

Shifting Geer

Welcome to *Shifting Geer*, Herbert Geer's superannuation and funds management quarterly newsletter.

1. APRA AND ASIC UPDATES

1.1 **ASIC Class Order [CO 11/1140]: Financial resources for responsible entities**

On 11 November 2011, ASIC Class Order CO 11/1140 was registered. The Class Order varies section 912A(1)(d) of the *Corporations Act 2001* (Cth) (**Corporations Act**) as it applies to non-APRA-regulated financial services licensees by imposing revised minimum standards for those entities to have available adequate financial resources to provide the financial services covered by their Australian Financial Services Licence (**AFSL**).

The class order provides further requirements in respect of these entities':

- (a) cash needs requirements;
- (b) net tangible asset requirements; and
- (c) audit requirements.

Cash need requirements

The Class Order requires that licensees must now hold net cash or cash equivalents of at least the greater of:

- (a) \$150,000 (dependent upon how certain scheme property is held); and
- (b) 50% of the amount of net tangible assets (**NTA**) that would be required (as referred to below).

Net tangible asset requirements

The Class Order requires that licensees must now hold NTA of at least the greater of:

- (a) \$150,000 (dependent upon how certain scheme property is held);
- (b) 0.5% of the average value of scheme property (capped at \$5 million); and
- (c) 10% of average gross revenue with no maximum NTA.

Audit requirements

Licensees must lodge an annual independent audit report with ASIC in order to confirm their compliance with the relevant cash needs and NTA requirements under the Class Order.

The revised minimum standards apply from 1 November 2012.

1.2 **Outsourcing super product design to fund promoters: APRA requirements**

On 15 November 2011, APRA wrote to superannuation fund trustees (**Trustees**) to remind them that activities outsourced to Fund Promoters (those who provide product design and/or marketing services) must comply with APRA's Outsourcing Standard.

Where existing arrangements do not comply, APRA expects trustees to take immediate steps to ensure compliance with the Outsourcing Standard.

APRA states that it will be following up on this matter to confirm that Trustees have taken the appropriate action. APRA will also be looking for evidence which supports robust reporting, monitoring and review of Fund Promoter performance by Trustees.

APRA also expects Trustees to exercise their own independent and informed judgement in relation to decisions concerning the fund, including such matters as product design, investment strategy and the types of investments that Trustees offer members. In this regard, APRA reminds Trustees of their duty to act in the best interests of members in priority to their own interests or those of other third parties. To this end, Trustees should be prepared to enforce the terms of any material outsourcing agreement, if necessary.

Herbert Geer Comment

We are of the opinion that these requirements do not extend to independent marketing firms or individuals who provide one-off services to superannuation fund trustees as these firms and individuals clearly do not provide the type of services contemplated by APRA.

1.3 ASIC Regulatory Guide Amendments

On 30 November 2011, ASIC announced that it had updated the following regulatory guides, in respect of disclosure:

- (a) Regulatory Guide 55: Statements in disclosure documents and PDSs: Consent to quote (**RG 55**);
- (b) Regulatory Guide 65: Section 1013DA disclosure guidelines (**RG 65**); and
- (c) Regulatory Guide 97: Disclosing fees and costs in PDSs and periodic statements (**RG 97**).

The amendments do not represent substantive policy changes.

Regulatory Guide 55

RG 55 provides guidance on how ASIC will administer the requirement under the Corporations Act for an issuer to obtain consent before citing a person in a disclosure document or product disclosure statement (**PDS**).

Guidance on “How to apply for relief” contained in RG 55 has been removed and is now provided separately under Regulatory Guide 51: *Applications for relief*.

Regulatory Guide 65

RG 65 sets out ASIC’s guidelines on how product issuers can meet their obligations under section 1013DA of the Corporations Act to disclose in PDSs how labour standards or environmental, social or ethical considerations are taken into account in selecting, retaining or realising an investment.

