Review of the Superannuation Industry (Supervision) Act 1993 and Certain Other Superannuation Legislation

SUBMISSION NO: 49

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AUSTRALIAN PRUDENTIAL REGULATION AUTHORITY (APRA)

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Productivity Commission Questions

APRA's submission

How do the various terms for 'superannuation entities' which appear in the SIS legislation translate into the industry classifications that appear in the table at page 3 of its submission to the Commission?

The SIS legislation defines various superannuation entities. The definitions are listed in the APRA Annual Return Information Guide and include:

• Small APRA Superannuation Funds;
• Public Offer Superannuation Funds;
• Other APRA Regulated Superannuation Funds;
• Single Member ADFS;
• Multi Member ADFS;
• Pooled Superannuation Trusts;
• Eligible Rollover Funds; and
• Self-Managed Superannuation Funds.

For the purposes of Superannuation Trends, funds are classified into the functional categories below:

- *Corporate funds* are funds sponsored by a single non-government employer, or group of employers;

- *Industry funds* are those established under an agreement between the parties to an industrial award;

- *Public Sectorfunds* are sponsored by a government employer or government controlled business enterprise.

- *Retail _funds* are publicly offered superannuation funds that members join by purchasing investment units or policies directly or through intermediaries such as life insurance agents or financial planners; and

- *Small funds* are those funds with less than five members and include both APRA and ATO regulated funds.

These functional descriptions reflect how the superannuation entity operates in commercial reality and also reflects how the entity views itself. Funds are asked to indicate their functional categorisation on the Annual Returns to APRA. Where the return data are not clear, APRA uses the following basis to allocate funds to the functional categories:

- Small APRA funds and self-managed superannuation funds and single member ADFs are classified as small funds;

- Public offer funds may be classified as retail funds, industry funds or corporate funds;

- Other APRA Regulated funds may be classified as corporate, industry and public sector funds;

- Multi-Member ADFs may be classified as retail funds, industry funds or corporate funds;

- Eligible Rollover Funds are classified as retail funds; and

- Pooled Superannuation Trusts are not separately classified in the Superannuation Trends (including them would give rise to double counting as they are investment vehicles).

Fund numbers in the Superannuation Trends are an estimate for the whole superannuation industry, and include funds which are currently inactive or uncontactable. APRA has been directing a lot of efforts towards determining the status of these funds. As inactive funds get identified and wound up, these numbers will diminish.

Could APRA provide more detail about the problems that it encountered with funds, listed on the top of page 5? For example, how many times has each of these problems occurred over a period of time?

These comments are based on both case listings and anecdotal evidence from files managed by our specialist Rehabilitation and Enforcement (R & E) Unit and commentary provided by our various regional offices which still retain management responsibility for some problem entities. The details in terms of the number of problems encountered over a period of time are not readily available. However there are currently around 30 or so superannuation funds in R & E.

In relation to regulated superannuation service providers on pages 9 and 10, APRA said that 'there may be a case to provide in legislation for APRA's explicit regulatory access to and oversight of service providers where systemic issues potentially arise.' Could this statement be clarified? For example, would this explicit regulatory access be in addition to that currently provided by ASIC- administered regulation?

The concentration of large service providers has the potential to give rise to systemic risks, in addition to the normal risks associated with outsourcing. Where there are a large number of trustees being serviced by a small number of service providers, major problems (such as fraud or systems failure) experienced by a single provider can severely impact the industry. Further, because there is a concentration of large providers who have significant financial capacity, the trustees may find themselves in a weak bargaining position, with no capacity to switch providers even if they are dissatisfied with the service.

APRA intends to seek greater powers to obtain information on the operations and risk management systems of service providers. A-PRA does not currently have any powers to obtain this information. To date, we have relied on trustees to manage the risks involved with outsourcing and undertake the necessary due diligence to ensure that the service provider's internal control environment and risk management processes are adequate. However, we do not believe that all trustees across the range of funds (large to small, with varying degree of sophistication and resources) can properly evaluate whether the service being provided is adequate, that risks are being appropriately managed, and that requirements of the SIS legislation and Instruments of Approval are met. This is because outsourcing is often undertaken by trustees of small funds who lack the expertise in the areas being outsourced. Where related parties provide the service, the manner in which conflicting interests have been managed in the best interests of fund membership raises issues for assessment. Under such circumstances, it would be beneficial for APRA to be able to discuss issues and obtain documentation directly from the service provider.

