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AUSTRALIAN
Superannuation
LAW BULLETIN

Volume 18 Number 1

Print Post Approved 255003/00770

Rethinking the nature of a 'superannuation interest'

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Michael Chaaya
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A number of the recent reforms within the superannuation industry have generated considerable debate regarding how best to characterise the precise nature of a member's interest in a superannuation fund and the impact of that characterisation on the reform initiatives.

Initiatives such as financial services reform, family law splitting, contributions splitting and the introduction of the transition to retirement income streams have raised, yet again, the interesting relationship between trust law, contract law and legislative reform in the context of superannuation.

This article explores the definition of a superannuation interest as a single beneficial interest in a fund. Part 2 of this article, to be published in the next issue of the *Australian Superannuaion Law Bulletin*, considers the consequences of this definition having regard to contributions splitting as a recent policy initiative.

Interplay of trust law, contract law and legislative reform

Regulation of superannuation in Australia — trust law and legislation

As readers are only too well aware, the superannuation industry is regulated by a collection of legislative instruments, the most significant of which are the *Superannuation Industry (Supervision) Act 1993* (Cth) (SIS Act) and the *Superannuation Industry (Supervision) Regulations 1994* (Cth) (SIS Regulations). By virtue of s 19 of the SIS Act, superannuation funds that are regulated by the SIS Act and Regulations must be constituted as a trust. Accordingly, a superannuation fund has all the traditional hallmarks of a trust: namely, a trustee, trust property and beneficiaries. This means that unless otherwise excluded by legislation or by the provisions of a trust instrument, the general law is still applicable to superannuation funds.

Indeed, in his address to the Law Council of Australia Superannuation Conference in 2002, Justice Graham Hill concluded that:

> … the situation in Australia will be that the true nature of the employee's interest in the normal scheme, whether contributory or non contributory, and whether the benefits may be accumulation or defined end benefits, is a beneficial interest in a trust estate governed wholly (subject to legislative intervention or administrative action, for example by the Superannuation Complaints Tribunal) by the law of trusts.[1]

His Honour's conclusion would appear to be consistent with the definition of 'superannuation interest' in s 10 of the SIS Act. That section defines superannuation interest as 'a beneficial interest in a superannuation entity'. Unfortunately, the SIS Act goes no further in terms of defining the phrase 'beneficial interest', and thus

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The *Australian Superannuation Law Bulletin* welcomes Anthea Nolan, David Shirlow and Bill Stanhope to our Editorial Panel. We also farewell Glenys Hodges and thank her for her contribution.

reliance is placed on general law principles to ascertain the meaning of the phrase.

In a simple formulation, a beneficial interest has been defined as '[a] right or expectancy in something (such as a trust or an estate), as opposed to legal title to that thing'.[2] This is vitally important when it comes to interpreting the scope of some of the recent legislative reforms to superannuation and the issues they create for those seeking to take advantage of the reforms (see the discussion in Pt 2 of this article).

Dal Pont and Cockburn have commented that '[t]he nature of a beneficiary's right in a superannuation trust has traditionally been viewed as no more than an expectancy'.[3]

The authors quote from the decision in *Re Coram* where it was held that:

> ... [u]ntil the happening of a prescribed event that will crystallise his right into an actual entitlement, a member of a superannuation fund is neither the legal nor the beneficial owner of the amount that stands to the credit of his account from time to time.[4]

More recent decisions have taken issue with the decision in *Re Coram*. For example, in *Sayseng v Kellogg Superannuation Pty Ltd*,[5] a case involving a dispute as to whether a member of a superannuation fund was entitled to a total and permanent disablement benefit, Bryson J expressed the following view:

> Perhaps in their origin discretionary trusts in superannuation schemes were perceived as having a similar function as exercises of bounty, but if this was once so it has for a long time not accorded with the realities of the employment relationship, in which employees contribute their own funds, sometimes over many years, and bargain for employer contributions which have the economic function of being part of the reward for employee services. Notwithstanding the incorporation of discretionary tests, the shared expectation that benefits will actually be available as contemplated is extremely strong, and reasonably so. These circumstances must have some influence on the responsibilities of trustees and on the approaches of courts to the tests (to which McLelland referred to in *Rapa v Patience*) of good faith in the exercise of powers, real and genuine consideration, compliance with the purposes for which power was conferred, and soundness of reasons when reasons are given. In the context of the employment relationship, and of the importance of retirement benefits, including benefits for total and permanent disablement, the responsibility of trustees is high and scrutiny of their decisions is only to be expected and is appropriate.
>
> A discretionary trust is not a satisfactory vehicle to secure entitlement to superannuation or retirement benefits. Discretionary superannuation trusts are not well suited to the expectations of those involved in employment relationships and the actual functioning of those relationships. The persistence of this kind of scheme, rather than some scheme in which entitlements are more open to objective ascertainment, is remarkable.

Does contract law have any role to play in the relationship between a member and a trustee?

Another complicating factor in implementing some of the recent regulatory reforms is the extent to which, if at all, a member's interest in a superannuation fund is characterised as a right in contract, as well as (or instead of) a beneficial interest in a trust. A definitive analysis of both sides of this debate is beyond the scope of this article. However, before considering some of the recent reforms and their relationship with the characterisation of a member's interest in a superannuation fund, it is important to note the argument that in the Australian superannuation context, two distinct legal relationships may exist — one founded in trust law, the other in contract law.

For example, Santow J in *Uncle v Parker, Warner and Millott* was of the opinion that:

> In construing the provisions of a superannuation trust deed, I accept that while the document reflects a trust relationship it is also a contract struck against an employee background which creates rights that increasingly are an important part of the employees' remuneration package.[6]

In *Imperial Group Pension Trust Ltd v Imperial Tobacco Ltd* (a case regarding the ability of the trustee of a defined benefits scheme to amend the benefits payable), Lord Brown said:

> Pension scheme trusts are of quite a different nature to traditional trusts. The traditional trust is one under which the settlor, by way of bounty, transfers property to trustees to be administered for the beneficiaries as objects of this bounty. Normally, there is no legal relationship between the parties apart from the trust. The beneficiaries have given no consideration for what they receive. The Settlor, as donor, can impose such limits on the bounty as he chooses, including imposing a requirement that the consent of himself or some other person shall be required to the exercise of powers.
>
> As the Court of Appeal have pointed out in *Mihlenstedt v Barclay Bank International Ltd* ... a pension scheme is quite different. Pension benefits are part of the consideration which an employee receives in return for the rendering of his services. In many cases, including the present, membership of the pension scheme is a requirement of employment. In contributory schemes, such as this, the employee is himself bound to pay his or her contributions. Beneficiaries of the scheme, the members, far from being volunteers have given valuable consideration. The company employer is not conferring a bounty. In my judgment, the scheme is established against the background of such employment and falls to be interpreted against that background.[7]

Although in some cases superannuation benefits will be considered a term of the employment contract, this does not necessarily mean that the trustee of the relevant fund is a party to any contract with the employee. It is conceivable that there is a contractual relationship between employer and employee where the employer agrees with the employee to contribute an amount to a superannuation fund. However, the difficulty in finding a contract between the trustee and the employee is largely as a result of no consideration passing between them.

