



COMMONWEALTH OF AUSTRALIA

# Official Committee Hansard

## **SENATE**

ECONOMICS LEGISLATION COMMITTEE

ESTIMATES

**(Budget Estimates)**

WEDNESDAY, 31 MAY 2006

CANBERRA

BY AUTHORITY OF THE SENATE



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**SENATE**  
**ECONOMICS LEGISLATION COMMITTEE**  
**Wednesday, 31 May 2006**

**Members:** Senator Brandis (*Chair*), Senator Stephens (*Deputy Chair*), Senators Chapman, Murray, Watson and Webber

**Senators in attendance:** Senators Boswell, Brandis, Chapman, Conroy, Ludwig, Murray, Parry, Sherry, Watson and Wong

**Committee met at 9.03 am**

**TREASURY PORTFOLIO**

Consideration resumed from 30 May 2006

**In Attendance**

Senator Minchin, Minister for Finance and Administration

Senator Coonan, Minister for Communications, Information Technology and the Arts

**Department of the Treasury**

Dr Ken Henry, Secretary

**Outcome 1: Sound Macroeconomic Environment**

**Output Group 1.1: Macroeconomic Group**

Dr Martin Parkinson, Executive Director

Mr David Parker, Alternate Executive Director

Dr David Gruen, Chief Adviser (Domestic)

Mr David Pearl, General Manager, International Economy Division

Mr David Turvey, Manager, International Economy Division

Mr Nathan Dal Bon, Manager, International Economy Division

Dr Steven Kennedy, General Manager, Domestic Economy Division

Mr Jason Allford, A/Principal Adviser (Forecasting)

Ms Angelia Grant, Domestic Economy Division

Mr Graeme Davis, Manager, Macroeconomic Policy Division

Mr Paul O'Mara, General Manager, Macroeconomic Policy Division

Mr Greg Coombs, Macroeconomic Policy Division

Mr Russell Campbell, Manager, Macroeconomic Policy Division

**Outcome 2: Effective Government Spending Arrangements**

**Output Group 2.1: Fiscal Group**

Mr David Tune, Executive Director

Mr David Martine, General Manager, Budget Policy Division

Mr Jason McDonald, Manager, Budget Policy Division

Mr Rob Heferen, General Manager, Social Policy Division

Mr Peter Robinson, Principal Adviser, Social Policy Division

Mr Michael Willcock, General Manager, Commonwealth-State Relations Division

Ms Maryanne Mrakovcic, General Manager, Industry, Environment and Defence Division  
Mr Frank Di Giorgio, Specialist Adviser, Industry, Environment and Defence Division  
Mr Ian Robinson, General Manager, Corporate Services Division

**Outcome 3: Effective Taxation and Retirement Income Arrangements**

**Output Group 3.1: Revenue Group**

Mr Mike Callaghan, Executive Director  
Mr Paul McCullough, General Manager, Tax System Review Division  
Mr John Lonsdale, General Manager, Superannuation, Retirement and Savings Division  
Mr Trevor Thomas, Principal Adviser, Superannuation, Retirement and Savings Division  
Mr Patrick Boneham, Senior Adviser, Superannuation, Retirement and Savings Division  
Mr Mark O'Connor, General Manager, Individuals and Exempt Tax Division  
Ms Marisa Purvis-Smith, Manager, Individuals and Exempt Tax Division  
Mr Nigel Ray, General Manager, Tax Analysis Division  
Mr Phil Gallagher, Manager, Tax Analysis Division  
Mr Colin Brown, Manager, Tax Analysis Division  
Mr Peter Greagg, Manager, Tax Analysis Division  
Mr Colin Johnson, General Manager, Business Tax Division  
Mr Mike Rawstron, General Manager, International Tax and Treaties Division  
Ms Jo Laduzko, Manager, International Tax and Treaties Division  
Mr Hadyn Daw, Manager, International Tax and Treaties Division  
Mr Bruce Paine, General Manager, Board of Taxation

**Outcome 4: Well Functioning Markets**

**Output Group 4.1: Markets Group**

Mr Jim Murphy, Executive Director  
Mr Gerry Antioch, General Manager, Foreign Investment and Trade Policy Division  
Mr Ian Beckett, Manager, Foreign Investment and Trade Policy Division  
Mr Chris Legg, General Manager, Financial System Division  
Ms Vicki Wilkinson, Manager, Financial System Division  
Mr Damien White, Manager, Financial System Division  
Mr Trevor King, Manager, Financial System Division  
Mr Andre Moore, Manager, Financial System Division  
Ms Kerstin Wijeyewardene, Manager, Financial System Division  
Mr Geoff Miller, General Manager, Corporations and Financial Services Division  
Mr Andrew Sellars, Senior Adviser, Corporations and Financial Services Division  
Mr Matt Brine, Manager, Corporations and Financial Services Division  
Mr David Love, Manager, Corporations and Financial Services Division  
Ms Ruth Smith, Manager, Corporations and Financial Services Division  
Mr Bede Fraser, Manager, Corporations and Financial Services Division  
Mr Jorge del Busto, Senior Adviser, Corporations and Financial Services Division  
Mr Steve French, General Manager, Competition and Consumer Policy Division  
Ms HK Holdaway, Manager, Competition and Consumer Policy Division  
Ms Sandra Patch, Senior Adviser, Competition and Consumer Policy Division  
Ms Louise Seeber, Senior Adviser, Competition and Consumer Policy Division  
Mr Aidan Storer, Senior Adviser Competition and Consumer Policy Division

Mr David Hall, Manager, Competition and Consumer Policy Division  
Mr Brad Archer, Manager, Competition and Consumer Policy Division  
Mr Peter McCray, General Manager, Financial Literacy Foundation  
Mr Grahame Crough, Manager, Financial Literacy Foundation  
Mr John Riley, Financial Literacy Foundation  
Mr Peter Martin, Australian Government Actuary

**Australian Taxation Office**

Mr Michael D'Ascenzo, Commissioner  
Mr Greg Farr, Second Commissioner  
Ms Raelene Vivian, Deputy Commissioner  
Ms Donna Moody, Chief Finance Officer  
Mr Mark Jackson, Deputy Commissioner  
Ms Stephanie Martin, First Assistant Commissioner  
Ms Margaret Crawford, Chief Operating Officer  
Mr Mark Konza, Deputy Commissioner  
Mr Shane Reardon, Deputy Commissioner

**Inspector-General of Taxation**

Mr David Vos, Inspector-General  
Mr Rick Matthews, Deputy Inspector-General

**Australian Office of Financial Management**

Mr Neil Hyden, Chief Executive Officer  
Mr Paul Power, Chief Operations Officer  
Mr Michael Bath, Director, Financial Risk  
Mr Gerald Dodgson, Head, Treasury Services  
Mr Pat Raccosta, Chief Financial Officer

**National Competition Council**

Mr John Feil, Executive Director

**Takeovers Panel**

Mr Nigel Morris, Director

**Financial Reporting Council**

Mr Charles Macek, Chairman  
Jorge del Busto, Secretary

**Australian Securities and Investment Commission**

Mr Jeffrey Lucy, Chairman  
Mr Jeremy Cooper, Deputy Chairman  
Mr Mark Steward, Deputy Executive Director, Enforcement

**Australian Prudential Regulation Authority**

Dr John Laker, Chairman  
Mr Ross Jones, Deputy Chair  
Mr Charles Littrell, Executive General Manager, Policy Research and Statistics  
Mr Brandon Khoo, Executive General Manager, Specialised Institutions

**Productivity Commission**

Mr Bernard Wonder, Head of Office  
Mr Garth Pitkethly, First Assistant Commissioner  
Mr Michael Kirby, First Assistant Commissioner

**Australian Bureau of Statistics**

Mr Dennis Trewin, Australian Statistician  
Mr Jonathan Palmer, Deputy Australian Statistician, Services Group  
Ms Susan Linacre, Deputy Australian Statistician, Population Statistics Group  
Mr Dennis Farrell, A/Deputy Australian Statistician, Economic Statistics Group  
Mr Paul Williams, Assistant Statistician, Census and Geography Branch  
Mr Carl Obst, Assistant Statistician, National Accounts Branch  
Mr Mark Whybrow, Chief Finance Officer

**Corporations and Markets Advisory Committee**

Mr John Kluver, Executive Director

**Australian Accounting Standards Board**

Mr David Boymal, Chairman  
Mr Angus Thomson, Technical Director

**Australian Competition and Consumer Commission**

Mr Graeme Samuel, Chairman  
Mr Joe Dimasi, A/Chief Executive Officer  
Mr Mark Pearson, Executive General Manager, Enforcement and Compliance Branch  
Ms Rose Webb, General Manager, Enforcement and Co-ordination Branch  
Mr Tim Grimwade, General Manager, Mergers and Asset Sales  
Mr Scott Gregson, General Manager, Adjudication Branch  
Mr Robert Antich, General Manager, Policy and Liaison Branch  
Mr Nigel Ridgway, General Manager, Compliance Strategies Branch  
Mr Michael Cosgrave, Executive General Manager, Communications Group  
Mr Gary Dobinson, Director, Transport and Prices Oversight  
Ms Helen Lu, General Manager, Corporate Management Branch  
Mr John Bridge, Chief Finance Officer  
Ms Lisa Anne Ayres, Executive Branch  
Mr Peter Maybury, Director Finance and Services

**CHAIR (Senator Brandis)**—We will resume the hearing of the Senate Economics Legislation Committee to consider the 2006-07 budget estimates for the Treasury portfolio. I invite to the table the witness from the Takeovers Panel.

**Senator SHERRY**—What is the current number of personnel on the Takeovers Panel?

**Mr Morris**—Are you talking about the panel itself or the executive?

**Senator SHERRY**—The panel itself.

**Mr Morris**—Forty-eight.

**Senator SHERRY**—And the number of staff?

**Mr Morris**—Four full-time employees of Treasury, and we normally run two secondees from commercial law firms.



**Senator SHERRY**—So six, including secondees?

**Mr Morris**—Yes.

**Senator SHERRY**—And we have 48 members of the panel?

**Mr Morris**—Yes.

**Senator SHERRY**—I am prompted to ask this because I noticed that the Parliamentary Secretary to the Treasurer announced some additional appointments to the Takeovers Panel—a further five new members and a reappointment of 10 existing members—on 24 May.

**Mr Morris**—Yes.

**Senator SHERRY**—We now have a panel with 48 members and six employees. It does seem a little top-heavy to me.

**Mr Morris**—It depends on how you look at the function. The Takeovers Panel is a dispute resolution forum and it gets applications made before it. When we get an application in, the legislation says three panel members are to be appointed to sit on an individual dispute. These people are part time. They are selected because they are active in business and the takeovers market. When we, the executive, get an application come in, the first thing we need to do is look at the issue of conflict. Frequently, the issue of conflict is going to reduce our 48 sometimes down to fewer than half of that number because of the conflicts with various people's law firms, investment banks or accounting firms having relationships with bidder, target, rival bidder, major shareholder or whatever. Then we look at where people are. We think that, if they are out of Australia and out of the jurisdiction, they probably cannot exercise the powers of the Commonwealth. Then we look for the various skill sets that we need for an individual panel. We generally look for an investment banker, a takeovers lawyer, and then we look at the skills for the third person. In fact, at times, 48 is almost too small for us. For a while, earlier this year, we were running on fewer than that and we struggled.

**Senator SHERRY**—Presumably, 48 minus five?

**Mr Morris**—Yes.

**Senator SHERRY**—Prior to the last appointments?

**Mr Morris**—Yes.

**Senator SHERRY**—Who allocates the individuals to a panel?

**Mr Morris**—It is the substantive president of the panel. At the moment that is Simon McKeon.

**Senator SHERRY**—Is that a full-time position?

**Mr Morris**—No, part time.

**Senator SHERRY**—The Remuneration Tribunal sets the remuneration?

**Mr Morris**—Yes.

**Senator SHERRY**—I turn to specific Takeovers Panel intervention—Alinta and AGL. Could you outline that decision briefly to the committee?

**Mr Morris**—We have three Alinta decisions. We have Alinta 01, Alinta 02 and Alinta 01R. I assume that you are talking about Alinta 01, which was the decision where the panel said that allowing two rival bids, each offering scrip for the other, could lead to significant problems. It is called the Pacman defence.

**Senator SHERRY**—Yes.

**Mr Morris**—We are talking about Alinta 01. For various reasons, we have two bidders each making takeover offers for the other, each offering scrip. Section 259C of the Corporations Act says that a transfer of shares in an entity that controls a company to the company is void. Basically, that is so that a subsidiary cannot acquire shares in its holding company so that you get the round robin. Because 259C works on not a bright line test of control but a practical and effective test of control, given both of these companies have fairly dispersed share registers—they have relatively few institutions on their share registers—it is reasonable to think that it could be argued, and it is the argument that is important, that either of these companies could be controlled with significantly less than 50 per cent, potentially down to 30 per cent or 35 per cent.

The panel was concerned that, because we had two takeovers, if each of them went unconditional and started transferring shares in the other to themselves as they became successful and, as they became successful they issued more shares in themselves, which changed the percentages all over again, there was a very significant possibility that we would be either in the panel or in the courts almost interminably with two fairly aggressive bidders each arguing that, no, they had control of the other and that transfers of shares of them in the other were void, and the other one arguing exactly the same thing. The panel decided that that was not an efficient way to resolve things. The panel said that there really ought to be a fairly clear bright line test so that we did not spend large periods with one arguing that it controls the other and going on like that.

**Senator SHERRY**—You just used the description that it is not an ‘efficient way’. Is it up to the Takeovers Panel to determine what is efficient within a market?

**Mr Morris**—It is directed to do that. Section 602A says that the purpose of the takeovers chapter is to ensure that control of the acquisition of shares in a listed company takes place in—the mantra is—‘an efficient, competitive and informed market’. Yes, it is the panel’s role to try and make sure of that.

**Senator SHERRY**—Have the decisions directly benefited any participant of that takeover struggle? Is that considered?

**Mr Morris**—The panel would hope that, yes, it was in general the shareholders of both the companies.

**Senator SHERRY**—Was consideration given to shareholders who might have sought to accept a takeover bid?

**Mr Morris**—Yes, as in all of the shareholders in both Alinta and AGL. The model that the panel came up with was that both of the bids could proceed. Shareholders in each of the companies could accept the offer if they wanted to, but the bids were only allowed to become unconditional and share transfers go through if there was going to be a clear result. The panel

said that there should be two defeating conditions put into each of the bids or offers. The first condition was that the offeror got at least 50 per cent of the other, which is a bright line test of control—clear, unarguable. The other defeating condition was that the rival, that bidder's target, not get more than 50 per cent of the bidder—again, a clear bright line test, unarguable. The panel said that, if we set that up, then in the circumstances where we have a clear winner there can be no argument. The takeover would proceed on normal takeover timetables and we would get a clear and relatively efficient outcome. The panel recognised that, while it would have been nice, it might not have eventuated and it said 'If you do not get a clear 50 per cent with the other one not getting 50 per cent, we will reserve the right to have parties come back to us and talk to us about where the outcome eventually came to in the end and see whether there is a way forward.'

**Senator SHERRY**—Was the intervention of the Takeovers Panel in the struggle, if I can use that description, triggered on application from AGL?

**Mr Morris**—Yes.

**Senator SHERRY**—You could not intervene until that application from AGL?

**Mr Morris**—We are a creature of application.

**Senator SHERRY**—There has been a recent Federal Court ruling in respect of the Glencore matter, which limits the effectiveness of the Takeovers Panel. Would you agree that it does limit the effectiveness and, if so, how?

**Mr Morris**—Justice Emmett is clearly a very learned and respected judge. We have some concerns that the fairly strict legal approach and, we would say, narrow reading that he has given of the Takeovers Panel's legislation runs into problems. We think that is likely to run into problems. On one reading of Justice Emmett's decision, the panel must be able to demonstrate at the time that it makes a declaration of unacceptable circumstances that there is an effect on control or potential control of the acquisition—or proposed acquisition—of a substantial interest. Take the example of someone alleging that a bidder's statement has false or misleading information in it. The bidder's statement has not gone out yet. The usual process is that the bidder's statement goes to the target for two weeks before it can be dispatched to the shareholders. The target comes along and says, 'Look, there is false or misleading or even just inadequate information in this bidder's statement. Panel, we want you to make a declaration of unacceptable circumstances.' The panel sits down and says, 'Yes, we think there is inadequate information in this bidder's statement.' On a strict reading of Emmett you would say, 'Well, what is the effect now?' There is not an effect now. There is the potential or likelihood of an effect but not an effect now. That is one of the ways that we think Justice Emmett's analysis and reading of the legislation might affect us.

The other is that the way Justice Emmett has read the construction of the particular very small section of the Corporations Act seems to make effect a jurisdictional factor, and the jurisdictional factor is then decided by a court, rather than a panel. The panel is an expert body and has got some very good takeovers people on it. If there is an expert body and you are going to appoint people like that to look at what the effects of circumstances are on a takeover, then it is appropriate for them to think about what an effect is rather than a court. Courts are very good for lots of things, but when you start talking about what the effect of

something on a takeover was, where you have an expert body, it ought to be that expert body rather than a court determining a jurisdictional factor.

**Senator SHERRY**—So there is a jurisdictional cloud, if you like, as a consequence of the decision—a question mark?

**Mr Morris**—Yes.

**Senator SHERRY**—Obviously, given your comments, you are examining the implications of the decision in Glencore?

**Mr Morris**—Yes.

**Senator SHERRY**—Have you publicly released any particular views on the Glencore matter yet, aside from what you have outlined this morning, by way of a view or a statement?

**Mr Morris**—The panel? No.

**Senator SHERRY**—Is it intended that there will be a sort of formal statement or response?

**Mr Morris**—The panel is fairly careful about what it says about court decisions.

**Senator SHERRY**—I understand that, but the implications of Glencore, as I am advised, are potentially significant for the future of the Takeovers Panel.

**Mr Morris**—Yes, and insofar as the panel making any statements, no, I do not think that we are likely to.

**CHAIR**—As there are no further questions, thank you very much, Mr Morris. I now invite to the table the witnesses from the National Competition Council.

[9.20 am]

#### **National Competition Council**

**CHAIR**—Mr Feil, there has been comment, as you are no doubt aware, in the financial press for quite a while now about procedural delays and delays in dealing with matters before the National Competition Council. Could you comment on that matter?

**Mr Feil**—I think that most of the recent comments have been around one particular matter where from the time of application to the council making its recommendation almost two years had elapsed. Generally, it is a relatively lengthy process to get a declaration recommendation from the council. I think we recognise, partly as a result of recent comments, that there is now a greater desire for speed in how we deal with these. The council's objective has always been to produce a sound and sustainable recommendation as quickly as possible, but that invariably involves lengthy discussions with applicants, with parties whose assets are looking to be declared and other interested parties. Sometimes those are very lengthy.

There are also opportunities to challenge jurisdiction, which can, if handled badly, cause extensive delays. I think the government has also recognised that timeliness is to be given a greater priority and there is now either legislation or policy agreed that will see indicative time limits put on various stages of the process and the overall process. In anticipation of that, the council has been looking at how its processes can be adapted to meet those targets. They will be a challenge to meet, particularly if we have inadequate application. As a first step we

have redesigned the template on which applicants should prepare their applications, and we are in the process of finalising that for release now. That will seek much more information at the beginning of the process. It is not uncommon under the current processes for the first month or so to be spent largely engaged with the applicant, assisting them to properly define the assets or services that they want access to and working through their application to a point where it is useful to disclose more widely so that people can respond to it. We are taking those steps. We are confident that we can in the vast majority of occasions work inside the indicative timelines proposed. There will always be cases that are highly contested where every point is taken at every stage.

**CHAIR**—I do not think anybody is blaming the National Competition Council for those delays that are inherent in the parties making applications, including challenges to jurisdiction. You cannot control that. What I am concerned about and what has been the subject of critical remark in the recent past are delays within the processes of the National Competition Council, which it is suggested were avoidable.

**Mr Feil**—I turn again to the particular matter that took two years and, it having taken that long and my having received the adverse comment, I have looked back and considered what we could have done to take that matter through a much quicker process. While there were things we might have pursued to take a few days or a week out of various parts of it, the only way that we could have shortened that significantly would have been to curtail submissions from parties and not accept or consider matters that arrived somewhat after time. Under the new environment it is clearer that it is the intention of parliament that we should only consider submissions that arrive in a timely fashion and that those that are late should be ignored. It has not been the council's practice to do that in the past. One reason for that is that the nature of the process—with our making a recommendation, a decision maker taking the decision and then, in most cases, an appeal going to the Australian Competition Tribunal—the appeals are *de novo*, so, in the end, they exclude evidence and submissions at our stage when they would not be excluded in being put before the tribunal for the first time. We think the tribunal is better off if we have had a first look at it. I agree you can see it as an error.

**CHAIR**—It is not at all unknown—particularly, I might say, in this field—for respondents to gain the system and so, by behaving strategically, leverage an advantage for themselves. Courts are very familiar with this and impose very rigorous and strict sanctions against it, including guillotine orders. That, I suppose, is what I am suggesting that the NCC might consider.

**Mr Feil**—We are certainly in the process of considering a significantly more rigorous adherence to time limits at the direction of what we presume will become the statute. It is quite clear that we have no obligation to consider anything that arrives after a deadline that we have set, and I think that will be our approach.

**CHAIR**—Senator Sherry?

**Senator SHERRY**—What was the matter to which you were referring?

**Mr Feil**—Fortescue Metals' application for the Mount Newman railway line.

**Senator SHERRY**—Yes, I thought it might have been!

**Mr Feil**—That is our only one that is at two years.

**Senator SHERRY**—In fact, I have a copy of the recommendation here and I want to go to a couple of aspects of it. Am I correct in understanding that the central point of the recommendation is that the 295 kilometres of railway was not a service? It was part of a production process within the meaning of section 44B of the TPA and, therefore, you could not further process the application by Goldsworthy service.

**Mr Feil**—That is not entirely correct. Initially there were two railways for which application was made: the Goldsworthy railway line and the Mount Newman railway line. Shortly after the matter arrived, there was a challenge to the council's jurisdiction—arguing essentially by BHP—that we did not have jurisdiction, for the reason that you set out. The council turned its mind to the jurisprudence, which essentially is a previous decision relating to a railway in the Pilbara. We came to the view that, based on the law as it was—not necessarily the law as we think it should be—the Mount Newman line was not part of a production process and therefore we had jurisdiction and we continued to consider that matter. However, on the basis of the tests set out in the jurisprudence, the Goldsworthy line did appear to be part of a production process; therefore, we had no jurisdiction and we did not continue with that. The remaining year and eight months was dealing solely with the Mount Newman line. There were appeals lodged in respect of those decisions by FMG, saying that we were wrong to exclude Goldsworthy, and by BHP saying we were wrong to include Mount Newman.

**Senator SHERRY**—You said that, on the basis of the advice you received, Goldsworthy was not—and not necessarily what the law should be but that that was the advice that you received. Why do you say 'not necessarily what the law should be'?

**Mr Feil**—The council has looked at the test put forward by Justice Kenny in the Hammersley decision, which to put it in the very shortest form is based around whether or not a marketable good is produced before the service for which declaration is sought. So: is there a marketable good before you put ore on the railway line and take it to the port?

**CHAIR**—Is this the issue about the point at which you define the beginning of the production process?

**Mr Feil**—Yes, whether you define the railway line as part of a production process or not. The litmus test that is put forward by the jurisprudence, and on advice that we are obliged to follow, is: is there a marketable product? In respect of the Goldsworthy line, the ore is all sold effectively free on to ship, and there is not a marketable product. In the case of Mount Newman, there were some products that are sold to another party at the mine. We think that that outcome, where one railway line is in and one railway line is out, is part of the problem, because the marketable good test is really one that depends on a whole lot of factors—none of which really have much to do with whether you should grant access to a railway line—and gives you a pretty perverse outcome that one is in and one is out.

I think our greater concern is that it is also something that a company can organise their business in a way that they simply refuse to market or sell the product at the mine and, therefore, they can effectively push the exemption from part IIIA down the process. We do not think companies make decisions simply to avoid part IIIA, but it is an outcome that we think

is far too open to manipulation. We are now facing the situation where, for a large number of declarations, people are making an argument about a production process being around the particular assets that someone is seeking declaration to. At the beginning of a process that we are trying to shrink in terms of time, we invariably now, wherever it is vaguely capable of being run, get an argument from the asset owner saying, 'This is all part of a production process.' In the past people have argued with respect to electricity distribution systems that there is no marketable product until you flick the switch in your house, so the entire distribution network is part of a production process.

**CHAIR**—Is part of your problem the fact that there is so little case law and jurisprudence about this—that the courts have yet to develop a sophisticated set of tests about what the production process is?

**Mr Feil**—It is fair to say that there is one case. It was considered almost as an interlocutory matter at the beginning of the process, on the basis of little or no economic evidence—and I am sure there is plenty of other evidence. It was not fully argued with the panoply of economists and argument.

**CHAIR**—Is that right? So the test was a decision made on an interlocutory application—or as a preliminary point of law?

**Mr Feil**—It was as a preliminary point of law, and it was set to go to appeal beyond that, but the asset owner bought the applicant and the whole matter went away. When this particular matter arose we, on advice, followed the law as it was. We also set out in brief some of our reservations about the law as it was. The anticipated appeals arrived and we were hopeful that those matters would enable the Federal Court to consider it again. We have proposed an approach to considering whether something is part of a production process, which we think is based more soundly in economics and tries to get at the issue that the act was set up for. Whether or not that matter now will be heard, we do not know. It is somewhat dependent on decisions that commercial parties will take in the next few weeks.

**Senator SHERRY**—The bottom line in this case is: how does a new mine operator get their ore to the port if they cannot ship it on a railway?

**Mr Feil**—We hoped that they might be able to do it on BHP's or Rio's railways under a declared arrangement.

**Senator SHERRY**—Yes, a commercial arrangement.

**Mr Feil**—The first option is to come up with a commercial solution. It is much better that parties deal with it commercially: come to a deal, pay a fee and get their ore carried. If that cannot be done, then the panoply of part IIIA applies. One option is declaration by applying to the council, which is what FMG did. Another option would be for the state to develop a state access regime that could then be certified as effective, and we understand there are discussions between various parties and the Western Australian government about whether that can be done. It is possible for asset owners to lodge an undertaking with the ACCC, although if you do not want to provide access you are hardly going to do that. Failing that, we run the risk that either the ore assets will be stranded and unable to be developed or they have the somewhat unpleasant choice of whether or not they sell to one or other incumbents.

**Senator SHERRY**—It does not seem to be a particularly competitive outcome.

**Mr Feil**—If you go through the pleasure of our recommendation, one of the markets we thought that access declaration would promote competition in was a market for stranded tenements. We do not think it is necessarily at the end. Whether or not it is done by way of declaration or the application has the effect of jogging the parties to a commercial solution or it jogs the state and the parties to come to a state access regime, any of those would be a positive outcome in terms of promoting competition.

**Senator SHERRY**—Or the new mine proposal has to build its own transport infrastructure.

**Mr Feil**—Yes. For a large development that might well be feasible. FMG has a larger mining operation planned on the other side of the Chester Ranges, where it is proposing to build a railway line. In terms of the one that was subject to this application and a number of the small tenements, there is clearly no way in the world that you can build a railway line off the back of those.

**Senator SHERRY**—Or roads, presumably.

**Mr Feil**—Most people rule out pretty quickly the idea of trucking iron ore 200 and something kilometres.

**CHAIR**—If you do not feel that you should answer this question, or if the minister feels you should not answer this question, please say so. Is it your view that it would be desirable if we had uniformity in the access regime laws between the Commonwealth and the states or, more broadly, uniformity in the competition laws between the Commonwealth and the states in this country?

**Mr Feil**—I will not go into competition laws more broadly.

**CHAIR**—For example, take the Western Australian case that we are all familiar with. There was the one set of Western Australian state laws and then there was part IIIA. They were broadly but not entirely consistent with each other. The extent to which there were inconsistencies became a feature in that case, did it not?

**Senator Minchin**—It is appropriate to remark upon the facts of inconsistencies and where the inconsistencies are, but not to traverse the policy question.

**CHAIR**—That is why I put in that caveat.

**Senator Minchin**—It would be perfectly proper to highlight the consequences of there being two regimes.

**Mr Feil**—It is fair to say that there is a broad policy and legislative arrangement put in place by part IIIA. Under that there are effectively three equivalent ways of dealing with access. The first is that a private party can make an access undertaking to the ACCC. If that is accepted by the ACCC, it becomes the arrangement and we cannot declare the asset. If a state has an arrangement that it thinks is satisfactory, it can seek certification of that arrangement as effective by coming to us. If we agree and certify the arrangement, it takes precedence and we cannot declare the asset. In the absence of either an access undertaking or a state regime that has been certified, then the middle part of part IIIA that we deal with comes into play. There is



a harmony in the sense that they all have to meet the similar standard of the competition principles agreement; they do have to result in access. They do have to have a certain number of features like independent price arbitration or independent price setting.

**CHAIR**—Although they are the same model, there are differences, are there not, in the legislation as written?

**Mr Feil**—There are differences, but they are of much more detail. In this case, of course, we did not have a certified effective state access regime. That option is one of the criteria that we had to consider, and we obviously came to the view that what the state had was not equivalent to what you could get under the other arrangements. Therefore, we proceeded to recommend declaration. Broadly, there is an overarching policy that provides for a degree of equivalence, as long as the arrangement has been certified. If it has not been, then we would not regard it as effective.

**Senator CHAPMAN**—Does the Western Australian legislation provide for a service arrangement?

**Mr Feil**—The Western Australian legislation as it is potentially provides for haulage arrangements where the incumbent rail owner carries the ore on its trains using its rolling stock. We do not regard that as an effective regime in respect of the FMG application for two reasons. Firstly, FMG sought access to the rails, not to the rolling stock. They wanted to run their own trains. It is a different service.

Even if it was the same service, the way the Western Australian regime as it operates today was set up, no-one has ever managed to get access under it in the entire life of the railway system, and the principal difficulty is a chicken-and-egg argument. You are obliged as an asset owner to negotiate a haulage arrangement with someone who has a developed mine. Of course, you are not going to develop a mine until you are sure that you can get access, so it becomes a circular arrangement. That is one of the major barriers to certification. If, as a result of the jogging effect of the declaration application, the Western Australian government and the asset owners can come up with something that decides whether it is chicken or egg and set up an arrangement, then we would hope that might well be a perfectly satisfactory outcome.

**Senator CHAPMAN**—Is there a guarantee requirement in the declaration that the physical standards of the truck and the system of managing the operation of those trucks is such that it does not interfere with the existing owner's operations, and also not damage their technology?

**Mr Feil**—That was clearly a matter of dispute between the parties. The council's view, and the recommendation was, that there would be management challenges posed by having third parties running trains on the tracks. But we believed that those were the ones that could be overcome and should be overcome and were not an absolute barrier to making the recommendation that we did. It is important to realise that declaration under part IIIA is not a free ride. Firstly, the party who gets access pays and pays a commercial rate, including a return on the asset. If they seek unreasonable terms, the arbitrator will not give them access.

It is entirely possible that had the declaration gone forward, a dispute would have arisen. If FMG was asking for unreasonable terms or would have caused unreasonable disruption to the asset owner, then they might not have got an arbitrated access by the ACCC. But at a level

higher, one removed from that level, the council was of the view that both BHP and Rio, to the extent that they have a railway down the road, are very sophisticated, skilled operators of railways. We thought it was a little bit excessive to argue that they had no ability to accommodate what would have amounted to, at best, four per cent additional usage of their railway line. While it was clearly a matter of dispute, it was not an argument that we accepted, at least not to the point where we were going to recommend against access.

**Senator MURRAY**—Minister, I was attracted by the question of the Chair with respect to regulatory regimes. I thought that the Treasurer's remarks and the government's support for addressing either harmonisation or the creation of national regulatory regimes in a general sense was important for Australia, and he was talking at that time about ports, infrastructure and all that sort of thing. With respect to this particular issue where you get something of a clash between national and state law with respect to the regulation of access in these circumstances, in its overall assessment of regulatory reform throughout Australia, is the government re-looking at this area or thinking about it? Are you suggesting that any changes should be made in this area?

**Senator Minchin**—I do not have a brief on that. It is not my area. I am not across the detail of that. I think we are involved in some process through COAG to review all of this as a result of our very good review of the regulatory arrangements regarding export infrastructure, which highlighted that in the infrastructure issue. With respect to Australia's exports, it is the regulatory arrangements that are the major inhibitor. There is a COAG process in place, the details of which I do not have at the top of my head. Obviously, we are seeking work through COAG to achieve the greatest degree possible of harmonisation of the regulatory environment and ensure that we have a regulatory environment that places the least obstacles in the face of infrastructure investment and cost-effective export capacity. I do not think the government is about to embark on some sort of unilateral uncoordinated shoot from the hip approach to this. It is more a case of cooperative federalism. I think there is goodwill on the part of the states. They seem to have accepted the wisdom of that report and the need to seek to harmonise regulation in this area.

**Senator MURRAY**—One of the broader aspects of this case which has disturbed me is the forum shopping that has been going on, switching between federal and state jurisdictions and playing off nuances in the law or in practice—

**CHAIR**—Or in the attitudes of the respective tribunals.

**Senator MURRAY**—That is quite right. That is why I thought the question from the Chair was a good one. From the specific example, you move to address the principle. The principle of due process and being assured of a consistency of adjudication and outcome has been breached in this case. It is an indication of there being a need to come to a single regulatory regime, which both the states and the Commonwealth agree to, so that these sorts of issues can be determined in a more consistent and more principled manner than the present regime allows for.

**Senator Minchin**—The chairman's questions, as always, are very good questions, but I thought the answer indicated that it was not as great a problem in this case. We are able to work it through. In any federal structure there is always that risk, but I think there is a process

in place to address that very issue and seek greater harmonisation. Every state government, as well as the federal government, has a vested interest in ensuring that we maximise the investment infrastructure, that it is cost effective and that it places the least obstacles in the path of our export industries.

**Senator MURRAY**—Minister, could you take it on notice to advise the committee whether this particular area is likely to fall within the overall COAG review?

**Senator Minchin**—I do not know if you have more information than I have off the top of my head on this, Mr Feil.

**Mr Feil**—There is obviously COAG consideration of the export task force report and the response is, I think, in hand for that. We are not involved in that directly. I think much of the debate about multiple regulators and the like is one level lower, about who sets the prices, who sets the access conditions, who gets to regulate. Does the ACCC, who would be the arbitrator under a part IIIA matter, have the same approach as the economic regulatory authority in the west, who would be the arbitrator cum regulator under a state access regime? It is more at that level than at the level of ‘what is in and what is out’ of declaration. We can take that on notice and get you—

**Senator MURRAY**—I would be heartened if it was part of a COAG review rather than if it was not, if that makes sense.

**CHAIR**—Can I just lend my support to your observations, Senator Murray. It seems to me to be not good policy to have a set of laws for access to infrastructure that are not uniform throughout the country when we have uniform generic competition laws in part IV but we have these nuances of difference in relation to part IIIA matters, or the equivalents in the states, which is really essentially, if you track the history of it, an outgrowth of part IV.

**Mr Feil**—Certainly part IIIA applies to both interstate and intrastate state owned and privately owned assets. As I said before, there are three paths, one of which is a state specific route. The other two are national. It is, to a degree, the choice of asset owners, applicants and governments as to which one they go down. There is a hierarchy. I do not believe you can have two of the regimes apply, but there is a degree of serendipity as to which one gets in.

**CHAIR**—Serendipity or forum shopping.

**Senator MURRAY**—Yes. I am inclined to the forum-shopping view. Mr Feil, putting my economist’s hat on, as a general principle I am biased against monopoly rights and think that they should be challenged. Of course, infrastructure can often fall into that broad categorisation. In the consideration of this matter, did the National Competition Council have regard to the fact that the original grant of the easements and the support for the construction of that rail line were facilitated by the state and therefore by the taxpayer and that it was not entirely a commercial venture right from the outset funded, fully motivated by and fully supported by the corporation—in other words, that the public interest was brought into play? That to me automatically implies, therefore, that what the public pays for the public should be allowed to determine the eventual use of, to some extent. Was that consideration brought to bear at all or is that peripheral to your considerations?

**Mr Feil**—Under the statute we have six criteria to consider. One of those is whether or not the asset is a natural monopoly or is likely to be replicated. In considering that particular criterion, we obviously have regard to the circumstances within which it was built. One of our concerns was obviously that, if someone wanted to build a duplicate track as well as all the physical infrastructure, they would have to go through planning, land acquisition and native title issues. Because of the way the original BHP line was built, it was somewhat more quickly dealt with than would be the case.

**Senator MURRAY**—Native title did not apply, for a start.

**Mr Feil**—Yes, and it is relevant for that—

**CHAIR**—Has that been factored in to the price of access to the service as part of the value of the return on capital?

**Mr Feil**—The asset owner is entitled to a commercial return on their investments. They are not entitled to a commercial return on monopoly profits. So one of the difficult tasks that the arbitrator, when a matter is declared, has to grapple with is making sure that they give the appropriate return on what BHP and others have spent on building the railway line but not allow any monopolisation returns to continue. There is a tension there. But it is not the intention of part IIIA to drive the price to the bare minimum to allow inefficient entry.

**Senator MURRAY**—Can you just respond, though, to my non price orientated question? The question was posited on the basis that, if you like, the construction of that infrastructure was a joint venture. The corporation was doing its bit and the public, through the state government of WA, was doing its bit. Therefore, I would have thought the public interest, from the perspective of the public's interest in the infrastructure, would have been a consideration. You were answering with respect to those six considerations—

**Mr Feil**—I think in respect of the criteria that goes to whether or not this railway line could be replicated or duplicated, it is relevant in that sense. More broadly, we treat this as an asset owned by BHP.

**Senator MURRAY**—In that case, is it a potential issue that the criteria against which you consider these matters are not sufficient?

**Mr Feil**—I think that the criteria set out in the statute let us consider all the issues that, from the council's point of view, would be relevant. The contribution that the state made some time ago in facilitating the construction and planning of the railway line was reflected to a degree in the state access regime, so the quid pro quo was some conditions for third party access and a number of other things, including royalties. As it turns out, the state access regime does not appear to have provided the degree of access that perhaps at the time parties thought might have occurred, but it is very hard to read exactly what the trade-offs were. So we treat this as a fresh application for an asset that is essentially privately owned. We go through the criteria, the last one of which is the overall public interest. I do not think it is necessary or appropriate to consider how much the state government or the people of Western Australia might have contributed some time in the past. But there is nothing in the criteria, we believe, that stops access being granted where it is appropriate to do so.

**Senator MURRAY**—My understanding of what you have said is that the history does not matter that much. Then you went on to say that you did not think it necessary or appropriate for it to matter that much. But, if the contribution by the public of WA through its government at that time is quantifiable or material in some fashion, why would you consider it not to be appropriate?

**Mr Feil**—I do not think it goes to the issue of whether or not a third party should be given access to that railway line as the criteria set out. It might well go to the question of whether the state wants to get a return on that investment, but that is a matter that should have been negotiated at the time.

**Senator MURRAY**—But the monopoly might not have been achieved. That ownership might not be achieved without the support of the public of WA as expressed through the government. To me that therefore brings into play a kind of joint venture concept, not in the formal legal sense but in the sense of a historical moral obligation to the other party, if you like, which is the public of WA.

**Mr Feil**—I understand your question. To the extent it is considered in the arrangement, it would be under the criteria of whether or not it is possible to duplicate economically the particular railway. Obviously, if they had a leg-up from the state and that leg-up is not available to a latter party then it goes to confirming that that particular criterion is met. Beyond that we would not—and the act does not provide for this—treat an asset that had a historic relationship with the state any differently from a purely private asset that was developed on a private basis.

**Senator MURRAY**—If it was the opinion of the government or the parliament that that criterion should be brought into play, it would need to be added to the criteria which you consider, wouldn't it?

**Mr Feil**—Yes.

**CHAIR**—There being no further questions, I thank you very much, Mr Feil. You are excused.

[10.00 am]

#### **Australian Office of Financial Management**

**Senator SHERRY**—I note on 10 May there was a notice providing details of expected Treasury bond issuance by the Office of Financial Management. What is the period over which the bonds are to be issued?

**Mr Hyden**—You mean the maturity connected to bonds?

**Senator SHERRY**—Yes.

**Mr Hyden**—There is no formal limit, but our practice is to issue bonds of around 13 years, which is our longest bond.

**Senator SHERRY**—Are you aware there has been what I think is a reasonably intense debate in some of the financial press about this issue—that is, the time periods?

**Mr Hyden**—I do not think so. The practice we follow at present is based on the policy the government announced in 2003 of issuing bonds to support the Treasury bond and bond

futures markets, rather than for revenue purposes. The issuance we make is tied to the needs of the futures contracts. There is a three-year contract and a 10-year contract, so we issue bonds that are a little longer than those periods so that we have, at any one time, several bond lines that can be drawn on in the futures baskets. That is why we issue normally at five-year and around 13-year maturities.

**Senator SHERRY**—Is any examination of the issuance period being undertaken internally?

**Mr Hyden**—As I said, the issuance that we undertake is based on the government's policy. We do consult with the Sydney Futures Exchange on their needs for their future baskets. The decision on which lines they include in the basket is theirs, but we aim to ensure that our issuance fits their needs.

**Senator SHERRY**—In the special appropriations as part of the budget I note that there is a section 22 interest for Snowy Hydro corporatisation under the Snowy Hydro Corporatisation Act of 1997. We know that Snowy is to be sold. What will be the impact of the sale on that interest? Presumably it disappears.

**Mr Hyden**—The Snowy Hydro was corporatised some years ago and, at that time, the Commonwealth took over the responsibility for debt that the corporation had previously issued. That is now fully a Commonwealth liability. The potential sale of the corporation will not affect our obligations under that arrangement.

**Senator SHERRY**—What is the total debt? There is an actual interest bill for 2005-06 of almost \$3.5 million; for 2006-07, it is \$2 million.

**Mr Hyden**—The total amount is \$20 million.

**Senator SHERRY**—This would be a policy decision, obviously, but you could pay off the debt or pay it out from sale proceeds, couldn't you? That is up to the government to decide.

**Mr Hyden**—We have no particular reason to do so at present.

**Senator SHERRY**—Yes. Other than that the Snowy is being sold.

**Mr Hyden**—The sale of the Snowy does not affect our commitment.

**Senator SHERRY**—I understand that, but the debt that is being carried could be paid out?

**Mr Hyden**—It could be.

**Senator SHERRY**—That is a decision for government. What is the interest rate on that debt?

**Mr Hyden**—I do not recall, but I see the budget estimate for next year is \$2 million, so that sounds as though it is about 10 per cent of the amount on issue.

**Senator SHERRY**—It does seem to be a fair rate of interest, doesn't it?

**Mr Hyden**—This is a debt that was contracted some years ago.

**Senator SHERRY**—Yes, by the Snowy.

**Mr Hyden**—Yes. I do not know the actual coupon rate, but presumably it is about that.

**Senator SHERRY**—Could you just take that on notice for me, please, and give me the actual interest rate on the debt? There may be different chunks of debt, or components with different rates, but if you could find that out for me, please do. I do not have anything else.

**CHAIR**—Does anyone else have anything more for these gentlemen? Thank you very much, Mr Hyden and Mr Bath, you are excused.

[10.08 am]

### **Department of the Treasury**

**CHAIR**—We will now return to the department. I invite to the table officers of the Fiscal Group of Treasury to deal with outcome 2, Effective government spending arrangements.

**Senator LUDWIG**—I wish to ask about the protocol or procedures when assessing programs of other agencies such as Customs. Before the Legal and Constitutional Legislation Committee a Customs official, on behalf of the Australian Customs Service, informed the committee:

Because the program would impact on government revenues, for any such proposal to go forward for government consideration such a costing would have to be agreed to by Treasury.

What in fact occurred was that an original 2001 bill which then became the trade modernisation legislation included a way forward for an accredited client program. That program provided for the way Customs would collect revenue—that is, duty, including GST, from importers or brokers representing importers—and then pay it to Customs. That program is to be amended by a proposed piece of legislation soon because in 2004—I am happy to be corrected—or a couple of years after that legislation, we were told that Treasury advised that that program was not going to be agreed by Treasury. Before I get to the specifics of that particular issue, what I wanted to understand was the process that Treasury might require agencies to go through and whether there are particular protocols. What do you require agencies to do when they have programs that have revenue implications?

**Mr Tune**—I am not aware of the details of the situation that you are describing, but I can give you a general answer that, where there is an impact on revenue, particularly if it is tax revenue, government processes require that costings of measures—the revenue impacts of those measures—be agreed with Treasury. That is a process of ensuring that the costings are done as well as they possibly can be. If it is non-tax revenue that we are talking about, generally the department of finance gets involved. I am not sure what we are talking about here.

**Senator LUDWIG**—If it is a customs duty?

**Mr Tune**—That is the general process.

**Senator LUDWIG**—Yes, I know. It will obviously turn on whether Treasury would do a costing. They did in this instance, at first blush, do a costing, so I suspected—

**Mr Tune**—If it was a revenue costing, it would have been done by my colleagues in the Revenue Group.

**Senator LUDWIG**—Which output are they in?

**Mr Tune**—They were the ones that were on yesterday.

**CHAIR**—You missed the boat!

**Mr Tune**—I did ask at the beginning, if you can recall, Chair, where this issue might arise. I was told it was at 2.1.

**CHAIR**—Not by me.

**Mr Tune**—Is it a measure in this year's budget?

**Senator LUDWIG**—No. It has arisen in the past. Perhaps I can also provide a document. Chair, what is the usual procedure here? This is the Senate legislation transcript. Do I give it to you to look at first or do I provide it to the committee?

**CHAIR**—What do you want to do with it? Do you want to put it to the witness?

**Senator LUDWIG**—Yes.

**CHAIR**—Just show it to the witness. Just identify it by reference to the page number for the *Hansard*.

**Senator LUDWIG**—This is a transcript of the Senate Legal and Constitutional Legislation Committee, Thursday, 25 May 2006, page 44. There are two parts to it.

**Mr Tune**—It appears to me we are talking about customs duty.

**Senator LUDWIG**—There is also GST on that as well, because there is a GST component. I want to understand a couple of things. One is the more specific issue relating to the accredited client program. Treasury was said to have done a costing of that program and then indicated that they were not going to support it. Then Customs could not proceed with that particular model. I wanted to understand whether that modelling was available. In other words, how and why Treasury would intervene to do that work and, secondly, what assessment they made and how they arrived at that outcome. There are a couple of others as well, but I want to pause there so we can assess where we are up to.

**Mr Tune**—It is around customs duty and GST. The costing, therefore, would have been done by my revenue group colleagues, so I am not in a position to comment on that other than to say that, whilst Treasury would be involved in doing costings of proposals where they involve revenue, that does not necessarily mean that Treasury would support the proposal. There are two distinct phases. Treasury will do the work of a costing, but that does not necessarily lead to Treasury then saying that we support what is being costed.

**Senator LUDWIG**—No, in this instance they did not support what was being proposed. They indicated that Treasury did not agree with the outcome and then asked Customs, by the look of it, to reassess and find a different mechanism, which Customs have subsequently proposed to do.

**Mr Tune**—We are going to have to take it on notice, because the people who would have been involved are not here. As I said, they were on yesterday. We can take it on notice and I can get the story for you and provide that information.

**Senator LUDWIG**—What I might do is take you through this for the purposes of both the transcript and to help those people who may have to look at the issue. There are two matters that I want to have looked at. The first is, as you indicated, the more general process of how and why Treasury would assess or be required to assess, and whether it is a necessity or



whether an agency or a department can choose not to have it assessed, if it has revenue implications—be it a tax, customs duty, collection charge or the like. That is a more general question.

**Mr Tune**—I think I have probably covered that one.

**Senator LUDWIG**—Yes. If it has a significant impact on the agency's bottom line, is there advice to the department from Treasury or is it more likely to be a, 'No, you can't proceed with this'? What is the authority upon which that decision might be made? The second part relates to referral of what is called self-assessment clearance declaration and import processing charges. Effectively, there are two parts. I am happy also to tender a self-assessment clearance declaration explanatory document to help, because it is Customs matters.

**CHAIR**—Again, what do you want to do with this document?

**Senator LUDWIG**—I will tender it for the witness to have a look at. It may help them understand what it is.

**CHAIR**—We need a motion to receive the document.

**Senator MURRAY**—I so move.

**CHAIR**—Yes. That is passed, thank you.

**Senator LUDWIG**—You do not need to read the document at this point. It just explains what a self-assessment process charge is. In this instance, what happened was that there was Customs Amendment Regulation 2005 (No. 6), which prescribed a value of \$1,000 below which goods imported other than by post would not be subject to a formal import entry. In effect, what that meant was the threshold was lifted from \$250 to \$1,000 for non-post. So, there is an effect on both GST and duty collection forgone in that instance. The question then is: was Treasury made aware of that decision for those changes to be made by regulation and was there a requirement to make Treasury aware? If there was a requirement and it did then what was the result of that? If it was a requirement and it did not make Treasury aware, why not, and does Treasury have an interest now in discovering that?

If of course there was not a reason for Treasury to be made aware, then it would rest at that point. If Treasury was made aware and there were costings done, is it available to the committee as to how that would impact upon revenue collection by the Customs Service? That is the self-assessment clearance. The second part relates to what is called an import-processing charge. This was a regulation made in 2006, which was called No. 82. It raised the import and warehouse declaration processing charge for imports by air and sea. That is effectively a charge on import processing by the Australian Customs Service. That charge was increased by something in the order of 30 per cent for imports by air. It was a significant increase. It is designed, I think—and I am happy to be corrected—as a way of recovering costs by the Australian Customs Service in import processing. It also means that there are significant charges that are made by the Australian Customs Service.

The first question relates to whether Treasury was made aware of these changes, if it is required to be made aware of those changes. If it is required to be made aware of those changes, was it made aware of those changes and did it do any costings with respect to the

import processing charge, the impact on the revenue and if, of course, it was not made aware of these changes, does it believe that it in fact should have been made aware of these increases to these charges? Of course, that would all fall in the bin if you are not required to.

**Mr Tune**—As I said, I will have to go back and talk to a number of people about this. We will take all of that on notice and get back to you as quickly as we can.

**Senator LUDWIG**—I understand that. I am sorry to take you through this in that painful detail, but it will help us understand without going too deeply back into all of these regulations. The part that you might want to be aware of, as well, is that in raising the threshold in 2005 the regulations mean an increasing number of import consignments will be exempt from GST and duty—of course unless they are tobacco products. The fee increase in the 2006 regulation does have another interesting effect. It could cause importers to then split their consignments up to fit in under the \$1,000 limit. If there are importers that then had a \$5,000 import, which would then have to have a declaration and be above the threshold, they may then as a wave, split their consignments up to below the threshold to avoid GST and duty. It would be caught in anti-avoidance measures, but it may simply be a business decision to split them up, not so much as an anti-avoidance mechanism, but the effect would then be to reduce the GST and duty that is paid. Does Treasury have an interest in that or has it considered that proposal?

