the Chairman of the Australian Accounting Standards Board, Mr Keith Alfredson, that while AAS 25 has played an important role in enhancing financial reporting by superannuation funds, the Standard is out of date and should be updated.[20] The Committee was also told that the superannuation accounts prepared in accordance with the requirements of the Standard may not give information to fund members that is relevant to member choice of investment. For example, the accounts may show the total investment performance results of an entire superannuation fund, but may not give the investment performance results of the various investment pools in which members may have chosen to invest (such as the balanced pool, the growth pool, the cash pool and the capital stable pool).

20 Committee Hansard, p. 330.

6.33 The Committee is also aware that there does not appear to be a standardised definition of a fund's 'administrative expenses' and that this issue has been a cause of concern and confusion for researchers and fund members alike. The Committee considers that this is an issue which could also be examined as part of a review of AAS 25.

6.34 The Committee has been advised that the Institute of Chartered Accountants is in the process of reviewing AAS 25 and will refer it to the Australian Accounting Standards Board for its consideration later this year. The Committee commends this initiative as part of ongoing efforts to ensure that accounting standards for superannuation funds are up to date and appropriate.

**Role of Auditors**

*Evidence to the Committee*

6.35 In addition to their responsibilities to directors and managers and through them to trustees, auditors have a responsibility to fund members and members of the public. Auditors are expected to report on the truth and fairness of the accounts, based on accounting and auditing standards. They are expected to inform the directors of risks, internal weaknesses and discrepancies in accounts. Auditors must maintain their independence in fact and appearance, so that their advice is reliable and objective.

6.36 Auditors of superannuation entities are required to inform the trustee in writing where the auditor considers that there may have been a contravention of the SIS Act.[21] If the trustee fails to comply with the auditor's request, or if the auditor is not satisfied with the action taken, the auditor must provide a written report to the regulator. A similar obligation arises where the auditor forms the opinion that a superannuation entity's financial position may be, or may be about to become, unsatisfactory.[22]

6.37 APRA's evidence to the Committee highlighted that in the period 1995–2000 in a number of cases where APRA, or its predecesssor the ISC, took enforcement action in the superannuation industry, a recurring issue of concern was the lack of auditor independence and audit competence and integrity.[23]

6.38 As a result of its inquiries into the institutions that are the subject of the case studies, the Committee also has some concerns about the allegations about the competence and independence of some auditors of some superannuation funds. These concerns, which impact on the ability of the trustees to do their job effectively, will be discussed in more detail in the separate report on case studies.

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21 SIS Act s. 129.

22 SIS Act s. 130.

23 Submission No 90, 'Enforcement Cases from 1995-2000'.

6.39 During its hearings the Committee asked APRA representatives whether there should be more stringent requirements for auditors of superannuation funds. The Committee noted that, under current arrangements, an approved auditor under the SIS Act is specified in regulation 1.04(2) as an individual who is registered under the Corporations Law and is either a member of a specified professional organisation such as the Institute of Chartered Accountant of Australia, or is approved by the regulator.[24] (Approval may be granted where the regulator is satisfied the auditor will audit the funds in accordance with Australian Auditing Standards.) There is no requirement for further examination of specific qualifications or experience in relation to superannuation.[25] While stating that imposing additional requirements 'would be a possibility', APRA noted that it already had the power to disqualify people from being auditors under the SIS Act, or to refer them to the appropriate industry bodies.[26]

6.40 In a subsequent submission, APRA added that the professional standards of the accredited accounting bodies such as the ICAA and the CPA require their members to have relevant expertise before undertaking any work.[27] Thus the SIS Act implicitly imposes a requirement for appropriate expertise. APRA also noted that where 'significant issues arise in respect of the quality of financial or compliance audit', APRA recommends appropriate training where there is evidence of lack of expertise. APRA considers this option before disqualification or reference to the professional associations is undertaken.

*Committee conclusions and recommendation*

6.41 The Committee notes that the former Senate Select Committee on Superannuation, in its first report in 1992, was also concerned about the special significance that auditors for private sector superannuation funds had in effective prudential supervision. At that time, the Committee recommended the establishment of a Board of Superannuation Auditors, allowing only those auditors registered with the Board to sign audit certificates on fund annual returns.[28] The government response to that report noted that the recommendation would be investigated in consultation with professional bodies,[29] but to date no such body has been established.

6.42 The Committee also notes the criticisms that have been levelled at APRA in respect of the auditing of HIH's accounts. In particular it is noted that several HIH directors were previously external auditors of HIH. While it is not this Committee's

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24 The Auditor-General of the Commonwealth, a State or Territory is also included in the definition.

25 Committee Hansard, p. 1295.

26 Committee Hansard, p. 1297.

27 Submission No. 225, p. 34.

28 Senate Select Committee on Superannuation *Safeguarding Super: The Regulation of Superannuation*, 1992, pp. 47-49, Recommendation 4.11.

29 Government response to recommendations of the Senate Select Committee's First Report on Superannuation entitled 'Safeguarding Super (The Regulation of Superannuation)'.

function to question whether HIH's accounts were correctly audited there is however a need to ensure that auditors are genuinely independent.

6.43 In the wake of recent corporate collapses and the mismanagement of some superannuation funds, the Committee considers that the allegations about the competence and integrity of auditors remain a major issue. Audit reports, which have traditionally been used in a technical sense to provide information to trustees, company directors and shareholders, now have a much broader use, as they are also considered by employees, creditors and others seeking to form a view on a fund or company's viability.

6.44 As was suggested in 1992, the Committee considers that there is scope to re-examine the current requirements for auditors of superannuation funds, with a view to requiring not only certain qualifications and professional membership, but also requiring an appropriate level of experience. These standards could be applied whether the audit is for a superannuation fund or company accounts.

6.45 The Committee notes that the Royal Commission into the collapse of HIH will examine, amongst other things, whether (and if so, the extent to which) decisions or actions of auditors and actuaries contributed to the failure of the company.

6.46 The Committee has received submissions from the National Institute of Accountants and the ICAA on this issue, and plans to hold a round table public hearing with peak professional bodies and the regulators, in order to explore the matter in more detail. Relevant issues to be canvassed include:

- the adequacy of auditing and accounting standards;
- the independence and accountability of auditors;
- the role of professional bodies in ensuring adherence by their members to ethical standards;
- the qualifications and experience required for auditors of small, medium and large superannuation funds; and
- the use made by APRA of external auditors.

6.47 The results of the round table will be conveyed to Government for information and action as appropriate.

6.48 In the meantime the Committee is concerned to ensure that the regulator has a full appreciation of the issues associated with the effective auditing and accounting of superannuation funds. The Committee therefore considers that there would be value in APRA working more closely with some of the peak professional accounting bodies, such as the Institute of Chartered Accountants in Australia, in order to identify ways to improve adherence by auditors to professional and ethical standards.

**Recommendation 16**

**6.49 The Committee recommends that APRA work more closely with the Institute of Chartered Accountants in Australia to identify ways to improve adherence by auditors to professional and ethical standards and ensure genuine auditor independence.**

# CHAPTER 7

# SUPERANNUATION REGIME – THE SIS ACT

## Introduction

7.1 Although the Committee's inquiry addressed prudential supervision for superannuation, banking and financial services, most of the evidence received related to superannuation issues. In particular, a number of matters brought to the Committee's attention related to aspects of the *Superannuation Industry (Supervision) Act 1993* (the SIS Act). The wide range of issues raised included the following:

- employer-sponsors 'raiding' surpluses;
- rules governing successor funds;
- the definition of 'dependant';
- binding death benefit nominations;
- arrangements for people over 65 years of age;
- extra requirements for funds with less than five members;
- the prescriptive nature of preservation rules;
- the impact of severe financial hardship claims on funds;
- the reduction in time to submit annual returns from six months to four months; and
- trustee power to delegate investment-related functions to an investment manager.

7.2 These issues are discussed in turn below.

## Employer–sponsors 'raiding' surpluses

7.3 Mr Daryl Dixon, a writer and consultant, argued that the SIS legislation inappropriately enables employer–sponsors of defined benefit members of defined benefit and hybrid superannuation funds to 'raid' the surpluses of defined benefit members.[1]

7.4 Hybrid superannuation funds have features common to both accumulation and defined benefit funds. Such funds can have both defined benefit members and accumulation members.[2] According to Mr Dixon, some employer–sponsors of defined

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1 Submission No 85, p. 2.

2 A defined benefit member is one who is entitled, on retirement or termination of employment, to be paid a benefit defined wholly or partly by reference to either the member's salary on a particular date (such as the date of retirement) or the member's salary averaged over a period before retirement, or a specified

benefit funds are, when the defined benefit fund is in surplus, taking 'contributions holidays' and using the surplus in respect of defined benefit members to meet their future superannuation obligations. This situation may arise where a long established defined benefit fund has more than sufficient assets to meet it future obligations. This practice is permitted under section 117 of the SIS Act. The practice is often justified on the grounds that the surplus does not belong to the defined benefit members. In fact, defined benefit members only have an interest in the amount of money to which they are entitled under the fund's governing rules (usually a multiple of years of service and a percentage of salary).

7.5 Mr Dixon does not dispute that this practice is permitted by the legislation, but argues that defined benefit members may have an equitable interest in the surplus, and cites two cases to support his position. First, a recent UK case[3] considered the issue of the duty an employer-sponsor owes to members and found that:

> …although the members of a pension scheme have no rights in the surplus revealed by an actuarial valuation they have a reasonable expectation that any dealings with a surplus, whether by the employers of the trustees of the scheme acting within the powers vested in them by the scheme, will pay a fair regard to their interests.[4]

7.6 The second case concerned a New Zealand superannuation scheme where the trustees amended the trust deed in order to return a surplus to the employer. In this case[5] all judges lamented the difficult equity and policy issues in dealing with surpluses in defined benefit funds in the absence of clear legislation.

7.7 It was recommended to the Committee that hybrid funds should not be permitted, or alternatively, that there should be a prohibition against the surplus of a defined benefit fund being used for any purpose other than the best interest of defined benefit members. The Committee noted that many defined benefit funds provide a level of superannuation support that exceeds that prescribed by the *Superannuation Guarantee (Administration) Act 1992*, and are therefore, quite generous by comparison. It is generally established in law that surpluses in defined benefit funds can be used by employer–sponsors to meet other obligations, including those for accumulation members of defined benefit funds. In plain terms, under the well established SIS legislation, surpluses do not belong to the defined benefit members, but can be accessed in certain circumstances by the employer-sponsor. This fact remains, irrespective of what courts in the UK and New Zealand have stated. The practice permitted by section 117 of the SIS Act apparently has wide acceptance and has been recognised in a Bill currently before the Senate, the Superannuation

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amount. In an accumulation benefit fund, the retirement amount payable to a member is the accumulated amount of the employer's contributions, the member's contributions (if any) and investment earnings.

3 *National Grid Co. PLC v Mayes* [2000] ICR 174.

4 Submission No 85, p.4.

5 *Re UEB Industries Pension Plan* [1992] 1 NZLR 294

Legislation Amendment (Choice of Superannuation Funds) Bill 1998, which effectively exempts a defined benefit scheme in surplus from the choice of fund requirements.[6]

*Committee view*

7.8 The Committee recognises that there may be different views on the 'ownership' of surpluses by employers and employees. However, in light of the general acceptance of the treatment of surpluses under section 117 of SIS by the superannuation industry, and the recognition of this practice in a Bill currently before the Senate, the Committee does not see any need at this time to prohibit hybrid funds or change the law affecting the access of employer-sponsors to surpluses in defined benefit funds.

7.9 However, the Committee is aware from additional correspondence it has received on this issue that some members may be concerned about their fund's practices. The Committee has referred the matter to APRA, commissioned a briefing paper on the subject, and will monitor the issue. In the meantime, the Committee considers that there may be merit in funds establishing separate trust funds to keep any surpluses separate from company reserves. This would provide a more practical safeguard in the event of a company collapse.

**Rules governing successor funds**

7.10 SIS rules enable bulk transfers between funds without the consent of the member where a new fund confers on the member equivalent rights to the original fund, and the trustees of both funds agree in writing that equivalent rights are conferred. These are called 'successor fund transfers'.

