Submission to Treasury on the Consultation Paper: Strengthening APRA's Crisis Management Powers

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The Association of Superannuation Funds of Australia (ASFA) would like to provide this submission to the Treasury consultation paper released in September 2012 on *"Strengthening APRA's Crisis Management Powers"* which seeks to explore possible options for enhancing and strengthening financial services legislation in relation to the prudential supervision of authorised deposit-taking institutions (ADIs), insurers and superannuation funds regulated by the Australian Prudential Regulation Authority (APRA).

About ASFA

ASFA is the peak policy, research and advocacy body for Australia's superannuation industry. It is a not-for-profit, sector-neutral, and non-party political national organisation whose aim is to advance effective retirement outcomes for members of funds through research, advocacy and the development of policy and industry best practice.

ASFA's focus is on whole of system issues and its core strategies are aimed at encouraging industry best practice, advocating for a system that plays a productive role in the Australian economy, and ensuring the industry delivers on its primary purpose of delivering decent retirement incomes.

Our membership - which includes superannuation funds from the corporate, industry, retail and public sectors, and, through its service provider membership, self-managed and small APRA funds - represents over 90 per cent of Australians with superannuation.

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We thank you for considering our submission and for providing us with the opportunity to participate in the consultation process.

Should you have any queries or comments regarding the contents of this submission, please contact our Senior Policy Adviser, Jon Echevarria, on (02) 8079 0859 or jechevarria@superannuation.asn.au.

Yours sincerely

Pauline Vamos
Chief Executive Officer

Support for simplification, streamlining and harmonisation

ASFA supports the aim of simplifying, streamlining and harmonising the authorised provisions of the various industry Acts wherever possible. A streamlined and harmonised framework across the various APRA-regulated sectors should serve to enhance transparency in relation to the application of the industry Acts and the SIS Act. We are hopeful that this will result in reducing the regulator's cost of doing business as well as their cost associated with administering the legislative framework, which we would expect will be passed on to regulated entities in due course by way of reduced levies.

The new APRA powers should, in general, allow the regulator to take a more proactive approach to intervening in situations where banks, insurers or superannuation funds are in distress, rather than a reactive approach where significant issues have already transpired (i.e. being the 'ambulance at the bottom of the cliff').

Comments on the various superannuation-related proposals

ASFA is broadly supportive of the proposals outlined in the consultation paper specific to the superannuation sector. Our comments in relation to the proposals impacting the superannuation industry are discussed in the remainder of this submission.

2.3 New direction powers for superannuation

In our view, direction powers including giving of draft directions would provide greater flexibility for APRA in working with superannuation entities. In particular, broadening the types of directions aligns with the manner in which APRA works with ADIs and insurers. This may include APRA having the ability to direct a licensee to remove an individual trustee, director or officer.

We would expect that a breach of any direction made to a licensee to be treated the same as banks and insurers – i.e. strict liability, continuing offence, punished by application of certain number of penalty units.

2.3.1 Potential new direction triggers

ASFA is broadly supportive the proposed change to the SIS Act to allow APRA to issue a direction based on the proposed triggers listed as bullet points in section 2.3.1 of the consultation paper. Further, we support the proposal that the decision by APRA to issue a direction for a breach, or anticipated breach, of the RSE licensee law or licence condition should be a reviewable decision under the SIS Act.

However, we do have some concerns in relation to the possible direction trigger of 'promoting instability in the Australian financial system' – i.e. the proposal to give APRA the power the issue a direction to address circumstances where the conduct of an entity may promote or cause instability in the financial system. In our view, this proposed power is already sufficiently covered by the new prudential standards for superannuation.

The consultation paper acknowledges that a directions power does not have to be used in order to be effective as a deterrent. In reality this means that there is an expectation that the power could lead to a change to investment behaviour, without APRA formally enacting its powers.

Our concern with this is that history has shown that we only know which instruments cause financial instability in hindsight. For instance, in the aftermath of the GFC it would be obvious to say that structured products such as mortgage back securities led to financial instability. If a regulator had the power being proposed in the consultation paper, they could have used it to prevent trustees of

superannuation funds from investing in such products. In the Australian context, whilst mortgage backed securities did no doubt lead to the market crisis in the US, the drying up of the mortgage backed securities market in Australia almost led to a freezing of Australia's banking system.

