

VII. PRIVATE PENSIONS SUPERVISORY METHODS IN AUSTRALIA

by
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Introduction

In Australia, the term *superannuation* refers to savings specifically dedicated to the provision of financial support in the retirement period. The term is preferred to *pension* for historical reasons, largely because of the long-standing preference for retirement benefits to be paid as lump sums rather than income streams.

Australia's retirement income provision system has three 'pillars':

- The Age Pension, a means-tested pension for retired citizens distributed by the federal government.
- Compulsory employer superannuation contributions (the Superannuation Guarantee). Since 1992, employers have been required to provide superannuation for their employees, with only a few exceptions. From 1 July 2002, the minimum contribution level is 9% of an employee's earnings base (generally the person's normal salary or wage but not including any overtime pay); and
- Voluntary member superannuation contributions, contributions made, usually by members of superannuation funds, over and above the compulsory superannuation contributions or where a person is not eligible for superannuation guarantee contributions to be made on her or his behalf.

Together, the Superannuation Guarantee and voluntary superannuation form Australia's private 'pension' system. The main information regarding number of funds, assets and account by type of fund is provided in Table VIII.1.

**Table VIII.1. Australia's Superannuation Industry
December Quarter 2002**

Type of fund	Funds ¹		Assets		Accounts	
	Number	Market Share (%)	AUD billion	Market Share (%)	Millions	Market Share(\$)
Corporate	2 045	0.80%	65	12.55%	1.4	5.58%
Industry	109	0.04%	52	10.04%	7.6	30.28%
Public sector	78	0.03%	102	19.69%	2.9	11.55%
Retail	240	0.09%	175	33.78%	12.7	50.60%
Small Funds	251 756 ²	99.02%	103	19.88%	0.4	1.59%
Subtotal	254 228	100.00%	497	95.95%	25.1	100%
Annuities, life office reserves etc	NA	NA	21	4.05%	NA	NA
Grand total	254 228 ³	100%	518	100%	25.1	100%

1: Fund numbers are preliminary estimates only based upon 2001-02 trends.

2: The number of small funds includes approximately 243 000 self managed superannuation funds regulated by the Australian Taxation Office.

3: APRA regulates approximately 11 000 funds in total, including approximately 8,000 small funds not regulated by the Australian Taxation Office (see Note 2)

For the year ending December 2002, aggregate contributions into superannuation funds amounted to AUD 51.7 billion, while benefit payments amounted to AUD35.4 billion.

Types of superannuation entities

Corporate funds are funds sponsored by a single employer or group of related employers. Membership is restricted to employees of the employer and, if the fund rules allow, contributions may also be accepted on behalf of the employee's spouse or partner.

Industry funds, often organised through industrial workplace arrangements, cater for members as a result of an agreement between the parties to an industrial award. An individual industry fund usually draws members from a large number of usually unrelated employers across a single industry.

A **public sector fund** is one where the employer sponsor is a government agency or a business enterprise that is majority government owned.

Retail funds are publicly offered superannuation funds that members join by purchasing investment units or policies that are sold through intermediaries such as life insurance agents or financial planners. Members of retail superannuation funds may include self employed people or people wishing to top-up their other employment based superannuation arrangements. Employers may use retail superannuation products to meet their superannuation obligations in respect of their employees, for example, by using a retail master trust.

The number of Corporate, Industry, Public Sector and Retail Superannuation funds has been in decline in recent years, consistent with the trend to consolidation. This is contrasted by the steady growth in the numbers of small funds, that is, those with fewer than five members.

As shown by Table VIII.1, the overwhelming majority of superannuation funds *by number* in Australia (approximately 99.0%), are small funds with fewer than five members. In late 1999, the Australian Tax Office (ATO) assumed responsibility for the regulation of the majority of small superannuation funds referred to as self managed superannuation funds (SMSFs). The 8 000 or so small funds that continue to be regulated by the Australian Prudential Regulation Authority (APRA) must have an APRA approved trustee and are referred to as small APRA funds or SAFs. Overall, despite small funds making up the majority of the superannuation funds in Australia, small funds represent a total of only 439 000 members, or less than 2% of individual Australians who have superannuation. The remaining 2 472 corporate, industry and retail funds represent over 98% of all member accounts.

Supervisory framework

Distribution of functions and responsibilities between regulators

The regulation of the private pension (superannuation) industry is largely the responsibility of the Australian Prudential Regulation Authority (APRA), although the Australian Securities and Investment Commission (ASIC) and the Australian Tax Office (ATO) are also involved.

Following the restructuring of the financial sector regulation in Australia in 1998, APRA was established as an integrated financial sector regulatory body and bears primary responsibility for the prudential regulation of superannuation, insurance and banking in Australia. APRA administers the prudential and retirement income provisions of the Superannuation Industry (Supervision) Act 1993 (SIS Act) and the associated Regulations, in respect of the superannuation entities for which it has regulatory responsibility. The SIS Act is the principal legislation relating to the prudent management of superannuation entities in Australia.

ASIC is responsible for market integrity and consumer protection across the financial system including some areas of superannuation such as market conduct, disclosure and complaints systems.

Aside from administering the entire Australian personal income, business and goods and services tax system, the ATO is also responsible for the regulation of self-managed superannuation funds under the SIS Act.

APRA has Memoranda of Understanding (MOU) with ASIC and the ATO, which formalise the information-sharing activities of the bodies in relation to supervisory responsibilities. The MOU are aimed at reducing duplication and compliance costs for industry as well as achieving effective enforcement and compliance outcomes for industry and the agencies involved. In addition, regular liaison meetings are held between APRA and other financial supervisory and industry bodies.

The Financial Sector (Collection of Data Act) 2001 provides for collection of data by APRA on behalf of other agencies, such as the Australian Bureau of Statistics, and data sharing arrangements between APRA and other regulatory agencies are codified under the Australian Prudential Authority Act 1998 (APRA Act). This study will focus primarily on APRA and APRA-regulated superannuation funds.

APRA's Supervisory approach

The primary role of APRA is to enhance public confidence in Australia's financial institutions through a framework of prudential regulation, which balances financial safety, efficiency, competition, contestability and competitive neutrality. Ultimately, APRA seeks to ensure that financial promises are met by regulated institutions. In relation to superannuation funds, this means that the trustees must operate in the best interest of their members, in order to maximise the member retirement savings outcome.

APRA's supervisory approach is forward-looking, primarily risk-based, consultative, consistent and in line with international best practice. This approach also recognises that management and boards of supervised institutions are primarily responsible for financial solutions.

APRA supervision is both proactive and reactive, being a continuous process of risk assessment, supervision strategies and supervision activities.

The risk assessment process involves supervisors forming an opinion on the risk profile of an institution, based on the likelihood of institutional failure and the impact of failure. The likelihood of failure is measured by the inherent risks of an institution, mitigated by the risk management, control features and capital support available to the institution. These risk ratings are not made public.

The risk assessment rating determines the supervision strategy to be applied to an institution. The strategy includes the type of supervisory activity required to address key risk areas identified during the risk assessment process.

The supervision strategy is implemented by coordinating and undertaking supervision activities. The main activities conducted are: on-site visits; prudential consultations; analysis of quarterly statistical returns lodged by funds with a minimum asset level of AUD 60 million; analysis of annual statistical data lodged by all funds; specific analysis; and external party liaisons

Organisation and management of APRA

Organisation structure

APRA is a statutory authority with the legal status of a body corporate with perpetual succession. However, APRA is generally not entitled to any immunity or privilege of the Crown. As it is a statutory body and not a government department, APRA is relatively autonomous from the Commonwealth Government. APRA currently has a non-executive Board comprising nine members, with the majority of representatives from the private sector and representation from the Reserve Bank of Australia (Australia's central bank) and ASIC. Post 30 June 2003, in place of the present board APRA will be headed by a commission-like body with a minimum of three full-time executive members (and up to five members in all). One member would be chairman - and effectively the CEO - and another would be the deputy chair.