While there is already a degree of regulatory reach over some service providers via the Instrument of Approval for Approved Trustees, specifically with respect to requirements placed on administrators and custodians and also section 123 of SIS in relation to custodians, these requirements do not allow APRA to make its own assessment should it wish to. APRA sees benefit in having the ability to conduct an on-site visit to a service provider in order to assess the adequacy of the service provider's risk management systems.
We emphasise, however, that A-PRA has no intention to supervise service providers.

Approved trustees

- **Could we obtain a copy of the application form to be an approved trustee?**

Forwarded by mail.

- **Is there a stated rationale or objective for the prescribed amount of $5 million net tangible assets (or some equivalent form) and for the condition Dl in the instrument of approval that $100 000 be liquid assets and $100 000 be other eligible assets?**

We are unable to trace a stated rationale for the prescribed requirement of $5 million which was introduced when SIS was first drafted. We assume that the figure was derived from the perceived comparability of approved trustees to life insurance companies and the requirement in the life insurance regime for registered companies to have at least $5 million in eligible assets. The rationale appears to have been focussed totally on the theory of allowing only entities of substance (ie $5m NTA) to hold superannuation assets in the retail area.

Condition D.1 requires trustees (using custodians) to hold both eligible assets of at least $100,000 and a level of liquid assets of at least $100,000 (the amount of eligible assets and the amount of liquid assets need not be separate amounts). This was introduced to give the then ISC some comfort that the trustee itself had some ready resources to address any administration or computer system problem. That is, this was a very early 'operational risk' capital requirement. The figure of $100,000 was determined on the basis of an 'estimate' of the cost of replacing administration systems for a reasonable sized fund.

- **One participant raised a concern that conditions A14 (business and commercial activities of trustees) and Dl (asset liquidity) were not within APRA's 'power' to impose. Does APRA have a response to that statement?**

APRA has reviewed the conditions under the IOA and determined that they all fall within APRA's powers under Part 2 of the SIS Act.

- **Could condition A14 be clarified? For example, does it mean that a responsible entity under the Managed Investments Act, who is also an approved trustee, must seek additional approval from APRA in regard to managed investment schemes?**

If when the trustee was approved by APRA, it was already acting as a responsible entity under the Managed Investments Act, it would have an exemption under A15(a)(ii). If not, the approved trustee must seek additional approval from APRA before embarking on managed investment schemes. The requirement was introduced because of growing concerns by the ISC/APRA about the capacity of approved trustees to manage effectively

and prudently a wide range of activities (many of which were outside the superannuation arena).

- **To what extent have approved trustees contravened the legislation or conditions of the instrument of approval? What has been APRA's response to those contraventions? Is it possible to distinguish these contraventions on the basis of type and size of the entity? What were the outcomes of any prosecutions of approved trustees?**

There have been fairly numerous minor breaches. They are dealt with on a case by case basis, depending on the significance of each breach. Where a breach is not material, APRA may accept an undertaking from the approved trustee to remedy the situation and then monitor progress. Breaches which have the potential to jeopardise member interests call for immediate rectification.

Serious contraventions would entail enforcement action. Since its inception, APRA has taken enforcement action against one approved trustee. In this case, the trustee's approval was revoked, and the trustee was replaced for all the funds for which it acted as trustee.

APRA reporting requirements

- **A number of inquiry participants have expressed concerns about the reduced lodgement period of four months for annual returns for some superannuation entities, especially small APRA funds. What is the stated rationale or objective for the reduced lodgement period? To what extent have entities complied with the reduced lodgement period? What is APRA's response to concerns expressed about the reduced lodgement period creating difficulties in obtaining the required information and having the returns audited, which in turn reduces the quality of the returns?**

A lodgement period of four months is consistent with the requirement for public offer superannuation funds as well as for other APRA regulated institutions.

APRA's risk-based approach to supervision involves regular off-site surveillance to identify high-risk entities for more intensive on-site reviews. Review of returns is a crucial part of the off-site surveillance process and its usefulness hinges on the timeliness and accuracy of the data provided in the returns. As it stands superannuation already lags other industries in the frequency with which returns are lodged. Superannuation returns are required only annually while most other APRA supervised entities report quarterly. The reduced frequency makes it difficult for APRA to detect deteriorations and institute preventive actions. A long lodgement period will aggravate the problem.

Serious and systemic late lodgement was common with superannuation funds, prior to the introduction of the shorter lodgement period. The situation has improved recently in response to efforts by both APRA and the industry bodies to encourage timely lodgement.