In the current context there are arguably a range of investments made by superannuation trustees that could be seen as promoting financial instability. For example, engaging in High Frequency Trading (HFT) investment strategies, lending stock to hedge funds that short the market and even engaging in dark pools can, at a system level, have implications on financial stability.

Whilst an argument could be made that APRA would not use their powers to ban such investments, our concern stems around giving the regulator such broad sweeping powers to ban certain investments without having sufficient confidence that APRA would fully understand the implications of any actions they might take in this regard.

Even so, there is an argument that regulating behaviours that promote financial instability is best done where the activity occurs. As an example the best place to regulate instability that could be caused by HFT is not to restrict the ability of superannuation funds to invest in HFT investment strategies, but to regulate the conduct of the ASX and provide ASIC with powers to manage behaviours in the market.

There is a danger of putting a covenant on the behaviour of superannuation trustees that others in the market do not have. In the hypothetical example of APRA banning trustees from utilising HFT investment strategies, this would not actually stop the practice of HFT. Rather, this would simply result in such practices shifting to others in a market. One of the features of Australia's superannuation system is that the sole purpose test has not restricted the investment universe of superannuation.

On this basis, in respect to a directions trigger around promoting instability in the financial system, we strongly believe that APRA should not be given a sectoral directions power. As an alternative, providing a broader power to direct that an activity that is causing financial instability be banned by all players in a market would be preferential as it would not lead to a situation where other less regulated investors arbitraged superannuation funds.

2.3.2 Contents of a direction

ASFA supports the proposal to amend the SIS Act to allow APRA, after identifying the relevant trigger that gave rise to the direction, to require within a specified amount of time:

- specific positive or negative actions for the trustee to undertake (or not undertake) in order to rectify the event that gave rise to the direction;
- the trustee 'to take or not take specific action in relation to the structure or organisation of the affairs, or the conduct of the affairs of the RSE'; and
- the removal of an individual trustee, director or officer of the superannuation entity.

In particular, we are supportive of the requirement for APRA to first identify the specific trigger for the issue of the direction (such as a breach or anticipated breach of the RSE licensee law or licence condition) before being able to direct the trustee to remove the identified individual trustee, director or officer. In this manner, APRA's desire to remove an individual trustee, director or officer would not, by itself, give APRA the ability to order such removal.

One area of potential concern relates to the discretionary nature of APRA's proposed powers and the timing of the proposed direction. For example, for a direction to remove an individual trustee,

director or officer, it may be more appropriate for this to occur after, rather than during, the crisis event.

8.1.5 Enabling APRA to keep and publish a register of authorised entities

ASFA supports the proposition that APRA should, as the sole prudential regulator of various industries, take a consistent approach to keeping and publishing registers of authorised persons for all industries it regulates.

We note that the proposal of amending and harmonising the current provisions of the industry Acts and SIS Act to enable APRA to keep and publish registers of authorised persons would be based on the existing provision in section 9C of the Banking Act, which states that:

> *"APRA may, from time to time, publish a list of ADIs:*
> *(a) in the* Gazette*; or*
> *(b) in such other manner as APRA determines."*

We would support a similar section being included in the SIS Act with respect to the publication of RSEs. We note that the Government's *Super Fund Lookup* website already enables stakeholders (fund members, employers, Government entities etc) to look up superannuation funds. However, the only information that is shown on *Super Fund Lookup* is the trustee's address, fund type (eg. Public Offer non-SAF) and status (active or inactive). Our view is that, in order to be of use to members/employers, more meaningful information should be published – eg. telephone number, fax number, hours of operation (if applicable), office address(es) and a link to the fund's website (if applicable).

Also, in many cases, trustees outsource their fund's administration to third party providers. It would be more useful to members/employers wishing to make inquiries or find out more about a particular fund for any published register to include the contact details (address, telephone number etc) of the fund's administrator rather than, or in addition to, that of the trustee.

Consideration could also be given to the development of a Government superannuation website containing more than just a register of funds. Such a website could contain information relevant to superannuation generally – eg. contribution rules, preservation requirements, information on how super works etc. Indeed, once established, such a Government website could be used by superannuation funds themselves to refer their members to general superannuation information, including generic information that would otherwise need to be disclosed by each fund in their shorter Product Disclosure Statement (PDS).

