CHAPTER 5:

PUBLIC OFFER FUNDS - CLAUSE 18

'As Hope J. A. in *Parkes Management Ltd v Perpetual Trustee Co Ltd (1977) ACLC 40-354* observed, the Manager's position in the whole scheme is central to its existence and its removal in a very real sense changes in an important way the character of the scheme'[15]

'We note that there are many management companies which are ill equipped or unable to perform trustee functions or meet the capital adequacy or net tangible assets tests proposal'[16]

Introduction

5.1 This chapter outlines the issues faced by public offer funds as a result of the SIS legislation provisions for transitional arrangements and elections. It describes the operation of a public offer fund and the reasons underlying the single entity concept. There follows an analysis of the difficulties facing public offer funds as to whether the trustee or manager should be appointed as the single responsible entity (i.e. a corporate trustee) and the issue of the irrevocable election to become a public offer fund.

5.2 Under the SIS legislation public offer funds (i.e. funds offering superannuation products to individual members of the public) will come under the prudential control of the ISC. Previously they were regulated by the Australian Securities Commission (ASC). It is envisaged that these

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15 Bankers Trust, SIS Sub No 36, p 4

16 Trustees Companies Association of Australia, SIS Sub No 33, p 2

public offer funds will be operated by a single entity being the corporate trustee who may be either the fund manager or the trustee company. Under Corporations Law these funds are operated under the joint control and management of a trustee and a fund manager.

Public Offer Funds

5.3 A public offer fund is essentially any fund which is not a standard employer sponsored fund unless a declaration has been made by the ISC Commissioner to the contrary under clause 18(6). These funds are, therefore, superannuation schemes offered to the public through a registered prospectus. An indication of the money invested in public offer funds and Approved Deposit Funds was provided by Mr Peter Hutley, who advised that members of the Investment Funds Association (IFA), currently manage $14 billion in these types of funds.[17]

Single entity concept

5.4 Currently public offer superannuation funds operate on a dual entity basis comprising the trustee and the fund manager. A major objective of the SIS legislation is to ensure there is a move away from the dual entity structure to a single responsible entity, that is, either the trustee or the fund manager should operate the fund.

SIS legislation

5.5 The SIS legislation is silent on the issue of whether, in the transition from the present arrangements, the trustee or manager should become the responsible entity. Instead it sets out the **procedures** for achieving single entity status. These include, for example, how the trustee or fund manager should give notice of retirement. The legislation does not provide for the circumstances under which either the trustee or fund manager should retire.

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[17] Evidence p 127

Who should be the responsible entity?

5.6 The Committee has received a number of submissions on which party should become the responsible entity for the superannuation fund under the SIS legislation, most of which support the appointment of the manager as the responsible entity. The reasons include:

- the manger will have committed substantial amounts of capital and resources to the establishment and operation of the fund;
- the manager will have put its reputation at stake in relation to the management of the superannuation fund; and
- the manager will have adopted specific strategies and investments techniques for managing the fund.[18]

Collective Investments: Other Peoples Money[19]

5.7 The Committee has noted the recommendations made in the Australian Law Reform Commission (ALRC) Report No 65[20] concerning the management of collective investments which stated:

> The split responsibility presently prescribed by the law should cease. The scheme operator should have a clear set of obligations, prescribed by law, that it owes to the investors in the scheme. These would include the obligation to act honestly in all matters concerning the scheme and to prefer the interests of the investors to its own interests in all matters concerning the scheme.[21]

5.8 The ALRC concluded that where agreement cannot be reached on which party (the trustee or fund manager) should become the single entity, ultimately the fund manager should assume that status.

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18 Bankers Trust, SIS Sub No 36

19 The Australian Law Reform Commission (ALRC) - Report No 65 *Collective Investments: Other People's Money,* AGPS, Sydney, 1993

20 ibid

21 The Law Reform Commission Report No 65 *Collective Investments: Other People's Money, 1993,* Summary p 5

5.9 In contrast, the submission by the Trustees Companies Association of Australia (TCA) argued against any unfair or arbitrary removal of trustees[22]. TCA submitted that any removal of trustees would effectively eliminate a layer of prudential control for the superannuation fund.

5.10 The Committee was advised that in many cases the promoter or investors may wish to retain the existing independent trustee and that existing funds management companies may be unable to meet the requirements placed upon them by the SIS legislation, such as the proposed $5 million capital adequacy requirement.[23]

5.11 The impression gained by the Committee through both written submissions and oral evidence is that there is a need for a definite appointment of either the trustee or manager as the responsible entity for the superannuation fund, which should take place as soon as practicable after the commencement of the SIS legislation.[24] However, constitutional and administrative considerations make the achievement of this objective extremely difficult.

Constitutional issues

5.12 For example, the automatic appointment of a manager as the single responsible entity raises certain constitutional issues about which the Committee has received varying opinions. One view is that section 51(xx) of the Constitution, the corporations power, does not permit the Commonwealth to legislate for one of the competing parties to be approved as the single entity.