7.11 The Committee was made aware of two complications that may arise during the use of the rules governing successor funds. First, a situation arose where a successor fund transfer was to take place, but was effectively blocked. In this case, the transferring trustee was not in complete agreement with the transfer agreement and blocked the transfer, thereby restricting mobility between funds.[7]

7.12 Second, the Committee was made aware of difficulty in determining whether benefits in the old and new funds are equivalent.

7.13 The Committee received evidence from Phillips Fox Actuaries and Consultants proposing a solution to these problems. According to Phillips Fox, the regulation[8] governing successor funds should be amended to provide that successor fund transfers should be permitted provided that there are equivalent rights under each

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6 See Item 25, Superannuation Legislation Amendment (Choice of Superannuation Funds) Bill 1998.

7 Committee Hansard, p. 79.

8 Superannuation Industry (Supervision) Regulation 1.03(2).

fund.[9] In addition, there should be an onus on the trustees of the new fund to advise members of any instance where benefits differ and may potentially be reduced. In practice, a certificate from a suitably qualified professional, such as an actuary or a lawyer, could certify the trustee's statement. Once such statements had been provided, the existing fund trustee would then be required to conduct the transfer.

7.14 Nonetheless, even with these changes being made, the successor fund provision is merely permissive, that is, it is still subject to the trust. According to Phillips Fox, this could be improved by additional regulatory changes. They suggest that the terms of the instrument of approval issued by APRA could be amended with a supporting regulation

7.15 Phillips Fox also suggest amendments be made to sections 58 and 59 of SIS to vary the restriction on directions that may be given to a trustee in circumstances of using the successor fund provisions.

*Committee view*

7.16 The Committee notes that there are some concerns about the rules governing successor funds. The Committee considers that the suggestions put forward by Phillips Fox appear to be a reasonable solution to the problem. The Committee considers that there is scope to amend the SIS legislation to address this issue.

**Definition of 'dependant'**

7.17 A ‘dependant’ is defined in the SIS Act as including ‘the spouse and any child of the person’. A ‘spouse’ is defined as including ‘another person who, although not legally married to the person, lives with the person on a genuine domestic basis as the husband or wife of the person’. A ‘child’ is defined as including ‘an adopted child, a step-child or an ex-nuptial child of the person’.

7.18 In a Superannuation Circular, APRA specifically notes that a ‘dependant’ includes any person who was financially dependent on the member at the time of the member’s death and that this may include a partner who does not meet the definition of spouse. Although financial dependency can generally be established where a person relies or relied on another as the source, wholly or in part, of his or her means of subsistence, financial dependency is not defined in the SIS Act. Under the SIS Act it is for the trustee to determine whether a person was dependent upon a deceased member, within the meaning of the legislation. In the event of a dispute, the Superannuation Complaints Tribunal is generally available to review the decision and resolve the dispute.[10]

9 Submission No 65, p. 2.

10 Submission No 87, p. 5.

7.19 The Committee has been alerted to the problems experienced by the restrictive definition of 'dependant' in the SIS legislation, which discriminates against some people in the distribution of superannuation benefits.

7.20 In its earlier *Report on the Provisions of the Superannuation (Entitlements of Same Sex Couples) Bill 2000,* the majority of the Committee drew attention to this issue, pointing out that 'discrimination occurs because the laws do not allow superannuation fund trustees to automatically consider same sex partners as dependent', and that 'discrimination against same sex couples can no longer be tolerated'. The Government Senators on the Committee added their support for the removal of all forms of discrimination from legislation affecting all members of superannuation funds, 'including those of any gender in close and bona fide domestic relationships (for example siblings, carers of aged and disabled people) where there are strong elements of personal and financial dependency'.[11]

7.21 APRA was asked to comment on this issue. It advised the Committee that it did not see this as a matter relating to prudential supervision, and that 'any change to the current arrangements would not seem likely to create any supervisory concerns for APRA'.[12]

*Committee view*

7.22 The Committee has had drawn to its attention in a number of inquiries, including most recently its inquiry into the Family Law Legislation Amendment (Superannuation) Bill 2000, that the definitions of key players either cause or have the potential to cause misunderstandings, unintended consequences or, in the case of the Superannuation (Entitlements of Same Sex Couples) Bill 2000, to introduce an unwelcome element of discrimination.

7.23 The Committee considers that there is scope to review the definition applying to 'dependant' in the SIS legislation in order to ensure that there is no misunderstanding, no unintended consequences and no discrimination associated with its use. In particular the Committee considers that it may be appropriate to define 'financial dependency' as this may assist the trustees to make determinations.

**Binding death benefit nominations**

7.24 The SIS Act was recently amended to enable superannuation funds to voluntarily structure their governing rules to accept binding death benefit nominations. For funds that adopt this approach, the trustees would automatically pay the death benefit to the person named on the beneficiary nomination form. The nominated beneficiary must still fall within the class of persons to whom death

11 Senate Select Committee on Superannuation and Financial Services, *Report on the Provisions of the Superannuation (Entitlements of Same Sex Couples) Bill 2000,* April 2000, pp. 30 and 37.

12 Submission No 88, p. 4.

benefits can be paid under the sole purpose test in the SIS Act (that is, the member's legal representative or dependants).

7.25 The AMP called the issue of binding death benefit nominations an 'administrative nightmare'.[13] The company also criticised APRA for having provided no leeway for a reasonable transition to the new arrangements:

> APRA's position is contrary to the recommendations of the industry and has led to most trustees not taking up the provisions or abandoning their existing binding nominations because the new process is too difficult and unreasonable constraints have been imposed by APRA. AMP believes this is contrary to Government policy and most definitely not in the best interests of members.[14]

7.26 Puzzle Financial Advice also raised the apparent anomaly between the legal power of an enduring power of attorney regarding wills and binding death benefit nominations. The company drew the Committee's attention to the complexity and confusion which professionals face in determining such issues. For example, Puzzle has received advice that under existing law, an enduring power of attorney does not have the right to re-write a person's will, but does have the right to change a person's binding death benefit nomination.[15] A contrary view was put to the Committee by Minter Ellison, who stated that the SIS Act and Regulations 'possibly cannot' permit an enduring attorney to make, amend or revoke or confirm a death benefit nomination.[16]

7.27 Puzzle Financial Advice also expressed concern about the requirement to 'refresh' a binding death benefit nomination every three years. In its view, the binding death benefit nomination should not lapse after 3 years, and should remain in place until the member of the fund:

- personally (but not an attorney) changes the nomination; or
- ceases to be a member of the fund; or
- dies and the benefit is distributed.[17]

7.28 Puzzle Financial Advice also suggested that the matter could be simplified for trustees and members if the SIS Act provided a standard well-documented default procedure for providing these nominations.[18]

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13 Submission No 31, p. 5

14 Submission No 31, p. 5.

15 Submission No 37, p. 3; Committee Hansard, p. 466.

16 Submission No 47, p. 1.

17 Submission No 46, p.2.

18 Submission No 46, p.2.

7.29 The Committee invited ASFA's views on the suggestions from Puzzle Financial Advice. ASFA explored three options where a member is physically or mentally unable to renew his or her binding death benefit nomination:

- providing for an opportunity for an enduring attorney to 'refresh' the nomination;
- enable the binding death benefit nomination to stay in force in a manner similar to a will; or
- where a binding death benefit nomination has lapsed, reverting to the trustee's discretion.[19]

7.30 Reporting the views of its members on these options, ASFA indicated that:

> The use of an Enduring Attorney gained only marginal support within the industry. In summary, there was consensus that building exceptions to the three year rule into what is already a complicated set of requirements is most undesirable. ASFA's view is that the decision should revert to trustee discretion.[20]

7.31 In contrast to this position, William M Mercer Pty Ltd supported the proposal that binding death benefit nominations stay in force in a manner similar to a will.[21]

7.32 APRA advised the Committee that it had 'seen little substantive problem in the application of these provisions that are, of course, voluntary'. APRA stated that trustees are able to decide not to provide fund members with a binding death benefit nomination; trustees can continue to operate on a discretionary basis. In response to industry criticisms about the new binding death benefit nominations, APRA advised the Committee that the organisation '(has) not seen, or been provided with data on cost increases', and from a prudential point of view, sees no evidence of problems with the new provisions. [22]

*Committee view*

7.33 The Committee is very conscious that, as many people grow older, a significant number may experience forms of dementia such as Alzheimer's disease, which may impact on a person's legal capacity to update wills or refresh binding death benefit nominations.

7.34 The Committee sees considerable merit in the suggestion that binding death benefit nominations stay in force in a manner similar to a will. However, as trustees

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19 Submission No 64, pp. 2-3.

20 Submission No 64, p. 1.

21 Committee Hansard, p. 411.

22 Submission No 88, p. 5.

have the discretion to either provide or not provide fund members with a binding death benefit nomination, it is a matter for individual funds to determine.

**Arrangements for people over 65 years of age**

7.35 It is government policy for individuals to use their superannuation entitlements for their retirement, rather than for estate planning purposes. Age limits and work tests therefore apply to ensure superannuation's role in providing for retirement.

7.36 Superannuation Guarantee contributions must be made if workers are less than 70 years old and award-related contributions must be made regardless of the employees age. Other contributions can be made if a work test of 10 hours per week is satisfied up to the age of 70. In a Superannuation Circular, APRA has indicated that trustees must be satisfied that the member is gainfully employed for a minimum of 10 hours each week and that the trustees must have arrangements in place, such as monthly monitoring.[23]

7.37 A superannuation fund must generally cash benefits for a member between 65 and 70 years of age who is no longer employed for 10 hours per week, or a member over 70 years of age who is no longer employed for 30 hours per week. In short, any person over the age of 65 who has not sought to access their superannuation is required to demonstrate that they remain employed. However, post-65 years of age, Superannuation Guarantee and Award contributions must remain in the fund until these contributions cease being made or are no longer liable to be paid.

7.38 In an age where there are increasing demands for flexibility in the workforce, and where there are increasing numbers of people over 65 wish to continue to work in some capacity, the arrangements for people in this age bracket attracted some comment during the inquiry.

7.39 AMP and William M Mercer Pty Ltd both argued that APRA have determined that this policy should be enforced by requiring superannuation funds to audit the employment status of their members over 65 years of age every month to determine whether the member satisfied the work test each week.[24] Both companies argued that this should be replaced by an annual requirement on the member to report to the trustees on their continuing employment, and notification of cessation of employment, a view which was supported by IFSA.[25]

23 Submission No 87, p. 1.

24 Submission No 31 and Submission No 19.

25 Submission No 31, p. 5; Submission No 19, p. 2 and Submission No 27, p. 19.

7.40 In the AMP's view, APRA's repeated rejection of industry views on this issue demonstrates a lack of commercial reality and failure to balance the cost of administration with the potential for breach of government policy.[26]

7.41 According to ASFA, the rules relating to compulsory cashing of benefits at age 65 are complex, inequitable, difficult to apply, not suitable for the modern workforce, and contrary to the Government's policy intention to allow a longer period in which to accumulate an adequate retirement income.[27]

7.42 The Committee notes that in its report, *Age Counts – an inquiry into issues specific to mature-age workers,* the House of Representatives Standing Committee on Employment, Education and Workplace Relations has also examined more flexible options for mature-age workers. That Committee recommended amendments to the SIS Regulations to allow workers over 60 to access their super funds as a supplement to reduced wages if they wished to partially retire.[28]

7.43 In its evidence to the House of Representatives inquiry, APRA explained that the current legislation requires the strict application by trustees of the 'over 65 test'. However when responding to this issue APRA advised the Committee that any changes to the current arrangements would not create any supervisory concerns for APRA.[29]

*Over 70s not able to contribute*

7.44 In another issue relating to the arrangements for people over 65 years of age, Mr John Teasdale from South Australia submitted to the Committee that the requirement for people over the age of 70 to work a minimum of 30 hours per week before they can make superannuation contributions amounts to age discrimination.[30]

7.45 In reply, APRA advised that it did not see this as a matter involving prudential supervision, but noted that any changes to the current arrangements would not create any supervisory concerns for APRA.[31]

*Committee view*

7.46 The Committee has a great deal of sympathy for those older Australians for whom the superannuation arrangements are less than flexible. The Committee accepts that there are many who wish to phase out of full-time work, but who still wish to make superannuation contributions.