APRA does not accept the argument that a shorter lodgement period would reduce the thoroughness of the audit and the quality of the returns. We believe that a substantial amount of the audit work should be undertaken during the year rather than at the end of the financial year. If a shorter lodgement period forces auditors to plan in advance and spread compliance work throughout the year, this would be a good outcome.

- **Could we obtain a copy of the quarterly statistical return that entities must provide to APRA?**

Forwarded by mail.

- **What does APRA do with the data collected, apart from publishing it? For example, is the data used to assist in monitoring and enforcement?**

Data from the quarterly survey are analysed in the off-site surveillance process.

Complaints mechanism

- **The SIS Regulations (part 2, 2.28) require trustees to give to each member information of arrangements that the entity has in place to deal with inquiries and complaints. Does this extend to advising members that they must first use internal dispute settlement arrangements before approaching the Superannuation Complaints Tribunal?**

This is a matter that would be more appropriately addressed by the Australian Securities and
Investments Commission.

Superannuation service providers

One participant claimed that lawyers could be capable of conducting compliance audits. We note that some aspects of a compliance audit are of a non-financial nature.

Could persons with non-financial auditing qualifications and experience be able to perform this function?

No. In respect of each year of income, the financial statements and accounts of a superannuation entity must be audited by an approved auditor (as defined in the SIS Act) who is required to give a report in the approved form to the trustee of the entity within the prescribed time (Section 113 of the SIS Act). In addition to the normal audit of the entity's financial position, the approved auditor of a superannuation entity must undertake a mandatory compliance audit of the entity and give his opinion on the fund's compliance with specific provisions of the SIS legislation. A statement of this opinion is an integral part of the 'approved form'. While lawyers may be capable of conducting compliance audits, they will not be able to give a report in the approved fortn as required under SIS.

- **We note that there has been a trend of a small number of financial auditors being disqualified or referred to their professional body for disciplinary consideration each year. Can these cases be 'broken'. down by the nature of problems being experienced (for example, fraud, incompetence and so on), and the type and size of entities involved?**

A common cause for disqualification was a breach of professional standards relating to independence, maintenance of working papers or asset verification. On other occasions, auditors had been disqualified because of fraud, which may or may not involve a superannuation fund. You may wish to contact the appropriate professional bodies for further information.

- **Have there been any problems with actuaries?**

There have been no noticeable problems with actuaries.

- **What proportion of all custodians of superannuation assets are substantially over the $5 million net tangible asset hurdle? Are the risks in respect of custodians different as between superannuation and non-superannuation assets? Does the Cross Industry Circular (CIC 1) merely clarify what was mostly good current practice? Or was it needed to address worrying trends and risks in respect of custodians services? While condition D4 of the instrument approval requires the approved trustee to check compliance that the custodian meets the $5 million net tangible asset requirement, what 'discipline' is there on non-approved trustees to check this?**

A large proportion of custodians are global players (eg State Street, Chase) with assets substantially in excess of the minimum $5 million net tangible assets.

We see little difference in the risks in respect of custodians of superannuation and non-superannuation assets. While most of CIC 1 reflects current good practice, it also reiterates the need for trustees to assess and manage the custodian relationship as an outsourcing arrangement and establishes the framework for the trustee and APRA to manage the relationship. Some provisions of CIC 1, most notably the liability arrangements, went beyond the industry standard at the time the ISC first started liaising with industry on the provisions/ requirements.

Although CIC 1 applies to all superannuation funds, not just to approved trustees, it is only mandatory on approved trustees. This is imposed via a requirement in the Instrument of Approval. In the absence of any power for APRA to set obligatory standards for trustees (as we can do for all other industries) the application of CIC 1 to other trustees relies on our encouragement and their willingness to adopt best practice. The $5 million NTA requirement applies to all custodians of superannuation monies and is a penalty provision on the custodian. Any trustee who contracts a custodian would be expected, in order to properly carry out its fiduciary duties, to do due diligence before handing over custody of fund assets.

The Superannuation Trends publication

- **How do the various terms for 'superannuation entities' which appear in the SIS legislation translate into the industry classifications that appear in APRA's quarterly publication Superannuation Trends?**

See response to first question.

- **Does the data for public sector funds include exempt schemes?**

The data in Superannuation Trends include unregulated public sector schemes with more than $60 million in assets (included in the Quarterly Survey of Superannuation) and estimates of other unregulated public sector funds.

