

15 February 2013

Manager
Philanthropy and Exemptions Unit
Indirect, Philanthropy and Resource Tax Division
The Treasury
Langton Crescent
Parkes ACT 2600

By e-mail: NFPReform@treasury.gov.au

Dear Sir

**AUSTRALIAN CHARITIES AND NOT-FOR-PROFIT COMMISSION (ACNC) REGULATORY
FRAMEWORK: Consultation On Draft Governance Standards**

State Trustees Limited (**State Trustees**) welcomes the opportunity to provide comments on the draft governance standards for the ACNC regulatory framework. As a member of the Financial Services Council (**FSC**), we have reviewed and had input into drafts of that organisation's submission. We have also sighted the advice of Herbert Smith Freehills (**HSF**) that is included in the FSC's submission. We share the concerns of the FSC and of HSF as to the serious, unintended consequences and risks associated with the interaction of the Commissioner's broad powers with the governance standards as drafted. Due to State Trustees' particular concerns, we also wish to make the additional points and recommendations set out in this letter.

1. Introduction and background to State Trustees' position

As Victoria's public-trustee organisation, State Trustees helps meet the estate planning and administration needs of Victorians. Apart from acting as trustee of a wide range of non-charitable trusts, State Trustees is currently the trustee for over 80 separate charitable funds, with an aggregate value in excess of \$80M. State Trustees' other services include Will preparation, deceased estate administration, administrations for persons with a disability, attorneyship services, and managed fund services. State Trustees is currently the only public-trustee entity in Australia that is both wholly government-owned and established as a public company under the Corporations Act 2001 (Cwth). In addition, State Trustees is an authorised trustee company under the Trustee Companies Act 1984 (Vic.) and is currently the only public trustee holding an Australian financial services licence. We conduct our activities within a highly regulated environment, being subject to a multitude of overlapping statutory and other regulatory obligations, both State and Federal, as well as the standards and duties that apply to professional fiduciaries under the general law.

State Trustees is supportive of the intentions underlying the introduction of the ACNC regulatory framework, including to increase accountability and transparency within the not-for-profit sector and to minimise the regulatory burden upon those operating in the sector. However, due to the comprehensive governance regimes already in place, we consider it inappropriate to make the various State and Territory public trustees and licensed trustee companies (**LTCs**) subject to an additional governance regime in relation to their charitable-trustee services. It would create further regulatory duplication, as well as the potential for confusion and conflict in the governance of charitable trusts administered by these entities. In particular, we believe the Commissioner's powers of suspension and removal under the ACNC Act are inappropriately broad and insufficiently fettered, and give rise to

risks of unfair outcomes, disproportionate penalties and unnecessary costs. We are concerned that these risks may result in damaging unintended consequences for the sector and ultimately for the ACNC framework itself.

2. Application of the governance standards – powers to remove and suspend

Of primary concern to State Trustees is the interaction of the provisions of the draft governance standards with the Commissioner's wide powers of suspension, removal and replacement contained in Division 100 of the ACNC Act.

A "responsible entity" in relation to a registered entity is defined in the Act as (among other things) a trustee of a registered charitable trust and, if the trustee is a body corporate, also includes any director of the trustee. The suspension, removal and replacement powers afforded the Commissioner in respect of breaches of the governance standards apply only to federally regulated entities. Because it is a public company under the Corporations Act, and a corporation to which paragraph 51(xx) of the Constitution applies, State Trustees falls prima facie within the definition of "federally regulated entity". We understand it is currently the only State public trustee to which the definition applies.