**Mr Tune**—Just by way of a further general comment, issues that involve a change to GST tax collections always go through a process whereby we consult with the states. There would have been a formal process conducted to seek the states' agreement to some of these changes that would impact on GST, particularly where there are legislative amendments required.

**Senator LUDWIG**—It would be helpful to understand that.

**Mr Tune**—We will take you through the process that we go through.

**Senator LUDWIG**—That would be helpful. My last issue is complex in some respects, but quite easy to understand. I refer to the accredited client program. The accredited client program was awaiting implementation until another part of the Customs computer system came online. It provides a mechanism where clients—that is, importers—can be accredited and get facilitated passage through the import processing procedures. They then sign up to the accredited client program. The benefit was originally going to be a duty deferral process where the duty would be deferred from one month to the next. In the context of the 2004 budgetary process, Treasury is said to have costed a proposal for an accredited client program put forward by Customs at \$89 million over four years. What I was seeking to understand was, firstly, the process by which Treasury came to consider the proposal and, secondly, how it was that Treasury arrived at the \$89 million. I have done my own calculations and I have trouble in understanding how they got to the \$89 million. I have put it to Customs.

Perhaps they explain it best in this way—that is, the national manager of the compliance branch of the ACS explained that the \$89 million cost was the result of duty deferral where the duty owed by an importer for an entire month was paid in the first week of the following month, so it would go on each month. That does not have an effect in that financial year, until you get to June. When you get to June, apparently it then flicks over into July. The costings they used were roughly \$20 million. So in June, when it flicks to July, it is no longer in that

year; so there is a \$20 million shift into the next financial year. Can someone explain to me how that, over four years, amounts to \$89 million? It seems that the easiest way of understanding that is each June you flick \$20 million over into July; therefore, over four years, it is \$80 million. You might have a growth component or an increased component that could account for the \$9 million. That seems explicable, but how is it a loss to the system where it still will be, in the next four years, picked up in the next July?

**Mr Tune**—It may not be a cost in that sense, but it is a cost to the budget in terms of looking at the particular financial years you are talking about. I will have to investigate this further, but it sounds as though it is just the accounting conventions. As you were explaining, if you push something forward from June to July, obviously cost is incurred in that following financial year. I imagine that is the situation there.

**Senator LUDWIG**—That is how I understand it. Perhaps this is why I am in legal and constitutional and not here, but what I cannot follow is that it then does not become a real loss, in the sense that it is just pushed forward each year on an ongoing basis and, therefore, there is no bottom-line cost in what I call money. But there might be an accounting—

**Mr Tune**— There is if you keep on going long enough, I suspect that is the case. Remember that we are looking at the forward estimates period. That has an end point as well, then you would flip over into the next one, which you will not pick up until the following budget. I think it is probably just around accounting conventions.

**Senator LUDWIG**—It seems the explanation that I was given in fact says that. I understand Treasury then said, ‘We won’t agree,’ and therefore they have had to come back and do another accredited client program. It is now proposed in the new customs bill that will be introduced—probably before July this year—that, to be revenue neutral, it will split it up into two dates. It is a much more complicated process and there is no duty deferral. You then have a situation where there is now a forward estimate of what the duty and GST will be and a reconciliation before the end of the month, which then holds it each month so that you do not get the flick-over in June. What you then do is get a forward estimate—a guesstimate, in that instance—by the importer, a reconciliation before the end of the month, no duty deferral and it is designed to be revenue neutral. Whether that went back to Treasury for costing is the second real point. The first model apparently did—I wanted that confirmed—but did the second model go back? It does not seem that it did. Would it have had to go back, given it was a new iteration of the original model, or, because the Australian Customs Service then indicated that it was revenue neutral, did Treasury say, ‘We don’t need to see it if you say it is revenue neutral’?

**Mr Tune**—No. If they say it, we need to check it. It is the same as a costing.

**Senator LUDWIG**—It would be interesting to understand that process. I do not think it did come back to you or, if it did, then no-one seems to be able to tell me. If it did, perhaps there is also some modelling or an explanation of how you then arrived at also concluding it was revenue neutral. There are interest issues involved and some guesstimates as to how many importers, how many processing transactions per month and the like there are. Also, in the process there was a charge under the system—in other words, the accredited client program. The normal import processing charge was \$40 to \$50. Instead, the accredited client

program will mean that they will pay a monthly fee of \$1,275 and a fee per consignment of \$9.40, which means that instead of paying per transaction they pay a flat monthly rate plus a smaller fee per transaction. Did that model have to go to Treasury as well to see whether it would have an effect on the revenue of the government and, if not, why not?

When I look at it—granted, it is probably the first time I have been in this area—for a company like a major retailer, where Customs informed us that there would be between 4,000 and 10,000 consignments per month, there would be, as you calculate it out, a loss of revenue due to lower fees in the order of \$1.5 million to \$3.7 million per year as a hypothetical calculation. These are their figures: they picked a major retailer and said the costing was done on a \$4,000 to \$10,000 basis per consignment using 200 participants each with a basket of goods. So there is a fair bit of averaging going on, somewhere in the order of 350 per month. The yearly cost would be almost \$23 million over four years. It would amount back to the \$89 million, strangely. I was interested to see whether Treasury would have or did have an interest in that, or whether the Australian Customs Service would be required to refer it to Treasury for their costing. I refer you to page 44 of the transcript of the Senate Legal and Constitutional Legislation Committee for 25 May 2006. You might recognise a couple of names there, but about three-quarters of the way down the page Mr Buckpit says:

I am not sure which figure you are referring to, Senator. My recollection is that, if you were to look at the \$89 million figure, it was roughly \$20 million per year that was being pushed from June to July, and when you total that you end up with the \$89 million figure.

That is the basic concept of what they were using. I am sure you can get back to the committee with clarification, and I am only too happy to help.

**Mr Tune**—We will take all that on notice and get back to you as soon as we can.

**Senator LUDWIG**—Thank you.

**CHAIR**—That is a convenient point to break for morning tea.

#### **Proceedings suspended from 10.34 am to 10.50 am**

**Senator SHERRY**—I draw the officers' attention to table 4, Reconciliation of Australian government general government sector underlying cash balance estimates, on page 2-10 of Budget Paper No. 1. In the MYEFO, the underlying cash balance over the four years from 2005-06 to 2008-09 was projected to be a total of \$42 billion. Is that correct?

**Mr Tune**—You have added up the four lines—\$11.452 billion, \$9.7 billion, \$10.1 billion and \$10.7 billion?

**Senator SHERRY**—Yes. That is almost exactly \$42 billion. That was the 2005-06 MYEFO. The 2006-07 budget reported an underlying cash balance of \$47 billion over the same four years. Is that correct? That is the total of \$14.8 billion, \$10.8 billion, \$10.6 billion and \$11.2 billion, which comes to \$47 billion.

**Mr Tune**—It looks about that number, yes.

**Senator SHERRY**—To \$47.486 billion, almost \$48 billion. The \$46 billion surplus followed a \$46 billion expenditure on new tax and spending measures since MYEFO. That is correct, is it not?

**Mr Tune**—How many billion, sorry?

**Senator SHERRY**—We have got 2005-06 MYEFO underlying cash balance—a total of approximately \$42 billion.

**Mr Tune**—Yes.

**Senator SHERRY**—Then we have effect of policy decisions (a), changes from MYEFO to 2006-07?

**Mr Tune**—Yes.

**Senator SHERRY**—We have a total across there of almost \$46 billion?

**Mr Tune**—Yes.

**Senator SHERRY**—Then I go to the previous question I asked: the total of the underlying cash balance for 2006-07 is almost \$47.5 billion?

**Mr Tune**—Yes.

**Senator SHERRY**—That is correct. The starting point in 2005-06—the underlying cash balance—was just over \$42 billion. Then we have policy decisions totalling almost \$46 billion, and we end up with not a deficit cash balance but a cash balance in 2006-07 of almost \$47.5 billion. How can we spend \$46 billion, take that off the underlying cash balance we started with of \$42 billion and end up with a greater cash balance of \$47.5 billion?

**Mr Tune**—The answer is just the residual of those numbers. It is just that next line on the table, which shows the effect of parameter and other variations. It is the combination of a change in revenue and a change in expenses.

**Senator SHERRY**—We start out with a \$42 billion underlying cash surplus, we then have policy decisions totalling \$46 billion and then we have the effect of the parameter and other variations, which leaves us with a greater underlying cash balance because of the effect of the parameter and other variations. So it is the effect of the parameter and other variations in terms of boosting the underlying cash balance after the expenditure decisions? That is correct, is it not?

**Mr Tune**—Yes.

**Senator SHERRY**—Is it not correct that if there were no policy decisions (a)—the decisions listed there—which total approximately \$46 billion, the underlying cash balance for 2006-07 in the budget would be \$93.5 billion?

**Mr Tune**—It would be higher by \$46 billion, the sum of the policy decisions.

**Senator SHERRY**—That is right—which would take the total to just over \$93 billion?

**Mr Tune**—Yes.

**Senator SHERRY**—The four-year surplus increased by approximately \$51 billion since MYEFO was released before new taxing and spending measures, did it not?

**Mr Tune**—By \$51 billion?

**Senator SHERRY**—Yes, the four-year surplus.

**Mr Tune**—If you start with the MYEFO surpluses of \$42 billion, I think we—

**Senator SHERRY**—Yes, just over \$42 billion.

**Mr Tune**—We have a forecast here. What we are saying here over the four years is \$47-and-a-bit billion—

**Senator SHERRY**—Yes.

**Mr Tune**—We have only increased by \$5 billion.

**Senator SHERRY**—Net. I am referring to \$51 billion. You have got—

**Mr Tune**—The sum of the effects of parameter and other variations is \$51 billion. Is that what you are saying?

**Senator SHERRY**—Yes.

**Mr Tune**—Yes.

**Senator SHERRY**—I would like to turn to page 2-6 of Budget Paper No. 1. This page states that parameter and other variations have decreased forecast expenses by \$1.4 billion. It includes in that list a \$287 million reduction in estimated parenting payment expenses, largely due to a stronger labour market reducing the expected number of benefit recipients. Can you explain what that means since, as I understand it, there was no change in the employment forecast between MYEFO and the budget?

**Mr Tune**—The first point about that explanation is that it is not directly comparable to the total we were looking at earlier. That first total we were looking at was underlying cash. This is in terms of accruals. That is point No. 1. On these sorts of issues you would not expect a big difference between underlying cash and accruals. Largely these reflect changes in the forward estimates between MYEFO and the budget. We think there will be less expenditure on some of those items than otherwise was forecast at the time of MYEFO. That would have been based on experience between MYEFO and when we did the final set of numbers for the budget.

**Senator SHERRY**—It is a recalculation.

**Mr Tune**—We carry those through into the next year as well.

**Senator SHERRY**—MYEFO showed employment growth of one per cent in 2006-07. The budget showed employment growth of one per cent for 2006-07. So we have had the same one per cent in both, but we have a reduction of some \$287 million in the parenting payment expenses.

**Mr Tune**—What I am saying is that, when we looked at what actually happened in 2005-06—we are not finished yet, but when we went from MYEFO to our last crunch of the numbers for the budget—we saw declines. The Department of Finance, in fact, would have been seeing declines; these numbers are their responsibility. They would have been seeing declines, as would the agencies involved in spending that money, and that would impact on 2005-06. You have then got a new base, in effect, so you run that base through on your new parameters for 2006-07. Because your base has come down—

**Senator SHERRY**—You have new base data.

**Mr Tune**—It lowers everything.

**Senator SHERRY**—Despite the fact that the employment growth figures were not varied, you were examining the actual expense.

**Mr Tune**—Yes, that is right. As you go through each step and you get a new update of the numbers, you are learning a bit more so you are adjusting as you go, and that will feed into the out years as well.

**Senator SHERRY**—Returning to my earlier question on the effect of parameter and other variations, which totals just over \$50 billion: that is a very significant parameter variation, is it not?

**Mr Tune**—Yes, that is a combination of revenue and expenses.

**Senator SHERRY**—It is significant. I cannot recall ever seeing such a significant parameter variation in my time—certainly looking at budget figures.

**Mr Tune**—If you go back to table 2.4, admittedly this is accrual stuff, rather than cash, but you can see the breakdown in that table, towards the bottom of it, between the revenue side and expenses side. You will see there that most of that variation has been caused on the revenue side.

**Senator SHERRY**—Yes. That was an issue that there was considerable discussion about yesterday—the failure to forecast on the revenue side with greater accuracy. That is what that reflects, doesn't it?

**Mr Tune**—I do not know if you would call it a failure, and it is not for me to respond on that issue. That is for my Revenue Group colleagues to explain, which I understand they did yesterday.

**Senator SHERRY**—They attempted to explain. The parameters and other variations is an outcome of a variation in revenue—in this case, significant additional revenue.

**Mr Tune**—Correct.

**Senator SHERRY**—Overwhelmingly.

**Mr Tune**—Yes. Some of it is forecast and some of it is projection.

**Senator SHERRY**—Casting your mind back, remembering the effect of policy decisions, first, the \$51 billion mainly revenue in the underlying cash balance from 2005-06 MYEFO to the budget, can you ever recall a parameter variation of such significant size in terms of net cash?

**Mr Tune**—I cannot recall, but I have not been doing budgets—well, I have been doing budgets a long, long time, but in terms of the macro side of the budget—

**Senator SHERRY**—How long is that?

**Mr Tune**—Too long to say.

**Senator SHERRY**—A bit like estimates.

**Mr Tune**—20-odd years.

**Senator SHERRY**—I am certainly told that there has never been a parameter variation, largely the revenue, overwhelmingly—

**Mr Tune**—I would like to go and check the numbers over the last 20 years at least before I would agree to that.

**Senator SHERRY**—You might take that on notice.

**Mr Tune**—We can do that, I suppose.

**Senator SHERRY**—I am advised that there is nothing anywhere near it in terms of the impact of a revenue variation over a six-month period.

**Mr Tune**—If it is the revenue side that you want to look at, I would have to refer that on to my colleagues.

**Senator SHERRY**—I understand that. What I would ask you to do is to look at the underlying cash balance. We know what has caused it; we examined that yesterday. But if you could go back and look at the effective parameter and other variations, the reconciliation historically, and perhaps give us a table.

**Mr Tune**—You are interested in the period between MYEFO and budget?

**Senator SHERRY**—Yes.

**Mr Tune**—I have not been doing MYEFOs for all of that 20 years, obviously.

**Senator SHERRY**—Yes. I would like to turn to table 3, which is on page 2-9. In this table we have got the Future Fund earnings shown on the second last line. The Future Fund earnings are projected to be over \$8 billion between 2006-07 and 2009-10. Is that correct?

**Mr Tune**—Yes, that is correct.

**Senator SHERRY**—The earnings basis is stated there. Is that the actual capital base on which those earnings are based?

**Mr Tune**—At the moment that is based on the \$18 billion that the government deposited with the Future Fund on 5 May this year and it also assumes the full proceeds from the sale of the remaining government shares in Telstra would be deposited with the Future Fund.

**Senator SHERRY**—So assuming the full sale, which is what—\$22 billion?

**Mr Tune**—We have not talked about a number. There are numbers in there. For the purposes of the budget, and this is an assumption only for the budget I should emphasise—

**Senator SHERRY**—I accept that.

**Mr Tune**—we used the 90-day average market valuation of Telstra. That is how we get a price per share.

**Senator SHERRY**—That is the base value which is assumed to be in the Future Fund which then reflects the earnings that you have included in here?

**Mr Tune**—That is right.

**Senator SHERRY**—What is that base value that you have used for Telstra—the 90 days? What does that give us in terms of a total figure?

**Mr Tune**—There are some commercial sensitivities around all of this, partly in relation to Telstra but also because we have lumped everything together. It has also got the Snowy in it and Medibank Private and those issues.



**Senator SHERRY**—I am sorry, Snowy and Medibank Private are included in this Future Fund base?

**Mr Tune**—No, I am talking about when you get to talking about what the value is that is in there.

**Senator SHERRY**—Yes.

**Mr Tune**—It is not disclosed in the budget papers for reasons of commercial-in-confidence.

**Senator SHERRY**—The aggregate sale price?

**Mr Tune**—Yes. The commercial-in-confidence issues relate to the fact that the Snowy is in this lump as well as Medibank Private, and those issues are obviously sensitive in the market at the moment.

**Senator SHERRY**—I understand that in respect to the privatisation process, but what is the approximate base figure on which those Future Fund earnings are based? You have got \$18 billion. We know there is \$18 billion.

**Mr Tune**—It is the same issue. There is the \$18 billion, which is quite clear, and then there is this other sum—

**Senator SHERRY**—X amount.

**Mr Tune**—X, yes. And X is the figure that we cannot pass on.

**Senator SHERRY**—That earnings figure would vary if Telstra were not sold, because presumably it would not end up in the Future Fund, would it?

**Mr Tune**—Correct.

**Senator SHERRY**—Would it vary if part or all of the Telstra shares were placed in the Future Fund? It would have to, would it not? If they had not been sold—

**Mr Tune**—It depends on the relative rates of return from the dividends of the Telstra shares vis-a-vis what you would earn with the proceeds.

**Senator SHERRY**—So the earnings, if you like, would effectively be the dividend proceeds of any Telstra shares placed in the Future Fund?

**Mr Tune**—Of that part of the Future Fund's operations, yes. There would still be earnings.

**Senator SHERRY**—Yes, I accept there would be earnings. They would be the dividend payments. I think it is almost a certainty that there would be some dividend payments from Telstra in the Future Fund earnings, because there would be some Telstra shares in the Future Fund.

**Mr Tune**—You would expect that, in a balanced portfolio, the governors of the Future Fund would choose to hold some Telstra shares.

**Senator SHERRY**—The minister has already indicated that there will be some transfer. We do not know the figure yet; I am not suggesting we do.

**Mr Tune**—I am not suggesting that they might be transferred by the government. I am saying that they may go out and purchase some Telstra shares at some future time to have a balanced portfolio.

**Senator SHERRY**—I think the minister has ruled that out.

**Mr Tune**—Both possibilities are open, I would have thought. I am just talking about the normal market transactions that they make.

**Senator SHERRY**—In terms of the initial set-up, I think the minister has ruled that out.

**Senator Minchin**—You are right, Senator Sherry; we have actually ruled that out.

**Senator SHERRY**—In terms of the earnings, at this point it is assuming the \$18 billion and the Telstra X-amount only—nothing else in there?

**Mr Tune**—That is correct.

**Senator SHERRY**—If we go to table 5 on 2-11, you will see the net interest payments there. Are the Future Fund earnings included in net interest payments in this table?

**Mr Tune**—Yes, they are.

**Senator SHERRY**—Can I confirm that the table shows that government is making net interest payments in 2005-06 of \$2.5 billion?

**Mr Tune**—That is what the table says.

**Senator SHERRY**—Can I confirm the table shows the government is also making those interest payments in 2006-07 and 2007-08?

**Mr Tune**—Yes. The estimate is—

**Senator SHERRY**—‘Estimate’; yes, I accept that.

**Mr Tune**—The estimate is \$0.5 billion in 2006-07, \$0.3 billion in 2007-08 and then negative thereafter.

**Senator SHERRY**—Is it correct at the moment, and for the 2006-07 estimates, to say the government does not pay interest any more?

**Mr Tune**—In respect of 2006-07?

**Senator SHERRY**—Yes. In respect of 2005-06, 2006-07 and 2007-08, there are net interest payments being made.

**Mr Tune**—That is what the table is showing there.

**Senator SHERRY**—Yes. So the government is paying interest for 2005-06, and is estimated to for the next two financial years?

**Mr Tune**—Small amounts.

**Senator SHERRY**—Yes, small amounts. A third of it would be in respect of—

**Mr Tune**—As you can see, in 2006-07 and 2007-08 they basically amount to zero per cent of GDP.

**Senator SHERRY**—Yes. I am puzzled, Minister, given the figures in front of us, how the Treasurer can claim that the government does not pay interest any more, when we are going to

be paying interest, according to these figures, it is estimated through to at least 2007-08. The net interest payments are shown.

**Senator Minchin**—The Treasurer has made the accurate statement that we have no net debt. Obviously to that degree there is no net interest payment on any net debt. However there is, as I recall from reading the budget papers, an explanation in there of why the government has a net interest payment—because we are a banker in a sense. We lend money to students and others at rates of interest which mean that there is a net interest payment which Treasury officials would probably be better explaining than me, but there is a statement that does explain why, although we have no net debt, because of the cash flows and the lendings and borrowings that do occur within that framework, there is a residual net interest payment. Obviously we are not paying the \$8 billion a year that we were paying when we first came into government because we do not have any actual net debt.

**Senator SHERRY**—Perhaps Mr Tune could explain why, when net debt is less than zero, and the minister for finance has referred to that, in 2005-06 net interest payments are \$2.5 billion?

**Mr Tune**—It largely reflects the point that the minister made: that we have got student debt out there as well, through HECS and so forth and FEE-HELP now. We are charging less than the market rate of interest so, when you net all of these things off, you will still end up with a positive number. That is basically the explanation.

**Senator Minchin**—It is differential rates of interest.

**Senator SHERRY**—We do not stop paying interest until 2008-09, when net debt equals minus \$37.1 billion, according to this.

**Mr Tune**—That is right. You can have a negative net debt and still have a small net interest.

**Senator Minchin**—We are lending money cheaply, in other words, but paying a higher rate ourselves.

**Senator SHERRY**—We are still paying interest for it.

**Senator Minchin**—Because of government policies that involve lending money to students at low rates.

**Senator SHERRY**—I am not arguing—

**Senator Minchin**—We have never made the claim that there is no net interest payment.

**Senator SHERRY**—Yes, you have.

**Senator Minchin**—We have said there is no net debt.

**Senator SHERRY**—No. The Treasurer boasted about it in question time: ‘The government does not pay interest anymore.’ That is clearly wrong, according to these tables.

**Senator Minchin**—It is technically true, as these papers reveal, that although there is no net debt for the Commonwealth, because of other government policies and the interreaction of us lending money effectively at lower rates of interest than it costs us—remember we are maintaining a market in Commonwealth government security, so we have debt out there; we

made that decision to have debt instruments out there—so we are talking about this gross debt, but there is no net debt. Nevertheless, as a result of government policy involving lendings on our part at lower interest rates than we pay ourselves, there is a continuing net interest payment, but not as a result of there being any net debt. It is true to say we are not paying interest because of net debt.

**Senator SHERRY**—That is not what the Treasurer said.

**Senator Minchin**—I think it is a fair—

**Senator SHERRY**—He said that the government does not pay interest any more.

**Senator Minchin**—Any fair commentator, outside the Labor Party, would certainly understand what the Treasurer was saying—that, as a result of there being no net debt, we are not paying interest on that basis, but of course, as a result of what I have just described, there is a net interest payment.

**Senator SHERRY**—There is still interest being paid.

**Senator Minchin**—But not because of there being net debt.

**Senator SHERRY**—As a result of the totality of government policy, there is still interest being paid.

**Senator Minchin**—Not because of net debt. We have eliminated net debt, so there is no interest payable as a function of there being net debt. There is net interest payment as a function of other government deliberate policy.

**Senator SHERRY**—As you represent the Treasurer and I have drawn your attention to his comment in the parliament in question time, where he declared, and indeed boasted, that the government does not pay interest anymore, could you draw his attention to table 5 and point out that we are still paying interest and will be until 2007-08? Could you point that out to him, please?

**Senator Minchin**—I am sure that you can do that. I think he would regard it as rather—

**Senator SHERRY**—You are his representative here.

**Senator Minchin**—I am sure the Treasurer is well aware that the budget papers provide for a net interest payment, but that is not a contradiction of his statement, which can only be properly read as meaning that payment of interest is not a function of there being a debt. In other words, there is no net debt, so we are not paying interest as a result of that—of there being net debt—but we may pay interest for other reasons. I am sure that you can point that out to him. I will let him know that you do not quite understand what he was saying.

**Senator SHERRY**—We read in the parliamentary *Hansard* Mr Costello's comment that the government does not pay interest anymore. When we look at the budget papers, which presumably he has read, and go to table 5, we see we will be paying interest through to 2007-08.

**Senator Minchin**—I will let him know that you do not understand—

**Senator SHERRY**—That does seem to be a touch contradictory—

**Senator Minchin**—the point he was making. I will let him know that if you like.

**Senator SHERRY**—Yes, thank you very much. Is Dr Henry going to attend? I have not been informed yet. Do we know?

**Mr Tune**—I think that may be the case. I cannot absolutely confirm that.

**Senator SHERRY**—We might just clarify that. I want to go to some issues that Dr Henry raised at the Australian Business Economists on 16 May 2006. He gave an address in Sydney to Australian Business Economists on fiscal and economic outlook. On page 8 of that speech he says:

The present terms-of-trade might turn out to be short-lived. Yet, in thinking about the implications for the Australian economy of the re-emergence of China, India and others, it would not be prudent to ignore the possibility that the terms-of-trade remain well above historic levels for a considerable period of time.

In terms of the fiscal implications, what do you understand him to mean by that comment?

**Mr Tune**—As my Revenue Group colleagues explained yesterday, we have built an assumption into our projections around nominal GDP that reflect the higher terms of trade that exist at the moment well above the long-term average and we have built in a step-down over two years. If that were not to eventuate, other things being equal—and who knows if they are going to remain equal; that is a very major assumption—

**Senator SHERRY**—Other things being equal.

**Mr Tune**—If that remains the case, you would expect there to be a higher level of revenue than is there at the moment.

**Senator SHERRY**—Indeed, in that speech there are a number of charts. Chart 6 is entitled ‘Commodity prices’. It shows a forecast for commodity prices in 2006-07 and then a projection for commodity prices over the forward estimates beyond 2007. That step-down approach which you refer to is shown quite graphically in that chart, is it not?

**Mr Tune**—Yes.

**Senator SHERRY**—Can you explain the difference between a forecast and a projection?

**Mr Tune**—Basically, when we are putting the budget together we are looking at four years, or five years including the current year. What we do is actually forecast what we think might happen for the remainder of the current year that we are in—in this case, 2005-06—and we put some forecasts together around what we think will happen in 2006-07. Once we get beyond that we basically run on projections and they are based on what history has shown us.

**Senator SHERRY**—What history suggests will happen?

**Mr Tune**—Yes.

**Senator SHERRY**—The chart shows the forecast. In fact, it sort of delineates the forecast period of 2006-07 and then the step-down effect that you referred to in terms of a projection. The chart shows commodity prices are projected to fall about 25 per cent, remaining 10 per cent or so above 2000 levels—the step-down effect. That is approximately right, is it not?

**Mr Tune**—I have not got Dr Henry’s speech in front of me but I am looking at a very similar chart and it is in the budget statements.

**Senator SHERRY**—Can you explain the logic of the projections?

**Mr Tune**—I think the logic was explained yesterday in that we have such a high terms of trade at the moment that, against the long-term average, they look atypical. So we are taking a cautious approach—I suppose that is the way to put it—around our projections. But we would expect that over time there will be some sort of global supply response in relation to the high terms of trade. It seemed prudent—I think is the word that we have used—to have some assumptions in there that deviate from what we normally do in terms of projections. We have admitted quite openly in the budget papers that we have deviated from that normal process on this one occasion where we think there is a possibility and it is prudent to take account of that possibility in putting together the budget.

**Senator SHERRY**—With the step down, the second step comes to about 10 per cent above the year 2000 levels. What is the significance of the 2000 levels in the sense that we were having a talk earlier about historic trends? Does the 2000 level correspond to that long-term historic trend?

**Mr Tune**—I would have to check that but I think that, yes, it is around that mark. If you do a straight line further back you will get a sort of slight trend up, from memory, so that is the point at which the—you can go a bit further, I think, because that dip after June 2001 would be part of the long-term average, but when you get to about beyond June 2004 you can see a very sudden increase. That is where it has deviated from the long-term average.

**Senator SHERRY**—Yes, you can see a step in June 2004 for about four or five months, by the look of it.

**Mr Tune**—Yes, then an evening out, then a big leap again.

**Senator SHERRY**—Then a big leap and so that figure—but that is still 120—which is still above the 2000 levels.

**Mr Tune**—Yes.

**Senator SHERRY**—In the speech, Dr Henry said, ‘... we have taken out quite a lot of insurance against a commodity price collapse.’ Does that mean that Treasury consider the commodity price projections to be conservative or too conservative at this point in time?

**Mr Tune**—I think that is just the same point I was making earlier, that we think we have been prudent about what could happen, and therefore we have put in the step-down approach. That is all it is saying.

**Senator SHERRY**—He went on to say, ‘... if commodity prices stay up at around present levels for many years, we won’t turn out to have been too conservative in our fiscal projections.’ Does this mean that the budget surpluses of \$44 billion shown in the current budget papers in 2006-07 through to 2007-08 could well turn out to be higher—indeed, far higher?

**Mr Tune**—It depends on what happens. There are a whole range of things. You can make all sorts of ‘if’ statements; if this, that or the other happens, yes, something will change. We know that for sure.

**Senator SHERRY**—Something will certainly change, won't it? If that step down does not occur—

**Mr Tune**—Yes, I said that earlier.

**Senator SHERRY**—You said earlier that, all other things being equal, if that step-down does not occur, there is a consequential increase in revenue?

**Mr Tune**—You would expect so—other things being equal. But other things can impact on revenue, not just this.

**Senator SHERRY**—I accept that, other things being equal, there would be an increase in revenue. At what point in time of the MYEFO would you be reconsidering this issue—the impact or the likelihood of a step down?

**Mr Tune**—Absolutely. We would think again about what history between budget and MYEFO has shown us. As you know, there are some negotiations going on at the moment around iron ore prices, in particular; some are settled, some are not. We would look at the outcomes of those and then make another assessment at that point.

**Senator SHERRY**—You referred to negotiations outcomes at the present time. What are those negotiations involving contractual prices for—

**Mr Tune**—Iron ore into China, in particular.

**Senator SHERRY**—So you are examining that. That outcome was pretty good.

**Mr Tune**—That is still under negotiation. We monitor, obviously, the impact of those to see what the results are.

**Senator SHERRY**—So you are monitoring those results and that is a key component of your evaluation?

**Mr Tune**—It would be one important component, yes, but we need to monitor all the other factors that impinge on the terms of trade.

**Senator SHERRY**—There was recently a contract included, but I cannot recall the precise details.

**Mr Tune**—I think it was Japan, from memory.

**Senator SHERRY**—Yes. It was a pretty good outcome, wasn't it?

**Mr Tune**—Yes. I cannot remember the details. My feeling is that it was something in the order of a 19 per cent increase.

**Senator SHERRY**—Yes. I thought it was in the high double figures. That is a good sign in terms of commodity price outcomes.

**Mr Tune**—It may be, yes.

**Senator SHERRY**—Nineteen per cent is a pretty good outcome, isn't it?

**Mr Tune**—It was not as high as last time. There were very large increases—70-plus per cent last year.

**Senator SHERRY**—But, even with a 19 per cent increase in price, the price is not coming down, is it?

**Mr Tune**—Yes, but the terms of trade are not just impacted on by these things. There are a whole lot of factors there as well—exports, for example.

**Senator SHERRY**—There are other issues, yes, but a very satisfying observation can be made that prices are not coming down.

**Mr Tune**—Yes, from the point of view of those Australian companies that have been negotiating, that is very satisfactory.

**Senator SHERRY**—Again, on that contract, can you recall the contractual period for the 19 per cent increase?

**Mr Tune**—No, I cannot.

**Senator SHERRY**—Given that contract as one of the indicators, isn't now more likely that the step-down effect would be adjusted?

**Mr Tune**—I am not in a position to say yes or no to that. All I can say is that is one factor. We are getting more information as time goes by and we would have to assess it at the time. To predict what we might be thinking in six months time now I think would be very imprudent.

**Senator SHERRY**—But you are gathering evidence which you will bring together for MYEFO.

**Mr Tune**—Absolutely, yes.

**Senator SHERRY**—Is there any sort of indicative period by which you have to make a call in terms of this issue in the preparation of MYEFO?

**Mr Tune**—We will go through various forecasting rounds, but in terms of the detail of that it is probably best directed to my macroeconomic colleagues. They actually do the macroeconomic forecasts that we feed into the budget in MYEFO.

**Senator SHERRY**—Let us go to page 2-12 of Budget Paper No. 1 again. I refer to the statement under the heading 'Fiscal policy in a medium term setting'. It says that the budget principles:

... require the Government to focus on financial and economic risks and the impact of fiscal decisions on future generations.

It goes on to say that this:

... ensures that budget commitments are affordable beyond the forward estimates period.

Can you explain the process by which the cost of budget commitments is assessed beyond the end of the forward estimates period?

**Mr Tune**—Largely they are reflected in the intergenerational report that we do periodically.

**Senator SHERRY**—That is due out in May next year, isn't it?

**Mr Tune**—Correct.

**Senator SHERRY**—Why do you say 'largely'?



**Mr Tune**—The intergenerational report, of course, is part of the Charter of Budget Honesty. That is the sort of direct link between the two things.

**Senator SHERRY**—You say ‘largely’. Are there costings prepared on all budget commitments beyond the end of the forward estimates period? There is not, is there?

**Mr Tune**—At the time the budget is put together?

**Senator SHERRY**—Yes.

**Mr Tune**—Not necessarily, no. I can only talk on the expenses side here. Finance would approve the costings, but the departments and Finance would do costings around the forward estimates.

**Senator SHERRY**—On all budget measures?

**Mr Tune**—On all budget measures. When you look at Budget Paper No. 2, you will see every measure has four years against it.

**Senator SHERRY**—But that is not in respect to revenue, is it?

**Mr Tune**—Yes, that is true also in respect of revenue. You will do the forward estimates period.

**Senator SHERRY**—For example, the measure in the budget superannuation plan, which we discussed yesterday, has not and will not be costed beyond the forward estimates.

**Mr Tune**—That is what I am saying—you will see on both the revenue side for new measures and on the expenses side for new measures costings through the forward estimates period.

**Senator SHERRY**—Yes, but not beyond.

**Mr Tune**—No, that is correct.

**Senator SHERRY**—So it is correct that superannuation proposals in that plan have not yet been costed beyond the forward estimates period.

**Mr Tune**—Yes.

**Senator SHERRY**—Is it your understanding that the costs of some of those proposals, particularly the tax treatment proposals, will not be costed as part of the intergenerational costing?

**Mr Tune**—That is what Mr Callaghan said yesterday.

**Senator SHERRY**—Yes, that is right. Table 17 on page 6-23 of Budget Paper No. 1, under statement 6, shows an ‘Interest on Australian government’s behalf’ expense in 2006-07 of \$3.514 billion. What is the difference between that figure and the \$2.5 billion net interest expense that we examined earlier?

**Mr Martine**—I do not have the full details of what makes up the \$3.5 billion, but the net interest payment figure we spoke about earlier is a net dollar amount which is driven by the net debt portfolio. That includes net debt assets, so they get netted off. What would be included in that figure would be the amount of interest we pay on Commonwealth government securities, for example. I am not sure of the exact amount of that \$3.5 billion, but

they are essentially talking about two different things. One is a net figure, which is the net interest payments. That is a gross amount of interest paid. But, as I said, I am not quite sure of the detail of what makes up the \$3.5 billion, other than that it obviously would include the interest paid on Commonwealth government securities that we have out there in the market.

**Senator SHERRY**—Yes, but there is a \$1 billion difference between the net figure and the actual interest on the Australian government's behalf. I am just seeking an explanation as to that billion-dollar difference.

**Mr Martine**—In terms of the net interest payments—we are referring to net debt there—it is essentially the difference between what we pay out on our net debt liabilities less what we receive on our net debt assets. So net debt assets include, looking at the balance sheet, for example, on page 2-19, cash and deposits, advances paid—which were essentially the student loans—and investment loans and placements. So, for example, our term deposits at the RBA earn interest and they are part of the net interest payment calculation.

**Senator SHERRY**—What does debt assistance of \$220 million in 2005-06 comprise? That is midway down table 17.

**Mr Tune**—At the very top of the next page, it mentions

... the cessation of the agreed debt redemption arrangement between the Australian Government and the States in 2005-06.

That is the extent of my knowledge of it.

**Mr Martine**—That is the top of page 6-24.

**Senator SHERRY**—You say that is the extent of your knowledge of it. Is that the explanation of the \$220 million?

**Mr Tune**—That explains why it is \$220 million in 2005-06 but zero thereafter.

**Senator SHERRY**—That is the sole factor?

**Mr Tune**—I am going on what is written there.

**Senator SHERRY**—Yes, I know you are going on what is written there; I can read that. I am just wondering if that is the total.

**Mr Tune**—We will take that on notice and confirm that.

**Mr Martine**—This part of the document is put together by the department of finance. We can ask them whether there is anything else in that amount.

**Senator SHERRY**—On the same table, I direct your attention to the contingency reserve, which is the second last line of the table. Over the four year period of 2006-07 to 2009-10, if you add that up that comes to approximately \$24.76 billion.

**Mr Tune**—Yes.

**Senator SHERRY**—That \$24.76 billion, the contingency reserve total, is equal to more than half the value of cash surpluses reported over the same period, is that correct?

**Mr Tune**—Yes.

**Senator SHERRY**—The contingency reserve over the four years from 2005-06 to 2008-09 was \$16.59 billion, was it not?

**Mr Tune**—No, I do not get that.

**Senator SHERRY**—What do you get?

**Mr Tune**—Nearly \$12 billion.

**Senator SHERRY**—Why is the contingency reserve in the budget over four years so much higher than in MYEFO? What is the explanation for that?

**Mr Tune**—I am looking at another table which does not suggest there is much change between MYEFO and budget.

**Senator SHERRY**—Which table are you looking at?

**Mr Tune**—Table 19 in statement number 3.

**Mr Martine**—In the MYEFO, page 41 of—

**Mr Tune**—Sorry, we are in the MYEFO document, yes. I guess that is budget to MYEFO, sorry.

**Mr Martine**—In the MYEFO, for example, on page 41 we reported the contingency reserve in 2006-07 as 2.748. On page 6-23 it is 747; 5.099 in 2007-08 versus 3.611 in the budget; and 9.594 in 2008-09 versus 7.303.

**Senator SHERRY**—If you go to MYEFO 2005-06, contingency reserve totals from 2005-06 to 2008-09, I get a net total for the contingency reserve in MYEFO in 2005-06 to 2008-09 of \$16.59 billion, the figure I asked about earlier.

**Mr Tune**—Yes. If you are coming from MYEFO that looks about right, yes.

**Senator SHERRY**—Referencing to that, and then we come to the contingency reserve over the four years in the budget for 2006-07 through to 2009-10, we have a total of \$24.76 billion approximately.

**Mr Martine**—That is adding in an extra year, I think. If you are comparing the same four-year period from MYEFO—

**Senator SHERRY**—Yes, if we do that in the budget—let us take the budget figure first—and you compare the same four years you are dropping out 12 from the figure in 2004-05, you still get—

**Mr Martine**—The MYEFO four years was \$16.5 billion from 2005-06. The same four-year period in the budget, is the sum of \$2.747 million, \$3.611 million and \$7.303 million. In the absence of a calculator, that is probably about \$12 million. So, in other words, the CR for the same four-year period has dropped from \$16.5 million to around \$12 million.

**Senator SHERRY**—Yes, but in MYEFO, if we look at the four-year period from 2008-09, which is the forecast period, the total adds up to almost \$17 billion.

**Mr Martine**—That is right—\$16.5 million versus \$12 million.

**Mr Tune**—But you are not comparing like with like when you are going from—

**Senator SHERRY**—We have got an extra year.

**Mr Tune**—One drops out and a new one comes in, in the budget.

**Senator SHERRY**—And we have got a figure added in the budget for 2009-10 of just over \$13 billion?

**Mr Tune**—Yes.

**Mr Martine**—I am just looking at those four years. There are a lot of different adjustments in there but I think Mr Bowen, in the Department of Finance hearing gave an explanation about the contingency reserve and the conservative bias allowance. One adjustment that is made between MYEFO and the budget is the backing out of the conservative bias allowance.

**Senator SHERRY**—That superannuation package, the \$6.2 billion, is included in the contingency reserve, is it not?

**Mr Tune**—I am not sure about that. I will have to check that.

**Senator SHERRY**—We were told that.

**Mr Tune**—It is in the bottom line. It is definitely in the bottom line.

**Senator SHERRY**—It is in the bottom line, but it is not listed because you see there are no budget measures.

**Mr Tune**—No, but there is a costing at the back of the document.

**Senator SHERRY**—There is a costing.

**Mr Tune**—A total costing year by year.

**Senator SHERRY**—That is right. My understanding is it is in the contingency reserve.

**Mr Martine**—The proposed plan costings are largely affecting revenue, so they have been incorporated, as I think Mr Callaghan indicated yesterday, in the revenue forecasts. So it is largely in the revenue estimates.

**Senator SHERRY**—It is not in the contingency reserve?

**Mr Tune**—No.

**Senator SHERRY**—The cost of that package is \$6.2 million?

**Mr Tune**—This is an expense item here. That part of the superannuation plan that relates to changes to the pension assets test would be reflected in here.

**Senator SHERRY**—The rest?

**Mr Martine**—The rest is against revenue, so this only affects expenses.

**Senator SHERRY**—That is included in revenue then?

**Mr Martine**—Yes.

**Senator SHERRY**—The nonexpense?

**Mr Martine**—Yes. The full cost of the package is included.

**Senator SHERRY**—So the full cost is included but in two separate parts if you like?

**Mr Tune**—That is correct.

**Mr Martine**—You separate the revenue and the expense side.

**Senator SHERRY**—In terms of the contingency reserve, can you provide a breakdown of the contingency reserve with respect to legislated policy decisions, policy decisions not yet legislated and commercial-in-confidence?

**Mr Tune**—We can take that on notice.

**Senator SHERRY**—Can you provide those figures at the moment?

**Mr Tune**—I do not have them.

**Mr Martine**—I do not have a breakdown of the contingency reserves but, as a general rule, all policy decisions and measures which get reflected in Budget Paper No. 2 are then allocated against particular portfolio estimates, which is why you then see them in the budget related papers and, off the top of my head, I cannot think of any policy decisions in the budget that are included in the CR, but I would need to take that on notice. In terms of all policy decisions in BP2 that are publicly disclosed, they would all be included in portfolio budget statements.

**Senator SHERRY**—Yes. One we did discuss was the superannuation changes, which are not policy, it is a plan.

**Mr Martine**—That is right. Hence it is not in Budget Paper No. 2.

**Senator SHERRY**—Yes. Despite the fact that the Treasurer pledged that it will be legislated for, it is not included.

**Mr Tune**—It is included. It is in the bottom line.

**Senator SHERRY**—I accept that, but it is not included as a costed item that we can identify, is it?

**Mr Tune**—Only in its totality.

**Senator SHERRY**—Yes, but the individual components are not provided—

**Mr Tune**—That is correct.

**Senator SHERRY**—at this point in time and apparently never, according to the minister. I have some questions with respect to output 2.1.4, Social and income support policy advice. Are you going to handle those, Mr Tune?

**Mr Tune**—I can, with my colleagues, yes.

**Senator SHERRY**—Are Treasury officials aware of the evidence given to a housing inquiry by University of Sydney economist Professor Patricia Apps?

**Mr Tune**—No, I am not.

**Senator SHERRY**—You are not. Is there anyone else here who is?

**Mr Tune**—I do not know.

**Mr Heferen**—I recall reading some material in the newspaper. I think it was around the issue that Professor Apps raised, but I must confess that I am not across the issue.

**Senator SHERRY**—You have acknowledged a general reading but not necessarily in any detail.

**Mr Heferen**—I might make the point that Professor Apps writes and speaks on a range of issues, so it may be something else.

**Senator SHERRY**—This may jog your memory a bit if it is the reference that you may have read. Professor Apps found that, for two-earner families where the primary earner's income is \$40,000 and the second earner's income is between \$30,000 and \$35,000, taking into account family tax benefit and Medicare levy changes, the second earner, which is usually a woman, gets a tax increase of \$369 a year in the budget. Are you aware of those findings?

**Mr Tune**—No.

**Mr Heferen**—We would have to go away and check that. I cannot answer that.

**Senator SHERRY**—Has Treasury done any research in this social area, or identified that, for a family when a second earner's income rises to between \$35,000 and \$40,000, that person's tax increases to \$840 a year?

**Mr Tune**—We have not done research of that nature.

**Senator SHERRY**—You have not done any research of that nature?

**Mr Tune**—We do constantly and you will see in the budget that there is a table here in the budget overview on page 27 which looks at changes in real disposable incomes and net tax thresholds for different household types since 1996-97 and shows, for a range of about 18 different types of families—not defined to the level of income that you are defining it, but for different types of families—changes in the real disposable income. We are looking at family types and the impacts of the tax transfer system on those.

**Senator SHERRY**—Yes, I accept that. Mr Heferen, is it your group that assists in that research?

**Mr Heferen**—The bulk of that would be put together by our Retirement Income Modelling Unit.

**Senator SHERRY**—Do you have any role in that?

**Mr Heferen**—We would have some discussion to make sure that any changes that are being made are reflected in those numbers. The table would be produced through RIM.

**Senator SHERRY**—But you are Social Policy Division?

**Mr Heferen**—That is correct.

**Mr Tune**—All the policy issues emanating from that are handled within Fiscal Group, but in particular through Social Policy Division.

**Senator SHERRY**—Yes.

**Mr Tune**—Often these issues involve both tax issues and also transfer issues—income support.

**Senator SHERRY**—Yes, I accept that, and there is an amalgam.

**Mr Tune**—Therefore we need to work together on those issues, which we do.

**Senator SHERRY**—I accept it is collaborative. In that collaborative work, were you able to observe any groups which actually incurred an increase in tax?

**Mr Tune**—As a result of what?

**Senator SHERRY**—As a result of the figures that were brought together and the research that was carried out.

**Mr Tune**—What period of time are we talking about?

**Senator SHERRY**—We are talking about as a consequence of the budget changes.

**Mr Tune**—Of the recent budget?

**Senator SHERRY**—Yes.

**Mr Tune**—I am not aware of any, no.

**Senator SHERRY**—I know you are not, but I am asking Mr Heferen. He is in social policy.

**Mr Heferen**—No, I am not aware of any.

**Senator SHERRY**—You are not aware of any?

**Mr Heferen**—No.

**Senator SHERRY**—Page 28 of the budget summary sets out the improvements in disposable income in 2006-07 from tax cuts and changes to family tax benefit for a number of different family types, and you are obviously looking at it still, Mr Tune. While it sets out the total improvement for each family type, it does not break down what happens to the income of each partner, does it?

**Mr Tune**—No, it does not. It is based on the household income.

**Senator SHERRY**—Would such a breakdown not show that, for two-earner couples with low total private household incomes, some second earners went backwards as a result of changes in the budget—the second income earner, for example: the one that I referred to earlier?

**Mr Tune**—I am trying to work out why. There does not seem to be anything in the budget that would cause that. If they are a low-income earner they would have received a tax cut, as long as they are above the tax-free threshold of \$6,000, and then there was the increase to the low-income offset.

**Senator SHERRY**—Professor Apps's research shows that for a group of second earners earning from \$30,000 to \$40,000 there is a tax increase for the second income earner.

**Mr Tune**—I cannot see where it comes from.

**Mr Heferen**—Taxes have been reduced. Family assistance has not been reduced for people in that income range. The relevant thing would be the reduction in the tax on both. I do not understand a situation where that would arise.

**Senator SHERRY**—What you are saying is that, where there are two earners, both earners in a family as a consequence of the budget receive an increase in their income? They will receive a tax cut, effectively?

**Mr Tune**—As you said, these numbers are combined household incomes, so you would have to look at the numbers. If you want me to look at a specific example, then that is a different thing. I am trying to think of something that causes something that would lead to an increase in tax for either partner, but quite honestly I cannot think of anything in the budget.

**Senator SHERRY**—Could you disaggregate those figures in the budget—I assume it is Mr Heferen's role—into the impact in terms of the two-income family?

**Mr Tune**—We can take that on notice.

**Senator SHERRY**—I am not expecting that sooner—if you have those figures available. You obviously do not believe there is any adverse impact in terms of tax. You have not been able to identify one, but I would like you to disaggregate because you may find out there is. I do not know, but according to Professor Apps there is a group of people earning between \$30,000 and \$40,000, second income earners, who actually have a tax increase as a consequence.

**Mr Tune**—Even if that were true—and I am not saying it is true—I think the relevant point is around the change in the family's total disposable income.

**Senator SHERRY**—As you have shown me, but I think the second earner would like to know whether their tax is going to go up or down, as well as know what the impact on the family unit is. If there is an increase in taxation for the second earner in the income band that I have raised of \$30,000 to \$40,000, what is the impact on workforce participation of those individuals?

**Senator Minchin**—This is utterly hypothetical, based on some press report that you are reading about some professor, the facts of which are not conceded from my perspective, and I think the officials cannot conceive how it could be right. I remember reading that article and thinking that her argument was about relative benefit. She seemed to be arguing that the relative benefits of the package favoured single income families in these income brackets, as opposed to dual income families, but not that they or anyone would be in absolute terms worse off. It was a relativity argument. We are not going to entertain hypothetical questions based on a postulation from an article that we do not have before us that someone or other might be paying more tax, which we reject.

**Senator SHERRY**—I have asked for information, and you are going to take it on notice. I think it is reasonable when you are dealing with family income in cameos to show the projected outcome for the two individuals. Where there are two individuals within a cameo outcome, I think that is reasonable.

**Senator Minchin**—We have taken on notice your request for that breakdown and we will do that.

**Mr Tune**—This is the conventional way of presenting changes in disposable incomes.

**Senator SHERRY**—I am sure that if there are individuals whose tax goes up within the family unit they would be interested to know.

**Mr Tune**—All I am saying is that this is the way it is always presented and you will find that not just in government documents but in a whole range of other documents.



**Senator SHERRY**—We could have a long argument about that, but that is not the issue at hand at the moment. That concludes my questioning in outcome 2.

**CHAIR**—Senator Murray, do you have any questions for Outcome 2?

**Senator MURRAY**—I do not have general questions but I do wish to pick up 2.1.2, the Commonwealth-state financial policy advice. Do your responsibilities cover the area which has been in dispute between some states and the Commonwealth with respect to the way in which the distribution of funds in various forms occurs between the Commonwealth and the states?

**Mr Tune**—Yes, it does. The fiscal group has a division by the name of Commonwealth-State Relations Division. That is headed by Mr Willcock, who is at the table. The actual issues around the distribution of GST are actually determined by the CGC—the Commonwealth Grants Commission—

**Senator MURRAY**—I am aware of that.

**Mr Tune**—on a recommendation to the Treasurer. They do all the technical work underlying that so called horizontal fiscal equalisation, which is the technical term for it, and then there are decisions made by government of which we are party to. Yes, we are involved.

**Senator MURRAY**—I appreciate that. I am really concerned with the broader policy issues, which have been raised, particularly by New South Wales, but Victoria has also been very strong on this matter. I want to ask you about the Warren report, which I understand has been fully released now. Has your division had the opportunity to look at the full Warren report?