Even though sections 1013D and 1013DA do not apply to shorter PDSs, ASIC strongly encourages product issuers to use RG 65 when preparing short form PDSs (**SFPDS**), particularly for material incorporated by reference into an SFPDS.

Regulatory Guide 97

RG 97 provides guidance on how to disclose fees and costs in PDSs and periodic statements.

The amendments to RG 97 reflect the fact that the SFPDS regime sets specific disclosure requirements on some Trustees and managed investment.

1.4 ASIC Class Order [CO 11/1227]: Relief for providers of retirement estimates

On 5 December 2011, ASIC Class Order 11/1227 was registered and provides relief to Trustees so that they do not have to comply with the requirement to hold an AFSL when providing members (aged under 65 years) with a retirement estimate contained in or accompanying a periodic statement.

Where the Trustee already holds an AFSL, the Class Order grants conditional relief from the disclosure and personal advice requirements contained in Divisions 2, 3 and 4 of Pt 7.7 of the Corporations Act.

2. LEGISLATION

2.1 *Superannuation Legislation Amendment (MySuper Core Provisions) Bill 2011*

The *Superannuation Legislation Amendment (MySuper Core Provisions) Bill 2011* (Cth) was introduced into the House of Representatives on 3 November 2011. The Bill sets out:

- (a) the APRA authorisation of trustees to offer MySuper products;
- (b) the offering of separate MySuper products in the one superannuation fund by the one trustee;
- (c) characteristics of a MySuper product; and
- (d) MySuper fee rules.

A review of the Bill against its Exposure Draft highlights the following:

- (a) *The offering of separate MySuper products in the one superannuation fund:*

APRA may allow a successor fund to hold both its own MySuper product and the transferor fund's MySuper product if there is "material goodwill" in the transferor fund's MySuper product.

The Bill does not define the term "material goodwill" and it will likely be a question of fact as to what goodwill (ie intangible assets including a strong brand name and good customer/employee relations) exists in the transferor fund's MySuper product and whether that goodwill is material.

APRA may authorise funds to provide tailored MySuper products in respect of members of large employer-sponsors (who contribute to the fund for the benefit of at least 500 members of the employer-sponsor or an associate of that employer-sponsor).

Further the Bill allows funds to seek registration in respect of tailored MySuper products, if APRA is satisfied that an employer-sponsor will become a large employer-sponsor by the end of a period specified in the authority. In the event the employer sponsor does not become a large employer-sponsor within the relevant period, the authorisation will be cancelled.

However, whilst the Bill states that APRA will cancel tailored MySuper product authorisations in respect of employer-sponsors who fail to become large employer-sponsors, the Bill fails to state whether APRA will cancel tailored MySuper Product authorisations in respect of a large employer-sponsor who downsizes and fails to contribute to the fund for the benefit of at least 500 members.

- (b) *MySuper fee rules:*

Because superannuation funds may actually be able to charge different fees and costs to different members, for example:

- (i) members of different tailored MySuper products, dependant upon employer-sponsor size;
- (ii) members of different MySuper products, based upon the introduction of a transferor fund's MySuper product under a successor fund transfer;
- (iii) different members of the one MySuper product, whose employer has negotiated an administration fee exemption; and
- (iv) different members of the one MySuper product based on life-cycle exceptions.

2.2 **Superannuation Guarantee (Administration) Amendment Bill 2011**

The *Superannuation Guarantee (Administration) Amendment Bill 2011* (Cth) was read for a third time in the House of Representatives on 22 November 2011. The Bill proposes to amend the *Superannuation Guarantee (Administration) Act 1992* (Cth) by increasing the maximum superannuation guarantee age limit from 70 to 75 years as of 1 July 2013, and to gradually increase the superannuation guarantee charge percentage from to 12% by 1 July 2019.

These amendments are proposed to commence on 1 July 2013 but are dependent on the passing of the Minerals Resource Rent Tax package.