APRA is currently organised into four main divisions:

- Diversified Institutions Division (DID)
- Specialised Institutions Division (SID)
- Policy, Research and Consulting Division (PRC)
- The Corporate groups: human resources, information technology, legal, public affairs, risk assessment, finance and secretariat.

Further information on APRA's operating structure is found in Annex VIII.2.

Staff levels and numbers

APRA's head office is located in Sydney, although there are regional offices in most states of Australia. There are 475 people currently employed at APRA, of whom 345 are engaged in supervision. During the 2003/04 year, 127 employees, equivalent to 37% of supervision staff, will be engaged in the

supervision of superannuation operations. Thirty per cent of APRA's current staff members were previously employed by its predecessor organisations including the Insurance and Superannuation Commission. The remainder of staff are drawn from within the finance sector (for example, banking, superannuation and insurance), accountants, graduates and other government agencies such as ASIC and the ATO.

Accountability mechanisms

APRA is ultimately accountable to the Australian Commonwealth Parliament and to that end APRA produces an Annual Report which is tabled in Parliament and is available to the public. APRA is audited by the Australian National Audit Office on a regular basis. APRA also has a responsibility to the regulated industries it levies to carry out its responsibilities as cost-effectively and efficiently as possible. In addition, the Commonwealth Treasurer (or his delegated Minister) may give APRA directions about the performance or exercise of its functions or powers under the SIS Act.

As APRA is a statutory body under the Commonwealth Authorities and Companies Act 1997, the legislature has the power to change APRA's procedures through amendments to relevant legislation and disallowance of associated regulations under which APRA operates, as well as those it administers. The Minister may also give APRA directions about the performance or exercise of its functions or powers. In addition, certain APRA decisions are defined as "reviewable decisions" under the SIS Act. A person affected by a reviewable decision may request APRA to reconsider the decision. If APRA confirms or varies the decision upon receipt of such a request, the affected person may seek to have the Administrative Appeals Tribunal¹ review the decision. The Administrative Decisions (Judicial Review) Act 1977 also provides grounds for the Federal Court to review an administrative decision made by APRA.

In addition to its annual report, there are a number of other avenues through which APRA maintains its ongoing accountability to the Parliament. These include:

- industry consultations as part of the annual levy determination process;
- the Treasurer's involvement in determining levy rates each year;
- regular appearances before Parliamentary Committees; and
- audit by the Australian National Audit Office.

Budget

The overall budget for APRA is determined by its Board in consultation with the Commonwealth Treasurer. In finalising APRA's budget the Board takes into account the resources required to conduct effective supervision for the forthcoming year for each industry under supervision.

Of the AUD 69.8 million in levies collected from APRA regulated institutions in 2001/02, AUD 28.6 million was collected from superannuation funds (however the whole amount does not accrue to APRA, see next paragraph). APRA's operating expenditure for that year was AUD 59.2 million spread over all the institutions regulated by APRA, including superannuation funds. Estimates for 2002/03 are total levy collection of AUD 75 million, of which AUD 31.9 million derived from superannuation funds. Forward estimates for 2003/04 are total levy collection AUD 68.6 million of which AUD 35.9 million is expected to derive from superannuation funds. The increase in superannuation levy revenue reflects a higher net asset basis rather than an increase in the number of entities levied.

APRA collects levies on superannuation funds on behalf of the other regulators, ASIC and the ATO, as well as in respect of funding of its own activities. Of the estimated AUD 35.9 million superannuation levy revenue for 2003/04, AUD 8.1 million will fund ASIC's consumer protection function and AUD 2.4 million will be paid to the ATO in respect of its administration of the unclaimed monies scheme. The balance of AUD 24.4 million will accrue to APRA.

Strategic planning

Objectives and outcomes

APRA's objectives are contained in the APRA Act, which sets out its constitution and its broad powers, and various other industry specific laws which it administers, such as the Banking Act 1959, the Life Insurance Act 1995, the General Insurance Act 1973 and the SIS Act.

APRA's mission is to establish and enforce prudential standards and practices designed to ensure that, under all reasonable circumstances, financial promises made by institutions APRA supervises are met within a stable, efficient and competitive financial system. This is achieved by:

- formulation and promulgation of prudential policy and practice observed by regulated institutions;

- effective surveillance and compliance programs and, where relevant, remediation or enforcement measures, to give effect to the laws administered by APRA and to the standards issued under those laws; and
- advice to Government on the development of regulation and legislation affecting regulated institutions and the financial markets in which they operate.

APRA's business plan is organised into six Key Result Areas (KRAs). These are:

- supervision, enforcement and rehabilitation;
- policies, standards and guidelines for prudential supervision;
- prudential advice – relations with external stakeholders including government, parliament, media, industry, professional bodies, general community, international agencies and others;
- staff numbers required and quality of people, now and into the future;
- infrastructure to support operations; and
- accountability framework.

The first three KRAs support the three APRA outputs of policy, surveillance and prudential advice. The KRAs relating to staff, infrastructure and accountability enable the first three KRAs to be performed within a sound administrative framework.

Allocation of resources

APRA is funded on a cost-recovery basis from the institutions it regulates. APRA is, accordingly, funded primarily from annual levies on financial institutions. A small proportion of funding comes from earnings on funds invested and charges for specific services provided, *e.g.* publications. The estimated percentage distribution of APRA's operating expenditure across its main activities in 2001/02 is shown below.

**Table VIII.2. Distribution of APRA operating expenditure
(2001/02)**

Main Activities	Distribution of expenditure (%)
Supervision, rehabilitation and enforcement	59
Development of prudential policies and standards	8
Prudential Advice	4
Administrative Support and corporate governance	29

Measurement of results

APRA's business plan sets out key performance indicators (KPIs) for each of the key result areas listed above. The table in Annex VIII.2 lists the KPIs.

Supervisory Methods: entry requirements

Legal requirements to licence or register a pension plan

At present, there is no compulsory licensing system for all superannuation trustees or compulsory registration of superannuation entities [funds, approved deposit funds (ADFs) and pooled superannuation trusts (PSTs)]. The minimum requirement for entry to the concessionally taxed environment available to complying funds is that trustees must elect to have their funds regulated under the SIS Act. However, trustees of public offer funds, ADFs and PSTs are required to be approved by APRA (that is, to become an 'approved trustee'). Trustees of funds that are not for public offer do not have to receive formal approval from APRA, but must still however comply with the trustee arrangements and requirements as provided in the legislation.

APRA issues comprehensive guidance "Circulars" which elaborate on the provisions contained in the SIS legislation and indicate the way in which APRA will interpret and enforce trustee obligations under that legislative framework.

This current system of approving only trustees of public offer entities however is set to change over the next two to three years, under the Federal Government's policy to introduce universal licensing of all superannuation trustees.

Trustee Approval

The trustee of a public offer fund or entity must be an ‘approved trustee’ within the meaning of the SIS Act. A constitutional corporation may apply to APRA to be an approved trustee in the approved form which must be accompanied by the prescribed fee, currently AUD 2000. APRA will approve an applicant for approved trustee status if satisfied that the applicant can be relied on to properly perform the duties of an approved trustee. In addition, applicants must also have at least AUD 5 million of net tangible assets or that amount available under an approved guarantee, or combination of the two, or else have agreed to comply with any requirements imposed by APRA in relation to the custody of assets. Furthermore, APRA must remain satisfied with the competence of the trustee board and with the compliance and other systems of the trustee’s operation on an ongoing basis. Copies of the applicant’s business plan are required to be provided to APRA as a part of the application process. The conditions under which an applicant is approved are set out in the Instrument of Approval.

