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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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Australian Prudential Regulation Authority Amendment
Bill 2003

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13 June 2003

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Australian Prudential Regulation Authority Amendment Bill 2003

Date Introduced: 5 June 2003

House: House of Representatives

Portfolio: Treasury

Commencement: The main schedules 1 to 3 commence on a day to be fixed by Proclamation.

Purpose

The main purpose of the Bill is to change the leadership and governance of the Australian Prudential Regulation Authority arising from the recommendations contained in the report of the HIH Royal Commission.

Background

Australian Prudential Regulation Authority (APRA)

APRA was established on 1 July 1998. APRA is responsible for the prudential regulation of banks, life insurers, general insurers, building societies, credit unions, friendly societies and superannuation. APRA is fully funded by the industries that it supervises. APRA's responsibilities cover about 85% of the assets in Australia's financial system. APRA sets and monitors compliance with standards, including capital requirements, for the prudential management of banks and other deposit takers, insurance companies and friendly societies. In superannuation matters, APRA aims to ensure that trustees are aware of their obligations to members and that the trustees manage the funds prudently.¹

The establishment of APRA was one of the responses to the report² of the *Financial System Inquiry* (referred to as the Wallis Inquiry) which was established by the Coalition Government in June 1996. The Wallis Inquiry recommended a single Commonwealth stand-alone prudential regulator of the Australian financial sector (Recommendation 31). The Wallis Inquiry report included the following argument for a single prudential regulator:

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One motivation for recommending a single prudential regulator is to provide greater flexibility, responsiveness and efficiency in the face of potentially major changes in the financial landscape.³

On 2 September 1997, the Treasurer, the Hon Peter Costello MP, made a Ministerial Statement to Parliament about the reform of the Australian financial system. In that statement, the Treasurer said of the then proposed APRA:

The operational effectiveness of the depositor protection provisions will be strengthened, by providing powers for early intervention in a financially troubled institution and by making it clear that the regulator can wind up an insolvent entity. The APRA will also be given enhanced powers to take action in the case of financial difficulties experienced by life and general insurance companies, and insurance funds.⁴

When delivering his Second Reading speech on the APRA Bill 1998, the Treasurer said that the package of Bills that followed from the Wallis Inquiry would see Australia become a world leader with best practice and leading edge financial sector regulation.⁵ One important feature of the APRA Bill 1998 was its board structure. In his Second Reading speech, the Treasurer stated:

APRA will be governed by a nine member board, whose terms and conditions of appointment will be subject to determination by the Remuneration Tribunal. To ensure that there is a close relationship between APRA, the Reserve Bank and ASIC, two of APRA's board members will come from the Reserve Bank and one from ASIC.

The bill provides for the duties and statutory appointment of the Chief Executive Officer who will also be an APRA board member.⁶

The then Deputy Leader of the Opposition, the Hon Gareth Evans, MP, speaking in the Second Reading debate of the APRA Bill 1998 said:

The new model of a single prudential regulator and a single market regulator, when it is finally fully implemented, will overcome a couple of fairly obvious weaknesses with the current arrangements. One is the split between the Commonwealth and state and territory regulator rules, with the Commonwealth hitherto being pretty much confined to banks and insurance but with the state and territory rules applying to building societies and credit unions, with differing restrictions and differing cost recovery regimes impacting on the competition potential between these two various institutions.⁷

Senator Murray of the Australian Democrats, in the Second Reading debate in the Senate on the APRA Bill 1998 (and related Bills), said:

Much of the legislation before us is about reorganising the institutions for regulation so that there is consistency across organisations providing similar services as the roles of the different parts of the financial industry merge and blur. The Australian

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Democrats do not have major problems with the model which Wallis legislation puts forward for the newest institutions and which in large part the government has now adopted.⁸

Taken overall, there was broad support for the Wallis Inquiry reforms to the regulation of the Australian financial sector implemented in 1998.

The failure of HIH Insurance and the Royal Commission

The major companies in the HIH Insurance Group (HIH) were placed in provisional liquidation on 15 March 2001. The collapse of HIH is likely to be the largest corporate failure in Australia to date. The losses and hardship inflicted on the Australian community by this corporate failure have been significant and have been a major contributing factor to the current insurance crisis. The liquidation process could take up to ten years and the financial return to creditors is expected to be negligible.⁹

The Australian community had an expectation that corporate regulation, audit and good corporate governance should have triggered early warnings of any looming crisis. Public confidence has been shaken.

The subsequent suspicions about a serious level of corporate mismanagement within HIH saw the appointment of a Royal Commission in August 2001.¹⁰ The Royal Commission's report was publicly released on 16 April 2003.¹¹

The Royal Commission found that although APRA did not cause or contribute to HIH's collapse, APRA did not recognise the seriousness of the situation or question the reliability of the information it was receiving from HIH until too late.

