

CIRCULAR



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To: All Members

147/98

No:

Legal Update Series

Amendments to the Insurance and Superannuation Regulations

Attached is Legal Update L1/98 in relation to SIS regulations which provide clarification on the use of derivatives by trustees of regulated superannuation funds and Approved Deposit Funds, with respect to the giving of a charge over the assets of the fund.

Please circulate to the relevant staff, in particular compliance and legal personnel in your office as soon as possible. Where Members have indicated relevant staff, the update will be directly circulated to those staff as well.



Legal Update

No: L1/98

Issued: 20 May 1998

AMENDMENTS TO THE INSURANCE AND SUPERANNUATION REGULATIONS

Introduction

Amendments were recently made under the *Superannuation Industry (Supervision) Act 1993* to the *Superannuation Industry (Supervision) Regulations* ("SIS") which clarify the use of derivatives by trustees of regulated superannuation funds and Approved Deposit Funds particularly with respect to the giving of a charge over the assets of the fund. A copy of the relevant portions of the amendments and the explanatory statement are attached.

Position Prior To The Amendment

The Insurance and Superannuation Commission ("ISC") has viewed cash or other security lodged with the Clearing House for initial and variation margin calls to represent a 'charge'. A trustee of a fund was prohibited, pursuant to *Superannuation Industry (Supervision) Regulation 13.14*, from giving a charge over, or in relation to, an asset of the fund. A charge is defined as including a mortgage, lien or other encumbrance.

The ISC Commissioner made Modification Declaration No.20 on 17 February 1997 which expressly nullified the effect of SIS Regulation 13.14 provided certain conditions were met (see Legal Update No. L1/97). The effect of this declaration was to permit the trustee of a fund to sign a futures client agreement containing the prescribed terms as set out in part B of the First Schedule of the SFE Business Rules without contravening the SIS legislation.

Purpose of Amendments

The purpose of the amendments which pertain to derivative trading was to place within the body of the Principal Regulations the substance of the prior declaration (No.20) made by the Commissioner in 1997. However as noted below the regulation omits the requirement to include cash in the threshold for the reporting requirements.

How the Amended legislation Operates

These amendments operate in much the same manner as the declaration in that they permit a trustee of a fund to give a charge over an asset of a fund if the charge is in relation to a derivatives contract entered into by or on behalf of the trustee. The new regulations includes contracts entered into by a broker on instructions of a trustee or by a broker for the benefit of the trustee as well. All of the foregoing applies only where the charge is given in order to comply with the rules of an approved body and the investment to which the charge relates is made in accordance with the funds risk management statement and that statement sets out:

- “(i) policies for the use of derivatives that include an analysis of the risks associated with the use of derivatives within the investment strategy of the fund; and
- (ii) restrictions and controls on the derivatives that take into consideration the expertise of staff; and
- (iii) compliance processes to ensure that the controls are effective (for example, reporting procedures, internal and external audits and staff management procedures);” (see attached Reg. 13.15A(c)).

The Sydney Futures Exchange Limited (“SFE”), the Sydney Futures Exchange Clearing House Pty Limited (“SFECH”), and a body specified in Schedule 11 of the Corporations Law (recognised foreign futures exchanges), are among the entities which have been selected as approved bodies for purposes of the regulation. Therefore where a charge is given as a consequence of complying with the rules of one of the above mentioned bodies in relation to the performance of obligations in relation to the securing of a derivatives contract then contravention of the legislation has not taken place as long as a risk management statement exists and it conforms with the legislated mandate as set out in the penultimate paragraph above.

Disclosure Regime To Continue

What the amended legislation permits is the making of initial and variation margin payments to SFECH pursuant to SFE and SFECH rules and requires the reporting of that charge by the trustee to the fund and to the Insurance and Superannuation Commissioner when the “derivative charge ratio” exceeds 5%. The “derivatives charge ratio” of a fund is expressed as:

$\frac{X}{Y}$

Where: **X** is the market value of the assets of the fund (other than cash) that are subject to a charge in relation to a derivatives contract and **Y** is the market value of all of the assets of the fund.