A copy of the relevant application forms and the conditions of the ‘Instrument of Approval’ for approved trustees can be found at the APRA website.² Where there is no requirement for an ‘approved trustee’, the trustees must comply with the basic equal representation rules:

- in cases where funds have a group of two or more individual trustees, the number of employer and member representatives in the group must be equal; and
- in cases where funds have a single corporate trustee, the number of employer and member representatives on the board of the corporate trustee must be equal.

There are also restrictions under the SIS legislation on who may be a trustee or a director of a corporate trustee of a regulated superannuation fund, ADF or PST. A disqualified person (including a body corporate) is prohibited from acting as a trustee or a responsible officer of a corporate trustee of a superannuation fund.

An individual is a disqualified person if that person:

- at any time was convicted of an offence in respect of dishonest conduct or in relation to whom a civil penalty order was made; or
- is an insolvent under administration; or
- has been disqualified by APRA on the grounds of serious

contravention of the SIS Act or the Collection of Data Act or APRA is otherwise satisfied the person is not a fit and proper person to be a trustee.

A body corporate may be disqualified if:

- an official manager or administrator has been appointed; or
- a provisional liquidator has been appointed; or
- it has begun to be wound up; or
- it knows, or has reasonable grounds to suspect, that a person who is a responsible officer is a disqualified individual.

In certain circumstances, a disqualified person (including a corporation) may apply to APRA for a declaration waiving their disqualified person status.

APRA also has the power to suspend or remove a trustee on one or more of the following grounds:

- the trustee becomes a disqualified person;
- it appears to APRA that the trustee's conduct may result in the financial position of the fund becoming unsatisfactory; or
- APRA revokes the approval of the trustee (in cases where approval is required).

Under reforms proposed to commence in 2004, all new superannuation fund trustees (other than trustees of self-managed superannuation funds and exempt public sector superannuation schemes) will require an APRA Superannuation Trustee Licence (STL). The conditions for obtaining a STL will include requirements for all trustees to meet minimum standards of fitness and propriety, have adequate resources, a risk management plan and adequate risk management systems (including a fraud control plan), systems to manage outsourcing, as well as any other conditions that APRA considers appropriate. These requirements will need to be met on an ongoing basis. Retail fund trustees will continue to be required to satisfy capital adequacy requirements. In addition, APRA must be satisfied that there is no reason to believe that the trustee licence applicant would not comply with the law or any conditions imposed if a licence was granted.

Superannuation funds

As noted above, superannuation funds currently do not have to be registered. However, all superannuation entities (other than Retirement Savings Accounts (RSAs) and some public sector superannuation schemes) must be established as trusts for the core purpose(s) of providing benefits to members upon retirement. The sole or primary purpose of the fund must be the provision of retirement benefits (or death benefits in the event of death before retirement).

After a superannuation fund is established, the trustee(s) must notify the ATO of their election to have the fund regulated under the SIS Act. A decision to be a regulated superannuation fund is irrevocable. While supervision under the SIS Act is not compulsory, only regulated superannuation funds that comply with the relevant legislation are eligible to accept compulsory superannuation guarantee contributions and receive concessional tax treatment (complying superannuation funds).

The governing rules of a regulated superannuation fund are deemed by legislation to contain the following trustee covenants which are codified in the SIS Act:

- to act honestly in all matters concerning the fund;
- to exercise, in relation to all matters affecting the fund, the same degree of care, skill and diligence as an ordinary prudent person would exercise in dealing with property of another for whom the person felt morally bound to provide;
- to ensure that their duties and powers are performed and exercised in the best interests of the beneficiaries;
- to keep the money and other assets of the fund separate from any money and assets that are held by the trustee or that are money or assets of a sponsoring employer or an associate of a sponsoring employer;
- not to enter into any contract, or do anything else, that would prevent them from properly performing or exercising their functions or powers;
- to allow a beneficiary access to any prescribed information or any prescribed documents.

Trustees may engage or authorise service providers (such as external fund administrators, actuaries, lawyers and investment managers) to act or do things on their behalf, however the trustee retains responsibility for the function.

Banks, life insurance companies and investment managers may be appointed as service providers offering investment services, custodianship of assets, administration of records and other similar services.

The reforms commencing in 2004 will require all licensed trustees to register with APRA the funds under their trusteeship. They must also register any new fund under their trusteeship before that fund may accept contributions. Similarly, any fund without a licensed trustee at the expiry of the two year transitional period will either be wound up, with members and assets transferred to a licensed trustee, or otherwise have a licensed trustee appointed.

Tax concession requirements

Tax concessions do not depend on the ‘approved’ status of a trustee. Rather, eligibility for tax benefits is linked to the status of a superannuation fund being a complying fund. Under Part IX of the Income Tax Assessment Act 1936, which operates concurrently with the Income Tax Assessment Act 1997, a superannuation fund is eligible for concessional tax treatment as a complying superannuation fund if it satisfies the following conditions:

- the entity is a superannuation fund;
- the fund is a resident regulated superannuation fund;
- the fund has met the prescribed requirements to be a complying superannuation fund for the purposes of the SIS Act; and
- the trustee of the fund has received a notice from APRA stating that the fund is a complying superannuation fund, and has not subsequently received a notice stating that it is non-complying.
- a fund that is, or is part of, an exempt public sector superannuation scheme is taken to be a complying superannuation fund for the purposes of entitling it to concessional tax treatment, without having to be a regulated superannuation entity or being subject to the SIS Act.

Number of applications in the last three years

As only trustees operating public offer superannuation entities are currently required to be licensed by APRA, information on the establishment of new trustees is limited to those who apply for approved trustee status. Currently, there are 157 approved trustees; of these, 28 were approved in the last three years.

Number of applications denied and reasons

Applications are dealt with on a case by case basis by the responsible supervisor and over the last three years there have only been occasional instances where applications have been refused. A recent example was refusal on the grounds of a conflict of interest resulting from the Chief Executive Officer of the trustee having a 50% interest in the administration firm providing administration services to the fund.

Monitoring changes

In addition to notifying APRA of their election to have superannuation funds regulated by APRA, a trustee must also notify APRA if it elects to treat a fund as a public offer fund. If a small fund switches status to or from that of a self managed fund the trustee must disclose the change to the ATO. Such information is passed by the ATO to APRA

Other changes to be notified: trustees are required to notify APRA of events having a significant adverse effect on the financial position of the superannuation fund. Significant events include those that may result in the trustee being unable to make payments to beneficiaries as and when the obligation to make those payments arises. There are civil and criminal consequences for failure to comply with these mandatory notification requirements. Other information requirements include any changes in the entity's contact details, or decisions or resolutions to wind up the entity. In addition, the Regulator may by written notice require the fund or entity to provide information about the fund for a particular year of income. Superannuation fund actuaries and auditors are also required to notify APRA if they form the opinion that the financial position of the entity may be or become unsatisfactory.

As discussed above, trustees wishing to become approved trustees must apply to APRA for approval. An approved trustee must notify APRA if a condition imposed by APRA is breached or there is a change in the conditions of eligibility with 30 days of the event. Failure to comply with this requirement is a strict liability offence. Relevant conditions include the provision of information regarding certain events to APRA, notification to APRA of a change in contact details, material change in the business estimates given upon application, any event which may affect the trustee's ability to perform in a proper manner the duties of a trustee of an entity, any changes to the office holders of the trustee and a notification if the trustee wishes to engage in any other business or commercial activity. Any material changes to the trustee's capital position must also be notified.

If a trustee has been appointed by APRA, the trustee may resign by writing to APRA. APRA may also revoke the approval of an approved trustee after first gaining the Minister's consent.

Trustees of funds that are not public offer funds are required to meet equal representation requirements. In the event of a failure to continue to meet these requirements, APRA may direct the trustee not to accept employer contributions.

