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No. 11 2002–03

Financial Sector Legislation Amendment Bill
(No. 2) 2002

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I N F O R M A T I O N A N D R E S E A R C H S E R V I C E S

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No. 11 2002–03

Financial Sector Legislation Amendment Bill (No. 2) 2002

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Law and Bills Digest Group
21 August 2002

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Financial Sector Legislation Amendment Bill (No. 2) 2002

Date Introduced: 26 June 2002

House: House of Representatives

Portfolio: Treasury

Commencement: The majority of the amendments commence on either the day of royal assent or the day after royal assent. The amendments to the *Banking Act 1959* commence on the day after royal assent

Purpose

The purpose of this Bill is to amend seven Acts that affect the operation of the financial services sector.

Background

As this Bill has no central theme the background to the various measures is included in the discussion of the main provisions

Main Provisions

Australian Securities and Investments Commission Act 2001

Schedule 1 of the Bill contains four minor technical amendments to the *Australian Securities and Investments Commission Act 2001*. These amendments do not raise any policy issues.

Banking Act 1959

Schedule 2 to the Bill amends the *Banking Act 1959*. The Banking Act sets out principles for the regulation of bodies corporate that carry on banking business in Australia. The Act

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was significantly amended with the changes taking effect in 1998 to implement the recommendations made by the Wallis Financial System Inquiry. The Act determines that the Australian Prudential Regulation Authority (APRA) is the prudential regulatory supervisor for the banks.

Under the post Wallis legislative regime, an entity may only conduct a banking business if the entity has been granted an authority by APRA under section 9 of the Act.¹ The Act also provides for the regulation of non-operating holding companies (NOHC) that head conglomerate groups where an Authorised Deposit-Taking Institution (ADI)² is a member. Under section 11AA of the Act, the NOHC may apply to APRA for “authority” to be a non-operating holding company. APRA may revoke authority to carry on banking business (section 9A) or authority to be a NOHC (section 11AB) in the circumstances set out under the Act.

APRA makes prudential standards to regulate the conduct of ADI’s and NOHC’s (Part II Division 1A) and enforces compliance with the standards and other requirements under the Act (Part II Divisions 1BA). Failure to comply with the prudential standard is not an offence, however APRA may issue a direction under section 11CA of the Act. Failure to comply with the direction can result in a revocation of the section 9 or section 11AA authority.

The Act also currently imposes obligations on auditors of ADI’s and NOHC’s and their subsidiaries to supply information to APRA to assist in the performance of its prudential regulatory function (Part II Division 2A).

In 1997, the Basel Committee on Banking Supervision issued its *Core Principles for Effective Banking Supervision*³ and in 1999 released the *Core Principles Methodology*⁴ for use by countries in assessing compliance with the Core Principles. Following this, APRA released *Core Principles for Effective Banking Supervision - Self Assessment for Australia - Information Paper*⁵ in April 2001 which contained its assessment of Australia’s banking supervisory arrangements, including the way that it regulates conglomerates and fit and proper person requirements for bank directors and management. Whilst it was generally concluded that Australia’s system of banking supervision is strong and ranks well against international standards, the paper contained some recommendations for change to bring Australia’s banking supervisory arrangements on a par with the Basel Committee’s Principles. APRA has also refined its approach to the regulation of conglomerate groups containing ADI’s in two policy discussion papers *Policy Framework for the Prudential Supervision of Conglomerate Groups Containing Authorised Deposit-taking Institutions (April 2000)*⁶ and *Capital Adequacy and Exposure Limits for Conglomerate Groups Including ADI’s (October 2001)*.⁷

This Bill gives effect to some of APRA’s recommendations regarding Australia’s compliance with the Basel Committee’s principles and it also implements part of APRA’s policy position on the regulation of conglomerates. The changes that are proposed include:

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- Extending APRA's supervisory powers over conglomerates that have an ADI as one of its members,
- Increasing the level of auditor reporting to APRA,
- Including fit and proper person requirements for ADI and NOHC directors, and senior managers and fit and proper requirements for company auditors. This new requirement includes an appeals regime, and
- Placing a requirement on ADI's, NOHC's and their subsidiaries to notify APRA of a breach of the prudential requirements, the Act, and other matters that affect its financial stability or that of the conglomerate group.