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26 Submission No 31.

27 Submission No 40, p. 6.

28 House of Representatives Standing Committee on Employment, Education and Workplace Relations, *Age Counts – an inquiry into issues specific to mature-age worker*s, June 2000, p. xxvi.

29 Submission No 88, p. 6.

30 Submission No 24, p. 1.

31 Submission No 88, p. 5.

7.47 The Committee has commented on this issue in its report on *Enforcement of the Superannuation Guarantee,* which was presented to the President on 27 April and tabled on 22 May this year.

7.48 In that report, the Committee expressed its concern about the onerous reporting and monitoring requirements applying to employees over 65. These arrangements, in the view of the Committee, not only put an unnecessary administrative burden on business, they also disadvantage older employees and reduce their flexibility to remain in the workforce. The Committee also expressed the view that the current system should be made more flexible so that employment need not be a pre-requisite for individuals contributing to superannuation.

7.49 Given the Government's support for the removal of age discrimination in the work place, the Committee concluded that some of the age limits and work tests are discriminatory and should be removed. In particular, the Committee recommended that the current age limits and work tests that apply for superannuation guarantee contributions for individuals over 70 years be removed from the legislation.

7.50 The Committee also has some sympathy for those over 70 who are required to work a minimum of 30 hours per week before they can make superannuation contributions. The Committee concluded in its report on the *Enforcement of the Superannuation Guarantee Charge* contributing to superannuation after age 70 should be voluntary. This would give flexibility to individuals over 70 while at the same time not creating a situation where other fund members could effectively be subsidising the retirement of individuals who may already have received superannuation pay-outs. The Committee also concluded that the issue was a complex one, and that while 70 may be reasonable age limit for compulsory superannuation guarantee contributions at present, this may need to be reviewed over time.

7.51 The Committee notes that the Government has asked the Productivity Commission to review the SIS Act and related superannuation legislation. The Committee considers that it would be appropriate for the issues related to mature-age workers to be considered in more detail as part of that review.

**Extra requirements for funds with less than 5 members**

7.52 As discussed in Chapter 3, the regulation of self-managed superannuation funds with fewer than five members, where all the members are fund trustees, was transferred from APRA to the ATO in October 1999. Other superannuation funds with fewer than five members that do not meet the new definition are subject to regulation by APRA and must appoint an approved trustee. Prudential regulation of these 'small APRA funds' is considered necessary in order to protect the interests of members at arm's length. Concerns about the difference in treatment of the two types of small funds was drawn to the Committee's attention.

7.53 For example, Mr Jeremy Porteus, a Chartered Accountant from WA, argued that the requirement for members of self-managed superannuation funds also to be trustees are troublesome, onerous and unnecessary. He recommended that this

requirement be replaced with requiring all trust deeds to be amended to recognise a member's committee that included all members of the fund, and had the power to direct the trustees.[32]

7.54 The Institute of Chartered Accountants in Australia raised the following issues of concern in relation to funds with less than five members:

- supervisory levies for self-managed superannuation funds administered by the ATO are $45 per annum compared to $300 per annum for APRA supervised small APRA funds;
- the reduction in the reporting deadline from 9 months to 4 months and increased reporting requirements (ie, production of a cash flow statement) increases the cost of preparation and audit without adding any value to fund members; and
- members of small APRA funds must be given new member information, annual member statements, annual member booklets, and exit information, which increases costs without adding any value to fund members.[33]

7.55 Deloitte Touche Tohmatsu also expressed concern about the onerous requirements placed on small APRA funds. It recommended that APRA exempt small APRA funds from preparing statements of cash flow, and/or changing the exemptions within SIS so that funds with less than five members would no longer be required to prepare statements of cash flow.[34]

7.56 In its response to the Committee about the extra requirements for regulation of funds with less than five members, APRA advised that, because of the differences in the nature of the funds, it did not consider it appropriate to compare the regulation of the funds regulated by the ATO and APRA. However, APRA agreed that the provision of cash flow statements was not necessary and that it would be recommending legislative change to the Department of the Treasury.

*Committee view*

7.57 The Committee notes the concerns expressed about the apparently inequitable treatment of small APRA funds compared to the ATO-regulated self-managed superannuation funds. The Committee accepts that they are by nature different, and that this may place different requirements on the two types of fund.

7.58 The Committee notes that one of the more onerous burdens on the small APRA funds, that of preparing cash flow statements, is currently being reviewed, and that removing this requirement may go some way to alleviating some of the concerns expressed.

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32 Submission No 9, p. 1.

33 Submission No 51, pp. 1-2.

34 Submission No 63, p. 2.

7.59 Further discussion on APRA's role in regulating small and medium sized funds is in Chapter 3.

**Preservation rules too restrictive**

7.60 The superannuation preservation rules are designed to ensure that superannuation savings that have benefited from Australian tax concessions are used to provide income in retirement. Since 1 July 1998, permanent departure from Australia is no longer a condition for early release of benefits from superannuation funds. However, according to the Department of the Treasury, the Government has announced that it would be prepared to enter into bilateral negotiations with other countries to facilitate the transfer of superannuation benefits by non-residents on permanent departure on a reciprocal basis.[35]

7.61 The Committee heard complaints about the inability of the fund members to transfer their entitlements out of a superannuation fund on their leaving the country. Prior to the 1998 changes to the preservation rules, such transfers were permitted.

7.62 Both William M Mercer Pty Ltd and BHP made a number of suggestions aimed at increasing the portability of superannuation funds. In particular, William M Mercer Pty Ltd submitted that members should be allowed to transfer their preserved superannuation benefits to an overseas superannuation fund, and that the tax treatment change with respect to superannuation contributions made to an Australian superannuation fund from money brought from overseas.[36]

7.63 APRA does not see this as a matter involving prudential supervision, but noted that any changes to the current arrangements would not create any supervisory concern for APRA.[37]

*Committee view*

7.64 The Committee has commented on this issue in both its report on the opportunities and constraints for Australia to become a centre for the provision of global financial services and its report on the enforcement of the superannuation guarantee charge. In those reports, the Committee expressed its concern about the anomalies which exist in the treatment of expatriate staff and recommended that the arrangements be reviewed in order to ascertain whether portability of funds could be effected more expeditiously than is presently the case and that the Government review its policy in relation to preservation rules.

7.65 The Committee notes that the Government announced on 25 June 1997 that it would be prepared to enter into bilateral negotiations with other countries to facilitate reciprocal agreements for the transfer of superannuation benefits by non-residents on

35 Submission No 87, p. 6.

36 Committee Hansard, p. 409.

37 Submission No 88, p. 5.

permanent departure from Australia, but that Australia is yet to be approached by another country.[38]

7.66 The Committee welcomes moves to improve the portability of superannuation benefits by non-residents departing Australia permanently and reiterates the views expressed in its earlier reports that there may be a case to review the preservation rules to facilitate such portability.

**Impact of severe financial hardship claims on funds**

7.67 The Government's retirement incomes policy strikes a balance between ensuring superannuation is used for income in retirement while also ensuring that the restriction of superannuation benefits does not cause undue hardship. The SIS legislation provides for the early release of superannuation benefits in a limited number of circumstances. The final decision on whether early release is permitted rests with the trustees of the applicant's superannuation fund, subject to the funds governing rules.

7.68 Tasplan Super advised the Committee of a number of issues concerning the impact of severe financial hardship claims on the fund. According to Tasplan, the severe financial hardship provisions are cumbersome, costly, time consuming, and are open to abuse by members. Processing claims accounts for 15 to 20 per cent of all for Tasplan's administrative activity, and has an impact on member benefit protection costs when a small balance is left in the fund. Tasplan would like the severe financial hardship regulation amended. The General Manager of Tasplan advised the Committee that it was the Board's intention to withdraw the availability of the benefit if the process is not modified. [39]

7.69 APRA advised that this issue has not been raised with them on a widespread basis during its inspections, nor has it been raised with them during liaison meetings with industry.[40]

*Committee view*

7.70 The Committee is mindful of the potential for abuse and the additional administrative costs incurred by a fund dealing with a large number of severe financial hardship claims.

7.71 The Committee is also mindful of the House of Representatives Standing Committee which recommended that the Government explore the feasibility of

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38 Submission No 87, p. 7 and Submission No 31 from the Department of the Treasury to the inquiry into the opportunities and constraints for Australia to become a centre for the provision of global financial services.

39 Submission No 50, pp. 1-3; Submission No 61, Attachment p. 10

40 Submission No 88, p. 5.

allowing people over the age of 45 to access their superannuation contributions for mortgage payment purposes in situations where the person has just lost their job.[41]

7.72 The Committee considers that as the availability of the benefit is at the discretion of the trustees, it should be a matter for each fund to determine. However the Committee will monitor the issue.

**Reduction in the time to submit annual returns from 6 months to 4 months**

7.73 In 2000, the time from the end of the financial year for superannuation funds to lodge their annual return to the regulator was decreased from six months to four months.

7.74 In recommending a return to the six month requirement, William M Mercer advised the Committee that a four month period is likely to be unachievable due to the industry's shortage of trained and experienced staff. The change also will increase audit costs due to the staff shortage.[42]

7.75 The Committee was advised that the aim of the shorter lodgement period was to harmonise all APRA–supervised superannuation funds with public offer superannuation funds. While acknowledging the impact of this change, APRA noted that this change improved the quality of prudential information available to it from the only prudentially regulated entities that report annually. APRA further advised that, despite the concerns raised by the accounting profession about the 'stress' which this reduction in time would create, there appears to have been no widespread difficulty in meeting the revised deadline.[43]

7.76 APRA subsequently advised the Committee in June 2001 that 323 funds had still not lodged annual returns which were due on 31 October 2000. APRA officials indicated that this may have been because most of the funds involved had wound up without informing APRA.

*Committee view*

7.77 The Committee notes the concerns expressed about reducing the time in which annual reports had to be lodged with the regulator. However, it notes that despite these concerns, APRA advised at one stage that there did not appear to be any difficulty in most funds meeting the revised deadline.

7.78 The Committee was therefore surprised when APRA subsequently indicated that it would be referring those who were late lodging their returns to the Director of Public Prosecutions. The Committee considered this to be a somewhat heavy handed

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41 House of Representatives Standing Committee on Employment, Education and Workplace Relations, *Age Counts – an inquiry into issues specific to mature-age worker*s, June 2000, p. xxx.

42 Submission No 19, pp. 2-3.

43 Submission No 88, p. 6.

approach, which appeared to deny access to principles of natural justice, and advised the regulator accordingly.

7.79 The Committee notes that this matter appears to have been resolved following consultation between APRA and the aggrieved parties. The Committee also notes that more timely information can only improve APRA's knowledge and awareness of prudentially regulated entities.

**Trustees' power to delegate investment–related functions to an investment manager**

7.80 Institutional Analysis Pty Ltd raised the issue of whether the existing law provides a clear and reliable basis for trustees to delegate the investment function. The company submitted that there is a risk that a court will interpret the engagement of an investment manager by superannuation fund trustees as involving a delegation of discretion by the trustees. Any clause in the trust deed permitting the delegation would run the risk of being declared invalid due to section 59 of the SIS Act. As a solution, Institutional Analysis recommended that:

> The SIS Act should be amended to make it clear that superannuation scheme trustees have the power to appoint an investment manager and delegate investment–related functions to that investment manager. The amendment should also require any exercise of this delegated power by the investment manager to be in accordance with the investment strategy formulated by the trustees under section 52(2)(f).[44]

7.81 APRA has been examining this issue and advised that it had seen no evidence of a need to make outsourcing subject to more specific legislative provisions – whether for investment management or any other function. APRA also advised that modifying the SIS Act to include a specific trustee power to delegate investment-related functions to an investment manager has the potential to be at odds with the fundamental principle of trustee responsibility for the management of the funds.[45]

7.82 However, the Committee notes that since making that submission, APRA has modified its position somewhat, at least in relation to electronic commerce. APRA has stated that the changes brought about by electronic commerce and the increased role of outsourcing in that area was a 'potential source of concern to APRA, especially where there are systemic implications resulting from a third party providing services to a large number of institutions'.[46] APRA also stated that it was currently considering whether there was a case for specific legislation to allow it to make a more thorough assessment of those third-party service providers.