**Mr Tune**—Very briefly. I could not say that we have done a full analysis of it.

**Senator MURRAY**—Without going into the policy issues within, because you obviously would not be able to respond, I assume that once you have examined the Warren report in full you would report your views on that report to the Treasurer?

**Mr Tune**—Most certainly.

**Senator MURRAY**—One of the options you might include would be whether there is a valid case for reviewing the whole area of funds calculation and distribution. That is correct, is it not?

**Mr Tune**—As I said, that is an issue for government. We provide advice on that, certainly. You may be aware of it and you may not be, but the Commonwealth Grants Commission is actually looking at a process. It is called a simplification process. It is around a methodology. One of the concerns that states like New South Wales and Victoria often express around these issues is that the system is so complicated that very few people can actually get to grips with it and there are so many checks and balances in it and that, relative to other countries that operate federal systems, we have a much more complex system. We agree with that view. We think the system is too complicated and too detailed, and the Treasurer, with his ministerial colleagues—the state Treasurers—a year or so back agreed to a process of simplification over the course of the next few years.

The Commonwealth Grants Commission is in the process of developing options around the simplification of the process. That is a process going on to try and make the system more transparent, I suppose, as an objective, and that can help in people's understanding of it. Whether that then leads into something around whether the whole system changes is another set of issues—probably a more complicated and higher level set of policy issues. That is largely an issue that has been ongoing. The Warren report is one input into all of that. There have been other reports done in recent years. There was one done by Fitzgerald and Garnaut a couple of years ago, looking at similar sorts of issues. All of that becomes grist for the mill in the policy advice that we provide to the Treasurer.

**Senator MURRAY**—I agree with the central proposition that if something is difficult to understand it is far preferable in public policy to make it easier to understand because of the perceptions that arise from it. So I think that is a good starting base. I am aware that the issues concerned are so complex and so important that it would take quite some time for a review to occur and for any recommendations to flow through. But, of course, there is the budget cycle for the state governments as well as our own and, ideally, any changes should be in advance of that budget cycle so that they can factor in the changes. But I assume it would be impossible to expect any change—if change were to be considered, and I am not asking if that is happening—to occur by the end of this year.

**Mr Tune**—Yes, it would. I would imagine that if there were to be a fundamental change in the process you would probably need a couple of years advance notice of that change before you actually implemented it, because there would be periods of adjustment. What we are talking about here is a zero-sum game.

**Senator MURRAY**—Yes.

**Mr Tune**—There is a pool of GST funds and they get divvied out to the states and, if someone wins or gains out of that, someone else loses. You need to think about transitions around all of that if you are going to do those sorts of things, because the impacts can be quite severe and sudden if you make too big a jump. So I think if you were going to make a change you would certainly want to have some lead time and you would probably want to have some transitions in there as well.

**Senator MURRAY**—In my own mind, the earliest time, if the issue were really brought forward, might be for the 2008-09 financial year but, more likely, the 2009-10 year.

**Mr Tune**—I think that is probably more realistic, yes.

**Senator MURRAY**—All right.

**Mr Tune**—The simplification review is not due to report until 2010, I think. We are talking about two different things here but they are related, in a way. You can see from that that there is a very long lead time envisaged even to try and do something around simplification of the system. To make radical change to the system may, in fact, be a longer period again.

**Senator MURRAY**—I see. That is all I needed to know: your prospective time line.

[12.08 pm]

**CHAIR**—We will now move to outcome 4, Well functioning markets.

**Senator SHERRY**—I wish to deal with foreign investment trade policy advice. I understand there is a new trade policy unit that has been established within Treasury in this area?

**Mr Murphy**—Yes, six months ago the executive board of Treasury decided that we should put more resources into trade policy issues and it was decided that that function should reside with the Foreign Investment Division, so now we have the Foreign Investment and Trade Division.

**Senator SHERRY**—What is the trade unit charged with doing?

**Mr Murphy**—A range of matters. At the moment the government is negotiating free trade agreements with various countries. That is one aspect—I would give advice on that. Another is to liaise and develop trade policy and liaise closely with the Department of Foreign Affairs and Trade. Arising out of, in particular, the US free trade agreement, we have been discussing with the United States' agencies issues relating to the liberalisation of the regulation of financial services in both countries. So it has a range of functions relating to policy.

**Senator SHERRY**—How large is the unit? How many people are there and what is the funding?

**Mr Antioch**—The unit itself comprises two people. It is pretty much a coordination function.

**Senator SHERRY**—And the budget funding?

**Mr Antioch**—It is funded from existing Treasury resources.

**Senator SHERRY**—What is it? There has to be a funding for a unit that is identified.

**Mr Antioch**—The salary is at about, say, \$100,000 for each position, so probably about \$200,000.

**Senator SHERRY**—You referred earlier to the free trade negotiations. Does the unit provide direct input into the negotiations by DFAT?

**Mr Antioch**—Yes, we do. As you know, with all of these free trade agreements, various departments have responsibilities. Treasury has its own portfolio responsibilities; they are in the areas of financial services, competition policy and investment policy. That is our direct input but of course Treasury, being the department that it is, also contributes to other aspects of the free trade agenda, if you like—rules of origin, those sorts of thing.

**Senator SHERRY**—I understand there is a preferential agreement being negotiated at the moment with the UAE. Does Treasury have any input in respect of negotiating that agreement?

**Mr Antioch**—Yes, we do.

**Senator SHERRY**—You do?

**Mr Antioch**—In relation to investment. DFAT coordinates the overall effort and leads the delegation, the negotiations.

**Senator SHERRY**—What are the investment issues with the UAE?

**Mr Antioch**—They wanted the kind of treatment that we gave the US—you are aware of that?

**Senator SHERRY**—Yes.

**Mr Antioch**—Like most of the countries, I suppose their starting position was that they would like what Australia gave to the US and that is being negotiated around. They also wanted some special tax arrangements.

**Senator SHERRY**—In terms of investment issues, what are the practical issues that are being raised by the UAE? I appreciate that they want the same regime as the US but, obviously, the UAE is very different from the US.

**Mr Antioch**—It is very different, definitely. We have actually yet to hear formally from the UAE as to what they want from us. Ambit claims aside, they have actually yet to put on the table what investment treatment they want from us.

**Senator SHERRY**—UAE is oil based mainly, isn't it?

**Mr Antioch**—Yes, it is a corporation of states in the Gulf.

**Senator SHERRY**—I have been there, so I know where it is. Aren't they trying to develop a financial centre?

**Mr Antioch**—Yes, that is right.

**Senator SHERRY**—In deciding which countries to have agreements with, does Treasury have a role?

**Mr Antioch**—We might be consulted. There are times when we are not, but we might be consulted on which countries we do free trade agreements with. Generally speaking, there is a precursor to this. We look, there is a study—the government commissions a joint study. I think the latest one that was commissioned was on Mexico, for example. These sorts of studies can lead—they do not necessarily have to lead—into a commitment down the track to negotiate a free trade agreement.

**Senator SHERRY**—Did that occur with the UAE?

**Mr Antioch**—Not to my knowledge.

**Senator SHERRY**—It did not?

**Mr Beckett**—The Department of Foreign Affairs and Trade, I understand, commissioned a feasibility study into the UAE FTA before commencing negotiations.

**Senator SHERRY**—What does Australia export to the UAE?

**Mr Beckett**—From memory, I think some of our large exports are bauxite and some livestock; we also have a significant export business in relation to motor vehicles. I understand Toyota exports Camry vehicles to the UAE and to the wider Gulf region, and General Motors exports some of their Statesman vehicles as well.

**Senator SHERRY**— Presumably, there is a processing operation for alumina in the UAE.

**Mr Beckett**—I really do not know, I am sorry.

**Senator SHERRY**—It would seem to be the logical explanation for exporting bauxite, would it not?

**Mr Antioch**—It might be an entrepot.

**Senator SHERRY**—Yes, perhaps into Saudi Arabia or somewhere else. Is there complementarity in industry sectors between the UAE and Australia?

**Mr Antioch**—Probably not a great deal.

**Senator SHERRY**—That is what I would have thought, thinking about the UAE and what we export there. What do we import from the UAE? Obviously oil, presumably?

**Mr Beckett**—I think, oil; there are some travel services via Emirates and some transport services.

**Senator SHERRY**—What transport services?

**Mr Beckett**—I think it would be shipping goods from the ports in the UAE into Australia. So the costs of transportation of goods show up as an import in the current account.

**Senator SHERRY**—Yes. But in terms of goods, it is oil. It would have to be predominantly oil and oil products, surely.

**Mr Beckett**—I think they are one of the larger imports.

**Senator SHERRY**—Has there been any modelling done on the benefits of the free trade agreement with the UAE?

**Mr Beckett**—There has not been any economic modelling done. The feasibility study commissioned by DFAT was more of a qualitative study which looked at our current relationship in terms of goods and services and looked at the potential for growth in terms of Middle Eastern markets, partly in terms of exports of motor vehicles but partly in the capacity for Australian service providers to gain greater entry to those markets. It also looked at some of the UAE's interests in investment in Australia. So, it decided on the basis of that that there was merit in considering whether we could reduce the relevant barriers to trading goods and services.

**Senator SHERRY**—Was there any assessment of the economic value of it?

**Mr Beckett**—There was an assessment undertaken of where the current trade investment flows were, the significance of the barriers and potential growth in trade flows between the two countries. That was done by DFAT.

**Senator SHERRY**—What was identified as a barrier or barriers?

**Mr Beckett**—There were a number of barriers. To some extent, there are tariff barriers. To some extent, there are non-tariff barriers which might relate to the packaging of goods, procedures or issues like halal certification of meat or livestock that you might want to send there. There are also investment barriers; for example, there may be a requirement for an Australian service provider to engage a local facilitator, or there may be a restriction on how much you can invest or a requirement to undertake a joint venture. Those are the types of barriers that currently would restrict trade in goods and services.

**Senator SHERRY**—You have referred to their local employment initiatives as a barrier. Certainly when I was there there was a requirement on foreign firms to employ a certain proportion of locals in terms of local employment development. Is that still the case? Do you regard that as a barrier?

**Mr Beckett**—I do not know if that requirement exists. I am aware that there are limits on how much companies can invest in the UAE and I am also aware that there are requirements relating to the need to have a local agent, a locally based company in the UAE. These are things that can increase the cost for Australian service providers that want to operate in that jurisdiction.

**Senator SHERRY**—With regard to the US free trade agreement, has there been any analysis of the level of deficit with the US in trade?

**Mr Antioch**—Not as part of the free trade agreement.

**Senator SHERRY**—Has the trade deficit with the US not increased since the agreement began operation last year?

**Mr Antioch**—It might have. I do not have the figures in front of me. I am not sure if Mr Beckett has. I would say, though, that it is hard, because it has only been in operation for a little while—since 1 January 2005—to attribute certain flows of either trade or investment specifically to the free trade agreement so early in the piece.

**Mr Beckett**—I think the overall figure we have is that there was a decline—I think, 0.8 per cent—overall in goods and services. Goods went down a little bit and services went up.

**Senator SHERRY**—What about total value?

**Mr Beckett**—The total value of two-way trade between our countries went up by 2.3 per cent in 2005.

**Senator SHERRY**—What about the value of the trade deficit?

**Mr Beckett**—In 2004, our total exports were \$13.8 billion and in 2005 they were \$13.7 billion, approximately, so there was a very slight drop.

**Senator SHERRY**—So what you are saying is that at this point in time correlation is not causation; it is too early to tell.

**Mr Antioch**—It is, yes.

**Senator SHERRY**—When do you think it will be an appropriate time?

**Mr Antioch**—That is hard to say. It varies quite a bit, obviously, from country to country. There are all sorts of other confounding factors in here. But, without hazarding a guess here, you would want to give it a run of a few years, I think, before drawing any conclusions.

**Senator SHERRY**—You say ‘a few years’. Some people would say ‘a few years’ is 10 years and some would say two years—

**Mr Antioch**—That is why I chose the phrase ‘a few years’.

**Senator SHERRY**—I have a reputation for being so reasonable with witnesses, but I am going to be unreasonable. I think we should try and narrow the definition of ‘a few’ down. It is in a range of two to 10.

**Mr Antioch**—I would hazard a guess if I really could, but I think it is not a useful thing. The other thing to bear in mind with these free trade agreements, too, is that there are dynamic gains. That is why countries enter into agreements: because, down the track, you do expect opportunities to emerge for companies and consumers to take advantage of. Those are the sorts of thing that will evolve. There is a pace at which they evolve, and it is very hard to ascertain at the start or even at this point.

**Senator SHERRY**—It would be nice to.

**CHAIR**—I was going to say, Mr Antioch, that it is not merely a matter of extrapolating existing trends but anticipating new opportunities which do not exist in the immediate pre free trade agreement environment but which may emerge consequentially.

**Mr Antioch**—That is quite right. They are termed ‘dynamic gains’ for want of a better word.

**Senator SHERRY**—Yes, I heard the terms ‘dynamic gains’ and ‘the emergence of these dynamic gains’. It would be nice to quantify and have some evidence to evaluate it, though.

**Mr Antioch**—Ex post you could, I suppose. In principle, you could. But where we are at right now, it is just impossible.

**Senator SHERRY**—So it is too early to evaluate these dynamic gains that are wriggling around in the free trade ether?

**Mr Antioch**—That is right.

**CHAIR**— I suppose what we can say—and some of the witnesses to the Senate inquiry into the free trade agreement did say this—is that experience of other free trade agreements gives one a high level of confidence that such dynamic gains will emerge, albeit that they cannot be quantified in advance, obviously.

**Mr Antioch**—That is quite right. As I said earlier, I think that is why governments enter into these agreements in the first place.

**Senator SHERRY**—How long has it been since the agreement was signed with Thailand?

**Mr Antioch**—It also came into force on 1 January 2005, the same date as the US one. I am not sure when it was signed.

**Mr Beckett**—I think it was signed during the latter part of 2004.

**Senator SHERRY**—The precise date of signing does not matter; it is the coming into effect.

**Mr Beckett**—It came into effect at the same time as the US FTA.

**Senator SHERRY**—Yes. And there has presumably been no examination of the impacts of that to date?

**Mr Antioch**—Again, it is the same time frame. We face the same issues there with Thailand.

**Senator SHERRY**—What has happened to our trade balance with Thailand in the last year? You seem to be a mine of information, Mr Beckett.

**Mr Beckett**—What I can say is that total trade has risen by 26 per cent, so it is large growth in two-way trade. Our exports of goods and services to Thailand have risen, according to this, from about \$3.6 billion to \$4.6 billion. So it has been a large increase, especially in the export of goods to Thailand.

**Senator SHERRY**—How long has it been since the Singapore free trade agreement came into effect?

**Mr Beckett**—The Singapore agreement came into effect in July 2004.

**Senator SHERRY**—So we have a little bit more time there. Where are we with our balance of trade with Singapore?

**Mr Beckett**—I think trade has increased both ways, but trade from Singapore has increased faster. Our imports from Singapore have increased faster than our exports.

**Senator SHERRY**—The net trade balance has dropped?

**Mr Beckett**—Yes, but I suspect, although we would have to check it, that that may be a product of our refined oil imports from Singapore and the value effects of that.

**Senator SHERRY**—You may be right, I do not know. Perhaps you could just check that and give us something on notice. They are a big oil refiner, aren't they?

**Mr Antioch**—Yes.

**Senator SHERRY**—Is there proposed to be any evaluation of either the Thai or the Singapore free trade agreements?

**Mr Beckett**—There is a review process by which the trade ministers of our countries review the implementation of the agreements and how they are progressing and look for opportunities to expand them. That has happened with Singapore. We got some new arrangements in relation to law firms and a relaxation of Singaporean restrictions on wholesale banking licences. I am not sure that the first review of the Thailand—

**Senator SHERRY**—Just on Singapore, for a moment—the banking services which I think Treasury would have an obvious interest in are financial services. What has been the consequence of the relaxation of banking restrictions? Have we got any Australian banks that have been able to take advantage of that yet?

**Mr Beckett**—My understanding is that the removal of restriction we negotiated has only just come into effect. I do not have any information on that for you.

**Senator SHERRY**—I do not think I have any more questions.

**CHAIR**—This might be a convenient time to have the luncheon suspension.

**Senator SHERRY**—Could I just indicate that in terms of foreign investment and trade policy advice administration, we do not have any more questions on 4.1.1.

**CHAIR**—All right. Thank you.

**Proceedings suspended from 12.30 pm to 1.33 pm**

**Senator WONG**—I understand the Financial Reporting Council is listed with this outcome. Is that right?



**Mr Murphy**—Yes.

**Senator WONG**—Can we have Mr Macek as well?

**Mr Murphy**—Yes.

**Senator WONG**—There were a number of questions on notice from the last hearing—AT-10 to AT-16—which Ms Wijeyewardene took on notice. I do not know if we have received a response to those questions. Were they referred to the FRC by Treasury?

**Mr Murphy**—I know responses have been prepared, but they are yet to be processed through the minister's office.

**Mr del Busto**—Yes, all responses were prepared within the allocated time. As Mr Murphy has said, they have been provided to the minister's office.

**Senator WONG**—Do they go through you as well, Mr Macek?

**Mr Macek**—Not the final response, but obviously there is a discussion in terms of the question and then the FRC secretariat prepares the response.

**Senator WONG**—Did you see the draft answers before they were provided to the minister's office?

**Mr Macek**—I was involved in discussing the preparation of responses, but the final response was left in the hands of the FRC secretariat.

**Senator WONG**—Is that Mr del Busto?

**Mr Macek**—Yes.

**Senator WONG**—The answers have not been provided by the deadline or by the commencement of the hearing. Is the reason for that that they are still with the minister?

**Mr Murphy**—Yes. We are quite happy to go through those questions now if you wish, but you may have other questions.

**Senator WONG**—If they could be provided as soon as possible, we would certainly appreciate that. Senator Minchin might follow that up if they are with his colleague. Can I turn now to the abolition of the Urgent Issues Group. Is the FRC aware of some concerns being expressed by the business community in relation to the abolition of the Urgent Issues Group?

**Mr Macek**—Yes, we are, and we have communicated the view of the FRC to the AASB. The thrust of the advice that we have given to the AASB is that, firstly, we are satisfied that they have consulted widely with all of the interested stakeholders. They have taken into consideration a number of concerns raised, but we gave them one additional piece of advice, which was that appointing a transparent public panel, in our judgment, would overcome the thrust and the substance of most of the concerns that are still being aired.

**Senator WONG**—Has that occurred?

**Mr Macek**—It is their intent to do so. The new arrangements, of course, are not intended to come into force until 1 July. I have a written response from the AASB, in which they have accepted and agreed with the advice of the FRC, and I understand that they have approached

numerous people who would be considered suitable subject matter experts to be part of that panel.

**Senator WONG**—As of when is the abolition of the UIG effective?

**Mr Macek**—It is effective from 1 July.

**Senator WONG**—Has the new structure that is proposed, this transparent panel, been the subject of discussion and consultation with members of the business community?

**Mr Macek**—Yes, absolutely.

**Senator WONG**—Is the feedback positive?

**Mr Macek**—The feedback overall is supportive and understanding. There are some residual concerns raised by a minority of stakeholders. One of the main concerns there was the one which we believe is adequately dealt with by having a transparent panel of subject matter experts and in that way supplementing the technical expertise that the AASB board members will provide. The substance of some of the business concerns was that interpretations would be made by technical accountants without due regard to practical business considerations, and we believe that is now being overcome.

**Senator WONG**—Does this panel overcome the concerns of the businesspeople with whom you consulted that this will be essentially a structure in which technicians will dominate?

**Mr Macek**—It overcomes the concerns of all institutions that represent segments of the business community, with one exception, and that is the AICD. They continue to have a particular view that we do not agree with.

**Senator WONG**—Has this issue been the subject of advice to government from the FRC or recommendations from the FRC?

**Mr Macek**—Yes. When the AASB initiated their public consultation, the FRC was invited to comment. We chose not to provide any feedback to the AASB at that point but we wanted to hear back from the AASB what the outcome of their public consultative process was. When we received that feedback—and we reviewed all of the responses made in order to understand the concerns that people raised—we were satisfied that there had been adequate consultation and that the AASB had taken into account those concerns, but there was one additional improvement that we, the FRC, recommended, which was the establishment of that panel. We gave the AASB that advice and they have accepted that advice.

**Senator WONG**—Did the advice go just to the AASB or to the Treasurer's office?

**Mr Macek**—Presumably the minister is kept informed through the FRC secretariat, Treasury and periodic discussions that I have. The minister's office would be aware.

**Senator WONG**—I want to ask you some questions in relation to the Auditing and Assurance Standards Board. Were you involved in the establishment of the Audit Quality Review Board?

**Mr Macek**—We are aware of their establishment, yes.

**Senator WONG**—Can you explain to me the relationship between the AQRB, which is essentially, as I understand it, an industry initiative—would that be a correct interpretation—

**Mr Macek**—Yes, that is a correct interpretation.

**Senator WONG**—and the statutory authorities, including yours, the AUASB and the AASB?

**Mr Macek**—Prior to the CLERP 9 bill, the audit profession was responsible for its own regulation.

**Senator WONG**—I will just stop you there, in the interests of time. I am familiar with the establishment of the AUASB. I am interested in what the relationship between the AQRB and the statutory authorities will be, if you have a view or any knowledge of that.

**Mr Macek**—A co-regulatory framework now exists, which is an improvement from the previous self-regulatory framework. However, despite the additional responsibilities of the FRC and ASIC and the making of auditing standards as legal instruments, that does not necessarily mean that the profession should not have some of its own internal procedures and a framework designed to enhance the performance of the profession, and we view the establishment of the AQRB in exactly that light. It is the profession trying to manage itself and in no way does that cut across the responsibilities of the statutory bodies that you have referred to.

**Senator WONG**—Will you perform any oversight of the AQRB?

**Mr Macek**—We do not have formal oversight of them specifically, but obviously we have oversight of the profession with regard to independence and the teaching of ethics to the extent that it pertains to independence. We will have a relationship with the AQRB. We have already had discussions chairman to chairman, and we are exploring the merits of having a memorandum of understanding similar to that which the FRC has with other bodies that have an involvement in the audit profession.

**Senator WONG**—Will recommendations or considerations of the AQRB feed into the various monitoring and review processes undertaken by the AUASB?

**Mr Macek**—It remains to be seen how that relationship evolves. At the moment, they keep us informed of the status of the establishment of AQRB. It was a long time in its gestation, for various reasons. We have already had exploratory discussions as to whether an MOU makes sense. Obviously, the relationship would then follow on from the nature of that memorandum of understanding.

**Senator WONG**—The MOU would be between the Audit Quality Review Board and the AUASB or the FRC or all three parties?

**Mr Macek**—No, it would be between the FRC and the AQRB.

**Senator WONG**—Do you envisage that any of the functions currently performed by the AUASB might transit to the AQRB?

**Mr Macek**—No, their roles are very different. The AUASB is a statutory body that is in the business of making standards that now will have the force of law, whereas the AQRB is a

professional body looking at reviewing the performance of its profession with regard to the quality of the work undertaken.

**Senator WONG**—The role of the AUASB includes monitoring and reviewing auditing and assurance standards. I am not clear how the AQRB feeds into that process.

**Mr Macek**—The role of the AUASB is to make standards, not to review the profession.

**Senator WONG**—What about monitoring and reviewing the standards?

**Mr Macek**—The monitoring and reviewing of standards, to the extent that the standards might need to be modified, is obviously an ongoing function, but the enforcement of those standards and the performance of the profession is the responsibility of other regulatory agencies, in particular ASIC.

**Senator WONG**—Would you envisage that any of those enforcement aspects would transit out of the regulatory framework to a self-regulatory framework through the AQRB?

**Mr Macek**—No, that is not consistent with current government policy.

**Senator WONG**—On the previous occasion I asked some questions on the audit independence provisions. The government has foreshadowed some consideration of changes to the audit independence regulations through its regulation review of corporate and financial services. Did the FRC have some input into that proposition?

**Mr Macek**—The FRC has the role of monitoring the performance of the profession with regard to independence, and in the monitoring role that we have we obviously engage with other groups, with all of whom we have entered into an MOU. Our obligation with regard to that monitoring is to produce a report to the minister, which is tabled in parliament. Last year was the first year of our new responsibilities and we made reference in that report to the fact that within the profession there were some concerns about the practical consequences of the very prescriptive approach to defining independence, which could have unintended consequences, and therefore it might be appropriate to review whether some modification could be made.

**Senator WONG**—Is it the FRC's view that the current definitions of 'independence' are, to quote you, 'very prescriptive'?

**Mr Macek**—The FRC was merely reporting the feedback that it was getting from the profession which, because of the widespread nature of that feedback, in our view has some veracity. As to whether or not that is the case and what specific changes need to be made, that is not a matter for the FRC.

**Senator WONG**—Did the FRC recommend to government the two changes identified in the discussion paper in relation to auditor independence?

**Mr Macek**—I do not believe so.

**Senator WONG**—Does the FRC have a view about the appropriateness of those?

**Mr Macek**—I am not aware that the FRC has made any recommendations to government about the appropriateness of specific changes, unless you are referring to the proposed changes that would enable ASIC to have a role in undertaking the monitoring of Australian auditors in conjunction with the PCAOB in the US.

**Senator WONG**—There are two particular aspects of the auditor independence requirements that are termed as ‘anomalous’ or ‘unintended’ consequences, which is similar to how you described them—that is, the prohibition on an auditor owing an amount of more than \$5,000 to an audit client and the prohibition on an audit client owing amounts to the audit firm under a loan. Does the FRC have a view about the appropriateness of those aspects of the auditor independence definition being altered?

**Mr Macek**—No, the FRC does not have a specific view on those issues. But in its monitoring role and under its reporting obligations, it was bringing to the attention of the government that there were concerns within the profession that clearly, by including them in the report, we regard as having some legitimacy and as being therefore worthy of consideration for whether or not some appropriate changes need to be made. But what those changes should be is not a matter for the FRC.

**Senator WONG**—What other legitimate concerns have you identified within the audit profession in relation to the independence requirements?

**Mr Macek**—The main thrust of our report last year was that the system is not broken. It is working very well. The audit profession is doing a satisfactory job. Within the profession there were some differences. Most of these findings came out of the detailed surveillance that ASIC undertakes. When you have competitive firms it is not surprising that some firms would have particular procedures that may be different from those of others. To the extent that judgments can be made as to which of those might provide stronger protection, that observation can be made and then it is a matter of encouraging the firms, where there might be some room to strengthen their procedures, to do so. Having said that, in no case was there any concern about the performance of the audit in terms of the assurance work that it undertakes.

**Senator WONG**—I am not sure if you have really answered the question. I was interested in knowing—in terms of what you regard as legitimate concerns within the profession about the audit independence regime—whether there are matters other than those already identified.

**Mr Macek**—No.

**Senator WONG**—Is it the FRC’s view that there are legitimate concerns, for example, in relation to the imposition of cooling-off periods for all departments and during which an audit partner cannot join the relevant company board?

**Mr Macek**—Yes, one of the main challenges that the audit profession is facing is the shortage of skilled staff. To some extent, in the short term, that problem is exacerbated by virtue of so many countries moving towards global standards. The challenges are in the area of being able to attract staff, in the frequent rotation of audit partners that is required under legislation, and the ongoing concerns about the vulnerability of the system should any of the current big four fail. We have had a recent illustration in Japan of how vulnerable the system is, in terms of a lack of choice in the event that there is any further contraction or, should I say, consolidation and concentration of the audit profession.

**Senator WONG**—That seems to be an argument for some amelioration of the cooling-off period provision. Is that the view of the FRC?

**Mr Macek**—Yes, we have some sympathy with the concerns of the profession. In the event that the concerns were validated, it would reduce the choice available to the corporate sector, and that clearly would run counter to the thrust of policy.

**Senator WONG**—Has this sympathy translated to either a recommendation or advice to government?

**Mr Macek**—No, there has not been a specific recommendation or advice given to government.

**Senator WONG**—What about you? Do you have a similarly sympathetic view to the prohibition or the regulation of the provision of non-audit services by audit firms?

**Mr Macek**—The FRC does not have a view on that, albeit we are aware that there are some stakeholders who take the view that as long as audit firms undertake non-audit work then their independence is compromised. In our monitoring and surveillance undertaken by ASIC we have not found any evidence of that.

**Senator WONG**—Do you not regard that as a necessary provision in terms of independence?

**Mr Macek**—We have not found any support for the proposition that audit independence is compromised by virtue of the fact that they also undertake some non-audit work. Clearly, there are some non-audit services that are prohibited, for very good reasons. But in terms of the services that are currently undertaken, we see no evidence that that ought to be a matter of great concern in terms of compromising audit independence.

**Senator WONG**—Are you sympathetic to the view that there should be less prohibition or less regulation of what non-audit services can be provided?

**Mr Macek**—We do not have a view on that because it is not part of our mandate.

**Senator WONG**—Do you have some sympathy for the impact of cooling-off periods?

**Mr Macek**—Yes.

**Senator WONG**—Do you not regard that as the flipside of that issue, which some might argue is an important aspect of ensuring auditor independence?

**Mr Macek**—No.

**Senator WONG**—Do you not agree with that?

**Mr Macek**—No.

**Senator WONG**—Is that the FRC's position?

**Mr Macek**—The FRC has not discussed that.

**Senator WONG**—Is that a personal view?

**Mr Macek**—That would be a personal view, yes.

**Senator WONG**—Your personal view is counter to the current provisions, is it not?

**Mr Macek**—No, the policy of the FRC is determined by the full council having a deliberate discussion and taking all of the views into account.

**Senator WONG**—Does the current audit independence regime oppose certain cooling-off periods?

**Mr Macek**—The council has not discussed that, because we have not seen it as an issue that needs to be discussed by the FRC.

**Senator WONG**—But your personal view is you do not believe cooling-off periods for audit partners before joining company boards is one of the ways in which one can try and encourage independence of audit?

**Mr Macek**—Clearly, but the debate really is only over what the appropriate time period needs to be.

**Senator WONG**—What is your view about the appropriate time period?

**Mr Macek**—I do not think my view is relevant on this matter.

**Senator WONG**—You put it before that you thought you had some sympathy, so I am inviting you to clarify what your view really is.

**Mr Macek**—In general, I think there needs to be some cooling-off period, but one could always find exceptions to that rule because, at the end of the day, we should be concentrating on the quality of the overall result. Independence is clearly one issue that can compromise quality, but it is only one element.

**Senator WONG**—Is the FRC going to consider the issue of cooling-off periods?

**Mr Macek**—It is not a matter that the FRC has felt necessary to discuss, so the FRC does not have a view.

**Senator WONG**—So this is your personal view?

**Mr Macek**—Yes.

**Senator MURRAY**—You said the FRC has a role in monitoring independence—is that right?

**Mr Macek**—Correct.

**Senator MURRAY**—How do you test that independence as a general proposition?

**Mr Macek**—Clearly, independence is a requirement under CLERP 9, so there are proscribed procedures and relationships that are prohibited. For example, certain non-audit services are prohibited. There are specific provisions that prevent an audit firm having an economic interest in an audit client et cetera.

**Senator MURRAY**—I am aware what the legislation says, but how do you test that the audit firms are complying with the legislation?

**Mr Macek**—ASIC undertakes very detailed surveillance and that is complemented by independent evaluations that the FRC undertakes as well. The principal focus of those is to understand what internal procedures and systems that are applied to maintaining those procedures are being adopted within the audit firms.

**Senator MURRAY**—You are not monitoring independence. You are telling me ASIC is monitoring the independence?

**Mr Macek**—Under current government policy and legislation ASIC is the statutory body that has been funded specifically with the role of undertaking that detailed surveillance given that it complements the role it has always had and continues to have in terms of enforcing compliance with the law, and audit is part of that.

**Senator MURRAY**—Why do you say you have a role in monitoring independence, then, if you do not have any role at all?

**Mr Macek**—We do have a role. It is established under legislation. Our responsibility is to monitor and report to the minister with regard to the two features that I have highlighted, namely, audit independence and the teaching of ethics as it pertains to audit independence. In forming a view we consult widely with various stakeholders. In terms of the detailed surveillance of individual firms, we rely quite heavily on, but work cooperatively with, ASIC which has been funded to undertake that detailed surveillance.

**Senator MURRAY**—Let me repeat back to you my understanding of your response. It is ASIC which tests the independence; it is the FRC which consults with respect to the remit you are given by the legislation.

**Mr Macek**—Correct.

**Senator MURRAY**—In your discussions with ASIC, do you ever give them guidance as to areas you would like them to test with respect to independence?

**Mr Macek**—We have that capacity, and certainly we can provide them with feedback that we might obtain through our dialogue with the profession. The profession might be more reluctant to relay directly to ASIC, given that they also see ASIC as the enforcement agency.

**Senator MURRAY**—You say you have that capacity. Do you exercise that capacity? Have you discussed with ASIC specific areas of independence you would like tested either more thoroughly or areas that have not been tested before?

**Mr Macek**—Independence is independence. There are not specific areas of independence that one needs to dissect. Auditors are either independent or not, and our interest is how the audit profession exercises that responsibility in terms of its own internal procedures. Therefore, our principal interest is in understanding the nature of ASIC's inquiries, with whom they are engaging, how widespread that is and, to the extent that we had any concerns about the adequacy of ASIC's activities, we clearly, under our responsibilities, would need to engage additional surveillance. To date we have had confidence in the activities that ASIC are undertaking.

**Senator MURRAY**—You say independence is independence. Let me test that proposition. Do you, for instance, regard someone under the patronage of a dominant shareholder as independent?

**Mr Macek**—To a large extent, independence is a state of mind. The role of audit is to verify that the financial statements that the company presents to the public as reflecting the state of health of that business are accurate.

**Senator MURRAY**—You look far from naive, Mr Macek, but my long experience in business and politics indicates you need more than a state of mind to guarantee independence. Let me give you this proposition: I understand from ASX and other research that there is a



dominant shareholder or shareholders in probably a majority of listed companies. Therefore, they are capable of determining who will be the directors on that board. Those directors then form the audit committee. The audit committee appoints the auditor. There is a clear run in patronage all the way through. Auditors who are subject to that downstream patronage are not independent even if they might present themselves so. Also, I might say, neither are directors who couch themselves as independent in that sense—they are subject to patronage. You say independence is independence. Do you regard someone under the patronage of a dominant shareholder either directly or indirectly as being independent?

**Mr Macek**—The auditor has clear responsibilities under law in terms of the activities that they undertake. They have to sign off on their audit and they therefore have no incentive whatsoever to be swayed by, as you put it, the patronage of a dominant shareholder or management team that is there by virtue of the grace of the dominant shareholder.

**Senator MURRAY**—There are numerous instances, both pre and post CLERP 9, where auditors' lack of diligence is implicated by either inference, allegation or fact in companies being in difficulty. I am not convinced that your answer in fact covers the ground and, if I may say so, you avoided the question. I do not think you did that in any devious sense; you simply said that the law requires a certain performance. But as you know well, as an experienced man, indirect allegiances or ties or obligations can put an onus on somebody that may or may not influence the conduct of their duties. That applies as much to politicians, auditors, directors or anybody else.

**Mr Macek**—The main scenario under which the auditor's independence might be compromised would be where they have an undue reliance on the audit fees from one client and therefore would feel concerned about losing that client, or where they undertake substantial non-audit work that might cause them to compromise the audit. Having said that, there is little evidence that there are systemic issues with regard to the performance of the audit profession in Australia in general and in particular relating to independence. One can always find isolated cases. On some occasions they may involve significant loss, which is unfortunate. But in terms of the systemic issues, which is the main focus of the surveillance, there is no evidence that there is a systemic problem with the performance of the audit profession.

**Senator MURRAY**—As someone who has been intimately involved with corporate law at a legislative level for 10 years, I do agree that CLERP 9 has significantly improved matters, and the government is to be complemented on advancing the standards. But I am still not satisfied in my own mind that either ASIC, the FRC or anyone else is sufficiently across the indirect obligations. They have tended to address the direct obligations—and correctly so. Anyway, we will leave it there. Thank you for your answers.

**ACTING CHAIR (Senator Watson)**—What is the view of Financial Reporting Council towards the retention of separate public sector accounting standards?

**Mr Macek**—As you may or may not be aware, when the current institutional arrangements were put in place the two separate boards, one dealing with private sector accounting and one dealing with public sector accounting, were rolled effectively under the one umbrella, being the responsibility of the AASB. The FRC has the responsibility of providing strategic

direction or directives to the AASB in its activities of making the standards, and it has done so with regard to both the private sector and the public sector. With regard to the public sector, the strategic directive that was issued in December 2002 was that the board, in developing public sector accounting standards, should seek to harmonise between GFS and GAAP, with the intent of producing a single set of accounting standards that would represent the financial reporting for the public sector. Historically in Australia the two boards previously and now the one board have by and large adopted what many people refer to as sector neutral accounting. What they mean by that is that like transactions are treated in like fashion, regardless of the sector under which that activity is undertaken.

**ACTING CHAIR**—What progress has been made since that earlier date that you mentioned?

**Mr Macek**—There are two initiatives that are relevant to answering that question. Firstly, with regard to the harmonisation of GFS and GAAP, not surprisingly given the enormous task in moving to adopting and then implementing IFRS for the private sector, the AASB did not progress rapidly its development of public sector standards. Over the last 18 months or so, the public sector standards have assumed a much higher priority. There have been various exposure drafts put into the public domain. We understand that there have been significant concerns expressed by the public sector with regard to some of those standards. Those concerns are being taken into account by the AASB and that is still very much a work in progress. With regard to the underlying principle under which the standards are being developed—namely, sector neutrality—the FRC has appointed an independent consultant to undertake a review of the principles of sector neutrality, to examine the practices in different jurisdictions that we might regard as having high-quality standards, to understand the reasons for those differences and to form a view and make some broad observations as to the appropriateness or not of that particular principle. The consultant is due to present its draft and final report to the FRC ahead of our meeting on 22 June.

**ACTING CHAIR**—You have some fairly strong advocates of retention in some instances of public sector standards, from a CPA and even from the Australian national auditor, all of whom have spent a lot of time in terms of developing those standards for the peculiarities of accounting in terms of the public sector. A lot of work has gone on over the years, and obviously you would be aware of that. I come back to the basic question, which I think has to be answered: what is the purpose of the uniformity that you are seeking?

**Mr Macek**—We are not seeking any uniformity in the way that I think you are phrasing the question.

**ACTING CHAIR**—What you are doing is leading to that situation.

**Mr Macek**—Are you referring to the harmonisation of GAAP and GFS or sector neutrality?

**ACTING CHAIR**—Sector neutrality.

**Mr Macek**—That has been an historical approach that Australia has taken. Interestingly, in the consultation with various stakeholders there is widespread support for the principle that the measurement principles underpinning standards should be the same. However, there is also an acknowledgement that the purpose of the activities undertaken by the private sector,

the public sector and the not-for-profit sector are quite different, and there are some specific reporting requirements that might relate to only one sector that might, as a result, mean that having some variations to reflect those differences might be appropriate. That is something that we, the FRC, are hoping will be brought out in the review of sector neutrality that is being undertaken by our independent consultant.

**ACTING CHAIR**—Let me raise the case of heritage structures or buildings et cetera. I put it to you that a valuation in such circumstances can be quite complex and can cost a lot of money and, at the same time, have absolutely no influence in terms of a bottom line outcome, given that its revenue is determined at the whim of the Treasurer of the day in conjunction with maybe the minister for environment or even cabinet. I ask: why put such a heavy charge on a public sector asset where that valuation cost is going to have absolutely no influence in terms of its profitability or its bottom line, just for the sake of a uniformity type principle?

**Mr Macek**—You have highlighted one of the very clear examples of difference between the various sectors that are coming out in terms of the review. The specifics of making a standard are very much the responsibility of the AASB and are not an issue that the FRC would specifically deal with. However, the FRC does have the responsibility to give strategic directives. One of the possible scenarios that might flow from a review of the principle of sector neutrality that obviously we will need to consider over coming months could be to give greater leeway or clearer guidance to the AASB that they should take into account these differences between the various sectors.

**ACTING CHAIR**—It is a case, I believe, of one size does not necessarily fit all, particularly in the case of the public sector and particularly in the case of certain public sector assets, which are less likely to provide a meaningful guide for investors, because, after all, that is probably the bottom line. That is why I came back to you asking you for a definition of what you are aiming for in harmonisation in terms of neutrality because I think even within that framework it should not be so stereotyped as not to allow for some differences where those differences are very significant and impose enormous costs relative to their revenue in terms of valuation.

**Mr Macek**—Possibly the easiest way to answer the thrust of your question is that what the FRC would hope will come out of this review is, in a sense, either an answer or very clear pointers to the question you phrased, which is: does one size fit all? That, in a sense, is the question that we are trying to evaluate. And if the judgment down the track is that one size does not fit all, then what strategic directive might the FRC need to give to the AASB in order to give the AASB the flexibility to produce standards that are relevant and applicable to the different sectors, given that each sector has a different purpose in terms of its activities?

**ACTING CHAIR**—I would just mention, by way of background, thousands of man hours went into the development of these public sector standards. I, for one, would not necessarily wish to see them completely wiped out in this so-called new regime, which in itself possibly does have some limitations across all jurisdictions. So what are the terms of reference for this inquiry and does the inquiry allow for the development of exceptions to the general rule?

**Mr Macek**—The terms of reference are basically to undertake a review of the conceptual framework that underpins the principles of sector neutrality and to examine different

jurisdictions. It is fair to say that Australia and New Zealand probably lead the world or are ahead of other jurisdictions in terms of embracing this broad principle of sector neutrality, albeit the AASB would say that we do not, strictly speaking, have sector neutrality, that what we have is transaction neutrality. There are other jurisdictions such as the United States, the United Kingdom and Canada, all of whom have very high-quality standards and have a legal and a market framework that is somewhat similar to ours, and part of the review is to review and understand how they deal with this issue and why and what learnings might be developed from that review.

**ACTING CHAIR**—To use another analogy, we may say that Australia has some of the most stringent arrangements to allow the locking up of the maximum amount of ocean against exploitation of fishing, and the environmentalists would say that is a great thing, but of course that comes at a cost. It comes at a cost to certain fishermen, fishing villages and so on, even down to the extent of recreational fishing. While we say we are leading the world in all these sorts of things, it is great in a sense but I would just point out it comes at a cost. I would ask you to bear in mind the cost in being absolutely too pure, as against being pragmatic in terms of the need for the public sector standards. In terms of the second issue, could you tell me what developments are really occurring there? What progress are we making towards getting a single reporting approach, where we have differences currently between the Treasury and, for example, the Bureau of Statistics in terms of how they prepare their documentation? What progress has been made there?

**Mr Macek**—I can give you a high-level view on that but it might be a question, in terms of getting a more detailed answer, that is perhaps best addressed to the AASB. But before I deal with that I would just like to make one final observation with regard to the previous matter. The FRC are very much aware of the need to evaluate, in a sense, a cost-benefit analysis of the implications of the standards that might evolve from our process. Our overarching criterion—and this is one that we will apply in reviewing the sector neutrality issue—is one of public interest. Clearly, the public interest in terms of who is the public is different in the private sector for businesses, as it is in the public sector, as it is in the not-for-profit sector. So we are very much on the same page as you are in terms of understanding the importance of acting in the best interests of the public and, by implication, getting the cost-benefit analysis right.

In terms of harmonisation, the process is one where there has been an exposure draft that was put out early this year. It raised considerable concerns from within the public sector. There have been ongoing discussions between those various stakeholders airing their concerns and making various recommendations. My understanding is that the AASB is taking those on board and is progressing to effectively finalising a draft of the standards that would achieve one principal effect—that is, a single set of accounting standards, as opposed to two different sets that could be reconciled. I also understand that whilst that is the direction that the board is taking, and that direction does have the support of the public sector stakeholders, the board itself is by no means unanimous on that being the right outcome. But as I prefaced my remarks—

**ACTING CHAIR**—Could you elaborate on that just a little bit more because that is an interesting concept that you have raised.

**Mr Macek**—What I am saying is that the standards board has listened to the concerns raised by the public sector, it has taken them on board and is moving in a direction that is consistent with the advice that the public sector has given it, which would be consistent with alleviating and overcoming the majority of the concerns. But in doing so—and bearing in mind that the standards, as a result, are still work in progress—it will require a strong majority of the board to endorse those standards. My understanding is that it is not yet clear whether the board within itself yet has arrived at that strong consensus.

**ACTING CHAIR**—Does that mean the board is leaning one way, is it leaning the other, or is it going to be a compromise between the two approaches? Can you give us some idea of the direction in which the outcome is likely to proceed?

**Mr Macek**—As I said earlier, it is probably a question best directed to the AASB, but essentially the AASB will finalise—

**ACTING CHAIR**—But they take advice from you.

**Mr Macek**—the draft set of reporting statements that are consistent with what we the FRC believe would be acceptable to the public sector, but, in the process of converting that draft into final standards that are then submitted to parliament, it will require a certain majority of the board to endorse those standards. It is not yet clear whether, given the mix of people sitting around the AASB, they yet have the necessary majority.

**ACTING CHAIR**—Which way is the dice likely to fall—in favour of the Treasury approach or the Bureau of Statistics approach?

**Mr Macek**—It is not a question of one approach or the other. It is a question of a single set of standards, because that is the principle objective—so that there is one set of standards that the public sector can use for its financial reporting for general purpose accounts for general government as opposed to whole of government. That is clearly what will be the outcome of the work the board is undertaking at the moment; that is what it is producing. But, in terms of the process by which that draft work becomes a standard that is then tabled in parliament, it does require the necessary support of the members of the board. As to the likely outcome of that, that is not a judgment I can make; I am not involved with the board and it is a question that is perhaps best directed to the chairman of the board.

**ACTING CHAIR**—When is this likely to be resolved?

**Mr Macek**—Again, that is a question that should be directed to the board. I am not sure exactly what their timetable is for completion of the draft standards.

**ACTING CHAIR**—But at the same time they are dependent on your finalisation of the issue, the resolution from your point of view of what the direction should be. They will not make that decision until your people have come to some resolution.

**Mr Macek**—No, the two areas of FRC interest or focus are separate and independent of each other. The view that we take ultimately on the principle of sector neutrality is not really germane to the issue of producing a single set of general purpose financial statements that can be used by the government sector. The directive and the objective of the activities of the AASB essentially are to take, on specific standards, the best option from either GFS or GAAP

so that the final version will, in a sense, be a hybrid but it will be a single set of high-quality reporting standards.

**ACTING CHAIR**—I put it to you that we would have a very unsatisfactory situation from a parliamentary point of view, if it has to be put to the parliament, if you each came to different conclusions.

**Mr Macek**—There will only be one conclusion. That will be a standard. The issue is whether that standard is acceptable to the stakeholders that have the principal concern in those standards, namely the public sector. My understanding is that the board is working in the direction that is consistent with all of the feedback that it has received from the public sector.

**ACTING CHAIR**—That is a little bit more encouraging. Perhaps we had better leave it at that.

**Senator SHERRY**—I do not have any questions for the Financial Reporting Council but I have a question in respect of mortgage brokers legislation. This is the appropriate section, isn't it?

**Senator MURRAY**—Can the FRC go?

**Senator SHERRY**—Yes. I do not have anything for the Financial Reporting Council. As to mortgage brokers, I understand that the states are developing legislation on the regulation of the mortgage broking industry.

**Mr Love**—Yes, that is correct; they are working through the Ministerial Council on Consumer Affairs.

**Senator SHERRY**—Each state is to draft its own legislation in coordination and in an attempt to achieve uniformity, as I understand.

**Mr Love**—Yes. My understanding of the situation is that it is an approach based on template legislation and that New South Wales is taking the lead on this issue and that the other states will be following along the lines of the template developed by New South Wales.

**Senator SHERRY**—I note your comment 'along the lines'. Do we have a draft template publicly available yet?

**Mr Love**—The working group on this issue is still working there. The Australian government is actually not a part of that particular ministerial council working group. Our role is monitoring it.

**Senator SHERRY**—What is your understanding—surely you would be keeping an eye on this?

**Mr Love**—Yes.

**Senator SHERRY**—Is there a publicly available template?

**Mr Love**—Not yet. The group has not settled on their final recommendations and made a report to the ministerial council yet.

**Senator SHERRY**—Do you have an indicative date as to when we are likely to see that?

**Mr Love**—At the last meeting of the ministerial council, the working group reported to the council on their progress, but I do not recall and I would have to take that on notice. I am not aware if they have announced a date.

**Senator SHERRY**—I note comments from Mr Naylor, who is the chief executive of the Mortgage Industry Association of Australia, saying he hoped final legislation would be ready in about two years. That was a comment made on Monday, 8 May. Is that your understanding, that on the current rate of progress we are looking at about two years?

**Mr Love**—We are talking about progress that is in the control very much of the states and not the Commonwealth.

**Senator SHERRY**—I understand that.

**Mr Love**—Looking at previous attempts at putting together uniform template legislation—for example, the Uniform Consumer Credit Code—that is probably a realistic working time.

**Senator SHERRY**—I am not having a go at anything the Commonwealth is doing, but the states do not come to estimates, unfortunately. Has the Commonwealth's ability to regulate legally in this area been assessed?

**Mr Love**—This relates to basically the provision of lending and credit.

**Senator SHERRY**—Yes.

**Mr Love**—At present the situation is that that is being left up to the states. In a constitutional sense it is a matter where it would be possible for the Australian government and the states to discuss the issue about how they would be approached. That is not a matter of government policy at the moment.

**Senator SHERRY**—No, I am not asking about government policy; I am asking about a matter of fact as to the legal basis head of power for the Commonwealth to legislate in respect of financial services regulation, in this case mortgage brokers.

**Mr Love**—There are aspects of credit which the Commonwealth already does deal with, for example, under the ASIC Act. The general consumer protection powers do extend to credit.

**Senator MURRAY**—Is the national regulator, ASIC, involved in this working group, if they have a specific regulatory function?

**Mr Love**—In regard to the development of the actual legislation, no, ASIC is not a part of the working group. This is a working group of the states.

**Senator MURRAY**—Yes, I appreciate that, but, if mortgage broking affects some Commonwealth responsibilities and intersects to some degree with a national Commonwealth regulator, how are those interests taken into account?

**Mr Love**—At the moment it is being done through the forum of the Ministerial Council on Consumer Affairs, which reports to the minister and which includes the Parliamentary Secretary to the Treasurer as the minister representing the Australian government there, and through the advice that he receives from us we have a role in monitoring the developments in that area and checking on how that policy is being developed.

**Senator MURRAY**—How does occur in practice? Do you have an observer at the working group sessions?

**Mr Love**—As a general part of the reporting systems of the Ministerial Council on Consumer Affairs, papers are circulated to all the jurisdictions there. We see all these papers and we examine those and we advise the government on the progress.

**Senator MURRAY**—When they meet physically do you have an observer there?

**Mr Love**—In their working group meetings, no. There is a particular working group that has been set up to prosecute this issue. Certainly the working group reports through to the committee of the officers of MCCA, and they receive a report on where the working group is up to. We have an officer at those meetings.