- **How many public sector superannuation schemes are currently subject to the SIS legislation?**

As at 30 June 2000, there were approximately 40 public sector funds.

- **Is there data for superannuation contributions per annum/quarter available prior to the September quarter 1995 and consistent with the series presented in Superannuation Trends?**

APRA has data on contributions from June 1995 to present. Prior to the Quarterly Survey of Superannuation and the commencement of SIS annual returns, life office superannuation funds were not required to report any financial details to the ISC. Therefore, the data on contributions prior to 1995 are incomplete and inconsistent with, what is in Superannuation Trends.

Is separate data available for 'voluntary' contributions?

No, we have no data on 'voluntary' contributions. Contributions are defined in terms of member and employer contributions. Member and employer contributions are not further broken down into components.

Member contributions include all contributions made personally to the fund by members, including amounts deducted from their salary or wages. Member contributions do not include contributions made by an employer under a salary sacrifice agreement.

Employer contributions include all contributions made to the fund by employers or associates, including those made as a consequence of Superannuation Guarantee charge obligations or industrial awards and, as noted above, those under salary sacrifice arrangements.

- **What is the relationship between the data on superannuation contributions and the Reserve Bank of Australia's data series on contributions in 'Financial Flows of the Household Sector' (Australian Economic Statistics, Occasional Paper No. 8) which goes back to 1953-54 and covers both life insurance and superannuation funds?**

Data on superannuation contributions published in Superannuation Trends are compiled from the Quarterly Survey of Superannuation, APRA Annual Returns and estimates of other industry components. The Reserve Bank of Australia's data series on contributions in 'Financial Flows to the Household Sector' is based on estimates compiled from the Australian Bureau of Statistics. For information on how this series is compiled, please contact:

Derick Cullen
Director of Financial Accounts
Australian Bureau of Statistics
Phone: 02 6252 6244
Email: d.cullen@abs.gov.au

- **Could we have the data which APRA used to draw the figure for total superannuation coverage 1984-98 which appears in the APRA Insurance and Superannuation Bulletin of December 1998 in the article Superannuation Coverage Update. Any more up to date data would also be good.**

The figure for total superannuation coverage 1984-1998, published in the ISC Bulletin of December 1998 was taken from the Australian Bureau of Statistics (ABS) (catalogue numbers 6334.0, 6319.0, 6310.0 and 5325.0). The ABS has recently released a new issue of Employment Arrangements and Superannuation' (catalogue number 6361.0 April to June 2000) which details superannuation coverage for all persons aged 15 to 54.

Annual report data

- **Can APRA provide further breakdown in respect of the results from the Review Program (1995-96 through 1997-98)? For example, in respect of 'Category 2' (shortcomings which would have created a potential risk) -**

ranging from 31-50% of funds reviewed - can the nature of the shortcomings be identified, the fund types and the assets at risk? And, similarly, in respect of 'Category 3' (Serious shortcomings) which ranged from 2-8% of funds reviewed?

Further breakdown not readily available.

- **The 1999-2000 Annual Report refers to 23 SAFs being issued notices of non-Compliance - were there any such notices for other fund types? In 1998-99 it is not clear to us whether the figure of 24 notices of non-compliance is for SAFs only or all fund types.**

The notices of non-compliance would all relate to small funds. Under the SIS legislation, a fund must fail the culpability test before a notice of non-compliance can be issued. This requires that all members must have been party to the contraventions which warrant non-compliance, or any "innocent" member must not suffer any significant financial disadvantage as a consequence of non-compliance. There has only been one instance of non-compliance under the SIS legislation of a fund with more than four members - that had 6 or 8 members who were all related.

The 1998-99 Annual Report referred to 4 cases of removing a trustee and the 1995-96 annual report noted 2 cases. We are assuming there were nil cases in other years; as the annual reports did not explicitly say so (such as a time series table showing nil for those other years) we are unsure. Further, in the cases where a trustee was removed can the eason be given (such as what part of the legislation or conditions of the instrument of approval were contravened)?

The ISCIAPRA removed trustees in each financial year as follows:

1995/1996	2 cases
1996/1997	0 cases
1997/1998	0 cases
1998/1999	4 cases
1999/2000	1 case
2000/2001	3 cases

A trustee may be suspended or removed only if one of the triggers specified in section 133 of the SIS Act exist. These are, broadly, that:

- the conduct of the trustee may result in the financial position of the fund becoming unsatisfactory;

- the trustee (or one of the trustees) is a disqualified person (that is, have been convicted of an offence of dishonesty, being an insolvent under administration; for a body corporate, has a provisional liquidator appointed; has been disqualified by APRA under section 120A of the SIS Act; or has had a civil penalty order made against it under the SIS Act);

- in the case of an Approved Trustee, has had its approval revoked by APRA under section 28 of SIS Act; or

- in the case of a fund with fewer than 5 members, the fund is not a self managed superannuation fund and the trustee is not an approved trustee.