2.3 **Tax Laws Amendment (Stronger, Fairer, Simpler and Other Measures) Bill 2011**

The *Tax Laws Amendment (Stronger, Fairer, Simpler and Other Measures) Bill 2011* (Cth) was read for a third time in the House of Representatives on 22 November 2011. Among other things, the Bill contains various amendments including changes to amend the *Superannuation (Government Co-Contribution for Low Income Earners) Act 2003* (Cth) to reduce the maximum Government Co-Contribution, in respect of low income members who make non-concessional contributions, from \$1,000 to \$500.

The amendments in respect of the Government Co-Contribution are proposed to commence on 1 July 2012 but are dependent on the passing of the Minerals Resource Rent Tax package.

2.4 **Corporations Amendments (Further Future of Financial Advice Measures) Bill 2011**

The *Corporations Amendments (Further Future of Financial Advice Measures) Bill 2011* (Cth) was introduced into the House of Representatives on 24 November 2011.

The Bill introduces:

- (a) retail client best interests obligations;
- (b) the ban on conflicted remuneration; and
- (c) the ban on other forms of remuneration including volume-based shelf-space fees and asset-based fees.

The best interests obligations:

- (a) take on the initial proposals set out in the *Future of Financial Advice Exposure Draft* except that the following are removed:
 - (i) the requirement to advise the client in writing that it should seek additional advice, as appropriate;
 - (ii) the requirement to assess whether the client's objectives could be achieved through means other than the acquisition of financial products; and
 - (iii) if the provider proposes to advise the client to acquire a financial product in substitution for, or in addition to, another financial product the requirement to:
 - (iv) weigh up the advantages and disadvantages in acquiring the product; and
 - (v) advise the client to acquire the product only if it is reasonable to conclude that the client's objectives could be better achieved if the client acquired the product;
- (b) provide further guidance as to what would reasonably be regarded as being in the best interests of the client;
- (c) remove the initially proposal restriction on recommending products from an approved product list when this would be against a client's best interests;
- (d) removes the absolute requirement for product advisers to give priority to a client's interests in the event of a conflict of interest, to only requiring such priority where the provider knows or it is reasonably apparent that a conflict exists; and

- (e) enable a court to include profits resulting from the contravention that are made by the provider or its representatives when determining damages.

The ban on conflicted remuneration differs to that as proposed under the initial *Further Future of Financial Advice Exposure Draft* by only excluding platform operators (as opposed to all financial services licensees and Trustees) from accepting volume-based shelf-space fees.

2.5 **Tax Laws Amendment (2011 Measures No 7) Act 2011 (Cth)**

The *Tax Laws Amendment (2011 Measures No 7) Act 2011* (Cth) received Royal Assent on 29 November 2011. Among other things, the Act extends the end date of the temporary loss relief for merging super funds until 30 September 2011.

2.6 **Tax Laws Amendment (2011 Measures No 9) Bill 2011**

The *Tax Laws Amendment (2011 Measures No 9) Bill 2011* (Cth) was introduced into the House of Representatives on 29 November 2011. Among other things, the Bill proposes to amend the *Superannuation Industry (Supervision) Act 1993* (Cth) to enable superannuation fund members to request the consolidation of their superannuation benefits via the use of an "electronic portability form".

The electronic portability form will provide certain members with a simplified and streamlined electronic method to facilitate the consolidation of their benefits. Lost members, after first locating their benefits through SuperSeeker, may complete a transfer request and submit it electronically to the ATO who will then verify the member's identity and match it to the recorded account, and verify the status of the nominated receiving fund. If the verification processes are successfully completed, the ATO will electronically transmit the transfer request to the fund that reported the member as lost (**Transferring Fund**). The Transferring Fund will then be able to send the member's benefits to the nominated receiving fund under the current portability arrangements.