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44 Submission No 30, p. 5.

45 Submission No 88, p. 6.

46 APRA *Insight*, 1st Quarter 2001, p. 8.

7.83 Where supervised institutions appear to have equated outsourcing of functions with the outsourcing of responsibility, APRA informs the trustees that it is not an acceptable view and that the trustees must have appropriate contractual arrangements in place and must monitor and evaluate the performance of any service provider.

*Committee view*

7.84 The Committee is most concerned about the issue of outsourcing functions without appropriate contractual arrangements in place. The Committee accepts that for various reasons trustees may wish to outsource functions in which they lack a particular expertise, but the Committee emphasises that outsourcing of functions does not equate to outsourcing responsibility.

7.85 The Committee notes APRA's advice that there is no need to make outsourcing for investment management subject to more specific legislative provisions. However, the issue remains one of educating the trustees about their responsibilities, which is a role for APRA.

**Conclusion and recommendation**

7.86 As can be seen from the discussion above, there appear to be a number of concerns with aspects of the SIS legislation which require clarification or investigation. The Committee has not made specific recommendations on every issue, as some of the issues do not appear to require further examination while others require more detailed investigation. However, the Committee considers that the issues raised should be reviewed by the Government.

**Recommendation 17**

**7.87 The Committee recommends that the Government review those aspects of the *Superannuation Industry (Supervision) Act 1993* (the SIS Act) referred to in this report.**

7.88 Finally, the Committee notes that weaknesses in the SIS regime contributed to the problems experienced by investors in the Enhanced Cash Management Trust (ECMT) managed by an APRA approved trustee, CNA. Of particular concern is that APRA did not have prudential responsibility for the ECMT. The need to tighten the SIS rules to overcome this weakness is a matter which will be discussed in the Committee's report on the case studies.

**Senator John Watson**

**Committee Chair**

# APPENDIX 1

## SUBMISSIONS RECEIVED

1. Mr Peter Williams, WA
2. Mrs Patricia A. King, NSW
3. Mr Dan Scheiwe, Queensland University of Technology, QLD
4. Mr Peter Armstrong, VIC
5. Industry Funds Forum (IFF)
6. Australian Consumers' Association (ACA)
7. Australian Taxation Office (ATO)
8. The Institute of Chartered Accountants in Australia
9. Mr Jeremy Porteus, WA
10. Care Incorporated, Financial Counselling and Consumer Credit Legal Service
11. Australian Securities and Investments Commission (ASIC)
12. Consumer Credit Legal Service Inc
13. National Farmers' Federation (NFF)
14. WA Shearing Contractors Association (Inc)
15. NFF (Supplementary Submission)
16. Australian Association of Permanent Building Societies
17. Association of Superannuation Funds of Australia (ASFA)
18. NRMA
19. William M. Mercer Pty Ltd
20. Australian Society of Certified Practising Accountants (Now CPA Australia)
21. Ms Fiona Ogilvy-O'Donnell, VIC
22. Automotive, Food, Metals, Engineering, Printing and Kindred Industries Union (AMWU)

23. Australian Prudential Regulation Authority
24. Mr John Teasdale, SA
25. Council of Small Business Organisations of Australia Ltd (COSBOA)
26. Financial Services Consumer Policy Centre (FSCPC)
27. Investment & Financial Services Association (IFSA)
28. Phillips Fox Actuaries and Consultants
29. Australian Council of Trade Unions (ACTU)
30. Institutional Analysis Pty Ltd
31. AMP
32. Corporate Super Association
33. Process Pack Pty Ltd
34. Goodman Fielder Limited
35. Mr Shawn Fracchia, ACT
36. Westpac Banking Corporation
37. Puzzle Financial Advice P/L
38. Towers Perrin
39. AMWU (Supplementary Submission)
40. ASFA (Supplementary Submission)
41. Mr Shawn Fracchia, ACT (Supplementary Submission)
42. Queensland Furnishing Industry Superannuation Trust (QFIST)
43. Mr Geoffrey Heaton, QLD
44. Association of Independent Retirees Inc, SA
45. Industry Fund Services Pty Ltd
46. Puzzle Finance Advice P/L (Supplementary Submission)
47. Mr Gary Lanham, Minter Ellison, QLD
48. Ms Carmel Reading, QLD

49. Institute of Actuaries of Australia

50. Tasplan Super

51. The Institute of Chartered Accountants in Australia (Supplementary Submission)

52. ACTU (Supplementary Submission)

53. De Santis Management Agency

54. Australian Conservation Foundation

55. Puzzle Finance Advice P/L (Supplementary Submission)

56. Ms Carmel Reading, QLD (Supplementary Submission)

57. Mr Pat Hannan, QLD

58. IFF (Supplementary Submission)

59. Towers Perrin (Supplementary Submission)

60. REST Superannuation

61. Tasplan Super (Supplementary Submission)

62. Mr Greg Lisk, NSW

63. Deloitte Touche Tohmatsu

64. ASFA (Supplementary Submission)

65. Phillips Fox, Actuaries and Consultants (Supplementary Submission)

66. Insurance Council of Australia Ltd (ICA)

67. Hotel Motel & Accommodation Association of Queensland (HMAA Queensland)

68. Confidential

69. Confidential

70. Australian Chamber of Commerce and Industry

71. Confidential

72. Financial Planning Association of Australia Ltd (FPA)

73. APRA (Supplementary Submission)

74. First Samuel Limited

75. ATO (Supplementary Submission)

76. Department of the Treasury

77. The Institute of Chartered Accountants in Australia (Supplementary Submission)

78. Investment Initiative

79. Institute of Actuaries (Supplementary Submission)

80. Australian National Audit Office (ANAO)

81. Superannuation Complaints Tribunal

82. ACA (Supplementary Submission)

83. Confidential

84. Confidential

85. Mr Daryl Dixon, Writer and Consultant, ACT

86. Association of Financial Advisers

87. Department of the Treasury (Supplementary Submission)

88. APRA (Supplementary Submission)

89. Law Employees Superannuation Fund (LESF)

90. APRA (Supplementary Submission)

91. ASIC (Supplementary Submission)

92. Australian Competition & Consumer Commission

93. ATO (Supplementary Submission)

94. Confidential

95. Confidential

96. Mr John Crosby

97. Mr & Mrs R D & M I Gregg

98. Morton Family Superannuation Fund

99. Mr Spencer Bell
100. Name withheld
101. Mr John Crosby (Supplementary Submission)
102. Mr & Mrs Richard & Jennifer Kaan
103. Mr & Mrs P R & V T Marshall
104. Mr Dominic Galati
105. Name withheld
106. Watts Family Superannuation Fund
107. Saxby Bridge Financial Planning Pty Ltd
108. Price Waterhouse Coopers
109. APRA (Supplementary Submission)
110. Confidential
111. Mr & Mrs R D & M I Gregg (Supplementary Submission)
112. Mr & Mrs P R & V T Marshall (Supplementary Submission )
113. The McKellar Family Superannuation Fund
114. Name withheld
115. Mr John Crosby (Supplementary Submission)
116. Australian Securities & Investments Commission (ASIC)
117. Mr & Mrs P Sautelle
118. Mr Phil Dally
119. Mrs Helen Hills
120. Name withheld
121. APRA (Supplementary Submission)
122. Confidential
123. Ms J M Schott
124. Mr & Mrs L & S Morrell

125. Mr Michael Spalding
126. Mr Ian Young
127. Mr Gordon Dilger
128. Name withheld
129. Ms Cherylyn Harris
130. The Hon Ray Groom MHA
131. Mr & Mrs Arnold & Maureen Sierink
132. Ms Jocelyn Walsh
133. Name withheld
134. Mr & Mrs Neville & Margaret Newman
135. Mr Alastair Shepherd
136. Mr John Woods
137. Mr P C Toomey
138. Mr Jeff Trimmer
139. Mrs Janice Holland
140. Mr & Mrs Colin & Lauren Trevena
141. Tasmanian Ombudsman
142. Mr John Meyer & Ms Jill Dalrymple
143. Mr & Mrs David & Marie Hudson
144. Ms Gillian Maguire
145. Confidential
146. Mr & Mrs G R & M J Shuptrine (Supplementary submission)
147. John, the Duke of Avram
148. Ms Margaret Mitcehll
149. Department of Justice and Industrial Relations
150. The Law Society of Tasmania

151. The Law Society of Tasmania (Supplementary submission)
152. Garrisons Financial Advisers
153. Deputy Commissioner of Police
154. Mr Arnold Sierink (Supplementary submission)
155. Peter Worrell Lawyers
156. Confidential
157. Mr & Mrs Pidd
158. Mr Ben McIntyre
159. Mr N W Tesdorf
160. McCulloch & McCulloch Mortgage Fund
161. Mr Anthony Clennett
162. D W & I M Tapping
163. Piggott Wood & Baker
164. Mr Peter Kang-Scheit
165. Mr Jon Jovanovic
166. Rae & Partners, Lawyers
167. Mr N W Tesdorf
168. Ms Anne Moutafis OAM
169. Mr Charles Phillips
170. Confidential
171. Department of Justice & Industrial Relations (Supplementary submission)
172. Mr James G Turner
173. E R Henry Wherrett & Benjamin
174. Confidential
175. Mr David Newitt
176. Piggott Wood & Baker

177. Tasmanian Trustees Limited

178. Paul Cook & Associates

179. Eastside Financial Services

180. Resource Management & Planing Appeal Tribunal

181. Mr & Mrs A D & M Oldham (Supplementary Submission)

182. Kingborough Council

183. Dobson, Mitchell & Allport

184. Mr & Mrs Arnold & Maureen Sierink (Supplementary Submission)

185. Garrisons Pty Ltd (Supplementary Submission)

186. Mr D Gillie, Mrs S Sutcliffe & Mr B Griffin

187. Barringtons

188. Mr Mark Johnson

189. Mr Donald Hurburgh

190. Legal Ombudsman, Tasmania

191. Murdoch Clarke

192. Official Liquidator of D W & I M Tapping Pty Ltd

193. Australian Stock Exchange Limited (ASX)

194. Mr J Meyer (Supplementary Submission)

195. Mr Sydney Dwyer

196. The Solicitors' Trust

197. APRA (Supplementary Submission)

198. Australian Securities and Investments Commission (ASIC) (Supplementary Submission)

199. Australian Property Institute (Tasmanian Division)

200. Valuers Registration Board

201. The Law Society of Tasmania (Supplementary Submission)

202. Garrisons Pty Limited (Supplementary Submission)

203. Confidential

204. Confidential

205. Sorell Council

206. Garrisons Corporate Services (Supplementary Submission)

207. Mr Peter Worrall (Supplementary Submission)

208. The Law Society of Tasmania (Supplementary Submission)

209. Australian Stock Exchange Limited (Supplementary Submission)

210. Department of Police and Public Safety, Tasmania (Supplementary Submission)

211. P G Brownrigg & Associates

212. Mr Jeff Trimmer (Supplementary Submission)

213. Department of Justice & Industrial Relations, Tasmania (Supplementary Submission)

214. Name withheld

215. Australian Securities & Investments Commission (Supplementary Submission)

216. APRA (Supplementary Submission)

217. Mrs Janice Holland (Supplementary Submission)

218. Confidential

219. Confidential

220. Official Liquidator of Commercial Nominees of Australia Limited

221. Australian Securities & Investments Commission (Supplementary Submission)

222. Arthur Andersen

223. Confidential

224. National Institute of Accountants

225. APRA (Supplementary Submission)

226. Ferrier Hodgson Management

227. Mr S P Dwyer (Supplementary Submission)

228. Murdoch Clarke (Supplementary Submission)

229. Mr C E Clark

230. Clerk Walker & Stops

231. Garrisons Corporate Services (Supplementary Submission

232. APRA (Supplementary Submission)

233. APRA (Supplementary Submission)

234. Legal Ombudsman (Tasmania) (Supplementary Submission)

235. Australian Property Institute, Tasmanian Division

236. The Institute of Chartered Accountants in Australia

237. APRA (Supplementary Submission)

(Submissions 1-95 were tabled on 22 May 2001 when the Committee tabled its report on term of reference (c) *Enforcement of the Superannuation Guarantee Charge*.)