It is unclear whether this argument is applicable in the context of public offer superannuation funds. For these funds, a prospective member is required to complete an application form issued by the trustee before becoming a member of the fund.[8] It is common for such forms to require a declaration by the member to agree to be bound by the fund rules. Does the completion and acceptance of such forms create a contractual relationship between the member and trustee?

In *United Super Pty Ltd v Built Environs Pty Ltd* [2001] SASR 339, a case concerning an industry fund for workers in the building industry, the fund member signed an application form which summarised the benefits payable under the fund and applied to the trustee for admission as a member of the scheme upon the terms and conditions contained in the deed by which the fund was established. It was held by Gray J of the Supreme Court of South Australia that, in addition to a trust relationship between the trustee and the member, there was also a contractual relationship between them, the contract being formed upon acceptance of the application form by the trustee. Unfortunately, the judgment contains no discussion of what the consideration was, which passed between the trustee and the member.

The significance of this is the remedies that a member may seek to rely on if their interest is grounded in contract law as opposed to equity (or even both contract and equity).●

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Against the backdrop of the preceding discussion of the interplay of trust law and contract law in the context of superannuation, Part 2 of this article will consider whether the principle of a single beneficial interest works for superannuation funds.

This article draws on a paper which was presented by the author at the Law Council of Australia Superannuation Conference in Melbourne on 25 February 2006.

Endnotes

1. Justice Graham Hill 'The true nature of a member's interest in a superannuation fund', paper delivered at the *Law Council of Australia Superannuation Conference* Adelaide 20–23 February 2002.
2. Garner B A (ed) *Black's Law Dictionary* Thomson West, USA 2004 at p 828. It is noteworthy that in a recent decision of the High Court of Australia, it was held that where a trust deed provides unitholders with an interest in the assets of the trust as a whole, it does not confer any ownership interest in any particular asset of the unit trust such that the unitholder does not own the land held by the trust: see *CPT Custodian Pty Ltd v Commissioner of State Revenue; Commissioner of State Revenue v Karingal 2 Holdings Pty Ltd* [2005] HCA 53; BC200507253.
3. Dal Pont G and Cockburn T *Equity and Trusts in Principle* Law Book Company, Sydney 2005 at p 349.
4. (1992) 109 ALR 353 at 357.
5. [2003] NSWSC 945; BC200306802 at [59], [60].
6. (1994) 55 IR 120.
7. [1991] 1 WLR 589 at 597.
8. See the requirements under s 1016A of the *Corporations Act 2001* (Cth) regarding the use of application forms in disclosure material.

New super — age pension rules

Bill Stanhope

The new retirement income world will see the social security rules — the means tests governing access to the age pension — take on the role that tax planning has occupied. This is not to say that the means tests are anywhere near as complex as tax rules (consumers cheer, technical specialists sigh) ... but they are different, so it's worth going over them.

The Rules — err — Law

The operative legislation here is the Commonwealth *Social Security Act 1991* (SSA). Social security administration has had a strong tradition of using the principal Act for regulation, with few regulations and little reliance on legislative instruments. In fact, the inclusion of discretions in the 1998 income streams rules in s 9A of the SSA was quite a departure.

The operational interpretation and administration of SSA rules is governed by the *Guide to the Social Security Act* (the Guide) at <www.facsia.gov.au/guides_acts/ssg/ssg-rn.html>. The Guide is the Department of Families, Community Services and Indigenous Affairs' (DFaCSIA's) formal instruction to Centrelink on interpretation of the SSA. Most provisions relating to income streams are found in Ch 4.

The means test and payment calculations in the SSA are in theory written in plain English, but they in tabular form with many internal and cross-references. Read them if you must!

The *Social Security (Administration) Act 1999* contains provisions governing claims, processing and review of benefits. It is not particularly relevant to the means tests themselves.

A word on interpretation. While welfare law is generally interpreted by the courts to the benefit of potential recipients, this presumption is reversed for the means tests.

The changes announced in the 2006 Budget commence on 20 September 2007. Why? Because that's the date the pension is indexed semi-annually and changes are made to coincide with indexation to reduce confusion among retirees. The 20 March and 20 September dates are used because this fits with the cycle of reporting changes in the consumer price index on which pension indexation is based.

Just to confuse matters further, the assets test thresholds (ATTs) are indexed on 1 July annually.

Means test structure

The SSA imposes an income test and an assets test independently, and the test that results in the lower rate of age pension is the one that applies. This means that there are people for whom one test can be ignored. For people seeking financial planning, it's usually the assets test which is operative, meaning that higher wealth retirees are not actually affected by the income test under current rules.

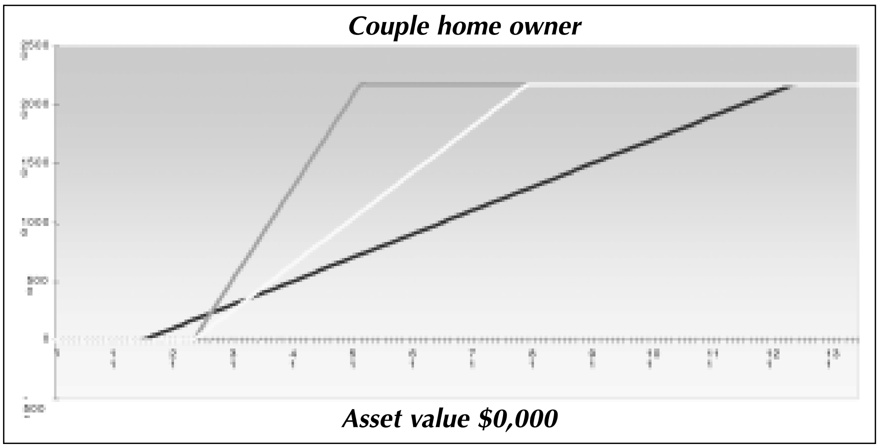
However, for retirees with significant income that has no asset value, the income test will apply. These retirees are those who have defined benefit pensions (usually from unfunded public sector schemes) and foreign social insurance pensions.