5.13 Another view, which was contested, was that the automatic appointment of a fund manager may constitute an acquisition of property (that is, for example, the denial of a trustee's commission) by the Commonwealth of a kind which requires 'just terms' within the meaning of section 51(xxxi).[25] [26]

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22 SIS Sub No 33

23 ibid

24 MLC Investments, SIS Sub No 86, also advised the Committee of the need to have a streamlined solution to the transitional issue from dual to single entity, as did Potter Warburg Asset Management, SIS Sub No 89, and Sly & Weigall SIS Sub No 79.

25 IFA, SIS Sub No 37 (Freehill's opinion) - See Appendix E

5.14 The Committee believes that the lack of legal certainty in this area is sufficient to warrant caution. To act decisively in favour of either the fund managers or the trustee companies may subject the Commonwealth to a legal challenge involving substantial claims for compensation. Accordingly, the Committee does not recommend the automatic appointment of either the trustee or manager as the single responsible entity for the fund.

Alternatives to automatic appointment

5.15 The Committee considered the option of providing grandfathering provisions to enable the trustee and fund manager to continue their current dual entity arrangement until one party becomes the single entity at a predetermined date in the future. This would involve the existing scheme not accepting any new members and a new scheme being created into which members of the existing scheme could transfer. However, given the need for stability and certainty within the superannuation industry this option is unnecessarily complex and time consuming and therefore has limited merit only.

5.16 Another approach would be to convene a meeting of members of the fund to determine their choice of who should be the single entity.[27] The Corporations Law currently provides for the removal of the trustee or fund manager by a resolution of 50 per cent or more of the value of units in the trust. However, many trust deeds have separate removal provisions which may favour trustees.[28]

5.17 In some funds the removal of the fund manager may only require an ordinary resolution, being 50 per cent of a certain unitholders votes. Whilst the trustee removal may require a special resolution, being 75 per cent of a certain percentage of unitholder votes.[29] The removal of a fund manager under these circumstances would appear to be inequitable. The Committee noted the Law Reform Commission Report No 65,[30] which provided for the appointment of either the trustee or fund manager under the transitional

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[26] Attorney General's Department, Chief General Counsel's opinion of 21 October 1993 - Appendix F

[27] Bankers Trust, op cit

[28] ibid, p 4

[29] ibid

[30] ALRC, op cit

arrangements for collective investments. The Report recommended that within 18 months application of one party to remove the other party can be made to the ASC, provided the other party agrees. If this does not occur within 18 months the Report recommended that the manager be automatically appointed.

5.18 Whilst this solution might appear to provide certainty it is predicated on the possible removal of one of the competing parties, a course of action already described as having potentially adverse outcomes for the Commonwealth (see para 5.13).

5.19 The Committee was advised of another solution in an additional submission made by the Investment Funds Association which recommended:

> that additional covenants be inserted in the Corporations Law which place the manager on even footing with trustee by allowing it to request the trustee to retire if the manager believes that it is in the best interests of unitholders that further interests in the scheme are able to be issued after 1 July 1994. Freehill's advice supports this action.[31]

5.20 The Chief General Counsel's opinion is that this advice does not offer a solution in that it omits to expressly provide that the assets vest in the management company and that if an express provision were made it could be 'characterised' as a law with respect to the 'acquisition of property'.[32]

5.21 Notwithstanding this, if a dispute arises between the trustee and the fund manager it is of critical importance that neither party be or be seen to be placed at an unfair advantage. For example, if a ballot is required to determine single entity status, the right of one party to request that the other stand down could give it an unfair electoral advantage. It is possible that the party with the right under Corporations Law to request that the other stand down may use this power to add moral and legal force in any campaign to become the sole entity. The Committee believes that this is an unsatisfactory arrangement.

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31 IFA Additional material of 21 October 1993 to Sub No 37

32 See Appendix F

Recommendation 5.1:

The Committee recommends that the Government consider amending the Corporations Law to provide public offer superannuation fund managers with the right to request that the trustee retire on the grounds that it is in the best interests of unitholders.

Election to become a Public Offer Fund is irrevocable (Clause 18)

5.22 Under the SIS legislation, where a fund chooses to become a public offer fund it must make an irrevocable election to do so. The Committee has received a number of submissions stating that the necessity for the election to be irrevocable is unnecessarily restrictive.[33]

5.23 It was submitted that circumstances may change and at a later date the fund may wish to revert to an equal representation arrangement, for example, as a means of avoiding the potentially higher operating costs associated with public offer funds.[34] In these cases it is the Committee's understanding that the election may be revoked following a declaration by the Commissioner that the fund is not a public offer fund under clause 18(6). This can only occur where the Commissioner is satisfied that the internal corporate trustee will provide for equal employee/employer representation.

5.24 Mercers submission proposed that this should be clarified in the legislation.[35] The Committee was unable to form the opinion that this is necessary for the reason that clause 18(6) provides adequate scope for the revocation of the election.

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33 William M Mercer, SIS Sub No 72

34 ibid

35 ibid