



**SUBMISSION TO THE SENATE ECONOMICS LEGISLATION  
COMMITTEE**

**INQUIRY INTO THE SUPERANNUATION SAFETY AMENDMENT BILL 2003**

**January 2004**

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## 1. Introduction

The Australian Prudential Regulation Authority (APRA) is pleased to make this submission to the Senate Economics Legislation Committee regarding its Inquiry into the *Superannuation Safety Amendment Bill 2003* (SSAB or the Bill).

APRA has been an active participant in the development of the proposed reforms since the formation of the Superannuation Working Group (SWG), which was established by the Government in October 2001 to review the regulatory framework governing superannuation. The SWG undertook several rounds of public consultations to canvass options for improving the regulatory framework. The outcome of these consultations formed the basis of the SWG's recommendations for superannuation reform which were reported to the Government on 28 March 2002. On 28 October 2002, the Government accepted a majority of the SWG's proposals, many of which are contained in the SSAB.

Throughout 2003, APRA worked with Treasury to ensure that the provisions contained in the Bill are practical and enforceable. The amendments take into account the highly diverse structure of the superannuation industry and aim to ensure that no unnecessary barriers to entry are created. Treasury undertook industry consultation in May/June 2003 and many of the comments received from industry were incorporated into the Bill.

The licensing regime and prudential framework in the Bill is intended to allow APRA to carry out its supervisory mandate more rigorously and effectively. Superannuation is currently the only industry regulated by APRA for which it is not necessary to obtain a licence to operate (with the exception of trustees intending to engage in public offer superannuation). This is in contrast to requirements in the managed investments regime, where all schemes with more than 20 members must be registered, and must be operated by a licensed responsible entity. The implementation of the SSAB will therefore provide APRA with additional means to minimise the risk of failure and to ensure improved prudential outcomes across APRA-regulated superannuation funds.

After summarising the main features of the Bill, the focus of this submission is solely on APRA's role in implementing the proposed licensing regime and the accompanying regulations and operating standards.

### 1.1 The Superannuation Safety Amendment Bill reforms

The reforms contained in the SSAB are intended to modernise and strengthen the prudential regulation of superannuation.<sup>1</sup> The Bill will amend the *Superannuation Industry (Supervision) Act 1993* (SIS Act) to provide for:

- the licensing of trustees of superannuation entities regulated by APRA and the registration of those entities;
- improved disclosure requirements, including requirements for actuaries and auditors to report information to APRA in certain circumstances; and
- more effective enforcement powers to underpin the new framework.

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<sup>1</sup> Please refer to the Explanatory Memorandum to the Bill.

In general, the Bill provides for a licensing regime under which trustees of all APRA-regulated superannuation entities must be licensed. A defined term “registrable superannuation entity” (RSE) covers these entities. The new trustee licence, otherwise referred to as the RSE Licence, will be subject to conditions, including requirements for trustees to meet minimum standards of fitness and propriety and to maintain risk management strategies governing the trustee’s operations and risk management plans for each fund under the trustee’s control.

The Bill provides for classes of licence, with separate classes covering the operation of public offer entities and non-public offer funds. The class of licence granted to an applicant trustee will depend on the trustee’s operations. There is also provision for additional classes of licence to be specified under the regulations.

From the commencement of the legislation, new entrant trustees must be licensed prior to commencing operations. Existing trustees will have the benefit of a two-year transitional period in which to either obtain a licence or exit the industry. The reforms will provide for the orderly exit of trustees that are unable or unwilling to meet the new licensing requirements at the end of the transition period.

In addition to the licensing of trustees, the Bill requires the registration of superannuation entities (other than self-managed superannuation funds), whose trustees are regulated under the SIS Act. Registration will enable APRA to gain important information about the superannuation entities that it regulates and, going forward, will ensure that this information is provided prior to commencement of operations.

New provisions are introduced requiring actuaries and auditors to report certain information to APRA about the activities of trustees and the operation of superannuation entities, at the same time as reporting to the trustees.

The Bill also provides for appropriate enforcement powers, supported by penalty provisions, to underpin the new framework. Consistent with existing provisions in the SIS Act of a comparable nature, many of the penalty provisions contained in the Bill have both a fault and a strict liability component. This two-tiered regime aims to create a more robust regulatory framework and improve the enforceability of the provisions to which strict liability is attached. By facilitating more effective enforcement, the regulatory framework for superannuation will be strengthened to help ensure that superannuation entities are administered prudently and that superannuation savings of members are adequately protected.<sup>2</sup>

The Bill contains a number of formal provisions giving effect to commencement of a range of Schedules which amend the SIS Act, to ensure a smooth transition to the new trustee licence arrangements. Subject to the Bill’s approval by Parliament, it is expected that licensing will commence on 1 July 2004.