Approved trustees may apply to APRA for variation of approval, including changes to the conditions imposed on the trustee under its Instrument of Approval. Trustees may apply to have a fund declared not to be a public offer fund. Individuals may apply to APRA for a declaration waiving their status as disqualified persons.

Supervisory methods: on-going supervision

Compliance checks

All three regulators – APRA, ASIC and ATO – are involved in assessing compliance of superannuation trustees and their funds with relevant legislative requirements and specific conditions. For its part, APRA focuses on monitoring compliance of trustees and superannuation funds with prudential operating requirements and retirement income standards such as those relating to contributions and the preservation of benefits within the superannuation system. As noted above, APRA supervision is a continuous process of risk assessment, supervision strategies and activities, and evaluation.

In assessing the compliance of trustees, APRA conducts a two-year on-site review cycle as well as ongoing monitoring, data collection and analysis and risk assessment. In relation to approved trustees of retail funds, APRA looks to the trustee's adherence with the requirements stipulated in its Instrument of Approval, data submitted annually by the trustee (including audited accounts) and the prudential management certificate submitted to APRA, in which the approved trustee attests to its compliance with requirements. Approved trustees that are not compliant risk having their approvals revoked.

In monitoring the operations of superannuation funds, APRA uses information from a variety of sources including the trust deed; returns lodged with APRA; audited accounts that detail relevant financial and legislative compliance; PAIRS assessments;³ media comment and professional advice. Also examined are the effectiveness and competency of the trustees and their operating structures, outsourcing arrangements and investment management.

With the introduction of the proposed licensing reforms, supervision of these trustees and funds will also become much more risk management focused.

Compliance with governance rules

Where the trustee entity is a corporate entity, the trustee must comply with the Corporations Law administered by ASIC. In relation to compliance with the governing rules of the fund and the relevant legislation, APRA relies to a large extent on the annual independent audit of both the financial statements and compliance of the trustee with specific provisions of SIS and the Collection of Data Act. In moving to the new licensing regime in 2004, APRA will focus on trustee decision making processes within the risk management framework.

Contributions and regularity of payment

The Superannuation Guarantee scheme, which requires employers to provide a prescribed minimum level of superannuation support in each financial year to their employees (equivalent to nine percent of the employee's income), is administered by the ATO, and from 1 July 2003 these contributions must be paid at least quarterly. APRA has the power to direct the trustee of a regulated superannuation fund that has contravened a regulatory provision not to accept employer contributions⁴.

It is a strict liability offence for an employer not to remit voluntary employee contributions to the fund within a specific timeframe.

Part 7 of the SIS Regulations set out eligibility criteria in relation to persons in respect of whom contributions may be accepted. While these basically relate to age and employment status, contributions may also be accepted in relation to the spouse or partner, or eligible child, of a member.

There are no legislative restrictions on the regularity of payment of voluntary contributions, with many self-employed members making only annual contributions.

As with all retirement income policy measures that impact on fund operations (including in relation to membership and benefit payment requirements discussed below), APRA expects trustees to have robust processes and controls to ensure compliance with the law and to ensure beneficiary interests are safeguarded. APRA's supervision approach places emphasis on operational risk issues (including compliance risk) and the identification and management of such risks. While APRA relies to a large extent on the annual independent compliance audit, where member complaints have been recorded in

respect of operational issues, APRA's supervisory processes will include examination of fund systems and processes.

Membership and portability

While 'choice of fund' has been a policy of the current federal Government since 1996, there is not yet a comprehensive choice or portability scheme in place for members of superannuation funds in Australia. The rules of some company funds still require that benefits remain preserved within that fund despite a member changing employment, while more commonly benefits must be taken out of the fund when a member changes employment. Due to changes in employment and the trend for many people to have several part time jobs at any one time, there is a trend for people to have several superannuation accounts. The Government has released draft 'portability' regulations that will, if agreed, permit members to roll over their benefits from one fund to another at specified times. There are also provisions for the "rolling over" of members' benefits into "eligible rollover funds" that are also regulated by APRA.⁵

Benefits eligibility conditions and access to benefits

The provisions covering these aspects are mainly located in Part 6 of the SIS Regulations and are the responsibility of APRA and the ATO (in respect of SMSFs). Part 5 of those Regulations also provide for the protection of members' benefits, particularly minimum benefits. The ATO also oversees the access of members to their superannuation benefits to the extent to which it relates to income tax matters. A member's benefits in a regulated superannuation fund may comprise preserved benefits, restricted non-preserved and unrestricted non-preserved benefits. On 1 July 1999 a new preservation regime commenced which deemed all contributions made by or on behalf of a member 'preserved' until the conditions of release are satisfied, including reaching a prescribed preservation age, retirement, death, permanent incapacity or temporary residents departing Australia permanently. Previously unpreserved amounts were 'grandfathered'.

Benefits are payable on permanent severance from the workforce, including on retirement, death after retirement, or permanent disability. Under certain circumstances, such as severe financial hardship or on specified compassionate grounds, limited amounts may be released to a member in advance of retirement, etc. However, requests for release of preserved benefits on grounds such as contributions made on the basis of bad or misleading advice, or lack of understanding of the law by the individual or other such reasons will not be acceded to by APRA.

Investments, asset allocation, performance

The SIS Act prescribes⁶ limits on in-house assets, prohibition on borrowing, sole purpose tests, and guidance on arms length investments. Trustees must formulate and give effect to an investment strategy that has regard to the whole of the entity's circumstances including risks involved in the investments chosen, the composition of the investments as a whole and the liquidity of the investments undertaken. Non-compliance with this requirement may give rise to a civil liability action. In addition, trustees must comply with other prudential requirements relating to its investment function generally. These include requirements for the trustee to appoint an investment manager in writing and ensure that the investment manager is a body corporate and is not a disqualified person. Trustees must also ensure that agreements made with the investment manager allow the trustee to obtain sufficient information about the investments, termination of the agreement without liability, and maintenance of proper records and accounts for investments for at least five years. Penalties may be imposed for a breach of these prudential requirements.

The legislation provides strict controls on the circumstances under which payments may be made out of a fund to an employer-sponsor.

There are no quantitative requirements in the SIS legislation relating to investment returns, that is, investment results are not guaranteed by the Government. Members with an account balance of less than AUD 1 000 are treated as 'protected members', that is, the quantum of administrative fees and charges that can be imposed on the member's balance must not exceed credited investment returns. This measure was designed to prevent erosion of small account balances at the start of the accumulation phase, and involves a degree of cross subsidisation by larger account holders. The provision is suspended during periods of poor investment returns.

Risk management

The risk management capability of an institution arises from the underlying governance, policies, practices, systems and controls established by the institution for the particular risks to which it may be exposed. Risk management is the process by which an institution identifies, measures, monitors and controls risk to ensure that:

- risks are recognised and understood;
- risks are within tolerances established by the board or senior management;

- risk-taking decisions are explicit, clear and consistent with strategic business objectives;
- expected return has been assessed as compensating for the risk taken; and
- capital allocation is consistent with risk exposures.

Currently, only approved trustees are required to produce a risk management plan for their fund operations however this is due to change over the next two years when the Federal Government introduces reforms that will require trustees to produce not only a risk management strategy for their trustee activities but also a risk management plan for each fund under trusteeship.

Custodian procedures

A custodian of a superannuation entity performs custodial functions in relation to the entity's assets under a contract with the entity's trustee or investment manager. A custodian under the SIS legislation must be a body corporate under SIS and meet capital requirements where relied on by an approved trustee that cannot, of itself, meet those capital requirements. APRA sets requirements for custodian agreements in its Instrument of Approval for approved trustees. However, the agreement itself is governed by contract law. If the trustee becomes aware of any problems with the custodian that jeopardise the safety of the assets of an entity or that indicate that the custodian can no longer be relied on to perform, in a proper manner, the duties of custodian of the assets of an entity, it must advise APRA in writing. The trustee must also notify APRA in writing at least 30 days prior to any change of custodian.

