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THE PARLIAMENT OF THE COMMONWEALTH OF AUSTRALIA

SENATE

FINANCIAL SECTOR LEGISLATION AMENDMENT (REVIEW OF
PRUDENTIAL DECISIONS) BILL 2008

EXPLANATORY MEMORANDUM

(Circulated by the authority of the
Minister for Superannuation and Corporate Law, Senator the Hon Nick Sherry)

Table of contents

Glossary	1
General outline and financial impact.....	3
Chapter 1 Court power of disqualification	5
Chapter 2 Direction powers	19
Chapter 3 Removal of ministerial consent	29
Chapter 4 Review of decisions	39

Glossary

The following abbreviations and acronyms are used throughout this explanatory memorandum.

<i>Abbreviation</i>	<i>Definition</i>
ADI	authorised deposit-taking institution
APRA	Australian Prudential Regulation Authority
ASIC	Australian Securities and Investments Commission
ATO	Australian Taxation Office
Banking Act	<i>Banking Act 1959</i>
Corporations Act	<i>Corporations Act 2001</i>
DMF and DOFI Act	Financial Sector Legislation Amendment (Discretionary Mutual Funds and Direct Offshore Foreign Insurers) Act 2007
FSCODA	<i>Financial Sector (Collection of Data) Act 2001</i>
Insurance Act	<i>Insurance Act 1973</i>
Life Act	<i>Life Insurance Act 1995</i>
NOHC	Non-Operating Holding Company
Prudential Acts	<i>Banking Act 1959, Insurance Act 1973, Life Insurance Act 1995, Superannuation Industry (Supervision) Act 1993</i>
<i>Rethinking Regulation: Report of the Taskforce on Reducing Regulatory Burdens on Business</i>	<i>Rethinking Regulation</i>
RPD Bill	Financial Sector Legislation Amendment (Review of Prudential Decisions) Bill 2008
RSA Act	<i>Retirement Savings Accounts Act 1997</i>
SIS Act	<i>Superannuation Industry (Supervision) Act 1993</i>
SMSF	self managed superannuation fund
SPR Act	Financial Sector Legislation Amendment (Simplifying Regulation and Review) Act 2007

General outline and financial impact

Overview

The Financial Sector Legislation Amendment (Review of Prudential Decisions) Bill 2008 (the Bill) amends the *Banking Act 1959* (Banking Act), *Insurance Act 1973* (Insurance Act), *Life Insurance Act 1995* (Life Act) and *Superannuation Industry (Supervision) Act 1993* (SIS Act) (collectively, the Prudential Acts), the *Retirement Savings Accounts Act 1997* (RSA Act) and the *Financial Sector Collection of Data Act 2001* (FSCODA), to improve the efficiency, transparency and consistency of the process for disqualifying individuals from operating financial sector entities and enhance the accountability of the regulator for administrative decision-making under the Prudential Acts, RSA Act and FSCODA.

The amendments introduce a court-based process for disqualifying an individual from operating an entity regulated by the Australian Prudential Regulation Authority (APRA), streamline APRA's directions powers where appropriate, and remove ministerial consent from, and expand the availability of merits review for appropriate administrative decisions made by the regulator under the Prudential Acts and FSCODA.

Court power of disqualification

Schedule 1 of the Bill amends each of the Prudential Acts to introduce a court-based process for disqualifying an individual from operating an APRA-regulated entity. The new regime is broadly consistent with the Court disqualification regime under the *Corporations Act 2001* (Corporations Act).

Date of effect: These amendments apply from the date of Royal Assent unless specified otherwise.

Proposals announced: Detailed proposals were released for public comment on 31 May 2007 in a paper entitled *Review of Prudential Decisions*.

Financial impact: The measures have no significant financial impact.

Compliance cost impact: Low. The measures simplify existing processes and affect a very small proportion of the financial community.

Directions powers, removal of ministerial consent and review of decisions

Schedule 2 of the Bill streamlines APRA's direction powers, currently scattered throughout the Banking Act, Insurance Act and Life Act, into a general directions provision under each of these Acts. Such directions, if triggered by certain conditions specified under the general directions provisions, are subject to merits review by the Administrative Appeal Tribunal (the AAT).

Schedule 3 of the Bill amends each of the Prudential Acts to remove ministerial consent from certain administrative decisions made by APRA or the Australian Taxation Office (the ATO) (in the case of self managed superannuation funds (SMSFs)) where wider policy interests are not involved.

Schedule 4 of the Bill amends each of the Prudential Acts to expand the availability of merits review for appropriate administrative decisions made by APRA or the ATO (in the case of SMSFs) consistent with the guidelines developed by the Administrative Review Council. Under the amendments, merits review will be available for licensing and authorisation-related decisions, decisions to ensure compliance with minimum prudential standards and certain directions decisions.

Date of effect: These amendments apply from the date of Royal Assent unless specified otherwise.

Proposals announced: The proposals were released for further public comment on 31 May 2007 in a paper entitled *Review of Prudential Decisions*.

Financial impact: The measures have no significant financial impact.

Compliance cost impact: Low. The measures will simplify existing regulatory powers and processes, and broaden access to the review of decisions. The measures will affect a small proportion of the financial community in practice.

1 Chapter 1

Court power of disqualification

Outline of chapter

.1 Schedule 1 of the Bill amends the *Banking Act 1959* (Banking Act), *Insurance Act 1973* (Insurance Act), *Life Insurance Act 1995* (Life Act), *Superannuation Industry (Supervision) Act 1993* (SIS Act) (collectively, the Prudential Acts) and the *Retirement Savings Accounts Act 1997* (RSA Act). The amendments replace the existing APRA-determined disqualification regime under each of the Prudential Acts and the RSA Act with a court-based disqualification regime, similar to the disqualification regime available to the Australian Securities and Investments Commission (ASIC) under the *Corporations Act 2001* (Corporations Act).

.2 The new disqualification regime will apply to responsible persons of APRA-regulated entities, including directors, senior managers, principle executive officers, auditors, actuaries, individual trustees where relevant to a Prudential Act, directors, secretaries and executive officers of a body corporate that is a trustee, investment manager or custodian of a regulated superannuation entity under the SIS Act, senior managers or agents in Australia for a foreign general insurer under the Insurance Act and approved auditors under the RSA Act.

.3 The new disqualification regime will not apply to responsible persons relating to self managed superannuation funds (SMSFs), regulated by the Australian Taxation Office (ATO).

Context of amendments

.4 Consistent with recommendation 5.4 of *Rethinking Regulation: Report of the Taskforce on Reducing Regulatory Burdens on Business (Rethinking Regulation)*, public comment was sought on the proposal to enhance the consistency and flexibility in the disqualification regime applying to individuals under the Prudential Acts, in a consultation paper *Streamlining Prudential Regulation: 'Response to Rethinking Regulation'* released on 4 December 2006.

.5 While industry submissions were generally supportive of enhancing the robustness and flexibility of the disqualification regime, concerns were also raised about inconsistencies between the APRA-determined disqualification regime under the Prudential Acts and the court-based disqualification regime under the Corporations Act.

.6 In light of industry comments, a court-based process for disqualifying individuals under APRA-administered legislation will be introduced, similar to the disqualification framework used by ASIC. Detailed proposals were canvassed in a paper *Review of Prudential Decisions*, which was released for public comment on 31 May 2007. Schedule 1 of the Bill gives effect to these proposals.

Summary of new law

.7 Schedule 1 of the Bill amends each of the Prudential Acts and the RSA Act to introduce a court-based disqualification regime that is similar to the regime available to ASIC under the Corporations Act.

.8 There are also miscellaneous amendments to the Prudential Acts to ensure APRA's powers to remove a responsible person on 'fit and proper' grounds are consistent with the new disqualification regime.

Comparison of key features of new law and current law

<i>New law</i>	<i>Current law</i>
Under the Prudential Acts, the Federal Court may disqualify an individual from being or acting as a responsible person for an APRA-regulated entity on 'fit and proper' grounds on application by APRA.	Under the Prudential Acts, the power to disqualify an individual from being or acting as a responsible person for an APRA-regulated entity on 'fit and proper' grounds rests with APRA.