The 1998-99 and 1999-2000 Annual Reports did not appear to provide Disaggregated data on the types and coverage of reviews and audits. All we are aware of is the figure of 647 total audits in 1999-2000. In contrast, the Annual Reports for 1994-95 through 1997-98 provided further data as to the asset value of the funds under review, reviews of approved trustees and reviews of accounting practitioners.

APRA did not maintain any disaggregated data.

Other

- We understand that APRA has initiated a project to develop a framework in which the benefits and costs of prudential regulation can be considered more rigorously? At what stage is the project now at? Has anything being published?

The project is still at its planning stage.

QUESTIONS FOR APRA

Custody of superannuation assets

1. Is it true to say custody of superannuation assets can be held in (one of) three ways?:

- by the trustee of the fund;
- by master custodians appointed by the trustee or investment manager; or
- by the investment manager.

No, this is not strictly true. Trustees have the primary duty to be holders of all assets in superannuation funds. However, trustees are able to engage or appoint a custodian to hold the assets of the superannuation fund and indeed, SIS requires such an appointment in the case of approved trustees which do not have $5million net tangible assets in their own right.

Part 15 of SIS sets out the rules for the eligibility of custodians of superannuation funds (as summarised below). Other than the Part 15 requirements, there are no legislative restrictions on custodians or on who may be a custodian. Therefore an entity which meets the Part 15 requirements can be both the custodian and an investment manager of a superannuation fund, or it can be the administrator and the custodian.

Although there is no specific requirement in SIS for the appointment of a custodian by the trustee to be in writing, the ISC, and now APRA, has promulgated that such appointments need to be in writing for the trustee to meet its duties under section 52 of SIS. If, in addition to being the custodian, the entity is also acting in another capacity for the superannuation fund, APRA would expect either separate agreements for the different roles or clear identification of the different roles in one formal agreement.

APRA has, following discussion with ASIC and considerable industry consultation, issued Cross Industry Circular No.1 (C1C1) to provide guidance on custodian arrangements for APRA Supervised Entities, including superannuation entities. (Please refer to our response to the PC's question last round on CIC 1).

An appointed custodian must be a body corporate (except for self managed funds) and must have at least $5 million in net tangible assets (NTA), or else provide an 'approved' guarantee, where the sum of the approved guarantee and the value of net tangible assets of the body corporate is not less than $5m. (There are also general probity standards - certain persons, such as bankrupts, are disqualified).

2. What is the approximate split of the $500b or so of superannuation assets between the three 'types' of custody arrangement?

Total assets of superannuation funds which have indicated in their 1999-2000 APRA returns that they use custodians amounted to $142b. Within these funds, however, a proportion of assets may be held directly by the trustees. We have

no data on the split of assets into direct holdings by trustees and holdings by custodians.
Please note that these funds were a subset of the APRA supervised superannuation population (total value of $292b. as detailed in the Table in our submission to the PC). We have no information on how assets of non-APRA supervised superannuation funds (public sector funds or those in life office statutory funds) are held.

- For example, in 2000, there was $142 billion of superannuation assets - about 25 per cent - with eight master custody service providers. (see table, attached)

- How much of the remainder of superannuation assets ($360b or so) is held directly by trustees and how much is held by investment managers (which meet the $5m NTA requirement)?

See answer to 2. above.

- How many investment managers (which meet the $5m NTA) have custody of superannuation assets?

This cannot be readily determined from our data.

- Is there any 'pattern' in which types of funds (eg 'small' versus 'large'; corporate v. industry v. public sector etc) tend to use which type of custody arrangement?

There is no 'pattern' except that 'small' funds are the least likely users because of the relatively high level of minimum costs involved in the use of a custodian.

3. Does APRA have any comments to add about prudential risks and custody arrangements in respect of superannuation?

Currently **SIS** only requires the use of custodians when an approved trustee does not have $5million net tangible assets in its own right. APRA sees merit in having the power to require a trustee to use a custodian in other circumstances where the security of members' monies may be at risk. Such circumstances could include: significant concern with the administration and accounting infrastructure of a fund, dominance of decision making and transactions by an individual trustee (or small group of trustees), or fund investing in markets where the specialist expertise of custodians would add value.

