

Confidential & Privileged

SuperChoice Services Pty Limited

Superannuation clearing houses – Comment on proposed legislative amendments

Advice requested

You have asked us to comment on the following in relation to the proposed legislative amendments regarding superannuation clearing houses:

- 1 What is the nature and extent of any legal risk that would apply to consumers should a private sector clearing house become an approved clearing house (**ACH**)?
- 2 Could relevant legislation be amended to deal with the risk of a clearing house failure (by which we refer to fraud or company financial failure)? How could this be effected?
- 3 Could amendments to the *Corporations Act 2001* (Cth) (**Corporations Act**) be passed concurrently with the proposed amendments to the *Superannuation Guarantee (Administration) Act 1992* (Cth) (**SG Act**), to facilitate a private sector entity acting as an ACH?
- 4 Would you expect advice provided by ASIC or any other appropriate regulator to Treasury (if there was any formal written advice) to be produced in evidence as part of the Senate Inquiry?
- 5 Comment on whether a superannuation guarantee (**SG**) contribution made to Medicare is able to discharge an employer's SG obligation in circumstances where the contribution information it receives is subsequently determined to be inaccurate by the receiving fund. In the event that a discharge is given but the receiving fund has not received or could not accept the contribution please outline legal implications for employers and employees as well as any liability arising for Medicare and the extent of any moral hazard that is created.

Background

The proposed amendments to the SG Act facilitate discharging an employer's SG obligation on payment to, and acceptance by, an ACH. It is proposed that this will only apply where contributions are made to Medicare on the basis that employees would be protected by a government

guarantee in relation to employers' contributions.

This position does not apply to private clearing houses.

Question 1

In our view, a risk of private sector clearing house failure can exist in terms of consumer protection and compensation because, where an employer's SG obligation has been discharged by making a contribution to a clearing house, the proposed legislation does not confer any statutory redress on an employee against:

- the employer, as the SG contribution is taken to have been paid; or
- the clearing house, as no contractual relationship exists between the employee and the clearing house.

Therefore, the legal risk associated with the use of a clearing house is transferred from the employer (as is the case under the current arrangements) to the employee.

That said, whilst a legal risk can be identified, any assessment of risk has to be considered in terms of the likelihood of market failure with regard to historical occurrences and future prospects of such failures occurring. We are not aware of any historical occurrences in Australia.

The existing Australian financial services licensing regime for a non-cash payment facility operator does not specifically impose standards and obligations on the operators that relate to the risks associated with the SG discharge proposal. However, in our view, certain measures could be put in place to mitigate the risks where the SG discharge proposal applied in respect of private clearing houses.

Question 2

In our view, there are a number of legal alternatives available to manage risks associated with the failure of a private sector clearing house. This would not necessarily need to involve legislative amendments.

We have outlined some of these below. However, please note that we have only considered these options at a high level.

Option 1 – Changes to the Australian financial services licensing regime

The existing Corporations Act provisions relating to Australian financial services licensing could be utilised to modify the requirements in respect of a private clearing house who applies to be an ACH.

Under such a regime, the Australian Securities and Investments Commission (**ASIC**) could impose more onerous conditions than are currently required for a non-cash payment facility operator, which could assist in addressing consumer risk, such as:

- financial requirements, for example, an ACH could be
-

- required to have net tangible assets of \$5 million;
- specific requirements around risk management processes could be introduced;
- a higher benchmark for adequacy of resources requirements; and
- minimum compensation arrangements, which could include:
 - minimum levels of professional indemnity insurance; and/or
 - other compensation arrangements approved by ASIC under section 912B(2)(b) of the Corporations Act, such as an industry compensation fund. An alternative could be to leverage off Part 23 of the *Superannuation Industry (Supervision) Act 1993 (Cth) (SIS Act)* by extending the financial assistance scheme in respect of superannuation funds to ACHs.

We also note that many of the existing private clearing houses are APRA-regulated. Therefore, imposing a condition requiring an ACH to be ARPA-regulated could be adopted either as an interim measure or instead of developing requirements for ACHs in respect of financial and other resourcing standards and risk management.

