MFCo

Date
12 February 2016

PAF Guidelines
Exposure Draft Response

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Dear Sir/Madam

Exposure draft of amendments to the *Private Ancillary Fund Guidelines 2009*

The Myer Family Company (MFCo) is pleased to respond to the exposure draft of amendments to the Private Ancillary Fund (PAFs) Guidelines 2009.

In line with its mission to build strong families and communities, MFCo has established over 100 PAFs for individuals and families since the enabling legislation was introduced. It continues to support many of these clients with secretariat, compliance, investment and grant-making support and advice on distributions totalling $15m per year into the non-profit sector. Our PAF client portfolio varies across corpus size, maturity and granting strategy and combined with our broad range our philanthropy services (secretariat, compliance, administration, investments) we have a working experience across many of the issues raised in the exposure draft.

Overall, we support and endorse the submission lodged by the peak organisation, Philanthropy Australia (PA), and its recommendations therein. Like PA, which has canvassed its membership base on these proposed changes, we contacted our PAF client representatives on the particular issue of the proposed change to the minimum distribution as we felt this change was potentially the most contentious. We received some mixed feedback to the proposed changes, but the majority of our clients who responded were in support of the current guidelines remaining in place. This is a position that MFCo supports. We provide some supporting comments around this proposed change to the level of the minimum distribution, as well as some of the other guidelines, in the notes that follow.

Please contact me should you wish to discuss MFCo's submission.

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MFCo Notes on amendments to the PAF Guidelines

Guideline 19.1. The arguments for or against the proposed changes to minimum distribution are finely balanced, and can differ depend on the particular circumstances of a PAF and the philosophy of its trustees.

Our clients raised the following issues, in order of priority and number of mentions, which on balance favour the status quo and maintaining the minimum of 5% net assets:

- the attraction of **simple and easily quantifiable guidelines** that set clear expectations between PAF stakeholders and service providers
- the requirement of non-profit organisations **for regular distributions from philanthropy** and that such distributions should be counter-cyclical rather than pro-cyclical (because non-profit organisations typically require more support in financial downturns)
- the PAF **investment strategy** and risk appetite, the historical performance of the PAF, and the investment outlook of the trustees or the investment advisors
- the **social license to operate** for a PAF, and its philanthropic mandate to support the community in return for receiving preferential tax benefits rather than to accumulate a corpus
- the **sequencing** of years of negative investment returns following the establishment of a PAF and allowing greater flexibility to trustees around distributions
- the **life stage** of the PAF, such as accumulate/stable/spend down, and the ability to build its corpus to a 'critical size' for those in accumulation phase
- the **granting strategy** of the fund, and the preferences of trustees to distribute more than the minimum and to be self-directed in this regard

It is also worth looking at the impact of the proposed guidelines had they been in place over the last 10 years, and had the trustees had chosen to distribute the minimum amount according to the guidelines. Assuming a model PAF portfolio of **70%:20%:10%** for AU equities (Myer Family Charities Equity Fund): Fixed Income (UBS Composite Bond Index): Cash respectively, the proposed guidelines would have been to effectively reduced the minimum distribution requirement from 5% of the market value of the fund's net assets to the average RBA cash rate (currently sitting at 2.0%), or a minimum of $11,000 in years when the fund experienced negative returns. This outcome is depicted by the 'green line' in Figure 1 below (Min. Distribution PROPOSED).

It is interesting to note that, in this 10 year period, the 'green line' is the lessor of the RBA cash rate or $11,000. Because net investment returns of the fund per year are either above the RBA cash rate, or negative, this option as a minimum distribution level effectively becomes redundant as the RBA cash rate tends towards zero. Subject to the outlook for interest rates and investment returns, the proposed guidelines in a low interest rate environment are effectively making the lessor of the RBA cash rate and $11,000 the effective option for trustees.

The Balanced Portfolio average total return for this model portfolio over the last 10 financial years is 8.1% (before franking credits, net of investment expenses). While returns have been admittedly volatile and cover a period including the recent global financial crisis, they illustrate that, over the last 10 year period and given similar investment strategy settings to the model portfolio, adequate total fund returns were achievable to cover:

- minimum distribution requirements (**5%** net assets)
- inflation, thereby retaining real value of the corpus (**2.6%** average the last 10 yrs)