Extension of APRA's prudential powers for surveillance of conglomerates

This Bill gives effect to the policy of extending APRA's regulatory powers so that it can monitor and supervise companies that are associated with ADI's. These measures will assist in limiting the "contagion effect" where the circumstances of one company within a conglomerate can adversely affect other parts of the conglomerate (such as an ADI). This proposal has been the subject of extensive public comment and will improve overall oversight of banks.

Prudential matters

Item 1 of the Bill amends the definition of "prudential matters" to include a relevant group of bodies corporate. **Items 2 and 4** of the Bill define a relevant group of bodies corporate to mean the subsidiaries of the ADI or NOHC. The effect of this is to extend APRA's regulatory power to subsidiaries of ADI's and NOHC's.

APRA's power to give directions

As noted above, the Act gives APRA power to make prudential standards for ADI's and NOHC's and it may issue a direction to an ADI or NOHC to perform a function where for example it is in breach of the prudential requirements. **Item 7** of the Bill gives APRA the power to set standards imposing prudential requirements upon subsidiaries of the ADI or NOHC. **Item 8** of the Bill gives APRA the power to direct a subsidiary of an ADI or NOHC to undertake certain activities to ensure that the subsidiary complies with the prudential standards or behaves in a way that is in the interest of depositors. These amendments give effect to the policy of giving APRA power to regulate companies that are associated with ADI's.

Item 9 – 12 ensures that the associated subsidiary is able to perform that Act as per APRA's direction despite the subsidiary's constitution or other legal arrangements.

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APRA's powers of investigation

The Act currently vests APRA with power to investigate ADI's, NOHC's and their subsidiaries. **Item 19** of the Bill extends APRA's powers of investigation so that where an ADI is a subsidiary of a foreign corporation and that foreign corporation has other subsidiaries either operating in Australia (relevant foreign incorporated subsidiary) or incorporated in Australia (relevant Australian incorporated subsidiary), APRA may investigate those subsidiaries.

Supplying information to APRA

The Act also currently vests APRA with the power to seek information from ADI's and NOHC's. **Item 20** amends the Act so that APRA can seek information from any member of the conglomerate about the operations of any other member of the conglomerate. This includes information from relevant foreign incorporated subsidiaries and relevant Australian incorporated subsidiaries.

Auditor reporting to APRA

APRA's power to obtain information from company auditors is extended under **items 13-16** of the Bill.

APRA currently has the power to ask an auditor of an ADI, NOHC or their subsidiaries to give APRA information where it would assist APRA in performing its functions under section 16B of the Act. Under **item 13**, this power to obtain information is extended to auditors of relevant Australian incorporated subsidiaries and relevant foreign incorporated subsidiaries.

Under the Act, auditors of ADI's, NOHC's and their subsidiaries are required to give certain information to APRA in certain situations, such as information that an ADI is insolvent or is becoming insolvent. Failure to pass this information onto APRA is an offence. **Item 15** of the Bill extends this power so that auditors of relevant Australian incorporated subsidiaries and relevant foreign incorporated subsidiaries will be required to give certain information to APRA, such as that the subsidiary is insolvent or is becoming insolvent.

The Bill also provides in **item 16** that auditors of relevant Australian incorporated subsidiaries or relevant foreign incorporated subsidiaries may provide information about the company to APRA if the auditor considers that it will assist APRA in the performance of its functions. Where an auditor provides this information, they will not be liable to any person if this is done in good faith and without negligence (**item 26**).

Fit and proper person requirements for company auditors, directors and managers

In accordance with the Basel Committee's principles for effective prudential supervision of banks, this Bill imposes fit and proper person requirements on directors and senior managers of ADI's, NOHC's and senior managers of foreign ADIs. It also places fit and

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proper person requirements on auditors of ADI's. Under the *Insurance Act 1973* (Insurance Act), general insurer auditors are required to comply with fit and proper person requirements (Part IV Division 1). This new obligation for ADI auditors ensures that they are required to comply with the same standards as auditors of general insurers.

"fit and proper" requirements for company auditors

The Bill contains a new governance regime putting in place "fit and proper person" requirements for auditors of ADI's.

Item 17 of the Bill places "fit and proper" person requirements upon ADI auditors. If an auditor does not meet these standards, APRA has the power to remove the auditor. Before the auditor is removed, both the auditor and the company has the opportunity to make submissions to APRA. APRA is given the power to discuss these submissions with any person appropriate to assess the matter. APRA must ensure persons making the submission know it may discuss the contents of its submission with another party. APRA is not required to supply the auditor with a statement of reasons.