Checks on the performance of outsourcers

Trustees have ultimate fiduciary responsibility for the performance of the service providers they engage. Applicants for 'approved trustee' status are required in their application to provide information to APRA relating to the procedures that have been established to ensure that service providers to the relevant entities, delegates, and sub-contractors have appropriate qualifications, capacity and evidence of experience. They are also required to provide details regarding access to expert advice, and guidelines for determining the capacity, experience and qualifications of the expert. APRA will take this in to consideration as part of the applicant's overall capacity to act as an approved trustee. APRA has published a prudential standard relating to outsourcing which will be reflected in requirements for licensing of all superannuation trustees.

Financial, actuarial and accounting methods

Professional bodies determine the actuarial and accounting principles followed by their members in discharging their duties. APRA has the power to “approve” auditors and actuaries to carry out duties under the SIS Act. Actuaries and auditors must meet specified criteria, namely actuaries must be a Fellow or Accredited Member of the Institute of Actuaries of Australia and auditors must be a member of one of a number of specified organisations, and in addition, be approved by APRA or otherwise be registered company auditors.

Under Part 16 of the SIS Act, actuaries and auditors are also required to inform APRA when trustees breach their obligations under the SIS Act or are in an unsatisfactory financial position. APRA also has the power to refer an auditor/actuary for investigation by their respective professional bodies if it believes this individual has failed to adequately perform his/her duties under the superannuation legislation, or they are otherwise not a fit and proper person to be an approved auditor/actuary. For these same reasons, APRA can also disqualify a person from being an approved auditor/actuary.

Administrative cost, fees and marketing

ASIC supervises disclosure and market conduct as part of their oversight of reporting, disclosure and consumer protection under the Corporations Act 2001. In addition, member protection rules prohibit administration fees exceeding investment returns being charged on small accounts (accounts with a balance under AUD 1 000) except in periods of bad investment returns. In such periods member balances may be reduced if costs are apportioned in a fair and equitable manner.

Disclosure requirements are set out in Annex VIII.4.

Merger and liquidation processes

APRA is responsible for oversight of winding-up of superannuation entities and transfer of members and assets to receiving funds. Successor fund provisions in the SIS Regulations provide for bulk transfer without individual member consent provided the successor fund offers equivalent rights and benefits. A wind-up return must be lodged with APRA when the transfer and wind-up process has been completed.

Vested rights

Compulsory employer contributions and member voluntary contributions vest immediately in the member. However, vesting scales still operate in some employer-sponsored funds in respect of employer contributions in excess of the 9% required under the Superannuation Guarantee regime.

There are restrictions in SIS Regulation 13.16 on adverse alteration of accrued benefits. Exceptions relate to alteration may be made in compliance with tax laws or, in the case of marriage breakdown, with property settlements made in accordance with Family Law legislation. APRA may also agree to an adverse alteration of accrued benefits if two thirds of beneficiaries have agreed to an alteration that does not reduce minimum benefits, or if the alteration relates to rectification of an error that had permitted an advantageous alteration to a member's benefit

Supervisory examination

Data collection instruments and techniques – annual returns

The primary means by which the Regulators can review the management and operations of a superannuation entity is through analysis of the annual return and auditor's report that are lodged with APRA by the entity, complemented by on-site review. In particular, the returns can assist in the examination of whether the entity has complied with the SIS Act requirements and the entity's overall investment strategy and performance. APRA regulated superannuation funds must send annual returns to APRA within four months after the end of each financial year. These returns are submitted electronically through APRA's D2A (direct to APRA) system. APRA is currently setting requirements for more thorough and relevant reporting criteria. Table VIII.3 at Attachment E sets out the information to be contained in the returns for each type of fund, to apply in respect of the year ending 30 June 2004 onwards. Funds with a threshold asset value of AUD 60M also lodge quarterly, unaudited, statistical returns.

Financial Risk Analysis Methodology

APRA uses a risk based assessment approach in performing its supervision responsibilities. To support the risk assessment task, APRA has introduced PAIRS, or Probability and Impact Rating System (PAIRS). This is APRA's central risk assessment model, and applies to roughly 3 000 regulated entities.

In PAIRS, two estimates are created: the probability of failure, over a five-year time horizon, and the impact of entity failure should it occur. Failure impact is relatively straightforward, as it is based upon entity size. Failure probability is exceedingly difficult, and there is a major global industry centered on debt rating agencies trying to improve the state of the art.

APRA's PAIRS analysis starts with a structured risk assessment, and an assessment of an entity's ability to manage risk. These two factors generate a net risk assessment, which is then compared to the entity capital position to determine an overall probability of failure.

The major risk mitigants include a strong board and executive management supported by good corporate governance arrangements, internal compliance supported by independent audit, and good technical risk management particularly in determining liabilities and setting investment management guidelines.

Once APRA has established a PAIRS grid position for an entity, the risk and likely impact of failure has been estimated. Then the appropriate supervisory stance to take with an entity is determined. APRA's Supervisory Oversight and Response System (SOARS) is APRA's core tool to determine its supervisory strategy with each regulated entity.

There are four supervisory stances in SOARS. Normal entities are subject to routine information gathering from statistical returns and onsite visits. Oversight entities are not at material risk of failure, but some aspect of their risk position requires more extensive examination by APRA. Typical supervisory responses to oversight entities include more frequent and searching visits, more robust communication with the entity management and board, and possibly adjustments to minimum capital ratios. Some regulated entities follow business plans that mean that the best supervisory stance they can achieve is oversight. These entities have elected to accept more intensive APRA supervision, in order to pursue higher risk but hopefully higher return shareholder outcomes.

Mandated improvement entities lie outside APRA's tolerable risk range. Mandated improvement entities are unlikely to fail; typically, the split between medium and high risk, for example, is a 97% probability on expected five year performance.

APRA intervenes vigorously in mandated improvement entities, particularly by issuing directions or accepting enforceable undertakings to improve some aspect of the entity's risk position.

Finally, come restructure entities. These entities have lost APRA's confidence, and APRA looks to transfer the business to stronger hands while protecting beneficiaries from any potential losses.

APRA's supervisory strategy is based upon PAIRS and SOARS. Supervision starts with information flowing to supervisors. APRA's data sources include statistical returns, on site visits, actuarial and audit reports, external ratings reports, and informal sources such as the media and whistle blowers.

Out of this range of data APRA's supervisors apply their professional judgment and experience to develop a PAIRS grid position. The PAIRS position is fed to SOARS. The SOARS supervisory stances are set by APRA senior management, and are the explicit embodiment of APRA's institutional will to increase intervention as it observes worsening risk prospects for a regulated entity.

The SOARS stance then feeds back to the supervisor, who crafts and executes a supervisory action plan. It is important to understand that there is a duality here for APRA's supervisory cadre. Supervisors drive PAIRS, but are driven by SOARS. APRA follows this approach to achieve a good balance between supervisor independent judgment and the need for consistent and effective supervisory intervention across the regulated financial sector.

PAIRS and SOARS were introduced in October 2002. Over 70% of the budget APRA supervises has been rated in the system, but it will require about two years to process all 3 000 regulated entities into the new setup. Diagrams in Annex VIII.5 illustrate the PAIRS/SOARS process.

On site visits and inspections

APRA's risk-based supervision framework is a continuous cycle comprising four main components: analysis of risk exposure and risk management, assessment and supervision.