We share the concern of the FSC and of HSF that the removal and suspension provisions would be disproportionately punitive in their effect if applied to professional trustee companies that operate in the sector. The flow-on effects of suspension or removal of the directors of a trustee that is a public company, and/or a public trustee, are significantly more severe than the effect of removal of a director of, say, an incorporated charitable entity. Under the ACNC Act, directors of trustee companies and public trustees would in many cases be the "responsible entities" of hundreds of trusts and, if they were to be suspended or removed under the terms of Division 100, then this would mean they would be automatically suspended or removed from being the "responsible entity" of all other registered entities managed by the trustee company, notwithstanding that the contravention may have related to only a single trust. This penalty is grossly disproportionate to that which would be borne by other types of responsible entities, such as those of an incorporated charitable entity.

In these circumstances, there is a real possibility that, in order prudently to mitigate the risk of any such penalty, professional trustee companies, in their role as trustee of charitable trusts, will be much less hesitant to have recourse to the courts for the purpose of obtaining judicial advice in order to protect their position. Such proceedings would generally be at the expense of the relevant charitable trust. Alternatively, some professional trustee companies may conclude that the most prudent course is to curtail or cease their involvement in the charitable and NFP sector.

In our view, it was not appropriate for the Commissioner to have been given the power, as of right, to suspend or remove a trustee or a director of a trustee. Whilst it is clearly anomalous that this power applies to some entities and not others, and to some *public trustees* and not others, it is in our view highly inappropriate that the Commissioner be able unilaterally to suspend or remove any public trustee, or one or more of its directors. Public trustees operate under separate legislation in each of the Australian jurisdictions, with rigorous governance requirements appropriate to entities entrusted with such a role of public trust and responsibility. These requirements (including audit, reporting, remuneration, governance, director liability and related party transaction controls), are more clearly defined than, and in most respects more onerous than, those contained in the draft governance standards.

The special regulated status of public trustees is recognised under the Corporations Act: A public trustee cannot be made subject to the traditional trustee company services regime under Chapter 5D of the Corporations Act unless the relevant State or Territory so requests, and the Federal Minister agrees.¹ This acknowledges the appropriateness of the parallel regulatory regime established for each public trustee in its respective jurisdiction, and of the necessary connection to the government of the State or Territory. For example, in the case of State Trustees, its directors are, in effect, appointed by the Treasurer of Victoria (in his capacity as sole shareholder). We envisage that, in the unlikely event that the Commissioner, in the purported exercise of her Division 100 powers, were to seek to remove or suspend a public trustee (or indeed an LTC), or one or more of the directors of such an entity, the matter would of necessity be the subject of a legal challenge, potentially including a challenge to the constitutionality of the ACNC regulatory framework itself.

3. Position of statutory custodian trustees

We are also concerned that the governance standards may be applied to a “custodian trustee” of a charitable trust in a manner that is inappropriate in light of the unique statutory status of that role.

Pursuant to s 71 of the Trustee Act 1958 (Vic.) (see Appendix), State Trustees or another approved corporation may be appointed to the position of “custodian trustee” whereby the title to trust property is held by the custodian trustee but the trust’s “managing trustees” retain the power of management and all other powers and discretions. The custodian trustee must invest the funds and dispose of its assets as the managing trustees direct. State Trustees acts as custodian trustee for many charitable trusts as do other public trustees and approved corporations throughout Australia.

Division 100 of the ACNC Act and the draft governance standards do not recognise or make provision for the unique role of the custodian trustee. Prima facie, the interaction of Division 100 and the draft governance standards would enable the Commissioner to suspend or remove **all** trustees (meaning the managing trustees and the custodian trustee) for a breach or potential breach of the governance standards. This would place a custodian trustee in the position of being vulnerable to removal when it did not have legal or practical control of decision-making in respect of the trust.

Recommendations

We recommend that, due to their special status within each State and Territory jurisdiction, the specific and comprehensive regulatory and governance regimes to which they are subject, and the practical and legal issues that would arise from the purported suspension or removal of them or their directors, the public trustees of all States and Territories should be exempt from the obligation to comply with the ACNC governance standards. The same considerations will apply to the external conduct standards.