APRA's decision to remove an auditor is subject to internal review and is also appealable to the Administrative Appeals Tribunal (AAT) (the appeal regime is established by **item 18**).

If APRA decides to remove a person, it may refer details of its action to the Companies Auditors and Liquidators Disciplinary Board and the appropriate professional association (**item 17**).

"fit and proper" requirements for directors and senior managers

The Bill contains a new governance regime putting in place "fit and proper person" requirements for persons who are directors or who hold senior management positions with ADI's and NOHC's.

This is facilitated by providing that a person cannot hold the position of director or senior manager of an ADI, NOHC or the Australian operations of a foreign ADI if they are a disqualified person. A person becomes a disqualified person if they fall within one of the categories under **proposed section 20** including:

- The person has been convicted of an offence under the *Banking Act 1959* or the *Corporations Act 2001*
- The person has been convicted of an offence under a law in force in Australia or a foreign country that relates to dishonest conduct
- The person has become a bankrupt
- The person has been disqualified under a foreign law from managing or taking part in the management of a banking, insurance or other financial business, and

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- APRA has determined that the person is disqualified under **proposed section 21**.

APRA is vested with the power to declare that a person is not a disqualified person if it considers that the person is highly unlikely to be a prudential risk to an ADI or authorised NOHC (**proposed section 22**).

APRA has the power to remove a director or senior manager if they are disqualified or they do not meet the prudential “fit and proper” standards (**proposed section 23**).

APRA’s decision is subject both to internal review and is appealable to the AAT. APRA is not required to supply the person with a statement of reasons if they determine that they are disqualified.

Reconsideration and Review of decisions

As noted above, APRA’s decision to remove auditors, disqualify directors and senior managers, make a determination that a person is not a disqualified person and remove directors or senior managers of ADI’s and NOHC’s is subject to internal review by APRA and review by the (AAT). The review regime is established by **item 18**.

Under the internal review process, APRA is required to consider the decision and may confirm, revoke or vary the decision. If APRA makes this decision within the 21 day time period they are required to tell the person the result of APRA’s consideration, set out findings on material questions of fact, refer to the evidence or other material on which the findings were based and give APRA’s reasons for the decision.

If APRA does not do this within 21 days, APRA is taken to have confirmed the decision. Interestingly, in these circumstances, APRA is not required to report confirmation of the matter to the appellant.

Notification to APRA

The bill also places a new obligation on ADI’s, NOHC’s and other members of the conglomerate group to notify APRA if it or another member of the group is not in a sound financial position, has breached their legal obligations (such as breached the Act or regulations) or has breached a prudential standard **item 24**.

Item 25 of the Bill seeks to ensure the constitutional validity of the amendment giving APRA powers over subsidiaries of foreign corporations by invoking the corporations power and the banking power.

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Other general amendments

Revocation of authority to carry on banking business and authority to be a non operating holding company

Items 5 and 6 of the Bill amends APRA's powers to revoke the authority to carry on banking business or be a NOHC. This amendment extends APRA's powers so that it may revoke the authority if the body corporate supplied it with false or misleading information in the course of applying for the authority.

Corporations Act 2001

Schedule 3 contains amendments to the *Corporations Act 2001*. The amendments to the Corporations Act that are contained within this Bill are minor technical amendments. They correct drafting errors and clarify ambiguity in the meaning of two of the provisions in the Corporations Act as amended by the *Corporations Law Economic Reform Program Act 1999*. These amendments do not raise any policy issues.

The corrections to many of the drafting errors are self explanatory and the explanatory memorandum offers further clarification where needed.

The Corporations Act contains the Small Business Guide which "summarises the main rules in the Corporations Act that apply to proprietary companies limited by shares – the most common type of company used by small business.

A number of typographical errors in this guide are amended and the Bill also confirms the legal requirement that a company, other than a proprietary company must have a company secretary. A proprietary company may choose to have a company secretary.

Corporations (Repeals, Consequential and Transitional) Act 2001

Schedule 4 contains three items that correct typographical errors in the *Corporations (Repeals, Consequential and Transitional) Act 2001*. The amendments do not raise any issues.

Insurance Act 1973

Schedule 5 amends the Insurance Act.