<i>New law</i>	<i>Current law</i>
<p>The new disqualification regime applies to all responsible persons across APRA-regulated industries. Specifically, the Court may disqualify an individual on fit and proper grounds from being or acting as:</p> <ul style="list-style-type: none"> • a director, senior manager or auditor for an authorised deposit-taking institution (ADI) or an authorised none-operating holding company (NOHC) under the Banking Act; or • a director, senior manager, auditor and actuary for a general insurer, a senior manager or agent in Australia for a foreign general insurer, or a director or senior manager of an authorised NOHC under the Insurance Act; or • a director, principle executive officer, auditor or actuary for a registered life company under the Life Act; or • an individual trustee, auditor or actuary for a regulated superannuation entity other than a SMSF) under the SIS Act; or • a director, secretary or executive officer for a body corporate that is a trustee, investment manager or custodian of a regulated superannuation entity (other than a SMSF) under the SIS Act. 	<p>While APRA has the power to disqualify an individual on ‘fit and proper’ grounds under most Prudential Acts, such power is not consistent across industries. In particular, APRA does not have the power to disqualify on ‘fit and proper’ grounds:</p> <ul style="list-style-type: none"> • a director, principle executive officer, auditor or actuary under the Life Act; or • an auditor under the Banking Act; or • an actuary under the SIS Act.
<p>The Court may, on application by APRA, disqualify a person from being or acting as an approved auditor of an RSA provider under the RSA Act if it is satisfied that the person has failed to perform the required duties or functions or is otherwise not a fit and proper person.</p>	<p>Under the RSA Act, APRA is able to disqualify a person from being or acting as an approved auditor of an RSA provider if APRA is satisfied that the person has failed to perform the required duties or functions or is otherwise not a fit and proper person.</p>
<p>The Court may disqualify an individual from a position or positions in a specific entity, a class of entities or all entities for a period</p>	<p>An APRA-determined disqualification is permanent and prohibits a disqualified person from holding any responsible person</p>

<i>New law</i>	<i>Current law</i>
that the Court considers appropriate.	position from that industry.
A disqualification order by the Court is subject to the normal court-based appeals process. It is not subject to internal review by APRA or merits review by the AAT.	A disqualification decision is subject to internal review by APRA and merits review by the AAT.
Offence provisions for contravening a disqualification order by the Court are harmonised across the Prudential Acts and the RSA Act, largely based on the current arrangements under the Banking Act and Insurance Act. Offences of strict liability are introduced into the Life Act, RSA Act and SIS Act. Specific defence provisions are removed from the Banking Act and Insurance Act.	<p>Offence provisions for contravening an APRA disqualification order are inconsistent among the Prudential Acts and the RSA Act. In particular:</p> <ul style="list-style-type: none"> • the penalty level for a contravention is inconsistent across legislation; and • there is no strict liability offence in the Life Act, the RSA Act or offence provisions concerning a disqualified person acting as an investment manager or custodian of a superannuation entity under the SIS Act. <p>Specific defence provisions under the Banking Act and Insurance Act are redundant given the availability of a general defence (of mistake of fact) under the Criminal Code.</p>

Detailed explanation of new law

Part 1 Amendments commencing on Royal Assent

.1 The fit and proper criteria set out in APRA’s prudential standards and operating standards under the SIS Act seek to ensure individuals holding important positions in APRA-regulated entities have the appropriate expertise and experience and are of good fame and character. The disqualification regime in turn plays a critical role in ensuring that individuals who fail to meet these standards are prevented from operating a financial sector entity. Hence, it is important that the disqualification regime is robust and consistent across industries where appropriate.

.2 On the other hand, disqualification could have a significant reputational impact on an affected individual or entity. It is important that the disqualification process is transparent and efficient.

.3 In addition, as most APRA-regulated entities are also subject to regulation under the Corporations Act, it is preferable that the disqualification processes under the two regulatory frameworks are suitably aligned to ensure that the disqualification decisions are subject to a consistent level of scrutiny.

.4 Schedule 1 of the Bill introduces into each of the Prudential Acts and the RSA Act a court-based disqualification regime for responsible persons in relation to APRA-regulated entities and approved auditors for RSA providers, similar to the regime available to ASIC under the Corporations Act.

.5 Under the new regime, the Federal Court may, on application by APRA, disqualify an individual from being or acting as:

- a director, senior manager or auditor for an ADI or an authorised NOHC under *the Banking Act* (item 7 section 21); or
- a director, senior manager, auditor or actuary for a general insurer or a senior manager or agent in Australia for a foreign general insurer or a director or senior manager of an authorised NOHC under *the Insurance Act* (item 13 section 25A and item 17 section 44); or
- a director, principal executive officer, appointed actuary or auditor for a registered life insurance company under *the Life Act* (item 33 section 245A); or
- an approved auditor of an RSA provider under *the RSA Act* (item 38 section 67); or
- an individual trustee of a superannuation entity (other than a SMSF), a director, secretary or executive officer of a body corporate that is a trustee, investment manager or custodian of a superannuation entity (other than a SMSF), or an auditor or actuary of a superannuation entity (other than SMSF) under *the SIS Act* (item 57 section 126H and item 61 section 130D).

.6 The new regime allows a greater level of flexibility with regard to the nature of a disqualification. In particular, the Court has discretion to disqualify a person from holding a position or positions within an entity, a class of entities or all entities for a period that it considers appropriate in the circumstances under all Prudential Acts and the RSA Act.

.7 The Court may also subsequently revoke or vary a disqualification order if it sees fit to do so (item 7 section 22 of the Banking Act, item 13 section 26 of the Insurance Act, item 17 section 45 of the Insurance Act, item 33 section 245B of the Life Act, item 38 section 67A of the RSA Act, item 57 section 126J and item 61 section 130E of the SIS Act).

.8 Items 2-3, 10, 17 (section 43A of the Insurance Act), 32, 38 (section 67B of the RSA Act), 57 (section 126K of the SIS Act) and 67 (section 131C of the SIS Act) harmonise the offence provisions for contravening a disqualification order under the Prudential Acts and the RSA Act, based on the current arrangements in the Banking Act and Insurance Act. These amendments also seek to ensure that the offence provisions are compatible with the new disqualification regime, where it has been expanded to include auditors of ADIs, actuaries of superannuation entities and responsible persons of life companies, and to reflect that a person may be disqualified from any position or positions of a specific entity, a class of entities or all entities.

.9 Under the harmonised offence provisions, a person commits an offence if the person acts in a role from which the person has been disqualified. A person who contravenes this provision is subject to a fault-based offence that carries a penalty of imprisonment for two years or a strict liability offence of 60 penalty units.

.10 In addition, under the Prudential Acts, a body corporate commits an offence if the body corporate allows a disqualified person to act in a role from which the person has been disqualified. The penalty is 250 penalty units or 60 penalty units for a strict liability offence.

.11 Offences of strict liability do not require proof of a mental element. They are offences for non-compliance with basic regulatory requirements that should be complied by all persons. The use of offences of strict liability is designed to enhance the effectiveness of the enforcement regime in deterring contraventions of key prudential requirements.

.12 Items 4, 10 and 32 repeal from the Banking Act, Insurance Act and Life Act the subsections that provide a specific defence in a prosecution where the body corporate contacted APRA before allowing the person to act as a responsible officer and was incorrectly advised by APRA that the person was not disqualified. These specific provisions are redundant as a more general defence (of mistake of fact) can be claimed under the Criminal Code.

.13 The court-based disqualification regime will not apply to responsible persons in relation to SMSFs which are regulated by the ATO. Items 54 (section 126A), 62 and 63 retain the current power of the Commissioner of Taxation to disqualify an individual from being or acting as a

responsible person relating to a SMSF. In addition, the amendments also extend the disqualification power of the Commissioner of Taxation to include actuaries of a SMSF.

Application and transitional provisions

.14 The amendments made under part 1 of Schedule 1 (items 1-70) apply from the date of Royal Assent.

.15 Item 34 clarifies that the disqualification power introduced into the Life Act under item 33 applies in relation to conduct that has occurred before or after the commencement of section 245A. This is to ensure all conduct that may warrant a disqualification is captured under the new law, consistent with arrangements under the other Prudential Acts.

.16 Transitional measures are introduced into the Banking Act (item 9), Insurance Act (item 21), RSA Act (item 40) and SIS Act (item 70) to allow existing disqualifications by APRA and subsequent determinations to vary or revoke such disqualifications by APRA or the AAT to continue in force after the date of Royal Assent. The transitional measures also allow the AAT to continue hearing cases that are still before it at the day of Royal Assent.

.17 These measures ensure a smooth and equitable transition from the current APRA-determined disqualification regime to the new court-based disqualification regime.

Consequential amendments

Part 1 Amendments commencing on Royal Assent

.18 Item 1 allows APRA to direct an ADI to remove a disqualified auditor under the Banking Act. This is a consequential amendment to item 7 which expands the disqualification regime to auditors of ADIs. APRA currently has power to direct an ADI to remove an auditor on fit and proper grounds which are similar to grounds for the Court to disqualify an auditor under the new court-based regime.

.19 Items 8, 14 and 68 amend the Banking Act, Insurance Act and the SIS Act to ensure that APRA is only able to remove a person from a position or positions that the person is disqualified from holding under these Acts. They are consequential amendments to items 7, 13 and 57 which introduce a more flexible court-based disqualification process into the

relevant Acts where an individual may be disqualified from holding a position or positions of a regulated entity, a class of regulated entities or all regulated entities.

.20 The items 15 and 16 ensure that references to disqualification are updated to reflect the introduction of the court-based disqualification process in the Insurance Act under items 13 and 17. In simple terms, references to APRA's determination that a person is disqualified will be replaced by references to a court-based disqualification order.

.21 Item 15 removes a reference to an APRA determination under section 44 and inserts a reference to a court order under section 44, to reflect the new court-based disqualification system.

.22 Item 16 amends the new subsection 43(1)(c) by replacing the reference to an APRA determination with a reference to a court order, to reflect the new court-based disqualification system.

.23 Items 18 and 19 amend subsection 48(1) and 48(2) so that APRA may issue a direction to remove the auditor or actuary if the person has been disqualified by a court under section 44.

.24 Item 64 of the SPR Act inserts a new subsection 48(4) which provides that APRA may direct the removal of the auditor or actuary whether or not APRA has disqualified the person. This provision is incorrect with the introduction of the court-based disqualification regime. Therefore, item 20 removes the new subsection 48(4).

.25 Items 5, 6, 11, and 12 replace references to 'APRA' with references to 'the Federal Court of Australia' under the Banking Act and Insurance Act as a result of the change from an APRA-determined disqualification regime to a court-based disqualification regime effected through items 7 and 13.