Significant Change From Declaration

The “derivatives charge ratio” is defined in the regulation to represent the market value of the assets of the fund (other than cash) that are subject to a charge in relation to a derivatives contract as a proportion of the market value of all the assets of the fund (cash included). This represents a significant change from the prior Modification Declaration No. 20 made by the ISC Commissioner in which cash was included in the market value of the assets of the fund for purposes of calculating the percentage of the fund subject to a charge which must be reported to the fund and to the ISC Commissioner.

If you have any queries regarding this issue, please contact Francis Cox, Senior Manager - Regulation on (02) 9256-0505.

NB: The above information is for the guidance of Members and does not purport to be legal advice. The note should be read in conjunction with the Legislation and any ISC Circulars. Where appropriate, legal or other professional advice should be sought.

**The copy of the attached may be hard to read
Please refer to the distributed hard copy**



Statutory Rules 1998 No. 83¹

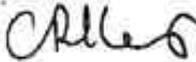
Superannuation Industry (Supervision) Regulations² (Amendment)

I, THE GOVERNOR-GENERAL of the Commonwealth of Australia, acting with the advice of the Federal Executive Council, make the following Regulations under the *Superannuation Industry (Supervision) Act 1993*.

Dated 26 APR 1998 1998.

WILLIAM DEANE
Governor-General

By His Excellency's Command,


Assistant Treasurer

1. Commencement

- 1.1 Regulation 15 commences on 1 November 1998.
- 1.2 The remainder of these Regulations commence on gazettal.

6. Regulation 2.29 (Specific requirements in particular cases)

6.1 Subregulation 2.29 (1):

After paragraph 2.29 (1) (g), insert:

- "(ga) if the derivatives charge ratio of the fund (as defined in subregulation (5)) exceeded 5% at any time during the reporting period:
- (i) the derivatives charge ratio as at the end of the reporting period; and
 - (ii) the highest derivatives charge ratio attained during the reporting period; and
 - (iii) an explanation of why the derivatives charge ratio exceeded 5%; and
 - (iv) an explanation of the meaning of 'derivatives charge ratio' in, or to the effect of, the following:
"The derivatives charge ratio is the percentage of the total market value of the assets of the fund (other than cash) that the trustee has charged as security for derivatives investments made by the trustee.".

6.2 Add at the end:

"(5) For the purposes of paragraph (1) (ga), the derivatives charge ratio of a fund is:

$$\frac{X}{Y}$$

expressed as a percentage, where:

X is the market value of the assets of the fund (other than cash) that are subject to a charge in relation to a derivatives contract (as defined in subregulation 13.15A (2)); and

Y is the market value of all the assets of the fund.

"(6) If paragraph (1) (ga) applies, the trustee must give the information mentioned in that paragraph to the Commissioner as soon as practicable, and in any event within 6 months, after the end of the reporting period to which the information relates."

- (ii) an interim lump sum (not exceeding the amount of the benefits ascertained at the date of an event mentioned in subregulation (1) or (1A)) and a final lump sum (not exceeding the balance of the benefits as finally ascertained in relation to the event)."

17. Regulation 6.25 (Compulsory cashing of benefits in approved deposit funds)

17.1 Subregulation 6.25 (2):

Omit the subregulation, substitute:

"(2) The form in which benefits may be cashed under this regulation is, in respect of each person to whom benefits are cashed:

- (a) a single lump sum; or
- (b) an interim lump sum (not exceeding the amount of the benefits ascertained at the date of an event mentioned in subregulation (1)) and a final lump sum (not exceeding the balance of the benefits as finally ascertained in relation to the event)."