A significant recommendation of the Royal Commission was an overhaul of APRA, including the replacement of its non-executive board with an executive group (Recommendation 18).¹² At present, the board of APRA is comprised of largely part-time non-executive members appointed by the Treasurer. These board members have expertise in the various industries regulated by APRA. The board also includes a representative from ASIC and two from the Reserve Bank of Australia who are appointed by their respective agency heads. Taken overall, this is referred to as a non-executive board. It is also a governing board which can determine the duties of the CEO of APRA (see section 36 of the *APRA Act*). The CEO is answerable to both the board and the Minister. Another option that could have been considered for APRA was for those persons with industry expertise to be an advisory group. The Royal Commission's preference was for the regulatory agency to be the responsibility of a small full-time executive group directly answerable to the government and with the power to appoint advisory panels.¹³

Subsequent media commentary included the comment that the Wallis Inquiry approach of 'light touch' regulation was wrong.¹⁴ The same commentary supported the view that

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APRA has to re-establish public confidence and that involves a necessary change of guard.¹⁵

APRA's Response to the Findings of the Royal Commission

At the Senate Estimates hearing on 4 June 2003, APRA made an opening statement which commented on the findings of the Royal Commission into the collapse of HIH. Those comments included the following:

The commission found that APRA was not as quick or aggressive as it should have been to detect and respond to the weaknesses of HIH's financial position. Misjudgments were made and we conceded these points publicly soon after the event. Significantly, Mr Justice Owen found that APRA did not cause or contribute to the collapse of HIH, nor could it have taken steps to prevent the failure of the company. He concluded that APRA's regulation of HIH from September 2000 was inadequate, but it is now clear that intervention at that stage would not have prevented the company from failing.

The commission also acknowledged that, in part, APRA's shortcomings arose from the fact that the agency was still in its establishment phase, with relatively inexperienced staff and underdeveloped internal processes, following implementation of the Wallis reforms. When the first signs of HIH's problems began to emerge in mid-2000, APRA was effectively only nine months old. This does not detract from the report's criticism of APRA but it is important to recognise that these are mostly historical, relating to events of more than two years ago. They are not criticisms of APRA now.¹⁶

Consequences of Non-Passage of the Bill

The consequences of the collapse of the HIH Insurance group will be felt in Australia for many years to come. It is understandable that APRA has commented that it has evolved and enhanced its regulatory approach. The overriding priority for government, however, is to restore public confidence. The implementation of the Royal Commission's recommendations for a major overhaul of APRA is preferable to maintaining the existing governance structure of APRA. If the Bill is not passed, APRA can continue to function but under a non-executive board structure that was considered inappropriate by the Royal Commission.

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Main Provisions

Schedule 1—Amendment of the *Australian Prudential Regulation Authority Act 1998*

The first of four main objectives of the Bill is to replace APRA's current board with an executive group. Section 3 of the *Australian Prudential Regulation Authority Act 1998* (*APRA Act*) contains definitions that define membership of the existing APRA board, including representatives of ASIC and the Reserve Bank (see also section 19 which specifies the composition of the board). **Items 1–7, 9, 11 and 12** repeal definitions, such as ASIC and Reserve Bank representative members, and insert changes that reflect the proposed new executive group for APRA. A Deputy Chair position is also created.

Items 8 and 10 move two definitions currently within section 56 of Part 6 of the *APRA Act* to section 3 (general definitions) to allow additional use throughout the legislation. 'Part 6—Secrecy' of the *APRA Act* contains sections 56 and 57 and deals with protected documents and protected information. (See related later items, **Items 30–31**, as well).

Items 14 and 15 clarify the conventional distinction that usually applies in terms of the responsibility for the development of legislative policy (a Ministerial responsibility) and the administration of the law (the responsibility of a regulatory agency, subject to its statutory functions and powers).

Item 16 is an important amendment. The existing section 10 in the *APRA Act* simply obliges APRA to inform the Treasurer as soon as practical that a body regulated by APRA is in financial difficulty. The new section 10 inserted by **Item 16** expands the obligation considerably to include advising the Minister on a much broader range of matters, including the Minister's functions and powers. **Item 16** also inserts a **new section 10A**. This section incorporates recommendations of the Royal Commission (e.g. Recommendation 39) that promotes the objective of wider liaison and exchange of information by APRA with other regulatory agencies, subject to the existing confidentiality requirements in the *APRA Act*. Regulations will also be made to list other relevant agencies that APRA should consult.

[In later items, such as **Items 27–29**, the title of 'Treasurer' in the *APRA Act* is changed to 'Minister'. This is just a drafting update. The new sections and Parts inserted by this Bill use the reference 'Minister'.]

Item 17 makes a significant change to the *APRA Act*. Section 12 of the existing statute sets out a process to preserve the independence of APRA in terms of the Government's view as to how APRA may best perform its functions and powers. Where a disagreement takes place, the matter is referred to the Governor-General in Council for determination. **Item 17** inserts a **new section 12** that centralises directions with the Minister. APRA's independence is maintained by precluding the Minister from issuing directions to APRA about a particular case. The Minister must also gazette any direction and table the direction in Parliament.