Electronic submission of the transfer request is not available in the following circumstances:

- (a) the member's account details are not recorded on the lost members register;
- (b) insufficient member details are provided on the transfer request;
- (c) details about the nominated receiving fund are not provided;
- (d) the member has previously submitted a form electronically for the same account;
- (e) the ATO cannot verify the member's identity or the status of the receiving fund; or
- (f) the Transferring Fund cannot receive electronic correspondence from the ATO.

In these circumstances, the member may print the transfer request and post it to their fund.

2.7 **Superannuation Industry (Supervision) Amendment Regulations 2011 (No 4)**

The *Superannuation Industry (Supervision) Amendment Regulations 2011 (No 4)* (Cth) were registered on 9 December 2012. The regulations amend the *Superannuation Industry (Supervision) Regulations 1994* (Cth) to include rules with which Trustees must comply with when using a member's Tax File Number (**TFN**) to locate accounts, and where they use TFNs in order to facilitate account consolidation.

The rules require that in order to facilitate the consolidation of amounts for a beneficiary, a Trustee must use either or both of the following procedures to determine whether amounts are held for the beneficiary by another superannuation entity (or retirement savings account (**RSA**) provider):

- (a) seeking superannuation information relating to the beneficiary using a facility provided by the Australian Taxation Office; and/or
- (b) contacting an RSA provider or superannuation entity to seek superannuation information relating to the beneficiary.

The *Retirement Savings Accounts Amendment Regulations 2011 (No 4)* (Cth) provide corresponding provisions in respect of the *Retirement Savings Accounts Regulations 1997* (Cth).

The regulations commenced as of 1 January 2012.

2.8 **Corporations Legislation Amendment Regulations 2011 (No 2)**

The *Corporations Legislation Amendment Regulations 2011 (No 2)* (Cth) were registered on 9 December 2012. The regulations amend the *Corporations Amendment Regulations 2010 (No. 5)* (Cth) (which introduced the SFPDS requirements for superannuation funds).

Among the amendments, the Regulations:

- (a) enable Trustees who have already prepared SFPDS to amend the disclosure via a supplementary product disclosure statement up until 22 June 2012; and
- (b) enable Trustees to continue to provide "standard" PDSs up until 22 June 2012, but, if they do so, the providers cannot then issue a SFPDS within this time frame.

The Regulations commenced as of 10 December 2011.

3. **CASES**

3.1 **Re KCA Super Pty Limited as Trustee of the Superannuation Fund known as "KCA Super" (No 2) [2011] NSWSC 1301**

On 2 November 2011, the New South Wales Supreme Court provided judicial advice to the Trustee (**Trustee**) of the KCA Super Fund (**Fund**) that it would be justified in consenting to Kimberley-Clark Australia Pty Ltd's (**Company**) compulsory conversion and transfer of all Fund defined benefit members (**DB Members**) to the Fund's accumulation division (**Conversion**), pursuant to the Company's 29 September 2011 offer (**September Offer**).

Background

The Fund is a corporate superannuation fund, established for the Company's employees (and spouses) comprising an accumulation and a defined benefits division (**DB Division**). Under the Fund's Deed, Member classification is determined by the Company, however any Member reclassification (and the determination of amounts to be credited to their new accounts) by the Company is subject to the Trustee's consent.

In November 2010, the Trustee became aware that the Company was proposing to close the DB Division for financial reasons, and to align with global best practice whereby many organisations were closing down their respective defined benefit divisions.

Over the period of 7 February to 10 June 2011, the Company and Trustee communicated and responded to varying proposals in respect of the proposed Uplift amount that should be provided to DB Members, upon Conversion. The Uplift amount's purpose is to ensure a high likelihood that DB Members (upon Conversion) would, over time, remain no worse off than if current defined benefits were maintained. By the end of this period the parties could not agree on proposed Uplift amounts and salary increase assumptions, such that the:

- (a) Company's final proposal offered a \$4.6 million Uplift; and
- (b) Trustee's final offer involved an \$8.16 million Uplift.