## **1.2 Draft regulations and operating standards**

The amendments in the Bill are to be supported by regulations, including new operating standards. The Government has released for comment proposed drafting instructions for regulations and operating standards relating to the following matters:

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<sup>2</sup> Explanatory Memorandum to the Bill, section 2.7

*Operating standards*

- adequacy of resources of trustees
- outsourcing
- fitness and propriety of trustees

*Regulations*

- risk management
- minimum capital for trustees of public offer entities
- net tangible assets
- licence classes
- defined benefit funds
- register of superannuation entities and licensees
- acceptance of contributions into unregistered RSEs.

Industry consultation on the proposed drafting instructions for the regulations and operating standards will close on 29 February 2004.

**1.3 Licence conditions**

As mentioned earlier, the new trustee licence will be subject to conditions, many of which will be outlined in the proposed regulations and operating standards. The legislation provides for there to be three main categories of licence conditions. These categories are:

- conditions that are imposed on all RSE licences;
- conditions prescribed by regulations; and
- additional conditions imposed on individual licences by APRA.

Importantly, the conditions must be met before a licence can be granted and on an on-going basis thereafter.

*Conditions imposed on all RSE licences*

Licence conditions with which all RSE applicants will need to comply in the legislation include:

- comply with the law applying to licensed trustees;
- properly perform the duties of a licensed trustee;
- have a risk management strategy and comply with it;

- ensure that all their RSEs are registered;
- comply with the RSE risk management plan or plans;
- be and continue to be fit and proper;
- notify APRA of changes to the composition of the trustee board or group; and
- comply with additional conditions as set out in the regulations.

#### *Conditions prescribed by regulations*

RSE licensees must also comply with other requirements of the Bill, as set out in the regulations. This includes the requirement for RSE licensees to have a Risk Management Strategy (RMS) and Risk Management Plans (RMPs) for each fund under trusteeship.

The regulations may also prescribe operating standards and Part 3 of the SIS Act will be amended to allow operating standards to apply to the trustees and RSE licensees. These operating standards will include ongoing requirements for RSE licensees to maintain adequate financial, technological and human resources, meet standards of fitness and propriety and meet outsourcing requirements.

#### *Additional conditions on individual licences*

APRA will also have the power to impose additional conditions on individual licences. Under the legislation, an additional condition imposed on a trustee licence must not be inconsistent with the conditions in the Act and regulations, and APRA must also consult with ASIC if the condition may interfere with the usual operations of the trustee for which ASIC has regulatory responsibility.

For example, if APRA determines that an RSE licence applicant is significantly dependent upon a certain person to demonstrate that it meets the standard on fitness and propriety, it may determine that the person is a 'key person' and impose a key person licence condition under section 29EA of the Bill. APRA may also determine that the resources of the RSE licence applicant are not adequate for the class of funds it manages, and APRA may impose a condition requiring the applicant to outsource certain functions such as its administration. APRA may also issue a direction to a trustee to comply with the specific conditions imposed on the trustee's licence, and may vary a licence or a condition. Failure to comply with the direction will be an offence under the legislation and may lead to the cancellation of the trustee licence.

## **2. Implementation of the SSAB**

APRA will be responsible for implementing the amended legislation during the two-year transition period and for the on-going monitoring of compliance.

During the transition period, APRA must decide an application from an existing trustee by the end of the period, provided the application is lodged during the first 18 months of the period. The Bill provides APRA with power to refuse to consider applications lodged by existing trustees during the last six months of the transition period. Consideration of an application received during the last six months may be deferred until after the end of the period, when it will be treated similarly to an application from a new trustee. Applications from new entrants must be decided within 120 days.

It is APRA's intention that all guidance notes and explanatory material outlining the licensing requirements will be settled by the commencement of the licensing period, so that there will be no advantage to trustees who delay applying in the expectation that the process will change.

### **2.1 APRA's administration of the application process**

The mechanics of the application process will reflect the current processes that apply to Approved Trustee applications. An application will be lodged, and APRA may request further information and visit the applicant to review its operations prior to deciding the application. Given the large number of potential applicants for an RSE licence, APRA will be tracking the application flow at all times and will be prepared to deal with a peak of applications towards the end of the first 18 months of the transition period.

APRA has appointed a General Manager, Superannuation Licensing, who will oversee a dedicated licensing team and will be responsible for ensuring that all applications are processed by the due dates. Additional (temporary) staff will be committed to this team, so that APRA can maintain its normal supervisory activities during the licensing period. APRA will be coordinating these activities with the licensing operation as far as possible.

APRA also intends to administer the fund registration process simultaneously with the trustee licence application process, so that there is no unnecessary duplication of time and resources. The Bill requires APRA to register RSEs within 21 days of a trustee being granted its licence. The licensing team and the responsible front-line supervisors will therefore review the trustee licence application and the fund registration documents simultaneously.