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Item 20 repeals the existing 'Part 3—APRA's Board' of the *APRA Act* and inserts a revised 'Part 3—APRA membership and other corporate matters'. This is one of the key recommendations of the Royal Commission and it provides for the replacement of the non-executive board structure with an executive group. Under the new arrangements, members of APRA will be appointed by the Governor-General. The Governor-General will also appoint the Chair and Deputy Chair. The term of appointment for a member must not exceed 5 years. The Minister may make acting appointments. Part 3 also specifies the quorum requirements, voting and the conduct of meetings of APRA.

Items 21 to 25 amend 'Part 4—The CEO and APRA staff members' of the *APRA Act* to remove the statutory office of CEO and to remove references to the board. The new Part 4 will be headed 'APRA staff members'.

Item 26 inserts a new 'Part 4A—Disclosure of interests of APRA members, APRA staff members and delegates'. The new Part 4A creates a standing obligation on APRA members, staff and delegates to disclose any matter that could conflict with the performance of their duties. Disclosure is made to the Minister.

Item 40 provides an additional head for disclosure of protected information in 'Part 6—Secrecy' of the *APRA Act*. The purpose of Part 6 is to enable APRA to determine whether information provided to it is protected information and whether that information may be disclosed to other parties. This amendment enables other agencies that are provided with information by APRA to further disclose that information if disclosure is consistent with the same purpose.

Item 44 will enhance APRA's authority to make public statements about regulatory action.

Schedule 2—Amendments of other Acts

Items 1 to 23 make consequential amendments to a range of other Acts to reflect the significant statutory changes to APRA (e.g. replacement of the board and statutory CEO).

Schedule 3—Transitional provisions

Items 1 to 8 are necessary transitional provisions to protect the validity of rights, liabilities and obligations that have arisen under the corporate activities of APRA when it had a board and statutory CEO, so that those matters continue under the new corporate governance structure contained in this Bill.

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Concluding Comments

The searing financial regulatory lessons that have been experienced with the HIH Insurance collapse are, at least, an alert to the importance of APRA's role in the financial sector. Apart from the problems of the insurance industry, measures that will improve prudential supervision are also important in the areas of financial institutions and particularly for the superannuation sector. Although the Royal Commission found that APRA was not to blame for the collapse of HIH, a major overhaul of APRA governance structure is, hopefully, a further step towards creating a regulatory environment that can monitor the financial sector more closely and react quickly when there are indications of concerns about the reliability of information or tardiness in filing returns.

Endnotes

- 1 Drawn from APRA's information brochure, *APRA: Australia's prudential financial regulator*, available on www.apra.gov.au.
- 2 Stan Wallis, *Financial System Inquiry Final Report*, Australian Government Publishing Service, March 1997.
- 3 *ibid.*, p. 318.
- 4 Ministerial Statement, 'Reform of the Australian Financial System', The Hon Peter Costello MP, the Treasurer, House of Representatives, *Debates*, 2 September 1997, p. 7518.
- 5 Australian Prudential Regulation Authority Bill 1998, Second Reading Speech, The Hon Peter Costello MP, Treasurer, House of Representatives, *Debates*, 26 March 1998, p. 1649.
- 6 *ibid.*, p. 1650.
- 7 Australian Prudential Regulation Authority Bill 1998, Second Reading Speech, The Hon Gareth Evans MP, Deputy Leader of the Opposition, House of Representatives, *Debates*, 8 April 1998, p. 2761.
- 8 Australian Prudential Regulation Authority Bill 1998, Senator Andrew Murray, Second Reading Speech, Senate, *Debates*, 28 May 1998, p. 3332.
- 9 Juan-Carlo Thomas, 'The shattered lives behind an insurance catastrophe', *Sydney Morning Herald*, 17 April 2003. One estimate of the possible recovery is 20 cents in every dollar. Marcus Priest 'HIH creditors may recover 20pc', *Australian Financial Review*, 28 April 2003.
- 10 The Royal Commissioner, Hon. Justice Neville John Owen, was appointed to inquire into the reasons for and the circumstances surrounding the failure of HIH prior to the appointment of the provisional liquidators.
- 11 'Report of the HIH Royal Commission', *Media release*, The Hon. Peter Costello, MP, Treasurer, no. 2003/020 of 16 April 2003.

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- 12 The HIH Royal Commission, *The Failure of HIH Insurance*, Volume 1, April 2003, p. lxix and p. 209. A very brief summary of the HIH Royal Commission is found in, Brendan Bailey, 'Report of the Royal Commission into HIH Insurance', [Research Note No. 32, 2002-03](#), Department of the Parliamentary Library, 13 May 2003.
- 13 *ibid.*, pp. 208–209.
- 14 Andrew Main, 'Necessary change of guard', *Australian Financial Review*, 7 June 2003.
- 15 *ibid.*
- 16 Consideration of Budget Estimates, Economics Legislation Committee, Senate, *Hansard*, 4 June 2003, pp. E343–E344 (*Proof*).

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