.26 Item 30 replaces the reference to 'this section' in subsection 245(1) of the Life Act with a reference of 'this Act' to account for the introduction of a new section concerning the Court power to disqualify a person on fit and proper grounds through item 33.

.27 Item 28 inserts a new power for APRA to direct the removal of the auditor or actuary of a life company. This is modelled on similar directions powers currently found in the Banking Act and SIS Act. The SPR Act inserts this directions power under the Insurance Act. The SPR Act was the main vehicle to make such directions powers consistent across the four Prudential Acts, as such it is only appropriate to give APRA this directions power. The SPR Act removes section 125A, and so this section number can be re-used here.

.28 Item 29 makes directions issued under the new section 125A subject to merits review, by adding a new paragraph (za) under subsection 236(1) of the Life Act.

.29 Item 31 adds a reference to a court-ordered disqualification to the definition of a disqualified person under subsection 245(1) of the Life Act, also consequential to item 33.

.30 The SPR Act, removes the requirement under the Life Act for APRA to approve the appointment of the auditor and actuary of a life company, and remove APRA's power to revoke its approval of the auditor and actuary. A life company would be required to notify APRA when it appoints the auditor or actuary, and instead of revoking its approval of a person, the SPR Act gives APRA the powers to declare an individual 'ineligible' to be appointed as the auditor or actuary of a life company.

.31 Under the RPD Bill, APRA's power to apply to the court to disqualify the auditor or actuary of a life company replaces APRA's power to make 'ineligibility' declarations. Therefore, items 24 and 27 remove APRA's power to make these declarations, by repealing the sections 86 (relating to auditors) and 94A (relating to actuaries) inserted by the SPR Bill. References to APRA's 'ineligibility' declarations need to be replaced with reference to disqualification orders made by the court under the new section 245A.

.32 Items 22, 23, 25 and 26 replace references to APRA's 'ineligibility' declarations with reference to the new disqualification orders made by the court in paragraphs 84(b) and 85(1)(c), in relation to auditors, and paragraphs 93(3)(b) and 94(1)(c), in relation to actuaries, respectively

.33 Item 41 updates the definition of approved auditor in subsection 10(1) of the SIS Act by inserting an exclusion for auditors who have been disqualified by the Court under the new section 130D. This amendment is consequential to the introduction of a Court power to disqualify an auditor of an APRA-regulated superannuation entity under item 61. Item 42 ensures updating the definition of approved auditor under item 41 does not unduly affect the continuity of any regulations made for the purposes of that definition.

.34 In addition, items 41 and 47 together ensure the definition of an approved auditor under the SIS Act reflect the more flexible court-based disqualification regime introduced under item 61 where an individual may be disqualified from being or acting as an auditor for a regulated superannuation entity, a class of regulated superannuation entities or all regulated superannuation entities.

.35 Similarly, items 35 and 37 respectively amend section 16 and subsection 65(1) of the RSA Act in relation to the definition of approved auditor to reflect the enhanced level of flexibility in the new court-based disqualification regime where the Court may disqualify a person from being or acting as an auditor for a particular RSA provider, a class of RSA providers or any RSA provider.

.36 Item 36 removes references to current disqualification provisions from the list of reviewable decisions set out in section 16 of the RSA Act, as a disqualification order by the Court under the new regime is not subject to merits review. These amendments are consequential amendments to item 38 which introduces the court-based disqualification regime into the RSA Act.

.37 Item 39 amends subsection 68(3) of the RSA Act to replace the reference to an APRA disqualification with a reference to the new court-ordered disqualification made under a new section 67, introduced through item 38.

.38 Items 43, 44, 45 and 69 update the definition of reviewable decision under subsections 10(1) and 344(12) of the SIS Act to make clear that a disqualification order made by the Court is not a reviewable decision, whilst a disqualification decision made by the Commissioner of Taxation continues to be a reviewable decision. These amendments are consequential to item 54, which preserves the power of the Commissioner of Taxation to disqualify a responsible person in relation to a SMSF, and item 57 to introduce a court power to disqualify a responsible person in relation to an APRA-regulated superannuation entity.

.39 Item 46 is consequential to item 61 and ensures that persons disqualified under the new section 130D cannot act as the approved auditor of a superannuation entity, for the purposes of their annual audit of the entity's operations.

.40 Item 8, Schedule 3 of the SPR Act inserts a new requirement that, each year, the trustee must appoint an approved auditor to provide a report of the operations of the entity and the RSE licensee of the entity (if any). Item 47 inserts a new subsection 113(1AA) to ensure that a person who has been disqualified from acting as the entity's auditor under new section 130D cannot be the approved auditor.

.41 Item 49 amends subsection 120(1)(c) to ensure the definition of a disqualified person includes individuals disqualified by both the Commissioner of Taxation and the Court. This amendment is consequential to amendments under item 54 (section 126A), preserving the power of the Commissioner of Taxation to disqualify a responsible person in relation to a SMSF and items 57(section 126H) and 61 (section

130D) to introduce a Court power to disqualify a responsible person in relation to an APRA-regulated superannuation entity.

.42 Items 50 and 51 amend section 120 of the SIS Act to ensure the arrangements for automatically disqualifying a body corporate are compatible with the court-based disqualification regime which provides flexibility for an individual to be disqualified from holding a position or positions within a regulated entity, a class of regulated entities or all regulated entities. These amendments are consequential amendments to item 57 which introduces a more flexible court-based disqualification regime.

.43 Item 52 repeals section 120A of the SIS Act which has been replaced by an ATO disqualification power and a court disqualification power through amendments under items 54 and 57.

.44 Item 52 also repeals section 121 of the SIS Act as these offence arrangements are now set out in section 126K, introduced under item 57.

.45 Item 54 repeals sections 126 and 126A of the SIS Act which prohibit a disqualified person from acting as investment managers or custodians. These prohibitions are now set out in the new section 126H of the SIS Act, introduced through item 57.

.46 Items 48, 53, 58, 59, 60 and 64 insert titles for relevant divisions and subdivisions applicable to the new disqualification framework under the SIS Act. These are consequential amendments to items 54 and 57 which establish the new disqualification framework.

.47 Item 55 repeals subsection 126D(1) of the SIS Act which sets out APRA's power to waive a person's disqualification status. Under the new regime introduced under items 57 (section 126H) and 61 (section 130D), such power rests with the Court.

.48 Item 56 is a consequential amendment to item 54 (section 126A) which introduces a separate division to retain the ATO's disqualification power with respect to SMSFs under the SIS Act. Item 56 retains the ATO's power to waive a person's disqualification status under subsection 126D(1A), while replacing the reference to 'the Commissioner of Taxation' with a reference to 'the Regulator' so that references to the Regulator are consistent through out that division.

.49 Item 65 replaces the reference to the current subsection 131(1) of the SIS Act which sets out the Regulator's power to disqualify an auditor with a reference to the new section 130D, which allows the Court to disqualify an auditor or actuary in relation to an APRA-regulated superannuation entity, and section 131, which allows the Commissioner of Taxation to

disqualify an auditor or actuary in relation to a SMSF. This is a consequential amendment to items 54, 57, 62 and 63, which set out the Court disqualification regime and the Regulator disqualification regime respectively.

.50 As the SPR Act already inserted a new section 131AA in the SIS Act, item 66 simply replaces the reference to section 131 in paragraph 131AA(2)(a) with a reference to section 130.

.51 Item 61 amends the heading of Division 3 of Part 16, to reflect the new disqualification regime under the RPD Bill as well as APRA's new power to direct the removal of auditors and actuaries under the SPR Act.

Part 2 Amendments contingent on the *Financial Sector Legislation Amendment (Discretionary Mutual Funds and Direct Offshore Foreign Insurers) Act 2007*

Insurance Act

Items 71 to 83

.52 In the DMF and DOFI Act, items 9A to 9G of Schedule 2 amend sections 24 to 26 of the Insurance Act to add the concept of a 'corporate agent' of a direct foreign insurer. As the RPD Bill also amends sections 24 to 26, it is necessary to ensure that changes made by both pieces of legislation are captured in the final version of the Insurance Act.

.53 Items 71 to 83 implement these changes based on two contingencies. The first is that Schedule 2 of the DMF and DOFI Act commences before the RPD Bill; the second is that the RPD Bill commences before Schedule 2 of the DMF and DOFI Act.

Schedule 2 of the DMF and DOFI Act commences before the RPD Bill

.54 The first contingency is dealt with by items 72 to 83. Items 9A to 9G in Schedule 2 of the DMF and DOFI Act would have amended sections 24, 25, 25A and 26 of the Insurance Act by adding the concept of 'corporate agents'. These changes affect subsections 24(1), 24(4), 25(1), 25A(1), 25A(5), 26(6) and 26(8).

.55 When the RPD Bill commences, item 10 of the RPD Bill would repeal subsections 24(1) to 24(7) of the Insurance Act and insert new subsections 24(1) to 24(6) that do not contain references to 'corporate agents'. Item 11 of the RPD Bill would amend subsection 25(1) without inserting a reference to corporate agents. Item 13 of the RPD Bill would repeal sections 25A and 26 and insert new sections 25A and 26 that do not

refer to corporate agents. To ensure that the changes in Schedule 2 of the DMF and DOFI Act are still captured in the Insurance Act, it would be necessary to add references to 'corporate agents' in the new sections 24, 25 and 25A (the new section 26 does not need to refer to corporate agents). This is done by items 72 to 82 in Part 2 of Schedule 1.