On 16 September 2011, the Company provided DB Members with a Transfer Guide and offered DB Members the options (**Transfer Guide Offer**) to either :

- (a) convert to accumulation membership (effective 1 December 2011) and receive an immediate uplift of 1% on their vested benefit to their current super entitlement (which represented an aggregate Uplift amount of \$4.7 million); or
- (b) remain in the DB Division, subject to salary freezes, to the extent allowed by law.

The Transfer Guide Offer was subsequently withdrawn following interim court orders having the effect of requiring the Company to provide the Trustee with the relevant actuarial model it relied on in making its offers (so that the Trustee would be in a position to form an opinion in respect of the Company's determinations). Following this, the Fund Actuary found that the Company's previously proposed Uplift amounts were based upon outdated salary data and readjusted the Uplift amount to \$10.2 million, subject to revised salary data.

On 29 September 2011, the Company notified the Trustee that it intended to withdraw its Transfer Guide Offer and that it was considering terminating the Fund unless the Trustee consented to the Conversion from 1 December 2011 in consideration of the allocation of the amount of \$7 million (inclusive of the Trustee's legal expenses) from the Fund surplus (**Surplus**) to the aggregate crystallised defined benefit withdrawal benefits (**September Offer**).

The Trustee resolved to agree to the September Offer (in principle, and subject to judicial opinion, advice and direction), considering, among other things:

- (a) although the proposed Uplift was significantly less than the Trustee's revised estimate (being \$10.2 million), if the Company dissolved the Fund, the eventual amount available for payment to DB Members would be less than the amount that would be allocated to DB Members from the Uplift in the Company's September Offer;
- (b) the individual circumstances of certain groups of DB Members who, given their circumstances, would benefit from the Company's proposal; and
- (c) the impact upon the morale of DB Members as a result of the current uncertainty.

On 12 October 2011, the parties executed a document recording the amount and basis of calculation of each DB Member's Uplift, and also contained a number of undertakings by the parties, including:

- (a) communication in relation to the Conversion, by the Company, would be done in consultation with the Trustee;
- (b) no DB Member would incur the initial transfer costs or the Buy/Sell spread on the transfer of the DB Member's account from the DB Division to the Accumulation Division;
- (c) the Company agreeing to offer one further voluntary financial planning session to DB Members;
- (d) following the payment of bonuses in or about February or March 2012, the crystallised defined benefit withdrawal benefit would be recalculated (and if required, funded from the Surplus) to take account of each former DB Member's actual "Earnings" (as defined in the Fund's Deed) for 2011. The individual Uplift amount would not be amended despite any increase; and
- (e) only DB Members who are employed by the Company as at 30 November 2011 would be entitled to an individual Uplift transferred to the Accumulation Fund.

The Fund Actuary accepted the Surplus estimate of \$12 million that resulted from contributions made by the Company to date exceeding the Fund's projected future defined benefit liabilities.

Decision

In seeking judicial advice, the Trustee was faced with the dilemma that either:

- (a) the proposed Conversion might not adequately compensate all DB Members for the additional investment risk, expenses, costs and potential personal tax liability involved in becoming an Accumulation Member; or
- (b) the Company may decide, to terminate the Fund in its entirety, thereby affecting the interests of all Fund members and resulting in a lower total Uplift amount for the DB Members.

It was confirmed that an aggregate Uplift of about \$6.6 million (being \$7 million less Trustee's legal expenses) would result in an "equivalence ratio" of 80%, meaning that under the

Conversion a particular ex-DB Member could be worse off in up to 20% of the years of future service from 30 November 2011 to age 65. The Fund Actuary's advice was that, on reasonable assumptions, an aggregate uplift amount of \$10.2 million would be required if all reclassified DB Members were to be no worse off upon retirement.