8.2.12 Requirements regarding investigation reports

ASFA supports the proposal to simplify the obligations relating to investigation reports across the industry Acts and the SIS Act to achieve consistency in treatment across the APRA-regulated industries. In particular, we support:

- the preparation by APRA of a report to be prepared on completion of an investigation, including removing the requirement under the SIS Act for transcripts to be attached to the report;
- allowing APRA to decide whether a report needs to be prepared upon discontinuation of an investigation (however, we believe that APRA should be required to prepare a report if specifically request by the entity that was under investigation); and
- making a copy of the report, once prepared, available to the entity being investigated.

8.2.16 Ensure that the whistleblower protection provisions apply to former employees, directors etc.

We support amending subsection 336A(1) of the SIS Act to ensure that a person who is **or was** any of the following persons is provided protection under the whistleblower protection provisions:

(a) a trustee of the superannuation entity;

(b) an officer of a body corporate that is a trustee, custodian or investment manager of the superannuation entity;

(c) an employee of an individual referred to in paragraph (a) or a body corporate referred to in paragraph (b);

(d) a person who has a contract for the supply of services or goods to an individual referred to in paragraph (a) or a body corporate referred to in paragraph (b);

(e) an employee of a person referred to in paragraph (d).

8.3.4 Consequences of late, incorrect, incomplete or misleading data submissions

Where an entity provides incorrect or inadequate information to APRA, we believe it is generally appropriate that the timeframe for the entity to rectify this and provide correct and complete information to the regulator be reduced from 28 days to 4 business days. This is particularly important where the entity is in crisis and a timely intervention by APRA may be required.

However, we note that in some cases the relevant information required to be provided by an entity to APRA may be sourced from an external provider. Depending on the nature of the underlying data needed to be sourced and the extent of the information required to be provided, this reduced reporting timeframe could impact on the entity's ability to comply with this proposed requirement.

8.4.1 Make it an offence to mislead actuaries

Actuaries play an important role in assessing the overall financial condition of defined benefit superannuation funds and public sector superannuation schemes which are not fully funded. This includes, but is not limited to, the preparation of regular and interim actuarial investigations, assessing whether a fund is in a satisfactory financial position and providing recommended actions to restore a fund to, and maintain it in, a satisfactory financial position.

In order for actuaries to be able to undertake their roles effectively, it is crucial that all relevant information supplied to an actuary is reliable and accurate. As such, ASFA supports an amendment to the SIS Act to make it an offence to mislead an actuary. This will ensure there is consistency with section 130BB of the SIS Act which states that it is an offence to mislead an auditor. And since there is no reason why auditors and actuaries should be treated differently in this regard, we support modelling the new provisions and associated penalty provisions on those already applicable in the case of auditors (i.e. 5 years imprisonment or 200 penalty units, or both).

We also support the proposal that require an actuary to notify APRA if they are aware of an attempt to mislead or unduly coerce them.

8.4.2 Auditors and actuaries providing information to APRA and regulated entities to treat this information as confidential

We are supportive of the proposal to amend the SIS Act to ensure that all auditors and actuaries providing information to APRA and regulated entities in accordance with the SIS Act and associated prudential standards treat this information as confidential.

8.6.1 Streamlining the definition of 'disqualified person'

It is proposed that section 20 of the Banking Act be used as a model and replicated across the various insurance Acts as well as the SIS Act.

ASFA is broadly supportive of harmonising the definition of 'disqualified person' across the APRA-regulated industries as much as possible. For example, it seems reasonable for a person who has been convicted of an offence under the FSCODA or the Corporations Act to be considered a 'disqualified person' under all the various Acts, not just the Banking Act and Insurance Act. That said, we note that sections 126A and 126H of the SIS Act enable the Commissioner of Taxation and the Federal Court respectively to disqualify a person who has contravened the FSCODA Act and the seriousness of the contravention provides grounds for disqualification. In contrast, section 20 of the Banking Act requires the individual to have been convicted of an offence under the FSCODA, which is a more onerous requirement. Our view is that the test under sections 126A and 126H of the SIS Act is more appropriate.

In addition, we note that there may be a need for some slight differences to exist between the definitions in the various Acts to cater for circumstances specific to each sector. For example, with respect to the SIS Act, the following should still apply:

- The reference in section 120 of the SIS Act to a civil penalty order should be retained. That is, for the purposes of the SIS Act, the definition of a disqualified person should continue to include an individual who has had a civil penalty order made against him/her.
- Sub-section 120(2) of the SIS Act provides for a body corporate to be a disqualified person under certain circumstances. We believe it is appropriate to retain this provision within the SIS Act definition.

