

# **Explanatory Statement**

## ***Superannuation Industry (Supervision) Act 1993*, section 11E**

### **Determination of requirements for an approved guarantee**

#### **The instrument to which this explanatory statement relates**

This explanatory statement relates to the instrument (the *instrument*) made under paragraph 11E(1)(a) of the *Superannuation Industry (Supervision) Act 1993* (the *SIS Act*) which is entitled Determination of requirements for an approved guarantee, which is dated 25 February 2005.

#### **Revocation of the Determination of requirements for an approved guarantee made on 15 July 2004**

The instrument revokes the Determination of requirements for an approved guarantee made on 15 July 2004 and substitutes a fresh determination of requirements for an approved guarantee given by an ADI in order to simplify the process for making a claim under the guarantee and to make minor practical amendments to provide for alternative forms for signature of the guarantee.

#### **APRA's authority to determine the requirements for approved guarantees**

The SIS Act provides for the prudent management of certain superannuation entities and for their supervision by APRA, ASIC and the Commissioner of Taxation. Under section 6 of the SIS Act (as amended by the *Superannuation Safety Amendment Act 2004* (the SSAA)), APRA has the general administration of Part 2A which relates to the licensing of trustees of APRA regulated superannuation entities (registrable superannuation entities or RSEs).

Under section 29D of the SIS Act, APRA must grant an RSE licence if certain conditions are met. Where an application is for a licence that enables the licensee to be trustee of public offer entities, APRA must be satisfied that the applicant is a constitutional corporation that meets the capital requirements in one of the ways set out in section 29DA.

Subsection 29DA(3) provides that a constitutional corporation meets the capital requirements in the section if APRA is satisfied that the corporation is entitled to the benefit of an approved guarantee that is of an amount equal to or greater than the amount prescribed in regulations and is in respect of the corporation's duties as trustee of each RSE of which it is, or is proposing to become, the trustee.

Subsection 29DA(4) provides that a constitutional corporation may also meet the capital requirements by a combination of net tangible assets and an approved guarantee that together amount to the amount prescribed in regulations.

In both cases, the prescribed amount is five million dollars.

‘Approved guarantee’ is defined in subsection 10(1) of the SIS Act (as amended by the SSAA) to have the meaning given by section 11E.

Section 11E provides that, in the SIS Act, an approved guarantee is one given by an approved deposit-taking institution (ADI), or given on behalf of a State, a Territory, or the Commonwealth, that meets the written requirements determined by APRA. Such a determination is a disallowable instrument for the purposes of section 46A of the *Acts Interpretation Act 1901*.

### **Purpose of the instrument**

The instrument, made by a delegate of APRA, is intended to require that an approved guarantee given by an ADI for the purposes of subsections 29DA(3) and (4) of the SIS Act must contain solely the terms set out in the Schedule attached to the Determination.

### **Background**

The capital requirements for trustees of public offer superannuation entities have a threefold purpose. They provide some financial resources to act as a buffer against risk; they evidence a commitment on the part of a trustee to its superannuation business; and they act as an incentive to the trustee to manage the entity well. The inclusion of options other than net tangible assets of not less than a prescribed amount prevented lack of capital from being a barrier to entry for smaller trustees at the commencement of the SIS legislation in 1993.

The options available to trustees of public offer superannuation entities include having the benefit of an approved guarantee of a prescribed amount. A guarantee is a binding promise by one party to be answerable for the debt or obligation of another if the latter defaults.

Prior to enactment of the SSAA, the only requirement specified in the SIS Act for the guarantee was that it be given by an approved deposit-taking institution or on behalf of the Commonwealth, a State or a Territory. Consequently, APRA was unable to determine the form of the guarantee, for example, to specify the minimum term of the guarantee; the events or circumstances which might occasion the guarantee being called upon, including where APRA might require that the trustee call upon the guarantee; or provisions by which the trustee would acknowledge that the assets of the fund were not available for the purpose of meeting any indemnity to the guarantor.

Various forms of guarantee were submitted to APRA and its predecessor the Insurance & Superannuation Commission. APRA was unable to impose requirements reflecting its view of what should be acceptable, and there was a real doubt that a relevant guarantee could always be invoked in a manner that would achieve the intent of the policy of protecting beneficiaries in the event of trustee default. There was a real risk that the guarantor might be able to recover amounts paid under the guarantee from the beneficiaries’ funds held by the trustee, and no practical way to ensure that

the guarantor had recourse only against the assets of the trustee itself. Overall, there was a concern that all the purposes for which regulatory capital is required would not necessarily be met by an approved guarantee as defined in SIS.

The SSAA introduced changes to the SIS Act aimed at strengthening the regulation of superannuation in Australia. The SSAA established, among other initiatives, a licensing regime for trustees of all APRA regulated superannuation entities. The means by which trustees of public offer entities may meet capital requirements are largely unchanged, in light of the Government's decision to leave unchanged the persons to whom the capital requirements apply and the amount required. However, the SSAA amendments made provision for APRA to determine the requirements for an approved guarantee and so address the identified deficiencies. An applicant for an RSE licence of the public offer class may only be granted a licence if it has the benefit of an approved guarantee that meets the requirements set out in this Determination.