Option 2 – Amendments to the Corporations Act

Alternatively, it would be possible for the Corporations Act to be amended to legislate specific requirements that would have to be met in order to become an ACH.

Again, this could set minimum standards in respect of the requirements we have mentioned under Option 1 above.

Option 3 – Bare trust arrangement

Under Option 1, the relationship between the clearing house and the superannuation fund trustee to whom the contribution is to be paid could be categorised as that of debtor/creditor. Therefore, in the event of insolvency the superannuation fund trustee is simply another creditor.

To provide further protection, an express bare statutory trust arrangement could be implemented (on similar terms to the requirements imposed under section 1017E of the Corporations Act), whereby, a private clearing house holds contributions received from an employer on trust for the superannuation fund trustee to which it is required to be paid.

The trust structure would protect the assets from creditors in the event of the insolvency of the clearing house.

In addition, for taxation treatment purposes, the superannuation fund trustee obtains ownership of an asset when beneficial ownership is acquired and beneficial ownership can be acquired earlier than legal ownership. If this structure were adopted, via either contractual or agency principles, the result could be reached that the contribution is actually made to the superannuation fund trustee once it has

a beneficial entitlement to the assets of the bare trust (ie once the contribution is paid to the clearing house).

The superannuation fund trustee would also have rights against the clearing house if the clearing house acts in breach of trust and as the amounts are superannuation fund assets, the superannuation trustee could be obliged to take action where it considers this to be in the best interests of members of the superannuation fund. This would offer an additional degree of consumer protection.

We envisage that this type of arrangement would require mechanisms to be put in place in relation to:

- the information required to be given to the clearing house; and
- a type of lost money regime in respect of contributions that the clearing house cannot pay to the relevant superannuation fund trustee. This could be aligned with the existing lost money and unclaimed superannuation regime.

Option 4 – APRA regulation

There is also scope to implement more of a prudential regulation model in respect of ACHs whereby APRA is given regulatory responsibility for such entities. However, in our view, this approach could be more costly and time-consuming as it would not have the benefit of leveraging off existing legislation.

Alternatively, combinations of the above could be implemented.

Question 3

There is no legal impediment to passing amendments to various Acts concurrently.

Indeed, the one amending Bill can amend various Acts.

Therefore, for example, the Corporations Act could be amended to facilitate a private clearing house becoming an ACH, in conjunction with the Bill proposing to amend the SG Act.

Question 4

This is not, in our view, a legal question per se. Rather, it depends on Parliamentary practice and procedures. We do not have access to the terms of reference of the Senate Inquiry. However, the Senate Inquiry may well have power to request the advice in order to obtain relevant evidence to make its decision.

Question 5

We are unable to comment on non-legal matters. However, the proposed legislation is designed to grant a discharge on acceptance of the SG contribution by Medicare regardless of the receipt by the destination fund and the accuracy of the information.

Given that an employer would not be responsible for the actual payment of the contribution to the superannuation fund, where Medicare is unable to pay the contribution on to the nominated fund for whatever reason (eg Medicare may not be able to identify the nominated fund or the fund may not be able to accept the contribution) further legislative amendments would need to be made to ensure that contributions which cannot be paid as directed are dealt with for the benefit of the employee.

The proposed amendments do not deal with this point. However, we note that the SG discharge only occurs on acceptance of the contribution by the ACH. Therefore, one possibility is that Medicare could implement administrative processes and procedures prior to acceptance of a contribution to limit the risk of this occurring.

As described above, in our view, a means of dealing with this is for legal machinery to prescribe:

- the information required to be given to Medicare before the contributions will be accepted; and
- a type of lost money regime in respect of contributions that Medicare cannot pay to the relevant superannuation fund trustee. This could be aligned with the existing lost money and unclaimed superannuation regime which utilises the Australian Taxation Office infrastructure.



Michael Vrisakis
Partner
Freehills

+61 2 9322 4411
+61 418 491 360
michael.vrisakis@freehills.com

5 March 2010