Where a trustee also holds an Australian Financial Services Licence (AFSL), APRA and the Australian Securities and Investments Commission (ASIC) are obliged to consult with each other if variation or cancellation of a licence or condition is contemplated by one of these agencies, and that action would prevent the trustee from carrying on the activities for which it is licensed by the other.

Subject to the Bill's approval by Parliament, APRA will make the licence application form available when the regulations and operating standards have been finalised. Applicants will be able to request the documentation in hard copy form, or access it online at the APRA website.

## **2.2 APRA's assessment of licence applications**

APRA-regulated superannuation funds vary in size, membership and activity. APRA will take into account the nature and complexity of a trustee's operations in assessing whether a trustee meets the requirements for a licence. For instance, APRA expects that risk management strategies and plans will vary considerably for trustees within a licence class. Funds that are classified as 'non-public offer', for example, will often have very different fund membership profiles, total assets, investment strategies and willingness to bear risk. Consequently, APRA expects that risk management strategies and plans will be tailored according to the individual funds for which the trustee will be licensed.

APRA will place particular emphasis on risk management in assessing licence applications. It expects that the major part of the information that a trustee will need to provide will deal with its risk management strategy and risk management plan for individual funds.

Decisions and recommendations made in relation to the grant or refusal of a licence, and any specific conditions placed on individual licences, are expected to be reviewed by a senior internal licensing panel prior to finalisation.

## **2.3 Supporting documentation to be required**

Licence applicants will need to substantiate claims made in the application form with supporting documentation. Examples include risk management strategies, copies of outsourcing agreements if applicable, the curriculum vitae and police checks of responsible officers, audited financial statements of both the trustee entity and the fund and the trustee's business plan. Those trustees who also hold an AFSL will be asked to provide a copy of the licence. Where appropriate, APRA may rely on some of the proofs provided to ASIC in the course of AFSL licensing. In addition to documentation, trustees will also need to provide supporting statements explaining how they comply with certain requirements and licence conditions - for example, an outline of the process by which the trustee ensures that the standard relating to fitness and propriety is met.

Fund registration will also require trustees to provide copies of the trust deed, governing rules and, importantly, the risk management plans of each individual fund to be registered. For funds that are generically similar, for example small APRA funds (SAFs), APRA will make provision for trustees of these funds to provide a generic risk management plan for the applicable funds.

## **2.4 Amalgamation of funds**

The licensing of trustees is not intended to act as a barrier to entry for new trustees or to discourage existing trustees from continuing to operate effectively. That said, the application process needs to be rigorous and comprehensive to ensure that the trustees of Australia's retirement savings have the competency and resources to manage these assets effectively and prudently. Where trustees are unable to meet the requirements of the RSE licence or do not apply, they will be able to continue to operate during the two-year transition period but will not be permitted to operate as trustees after that period ends.

Once that period ends, trustees unable to meet licence requirements or that did not apply for a licence will have to either wind-up the fund and transfer members and assets to another fund/s of the members' choice or on a successor fund basis, or appoint a licensed trustee. In the event that a trustee fails to make appropriate arrangements, the Bill provides APRA with a power to approve an amalgamation of funds. APRA may not exercise this power unless satisfied that all reasonable attempts to bring about a transfer under other provisions in the SIS Act - such as the successor fund arrangements - have failed, and must obtain the Minister's written consent to the transfer.

### **3. Education and promotion**

A comprehensive education and promotional campaign will be pivotal to the new reforms to ensure that trustees have all the appropriate information available to them once the licensing period commences. APRA will be developing a range of communication channels to inform trustees, fund members where relevant, and the superannuation industry generally.

The main elements of APRA's campaign will involve:

- provision of *guidelines* on the regulations and operating standards, as well as on the various licence conditions, which will be available online at the APRA website once all the legislation has been finalised;
- an *explanatory booklet* to accompany the application form, which will take trustees through the form section by section and, where applicable, alert trustees when to attach relevant supporting documentation;
- participation in *workshops* by the Securities Institute of Australia (SIA) and in education programs developed by industry bodies, aimed at guiding trustees through the legislation and the new licence requirements in an interactive manner. These workshops will be especially important to those trustees that have not been through a licensing process before (such as those trustees who are not Approved Trustees and trustees that have not been required to obtain an AFSL); and
- a specific *hotline* and email address to assist trustee applicants with specific questions in relation to licence applications.

### **4. Costs of implementation**

When announcing the Government's broad acceptance of the SWG recommendations in October 2002, the Minister stated that the costs incurred by APRA in the licensing process would be met by a licence fee. In setting licence application fees, APRA must have regard to the Government's principles and guidelines regarding cost recovery by Government agencies. Costs to be taken into account in setting the one-off licence fee are expected to include the administrative costs of processing the receipt and handling of applications for trustee licensing and fund registration, the costs attributable to review of the trustee entity and fund operation that are additional to normal supervision processes, and infrastructure and public education costs.