### **What the instrument covers**

The instrument has been drafted with the intention of overcoming some of the shortcomings of the previous regime for approved guarantees, to explicitly stipulate the circumstances in which a guarantee may be called upon, to deal with proof of default and financial loss, and to circumscribe (where an approved guarantee is invoked) the ability of a guarantor to seek indemnity from the assets of superannuation entities administered by the trustee.

The instrument sets out the following terms which are to be included in the deed of guarantee provided by the guarantor:

#### **(a) the parties to the agreement**

The guarantee is given by a constitutional corporation that is an ADI as defined in subsection 10(1) of the SIS Act. Under the deed of guarantee, certain covenants are given for the benefit of the trustee (or an acting trustee or other trustee appointed in place of the trustee). The trustee holds the benefit of the guarantee in trust for the beneficiaries of the entities of which it is the trustee. In appropriate circumstances a beneficiary or group of beneficiaries may approach the court to enforce the guarantee. The trustee must have applied to APRA for an RSE licence of a public offer class on the basis that the trustee meets the capital requirements by means of an approved guarantee or a combination of approved guarantee and net tangible assets.

#### **(b) the scope of the guarantee**

The guarantee is unconditional, and it covers all liabilities (up to the agreed amount of five million dollars, or a lesser amount where the trustee meets the capital requirements by means of a combination of approved guarantee and net tangible assets) of the trustee in respect of the trustee's duties in relation to all RSEs of which it is, or becomes, a trustee during the term of the guarantee. The guarantor will pay upon demand made during the term of the guarantee, in accordance with the terms of the guarantee.

A demand may be made where there has been a default on the part of the Trustee. Default means any failure to perform any duty or obligation imposed upon it under superannuation law which results in any financial loss to any superannuation entity under its trusteeship. 'Default' also covers a breach by the trustee of an enforceable undertaking (under section 262A of the SIS Act) to the effect that the trustee must make a payment of money to any superannuation entity of which it is the trustee.

The guarantor must be given particulars of the default and the financial loss when a demand is made and those particulars are conclusive evidence of the default and the amount of the loss, thereby avoiding the need for the guarantor to make enquiries to satisfy itself of the default or the amount of the loss. In this way the process of making a demand and the ability of the guarantor to be satisfied as to the obligation to pay under the guarantee, is simplified.

### **(c) the term of the guarantee**

Unless varied or revoked with the written consent of APRA, the term of the guarantee is fixed at five (5) years commencing on the date on which the RSE licence issued by APRA to the trustee comes into effect or the date on which the deed is signed, whichever is later. It is intended that on the first occasion the guarantor issues the deed, it will be executed in escrow, to commence operation on the date on which the RSE licence granted to the trustee comes into effect. After the expiration of the first 5 year term, each subsequent guarantee for a term of 5 years will commence on the date the Deed is signed by the guarantor.

### **(d) when the guarantee may be called upon and by whom**

The guarantee may be called upon by the trustee, or by an acting or other trustee appointed in the trustee's place. It may also be called upon by an appointed receiver, receiver and manager, administrator, liquidator or provisional liquidator, either of the trustee or of any superannuation entity operated by the trustee. The guarantee may be called upon in respect of any financial liability arising from breach of a trustee's duties or obligations. There is no requirement for the trustee or other party claiming in place of the trustee to exhaust any other remedies available to them before calling on the guarantee.

The guarantee provides for a demand to be made upon a default by the trustee, regardless of when that default occurs, provided the demand is made during the term of the guarantee.

A demand on the guarantee must be made in writing and must provide particulars of the default by the trustee, including quantification of the amount. The particulars are conclusive evidence of the default and the claimant's calculation of the amount claimed is conclusive unless there is a manifest mistake. The guarantor is under no obligation to make enquiries and in this way, can be satisfied that there is an obligation to pay under the guarantee when a demand is made. The guarantor must pay

the amount in cash within 30 days of the demand. The guarantor must pay interest on amounts payable but unpaid under the deed.

Although the guarantee may be called upon by a replacement trustee or a receiver or other appointee appointed in the place of the original trustee, the guarantee does not extend to any liability of those parties.

**(e) indemnity clauses**

The deed of guarantee provides that any liability occasioned by the trustee to the guarantor is incurred solely in its personal capacity. The guarantor is not entitled to be indemnified out of the assets of the superannuation entities operated by the trustee, but will secure its rights against the trustee over assets of the trustee itself or its related entities.

**(f) limitations on revocation and variation**

The terms of the guarantee may be revoked or varied only with the written consent of APRA.

**(g) guarantor cannot rely on representations**

The guarantor is required to warrant that it has not entered into the guarantee in reliance on any representations or promises by the trustee or beneficiaries. This should ensure that the guarantor makes appropriate inquiries, and will reduce the scope for the guarantor to repudiate the guarantee at a later time.