18. Regulation 13.14 (Charges over assets of funds)

18.1 Omit "subject to regulation 13.15.", insert "subject to regulations 13.15 and 13.15A."

19. New regulation 13.15A

19.1 After regulation 13.15, insert:

Charges in relation to certain derivatives contracts

"13.15A. (1) A trustee may give a charge over, or in relation to, an asset of a fund if:

- (a) the charge is given in relation to a derivatives contract entered into:
 - (i) by, or on behalf of, the trustee; or
 - (ii) by a broker on the instructions, or on account, of the trustee; or
 - (iii) by a broker for the benefit of the trustee; and

- (b) the charge is given in order to comply with the rules of an approved body (as defined in subregulation (2)) that requires the performance of obligations in relation to the derivatives contract to be secured; and
- (c) the fund has in place a risk management statement that sets out:
 - (i) policies for the use of derivatives that include an analysis of the risks associated with the use of derivatives within the investment strategy of the fund; and
 - (ii) restrictions and controls on the use of derivatives that take into consideration the expertise of staff; and
 - (iii) compliance processes to ensure that the controls are effective (for example, reporting procedures, internal and external audits and staff management procedures); and
- (d) the investment to which the charge relates is made in accordance with the risk management statement.

(2) In this regulation:

approved body means:

- (a) Australian Stock Exchange Ltd;
- (b) Options Clearing House Pty Ltd;
- (c) Sydney Futures Exchange Ltd;
- (d) Sydney Futures Exchange Clearing House Pty Ltd;
- (e) a body that is an approved foreign exchange within the meaning of regulation 1.2A.02 of the Corporations Regulations;
- (f) a body specified in Schedule 11 of the Corporations Regulations;
- (g) a body that performs clearing house functions in relation to a body mentioned in paragraph (e) or (f) (*the second body*) in accordance with the rules of the second body or a law of the country where the second body is situated.

derivative means a financial asset or liability the value of which depends on, or is derived from, other assets, liabilities or indices.

derivatives contract means an option contract or futures contract relating to any right, liability or thing, including in particular:

- (a) an option contract as defined in section 9 of the Corporations Law; and
- (b) a futures contract within the meaning of section 72 of the Corporations Law; and
- (c) an agreement to which section 72A or 92A of the Corporations Law applies."

20. Schedule 1AA (Part 1—Exempt public sector superannuation schemes (1994-95 and 1995-96 years of income))

20.1 Omit "Schemes established by or under:" (wherever occurring), substitute "Schemes established by or operated under:".

20.2 Under the heading "COMMONWEALTH", insert the following Act:

"*Defence Act 1903*".

21. Schedule 1AA (Part 2—Exempt public sector superannuation schemes (1996-97 year of income and subsequent years of income))

21.1 Omit the Part, substitute:

**"PART 2—EXEMPT PUBLIC SECTOR SUPERANNUATION
SCHEMES (1996-97 YEAR OF INCOME)**

COMMONWEALTH

Schemes established by or operated under:

Defence Act 1903

Defence Force Retirement and Death Benefits Act 1973

Governor-General Act 1974

Judges' Pensions Act 1968

Parliamentary Contributory Superannuation Act 1948

EXPLANATORY STATEMENT

STATUTORY RULES 1998 NO

Issued by the authority of the Assistant Treasurer

Superannuation Industry (Supervision) Act 1993

Superannuation Industry (Supervision) Regulations (Amendment)

The *Superannuation Industry (Supervision) Act 1993* (the Act) and the *Superannuation Industry (Supervision) Regulations* (the Principal Regulations) provide for the prudent management of certain superannuation funds, approved deposit funds and pooled superannuation trusts and for their supervision by the Insurance and Superannuation Commissioner.

Section 353 of the Act provides that the Governor-General may make Regulations for the purposes of the Act.

The purposes of these Regulations are to amend the Principal Regulations to implement certain minor amendments to improve the efficiency and effectiveness of the regulatory framework for superannuation and to make miscellaneous technical refinements to the Principal Regulations. The amendments have been prepared in light of administrative experience and/or industry representations. All amendments are 'stand alone' and relatively minor in nature. In summary, the Regulations:

- include in the definition of 'reviewable decision', a decision by the Insurance and Superannuation Commissioner under regulation 12.08 of the Principal Regulations to specify a deadline for a fund trustee to make an application for a pre-1 July 1988 funding credit (Regulation 3);
- make changes to Schedule 1AA of the Principal Regulations which lists those Commonwealth, State and Territory public sector superannuation schemes which are exempt public sector superannuation schemes (ie, exempt from the provisions of the SIS Act and the *Superannuation (Resolution of Complaints) Act*) (Regulations 4, 20 and 21);
- insert into the body of the Principal Regulations, the substance of Modification Declaration No. 20 (MD 20), which was effective from 17 February 1997. MD 20 allows trustees of regulated superannuation funds and Approved Deposit Funds (ADFs) to give a charge over the assets of the fund in relation to derivatives transactions (Regulations 6, 18 and 19);
- provide that certain fund documents be given on request to a concerned person or an employer-sponsor (Regulation 7);

- restrict the application of the provision of disclosure of information regarding the existence and functions of the Superannuation Complaints Tribunal to cases of 'complaints' only (Regulations 8, 9 and 10);
- provide that a decision by a delegate of the trustee who has been properly delegated by the trustee to make such decisions is valid without requiring a two-thirds majority of a trustee board (Regulation 11);
- permit the arrangement for Deferred Annuities to provide reversionary annuities (Regulation 12);
- provide that fund trustees may treat certain benefits as unrestricted non-preserved benefits under the Principal Regulations (unrestricted non-preserved benefits are benefits which the fund member can access anytime) (Regulations 13, 14 and 15); and
- enable a trustee to pay up to two lump sums for compulsory cashing of benefits: an interim payment of a portion of the benefit when the member's entitlement arises and the remainder of the benefit when finally ascertained (Regulations 16 and 17).

The Regulations are described in detail in the Attachment.

The regulations will commence on gazettal, except for Regulation 15 which will commence on 1 November 1998.

Regulation 6 - Regulation 2.29 (Specific requirements in particular cases)

Regulation 2.29 of the Principal Regulations requires trustees of superannuation fund to give to each member of the fund items of information as prescribed in the regulation so far as they are applicable.

Subregulation 6.1 amends subregulation 2.29(1) by inserting new paragraph (ga) to require the trustee to inform members of the fund if the derivatives charge ratio of the fund exceeds 5% at any time during the fund reporting period.

Subregulation 6.2 inserts new subregulations 2.29(5) and (6).

Subregulation 2.29(5) inserts a definition of 'derivatives charge ratio' for the purposes of paragraph 2.29(1)(ga). The ratio represents the market value of the assets of the fund (other than cash) that are subject to a charge in relation to a derivatives contract as a proportion of the market value of all the assets of the fund.

Subregulation 2.29(6) requires the fund trustee to inform the Insurance and Superannuation Commissioner, as soon as practicable, and in any event within six months after the end of the reporting period, if the derivatives charge ratio of the fund exceeds 5% during the fund reporting period.

Regulation 7 - Regulation 2.41 (Specific requirements)

At present, subregulation 2.41(2) of the Principal Regulations provides that particular documents, such as the governing rules and the most recent actuarial report of the superannuation entity, need not be given on request to a 'person', if the person is not a 'concerned person'. A 'concerned person' is defined in subregulation 2.40(3) as a person who is, or was within the preceding 12 months, a member of the superannuation entity or is a beneficiary.

As employer-sponsors may wish to make a decision as to whether to continue contributing to the superannuation entity, it is reasonable to provide employer-sponsors with access, on request, to the governing rules of the entity and financial information on the entity.

Therefore, subregulation 2.41(2) is amended to provide the exception that the above documents need not be given to a person other than a concerned person or an employer-sponsor. By implication, the documents specified in subregulation 2.41(1) would therefore be given on request to a concerned person or an employer-sponsor.

Regulation 8 - Division 2.6A (Information in respect of inquiries and complaints)

The Regulation amends the heading of Division 2.6A to reflect the application of the Division to complaints only, as amended by Regulations 9 and 10 below.

The Principal Regulations currently provide that, unless taken as a pension or annuity, superannuation benefits must be cashed as a single lump sum only.