**Senator SHERRY**—Another area is promissory notes.

**Mr Love**—Yes.

**Senator SHERRY**—My understanding is the Commonwealth at the moment has a question mark in respect of its ability to regulate promissory notes?

**Mr Love**—I do not think there is a question about our ability to regulate promissory notes. We do regulate under chapter 2L of the Corporations Act currently. However, you have to understand that promissory notes have two elements to them. There is the credit side, when someone has actually been lent money under them. As a credit issue, they are dealt with through the Uniform Consumer Credit Code but, as an investment issue, they are dealt with through the Corporations Act.

**Senator SHERRY**—Again, there is no legal or constitutional impediment to the regulation of promissory notes in respect of the credit aspect, is there?

**Mr Love**—No. They fit more generally as well under the general framework of the Bills of Exchange Act, which is another piece of Commonwealth legislation.

**Senator SHERRY**—Thanks for that.

**ACTING CHAIR**—Why have you not moved to ensure that instruments—mezzanine finance and promissory notes—come under the influence of the Managed Investments Act? Surely that would be the logical head of power to encompass these sorts of transactions, because after all—I think it was in 1998 or 1999—that was the head that was used to regulate unit trusts. Why have you been so reluctant to use that head of power or regulation that I refer to as the Managed Investments Act?

**Mr Love**—There is currently a regulatory structure around various forms of debentures in chapter 2L of the act. There is an issue that is currently being litigated before the Western Australian Supreme Court on appeal regarding some definitional issues under the regulation of these things, and that is one of the matters currently that we understand is up for appeal and is subject to interpretation. Whether or not certain uses of promissory notes through investment schemes should be in fact seen as a form of managed investment, that is a question that ASIC has sought to litigate.

**ACTING CHAIR**—What is the argument that they should not be?



**Mr Love**—I have not brought the issue. I have not litigated. We would probably think that ASIC has taken a very reasonable view in its litigation on this in that—

**ACTING CHAIR**—It probably is. It has gone to the courts.

**Mr Love**—yes—there should be a managed investment scheme.

**ACTING CHAIR**—And in the meantime people have lost lots of money while the litigation continues. It is not a very satisfactory outcome when we get dozens and dozens of letters—

**Senator SHERRY**—Hundreds.

**ACTING CHAIR**—yes, maybe hundreds in your case—from people who have lost most of their life savings. We are a little bit impatient with respect to regulators suddenly discovering gaps in their jurisdiction.

**Mr Love**—I do not think that it is necessarily a question of whether or not a gap presently exists. That is a matter which we would have to examine as a consequence of the outcome of the present litigation.

**Senator SHERRY**—You do not believe a gap exists? Why not?

**Mr Love**—Some of the issues that have been raised in the present litigation arose prior to the introduction of the financial services reforms. One of the aspects of the financial services reforms is an extremely wide definition of what is an investment type arrangement. Not necessarily the disclosure items around the promissory notes themselves but, in relation to the wider issue about advice regarding promissory notes, our current view would be that they would be covered by financial planners, for example, giving advice on those which could be covered by the present chapter 7 requirements.

**Senator SHERRY**—From what date?

**Mr Love**—There was a transitional period, as you know, with the introduction of the financial services reforms, and persons became subject to the regime at the point at which they became licensed during that transitional period. So it would depend very much on what time a person providing advice came under a current financial services licence.

**Senator SHERRY**—Would any advice on existing contractual arrangements be automatically covered once they became licensed?

**Mr Love**—Do you mean advice that was provided prior to them coming under the rules of the regime?

**Senator SHERRY**—No. They provide advice prior to coming under the rules once they are given their licence. So they have provided that advice. If they give subsequent advice after receiving their licence, presumably that advice comes under the regulation. The advice they gave prior to coming under the licensing regime—question mark?

**Mr Love**—Yes. That is where there would be a question mark about the extent to which the rules were applying at that stage.

**Senator SHERRY**—I have two other quick matters. Has there been an examination of clearing houses?

**Mr Love**—Clearing houses in what sense? That covers a very wide range—

**Senator SHERRY**—A clearing house that clears monetary, superannuation and financial services transactions that is not an entity within an existing regulated financial institution, such as a bank, a credit union or a super fund. There are stand-alone clearing houses that are involved to varying degrees in money transactions. What is their status?

**Mr Love**—The regulators, ASIC and APRA, have been examining this issue about their operation and are having a look at that. There is an ongoing examination of their operation to understand exactly what they are doing. We understand from preliminary views provided to us by ASIC in particular that there is quite a variation in how they exactly operate, and so ASIC is considering, in discussion with APRA, the most appropriate way that this should be dealt with through the regulatory system—for example, whether or not they are required to have an Australian financial services licence.

**Senator SHERRY**—At least you are aware of the issue and the potential problems that could occur.

**Mr Love**—Yes. For more than the last year, they in particular have been looking at their operation.

**Senator SHERRY**—One last issue—banking fees. I understand the Treasurer recently had a meeting with the banks. There were reports in the media about it and a report from the ABA is to go to Treasury on aspects of banking fees. Has such a report been sent to Treasury yet?

**Mr Love**—That is outside my area.

**Mr Legg**—I believe the ABA has provided the Treasurer with a report and we have a copy of it.

**Senator SHERRY**—Treasury has been provided with a copy as well?

**Mr Legg**—Yes.

**Senator SHERRY**—Can you tell me when that was received?

**Mr Legg**—Within the last two or three weeks. It is in that time frame.

**Senator SHERRY**—When I use the term ‘banking fees’, it was reported that it went, as an example, to issues in respect of entry and exit fees?

**Mr Legg**—Yes. The Treasurer, as I think he said publicly, raised with the banks the importance of customers being able to move smoothly from one institution to another to ensure competitive forces work in the way we would hope them to, and they assured him that they thought that was the case and they said that they would provide him with a paper which set out why they thought that was the case. So that paper has been provided.

**Senator SHERRY**—In fact exit fees are much more prevalent in superannuation; that would be my observation. Has there been any report from the superannuation industry to Treasury on entry and exit fees in superannuation products?

**Mr Legg**—Not that I am aware of.

**Senator SHERRY**—Has the incidence of entry and exit fees across the financial services sector ever been the subject of any surveillance, investigation or reporting by Treasury?

**Mr Legg**—I am not aware of any systematic approach to that issue.

**Mr Murphy**—We are looking at a proposal from IFSA in relation to the legacy products to rationalise. One of the problems with people moving out of old products is that some of those products have very prohibitive exit fees.

**Senator SHERRY**—They certainly do.

**Mr Murphy**—Yes, notorious. As part of that exercise on seeing whether we can fairly, for the industry and for investors, come up with a regime of winding up legacy products and enabling the investments to be shifted to new products, we will be addressing those issues about these outstanding exit fees.

**Senator SHERRY**—So there is a document that has gone from IFSA to Treasury on this matter?

**Mr Murphy**—Yes, and in the document which was released by the parliamentary secretary on corporate law and financial services I think he has identified that as one of the issues he is seeking public comment on.

**Senator SHERRY**—What is the time frame? Is there any time frame for resolution of this issue? I understand there are about half a million Australians who have a so-called legacy product.

**Mr Murphy**—We would be initially seeking public comment. If you were doing something you would be looking at maybe getting some policy approval from the government in the second half of this year and then trying to do it.

**Senator SHERRY**—Has there been any report received from industry organisations in respect of exit fees going forward, prospectively?

**Mr Murphy**—No, I do not—

**Mr Love**—I will deal with that. No, there are—

**Senator SHERRY**—So you deal with the future, Mr Murphy deals with the past.

**Mr Love**—He is my boss, so he knows everything I am doing.

**Senator SHERRY**—I am glad he has given you the future. He is dealing with the past. Is that a good sign for your future?

**Mr Love**—The industry is suggesting that this is very much a problem that was mainly related to older style life insurance products.

**Senator SHERRY**—Yes.

**Mr Love**—The view that has been put to us by industry is that modern products will not raise this sort of problem down the line. That is an issue we are exploring with industry very much.

**Senator SHERRY**—I am glad you are exploring it with them, because I have been to a few websites and looked at these so-called non-exit fee products. Have you carried out any research work in respect of the so-called administration charges for exiting products—they do not carry the tag of ‘exit fee’ but there is an administration charge applied?

**Mr Love**—Specific research, no. At the moment we are gathering information from industry in order to carry out a regulatory impact analysis and assessment and to look at the legacy product issue.

**Senator SHERRY**—It is not the legacy product I am talking about; it is products currently available for investment.

**Mr Love**—One thing I would say there is you might be aware from last year that we introduced an enhanced fee disclosure package.

**Senator SHERRY**—Yes.

**Mr Love**—The template has been to be put in PDSs. One of the desirable outcomes—

**Senator SHERRY**—These are PDSs that no-one can understand yet.

**Mr Love**—One thing it has done, and one of the key outcomes of this, is that it has forced standardisation of calculation and methodologies on the industry.

**Senator SHERRY**—Yes, I accept that.

**Mr Love**—It is making things far more transparent.

**Senator SHERRY**—When people can find it to read it, I accept that that is the case.

**Mr Love**—You have got to look at these things holistically. What you are doing is that by introducing that standardised methodology you are forcing industry to talk about things in the same way. Even though people might not necessarily read the PDSs in great detail themselves, it is allowing people who monitor these to present that information in a standardised form.

**Senator SHERRY**—Sure. I have got a 100-page PDS here. I was not going to raise it with you; I was actually going to raise it with ASIC. But I am just wondering how bewildered consumers can understand this gobbledegook that is being issued in the name of protecting consumers.

**Mr Love**—The actual rules themselves are not driven by us. I think I have mentioned in previous sessions to you that we have introduced a short-form PDS regime which allows the industry to present that core information that they need to. The current PDS regime or what were the rules up till now basically said that there has to be a large class of information that should be made public, and we have not moved away from that. But what we are saying is the form of a document that gets handed over at one particular time—you can do it in much shorter form—

**Senator SHERRY**—How short?

**Mr Love**—Everyone wants particular pages or numbers—that is not up to us.

**Senator SHERRY**—But from your observation, how short are they?

**Mr Love**—They should be able to get them down to under 20 pages.

**Senator SHERRY**—Under 20 pages! Is this from particular factual analysis of these things?

**Mr Love**—We did some analysis last year of PDS length and we found out that 70 per cent of the information that was provided in a lot of these very big PDSs was not actually mandated information. It was all about investment options and things that were in the hands of industry.

**Senator SHERRY**—Yes, sure. But what about these short-term PDSs—what are the observations that you can make? There are drafts available now, as I understand.

**Mr Love**—The industry is working on them at the moment and looking at trying to drive that.

**Senator SHERRY**—Yes. How many pages are they running to at the moment?

**Mr Love**—As I say, the document is under 20 pages.

**Senator SHERRY**—Under 20? How far under 20—19?

**Mr Murphy**—Surely it is a matter of where people are comfortable with the information they are given when they are investing their money. I know we think that a PDS of 100 pages may be excessive, but for some people, if you are investing money, you might find it worth reading.

**Senator SHERRY**—Sure. Critically, have you done any consumer testing as to the readability of these shorter PDSs?

**Mr Love**—It is up to industry. It is their job; it is their legal obligation to produce documents that are clear and concise and effective—

**Senator SHERRY**—Why is it their legal obligation?

**Mr Love**—It says so in the law.

**Senator SHERRY**—Yes, exactly. Who imposes the law?

**Mr Love**—What we have said is that—

**Senator SHERRY**—‘It is up to industry’! Flick it to industry.

**Mr Love**—They are the ones who write the stuff. It is their consumers, and they are the ones trying to communicate with the consumers.

**Senator SHERRY**—Have you been listening to industry recently about this issue? The law and the regulations set out what is required to be in a PDS. Sure, they write it, but they have to respond to the law. They can only do what is contained within the law, which the parliament passes, surely.

**Mr Love**—But it is not just a case of what is in the law, it is where they have taken their interpretation of the law. As you know, we have very carefully looked at and we are continuing to look at the drivers behind why the behaviours have been such. It is not just what is in the law. The law, actually, is not that prescriptive.

**Senator SHERRY**—Are you trying to blame the lawyers now?

**Mr Love**—Yes, we can always blame the lawyers in this area.

**Senator SHERRY**—Well, I do not.

**Mr Murphy**—No, I think it is a complex issue, and to try to get it right on the adequate or appropriate amount of information which a person needs to have to make an informed investment decision is a difficult thing.

**Senator SHERRY**—But the bottom line is: has there been any consumer testing yet? You have put out your proposed short-term PDSs, you have put out the templates and made the suggestion, but has there been any consumer testing undertaken to determine whether this stuff is readable? Have you done it?

**Mr Murphy**—Treasury has not done it.

**Senator SHERRY**—Right. Okay.

**Mr Murphy**—I think you should ask ASIC, but also—

**Senator SHERRY**—They have not done it, either.

**Mr Murphy**—I reiterate David's point.

**Senator SHERRY**—No-one seems to have done it.

**Mr Murphy**—It is in the financial interests of these companies—

**Senator SHERRY**—Of course it is. It is in everybody's interest to get this right, Mr Murphy. We have got FSR, we have PDSs flowing out at 100 pages-plus, we have had two sets of refinements, and no-one has yet bothered to consumer-test whether these things are readable and understandable by consumers. You have not done it. The regulators have not done it.

**Mr Murphy**—I might get back to you on that because I think you would find, if you talk to industry, that there has been a hell of a lot of consumer testing. You might say that that is not appropriate or that they are not the ones who should be doing it, but I think there has been a lot of consumer testing.

**Senator SHERRY**—Are you aware of any of those results? We are talking about individual firms here doing consumer testing?

**Mr Murphy**—Yes. But a lot of this stuff would have been done a few years back. I am not aware of any at this stage.

**Senator SHERRY**—What, of the 100-page PDSs?

**Mr Murphy**—No, about what people are interested in knowing about when they make investment decisions. I think it is a hard decision. Anyway, there are experts in this area, but I think it is a hard thing to know.

**Senator SHERRY**—We have got an initial go and I think we are into the second refinement stage at the moment, aren't we?

**Mr Murphy**—Yes.

**Senator SHERRY**—I am not blaming you. At the end of the day, it is government's responsibility. They pass the law, they make the regulations. What flows from that flows from the law. It is not your fault. I do not even think it is ASIC's fault, or the industry's fault.

**Mr Murphy**—It is a process that can be improved upon, that is all I am saying.

**Senator SHERRY**—Yes. Well, everyone's in screaming agreement about that. It is just taking a long time. Okay, thanks.

**Mr Murphy**—Thank you.

**Senator SHERRY**—I understand that at the Council of Australian Governments meeting in February there was consideration given to changing the method of appointing officials to the ACCC?

**Ms Seeber**—One of the recommendations that came out of the COAG communique was that the conduct code agreement be reviewed by senior officials to look at the appointments of commissioners to the Australian Competition and Consumer Commission.

**Senator SHERRY**—Does this also include a review of the states' consultation?

**Ms Seeber**—Yes.

**Senator SHERRY**—And the 35-day period?

**Ms Seeber**—Yes. It is the appointments process, the consultation processes and also the consultation processes associated with proposed amendments to part 4 of the Trade Practices Act. It is basically to try and streamline the arrangements.

**Senator SHERRY**—Also the reform process in respect to companies' appeal decisions of the ACCC decisions. Have you been handling a review of that?

**Ms Seeber**—No, not myself.

**Senator SHERRY**—Where would that fall?

**Ms Seeber**—The reform of—

**Senator SHERRY**—The process by which companies appeal decisions of the ACCC? Who would be handling that in the Treasury?

**Mr Murphy**—That is not an issue in COAG. There is in the Banks report on *Rethinking regulation* a view that largely the decisions of the regulatory bodies should be in certain aspects and that merits review should apply to certain decisions, but that is not in particular to the ACCC, so I would have to check that out.

**Senator SHERRY**—Who is handling this response within the Treasury?

**Mr Murphy**—For the Banks review?

**Senator SHERRY**—Yes.

**Mr Murphy**—Our group is.

**Senator SHERRY**—You are handling the response on all the recommendations, or just in respect to financial services?

**Mr Murphy**—Financial services and those aspects of regulation. The revenue group will be handling tax. There are also recommendations on the environment.

**Senator SHERRY**—Yes, I understand. It might take a bit longer than I thought.

**Mr Murphy**—I thought it would.

**Senator SHERRY**—What is the timetable for response in respect to financial services?

**Mr Murphy**—In response to this *Rethinking regulation* report, half of the recommendations have been responded to in the government's interim response. There is an interdepartmental committee, chaired by Prime Minister and Cabinet, with all the other departments working through all the various recommendations. I think they are hoping to put something out in the next couple of months. The Prime Minister will respond to the remaining recommendations.

**Senator SHERRY**—Have you examined the recommendation by the PC in respect of the minimum cut-in for the payment of the superannuation guarantee levy?

**Mr Murphy**—No.

**Senator SHERRY**—You have not. That is a recommendation.

**Mr Murphy**—That would be, as mentioned earlier, a revenue group report.

**Senator SHERRY**—Who is coordinating that?

**Mr Murphy**—The revenue group.

**Senator SHERRY**—It is listed under financial services though, is it not?

**Mr Murphy**—It might be. It depends if it is a tax issue or it is a disclosure issue. Under our arrangements in Treasury, where it is issues of disclosure or licensing of superannuation providers, it is the markets group; where it is related to tax, like the superannuation plan, then it is the revenue group.

**Senator SHERRY**—That is a tax matter?

**Mr Murphy**—Yes.

**Senator SHERRY**—It is not a tax?

**Mr Murphy**—It is superannuation.

**Senator SHERRY**—It is not a tax?

**Mr Murphy**—Yes, I know.

**Senator SHERRY**—Are you aware of that? We are all in screaming agreement that it is not a tax.

**Mr Murphy**—I will not buy into that.

**Senator SHERRY**—You do not have to; we are all in agreement, it is not a tax, which is why I am wondering how Tax ended up with it. There are a whole range of proposals in respect to reducing duplication overlap of APRA and ASIC. Have you been handling those?

**Mr Murphy**—Yes.

**Senator SHERRY**—Do the proposals to resume national competition payments to states fall within your area?

**Mr Murphy**—Yes.

**Senator SHERRY**—Where are we up to?

**Mr Murphy**—That is why we bring a lot of people.

**Senator SHERRY**—Yes, you are very busy.



**Ms Seeber**—There is the final assessment under the current National Competition Policy arrangements. The Treasurer made an announcement last December about payments, and then there were also some water related NCP commitments for which the National Water Commission made assessments recently, so basically 2005-06 is the final year under the current National Competition Policy.

**Senator SHERRY**—There are payments still outstanding, are there not?

**Ms Seeber**—That is for this financial year, 2005-06.

**Mr Murphy**—Then that is the end of that scheme.

**Senator SHERRY**—Is there any indicative date or time frame on when there will be announcements on the outstanding payments?

**Ms Seeber**—The announcement was made in December last year by the Treasurer for the payments which included penalties which were permanent deductions, because it was the final arrangements. Just before Christmas there was a press release by the Treasurer.

**Senator SHERRY**—So there are outstanding payments, but they are covered by that press release?

**Ms Seeber**—Yes, by that press release. There are some water-related assessments that the National Water Commission has made just recently, which include suspension payments, but that will be following under a separate arrangement.

**Senator SHERRY**—That is subsequent to the Treasurer's announcement last year?

**Ms Seeber**—Yes.

**Senator SHERRY**—Are there any other outstanding areas?

**Ms Seeber**—No.

**Senator SHERRY**—COAG is developing a framework to speed up regulatory decisions to a maximum of six months. Are you aware of that?

**Mr Murphy**—There are various aspects of the COAG agenda. I think you might be referring to the infrastructure?

**Senator SHERRY**—Yes.

**Mr Murphy**—There is a COAG working group. In the communique of 10 February COAG committed to a number of principles to try to improve infrastructure decision making, and at the moment there is a committee of officials largely working through putting time deadlines on when these recommendations have to be implemented from.

**Senator MURRAY**—Is that state and federal officials?

**Mr Murphy**—Yes. It is actually meeting today. It is chaired by Treasury. I usually chair it but Mr French is chairing it for me.

**Senator MURRAY**—Whilst you are on regulations, I questioned Prime Minister and Cabinet on the recommendations of the Productivity Commission's regulation review, and half of those recommendations have so far been responded to.

**Mr Murphy**—Yes.

**Senator MURRAY**—Does your division have responsibility for tracking that one through COAG?

**Mr Murphy**—As well as the Banks committee report, COAG has also agreed on reforms to ensure better regulation-making practices and it has also identified eight hot spot areas where there should be largely uniform regulation throughout Australia—occupational health and safety and things which will be of great benefit.

**Senator MURRAY**—Does that cross over to the Banks report?

**Mr Murphy**—Yes, in some aspects. So some of the Banks recommendations will have to be implemented through Commonwealth-state relations or COAG.

**Senator MURRAY**—Does that mean effectively you have responsibility for the Banks recommendations implementation, where they have been accepted by government?

**Mr Murphy**—We are a part of a number of departments who have responsibility. For instance, in say largely financial services, Treasury would largely be responsible. The Banks report is a report to the Prime Minister and the Treasurer, so Treasury has a very strong interest in making sure that all the recommendations of the Banks report, where accepted by the government, are implemented.

**Senator MURRAY**—As a department you only have responsibility for the specific areas that fall under your responsibility. The rest—say, Transport or Health—are coordinated through PM&C; is that right?

**Mr Murphy**—Yes. We are with them, but we would say that, because the Treasurer was a co-commissioner of this report, the department takes a keen interest in making sure that these recommendations are implemented across the board.

**Senator MURRAY**—So, although you do not have prime responsibility, you are monitoring it all; is that the way to describe it?

**Mr Murphy**—Yes, that is right.

**CHAIR**—We move to output 4.1.4, actuarial services.

**Senator SHERRY**—Mr Martin, I notice in the statements that the budget estimate for actuarial services is the same as the figure for 2005-06. Why is that the case?

**Mr Martin**—That has been the case for some time. The office, as you would be aware, operates on a fully self-funding basis. The expenditure for the coming year is, for simplicity, driven off what it was in the preceding year. In practice, there is some variation around that, but that is normally not too big.

**Senator SHERRY**—What is the current employment level?

**Mr Martin**—We have one fewer than when we previously spoke. We have three qualified actuaries and three analysts. We also engage a retired actuary on a casual basis from time to time.

**Senator SHERRY**—Where does the generation of revenue appear in the budget statement? You charge for services to departments, don't you? Is there an aggregate figure that I can identify somewhere in the budget papers? I could not find anything.

**Mr Martin**—It would be equal to or projected at least to be equal to the budgeted expense.

**Senator SHERRY**—That is \$1.6 million?

**Mr Martin**—Yes. It will be what it will be, but that is the projection.

**Senator SHERRY**—The workload that you are undertaking is not projected to change at all; it will remain constant?

**Mr Martin**—For that purpose.

**Senator SHERRY**—Are there government departments and agencies that employ the services of outside actuarial consultants?

**Mr Martin**—Yes, indeed there are.

**Senator SHERRY**—That is what I thought. Is there a published list?

**Mr Martin**—Of what, sorry?

**Senator SHERRY**—Outside actuarial consultancy services? It would be presumably listed within the reports of each department and agency. Is there no way to identify that across the entire public sector?

**Mr Martin**—Not that I am aware of, no.

**Senator SHERRY**—Is your office normally approached in respect of bidding for the work that is contracted to the private sector?

**Mr Martin**—That will depend on the individual agency. Certainly everything we do is fully contestable in the sense that we would compete with the private sector for the majority of our work. Individual agencies will seek quotes from private sector firms and from us. For certain contracts they are required to go to tender on an open tender basis.

**Senator SHERRY**—Do you do any work or is there any prospect of consultancy work with governments overseas?

**Mr Martin**—That will happen from time to time. We had a very small job in Canada at the start of this year.

**Senator SHERRY**—What was that about?

**Mr Martin**—Canada has been revising its compensation scheme for its veterans. It is doing so along similar lines to the revisions that were undertaken here two or three years ago. Prior to that, we were in Thailand looking at its pension scheme, but that was back in 2004. So it is pretty infrequent.

**Senator SHERRY**—And you do not tender for any work at all in the private sector, do you?

**Mr Martin**—No, we do not.

**Senator SHERRY**—Is there any legal constraint on you being able to do that?

**Mr Martin**—There is no legal constraint that I am aware of. That has been the convention forever and a day; that practice does mean that the Government Actuary's office is free from any private sector conflict of interest.

**Senator SHERRY**—But they can tender against you, can't they?

**Mr Martin**—Yes, that is correct.

**Senator SHERRY**—Thank you.

**CHAIR**—We can now excuse those remaining officers in outcome 4.

[3.13 pm]

### **Australian Securities and Investments Commission**

**CHAIR**—Mr Lucy, do you have an opening statement?

**Mr Lucy**—I have a very brief one, if I may.

**CHAIR**—Do you happen to have any copies of the text of your opening statement to hand?

**Mr Lucy**—Yes, we do.

**CHAIR**—Can those be circulated, please?

**Mr Lucy**—Yes. Mr Chairman, members of the committee, in attendance today we have Jeremy Cooper, Deputy Chairman, who is of course known to the committee; and Mark Steward, from Enforcement, who is attending if the committee wishes to pursue its interest in the Westpoint Group, the actions in respect of which Mark is leading within ASIC. At the outset, I note that we trust the committee understands that, given our current and ongoing investigations into the Westpoint Group, we may need to be somewhat circumspect in our answers to particular questions to ensure that our investigations are not prejudiced, with the exception, of course, of historical matters. As it has been only three months since our last appearance before this committee—on 16 February—and we are due also shortly to appear before the parliament joint committee on 13 June 2006, I therefore have no intention on going into the detail of our activities and achievements in the last quarter, which is to be reflected shortly in our half-year end results.

However, I would like to mention a matter that is unlikely to have come to the attention of members of the committee. Under the Australia-Indonesia Partnership for Reconstruction and Development—the government partnership fund of \$1 billion that supports the Indonesian reconstruction and development efforts following the effects of the tsunami—\$50 million has been set aside for a five-year program that will assist Indonesia in economic, financial and public sector management through the exchange of skills and expertise between Australian and Indonesian government agencies. ASIC has successfully applied for a grant of more than \$1 million under this fund, which covers internal and external secondments between ASIC and the Indonesian capital markets supervisory agency, Bapepam.

There are currently eight Bapepam secondees at ASIC, with two of those being made available from a financial contribution by the World Bank. The program is designed to build capacity with Bapepam in the areas of prospectus, enforcement and market surveillance. The program is being viewed as a pilot program with a broader objective of ASIC providing technical assistance in the region and, in so doing, producing financial stability. One highly experienced ASIC officer will also go to Jakarta in June for three to six months to provide

technical on-the-ground advice and support in developing and implementing the action plans in consultation with Bapepam senior management.

ASIC will be meeting with the new Chairman of Bapepam at an upcoming IOSCO conference in Hong Kong to discuss this program and to ensure that it continues to deliver on the aim of capacity building for the agency. I intend to visit Indonesia during the term of our staff secondments. ASIC remains vigilant in managing security and safety issues for staff and the confidential information we obtain in undertaking our regulatory activities. I would also like to take the opportunity to table our *Better regulation: ASIC initiatives* booklet, which we launched earlier this month. It outlines a number of regulatory enhancements which we intend to deliver as part of our agenda for the next 18 months. This document has been widely circulated.

**CHAIR**—It has been circulated to all of us, I believe. It is a very handsome publication, if I may say so.

**Mr Lucy**—Thank you, Mr Chair. I was keen to have it tabled today. That was for the purpose of referring to it now.

**CHAIR**—Senator Sherry has a couple of general questions. Senator Watson, Senator Murray and Senator Sherry all wish to ask some questions about Westpoint, so we will have Senator Sherry's general questions first. We will then go to Senator Watson, then Senator Sherry and then Senator Murray, in that order, in relation to questions about Westpoint. However, in a thematic sense, if senators want to jump in on one another, subject to the usual courtesies, that is fine.

**Senator MURRAY**—I should advise you that Senator Boswell called in and said that he had a specific interest in Westpoint.

**CHAIR**—Senator Boswell's mind might be elsewhere at the moment.

**Senator MURRAY**—He may be added to your list.

**Senator SHERRY**—The National Party's perspective.

**CHAIR**—Thank you, Senator Sherry, there are no politics in this committee.

**Senator SHERRY**—Turn it up—it is all about politics. I have a couple of general questions on resourcing issues, which my colleague Senator Wong will go to a little later. In terms of the current appropriation—not the new announcements made in the budget—what proportion is covered by the levy system? Do we know? A regulatory levy applies. Is that funding all of ASIC's operations, putting aside the moneys that were outlined in the budget?

**Mr Lucy**—Are you referring to 2005-06?

**Senator SHERRY**—Yes.

**Mr Lucy**—During that year we will recover, on behalf of the federal government, about \$550 million, which is repatriated as part of general revenue. That is a clear transaction. Separately, the federal government makes an appropriation in favour of ASIC. To the extent that you could describe one being paid out of the other, I would suggest that is an oversimplification, because certainly the moneys we raise do go to general revenue.

**Senator SHERRY**—Putting aside the budget announcements—a couple of hundred million dollars—for the moment, it is not full cost recovery yet? Are you still a bit short of full cost recovery?

**Mr Lucy**—No, we recover greater than the moneys—

**Senator SHERRY**—That was in 2005-06.

**Mr Lucy**—Yes.

**Senator SHERRY**—Going forward, in 2006-07, there were significant allocations in the budget, which I know Senator Wong wants to ask about in some detail. Is that a straight allocation from general revenue?

**Mr Lucy**—Yes, it is.

**Senator SHERRY**—So it is not to be recovered through the levies?

**Mr Lucy**—No, it is not.

**Senator SHERRY**—Thank you for explaining that to me . I have one other matter—

**Senator MURRAY**—Are you on a general budget question?

**Senator SHERRY**—Yes.

**Senator MURRAY**—I just want to ask a general budget question, if I may. Mr Lucy, you were given increased funding of \$14.2 million towards information technology for ASIC over four years. Of your additional funding of over \$200 million, only \$30 million was to be used by ASIC to fund enforcement activities associated with the investigation of exceptional matters that are of significant public interest. My question to you is whether that is adequate.

We heard from the tax office how much money it needs to pursue particularly large issues. For instance, \$300 million was allocated in January for Wickenby matter. There was another \$82 million for another matter. Yours seems light by comparison, given your load. I am not certain you have enough for what may be in prospect.

**Mr Lucy**—If I can answer that in two parts, starting with the IT aspect. For the year ended June 2006, our focus has been to ensure that we have the necessary reliable hardware so that we can move forward in developing new software for our systems. We now have hardware that is robust. It is now working at 60 per cent capacity, whereas perhaps a year ago it was running at about 120 per cent capacity. We have also rolled out, throughout the agency, new laptops, PCs, et cetera. From a hardware perspective, we have completely refreshed what we need.

Going forward, there are going to be some very big decisions taken as to which direction we go as far as, firstly, platforms and then systems. For example, ASCOT, which is our major database as far as the corporate register, is about 15 years old. Indeed, I think we are one of only two agencies in Australia using that software. As a result, the cost of maintaining it is going up astronomically. We expect during the 2006-07 year to be in a position to make some significant decisions going forward as to the direction we go from an IT perspective.

Our funding bid, which was supported by the budget, was to do with two aspects. One is to further enhance our security and business recovery areas and the other is to put us into

a position to undertake whatever is necessary to determine which big decisions will be taken regarding our IT going forward. That is a matter for future funding requests.

**Senator MURRAY**—So is it essentially evaluative and project money rather than implementation money?

**Mr Lucy**—Yes, there is security and, yes, there is business recovery—which is real money that we need to spend this next financial year—but the balance of it is exactly as you describe. It is preliminary to making decisions as to where we go.

In relation to enforcement, that comes under several areas. It is the amount that you referred to, but we have also received an amount of \$120 million over four years. We describe that as a litigation contingency. When that was considered in the budget process 2004-05, the government essentially said to us and to Treasury that it wanted a more appropriate method to deal with litigation contingency without the need to go back to the government to seek funding on a case-by-case basis. That was worked on during the last six months, and the process has now been put forward through the budget. The process allows us to draw up to \$30 million per annum over four years, which obviously equals \$120 million. From our perspective, we have sufficient funding to fund our resource requirements in enforcement for the next 12 months and the balance of the next three years after that.

**Senator MURRAY**—Major cases are hugely expensive.

**Mr Lucy**—They are.

**Senator MURRAY**—I have seen estimates in terms of AWB Ltd. Their legal expenses to date are about \$20 million. That is one set of defendants, if you like, in one circumstance. For a prosecuting agency, any major litigation would be tens of millions, I would assume.

**Mr Lucy**—That is true, except that much of what you might be thinking about would be in the criminal area, which is not our responsibility to prosecute; that is with the DPP.

**Senator MURRAY**—But the investigations?

**Mr Lucy**—Investigations would definitely be in our area.

**Senator MURRAY**—It seems to me that you constantly have to be watching what goes on and be fortressing your investigation by contesting injunctions or attempted impediments that are put before you in the courts.

**Mr Lucy**—Yes. Nevertheless, \$30 million is a significant amount of money. In the past, for example, for the current financial year, our expenditure on external litigation costs, apart from HIH, James Hardie and One.Tel but insofar as general business, is about \$7 million.

**Senator MURRAY**—Can you assure me that I am not going hear from citizens of Australia a complaint that some ASIC officer has told them they cannot deal with their case because they do not have the money to pursue it?

**Mr Lucy**—Yes. I am assuring you of that.

**Senator SHERRY**—I have a couple of other matters. I notice that the average staffing level will increase—I think for pretty obvious reasons, the extra budget allocation—from 1,476 to 1,578, an increase of just over 100, or about seven per cent. That is a substantial staffing increase, is it not?

**Mr Lucy**—It is, yes. But, again, it is primarily in the area of surveillance, because we have received substantial moneys to increase our involvement in surveillance as well as identifying and better understanding some of the more sophisticated products that are there and also dealing with the increased enforcement capacity.

**Senator SHERRY**—I asked a number of questions in February, and I know my colleague Senator Conroy is in the same position. We do not seem to have an answer to the questions taken on notice.

**Mr Lucy**—I can advise you that we have responded to every question and it must be with the minister's office, if you have not received them.

**Senator SHERRY**—Do you know approximately when those responses were sent to the minister's office?

**Mr Lucy**—I must say that some would have been last week. But I would suggest three weeks ago to last week.

**Senator SHERRY**—I have received some. Senator Minchin, can you shed some light on this, because we do not have all of the answers to questions on notice. Apparently there are some in the minister's office.

**Senator Minchin**—The minister or the Treasurer?

**Senator SHERRY**—Yes, presumably the Treasurer. It would be the Treasurer's office, would it not?

**Mr Lucy**—Yes.

**Senator SHERRY**—This goes back to February's hearings. We do not have the responses.

**Senator Minchin**—I will chase that up in the afternoon tea break.

**Senator SHERRY**—If you could. You are aware that we will see you again in just over a week's time too, Mr Lucy?

**Mr Lucy**—Yes.

**Senator SHERRY**—I thought you would be. They were the only general questions I had.

**Senator MURRAY**—Mr Lucy, let me again, as is my practice, congratulate your public communications unit, the ASIC media unit, on the regular provision of your media releases. I find them very useful. Yesterday's, dated Tuesday, 30 May 2006, was headed 'Queensland investors recover losses in failed solicitors' mortgage scheme'. It detailed as an attachment the action ASIC had taken in relation to a number of matters. There was well over a page in small type—it looks like font size 10. It listed a substantial number of matters concerning solicitors' mortgage schemes, which would affect the probity and integrity with which the solicitors concerned had operated those mortgage schemes. The ATO has taken a great interest in solicitors, because of their past failure—they have been brought pretty well up to date—to conduct their tax affairs correctly. Indeed, the various law societies have been active in that regard. Where solicitors have been investigated and found to be in breach of their duties in areas such as this, is the ATO aware of them and is it cross-checking? As you know, there is often a link, in that people who do not fulfil their duties in one area often do not do so in



another. Is this information automatically communicated in the dialogues that I know you have with ATO?

**Mr Lucy**—I can confirm that. Indeed, our relationship with all agencies, including the Taxation Office, is as good as it has ever been at all levels. For matters that might be described as routine, yes, they would be made aware of them on a prompt basis. For example, you mentioned Wickenby earlier. Again, the dialogue between the two agencies in respect of Wickenby is very fluid and very effective.

**Senator MURRAY**—With regard to this list of miscreants, shall we call them, would the ATO have been made aware of those on a standard basis?

**Mr Lucy**—That is correct.

**Senator MURRAY**—Is it correct that the super complaints tribunal cannot look at fees? Somebody has written to me and said that the super complaints tribunal does not look at fees. Is that true?

**Mr Lucy**—We will have to take that on notice. It is obviously a question that would be ideally answered by the super complaints tribunal, but I can obtain the information for you and provide it on notice, if you wish.

**Senator MURRAY**—Yes. Obviously, ASIC takes an interest in the fees area. It would seem strange to me that a complaints tribunal would not deal with that area. I will read a paragraph from this. I have not found out whether I can release it, otherwise I would give it to you. It states:

One essential point is that there are no arrangements in place to oversee the exercise of discretion of fund administrators in setting fees fairly and fairly changing the setting of fees for different groups of existing members who may have limited mobility.

It goes on to suggest that the complaints tribunal does not set fees. Can you come back with that?

**Mr Lucy**—Certainly.

**Senator MURRAY**—The next issue is a strange one to me. Since you are the corporate regulator, I will put it to you. On today's Crikey.com.au—

**Mr Lucy**—I thought we were the only ones that read that.

**Senator MURRAY**—I remind everybody that I have a subscription, so I am not touting for one. They quote Phil Burgess from Telstra—it does not say where it comes from—as having said:

... we want our shareholders to know what's going on, not just financially ... we want our shareholders to know what's going on socially, politically and economically—and how social, economic and political forces affect their share value ... we believe one of the things people ought to be aware of when they vote is public policy affects the value of their investment in companies.

It stated earlier that this concerns a large number of households. In terms of electoral districts, in some places this could have a significant impact. The article goes on to state:

He went on to say that Telstra would like its shareholders to write letters to their political representatives, and when asked whether Telstra's shareholder base was large enough to potentially swing marginal seats in an election, Big Phil replied: "Probably."

I am acquainted with the Australian Constitution and the fact that you may not improperly pressure a parliamentarian in the conduct of their duties. This seems to me to be on the edge of that issue. What I would like you to do, because I doubt that you would be able to respond to this one off the cuff, is give some thought to this issue and tell me in due course whether you think, as a regulator of corporations, it is within your ambit of interest to consider any potential breaches of the law, if you like, which this could entail. I am not alleging that it is a breach of the law, but it does seem to me to be on the edge of trying to interfere in the political process in a way which is quite different from the normal lobbying and submission process that big corporations must undertake and should undertake in the interests of their shareholders.

**Mr Lucy**—I am happy to have a look at it. It may well be that an aspect of it—indeed, a significant aspect of it—might be out of our immediate jurisdiction. But to the extent that it is, I will raise it with the AGS and they can complement what we are looking at.

**Senator MURRAY**—I am not sure, but you are the corporate regulator.

**Mr Lucy**—Certainly, any communication to shareholders is an area we are vitally interested in.

**Senator MURRAY**—It does strike me as an odd thing to do, to threaten parliamentarians in that way.

**CHAIR**—Senator Watson, would you like to begin your questions?

**Senator WATSON**—My first questions concern the Westpoint scheme. If I may commence with the general observation that I believe the Senate is increasingly becoming frustrated by the inability of regulators to act in a timely manner to prevent consumers from unnecessary losses and hardship, and the subsequent discovery of legislative gaps in regulatory powers. I remind you, Mr Lucy, that the most recent case came before us yesterday, when the regulator in that case, the Australian Taxation Office, sought to quickly remedy the problem. Therefore, I ask you: were concerns about Westpoint's operations formally raised with ASIC as early as 2001 by the Real Estate Consumers Association and in 2002 by the Western Australian government, in particular about an apparent gap in the Corporations Act in relation to promissory notes?

**Mr Lucy**—I am very happy to answer that. Indeed, I think it is important that we again put on the record the background to Westpoint, because there is some misunderstanding.

**Senator WATSON**—Misunderstanding by whom?

**Mr Lucy**—The media in particular.

**CHAIR**—Senator Watson, let Mr Lucy make the preliminary remark he wants to make.

**Mr Lucy**—If I could remind the Senate that Jeremy Cooper does not participate in matters to do with Westpoint, so to the extent that he does not respond on these issues it is simply a reflection of his ongoing situation regarding a former conflict, so he is not engaged. I am engaged. I have advised the Senate of that previously. I am engaged literally on a daily basis.

But Mark Steward is engaged on a minute-by-minute basis as far as Westpoint. With your indulgence, I will ask Mark to perhaps talk about where our investigation is at the moment, although we do have some constraints as to what we can talk about. Nevertheless, as fully as we possibly can, he can talk about our investigation, and then trace back to 2001, the earlier date that Senator Watson referred to.

**CHAIR**—I know this goes without saying, but let me just say for the record anyhow that, if any questions trespass beyond what you feel you are able to answer without compromising the investigation, you will indicate it at once, won't you, Mr Lucy?

**Mr Lucy**—Thank you, Chairman.

**Senator WATSON**—Mr Lucy, that may well come later, because I would like to find an orderly development in terms of a calendar approach to how you have managed this scheme, rather than where we are now, because where we are now is that millions of dollars have been lost, homes have been broken, fortunes have been lost and there is a lot of hardship out there. I would like an answer to my question, firstly, going to 2001 and concerns from the Real Estate Consumers Association, and then in 2002 from the Western Australian government about an apparent gap in the Corporations Act in relation to promissory notes. And then in due course, I think we will come up to the current situation, which obviously we have a lot of interest in.

**Mr Lucy**—Up to the year 2004, which of course encompasses the years 2001 and 2002, ASIC received an aggregate of 12 complaints to do with Westpoint. During that period, we would have typically received about 40,000 complaints. Of those 12 complaints, none related to any suggestion of financial difficulty as far as the Westpoint Group. None related to its viability as an operation. All of the questions related to our jurisdiction.

**Senator WATSON**—That was not my question, with respect, Mr Lucy. My question was: were concerns about Westpoint's operations formally raised with ASIC as early as 2001 by the Real Estate Consumers Association and in 2002 by the Western Australian government about an apparent gap in the Corporations Act in relation to promissory notes? I am not asking about how many you received or whether it was financially viable. My question was quite specific. It was about two organisations that allegedly approached you in 2001 and 2002 concerning a legislative gap.

**Mr Lucy**—I will ask Mark to respond, but I was indeed responding to your point and your comment regarding the apparent inability of regulators to protect consumers, and the regulatory gap. That was the reason I was talking about that. But let us ask Mark to respond to your specific questions.

**Mr Steward**—There were issues raised about the fact that promissory notes did not appear to be regulated under the Corporations Act. There was certainly correspondence—I am not sure there was any correspondence from the first organisation you mentioned in 2001—and certainly there was ongoing discussion with the Department of Consumer and Employment Protection in Western Australia and staff of ASIC about a whole range of consumer issues. One of those issues was the fact that there was no coverage under the Corporations Act of promissory notes, and in particular there was correspondence about consumer warnings that both the Minister for Consumer and Employment Protection in Western Australia was issuing

in 2002 and that ASIC was also raising about mezzanine finance. The answer to your question is, yes.

**Senator WATSON**—Obviously, you have confirmed the Western Australian government's acknowledgment of a gap in 2002. But you cannot recall correspondence? Could you check your correspondence from the Real Estate Consumers Association?

**Mr Lucy**—We have checked that, and there is no correspondence. There were communications, but there was no correspondence.

**Senator WATSON**—What was the nature of that communication?

**Mr Steward**—I think it was the same issue that was being discussed between ASIC officers and officers of the Department of Consumer and Employment Protection in Western Australia, that there was no coverage on the face of the Corporations Act for these sorts of promissory notes.

**Senator WATSON**—The lesson is that people have to write to you rather than just communicate with you?

**Mr Lucy**—No, of course not.

**Senator WATSON**—You said they contacted you or communicated with you but did not write to you.

**Mr Lucy**—Sorry; it was a misunderstanding. I thought you were using the word 'communicate' as in written communications. That was the specific point that I was responding to. You are quite right. I will make the point clear: yes, we received oral communications.

**Senator WATSON**—My next question follows from that: how many Westpoint projects were established between those initial concerns being raised and the eventual collapse of this organisation?

**Mr Steward**—I am not sure what you mean by 'projects'. Certainly in 2002 when there were discussions between the Department of Consumer and Employment Protection in WA and staff of ASIC and consumer warnings were issued, ASIC also started looking more closely at what could be done to deal with the risk that seemed to exist. A matter was commenced in the enforcement directorate of ASIC in January or February 2003 to look more closely at this issue. That exercise has largely been ongoing since that time. I am not sure what you mean by 'different projects'. There have obviously been different actions and different formulations since the beginning of 2003, but certainly there has been something ongoing since then.

**Senator WATSON**—In other words, Westpoint added to its structure and continued to borrow money to finance its new widened operations?

**Mr Lucy**—Absolutely. But, again, a lot of the money was in a structure that was determined by parliament. Parliament specifically carved out promissory notes of greater than \$50,000, and Westpoint exploited that.

**Senator WATSON**—You are uncertain about your legislative powers, because you acknowledge that you thought there was a gap. Is that right? You felt there was a gap at that time?

**Mr Steward**—There was an exclusion.

**Senator WATSON**—That is the impression you have given me, so I am giving you the opportunity to clarify as to whether you believe there was a gap or there was not a gap.

**Mr Steward**—I am not sure about the word ‘gap’. There was an express exclusion for promissory notes over \$50,000 from the definition of ‘debentures’; that was the problem. We looked at what could be done given that that is what the situation appeared to be, that these were not covered by the legislation that we are tasked to regulate. We developed an argument that we thought had some merit and we thought we needed to raise directly with Westpoint to persuade them that what they were doing, which purported to rely upon the exclusion, did not in fact do so.

That occupied several months in 2003. It would be fair to say there was a lot of toing-and-froing between ASIC and Westpoint and in particular their lawyers, Freehills—they might say ‘toing-and-froing’; we might say ‘cat and mousing’—over this issue. We eventually realised by the end of 2003 that we were being stalled, we were being given the run around, and we delivered an ultimatum to Westpoint to either comply with the argument that we had put forward about the Corporations Act or we would take court action. We ended up taking court action to force Westpoint to comply with the Corporations Act, based on a very difficult technical argument that in part relied upon an interpretation of the Bills of Exchange Act rather than the Corporations Act. Nonetheless, we had to fight for our jurisdiction and that is what we did.

**Senator WATSON**—If there was uncertainty, why did you not approach the minister to introduce an amendment to clarify the law?

**Mr Steward**—I think the issue we were facing, as a practical pragmatic matter, was that we were dealing with the here and now; we had to do something. It was not a matter of waiting for law reform through the normal processes. I am not sure how long that would have taken. We had to deal with something in the here and now and that is what we did.

**CHAIR**—Senator Watson, we were going to take the afternoon break now until four o’clock. If that suits you, we will resume at four o’clock with you in the chair.

#### **Proceedings suspended from 3.48 pm to 4.01 pm**

**Senator SHERRY**—I will ask a preliminary but overall question on Westpoint. Can you give us the latest update assessment on, firstly, the level of liabilities—moneys owing—and, secondly, the number of people affected? We had an update from Mr Lucy at the last estimates, but has there been any further information on that macro impact?

**Mr Steward**—I do not think there is any change and I think those figures were the best estimates that we had.

**Senator SHERRY**—Yes, I accept that.

**Mr Steward**—We conducted a questionnaire survey of investors and we are looking at those results now to try to come up with a firmer figure, or a figure that we can justify with some data. Similarly, in relation to the size of liabilities and losses incurred by the companies, we are reliant on what the various insolvency practitioners will be reporting to us about that, so I do not have any further updated figure on that at this stage.

**Senator SHERRY**—If there is a prima facie case of theft and fraud, there is a provision under the SI(S) Act for compensation that may be awarded by the minister in those circumstances. My understanding is that with respect to self-managed superannuation funds that provision is not applicable.

**Mr Steward**—I think that is right. We have looked at it. That is the early indication.

**Senator SHERRY**—I have lots more detailed questions, but I just wanted to deal with those macro matters.

**ACTING CHAIR (Senator Watson)**—Mr Lucy, I think you referred to ‘toing-and-froing by the solicitors’ and I think you mentioned Freehills. You were very patient with the solicitors right up until 2004 before starting to take action. Is that correct?

**Mr Lucy**—I would not accept that assessment.

**ACTING CHAIR**—That is an incorrect interpretation?

**Mr Lucy**—Yes.

**ACTING CHAIR**—You did not use the words ‘toing-and-froing’?

**Mr Lucy**—I think it might have been Mark who used those words. It certainly was not in the sense of toing-and-froing, it was all very relaxed and a nice easy dialogue; there was a significant amount of tension, but it might be better for Mark to—

**ACTING CHAIR**—Perhaps Mark could explain the significance of his words ‘toing-and-froing by the solicitors’ until you became impatient in 2004.

**Mr Steward**—What I meant was that we did embark initially on a dialogue with Westpoint through its solicitors to try to come up with an agreed approach. We thought that there was a basis for Westpoint to agree that our interpretation of the legislation was one that they should adopt. That appeared to be something that was being entertained and what I meant by the catting and mousing was that we formed the view fairly quickly that we were not being seriously entertained and that we were being stalled.

**ACTING CHAIR**—Your interpretation of the legislation was?

**Mr Steward**—We said a couple of different things. We said that what was being offered to investors through the information memoranda that had been issued by the various Westpoint companies was an undertaking to repay within the definition of a debenture in the Corporations Act, regardless of the existence of the promissory notes, and that that undertaking to repay was combined with a series of risk mitigation promises that meant it was something different. It was something different within the definition of debenture in the Corporations Act, without even getting to the fact that there were promissory notes being issued. The second argument was that these were not in fact promissory notes that complied with the Bills of Exchange Act. That is why I said earlier that part of the argument rested on a

fairly unique way of tackling this issue, which was a statutory interpretation exercise involving not just the Corporations Act but, significantly, the Bills of Exchange Act, which we do not regulate.

**ACTING CHAIR**—It was a very softly-softly approach, was it not?

**Mr Steward**—Not at all.

**ACTING CHAIR**—You do not think so?

**Mr Steward**—No. As I said, we formed the view that we were getting the run-around and we issued an ultimatum to the company.

**ACTING CHAIR**—In 2004?

**Mr Steward**—Yes, in January 2004.

**ACTING CHAIR**—So you were fairly confident about your powers?

**Mr Steward**—We were confident that we had a good argument. It was an argument that seemed to be contrary to what was explicitly set out in the Corporations Act.

**ACTING CHAIR**—But that argument seemed to have been reinforced today when the matter was raised with Mr David Love, who is the manager of Corporation and Financial Services, Market Group. I am interpreting here, but my belief was that it was reasonably clear to him that there was a mandate and he disputed whether a gap did exist in terms of regulatory power. That was my view and I stand corrected. That is why I asked whom you consulted with.