The chart on p 5 shows how the means tests interact for a homeowner couple. For ease of comparison, this chart assumes all assets are 'financial assets' under the SSA, but in practice people will have other assessable assets (car, furniture and so on). The chart shows the amount of age pension withdrawn at each value of financial assets — the highest line is the test that applies.

Assets test

The proposals will reduce the assets test withdrawal rate (ATWR) from \$78 to \$39 per annum per \$1000 in assessable assets. This will

Chart: How the means tests interact for a homeowner couple



significantly increase the value of assets a retiree can hold and still qualify for a part rate age pension. Technically, the ATWR is applied at $19.50 for each (whole) $250 in assessable assets above the ATT. The new reduction will be $9.75 per $250. The final age pension rate payable is subject to rounding. The assets test is applied to the balance or value of each income stream. Where there is no account balance, the asset test value is a straight-line reduction of the purchase price over the term.

The current partial assets test exemption from non-commutable income streams will be removed from 20 September 2007 (with grandfathering of existing income streams). This will make the assets test simpler in operation, and of course will means there is no age pension incentive to take a non-commutable income stream.

These changes reverse the recent trend in assets test impact. The assets test has affected an increasing share of age pensioners, even though it was initially intended to affect only a small proportion of retirees. It was introduced on 21 March 1985 at the rate of $4 per fortnight per $1000 in assets, yet less than 1 per cent of pensioners (actually 0.77 per cent) were paid under the assets test in 1989 (Source: *Occasional Paper 1,* DFaCSIA). Since that time, the assets test has become much more significant, so that by June 2004 7.3 per cent per cent of age pensioners were paid under the assets test (Source: *Income support customers: a statistical overview 2004*: DFaCSIA). Some 20.4 per cent of retirees who paid a part-rate age pension were assessed under the current assets test in 2003/04.

It is interesting to note that the detailed outline for this package refers to retirees needing to earn a rate of return of 3.9 per cent to match the ATWR. In the original design of the assets test, the withdrawal was based not on a rate of return, but on a relatively high starting threshold and a relatively low cut-out point. This was intended to achieve an assets test that affected few retirees and kept 'wealthy' retirees from qualifying for a part-rate age pension. The steep withdrawal rate was an artefact of these principles rather than an end in itself.

Income test

No proposals were published for changes to the income test. There are technical issues for the income test arising from other law changes, one of which is very significant. Removal of other rules, such as the lump sum tax, will also affect where retirees place their funds thus how the income test affects them.

There are, in effect, three income tests.

Ordinary income (employment, foreign pensions, and so on) is subject to a withdrawal rate (ITWR) of 40 cents in the dollar above the income test free area (ITFA) ($5298 pa for couples). Income assessed under the income stream rules and the deeming rates is added to other assessable (ordinary) income, the ITFA deducted and the ITWR applied to calculate the age pension payment rate under the income test.

The 'deeming rates' apply to financial assets, and assess income according to the deemed rates, which are set by the minister under SSA delegation. Capital withdrawals are not assessed.

Income streams are subject to a test which deducts an amount (representing the return of original capital over term) from the actual income paid. Where there is no purchase price, only the current income tax deductible amount (DA) is deducted from actual income paid. Capital withdrawals are not assessed.

There has been no public statement that the income stream deduction rules will be retained. However, removal would be a very significant policy change and so it is unlikely. The income test deduction can be a generous provision, particularly where the account balance is high, so it is a remaining incentive for retirees to use income streams.

If the income test deduction rules are retained, there will be a need to establish a social security rule that determines at what point annual payments will cease to be counted as income. This is a normal notion of a lump sum withdrawal, currently called a (partial) commutation. Since the income stream rules in the Superannuation Industry (Supervision) (SIS) legislation will be simplified, it is unlikely that SIS regulations or tax law will need to identify a 'commutation'.

For example, an elderly retiree with no assets outside their home and superannuation may need to withdraw a larger than usual sum to make repairs or maintenance to their home. There are numerous possibilities, but let's say the retiree needs to repair a roof. The sort of sum needed for these repairs could, if counted as income, reduce their age pension to zero. If so, they could need to use up more capital to replace the age pension for up to a year, further depleting their savings.

The simplest solution would be for the SSA to authorise a schedule or formula to limit the amount of assessable income for the income test (before the deduction is applied). Drawings above this amount would be disregarded for the income test, as now.

A number of technical changes will also be needed, for instance to identify the deductible amount that is to be applied to 'defined benefit' pensions. This is currently established under tax law but will be redundant for people aged over 60 from 1 July 2007. The SSA will need to either continue whatever tax rule applies before age 60, or perhaps establish its own rule to apportion the exempt component (under the new tax rules) over the life of the income stream. Note that the SSA definition of 'defined benefit' is not its ordinary or technical meaning … a long story.

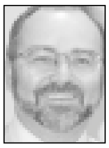
How will the age pension rule?

This isn't a planning article, so I won't go into great detail about the application of the means tests and strategies to deal with them.

It is worth pointing out that retirees with assessable assets above the point where the assets test takes over from the income test will be less interested in the income test deduction rule, at least early in retirement. Since the assets test will cut out pension at $783,500 (indexed) for a homeowner couple, there will be a significant number of wealthier retirees in this group. They are likely to care much less about income streams, or care less about having all their fund in an income stream, since the assets test will drive their age pension rate.

Retirees with higher levels of income, but which does not have an assets test value, will also be in an interesting position. The reduced ATWR will put more ex-public servants and retirees with overseas pensions into this space.

In summary, the 2006 Budget changes will bring the age pension rules into a more prominent position for retirees. Right now, there are some basic questions unanswered about how the new SSA rules will work. Given its new prominence, this is a space more people will be watching. ●



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ATO NEWS

Draft Taxation Determination TD 2006/D26

Small business concessions: is the rollover of an ETP from a discretionary trust to a superannuation fund, in relation to an employee who is also a beneficiary of the trust, a 'distribution of income or capital' by the trust?