In using a custodian (whether mandatory or voluntary) a fund is exposed to any weakness or inadequacy in the internal control and risk management practice of the custodian. To this end, CIC1 sets best practice benchmarks. However, except where the Circular requirements are imposed through an approved trustee's Instrument of Approval, APRA can only rely on the trustees' willingness to adopt best practice and follow the requirements of the Circular.

4. Who should we contact at ASIC if we need to ask them about custody arrangements?

Darren McShane.

Table The Master custody market(a)
Period ending 30 September 2000

Custodian	*Clients*	Master custody: Total assets		Master custody: Superannuation assets	
		$b	%	$b	%
Chase	*33*	76.1	21.8	64.5	45.5
National	*46*	122.8	35.2	35.1	24.7
Commonwealth	35	34.2	9.8	28.2	*19.8*
AMP Investment Administration	25	17.5	5.0	4.8	*3.4*
State Street	*21*	45.7	13.1	4.3	3.0
Perpetual	17	19.4	5.6	2.1	1.5
Permanent	24	13.2	3.8	2.2	1.5
BT Portfolio Services	28	19.9	5.7	0.8	0.6
Total	229	348.8		142.0	

a Statistics exclude assets of related parties.

Source: Intech Financial Services.

The requirement would definitely need to be reconsidered in the course of any review to the flat $5m approach.

7. Section 26(1) requires APRA to be satisfied that an applicant can be relied upon to perform, in a proper manner, …

In determining what constitutes "can be relied upon" and "proper manner" does the applicant pass the test if it meets the entry requirements specified in the legislation such as s26 (which includes conditions in the instrument of approval) as well as the disqualified person's test and corporate entity test? Or does APRA have the discretionary power to make a judgement, notwithstanding that the applicant meets the specified entry requirements, that the applicant may not be (sufficiently) relied upon to 'uphold' (comply with) the duties/standards of a trustee specified elsewhere in SIS?

APRA has the discretion to make a judgement on whether an applicant can satisfy section 26(1). Apart from meeting specific legislative requirements and the disqualified person's test, the applicant must demonstrate that it has in place the necessary skills and competence, appropriate systems and controls, and achievable budgets and targets to discharge the duties and responsibilities of an approved trustee.

Question for APRA (19 August 2001)

Approved Trustees

1. Section 26(3) of the SIS Act appears to read as though an applicant must (at least) have $5m net tangible assets (or 'equivalent' form) or agrees to certain custody arrangements. That is, 26(1)(b) requires at least one of 26(1)(b) (i)-(iii) to be satisfied.

Does this mean an applicant could, in principle, be approved if it had less than $5m, as long as it complied with the custody arrangements? If so, have any trustees been approved with less than $5m in their own right (or equivalent form)? Or, in practice, does APRA use the instrument of approval (26(3)) to require that trustees meet the $5m 'rules' regardless of the custody arrangements?

Yes, an applicant only has to meet one of the options under section 26(b) of SIS so if it chooses to comply with custody requirements (section 26(b)(iii)) it does not have to hold $5m net tangible assets (or 'equivalent' form) in its own right. Quite a large proportion of approved trustees have been approved on this basis.

2. We understand that at present there are 157 approved trustees (website 12 April).

Is there a time series of the number of approved trustees - the precise tally date does not have to be the same eg 30 June? Can you please indicate whether increases are gross or net additions - that is, new approvals less 'exits'.

There is no time series of the number of approves trustees. The ISC approved 124 approved trustees in 1993-94 when SIS first became operative. A further 45 were approved in 1994-95 while 2 were revoked, taking the total to 167. There were about 160 approved trustees in early 1999 after APRA took over from the ISC.

3. Previous correspondence noted that APRA had not (formally) rejected any applications for approved trustees - that is, no instruments of refusal have been issued.

Did this answer apply since APRA was formed or since the SIS Act 1993? Could you please give some indication of the frequency' or 'scale' of 'informal' rejections - that is, how common is it for potential applicants to enter into discussions with APRA only to realise they will be unable to pass the test? In these cases, what is the most 'common' failing of potential applicants?

The previous answer that APRA had not formally refused any applicants did not cover the ISC period (ex ISC staff can recall a couple of formal rejections but we would have difficulty with tracing previous records/files).