Underpinning the framework is an assessment of the capability of an institution to manage the risks to which it is exposed. This overall assessment of an institution's risk profile (risk assessment) will drive the development of an effective supervision strategy and appropriate supervisory actions. The framework promotes the concentration of resources more precisely on those institutions that exhibit greater risk and subsequently require more intensive supervision. As a result of undertaking such supervision actions APRA will be in a position to assess, on an on-going basis, the capability of an institution to manage the risks to which it is exposed.

The supervision strategy for each institution is designed to project the frequency and intensity of supervision required to attend to the issues identified by our risk assessment processes and varies based on the institution's overall risk profile.

Under normal circumstances, APRA sets a program of on-site visits and inspections on a two yearly basis. Where the Supervisory Attention Index indicates other than normal, the frequency of visits will be increased.

Allocation of time and resources

As noted above, the determination of APRA's supervisory stance and allocation of resources is based on the Probability Rating and Impact Rating for each rated institution.

APRA has four supervisory stances: Normal, Oversight, Mandated Improvement and Restructure. A Normal mode means APRA collects and analyses data and makes routine on-site visits. Oversight' means a significant step-up in information collection and inspection intensity. APRA may increase minimum capital requirements for 'Oversight' institutions. Mandated Improvement means the institution is operating in an unsustainable way. APRA will direct these institutions to present and execute a remediation plan that addresses the area of identified weakness and restores financial stability. At this level, APRA allows the regulated institution to retain control of its destiny, but clearly signals that improvements must be made. APRA may issue directions and take other enforcement actions at this level. Restructure institutions are in serious danger of failure. Here, APRA applies its full enforcement powers, including issuing directions to replace persons and service providers and to restrict business activities. APRA's paramount concern in this situation is to quarantine the entity from further deterioration and minimise losses to depositors, policyholders and superannuation fund members.

Number of on-site inspections in the last three years

On-site visits and inspections to, and meetings and consultations in respect of, superannuation entities have increased over the past three years as set out below:

1999-2000	333
2000-2001	622
2001-2002	1 073

Whistle blowing

If an auditor or actuary forms the opinion that there has been a breach of any SIS or regulatory provision, the legislation requires that the auditor or actuary must inform the trustee in writing of the matter. In addition, the auditor or actuary is required to notify the Regulatory in writing if the trustee fails to comply with the auditor or actuary's request for a written report about how the trustee intends to rectify the matter or if the actuary or auditor is dissatisfied with the action taken by the trustee to rectify the matter.

Member / beneficiary complaints

Trustees must establish arrangements for dealing with inquiries or complaints that enable them to be considered and dealt with within 90 days after being made. Only after a complaint has been dealt with by the trustee can an unsatisfied complainant refer the matter to the independent Superannuation Complaints Tribunal. ASIC administers the complaints and inquiries processes; however APRA will take up with a trustee any indication that there are trustee processes that give rise to other than isolated complaints.

Promotion of prudent management

In addition to regulatory requirements, APRA publishes circulars and guidelines to promote prudent management of superannuation entities. These publications are available on the APRA website.

Monitoring of provision of adequate information to members

Member disclosure responsibilities are administered by the Corporations Act 2001 and fall under ASIC jurisdiction.

Compliance enforcement and sanctioning

Main irregularities observed during on-site and off-site supervision and what are the applicable fines, other penalties and enforcement procedures

Main irregularities observed during on-site visits are operational risks and poor risk management practices. Examples of material operational risks usually found on-site include administration risk (risk of error or failure associated with the human administration aspects of the operation of the business); governance risk (risk associated with the board and / or senior management of an institution not effectively performing their respective roles); outsourcing and agency risk (risk arising from poorly drafted, executed and monitored arrangements with

external service providers) and strategic risk (risk which arises from an institution's inability to implement appropriate business plans and strategies, make decisions, allocate resources or adapt to changes in its business environment).

Main irregularities observed off-site are usually increases in financial risks, and are determined by the types of products and services offered by an institution. Funds offering market linked investment products (such as accumulation superannuation) usually demonstrate irregularities linked to credit risk, asset concentration risk, pricing risk and liquidity risk. Those institutions offering assurance products (such as defined benefit superannuation funds and general insurers) usually exhibit irregularities related to liability concentration risk, liability valuation risk, liquidity risk and market risk.

Fines, other penalties and enforcement procedures are dependent on the legislation under which an institution operates. In extreme cases in the superannuation industry, APRA has the power to revoke an approved trustee's approval to operate retail superannuation funds, and may remove and replace a trustee. In less dire situations APRA may issue directions to a trustee to address the area of concern and monitor a rectification program.

APRA also has a dedicated "Rehabilitation and Enforcement" function which oversees institutions which represent a "high risk" and are classified as "mandated improvement" under the PAIRS process.

Reasons justifying an intervention in a pension fund or a pension fund trustee company

As noted above, APRA determines its supervisory stance based on the PAIRS rating for each institution. "Mandated Improvement" means the institution is operating in an unsustainable way and APRA will use its power to direct these institutions to present and execute a remediation plan that addresses the area of identified weakness and restores financial stability. Funds rated "Restructure" are regarded as in serious danger of failure. Here, APRA can apply its full enforcement powers, including issuing directions to replace persons and service providers and to restrict business activities, or even to direct the wind up of a fund.

The procedures for interventions

Internal procedures will vary depending on the type of intervention, however it is usual that a formal recommendation will be made by the responsible supervisor with the Executive General Manager and Senior Manager Legal

(usually) approving such action, with input often sought from external legal sources as well. Action is always based on a PAIRS assessment and cost/benefit analysis of potential enforcement actions and impact on beneficiaries.

APRA must obtain the Minister’s consent in advance in regard to actions such as revoking an approval to operate a retail fund or suspending or removing a trustee. It is also common for ASIC to be informed about such action due to requirements under the MOU.

Table VIII.4. Sanction by type in the last three years

Enforcement Action	Scope	Application (administrative, court procedures, other public authorities)	When required	Number of sanctions in last three years
Administrative remedies	Show cause letter issues	Administrative	After trustee warnings & education have failed to produce a satisfactory result and before APRA takes action that may adversely affect trustees	22
	Follow up delayed contributions	Administrative & other public bodies (ATO)	Delay of contributions	72
Punitive / compensatory sanctions	Disqualify auditor / refer to industry body	Administrative, other public authorities	When SIS obligations have been breached by auditor	4
Enforcement Action	Scope	Application (administrative, court procedures, other public authorities)	When required	Number of sanctions in last 3 years

Enforcement Action	Scope	Application (administrative, court procedures, other public authorities)	When required	Number of sanctions in last three years
Intervention procedures	Replace trustees	Administrative, court	Where appropriate; usually a last resort but may be immediate in cases of fraud	9
	Investigator / liquidator / inspector appointed	procedures, other public authorities		7
Referrals to other bodies	Police /ASIC / Director of Public Prosecutions		Breaches of sections of the SIS Act with criminal penalties	24
	ATO	Administrative / other public authorities	Matters involving self managed superannuation funds; Matters involving breaches of superannuation guarantee obligations by employers	18
Other	Education, Issued notices, directions, enforceable undertakings obtained from institutions	Administrative, Court procedures if breached	Preliminary action to give trustees opportunity to rectify deficiencies and issues before resorting to more strict enforcement.	32

Conclusion

The main issues for supervision of superannuation entities over the coming year that APRA intends to concentrate its focus and resources include:

- continuing refinement of the PAIRS risk assessment process;
- introduction of the new annual reporting requirements for all superannuation entities regulated by APRA, and
- the implementation of proposed licensing of all trustees.

