

Senate Select Committee on Superannuation and Financial Services

Main Inquiry Reference (a)

Submission No. 88

(Supplementary to Submission Nos. 23 & 73)

Submittor: **Australian Prudential Regulation
Authority**

GPO Box 9836

SYDNEY NSW 2001

Ms Thea Rosenbaum

Company Secretary

 - 9210 3103

 - 9210 3430

E-mail:

thea.rosenbaum@apra.gov.au



Australian Prudential Regulation Authority

GPO Box 9836 Sydney NSW 2001
400 George Street NSW 2000

FACSIMILE

<p>To: Ms Susan Morton Secretary Senate Select Committee on Superannuation and Financial Services Phone: 02 6277 3433 Fax: 02 6277 3130</p> <p>From: Thea Rosenbaum Company Secretary Phone: 02 9210 3103 Fax: 02 9210 3430 E-Mail: thea.rosenbaum@apra.gov.au</p> <p>Date: 27 November 2000</p>	<p>Total number of pages (including this page): 8</p>
---	---

**Subject: Senate Select Committee on Superannuation and Financial Services
Questions on Notice – Public Hearing on 17 October 2000**

Attached are the responses to the questions on notice referred to Mr Phelps during APRA's appearance before the Committee on 17 October 2000. Item 6 (Performance Indicators) will be responded to by Thursday 30 November 2000.



IMPORTANT NOTICE

This fax is intended solely for the person or organisation to whom it is addressed, and may contain secret, confidential or legally privileged information.

If you have received this fax in error or are aware that you are not authorised to have it, you **MUST NOT** use or copy it, or disclose its contents to any person. If you do any of these things, you may be sued or prosecuted.

If you have received this fax in error, please ring the sender immediately so that we can arrange for the return of the fax to us (at no cost to you).



Australian Prudential Regulation Authority

GPO Box 9836 Sydney NSW 2001
400 George Street NSW 2000

FACSIMILE

<p>To: Ms Susan Morton Secretary Senate Select Committee on Superannuation and Financial Services Phone: 02 6277 3433 Fax: 02 6277 3130</p> <p>From: Thea Rosenbaum Company Secretary Phone: 02 9210 3103 Fax: 02 9210 3430 E-Mail: thea.rosenbaum@apra.gov.au</p> <p>Date: 27 November 2000</p>	<p>Total number of pages (including this page): 8</p>
--	---

**Subject: Senate Select Committee on Superannuation and Financial Services
Questions on Notice – Public Hearing on 17 October 2000**

Attached are the responses to the questions on notice referred to Mr Phelps during APRA's appearance before the Committee on 17 October 2000. Item 6 (Performance Indicators) will be responded to by Thursday 30 November 2000.



IMPORTANT NOTICE

This fax is intended solely for the person or organisation to whom it is addressed, and may contain secret, confidential or legally privileged information.

If you have received this fax in error or are aware that you are not authorised to have it, you **MUST NOT** use or copy it, or disclose its contents to any person. If you do any of these things, you may be sued or prosecuted.

If you have received this fax in error, please ring the sender immediately so that we can arrange for the return of the fax to us (at no cost to you).

1. *How do you respond to the claim that there is an inequitable levy structure? Do you think these concerns are well founded? If not, why not?*

The Wallis Committee recommended, and the Parliament accepted, that APRA should be funded on a cost recovery basis from the institutions it regulates. On page 532 of its Report the Committee said: "For reasons of equity and efficiency, as a general principle the costs of financial regulation should be borne by those who benefit from it... The regulatory agencies should collect from the financial entities which they regulate enough revenue to fund themselves, but not more."

APRA is, accordingly, funded primarily from annual levies on the financial institutions it regulates. A very small proportion of funding comes from charges for specific services provided eg publications and from earnings on funds invested.

The levies collected by APRA also cover some consumer protection costs of the Australian Securities and Investments Commission (ASIC) and the Australian Taxation Office (ATO).