Where a benefit in a fund is cashed and the fund's actual earning rate is not yet known for the period since the fund's last balance date, a fund's estimated earning rate is generally used to calculate the benefit for that period. If the estimated earning rate is lower than the actual earning rate, the earnings of a member who cashed his or her benefit according to the interim rate will be lower than the earnings of a member who has retained his or her benefit in the fund. This could lead to inequities between members.

Alternatively, the trustee can delay paying the single lump sum until the actual earning rate is known. In some circumstances, on the death of a member, the member's dependants may face financial hardship as a result of having to pay bills, and may be without income for a period until the benefit is paid.

Regulation 18 - Regulation 13.14 (Charges over assets of funds)

Under regulation 13.14, it is an operating standard, subject to regulation 13.15, that regulated superannuation funds must not give a charge over, or in relation to, an asset of the fund. With the introduction of the exception to the standard in regulation 13.15A below, regulation 13.14 is amended to include the exception in regulation 13.15A.

Regulation 19 - New Regulation 13.15A

At present, regulation 13.14 of the Principal Regulations prohibits trustees of regulated superannuation funds and ADFs from giving a charge over an asset of the fund. However, this prohibition was temporarily lifted by Modification Declaration No 20 issued by the Insurance and Superannuation Commissioner on 17 February 1997. Regulation 19 incorporates the Modification, with some amendments, as Regulation 13.15A, into the body of the Principal Regulations. Modification Declaration No 20 will be revoked after Regulation 19 comes into effect.

Regulation 13.15A is inserted into the Principal Regulations to provide that a trustee of a regulated superannuation fund or an ADF may give a charge over the assets of the fund in relation to derivatives contracts entered into on Australian, and certain specified foreign, stock exchanges or futures exchanges or clearing houses.

Subregulation 13.15A(1) provides that the trustee of a fund may give a charge over, or in relation to, an asset of a fund if the charge is given to comply with the rules of an 'approved body' (defined in subregulation 13.15A(2)). The trustee may only give a charge if the fund has in place a risk management statement and that the investment to which the charge relates is made in accordance with the risk management statement.

Subregulation 13.15A(2) prescribes, for the purposes of subregulation 13.15A(1), the names or types of bodies as approved bodies whose rules require the performance of obligations in relation to the derivatives contract to be secured.

In addition, subregulation 13.15A(2) defines 'derivative' and 'derivatives contract'. A derivatives contract means an option contract or futures contract relating to any right, liability or thing, including in particular an option contract or futures contract as defined in sections 9 and 72 respectively of the Corporations Law or an agreement to which section 72A or 92A of the Corporations Law applies.

Regulation 20 - Schedule 1AA (Part 1 - Exempt public sector superannuation schemes (1994-95 and 1995-96 years of income))

Subregulation 20(1) replaces the heading of 'Schemes established by or under' wherever it occurs in the Schedule with 'Schemes established by or operated under' to recognise that the original legislation establishing some public sector schemes has been repealed or replaced.

Subregulation 20(2) inserts the name of the *Defence Act 1903* into the Schedule to correct the list of Commonwealth exempt public sector schemes from the years 1994-95.

Regulation 21 - Schedule 1AA (Part 2 - Exempt public sector superannuation schemes (1996-97 year of income and subsequent years of income))

This Regulation substitutes a new Part 2 applicable to the 1996-97 year of income, and inserts Part 3 into Schedule 1AA, applicable to 1997-98 year of income and subsequent years of incomes. Part 3 and the new Part 2 remove from the list of exempt public sector superannuation schemes from the years 1997-98, schemes established by or under, in respect of Victoria, the *Port of Geelong Authority Act 1958* and the *Port of Melbourne Authority Act 1958*, and in respect of Queensland, the Government Officers' Superannuation Scheme (GoSuper), the Police Superannuation Fund (Police Super), the State Service Superannuation Fund (State Super) and the Queensland Fire Service Superannuation Plan.

The Regulation also replaces the name of the *New South Wales Superannuation Administration Act 1991* with the *Superannuation Administration Act 1996* from the year 1996-97 and the name of the *Victoria Director of Public Prosecutions Act 1994* with the *Public Prosecutions Act 1994*.

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20/05/98

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