The Australian Taxation Office (ATO) has issued a draft Taxation Determination (TD) stating that the rollover of an eligible termination payment (ETP) from a discretionary trust to a superannuation fund, in relation to an employee who is also a beneficiary of the trust, is not a 'distribution of income or capital' for the purposes of the controlling individual test.

To qualify for the small business capital gains tax (CGT) concessions a discretionary trust must, among other things, satisfy the controlling individual test in s 152-50 of the *Income Tax Assessment Act 1997* (Cth) (ITAA 1997). The controlling individual test requires the entity to have a controlling individual just before the CGT event (that is, the event which led to the crystallisation of a capital gain or loss, for example, disposal of an asset).

An individual is a controlling individual of a trust (where entities do not have entitlements to all the income and capital of the trust) at a time if, during the income year, the trust made a distribution of income or capital, or both.

A trust distributes income or capital of the trust to a person if it:

- pays or credits the income or capital in the form of money to the person;
- transfers the income or capital in the form of property to the person;
- reinvests or otherwise deals with the income or capital on behalf of the person or in accordance with the directions of the person; or
- applies the income or capital for the benefit of the person,

in the person's capacity as a beneficiary of the trust.

As the rollover of the ETP is made for the person in their capacity as an employee and not in their capacity as a beneficiary of the trust, the amount is not a 'distribution of income or capital' for the purposes of the controlling individual test.

If a discretionary trust did not make any other distribution of income or capital during the year in which a CGT event happened, the trust will not have a controlling individual and therefore will not be able to access the small business CGT concessions. ●

14 June 2006

Draft Taxation Determination TD 2006/D29

Small business concessions: can trustees or members of a complying superannuation fund 'control' the superannuation fund?

In this draft TD the ATO has indicated that, in its view, the trustees or members of a complying superannuation fund do not 'control' the fund for the purposes of the 'small business concessions' provisions.

Under s 152-30(1) of the ITAA 1997, an entity is 'connected with' another entity if either entity controls the other entity in the way described in s 152-30 or both entities are controlled in that way by the same third entity.

Under s 152-30(2)(a), an entity controls another entity, that is not a discretionary trust, if it or its small business CGT affiliates, or all of them together beneficially own, or have the right to acquire the beneficial ownership of, interests in the other entity that carry between them the right to receive at least 40 per cent of any distribution of income or capital by the other entity.

The members of a complying superannuation fund do not beneficially own, or have the right to acquire beneficial ownership of, interests carrying the right to distributions of income or capital. Further, a complying superannuation fund does not distribute income or capital as such, but rather pays benefits in the form of pensions or lump sums on the occurrence of certain events, such as retirement, death while in employment or the attainment of a stated age. Similarly, the trustee of a complying superannuation fund does not beneficially own, or have the right to acquire beneficial ownership of, interests in the fund carrying the right to receive distributions of income or capital.

As a result, neither the trustees nor the members relevantly 'control' the fund. The fund is not connected with the members or trustees under s 152-30(1)(a).

Neither the members nor the trustees of a complying superannuation fund are small business CGT affiliates of the fund under s 152-25(1)(b). Accordingly, a complying superannuation fund does not control another entity under s 152-30(2), via aggregation of its affiliates' interests, even if the fund's members or trustees control the other entity and therefore the fund is also not connected with the other entity under s 152-30(1)(a).

For the small business concessions to apply in relation to business real property owned by a complying superannuation fund and used in the related entity's business, the active asset test in s 152-35 must be satisfied. Since the fund is not connected with the related entity under s 152-30, the property is not an active asset of the fund and the small business concessions will not be available to the trustees.

Likewise, the assets of a complying superannuation fund, including any business real property which is used in a related entity's business, are not included in the related entity's maximum net asset value test in s 152-15 even if the members or trustees of the fund control the related entity. ●

14 June 2006

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Fund GOVERNANCE

Dis-close: verb, the opposite of close; to open or inform

Michael Vrisakis
FREEHILLS

If superannuation disclosure is intended to be clear, concise and effective, then the legislation is a good starting point. And within the legislation, a good starting point is the ongoing reporting obligations residing in s 1017B of the *Corporations Act 2001* (Cth) (the Act). The operation of this section is somewhat opaque. As this article will explore, the legislative provisions dealing with disclosure should be open and accessible precisely because of the legislative imperative that disclosure itself be clear, concise and effective.

Section 1017B — what has to be disclosed?

The central provision of the section requires disclosure of, in essence, material changes to a matter or a significant event which affects a matter, where that matter would have been required to be disclosed in a product disclosure statement (PDS) prepared for the relevant financial product on the day before the change or event occurs.

The gravamen of the test is therefore the criterion that the matter would need to be disclosed in a PDS. In essence, this means that disclosure is required by either s 1013D or s 1013E of the Act. The criterion for disclosure under s 1017B, that it would have needed to be included in the PDS prepared on the day before the change or event occurs, is somewhat H G Wellsian in nature. If the change or event is one which the relevant issuer would not be aware was going to happen, how would it be included in a PDS? Either the section does not require disclosure of such an event or it proceeds on the assumption (or deems) the issuer to have pre-knowledge of the event. The section also requires disclosure of other matters that are of a kind specified in the regulations *made for the purposes of s 1017B(1A)*.

In the superannuation context, additional disclosure obligations of a superannuation trustee are to be found (with some difficulty) in Sch 10A of the *Corporations Regulations 2001* (Cth). These provisions employ the new-fangled approach of inserting new sections into the Act. Interestingly, these provisions seem to adopt a different test than the test embodied in s 1017B(1A) described above. They are not made for the purposes of s 1017B(1A) but in effect act as a supplement to those provisions.

Section 1017B(5A) requires disclosure of a decision of an issuer or the winding-up or termination of the relevant superannuation entity if a product holder would reasonably expect to be informed of such a matter *prior to it occurring*. This means that, on its face, a trustee must ask itself whether an investor would reasonably expect to be informed of a decision before it occurs and does not need to disclose under this provision if this test is not satisfied. Some, if not many or most, decisions will not be something that the trustee will be aware will occur. In these circumstances could a reasonable investor reasonably expect to be notified before the event? Certainly a winding-up or termination will be somewhat easier to identify in advance.

Added to this complexity is the issue of whether s 1017B(5A) operates independently of, or as appears to be the case, is subject to the PDS test in s 1017B(1A).