.56 Items 9H to 9V of Schedule 2 of the DMF and DOFI Act amends section 27 of the Insurance Act by adding the concept of 'corporate agents'. When the RPD Bill commences, item 14 would repeal paragraph 27(2)(a) and insert a new paragraph 27(2)(a) into the Insurance Act that does not contain a reference to corporate agents. Item 83 of the RPD Bill would also add a reference to 'corporate agents' to the new paragraph 27(2)(a), so as to ensure that it is consistent with the other subsections in section 27.

.57 Items 72 to 83 would commence when both the RPD Bill and DMF and DOFI Act have commenced, whichever is later.

RPD Bill commences before Schedule 2 of the DMF and DOFI Act

.58 In the second contingency, where the RPD Bill commences before Schedule 2 of the DMF and DOFI Act, item 71 would be triggered as well as items 72 to 83.

.59 As described above, before Schedule 2 of the DMF and DOFI Act commences, items 10, 11 and 13 of the RPD Bill would repeal and replace the old subsections 24(1), 24(4), 25A(1) and 25A(5).

.60 As a result, items 9A to 9G of Schedule 2 of the DMF and DOFI Act would be 'misdescribed amendments' and would not insert references to 'corporate agents' in sections 24 to 26 as intended. In this circumstance, item 71 would remove these 'misdescribed amendments'. Items 72 to 83 would then insert references to 'corporate agents' in the new sections 24, 25A and 27(2)(a). This mechanism ensures that the policy intention of the DMF and DOFI Act is still given effect.

2 Chapter 2

Direction powers

Outline of chapter

.1 Schedule 2 of the Bill amends the *Banking Act 1959* (Banking Act), *Insurance Act 1973* (Insurance Act) and *Life Insurance Act 1995* (Life Act) to streamline APRA's specific direction powers, currently spread through these Acts, into a general directions provision under each of these Acts. Where appropriate, directions issued under the general directions provision are subject to merits review by the Administrative Appeals Tribunal (the AAT).

.2 Schedule 2 of the Bill also amends the *Superannuation Industry (Supervision) Act 1993* (SIS Act) to incorporate a materiality test into the trigger for APRA to issue a direction to freeze assets of a superannuation entity.

Context of amendments

.3 The Banking Act, Insurance Act and Life Act have evolved separately and in response to specific industry developments at different times. As a result, APRA's current direction powers are set out in different parts of these Acts. The triggers, thresholds and requirements for the exercise of these powers also vary considerably across legislation.

.4 In December 2006, a consultation paper *Streamlining Prudential Regulation: 'Response to Rethinking Regulation'*, was released in which it proposed to streamline APRA's specific direction powers into a general directions provision where appropriate, thereby removing unnecessary complexity and promoting consistency in APRA's directions regime.

.5 The proposal was further refined in light of industry comments and was released on 31 May 2007 for further public comment through a consultation paper *Review of Prudential Decisions*. The revised proposal specifies clearly the circumstances where an APRA direction is subject to merits review. The amendments in Schedule 2 of the Bill give effect to this proposal.

Summary of new law

.6 The amendments in Schedule 2 streamline APRA's specific direction powers currently spread through the Banking Act, Insurance Act and Life Act into a general directions provision under each of these Acts.

.7 An APRA direction issued under the general directions provisions is subject to merits review if it is issued as a result of certain triggers specified in that provision being invoked.

Comparison of key features of new law and current law

<i>New law</i>	<i>Current law</i>
<p>A harmonised general directions provision will replace the various specific powers for APRA to issue directions concerning entity-level activities under the Banking Act, Insurance Act and Life Act.</p> <p>The general directions provisions set out the triggers for APRA to issue a direction and specify what triggers, if invoked, will subject the resultant directions to merits review.</p>	<p>APRA's direction powers are set out in different parts of the Banking Act, Insurance Act and Life Act. The triggers, thresholds and requirements for the exercise of these powers vary considerably across legislation.</p> <p>Most of APRA's current direction decisions, particularly those triggered by entity-level factors, are not subject to merits review.</p>
<p>APRA or the ATO can only issue a direction to freeze a superannuation entity's assets if it appears to APRA or the ATO (as the case requires) that the entity's conduct is likely to adversely affect the values of the interests of beneficiaries to a significant extent.</p>	<p>APRA or the ATO (in the case of SMSFs) can issue a direction to freeze a superannuation entity's assets if it appears to APRA or the ATO (as the case requires) that the entity's conduct is likely to affect adversely the values of the interests of beneficiaries.</p>

Detailed explanation of new law

Part 1 Amendments commencing on Royal Assent

.1 Effective direction powers, allowing rapid and decisive action to deal with emerging prudential concerns and protect beneficiaries, promote confidence in the effectiveness of prudential supervision and the safety of financial sector entities.

.2 While APRA currently has a wide range of direction powers under the Banking Act, Insurance Act and Life Act, these powers are spread throughout each Act and, in some cases, are fragmented and inconsistent. The triggers, thresholds and requirements for the exercise of these powers vary considerably across the legislation. These make the directions regimes under these Acts unnecessarily complex and promote uncertainty as to their scope and application.

.3 Furthermore, direction powers are strong intervention tools, which could have a significant impact on affected entities or individuals. Accordingly, directions should be subject to appropriate review. Currently, the majority of APRA's direction powers, particularly those triggered by entity-level factors are not subject to merits review.

.4 In considering the review mechanism and scope for reviewing APRA's direction decisions, it is important to balance fair treatment for a person or entity affected by an APRA direction with ensuring that APRA can act decisively where it is necessary in the public interest. Broadly speaking, merits review should be made available for APRA directions that affect a specific individual or entity, except where failure by APRA to act immediately would materially prejudice the national interest, the interests of beneficiaries or the stability of Australia's financial system.

.5 Schedule 2 of the Bill streamlines and harmonises APRA's specific powers to issue directions triggered by entity-level activities into a general directions provision under the Banking Act, Insurance Act and Life Act.

Amendments to establish the general directions framework

.6 Item 1, item 12 and item 19 set out a harmonised set of triggers for APRA to issue a direction under the general directions provisions under the Banking Act, Insurance Act and Life Act respectively. These triggers are similar to the triggers currently set out in section 11CA of the Banking Act and section 230B of the Life Act and are summarised in Table 1 below.

Table 1: Triggers for APRA to issue a direction under the Banking Act, Insurance Act and Life Act

<p><i>Part A: Under the new general directions provisions, APRA is able to issue a direction, which is subject to merits review by the AAT, if it has reason to believe that:</i></p>
<ul style="list-style-type: none"> • the entity has contravened the relevant Prudential Act, FSCODA, a prudential regulation or prudential standard; or
<ul style="list-style-type: none"> • the entity is likely to contravene the relevant Prudential Act, FSCODA, a prudential regulation or prudential standard, and such a contravention is likely to give rise to a prudential risk; or
<ul style="list-style-type: none"> • the entity has contravened a condition or direction under the relevant Prudential Act or FSCODA; or
<ul style="list-style-type: none"> • the direction is necessary in the interests of depositors, policyholders or beneficiaries.
<p><i>Part B: Under the new general directions provision, APRA is able to issue a direction, which is not subject to merits review by the AAT, if it has reason to believe that:</i></p>
<ul style="list-style-type: none"> • the entity is, or is about to become, unable to meet its liabilities; or
<ul style="list-style-type: none"> • there is, or there might be, a material risk to the security of the entity's assets; or
<ul style="list-style-type: none"> • there has been, or there might be, a sudden material deterioration in the entity's financial condition; or
<ul style="list-style-type: none"> • the entity is conducting its affairs in an improper or financially unsound way; or
<ul style="list-style-type: none"> • the failure to issue a direction would materially prejudice the interests of the depositors, policyholders or beneficiaries; or
<ul style="list-style-type: none"> • the entity is conducting its affairs in a way that may cause or promote instability in the Australian financial system.

.1 As set out in Part A of Table 1 above, the amendments expand the availability of merits review for appropriate APRA directions. Application of merits review is set out in Schedule 2, item 12 subsection 104 (10) of the Insurance Act and Schedule 4 items 7 and 35 in relation to the Banking Act and Life Act.

.2 An APRA direction is not subject to merits review if it is issued because one of the triggers in Part B of Table 1 is invoked. Triggers in Part B contain appropriate materiality tests and are serious situations where failure by APRA to act immediately would materially prejudice the interests of depositors, policyholders or beneficiaries, or the stability of the Australian financial system.

.3 Item 1 subsection 1(1A), item 12 subsection 104 (2) and item 19 subsection 230B(1A) introduce a requirement into the Banking Act, Insurance Act and Life Act for APRA to specify the ground on which a direction is given in its written notice to the entity it directs. This requirement is designed to ensure the availability of merits review for that direction is made clear to the target of the direction, given that the availability of merits review for an APRA direction is dependent upon the trigger for the direction.