**Mr Steward**—The fact is that the argument that we thought was a good one, we lost. We lost the argument before the judge. We lost that argument, the issue is under appeal and we are still awaiting a decision from the Full Court of the Western Australian Supreme Court. It is not a simple, straightforward argument or a straightforward issue by any means. It is a very technical issue, a very difficult issue, and it is beyond doubt that the Corporations Act does exempt or exclude promissory notes with a face value of \$50,000 or more from the definition of 'debenture'. That is in black and white in the Corporations Act.

**ACTING CHAIR**—Why did you not seek to clarify your powers, say, under the Managed Investments Act at an earlier date? It still has not happened. That would seem to be the appropriate vehicle.

**Mr Steward**—The action that we took did include that as an alternative argument. Both arguments cannot sit side by side. Either one is right and the other is wrong or vice versa, and we raised both issues with the court in May 2004.

**ACTING CHAIR**—And they knocked you out on both counts?

**Mr Steward**—The court said that we were wrong on the promissory note issue but that the promissory notes gave rise to interests in a managed investment scheme.

**ACTING CHAIR**—Did that then give you power to act?

**Senator MURRAY**—It sounds like a lose-win option.

**Mr Steward**—That was a ruling by the court in a substantive proceeding which both parties appealed. Both parties appealed that. We appealed on the promissory note issue and

Westpoint appealed on the managed investment scheme issue. The question you are asking is: should we have done something about the finding that it was a managed investment scheme? That was certainly something that was under consideration. But in order to take action at that point and, given that this trial was still on foot—the proceedings were still on foot—and the relief that we were seeking as a consequence of that finding was still before the court, we needed to have some additional here and now urgency or some here and now risk that meant the issue could not wait. We were very concerned about things like financial vulnerability. We had sought further audited accounts to be lodged by the Westpoint Group. They came back audited and unqualified, so we did not seem to have any financial grounds on which to attack Westpoint at that point. We had raised arguments before the court about misleading representations in the information memoranda that were issued by Westpoint. We lost that argument. We did not seem to have that.

**ACTING CHAIR**—On misleading representations?

**Mr Steward**—Yes. We lost that argument. We had circulated to all the investors about the action that we had taken in 2004. We did not hear any responses from them. In the meantime, Westpoint was continuing to meet redemption requests. It was continuing to pay monthly interest to investors. There did not seem, at that point, to be an urgent issue that would require the court to take immediate action as opposed to continuing to hear the matter in the normal course, which meant awaiting the appeal.

**Senator SHERRY**—On the appeal, do you have any indicative date, time line or idea of when that appeal decision will be handed down?

**Mr Steward**—We do not know. The appeal was heard in February this year and we have not heard anything from the court at this stage.

**Mr Lucy**—Allow me to recap a little on what Mark said, perhaps in layman's terms, because that is what I present here. The matter in 2004 argued, firstly, that the documentation was false and misleading. Part of the directions that the court gave us was that we needed to write to all the investors, that is, to every one of the investors, in two particular undertakings in a manner that was approved by the court, inviting the investors to join our action that these were false and misleading communications from Westpoint. So we wrote to every one of the investors and not one came back and said that they felt that there was any false or misleading representation and that they wanted to join us.

In the other two areas of the court, the court gave us one, it gave Westpoint the other and we have cross-appealed. So at that stage we had the option of going to the court and seeking the appointment of a receiver. Because the issue of an appeal was on foot, the only ground on which they would appoint a receiver was if there was some financial viability threat or sustainability of business threat. At that stage, we sought audited accounts. They were provided by KPMG, unqualified. At that stage, none of the complaints received into the office related to the lack of payment of any interest or to rolling capital not being repaid. At that stage, we felt that we had no opportunity to go to the court.

**ACTING CHAIR**—It is becoming a lot clearer. I note that during the meeting of Westpoint investors in late February this year, ASIC's Executive Director of Enforcement, Jan Redfern, stated that the Westpoint investigation is 'high-priority, multi-faceted and resource-



intensive for ASIC'. Does ASIC share the concerns as reported in *The Australian* of 19 April 2006 by the Australian Property Institute that Westpoint-style structures were not unique and that there could be more Westpoint-style collapses on the horizon?

**Mr Lucy**—Yes and yes. ASIC continues to support the concerns expressed by Jan Redfern to the investors. We do take this issue very seriously and we have allocated very substantial resources to it. Yes, there is the potential for further Westpoints.

**ACTING CHAIR**—What action can be taken by ASIC or the parliament to intervene to stop any further losses of this nature reasonably quickly?

**Mr Lucy**—In the first instance, the government traditionally and reasonably does not undertake law reform where there is a matter before a court; they wait for the court to determine whether or not there is jurisdiction and, if there is not jurisdiction, they act. At this stage, we continue to be in a situation, as all of us are, including the investors, where simply we do not know which way the court is going to determine in respect of the appeal. In respect of the potential for others, we are surveilling the Australian financial market landscape very closely. We have dialogue with a small number of entities where we have varying levels of concern and we think that those issues are being managed satisfactorily.

**ACTING CHAIR**—My next question concerns advertising. Can you assure the Senate that, given mezzanine finance is recognised as a high-risk commercial product, currently in the daily financial pages and on radio, no Westpoint products are still being advertised? They have been, but I have not seen any lately.

**Mr Lucy**—When you say Westpoint products, what do you mean?

**CHAIR**—Mezzanine finance.

**Senator SHERRY**—Westpoint-like products.

**Mr Lucy**—That is what I am seeking clarification on.

**Mr Cooper**—The point is that these products are not illegal but we did a considerable amount of work during 2005 that did not relate to Westpoint but to other entities and to assertions made in advertising that these products were 'secure, certain, guaranteed'—language like that. In one case we actually forced an issuer to offer a full refund to all investors that, we said, had been misled. That was an issuer that had not run into difficulties like Westpoint; it was still in business but, nonetheless, we forced them to offer all investors their full money back if they so chose.

**ACTING CHAIR**—Have you contacted the newspapers in relation to their social responsibilities about taking advertising for these high-risk, mezzanine-type schemes and the consequences that can have on consumers, if you do not feel that you can act in any other way at the moment?

**Mr Lucy**—We have certainly had a very high level of dialogue with the media generally and, indeed, it is the media that typically carry our consumer warnings.

**Senator SHERRY**—I love the way you describe that.

**Mr Lucy**—I think that they are very much aware of our attitude to this. Frankly, it really is a very serious issue.

**ACTING CHAIR**—Absolutely.

**Mr Lucy**—It is true that people are continuing to invest in types of investment that we would still regard as high risk.

**Senator SHERRY**—On this advertising issue, there are certainly Westpoint-type products still on the market, aren't there?

**Mr Lucy**—Yes.

**Senator SHERRY**—Have you taken any action in respect of Westpoint-type products that you can name?

**Mr Cooper**—Yes, we have. Our typical tool is what we call an interim stop order or a stop order that actually stops the capital raising, and we have done that with a number of issuers.

**Senator SHERRY**—I suspect I know a number of them you are going to name and I will ask some more detailed questions. Can you name those you have taken action against?

**Mr Cooper**—Fincorp is an example.

**Senator SHERRY**—Given the issue in respect of the question over power, how have you been able to do that?

**Mr Cooper**—That is a disclosure-based power, so we look at the disclosure document, typically—in the case of debentures, a prospectus; in the case of other products, a product disclosure statement. We form a view that there is inadequate disclosure and that enables us to issue a stop order.

**Senator SHERRY**—Senator Watson raised the advertising issue. With due respect, even if they stopped advertising, isn't the reality—I do not know whether this is true or not—that a lot of these people are channelled into these types of product through a planner? They may not be channelled as a consequence of any advertising; it may be the advice given by a planner.

**Mr Cooper**—Typically not. I would have to disagree. In fact, our knowledge of the industry suggests that Westpoint was unusual in that most of these products are what they call in the jargon of the trade 'disintermediated'; in other words, they do not rely on a financial planner chain. There are a couple of reasons for that. One is, as we saw in Westpoint, a substantial amount of each dollar that is invested has to be shared through commissions. The other reason is that by going through the vehicle of newspaper advertising these issuers can effectively control the tap of funds. The worst thing that can happen to someone who is in the high-yield market is that they actually have too much money on hand on which they have to pay high interest and, unless they have got projects to lend it out to, they get themselves into financial difficulty.

**Senator SHERRY**—It is a mismatch of inflow of funds as against generation of return.

**Mr Cooper**—Correct. If you are paying nine per cent you do not exactly want to have a whole lot of cash on deposit with one of the main banks because you are going to go out of business in a big way.

**Senator SHERRY**—Even if the advertising ceased, it does not mean that these products are not being offered.

**Mr Lucy**—It does not eliminate the risk.

**Mr Cooper**—That is right. They are still lodging documents with us and seeking to raise funds on them.

**ACTING CHAIR**—It appears that we are now at the stage of mopping up and waiting for court decisions. Given the resource-intensive nature of such an operation—Jan Redfern’s ‘high-priority, multi-faceted, resource-intensive’ investigation—and the impact that these operations are likely to have on ASIC’s overall effectiveness, can you assure the Senate that ASIC now has, to use a colloquialism, a fence at the top of the cliff—you have mentioned one fence in terms of advertising, newspaper proprietors and others, so to speak—rather than an ambulance at the bottom with regard to monitoring of high-risk public offers similar in structure to Westpoint?

**Mr Lucy**—I can answer that in two parts. The first is that you refer to the fact that they have been waiting on a determination by the appeal court and our investigation. The facts are that in 2005, notwithstanding the fact that we were still seeking communications with the auditor, still not obtaining advice from the auditor as to issues to do with going concern and so on, and largely still not receiving complaints from the public regarding the financial model of Westpoint, our commission took the risk, and it was a risk, prior to Christmas and actually sought the appointment of administrators. The timing of that was that we were aware that there was a group of investments which were due to roll over and we felt that if we were to act it was ideal, if not crucial, to act before that rollover, so we took the decision, and fate may well have gone in a different direction, to seek the appointment of an administrator, which in turn brought the whole organisation down to ground.

**ACTING CHAIR**—You mentioned your relationship with the auditor. Did you have some problems there?

**Mr Lucy**—That is a matter of an ongoing investigation. It is true that we did have dialogue with the auditor on a number of occasions up until December 2005. The fact that we have now commenced an investigation on a wide range of areas, including the role of the auditor, is a matter that we have in front of us.

**ACTING CHAIR**—The last time the auditors or firm gave an unqualified clearance of the accounts was in what year?

**Mr Lucy**—June 2004, but of course those were issued subsequent to that. The auditors have a responsibility under section 311 to notify ASIC, the regulator, in the event that various events occur with their clients, including, for example, concerns about going concern. That is not an annual, yearly cycle.

**ACTING CHAIR**—No. It is immediately it comes to their notice.

**Mr Lucy**—Precisely.

**Senator SHERRY**—On the issue of the auditor, KPMG is the firm in this case, isn’t it?

**Mr Lucy**—Yes.

**Senator SHERRY**—We have not explored this, at least at these committee hearings, in great detail, but you were on the *Four Corners* program.

**Mr Lucy**—Yes.

**Senator SHERRY**—I certainly did not know until I saw that program that Mr Beck, who is part of the investigation and a primary operator involved in Westpoint, was the former chief compliance officer with KPMG.

**Mr Lucy**—Yes, I understand that was the case, although I also understand that it was for a relatively short period. But he did have an employee relationship with KPMG.

**Senator SHERRY**—Yes. That struck me as a little beyond coincidence that KPMG were the auditors that had signed off the unqualified audit reports.

**Mr Lucy**—Really, we do need to be careful about that aspect because it is a matter of an ongoing investigation.

**Senator SHERRY**—Yes. We have not asked about this, but you are now carrying out an investigation in respect to KPMG and the auditing that occurred?

**Mr Lucy**—Yes.

**Senator SHERRY**—Good. I also notice that, on at least one of the research house reports, KPMG was also the auditor that signed off on that.

**Mr Lucy**—I think you referred that to us at the last hearing.

**Senator SHERRY**—Yes.

**Mr Lucy**—Yes, we have taken that on board and that is also part of our consideration.

**Senator SHERRY**—But KPMG were the auditor in respect of that research house?

**Mr Lucy**—I believe that is the case.

**Senator SHERRY**—Do we know whether it is the same partner involved in the auditing of Westpoint and the research house?

**Mr Lucy**—I have to take that on notice.

**Senator SHERRY**—We do know that there were planners associated with Westpoint who were recommending Westpoint products through self-managed superannuation funds. Do we know whether any of those self-managed superannuation funds, which were the channel vehicle, were audited by KPMG? Is that a matter that is being examined at all?

**Mr Lucy**—I doubt whether we would know that yet. We are certainly now getting a fairly clear profile on the investors, including those that were a part of the self-managed super fund group and the quantum of investments, the nature of the investments and so on.

**Senator MURRAY**—That is a result of your survey?

**Mr Lucy**—Yes, it is. It was an online survey; indeed, it was a first and it has been very effective. For example, investors totalling in the aggregate of something like \$300 million have responded to the survey. It is becoming a very reliable piece. Again, that is something which clearly we will look at down the track as to whether or not the auditors of the super funds indeed have been truly independent.

**Senator SHERRY**—I just think it is passing coincidence that so many tracks lead to KPMG in respect to auditing.

**Mr Lucy**—I do not think that we can assume that there is a track as far as the self-managed super funds are concerned at this point.

**Senator SHERRY**—Not yet. On that issue, I am not concerned with your activities in respect of self-managed super funds, but that is regulated by the tax office, is it not?

**Mr Lucy**—Yes.

**Senator SHERRY**—I questioned them about this yesterday. You are transmitting information to the tax office in respect to the regulation of self-managed super funds?

**Mr Lucy**—Yes, we are.

**Senator SHERRY**—I am still concerned about what appears to be a sort of lack of ‘get up and go’ in respect of the tax office. They are the regulator of self-managed super funds and my understanding is that we are looking at a substantial proportion, if not the majority, that was channelled through self-managed super funds?

**Mr Lucy**—About 30 per cent we think, which is a substantial amount.

**Senator SHERRY**—There is one other aspect of the *Four Corners* interview which was again something I had not been made aware of. There was a Mr Carey, who was also associated with Westpoint. He is under investigation, isn't he?

**Mr Lucy**—Yes, he is.

**Senator SHERRY**—Apparently, according to that program, he is still operating, but indirectly, through a company called Ferntree.

**Mr Lucy**—Yes, we understand that.

**Senator SHERRY**—Is he still operating as an advisor through this new company, Ferntree?

**Mr Lucy**—I will ask Mr Steward to advise, but I do think that we are getting very close to saying that that is operational.

**Mr Steward**—What I can say is that Ferntree Financial Services was a business name under an entity called Redchime. Redchime is a defendant in the proceedings that we commenced in March this year, which has ultimately led to receivers being appointed to that entity, as well as to a number of others, and some former directors of Westpoint. We now understand that that business may be operating under a different regime now and that is something that we are looking at.

**Senator SHERRY**—Which different regime?

**Mr Steward**—Pursuant to a different company. That is something we are interested in.

**Senator SHERRY**—Was Ferntree operating with a licence from ASIC?

**Mr Steward**—No.

**Senator SHERRY**—This fellow Carey has morphed into a new entity, Ferntree, and apparently now into another unnamed entity. Short of locking him up and throwing away the key, how do you contain this? The fellow keeps morphing into a new financial advisory business.

**Mr Lucy**—We really respect your interest, but you have to assume that we are thinking along the same lines and we do not want to go there as far as providing an answer, I am afraid.

**Senator SHERRY**—Has there been any preliminary analysis of the number of new clients and moneys involved in this Ferntree entity?

**Mr Steward**—I think the understanding, and I will put it as an understanding because of what the chairman has just said, is that Ferntree really operates more like a finance broker than a financial services business. Its name is suggestive of something that perhaps may not be the case, but its activities remain of interest, perhaps because of the name itself.

**Senator SHERRY**—You mentioned finance broking type activity. How is that regulated?

**Mr Steward**—I think there are state laws that govern the conduct of that style of business.

**Mr Lucy**—WA law in particular.

**Senator SHERRY**—Have you had any liaison with the WA—

**Mr Lucy**—I would rather not go there, I am sorry.

**Senator SHERRY**—You are aware that we had a discussion about broking earlier; you may or may not have heard it. It is not regulated yet, uniformly, nationally?

**Mr Lucy**—Yes.

**Senator SHERRY**—There is regulation in WA but we are awaiting the completion of a sort of template regulation which apparently is a couple of years away.

**Mr Lucy**—Yes, we did view that, but the situation that might exist at the moment between ourselves and Western Australia is not waiting for that sort of template.

**ACTING CHAIR**—You indicated that you sent letters out to a whole host of investors.

**Mr Lucy**—About 250.

**ACTING CHAIR**—And you invited them to join in an action with you?

**Mr Lucy**—Yes.

**ACTING CHAIR**—That was a suggestion from the court?

**Mr Lucy**—In fact, it was a direction of the court.

**ACTING CHAIR**—Why did you not take action yourself?

**Mr Lucy**—We did.

**ACTING CHAIR**—You took action at that stage?

**Mr Steward**—This was in proceedings that we had commenced and, because the proceedings might have some impact on the investors' interests in those companies, we raised with the court the interest that these third parties would have. As a result of that, the court, effectively at our request, ordered us to write to all of these investors so that they understood what was happening, which is what we did.

**ACTING CHAIR**—Nobody responded in the affirmative?

**Mr Steward**—That is right.

**ACTING CHAIR**—My question is: did you have the opportunity to go it alone to take action?

**Mr Lucy**—We did take that matter through the court, under the false and misleading provisions, and the court ruled against us.

**ACTING CHAIR**—On what ground did the court rule against you?

**Mr Lucy**—Presumably one ground is the fact that no investor felt that there was any false or misleading material provided to them.

**ACTING CHAIR**—Despite the fact that you, the experts, were of the view that the information was false and misleading?

**Mr Lucy**—That is right.

**ACTING CHAIR**—So they took your view rather than that of an amateur investor?

**Mr Lucy**—They did not take our view.

**ACTING CHAIR**—They rejected your view?

**Mr Lucy**—Yes.

**ACTING CHAIR**—That is absolutely surprising, isn't it?

**Mr Cooper**—It is a key part of life at ASIC that we are subject to the rule of law.

**ACTING CHAIR**—Absolutely.

**Senator SHERRY**—It is surprising that, in terms of the court hearing, it was the weighing up of the evidence. You gave evidence that it was misleading, and presumably no punter turned up.

**ACTING CHAIR**—It has certainly put a slightly different light on your role and I thank you for that.

**Senator SHERRY**—Unfortunately, we are not in receipt of the answers that I sought. I am not blaming you. You would recall that I did ask on the last occasion about the correspondence between the Western Australian Department of Consumer and Employment Protection and the minister and indeed the meeting that apparently took place warning about the activities of Westpoint. We do not have those answers.

**Senator MURRAY**—Senator Minchin said he would check it out during the tea break. Have we had any response to that, Mr Chairman?

**Senator SHERRY**—We will see how we go. I may come back to that, because it places us in the difficult position of having to go through all the questions that I asked you last time, Mr Lucy. My general concern is that I am interested to know what, if any, the response from ASIC, from the Treasurer and his parliamentary secretary was in respect of the warnings about Westpoint activities. We do not have the answers yet.

**Mr Lucy**—Can I say that I am sure that you will get the questions as soon as the minister approves. To the extent that you would like to follow up out of session with a question, I am happy for you to do so.

**Senator SHERRY**—Yes. I might get the opportunity to follow that up.

**Mr Lucy**—In June.

**Senator SHERRY**—Yes, in June. It is only just over a week away, isn't it? I should say I have lots of questions with respect to your very useful shadow shopping exercise, but I might have to leave those until June too, just in case—

**Mr Lucy**—What a pity.

**Senator SHERRY**—anyone in the media watching believes that I am going to let that one pass today, given the time.

**Mr Lucy**—Thank you. To the extent that you choose, any advance advice that you might give us of those questions will mean that we really are in a position to provide full and comprehensive answers. That is a matter for you, of course.

**Senator SHERRY**—Of the ongoing investigations into financial advisers, what is the number that has been identified so far?

**Mr Lucy**—Out of the shadow shopping?

**Senator SHERRY**—No, I am not going to shadow shopping. I am still on Westpoint.

**Mr Steward**—We have identified to date about 37 licence holders. Of course, they will have a much larger number of representatives who would have been engaged in giving advice to clients.

**Senator SHERRY**—So it is 37 licence holders and, underneath that, do you have any idea? Are we dealing with hundreds here?

**Mr Steward**—I can only give you a guess. We have issued information requests to those 37, seeking a range of information, and that is something that we are trying to gather ourselves. We need that data from those 37.

**Senator MURRAY**—Are they primarily in Western Australia?

**Mr Steward**—No.

**Senator SHERRY**—They are all over the country, aren't they?

**Mr Lucy**—Yes, particularly the eastern seaboard and Western Australia—not so much in South Australia or the Northern Territory.

**Senator SHERRY**—We are dealing with a much larger number of planners underneath the 37 licences. I must say that certainly the impression seems to be that it is about 37 planners, but it is licences.

**Mr Steward**—That is right.

**Senator SHERRY**—Presumably, in going to the licence holders, it would be the role and the responsibility of the compliance officers within the licence holders who oversee the regulatory regime of the planners. They would have a central role in all of this?

**Mr Steward**—They certainly have a central role in helping to ensure that the licence holder does what it is required to do to monitor the representatives.

**Senator SHERRY**—When did ASIC first conduct checks on financial advisers or licence holders, or both, with respect to Westpoint?



**Mr Steward**—I am not quite sure what you mean.

**Senator SHERRY**—You had a concern about Westpoint.

**Mr Steward**—Yes.

**Senator SHERRY**—When did you first go to the licence holders and/or the financial advisers?

**Mr Steward**—I think our concern was about Westpoint fighting the jurisdiction fight and then trying to go behind the accounts to look at the real financial position. They were the two main broadly thematic concerns that we have had in relation to Westpoint.

**Senator SHERRY**—I understand that that battle is going on, but you have jurisdiction with respect to licence holders and financial advisers whom you knew were recommending selling products. You were aware that there was some distribution at least?

**Mr Steward**—Yes. I suppose we must have assumed that.

**Senator SHERRY**—Yes. That would be a reasonable assumption, but I am just interested to know: when did you first go to the licence holders and the planners?

**Mr Lucy**—In 2006.

**Mr Steward**—Specifically about Westpoint, it was this year in relation to the information requests. Of course, there are other surveillances that are carried out on licence holders on that general basis but, specifically to do with Westpoint, it was this year.

**Senator SHERRY**—That is one of my concerns. You say you have the ongoing battle about Westpoint in the courts—that that is occurring and you are awaiting the outcome. You clearly had jurisdictional responsibility in respect of the licence holders and the planners but you did not initiate any investigative checking activity—I am not talking about enforcement activity—until this year of those individuals who were distributing the product. That was even though you are fighting a court battle over Westpoint and you had some concerns about Westpoint.

**Mr Steward**—I think that is right, and we did not have any complaints about advice that people were getting, either.

**Senator SHERRY**—I accept that, but ASIC was sufficiently concerned to be taking action in the court about the Westpoint entities. You were obviously concerned about that because you would not have taken the court action otherwise. Why then at the same time, certainly earlier than the beginning of this year, despite the fact that you had received no complaints from the individuals, were you not at least carrying out some checks, surveys or whatever with respect to the planners who were recommending and distributing the Westpoint products?

**Mr Steward**—I just think they are different issues.

**Senator SHERRY**—They are interconnected.

**Mr Steward**—The issue that we had in relation to Westpoint was whether the fundraising was in compliance with the Corporations Act or not. But that is a very different issue—

**Senator SHERRY**—Yes, I understand it is a different issue.

**Mr Steward**—to whether or not the financial advisers properly understand what they are advising on and are properly disclosing the nature of and the risks involved in investing in those sorts of products.

**Senator SHERRY**—You initiated the court action because you had concerns about Westpoint.

**Mr Lucy**—There were two court actions. The first one was in 2004 and, in fairness, that would not have given rise to a concern that we should go out and look at the financial planners. It is true, though, that towards the end of 2005, when we were starting to have our own concerns about its financial viability, it would have been open to us to start visiting financial planners at that stage, and we did not.

**Senator SHERRY**—You have used that that description, that you had not received a complaint.

**Mr Lucy**—Yes.

**Senator SHERRY**—You had your concerns about the entities, but you had not received a complaint. Surely you would not have been receiving a complaint, because the entities presumably were continuing to just pay out the money. The whole thing is a pack of cards that has subsequently fallen down. How is the average punter investor to know anything? You did know; they did not. Why wait for a complaint?

**Mr Lucy**—We thought that we knew. We were the odd man out, frankly, because the directors and the auditors who are primarily responsible—the directors and officers in the first instance—for running the company were saying to us, under our query, that the business model was fine; there was no difficulty. The auditors were saying to us, similarly, that they did not think there was any concern. Yet we were starting to develop a level of anxiety about it, which reached the point late in 2005 where we sought the appointment of an administrator.

**Senator SHERRY**—When did ASIC first become aware of the size of the commission based payments in respect of Westpoint investments being made to planners?

**Mr Lucy**—In 2006, I believe.

**Senator SHERRY**—Approximately when would that have been?

**Mr Lucy**—Almost certainly immediately following our appointment, or seeking the appointment, of an administrator, when things very quickly came to the surface. It was probably in January this year, I expect. It was either December 2005 or January 2006, I expect.

**Senator SHERRY**—Was the size of the commission itself an issue of concern to ASIC?

**Mr Lucy**—It certainly is a level of commission that is extremely high, and we have been the very first to state that. In the first instance, our anxiety is to make sure that that is disclosed and, if it is disclosed, then, high or not, in the first instance the financial planners have met their responsibilities.

**Senator SHERRY**—Allegedly, people are protected by the disclosure of commissions. What about the independence of the planner in recommending a product with such a substantially high commission?

**Mr Lucy**—Again, we really are getting into enforcement territory, because that avenue is exactly the sort of thing we are looking at when we are investigating the planners.

**Senator SHERRY**—I am aware that you have issued a discussion paper that includes comment on the issue surrounding the independence of advice and the impact of commission selling.

**Mr Lucy**—Yes.

**Senator SHERRY**—Have there been any issues raised by investors in respect of the so-called independence of advice? I understand some of the advisers worked for a Westpoint related entity.

**Mr Lucy**—Certainly, at the meeting in Sydney between us and the investors there were a number of investors who indicated that they were not aware of commissions of the order of 10 per cent having been paid. Whether or not that ultimately is the fact, time will tell. There was also a suggestion that there were one or two ethnic community planners that seemed to be very effective as far as spreading within the network of their particular community.

**Senator SHERRY**—When you say they had stated they were not aware, was it because they had not read the documentation, the disclosure, or had it not been issued?

**Mr Lucy**—It was quite an emotional meeting, and a number of investors spoke of their own circumstances. Some of them had a fairly high level of difficulty in communicating in English and they were resorting to interpreters. I think that it would be perhaps unfair on those investors to say whether or not they were specific enough to say whether or not they noticed it was there but did not understand it or that it was not there. That is all part of our investigation going forward, and that is exactly the sort of material we are collating at the moment.

**Senator SHERRY**—As to the issue we touched on earlier of the research houses—and we touched on them at the last hearing—is that a matter that is being followed through?

**Mr Lucy**—Yes. I think it is ‘house’.

**Senator SHERRY**—That was going to be my next question. I am certainly aware of one.

**Mr Lucy**—I am aware of only one at the moment.

**Senator SHERRY**—It is one that is being investigated at the present time?

**Mr Lucy**—At the moment.

**Senator SHERRY**—Was ASIC made aware of the online superannuation ‘advertising campaign’ run in metropolitan areas? This is related to Westpoint.

**Mr Lucy**—When was it being run?

**Senator SHERRY**—Earlier this year and, I understand, last year.

**Mr Lucy**—We would have to take that on notice. I am not immediately aware of it. We should take that on notice.

**Senator SHERRY**—I am told that those who attended the workshops for Online Super—there was an advertising campaign, and then people attended workshops—were allocated an ASIC licensed financial planner who worked for Online Super. These licensed planners

advised attendees to establish a self-managed super fund. The workshops continued and, once the investor had set up their self-managed super fund, they were then informed of the benefits of investing in Westpoint mezzanine finance projects. That was one of the ways in which the propaganda was disseminated, through this campaign. Are you not aware of that?

**Mr Lucy**—If they were giving advice in relation to Westpoint, you can be assured that they are part of our investigation. If it is the case that people invested in Westpoint through that organisation, yes, they will be part of our investigation.

**Senator SHERRY**—Apparently the licensed financial planners—they claimed they were licensed; let us assume they were—were advising the SMSF clients to put all their money in Westpoint mezzanine projects. The extent that that occurred is a matter of fact and consequence. Is that one issue that is under investigation into the activity of planners—the recommendation that all moneys go into Westpoint entities?

**Mr Lucy**—Yes, it is. That will also be an issue for the Australian Taxation Office, because it also has that interest. Yes, is the short answer.

**Senator SHERRY**—We touched on the issue of this Kebble bank.

**Mr Lucy**—Yes.

**Senator SHERRY**—I did speak to APRA afterwards. Apparently some of these planners were being introduced as associated with Kebble bank. Are you aware of that?

**Mr Lucy**—Through hearsay, yes.

**Senator SHERRY**—It has subsequently come to light that Kebble bank was not a bank.

**Mr Lucy**—Correct.

**Senator SHERRY**—Has ASIC had any liaison with APRA? APRA is responsible for regulating banks. Only banks can use the title ‘bank’. Have you had any liaison with APRA about this issue of the Kebble bank that was not a bank?

**Mr Lucy**—Yes, we did raise that issue with APRA.

**Senator SHERRY**—I did ask APRA about this—I am sure they are listening—but I recall them saying in evidence that they visited this ‘bank’ and shut down the offices. Are you aware of whether there was any specific action taken, beyond the closure of the bank, against the purported operators of the bank?

**Mr Lucy**—That is a matter of ongoing investigation.

**Senator SHERRY**—The reason I ask this is that it is one thing if perhaps, standing alone, an individual or individuals are claiming they are operating a bank, but this so-called bank seems to be part of a greater operation, an intermingled web, if you like. Do you accept that that was one of the ways in which people were enticed?

**Mr Lucy**—I can confirm that that is definitely part of our investigation.

**Senator SHERRY**—On what date did ASIC become aware that Kebble bank was operating in the name of a bank but obviously not as a bank?

**Mr Lucy**—I would have to take that on notice.

**Senator SHERRY**—Have you received any specific complaints about Kebble bank operating as a bank when it was not?

**Mr Lucy**—Yes, we have received complaints and, again, that did come up at our meeting with the investors. A number of them also referred, as you have just described, to the fact that their involvement came through Kebble bank.

**Senator SHERRY**—Prima facie it is fraudulent, is it not, to claim that you are working for or operating a bank when you do not have a banking licence?

**Mr Lucy**—Yes. That would be a superficial view but, again, all of that is part of our investigation.

**Senator SHERRY**—With respect to the resourcing that you have available to carry out this investigation, which was touched on at the previous hearing, what number of staff are involved? There might even be a budget for this now, I suspect. What is the latest?

**Mr Lucy**—There is a budget, which includes both our internal expenses as well as any external expenses—for example, for experts. As far as the staffing structure goes, Mark can respond to that.

**Mr Steward**—There is a growing number of staff, firstly, centred in Perth, and there are staff in Melbourne, Sydney and Brisbane in other areas of ASIC. I particularly do not want to go into the numbers of staff in Perth. I think it is not appropriate, given what they are doing and what they are undertaking.

**Senator SHERRY**—Why do you not think the number of staff is appropriate? I am not going to go into what they are doing; I am just interested to know what the level of resourcing is.

**Mr Lucy**—I think there is an adequate number. For example, we are dealing with 3,000 boxes of evidence.

**Senator SHERRY**—It is truly massive.

**Mr Lucy**—Part of it is the scanning process. We have outsourced that. Nevertheless, we have to manage it. There are a whole host of activities going on. There are tens of people engaged.

**Senator SHERRY**—Tens of people engaged?

**Mr Lucy**—Yes.

**Senator SHERRY**—How would you characterise the size of this investigation compared with investigations that you have undertaken in the last five years?

**Mr Lucy**—It would be one of our top 10.

**Senator MURRAY**—I would be surprised if it were not.

**Senator SHERRY**—I am not surprised.

**Mr Lucy**—It is receiving the attention that it requires.

**Senator SHERRY**—Will some of the moneys that were allocated in the budget announcement be used for this ongoing investigation?

**Mr Lucy**—Potentially, because the \$30 million that I referred to has an entry point of expenditure of \$1.5 million, once we spend in excess of \$1.5 million, we can access that fund. Realistically, we will certainly be spending in excess of \$1.5 million in respect of Westpoint, so, yes, we will be accessing it.

**Senator SHERRY**—We have touched on the research house and I did refer to the three out of five star rating. With respect to non-Westpoint activity, since the discussion on the research house, have you had occasion to examine or do you intend to examine the claims made by research houses more generally?

**Mr Lucy**—I would rather not provide any answer in respect of that particular research house.

**Senator SHERRY**—I was not seeking that.

**Mr Lucy**—More broadly?

**Senator SHERRY**—I am talking about research houses having important documents that at least some investors do take notice of and, more broadly, the issue of research houses and their activities.

**Mr Lucy**—Yes, that is an area that our compliance unit is looking at. Indeed, it is a global issue, so therefore it has been picked up by IOSCO.

**Senator SHERRY**—Does that include not just the analysis by the research house but also the level of independence?

**Mr Lucy**—Correct.

**Senator SHERRY**—Are there any other features of examination?

**Mr Lucy**—I guess it would be their grading method. How do they describe a grading? What is A, what is A-plus et cetera?

**Senator SHERRY**—Or the three out of five stars?

**Mr Lucy**—Precisely. It is the manner in which they communicate and the reliability of their communication, including independence.

**Senator MURRAY**—You would describe that as the integrity of their communication, wouldn't you?

**Mr Lucy**—Yes, their integrity and reliability. That is a fair point.

**Senator SHERRY**—Research houses require a licence, don't they?

**Mr Lucy**—In most cases.

**Senator SHERRY**—With respect to financial services, I am talking about.

**Mr Lucy**—Yes.

**Senator SHERRY**—You say in most cases. What would be the exceptions where they would not—non-financial services?

**Mr Lucy**—Yes.

**Senator SHERRY**—There are lots of research houses and firms.

**Mr Lucy**—Some of them are more what you would describe as rating agencies, as distinct from research houses.

**Senator SHERRY**—It is more complicated?

**Mr Lucy**—Yes.

**Mr Cooper**—There is credit rating, where they are not carrying on a business, for example, and where they are issuing research about their own products. But in the routine sense that you are talking about, where research is getting into the hands of retail clients or other consumers, then, yes, they do need a licence.

**Mr Lucy**—For those that are general advice providers.

**Senator SHERRY**—An Australian Financial Services Licence.

**Mr Lucy**—Yes.

**Senator SHERRY**—With respect to the ongoing supervision of research houses, are any additional resources being allocated to this area generally?

**Mr Lucy**—That is a timely question, because we are right now doing our business plans and that includes our compliance business plan. They received quite a substantial allocation, which I am just trying to look up to be accurate, for increased surveillance. How they allocate that amongst their various population is something that we are working on at the moment.

**Senator SHERRY**—There is some focus but not yet additional resource allocation with respect to research houses?

**Mr Lucy**—We are almost in June and we are talking about 1 July, so we are recruiting at the moment for that directorate. How those parties are allocated within that directorate and what they do is something that is before the commission. We are meeting later this week to deal with those business plans.

**Senator SHERRY**—Mr Cooper mentioned rating houses. Do we have a situation where you have rating agency houses that are separate from research houses, that are rating the research house products and that are unlicensed in respect of financial products?

**Mr Lucy**—I think you would have to say that that is potentially the case, because some of the international rating agencies would fall into that category.

**Senator SHERRY**—So an international agency could rate an Australian financial product and you cannot regulate their rating or their research?

**Mr Cooper**—Typically the international agencies, which are Moody's, Standard and Poor's and Fitch—there are only three relevant ones—rank credit and debt products. Consumers do not buy them. They do not get into the market of looking at the sorts of products that we are talking about.

**Senator SHERRY**—Mr Lucy, are you aware of the press release put out by the Westpoint Investors Group on 23 May 2006?

**Mr Lucy**—No. Indeed, I have had communications from them, including as late as this week, but I cannot recall seeing that communication.

**Senator SHERRY**—In that press release they raise a number of questions with respect to ASIC. One of the issues raised is that ASIC should provide a copy of the warnings that were issued to Westpoint investors. Is there any particular difficulty with that?

**Mr Lucy**—No. As I said, I have not seen the release that you have referred to.

**Senator SHERRY**—And the location, date and publication of the warnings—

**Mr Lucy**—Yes.

**Senator SHERRY**—There is no particular difficulty in that?

**Mr Lucy**—No, I would not have thought so.

**Senator SHERRY**—It is alleged by the Westpoint Group that their requests for a meeting with Ms Redfern were not agreed to on three occasions.

**Mr Lucy**—I do not think that is a fair reflection, frankly, in that their request for a meeting and the agenda for that meeting was discussed with Jan. Indeed, as late as this week they agreed to hold a meeting in the manner that both they and we think would be the most fruitful. I expect that meeting will occur within the next couple of weeks. They were angling for a meeting that simply was not appropriate. There has been dialogue with the chairman of that group. He has accepted that that was the case and has now accepted with Jan an approach for a meeting which will be convened in the near future.

**Senator SHERRY**—Will that be with Ms Redfern?

**Mr Lucy**—Yes, definitely. Whether I will attend that I am not sure. It depends upon what the final agenda is. One of their key interests, of course, is how we are going with our investigation. Of course, that is an appropriate expectation that they have. We are limited as to how much we can communicate. I expect there is going to be an expectation gap, a difference, between what they seek out of the meeting and what we can provide.

**Senator SHERRY**—You say you are limited in respect of communication. Is that a budgetary limitation or a practical limitation?

**Mr Lucy**—No, it is a legal limitation. It is just prudence and nothing to do with the budget.

**Senator SHERRY**—In a letter from Freehills on 2 June 2004 to the directors of Emu Brewery Mezzanine Ltd and Bayshore Mezzanine Pty Ltd it was revealed that ASIC was ordered by a preliminary hearing on 1 June 2004 that notice be given immediately to all the promissory note holders in both Emu Brewery and Bayshore fundraisings by sending them copies of the originating summonses, counterclaims, orders and a pro forma letter prepared by ASIC giving them 21 days to seek to be joined in the proceedings. Did ASIC follow through on that order? If so, how?

**Mr Lucy**—Yes. That was the matter I was referring to when I was speaking with Senator Watson, in that we were directed by the court to write to about 250 investors, which we did.

**Senator SHERRY**—You followed that through. You referred to not receiving feedback or a response.

**Mr Lucy**—Yes.

**Senator SHERRY**—Was that in respect of that matter as well?



**Mr Lucy**—No, not as well. That is that matter.

**Senator SHERRY**—Approximately how long after the order were those letters sent out?

**Mr Lucy**—We think it was 4 June. If that is incorrect, we will advise.

**Senator SHERRY**—So a couple of days?

**Mr Lucy**—Yes.

**Senator SHERRY**—If you could, let me know. I will not hold you to that precise date. Can you provide a copy of that letter for estimates?

**Mr Lucy**—Certainly. We probably will not have the title of the investor, respecting the names of the investors; we will just send you a—

**Senator SHERRY**—Just blank it out?

**Mr Lucy**—Yes. Would you have any appetite to let us have a look at that letter that you refer to?

**Senator SHERRY**—Which letter?

**Mr Lucy**—That Freehills letter?

**Senator SHERRY**—I will have to check on that. I do not think I have it here. I am not sure.

**Mr Lucy**—If that was possible, we would be very interested in that letter.

**Senator SHERRY**—Have you asked them for it?

**Mr Lucy**—They would probably claim it was privileged.

**Senator SHERRY**—I do not know whether I have it. I have some questions in respect of the Freehills letter. I will check to see if I have it. I would have to check with them.

**Mr Lucy**—I understand.

**Senator WATSON**—My question concerns the solicitors. I have been reflecting, Mr Steward, on your term ‘toing-and-froing’ in terms of the negotiations between ASIC and the solicitors and the scope, I suppose that would be the correct word, of the regulatory powers. Being a large firm, would you say they were acting in an intimidatory, overbearing or unreasonable way?

**Mr Steward**—They may well say the same about us.

**Senator WATSON**—Obviously they must have had some impact of terms of a degree of hesitancy on your part. Could you give the Senate some feeling of the sort of environment in which you suddenly placed yourself?

**Mr Steward**—Firstly, I was not personally involved in this. But I have looked at and reviewed what occurred. It was no different to what often occurs when we have a view that we want to impose on someone that we are looking at. I am not too sure what you are seeking to characterise our negotiating position as, but it certainly was not timid or reluctant. It was forceful and willing, and theirs was the same.

**Senator WATSON**—I would be surprised if they were timid. I am not querying your approach. But I could imagine very large firms could have the capacity to be quite overbearing and intimidatory.

**Mr Steward**—No.

**Senator WATSON**—So they just in a quiet way put their legal argument. Is that right?

**Mr Steward**—Yes, that is right. We had opposing views.

**Senator WATSON**—It was all done in a very professional manner, without threats on their part?

**Mr Steward**—I am not sure what you are getting at. We delivered an ultimatum to them, if you want to call it that, about the way in which this issue was going to be resolved.

**Senator WATSON**—Ultimately, but before you got to ultimatum stage—

**Mr Steward**—I am not aware of any—

**Senator WATSON**—You eventually lost patience, did you not?

**Mr Steward**—Yes, we did.

**Senator WATSON**—I am trying to work out why you did not act sooner and go in earlier with your ultimatum but instead allowed a fair bit of toing-and-froing, negotiation and lots of opportunities.

**Mr Steward**—We were dealing with a very technical legal issue. They had advice that they felt supported their view. We had a view supported by advice and we were at loggerheads over it, as we are on a host of issues every day with a host of people. If your question implies that we did anything that was overbearing or threatening, that is certainly not the case.

**Senator WATSON**—No, quite the other way this time.

**Mr Steward**—No. It was a forceful, willing contest between two people who had opposing views. That is really what it was. At the end of the day, we felt that we were not getting where we needed to get to quickly enough, so we thought we had to bring it to a head.

**CHAIR**—I suppose it is also relevant to this discussion to say that you are a regulator, not a prosecutor, and your core obligation is to secure compliance, which is done in a variety of ways but, at least in the initial phases, by discussion rather than any other mechanism?

**Mr Steward**—That is certainly what we had on our mind. We were seeking to impose a fairly fundamental change on the way in which the Westpoint Group was going to conduct its fundraising activities in the future and going to be dealing with its current investors. Before taking such a major step, it was sensible for us to raise that and try and negotiate and persuade Westpoint to comply rather than simply go off to court straightaway.

**Senator WATSON**—It seems a bit of a soft-touch approach. That is what I am really worried about. I have a view of a regulator as a bit of a policeman, in effect—

**Mr Steward**—I disagree.

**Senator WATSON**—who says, ‘This is the law, why are you not complying with it?’ Bang!

**Mr Steward**—The difficulty was—

**Mr Lucy**—The bang came through the court, and we lost.

**Senator SHERRY**—I am actually not fundamentally disagreeing with you in respect of that action. My argument is that you should have taken action earlier and against a wider range of people for a wide array of reasons. I want to go back to the compensation issue. We know that self-managed super funds are not covered by the theft and fraud provision of the CIS Act. Are you aware of whether any of the persons who placed money have complained to FICS, as I think it is known?

**Mr Lucy**—Yes, we are. There are a number that have complained.

**Senator WATSON**—Right.

**Senator SHERRY**—But FICS has a limit, doesn't it, on the amount that it can award?

**Mr Lucy**—Yes. It is \$100,000, but it can be waived by consent.

**Senator SHERRY**—Do you know of the approximate number of individuals who have sought to take that course?

**Mr Lucy**—It is a work in progress. At this stage, it is a relatively low number.

**Senator SHERRY**—There would be some, I would have thought, commonsense in persons, certainly those with relatively small amounts of money, under \$100,000, taking this avenue. It is a relatively quicker form of restitution.

**Mr Lucy**—We would certainly support that observation and, indeed, we have been almost aggressive in trying to encourage investors to take that route.

**Senator SHERRY**—Yes. None of those matters have been heard by FICS yet, have they?

**Mr Lucy**—Not to my knowledge.

**Senator SHERRY**—Under the CIS Act compensation, theft and fraud *prima facie* is not going to be applicable. FICS is a possibility for some people and, I suspect, a probability for some. That is another avenue. What other avenues are available for compensation?

**Mr Lucy**—It is a question of whether or not there is any culpability sheeted home to the directors, officers and third parties such as auditors and, in the event that that is the case, whether or not that bears fruit. It is also a question of looking at the assets of particular entities and parties that may not be secured by way of a first-charge security to see whether or not there is any opportunity for introducing further funds there and then, ultimately, whether or not we conduct a section 50 process.

**Senator SHERRY**—In respect of Westpoint—and there is a time issue, obviously—whatever assets are left after the receiver is finished, what is the position with auditors if there is a finding that they were negligent? Is it possible to access compensation from the auditing firm?

**Mr Lucy**—Yes.

**Senator SHERRY**—What section of the act would allow that?

**Mr Lucy**—Just the law of negligence.

**Senator SHERRY**—In terms of the investors, I frankly do not think there is a likelihood that there is going to be a substantial amount of money from the Westpoint entities, whatever is left over. If there was a negligent case *prima facie* to recover moneys from the auditors, would ASIC leave that to the individual investors to initiate or could it do that itself on behalf of investors?

**Mr Lucy**—My expectation is that the liquidators and/or the receivers would take that action in the first instance.

**Senator SHERRY**—Could ASIC do that itself?

**Mr Lucy**—In the event that there was nobody else willing to take it and it passed the public interest test then, yes, we would take it.

**Senator SHERRY**—It is probably too early, but I certainly think—

**Mr Lucy**—It is too early, with respect. It is something which we are very much alive to.

**Senator SHERRY**—One of the difficulties for many of the investors I have spoken to is, first, their frustration with the likely length that this will take. You understand that many of them are elderly.

**Mr Lucy**—I totally understand.

**Senator SHERRY**—It could be years away. Second, whatever money is left in Westpoint, it will certainly be less than they have put in. There are also the costs of litigation for them as individuals. These are all issues that they are concerned about.

**Mr Lucy**—Perhaps a smaller issue, but a side issue, is their own taxation circumstances.

**Senator SHERRY**—Yes. On that issue and tax liabilities, have you had any liaison with the tax office? That is not something I asked the tax office about yesterday.

**Mr Lucy**—Yes, because one of the issues will be the ability of the investors to crystallise the loss.

**Senator SHERRY**—Yes. So you have obviously had some discussions with the ATO about it.

**Mr Lucy**—Yes.

**Senator SHERRY**—What information is known about the likely treatment?

**Mr Lucy**—We cannot speak for the tax office on that. We have raised the issue, they are alive to it and clearly it is in the interests of the investors to have their position clearly understood as quickly as possible.

**Senator SHERRY**—I can raise that. There will be plenty more estimates hearings over the next couple of years. I will raise it with the ATO.

**Mr Lucy**—I have no doubt. It is an important issue for many investors.

**Senator SHERRY**—Yes.

**Senator WATSON**—On that question of the responsibility of the tax office in relation to their small superannuation fund regulatory powers, I have to point out that diversification of investment is just one issue that the trustees have to look at.

**Mr Lucy**—It is.

**Senator WATSON**—Obviously, I think it is going to be very hard to pin much on the tax office, given the fact that it is not mandatory for them to enforce or anything like that; it is just one of the issues.

**Mr Lucy**—My understanding is that it is part of their qualifying test. We have had situations, for example, where investors have put investments into four separate Westpoint investments, saying, ‘There is the diversification.’ How the tax office will treat that is for the tax office. What we are raising with the tax office, the liquidators and so on is that the funds and the individual investors will want to crystallise a loss and they need to be in a position to be able to crystallise it, the earlier the better.

**Senator WATSON**—That is a different issue.

**Mr Lucy**—Quite right; it is.

**Senator WATSON**—Senator Sherry is giving us the appearance that, perhaps, the tax office regulation was remiss.

**Senator SHERRY**—I think it was. I think they are remiss in respect of self-managed super funds generally. I make no bones about it. They are not doing enough. There might be a range of reasons for it that the tax office cannot help, but they are not doing enough. To come back to Mr Lucy, one of the issues here is that the tax office, to be fair to them—and I am critical of their lack of action in respect of self-managed super funds generally—have not yet received the audited reports or accounts of the trustee entities, the self-managed super funds, in which moneys were placed in Westpoint, in many cases. That is the case, isn’t it?

**Mr Lucy**—I cannot speak for the tax office. We would not know of that circumstance.

**Senator SHERRY**—Coming back to the meeting that you had on, I think, 23 February with about 70 individuals in respect of Westpoint, have you given a commitment to them? I think you have referred already to the fact that some people were emotional and upset, which is understandable.

**Mr Lucy**—Yes.

**Senator SHERRY**—Did you give a commitment to come back with a response to the issues they raised?

**Mr Lucy**—Yes. We have a specific website dealing with Westpoint and we have issued at least three specific releases on that already.

**Senator SHERRY**—Specifically addressed to those people who were at that meeting?

**Mr Lucy**—Yes. We advised them that we were setting that website up and we referred them to it. My recollection is that the first update was within 24 hours of that meeting and that we continued to refresh it as appropriate.

**Senator SHERRY**—Unfortunately I have to raise a number of non-Westpoint related scandals in which, unfortunately, some of the victims also invested moneys in Westpoint. There are three scams I want to raise. ‘Scams’ may be a bit harsh; I do not cast judgment at this point in time. The first point I want to raise is about Paridian Property Development

Fund. There was an article in *The Australian* newspaper on Monday 22 May regarding Paridian Property Development Fund. Are you aware of this?

**Mr Lucy**—No. We could take it on notice, but I would urge you, when those situations present to you, to encourage these people to lodge a complaint with us.

**Senator SHERRY**—Yes. I first became aware of Paridian when I read the newspaper article and have since been contacted by a number of investors. I urge them to do everything they possibly can—get on to the tax office with respect to self-managed super funds and get on to you to try to get some containment with respect to these issues. My understanding is that Paridian Property Development Fund is a \$45-million fund. Paridian has raised \$25 million selling shares and \$20 million selling debt notes. It is a company offering financial advisers up to 10 per cent commissions. Financial planners receive up to 10 per cent of all funds raised for debt notes and up to 8.5 per cent of all funds raised for shares. Paridian have been highlighted due to their poor disclosure of a rule that prevents investors from ever withdrawing their money or that makes it extremely difficult for them to ever do that. Before I get to that issue, is Paridian under investigation by ASIC?