We also support the FSC in seeking acknowledgement of the unique position of LTCs. We recommend, as a minimum, exempting LTCs from Standard 6, and (if they are not to be exempted from all the governance standards) that all public trustees also be so exempted.

Should adoption of the preceding recommendations not be possible, we support the alternative suggestions made by the FSC in regards to alternative exclusions, which would go some way to mitigating the problems we see with the application of draft standard 6.

¹ Corporations Regulations, r 5D.1.01(2).

We also recommend that a custodian trustee appointed under s 71 of the Trustee Act 1958 (Vic.), or its equivalent in other Australian jurisdictions, be deemed not to be a “responsible entity” for the purposes of the ACNC regulatory framework.

If you have any queries in relation to our comments or recommendations, or require any further information, please contact Ms Karen Bradshaw, Senior Corporate Lawyer, via e-mail at karen.bradshaw@statetrustees.com.au or by phone on (03) 9667 6443.

Yours faithfully



A G Fitzgerald
Managing Director

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Appendix

Trustee Act 1958 (Vic.), section 71:

Appointment of certain corporations as custodian trustees

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- (2) For the purposes of this section **approved corporation** means any body corporate which—
- (a) has been formed for the purpose of—
 - (i) promoting art science religion education charity or any other useful object; or
 - (ii) acting as trustee in respect of any trusts for the benefit of any body which has for or included in its principal objects the promotion of art science religion education charity or any other useful object; and
 - (b) applies its profits (if any) or other income in promoting all or any of such purposes; and
 - (c) is approved by Order of the Governor in Council published in the Government Gazette as a corporation which may be appointed custodian trustee pursuant to this section.
- (3) State Trustees or an approved corporation may be appointed custodian trustee by—
- (a) the trust instrument; or
 - (b) any person having power to appoint new trustees; or
 - (c) order of the Court on the application of a beneficiary or of any person on whose application the Court would have power to appoint a new trustee.
- (3A) State Trustees may consent to be appointed custodian trustee whether or not the number of trustees has been reduced below the original number.
- (4) The following apply if State Trustees or an approved corporation is appointed custodian trustee—
- (a) the trust property is to be transferred to the custodian trustee as sole trustee;
 - (b) the management of the trust property and the exercise of any power or discretion exercisable by the trustees under the trust remain vested in the trustees other than the custodian trustee as managing trustees;
 - (c) the custodian trustee has custody of all securities and documents of title relating to the trust property but the managing trustees have free access to the securities and documents and are entitled to take copies or extracts;
 - (d) the custodian trustee must concur in and perform all acts necessary to enable the managing trustees to exercise their powers of management or any other power or discretion vested in them unless the matter is a breach of trust or involves a personal liability;
 - (e) if the custodian trustee does not concur the custodian trustee is not liable for any act or default on the part of a managing trustee;
 - (f) any sum payable to or out of the income or capital of the trust property is to be paid to or by the custodian trustee;
 - (g) the custodian trustee may allow the dividends and other income derived from the trust property to be paid to the managing trustees or as they direct;
 - (h) if paragraph (g) applies the custodian trustee is not answerable for any loss or misapplication of that income;
 - (i) the power of appointing a new trustee when exercisable by any continuing trustee is to be exercised by the managing trustees alone;

- (j) State Trustees or an approved corporation has the same power to apply to the Court for the appointment of a new trustee as any other trustee;
- (k) if the custodian trustee acts in good faith the custodian trustee is not liable for accepting as correct and acting upon any written statements by the managing trustees as to any matter of fact upon which the title to any trust property may depend or acting upon any legal advice obtained by the managing trustees independently of the custodian trustee;
- (l) any matter in dispute between the custodian trustee and any managing trustee may be submitted in a summary manner to the Court whose decision is final and binding;
- (m) the custodian trustee, a managing trustee or any beneficiary may apply to the Court to terminate the custodian trusteeship;
- (n) if the Court is satisfied that the custodian trusteeship should be terminated the court may make any orders and give any directions it considers appropriate.