8.6.3 Extend disqualification in one regulated industry to disqualification in other regulated industries

There is no question that the current legislative framework, whereby APRA must apply to the Federal Court separately under each industry Act and the SIS Act to ensure that an individual is disqualified from holding a stipulated position of responsibility in a regulated entity, is unnecessarily burdensome. In most cases, an individual disqualified in one area probably deserves to be disqualified across all APRA regulated industries, so there needs to be a simple mechanism to achieve this. However, there may be cases where disqualification should be limited to one regulated industry.

In our view, Option B is the preferable approach as it places the onus on APRA to satisfy the Court that the individual should be disqualified across multiple pieces of legislation and leaves the final decision in the hands of the Court rather than the regulator. In most cases this could be done during the substantive disqualification hearing and so should not create an unacceptable burden on APRA. We would envisage that disqualification across all APRA regulated industries would only be applied in limited circumstances – eg. where the person has been found to be dishonest, fraudulent or has been found guilty of a criminal offence.

We believe Option A should be rejected as there may be issues of natural justice here.

8.7.7 Minor drafting amendments to the industry Acts

The minor amendments relevant to the superannuation sector include:

- an amendment to section 8 of the *Superannuation (Financial Assistance Funding) Levy Act 1993* to change the references from "value of assets" to "levy base"; and
- a provision that enables the relevant Minister to determine the methodology under which the "levy base" is calculated.

We support these proposed amendments on the basis that other levy Acts (in relation to the Annual APRA levy) were similarly amended by the *Financial Sector Legislation Amendment (Prudential Refinements and Other Measures) Bill 2010*, but for various reasons the *Superannuation (Financial Assistance Funding) Levy Act 1993* was not amended at that time. We acknowledge that the proposed amendment would ensure consistency with the other levy Acts in this regard.

As well, allowing the relevant Minister to determine the methodology under which the "levy base" is calculated (i.e. through Ministerial determination) rather than through the Act would provide greater flexibility in relation to the application and methodology of calculation of the levies going forward.

9.4.1 APRA discretionary power to appoint an acting trustee

ASFA supports the proposal for APRA to be given discretionary power to appoint an acting trustee in circumstances where APRA has taken all reasonable steps to identify or locate a trustee but has been unable to do so.

The main potential advantage with providing APRA with this discretionary power is ensuring that the relevant members' interests are protected and maintained, which is of paramount concern to the whole industry. As such, APRA should have the ability to act quickly to appoint an acting trustee once all reasonable steps have been taken.

We recognise that section 134 of the SIS Act already allows APRA to appoint an acting trustee in the case of suspension or removal of the trustee (eg. in cases of fraud). We believe this power should be extended to cover situations where the existing trustee cannot be located and identified after APRA has first made all reasonable efforts to do so, subject to decision by APRA to appoint an acting trustee being subject to a merits review.

9.4.2 To treat Limited Liability Partnerships consistently with body corporates in relation to investment managers

Section 125 of the SIS Act states that:

> *"a person must not intentionally be, or act as, an investment manager of a superannuation entity (other than a self-managed superannuation fund) if the person is not a body corporate.*
>
> *Penalty: Imprisonment for two years."*

In the last 10 years there has been an increase in the number of international investments whereby the structures proposed by overseas investment managers are not akin to managed investment schemes or pooled wholesale trusts in a trust structure but have been structured on either a limited liability partnership (LLP) or a limited liability corporation (LLC). The latter structure is clearly acceptable as it is a body corporate.

We are supportive of the ability of trustees of regulated superannuation funds having the ability to participate in private equity investments structured as LLPs. In our view, the treatment of LLPs on a basis consistent with bodies corporate for the purposes of section 125 of the SIS Act would be of great assistance in this regard and would also likely improve the transparency of these arrangements by removing the need for an interposed structure (such as a special purpose trust) to hold the LLPs interests.

However, notwithstanding this proposed consistency of treatment between LLPs and bodies corporate, there may be an issue for superannuation trustees who invest in private equity investments structured as LPPs in terms of their ability to comply with the borrowing requirements (SIS Act, section 67) and the requirement under SIS Regulation 13.14 in relation to charges over assets of funds.

