

# Explanatory Statement

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

**Superannuation Industry (Supervision) (approved guarantee)  
determination No. 1 of 2006**

## **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*) for the purposes of sub-paragraphs 123(1)(b)(ii) and 123(1)(b)(iii) of the *SIS Act*, which is entitled **Superannuation Industry (Supervision) approved guarantee determination No 1 of 2006**, and dated 26 October 2006.

## Background

*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(5) provides that a constitutional corporation may satisfy the capital requirements by agreeing in writing to comply with written requirements given to it by APRA relating to the custody of the assets of each of the RSEs of which it is the trustee.

An applicant for an RSE licence of the public offer class who seeks to meet the capital requirements through use of a custodian may only be granted a licence if the custodian meets the eligibility requirements set out in section 123 of the *SIS Act*.

A custodian is defined in subsection 10(1) of the *SIS Act*, to mean a person (other than the trustee of an entity) who, under a contract with a trustee or an investment manager of the entity, performs custodial functions in relation to any of the assets of the entity.

A contract between a trustee and a custodian must meet the requirements set out in the Operating Standard for Outsourcing Arrangements of RSE Licensees (the Outsourcing Operating Standard) contained in sub-regulation 4.16(4) of the

*Superannuation Industry (Supervision) Regulations 1994* (the SIS Regulations). The contract must:

- be in writing; and
- state the commencement date of the agreement; and
- contain default arrangements and termination provisions; and
- provide for dispute resolution; and
- contain liability and indemnity provisions; and
- provide for confidentiality, privacy and security of information; and
- contain a pricing, fee and payments structure in relation to the performance of the material business activity; and
- contain audit, monitoring and assessment procedures in relation to the performance of the material business activity; and
- provide for business continuity planning, including transfer protocols relating to the handover of functions from the service provider to either a successor service provider or the RSE Licensee on the cessation of the material business activity.

Section 123 of the SIS Act sets out the eligibility requirements for a custodian. The “person” must be a body corporate. Paragraph 123(1)(b) sets out the financial criteria. The body corporate must either have net tangible assets of the value prescribed by the regulations, or the trustee of the entity must be entitled to the benefit, in respect of the due performance of the body corporate’s duties as custodian of the entity, of an approved guarantee of an amount not less than the amount prescribed by the regulations; or the combined value of an approved guarantee and the value of net assets of the body corporate must be not less than the amount prescribed by regulations. In each case, the regulations prescribe the amount of five million dollars.

A custodian would generally be the holder of an Australian Financial Services Licence (AFSL) and be subject also to regulation by ASIC under the provisions of the *Corporations Act 2001*. ASIC’s requirements in respect of custodians are set out in Policy Statement 166 (PS 166).

‘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*.

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 approved 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 guarantor; or provisions by which the guarantor 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 custodian default. 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.

APRA has previously determined under section 11E the form of approved guarantee to be used by RSE Licensees for the purpose of meeting the capital requirements under subsection 29DA(3) and subsection 29DA(4). The drafting of the instrument is broadly consistent with the previous determination, but reflects the fact that the relationship between the trustee and the custodian is one which is contractual and governed by the Outsourcing Operating Standard.

In the event that an approved guarantee is called upon, it ceases to be a guarantee for the prescribed amount and the custodian must either provide net tangible assets or another guarantee to meet the prescribed amount or subsection 123(3) will operate to render the custodian ineligible to be a custodian, thereby providing another measure of protection for trustees and the beneficiaries of the superannuation entities for whom the custodian acts.

### **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 paragraph 123(1)(b) (ii) and paragraph 123(1)(b)(iii) of the SIS Act must contain solely the terms set out in the Schedule attached to the instrument.

### **Operation of the instrument**

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 liability and to circumscribe (where an approved guarantee is invoked) the ability of a guarantor to seek indemnity.

The instrument has been drafted in such a way as to permit a custodian which holds an AFSL and which is desirous of using the approved guarantee for the purposes of satisfying ASIC's requirements under Part C of Policy Statement 166 (PS 166), to apply to ASIC to accept the approved guarantee for that purpose, thereby avoiding the need to meet separate requirements of APRA and ASIC in an appropriate case.