As mentioned, in relation to both a decision and a winding-up (or termination), the disclosure obligation only materialises if an investor would reasonably expect to be informed before the event. Section 1017B(5B) works on a different basis. It links back to s 1017B(1A) and (5). It expands the ambit of 'event' to include certain changes having adverse effects on benefits. But in doing so, it appears to *not* depart from the fundamental test in s 1017B(1A) that the change must be one which would be required to be disclosed in the relevant PDS before the event occurred.

To add an additional layer of complexity to the provisions, new s 1017B(5E) adds to the content of subss (5), (6) and (7) requiring disclosure of the transfer of a member between categories in a fund or to another fund.

As can be seen, in the content stakes, the following interactions are not clear:

- disclosure of decisions and windings-up under s 1017B(5A) and events required to be disclosed in a PDS under the s 1017B(1A) test;
- disclosure of changes to governing rules under s 1017B(5B) and disclosure in a PDS under s 1017B(1A);
- disclosure of transfers under s 1017B(5E) and disclosure in a PDS under s 1017B(1A);
- disclosure of changes to governing rules under s 1017B(5B) and decisions under s 1017B(5A); and
- disclosure of changes involving windings-up and terminations under s 1017B(5A) and transfers under s 1017B(5E).

Some of these interactions are relevant in the context of the latest release by the Australian Securities and Investments Commission (ASIC) discussed below.

When is disclosure required?

The basic premise of s 1017B is that disclosure can be made:

- before the event or as soon as practicable after the event but not more than three months' after the event; and
- if not adverse, within 12 months after the event,

except for changes which are increases in fees or charges, in which case disclosure must be made within 30 days *before* the change takes effect.

It should be noted that except with fees or charges, a *choice* is given in terms of disclosing *before* the event or *after*.

You can elect to disclose either *before* the event *or* as soon as practicable after the event. But how does this then interact with the timing requirements for the specific superannuation provisions discussed above?

As mentioned above, in relation to decisions, windings-up and terminations, the event must only be disclosed *at all* if a investor would reasonably expect to be informed before the event. If this test is satisfied, then the issuer must disclose information as soon as practicable after it becomes reasonable for the issuer to expect that the event will happen with the proviso that the information need not be given more than three months before the expected date of the event.

Changes to the governing rules which are adverse (s 1017(5B) (and changes involving transfers (s 1017D(5E)) are subject to this basic timing premise described above.

ASIC QFS163

ASIC has just released the above FAQ entitled: 'I am a superannuation trustee. Do I need to notify members about member transfers without consent?'.

The FAQ is accompanied by a media release in which a senior ASIC spokesperson notes:

> Any decision that fundamentally affects a members investment, including a decision to transfer a member's benefits without their consent, is a material change or significant event that must be disclosed to that member.
>
> It is imperative members are advised of these decisions clearly, early, and in a manner which will come to their attention (for example, a personally addressed letter). Delayed or obscure notices significantly affect a member's ability to make an informed decision about whether to exercise their right to exit the fund.

In this FAQ, ASIC states:

> In our view, any decision that fundamentally affects a member's investment, including a decision to transfer a member's benefits without

> their consent, is a change or event that must be disclosed.

Examples are given of transfers to successor funds, changing the class of members affected by an ERF policy and transfers between categories.

ASIC notes that affected members can be notified either before or as soon as practicable after the decision but within three months. In relation to transfers, however, ASIC notes that a trustee must notify affected members before the transfer because a fund member would reasonably expect to be informed of such a decision before it occurs.

Two observations can be made. First is as mentioned above, if it is intended to require disclosure of a decision before it occurs, this may be difficult. Second, if it is the transfer which must be disclosed, actually s 1017B(5E) deals with this situation and, as mentioned above, requires disclosure before *or* as soon as practicable after the transfer.

ASIC also notes that delaying making an official decision will not give a trustee more time to disclose; what is relevant, they note, is an actual decision. They also note that whether there has been an actual decision depends on all of the relevant circumstances. ASIC also notes that if the change involves an increase in fees or charges (which would include a reduction in a rebate), then 30 days' prior notice must be given.

It is not clear whether this refers to a successor fund transfer; if it does, it is not clear that increased fees imposed by the trustee of another fund is captured by s 1017B(5).

ASIC then addresses how members can be notified and points out that members must be notified in a way which comes to their attention and not through relevant information buried in other information that does not affect members' fundamental rights.

ASIC then turns to the content of disclosure. In this regard, they say that:

> Disclosure that does not explain the full scope of the change and the differences between the two funds, or two categories within a fund, would not satisfy this requirement.
>
> It may be necessary to provide comparative information to enable members to properly understand the nature and effect of the change. For example, where fees have changed (including fee rebates) you would need to explain the differences between the fees (including rebate differences) and the impact this may have upon final benefits. Similarly, where insurance cover is affected (for example, because the member will move from group cover to individual cover) you would need to explain the differences between the old and the new cover.

Drip-feeding information about particular changes or individual events without explaining the consequences of the changes or events as a whole is not acceptable.

Finally, ASIC points out that these disclosure obligations apply even if the information was given to persons already via a PDS. They say:

> The ongoing obligation to disclose material changes and significant events is an additional obligation to the PDS disclosure obligations. This means that if information about a matter would be required to be included in a PDS prepared on the day before the change or event occurs, then the member must be notified: eg, see s 1017B(1) and (1A). This is the case even if the PDS that was provided to the affected member described what would or might occur if such a change or event occurred.

The above observations are true, although if the actual change or event has already been disclosed in a PDS, then on the basis of s 1017B(1A), there is an argument that information would not be required to be disclosed again by virtue of s 1013F on the basis that a reasonable client would not reasonably expect to find the information repeated in the PDS.

As the above discussion demonstrates, one essential pre-requisite to clear, concise and effective disclosure is that the relevant legislative provisions 'dis-close' to issuers just what requirements apply in a manner which is open and capable of ready assimilation. ●

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Super NEWS

Superannuation loophole in bankruptcy closed

On 27 July 2006 the Attorney-General and the Minister for Revenue and Assistant Treasurer announced that superannuation contributions made prior to bankruptcy with the intention to defeat creditors will now be recoverable by bankruptcy trustees following changes.

The media release issued to accompany the announcement follows.

