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Submission from Arnold Bloch Leibler

Improving the integrity of Public Ancillary Funds

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1 Background & Summary

1.1 This submission has been prepared by Joey Borensztajn and Anetta Curkowicz as part of the Arnold Bloch Leibler ("**ABL**") Public Interest Law practice. It responds to the Discussion Paper released by Treasury in November 2010 entitled "Improving the integrity of Public Ancillary Funds" ("**Paper**").

1.2 ABL is a commercial law firm with offices in Melbourne and Sydney. A commitment to serving the public has always been deeply ingrained in ABL's culture. The firm has a significant pro bono public interest practice and a long standing and genuine interest in giving back to the community. ABL is a long time supporter of Australian philanthropy.

1.3 In addition, ABL acts for a significant number of not for profit entities and high net wealth individuals, many of whom are philanthropists or philanthropically minded. ABL has been involved in establishing and providing ongoing advice and guidance to a number of public ancillary funds.

1.4 Although the Paper highlights a number of issues of concern, it is fundamental that any proposed Guidelines do not:

(a) impact on the crucial role of public ancillary funds in philanthropy in Australia; or

(b) adversely apply to existing public ancillary funds and thereby prejudice, retrospectively, those public ancillary funds which were established within the then applicable regulatory framework. It would be unfair to change the ground rules for existing public ancillary funds. Only public ancillary funds established after the new Guidelines come into effect should be subject to the new requirements.

2.1 PRINCIPLE 1 - PUBLIC ANCILLARY FUNDS

2.1.1 Required distributions

What is an appropriate minimum distribution rate for public ancillary funds and why?

(a) The minimum distribution rate should only apply to new public ancillary funds. Existing public ancillary funds that have obtained Australian Taxation Office ("**ATO**") approval to accumulate funds on a different basis should not be prejudiced retrospectively. If a public ancillary fund has received ATO approval for a permanent accumulation for the whole or part of the amount in the public ancillary fund (for example, to fund a perpetual gift or endowment) then it would be unfair to now change the approved accumulation plan.

(b) ABL supports the Government's proposal to set a minimum distribution rate for new public ancillary funds. A minimum distribution rate, if appropriately set, would simplify the process of both providing funds to the community and retaining them to grow a public ancillary fund corpus.

(c) A public ancillary fund provides funds year in year out, irrespective of economic conditions to continue to support not for profit institutions when they need it most. This means that not for profit institutions are more likely to receive a consistent source of funding rather than donations that rise and fall with the economic conditions of the day.

(d) In determining an appropriate distribution amount, consideration must be given to finding a figure that ensures that public ancillary fund dollars reach the community without relegating the philanthropic initiative of establishing and maintaining the public ancillary fund to a premature demise.

(e) ABL suggests that a minimum distribution rate of 50% of the gifts and all income received during the prior income year is appropriate. The minimum distribution rate should not be based on the 'market value' or 'closing value' of the public ancillary fund's total assets at a particular point in time. Of course, a minimum distribution rate is simply that, a minimum, and many public ancillary funds will distribute at a higher rate.

(f) Although ABL supports a minimum distribution rate for new public ancillary funds, flexibility should exist to enable new public ancillary funds, in special circumstances, to seek to vary the minimum distribution rate. This is particularly important for public ancillary funds that exist for the purposes of funding perpetual gifts, scholarships, research grants or endowments. Prolonged accumulation of gifts is not inconsistent with the principles of a public ancillary fund and in fact there are many circumstances where accumulation should be permitted. For example, where a donor gifts say $5 million to a public ancillary fund for the purposes of funding a yearly distribution to a hospital for a research grant, imposing a minimum distribution rate would result in the capital being reduced at an accelerated rate greater than that intended by the donor. Rigidly imposing a minimum distribution amount would mean public ancillary funds established for funding perpetual gifts or endowments would be limited to operating for a finite period of time. ABL agrees the Guidelines should provide additional clarity in relation to the circumstances which the ATO will permit a plan of accumulation.

(g) If a high minimum distribution rate is imposed and there is no flexibility for variation, public ancillary funds established with an initial endowment that does not solicit further donations will cease to exist. This is acknowledged in the Paper

at paragraph 34, which states: "Imposing a distribution rate means that public ancillary funds not continuing to receive donations are eventually wound down."