.4 Items 2, 20 and 22 address gaps in the general directions powers in the Banking Act and Life Act so that APRA is able to issue directions to comply with the whole or a part of the Banking Act or FSCODA a condition or direction issued under the respective Act or FSCODA, and relating to the amount of capital to be held by a life insurer. Item 12 (subsection 104(3)) sets out the types of directions that may be given under the general directions power under the Insurance Act. Collectively, these amendments harmonise the range of directions that APRA may give under the Banking Act, Insurance Act and Life Act and address some specific gaps. The range of directions that may be given by APRA as a result of the amendments are summarised in Table 2 below:

Table 2: The types of directions that APRA is able to issue under the Banking Act, Insurance Act and Life Act

<i>Under the new general directions provisions, when any of the triggers set out in Table 1 is satisfied, APRA is able to direct an entity:</i>
<ul style="list-style-type: none"> • to comply with the whole or a part of the relevant Prudential Act, FSCODA, a prudential regulation or prudential standard; or
<ul style="list-style-type: none"> • to comply with a condition or direction made under the relevant Prudential Act or the FSCODA; or
<ul style="list-style-type: none"> • to order an audit of the affairs of the entity, at the expense of the entity, by an auditor chosen by APRA; or
<ul style="list-style-type: none"> • if the entity is an insurer—to order an actuarial investigation of the affairs of the entity, at the expense of the entity, by an actuary chosen by APRA or
<ul style="list-style-type: none"> • to remove a director, senior manager, auditor or actuary (where relevant to the Act) from office; or
<ul style="list-style-type: none"> • to ensure a director or senior manager does not take part in the management or conduct of the business of the entity except as permitted by APRA; or
<ul style="list-style-type: none"> • to appoint a person or persons as a director, senior manager, auditor or actuary of the entity for such term as APRA directs; or
<ul style="list-style-type: none"> • to remove any auditor of the entity from office and appoint another auditor to hold office for such term as APRA directs; or
<ul style="list-style-type: none"> • if the entity is an insurer—to terminate the appointment of the actuary

<i>Under the new general directions provisions, when any of the triggers set out in Table 1 is satisfied, APRA is able to direct an entity:</i>
appointed by the entity and to appoint another actuary to hold office for such term as APRA directs; or
• not to give financial accommodation to any person; or
• if the entity is an insurer—not to issue any policy, undertake liability under any contract of insurance or accept any premium; or
• if the entity is an ADI—not to accept the deposit of any amount; or
• if the entity is a general insurer—not to renew any policy; or
• not to borrow any amount; or
• not to accept any payment on account of share capital, except payments in respect of calls that fell due before the direction was given; or
• not to repay any amount paid on shares; or
• not to pay a dividend on any shares; or
• if the entity is an insurer—not to discharge any policy or other liability; or
• if the entity is an ADI—not to repay any money on deposit or advance; or
• not to pay or transfer any amount to any person, or create an obligation (contingent or otherwise) to do so; or
• not to undertake any financial obligation (contingent or otherwise) on behalf of any other person; ¹ or
• if the entity is a general insurer—to provide, or further provide, in its accounts for the purposes of the relevant Prudential Act and prudential standards, a specified amount or an amount determined in a specified way in respect of its liabilities or the value of a specified asset of the entity; or
• if the entity is a life insurer—not to transfer any asset of a statutory fund; or
• if the entity is a life insurer—to do a specific act concerning the amount of capital held; or
• to do anything else as to the way in which the affairs of the entity are to be conducted or not conducted.

Amendments to the Insurance Act to harmonise general aspects of APRA’s directions powers

.1 As there is no comprehensive directions provision in the Insurance Act at present, amendments are also made to set out various general

¹ A direction not to pay or transfer any amount does not apply to the payment or transfer of money under an order of a court or a process of execution.

aspects of the operation of the general directions power under the Insurance Act, consistent with current arrangements under the Banking Act and Life Act. These amendments are contained in item 12, including:

- subsection 104(4) which allows the direction to be flexibly applied to part of the matters, a class or classes of the matters, or different matters referred to in the types of directions set out in Table 2;
- subsection 104(5) which allows a direction to specify a time period for it to be complied with;
- subsections 104(6) and (7) which require a body corporate or subsidiary to comply with a direction despite anything in its constitution or other contractual obligations;
- section 105 which sets out that a direction is not grounds for a denial of contractual obligations and that a party to a contract may apply to the Federal Court for an order relating to the effect on the contract of a direction;
- subsection 106(1) which allows APRA to publish notice of directions in *Gazette* and inform the Treasurer of a direction;
- subsection 106(2) which requires APRA to publish notice of revocation of a direction as soon as practicable;
- subsection 106(3) which requires APRA to provide information about a direction if the Treasurer so requires;
- subsection 106(4) which allows APRA to provide any information that it considers appropriate to the Treasurer about a direction or revocation of such a direction;
- subsection 106(5) which requires APRA to inform the Treasurer of the revocation of a direction if it previously informs the Treasurer about the making of the direction; and
- section 107 which sets out that information relating to directions and revocations of directions (other than Gazetted information) is subject to secrecy requirements under the APRA Act.

.2 Item 12 section 108 sets out penalties for non-compliance with a direction under the Insurance Act, consistent with current arrangements under the Banking Act and Life Act. Under section 108, it is an offence if

the entity contravenes a direction given to it by APRA, with the penalty being 50 penalty units and an offence of strict liability. Furthermore, an officer of a regulated entity would commit an offence if the officer fails to take reasonable steps to ensure that the entity complies with a direction given to it, with the penalty being 50 penalty units and an offence of strict liability.

.3 These offences are ones of strict liability because they are basic, objective requirements of APRA's prudential supervision functions, and should be complied with by all persons. Strict liability offences are necessary to ensure the integrity of the regulatory regime and do not require proof of a mental element. They are designed to enhance the effectiveness of the enforcement regime in deterring contraventions of key prudential requirements.

Other amendments to the Banking Act, Insurance Act and Life Act implementing the new general directions power

.4 Amendments are made to the Banking Act (item 4), Insurance Act (item 12) subsections 104 (8) and (9) to ensure APRA's power to vary or revoke a direction is explicit, consistent with current arrangements under the Life Act.

.5 Items 3, 5 and 21 remove references to 'secretary' and 'employee' in the Banking Act and Life Act directions powers. These items also replace references to 'executive officer' with references to 'senior manager' under these provisions. This ensures the directions power is targeted at individuals who, under the prudential Acts, are ascribed prudential functions, namely directors, senior managers and responsible persons.

.6 Items 5, 12 (subsection 104(11) of the Insurance Act) and 23 also define the terms 'senior manager', 'director' and 'affair of a body corporate' under the relevant general directions provisions to remove doubt about the scope and application of these powers.

Amendments to the SIS Act

.7 Item 26 introduces a materiality test into the trigger for APRA or the ATO to issue a direction to freeze a superannuation entity's assets under section 264 of the SIS Act. The amendment ensures that APRA or the ATO may issue such a direction only if the superannuation entity's conduct is likely to adversely affect the values of the interests of beneficiaries to a significant extent. This more properly reflects the circumstances in which such a direction should be given.

Application and transitional provisions

.8 The amendments made under part 1 of Schedule 2 (items 1-27) apply from the date of Royal Assent.

.9 In addition, item 6 clarifies that APRA's power to vary a direction under the Banking Act which is introduced through item 4 applies to any directions, whether given before or after item 4 commences. This is consistent with existing arrangements in the Life Act.

.10 Items 16 and 25 clarify that directions made before the date of Royal Assent under the specific directions provisions (sections 36, 49M, 49N, 51, 62 of the Insurance Act and sections 134 and 150 of the Life Act) continue in force as if they were given under section 104 of the Insurance Act and section 230B of the Life Act after the date of Royal Assent.

.11 Item 27 makes explicit that the materiality test introduced into section 264 of the SIS Act through item 26 applies to any direction after item 26 commences.

Consequential amendments

Part 1 Amendments commencing on Royal Assent

.12 Items 7, 8, 9, 11, 17 and 18 repeal various specific direction provisions under the Insurance Act and Life Act. These specific direction powers become redundant as similar powers are contained in the general directions provision introduced through items 12 and 19.

.13 Items 10 and 13 replace references to previous specific direction provisions (sections 62 and 49M) with reference to the new general directions provision (section 104 of the Insurance Act). This is because the specific directions are repealed and equivalent powers are incorporated into the general directions provision (section 104) through item 12.

.14 Item 14 removes references to sections 37 and 49P from the Insurance Act as they are repealed through items 7 and 8.

.15 Item 15 replaces the references to '49M or subsection 62(9)' with the reference to section 108 as sections 49M and 62 are repealed through items 8 and 11 and equivalent, offence provisions are set out in section 108 introduced through item 12.

.16 Item 24 amends subsection 236(1) of the Life Act by removing references to directions in the definition of reviewable decision which are redundant due to the consolidation of the directions power.

2 Chapter 3

Removal of ministerial consent

Outline of chapter

.1 The amendments in Schedule 3 of the Bill remove ministerial consent from administrative decisions made by the Australian Prudential Regulation Authority (APRA) or the Australian Taxation Office (ATO) under the *Banking Act 1959* (Banking Act), *Insurance Act 1973* (Insurance Act), *Life Insurance Act 1995* (Life Act) and *Superannuation Industry (Supervision) Act 1993* (SIS Act) where wider policy interests are not involved.

Context of amendments

.2 On 12 September 2003, the former Government released its final response to the HIH Royal Commission Report, in which it accepted all of the recommendations made by the HIH Royal Commission. This included a recommendation that the Government consider removing the requirement for the Treasurer's agreement to operational decisions involving APRA's prudential oversight of general insurers (Recommendation 22).

.3 This recommendation is consistent with a later recommendation by the International Monetary Fund (IMF) in its 2006 Financial System Stability Assessment (FSSA) of Australia to establish clearly the independence of APRA.