NOTES

1. *SIS Act* section 344.
2. <http://www.apra.gov.au/Superannuation/Forms-for-Superannuation-Entities.cfm>.
3. The Probability and Impact Rating System (PAIRS) is APRA's primary risk assessment tools for the institutions it regulates. A guide to APRA's use of PAIRS can be found at <http://www.apra.gov.au/PAIRS/home.cfm>.
4. Section 63 of the Superannuation Industry (Supervision) Act: <http://scaleplus.law.gov.au/html/pasteact/0/443/top.htm>.
5. See Part 24 of the *SIS Act*: <http://scaleplus.law.gov.au/html/pasteact/0/443/top.htm>.
6. See, for example, Part 8 of the *SIS Act*: <http://scaleplus.law.gov.au/html/pasteact/0/443/top.htm>.

Annex VIII.1.

Explanation of Some Terms Used to Describe Various Arrangements and Structures

Regulated superannuation funds

Regulated superannuation funds have a trustee that has elected to be regulated under the SIS Act. Trustees are either bodies corporate, or a group of individuals, or have the sole or primary purpose to provide old age pensions. A regulated superannuation fund cannot receive tax concessions unless it is a resident regulated fund. A regulated superannuation fund is established by governing rules in the form of a trust deed. The trust deed specifies who is allowed to make contributions to the fund and defines how those contributions are to be determined. The deed also specifies who is to receive benefits from the fund and the circumstances in which benefits are to be paid. Benefits may take the form of a lump sum, usually paid on or after retirement or termination of employment, or a pension usually payable from the time of retirement.

Public-offer superannuation funds

Public Offer funds are regulated superannuation funds that operate as retail funds which conduct their business by issuing interests to the public. They have at least one member who has joined the fund by his or her own choosing (*i.e.* the fund is not sponsored by an employer under an arrangement between the employer and the trustee). Other funds that do not have such members may elect to be public offer funds. Public offer funds include (but are not limited to) eligible rollover funds (ERFs – funds that must accept rolled over benefits from other funds) and master trusts (trusts that allow a large number of unconnected individuals and/or companies to operate under a single common trust deed). The trustee of a public offer fund must satisfy certain capital adequacy requirements and be approved by APRA.

Small APRA funds (SAFs)

SAFs are small regulated superannuation funds with an approved trustee and fewer than five members. SAFs are regulated by APRA and are exempted from certain SIS regulatory requirements.

Standard Employer-Sponsored Superannuation Funds

A standard employer-sponsored fund is a regulated superannuation fund that has at least one employer-sponsor who contributes to the fund either wholly or partly pursuant to an arrangement between itself and the trustee. Employers make contributions to the fund for the benefit of the employees who are eligible for membership of the fund. Employer-sponsored funds fall into two main groups, defined benefit funds and defined contribution or accumulation funds. Members of defined benefit funds are entitled on retirement or termination of employment to a benefit that is defined in relation to either a specified amount or the amount of the member's salary at a given time. Members of an accumulation fund are entitled to the total contributions made by the employer (and any voluntary contributions made by the employee) which have accumulated in the fund in respect of the member.

Approved Deposit Funds (ADFs)

An ADF is an approved rollover fund that can accept superannuation rollover payments made to a fund member after leaving employment with an employer but before age 65, however there are usually minimum entry contribution requirements. ADFs are required to have approved trustees. The purpose of an ADF is to receive, hold and invest certain types of rollovers until such amounts are withdrawn, the beneficiary reaches age 65 or when he dies.

Pooled Superannuation Trusts (PSTs)

PSTs are investment management trusts regulated under the SIS Act in which assets of a number of superannuation funds, ADFs and/or other PSTs are combined, invested and managed by a professional manager. A PST is required to have an approved trustee.

Public sector superannuation schemes

These types of superannuation funds provide benefits for government employees. They are established by or under law or under the authority of the Commonwealth, a State or Territory and may elect to be regulated under the *SIS Act*.

Some public sector superannuation schemes are not regulated under the *SIS Act*, but are instead subject to Commonwealth, State or Territory government supervision under their enabling Acts. These are referred to as exempt public superannuation schemes and are not regulated superannuation

funds under the SIS Act; however, a Heads of Government Agreement (HOGA) requires these funds to comply with the spirit of the SIS Act.

Retirement Savings Accounts (RSAs)

RSAs are capital-guaranteed, non-trust based superannuation accounts that are offered directly off the balance sheets of either life *companies* or Approved Deposit-taking Institutions (banks, credit unions, building societies). RSAs are governed by separate legislation (the *Retirement Savings Account Act 1997*).

Self-Managed Superannuation Funds (SMSFs)

SMSFs are regulated superannuation funds that have fewer than five members where all the members are trustees (and there are no other trustees that are not members) and therefore actively participate in the fund's management. SMSFs are supervised by the Australian Tax Office (not by the *prudential* regulator, APRA).

Annex VIII.2.

Divisional Structure of APRA

The two divisions of APRA most directly involved with the supervision of superannuation funds are Specialised Institutions Division (SID) and Diversified Institutions Division (DID). Both these divisions are responsible for assessing applications for approved trustee status, conducting risk assessments of entities as well as ongoing monitoring of their performance and compliance with regulatory requirements. APRA's Policy, Research and Consulting Division (PRC) provides support to the SID and DID frontline supervisors.

SID

Supervisors and analysts in this Division work in small teams with responsibility for a wide range of institutions including superannuation funds and approved trustees. In addition to ongoing review of institutions, SID analysts undertake on-site visits of every regulated superannuation fund on average once every two years, although depending on the risk status of a superannuation fund, visits can be as frequent as biannually or triennially.

Located within SID is the Rehabilitation and Enforcement (R&E) branch of APRA. Institutions that are found to be in serious breach of their regulatory obligations or in a financially unsatisfactory condition are referred to R&E. It is the responsibility of R&E to assist troubled institutions to rectify their problems or to facilitate a smooth exit from the market.

DID

DID is responsible for the prudential supervision of more than 275 functionally diversified financial institutions, many with international connections. These include large financial conglomerates, banks, insurance companies and superannuation firms. Analysts conduct prudential and risk assessment duties on the institutions they are supervising. This involves off-site analysis of data and information, regular contact with senior people within the supervised institutions, as well as on-site reviews of those institutions. Research and analysis is also undertaken by analysts in the Technical Advice and Support (TAS) branch of DID.

PRC

Supporting SID and DID in their direct supervisory role is the PRC Division of APRA. PRC provides specialised risk management and consulting

services to the other divisions of APRA. It is also responsible for the development of prudential policies relating to the full spectrum of institutions supervised by APRA and for financial sector statistics. Substantial research activities are also conducted in this division.

PRC's Risk Analysis and Research group provides policy staff and front-line supervisors with high-quality advice and recommendations on supervisory issues, particularly those with a quantitative aspect.

PRC's Capital and Risk Analysis is responsible for the analysis of issues associated with risk measurement and capital allocation. The group has a key role to play in the development of improved capital adequacy requirements for supervised institutions, including the gradual harmonisation of risk measurement and capital allocation techniques across traditional industry boundaries.

The Actuarial Support Unit within PRC provides advice and guidance relating to actuarial issues which arise in the frontline supervision of insurers, friendly societies and superannuation funds e.g. analysing liabilities, providing commentary on financial reports. The unit also offers policy advice on actuarial matters relating to prudential standards.

PRC's Research Unit is responsible for a range of activities including publication of academic research papers and the development of APRA's library facilities. The main priority of the unit is to undertake high quality research into topics of relevance to APRA, its regulated industries, and the financial system more generally. After internal review, research work is usually published internally as a working paper and is often followed by external review and publication in refereed journals.

The Policy Development team within PRC develops policy proposals and advice, liaises with government agencies, other financial regulators (in Australia and overseas) and industry groups, and monitors regulatory and market developments in the financial sector.