The existing Surplus of \$12 million in the DB Division exceeded the Uplift required to adequately compensate all reclassified DB Members, and could be applied for that purpose. However, it was being applied to fund a "contributions holiday" for the Company, which was expected to continue for about ten years. Increasing the Uplift would reduce the holiday.

In considering the equivalence ratio, the Court noted the possibility that in 80% of future years, a transferring member may be not only as well off, but better off, than under existing DB Division arrangements.

The Court then considered the impact of the Company's alternative proposed course of action, to terminate the Fund in its entirety. In this case, if the Fund was dissolved:

- (a) DB Members would receive their defined benefit withdrawal benefits referred to in the September Offer; and
- (b) of the balance (ie the Surplus) the Company and DB Members would each receive half.

Accordingly, in the event of Fund closure, pursuant to the Fund Deed's terms, DB Members would be entitled to 50% of the Surplus of \$12 million (less termination costs), which would be less than the amount of the Uplift under the September Offer. Further, given that the estimated cost of terminating the Fund was between \$50,000 and \$250,000, DB Members could expect to receive between \$5.75 and \$5.95 million from the Surplus, whereas under the September Offer, the estimated Uplift for DB Members (after the Trustee's legal costs), to be provided from the Surplus, was \$6.6 million.

Accordingly, as the September Offer involved an Uplift of somewhat in excess of half the current Surplus, DB Members were likely to be slightly better off if reclassified as Accumulation Members than in the event of dissolution of which the Court opined that it was strongly in the Trustee's favour to provide its consent, notwithstanding that the Uplift might be considered less than full compensation, for the reason that the alternative Fund closure would be still more detrimental to members.

The Company's power to dissolve the Fund, conferred by the Trust Deed, is not subject to any express limitation, and the Company was not bound by any fiduciary obligation in exercising its powers under the Fund's Deed. Even if the Company was obliged to exercise its powers honestly and in good faith, the Court's view was that it was very doubtful that such an obligation would prevent the Company from dissolving the Fund, even for its own benefit, especially as a purpose of the dissolution power was to provide a means by which the Company could at any time free itself of the burdens imposed on it by the Deed.

In determining whether consent was a course reasonably open to a prudent trustee. The Court held the view that the September Offer:

- (a) provided an outcome which should see DB Members at least as well off, and possibly better off, in the other 80% of those years, and;
- (b) was, in overall terms, superior to an alternative which the Company could lawfully bring about by dissolution of the Fund.

In those circumstances, a prudent trustee could reasonably conclude that the interests of the beneficiaries and the Fund as a whole would be better served by consenting to the September Offer, than by risking the more detrimental alternative of dissolution.

Herbert Geer Comment

Herbert Geer's Superannuation and Litigation teams acted for the Company in this matter, including its representation at the Supreme Court hearing.

4. OTHER RECENT DEVELOPMENTS

4.1 AASB Exposure Draft 223: Superannuation Entities

The Australian Accounting Standards Board (**AASB**) has issued for comment Exposure Draft ED 223 *Superannuation Entities (Exposure Draft)*. The AASB said it considered a comprehensive review of the general purpose financial reporting requirements applicable to superannuation entities is necessary in light of developments in the superannuation industry since AAS 25 *Financial Reporting by Superannuation Plans (AAS 25)* was originally promulgated and the introduction of International Financial Reporting Standards.

The AASB states that there is broad support for the AASB developing a replacement Standard for AAS 25 that substantially aligns reporting by superannuation entities with other entities applying Australian Accounting Standards. However, the AASB noted concerns with proposals its previous Exposure Draft ED 179 *Superannuation Plans and Approved Deposit Funds (ED 179)* concerning cost-benefit grounds.

In light of these concerns, the AASB has issued the Exposure Draft which includes amendments to a number of the ED 179 proposals.

Comments are due to the AASB by 30 April 2012.

**These articles were produced by Herbert Geer.
They are intended to provide general information in summary form on legal issues.
The contents do not constitute legal advice and should not be relied upon as such.**

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