> The amendments will address the High Court's decision in *Cook v Benson* [(2003) 214 CLR 370] which cast doubt on a trustee's ability to recover superannuation contributions using the existing 'clawback' provisions in the *Bankruptcy Act*.
>
> In determining whether contributions were made to defeat creditors, courts will be able to take into account the person's history of contributions and whether the contributions in question are 'out of character'.
>
> The Government has decided not to proceed with earlier proposals to allow for recovery of 'excessive' superannuation contributions as these would have unduly complicated both the bankruptcy and superannuation systems.
>
> [This] announcement is consistent with the Government's plan to simplify and streamline superannuation.
>
> The amendments will prevent unscrupulous debtors from transferring assets into superannuation when bankruptcy is looming. However, genuine contributions to superannuation for retirement income purposes will be protected from recovery.
>
> The reforms had been developed following extensive public consultation. They strike an appropriate balance between encouraging people to save for their retirement and creditors' rights to be paid what is owing to them.
>
> The amendments apply to superannuation contributions made after today. Legislation giving effect to this announcement will be introduced as soon as practicable.

AML/CTF draft Bill released

Revised exposure draft AML/CTF Bill and draft AML/CTF Rules

The Minister for Justice and Customs, Senator the Hon Chris Ellison, released a revised exposure draft anti-money laundering and counter-terrorism financing (AML/CTF) Bill 2006 and draft AML/CTF Rules for public consultation on 13 July 2006. Submissions are due on 4 August 2006.

The revised exposure draft AML/CTF Bill 2006 proposes a number of improvements to Australia's AML/CTF system, in line with international standards issued by the Financial Action Task Force on Money Laundering (FATF). The revised exposure draft AML/CTF Bill 2006 aims to provide a flexible risk-based framework allowing businesses to identify, manage and mitigate money laundering and terrorism financing risks.

Also released with the revised exposure draft AML/CTF Bill 2006 is a package of draft AML/CTF Rules. The Rules have been developed by the Australian Transaction Reports and Analysis Centre (AUSTRAC) in consultation with industry. They set out specific requirements on matters such as customer identification, ongoing customer due diligence, reporting of suspicious matters, and the development of AML/CTF Programs.

The exposure Bill and sample Rules were released on 16 December 2005.

The period for the provision of submissions on the exposure AML/CTF Bill 2005 and sample AML/CTF Rules closed on 13 April 2006. In addition, the Senate Legal and Constitutional Legislation Committee conducted an inquiry into the exposure AML/CTF Bill 2005 and published its report on 13 April 2006.

<*www.ag.gov.au*>.

ASFA applauds Bill

The Association of Superannuation Funds of Australia (ASFA) congratulated the Attorney-General's Department on the revised exposure draft of the AML/CTF Bill and Rules:

> 'The new version responds directly to the concerns raised by ASFA in extensive consultation and submissions. The previous draft required up-front identification of new members and failed to recognise the low risk presented by superannuation,' said Dr Michaela Anderson, ASFA's Director of Policy & Research.
>
> The new bill proposes that the Part 2 Identification Procedures do not apply to accepting superannuation contributions where the person has not reached preservation age (because the money laundering risk in superannuation is very low). However, identification procedures will be applied where the person reaches their preservation age, and can be carried out when the interest is being cashed out, rolled over or transferred.
>
> As ASFA anticipated, it has been difficult to include self managed super funds (SMSFs). As a result these will not be directly regulated by the first tranche of AML/CTF legislation. It is expected any money laundering and terrorist financing risks arising from new SMSFs will be dealt with when the fund opens an account with another financial institution.
>
> It is further anticipated that SMSF activity will be reviewed in the development of the 'second tranche' of reforms that focus on lawyers and accountants.
>
> ASFA will prepare a further submission and continue to examine issues such as transaction and event reporting, the use of agents and verification requirements.

<*www.superannuation.asn.au*>

IFSA welcomes Bill

The Investment and Financial Services Association (IFSA) also welcomed the release of the revised Bill and Rules:

> 'This second round of consultation is an important next step towards developing a risk based regime that meets the Government's objectives without unduly burdening industry,' said IFSA Deputy CEO, John O'Shaughnessy.
>
> 'It appears the Government has taken on board a large number of the key issues that the industry raised during the first round of consultation, however, some issues do remain unresolved and IFSA will continue to advocate for a true risk based approach that recognises existing industry structures and regulation.
>
> 'In this regard, the three week consultation period will be used to gather our membership's views on the state and content of the package so that IFSA can present a clear case to Government on any outstanding issues.
>
> 'One such outstanding issue on which IFSA will stand firm is the need for a 3 year transition period to the new regime. IFSA has previously stressed that not all industry sectors have been subject to AML obligations in the past and therefore more time will be needed to implement the necessary AML/CTF systems and controls.
>
> 'IFSA remains committed to working with the Government to deliver a workable risk-based AML/CTF regime that does not impose an undue cost burden on industry, or unnecessarily inconvenience consumers,' concluded Mr O'Shaughnessy.

<*www.ifsa.com.au*>

RSE transition completed

The Australian Prudential Regulation Authority (APRA) announced on 4 July 2006 that on 30 June 2006 it had completed the transition to the new trustee licensing system for Australia's superannuation industry.

Of 325 applications received, 307 trustee companies have received the new Registrable Superannuation Entity (RSE) licence, while 17 applications were withdrawn and one was rejected as it did not fully meet the criteria. This application was not for a public offer licence.

APRA Deputy Chairman Ross Jones said: 'The superannuation industry is now licensed and prudentially regulated in a similar way to banking and general and life insurance. The Government required RSE licensing of superannuation trustees to enhance the safety of members' funds. Licensees are required to comply with new standards covering proper governance, managing relationships with third parties, maintaining adequate resources and implementing sound risk management systems.

'The end of the transition period is a significant milestone, but it also marks the start of more risk-based supervision of the superannuation industry for APRA.'

APRA releases trustee liability insurance guidance

APRA released an Information Paper (the paper) on 'Trustee Liability Insurance' on 30 June 2006 to provide updated guidance to superannuation trustees when obtaining liability insurance.

The paper contains the findings of a survey conducted in 2005 with insurance brokers on the availability of professional indemnity insurance in the marketplace and the level of coverage bought by trustees. The aim of the survey was to help APRA assess the adequacy of professional indemnity insurance cover for RSE licensees. The paper also outlines APRA's expectations for RSE licensees to ensure adequate insurance arrangements are in place covering the trustee and fund operations.