In our view, it would be appropriate to give clarity as to the operation of section 67 on borrowing and SIS Regulations 13.14 on charges over fund assets in respect of trustees' investments in private equity structured as LLPs. This clarity should confirm that such investments by superannuation trustees are allowable where the limited partnership agreement provides that:

- a limited partner is not personally liable for the partnership's borrowings (or clauses to a similar effect); and
- a recall on distributions is not a charge on the fund's assets but merely a contractual obligation on the investor (i.e. on the trustee of the superannuation fund).

9.4.3 To extend APRA's powers so that it can investigate any contravention as far as it relates to a superannuation interest, superannuation entity or an RSE licensee

ASFA supports in principle the proposal that APRA's powers under the SIS Act be clarified to specifically enable investigation of any breach of a licence condition of an RSE licensee – i.e. broadening the regulator's investigation powers to fraudulent conduct in relation to a 'superannuation interest' or 'superannuation entity' (as defined under the SIS Act). We believe this would reduce the risk of some contraventions 'falling through the cracks'.

However, there needs to be a mechanism to prevent overlap between different investigating parties in relation to the same contravention. What is not clear under this proposal is exactly how any overlap resulting from APRA's increased investigation powers with other regulators, namely ASIC, will be managed. Section 13 of the ASIC Act allows ASIC to investigate any contraventions of the Corporations legislation or of any Commonwealth, State or Territory jurisdiction that has been contravened where it involves fraud or dishonest conduct relating to the management or affairs of a body corporate or managed investment scheme or to a financial product. If APRA is granted the same (or similar) powers, there is the potential that both APRA and ASIC could investigate the same contravention, duplicating costs and creating inefficiencies. We believe there should be a clear protocol, preferably enshrined in legislation, which deals with this potential overlap and ensures that the two regulators do not unnecessarily investigate the same contravention (or alternatively, they work closely together on a single investigation).

Whilst we support, in principle, the ability for APRA to investigate a breach by an employer to remit superannuation contributions to the trustee of a superannuation fund, we recognise this would represent a significant departure from current regulatory environment and would require a number of issues to be considered including:

- How would this proposal impact on other regulators, such as the ATO, which currently has responsibility for regulating employers who have failed to satisfy their SG obligations? This appears to represent a specific overlap with the ATO's responsibilities, which would need to be addressed to avoid any unnecessary duplication.

- Also, how would APRA become aware that a breach has occurred with respect to an employer's obligation to remit contributions to the fund?
- Currently, the SIS Act only requires employers to remit amounts promptly to the superannuation fund (i.e. within 28 days) where the amount has been deducted from an employee's salary or wages [section 64]. If APRA's powers were to be extended beyond the prompt remittance of salary sacrifice and member post-tax contributions, the SIS Act would need to be amended accordingly.

9.4.4 To expand APRA's disqualification powers under section 126H of the SIS Act

We have received feedback from some of our members that the extent to which a problem in this area actually exists whereby disqualified individuals take up positions of influence over investment managers or superannuation entities (or managerial positions in these entities) is arguable. And as such, there is a view that granting APRA further disqualification powers to deal with such circumstances may not be warranted.

That being said, whilst the extent to which a problem in this regard currently exists is unclear, the proposed expansion of APRA's disqualification powers, in our view, can only serve to enhance the integrity of the superannuation system.

We therefore believe it would be prudent for APRA's powers to be enhanced such that disqualification of individuals can be extended to officeholders upstream of the trustee, investment manager or custodian, thereby removing such disqualified individuals from being in a position to continue exerting influence over the superannuation entity. This would effectively eliminate the gap that currently exists whereby a person disqualified by APRA from having direct involvement in the operations of a trustee, investment manager or custodian could still have influence over it and generally still operate within the superannuation industry.

On this basis ASFA supports the proposal to extend the scope of APRA's disqualification power under section 126H of the SIS Act.

9.6 Minor amendment to the SIS Act

ASFA is supportive of reinstating the definition of 'involved' (formerly in section 17 of the SIS Act) in respect of persons involved in a contravention of the SIS Act.

We note that this section was repealed by the *Treasury Legislation Amendment (Application of Criminal Code) Act (No. 1) 2001*. Whist this repeal was appropriate for criminal law purposes, we recognise that it occurred without appreciation of the fact that the SIS Act definition was needed for the purposes of defining when a person is involved in a breach of a civil penalty provision under the SIS Act. On this basis, we support the proposal that the definition, or a similar one applying specifically to civil penalty proceedings, be reinstated into the SIS Act.

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