



**Australian Government**

**The Treasury**

# **Joint Standing Committee on Trade and Investment Growth: Inquiry into the prudential regulation of investment in Australia's export industries**

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Submission

30 April 2021



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# 1. INTRODUCTION

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This submission responds to the Chair of the Joint Standing Committee on Trade and Investment Growth's invitation to the Department of the Treasury to provide a submission to the Inquiry into the Prudential Regulation of Investment in Australia's Export Industries.

## Scope of this submission

This submission provides information on the regulatory framework for investments made by authorised deposit-taking institutions (such as banks, building societies and credit unions), and insurance and superannuation institutions. Investments by these entities are ultimately commercial decisions.

# 2. THE REGULATORY FRAMEWORK

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The regulatory framework for investment by authorised deposit-taking institutions, and insurance and superannuation institutions is governed and regulated by a framework of legislation, standards, and regulators.

The financial sector authorities are:

- the Australian Prudential Regulation Authority (APRA), which is responsible for the prudential regulation and supervision of authorised deposit-taking institutions (ADIs), general insurers and reinsurance companies, life insurers, private health insurers, friendly societies and superannuation funds (other than self-managed funds), administration of the Financial Claims Scheme (FCS) and for promotion of financial stability;
- the Australian Securities and Investments Commission (ASIC), which is responsible for the registration and supervision of corporations and, in the financial sector, for licensing of financial service providers, credit providers and for market conduct; and
- the Reserve Bank of Australia (RBA), which is responsible for monetary policy as well as overseeing financial system stability and the payments system.

The Treasury is responsible for providing advice to the Commonwealth Government on that regulatory framework and the stability and efficiency of the financial system.

## 3. AUSTRALIAN PRUDENTIAL REGULATION AUTHORITY

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APRA's mandate is to protect the Australian community by establishing and enforcing prudential standards and practices designed to ensure that, under all reasonable circumstances, the interests of depositors, policyholders and superannuation fund members of the institutions it supervises are protected within a stable, efficient and competitive financial system.

The prudential framework comprises legislation enacted by Parliament and administered by APRA. The prudential standards for banking and insurance may be disallowed by Parliament.

For the banking, insurance and superannuation industries, APRA's regulatory requirements are outlined in its prudential framework. The framework has three pillars:

1. **Prudential Standards:** the prudential standards set out APRA's minimum requirements in relation to capital, governance and risk management. They are legally binding, and APRA-regulated entities must comply with them.
2. **Prudential Practice Guides:** the prudential practice guides provide guidance on APRA's view of sound practice in particular areas. Prudential practice guides frequently discuss legal requirements from legislation, regulations or APRA's prudential standards, but do not themselves create enforceable requirements.
3. **Reporting Standards:** the reporting standards dictate the data that regulated entities must report to APRA and when they must provide it. APRA's reporting standards are legally binding.

The prudential standards cover a broad range of issues including capital and liquidity, governance matters and the management of operational and behavioural risks. They are intended to ensure regulated institutions have the appropriate governance and risk management frameworks, internal controls and financial resilience to mitigate and withstand the risks from their activities. The nature, format and timing of reporting of supervisory information to APRA is defined in APRA's reporting standards.

The banking, insurance and superannuation industries have specific prudential standards, prudential guidelines and reporting standards that apply to them. In addition, APRA has standards and guidelines that apply to multiple industries, such as Prudential Practice Guides on Pandemic Planning and Managing Data Risk, and the Prudential Standard on Risk Management. For example, the Risk Management prudential standard requires an APRA-regulated institution and a Head of a group to have systems for identifying, measuring, evaluating, monitoring, reporting, and controlling or mitigating material risks that may affect its ability, or the ability of the group it heads, to meet its obligations to depositors and/or policyholders.

### 3.1 Authorised Deposit-Taking Institutions

The *Banking Act 1959* provides for the prudential supervision of authorised deposit-taking institutions (ADIs) by APRA through the making of prudential standards and taking other actions to ensure the prudent management of ADIs.

The ADI prudential standards cover capital, including capital adequacy and securitisation; governance; risk management, including liquidity, credit quality and large exposures; and other requirements. For example:

- for capital, APRA requires ADIs to hold capital against their risks. The amount of required capital is broadly proportionate to the risks. For example, loans to companies with a strong credit rating will have a lower capital requirement than loans to companies with a weaker or no credit rating, as the risk of non-payment is lower.
- for risk management, the Credit Quality prudential standard requires an ADI to control credit risk by adopting prudent credit risk management policies and procedures, and the Large Exposures prudential standard requires an ADI to implement prudent measures and to set prudent limits to monitor and control their large exposures and risk concentration.

### 3.2 Insurance

APRA's responsibilities for the prudential regulation and supervision of general, life and health insurers are provided for by the *Insurance Act 1973*, the *Life Insurance Act 1995* and the *Private Health Insurance Act 2015*. The prudential standards determined by APRA under these Acts set minimum requirements for general, life and health insurers operating in Australia. The standards cover capital adequacy, risk management and governance, including insurers' asset and liability management practices, their investment and liquidity strategies, and investment risk.