APRA Deputy Chairman Ross Jones said that determining the level of insurance cover is an RSE licensee's responsibility. APRA does not advise an RSE licensee how much insurance it must hold but APRA will take insurance into account when assessing the RSE licensee's resources.

<*www.apra.gov.au*>

Last opportunity for TAPs

Louise Biti
ASTERON

Among the proposed reforms for superannuation and income streams in this year's Federal Budget was a significant and unexpected change to age pension eligibility — a change which brings equality to the asset assessment for all investments and an increase in the assets test thresholds.

It is proposed that income streams purchased on or after 20 September 2007 will not receive any assets test exemption. Income streams purchased from this date will be fully assessable as an asset in the same way as money invested in a term deposit, shares, allocated pension or unit trust. However, income streams will continue to retain an income test advantage.

Clients who purchase a *complying* income stream before 20 September will continue to receive some assets test exemption:

- 100 per cent exempt if purchased before 20 September 2004; or
- 50 per cent exempt if purchased between 20 September 2004 and 19 September 2007

To be complying, the income stream needs to satisfy a number of criteria specified in ss 9A and 9B of the *Social Security Act 1991* (Cth), including no access to withdrawals of capital as lump sums. Term allocated pensions (TAPs) are examples of a complying income stream. Lifetime and term-certain (life expectancy) pensions and annuities can also be structured to meet the requirements of a complying income stream.

So does this create a window of opportunity for people to rush out in the next 16 months and invest into TAPs or is this a wasted opportunity?

Consider the following case study.

Ben and Marie are both age 65 and eligible to apply for the age pension. They have $550,000 in assessable assets in addition to owning their own home. Their assets exceed $509,500, which is the current cut-off threshold for a homeowner couple, so they do not qualify for any age pension. For each $1 of assessable assets over the couple homeowner lower limit of $229,000, the age pension currently reduces by $3 per fortnight, fully cutting out at $509,500 of assessable assets.

Ben and Marie could consider using superannuation money to invest into a TAP, reducing their assessable assets. For example:

- investing $100,000 into a TAP reduces assessable assets by $50,000 providing a combined age pension of $707 per annum; and
- investing $200,000 into a TAP reduces assessable assets by $100,000 providing a combined age pension of $4607 per annum.

The downside of this strategy is that Ben and Marie have to lock away a large part of their savings. They still retain access to the rest of their money and can draw down on these investments if access to capital is needed.

But what is the real long-term value of locking away the money? Consideration needs to be given to the proposed changes and the situation after 20 September 2007.

Assume Ben and Marie do not buy a TAP and invest all their savings into an allocated pension to retain full access to capital. They will receive no age pension until 20 September 2007 when the assets test reduction rate is proposed to reduce from $3 to $1.50 per fortnight. With $550,000 of assessable assets they would become eligible for an age pension of $9326 per annum under the assets test.

The purchase of a TAP before 20 September 2007 would further increase their entitlement. If they invested $100,000 into a TAP, their age pension would increase to $11,276 from 20 September 2007 and to $13,226 if they invested $200,000.

Ben and Marie need to decide if they are happy to forgo the age pension for the next 14 months to then receive $9326 from 20 September 2007 with full access to all capital, or whether they prefer to lock away part of their capital to access an increased pension entitlement.

Note: This case study uses the current age pension rate and thresholds applying to 19 September 2006. These rates and thresholds are indexed regularly and should expect to be higher at 20 September 2007.

Before rushing out to a purchase a TAP or other complying income stream, investors should consider the benefit they gain now and the continuing value going forward. In some cases, investors may wish to defer decisions until legislation is passed to determine with certainty the outcomes. The real winners from buying a TAP before 20 September 2007 may be those investors who would otherwise have assessable assets just above the new thresholds at that date. ●

The real winners from buying a TAP before 20 September 2007 may be those investors who would otherwise have assessable assets just above the new thresholds at that date.

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Federal legislation update

Tax Laws Amendment (2006 Measures No 2) Bill 2006

The above Bill completed its passage through Parliament during June, and has now received Royal Assent.

The Bill includes amendments to the choice of fund legislation to ensure that employers who currently make superannuation guarantee contributions to a fund nominated in a state law do not have to contribute to that fund if an employee chooses an alternative fund.

Tax Laws Amendment (2006 Measures No 3) Bill 2006

The above Bill completed its passage through Parliament during June, and has now received Royal Assent.

Note that amendments made by the House of Representatives did not affect the superannuation-related provisions of the Bill, which:

- introduce new requirements for superannuation funds to report certain information regarding employer contributions to the Australian Taxation Office, and to other funds where those contributions are transferred; and
- implement the Government's Budget night announcement regarding appropriate use of pre-1 July 1988 funding credits.

Age Discrimination Amendment Bill 2006

The above Bill completed its passage through Parliament during June, and has now received Royal Assent.

The Bill proposes a range of amendments to the age discrimination laws, including clarification and extension of existing provisions which allows certain age-based discrimination in Commonwealth legislation relating to superannuation.

Modification Declaration No 3 of 2006

The Australian Prudential Regulation Authority (APRA) has issued Modification Declaration No 3 of 2006 (MD 3), modifying reg 6.21 of the *Superannuation Industry (Supervision) Regulations 1994* (SIS). Regulation 6.21 deals with the circumstances in which a trustee is required to pay out, or 'cash', a member's superannuation benefits.

In general terms, reg 6.21 requires that benefits be cashed where a member has attained age 65 and was not gainfully employed for at least 240 hours in the previous financial year, the member has attained age 75, or the member has died.

In 'A Plan to Simplify and Streamline Superannuation', released with the 2006/07 Federal Budget on 9 May 2006, the Government indicated its intention to abolish the compulsory cashing rules from 1 July 2007. Taking into account industry feedback, the Treasurer subsequently announced that the compulsory cashing would be removed with effect from 10 May 2006.

Regulations to give effect to the Government's announcement on compulsory cashing will not be made until other aspects of the simplification plan have been legislated. Accordingly, APRA has issued MD 3 to provide interim relief in conformity with the proposed amendments.

The key points in relation to the relief follow.

- The obligation on trustees to cash the benefits of members aged 65 or older for the period from 10 May 2006 to 30 June 2007 is removed.
- A trustee that cashed a member's benefits between 10 May and 30 June 2006 in accordance with reg 6.21, as it then stood, will not be in breach of the modified reg 6.21.
- The obligation to compulsorily cash benefits after the death of a member remains in place.

