



12 February 2016

General Manager  
Law Design Practice  
The Treasury  
Langton Crescent  
PARKES ACT 2600

Dear Sir/Madam,

**RE: PROPOSED AMENDMENTS TO PAF AND PuAF GUIDELINES**

Thank you for the opportunity to provide feedback in relation to the proposed amendments to the *Public Ancillary Fund Guidelines 2011 (PuAF Guidelines)* and *Private Ancillary Funds Guidelines 2009 (PAF Guidelines)* (collectively, **the Guidelines**) released for public consultation in December 2015.

The Financial Services Council (**FSC**) represents Australia's retail and wholesale funds management businesses, superannuation funds, life insurers, financial advisory networks, licensed trustee companies and public trustees.

Within the trustee sector of their businesses, the FSC's trustee members act as trustee or co-trustee for over 1,500 charitable trusts or foundations with assets of around \$4.37bn. During 2013/14 alone, trustees distributed over \$190 million to charities via donations and as project grants from those trusts and foundations.

Trustees are held to the highest professional and fiduciary obligations under the common law and legislation. Without licensed trustee companies and public trustees, vast sums of money donated for charitable purposes, such as to fund critical work in health, education and research, would not be responsibly managed. For over 100 years, trustees have lain at the heart of philanthropy in Australia.

Philanthropy, which benefits all Australians, and provides strong financial support to the not for profit (**NFP**) sector, grows each year as a result of the expertise of trustees. There is strong demand for the services of professional trustees who have years of experience prudently administering charitable trusts.

As a guiding principle, we believe the Guidelines should aim to smoothly facilitate and encourage philanthropy in Australia, noting that our rates of charitable giving continue to lag behind other countries, such as the UK, US, and Canada. Unnecessary rigidity, complexity and administrative burden should be removed from the Guidelines so as to help Australia realise its tremendous growth potential.

The Guidelines should also operate as important instruments of governance, strengthen accountability to the community, and engender confidence in Australia's rapidly maturing philanthropic sector.

Our comments below reflect those of FSC members which are licensed trustee companies or public trustees actively involved in philanthropy.

## **General comments**

It is important that administrative arrangements operate sensibly and efficiently, allowing the NFP sector to focus on providing important services to the community. Red-tape and compliance costs should be front of mind when considering the regulation applicable to this sector. Careful cost benefit analysis should be undertaken before imposing new regulatory and administrative obligations on the NFP, recognising the important role charitable entities play in society.

In particular, the FSC encourages the Government to consider ways to streamline administrative processes in relation to the establishment and reporting of private ancillary funds (**PAFs**) and public ancillary funds (**PuAFs**).

We believe there are **opportunities to expedite the establishment of PAFs and PuAFs**, especially where the client is using a model deed. Currently, the process to obtain the necessary approvals (charitable registration, and DGR status) from the two co-regulators, the Australian Tax Office (**ATO**) and Australian Charities and Not for Profits Commission (**ACNC**), can take six to eight weeks. These delays can deter clients who often wish to create a PAF or PuAF in June of a financial year, shortly prior to the close of that year.

We also encourage **the alignment and consolidation of ATO and ACNC reporting obligations**. For example, the current PAF Guideline 17 allows 21 days to report to the Commissioner on Governing Rules, whereas the ACNC provides 28 days (for medium and large charities) and 60 days (small charities). Similarly, duplication exists where an annual audited information statement and audited financial accounts must be lodged with the ACNC, in addition to a PAF or PuAF return and audited financial accounts provided to the ATO.

## **PuAF Guidelines**

- Guideline 14: Responsible person requirement

We believe that the existing “Responsible Person” requirement has deterred some professional trustees from managing PuAFs, with a concomitant loss of expertise for those funds. In particular, the current wording of the requirement appears to dictate that the controlling body of a PuAF be comprised of a majority of independent persons.

As outlined above, professional trustees are deeply involved in the philanthropic sector, and have provided expert advice to donors and the NFP sector for over 100 years. Accordingly, we **advocate for a relaxation of this requirement where a licensed trustee company is a member of the controlling body** of a PuAF (noting that such an exemption already rightfully exists for public trustees).

Further, we note that trustee companies are subject to regulation and oversight by the corporate regulator, the Australian Securities and Investments Commission (ASIC), which imposes license conditions to ensure clients are appropriately protected. These conditions include requiring trustees to have substantial financial backing, adequate risk insurance and client access to a legislated external dispute resolution scheme.