Levies are raised from institutions according to the Financial Institutions Supervisory Levies Collection Act 1998 and six supervisory levy Acts that apply to sectors of the financial system. These are Authorised Deposit-taking Institutions, Life Insurance, General Insurance, Superannuation, Retirement Savings Accounts and Non-operating Holding Companies. In each case it is provided that levies will be applied as a percentage rate on assets of institutions in each category, subject to a minimum amount and a maximum amount per institution. The rationale for this structure is that, within limits, supervisory costs are broadly proportional to institutional size.

The aggregate amount of revenue to be collected through levies is agreed annually by APRA, ASIC and the ATO with the Commonwealth Treasury. This takes account of required expenditure by each agency and APRA's balance sheet reserves.

APRA puts a good deal of effort into calculating the industry sector expenditure figures needed for levy determination. Our process for doing this is broadly as follows:

- costs are collected annually in 32 activity cost centres that roll up into the Divisional structure;
- these costs are, in turn, allocated to industry sectors according to cost ratios described below. First, a direct allocation is made based on estimated periodic information about the time taken to perform supervisory duties in relation to different sorts of institutions. Second, corporate support costs are distributed in proportion to the direct allocations;

- estimates of industry cost ratios are averaged over a three year period. The average is determined from the previous year's figures, the estimate for the current year and an assessment for the year ahead - this process is intended to take into account the very approximate nature of each year's calculation and the desirability of avoiding sharp swings in levy rates because of unusual circumstances in a particular year;
- the resulting ratios are applied to budgeted expenditure for the year ahead to produce estimates of the amount to be collected from each sector plus allocations determined by ASIC and ATO;
- adjustments are made for any significant over or under collections from the current year, and for APRA's balance sheet reserves target. (In this way any over-collections will be returned to industry subsequently.)

When industry amounts have been estimated APRA, ASIC and Treasury conduct a round of consultation with industry covering both the funds required for the financial year ahead and various levy structures that would raise those.

When industry views have been taken into account, a recommendation is then made to the Minister who, in accordance with the legislation, determines the levy rates for the year ahead.

2. How are levy funds used and in what way are you accountable to levy payers?

Levies finance APRA's operations and certain functions of ASIC and the ATO. APRA's basic role is prudential regulation of financial institutions in Australia. Associated with this it collects statistics, conducts research, develops new supervisory policies and standards and advises the Government on legislation and the condition of the financial sector. APRA's Annual Report and industry consultation documents include more information on the break-up of total spending.

APRA's management is accountable to the APRA Board which has a majority of members appointed by the Treasurer from the private sector.

There are numerous avenues through which APRA is accountable externally for its expenditure of levy funds. They include:

- industry consultations as part of the annual levy determination process;
- the role of the Treasurer in determining levy rates each year;
- regular appearances before Parliamentary Committees (as well as Senate Estimates hearings, APRA is subject to annual review by the House of Representatives Committee on Economics, Finance and Public Administration.);
- performance and financial audits by the Australian National Audit Office;
- its Annual Report to Parliament.

In addition, the Government proposes to conduct an assessment in 2003 of the effectiveness of the various reforms arising from the Wallis Committee's report. The Financial Sector Advisory Council, which advises the Treasurer, has been asked to contribute to this assessment.

Specifically in relation to the framework for levy collection, the Government conducted a review in late 1999 and, apart from minor modifications, confirmed the arrangements introduced with APRA's formation in 1998. It has announced that a further review will be conducted in 2003 in conjunction with the broader assessment noted above.

The Productivity Commission is presently conducting an inquiry into cost recovery arrangements of government agencies. APRA has appeared before this inquiry.

3. *What risk management controls do you have in place?*

At the beginning of 2000, APRA's executive management introduced a broad-based approach to risk management within APRA. 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 with 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.

The Risk Management and Audit Committee of APRA's Board has endorsed this approach and monitors it in practice.