# APPENDIX 2

## WITNESSES WHO APPEARED BEFORE THE COMMITTEE AT PUBLIC HEARINGS

### Monday, 15 May 2000, Sydney

*Australian Mutual Provident Society Ltd*
Mr Kevin Casey, Senior Strategy and Technical Adviser
Mr Gerald Naughton, Senior Investment Manager

*Association of Superannuation Funds of Australia*
Dr Michaela Anderson, Director, Policy and Research
Ms Philippa Smith, Chief Executive Director

*Financial Services Consumer Policy Centre*
Mr John Berrill, Partner Superannuation, Martin Blackburn Cashman
Mr Chris Connolly, Director
Mr Khaldoun Hajaj, Researcher

*Australian, Food, Metals, Engineering Printing and Kindred Industries Union*
Mr Barry Terzic, National Research Officer

*Retail Employees Superannuation Trust*
Mr Damian Hill, Administration Manager
Mr Elliott Sabbah, Operations Manager

*Phillips Fox Actuaries and Consultants*
Mr Michael Rice, Managing Director

*Investment and Financial Services Association*
Miss Lynn Ralph, Chief Executive Officer
Ms Annabelle Kline, Senior Policy Manager

### Tuesday, 16 May 2000, Sydney

*Australian Stock Exchange*
Ms Rosemary Kennedy, National Manager, Interest Rates Markets
Mr Michael Roche, Executive General Manager, Strategic Planning and Corporate Relations

*Australian Centre for Global Finance, Treasury*
Mr Leslie Hosking, Chief Executive Officer
Miss Maryanne Mrakovcic, General Manager

*Australian Financial Markets Association*
Mr Kenton Farrow, Chief Executive
Mr John Rappell, Director Research and Policy

Dr George Gilligan

Prof Gordon de Brouwer

*Vanguard Investments Australia Ltd*
Mr Jeremy Duffield, Managing Director

*Skandia Assurance and Financial Services*
Mr Johan Hofvander, Regional Manager, Asia-Pacific
Mr Ross Laidlaw, Country Manager

*International Banks and Securities Association of Australia*
Mr Robert Webster, Executive Director

## Friday, 9 June 2000, Melbourne

*Superannuation Complaints Tribunal*
Mr Graham McDonald, Chair
Ms Nicole Cullen, Deputy Chairperson
Mrs Margaret McDonald, Director

*Osborne Associates*
Mr Bradley Treadwell, Managing Director

*Insurance Council of Australia Ltd*
Mr Philip Maguire, Deputy Chief Executive
Ms Joan Fitzpatrick, Member International Committee for General Insurance
Mr Vincent McLenaghan, Chairman, International General Insurance Committee

*Reserve Bank of Australia*
Mr Ric Battellino, Assistant Governor, Financial Markets
Dr Robert Rankin, Head of International Department

*Finance and Treasury Association*
Mr Anthony Michell, Technical Manager, Policy, Research and Professional Development

*Australian Banking Industry Ombudsman*
Mr Colin Neave, Banking Ombudsman

*J B Were & Son*
Mr Terrence Campbell, Executive Chairman

Ms Priscilla Boreham, Corporate Counsel
Ms Lisa Gay, General Counsel

*Australian Securities and Investment Commission*
Mr Alan Cameron, Chairman
Ms Delia Rickard, Director, Office of Consumer Protection
Ms Jillian Segal, Commissioner
Mr Shane Tregillis, National Director Regulation

*Australian Accounting Standards Board*
Mr Keith Alfredson, Chairman

## Thursday, 15 June 2000, Melbourne

*Australian Council of Trade Unions*
Ms Linda Rubinstein, Senior Industrial Officer

*Industry Funds Forum*
Ms Ann Byrne, Convenor
Ms Anne-Marie Darke, Executive Member

*Corporate Super Association*
Mr Mark Cerche, Chairman
Mr Nicholas Brookes, Secretary

*Institute of Chartered Accountants of Australia*
Mr David Coogan, Chairperson, Superannuation Taskforce
Mr Richard Rassi, Partner Deloitte Touche Tohmatsu

*William M Mercer Pty Ltd*
Mr Wayne Walker, Executive Director
Mr John Ward, Manager, Research and Information

Ms Fiona Ogilvy-O'Donnell

*Towers Perrin*
Mr Kenneth Lockery, Principal

*CPA Australia*
Mr Bradley Pragnell, Superannuation Policy Adviser

*Association of Independent Retirees Inc*
Mr Alan Beaton, President, South Australian Division and National Councillor

## Friday, 16 June, 2000, Brisbane

*Puzzle Finance Advice Pty Ltd*
Mr Bruce Baker, Director
Mr Gary Lanham
Mr Mervyn Whimp

*Hairdressers Association Superannuation Fund*
Mrs Yvonne Bell, Consultant to Fund
Mr Jeffrey Osborne, Director (Trustee Company)

Mrs Carmel Reading

*Law Employees Superannuation Fund*
Mr Peter Short, Chairman
Mr Ray Rinaudo, Director

*Voyager Resort Ltd*
Mr Geoff Heaton, Company Secretary and Resort Manager

Mr Dan Scheiwe

Mr Paul Henderson

## Friday, 14 July, 2000, Canberra

*Australian National University*
Prof Peter Drysdale, Head Australia-Japan Research Centre and Acting Director Asia Pacific School of Economics and Management
Prof Anthony Milner, Dean, Faculty of Asian Studies

*The National Office for the Information Economy, Department of Communications, Information, Technology and the Arts*

Dr Rodney Badger, Deputy Chief Executive Officer NOIE and Executive Director Information Technology
Mr Phillip Malone, Acting General Manager, E-Commerce
Mr Gregory Piko, Acting General Manager, Information and Communications Industry Development
Mr Brenton Thomas, Acting General Manager, Consumer and Competition Branch

*Namoi Cotton Cooperative* (teleconference)
Mr Andrew Lennon, Risk Manager

*The Broken Hill Proprietary Co Ltd* (teleconference)
Mr Ian Edney, Vice President Taxes
Mr Alistair Mytton, Manager, Corporate Tax Advisory

*Australian Principals' Centre*
Mr Nicholas Thornton, Chief Executive Officer

*Australian Greenhouse Office*
Dr David Harrison, Special Adviser, Emission Trading
Dr Gary Richards, Manager, National Carbon Accounting System
Mr Stephen Moran, Director, Climate Section, Department of Foreign Affairs and Trade

*Securities Institute of Australia*
Ms Penelope Le Couteur, Managing Director
Mr Darren Davis, National Policy Adviser

*Department of the Treasury*
Mr Blair Comley, General Manager, Indirect Tax Division
Mr Bruce Paine, General Manager, Business Entitics and International Tax Division
Mr Gary Potts, Executive Director, Markets Group
Mr Michael Willcock, General Manager, Financial Markets Division
Mr Leslie Hosking, Chief Executive Officer, Axiss Australia

*Australian Taxation Office*
Mr James Killaly, Deputy Commissioner, Large Business and International

## Friday, 1 September 2000, Canberra

*Australian National Audit Office*
Mr Peter White, Executive Director, Revenue Branch
Mr Norman Grimmond, Senior Auditor Performance Audit Services Group

*Financial Planning Association of Australia*
Mr Con Hristodoulidis, Senior Manager, Public Policy
Mr Maurice Pinto, Chairperson, Superannuation and Retirement Incomes Committee

*Australian Consumers Association*
Ms Louise Petschler, Senior Policy Officer, Financial Services

*Australian Taxation Office*
Mr David Diment, Assistant Commissioner, Superannuation

*Institute of Actuaries of Australia*
Dr David Knox, President
Ms Jane Ferguson, Director Public Affairs
Ms Christa Marjoribanks, Member, General Insurance Practice Committee

*Australian Institute of Criminology*
Dr Adam Graycar, Director
Dr Peter Grabosky, Director of Research

*WA Shearing Contractors Association (teleconference)*
Mr Neville Munns, Secretary

## Monday, 16 October 2000, Canberra

*Care Incorporated*
Mr David Tennant, Director

*National Farmers Federation*
Mr Richard Calver, Director, Industrial Relations

*Australian Association of Permanent Building Societies*
Mr Jim Freemantle, Chairman
Mr Jim Larkey, Executive Director

*First Samuel Ltd*
Mr Anthony Starkins, Managing Director

*Association of Financial Advisers*
Mr John Hibberd, President
Mr Dugald Mitchell, Consultant

## Tuesday, 17 October 2000, Canberra

*Australian Securities and Investments Commission*
Mr Sean Hughes, Director, Deposits, Investment, Superannuation and Consumers
Mr Peter Kell, Coordinator, Office of Consumer Protection
Ms Angela Longo, Senior Lawyer
Ms Delia Rickard, Office of Consumer Protection
Mr Malcolm Rodgers, Director, Regulatory Policy

*Australian Prudential Regulation Authority*
Mr Roger Brown, Senior Manager, Rehabilitation and Enforcement
Mr Keith Chapman, General Manager, Specialised Institutions Division
Mr Leslie Phelps, Executive General Manager, Specialised Institutions Division
Mr Darryl Roberts, General Manager, Policy Development and Statistics

*Department of the Treasury*
Mr Roger Brake, General Manager, Retirement and Personal Income Division
Mr Raphael Cicchini, Manager, Superannuation Unit, Retirement and Personal Income Division

Ms Jan Harris, General Manager, Consumer Affairs Division
Mr William Keown, Acting General Manager, Financial Institutions Division
Mr David Maher, Analyst, Financial Institutions Division
Mr Michael Rosser, Manager, Investor Protection Unit, Financial Markets Division
Ms Karen Witham, Manager, Superannuation and Insurance Unit, Financial Institutions Division
Mr Michael Willcock, General Manager, Financial Markets Division

*Australian Taxation Office*
Mr Leo Bator, Deputy Commissioner of Taxation
Mr David Diment, Assistant Commissioner of Taxation

*Australian Competition and Consumer Commission*
Mr Allan Asher, Deputy Chairman
Mr Carl Buik, Director, Consumer Protection

## Friday, 30 March 2001, Canberra

Mr Spencer Bell (private capacity)

Mr John Crosby (private capacity)

*Saxby Bridge Financial Planning Pty Ltd*
Mr Phillip Dally, General Manager

Mrs Marianne Gregg (private capacity)

Mr Richard Kaan (private capacity)

Mrs Jennifer Kaan (private capacity)

Mrs Valda Marshall (private capacity)

Mr Eric Watts (private capacity)

## Friday, 18 May 2001, Hobart

*Department of Justice and Industrial Relations*
Mr Peter Maloney, Director, Legislation of Policy

Mr Leon Morrell (private capacity)
Mr Allan Oldham (private capacity)
Mrs Mary Oldham (private capacity)

The Hon Ray Groom, Shadow Minister for Justice (Tas)

*Law Society of Tasmania*
Mr Timothy Bugg, Past President
Ms Christine Harvey, Deputy Secretary-General, Law Council of Australia
Mr Philip Jackson, President
Mrs Jan Martin, Executive Director

*Toomey Maning and Company*
Mr Patrick Toomey

Ms Cherylyn Harris (private capacity)
Ms June Schott (private capacity)
Mr Arnold Sierink (private capacity)
Mrs Maureen Sierink (private capacity)

Mr John Meyer (private capacity)
Mr John Woods, Official Liquidator of D W & I M Tapping Pty Ltd

Mr John Fyle (private capacity)
Mr David Newitt (private capacity)
Mrs Melba Truchanas (private capacity)