.4 On 4 December 2006, a consultation paper *Rethinking Regulation: Report of the Taskforce on Reducing Regulatory Burdens on Business*, was released containing proposals to remove the requirement for the Treasurer's consent from operational decisions made by APRA or the ATO (in the case of SMSFs) where wider policy considerations are not involved. The paper also contained related proposals resulting from the proposed removal of the requirement for the Treasurer's consent, including proposals relating to the regulation of Lloyd's insurers and the triggers for APRA to initiate an investigation under the Insurance Act.

.5 The proposals were further refined in light of industry comments and consulted on again through a subsequent consultation paper – *Review of*

Prudential Decisions, released on 31 May 2007. The amendments in Schedule 3 of the Bill give effect to these proposals.

Summary of new law

.6 The amendments in Schedule 3 of the Bill remove the requirement for the Treasurer's prior agreement for certain decisions made by APRA or the ATO (in the case of SMSFs) under the Insurance Act, Life Act and SIS Act where these decisions do not involve wider policy considerations.

.7 There are also miscellaneous amendments to the Insurance Act to remove regulatory gaps resulting from the removal of the Treasurer's agreement in relation to certain administrative decisions. These include introducing new triggers for APRA's investigation power and its direction power in relation to security trust funds concerning Lloyd's, and transferring the administration of Lloyd's \$2 million security deposit from the Treasurer to APRA.

Comparison of key features of new law and current law

<i>New law</i>	<i>Current law</i>
Treasurer's agreement is no longer required for administrative decisions under the Insurance Act, Life Act and SIS Act that do not involve wider policy issues. Where a decision concerns licensing and authorisation or removal of a responsible person or handling of a regulated entity's assets merits review is made available (also see Chapter 4 of this explanatory memorandum of merits review).	Treasurer's agreement is required for a range of administrative decisions made by APRA or the ATO under the Insurance Act, Life Act and SIS Act.
The Treasurer's agreement as a trigger to issue a 'show cause' notice under the Insurance Act is replaced by a new trigger which allows APRA to issue a 'show cause' notice if it appears to APRA that information in its possession calls for an investigation.	Under the Insurance Act, with Treasurer's agreement, APRA may issue a notice to a general insurer or authorised NOHC, requiring it to 'show cause' within a prescribed time why APRA should not investigate the whole or part of the business of the entity.

<i>New law</i>	<i>Current law</i>
Lloyd's, or a company nominated by Lloyd's is required to lodge with APRA a security deposit valued at \$2 million.	Under the Insurance Act, Lloyd's or a company nominated by Lloyd's is required to lodge with the Treasurer a security deposit valued at \$2 million.
The Treasurer's agreement to directions in relation to Lloyds insurers is replaced by a new trigger which allows APRA to issue a direction if it has reason to believe that the provisioning for liabilities in the accounts of a designated security trust fund is insufficient. In addition, merits review is made available for such a direction.	Pursuant to section 76 of the Insurance Act, with the Treasurer's agreement, APRA is able to direct the trustee of a designated security trust fund (concerning Lloyd's) with respect to its liabilities provisioning.

Detailed explanation of the new law

Part 1 Amendments commencing on Royal Assent

.1 The involvement of the Treasurer in operational prudential decisions made by APRA or the ATO runs the risk of blurring the lines of accountability for those decisions. It is important to balance the need for clear accountability of the regulators for the performance of their functions against ensuring the clear independence of the Regulators in their execution of administrative powers.

.2 While APRA and the ATO currently have independence for most of their operational decisions in the administration of the Insurance Act, Life Act and SIS Act there are several administrative decisions for which they require the Treasurer's agreement.

.3 The removal of the Treasurer's agreement from operational decisions will enhance the regulators' operational independence and improve the timeliness and effectiveness of the supervisory process. It ensures accountabilities are clearly allocated to the responsible decision-maker, allowing the regulators to undertake and enforce their prudential powers without giving rise to the perception that they are influenced by external interference.

.4 The amendments in Schedule 3 of the Bill aim to achieve these goals by removing from the Insurance Act, Life Act and SIS Act the requirement for the Treasurer's prior agreement for administrative

decisions made by APRA or the ATO that do not involve broader policy considerations. A summary of these amendments is set out in Table 3 below:

Table 3: Amendments to remove ministerial consent under the Prudential Acts

<i>Insurance Act 1973</i>
<p>Items 1 to 4 remove from sections 15 and 21 requirements for the Treasurer's prior agreement to an APRA decision to revoke an authorisation of a general insurer or an authorised NOHC under the Insurance Act.</p>
<p>Item 5 repeals subsection 32(3E) of the Insurance Act which requires APRA to seek the Treasurer's prior agreement for a decision to modify a prudential standard to cater for an in-house capital adequacy model proposed by an insurer or vary or revoke such a modification.</p>
<p>Item 6 removes from section 52 of the Insurance Act the requirement for the Treasurer's agreement prior to APRA issuing an investigation 'show cause' notice to a general insurer or an authorised NOHC.</p> <p>This amendment, however, limits APRA's ability to use its investigation powers in some situations to ensure financial system stability as the remaining triggers are specific and have proven to be insufficient in the past.</p> <p>To address this issue, item 6 also introduces a new trigger into paragraph 52(1)(b) of the Insurance Act which allows APRA to issue an investigation 'show cause' notice if it appears to APRA that information in its possession calls for an investigation. A similar trigger is currently available to APRA under the Banking Act and Life Act.</p>
<p>Item 7 removes from section 52 of the Insurance Act the requirement for the Treasurer's agreement before APRA can specify in an investigation notice a period of notice that is less than 14 days.</p> <p>To ensure APRA has the flexibility to specify a notice period of less than 14 days where timeliness is of critical importance to protect the interests of policy holders, item 7 inserts a new requirement into subsection 52(1AB) such that APRA is permitted to specify a period of less than 14 days in a 'show cause' notice if APRA considers specifying a shorter period is necessary and the period specified is reasonable in the circumstances.</p>
<p>Item 8 and Items 15 to 21 amend the Insurance Act to transfer the administration of Lloyd's \$2 million security deposit from the Treasurer to APRA as a result of the removal of the Treasurer's agreement from the Insurance Act. Item 17 further clarifies that under the new arrangements, the legal and beneficial interest in these securities remains with the Commonwealth and APRA is taken to have custody of the securities for and on behalf of the Commonwealth.</p>
<p>Items 9 and 10 remove the requirement for APRA to seek the Treasurer's agreement prior to issuing directing a Lloyd's underwriter to not issue or renew policies under section 74.</p>

<i>Insurance Act 1973</i>
Items 11 and 12 remove the requirement for APRA to seek the Treasurer's agreement prior to directing Lloyd's in relation to the provision of liabilities in the accounts of designated security trust funds under section 76 of the Insurance Act. However, the amendment would result in such an APRA direction being subject to no trigger mechanism. Item 11 clarifies that APRA may issue such a direction if it has reason to believe that the provisioning for liabilities in the accounts of the designated security trust fund is insufficient.
Items 13 and 14 remove the requirement for APRA to seek the Treasurer's agreement prior to directing Lloyd's not to deal with certain assets.
Items 22 to 26 remove from section 93 of the Insurance Act the Treasurer's involvement in determining that the authorisation of a Lloyd's underwriter ceases to have effect.
<i>Life Insurance Act 1995</i>
Item 28 amends new section 21(1) to remove the requirement for APRA to obtain ministerial consent.
Item 29 repeals subsection 40(3) of the Life Act so that the Treasurer's agreement is no longer required for the regulator to approve a life company mortgaging or issuing a charge over an asset of a statutory fund.
Item 30 removes from section 49 of the Life Act the requirement for APRA to seek the Treasurer's agreement prior to giving notice to a life company to take action to remedy a contravention of the duties of directors in relation to statutory funds.
Item 31 repeals subsections 62(4A) and 63(2A) of the Life Act which require APRA to seek the Treasurer's agreement prior to refusing to permit distributions of retained profits or shareholder's capital in a statutory fund.
<i>Superannuation Industry (Supervision) Act 1993</i>
Items 32 to 34 remove from section 29G the requirement for APRA to seek the Minister's consent prior to cancelling an RSE licence.
Item 35 removes from section 133 the requirement for APRA or the ATO to seek the Minister's consent prior to suspending or removing a trustee of a superannuation entity.
Items 36 and 37 remove from section 146 the requirement for APRA to seek the Minister's consent prior to approving the transfer of all benefits of members and beneficiaries in a transferor fund to a transferee fund.
Item 38 removes from section 264 the requirement for APRA or the ATO to seek the Minister's consent prior to issuing a direction to freeze assets of a superannuation entity.

Application and transitional provisions

- .1 The amendments made under part 1 of Schedule 3 (items 1-31) apply from the date of Royal Assent.
- .2 Item 27 further clarifies that, for securities that are lodged with the Treasurer under section 92Q of the Insurance Act immediately before the date of Royal Assent, the legal and beneficial interest in the securities remain with the Commonwealth, and APRA is taken to have custody of the securities for and on behalf of the Commonwealth immediately after the date of Royal Assent.