MD 3 came into force on 30 June 2006, the date it was registered on the Federal Register of Legislative Instruments.

[Note: Modification Declarations have the effect of amending a modifiable provision of specified legislation, without requiring an amendment to be passed through Parliament. A substantial portion of the SIS Act and Regulations, including the key 'operating standards', are 'modifiable provisions'.]

<*wwwsuperpartners.biz*>.

contributions

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Copy should preferably be presented as an email with an electronic copy of the submission attached.

Super CASES

Gary Riordan HOLDING REDLICH

VISION SUPER PTY LTD v POULTER

[2006] FCA 849; BC200605166

This decision of Justice Young in the Supreme Court of Victoria related to the interpretation of a particular superannuation fund trust deed and so is very fact-specific; however, Young J enunciated some principles relating to the jurisdiction of the Superannuation Complaints Tribunal (SCT) and the construction of trust deeds generally.

This decision is significant because Young J gives an expansive interpretation to the jurisdiction of the SCT with his construction of ss 14(1)(a) and (6) of the *Superannuation (Resolution of Complaints) Act 1993* (Cth) (ROC Act).

Background

The Local Authorities Superannuation Fund (the Fund) provides that members resigning before reaching the age of 55 can elect to accept either a deferred retirement benefit or a resignation benefit. Clause C.4.10 of the Fund's trust deed (the deed) begins:

> (a) A Member who resigns before attaining age 55 may instead of the benefit in clause C.4.9 choose to accept a deferred retirement benefit equal to the sum of — (1) the retirement benefit calculated under clause C.4.2; and (2) interest on the amount of that retirement benefit from the date on which that benefit falls due until the date is paid …

The advantage of accepting the deferred retirement benefit is that the retirement benefit payable at the point of election is 'substantially greater' than the resignation benefit.

The respondents were three members of the Fund who, during the period August 1993 and May 2000, elected to accept a deferred retirement benefit. In respect of the periods 1 July 2001 to 30 June 2002 and 1 July 2002 to 31 March 2003 (and for a shorter period for one of respondents who ceased to be a deferred benefit member), they each received member statements advising that their benefits had been reduced by net investment returns. The reduction even meant that for one of the respondents her accrued benefit was less than the deferred retirement benefit that fell due upon her election! The trustee attributed the negative adjustments to a negative return on its investments during the relevant periods.

Each respondent lodged a complaint about the reduction in their benefit with Vision Super, the trustee of the Fund (trustee), which was rejected. The respondents then lodged complaints with the SCT. The SCT determined that the trustee's decisions should be substituted with the decisions that 'the applicant repay to the respondents' deferred benefit accounts all amounts of "negative interest" deducted and interest calculated at the trustee's reasonable determination of the rate obtainable from investment in cash and bank bills from the date the deduction was made to the date of repayment' [33]. The trustees appealed to the Supreme Court of Victoria.

> … Young J gives an expansive interpretation to the jurisdiction of the SCT with his construction of ss 14(1)(a) and 14(6) of the Superannuation (Resolution of Complaints) Act 1993 (Cth).

Decision

The trustees argued three points before Young J, that:

- applying s 14 of the ROC Act meant that the SCT did not have jurisdiction to deal with the complaints because the trustee's decision was not made 'in relation to a particular member' and the respondents' complaints 'relate to the management of the fund as whole';
- the SCT misinterpreted cl C.4.10 when it held that this clause did not contemplate 'negative interest'; and
- its determinations were contrary to law and/or to the deed.

Young J rejected each of these arguments and upheld the SCT's determinations.

Broader ramifications of the decision

Section 14(1)(a) of the ROC Act

Young J considered when a trustee has made a decision 'in relation to a particular member'. He said just because the trustee has previously made a broader decision in relation to the members does not preclude the conclusion that they had made another one when implementing this decision in relation to each member.

Moreover, Young J held that even if the only decision is that of the trustee setting a negative crediting rate for all deferred benefit members, the fact that this is carried into effect with different financial consequences for each member means that there will be a decision in relation to a particular member. He reasoned that the words 'in relation to' are very broad and the relationship that they require depends on the scope and purposes of the ROC Act, and concluded that this decision to set a negative crediting rate was sufficient to give members a right to obtain review of the trustee's decision.

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AUSTRALIAN Superannuation LAW BULLETIN

Section 14(6) of the ROC Act

Young J considered when the SCT will not have jurisdiction because the complaint 'relates to the management of a fund as a whole'. He said that the trustee's decision in this case to debit deferred benefit accounts is not comparable with a decision concerning the adoption of an investment policy, the example given by Branson J in *Employers First v Tolhurst Capital Ltd* (2005) 143 FCR 356 of a complaint that would be prohibited under s 14(6). Moreover, he held that the mere fact that a trustee's decision relates to action to be taken in relation to the management of a particular class of members is not decisive either way of whether the complaint will be prohibited.

Significantly, Young J stated that (at [59]):

> ... a Complaint that the Deed has been contravened in a way that directly and adversely affects the financial position of the particular member lodging the complaint cannot be described as a complaint relating to 'the management of the fund as a whole'.

Combined with the aforementioned possibility that a broader range of complaints might fall within the purview of s 14(1)(a), this means that the SCT may have jurisdiction over a wider range of trustee decisions.

Trust deed interpretation

Young J said that a 'practical and purposive' approach as opposed to a 'detached and literal' one should be taken to construing deeds. He likened the process to that of the modern approach to statutory construction.

Young J held that the general powers and discretions afforded to the trustee in the deed did not give the trustee an independent power to determine that the interest payable should be a negative sum. While these empowered the trustee to determine the applicable rate of interest for the purpose of applying cl C.4.10, this power had to be exercised bona fide for the purposes for which it was conferred and so the trustee cannot 'convert the obligation to pay interest ... into a right to debit a negative investment return'.

As it is common to provide trustees with general expansive powers in trust deeds, Young J's comments might have broader relevance in preventing trustees relying on these types of powers in the future.

In the result, this may only lead trustees to more frequently approach the court's for assistance in either the interpretation or alteration of a provision in a trust deed, in order to protect either themselves, or as the case may be put, as being in the interests of members as a whole! ●

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ISSN 1035–2163 Print Post Approved PP 255003/00770 This publication may be cited as (2006) 18(1) SLB