- Guideline 19: Minimum annual distribution

We **welcome the proposed amendment of the Guidelines so as to link the minimum annual distribution amount for both PuAFs and PAFs to income** rather than net assets. This is sensible reform given it is the nature of investment markets that returns fluctuate year on year. To link a minimum distribution amount to the net assets of the fund rather than the income, means that in times of low or negative investment return, the proposed guidelines would require the distribution of capital to make up for any income shortfall. Such a provision would often be in direct conflict with the trust deed that evinces an intention for the fund to operate in perpetuity.

However the FSC believes that the formula outlined in the proposed amendment to the Guidelines is complex and in the absence of clarification, may lead to unintentional non-compliance, including the (incorrect) belief that there is no obligation to distribute in some years.

Any preference by Treasury for a mandatory rate linked to income rather than capital should be simple and easy to understand. Our suggested formula would be: the higher of all income including franking credits (net of expenses) or the average RBA cash rate over the previous financial year (to be advised by the ATO for consistency across the sector).

However, we understand that any change to the Guidelines so as to link the minimum distribution rate to income rather than assets may generate some concern within the NFP sector (i.e. that the overall rate of distribution/support may fall in a given year). The FSC encourages trustees to carefully consider the impact that any reduction (in a given year) may have on the financial state of charities that the fund supports, noting that the Guidelines will only mandate a *minimum* distribution rate and that it remains the duty of the fund's controlling body to make decisions consistent with its object of being a vehicle for philanthropy.

Should the Government decide not to proceed with an income-based minimum distribution rate, we suggest that further, targeted consultations be undertaken.

We also support the **alignment of distribution rates** of PuAFs and PAFs to the same level. Historic differences in the distribution rate have been linked to the requirement for PuAFs to solicit funds from the public. However, today, many philanthropists choose to structure their giving for simplicity, scale and distribution reasons, via PuAFs.

The FSC would welcome clarification from Treasury that the **distribution requirement is gross of fees**, as there is currently some ambiguity. We also ask Treasury to consider the current *Corporations Act 2001* requirement that trustee fees for charitable trusts (including PuAF and PAF structures) be taken from income, given that the model deeds appear to suggest fees can be sourced from either income or capital.

- Guideline 19.3: Social impact bonds

We believe that it is virtually impossible to determine the market rate of return for a "similar corporate bond" given that a market for bonds issued by charitable/NFP institutions does not exist in Australia. Accordingly, in the interests of clarity, we suggest that **any social impact bond that is issued should advise investors from the outset on the agreed return differential** between the impact bond and a similar corporate bond.

- Guideline 42: Uncommercial transactions and benefits to Founder/Donor

It is attractive for charitable organisations to be able to budget for an ongoing stream of income rather than relying on irregular donations. This objective is achievable through a named fund where the organisation is the beneficiary of that fund. In many instances, charitable organisations have provided "seed money" to create a named sub-fund, enabling them to avoid high initial start-up costs and ongoing management costs.

Often the structure and governance arrangements of Community Foundations, being already in place, attract charitable organisations wishing to establish a fund that will harvest future contributions from donors and provide the organisation with that perpetual source of future income.

Being part of a Community Foundation provides them with the ability to attract ongoing support and growth of their named sub-fund through donors attracted to the notion of providing ongoing income through the perpetual investment of the capital.

The FSC believes that **the Guidelines should not prevent organisations from seeding funds into a named sub-fund**, as it would constrain their ability to attract donors wishing to leave a lasting gift.

- Guideline 44: Non-binding donor preferences

The FSC supports the apparent intention behind the insertion of a note to the effect that it is good practice for trustees to review, amongst other things, any non-binding preferences indicated by donors, before making distributions.

However we believe that the Guidelines can go further, by requiring trustees to *consider* these preferences (acknowledging that they must remain non-binding). Some clients of FSC members who do not wish to create a PAF, have expressed their concern with the fact that there is no such obligation for PuAFs, which has deterred them from establishing such a fund and therefore limited the total pool of funds available to charities.

- Guideline 50: Portability

**The FSC believes that portability should be allowed between PuAFs and PAFs, rather than being limited to public ancillary funds.** Generational change, compliance costs, and a desire for greater input on investments are all sound reasons presented by philanthropists for such a change. See also our comments below regarding proposed PAF Guideline 51A.

We also recommend an amendment to the Guideline so as to allow for sub-account transfers to occur at any point in a year so long as the mandated distribution has already occurred. Currently, the wording of this Guideline appears to require an entire PuAF to have already met its minimum distribution requirement before any sub-account can be transferred. This runs counter to the apparent intention of the Guideline – to note the sub-account’s compliance for the year.