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

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

The guarantee is given as a deed poll by a constitutional corporation that is an ADI as defined in subsection 10(1) of the SIS Act. The covenants in the guarantee are given for the joint and several benefit of all trustees of all superannuation entities in respect of which the custodian is or has at any time been the custodian, and the custodian itself.

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

The guarantee is unconditional, and it covers all liabilities as defined (up to the agreed amount of five million dollars in the aggregate, or a lesser amount where the custodian meets the capital requirements by means of a combination of approved guarantee and net tangible assets) of the custodian in respect of the custodian's duties in relation to all RSEs of which it is, or has at any time been the custodian under a custodian agreement. The guarantor is required to 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 is a liability (as defined) on the part of the custodian or where the custodian makes a written demand for payment under the guarantee. The ability of the custodian to make a demand for payment is included to meet ASIC's requirements under PS 166 and is not restricted to the custodian's liabilities to RSEs.

A liability is defined as either an amount payable by the custodian pursuant to a judgment or order of any court or tribunal, or an amount which the custodian has agreed in writing to pay, in respect of a failure to perform the duties or obligations arising under or pursuant to a custodian agreement.

A demand must be made in writing and attach a copy of the judgment or order or the custodian's written agreement to pay or, in the case of a demand by the custodian, a certificate signed by certain officers of the custodian. The trustee is not required to claim or enforce any remedies it may have against the custodian or any other person in relation to the liability of the custodian under a custodian agreement.

The demand is conclusive evidence of the liability and the guarantor is not obliged to make enquiry to satisfy itself of the liability or the amount to be paid.

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

Unless revoked with the written consent of APRA (and, where the custodian is the holder of an AFSL, with the written consent of ASIC), the term of the guarantee is fixed at five (5) years commencing on the date on which the guarantee is signed.

**(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 in respect of any liability of the custodian as defined in the guarantee.

The guarantee requires the written demand to attach a copy of the judgement or order of a court or tribunal or the written agreement of the custodian to pay, reflecting the fact that the relationship between the trustee and the custodian is contractual and consistent with the requirements in the Outsourcing Operating Standard for custodian agreements to have liability and indemnity provisions and dispute resolution procedures.

The guarantee may also be called upon by the custodian itself upon providing a certificate signed in accordance with the guarantee.

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 during the term of the guarantee, irrespective of when the liability arises. This provides a measure of protection for trustees where the failure to perform is not discovered until some time after the event or time is taken to obtain a judgment or order or agreement of the custodian to pay, but also ensures that the guarantor's security for the guarantee is still available when the guarantee is called upon.

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.

**(e) the guarantee is absolute and unconditional**

The guarantee is absolute and unconditional. Clause 8 specifically provides that the guarantor's obligations under the guarantee are not prejudiced, released, discharged reduced or otherwise affected by the events listed, which include the variation or novation of the principal agreement giving security for the guarantee or a variation of the custodian agreement or revocation or cancellation of the trustee's RSE licence.

**(f) indemnity clauses**

The guarantee provides that any liability occasioned by the custodian 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 for which the custodian acts as custodian, but will secure its rights against the custodian over assets of the custodian itself or its related entities.

**(g) limitations on revocation**

The guarantee may be revoked only with the written consent of APRA and, where the custodian is the holder of an AFSL, with the written consent of ASIC.

**(h) warranty of capacity to enter into guarantee**

The guarantee provides a warranty by the guarantor that it has capacity to enter into and comply with the guarantee.

**(i) 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 custodian. 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.

## **Consultation**

APRA has been requested to make the instrument by a particular entity desirous of meeting the eligibility requirements to be a custodian under section 123 of the SIS Act by means of an approved guarantee.

Consultation about the instrument was limited to ASIC and the legal advisers for the particular entity at whose instigation APRA has made the instrument, as the particular circumstances of that entity required urgency.

The instrument is not likely to have a direct, or a substantial indirect, effect on business or to restrict competition.

Consultation with a group of ADIs occurred in the course of determining the approved guarantee for the purposes of section 29 of the Act, which is similar in its provisions to the instrument.