**Mr Lucy**—I would have to take that on notice, but the circumstances that you have just referred to, namely the inability for people to be able to exit, are familiar to me. Whether or not that is the company that you described, I will have to take on notice.

**Senator SHERRY**—I am going to get to the issue of the disclosure in a moment. I have the disclosure document with me.

**Mr Lucy**—You did refer to the fact that they are unable to get out, to exit. I am familiar with that.

**Senator SHERRY**—Before we get to that aspect, we have financial advisers allegedly receiving up to 10 per cent commissions in Paridian. Is that an issue of interest to ASIC?

**Mr Lucy**—It would be, yes.

**Senator SHERRY**—It strikes me that the model is remarkably similar, in terms of the distribution commission change, to Westpoint, and Paridian is operating at the present time. One of the investors who contacted me has already placed money in Paridian but also placed money in Westpoint. He sought to withdraw the money from Paridian and he was directed to a paragraph on page 79 of the prospectus. It is more than 100 pages. I am talking about the issue of withdrawal of moneys. He sent me a copy of the prospectus. Do you know if ASIC oversighted the Paridian prospectus?

**Mr Lucy**—It would have been lodged with us. Whether or not we reviewed it—

**Mr Cooper**—It might or might not have been.

**Senator SHERRY**—I do not know. That is why I am asking.

**Mr Cooper**—You are quoting a newspaper article of this week.

**Senator SHERRY**—I am quoting a newspaper article but I am going to the actual prospectus.

**Mr Lucy**—We will have to take it on notice.

**Mr Cooper**—Yes. We will have to take all of this on notice. The point is that there must be 12,000 or 15,000 such products out there.

**Senator SHERRY**—I accept that. With respect to the Paridian prospectus and the investor, they have sought to withdraw their money from Paridian but cannot get it out, and their attention was drawn to a paragraph on page 79 of this prospectus, which is titled ‘Illiquidity’:

An investment in Securities in Paridian is not a liquid investment. There is no established market for the sale of Securities. Investors have no right to require Shares to be purchased by Paridian or to have their Shares redeemed.

I understand that is the disclosure sentence on which the investor has been denied redemption of their funds by Paridian. With respect to a disclosure such as this, what hope does the ordinary investor have of (1) understanding that sentence and (2) finding it in a prospectus of more than 100 pages?

**Mr Lucy**—They should rely on a licensed financial adviser, because a licensed financial adviser has a very clear responsibility, firstly, to know the circumstances of his or her client, which would include whether or not they have got investments in a company such as Westpoint and, secondly, to know the product. If that product has such a unique feature as you described then the licensed adviser should be aware of it and should bring that to the attention of their client.

**Senator SHERRY**—Are you aware of any other issues with respect to Paridian?

**Mr Lucy**—Not as we sit. We would have to take that on notice.

**Senator SHERRY**—One of the investors that has contacted me has unfortunately been caught up in Westpoint as well. On the actual power to regulate debt notes, do we have the same issues arising as we had with Westpoint?

**Mr Cooper**—No, I doubt it. I would imagine we would be talking about a debenture that we do regulate, and the disclosure document is a prospectus. On top of that there is typically a trustee that holds certain rights in trust. So there is a workable system of regulation for debentures.

**Senator SHERRY**—It is not an issue of lack of power on this one?

**Mr Cooper**—The important point to make is that it is a disclosure power. We do not prudentially regulate. We do not guarantee that there will not be problems with property development but we do regulate disclosure.

**Senator SHERRY**—You mentioned earlier Sovereign Capital Ltd. Is it correct that Sovereign now has around \$61 million owing to approximately 600 investors?

**Mr Cooper**—I can discuss Sovereign in general terms with you. We can take specific details on notice and confirm the specific facts.

**Senator SHERRY**—Are some of their projects in default?

**Mr Cooper**—Yes, they are.

**Senator SHERRY**—Do you know the number of projects that are in default?

**Mr Cooper**—I can tell you that the PDS that they issued last year indicated that more than half of the projects to which they lent funds were in default. They take up money from investors and then on-lend them to property developments, and more than 50 per cent of those on-lendings were in default.

**Senator SHERRY**—I can name a particular individual investor, because he has asked me to do so. It is a Mr Parker Simmonds. When did ASIC first receive a complaint in respect to Mr Parker Simmonds of Parker Simmonds Securities?

**Mr Lucy**—We would have to take that on notice.

**Senator SHERRY**—Apparently after three years of operation Parker Simmonds Securities changed its name to Sovereign Capital. Is it correct that Parker Simmonds Securities had action taken against it by ASIC prior to the change to Sovereign Capital?

**Mr Lucy**—Again, we would have to take that on notice.

**Senator SHERRY**—That is apparently relating to misleading information in the prospectus. Was ASIC aware that the directors of Parker Simmonds Securities started up the new company, Sovereign Capital?

**Mr Lucy**—Another one on notice.

**Senator SHERRY**—Can you tell me when Sovereign Capital commenced as a company?

**Mr Lucy**—Again on notice.

**Mr Cooper**—You have to understand that there are 1.4 million companies in Australia.

**Senator SHERRY**—Yes, I accept that, but you apparently had taken some action against Parker Simmonds Securities. They then morphed into Sovereign Capital. I use that expression because—

**Mr Cooper**—We understand what you mean.

**Senator SHERRY**—there are at least some of the same individuals re-emerging in another entity in a not dissimilar way to the one we discussed earlier with respect to Westpoint and Mr Carey.

**Mr Lucy**—Ferntree.

**Senator SHERRY**—I have a number of other questions but I do not think that you can respond, given the current indications. Suffice to say Sovereign Capital and their activities are currently under investigation.

**Mr Cooper**—We are certainly working diligently on Sovereign Capital. We have a stop order on them. They are incapable of raising funds and we are continuing our very close interest in Sovereign. We use ‘investigation’ in a specific sense. I think our interest in Sovereign Capital falls short of a specific investigation.

**Senator SHERRY**—Does it? I am not sure that I am happy to hear to hear about that. Have you followed through in respect to any of the planners who recommended Sovereign Capital?

**Mr Cooper**—We would have to take that on notice. I would have to say as an overall comment, dealing with problem products, if I can put it that way, by going down the



distribution chain and then working back upwards is a very inefficient way of using our resources, when you consider that, as I have said, there are some 15,000-odd products and some 25,000 to 40,000-odd financial planners.

**Senator SHERRY**—But we are dealing here with people who have lost part or all of their moneys.

**Mr Lucy**—I think that we are better off to give you a comprehensive answer about Sovereign by taking it on notice, because we do not want to mislead you and I think that we are getting close to doing so if we continue to provide short answers.

**Senator SHERRY**—Yes, and my ongoing interest is not just the human interest, in the people that have lost money, but also the regulatory features around the entities that are involved. In respect of the complaint I have received, it is yet again a self-managed superannuation fund. We seem to be getting a sort of pattern— a self-managed super fund, planners on commissions, and at least in a number of significant areas of this property development.

**Mr Lucy**—It is true that there is that pattern that you describe, but it is a very small fraction of the overall financial markets.

**Senator SHERRY**—I accept that.

**Mr Lucy**—It is a bad trend that is emerging. It needs to be focused on very clearly by the regulators but, on the other hand, we have to keep it in perspective.

**Senator SHERRY**—Yes, I accept that, but from the perspective of the individual it is catastrophic.

**Mr Lucy**—I understand that, yes.

**Senator SHERRY**—You accept that?

**Mr Lucy**—Totally.

**Senator SHERRY**—Do you accept that we are dealing with superannuation, to some extent, which is a preferred investment vehicle for retirement in this country?

**Mr Lucy**—Yes, and indeed typically by people who are older in years and who have less opportunity to re-stake those moneys.

**Senator SHERRY**—That is right. In your sixties you can hardly go back to work for another 40 years to recoup your losses, can you?

**Mr Lucy**—When you say ‘can you’, that is a well-put question.

**Senator SHERRY**—The current government has put a great deal of emphasis on superannuation in recent times, as the previous government did. It is the preferred retirement savings vehicle across a whole range of fronts and, as I say, the use of self-managed super funds is part of that. With the response in respect of Sovereign Capital, will you examine aspects in relation to auditors, tax agents, planners and related entities?

**Mr Lucy**—As I have said, I would rather provide you, on notice, with a more comprehensive response rather than a piecemeal one, particularly in this forum.

**Senator SHERRY**—I turn, unfortunately, to another one—Streetwise group, and Mr Kovelan Bangaru, who I understand was involved in the Streetwise group. Firstly, is ASIC aware of Streetwise?

**Mr Cooper**—Certainly, but I think with this one it is definitely under investigation and we are not really in a position to talk about Bangaru.

**Senator SHERRY**—You have talked about Westpoint. I do not know how far I can go. I am always pretty careful about this. Do we have any idea of the size of moneys involved in Streetwise and the number of people? You could do that with Westpoint and you have an investigation under way.

**Mr Cooper**—To put it in context, we are considerably further down the track with Bangaru. In fact, Bangaru was something that we have talked about on several previous occasions.

**Senator SHERRY**—Yes.

**Mr Cooper**—It is well and truly under investigation and really we have not come specifically prepared to discuss Bangaru because it is well and truly in that phase.

**Senator SHERRY**—Then my assumption is you would have to have more information.

**Mr Cooper**—It is all there and we can certainly take it on notice and give it all back to you.

**Senator SHERRY**—I understand it is about \$30 million, but I do not know the number of persons who have been hurt. One thing I think you would know is this: I understand Mr Bangaru is overseas somewhere. You say ‘further down the track’; have we tracked him down in order to extradite him back to Australia? Where is that up to?

**Mr Cooper**—We would not want to answer that. We would not want to give him a free kick, as it were.

**Senator SHERRY**—Do you know where he is located?

**Mr Lucy**—If we were to respond to that, that would be an inappropriate response.

**Senator SHERRY**—You say it is considerably further down the track. Have you got an indicative date about when this is—

**Mr Lucy**—Again, it would be inappropriate for us to respond to that.

**Senator SHERRY**—Do we know if self-managed super funds were involved as an entity through which moneys were invested?

**Mr Lucy**—I think you have to assume that that was the case, but as to the extent we are not in a position to answer.

**Senator SHERRY**—The information I had was that it was at least so with some people, but I am not just sure of the extent.

**Mr Lucy**—I do not know.

**Senator SHERRY**—That is one of my concerns on the policy front: self-managed super funds occurring time and time again.

**Mr Lucy**—I suppose that is a problem in the sense that you mentioned the word ‘policy’, and I guess that we see the general theme that you are running but the fact is that currently the government has policy settings on self-managed super funds and we are somewhat powerless to prevent them.

**Senator SHERRY**—Of course. You are somewhat powerless. You do not have any power with respect to self-managed super funds direct regulation, and I have absolutely no criticism of that. As I referred to earlier, the tax office and what they are doing or not doing in this area is of great concern.

**Mr Lucy**—Without trying to restate what Mr Cooper said, we do know that there are literally hundreds of thousands of these super funds.

**Senator SHERRY**—There are 300,000 plus.

**Mr Lucy**—The overwhelming majority are legitimate, their investments are prudent and they meet the expectation of the retirees.

**Senator SHERRY**—Yes, but we do know that superannuation is compulsory in this country. There is a growing use of self-managed super funds, and in the case of prima facie theft and fraud there is no compensation for a person’s retirement income. I accept your point that in the scheme of things, of the totality of superannuation investments, theft and fraud is infinitesimal in terms of the \$840 billion, but if you are a person who is approaching retirement or in retirement and you lose a substantial part of your \$100,000 or \$200,000 or \$500,000, whatever the figure is, it is catastrophic.

**Mr Lucy**—Yes, I have no argument. But that again brings us back to the point that one of our consumer messages—and we are very active about consumer messages—continues to be, ‘If you do not understand it, do not invest in it; seek proper advice.’

**Senator MURRAY**—I am interested in how people are targeted. In marketing there are a couple of phrases used which are quite useful. The shotgun effect hopes to hit someone with one of the pellets and that is what advertising is. You advertise to a mass market and hope you get some reaction. A rifle effect is you target the one you want to hit. You have said in some of your earlier remarks that not all of these targets that the shysters pick up on are found through advertising. I just want to be assured you are trying to find the ways in which people are being targeted so that in your own response you are not just issuing general warnings to a general population which are difficult to find. I am thinking of, for instance, do they find people through tax agents who would know which of their clients have large cash balances in their superannuation funds, or do they target them through accountants or through solicitors or through financial planners? How do they find people who are perhaps not financially literate, are perhaps older or perhaps non-English speaking, or perhaps have high levels of cash balances in their superannuation funds and so on, and who would have that information which they would be able to find? There are obvious groups of people that do have that information. What I want to be assured of is when you are doing your investigations that you are also looking at sweeping up this kind of market information, if I can call it that.

**Mr Lucy**—We are doing that from a number of ways. One is the complaints, because complaints, apart from sorry stories, provide sometimes very unique intelligence to us. Another is through our surveillance activities, but we are also undertaking some research. It is

interesting you use the words ‘financially literate’ or therefore financially illiterate. I think that is a distinction that does not necessarily help.

**Senator MURRAY**—Yes, I agree with that.

**Mr Lucy**—I think that we used to oversimplify it thinking that if you financially literate you were safe, as it were, from these people. Our experience is that that is not necessarily the case.

**Senator MURRAY**—Let us use the Westpoint survey as an example. You got a good response from that. Would you know from each of those people who their tax agent was, who their solicitor was, who their accountant was, and who their financial advisor was?

**Mr Lucy**—No, not at this stage.

**Senator MURRAY**—And if you suddenly found Mr X tax agent appearing across a range of them you would say, ‘Hello, this is where the access point was.’

**Mr Lucy**—The common ingredient at the moment is the financial planner.

**Senator MURRAY**—But if you have not asked the question who the tax agent is you would not know.

**Mr Lucy**—No, and we have not asked that question yet. Step 1 was to find out the links between the financial planners. To the extent that the financial planners then go down to, for example, accountants, which you mentioned, yes we will look at that. But that information we are going to get from the financial planners as distinct from the investors. The investors know how they got into it, which is the financial planner, and the next level down is for us to find out how did the financial planner get the names of the people to approach in the first place.

**Senator MURRAY**—I am just fairly convinced that an efficient shyster conducts market intelligence and determines their target market, and they would do so on a rational basis, so there must be a sweeping up of market intelligence through some mechanism.

**Mr Lucy**—Frequently we find that indeed it is the investors who encourage their friends and colleagues to get involved as well.

**Senator MURRAY**—That happened with the mass market tax effective investment schemes.

**Mr Lucy**—Yes.

**Senator MURRAY**—It was very much that word of mouth.

**Mr Lucy**—Yes.

**Senator SHERRY**—We were just having more a discussion than making some points about self-managed super funds. I want to touch on another point about self-managed super funds. In the context of you sending you information out, you are not the regulator of them, so presumably your warning documentation, educative documentation, et cetera, is going to the entities you do have a direct regulatory authority over—planners, for example.

**Mr Lucy**—Yes, but also in the press more broadly. We undertake a lot of press alert, we have a FIDO website that we are proud of. In fact, it does not matter if you are an individual investor or a superannuation investor, it is still relevant material for you.

**Senator SHERRY**—Yes, but also are we not more limited in terms of being able to distribute when self-managed super funds are not covered by the disclosure laws, for example, whereas other super funds are?

**Mr Lucy**—We do not communicate on a direct basis with investors.

**Senator SHERRY**—No, I accept that.

**Mr Lucy**—So be they an individual or a super fund it really does not matter.

**Senator SHERRY**—But in the case of self-managed super funds they are exempt from disclosure, so to the extent that disclosure is a protection they are not covered by disclosure, are they?

**Mr Cooper**—In the sense that they consume financial products they receive all the regulated disclosure documents that are out there. They are treated in that sense just like any other consumer.

**Senator SHERRY**—Including on fees?

**Mr Cooper**—Yes. Perhaps we are on different tangents but the self-managed super fund has to invest in something.

**Senator SHERRY**—Yes, I accept that. I am talking about the establishment of the self-managed super fund; they are not?

**Mr Lucy**—No.

**Senator SHERRY**—My attention has just been drawn to a successful conclusion of a case which I am interested in in terms of the precedent. The settlement was announced on Tuesday, 30 May. It involved the 37 investors in Queensland-based mortgage investment scheme who were awarded \$792,000. It is off your website.

**Mr Lucy**—Yes, it is.

**Senator SHERRY**—You did mount a successful class action in that case and you did get compensation.

**Mr Lucy**—Yes.

**Senator SHERRY**—It was against Lawyers Private Mortgages Pty Ltd. I am interested in that in the sense that you did mount for investors a class action on their behalf and recovered moneys.

**Mr Cooper**—That is a pretty old case. In the history of ASIC we have used section 50 about 15 times, so that is one a year. There are a number of difficulties with section 50 and I will not go into them. The chairman has mentioned the public interest threshold and so on. In reality, we are not in the compensation business, we are in the regulation business and it creates a very difficult environment if consumers are led to believe that in all situations where there is unfortunate financial loss that the regulator will be there cleaning it all up and handing out compensation.

**Senator SHERRY**—I accept that that cannot happen in all cases, but you have given me less hope than the hope that Mr Lucy gave me earlier when I asked him about ASIC and possibly representing individuals to recover moneys.

**Mr Cooper**—I am not contradicting it. It certainly would be a possibility, yes.

**Senator SHERRY**—You are giving me a different nuance, Mr Cooper.

**Mr Cooper**—But I did not want you to get too much hope from the MDRN case, because it is just one of the 15.

**Senator SHERRY**—One, you won. That gives me some hope.

**Mr Cooper**—Yes, we did.

**Senator SHERRY**—Two, you got some money.

**Mr Cooper**—Yes.

**Senator SHERRY**—You refer to it as being an old case. This is dated Tuesday, 30 May 2006.

**Mr Cooper**—Certainly, but the genesis of it has been going on for some time.

**Senator SHERRY**—It is three years sold, yes. I notice it is August 2003. I think what does concern me with that is—and this is not a criticism, it is understandable—that it took some years to finalise.

**Mr Cooper**—Correct.

**Mr Lucy**—Would I be allowed to ask whether or not we have finished on Westpoint, because Mr Steward has a flight to catch.

**Senator SHERRY**—Yes. In fact, because of the time constraints we have run into and because we get another opportunity, and I have a lot on your very effective shadow shopping, we will have the opportunity for that because APRA are waiting, I know, so I was going to finish my questions there. I have certainly finished on Westpoint for today. I do not know whether anyone else has a question.

**Senator MURRAY**—I have no further questions because I know that we are going to be going through you tooth by tooth in a week or two's time.

**Mr Lucy**—Thank you.

**Senator SHERRY**—Sorry, there was one other thing, and not Westpoint, that I should raise because I promised I would.

**Mr Lucy**—Would you allow Mr Steward to leave so he has a chance of catching his plane?

**Senator SHERRY**—Yes. I have had a number of complaints in respect to banking and I do just want to place them on the record, and I would ask you to examine these. I have had a complaint, and I have been authorised to raise their names, from a Ms Eedra Zey, which she has referred to ASIC and to a number of other regulators about a self-managed super fund.

**Mr Lucy**—Can you recall when that was?

**Senator SHERRY**—The email I have received there is no file number or I do not think even a date about when she had taken the matter up with ASIC, but I just ask if you could examine the complaint because she is not satisfied.

**Mr Lucy**—Certainly.

**Senator SHERRY**—She is not satisfied with ASIC and the ASIC response or indeed the response of other regulators in this matter.

**Mr Lucy**—As a matter of course, when people are dissatisfied we always refer them to their rights with the Commonwealth Ombudsman.

**Senator SHERRY**—Yes.

**Senator MURRAY**—She has provided a number of us with emails.

**Senator SHERRY**—You are aware of it too, are you?

**Senator MURRAY**—Yes, and she gave a mobile phone contact with that email. It is your intention that we pass it onto ASIC?

**Senator SHERRY**—She has complained to ASIC, as I understand, and it involves the Commonwealth Bank and Colonial.

**Mr Lucy**—Yes.

**Senator SHERRY**—It is just on this banking theme that I want to finish on. I have another case, Rabobank.

**Mr Cooper**—I think that is a Dutch bank.

**Senator SHERRY**—Again, a complaint has been lodged in respect to Rabobank. I will provide you with some of the case overview and again they are concerned about a lack of response from ASIC. In this case again it involves a complaint about bank fees, Rabobank, and disclosure documents. Then the third case is the Pollie case, and it is not a reference to politicians. It concerns a Mr Oliver Pollie, and again involves the CBA and issues going to statement of advice which I understand has also been referred to you, so I would appreciate a response. My concluding question concerns the fact that I am obviously getting a lot of complaints on a lot of areas at the moment. In respect to banks and their practices, fees and disclosures, banks have internal disputes mechanism procedures. When was the last time ASIC carried out an oversight as to the way in which the banks generally were handling complaints through their internal procedures?

**Mr Lucy**—I will take that particular question on notice. Certainly we do receive complaints in respect of banks, and you have mentioned the CBA I think twice. Typically we find that when we raise issues with the banks they are sorted to the full satisfaction of the customers. There was recently a series of loans to indigenous people up in Queensland.

**Senator SHERRY**—Yes, I saw that.

**Mr Lucy**—That was resolved by the bank to the full satisfaction, I believe, of the borrowers. We will take the question on notice regarding when did we last look at the dispute resolution mechanism of the banks, and to the extent that we need to tease it out further we will do so.

**Senator SHERRY**—It just seems to me that oversighting the dispute resolution procedures and processes, which, hopefully, is where disputes about fees and disclosure and other things would be resolved, to see whether it is working fairly and reasonably is part of ASIC's role.

**Mr Lucy**—Yes, and of course the parties that are not satisfied can then go further on.

**Senator SHERRY**—Yes.

**Mr Lucy**—It is a fair question, and I for one have not looked at it recently so I will do so and come back to you.

**Senator CONROY**—Senator Minchin, I know you were chasing up Senator Sherry's question about answers to questions on notice.

**Senator Minchin**—I was advised by the Treasurer's office that they have been supplied to the committee. I gather from the secretary to the committee that they are being processed and that the committee is hoping to receive them tonight.

**Senator CONROY**—I have a couple of specific questions on notice to ASIC that I was waiting on answers for, and I have not received them yet. Mr Lucy, I am not holding you responsible at all. It is clear the Treasurer's office is holding things up.

**Senator SHERRY**—Yes, once again.

**Senator CONROY**—Mr Lucy, given that you have had time to go away—and taken the questions on notice and got three months—you will remember we were discussing a *7.30 Report* interview with you.

**Mr Lucy**—Yes.

**Senator CONROY**—I read the transcript out and you said, 'I would need to take that on notice to be precise, but I am happy to give an off-the-cuff response.'

**Mr Lucy**—Yes, I do recall that.

**Senator CONROY**—You took it on notice two or three times. You essentially kept coming back and saying, 'I will have to take it on notice.' The question that I was asking you was in relation to a comment you made, and you replied:

There has been that suggestion. And indeed, there was the suggestion, I think, that indeed it may not have been necessarily the Government but it might have been the Opposition.

I asked whether you could you explain that comment, which was a reference to political interference. Given that I have not seen your answer, do you want to read it out? Or you might just want to give me a verbal response.

**Mr Lucy**—I would be pleased to. You referred to an aspect of the response that I gave in that interview on the *7.30 Report*. You were quoting me, and your statement was, 'There was a suggestion, I think, that it may not have been necessarily the government but it might have been the opposition.' And you stopped there. Indeed, if you read the full transcript it is shown that I said:

There has been that suggestion. And indeed, there was the suggestion, I think, that indeed it may not have been necessarily the Government but it might have been the Opposition.

I went on, and you did not refer to this:

Now I can categorically state that we have not been approached by any member of parliament on either side of the house as to whether or not we should be taking any form of action. Our decision is entirely our own decision.



So I think that the second sentence of what I was quoted as saying that night answers the point.

**Senator CONROY**—No. I had not heard that suggestion. The first time I was aware of the suggestion was actually from your lips, so it was a case of having a rumour put into the national political discourse by the chairman of ASIC that he had heard a rumour, and so my question to you was: ‘Where did you hear the rumour?’ And there were three or four different questions on this issue.

**Mr Lucy**—The point that I made in that interview, and I made it quite emphatically, was that ‘I categorically state that we have not been approached by any member of parliament on either side of the house as to whether or not we should be taking any form of action.’ So, to the extent that I made a clarification, I believe that I made it emphatic that indeed there was no political influence.

**Senator CONROY**—No. I was asking where you got the proposition from that it might be the ‘opposition’. It is your own word.

**Mr Lucy**—The commentator put that as a suggestion to me, and I said that, well, there was that suggestion.

**Senator Minchin**—What was the question put to you, Mr Lucy, that prompted the comment? Some context here might be helpful.

**Mr Lucy**—The question was:

Going back to Mr Lucy’s definition of ‘political inference’, who suggested the opposition had interfered with ASIC’s investigation?

The point I am making is that I made it quite clear, and emphatically clear, when I said:

Now I can categorically state that we have not been approached by any member of parliament on either side of the house as to whether or not we should be taking any form of action.

**Senator CONROY**—I am not for a moment contradicting your follow-up quote. My point was that she put to you a question about political interference, and you said, ‘There has been that suggestion’—that is, that there has been a suggestion of political interference. You go on to say—

**Mr Lucy**—I will quote what I said:

I do not believe that I suggested that there was any interference with our investigation.

You then referred again to that first sentence only.

**Senator CONROY**—No, my question refers specifically to your statement when you said, ‘And indeed there was the suggestion, I think, that indeed it may not have been necessarily the government but it might have been the opposition.’ I am not asking you whether it is true or not, because I am confident it is not true that the opposition actually committed a criminal act by trying to interfere in an ASIC investigation. What I want to know is who told you or who suggested that to you?

**Senator Minchin**—But that is the point I am making, is it not: it was the questioner, the interviewer.

**Senator CONROY**—No, it was not. The interviewer at no stage mentions the opposition.

**Senator Minchin**—I thought she did.

**Senator CONROY**—At no stage does Emma Alberici suggest that the opposition politically interfered. Her suggestion is that the government have. I accept Mr Lucy's point that nobody interfered, but I just want to know on what basis Mr Lucy said on national television that he had heard a rumour that the opposition had interfered. That is a fairly serious suggestion. If an interviewer wants to make an imputation against the government that is fine. What I am concerned about is you putting on the public record what is a completely unfounded rumour that the opposition had attempted to interfere.

**Mr Lucy**—With respect, you cannot say that I was putting onto the public record a suggestion of interference. What I said was, and I will read it again:

Now I can categorically state that we have not been approached by any member of the parliament on either side of the house as to whether or not we should be taking any form of action. Our decision is entirely our own decision.

**Senator CONROY**—But, Mr Lucy, I know that. I know that I never approached you. I wrote to the Stock Exchange. I know that no other member of the federal parliamentary Labor Party, which could be characterised by the term 'opposition', contacted you. I know that factually. But what I had never heard until that night was any suggestion, as you have put on the public record, that 'indeed it may not have been necessarily the government'—meaning political interference—'but it might have been the opposition.' Where did you hear that rumour? And that is what you took on notice.

**Mr Lucy**—With respect, you provided an extract of my commentary to the *7.30 Report*, and you did not mention the second sentence where I categorically state—

**Senator CONROY**—I do not need it to be cleared by you. I know for a fact that the rumour was untrue.

**Mr Lucy**—But what I am stating quite categorically—

**Senator Minchin**—Mr Chairman, can Mr Lucy finish his answer?

**Mr Lucy**—What I am stating quite clearly is that any suggestion whatsoever—indeed the interviewer put it—was entirely inappropriate because I categorically stated that there was no interference. So I put it to rest.

**Senator CONROY**—No.

**Mr Lucy**—I put it categorically to rest.

**Senator CONROY**—But I can assure this country that you are not a criminal, Mr Lucy.

**Mr Lucy**—I beg your pardon?

**Senator CONROY**—I can assure everyone in this country, on the public record, you are not a criminal. But there is a slur in there. The fact that I have to say that you are not a criminal suggests that there has been some rumour that you are a criminal, which is completely untrue, but what you have done is put on the public record an unfounded rumour and then denied it.

**Mr Lucy**—No, the interviewer put it.

**Senator Minchin**—Do you want to repeat that question that was put to you?

**Senator CONROY**—No, she did not. The interviewer at no stage mentions the opposition. The only person who mentions the opposition in this interview, Mr Lucy, is you. You have put up a straw man; you have smeared the opposition and then gone on to exonerate us, when we did not need to be exonerated. You actually said ‘and indeed there was the suggestion’; it was not Ms Alberici’s suggestion.

**Mr Lucy**—I said, ‘I think.’

**Senator CONROY**—You went on to add an extra suggestion:

... there was the suggestion, I think, but it may not have been necessarily the government but it might have been the opposition.

No-one in the country had heard that. I do not know one journalist who ever suggested it. I do not know one member of parliament who had ever suggested it. Even my worst enemy, Senator Minchin, had never made such a suggestion that the opposition had attempted to criminally interfere in this case. My question continues to be: where did you hear that suggestion? I am not asking if it is true because you go on to say it is not true. My question to you three months ago was: where did you hear that suggestion, and I go on to have a discussion with you in later transcripts, because I go back to this three or four times—you would remember the afternoon, I am sure—and I ask could you tell us who your source was? I appreciate you could not necessarily name the source.

**Mr Lucy**—It is much easier than that. You may or may not recall that indeed the Leader of the Opposition made comments in parliament, I think, in September that ASIC was investigating the Prime Minister.

**Senator CONROY**—That is because you said you were investigating the Prime Minister.

**Mr Lucy**—No.

**Senator CONROY**—Penny Wong actually conducted that. I am happy to get Penny back here and you can continue that conversation.

**Mr Lucy**—By all means. I think it was on the ABC on the following morning after—

**Senator CONROY**—We appreciate you were dragged out—

**Mr Lucy**—Hang on. Can I answer.

**Senator SHERRY**—I recall that the issue raised was based on the *Australian*—

**Mr Lucy**—No, my understanding is that on the day after—

**ACTING CHAIR**—Can we let Mr Lucy finish.

**Senator SHERRY**—I do not know what this has got to do with the issue that Senator Conroy is raising.

**Mr Lucy**—My understanding is that on the day after either the estimates or the PJC—I forget which hearing it was—there was quite a bit of discussion about Telstra. The following morning, the Leader of the Opposition said that ASIC was investigating the Prime Minister.

**Senator CONROY**—My reading of the transcript is that that was correct.

**Mr Lucy**—I am not talking about the transcript; I am talking about the ABC radio.

**Senator SHERRY**—That is not the issue, anyway.

**Senator CONROY**—This is actually irrelevant, unless you are suggesting what Kim Beazley did was to interfere in your investigation.

**Mr Lucy**—It is political commentary about Telstra.

**Senator CONROY**—Yes, but you have just given political commentary about the Labor Party—

**Mr Lucy**—I gave political commentary about both the opposition and the government.

**Senator CONROY**—and all you have got to do is apologise and we can end the conversation.

**Mr Lucy**—Clearly, I did not intend any slur on the Labor Party.

**Senator CONROY**—Thank you.

**Mr Lucy**—Indeed, I tried to absolutely and categorically say, that there has been no suggestion of interference to us.

**Senator CONROY**—No, but the only person who suggested it was you.

**Mr Lucy**—I think that, in a political environment where the Leader of the Opposition is making a suggestion that we are investigating the Prime Minister—

**Senator CONROY**—That would be off the transcript in which you were asked, ‘Does this include the Prime Minister?’, and you said, ‘Yes’. You came out and corrected it the next day, or changed your definition. Kim would have made those comments first thing in the morning before your correction came out—to be fair to Kim.

**Mr Lucy**—Quite right. I am not being disrespectful to him at all. I am just saying that my reading of what I said in the hearing the night before was not categorically that we were investigating the Prime Minister; I said that we were investigating all matters to do with Telstra and communications in parliament.

**Senator CONROY**—To which Senator Wong asked you, ‘Does that include the Prime Minister’s comments?’, to which you said, ‘Yes’.

**Mr Lucy**—Yes, that is right.

**Senator CONROY**—The fact that you went on to clarify it the next day is entirely up to you. I am sure that you got a number of phone calls. I am not interested in that; I am only interested in getting to the heart of—

**Mr Lucy**—Be assured there has been no attempt at any slur against you or your party whatsoever. I tried to be quite emphatic. On *The 7.30 Report* you are on the run. I was being interviewed and, when it was put to me, I tried to lay it to rest absolutely and categorically.

**Senator CONROY**—Every time your name comes up, I want to publicly assure the Australian public that, despite these statements about Mr Lucy, he is not a criminal! How are you going to feel about that?

**Senator Minchin**—Senator Conroy! Mr Lucy has made it clear he meant—

**Senator CONROY**—I will set up the straw man and then I will deny it for you.

**Senator Minchin**—Chair, come on. Senator Conroy, Mr Lucy has made it quite clear that he meant to inference. He has given that categorical assurance on the record. You know what it is like doing *The 7.30 Report*.

**Senator CONROY**—But he is the only person in the country who implied the Labor Party had acted in a criminal way.

**Senator Minchin**—You are showing extraordinary sensitivity to this interview, unbelievable sensitivity, in the context of the quote and what Mr Lucy then went on to say.

**ACTING CHAIR**—No-one else has even raised it.

**Senator CONROY**—Correct. No-one else raised it.

**ACTING CHAIR**—No-one has even raised a comment, though.

**Senator Minchin**—Mr Lucy has done the right thing here and now and put on the record that he meant absolutely no inference against the opposition—he absolved you of any in that same interview. I respect your right to come here and question, but the sensitivity that you are displaying is remarkable. I think Mr Lucy has demonstrated professionalism and his absolute independence.

**Senator CONROY**—No, Mr Lucy has implied that there are stories circulating in the broader community. He has implied that there are stories circulating that the Labor Party has acted in a criminal manner, which is just frankly preposterous.

**Senator Minchin**—He was responding to a proposition put to him by *The 7.30 Report*.

**Senator CONROY**—I accept the point that Mr Lucy has made now. He has said that he did not intend that and I will accept that at face value.

**Senator Minchin**—Good, thank you.

**Senator CONROY**—I am finished.

**Senator SHERRY**—I have got a few more, not about Westpoint but of a general nature. Coming back to you, Mr Cooper, we had the discussion a little earlier about the disclosure document. My attention has just been drawn to some comments. This is in the context of the effectiveness, or lack of, of disclosure documents. I want to determine whether you were accurately quoted or referred to. In the *Sydney Morning Herald* on 6 February, Mr Garnaut—one of the more investigative and effective journalists in this area, I have to say—reported that he had spoken to you and, apparently, you had conceded that:

... thick, legalistic and often impenetrable disclosure statements brought in with the new financial services reform regime just three years ago have not worked. 'Most investors simply don't understand the information in disclosure documents,' Mr Cooper told the *Herald*. It may be time to chart 'a whole new direction for clear, concise and effective disclosure'.

Do you think that is an accurate reflection of your comments and your observations about disclosure?

**Mr Cooper**—Not entirely, no.

**Senator SHERRY**—How is it not an accurate reflection?

**Mr Cooper**—It seeks to bring into question the entire regime. The fact is that the regime is a very elegant and sensible regime because it is principles based and relies on clear, concise and effective disclosure. The difficulty is that many market participants are simply not engaged properly with that concept. Only this week we have stopped a prospectus on the basis that it is simply too long.

**Senator SHERRY**—In reference to that.

**Mr Cooper**—Mr Garnaut's words make it look like I am criticising it and that the whole regime is not working. The point is that the regime is actually very well set up; it is merely that we have further challenges in front of us to make, by various mechanisms—and I will get on to some of them later on—people who issue these documents to actually play ball with what parliament intended.

**Senator SHERRY**—You used the phrase 'make them play ball with what the parliament intended'. Actually, I am not that critical of ASIC's activity in respect to this issue, but the bottom line is that it comes back to parliament. If parliament intended something, why did it not legislate it and regulate?

**Mr Cooper**—I think it did legislate.

**Senator SHERRY**—Yes, it did.

**Mr Cooper**—It is merely human behaviour. Legislation does not necessarily change human behaviour overnight.

**Senator SHERRY**—I accept that.

**Mr Cooper**—That is why we have regulators.

**Senator SHERRY**—If parliament intended legislation that was clear and concise, which I accept it did—and you certainly want that and industry participants want that—why do we not have that in the regulations in a standard, simple format, at least for some of the documentation that is issued?

**Mr Cooper**—You mean a template form?

**Senator SHERRY**—A template, yes.

**Mr Cooper**—Because when you get into the financial product landscape, it simply does not work like that. There is myriad—every financial product is different.

**Senator SHERRY**—Not every one is different. But you can make some attempt in some areas to do that. For example, you look at the choice of fund form. It is a standard format document—is it not? I am not suggesting you would apply that approach in respect to everything.

**Mr Cooper**—Over time, through the various refinements that the government has made and through our work, for example, in the basic deposit product area, we are seeing a specific pattern of a very low and simple disclosure in that regime. We are seeing, over time, various financial products treated differently. The danger with that, of course, is that if you go too far down that track, you end up with the patchwork quilt that the whole Wallis inquiry was seeking to overcome. The beauty of the clear, concise and effective rule is that it is not prescriptive; it does not involve thousands of stages of rules about how it works.

**Senator SHERRY**—Yes, but we do not have that in many areas. As I say, I am not particularly blaming ASIC for this, and nor do I blame the lawyers or the industry participants particularly. It is up to parliament. If that is what parliament wants, let it legislate and regulate for it so there is no doubt. Surely there is an onus on the parliament itself. It is our law.

**Mr Cooper**—If that is right then it is a matter for parliament to deal with, but I do not think that that is right. The forces that we are grappling with are global.

**Senator SHERRY**—Global?

**Mr Cooper**—They are forces whereby people who issue financial products seek to minimise their liabilities to the maximum extent possible.

**Senator SHERRY**—I understand and agree with that conclusion. They are trying to minimise their legal liabilities. If you refer anything to a lawyer, there is going to be a whole stream of ifs, buts, maybes, caveats—the whole lot. That will be their approach unless you have a simple standard format in the regulations of the act.

**Mr Cooper**—That is a policy question for the government.

**Senator SHERRY**—I know that is not the government's approach, and it is not the view that you are putting. But where are we at? We are in the second round of refinements consultation. As I say, I am not particularly blaming ASIC for this. It is the parliament's and the government's responsibility, but the government has undertaken a second round of refinements. Where are we at? Have you done any surveys about the documents that are currently being produced in terms of their simplicity, conciseness and average length?

**Mr Cooper**—Based on our empirical evidence, the people that we speak to and the documents we see, there is a fair consensus that the documents are still too long. Refinements 1, if I can call it that, put forward the short form PDS option. In refinements 2, we see exploration of the incorporation by a reference technique into the PDSs. If that proposal goes forward into legislation, that will be significant. We have already indicated that, should that happen, ASIC will be right there in terms of giving guidance about how it works to make shorter documents much more workable.

**Senator SHERRY**—Should that happen, do you accept that it would require parliamentary action?

**Mr Cooper**—Certainly the incorporation by reference does, yes.

**Senator SHERRY**—By legislation or regulation or both?

**Mr Cooper**—Probably by legislation.

**Senator SHERRY**—In the work that you are undertaking in this area and the refinements 2—you are obviously involved in the consultations in this area—has there been any consumer testing to date? I am not talking about the providers. Have we had any consumer testing about what is simple, concise and understandable for the average punter?

**Mr Cooper**—ASIC itself has not conducted consumer testing on that.

**Senator SHERRY**—I know from my earlier questioning that the relevant responsible division in Treasury has not. Aside from product providers, has there been anything done yet from anyone else that you are aware of?

**Mr Cooper**—Specifically in relation to PDSs?

**Senator SHERRY**—Yes.

**Mr Cooper**—No that I am aware of, no.

**Senator SHERRY**—Is ASIC considering some consumer testing?

**Mr Cooper**—In a sense, it is the wrong end of the pipeline, as it were.

**Senator SHERRY**—It should have been done three years ago?

**Mr Cooper**—It is not so much that. We administer the laws that get made.

**Senator SHERRY**—Yes.

**Mr Cooper**—If you wanted to do research, it would not necessarily be us doing it.

**Senator SHERRY**—So you are saying that it is the parliament's responsibility?

**Mr Cooper**—No. I am not sure exactly what the research would show. It is anecdotally widely known that many consumers do not read these documents.

**Senator SHERRY**—It is anecdotal?

**Mr Cooper**—Yes.

**Senator SHERRY**—I think that is true of a very significant proportion of consumers, depending on the documentation. I have seen surveys by superannuation funds, for example, about the number of people who read the statutory obligatory single-page superannuation statement about money in, fees, charges, rate of return—the number of people who read that and look at it closely, as distinct from the annual reports, which are 12, 15 or 20 pages. Over 90 per cent put the annual report in the rubbish bin unread, but 90 per cent look at the single-page document. I have seen data on that and I think it is pretty well-based research. Why have we not got that sort of research in respect of the FSR/PDS type documents? Would that not be helpful?

**Mr Cooper**—It is really a policy question. We get given the laws and we administer them.

**Senator SHERRY**—Yes. In the absence of my colleague Senator Wong, who was going to ask some questions about the new appropriations in the budget, I have a question about the extra budgetary moneys. What is the purpose of the policy guidance laws administered by ASIC, in greater detail? Where have you identified shortfalls in ASIC's ability to oversight and regulate in this area? I am looking at the portfolio budget statement.

**Mr Lucy**—At table 3.1?

**Senator SHERRY**—On page 190 of the portfolio budget statement.

**Mr Lucy**—Yes, I have it.

**Senator SHERRY**—Just for reference, it is table 3.1, output 1.1.

**Mr Lucy**—That comes back to the comments that the Treasurer made in his release that demand for our activities continues to grow and there is ongoing pressure on the workload. One of the areas that ASIC has worked very hard on over the last 12 months is to make sure that we look at every opportunity to gain efficiencies. For example, we have renegotiated a number of our leases and we have done things to bring us down to the bare minimum as far as



expenditure is concerned. We have reached a point where we need to undertake an expansion of our work, and that is undertaken through an NPP process. The government has provided an extra \$8.3 million for that expenditure.

**Senator SHERRY**—You referred in passing to leases; has there been the closure of offices in some locations?

**Mr Lucy**—Yes, service centres. In Perth, for example, we have downsized slightly. In Traralgon we have renegotiated our lease.

**Senator SHERRY**—Are there any further proposals for the next financial year?

**Mr Lucy**—Not in relation to closures. We are relocating in Melbourne, but that is the only major property decision that we have taken.

**Senator SHERRY**—Have you looked at co-location with APRA at all?

**Mr Lucy**—Yes. Indeed, we have looked at co-location with both APRA and the DPP, and in particular in smaller offices where critical mass is a factor for all three agencies. That is in front of us and there is some potential for that.

**Senator SHERRY**—But there have been no decisions yet?

**Mr Lucy**—No decisions, but there is agreement in principle that we should pursue this further.

**Senator WONG**—Can I ask for an update on the progress with the James Hardie investigation?

**Mr Lucy**—Yes, of course. Firstly, in respect of the scanning of the documents, we are well advanced. I think we referred to that previously.

**Senator WONG**—Yes, you did.

**Mr Lucy**—There is a large issue in front of us. We continue to meet. Indeed, we met as a board within the last two weeks. The commission is satisfied with the way that the investigation is proceeding. It is an ongoing investigation. We have whatever resources are necessary for it, the right expertise, and we are satisfied with the progress to date.

**Senator WONG**—What is the cost of the investigation to date?

**Mr Lucy**—The expenditure for the 2004-05 year was \$1.383 million, and the anticipated expenditure for this financial year is \$5.7 million, which totals \$7.092 million.

**Senator WONG**—Your budget appropriation that we discussed on the last occasion was \$3.1 million to fund the dedicated Hardie's task force. So, to clarify, your expenditure to date is over \$7 million?

**Mr Lucy**—Yes. We have carried forward an amount of \$1.621 million into future years. We have underspent in the first two years and we have carried forward that allocation into future years.

**Senator WONG**—On the last occasion I asked and you confirmed that the \$3.1 million was to fully fund the dedicated James Hardie task force. You have spent over double that. It is a very important investigation. I am more interested in how much more money you are going to need from the government to finalise the investigation.

**Mr Lucy**—I understand. At this stage we have the \$1.6 million underspend. In this appropriation we received an allocation of \$30 million per annum for enforcement expenditure.

**Senator WONG**—Yes. I will come to that after the dinner break. You are utilising some of that for Hardie?

**Mr Lucy**—No, not yet.

**Senator WONG**—You are proposing to?

**Mr Lucy**—If necessary, yes.

**Senator WONG**—The \$1.6 million underspend is from previous years?

**Mr Lucy**—Yes.

**Senator WONG**—Is that from your enforcement funding in previous years?

**Mr Lucy**—Specifically for James Hardie, yes.

**Senator WONG**—Did you seek more than \$3.1 million prior to the last budget round?

**Mr Lucy**—I do not believe so but I would have to take that on notice.

**Senator WONG**—If you did not, you obviously sought far less than was required.

**Mr Lucy**—Our expectation is that we will be fully funded for James Hardie.

**Senator WONG**—You are not sure what you sought. You were allocated \$3.1 million last time and, on the last occasion, you indicated to me ‘yes’ when I asked whether that was to fully fund the dedicated Hardie task force. You have now told me that it is in excess of \$7 million.

**Mr Lucy**—The money that I have mentioned is the funding. Initially it was funded over two years, totalling \$7.092 million. At this stage we are carrying forward into next year an underspend of about \$1.6 million.

**Senator WONG**—From previous funding?

**Mr Lucy**—Yes.

**Senator WONG**—How much of the \$3.1 million, which is the additional allocation for 2005-06 in the 2005-06 budget, have you spent?

**Mr Lucy**—About \$4 million.

**Senator WONG**—You spent more than you were allocated last year?

**Mr Lucy**—This year that we are in at the moment.

**Senator WONG**—Yes, you have spent more?

**Mr Lucy**—Yes.

**Senator WONG**—In terms of your having some view about the resources required for this investigation, why you did not seek more funding for the 2005-06 budget year, given that you have already—

**Mr Lucy**—We did not think that we needed it.

**Senator WONG**—But you did?

**Mr Lucy**—But we did. Yes, we did.

**Senator WONG**—You are at \$7 million now. Do we have some view given past experience and your experience with other major investigations, such as HIH, what your total expenditure is likely to be on finalising investigations and making decisions about whether any further legal action is required?

**Mr Lucy**—At this stage, as I said, we have \$1.6 million and our best estimate is that that will be adequate.

**Senator WONG**—To get to what point?

**Mr Lucy**—To conclude our investigation.

**Senator WONG**—Not including any legal proceedings that may or may not result?

**Mr Lucy**—It depends upon what form the legal proceedings take—criminal or civil.

**Senator WONG**—Regardless of what form they take, I am asking whether the \$1.6 million, on your answer, only takes you to the end of the investigations process?

**Mr Lucy**—To clarify, we think that \$1.6 million will conclude ASIC's involvement with James Hardie.

**Senator WONG**—Are you making assumptions about what legal action may or may not be taken in determining that?

**Mr Lucy**—We are, to an extent. Again, this is an ongoing investigation. I really do not want to get into a level of detail that is not appropriate.

**Senator WONG**—I have no interest in prejudicing your investigation or what legal options you might undertake. What I have an interest in is getting some sort of view about whether your current level of funding is appropriate in circumstances where you have clearly needed greater resources than were allocated in the 2005-06 budget for this investigation.

**Mr Lucy**—The major reason for that was the scanning. But as I said, we believe that we have adequate funding.

**Senator WONG**—To do what?

**Mr Lucy**—To complete our role within James Hardie.

**Senator WONG**—Role or investigation?

**Mr Lucy**—Both.

**Senator WONG**—What about legal action?

**Mr Lucy**—Potentially to include that as well.

**Senator WONG**—Potentially to include that as well. That, presumably, would be a fairly significant additional amount.

**Mr Lucy**—It is too much of a hypothetical. We have an expectation that we are appropriately funded. For example, in HIH, which is another large issue, we are likely to be significantly underspent. In relation to litigation contingency, we have this \$30 million

provision made available to us. To the extent that we may or may not need to access that for James Hardie, that is something that I cannot answer at the moment.

**CHAIR**—Senator Wong, we will break now and you can continue your questions at 8 pm.

**Proceedings suspended from 6.31 pm to 8.00 pm**

**CHAIR**—Order! The hearing is resumed.

**Senator WONG**—I want to finish the issue we were discussing prior to the break. Mr Lucy, I want to make sure I understood your evidence. You indicated to me that the expenditure to date on the Hardie investigation was \$7 million. You also indicated that in the last financial year you have expended \$4 million. Is that right?

**Mr Lucy**—Perhaps I will go back over that. I was seeking some clarification. The total funding we received for James Hardie was \$7.092 million, of which we spent \$1.383 million, which I think I mentioned before, in 2004-05. We had a budget of \$5.709 million for the 2005-06 year.

**Senator WONG**—Could you give the last two figures again?

**Mr Lucy**—Yes, \$5.709 million.

**Senator WONG**—For?

**Mr Lucy**—For the 2005-06 year, with an expectation that we would underspend in that year.

**Senator WONG**—What was the 2004-05 year?

**Mr Lucy**—Actual?

**Senator WONG**—Yes.

**Mr Lucy**—It was \$1.383 million.

**Senator WONG**—And what was budgeted?

**Mr Lucy**—The original budget was \$3.666 million, but we reduced that because we knew that we were going to be underspending in the first year, and we carried forward the balance. Therefore, the second year went up. As I mentioned, we anticipate carrying forward into 2006-07 approximately \$1.6 million.

**Senator WONG**—I am not clear where you are drawing your different allocations from. You had \$3.1 million in the 2005-06 year, of which you spent \$5.7 million, so you supplemented it with what?

**Mr Lucy**—No. We budgeted for \$5.7 million. We will actually spend \$4.088 million.

**Senator WONG**—A sum of \$4.08 million?

**Mr Lucy**—Yes.

**Senator WONG**—But the \$3.1 million was the amount for which year, then, that we discussed at last year's estimates?

**Mr Lucy**—No. I think it was \$3.426 million.

**Senator WONG**—Yes. I am sorry. I am reading from the *Hansard*. It was \$3.1 million to fully fund the dedicated Hardie task force. Whether it was \$3.1 million or \$3.4 million, Mr Lucy, that was budgeted for the 2005-06 year?

**Mr Lucy**—Yes.

**Senator WONG**—But you actually spent \$4.08 million?

**Mr Lucy**—It was initially budgeted for the 2005-06 year. We revised that, with the approval of the government, because we underspent in the first year, so the \$3.46 million became \$5.79 million, both amounts in aggregate equalling \$7.092 million.

**Senator WONG**—To what extent have you funded the Hardie investigation out of other appropriation revenue—

**Mr Lucy**—None.

**Senator WONG**—and not the allocated revenue for Hardie?

**Mr Lucy**—None. It came entirely out of this.

**Senator WONG**—Is one of the matters that is the subject of the investigation the cancellation of the partly paid shares?

