Layers of safety in the Australian financial system

The Australian Government established the Australian Prudential Regulation Authority (APRA) to promote stability and confidence in the Australian financial system for the benefit of the broader Australian economy. Banks, building societies, credit unions, life and general insurance companies and most of the superannuation industry are supervised by APRA. However, APRA is but one element within the layers of safety that exist in the Australian financial system.

Boards and management
The primary responsibility for the financial safety and soundness of a financial institution rests with its board of directors and senior management. APRA’s approach is to ensure that boards and managers understand and carry out these responsibilities.

APRA’s prudential supervision
Through a framework of legislation, prudential standards and ongoing supervision, APRA aims to ensure that the risks undertaken by the institutions it supervises are clearly identified and well managed, and that the likelihood of financial losses to consumers are minimised. In this way, APRA acts to protect the interests of depositors, policyholders and superannuation fund members (whom APRA collectively defines as ‘beneficiaries’) and to promote the stability of the Australian financial system.
APRA continuously oversees the activities of the financial institutions it supervises to ensure that they comply with prudential standards, are in sound financial condition and have adequate and effective governance and risk management systems. Where an institution falls short of APRA’s requirements, APRA prefers to take a cooperative approach to resolving outstanding issues. However, when an institution is unwilling or unable to cooperate, APRA will take appropriate enforcement action to safeguard the interests of beneficiaries.

Private sector monitoring
Monitoring of financial institutions is also carried out by private sector companies and individuals such as auditors, actuaries and rating agencies. Other groups play a role in scrutinising the actions of financial institutions, including major and institutional shareholders, consumer groups and the media.

Other public sector monitoring
An important layer of safety in the Australian financial system is provided by the activities of other public sector agencies such as the Reserve Bank of Australia (RBA), the Australian Securities and Investments Commission (ASIC) and the Australian Competition and Consumer Commission (ACCC).

Failure resolution
A final layer of safety in the Australian financial system is the various protections offered when an institution fails.

Depositor preference
In the case of authorised deposit-taking institutions (ADIs) — banks, building societies and credit unions — protection is firstly provided for depositors under what is termed ‘depositor preference’. ‘Depositor preference’ is enshrined in the Banking Act 1959 and requires that depositors in Australia are first in line to recover their funds from the assets of a failed ADI (after amounts paid under the Financial Claims Scheme have first been met from the assets of the failed ADI).

Financial Claims Scheme
Since the process of recovering money from a failed institution can take some time, depositors and general insurance policyholders receive additional protection from the Australian Government’s Financial Claims Scheme, which is administered by APRA.

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Under the scheme for ADIs, the Government provides a guarantee for deposits in a bank, building society or credit union authorisation in APRA up to $250,000 per account-holder. The Scheme is designed to give individuals early access to their deposits up to this limit to enable them to carry on with their day-to-day lives. Under the Scheme for general insurers, valid insurance claims by eligible claimants made on a failed general insurer, within a specified period of time, will be paid even if the insurer has insufficient assets to meet the claim.

For further information, refer to information on the Financial Claims Scheme on the APRA website.

Life insurance
Life insurance companies are required to keep their life insurance business in separate funds, called statutory funds. These are akin to trust funds and are subject to specific legal requirements. The assets of a statutory fund are kept distinct (‘ring-fenced’) from assets of other statutory funds and from all other business of the company. This is to ensure they cannot be used for any other purpose. Life insurance policyholders receive first priority in the recovery of benefits that are due to them from the assets of the statutory fund in the event that it becomes insolvent.

Friendly societies operate like life insurance companies. However, they maintain benefit funds rather than statutory funds for their life insurance business. Benefit funds are subject to the same specific legal requirements as those described for statutory funds, including priority payments to benefit fund members or policyholders in the event of insolvency.

Superannuation
Under the Superannuation Industry (Supervision) Act 1993, the trustees of APRA-regulated funds can apply to the Minister for a grant of financial assistance where the fund has suffered a loss as a result of fraudulent conduct or theft. The Minister must be satisfied that that loss has caused a substantial reduction in the fund’s assets leading to difficulty in paying benefits, and that the public interest requires a grant to be made.

The Australian Government has also established an independent body, the Superannuation Complaints Tribunal (SCT), to deal with complaints about superannuation entities. The SCT can also make determinations to compensate members in certain situations where negligent action by the trustee or poor administration has resulted in a loss to members.