*Tasmanian Ombudsman*
Mr Anthony Allingham, Senior Investigation Officer

*Garrisons Pty Ltd*
Mr Philip Creswell, National Audit and Compliance Manager, and Company Secretary
Mr John Sikkema, Managing Director
Mr Michael Spinks, Executive Director

Mr Peter Worrall, Manager, Lewis Driscoll and Bull

Mr Peter Joyce, Manager, McCulloch and McCulloch

Mr John McCausland, Editor *The Mercury* and *The Sunday Tasmanian*

## Tuesday, 12 June 2001, Sydney

*PricewaterhouseCoopers*
Mr Peter Hedge, Partner

*Australian Stock Exchange*
Ms Luise Elsing, Manager, Companies, Sydney
Mrs Karen Hamilton, General Counsel and Company Secretary

*Australian Securities and Investments Commission*
Mr Simon Dwyer, Regional Commissioner
Mr Michael Gething, Western Australian Regional Commissioner
Mr Ian Johnston, Executive Director, Financial Services Regulation
Mr David Knott, Chairman
Mr Ian Mackintosh, Chief Accountant
Mr Darren McShane, Director, Managed Investments
Ms Jan Redfern, Regional General Counsel
Ms Jillian Segal, Deputy Chair
Mr Shane Tregillis, Executive Director, Policy and Markets Regulation
Mr Peter Wood, Executive Director, Enforcement

*Australian Prudential Regulation Authority*
Mr Earl Burgess, Senior Manager, Rehabilitation and Enforcement
Mr Bill Gole, General Manager, Coordination, Rehabilitation and Enforcement
Mr Thomas Karp, Executive General Manager, Diversified Institutions
Mr Leslie Phelps, Executive General Manager, Specialised Institutions Division
Mr William Stow, Manager (Legal), Rehabilitation and Enforcement, Specialised Institutions Division
Mr Craig Thorburn, General Manager, Diversified Institutions Division

## Friday, 15 June 2001, Hobart

Mr Cyril Clark (private capacity)
Mr Sydney Dwyer (private capacity)

*Law Society of Tasmania*
Mr Timothy Bugg, Past President and Council Member
Mr Philip Jackson, President
Mrs Jan Martin, Executive Director
Ms Christine Harvey, Deputy Secretary-General

*Australian Property Institute*
Mr Louis Rae, Chairman, Valuers Registration Board
Mr Raymond Westwood, Chairman, Complaints Commission; Board Member, Australian Valuation and Property Standards Board; and Tasmanian Divisional Chairman, Australian Property Institute

Mr Paul Wilson, Tasmanian Divisional President, Australian Property Institute

Ms Judith Paxton, Tasmanian Legal Ombudsman

Mr Bernard Harrington, Retirement Manager, Centrelink

## Monday, 25 June 2001, Canberra

*Australian Prudential Regulation Authority*

Mr Earl Burgess, Senior Manager, Specialised Institutions Division
Mr Les Phelps, Executive General Manager, Specialised Institutions
Mr William Stow, Manager, Specialised Institutions Division
Mr Graeme Thompson, Chief Executive Officer

(Hansard transcripts of the nine hearings held in 2000 were tabled on 22 March 2001 when the Committee presented its report on term of reference (b) - *The opportunities and constraints for Australia to become a centre for the provision of global financial services.*)

# APPENDIX 3

# TABLED DOCUMENTS/EXHIBITS

1. ASFA submission on Financial Services Reform Bill. May 2000 – tabled by Ms Philippa Smith, CEO, ASFA, 15 May 2000, Sydney.

2. Correspondence from Hesta Super Fund to Barry Terzic, AMWU, dated 12 May 2000 relating to Superannuation – Process Pack – tabled by Mr Barry Terzic, National Research Officer, AMWU, 15 May 2000, Sydney.

3. Extract from Workplace Relations Act 1996 – tabled by Mr Barry Terzic, National Research Officer, AMWU, 15 May 200, Sydney.

4. Correspondence to APRA, dated 20 August 1999 and correspondence from APRA, dated 9 September 1999 relating to monitoring gainful employment for members over age 65 – tabled by Ms Lynn Ralph, CEO, IFSA, 15 May 2000, Sydney.

5. Opening statement by Mr Les Hosking, Chief Executive Officer, Australian Centre for Global Finance and fact sheets about the Centre – tabled by Mr Les Hosking, CEO, Australian Centre for Global Finance, 16 May 2000, Sydney.

6. *AFMA 1999 Australian Financial Markets Report – Overview* – tabled by Mr Kenton Farrow, Chief Executive, Australian Financial Markets Association, 16 May 2000, Sydney.

7. *IBSA 1999 Annual Report* – tabled by Mr Robert Webster, Executive Director, International Banks and Securities Association of Australia, 16 May 2000, Sydney.

8. *'Disclosure Model'* – tabled by Ms Ann Byrne, Convenor, Industry Funds Forum, 15 June 2000, Melbourne.

9. The following documents, issued by the Queensland Department of Justice and Attorney-General were tabled by Mr Baker, Puzzle Financial Advice Pty Ltd, 16 June 2000, Brisbane:

   - Enduring Power of Attorney
   - Powers of Attorney Act 1998
   - Advance Health Directive
   - Statutory Health Attorney
   - Enduring Power of Attorney – long form.

10. *Law Employees Superannuation Fund (LESF), Annual Report to Members for the year ending 30 June 1999* – tabled by Ms Carmel Reading, 16 June 2000, Brisbane.

11. A document issued by the Hotel Motel & Accommodation Association of Queensland entitled ' Important notice to members – EPAS superannuation 28/9/98' – tabled by Mr Geoff Heaton, 16 June 2000, Brisbane.

12. Report prepared for ASIC by Phillips Fox Actuaries and Consultants, *Financial Products and Intermediary Remuneration,* 10 November 1999 – provided by ASIC in response to questions taken on notice at the public hearing in Melbourne on 9 June 2000.

13. A document entitled, 'An IOSCO Technical Committee Release: International Securities Regulators Issue New Economy Bulletin, Sydney Australia 19 May 2000', provided by ASIC in response to questions taken on notice at the public hearing on 9 June 2000.

14. Response by Ms Yvonne Bell, Hairdressers Association Superannuation Fund, to questions taken on notice at the public hearing in Brisbane on 16 June 2000, relating to names of trustees and the court involved.

15. A document entitled, 'National Bandwidth Inquiry – Report of the Australian Information Economy Advisory Council', provided by National Office of Information Economy in response to questions asked at the public hearing on 14 July 2000.

16. Four discussion papers, 'Establishing the Boundaries', 'Issuing the Permits', 'Crediting the Carbon' and 'Designing the Market', provided by the Australian Greenhouse Office in response to questions asked at the public hearing on 14 July 2000.

17. Final Report from the Centre for International Economics Canberra and Sydney, which was commissioned by the Australian Greenhouse Office, provided by the Australian Greenhouse Office in response to questions asked at the public hearing on 14 July 2000.

18. Australian Institute of Criminology brochure outlining the Institute's function, aims and programs, tabled by Dr Adam Graycar, Director, at the committee's public hearing on 1 September 2000.

19. Australian Institute of Criminology brochure No. 56 - *Superannuation Crime* - tabled by Dr Adam Graycar, Director, at the committee's public hearing on 1 September 2000.

20. Australian Institute of Criminology brochure No. 132 - *Fraud & Financial Abuse of Older Persons* - tabled by Dr Adam Graycar, Director, at the committee's public hearing on 1 September 2000.

21. Australian Institute of Criminology brochure No. 139 - *Substitute Decision Making and Older People* - tabled by Dr Adam Graycar, Director, at the committee's public hearing on 1 September 2000.

22. Chant Links & Associates, 1*999 Superannuation Guarantee Audit Summary Report*, provided by the Australian Taxation Office and received as an exhibit to the inquiry on 3 October 2000.

23. Brochure entitled *Code of Ethics & Rules of Professional Conduct*, provided by the Financial Planning Association and received as an exhibit to the inquiry on 3 October 2000.

24. National Farmers' Federation publication Reform, Spring 2000, provided by Mr Richard Calver, NFF, during the public hearing on 16 October 2000.

25. Article entitled Disclosure paper on the current commission disclosure issue in Australia, provided by Mr John Hibberd, Association of Financial Advisers at the public hearing on 16 October 2000.

26. Policy/discussion paper entitled Distribution Disclosure or Commission? Bias and Conflict of Interest Examined, provided by Mr John Hibberd, Association of Financial Advisers at the public hearing on 16 October 2000.

27. Australian Competition and Consumer Commission - Overview of consumer protection functions, October 2000, tabled by Mr Allan Asher, ACCC, at the public hearing on 17 October 2000.

28. Approval of external complaints resolution schemes, tabled by the Australian Securities and Investments Commission at the public hearing on 17 October 2000.

29. A User's Guide to ASIC, tabled by the Australian Securities and Investments Commission at the public hearing on 17 October 2000.

30. ASIC more than a corporate watchdog, tabled by the Australian Securities and Investments Commission at the public hearing on 17 October 2000.

31. Educating Financial Services Consumers, discussion paper tabled by the Australian Securities and Investments Commission at the public hearing on 17 October 2000.

32. Submission to the Review of the Code of Banking Practice, tabled by the Australian Securities and Investments Commission at the public hearing on 17 October 2000.

33. Submission to the Parliamentary Joint Committee on Corporations and Securities inquiry into fees on electronic and telephone banking, tabled by the Australian Securities and Investments Commission at the public hearing on 17 October 2000.

34. Documents provided by the ACCC in response to questions taken on notice at the public hearing on 17 October 2000.

- *Report to the Australian Senate on anti-competitive and other practices by health funds and providers in relation to private health insurance* for the period ending 30 June 2000;
- *Debit and credit card schemes in Australia. A study of interchange fees and access*. Reserve Bank of Australia, Australian Competition and Consumer Commission, October 2000;
- ACCC submissions – First, Second and Third - to the Financial System Inquiry (Wallis Inquiry) 1996 and 1997.

35. Extract from Hobart Council minutes of 4 February 1990 on Trust Account Inspections - tabled by Mr C E Clark on 15 June 2001 in Hobart.

36. Extract from Minutes of a Meeting of the Executive Committee held at Hobart on Monday, 28th May 1990 at 1.00 pm - tabled by Mr Jackson, Law Society of Tasmania, on 15 June 2001 in Hobart.

37. Memorandum from the Legal Ombudsman, Tasmania to Legal Profession Act Review at the Department of Justice and Industrial Relations, Hobart dated 1 September 2000 - tabled by Ms Judith Paxton, Legal Ombudsman on 15 June 2001 in Hobart.

38. Legal Ombudsman Annual Report for 1 January to 31 December 2000 and covering letter to the Hon P. J. Patmore, MHA, Attorney-General, Tasmania - tabled by Ms Judith Paxton, Legal Ombudsman on 15 June 2001 in Hobart.

39. Legal Ombudsman Annual Report for the year ended 31 December 1999 - tabled by Ms Judith Paxton, Legal Ombudsman on 15 June 2001 in Hobart.

# APPENDIX 4

# AUSTRALIA'S REGULATORY FRAMEWORK —THE PRINCIPAL PLAYERS

## Conduct, disclosure and consumer regulation

1.1 Financial markets cannot work well unless participants act with integrity, to ensure mutual trust, and provide adequate disclosure to facilitate informed judgements. Regulation is necessary to ensure that these conditions hold. Market integrity regulation seeks to ensure that markets are sound, orderly and transparent, users are treated fairly, the price formation process is reliable and markets are free from misleading, manipulative or abusive conduct. Consumer protection regulation seeks to ensure that retail customers have adequate information, are treated fairly and have adequate avenues for redress.

1.2 Prior to the Wallis Inquiry, such conduct and disclosure regulation was undertaken by several Commonwealth agencies, such as the Insurance and Superannuation Commission (ISC), the Australian Securities Commission (ASC), the Australian Competition and Consumer Commission (ACCC), and the Australian Payments System Council (APSC). Such regulation was based on the institutional form of the service provider, although market integrity regulation was conducted on a functional basis by one agency alone, the ASC. This regulatory structure was inconsistent with the broadening structure of markets, resulted in inefficiencies, inconsistencies and regulatory gaps, and was not conducive to competition in the financial system.