**Mr Lucy**—We are looking at all aspects of James Hardie, including the partly paid shares, yes.

**Senator WONG**—And ‘undertakings’ might have a certain meaning to it, but certainly the indications that were made by Hardie before the New South Wales Supreme Court?

**Mr Lucy**—Senator, really, it is not appropriate to go into the detail.

**Senator WONG**—I am not asking what your conclusion is. I am asking if that is a matter that is being investigated.

**Mr Lucy**—All aspects of Hardie, including any particular matters that have been referred to us, we are looking at.

**Senator WONG**—Thanks. I will now turn to an issue that Mr Cooper and I discussed in the context of the PJC corporate responsibility inquiry. Mr Cooper, you will recall we discussed various pieces of evidence that had been presented to that inquiry, including a suggestion about alterations to directors’ duties. I think we specifically discussed a safe harbour provision and a proposition put by Mr Beerworth in relation to the business judgment rule. Is it still your view that you do not believe such a clarification, such as a change to the business judgment rule, is required?

**Mr Cooper**—Yes.

**Senator WONG**—And have you been asked to investigate, consider or provide advice as to the implications of a change to the business judgment rule such as Mr Beerworth suggests?

**Mr Cooper**—Not to my knowledge, no.

**Senator WONG**—Are you aware that that possibility is flagged in the government’s recently announced business regulation review?

**Mr Cooper**—Yes.

**Senator WONG**—Were you asked to give advice about that?

**Mr Cooper**—We have made a submission about that.

**Senator WONG**—To?

**Mr Cooper**—To the review, I suppose, yes.

**Senator WONG**—When did that occur?

**Mr Cooper**—When did that happen?

**Senator WONG**—Yes.

**Mr Cooper**—In the last few weeks.

**Senator WONG**—As I recall your evidence, Mr Cooper—I will not go through the transcript—one of the issues you raised was how this might be enforced, if one put in such an alteration to the Corporations Law. Do you have any enforcement related concerns about a proposed change, such as is proposed by Mr Beerworth and flagged in the government's paper?

**Mr Cooper**—Do we have concerns about enforcement?

**Senator WONG**—Yes.

**Mr Cooper**—Well, it depends on what changes are made.

**Senator WONG**—In the context of discussing Mr Beerworth's suggestion, which I understand is identical to what is discussed in the government's paper, I asked you whether you have legal difficulties with the permissive provision. You said yes. I am reading from the transcript on Wednesday, 29 March. I asked why. You said:

Because, with our enforcement regulator hat on, given that our task is to enforce directors' duties—and I am using fairly blunt language here—and given the number of excuses a director can come up with where we think that there has been wrongdoing, it increases (1) the number of excuses and (2) the level of uncertainty about what is what.

Is that still your view, Mr Cooper?

**Mr Cooper**—Yes, it is. But I guess that is a policy. We are talking about law reform, which is not our bag.

**Senator WONG**—You put a view about law reform to me as an opposition senator, Mr Cooper. Are you worried about doing it now that it is in a government discussion paper?

**Mr Cooper**—No, not at all, no. My position remains exactly the same. I am just making the point that it is entirely a policy matter. The consultation paper is out there with a suggestion on the business judgment rule. I suppose we will see what the government finally decides on that.

**Senator WONG**—Sure. I am just asking if some of the enforcement issues that ASIC raised when this was put to you in March remain.

**Mr Cooper**—Yes.

**Senator WONG**—And the potential for such a provision to impact upon decision making in board rooms?

**Mr Cooper**—Well, again, I think this is starting to get hypothetical because it depends on what ultimate decision is made, how wide the business judgment rule is and, if it is to be extended, whether there are counteracting changes. It is just very hypothetical.

**CHAIR**—I think that is right, Senator Wong. I accept that an agency like ASIC perhaps stands in a somewhat different position from the department when it comes to matters of policy because it might have an announced position in relation to a matter of law reform, for instance. But subject to that, I nevertheless think the policy exception does fairly apply to these officers.

**Senator WONG**—Well, I do not mind that except that Mr Cooper previously put fairly blunt evidence to the PJC—

**Mr Cooper**—Which I am not resiling from. I am simply saying that, now we are into a law reform issue, I think the context is quite different. The relevance of my comments is somewhat different.

**Senator WONG**—Well, there was a law reform issue before you. There was a parliamentary committee considering a submission about law reform and you did not resile then, Mr Cooper, from giving a view about enforcement related concerns associated with such proposals.

**CHAIR**—You have drawn Mr Cooper's attention to it. He does not dispute that he said that on the public record. That is really the end of the matter, is it not?

**Senator WONG**—Can I question him, or are you going to question through the chair?

**CHAIR**—If he does not want to go further or to elaborate, comment or editorialise upon views he may already have expressed, I think he is entitled to take that position. I do not think he can be pressed upon a policy issue beyond what he might already have said on the public record.

**Senator WONG**—Are you able to provide us with your submission to the consultation paper?

**Mr Cooper**—I will have to take that on notice. We have made a submission. It was deliberately non-public because we thought that it was not helpful, given the special nature of the proposals that had been put up. It is not, as I understand it, official government policy but a collection of ideas from BRAG, the Business Regulatory Advisory Group, and so on. We did not think it was helpful for the regulator to make public yet further submissions. I think there are something like a 55 different measures. So we have made a submission, but we have decided to keep it off the public record at this stage.

**Senator WONG**—But you are being asked at an estimates committee for that.

**Mr Cooper**—Correct.

**Senator WONG**—It is a bit different from a member of the public ringing up.

**Mr Cooper**—I do not think we have a strong objection. We whole-heartedly agree with a number of the suggestions and make comments on some others. There is nothing to hide so we have that—

**Senator Minchin**—Would you prefer it was not made public?

**Mr Cooper**—Oh, no.

**Senator Minchin**—What circumstances or conditions are you—

**Mr Cooper**—We merely thought it was unhelpful to have yet more commentary on things that really are not government policy. But there is certainly nothing in here that we have a problem with.

**CHAIR**—You want to consider it?

**Mr Lucy**—We do not want to be in a situation where we are in court having to defend a position.

**Senator Minchin**—No. You may be able to provide it in camera or something.

**Senator WONG**—Perhaps you can consider your position on that.

**CHAIR**—Perhaps. I do not think you can provide these documents in camera in estimates. But you could offer Senator Wong a private briefing.

**Senator WONG**—Yes. Alternatively, the PJC can receive it in camera.

**Mr Cooper**—Well, I do not think we have any objection to that.

**Senator WONG**—I do not have an agenda to pass it around, Mr Cooper. I would just like to see what your views are.

**CHAIR**—I do not think you should feel pressure to produce it this evening.

**Mr Lucy**—Thanks, Chair.

**Senator WONG**—I want to talk about the hedging of executive remuneration options. Are you aware of the ACSI survey of the top 200 companies in relation to those that have policies and those that do not et cetera?

**Mr Cooper**—Yes. I am aware from a press summary. I do not believe I have actually read a copy of the report, but I am aware of the subject matter and I am aware of its existence through the press.

**Senator WONG**—ACSI has indicated in the overview of the survey, which is a public record, that they wrote to 198 company trusts in the ASX and S&P200. There was a 42 per cent response rate. Thirty-four had a policy that covered hedging, 21 per cent did not have a policy and 23 per cent said it was not applicable to their incentive scheme. Does ASIC have any concerns about the practice of executives hedging their remuneration options?

**Mr Cooper**—We have had the matter brought to our attention from time to time. It is more of a governance issue. It can move into being misleading if in effect the shareholders are being told that there is an incentive plan that puts certain remuneration at risk whereas behind the scenes there are arrangements that effectively remove that risk. That is a concern.

**Senator WONG**—Well, that is the core of the issue, isn't it?

**Mr Cooper**—It is.

**Senator WONG**—If the idea is you have a range of performance related bonuses or options but you then enter into arrangements which essentially remove the risk, the whole argument that shareholders are somehow getting some value for money because your



remuneration package includes this performance based component is really out the window, isn't it?

**Mr Cooper**—Well, that is the whole problem. I think the position is this: you really have to look at every single one on its own merits. In other words, what were the shareholders told? What is the nature of the long-term incentive? How does the hedging work? Have the shareholders been told about the hedging? When does the hedging take place? In other words, does it take effect after the vesting of the securities? There are many, many issues that bear on whether there is in fact a problem. It is a relatively recent and complex issue. There is not a silver bullet solution.

**Senator WONG**—No. I agree.

**Mr Cooper**—We are pleased that organisations like ACSI are getting this issue out on the table because quite often putting some sunlight on these sorts of things actually has a regulatory effect in itself. The industry then moves, particularly if you are talking about the top 200 ASX listed companies. You would hope if there was a problem, the industry would move quickly to remedy it.

**Senator WONG**—You raise issues about how one might look at the effect of hedging and whether in fact it is undermining the principle of performance being the basis of a certain component of someone's remuneration. Do you believe that the current executive remuneration disclosure regime adequately covers those issues? In other words, is there sufficient information required such that hedging is a transparent issue or a disclosed issue or the effect of hedging may not be too problematic?

**Mr Lucy**—I must say this is one area that we have been talking about generally in the commission. We really do not have a definitive position on it. It is relatively new, as you describe, and it is complex because no one size fits all. You also have the role of the AASB, the Australian Accounting Standards Board. So it is something which we have on our radar screen, but at this stage we have not reached a definitive view on it.

**Senator WONG**—It is the case, isn't it, that there is not even necessarily a requirement that the board of a company knows that the executive has in fact engaged in the hedging of their options?

**Mr Cooper**—In some cases, yes, that is right. It becomes a private arrangement that the director entered into.

**Senator WONG**—I am not trying to trap you, Mr Cooper. I am trying to work our way through this. I understand the market is often ahead of where regulation is. You raise a reasonable point: to determine whether or not something is appropriate, you probably want to look at a range of issues. My question is: do you think the current remuneration disclosure regime gives that information?

**Mr Lucy**—I guess it really depends on where we finish up with our view. It also depends upon what happens with the accounting standards and whether or not there is any amplification of what is required there.

**Mr Cooper**—An off-the-cuff response might be that traditionally the standards are looking at the disclosure of quantum.

**Senator WONG**—Correct.

**Mr Cooper**—What is the remuneration? How is it structured and valued and so on? This is in effect a different issue.

**Senator WONG**—Correct.

**Mr Cooper**—Because it does not go to the quantum. It goes to the level of risk.

**Senator WONG**—That is right.

**Mr Cooper**—To that extent, it reflects, I suppose, the way the financial markets innovate quickly. And a lot of the innovation is around removing risk. That is exactly what is happening here.

**Senator WONG**—That is right. In this context, haven't they innovated in a way that undermines but is a bit beyond the current regulatory reach?

**Mr Cooper**—It could be. That puts us at a fork in the road, in one sense. Is it right to re-look effectively at the prescriptive black letter rules in the accounting standards, or is the solution in the directors' duties area? There are complex and myriad ways that you could do this. Maybe the directors' duties solution is that with any arrangement that seeks to obfuscate the level of risk, there are three ways you can deal with it. There is false or misleading conduct happening in relation to what the shareholders are being told. There is the directors' duties issue. Another way to fix it is to rework disclosure in the accounting standards.

**Senator WONG**—Sure. I am probably with you on this; I have not come to a view about what is the best way to deal with it. The issue with directors' duties, though, is that if the board is not aware that an executive is engaging in this, it is a bit hard to know how you make a direct response.

**Mr Cooper**—Well, that is one species, isn't it?

**Senator WONG**—Yes.

**Mr Cooper**—And then you have to assess all. All risk products come with a price of their own. So who pays for the hedge? How does that work? Does the company pay for it? Does the individual director pay for it? Should it be taken off the directors' remuneration? If I have had to part with money to secure one of these hedges, how do you calculate that?

**Senator WONG**—Okay. But you would agree, wouldn't you, that hedging potentially disrupts the alignment of interest between shareholders and executives?

**Mr Cooper**—Well, if it is fully disclosed—

**Senator WONG**—Okay. If it is not?

**Mr Lucy**—It depends who pays, I think. That is the key issue.

**Senator WONG**—That is not the issue. Why is who pays for that the issue?

**Mr Lucy**—Because I might have an entitlement to some shares, out of which carries the speculation as to the level of risk, at what price and at what profit and everything else. If someone is willing to take over that entitlement for a fee, there is a cost.

**Senator WONG**—Is that really ASIC's position, Mr Lucy?

**Mr Lucy**—No. I said earlier that we have not got a position on it. One of the complexities is the question of whether it is appropriate. If a person has an entitlement to anything, be it a life insurance policy, you name it, and they arrange their affairs to crystallise that into a certain amount at a particular point of time, is that anybody else's business?

**Senator WONG**—Hang on, Mr Lucy. There are two different issues. The cost of whatever contract the executive enters into is really not the issue. The issue is an arrangement which negates downside risk.

**Mr Lucy**—But it is open for directors to do it.

**Senator WONG**—No, that negates—

**Mr Lucy**—It is open for shareholders to do it.

**Senator WONG**—Can I finish? An arrangement which negates downside risk, I would argue, breaks the alignment of interest between shareholder and executive.

**Mr Cooper**—ASIC is agnostic about that principle. Companies are free to decide whether they want to align, whether they want to have these incentive arrangements or not.

**Senator WONG**—Which principle are you agnostic about?

**Mr Cooper**—The theory that aligning the interests of directors with the long-term growth of the company. That is not something that ASIC has a view on one way or the other. Our view is that companies are free, so long as they comply with relevant legal requirements, to believe that that is the right way to go or not. They are perfectly entitled to choose other methods of remuneration.

**Senator WONG**—But it goes back to the false and misleading conduct issue that you raised, doesn't it?

**Mr Cooper**—That is right. It does.

**Senator WONG**—We are talking about non-vested shares here. I am talking about options. We are clear about that?

**Mr Cooper**—Yes.

**Senator WONG**—The directors are saying: 'This is our remuneration policy. We have X proportion which is performance related in terms of share options. We think that's a good thing because it aligns this executive's interest with your interests as shareholders.' If the executive has gone and undertaken some hedging arrangement, that is inconsistent with what the shareholders are being told. Would you agree with that?

**Mr Cooper**—Yes and no.

**Senator WONG**—Potentially?

**Mr Cooper**—'Told by the company'. It depends on whether the company is aware of the hedging arrangement or not. That is a different issue. If the director has just gone off on his or her own bat and entered into a hedging arrangement, what do you impute back to the company? Probably nothing.

**Senator WONG**—I am not talking about it as a legal liability here. I am saying: would you agree as a matter of principle that, in circumstances where that is what shareholders had been

told, such arrangements would be inconsistent—regardless of whether any legal liability flows from that—with what shareholders have been told?

**Mr Cooper**—Yes.

**Senator WONG**—You would agree with that?

**Mr Cooper**—Yes.

**Senator WONG**—Thank you. It did not take us long to get there.

**Mr Cooper**—No. It was relatively painless, wasn't it.

**Senator WONG**—Has ASIC performed an investigation into the practice of hedging unvested shares by executives?

**Mr Cooper**—Not that I am aware of.

**Mr Lucy**—Not investigations.

**Senator WONG**—What have you conducted?

**Mr Lucy**—We are looking at it by way of a surveillance activity, but we are not investigating. Investigating from an ASIC perspective is a formal step.

**Mr Cooper**—Some matters have been brought to our attention that we have looked at from time to time.

**Senator WONG**—In relation to individual companies or more generally?

**Mr Cooper**—Yes.

**Senator WONG**—What action are you taking as a result of that?

**Mr Lucy**—It is really all forming part of the fabric of us making a decision as to how we want to treat these and how we think they should be treated. So it is just part of our intelligence gathering process at this stage.

**Senator WONG**—Mr Lucy, I understand your position is that you do not have a determined policy position on this yet.

**Mr Lucy**—Yes.

**Senator WONG**—I am just trying to work out what your process is. It has been brought to your attention in relation to, what, a number of companies?

**Mr Cooper**—No, I would not put it that strongly. I think one or two, perhaps.

**Senator WONG**—One or two companies. You are aware of the ACSI survey?

**Mr Lucy**—Yes.

**Senator WONG**—And you are aware of the views of a number of stakeholders on this issue?

**Mr Lucy**—Yes.

**Senator WONG**—Are you considering getting some further information? Are you planning on determining a view about whether, for example, we need to look at an accounting

standards alteration or whether other regulatory changes are required? What is your process here?

**Mr Lucy**—We are also looking internationally because this is not just an issue for the Australian market.

**Senator WONG**—What is the process?

**Mr Lucy**—Before your questioning we did not have a particular time line. We have commenced a review of this and we have asked our international people to come back with intelligence so we can look at what is happening elsewhere. To the extent that we need to determine a formal policy, we will. If it does require a formal policy, then from where we sit it will probably take us six months to get there. In the event that we do not require a formal policy, I expect we will get there within half that time.

**Senator WONG**—I want to follow up on that. You have commenced what you have called a review of this issue?

**Mr Lucy**—Yes. A review, an intelligence gathering exercise.

**Senator WONG**—And you are looking at international experience on these issues?

**Mr Lucy**—Correct. Not just historical but also what they anticipate.

**Mr Cooper**—One way of looking at this is that it is effectively a corporate governance issue.

**Senator WONG**—That is how you are treating it?

**Mr Cooper**—That could be one way of looking at it. In this country, we are not the only player. You do not go to part of the Corporations Act that is entitled ‘Corporate governance’. We have a principles based system in this country. Because there are so many myriad ways of achieving the elimination of risk, it may well be that the best way to deal with this is to do some work on the principles.

**Senator WONG**—Maybe we can discuss this again in the PJC context. I hope ASIC makes a contribution to the policy discussion around this.

**Mr Cooper**—Thank you. We will.

**Senator WONG**—I think that is not an unreasonable proposition you have just put.

**Mr Cooper**—We have a very useful relationship with ACSI. It may well be that one of the best ways is to go and have a chat with them about their work.

**Senator WONG**—You have not had any discussions with ACSI yet, though, on this issue?

**Mr Cooper**—No.

**Senator WONG**—I want to move to another topic. I have a question about Allstate Explorations. Is there a current investigation into Allstate Explorations?

**Mr Lucy**—No.

**Senator WONG**—Has ASIC received any complaints in relation to the administrator of the Allstate group?

**Mr Lucy**—I would have to take that on notice.

**Senator WONG**—Is it the case that ASIC received complaints regarding the conduct of the administrator some time ago?

**Mr Lucy**—Again, I would have to take that on notice. We have certainly received complaints in respect of Allstate. But as to whether or not it was particularly to do with the administrator, my expectation is that it was. That is my recollection, but I would need to be sure of that.

**Senator WONG**—Is it the case that some of these complaints were received some years ago?

**Mr Cooper**—Yes.

**Senator WONG**—Was any investigation undertaken by ASIC as a result of that?

**Mr Cooper**—I think we have looked at it twice.

**Senator WONG**—You have looked at it twice?

**Mr Cooper**—Yes.

**Senator WONG**—Perhaps you can tell me about that.

**Mr Cooper**—It is a bit of an old matter now. My recollection is that complaints were made. As these events were unfolding, ASIC looked fully at it and decided—

**Senator WONG**—What sort of time frame are we looking at?

**Mr Cooper**—Honestly, I would be—

**Mr Lucy**—It is some years back.

**Mr Cooper**—Further complaints were made. In effect, to use everyday parlance, the case was reopened and relooked at. Again, it was decided that there was not any further thing that ASIC needed to do.

**Senator WONG**—Both investigations concluded by October 2005?

**Mr Cooper**—I believe that would be correct, yes.

**Senator WONG**—That would be about right?

**Mr Cooper**—Yes.

**Senator WONG**—And no action was taken by ASIC as a result of these investigations?

**Mr Cooper**—That is my recollection, yes.

**Senator WONG**—In the context of the investigations, did ASIC interview the joint venture partner, Beaconsfield Gold?

**Mr Lucy**—I would have to take that on notice. I cannot remember.

**Senator WONG**—So you are not aware of whether you did or not?

**Mr Cooper**—To answer your question properly, we would have to take that on notice and come back.

**Senator WONG**—Is Taylor Woodings the name of the company? Are you familiar with it?

**Mr Cooper**—It does not ring a bell.

**Senator WONG**—Is Taylor Woodings one of the administrators that was originally on the Westpoint administration?

**Mr Lucy**—Taylor Woodings?

**Senator WONG**—Yes.

**Mr Lucy**—It does not ring a bell with me.

**Senator WONG**—The reason I mention October 2005 is that I understand there was a reasonably substantial safety incident at the Beaconsfield mine. I am wondering as a result of that whether ASIC had any further discussion with the administrator.

**Mr Lucy**—Just to clarify, it was October 2005?

**Senator WONG**—Correct.

**Mr Lucy**—I would have to take that on notice.

**Senator WONG**—Did ASIC ever investigate in relation to this administrator whether this person had the expertise to appropriately and safely run the mine in question at Beaconsfield?

**Mr Lucy**—Again, we can take that on notice.

**Mr Cooper**—We are getting a little bit out of our patch when talking about safety incidents and issues. It is really not something that we regulate.

**Senator WONG**—Where was the administrator located? Do you know?

**Mr Lucy**—Again, I think these events date back some time. We are better off to take them on notice to be sure.

**Senator WONG**—I am sorry, I thought the nature of some of the complaints made were, frankly, about the expertise of the administrator in running that company. Obviously safety in the mining operation is one aspect of that. Is that correct?

**Mr Cooper**—We are really taking all this on notice, I think, Senator.

**Senator WONG**—Does ASIC have any concerns about a situation in which an administrator can be the sole director responsible for a highly technical operation like a mining operation?

**Mr Cooper**—I am not really sure what you are asking me. It is common. There was a time when the entire collapsed Bond Group was being run by one administrator. They obviously appoint technical assistance; that is the way it works. It is a titular and legal appointment. They gather together technical experts, be they people in their employ or people they hire in. It happens when any business goes into external administration.

**Senator WONG**—We are talking about an industry which has both very high health and safety requirements and a high degree of technical expertise required.

**Mr Cooper**—So do many others.

**Senator WONG**—We are also talking about quite a protracted period, are we not, over which this company was being administered by a single person without any expertise on board?

**Mr Cooper**—You say ‘administered by a single person’. That is not how administrations work.

**Senator WONG**—Okay. We can have a discussion about that. You have mentioned the appointment of technical people. Is that a hypothetical or is that something ASIC ascertained?

**Mr Cooper**—Again, we are taking all this on notice.

**Senator WONG**—No. You mentioned it, Mr Cooper.

**Mr Cooper**—But it would be unique.

**Senator WONG**—You mentioned it. You said that people would appoint technical experts et cetera.

**Mr Cooper**—That is how these administrations work.

**Senator WONG**—So that is as a general principle. Are you able to tell us whether ASIC ascertained that that occurred in relation to Allstate’s operation of the Beaconsfield mine?

**Mr Cooper**—I think you know what my answer is going to be. We will take that on notice.

**Senator WONG**—It is easier for me to ask it than to write it out, is it not? Is ASIC investigating any allegedly improper behaviour by the administrator at this time?

**Mr Lucy**—I think we have already said that we are taking it on notice.

**Mr Cooper**—Not that we are aware.

**CHAIR**—Mr Lucy and Mr Cooper, it is a pleasure to see you, as always. You are excused.

#### **Proceedings suspended from 8.34 pm to 8.44 am**

#### **Australian Prudential Regulation Authority**

**CHAIR**—Order! The hearing is resumed. I welcome to the table officers of the Australian Prudential Regulatory Authority. Dr Laker, would you care to make an opening statement?

**Dr Laker**—On this occasion, no. We are happy to proceed straight to questions.

**Senator SHERRY**—Thanks. I want to start with a couple of general overview questions relating to resourcing. I notice in the budget agency papers only a modest staff increase—from 572 to 582. In posing that question, I contrast it, for example, with ASIC, where there is a very significant increase in resources and staffing.

**Dr Laker**—I think you are looking at two different slices of time there. The budgetary support we had to grow our numbers came in the two previous years. From the low point around the time of the failure of HIH, our numbers have grown from around 400 to that figure of 582, which is the level of staffing that we are funding out of the forthcoming budget. That is the target we sought new policy proposal funding for a couple of years ago and we had that funding agreed to by the parliament. We have reached that target in a fairly competitive market for the skills that we are after. So the difference between us and ASIC is that we had sought that increased funding for resources from the time that the new members arrived at APRA. It was our first initiative—to get the numbers up.

**Senator SHERRY**—Would you care to comment on staff turnover? I have to say from my context in the financial services industry that I am always running into ex-APRA staff, and



ASIC staff, for that matter. There was an article in the *Sydney Morning Herald* on Thursday, 4 May headed 'Serious staff problem with APRA'. I thought it was a little unfair comparing your turnover to that of the US Securities and Exchange Commission.

**Dr Laker**—Yes.

**Senator SHERRY**—Could you just comment on staff retention and the difficulty staff retention poses—what the contributing factors are and whether circumstances are in fact improving in this regard?

**Dr Laker**—The market is a tough market. It has been for the last two years. It is a strong financial system. There are a number of changes and regulatory initiatives which the financial institutions in Australia have had to contend with over the last few years. There has been an enhanced focus on risk. It is clear that the sorts of skills we look for in a prudential regulator are also in demand in the financial system more generally. The turnover for our frontline staff is running at about 15 per cent a year and has been for some time. That figure is lower than what is experienced by the financial sector more generally.

If you dig a little deeper into the turnover numbers, the turnover is really a problem of churn at the lower levels of APRA. The senior echelons of APRA have a turnover rate at around six per cent. So at the top senior management cadre of APRA we have a relatively stable, strong set of 'hard heads'. They are the same hard heads that are dealing with industry, and that is reassuring to me as the chairman. Below that though, there is a real problem of churn with people that have come into APRA in the last two or three years or have had two or three years experience with APRA. That is consistent with experience more generally in the finance sector. If you are running into some of our well-trained staff working in risk management, you should be assured. You should sleep more easily.

**Senator SHERRY**—I am actually, but I seem to be bumping into compliance officers everywhere I go. They have this grand title. Many of them form a—

**Dr Laker**—We are not accountable for where they go. We are just making sure that they are well-trained when they get there.

**Senator SHERRY**—Well-trained when they come from APRA. In a sense, are you a victim of your enhanced regulatory activities? I am actually going to get to some issues relating to superannuation funds later. Every superannuation fund now seems to have a compliance officer or two newly appointed.

**Dr Laker**—It is not our enhanced regulatory framework. It is the more general focus there has been on risk management, governance, and fitness and propriety in our financial system. It has been driven in part by some of our initiatives and by Sarbanes-Oxley in the United States and international financial reporting standards. We recruit a very broad church of people with actuarial, accounting, finance and risk management skills. Those who leave us with those skills enhanced will go to a range of activities, not just compliance. They will go into funds management. They will go into risk management. So it is broader than just going from APRA to compliance.

**Senator SHERRY**—I accept that. I was half joking about the sort of compliance officer explosion I seem to be encountering in areas of the financial services sector. It does seem to be the fastest growing profession in Australia at the moment.

**Dr Laker**—I would put the focus on risk management, not compliance.

**Senator SHERRY**—What about pay at these lower levels? I am not critical of the pay at the upper levels; I think it is appropriate. Do you think there is a comparative pay issue contributing to the churn at lower levels?

**Dr Laker**—There is always a pay issue. Whether it is the critical issue varies from circumstance to circumstance. In reality, we cannot compete with some of the top end of town positions. We may be able to compete—and we work as hard as we can within our salary structure—on salaries, but when it comes to the large one-off bonuses each year that recur that is where it is very difficult for APRA to compete. We talk to our younger staff. In general, people do not leave APRA to earn less money. There is salary augmentation in almost all cases, some of it quite substantial. But other factors also come into play—a wish to chance their arm in the private sector or to go to the coalface or broaden their experience. Some go overseas; they do not just stay in Australia. There is a recruiting drive from some of the prudential regulators in the Emirates area, which we lose staff to.

**Senator SHERRY**—The Emirates—the UAE?

**Dr Laker**—Yes, Dubai and Qatar.

**Senator SHERRY**—Why is that—because they are seeking to establish themselves as financial centres?

**Dr Laker**—Yes.

**Senator SHERRY**—And we have a former head of Australian—

**Dr Laker**—Yes. You can see the plot. That is only one of the agencies. That is the nature of the marketplace. Our staff go out really because they want to test themselves and try new opportunities. We work as hard as we can on the pay front but we accept that we will never be able to match those top end salaries.

**Senator SHERRY**—I talk to people with a background in not just APRA but also ASIC who are now working in the private sector. The issue of pay is not exclusive or even overwhelming. It is about broadening their experience and recognising that APRA or ASIC provide a very useful training ground for the private sector.

**Dr Laker**—Yes.

**Senator SHERRY**—For those interested in international experience, again there seems to be considerable interest and demand for that type of background.

**Dr Laker**—One thing we have done in response is to establish our own program of secondments for our staff to prudential regulators offshore. In the last 12 months that has also included the private sector offshore. We have people in insurance companies in Europe, including the United Kingdom. The program is in its early stages. It is easier for us to provide those kinds of secondments because the conflict of interest issues do not arise compared with moving into the private sector in Australia or bringing somebody from the private sector in

Australia into APRA. We look for these opportunities. We are able to get our young, ambitious staff other experience and bring them back into APRA.

**Senator SHERRY**—I think that is good. Does the international experience in other regulators include the FSA in the UK?

**Dr Laker**—Yes.

**Senator SHERRY**—Which other jurisdictions?

**Dr Laker**—We have had a two-way secondment process with the FSA. We have secondment arrangements with OSFI. We have OSFI staff with us at the moment. We have had some of our staff placed with the monetary authority of Singapore and the Reserve Bank of New Zealand. Where we can, we establish them as two-way processes so we get skills brought in and we second our people to see a different view of the world in prudential regulation.

**Senator SHERRY**—This is a semi-related issue and it is by the bye. This has just reminded me about it. You may be aware, but there is substantial private sector pension reform in the UK. It is very substantial. It is quite massive. There were some recent announcements only last week by the government. I have made three visits to the UK in this regard in the last year. From my observations, it seems that at least some of the Australian regulatory experience in respect of what are called superannuation funds here and pension funds in the UK would be directly relevant to the change process that is occurring in the UK. Have you had any direct contact from the UK regulators there about this, not just the FSA? I think they have a pensions authority in the UK.

**Dr Laker**—I think Ross would be right person to answer.

**Mr Jones**—It has the bland title of the Pensions Regulator.

**Senator SHERRY**—Yes.

**Mr Jones**—We are a member of a group called IOPSS—the International Organisation of Pension Supervisors—as is the Pensions Regulator. We meet three times a year, so there is regular contact. We are contemplating the development of exchange arrangements with them as well. But some of the types of pension issues that they have, with their much stronger emphasis on defined benefits pensions and shortages and those sorts of issues, are a bit different. But the main thing for many of our staff is the opportunity to go and work with another regulator. I think the other thing, though, is that a lot of our staff, as you mentioned before, see APRA as a good training ground. We provide a lot of good training. We provide a lot of skills fairly quickly. The market finds them highly desirable after about three or four years.

**Senator SHERRY**—I accept that. I think in the UK you are right. DB employer funds are under enormous pressure either converting to DC or reducing contribution levels. I thought what was of great interest—I do not want to spend lots of time on this because it is the UK, although it is interesting—is the proposed pension reform announcements from, I think, the Turner commission report. They are introducing soft compulsion or opt-out provisions. You are in a pension fund unless you opt out. That is a very radical change in the UK and will extend coverage significantly; by how much is open for debate. But the consequences of

going to a soft compulsion model, albeit not a compulsion model like Australia's, extends coverage and brings with it a whole range of issues in respect of trustee governance and the investment of moneys. APRA and others have had to tackle issues in Australia in the last 10 to 15 years with the growth of superannuation driven by compulsion. They will be very similar, if not the same, issues. It will be useful for the Australian jurisdiction to learn from them.

**Mr Jones**—I think that is true. Our preference would be to set up a secondment program so we can get our people back rather than simply have them take our people.

**Senator SHERRY**—Given the announcements in the UK last week, I suspect there will be a great brain drain into the UK. Hopefully, some of them will be from Australia, because I think we have some experiences to give them. There are probably not too many from APRA.

**Mr Jones**—We are quite happy for them to go as long as they come back.

**Senator SHERRY**—Okay. There were some additional funds allocated in respect of the insurance industry in the budget to oversee the insurance industry.

**Dr Laker**—That was for what is called the national claims and policies database, or NCPD, which is an initiative of the government. It fell to APRA to build a database on policies and claims for professional liability and personal indemnity. We seek cost recovery for that database from industry. The process requires us, first of all, to get an NPP to fund the database. It is already up and running, so some of the development costs have to be recouped. Industry ultimately pays that on a user-pays basis. It is very specific to that database.

**Senator SHERRY**—I was going to raise the issue of cost recovery. Are you currently on full cost recovery?

**Dr Laker**—Yes. You said insurance, for which we got extra money. There is the pursuit of individuals about whose fitness and propriety the HIH royal commission raised questions. We have had a program extending for some years to go through individuals who were named in the HIH royal commission report. That is funded by government. There was money in this year's budget for the completion of that program. Other than those special appropriations, we are funded by industry through the levy system and, in some specific cases, on a user-pays basis for specific services.

**Senator SHERRY**—I refer to the recent error, if I can term it that way, by ANZ, where it had to refund \$45 million to 200,000 MasterCard holders. I am not specifically going to this error. A growing number of significant errors—it may be that the press are picking them up for the first time—are being made by banks in respect of customers. Would you care to comment? Is there a growing problem in this area?

**Dr Laker**—We have always focused on what we call operational risk. We have certainly stepped up that focus over the last few years, as have the major institutions themselves. One of the reasons for that is the Basel II process, which has a very explicit coverage of operational risk and the sort of capital you need to hold against that. So it is an area of risk that we have identified. Institutions are aware of the vulnerabilities. We are focused in particular on security in the wake of so-called phishing attacks and other attempts to break the security of internet and electronic banking systems. The entities themselves are working on

that individually. They are working on that through their industry associations as well. It is an area of increasing focus, as it has to be.

**Senator SHERRY**—Does APRA keep statistics on errors that are published? I am not aware of any.

**Dr Laker**—Not a database. We certainly will follow up major operational glitches that are identified or that are experienced by our institutions. We will follow up to see what the cause of it was, what the rectification process was and what it tells us about the calibre of their systems. But that is really on an individual basis.

**Senator SHERRY**—I have been questioning the tax office and ASIC in respect of self-managed superannuation funds and what I regard as a lack of regulatory oversight. What has struck me in the number of complaints I have received and in cases I have been examining and questioning the tax office about is that APRA—I will come to the details of it shortly—is undergoing a rigorous relicensing process of superannuation funds within its jurisdiction. I would contend that is an area of lower risk—it is not risk free—compared to, say, self-managed super funds. The level and intensity of regulation is very minor by comparison. The tax office has regulatory responsibility in this regard. We have a very significant and growing proportion of superannuation savings in self-managed superannuation funds, as the stats show. Is APRA providing any ongoing contact or advice to the tax office in respect of the regulatory issues for self-managed superannuation funds?

**Mr Jones**—We have regular contact with the ATO. We have regular liaison meetings. In terms of the general principle, the self-managed super funds are funds where every member of that fund is a trustee. Our objective here is to protect those people who deal with the trustee and, therefore, do not have a one-to-one relationship or do not have the hands-on relationship. So it is a different structure. Prudential regulation is all about protecting those who are not in that same position.

**Senator SHERRY**—I understand that, and you do it well, so I am not critical of APRA. What is frustrating to me is, frankly, that the scandals in superannuation that are ongoing seem to be concentrated in self-managed superannuation funds. Westpoint is the latest, where the self-managed super fund was used as the entity or the vehicle for the investment. There are a number of others. I do not know whether you heard the questioning of ASIC officers earlier. That is the theory. I agree with you, Mr Jones. I suppose asking you is a bit unfair. It seems to strike me that these people who are trustees of self-managed super funds do not seem to realise the implication of being a trustee of their own money.

**Mr Jones**—I understand that ASIC has been offering more advice in recent times about the issues involved with self-managed funds. But our principal task here in dealing with the tax office is to ensure that we have consistency in approach between us and the tax office with regard to issues of mutual interest. That is where our interest lies in this.

**Senator SHERRY**—Sure. As I say, I am not being critical of APRA. It seems to me that there is an APRA interest in this because effectively we have seen and we will continue to see, I think, a fairly constant flow of funds out of APRA regulated entities into self-managed super funds. It seems to have been a constant trend in recent times. I am concerned that we see people convinced in a variety of ways, some legitimate and others not legitimate, to shift very

substantial sums of money out of APRA regulated entity super funds and into self-managed super funds.

**Mr Jones**—There is no doubt that the growth in the self-managed funds has been very rapid. Of course, the growth in our area has also been quite substantial.

**Senator SHERRY**—I accept that.

**Mr Jones**—I guess there are some circumstances where people are receiving what ultimately turns out, as you suggest, to be quite inadequate advice in terms of what is in their best interests.

**Senator SHERRY**—Okay. I know it is not your responsibility. You lost the responsibility, good or bad, some years ago. The tax office have it. I must say I am not impressed by the tax office's general approach to this area, particularly when I compare it to APRA's approach, given the levels of risk, the levels of prima facie theft and fraud, the levels of poorly weighted investment and a lack of diversification. There are a whole range of issues that APRA has tackled in respect of its area of regulation but are an ongoing and pressing problem in respect of self-managed super funds. I suppose it begs the question: do you want them back?

**Mr Jones**—You do not really want an answer to that, do you? The thought of another 330,000 superannuation funds, all with their unique set of problems, would generate a whole new set of issues for us, I think.

**Senator SHERRY**—I think you would be a bigger agency. Anyway, I will leave that.

**Mr Jones**—I do not know that it is in our interests to have that sort of expansion. As you mentioned before, given our turnover, we need to work on what we are doing best.

**Senator SHERRY**—I will not go any further with respect to the self-managed superannuation funds.

**Senator MURRAY**—You have just answered my question about your fear of a change of government.

**Senator SHERRY**—As I say, I am just frustrated. You have been doing a good job going through the licensing process. I will get to aspects of that in a moment. Here we have a sector growing rapidly. The risks are greater. We just do not have anywhere near the same level of vigilance. I will leave the self-managed super funds. I will keep up my questioning of the tax office in that regard. I have one other issue on this. Would you accept that, when there is a scandal in respect of self-managed superannuation funds, it does pollute the public's view of the entire superannuation industry? In the case of Westpoint, 'You can't trust super; you can't trust the regulation of super,' was the response of some consumers to me. It sullies the superannuation industry and regulation generally when this occurs, doesn't it?

**Mr Jones**—I think whenever there is a scandal in financial products you get consumer concerns. Those concerns are sometimes exaggerated. Sometimes those concerns are perfectly valid. But I accept your point. With any type of financial product, there is an effect that is sometimes greater than the initial effect on the individuals concerned, certainly.

**Senator SHERRY**—I want to go to an issue that I have questioned Mr Littrell about before. We have had a discussion on a couple of previous occasions—you were not at the last

Senate estimates—about the retail superannuation funds and the treatment of commissions. Where are we up to with that?

**Mr Littrell**—The current APRA collections record with reasonable accuracy the net return of funds but do not decompose that into gross return and expenses. We also have a deficiency in that we do not collect in many cases the front end and ongoing commissions necessarily taken out. They would largely be run by retail funds. At this point, following up on our previous advice, to sort that issue we would have to substantially amend our current collections. That is not particularly a priority at the moment in prudential terms because the net return is what we need for that. So it is scheduled to be reviewed the next time we review the collections, which is not going to lead to any change until 2008 at the earliest.

**Senator SHERRY**—Until 2008?

**Mr Littrell**—Yes.

**Senator SHERRY**—I thought APRA's approach was a bit more urgent than that the last time I talked to you.

**Mr Littrell**—Yes. But having consulted on the changes, it is a year of system changes and collections before a new publication comes out. So in terms of actually receiving any update on public information, it is that far out. Having said that, I would also point out that for our collection purposes, the issue of what fee is charged is not in the first rank of prudential issues.

**Senator SHERRY**—I understand it is not in the first rank of prudential issues but it probably is in the first rank of the consumer's mind. The reason I think this is so important from the APRA point of view is that you really are, in terms of independence and a government authority publishing data, the most authoritative. We have other surveys. Private sector funds tend to do surveys. I really am concerned that this is going to go out to 2008.

**Mr Littrell**—It is not as if work is not happening. There is a substantial research effort behind the scenes in our current collections. Again, for us to do more work in this area, we would be employing fewer supervisors on the front line. From our perspective, that is not a good trade-off. If the government asks us to do more collections for non-prudential purposes, certainly we will look at it. But absent that sort of request, it has to be prioritised against our ongoing supervision needs.

**Senator SHERRY**—I think we initially discussed this about a year ago.

**Mr Littrell**—Yes.

**Senator SHERRY**—I certainly gained the impression at those hearings that this issue was being followed through. I recall you remarking that some retail funds had provided the information requested.

**Mr Littrell**—Yes. There has been quite a lot of work. We have refined the current instructions in collections. Out of that effort it became clear that the current state of the art in terms of reporting was not sufficient for us to do a reliable split of fees, commissions and net returns. Without claiming that this is an accurate number, let me point out that the expenses of a typical retail fund would be in the order of 150 basis points a year, maybe 200. The net fee take in terms of commissions would be more like 25 basis points. So from our perspective, the

inability to satisfactorily separate out the ongoing expenses is a much larger issue than the inability to separate the ongoing planner commissions. We would like to know them both, to find them both out. Over the last year we have done a fair amount of work that has demonstrated to us that it would be a reasonably major task for the industry to report on that basis.

**Senator SHERRY**—They would claim that, wouldn't they.

**Mr Littrell**—No. We have the ability to go on site and look at files and computer systems. It is more than a claim. For us to do a—

**Senator SHERRY**—Surely it is work for you.

**Mr Littrell**—We can go on site to a retail fund and an industry fund and look at their systems and see what they collect.

**Senator SHERRY**—But they are not fessing up with the data.

**Mr Littrell**—Having done that work with a number of substantial firms, we are perfectly confident in saying that it is not a matter of us asking for data that these funds are holding on to and they are just not giving us. They do not collect on that basis. They would have to change their systems to give us that report. So, yes, we have been working on it. Most of the work to date has essentially had negative value in the sense of demonstrating that there is no easy solution to this question. For us to get a real solution to this question is a full consultation round under the Financial Sector Collection of Data Act and a reasonably long lead-in period to allow for system changes. It is a substantial effort.

**Senator SHERRY**—I seem to recall you saying that there was consultation initially in respect of this issue.

**Mr Littrell**—There was—over about two years, in fact.

**Senator SHERRY**—Yes, that is right. I seem to recall that some of the funds were able to provide the data you requested; that was not an issue. I seem to recall you indicating that there was no general disagreement as a consequence of that initial consultation period.

**Mr Littrell**—Yes.

**Senator SHERRY**—Here we are. I think it is just excuses, frankly. I am very concerned to hear this is blowing out to 2008.

**Mr Littrell**—Again, it is not our job—APRA does not have a government request—to go collect statistics for the general public interest. We are mainly collecting statistics for our purposes to help us find, in this case, super funds and trustees who need a closer supervisory look.

**Senator SHERRY**—Sure. But the fact remains that you publish a quarterly superannuation performance statement. It is very useful material. I suspect that I am one of the most avid readers of it; every time it is released, I am there pouring through it. I am sure that a lot of other people do.

**Senator CHAPMAN**—You need to get a life, Senator Sherry.



**Senator SHERRY**—I read this thing from cover to cover. It is one of the most useful set of statistics published.

**Mr Littrell**—My staff will be encouraged to hear that.

**Senator SHERRY**—Pass it on. If you are researchers preparing reports and overview analyses of the industry, I am sure it is very useful to them as well. There are tables on corporate funds, retail funds, industry funds and public sector funds. There is really good data on the breakdowns of the various costs. There are investment management fees, custodian fees and property maintenance costs et cetera. There are management fees, administration fees, directors' trustees fees and expenses—it is very good—across all the sectors. Self-managed super funds are not there, but that is another issue. One of the significant cost components about which there is significant public contention—commissions—is not here.

**Mr Littrell**—That is correct. I will try this again. The reports you are reading have a net return on assets line. That line, within the bounds of statistical tolerance, is an accurate line. You do not have in there a line that gives gross return on assets less expenses. The expenses we are reporting are the ones we collect directly. If a super fund invests through a third party, which is quite common, they will often in their systems receive only the net return and report it to us. They do not have the capacity to carry through the cost of that third party investment. So we have good data on direct investment by super funds. In many cases it is possible, though probably not in the majority of cases, to extract the third party information. For us to levy that requirement as a statutory matter requires substantial consultation. I can tell you today that I am quite confident that what we are collecting on net returns is pretty good. I am equally confident that moving to the gross returns and the fee split is more work than we expected it to be and more work for the industry than we expected it to be.

**Senator SHERRY**—We have exhausted the discussion on this. You went through these exhaustive discussions and consultations over a two-year period. It seemed that everything was on course. Then when it comes to the crunch point for some of these funds, it just did not happen.

**Mr Littrell**—Remember, though, that it did not happen for this item. But for the net returns, for the volatility of returns, for the balance sheet and for quite a number of specific items of prudential interest, we now have a very much better collection.

**Senator SHERRY**—But my central contention is this: it is not in the interests of some of these retail funds to disclose these commissions in a meaningful way to you. That is my concern. That is what I really believe is occurring. I am just concerned that it is now back to 2008. I will leave the issue there. I have one other possible suggestion. There used to be a summary page, which contained a reasonably significant historical comparison. You had a table of, for example, assets in super going back about, I think, 20 years. That seems to have been dropped, from what I can see.

**Mr Littrell**—Is that in the annual report and not the quarterly report?

**Senator SHERRY**—It would be in the annual report, but I think it was in the quarterly report as well.

**Mr Littrell**—I think we rationalised some of the quarterly report. I can check on that.

**Senator SHERRY**—I suggest it would be useful to have some of that historical summary data put back into the quarterly report and not just in the yearly report.

**Mr Littrell**—Okay. We will look at that.

**Senator SHERRY**—I make that as a suggestion. I want to come back to some specific issues of costs a bit later. I understand Senator Chapman has some questions.

**Senator CHAPMAN**—At previous estimates I asked some questions of APRA in relation to their proposed implementation of the Basel II recommendations. I would like to ask some further questions on that matter. Firstly, in valuing the risk transfer available to banks by mortgage insurance, does APRA distinguish between or record different risk value to products offered by independent mortgage insurers as against bank captives? If so, how?

**Mr Littrell**—Could you repeat the central part of that question again, please.

**Senator CHAPMAN**—Yes. In valuing the risk transfer available to banks via mortgage insurance, does APRA distinguish between or accord different risk value to products offered by independent mortgage insurers as against products offered by bank captives?

**Mr Littrell**—The answer to that specific question is no. A more useful answer, however, might be that the background rules for what creates a qualifying mortgage insurance contract differ for captives versus independents. So if an independent writes a qualifying policy or a captive writes a qualifying policy, they will both generate the same sort of capital concession for the ADI. But the rules on determining what the qualifying contract is differs for those two sources.

**Senator CHAPMAN**—Does APRA have any particular concern that there are only two large independent mortgage insurers in Australia?

**Dr Laker**—It is a highly concentrated mortgage insurance market. Some of that risk is passed offshore to other reinsurers. In the initial general insurance stage—two reforms we put out some years ago—we opened up the possibility of more institutions coming into the market by relaxing the requirement that they be monoline insurers. There was no interest in that proposal on their part, but we are aware that others are looking at this market. There has been some press speculation about others wishing to come into the market.

**Senator CHAPMAN**—Potential new entrants?

**Dr Laker**—Yes. I cannot comment on the specifics, but there has certainly been media coverage of the possibility.

**Senator CHAPMAN**—Do you have a view as to how many market participants you might regard as adequate?

**Dr Laker**—I have a colleague from the competition authority previously who might have a view on that. I do not know whether or not numbers define competition. Clearly what we are keen to see is risk diversification. We look at not just the numbers in our market but also whether the two larger institutions pass on that risk, where that risk goes and how strong the parents are to support the institutions. So it is a more complex assessment than just simply saying we have two, three or four. We want to have strong, viable lenders mortgage insurers

in a crunch. We need to look at their reinsurance arrangements and the extent of their parental support as well as their capital in Australia.

**Senator CHAPMAN**—With regard to the proposed changes to bank capital arrangements covering mortgages, it would appear that APRA is relying pretty heavily on the QIS 5 process. Is that a fair comment?

**Dr Laker**—I will comment first, and then Charles may want to comment. When you say relying on that QIS 5 process, all regulators around the globe who are implementing Basel II as a global reform are testing, step by step, the implications of the parameters that are being built into Basel II. The QIS, or quantitative impact study, is now up to No. 5. That is a very helpful process, in seeing how the numbers being generated by institutions marry, with a prudent approach to capital adequacy. We are taking part in that. Those results have not yet been released. We will do further work and further modelling ourselves. We will work with the international community to see what lessons are being drawn from their modelling across the globe. It is a very important part of the development of this framework.

**Senator CHAPMAN**—Are you able to tell me, as to the parameters, if any stress testing is included in the process?

**Mr Littrell**—I will comment here. The APRA research team in the 2002-03 year commenced extensive stress testing of Australian home loan portfolios. In 2003-04 we moved from directly testing ADIs to reverse testing, if you will, the LMI portfolios, which includes their business with unregulated lenders. Out of that we were able to generate a reasonably complete picture of both the regulated lender portfolios and the regulated mortgage insurer portfolios. They were subjected to a series of tests based on Australian historical experience and offshore historical experience. At the same time there was a series of QIS processes running, of which the fifth is the latest. So between those efforts we have spent several years now engaged in extensive stress testing. I also note that we have just been through an FSAP process which involved quite a lot of stress testing not only by APRA but by other agencies. I would go so far as to say that the banks have been exhaustively stress tested on their home loan portfolios and the LMIs extensively.

**Dr Laker**—I might just clarify that the FSAP process that Mr Littrell referred to is an IMF-World Bank financial sector assessment program which Australia has been conducting with the IMF and the World Bank. Those results have not been published by the IMF. The material is yet to go to the IMF board. But that involved quite extensive stress testing not just of the first round effects of what would happen if there was a fall in house prices but of second round effects if there was a general economic downturn. So that was a comprehensive test, but those results have not been published.

**Senator CHAPMAN**—How far back have you used data in the stress testing? How many years back?

**Mr Littrell**—We have used LMI data in some forms that would go back to the sixties. The good data starts in the eighties. We have used offshore data as proxies going back into the eighties, and not only lenders mortgage data but general macro data—house prices, default rates and things like that. At this point, we have several staff years of accumulated knowledge

built up of home loan stress testing. We have tapped out pretty much all the available relevant sources, I would say.