(h) One of the stated justifications by the Government is that such a distribution rate will prevent the erosion of a public ancillary fund through negative investments, fees and the like. However, the impact of negative investments is not enhanced by providing a minimum distribution rate, particularly a high minimum distribution rate. Irrespective of the minimum distribution rate, negative returns are always possible. In fact, if a high minimum distribution rate is imposed, during periods of negative returns, public ancillary funds will be unable to survive.

2.1.2 Regular valuation of assets at market rates

Are there any issues that the Government needs to consider in implementing the requirement to ensure public ancillary funds regularly value their assets at market rates?

(a) The Government's proposal that public ancillary funds value their assets annually on 30 June is not unreasonable. However, if the ABL proposal for a minimum distribution rate of 50% of the gifts and all income received during the prior income year as set out in paragraph 2.1.1 is accepted, valuations will not be necessary as the primary purpose of the market valuation is to calculate the minimum distribution amount.

Are the valuation rules that apply to private ancillary funds also appropriate for public ancillary funds? If not, why not?

(a) If it is necessary for public ancillary funds to regularly value their assets at market value, ABL agrees with the Government's proposal that the valuation rules should mirror the rules set out in the Private Ancillary Fund Guidelines.

2.1.3 Increased public accountability

Are there any issues with requiring public ancillary funds to lodge a return?

(a) ABL does not have any concerns with the proposal to require public ancillary funds to lodge an income tax return.

Are there any issues with imposing greater public disclosure requirements on public ancillary funds? What information should remain confidential and what information should be disclosed and why?

(a) ABL agrees that all public ancillary funds should be recorded on the Australian Business Register ("**ABR**") along with the indication that they are a public ancillary fund.

(b) Donors detail should remain confidential. It is not uncommon for people who want to give money to require their gift to be anonymous. Some do not want their wealth to be known publicly, others simply prefer to avoid the limelight. Often such anonymous donors are extremely generous and it would be a great pity to lose their contribution simply because they could not preserve their anonymity. Accordingly, ABL believes that it is imperative that the details of donors are kept confidential.

(c) It is important to be clear that this issue has nothing to do with secrecy because the details of all public ancillary funds are available to the ATO. It is purely an issue of ensuring that the resources of a public ancillary fund are used effectively, and that the privacy of donors who wish to give anonymously is respected.

2.2 PRINCIPAL 2 — PUBLIC ANCILLARY FUNDS ARE TRUSTS THAT ABIDE BY ALL RELEVANT LAWS AND OBLIGATIONS, AND ARE OPEN, TRANSPARENT AND ACCOUNTABLE

2.2.2 Increasing regulatory powers

Is the administrative penalty regime (including magnitude of penalties) that applies to private ancillary funds suitable for public ancillary funds?

(a) Yes. However, if, as the Paper suggests, there are instances of systematic abuse of public ancillary funds, ABL encourages taking appropriate action to stamp out that behaviour. The taking of such action is consistent with maintaining the integrity of the public ancillary fund system.

Are there any difficulties in requiring public ancillary funds to have a corporate trustee?

(a) If the corporate trustee proposal is implemented, then we submit that it should not be applied retrospectively to existing public ancillary funds and that only public ancillary fund established after the new Guidelines come into effect should be subject to this requirement.

Are the rules for suspension or removal of trustees of private ancillary funds suitable for public ancillary funds?

(a) Yes, ABL believes that the rules for suspension or removal of trustee of private ancillary funds are suitable for public ancillary funds.

What fit and proper person requirement should be imposed on trustees of private ancillary funds?

(a) The minimum standards of conduct for trustees included in the Private Ancillary Funds Guidelines should be included.

(b) Imposing training or other qualification standards may restrict the number of people eligible and/or willing to take on the role of the trustee. A stringent fit and proper person test would necessarily exclude the involvement of many interested and capable people.

(c) It is submitted that it is undesirable to impose a high threshold requirement of a "fit and proper person" which will not encourage and inspire Australians to act philanthropically, but will in fact restrict or limit the number of people that can participate in carrying on the public ancillary funds activities.

(d) The "fit and proper person" test for a Registrable Superannuation Entity ("**RSE**") seems to impose two elements to being a fit and proper person:

(i) being of good character, honesty and integrity among other things; and

(ii) having the required degree of educational or technical qualifications, knowledge and skills.[1]

(e) It is acceptable to have a high level of criteria imposed regarding the honesty and integrity of individuals. This is something that most people easily satisfy and would not be an impediment to attracting volunteers.