As 'informal' approaches turn up in all forms and to different officers in all areas of APRA, we cannot give any indication of numbers of such approaches. 'Common' failings of potential applicants include inadequate financial resources; lack of demonstrated capacity to operate a fund; poor compliance record; and unsatisfactory business plan/strategic plan.

4. Parts F, G and H of the standard draft instrument of approval require audited certificates that the $5m 'rules' have been met each financial reporting period.

What is the net tangible asset profile of the 157, or so, approved trustees -for example, how many have between $5m and $]0m? Depending upon the answer to Q1 how many have less than $5m?

Currently 56 approved trustees meet section 26(b)(i) of SIS, that is, have net tangible assets exceeding $5m in their own right. We cannot readily categorise them in terms of asset profile.

1

5. APRA can specify any conditions in the instrument of approval (s.26(3)). W*hat proportion of the instruments of approval 'diverge' from the standard draft instrument of approval (web site 11 May 2001)? If there is divergence what are the most 'typical' tailored conditions added to the standard instrument of approval? Referring back to Q3 are 'informal' applicants failing the standard conditions or unable to meet additional/specific conditions which APRA have suggested?*

About 70% of instruments of approvals contain specific conditions. A 'typical' condition limits the approved trustee to act only as trustee for a defined list of funds - this condition applies to all approved trustees who do not have $5m net tangible assets in their own right. Another 'typical' condition involves the replacement of condition D1 with a condition that the administrator maintains at all times both eligible assets of at least $100,000 and a level of liquid assets of at least $100,000 under the terms of the Fund Administrator Agreement between the trustee and the administrator.

'Informal' applicants could have been rejected because they failed to meet the standard conditions or because they did not have the capacity to comply with alternative conditions.

6. In previous correspondence APRA noted that the amount of the $100 000 eligible assets and liquidity requirements was based on replacement costs for computer systems.

Are there any plans to revise the amount? For example, would such a requirement be necessary if a 'more robust risk focussed minimum capital regime' was adopted as a replacement for the flat $5m approach?

We already have cases where we have increased the amount to $250,000.

Question and answer (7 September)

Section 26(3) of the SIS Act requires APRA to set out the reasons for the refusal of an application for an approved trustee

Q. How many applications have been refused and what is the breakdown of reasons for refusal?

A. We have no record of any formal rejection of approved trustee applications since APRA was formed.

APRA willingly enters into, in fact encourages, dialogues with prospective applicants before any formal applications are lodged. As a result, interested parties get a good understanding of what is required in an application and their chance of success. Candidates unlikely to meet the SIS requirements would not bother proceeding to the formal application stage, saving time and effort for all.

Further Questions from the Productivity Commission on reporting requirements

Further questions from the Productivity Commission
APRA reporting requirements

1 . Does the information obtained from the quarterly statistical survey feed into any of the ABS publications eg quarterly national accounts?

The information from the Quarterly Survey of Superannuation feeds into the Financial Accounts (5232), Managed Funds (5655) and indirectly into the National Accounts (5206).

Information can be obtained from:
Derick Cullen
Director of Financial Accounts
Australian Bureau of Statistics
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2. We note that you said in respect of the lodgement of returns by funds that' The situation has improved recently in response to efforts by both APRA and the industry bodies to encourage timely lodgement'. Can we get an idea of the numbers outstanding?

	2000 Return Outstanding	
As at:	No. of funds	% of total population
Nov 2000	9102	85.3
Dec 2000	8031	75.2
Jan 2001	7212	70.4
Feb 2001	6198	58.1
Mar 2001	4446	41.6
Apr2001	2073	19.4
May 2001	1415	13.3
Jun 2001	870	8.1
Jul 2001	723	6.8

The total population comprised funds which have lodged 1999 annual returns. They do not include funds which have not lodged any returns since 1998 or earlier.

The figures also include funds which elected to be regulated in 1999 but have not lodged any 2000 annual return. Funds which only elected to be regulated in 2000 are not included as they may not have any assets to report in their first year of operation.

Approved trustees requirements and ASIC requirements

3. We note that at page 8 of the approved trustee application form that an applicant must have a dealer's licence under the Corporations Law in order to proceed with its application to APRA. It is stated that the basis for this is ASIC advice that all approved trustees are required to hold a dealers licence. Is this advice on the public record such as in a policy practice statement?

You should check **with ASIC.**

Our understanding is that while ASIC sees a dealer's licence as necessary for all trustees, it has allowed exemptions for trustees of non-public offer funds (ie non-approved trustees). The arrangement may change under FSRB.