1.3 In order to overcome these problems, the Wallis Inquiry recommended that a single agency should be established to provide Commonwealth regulation of corporations, financial market integrity and financial consumer protection. It should combine the then existing market integrity, corporations and consumer protection roles of the ASC, ISC and APSC. The Wallis Inquiry argued that these three roles are more complementary than conflicting.

*Post Wallis*

1.4 The Australian Securities and Investments Commission (ASIC) was formed out of the ASC, the ISC and the consumer protection area for the financial system from the ACCC.[1] ASIC is an independent Commonwealth Government body established by the *Australian Securities and Investments Commission Act 1989*. It commenced operation in 1991 as the Australian Securities Commission to administer

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1 The States and Territories retain their consumer credit laws.

Corporations Law. In 1998, it received new responsibilities for consumer protection and began operations under its current name.[2]

1.5 ASIC's principal concern is market conduct, ensuring that market participants act with integrity and that financial service consumers are protected. In this context, it both regulates and enforces laws that promote honesty and fairness in financial markets, products and services in Australian companies, thus upholding the strength and international reputation of Australia's markets.

1.6 ASIC has powers to use a combination of regulatory approaches. In addition to its framework legislation, ASIC has the power to adopt detailed codes which prescribe appropriate conduct and disclosure in particular industries or to allow the industry to develop such codes. Given these broad powers, ASIC has the discretion to decide the best approach to regulation to be used in particular circumstances.

1.7 ASIC was also charged with establishing a single regime to license advisers providing investment advice and dealing in financial markets with separate categories of licence for investment advice and product sales, general insurance brokers, financial market dealers, and financial market participants.

1.8 ASIC works closely with other regulatory and supervisory bodies.[3] The Chair of ASIC is an ex-officio member of the Council of Financial Regulators (which comprises ASIC, the Australian Prudential Regulation Authority (APRA) and the Reserve Bank of Australia (RBA)). To advance its disclosure campaign, ASIC has also conducted an effective joint manoeuvre with the Australian Stock Exchange to reduce opportunities for insider trading.[4]

1.9 Like APRA, ASIC also works in partnership with other international regulatory bodies to build international financial architecture.

**Financial safety regulation**

*Pre Wallis*

1.10 Financial safety is fundamental to the smooth operation of the economic system. Government intervention through prudential regulation provides an added level of financial safety beyond that provided by conduct and disclosure regulation. The intensity of prudential regulation should be proportional to the degree of market failure it addresses, but it should not involve a government guarantee of any part of the financial system.

1.11 Prior to the Wallis Inquiry, the framework for prudential regulation was institutionally based, with separate agencies regulating the activities of each class of

2 *ASIC Annual Report 1999–2000,* p. [i].

3 *ASIC Annual Report 1999–2000,* p. 13.

4 *ASIC Annual Report 1999–2000,* p. 30.

institution. The RBA covered banks and the payments settlement, the ISC covered life and general insurance and superannuation, while the state-based Financial Institutions Scheme, coordinated by the Australian Financial Institutions Commission (AFIC) covered credit unions, building societies and friendly societies from 1 July, 1997.

1.12 The Wallis Inquiry recommended that a single Commonwealth agency should be established to carry out regulation for all these products. That is, it should conduct prudential regulation throughout the financial system and should be separate from, but cooperate closely with, the Reserve Bank.

1.13 A single prudential regulator offers regulatory neutrality and greater efficiency and responsiveness, provides a sounder basis for regulating conglomerates, offers the prospect of greater resource flexibility and economies of scale in regulation that should enhance the cost effectiveness of regulation, and provides the flexibility and breadth of vision to cope with changes that seem likely to occur in the financial system in the coming years.

1.14 The Wallis Report stated that separating the prudential regulator from the Reserve Bank recognises the supervision functions for non-bank institutions which the regulator would assume, clarifies the nature of the assurance provided by prudential regulation to customers of financial institutions, and enables each organisation to focus clearly on its primary responsibilities and clarifies the lines of accountability for their regulatory tasks. It also removes a potential conflict of interest for the regulator in cases where institutions require emergency liquidity assistance and the prudential regulator might be too willing to provide it in order to bolster its own reputation for preventing institutional failure. Allowing this function to remain with the RBA avoids this problem.

1.15 The Government accepted this recommendation and established APRA.

*Post Wallis*

1.16 APRA was established on 1 July 1998 under the *Australian Prudential Regulation Authority Act 1998*. APRA assumed the role of sole prudential regulator of banks and other deposit takers (such as building societies and credit unions), life and general insurance, and larger superannuation funds and retirement saving account providers. Several responsibilities have since been shed: the Office of the Australian Government Actuary was transferred from APRA to the Department of the Treasury on 1 April 2000, and regulatory responsibility for self-managed superannuation funds was transferred to the Australian Taxation Office (ATO) from 1 July 1999. [5]

1.17 APRA aligns Australian prudential standards with international best practice. APRA is active in the International Association of Insurance Supervisors, participating in the latter's revision of insurance core principals and the development

5 The ATO actually assumed responsibility from October 1999.

of a methodology for assessment against core principles. APRA is also an active contributor to the work of the Basel Committee on Banking Supervision.

1.18 Prudential regulation of all licensed deposit-taking institutions is consistent with standards approved by the Basel Committee of Banking Supervision and should aim to ensure that the risk of loss of depositors' funds is remote. Quantitative prudential requirements such as capital adequacy, liquidity requirements and large exposure limits apply. Regular on-site reviews of risk management systems form an integral part of the approach to prudential regulation.

1.19 The RBA has three ex-officio members on the APRA Board. The APRA is empowered under legislation to enforce prudential regulations on any licensed or approved financial entity. Unlicensed entities are prohibited from offering financial products for which approval has not been given.

**Competition policy and consumer protection**

1.20 Competition laws are administered by the ACCC, which was formed on 6 November 1995 from the merger of the Trade Practices Commission and the Prices Surveillance Authority. The ACCC administers the *Trade Practices Act 1974* and the *Prices Surveillance Act 1983* and has additional responsibilities under other legislation, including the *Telecommunications Act 1997* and the *Telecommunications (Transitional Provisions and Consequential Amendments) Act*. [6]

1.21 The Commission's mission is to foster competitive and well-informed markets while providing consumer protection for all Australian consumers. It seeks to promote competitive pricing wherever possible and restrain prices in markets where competition is less effective. The ACCC is the only national agency dealing with competition matters and the only agency with responsibility for enforcing the Trade Practices Act and the associated State/Territory competition rules.

1.22 The Government's acceptance of most of the recommendations of the Wallis Inquiry saw the ACCC lose broad jurisdiction over consumer protection in financial services (namely, general insurance, health insurance and superannuation) to ASIC. The Commission retained residual responsibilities for consumer protection in financial services: foreign exchange contracts, health insurance, GST in relation to financial services, e-commerce and unconscionable conduct in small business transactions. The Commission retained responsibilities for credit products and banking services but not for investment products.[7]

1.23 To ensure that the full range of responsibilities can be dealt with appropriately, the ACCC works closely with ASIC where possible. The Commission

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6 Information in this section is drawn from 'Australian Competition and Consumer Commission, Overview of Consumer Protection Functions', October 2000, document tabled Committee Hearing 17 October 2000, passim.

7 Drawn from above and ACCC, Committee Hansard, pp. 856–57.

has also signed Memoranda of Understanding with ASIC to overcome ambiguities in the regulatory regime, and a member of the ACCC acts as agent on behalf of ASIC on some matters.[8]

1.24 The ACCC maintains a network of formal and informal relations with agencies in Australia and overseas to help it realise its objectives on trade related issues. It is a member of the International Marketing Supervision Network, an informal network of consumer protection agencies, and has a strong involvement in its work and cooperative relationship with its members. This engagement strengthens the Commission's cross border enforcement activities.[9]

**Monetary policy system stability**

1.25 Monetary policy and financial system stability are the responsibility of the RBA, which is established under the *Reserve Bank Act 1959*. The RBA's powers are vested in the Reserve Bank Board and the Payments System Board, both of which are chaired by the RBA's Governor. The RBA has two broad responsibilities: monetary policy; and the maintenance of financial stability, including stability of the payments system. In carrying out its responsibilities, the Bank is an active participant in financial markets and the payments system. It is also responsible for printing and issuing Australian currency notes.[10]

1.26 The RBA acts independently of Government in determining Australia's monetary policy, but the Reserve Bank Act does provide for consultation at various levels.[11] The joint Statement on the Conduct of Monetary Policy, agreed between the Treasurer and the Governor of the RBA in August 1996, is indicative of this relationship. The statement recognised the Bank's independence in the conduct of monetary policy (as provided by statute) but formalised the target of keeping inflation between 2 and 3 per cent on average over the economic cycle, to guard against recessions caused by hyper-inflation.[12]

1.27 Under the division of the responsibilities prescribed by the Financial Systems Inquiry, the RBA's mandate to safeguard the stability of the economy was reconfirmed and given a sharper focus. The new regulatory arrangements saw the establishment of the Payments System Board within the RBA, taking effect from July 1998, to promote the safety and efficiency of the payments system. The Board has undertaken a number of 'benchmarking' exercises to determine the efficiency of the

8 Committee Hansard, p. 857.

9 This information and following is from the *ACCC Annual Report 1998–1999*, pp. 140–144.

10 Drawn from 'History' and 'About Us', *RBA* internet site: http://www.rba.gov.au/about/ab_over.html

11 'About the RBA', Monetary Policy, *RBA* internet site.

12 Department of the Treasury Submission No 12, p. 9.

domestic payments system and is also participating in the development of new international arrangements for the settlement of foreign exchange transactions.[13]

1.28 The RBA has a network of international contacts and participates in a wide range of fora. The RBA also provides technical assistance to a number of countries, mainly in the Asia Pacific region, [14] and provides support to Axiss Australia in its efforts to promote Australia as a global financial services centre.[15] In keeping with Wallis recommendations it works closely with Treasury, APRA and ASIC and is represented on the Council of Financial Regulators which facilitates cooperation between these bodies.[16]

**Policy advice**

1.29 The Department of the Treasury generates and oversees all regulatory policy advice. The three new regulatory agencies are responsible for operational and administrative polices, and have substantial autonomy in that, but their boards of directors or commissioners are accountable to the Treasurer and the Parliament for their performance.[17]

1.30 The Treasurer has responsibility for: economic and fiscal policy; taxation; prices surveillance; competition policy; national and occupational superannuation; fiscal matters, debt management; banking; insurance; currency and legal tender; foreign exchange; foreign investment in Australia, census and statistics; business law and practice; corporate and securities law; corporate insolvency; and valuation services. Some of these areas of responsibility are delegated to other junior Ministers.[18]

1.31 Treasury Ministers have responsibility for corporate and securities law, banking and prudential regulation, competition policy and consumer affairs. To carry out their responsibilities, the Treasury Ministers are advised by the relevant group functions within the Department of Treasury—the Budget, Economic and Markets groups. The Budget Group carries responsibility for tax reform. The Economics Group conducts domestic economic analysis and macroeconomic policy. Its International Finance Division manages Australia's contributions to important

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13 Such as in initiatives aimed at reducing foreign exchange settlement risk (the Continuous Linked Settlement Bank), *Reserve Bank of Australia Annual Report 1999*, p. 36.

14 *Reserve Bank of Australia Annual Report 2000*, pp. 22–24.

15 *Reserve Bank of Australia Annual Report 2000*, p. 25.

16 *International Banks and Securities Association of Australia Annual Report1999*, p. 8.

17 'Reform of the Australian Financial System', Statement by the Treasurer, the Hon Peter Costello, MP, House of Representatives, 2 September 1997, *Treasurer Press Release No 102*, p. 3.