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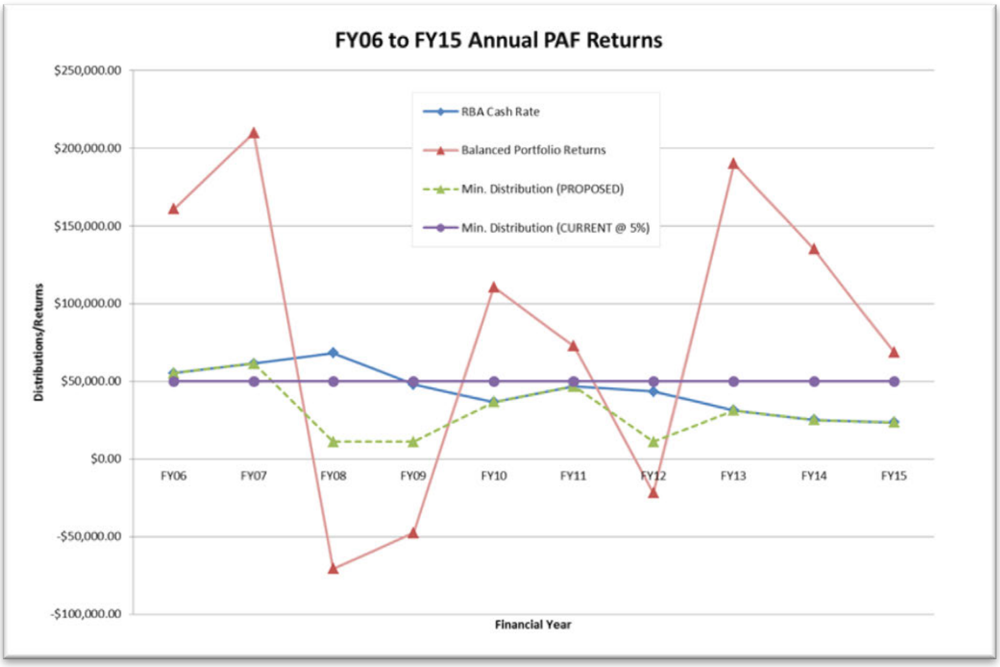
- reasonable expenses (between **0.25%** and **0.5%** of net assets)

This is before any accounting for franking credits that provide an additional boost to income for PAFs invested in Australian equities.

Overall, this 10 year performance suggests the current guidelines have been adequate.

Figure 1:
Annual PAF Returns vs. Min Distributions (FY06 – FY15)

Assume $1m PAF at the beginning of each financial year



Had the model PAF portfolio been **60%:20%:20%** for AU equities: Fixed Income: Cash using the same investment products, the historical 10 year average total return would have been 0.5% less at **7.6%** (before franking credits, net of investment expenses). With a lower margin to maintain the real value of the corpus, it raises the sensitivity of this issue of minimum distributions by PAFs to the fund's investment settings and performance.

Further to the views expressed by our clients on this issue, MFCo believe the current guidelines currently provide the correct balance between simplicity and consistency while also providing trustees with the bounded discretion to deliver on the purpose of the PAF to invest in the community in return for its tax concessions. Investment strategy and implementation are clearly important to generate adequate income to cover the minimum distribution requirement as well as CPI and expenses, and trustees need to ensure the fund has the adequate investment settings in place. PAFs in 'accumulate' or 'stable' phases should have longer-term investment settings in line with the model portfolio above, and while PAFs in 'spend down' are likely to hold shorter term securities, they are very likely to be distributing more than the minimum distribution anyway.

That said, any future changes to the minimum distribution should adopt the current format of a fixed percentage rate calculated on the net assets of the fund from the prior financial year.

Guideline 19.3. We agree with the PA position that greater guidance is required around 'impact investing' and how the PAF guidelines anticipate the variety of such projects now available to PAFs, including hybrids in some cases. Certain organisations have also applied for tax rulings to confirm the compliance with PAF guidelines for receiving impact investment from PAFs (as in the recent case of AUSiMED and its Venture Philanthropy Fund). A more generic approach will be required as the impact investing sector expands, such as an interpretation statement or public tax ruling.

Guideline 28.1A. We agree with PA that the minimum threshold for a 'review' rather than an 'audit' of PAF financial statements and compliance should be raised to $1,000,000. The granting strategies of PAFs below this size tend to be relatively simple and the investment strategies more formulaic, and often within managed funds or unit trusts. Therefore, the financial impost of a full audit is less necessary and a compliance review by a registered company auditor should be sufficient. This change in the guidelines would need to be reflected in changes to the PAF Trust Deed.

Guideline 51.A. We agree with the PA response to the proposed changes to guideline 51.A., including portability *'between ancillary fund types'* and the option for trustees to split the assets of the PAF to accommodate family circumstances. However, the latter recommendation needs to consider whether the resulting size of the ancillary fund receiving the portion of assets meets a certain size threshold so as not to split a PAF into uneconomic parts.