Part 2 Amendments contingent on the *Financial Sector Legislation Amendment (Discretionary Mutual Funds and Direct Offshore Foreign Insurers) Act 2007*

Items 39 to 67

- .3 In the DMF and DOFI Act, item 8 of Schedule 2 inserts a new section into the Insurance Act. The new section 3A provides for the Insurance Regulations to specify that certain contracts are not taken to be insurance business for the purposes of the Insurance Act. It provides the framing provision to draft an Insurance Regulation exemption allowing Australian risks that cannot be appropriately placed with an authorised insurer to be placed with an unauthorised offshore general insurer without the general insurer being in breach of the Insurance Act.
- .4 New paragraph 3A(3)(b) extends the Insurance Act Part VI merits review provisions to determinations that may be made pursuant to the Insurance Regulations under the new section 3A. To make the new section 3A merits review provisions effective, Schedule 2 of the DMF and DOFI Act also amends sections 63 and 64 in Part VI of the Insurance Act.
- .5 However, it was never intended that Part VI merits review provisions should apply to commercial activities. This would occur, for example, if the Insurance Regulations enabled insurance brokers to determine, on a narrow and well-defined basis, that an exemption was required where a risk could not be appropriately placed with an authorised insurer. Amendments made in this Bill will ensure that such a determination would not be subject to merits review under Part VI of the Insurance Act.
- .6 A person who could have exercised their rights to merits review under the provisions being repealed through this Bill would still, for example, have a range of alternative remedies against an insurance broker. These include legal remedies in common law (for example, breach of contract)

and under statute (for example, an action against an insurance broker for misleading and deceptive conduct).

.7 The repeal of these provisions also does not affect the Australian Securities and Investments Commission's powers under Chapter 7 of the *Corporations Act 2001* to seek a fine, revoke an insurance broker's Australian financial services licence or disqualify the insurance broker from providing financial service advice.

.8 Items 13 to 17 of Schedule 2 of the DMF and DOFI Act amend section 63 of the Insurance Act to remove the definitions 'reviewable decision of the Treasurer or APRA' and 'person affected by a reviewable decision of the Treasurer and APRA' (the old definitions), and insert the definitions of 'decision maker', 'reviewable decision' and 'person affected by a reviewable decision' (the new definitions) instead.

.9 As outlined above, Schedule 2 of the DMF and DOFI Act also amends sections 63 and 64 in Part VI of the Insurance Act.

.10 Items 18 to 33 of Schedule 2 of the DMF and DOFI Act replace sections 63 and 64 references to the old definitions with references to the new definitions.

.11 The DMF and DOFI Act changes affect subsections 63(1) and 63(2), 63(4) to (7), 63(9), and 63(12) to (14), and subsection 64(1), paragraphs 64(1)(a) and (b), subsection 64(2), and adds a new subsection 64(4).

.12 These changes are no longer necessary, from the perspective of the DMF and DOFI Act, as a result of the amendments to section 3A of the Insurance Act contained in this Bill.

.13 However, the RPD Bill also amends sections 63 and 64 to remove the requirement to seek ministerial consent. When the RPD Bill commences, it is intended that all references to the Treasurer, and thus ministerial consent, would be removed from the Prudential Acts.

.14 To ensure that references to the Treasurer are removed from sections 63 and 64, irrespective of whether the RPD Bill commences before or after Schedule 2 of the DMF and DOFI Act, it is necessary to remove references to the Treasurer from both the old definitions and the new definitions in section 63, and from the relevant subsections or paragraphs in sections 63 and 64.

.15 This ensures that changes made by both pieces of legislation are captured in the final version of the Insurance Act.

.16 Items 39 to 67 of Part 2 of Schedule 3 of the RPD Bill implement these changes based on two contingencies. The first is that the DMF and DOFI Act commences before the RPD Bill, the second is that the RPD Bill commences before the DMF and DOFI Act.

Schedule 2 of the DMF and DOFI Act commences before RPD Bill

.17 The first contingency is dealt with by Division 1 of Part 2, of Schedule 3.

.18 If the DMF and DOFI Act commences before the RPD Bill, it would be only necessary to repeal the sections extending merits review to determinations made in regulations under section 3A of the Insurance Act. Item 40 of Division 1 in Part 2 of Schedule 3 repeals section 3A of the DMF and DOFI Act and inserts a new section 3A into the Insurance Act. Items 41 to 43 of Division 1 in Part 2 of Schedule 3 removes references to determinations made under section 3A and the Treasurer from the new definitions. These items would commence when the RPD Bill receives Royal Assent.

.19 The DMF and DOFI Act would have already removed all other references to the Treasurer in sections 63 and 64 and replaced them with references to the 'decision maker' (that is, APRA).

.20 Item 39 also makes a consequential amendment to a note regarding the definition of insurance business in subsection 3(1) of the Insurance Act. The note makes readers aware that some contracts of insurance are not insurance business because of the operation of the new section 3A.

RPD Bill commences before Schedule 2 of the DMF and DOFI Act

.21 The second contingency is dealt with by Divisions 2 and 3 of Part 2 of Schedule 3.

.22 If the DMF and DOFI Act commences after the RPD Bill it will be necessary to, firstly, remove references to the Treasurer from the old definitions and, once Schedule 2 of the DMF and DOFI Act has commenced, remove references to the Treasurer from the new definitions. It will also be necessary to repeal section 3A of the DMF and DOFI Act and insert the new section 3A via this Bill. This is effected by Division 2 and 3 in Part 3.

.23 Division 2, consisting of items 44 to 64, removes references to the Treasurer from the old definitions as well as subsections 63(1) and (2), 63(4) to (7), 63(9), 63(12) and (13), subsection 64(1), paragraphs 64(1)(a) and (b) and subsection 64(2). Division 2 will come into effect when the

Bill receives Royal Assent, so that these references to the Treasurer are removed at the same time as Part 1 of Schedule 3.

.24 Item 65 of Division 3 repeals item 8 of Schedule 2 of the DMF and DOFI Act (the old section 3A) and inserts a new item 8 of Schedule 2 (the new section 3A). Item 65 commences immediately before the commencement of Schedule 2 of the DMF and DOFI Act and after the RPD Bill has commenced.

.25 In addition, item 66 of Division 3 of Part 2 of Schedule 3 of the RPD Bill removes ‘misdeshribed provisions’ in the DMF and DOFI Act.

.26 If the RPD Bill commences before Schedule 2 of the DMF and DOFI Act, items 44 to 48 will have already inserted the new definitions in subsection 63(1); items 49 to 63 will have already removed references to the Treasurer in subsections 63(2), 63(4) to (7), 63(9), 63(12) to (13), subsection 64(1), paragraphs 64(1)(a) and (b) and subsection 64(2); and item 64 will have already inserted a new subsection 64(4). As a result of these changes, items 13 to 33 in Schedule 2 of the DMF and DOFI Act will have become ‘misdeshribed provisions’, which will not produce the intended effect.

.27 Item 66 commences just before Schedule 2 of the DMF and DOFI Act commences.

.28 Item 67 then makes a consequential amendment to a note regarding the definition of insurance business in subsection 3(1) of the Insurance Act. The note makes readers aware that some contracts of insurance are not insurance business because of the operation of the new section 3A. Item 67 commences immediately after item 5 of Schedule 2 of the DMF and DOFI Act.

2 Chapter 4

Review of decisions

Outline of chapter

.1 Schedule 4 of the Bill amends the *Banking Act 1959* (Banking Act), *Insurance Act 1973* (Insurance Act), *Life Insurance Act 1995* (Life Act), *Superannuation Industry (Supervision) Act 1993* (SIS Act) (collectively, the Prudential Acts) and the *Financial Sector (Collection of Data) Act 2001* (FSCODA) to expand the availability of merits review for appropriate administrative decisions made by the Australian Prudential Regulation Authority (APRA) or the Australian Taxation Office (the ATO) (in the case of self managed superannuation funds (SMSFs)), consistent with the guidelines regarding merits review developed by the Administrative Review Council (the ARC).

Context of amendments

.2 In its response to the HIH Royal Commission Report, the former Government accepted all of the HIH Royal Commission recommendations, including a recommendation that the Government review the inconsistencies between the legislative provisions for merits review under the *Insurance Act 1973* and the *Banking Act 1959* (Recommendation 23).

.3 This is also consistent with Recommendation 5.7 of *Rethinking Regulation: Report of the Taskforce on Reducing Regulatory Burdens on Business (Rethinking Regulation)*, that APRA's administrative decisions be subject to merits review consistent with the guidelines developed by the ARC. The former Government accepted this recommendation in its final response to *Rethinking Regulation*, released on 15 August 2006.

.4 On 4 December 2006, a proposals paper – *Streamlining Prudential Regulation: Response to 'Rethinking Regulation'*, was released canvassing proposals to apply merits review to appropriate administrative decisions made by APRA or the ATO in the case of SMSFs.

.5 The proposals were further revised in light of industry comments and consulted on again through a subsequent consultation paper *Review of*

Prudential Decisions, released on 31 May 2007. The amendments in Schedule 4 of the Bill give effect to these proposals.

Summary of new law

.6 Schedule 4 of the Bill amends the Prudential Acts and FSCODA to apply merits review to appropriate decisions made by APRA or the ATO (in the case of SMSFs), consistent with the ARC guidelines.

.7 In broad terms, merits review will be made available for decisions to refuse to grant or revoke a licence, decisions to refuse to determine certain provisions of a relevant Prudential Act do not apply, various decisions to ensure compliance with minimum standards and appropriate direction decisions.