4. We note that there is some overlap between the approved trustee requirements and the requirements to be a responsible entity under the Managed Investment Act. Has APRA a view on the extent to which there is duplication or inconsistency between the two sets of requirements? Is there scope for reducing duplication such as by 'deeming compliance' with the MIA requirements by applicants seeking to be approved trustees?

Approved Trustees (ATs) are subject to prudential supervision by APRA because they handle members' superannuation funds. To this end, APRA seeks a high standard for ATs and is not prepared to automatically 'deem compliance' for entities meeting MIA requirements.

In practice, however, APRA and ASIC have worked together to minimise regulatory duplication for entities operating under both regimes. A single application kit is available for entities seeking both a dealer's licence from ASIC and an AT approval from APRA. In addition, the Cross Industry Circular No. 1 on Custodian Requirements is a joint product by APRA and ASIC so entities can meet the requirements of both regulators using one set of rules.

5. APRA's list of approved trustees on its website contain a number of trustees approved for small APRA funds. Does APRA apply specific criteria to these trustees? Or are these the same as for trustees of larger funds?

The ATs who are identified as being able to be trustee for small APRA funds all have net tangible assets of $5m in their own right. This reflects APRA's view that the complexities and administration load associated with small APRA funds warrant the strongest asset backing available under SIS. Currently, SIS 'capital' requirements permit, as an alternative to the approved trustee holding $5million in its own right, the use of a custodian with $5m net tangible assets or the holding of an ADI guarantee for $5m by the AT. These alternative arrangements are not considered adequate for an AT to act as trustee of small APRA funds. To restrict this class of ATs from acting as trustees of small APRA funds, APRA has adopted the policy of listing specific funds for which an AT can act as trustee in its Instrument of Approval.

No other specific criteria apply to ATs who can act for small APRA funds; all 'normal' provisions related to all ATs apply to this subset.

Other

6. Has there been any further work done on APRA's review of 'supervisory arrangements' for superannuation as mentioned in its statement to the Senate Committee and submission on p. 11 ?

Work is underway on the review of the various issues mentioned. It is APRA's intention to commence consultation with Treasury and the industry in the near future.

7. A participant, ARISA, expressed concerns about part 1 A of the SIS regs which define annuities and pensions (see attached submission 21). What does APRA see as the purpose of these regulations? Is APRA able to respond to the comments made by ARISA particularly in relation to the impacts on competition of these regulations on pages 3-5 of its submission?

The definitions of annuities and pensions reflect the Government's retirement income policy that is the responsibility of the Commonwealth Treasury. As noted in ARISA's submission, the definitions are also relevant for the Social Security Act and the Income Tax Assessment Act. Any review of what constitute annuities and pensions must involve Treasury, the Department of Family and Community Services, the Tax Department and APRA. APRA only has a role to provide comment on the prudential aspects of these products.

8. In previous email correspondence with Leslie Kelety (see attached email) about the Occupational Superannuation Standards Regulations Application Act, it was stated:

"... **[The Act] does not appear to have any effect on the substantive contents or operation of the Occupational Superannuation Standards Act 1987 or the Occupational Superannuation Standards Regulations 1987, in any of their incarnations.** ... **the purpose of the Occupational Superannuation Standards Regulations Application Act 1992 appears that have been to deal with a particular, obscure legal technicality, and it can safely be ignored for all other purposes."**

Could we use this statement in our report? Also, are there any practical examples which APRA could give as to the circumstances in which this legislation (and the OSS legislation) could be apply to superannuation funds today?

We have reworded the above statement below and agree to its use in the Commission's report:

The *Occupational Superannuation Standards Regulations Application Act 1992* was enacted to resolve a technical legal problem concerning the validity of a 1992 amendment to the Occupational Superannuation Standards Regulations. It does not have any ongoing effect on the substantive contents or operation of the *Occupational Superannuation Standards Act 1987* or the Occupational Superannuation Standards Regulations, both of which ceased to apply to superannuation entities after their 1993-94 year of income.

Please note that the *Occupational Superannuation Standards Act 1987* was renamed on 1 July 1994 as the *Superannuation Entities (Taxation) Act 1987* to impose supervisory levies on superannuation entities. The latter was subsequently renamed the *Superannuation (Excluded Funds) Taxation Act 1987* in July 1998 and again to the *Superannuation (Self Managed Superannuation Funds) Taxation Act 1987* in October 1999. The last imposes supervisory levies on self-managed superannuation funds.