Fundamental to the revised approach is the assessment of risk within APRA. An organisation-wide risk assessment of APRA was completed and key risk areas identified. Mitigation strategies and specific action plans for the high and significant assessed risks have been developed and adopted. A similar process for managing risks at business unit - or divisional - level is well advanced.

4. *How do you respond to the claim that trustees are inadequately trained? Do you think these concerns are well founded? If not, why not?*

As we have indicated previously in evidence before the Committee, APRA does not believe that there is any indication of systematic 'under capacity' of trustees for the superannuation funds that we supervise.

Further, the wide diversity of funds in both size and nature means that it is difficult to see how a useful industry wide education program or 'certification' standard could be devised. Certainly we see there are training and educational needs for trustees, but these requirements will vary quite considerably depending on the nature of the funds.

Over the six years since the SIS legislation was introduced, APRA (and the ISC as our predecessor) has observed gradually increasing competence on the part of trustees. Some funds have put in place very extensive training and induction process for new trustees. To reiterate, we see no indication of systemic problems with trustee awareness and knowledge. Where we do find deficiencies with particular funds, we recommend to the Boards that they undertake additional training or attend relevant seminars.

5. *How do you respond to the claim that there are the following anomalies in the SIS Act:*

- *Deficiencies in APRA's enforcement powers (did FSLAB (No 1) 2000 address all the deficiencies?)*

Experience in applying the SIS regime has highlighted deficiencies in the enforcement provisions. In a number of cases, APRA has found existing powers insufficient and/or ineffective when unexpected circumstances arose. The main lesson from this experience is the need for a wide spectrum of enforcement options so that supervisory action can be better tailored and targeted to the particular circumstances.

In response to this experience, FSLAB (1) 2000 contains a number of amendments to the *Superannuation Industry (Supervision) Act 1993* (SIS Act) designed to improve the enforcement regime under that Act. Specifically, the Bill amends various offence provisions as well as provides the regulators with various new or enhanced enforcement powers. We consider that these amendments will go some way towards addressing identified deficiencies.

APRA monitors on a continual basis the enforcement functions under the various Acts we administer. We are currently reviewing all of our enforcement powers with a view to developing a harmonised regime. Deficiencies in APRA's current enforcement powers and the disparate design of powers will be addressed through proposals for a single and consistent enforcement regime across all APRA regulated entities. It is intended that the single enforcement regime would contain a suite of powers, both proactive and reactive, including information gathering and investigatory powers for regulated and related entities.

- *The restrictive definition of 'dependant' which discriminates against some people in the distribution of superannuation benefits*

APRA does not see this as a matter relating to prudential supervision and, as such, is not a matter we should comment on. Any change to the current arrangements would not seem likely to create any supervisory concerns for APRA.

- *The new provisions for binding death benefit nominations*

APRA has seen little substantive problem in the application of these provisions that are, of course, voluntary. Trustees of funds are free not to introduce a binding nomination process and to continue to operate on a discretionary basis. Some industry players have advised us that the binding nomination process (particularly the timeframe for 'renewal' of nominations) carries costs. However, we have not seen, or been provided with data on, cost increases. From a prudential supervision perspective there is no evidence of problems with these new provisions.

- *People over the age of 70 not able to contribute to superannuation funds*

APRA does not see this matter as relating to prudential supervision and, as such, is not a matter we should comment on. Any change to the current arrangements would not seem likely to create any supervisory concerns for APRA.

- *Extra requirements for regulation of funds with less than five members*

The regulation of "self-managed superannuation funds" (SMSFs) with fewer than five members was transferred from APRA to the ATO in 1999. The primary effect of the new legislation is that SMSFs will not be subject to any prudential regulation since all members are fund trustees and are able to protect their own interests. Other superannuation funds with fewer than five members that do not meet these criteria must appoint an approved trustee. These funds, known as "small APRA funds" (SAFs) are prudentially regulated by APRA. Prudential regulation is needed for SAFs as they have arm's length members whose interests should be protected. Because of these differences in the natures of the funds, we do not consider that regulatory requirements for SMSFs and SAFs should necessarily be compared.