The Consulting Services area comprises five risk-based teams responsible for credit risk, operational risk, insurance risk, risk modelling, and balance sheet and market risk. These teams support the operational divisions of APRA by assessing the policies and practises of financial institutions, usually through on-site visits. The teams undertake detailed analysis of these risks within individual institutions and provide advice to the institutions and the operational divisions.

Annex VIII.3.

APRA Key Result Areas and Key Performance Indicators

Key Result area	Prime objective	Prime Key Performance Indicators
Supervision	Minimise financial loss to depositors, policyholders and fund members through appropriate intervention	Performing entity ratio
		Money protection ratio
		Save ratio
		Number of institutional visits
		Number of institutions entering and leaving enforcement
Policy	Develop prudential policies, standards and guidelines for minimising losses to depositors, policy holders and fund members	Supervision ratio
		Risk by institutional ranking
		Statistical profile of institutions by number and value
		Policy development to plan
		Non-conformance to policy and legislation
Prudential advice	Maintain open communication and constructive relationships with stakeholders	Policy development time to total time
		Public and media understanding of prudential issues
		Expenditure on communication programs/plan
		Number of meetings with Minister and Treasury
		Number of meetings with industry, professional and consumer groups
Staff	Sufficient staff with skills, experience and knowledge that meet prime objectives and strategy	Call centre response times
		Number of staff to plan
		Staff turnover ratio
		Training per employee
		Prudential supervision experience
Infrastructure	Cost-effective infrastructure that fully supports the prime objectives	Activity by function and by industry
		Industry returns on time
		Levies collected to plan
		Operating and capital expenditure to

Key Result area	Prime objective	Prime Key Performance Indicators
Account-ability	with professional support services	budget Cash flow to plan Occupancy per employee IT performance to targets Number of control risks rated as high Number of audit issues open
	Assurance that objectives are met and risks are managed	Accumulated reserves / levies Level of compliance with Basel and IAIS Core Principles Full set of operational KPIs Quality metrics to be further developed

Annex VIII.4.

Disclosure Requirements

Trustees of a regulated superannuation fund must disclose information to members, former members and other persons such as prospective members in accordance with the product disclosure requirements in the Corporations Act 2001 which is administered by ASIC. The disclosure regime covers such things as the point of sale disclosure requirements, the periodic statements for retail clients, the periodic disclosure of fund information, the ongoing disclosure of material changes and significant events, and information requirements about complaints.

New members

New members of a regulated superannuation fund must be informed of the following matters with regard to the fund within three months of joining: its main features; its management and financial condition; and its investment performance.

Existing members

Disclosure of information to existing members is usually sent out in a member benefit statement. This statement is distributed within six months of the completion of the fund's accounting period, and must be sent at least once a year. The information provided must include:

- The contact details of the fund.
- Specific details of the withdrawal benefits and any eligible rollover fund details (an eligible rollover fund is a regulated superannuation fund which is eligible to receive lost or small benefits automatically rolled over from other funds).
- If applicable, disclosure of contributions and rolled over benefits.
- The fees, charges and expenses deducted.
- The employer contributions and unpaid contributions.

Members must also be informed of the occurrence of a "significant event", defined as any event in relation to the fund of which the trustees believe the member would reasonably expect to be informed. This information is generally required to be provided within three months, or within twelve months, if the event does not adversely affect the members. The members must in any case be

informed, within specified timeframes, in the three following specific instances of significant events:

- Changes to the governing rules which adversely affect the members.
- The transfer of members to a different category of membership or to a different fund.
- The receipt by the fund of a notice of non-compliance from APRA.

Members must upon request be provided with the following information within one month:

- The governing rules;
- The audited accounts.
- The latest actuarial report (where relevant) and the latest annual report of the fund.

ASIC is the government body responsible for all consumer protection matters in the financial services sector, particularly concerning product disclosure. ASIC thus plays the leading role in ensuring that consumers receive adequate information to make informed decisions about financial products.

All regulated superannuation funds (except for self managed superannuation funds) must appoint a contact person to receive enquiries and complaints from fund members. Relevant details for the contact person must be provided regularly to members by the trustee. Complaints should be dealt with in writing within 90 days of receipt, and when the fund advises complainants about the outcome of a complaint they must also be advised of the existence and function of the external Superannuation Complaints Tribunal (SCT).

The SCT is a statutory body established to deal with complaints about decisions of superannuation fund trustees that affect the rights and benefits of individual beneficiaries. Complaints may only be made on the grounds that the decision concerned is "unfair or unreasonable". The SCT tries to resolve complaints by conciliation or voluntary arbitration. A SCT decision may only be overturned on a question of law, by appeal to the Federal Court. The SCT cannot hear a complaint unless it has already been made to the trustees under the funds' internal complaints arrangements.

Departing members

Members who leave a regulated superannuation fund must be provided with the following information within one month of leaving:

- The contact details of the fund.
- Details of withdrawal benefits, death benefits and insurance continuation options.
- Details of the funds' internal complaints arrangements.
- Details of the functions of the Superannuation Complaints Tribunal.

Annex VIII.5.

Annual Reporting Requirements to Commence from 1 July 2003 Statistical and Compliance

Annual Report Information	Fund Type						
	Public Offer Funds	Eligible Rollover Funds	Small APRA Funds	Multi-member Approved Deposit Funds	Single member Approved Deposit Funds	Pooled Super-annuation Trusts	Other
General Fund/Trust and Trustee details							
External administrator details							
External investment manager details							
Custodian details				✓			
Other service providers' details (actuaries, lawyers, accountants, other advisers)							
Auditor details							
Duration of the year for which the fund was a public offer fund	✓						

Annual Report Information	Fund Type						
	Public Offer Funds	Eligible Rollover Funds	Small APRA Funds	Multi-member Approved Deposit Funds	Single member Approved Deposit Funds	Pooled Super-annuation Trusts	Other
Retirement benefits details	✓		✓				✓
Reserve details	✓						
Functional description of the fund	✓						✓
Membership details	✓	✓	✓	✓			✓
Fund/Trust income	✓	✓	✓	✓	✓	✓	✓
Fund/Trust expenditure	✓	✓	✓	✓	✓	✓	✓
Fund/Trust balance	✓	✓	✓	✓	✓	✓	✓
Fund/Trust assets	✓	✓	✓	✓	✓	✓	✓
In-house assets	✓		✓				✓
Derivatives	✓	✓		✓	✓	✓	✓
Liabilities	✓		✓				✓
Compliance details (SIS requirements satisfied?)	✓	✓	✓	✓	✓	✓	✓

Annual Report Information	Fund Type						
	Public Offer Funds	Eligible Rollover Funds	Small APRA Funds	Multi-member Approved Deposit Funds	Single member Approved Deposit Funds	Pooled Super-annuation Trusts	Other
Whether all investments are in individual policies of life insurance			✓				✓
<i>Prudential Details</i>							
Details on beneficiary choice	✓			✓			
External review details	✓			✓		✓	
Significant events ¹	✓			✓			
Change in computer systems	✓						
Status of solvency certificate (defined benefit funds only)	✓		✓				
Financial and compliance audit report	✓	✓	✓	✓	✓	✓	✓

1. A significant adverse effect is legally defined as one that endangers the ability to make scheduled payments to beneficiaries.

ANNEX VIII.6. PAIRS/SOARS

Probability and Impact Rating System (PAIRS) 

PROBABILITY RATING

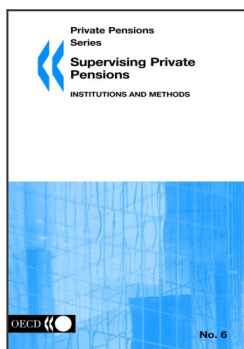
IMPACT RATING	LOW	MEDIUM	HIGH	EXTREME
Extreme	250	3750	18750	56250
High	50	750	3750	11250
Medium	10	150	750	2250
Low	1	15	75	225

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