Further, the proposed amendment appears to suggest that where the PuAF has received assets in the previous two years, it cannot transfer assets out. Such an outcome would be unduly restrictive given that PuAFs typically hold multiple endowed accounts. This apparent restriction should be removed, or at a minimum, offer an exemption for those funds with endowed accounts.

#### **PAF Guidelines**

- Guideline 14: Responsible Person requirement

The FSC believes that the Responsible Person requirement needs clarification in circumstances where there is more than one corporate trustee (this will now be common given the requirement that trustees be incorporated was introduced after the 2009 Guidelines).

It would be beneficial if there only needed to be one Responsible Person as a director of one of the trustees (especially if that trustee is a professional trustee – i.e. licensed trustee company or public trustee).

- Guideline 19: Minimum annual distribution

Please see comments above regarding PuAF Guideline 19. The same approach should be adopted for PAFs.

- Guideline 28: Audits

The FSC supports accountability for PAFs, acknowledging that annual audits can act as a valuable integrity measure. This notwithstanding, in our view, an annual audit for small PAFs can be costly and create an unnecessary compliance burden, especially in instances where the PAFs are low value/low transaction funds, and the fund is being managed by a professional trustee (i.e. licensed trustee company or public trustee).

In particular, public trustees are subject to significant governance and audit responsibilities as government instrumentalities, whilst licensed trustee companies are regulated and strictly licensed by the Australian Securities and Investments Commission (ASIC).

Regarding the proposed introduction of reviews rather than audits for PAFs with assets and revenues of less than \$500k (proposed Guideline 28.1A), we instead **suggest that there be an alignment with the reporting requirements of the ATO and ACNC.** More specifically, the ACNC and ATO mandate reporting sizes of either small (less than \$250k annual revenue) or small and medium (less than \$1m annual revenue). By proposing a \$500k threshold for a “review”, another ad hoc reporting level is added to compliance procedures.

It is critical to ensure the requirements of the review are aligned and the same for the ACNC and the ATO. To that end, **we ask Treasury to consider whether a review is satisfied for small (or medium) PAFs or PuAFs on the submission of mandatory annual financial data to the ACNC.**

Separately, we note that the ATO requires auditors of PAFs to confirm compliance with *all* PAF Guidelines. While the PAF Guidelines rightfully alert the trustees to their responsibilities, they also include matters of generality which, unlike the financial items, are difficult for an auditor to confirm compliance with. Many of the 60 items currently outlined in the PAF Guidelines are not financial in nature or matters on which auditors would typically give an audit opinion.

Equally, similar issues arise for PuAFs, whereby auditors are required to confirm compliance with all 57 items set out in the current PuAF Guidelines, some of which are non-financial.

Accordingly, **we propose that the audit requirements be amended to allow the trustee/committee of responsible persons to confirm compliance with the non-financial items.** Such a change would immediately reduce compliance costs for both PuAFs and PAFs.

The FSC also notes that the Commissioner has no discretion to waive the audit requirement in relation to any instances of non-compliance. Where a trust seeks to rectify non-compliance going back more than one year (before the trustee's involvement), we would **recommend the Guidelines (both PAFs and PuAFs) enable the Commissioner to waive the audit requirement** to prevent lengthy and expensive audits for prior years.

- Proposed Guideline 51A: Portability

While we welcome the proposed Guideline's permitting of portability between PAFs (with the Commissioner's consent), it still does not allow for a PAF to move into an endowed account in a PuAF. Such a restriction does not address some of the needs in the sector whereby accounts within public funds and community foundations are providing preferred solutions where PAFs were established for smaller funds.

**Instead we suggest that a discretion be granted to the Commissioner to enable portability across PAFs and PuAFs.**

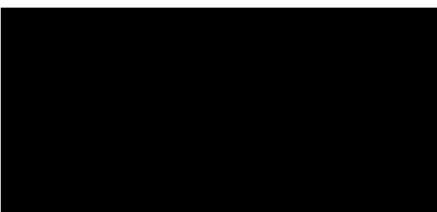
### ***Next steps***

Thank you for the opportunity to provide feedback in relation to the proposed amendments to the Guidelines. We believe this consultation process offers a valuable opportunity to enhance the regulatory framework, and stimulate the growth of philanthropy in Australia.

There are also further technical issues which would benefit from clarification and/or modification, for example, around the closure of PAFs. We would welcome the opportunity to discuss these issues further.

Please feel free to contact me on [REDACTED], if you have any questions, or would like to clarify, any points made in our submission.

Yours sincerely



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