(f) In addition, given the essential philanthropic character of a public ancillary fund it is desirable that people with good character and integrity are involved. Therefore, a strict test similar to the RSE licensees requirements in paragraph 15(b) of the Australian Prudential Regulation Authority's Prudential Practice Guide SPG 520 in this regard is acceptable.[2]

(g) It is also accepted that some degree of skill and competence is necessary. However, it is too onerous to require a trustee to have experience and expertise at a university or occupational level. This will cause potential difficulties for some public ancillary funds with trustees who may not yet have attained this level of experience or have chosen an occupational path not deemed "worthy" to be considered relevant knowledge or skills.

(h) It is especially considered too strict to require trustees of a public ancillary fund to demonstrate "the appropriate competence in fulfilling occupational, managerial or professional responsibilities previously and/or in the conduct of his or her current duties".[3]

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[1] *Superannuation Industry (Supervision) Regulations 1994*, Regulation 4.14(4).

[2] Australian Prudential Regulation Authority Prudential Practice Guideline SPG 520 - Fitness and propriety paragraph 23(b) ("**APRA PPG**"). This approach is also similar to the Law Institute of Victoria Admission Requirements for eligibility to apply for a practicing certificate to be admitted to the legal profession.

[3] APRA PPG, paragraph 23(a)(ii).

(i) The audit, annual ATO return and Responsible Person obligations ought to be adequate integrity safeguards.

(j) If the fit and proper person test proposal is implemented, then we submit that it should not be applied retrospectively to existing public ancillary funds and that only public ancillary funds established after the new Guidelines come into effect should be subject to this requirement.

(k) Furthermore, if the fit and proper test is implemented, ABL believes that it would be too cumbersome to require public ancillary fund's to develop a fit and proper policy[4] to assist it to manage the risk that responsible offers are not fit or proper as required.

2.2.3 Transitional rules

What transitional arrangements are required for existing public ancillary funds to conform to the new arrangements?

(a) In a number of instances in this submission, ABL has expressed the view that the new Guidelines should not apply retrospectively to existing public ancillary funds and should only apply to public ancillary funds established after the new Guidelines come into effect.

2.3 PRINCIPAL 3 - PUBLIC ANCILLARY FUNDS ARE PUBLIC

Should the term "public fund" be clarified in the guidelines in accordance with the principles set out in ATO *Taxation Ruling TR 95/27***?**

(a) Yes, ABL agrees with the proposal that the term "public fund" should be clarified in the Guidelines in accordance with the principles set out in Taxation Ruling TR 95/27. This will result in the requirements for a "public fund" being contained in a single document ensuring clarification and convenient access .

2.4 PRINCIPLE 4 - PUBLIC ANCILLARY FUNDS ARE ANCILLARY FUNDS

Can the investment and risk minimisation rules that apply to private ancillary funds be suitably applied to public ancillary funds.

(a) Trustees of a public ancillary funds are currently obliged, as a matter of law, to consider the benefits of diversified investments; to balance risk of loss; to maintain the real value of capital and to consider liquidity of investments.

[4] APRA PPG, paragraphs 9 to 15.

(b) ABL believes that the current standards that must be adhered to by trustees are adequate to ensure that public ancillary funds are able to meet their minimum distribution requirements while maintaining appropriate short, medium and long-term investments.

3 CONCLUSION

In summary, for the reasons articulated in this submission:

(a) any minimum distribution rate should not apply to existing public ancillary funds;

(b) a minimum distribution rate of 50% of the gifts and income received during the prior income year is appropriate for new public ancillary funds;

(c) there should be no minimum distribution rate based on a percentage of 'market value' or 'closing value' of the public ancillary fund's total assets at a particular point in time;

(d) flexibility should exist to enable public ancillary funds, in special circumstances, to seek to vary the minimum distribution rate and accumulate funds for a particular purpose;

(e) there should be no requirement for the personal details of donors to public ancillary funds to be disclosed to the public;

(f) if public ancillary funds are compelled to have a corporate trustee, the requirement should not apply to existing public ancillary funds;

(g) no fit and proper person test should be introduced;

(h) if a fit and proper person test is introduced, the fit and proper person test should not oblige trustees to have a minimum required degree of education or technical qualification, knowledge and skills; and

(i) none of the significant proposals should be applied retrospectively to existing public ancillary funds.

Arnold Bloch Leibler