.8 In addition, the automatic confidentiality provisions in relation to AAT hearings are removed from each of the Prudential Acts to enhance the transparency of the AAT process in respect of financial sector entities. Under the new regime, the AAT has discretion on a case by case basis to determine whether confidentiality should be provided through a private hearing under subsection 35(2) of the *Administrative Appeals Tribunal Act 1975* (the AAT Act).

Comparison of key features of new law and current law

<i>New law</i>	<i>Current law</i>
<p>Merits review will be available for appropriate APRA/ATO decisions consistent with the ARC guidelines.</p> <p>These include decisions in relation to licensing and authorisation, exemption, compliance with minimum standards and certain directions (also see Chapter 2).</p>	<p>Merits review is not available for all appropriate administrative decisions made APRA or the ATO under the Prudential Acts and FSCODA.</p>
<p>The general confidentiality provisions under the Prudential Acts are removed. However, relevant persons may apply to the AAT for a private hearing under subsection 35(2) of the AAT Act.</p>	<p>All AAT hearings of administrative decisions are confidential under each of the Prudential Acts.</p>

Detailed explanation of new law

Part 1 Amendments commencing on Royal Assent

.1 Merits review aims to ensure that all persons affected by a decision receive fair treatment. It also improves the transparency of administrative decisions and, where the regulators are seen to make consistent, well-formulated decisions, should engender greater public confidence in the regulatory framework.

.2 Merits review is currently available for most decisions made by APRA or the ATO under the Prudential Acts which affect individuals. However, there is inconsistent application of merits review for decisions which may impact substantially on entities. Such inconsistency may reduce the regulator's accountability for administrative decisions.

.3 In determining which decisions are appropriate for merits review, the ARC guidelines have been taken into account. Consistent with these guidelines, Schedule 4 of the Bill amends the Prudential Acts and FSCODA to make merits review available for appropriate administrative decisions made under these Acts.

.4 Items 1 and 2 amend sections 9 and 9A of the Banking Act to apply merits review to an APRA refusal to grant or refusal to revoke an authority to carry on banking business in Australia as well as decisions by APRA to revoke an authority to carry on banking business where procedural fairness processes apply. Similarly, items 4 and 5 amend sections 11AA and 11AB of the Banking Act to apply merits review to an APRA decision to refuse to grant or refuse to revoke a NOHC authority as well as a decision by APRA to revoke an authority of a NOHC where procedural fairness processes apply.

.5 Items 1 and 4 also expand the availability of merits review to APRA decisions to impose conditions on an authority of an ADI or an authorised NOHC or a subsequent decision to vary such conditions.

.6 Item 3 amends section 11 of the Banking Act to apply merits review to an APRA refusal to determine that one or more provisions of the Banking Act do not apply to a particular person or a subsequent variation or revocation of an exemption order made under this section.

.7 Item 6 amends section 11AF of the Banking Act to apply merits review to an APRA decision to determine a prudential standard for a specific ADI or authorised NOHC or a subsequent decision to vary such a standard.

.8 Item 7 applies merits review to directions given under section 11CA of the Banking Act that are triggered by certain prescribed circumstances. See Chapter 2 of this explanatory memorandum for further description of amendments to directions powers in the Banking Act as a result of this Bill.

.9 Item 9 applies merits review to an APRA refusal to certify an industry support contract under section 11CB of the Banking Act.

.10 Item 10 makes explicit that APRA may vary a direction in relation to compliance with an industry support contract under section 11CC of the Banking Act. Item 11 applies merits review to APRA's decisions under this section to give, vary or revoke such a direction.

.11 Item 13 applies merits review to an APRA decision under section 66 of the Banking Act to refuse to consent to a person assuming or using certain restricted words or expressions in relation to the person's financial business. Item 13 also applies merits review to an APRA decision to impose conditions on a consent, to vary or revoke such a consent, or to revoke such a consent.

.12 Item 14 applies merits review to an APRA decision under section 67 of the Banking Act to refuse to consent to the establishment or maintenance of representative offices of overseas banks, to impose conditions or additional conditions on a consent, to vary or revoke conditions imposed on a consent, or to revoke a consent.

Financial Sector (Collection of Data) Act 2001

.13 Items 15 and 16 introduce into the FSCODA general arrangements regarding review of decisions, consistent with arrangements under the Prudential Acts.

.14 Item 17 applies merits review to APRA decisions:

- not to exempt a corporation from the obligation to register under FSCODA (section 7);
- not to allow a longer period for the submission of required documents to APRA (section 9);
- to include a registered entity in a particular category of registered entities (section 11); and
- to determine or vary a reporting standard for an entity (section 13).

Insurance Act 1973

.15 Item 18 applies merits review to APRA decisions under section 7 of the Insurance Act to refuse to determine that certain provisions of the Insurance Act do not apply to a particular person, to impose conditions on or specify a period in such a determination, or to vary or revoke such a determination.

.16 Items 19 and 22 apply merits review to APRA decisions under sections 13 and 19 of the Insurance Act to impose conditions on an authorisation of a general insurer or an authorised NOHC or to vary such conditions.

.17 Items 20 and 23 apply merits review to APRA decisions under sections 15 and 21 of the Insurance Act to revoke an authorisation of a general insurer or an authorised NOHC.

.18 Item 24 adds a new subsection 32(7) to specify that APRA's decisions under new paragraph 32(1)(e), relating to one or more specified general insurers, NOHCs and subsidiaries, are now subject to review under Part VI of the Insurance Act.

.19 Item 21 applies merits review to APRA decisions under section 17 of the Insurance Act to direct the insurer to arrange, subject to APRA's approval, to assign certain liabilities to one or more other general insurers, to refuse to approve a proposed assignment or to impose conditions on an approval.

.20 Item 25 applies merits review to APRA decisions under section 49H of the Insurance Act to confirm or vary a delegation's decision to extend time for providing actuary's report.

.21 Item 27 applies merits review to APRA decisions under section 116A of the Insurance Act to determine an amount in relation to an insurer's assets liabilities in Australia or to vary such a determination.

Life Insurance Act 1995

.22 Currently, some decisions are included in both subsection 236(1) of the Life Act, which sets out a definition of reviewable decisions and 236(1A) which sets out a definition of non-reviewable decisions. This makes defining reviewable decisions under the Life Act unnecessarily complex.

.23 Item 36 removes subsection 236(1A) so that reviewable decisions are only listed in subsection 236(1) under the definition of reviewable decisions. In addition, item 29 and item 32 remove various decisions from the list of reviewable decision under subsection 236(1). These decisions

are not subject to merits review as they are currently included in both subsections 236(1) and 236(1A). These amendments seek to improve the clarity in defining reviewable decisions in the Life Act. Item 28 is a consequential amendment as it removes a reference to subsection 236(1A).

.24 Items 29 to 31 and 33 to 34 apply merits review to APRA decisions under the Life Act:

- to determine that a body corporate is a ‘friendly society’ or to vary or revoke such a determination (section 16C);
- to restrict the use of the expression ‘friendly society’ (section 16E);
- to refuse to approve benefit fund rules (section 16L) or to refuse to approve amendments of approved benefit fund rules (section 16Q);
- to give notice to require an amendment of approved benefit fund rules to rectify deficiency or to refuse to approve such amendments (section 16R);
- to refuse to give an approval to consequential amendments of company’s constitution (sections 16U and 16V);
- to refuse to register a company (section 21) or cancel the registration of a company (section 27);
- to refuse to give approval or impose conditions on an approval concerning mortgages of assets (section 40);
- to refuse to give an approval concerning investment of statutory funds (section 43);
- to refuse to give an approval concerning directors’ duties in relation to statutory funds (section 48);
- to refuse to allow the overseas policy owners’ retained profits to be distributed to owners of Australian policies or to be transferred to shareholders’ funds (section 62);
- to refuse to suspend or vary a life company’s obligation to make payments (section 208);
- to direct a life company to do certain acts on certain grounds specified in section 230B. See Chapter 2 of this explanatory

memorandum for further description of amendments to directions powers in the Life Act as a result of this Bill.

Superannuation Industry (Supervision) Act 1993

.25 Item 38 applies merits review to APRA directions to registrable superannuation entity licensees to modify their risk management strategies as set out in the directions (section 29HB).

.26 Item 39 applies merits review to APRA directions to registrable superannuation entity licensees to modify their risk management plans as set out in the directions (section 29PB).

.27 Item 40 applies merits review to the Regulator's refusal to approve the provision of other benefits under the sole purpose test provision (section 62).

.28 Item 41 applies merits review to the Regulator's decision to suspend or remove a trustee of a superannuation entity (section 133).

All Prudential Acts

.29 Currently, all AAT hearings of reviewable decisions are confidential under each of the Prudential Acts. This reduces the publicly available information on the rationale for, and the transparency of, the decisions being reviewed.

.30 Items 12, 26, 37 and 42 remove the automatic confidentiality provisions from each of the Prudential Acts to enhance the availability of public information concerning the decisions being reviewed. Following the amendments, where a private hearing is necessary, the relevant person may apply to the AAT for a private hearing under subsection 35(2) of the AAT Act.

Application and transitional provisions

.31 The amendments made under Schedule 4 (items 1-43) apply from the date of Royal Assent.

.32 Item 43 further clarifies that these amendments apply to decisions made on or after the day on which these amendments commence.

Consequential amendments

Part 1 Amendments commencing on Royal Assent

.33 Item 8 is a consequential amendment to item 9. It inserts (1) to allow for a new subsection (2) to be inserted under item 9.