### 3.3 Superannuation

The requirements imposed on superannuation trustees in relation to their investment decisions are set out in the *Superannuation Industry (Supervision) Act 1993* (SIS Act). APRA and ASIC co-regulate aspects of the SIS Act.<sup>1</sup> However, APRA is the regulator responsible for prudential regulation and investment matters in superannuation, including licensing and supervision of trustees.

The requirements in the SIS Act relating to investment decisions are designed to be agnostic to the type of investment so as not to create a regulatory preference for one asset class over another. Consistent with this, previous Parliamentary inquiries looking at the investment framework for superannuation funds have identified that there are no regulatory barriers to superannuation funds investing in particular types of assets, including investment in export industries.<sup>2</sup>

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<sup>1</sup> From 1 January 2021, legislation has amended the roles and responsibilities of the superannuation regulators, including by expanding ASIC's role as a consumer protection regulator. ASIC's role under the SIS Act has been extended so that ASIC will share administration of certain civil and criminal penalty provisions that have a consumer protection and market integrity element. ASIC will co-regulate these provisions with APRA. The Australian Financial Services Licensing regime (administered by ASIC) has also been expanded to cover all activities undertaken by superannuation trustees.

<sup>2</sup> For example, refer to paragraph 2.1 of the House of Representatives Standing Committee on Agriculture and Water Resources', *Super-charging Australian Agriculture: Inquiry into superannuation fund investment in agriculture*

Where a superannuation trustee selects to invest members' funds is primarily a commercial decision made by the trustee, but must be consistent with the best interests of the beneficiaries of the fund and the trustees must act with the same degree of care, skill and diligence as a prudent superannuation trustee.<sup>3</sup> In addition, trustees are required to determine on an annual basis whether the financial interests of beneficiaries are being promoted having regard to the investment strategy of the fund.<sup>4</sup>

Trustees are also subject to a range of specific obligations in relation to their investment decisions. These are outlined in subsection 52(6) of the SIS Act, which broadly requires the trustee to formulate and review their investment strategy having regard to risk, the composition of investments, liquidity of the investment based on the cash flow needs of the fund, valuation information, the liabilities of the fund, tax considerations and any costs. These obligations are supported by APRA's superannuation prudential standards and prudential practice guides.<sup>5</sup> Importantly, none of the requirements set out in the SIS Act or APRA standards/guidance are asset-type specific but seek to establish a principles-based framework that is equally applicable to all asset types that the trustee may consider investing in.

## 4. AUSTRALIAN SECURITIES AND INVESTMENTS COMMISSION

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ASIC is an independent statutory authority established under the *Australian Securities and Investments Commission Act 2001* (ASIC Act). ASIC has general administration of the Corporations Act, including the provisions in Chapter 6D which govern fundraising by publicly-listed companies. ASIC's role for securities includes: the reviewing of disclosure documents and fundraising activity, seeking to prevent fundraising activity from occurring without appropriate disclosure, providing relief from the law, and enforcement action where there have been serious disclosure failures.<sup>6</sup>

ASIC is also responsible for ensuring that the directors and officers of Australian companies carry out their duties honestly, diligently, and in the best interests of their company. Listed companies must disclose material price sensitive information on a timely basis and comply with listing rules of the relevant market.<sup>7</sup> ASIC can pursue civil penalty proceedings and issue infringement notices for breaches of these obligations.<sup>8</sup>

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<available at: [<sup>3</sup> Sections 52\(2\)\(b\) and \(c\) of the SIS Act.](https://parlinfo.aph.gov.au/parlInfo/download/committees/reportrep/024226/toc_pdf/Super-chargingAustralianAgriculture.pdf;fileType=application%2Fpdf>.</a></p></div><div data-bbox=)

<sup>4</sup> Sections 52(9) and (11) of the SIS Act.

<sup>5</sup> For example, Prudential Standard SPS 530 *Investment Governance* and Prudential Practice Guide SPG 530 *Investment Governance*.

<sup>6</sup> ASIC, August 2020. *Regulatory Guide 254: Offering securities under a disclosure document*. ASIC.

<sup>7</sup> For more information see Chapter 6CA of the Corporations Act.

<sup>8</sup> ASIC, October 2017. *Regulatory Guide 73: Continuous disclosure obligations: Infringement notices*. ASIC.



ASIC regulates compliance with the financial reporting and auditing requirements for entities subject to the Corporations Act. Certain entities must prepare and lodge with ASIC financial reports prepared in accordance with the Corporations Act and generally must also comply with accounting standards. The Corporations Act requires a disclosing entity or registered managed investment scheme to lodge the financial reports within three months after the end of the financial year. All other companies subject to these requirements must lodge their financial reports within four months after the end of the financial year.

## 5. RESERVE BANK OF AUSTRALIA

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The Reserve Bank of Australia's (RBA's) responsibilities include the implementation of monetary policy and promotion of financial stability, as well as regulating payments systems and other financial market infrastructures. Its specific powers and obligations are primarily provided by the *Reserve Bank Act 1959*, the *Payment Systems (Regulation) Act 1998*, the *Payment Systems and Netting Act 1998* and the *Corporations Act 2001*. The Statement on the Conduct of Monetary Policy issued by the Treasurer and the RBA Governor articulates key aspects of Australia's monetary and central banking policy framework.

The RBA does not regulate or issue regulatory guidance to banks, insurers, superannuation institutions or publicly-listed companies, except to the extent they operate a designated payment system or other financial market infrastructure.