A number of issues to do with the accounting requirements for these funds have been raised with APRA. These relate to the nature of the funds (eg whether they are reporting entities) and to the requirement that these funds provide cash flow statements on an annual basis. We have discussed both of these issues with the audit profession and believe it is appropriate for the funds to be considered to be reporting entities, but agree that the provision of cash flow statements is not necessary. Accordingly, we will be recommending legislative change to Treasury.

- *Preservation rules too restrictive – not permitting money to be transferred to an overseas fund*

APRA does not see this matter as relating to prudential supervision and, as such, it is not a matter we should comment on. Any change to the current arrangements would not seem likely to create any supervisory concerns for APRA.

- *The impact of severe financial hardship claims on funds*

While this is another matter not directly related to prudential supervision, concerns have not been raised with us on any widespread basis during our inspection work. Neither have they been raised during liaison meetings with industry representatives.

- *Need for increased flexibility in options for people over the age of 65*

As we recently stated in evidence to the House of Representatives Standing Committee on Economics, Finance and Public Administration, the current legislation requires a strict application by trustees of the 'over 65 test'. Any change to the current arrangements would not seem likely to create any supervisory concerns for APRA.

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

The aim of the shorter lodgment period is to bring all APRA-supervised superannuation funds in line with public offer funds as well as closer to other regulated financial institutions. A shorter lodgment period means that a substantial amount of audit work will need to occur during the year rather than at year's end. APRA considers that this will improve the quality of information we receive and assist our supervision. It is important to note that, unlike other regulated institutions, superannuation funds report only annually. With such infrequent reporting (that necessarily reduces the closeness of our monitoring) it is vital that the information we do receive is as timely as possible. The shorter lodgment period will help.

Despite the concerns raised by the accounting profession (in particular) about the 'stress' which this reduction in time would create, there appear to have been no widespread difficulties in meeting the revised deadline.

- *Trustee power to delegate investment-related functions to an investment manager should be made specific*

APRA is focusing closely on the general issue of outsourcing functions from superannuation funds (and from other supervised institutions for that matter). Sometimes supervised institutions equate outsourcing of functions with the outsourcing of responsibility. Where this arises, we tell trustees it is not an acceptable view - that they must have appropriate contractual arrangements in place and must monitor and evaluate the performance of any service provider.

We have seen no evidence that there is a particular need to make outsourcing subject to more specific legislative provisions – whether for investment management or other functions. Indeed, modifying SIS 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 funds.

6. *Performance indicators*

This will be provided under separate cover.

7. *Capital ratios of credit unions*

The following tables show over time how many credit unions had capital ratios below 10%, and the total number of credit unions.

Credit Unions with Capital Adequacy ratios below 10%

	Jun-93	Jun-94	Jun-95	Jun-96	Jun-97	Jun-98	Jun-99	Jun-00	Sep-00
NSW/ACT	9	10	7	4	7	5	5	6	6
QLD	9	6	4	3	2	3	4	3	2
SA/NT	11	5	5	4	6	4	4	3	2
VIC/TAS	23	14	12	9	7	1			
WA	3	1			3	2	1	1	1
Total	55	36	28	20	25	15	14	13	11

Total number of Credit Unions

	Jun-93	Jun-94	Jun-95	Jun-96	Jun-97	Jun-98	Jun-99	Jun-00	Sep-00
NSW/ACT	165	159	148	145	137	125	120	115	115
QLD	33	29	29	27	25	23	19	19	19
SA/NT	16	16	16	16	16	17	15	15	15
VIC/TAS	98	85	81	79	76	66	57	56	54
WA	17	17	17	15	15	12	11	10	10
Total	329	306	291	282	269	243	222	215	213

As indicated in the following chart, the average ratio for credit unions grew steadily in the early part of the 1990s but plateaued from March 1999 at around 14.5%. This compares with an average capital ratio for banks of 10% and the regulatory minimum for ADI's of 8%