18 See 'About the Portfolio', *Department of Treasury* internet site.

international fora, including the International Monetary Fund, the Asian Development Bank, the OECD, the G-22 and APEC.[19]

1.32 The Markets Group has principal responsibility for policy relating to the financial sector and to the establishment of the Global financial centre initiative. Responsibilities are divided between its Foreign Investment Policy Division, Structural Reform Division, and Consumer Affairs Division:

- the Foreign Investment Policy Division provides the secretariat for the Foreign Investment Review Board which was established in 1976. The Division is responsible for all aspects of policy advice relating to foreign investment in Australia, including international commitments and agreements. It is usually the first point of contact for foreign investment applicants and prepares draft reports on proposals.
- the Structural Reform Division is responsible for policy advice on microeconomic reform and national competition policy as well as the competition provisions of the *Trade Practices Act 1974*. It works closely with the Productivity Commission, the ACCC and the National Competition Council;
- the Financial Markets Division provides policy advice on the integrity of financial markets and investor protection in the financial services industry. It is responsible for policy relating to ASIC regulation of the financial markets. Jointly with the Corporate Governance and Accounting Policy Division, the Division is also undertaking the Corporate Law Economic Reform Program's reform of the regulatory framework for financial products, markets and service providers;
- the Financial Institutions Division provides policy advice and monitors developments relating to the financial sector, particularly prudential regulation and payments system issues, covering APRA and the RBA's Payments Systems Board. The Division monitors and advises on developments concerning competition in, and the efficiency of, the financial system including new entrants and products, new technologies, mergers and takeovers, and the impact of these developments on particular sectors of the economy. The Division is also involved in efforts to promote Australia as a global financial centre; and,
- the Consumer Affairs Division provides advice on consumer policy and consumer protection law. Key functions of the Division include promoting self-regulation through codes of conduct and industry dispute resolution mechanisms, administering the consumer protection provisions of the *Trade Practices Act 1974*, consumer education and representation initiatives, and policy advice on consumer aspects of electronic commerce.

19 'About the Treasury—Economics Group', at *Department of the Treasury* internet site.

> The Division provides secretariat services to the Ministerial Council on Consumer Affairs and the National Advisory Council on Consumer Affairs.[20]

1.33 Axiss Australia is also located within Treasury's Markets Group. By functioning as 'a vehicle for high–level strategic dialogue between government and finance sectors' Axiss aims to ensure Australia's financial sector is at the cutting edge by building a collaborative relationship between regulators and the industry.

1.34 To assist its work, the Government has established a Regulatory Advisory Committee which meets regularly to consider regulatory and promotional issues relating to Australia's role as a global centre for financial services. Its membership comprises Axiss Australia's CEO along with representatives from the Commonwealth Treasury, the RBA, APRA, ASIC, the ATO and the Australian Bureau of Statistics.

1.35 The Regulatory Advisory Committee reports directly to the Treasurer and the Minister for Financial Services and Regulation. Each of these agencies has as one of its key objectives, the promotion of the efficiency of the Australian financial services sector.[21]

**Revenue collection**

1.36 The ATO is part of the Treasury portfolio. To fulfil its mandate for revenue collection the ATO is structured into divisions known as business and service lines, which fall within the Office's Income and Other Taxes program. The business lines are responsible for a major market segment, such as individuals, small business and large business.

1.37 Superannuation laws are also shaped within the Large Business and International program. From 1 July 1999, the program took responsibility for the supervision of self-managed superannuation funds.

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20 'About the Treasury—Markets Group', at *Department of the Treasury* internet site.

21 'About Axiss Australia'; *Minister Joe Hockey* internet site.

# APPENDIX 5

## HIH ROYAL COMMISSION
## PROPOSED TERMS OF REFERENCE

The Commissioner will inquire into the reasons for, and the circumstances surrounding, the failure of HIH prior to the appointment of the provisional liquidators on 15 March 2001.

In particular, he will inquire into:

a) whether, and if so the extent to which, decisions or actions of HIH or any of its directors, officers, employees, auditors, actuaries, advisers or agents:

i) contributed to the failure of HIH; or

ii) involved undesirable corporate governance practices, including any failure to make desirable disclosures regarding the financial position of HIH;

b) whether those decisions or actions might have constituted a breach of any law of the Commonwealth, a State or a Territory and, if so, whether the question of criminal or other legal proceedings should be referred to the relevant Commonwealth, State or Territory agency;

c) the appropriateness of the manner in which powers were exercised and responsibilities and obligations were discharged under Commonwealth legislation;

d) the appropriateness of the manner in which powers were exercised and responsibilities and obligations were discharged under State or Territory legislation; and

e) the adequacy and appropriateness of arrangements for the regulation and prudential supervision of general insurance at Commonwealth, State and Territory levels, taking into account his findings in relation to the matters referred to in the preceding paragraphs and other relevant matters, including:

i) Commonwealth arrangements before and after the Financial System Inquiry reforms; and

ii) different State and Territory statutory insurance and tax regimes.

'HIH Insurance Group' includes HIH Insurance Ltd and other associated companies to which provisional liquidators were appointed on 15 March 2001;

a reference to a director, officer, employee, auditor, actuary, adviser or agent includes a reference to a former director, officer, employee, auditor, actuary, adviser or agent;

a reference to a decision or action includes a failure to make a decision or take an action;

a reference to the exercise of a power includes a failure to exercise a power;

a reference to the discharge of a responsibility or obligation includes a failure to discharge a responsibility or obligation.

Noting that the Australian Securities and Investments Commission (ASIC) is also investigating certain matters surrounding the failure of HIH, the Commissioner will, to the extent practicable, co-operate with ASIC and conduct his inquiry with a view to avoiding:

(a) any duplication of ASIC's investigation; and

(b) any adverse impact on any civil or criminal proceeding arising out of ASIC's investigation.

Source: Prime Minister 'HIH Royal Commission', *Media Release*, 18 June 2001

# APPENDIX 6

# LIST OF COMMITTEE REPORTS

## Reports of the Select Committee on Superannuation

## (1991-1998)

- *Super System Survey* - A Background Paper on Retirement Income Arrangements in Twenty-one Countries (December 1991)
- Papers relating to the Byrnwood Ltd, WA Superannuation Scheme (March 1992) Interim Report on Fees, Charges and Commissions in the Life Insurance Industry (June 1992)
- First Report of the Senate Select Committee on Superannuation - *Safeguarding Super* - the Regulation of Superannuation (June 1992)
- Second Report of the Senate Select Committee on Superannuation - *Super Guarantee Bills* (June 1992)
- *Super Charges* - An Issues Paper on Fees, Commissions, Charges and Disclosure in the Superannuation Industry (August 1992)
- Third Report of the Senate Select Committee on Superannuation - *Super and the Financial System* (October 1992)
- *Proceedings of the Super Consumer Seminar*, 4 November 1992 (4 November 1992)
- Fourth Report of the Senate Select Committee on Superannuation - *Super - Fiscal and Social Links* (December 1992)
- Fifth Report of the Senate Select Committee on Superannuation - *Super Supervisory Levy* (May 1993)
- Sixth Report of the Senate Select Committee on Superannuation - *Super - Fees, Charges and Commissions* (June 1993)
- Seventh Report of the Senate Select Committee on Superannuation - *Super Inquiry Overview* (June 1993)
- Eighth Report of the Senate Select Committee on Superannuation - *Inquiry into the Queensland Professional Officers Association Superannuation Fund* (August 1993)

- Ninth Report of the Senate Select Committee on Superannuation - *Super Supervision Bills* (October 1993)
- Tenth Report of the Senate Select Committee on Superannuation - *Super Complaints Tribunal* (December 1993)
- Eleventh Report of the Senate Select Committee on Superannuation - *Privilege Matter Involving Mr Kevin Lindeberg and Mr Des O'Neill* (December 1993)
- A Preliminary Paper Prepared by the Senate Select Committee on Superannuation for the Minister for Social Security, *Options for Allocated Pensions Within the Retirement Incomes System* (March 1994)
- Twelfth Report of the Senate Select Committee on Superannuation - *Super for Housing* (May 1994)
- Thirteenth Report of the Senate Select Committee on Superannuation - *Super Regs I* (August 1994)
- Fourteenth Report of the Senate Select Committee on Superannuation - *Super Regs II* (November 1994)
- Fifteenth Report of the Senate Select Committee on Superannuation - *Super Guarantee - Its Track Record* (February 1995)
- Sixteenth Report of the Senate Select Committee on Superannuation - *Allocated Pensions* (June 1995)
- Seventeenth Report of the Senate Select Committee on Superannuation - *Super and Broken Work Patterns* (November 1995)
- Eighteenth Report of the Senate Select Committee on Superannuation - *Review of the Superannuation Complaints Tribunal* (April 1996)
- Nineteenth Report of the Senate Select Committee on Superannuation - *Reserve Bank Officers' Super Fund* (June 1996)
- Twentieth Report of the Senate Select Committee on Superannuation - *Provisions of the Social Security Legislation Amendment (Further Budget and Other Measures) Bill 1996 - Schedule 1* (November 1996)
- Twenty-first Report of the Senate Select Committee on Superannuation - *Investment of Australia's Superannuation Savings* (December 1996)
- Twenty-second Report of the Senate Select Committee on Superannuation - *Retirement Savings Accounts Legislation* (March 1997)
- Twenty-third Report of the Senate Select Committee on Superannuation - *Superannuation Surcharge Legislation* (March 1997)

- Twenty-fourth Report of the Senate Select Committee on Superannuation - *Schedules 1, 9 & 10 of Taxation Laws Amendment Bill (No. 3) 1997* (June 1997)

- Twenty-fifth Report of the Senate Select Committee on Superannuation - *The Parliamentary Contributory Superannuation Scheme & the Judges' Pension Scheme* (September 1997)

- Twenty-sixth Report of the Senate Select Committee on Superannuation - *Super - Restrictions on Early Access: Small Superannuation Accounts Amendment Bill 1997 and related terms of reference.* (September 1997)

- Twenty-seventh Report of the Senate Select Committee on Superannuation - *Superannuation Contributions Tax Amendment Bills.* (November 1997)

- *Super Taxing* - An information paper on the Taxation of Superannuation and related matters. (February 1998)

- Twenty-eighth Report of the Senate Select Committee on Superannuation – *Choice of Fund*. (March 1998)

- Twenty-ninth Report of the Senate Select Committee on Superannuation - *Superannuation Legislation (Commonwealth Employment) Repeal and Amendment Bill 1997, Commonwealth Superannuation Board Bill 1997, Superannuation Legislation (Commonwealth Employment - Saving and Transitional Provisions) Bill 1997.* (April 1998)

- Thirtieth Report of the Senate Select Committee on Superannuation - *Workplace Relations Amendment (Superannuation) Bill 1997*. (May 1998)

- Thirty-first Report of the Senate Select Committee on Superannuation - *Resolving Superannuation Complaints* - options for dispute resolution following the Federal Court decision in *Wilkinson v CARE*. (July 1998)

# Reports of the Select Committee on Superannuation and Financial Services

## (1999 - 2001)

- *Choice of Superannuation Funds (Consumer Protection) Bill 1999* (November 1999)
- *Superannuation Legislation Amendment Bill (No. 4) 1999* (November 1999)
- *Roundtable on Choice of Superannuation Funds* (March 2000)
- *Provisions of the Superannuation (Entitlements of Same Sex Couples) Bill 2000* (April 2000)
- *New Business Tax System (Miscellaneous) Bill No 2 2000* (June 2000)
- *Financial Sector Legislation Amendment Bill (No 1) 2000* (August 2000)
- *Interim report on the Family Law Legislation Amendment (Superannuation) Bill 2000* (November 2000)
- *Taxation Laws Amendment (Superannuation Contributions) Bill 2000* (December 2000)
- *Family Law Legislation Amendment (Superannuation) Bill 2000* (March 2001)
- *The opportunities and constraints for Australia to become a centre for the provision of global financial services* (March 2001)
- *A 'reasonable and secure' retirement? The benefit design of Commonwealth public sector and defence force unfunded superannuation funds and schemes* (April 2001)
- *Enforcement of the Superannuation Guarantee Charge* (presented to the Deputy President April 2001, tabled May 2001)
- *Issues arising from the Committee's report on the Taxation Laws Amendment (Superannuation Contributions) Bill 2000* (May 2001)
- *Report on the Provisions of the Parliamentary (Choice of Superannuation) Bill 2001* (August 2001)