Penalty provisions

General insurers and non operating holding companies must be bodies corporate under the Insurance Act. The penalty provisions in the Insurance Act have been specified as if the person committing the offence was a person rather than a body corporate. **Item 1 – 10**,

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12-15, 17-30 amend the Insurance Act so that the penalty provisions appropriately apply to bodies corporate rather than persons.

Amendments to the “fit and proper” person requirements

Under the Insurance Act, APRA may remove a director or senior manager from a general insurer or a non operating holding company. Submissions from the company or the affected person may be made to APRA. **Item 11** of the Bill amends the Act to provide that APRA may discuss the contents of the submission with persons that it considers appropriate. APRA must make the persons aware that any submission that are made may be discussed by APRA with other persons.

APRA notification

The Bill, in **item 16 of schedule 5** also imposes the requirement on general insurers, NOHC’s and their subsidiaries to notify APRA if there has been a breach of the prudential standards or a matter affects its financial position.

Superannuation Industry (Supervision) Act 1993 and the Superannuation (Resolution of Complaints) Act 1993

Arbitration power consequential amendments

Schedules 6 and 7 amend the *Superannuation Industry (Supervision) Act 1993* (SISA) and the *Superannuation (Resolution of Complaints) Act 1993* (SRCA).

The Federal Court in *Wilkinson and Others v Clerical Administrative and Related Employees Superannuation Pty Ltd and Others*⁸ held that the review powers of the Superannuation Complaints Tribunal were invalid. As a result of this decision, the SRCA was amended to give the Tribunal the power to arbitrate over matters that were previously reviewed by the Tribunal.

The Commonwealth subsequently appealed the Federal Court’s decision and in *Attorney-General of the Commonwealth v Breckler*,⁹ the High Court held that the Tribunal’s review powers were valid.

The provisions in the SRCA that gave the Tribunal its arbitration powers, ceased to have effect by Proclamation on 13 September 1999.

This Bill amends the SISA to ensure that awards made by arbitration of the Superannuation Complaints Tribunal remain in force even though the arbitration powers of the Tribunal have now been removed.

The SRCA contains a number of references to the arbitration power of the Tribunal and this Bill removes those obsolete references.

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Disability complaints

Proposed item 12 of Schedule 7 of the Bill gives the Tribunal the discretion to hear disability complaints that would otherwise be precluded from being heard by the Tribunal because they fall outside the one year time frame for the hearing of complaints.

Requirement to attend a conciliation conference

Currently the Tribunal has the power to ask a person to attend a conciliation conference however if the person does not attend the conference, there is no sanction. This Bill (**in proposed item 13 of Schedule 7**) amends the Act making it an offence if a person does not attend the conference. A maximum penalty of 30 penalty units or imprisonment for 6 months will apply to a person who has failed to attend the conference.

Other amendments

The Bill also contains some minor amendments to give the Tribunal some further flexibility in its day to day operations.

Concluding Comments

The substantive amendments made by the Bill are to the *Banking Act 1959*. The amendments extend APRA's regulatory powers and are designed to improve the prudential regulation of the banks so that they more closely comply with the Basel Committees Principles.

The other amendments contained within the Bill are minor amendments that do not raise any significant policy issues.

Endnotes

- 1 Entities that have been granted such authority are referred to as authorised deposit taking institutions.
- 2 Banks, building societies and credit unions are examples of ADI's.
- 3 *Core Principles for Effective Banking Supervision, Basel Committee on Banking Supervision, Basel, September 1997* <http://www.bis.org/publ>.
- 4 *Core Principles Methodology, Basel Committee on Banking Supervision, Basel, October 1999.* <http://www.bis.org/publ>.

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- 5 *Core Principles for Effective Banking Supervision – Self Assessment for Australia – Information Paper, Information Paper April 2001*, Australian Prudential Regulation Authority. <http://www.apra.gov.au/policy>.
- 6 *Policy Framework for the Prudential Supervision of Conglomerate Groups Containing Authorised Deposit Taking Institutions, Policy Information Paper April 2000*, Australian Prudential Regulation Authority. <http://www.apra.gov.au/policy>.
- 7 *Capital Adequacy and Exposure Limits for Conglomerate Groups Including ADI's, Discussion Paper October 2001*, Australian Prudential Regulation Authority. <http://www.apra.gov.au/policy>.
- 8 (1998) 79 FCR 469.
- 9 (1999) 197 CLR 83.

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