**Senator CHAPMAN**—So it would go back further than what I would call the recent years, the last five or six years?

**Dr Laker**—Very much so.

**Mr Littrell**—The recent years are not terribly useful for stress testing because there was not a lot of stress.

**Senator CHAPMAN**—Is it your intention to release the results of the QIS 5 testing? If so, what level of detail would be released?

**Dr Laker**—We have not made a decision on that. We want to see the level of detail that is being released globally. We have to be very careful about what it says about the specific institutional data that has gone into QIS 5. We have to be very careful to protect confidentiality. What I will say is that we will certainly use those results to see how robust the Basel II framework is as we get to understand better the sort of data that is being generated by our institutions and the sort of stresses that their own modelling is subjecting them to. It is not just APRA imposing a model. It is the institutions themselves looking at what their history teaches them from their own experience on loan portfolios and how that would respond to downturns.

**Senator CHAPMAN**—You might be aware that I placed some questions on notice to the Assistant Treasurer at estimates towards the end of last year.

**Dr Laker**—Yes.

**Senator CHAPMAN**—In answer to one of those questions, the Assistant Treasurer said that APRA is currently consulting with interested parties on how the larger banks will approach mortgage insurance cover under the Basel II regime. Are you able to provide a list of the interested parties with whom consultation has taken place?

**Dr Laker**—We are going through an accreditation process at this stage with our major banks, which are seeking to adopt the so-called advanced approaches. We are looking at their own modelling and their own approach to determining economic capital and the role that lenders mortgage insurance plays. Those discussions are still underway. As you know, we have consulted quite widely with a range of parties generally about lenders mortgage insurance. Since you asked me those questions at the last Senate estimates, we have met twice with the Insurance Council of Australia to go over their submission, firstly in general and then secondly in specific, very close detail with technical staff. So we are continuing to consult. While the closing date for submissions has passed, we have kept that consultation process open. We have time to do this thoroughly and comprehensively and that is what we are doing.

**Senator CHAPMAN**—What do you consider to be the larger banks, when you say you are consulting with larger banks?

**Dr Laker**—A number have applied to us to be accredited as advanced model users, to be allowed to use their own economic capital modelling for determining their capital requirements. I do not want to nominate the specific institutions, but around half a dozen are seeking accreditation in the first round.

**Senator CHAPMAN**—But, in this process, you are also consulting with what you might call the smaller banks and the mortgage insurers?

**Dr Laker**—This process goes back several years. We have been consulting and continue to do so. I meet with the credit unions and the building societies. We have a large, very dedicated Basel II project team. A week would not go by without somebody coming in to discuss these with us.

**Senator CHAPMAN**—In another answer to those questions on notice, the Assistant Treasurer replied that APRA will not finalise its response to Basel II until, amongst other things, the approaches taken by regulators in other countries are clear. Can you explain why you are taking a different route with respect to the treatment of mortgage insurance from comparative economies, such as those, for example, in Europe or Canada?

**Dr Laker**—The approach taken in Europe hinges on the definition of insurance versus guarantee. This issue we have discussed with the Insurance Council of Australia. Our concern—and we made this very clear to the Insurance Council—is that, if we were to follow that approach, our other prudential guidelines would severely restrict the amount of lenders mortgage insurance business they could offer. So we have taken what we believe is the sensible approach, given the range of our prudential requirements. I think the Insurance Council understood that.

**Senator CHAPMAN**—Would it be fair to say your approach is also different from the USA, which seems to be taking an approach that recognises that a healthy banking sector involves protecting the competitiveness of regional banks?

**Dr Laker**—We have said from the outset that we will be implementing Basel II in a fair way in Australia. We have never deviated from that objective.

**Senator CHAPMAN**—Have any of the smaller ADIs raised concerns about the implementation of Basel II here?

**Dr Laker**—I think there was in the early development of Basel II a very narrow focus just on the risk weights for housing lending. It is clear that there are differences in those risk weights between those institutions that follow the standardised approach and the more sophisticated institutions that follow the advanced approach. But that is only a very narrow part of the story. Stepping back from it all, what we have said is that we expect on average that the smaller institutions will be able to operate with a modestly lower level of capital. We have said that we need convincing that the large institutions should be reducing their capital anything other than modestly in the current environment as well. I think when you step back and look at the totality of the impacts we are not seeing a major wedge being driven by Basel II.

**Senator CHAPMAN**—How are alternative products to traditional mortgage insurance, such as credit default swaps or financial guarantees, valued in your current modelling process?

**Dr Laker**—There are a set of risk weights for handling that. They are very technical. If you want a very detailed exposition of the calculation of credit default swap treatments, I will give it to you, but I will take it on notice.

**Senator CHAPMAN**—And, in relation to that, how the creditworthiness of suppliers of those products is taken into account.

**Mr Khoo**—Generally, there is a conversion factor which will be based on the counterparty's rating before they actually convert it into an amount of capital which has to be carried against them.

**Senator CHAPMAN**—Would it be the view of APRA that independent mortgage insurance provides substantially more robust risk transfer than those sorts of over-the-counter derivatives?

**Mr Littrell**—The question is a bit tricky. If you are asking whether lenders mortgage insurance companies are more expert at risk analysis than a typical credit swap provider, that is a pretty interesting discussion and both sides could probably hold their own. If you are asking whether LMI providers are more robust in their ability to cover claims, the answer on a portfolio view from an ADI is no. As you said earlier, there are only two of them. So it would make sense, probably, for a regulated lender wishing to diversify where they are laying off their mortgage risk to find a few guarantors or credit swap providers in addition to the LMIs. That is probably a reasonable strategy. The issue there, of course, is that they might be buying a credit default swap from someone who has a much more broadly diversified business than the LMIs. So the answer is that it depends. They are both professional markets and they both have sophisticated players.

**Senator CHAPMAN**—Dr Laker, in your speech to the London School of Economics in April, you referred to the Australian banking industry being highly concentrated. I think you indicated that 70 per cent of ADI assets are held by the four largest banks. Has APRA itself assessed, or have you asked Treasury, the ACCC or the Reserve Bank to assess, whether that concentration is more likely to increase under the implementation of Basel II?

**Dr Laker**—Has APRA asked Treasury? I do not have a crystal ball to answer that question. Let's make it very clear what Basel II is fundamentally about: it is about getting a better alignment between risk and economic capital. That is what drives Basel II. That is why we are committed to implementing Basel II—because it improves the safety and efficiency of our financial system. As I have also said, we do not see that on its face it will lead to a marked divergence in capital reductions for the standardised or the advanced players. The international regulatory community has built in floors to ensure that regulatory capital does not fall. So it is not clear on those views why this will change what has been happening already in Australia, which is a considerable consolidation of players in all of our regulated industries.

The figure I quoted in that speech is well-known. If you probe a little more closely, you will see that there has been a real consolidation of the smaller players. The number of credit unions has halved over the last period of time. We are now down to 14 building societies. That process has been happening all the way through the last 10 or 20 years. There are factors at play completely separate to Basel II which will see that continue. But it is not clear that the major banks themselves are getting larger market share. It is changing around the middle.

**Senator CHAPMAN**—Have you asked for any analysis to be done on the likely impact on interest rates offered by larger banks as against those offered by smaller banks or by non-ADI

mortgage providers? Have you looked at the potential effect on the housing market and perhaps on consumer access to mortgages and the pricing of mortgage insurance?

**Dr Laker**—That is part of what our consultation process is covering. We have not finalised our standards or our view on that. You have seen the responses from the Assistant Treasurer. Taken on its own, if an ADI requires marginally less capital for a housing loan, other things being equal, it is more inclined to provide lending for housing. That is a positive for the Australian community and that is what we would expect to flow from Basel II. For me to judge today the size of that impact is impossible. It depends on the circumstances at the time Basel II is implemented.

The other point I would make is that there is a lot of competition for mortgages coming out of the unregulated sector in Australia. What has been a major downward driving force on mortgage rates has been the mortgage origination sector, which is not regulated by APRA. It is not subject to capital weights. That has been a real spurt of competition. The community has welcomed the lower interest rates that have resulted from that. That process will continue. These are all part of the process of competition in the housing market. As I say, we do not cover the whole territory.

**Senator CHAPMAN**—You have not at this stage sought any analysis or modelling from Treasury or any of those other institutions that I referred to on those sorts of issues?

**Dr Laker**—No.

**Senator SHERRY**—I want to go to some issues relating to the APRA licensing process. I will start with the superannuation funds that clearly will not be licensed. I notice that 70 are not seeking a licence. Therefore, there will be replacement trustees. APRA advertised some weeks ago for replacement trustees for 70 funds. Before I go to the detailed questions, you have those 70. Is it apparent how many superannuation funds will not get licensed by the end of June in addition to those 70?

**Mr Jones**—There are a set of responses to that. First of all, there are hundreds that did not seek a licence. Where we are at now is that that 70 refers to our best estimate of those who are not going to seek a licence and are in the process of being wound up but will not be wound up by 30 June. We will have a better estimate by Friday because we are doing one last call around. The difficulty we have with some of these is that these are people who have said, 'Yes, we are winding up.' We started this process 2½ years ago and we still have a number who have said, 'Yes, we are winding up' and have done an insufficient amount.

The consequence of that is that our guess is there will probably be 70. What we may have to do with those 70 is move towards an acting trustee. There are others who will not be wound up by 30 June. My guess is there may be as many as 150 others that are not completely wound up. However, I think what we will be able to do with them—we have already begun the process—is take an enforceable undertaking, or EU, from them using our powers and specify a very specific process and time limit for the final wind-up. They might have a matter with the Superannuation Complaints Tribunal so they have not been able to wind up completely.

**Senator SHERRY**—A dispute over TPD that is not resolved?

**Mr Jones**—Yes. That is a good example.

**Senator SHERRY**—Technically, the trustee has to remain.

**Mr Jones**—Exactly. Those ones are fairly easy. The real dilemma, as I said, is this rump of probably 50 to 70, where, to be blunt, the trustees have failed in their duties.

**Senator SHERRY**—Before we go on, are we dealing here amongst this 50 to 70 with funds where there are no more contributions flowing into them as well as funds where there are contributions continuing to flow into them and will be after 30 June?

**Mr Jones**—No. If you do not have a licence post 30 June, end of story. These are wind-ups.

**Senator SHERRY**—I understand that. But there may be an intention for employers to place moneys in some of these 70 after 30 June.

**Mr Jones**—In that circumstance, we will also have the acting trustees in place by 30 June.

**Senator SHERRY**—So they can be received.

**Mr Jones**—We want to have one last go because it is not in the interests of members for us to have to do this. We will have one last try this week. For those remaining ones, we will go through the standard process of replacing those trustees, putting in an acting one and then doing the wind-up.

**Senator SHERRY**—You are right: it is not in the interests of members. Firstly, do you believe you have sufficient replacement trustees?

**Mr Jones**—Yes, I do.

**Senator SHERRY**—Where are they coming from?

**Mr Jones**—They are largely coming from the major accounting firms.

**Senator SHERRY**—What about independent trustees and retired trustees? The reason I am concerned about accounting firms is they are going to charge, aren't they?

**Mr Jones**—Everyone charges.

**Senator SHERRY**—No. That is not strictly true. Not all trustees are paid and charge for carrying out their responsibilities. But certainly with accounting firms they will be charged, presumably, some accounting commercial rate. Is there going to be competitive tendering?

**Mr Khoo**—Yes. Over the past few years where we have had to use replacement trustees, we have actually tendered. We have been able to install replacement trustees generally at fixed rates and at pretty competitive rates below what the normal charge-out rates would be.

**Senator SHERRY**—That is good. But what about compared to the rate that was being charged before the replacement trustees were put in?

**Mr Jones**—I do not think that is an accurate comparison. The reason we got into this case with these 70 is that these trustees were not doing their duties in the first instance.

**Senator SHERRY**—We have a tendering process with major accounting firms.

**Mr Khoo**—Not just the major accounting firms.



**Senator SHERRY**—Who else? For example, I know there are independent trustee companies, as I understand it, that now operate. I know of at least a couple. They could presumably tender.

**Mr Jones**—We have no objection to anyone tendering. We would be pleased to have the tenders.

**Senator SHERRY**—Would they require a licence?

**Mr Jones**—Yes. There is a specific licence for this purpose.

**Senator SHERRY**—If this is sort of a short-term solution, what interests me is the process. You have the tender and the accounting firm comes in at whatever the cost. What happens longer term? You have a set of moneys and members in a fund. The independent trustee is there. At some point in time they would presumably come out of this process and go somewhere.

**Mr Jones**—The objective is to wind them up and move the members out.

**Senator SHERRY**—Right. How would they be moved out?

**Mr Jones**—In some instances, the acting trustee will contact the members and explain the circumstances to them. In some cases, using choice of fund, they can move anyway.

**Senator SHERRY**—In some cases.

**Mr Jones**—Yes.

**Senator SHERRY**—My major concern is the cost of this to the member, the transparency and the genuine decision making of the member. The replacement trustee will not have authority to move members over en bloc into a new fund as it suits them.

**Mr Jones**—It is no different to the wind-ups with existing processes, whereby the current trustees decide to move their members. They determine what is in the interests of the members and they move the members out.

**Senator SHERRY**—That is not what I asked. You have an accounting firm that is a trustee of a fund. It has X amount of members and X amount of tens of millions of dollars—let us take that as an example.

**Mr Jones**—Hopefully that will not be the case.

**Senator SHERRY**—Hopefully it would not be.

**Mr Jones**—We are talking about fairly small ones, actually.

**Senator SHERRY**—The average figure I saw was \$48.6 million. Is that accurate? That is the average balance in the fund.

**Mr Jones**—Where did you get that figure?

**Senator SHERRY**—That is from a report in the *Financial Review* of 16 May.

**Mr Jones**—The average balance?

**Senator SHERRY**—Funds under management is \$48.6 million. That is their report—is that correct or not?

**Mr Jones**—I have no idea where they would get that number from.

**Senator SHERRY**—What is the correct figure that you could ascertain at the moment?

**Mr Jones**—You are talking about this category of 70?

**Senator SHERRY**—Yes.

**Mr Jones**—Most of the funds in this category of 70 are funds less than \$10 million. We allocate them into funds under \$1 million; \$1 million to \$5 million; and \$5 million to \$10 million and so on. Our estimate of the 70 is that most them are in the first three categories—that is, funds with less than \$1 million, funds with \$1 million to \$5 million and funds with between \$5 million to \$10 million—so I am not quite sure what that number refers to.

**Senator SHERRY**—That is why I am clarifying it. Are you going to be careful in respect of the conflict of interest? You have an accounting firm. They may have their own superannuation fund. The conflict of interest for the acting trustee is that they could use that as an opportunity to transfer some or all of those members into their own fund, for example.

**Mr Jones**—The trustees still have to act in the best interests of the members. When we license those acting trustees, they should be aware of what their duties are in that sense.

**Senator SHERRY**—Is that an issue you will keep an eye on?

**Mr Jones**—Yes.

**Senator SHERRY**—Again, it is fine to talk about individuals choosing. Some of these members may be lost members, for example. They cannot be found. There will certainly be a proportion of them. They may not indicate they want to do anything. There is inertia. They sit where they are. How would they be dealt with ultimately?

**Mr Jones**—They are no different to many of the other funds that wind up. There could be members that have been inert or who have not made any particular representations over time as to who they are and what they want. The trustee still has an obligation to move them. It is the trustee's responsibility to move them, try to make contact with them and let them know where they have been moved to.

**Senator SHERRY**—Will there be some period by which it is expected the acting trustees will wind up the funds?

**Mr Jones**—Absolutely. We hope that we are talking about a couple of months maximum. We are also hoping that this process is not particularly complex. We are hoping that when the acting trustees go in, it is simply a situation of reasonably simple wind-ups. This is the reason why we delayed it to the very last possible time and also why with the other ones we are using enforceable undertakings to get the existing trustees to serve the remaining duties. The problem with these ones is that they have been completely unresponsive for 2½ years.

**Senator SHERRY**—Presumably the fees charged by the acting trustee would be passed on to the member.

**Mr Jones**—Yes.

**Mr Khoo**—Ultimately, yes.

**Senator SHERRY**—Let us say some of the members leave in the first month but a diminishing number of members remain in the fund. The acting trustee would have a significant fixed cost, so the cost per member that is being charged against the members remaining, the diminishing number, goes up. How would you deal with that issue?

**Mr Jones**—I think you are absolutely correct. The per unit cost of the remaining members would go up.

**Senator SHERRY**—I do not know whether it would happen, but let us say you have a fund with 500 members. In the first month, the majority move out for whatever reason. There are 200 members left. You still have the acting trustee. They are charging the same cost. The admin fee is going up and being charged against those remaining members. In the third month, say, you are down to 50 members. There are still significant fixed costs. Then in the fourth month you are down to five members. The poor old five members have no money left because they are carrying the fixed costs of the admin for the acting trustee.

**Mr Khoo**—I think you have made a good point. We have every expectation that the trustees, in acting in the interests of all members, will ensure that situation does not arise. As it is, from a tendering process we are expecting that there will be a fixed fee for actually getting this initiated and we would expect that to be equally borne among the members.

**Senator SHERRY**—It does not seem to me that it is quite so simple in practice. If you have members who have left and been charged a fee and the number of members is ever diminishing, how do you fairly apportion a cost, say, four months later when you have a very small number of members? Those that have gone have paid whatever the fee that has been charged against them by the independent trustee. Those that are left will still cop a greater cost, it would seem to me.

**Mr Khoo**—As I said, I think we would expect the trustee, based on what they are tendering, to apportion that fee out among the members. As I said before, I think you have made a good point. It is something which I will follow up within APRA as to how we try and initiate this process.

**Senator SHERRY**—I accept, Mr Jones, that they have to act in the members' best interest, but they are also going to charge a fee.

**Mr Jones**—Sure.

**Dr Laker**—That fee is fixed at the outset. So if in the whole process of completing that transition it is fixed per capita—I understand your problem—your problem would not arise under that model.

**Senator SHERRY**—What if it took longer to wind up? Will they absorb the loss?

**Mr Jones**—If they quote a fixed price and it takes them longer, that will be their responsibility. As a unit cost, that will certainly be imposed upon the members.

**Senator MURRAY**—But the saving grace as to Senator Sherry's fear is the point you have just made. If it is a fee per capita and they aggregate it to a fixed fee in total, you do not have that fear.

**Senator SHERRY**—You could have the reverse circumstance. You could have member A, Joe Smith, leave on day one paying the same fee as B Smith, who stays in the fund for five months and does nothing.

**Mr Jones**—But the cost, though, is the cost of the wind-up. You are absolutely correct: the members will pay the cost of the wind-up. But it is possible to have a mechanism by the tender process with a fixed price whereby the cost per member is simply equal to the total cost divided by the number of members. If I stay in for six months and you leave after one week, it is quite true that you will pay the same cost as I will.

**Senator SHERRY**—There is certainly no incentive to get out; you sit back.

**Mr Jones**—The trustee has an incentive to get everybody out as fast as possible because the trustee is also on a fixed price. If the trustee manages to do it much faster, the trustee makes a bit more money.

**Senator SHERRY**—So you will be monitoring this process?

**Mr Khoo**—Yes.

**Mr Jones**—It should not be too difficult for us because hopefully we will not have many of these left over. We are talking about hundreds and hundreds that have already been done and gone.

**Senator SHERRY**—Yes. I understand that.

**Senator MURRAY**—But the way a businessman will think is that if he accelerates the process he will therefore have a pool of money. He can provide a rebate to encourage people to move earlier. That is the way it will work. He will work out a time period over which the exit must take place. If he can shorten that, he will then have a greater pool of money. That will provide the incentive if he needs to push people out earlier.

**Mr Jones**—Many of these things are fairly standardised functions in terms of alignment. It is not as though the trustee walks in and suddenly says, ‘Gee, there’s a whole lot of things here that I didn’t really anticipate,’ or at least that is what we expect.

**Senator MURRAY**—You are saying it is not open ended?

**Mr Khoo**—It is not open ended.

**Mr Jones**—No. It is not absolutely open ended.

**Senator SHERRY**—Now what about the circumstance—you have identified there are approximately 50 to 70 cases—where the funds are simply refused a licence? Are we likely to have that circumstance?

**Mr Jones**—It is interesting, given that we fully expected there would be circumstances where people would not get a licence, that there is an enormous amount of self-selection in this. We began the process 2½ years ago with 1,250 trustees. When we closed the window in mid-February, we had 325 applications. So in fact quite a number of trustees self-selected for whatever reason.

**Senator SHERRY**—I suspect cost was one of them.

**Mr Jones**—A lot of it is that they have to be far more sophisticated than they were before. It is a more complex industry than it was before. So 325 paid their money, in effect; they paid their fees. Since February, 15 of them have dropped out. So far we have not rejected a single application.

**Senator SHERRY**—I accept that. When the date comes, are you likely to?

**Mr Jones**—When the date comes, I do not think so. I also think, however, that between now and 30 June, which is 30 days away, one or two more might drop out. That is in the next four weeks.

**Senator SHERRY**—In the finalisation of this process—and you are issuing licences—are you issuing any funds with a caveat or a condition on the licence to deal with this, this, and this?

**Mr Jones**—Some funds have been given licences with conditions. There is no such thing as a conditional licence.

**Senator SHERRY**—Okay, they are licences with conditions. A raw number could be a bit misleading, because it might be a relatively minor condition that you think has to be dealt with. Do we have any sense of substantial conditions versus minor conditions?

**Mr Jones**—This is purely top-of-the-head stuff. I can think of one or two where I would describe the conditions as being reasonably moderate where we have some concerns.

**Senator SHERRY**—What are those reasonably significant concerns? What sorts of issues are they?

**Mr Jones**—To be truthful, I cannot give you the detail about exactly what those concerns were. I can probably give you more information if I took it on notice.

**Senator SHERRY**—Yes, take it on notice.

**Mr Jones**—We have a couple of hundred people who have been doing nothing but licensing. From the discussions I have had with some of our staff, it appears some of the licences have been approved with quite specific conditions. I am not sure of the numbers. Some have gone through with no trouble.

**Senator SHERRY**—Presumably some—you might be getting to this point anyway—have had issues raised and they have been corrected or adjusted prior to the licence being given.

**Mr Jones**—Precisely. That has been the case with a lot of them. If you look at the average time taken for a licence, you will find that some of them put their licence in in 2004 and received their licence in 2006. It is not because it took us that long to get around to it. It is because there were all sorts of conditions. We went back to them and said, ‘Under the current circumstances, you won’t be getting a licence.’

**Senator SHERRY**—I do not want to suggest onerous work. Is it intended that APRA, once this process has concluded, will come up with an overview report on process analysis and outcomes as to what has occurred, where weaknesses were identified and where correction is needed? For example, what is the level of problems with the application of the fit and proper person requirement to trustees? There are also the investment guidelines that you

have issued. Will you analyse those sorts of details, what the outcomes were and where there are ongoing concerns?

**Mr Jones**—It is something that has already been developing in the sense of giving guidance. Our superannuation licensing team has been learning, right from 2004, where the most likely faults are in the licence applications. We have adjusted our education program over the past two years so that our seminars have said, ‘These are the typical areas where there have been weaknesses in the past,’ and we use your types of examples. That process has been ongoing. In terms of whether we then go back and do a major analysis of the principal areas, we have not contemplated doing that largely because it has been a fairly iterative process and we have had different firms come through with different circumstances. They make some changes and you move on.

**Senator SHERRY**—I understand that has happened. Let me give you an example. Do we know how many trustees—or even employees of the trustee entity, for that matter—have been removed because of the fit and proper person test?

**Mr Jones**—No. Once again, if there were employees who did not meet the fit and proper person test, there would not have been a licence in the first instance.

**Senator SHERRY**—Say this was pointed out to the trustee entity: ‘Look, there’s a person who is not fit and proper,’ and it is either the trustee or an employee and they resign as a consequence.

**Mr Jones**—As far as I am aware, we would not have kept any records of the number of people who might have decided along the line that they would not pass the fit and proper person test and resigned. We would not necessarily ask them, ‘Are you resigning because you do not think you will pass the fit and proper person test?’

**Senator SHERRY**—Am I correct in concluding that no-one has been identified as unfit and improper as a consequence of this process?

**Mr Jones**—No. I do not think we are concluding that at all. Again, there is so much self-selection in this.

**Senator SHERRY**—Sure. It is a pretty fine line. It seems to me you are saying—I will raise this in respect of a couple of other matters that have been raised with me—‘Look, we haven’t been able to identify people who are unfit and improper but we have prompted them on the way through that we think this person should go.’

**Mr Jones**—Yes.

**Senator SHERRY**—That has happened, hasn’t it?

**Mr Jones**—Yes, it has happened. That is a fact.

**Mr Khoo**—In quite a number of cases, we have also worked with a number of the trustees and suggested that they actually needed to improve the quality of their trustee boards by finding new people. That has happened in quite a number of cases as well.

**Senator SHERRY**—I raise this because—there is no legal requirement for this, in my view—effectively you imposed some level of independent trustees.

**Mr Khoo**—‘Imposed’ might be a strong word.

**Senator SHERRY**—The comment I have had is: ‘Look, it’s do it or else.’ When APRA fronts up in the licensing process and says, ‘We’d like some independent trustees on the trustee board,’ what are they going to do? Knock it back, knowing that their licence is on the horizon?

**Mr Jones**—I guess we hope that they will take our advice.

**Senator SHERRY**—Are there any that have not?

**Mr Jones**—I do not know whether there are any that have not. Once again, the process is not that simple.

**Senator SHERRY**—I know it is not simple.

**Mr Jones**—If you say to somebody: ‘Look, we’ve looked at your trustee board. We really believe that you don’t have the adequate mix of skills,’ more often than not they come back a couple of months later and say, ‘We’ve got a reconstituted board. Here is a new set of skills.’

**Senator SHERRY**—That is in your eyes. But there could be a trustee board that you have concluded does not have the required mix. How do you come to the conclusion? What if that fund is running with a good average long-term rate of return? Have you taken that into account? What if it has low fees? Regardless of your observations as to the trustee mix, do you take those sorts of factors into account when you are concluding whether there is the correct trustee mix?

**Mr Khoo**—The way that we look at fitness and propriety is that we need the entire group of trustees to meet fitness. In other words, there is a range of extra fees and the like. But they need to be proper on an individual basis. If a person is not proper—

**Senator SHERRY**—What do you regard as proper?

**Mr Khoo**—Well, let’s put it this way: if a person has a previous criminal offence, they would not be regarded as proper.

**Senator SHERRY**—I have read your guidance notes. They are bedtime reading, believe it or not. I have read all your guidance notes over the last couple of years. I am just interested in the way this is working out.

**Mr Jones**—We are impressed, I have to say.

**Senator SHERRY**—Let’s take, for example, a trustee. It seems to me that common sense is a pretty decent old requirement. Are you looking for education levels and backgrounds, a mix of skills and a mix of experience? What exactly are you looking for here?

**Mr Jones**—I think the answer is all of the above, but not necessarily in an individual.

**Senator SHERRY**—Sure.

**Mr Jones**—For example, in terms of fitness and propriety, there is no requirement that every single person have financial skills, for instance. I return to your earlier point about making a good rate of return as evidence of something. We have come across funds relatively recently, fortunately on an infrequent basis, where they had made very good returns and had quite considerable asset concentration, for example, strictly in—

**Senator SHERRY**—I said a good average long-term rate of return.

**Mr Jones**—If you have invested in Queensland residential property, on average you have done pretty well over the past few years. We might walk in and say—

**Senator SHERRY**—That would be in defiance of the prudent person test, I suspect, if it is all in Queensland property. It is a bit like high-tech Korean shares, which we discussed on one occasion.

**Mr Jones**—We did, yes.

**Senator SHERRY**—I suppose my concern is this: we have a trustee model. It is not a professional model in this country. There is a cost to professional trustees. They are paid substantially more. I have heard of examples of some of these independent trustees picking up \$50,000 to \$100,000 per annum. Now that is a cost to the fund members. If there is no improvement in long-term performance on both rate of return and fees, it seems to me it is a pretty fine balance here.

**Senator MURRAY**—But there may be improvement in prudential behaviour, surely.

**Senator SHERRY**—While I think of it, I raised with the tax office—I do not have the person's name here—the case of an individual. Senator Murray was with me at the time. I mention this by the bye in terms of a fit and proper person. I will provide you with the name. It was an employer who had not paid superannuation guarantee contributions. Senator Murray will remember this yesterday with the tax office hearings. They had not paid it for five or six years. The tax office had not concluded the case and had not taken legal action. But that person turned out to be a trustee of the Quadrant superannuation fund in Tasmania, which sort of struck me as very peculiar.

**Senator MURRAY**—It began with an 'R'.

**Senator SHERRY**—Yes. Anyway, I will provide you with the name. By the bye, it was pointed out to me that this individual had not paid SG to their employees and was a trustee of a superannuation fund, which I found quite extraordinary. Would they fit the fit and proper person test?

**Mr Jones**—It is very dangerous for us to talk about hypotheticals without having a whole lot more information than one specific example.

**Senator SHERRY**—I will send you the information about this person. He has not paid his SG and he is sitting on a superannuation fund as a trustee, which I thought was a bit odd.

**Mr Jones**—It would be dangerous for us to come out and give you an instant opinion, given it takes us some considerable time to do the fitness and propriety test.

**Senator SHERRY**—I was going to go through these guidance notes in a fair bit of detail, but time does not allow me. I want to turn to your risk management guidance note, which is SGN 120.1. The guidance note covers trustee operations, the risk management strategy, or RMS, and, for the fund itself, the RMP, or risk management plan. In this process, to what extent have you been examining in detail the RMS and the RMP? It seems to me a very substantial amount of work. I am just wondering whether you are examining these things in detail, or are we just getting a templated strategy and plan being produced?



**Mr Khoo**—In a nutshell, the RMP and RMS are two of the most critical aspects of the licensing process.

**Senator SHERRY**—So you are examining each one of them in detail?

**Mr Khoo**—Correct.

**Mr Jones**—The other important point about that too is post licensing. What we have as a result of the licence is trustees telling us what their proposals are. In 2006-07, our task is to see whether in fact they are complying with what they have said they are going to do.

**Senator MURRAY**—Do you do that on a sample basis?

**Mr Jones**—No. We will do that on every one.

**Mr Khoo**—We will do that on every super fund that is licensed.

**Senator SHERRY**—I referred earlier to the explosion in the number of compliance officers. I am looking at the APRA dataset for the December quarter. Right across the board, except for corporate funds—I think there is an explanation; they are in very rapid decline—the trend line for the operating expenses of industry funds, public sector funds and retail funds from December 2004 through to December 2005 is up significantly. The funds tell me they have employed significant additional staff over the last two years. Superannuation fund annual reports are further bedtime reading for me. They show that admin costs are increasing significantly right across the board. Is this a function of the licensing process or an outcome of it?

**Mr Jones**—It may in part. But it is also a function of the fact that if you look at the costs per million dollars under control or some other statistics, you will find in fact the unit costs are going down. We are finding that the increased concentration in the number of funds and the drop in the number of trustees from 1,500 to 300 is leading to a substantial increase in the average size with assets under management and increasing complexity. Further, many of these trustees are going into far more complex products than they were a couple of years ago to maintain the types of high returns they have been getting. The consequence of that is that they are becoming more sophisticated. That sophistication requires—

**Senator SHERRY**—Sure. I talk to these people. They have employed a compliance officer or officers. They have employed a specialist investment manager or managers. Then they put on extra support staff. It is happening right across the board. Surely you must observe that. To what extent is it an outcome of this licensing process? There has to be some impact from the licensing process.

**Mr Jones**—Sure. Licensing is part of it. These firms are becoming more and more like the major sophisticated institutions that we deal with in insurance and banking. Until the licensing process, they did not have very sophisticated systems.

**Senator SHERRY**—Let's weigh that up against the level of risk and the outcomes in terms of investment rates of return and the long-term average. It is this increasing cost that really does concern me. I am seeing fees go up. I think the choice of fund regime actually has something to do with that as well. Costs are going up. Fees are going up across the board. There has not been a fee reduction across the board—fees are going up.

**Mr Littrell**—In rough numbers, the typical super trustees eight or 10 years ago might have had a \$50 million balance sheet. It was a bit of a labour of love. If you look now, post licensing, you will see that the typical trustee has \$2 billion. So the industry has really grown up very quickly.

**Senator SHERRY**—I accept that. I certainly accept that.

**Mr Littrell**—It may be the case that, for argument's sake, you had 10 \$200 million funds without much controllable infrastructure. Now you have one \$2 billion fund with controllable infrastructure. And that will cost you some money. But that cost is spread over \$2 billion. The general investment climate over the last 20 or 30 years, even, has been pretty positive. The general probity climate has been fairly positive too. But there are striking trends towards more risk of fraud, more risk of exotic investment failure and more reasons to think that sophisticated risk control is necessary. There have been attempts to steal tens of millions of dollars from funds, which have been foiled by expensive risk management controls.

**Senator SHERRY**—But this issue of costs does concern me. Let's look at the stats in the quarterly reports that you produce, Mr Littrell. In the case of industry funds from December 2004 to December 2005, there are operating expenses, being management fees, admin fees, directors' trustees fees and expenses—they have interestingly gone down in that case—and other operating expenses and total operating expenses. For that sector, despite some significant amalgamations, they have gone up from \$129 million to \$154 million. In public sector funds, interestingly, they have gone down. In retail funds they have gone up from \$428 million to \$523 million. So it is not just the industry funds; it is the retail funds as well. These are the operating expenses, not the investment expenses. They have gone up significantly.

**Senator MURRAY**—Does that include marketing costs?

**Senator SHERRY**—Presumably marketing would be in operating expenses, I suspect.

**Mr Littrell**—This is the 2004-05 report that you are quoting from?

**Senator SHERRY**—Yes. I have the last quarterly report for December 2005.

**Mr Littrell**—In that same period, the funds under management and the number of members both went up substantially too. That was also a period in which there was a bit of a triple threat in APRA licensing, super choice and financial services licensing.

**Senator SHERRY**—A triple whammy, if you like?

**Mr Littrell**—Sure.

**Senator SHERRY**—I accept that.

**Mr Littrell**—So a combination of very rapid growth and rapid intensification of risk requirements.

**Senator SHERRY**—I have not seen MERs coming down right across the board. I know there have been a few people trying to claim things. Some in the retail sector are claiming that their MERs are coming down on certain products. But across the board, I have not seen it.

**Mr Jones**—As we discussed another time we were here, we are seeing increased advertising in the industry. That is just one more example.

**Senator SHERRY**—Yes. But the argument was that the fees were going to go down. It is not an APRA argument. It was the argument coming from the minister and others. I have a couple of specific queries on the licensing process. I have had a couple of complaints. I have had a fund—I will not give you the name—that carried out a confidential peer review of the trustees on their own initiative, not on APRA prompting. They commissioned an outside, independent organisation to carry out a peer review of the trustees. It was on their own initiative. It had nothing to do with APRA. According to the email I received, they were silly enough to undertake this peer review. It was to be confidential amongst the board members. APRA came along, found out about it and wanted a copy of it. It was not an APRA requirement. It was not an APRA request. They did it on their own initiative. Are you aware of any circumstances where this has occurred?

**Dr Laker**—Yes.

**Senator SHERRY**—Do you think it is reasonable that APRA should demand a copy of a confidential peer review initiated by the trustees?

**Mr Khoo**—Without going directly to that circumstance, what I can say is yes, in those circumstances, entirely.

**Senator SHERRY**—Why?

**Mr Khoo**—That would be getting directly into the specifics of that matter.

**Mr Jones**—Let's say we are absolutely aware of the circumstance you are talking about. I believe that our staff acted in the appropriate manner in that circumstance.

**Senator SHERRY**—I could accept if you made it a condition of this licensing process that every trustee board carry out a peer review. I could accept it would be reasonable to say, 'We want to have a look at the results.' But this is a very major superannuation fund.

**Mr Jones**—It is.

**Senator SHERRY**—A very, very large fund. It is probably in the top 20, looking at the name of it. I am concerned about the justification for it.

**Mr Jones**—It would not be risk based supervision if we asked it from everyone. We asked it from particular people because we had particular concerns.

**Senator SHERRY**—You accept that you did not request the peer review to be carried out? APRA did not request it. The board did it themselves. Do you accept that they did it on the basis that it was confidential to them?

**Mr Jones**—I am not aware whether they did.

**Senator SHERRY**—It was not going to be shopped around.

**Mr Jones**—I am sure it was not going to be shopped around.

**Senator SHERRY**—No. So the peer review is completed. There are actions flowing from that. I still cannot see why APRA required a copy of it. Has action been taken against the trustees of this board? Have any been found to be unfit and improper? Have you said to them, 'Look, we want independent trustees on the board?' Have you removed anyone?

**Mr Jones**—No, we have not.

**Senator SHERRY**—Do you have any information that trustees have been acting improperly, either individually or collectively?

**Mr Jones**—I think we are starting to get into specific details here about a particular board. I am a little hesitant. At the moment you are talking about a supposedly hypothetical case.

**Senator SHERRY**—It is not hypothetical. I have the details here and I am well aware of it. If you have concerns or a question mark about this board, I just cannot see why you would not be insisting on an independent peer review of all trustees as part of the licensing process.

**Mr Jones**—I think the answer is that we did not have the same issues with most other boards that we had with this board.

**Senator SHERRY**—Have you requested a peer review of any trustee board?

**Mr Jones**—I am not sure. I will have to take that on notice.

**Senator SHERRY**—Another issue I have had raised as part of this licensing process is a concern that a fund—this is a corporate fund, employer sponsored—believed that APRA pressured them. They would get no licence unless they became a public offer fund—that is what they believed they were told.

**Mr Jones**—It may have been related to particular elements of the way in which they had some of their insurance arrangements set up. I do not know, again, without knowing the details of the specific fund. But in terms of this notion of pressuring, there were certain circumstances where we suggested that, depending upon the types of insurance arrangements they had, it was most appropriate that they apply for a particular type of licence.

**Mr Khoo**—There have also been a number of funds that have been verging on operating as public offer funds. In a number of our discussions with them, we suggested to them that it would be a better idea for them to go down the public offer route to remove any doubt.

**Senator SHERRY**—Let's call a spade a spade. You would accept, wouldn't you, that a suggestion by APRA, even if nothing in law requires it, has to be taken in a very considerable and serious way?

**Mr Khoo**—We expect that any suggestion or recommendation we put to any institution would be considered seriously. But we have another category of communication to our institutions which is a requirement that we use from time to time.

**Senator SHERRY**—In the case of requirements, where have you actually said, 'Look, do this,' have they said: 'No, we're not going to do this and this is the reason. Take us to court?'

**Mr Khoo**—Generally, if we put a requirement on an institution and they choose to ignore what we are requiring, that may be the subject of enforcement action.

**Senator SHERRY**—Have you been in that situation as part of this process?

**Mr Jones**—As part of this process, no. Another point is that if we refused to grant a licence, there is nothing to stop an institution taking us to court or the AAT.

**Senator SHERRY**—Yes—but, again, there is a practical issue there: legal battle, substantial costs.

**Mr Jones**—Very large funds? You suggested perhaps a top-20 fund; very large amounts of money.

**Senator SHERRY**—Yes, they probably have sufficient legal resources, I have got to say, looking at their name. But the capacity for a smaller fund would be much more limited. I do not want you to get the wrong impression. I am raising these issues because there is a reasonableness about the complaint I am raising with you. I actually think that the overall process has gone very smoothly and is done very well. I say congratulations. I think the changes and what has occurred with the upgrade have overall been very good. I have no complaints about this. I am focusing on a couple of individual complaints where I think there is a question mark and I am concerned about the compliance costs that are emerging. As I say, I do not believe it is solely a consequence of the licensing process. I am raising these issues because I think it is important to raise them.

**Mr Jones**—Sure; I understand. We have looked at this process as an opportunity to ensure that the governance in superannuation is the equivalent of what we have in the other regulated sectors. I hope that will be the consequence of the process on 30 June. It was a sector that did not require licensing and yet it is probably the most rapidly growing part of the financial sector.

**Senator SHERRY**—Except for self-managed super funds. But you are not responsible for them.

**Mr Jones**—No, we are not.

**Senator SHERRY**—I have further questions but I think I will have to call a halt. I was going to go to some of these guidelines in detail. I may leave that for another time. The licensing process is probably overtaking us. I notice most of the guidelines were issued in July 2004. Once this process has concluded, will there be updates of this? It seems to me these guidelines and the consequences that flow for funds are work in progress; this is not static.

**Mr Jones**—I think that is true. Once the licensing process is over and once effectively the clean-up in the next six months is done, it is certainly an area that we expect to spend some more time on in calendar year 2007.

**Senator SHERRY**—Once this process is concluded will you be having a publicly available database of every fund that is then licensed?

**Mr Jones**—Yes.

**Senator SHERRY**—With contact details and some of the useful information—fund size, fees and those sort of things?

**Mr Jones**—Not stuff like fund size and fees. But each person who is licensed is going up on the website now.

**Senator SHERRY**—What additional information? Will there be any additional information other than just the contact details and licence number, presumably?

**Mr Jones**—No. We do not have the mechanism, and I am not certain of our powers to publish information about individual funds.

**Senator SHERRY**—What about a cross-reference to their annual reports, which are usually pretty useful documents to read?

**Mr Littrell**—We essentially put up the name of the licence entity. ASIC runs a website that contains a lot more contact details and information on super funds.

**Senator SHERRY**—Yes, but it does not cross-reference to the annual report, does it?

**Mr Littrell**—No.

**Senator SHERRY**—I am looking for a totally comprehensive data set on funds. It seems to me as a consequence of this exercise we can get to that point.

**Mr Littrell**—Again, we could, but that is a whole separate consultation and publication process.

**Senator SHERRY**—You put their licence up and cross-reference to their annual report. I do not think they could complain if you brought in their annual report to the website.

**Mr Jones**—Brandon Khoo just made an important point. For public offer funds that might be a little bit easier, but for some of the corporate funds we are not even convinced that that information would be available in terms of an annual report.

**Mr Khoo**—One that is freely available. We are not sure. I was just making a point.

**Senator SHERRY**—I find it valuable, I suppose.

**Mr Jones**—We are just not sure.

**Senator SHERRY**—But it is useful in the context of looking at it. A lot of the corporate funds are not public offer and they are not going to be. I went to one on the website and could not get the annual report. I was just interested to find out. These members are bound because of the industrial provisions; there is no choice of fund. I was just interested in looking at what the MER was and what the admin fees were and the investment rates of return, but I could not access any details on the fund. I had to be a fund member to be able to do so.

**Mr Jones**—But it would not impact upon your decision because you could not join it.

**Senator SHERRY**—I know that. I am in a pretty good fund!

**Mr Jones**—I do not want to go there.

**Senator SHERRY**—I am not suggesting you put that one up on the website for the public to examine. I am in a pretty good fund. Being a super junkie, I find it useful to look at admin fees and investment rates of return and what is being charged—all those sort of things. If you were a research analyst doing analysis of corporate funds, retail funds, industry funds and public sector funds and you wanted fundamental and quite basic information, I am sure you would find it useful to be able to access that. You could examine whether a corporate fund is worth while being in.

**Mr Littrell**—There are commercial services that provide that. There is also at ASIC this emerging effort under FIDO to provide fee and expense comparisons and other information on funds. We are not typically in the consumer information business. We sometimes support ASIC in that business, but it is not really part of our statutory mandate. It is one thing to put up the name of the licensed entity and a link to their website. We do that. But to provide

essentially the statistical feed, absent some fairly specific circumstances, is not typically part of our mandate.

**Senator SHERRY**—Do you require the annual report to be forwarded?

**Mr Littrell**—To whom?

**Senator SHERRY**—To APRA.

**Mr Littrell**—We collect our own annual report through the statistical returns.

**Senator SHERRY**—The standard annual report on all funds, including corporate funds, that they have to provide them to their members: do you get copies of that as a matter of course?

**Mr Littrell**—My understanding is that we do not collect it as a statutory matter but it is collected routinely by the supervisors.

**Senator SHERRY**—Maybe it is part of the licensing process. You suggest they sign up to provide it forever more.

**Mr Khoo**—We get provided it as part of it.

**Mr Littrell**—We have the right to request it, but it is not a routine statistical collection to get the annual report. We collect our own statistical material and auditors' sign-offs.

**Senator SHERRY**—I have been to databases that purport to have a reasonably comprehensive list of funds. I have to say they fall a long way short—the lists I have been looking at; I am not talking about APRA's and ASIC's lists—of, say, 320, which is what we are likely to end up with. There are corporate funds. I think Mitsubishi has one and Sara Lee. There is a whole range of these corporate funds. I do not know whether they will go on past 30 June. If you go to the website, you have to log in as a member to read the annual report now. That is just another suggestion for work for you to do. That is it.

**CHAIR**—Thank you very much, Senator Sherry. Dr Laker and gentlemen, you are excused. Thank you.

**Senator SHERRY**—Thanks a lot. I will try to move on from super issues at the next hearing. I am starting to phase into bank documents and insurance documents.

**Dr Laker**—You have a lot of excitement ahead of you, then.

**Senator SHERRY**—I have.

[10.38 pm]

### **Productivity Commission**

**CHAIR**—The officers of the Australian Bureau of Statistics are excused and need not return. I welcome to the hearing the officers of the Productivity Commission. Mr Wonder, do you have any opening statement to make?

**Mr Wonder**—I was just going to make a few brief remarks. This is to give you a bit of an update on where we are with some of our key activities. In particular, I want to flag some recently completed reports and some work that the government has commissioned. I will do that quickly. Basically, in the first category, in terms of key reports, we have recently

forwarded to the government our final report on the conservation of historic heritage places. We have also finalised three commission studies. The first is on consumer product safety, which we released in February. The second is on the health workforce, which was released in January. The third, released earlier this month, is on the economic impacts of population and migration growth. Also this month we have published a research report on the role of non-traditional work in the Australian labour market. That followed the release last month of our trade and assistance review for 2004-05. We have also published a range of supporting research on productivity estimates and topics related to irrigation, water and other technical work concerning general equilibrium modelling. We have published our proceedings of a roundtable that we convened in October last year on productive reform in a federal system.

Currently we have four public inquiries that we are undertaking. We are doing a nine-month inquiry into the price regulation of airport services. We are doing a nine-month inquiry into the subsidisation of containerised and bulk shipping between the mainland and Tasmania. We are doing a review of economic costs of freight infrastructure and efficient approaches to transport pricing that needs to be presented to COAG by December this year. We are doing a 12-month inquiry into waste generation and resource efficiency in Australia. The government has asked us to undertake three research studies as well, which we are doing. One is a 12-month study into economic, social and environmental returns on public support for science and innovation. Another is a nine-month review we are doing on the Australian government's relationship with Standards Australia Ltd and the National Association of Testing Authorities. The final one is a nine-month study we are doing into the role of market mechanisms in rural water use and the environment.

I will probably leave my remarks there. I have not gone into the commission's other major outputs on performance reporting and regulation review, competitive neutrality and supporting research. But there is much under way across those activities as well. I thought I would just touch on the key pieces of work commissioned by the government.

**CHAIR**—Thank you, Mr Wonder. Senator Sherry.

**Senator SHERRY**—Thank you. I think you mentioned the investigation into Tasmanian freight.

**Mr Wonder**—Yes.

**Senator SHERRY**—Where are you up to with that? Do we have an indicative date when it will be completed?

**Mr Wonder**—Yes. The government commissioned the work. We have the dates here. The government announced the work in March this year. As I said in my opening remarks, that is a nine-month inquiry. Basically, it goes through to the end of the year.

**Senator SHERRY**—Presumably submissions have been called for?

**Mr Wonder**—Yes. An issues paper was circulated in April. Submissions have been invited in response to that issues paper. I will pass to Mr Pitkethly in respect of the timing of those submissions. I do not have those dates with me.



**Mr Pitkethly**—We have called for submissions in an issues paper, which was issued about three weeks ago. I cannot tell you the date. We normally give people about six weeks to respond.

**Mr Wonder**—I have the date here, actually, now that I have opened it up. The due date for initial submissions is 16 June.

**Senator SHERRY**—Thanks for that.

**Mr Wonder**—The draft report is scheduled in August this year.

**Senator SHERRY**—So it is a draft report. Does that then come back to you for further comment?

**Mr Wonder**—There are planned public hearings on the draft report to be held in September. As I mentioned earlier, the final report will be forwarded to the government in December.

**Senator SHERRY**—It is Tasmania we are talking about. There will be hearings in Tasmania?

**Mr Wonder**—I do not have the locations, but I imagine that that would be right.

**Mr Pitkethly**—That is correct.

**Senator SHERRY**—Are any locations indicated yet? Are we talking about just Hobart?

**Mr Pitkethly**—It will depend on the amount of interest. In the visits program that Mr Wonder referred to, we have been talking to basically shippers across the Bass Strait and what I might term as exporters and importers. Depending on where the submissions come from, we could go to one or both.

**Senator SHERRY**—Most freight in Tasmania comes in and out of the northern ports. There is very little now out of Hobart, if any, in fact. I suspect it is all airline traffic. Thanks for that. There is one particular aspect of the report *Rethinking regulation* that I want to go to. Is someone able to respond?

**Mr Wonder**—I might make a couple of remarks that might assist your questioning. Earlier in today's hearing, Treasury officers referred to the *Rethinking regulation* report as the Banks report. Of course, Gary Banks, the Chairman of the Productivity Commission, did head up that inquiry. However, the actual inquiry was not a Productivity Commission inquiry. It was not conducted under the auspices of our act. Indeed, it was commissioned by the Prime Minister and the Treasurer. So our role in it was basically to house the secretariat that worked on the study and reported to the taskforce. Indeed, we contributed a couple of staff to that secretariat ourselves. But the publication that the government has released has not been issued under the banner, you would have noticed, of the Productivity Commission. So in terms of its status, we would not see it as a Productivity Commission report, although it did involve, with a couple of others on the taskforce, the Chairman of the Productivity Commission.

**Senator SHERRY**—So whose is it? Is it with PM&C?

**Mr Wonder**—The responsibility in government is with the Prime Minister's department and the Treasury.

**Senator SHERRY**—And Treasury?

**Mr Wonder**—Yes, because it was commissioned jointly by the Treasurer and the Prime Minister.

**Senator SHERRY**—So to whom would questions on it go—PM&C or Treasury?

**Mr Wonder**—Both departments have a participating interest. I listened this afternoon to Mr Murphy's answer to your questions. I think he indicated to you that many departments are involved in taking that initiative forward and that there are IDCs involved. As an organisation, we are not involved in them because we were not, as I said, involved in the preparation of it. We are not normally involved in such things anyway once we have reported to government. But, yes, that is my understanding. It is those two departments with the lead.

**Senator SHERRY**—Did the PC provide any research staff?

**Mr Wonder**—Yes, we did. As I said, it was on the secretariat. How many staff did we have on it?

**Mr Pitkethly**—Six, give or take one.

**Senator SHERRY**—I do not have anything further.

**CHAIR**—Thank you very much indeed, Senator Sherry. Thank you very much, gentlemen. Thank you, Minister. You are excused. The hearing is adjourned until 9 am tomorrow morning, when we will begin with the Corporations and Markets Advisory Committee and proceed in accordance with the published program.

**Committee adjourned at 10.46 pm**