Ebsworth & Ebsworth LAWYERS

financial services law bulletin

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☐ SUPERANNUATION

Splitting superannuation contributions: How and is there a future?

The Budget proposals on superannuation have cast doubt on the practical value of recent regulatory amendments to allow splitting of contributions with a spouse.

Generally, contributions made on or after 1 January 2006 may be eligible for splitting, but only by an election made between 1 July and 30 June in the following financial year. For example, a contribution made in the period from January to June 2006 can be subject to an election made from 1 July 2006 to 30 June 2007. There is a splitting limit of 85% of contributions on which contributions tax is payable by the fund (e.g. employer contributions) but this does not apply to contributions that are not taxable (e.g. personal undeducted contributions).

Prior to the Budget, splitting contributions with a spouse was attractive, particularly where the spouse had relatively low superannuation savings. The family could access the post-83 component tax free threshold and a reasonable benefits limit for the spouse. A member may tell the fund to allocate the amount to be split to the spouse's account within the fund or to pay that amount to the spouse's account with another fund.

After the Budget, these strategies lose much of their attraction because there may no longer be any reasonable benefits limit or lump sum tax for superannuation benefits. However, another, less publicised benefit of splitting contributions is asset protection. At present, genuine provision for superannuation, up to the pension reasonable benefit limit, is protected from bankruptcy. The concept of a limit on the bankruptcy protection is likely to be carried forward with a similar ceiling. The result is that a professional person on the highest marginal tax rate can make contributions to a fund. If the account balance approaches the ceiling, the member could tell the fund to allocate the maximum permitted contributions split to their spouse. Although a trustee in bankruptcy may be able to attack flagrant misuse of the strategy, it offers a degree of protection unless there is a prospect of bankruptcy at the time of the contributions split.

If the strategy is to continue, trust deeds of most superannuation funds will need to be amended to allow splitting of contributions to spouse accounts both within the fund and within another fund.

If, during a financial year, a member wishes to rollover or transfer to another fund, superannuation entitlements that include contributions made during a financial year, the member may bring forward the splitting of qualifying contributions to a spouse's account to the time of the rollover or transfer. Subject to some transitional relief, if the member does not do so at that time, the member loses the right to split contributions made before the rollover or transfer. Amendments to trust deeds should also provide for this circumstance.

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in this issue

introduction

Brian Thomas
Partner

Welcome to the latest issue of our *Financial Services Law Bulletin*.

In this issue we consider whether splitting superannuation contributions has future practical value following the Budget and we review the recent High Court decision in *AssetInsure Pty Limited v New Cap Reinsurance Corporation Limited*.

We also wrap up recent developments in the "News in brief" section.

☐ CASE UPDATE

Certainty for creditors of insolvent reinsurer

This decision clarifies the distribution by a liquidator of recoveries to creditors. It held that section 116 of the *Insurance Act 1973* (Cth) gives rise to accrued rights as at the commencement of a company's winding up.

▮ *AssetInsure Pty Limited v New Cap Reinsurance Corporation Limited (in liquidation)* [2006] HCA 13 (7 April 2006)

New Cap Reinsurance Corporation Limited (NCR) was a publicly listed reinsurer incorporated in Australia that transacted (inward) reinsurance business for both Australian and international cedents. NCR was voluntarily wound up pursuant to the *Corporations Act 2001* in September 1999 as it was about to become insolvent and an administrator was appointed.

The creditors of NCR consisted primarily of cedent insurers. The winding up of NCR took place at a time when the *Insurance Act 1973* (Cth) (in its original form) was in force. The *Insurance Act 1973* (Cth) has now been substantially amended and reformed by virtue of the enactment of the *General Insurance Reform Act 2001* (Cth) but the relevant provisions remain substantially the same.

The statutory provisions considered were:

- section 116 of the *Insurance Act 1973* – on the winding up of a general insurer, the insurer's assets in Australia must not be applied in the discharge of its liabilities other than its liabilities in Australia unless it has no liabilities in Australia.
- section 31 of the *Insurance Act 1973* – in certain circumstances liabilities undertaken under contracts of insurance were liabilities in Australia (now 116A of *Corporations Act 2001*).
- section 562A of the *Corporations Act 2001* – deals with the application of proceeds of contracts of reinsurance.

The cedent creditors fell loosely into two categories: those like the appellant, AssetInsure, that were based in Australia and placed outward reinsurance with NCR to cover risks written solely in Australia, and those like the third respondent, Faraday Underwriting, that placed outwards reinsurance cover on behalf of Lloyd's interests reinsuring material damage and machinery breakdown risks in various locations outside Australia including the United States and the Caribbean.

The issues that arose were:

- whether "liabilities in Australia" under section 116 referred only to liabilities under contracts of insurance and whether section 31 provided an exhaustive and exclusive list of which liabilities under contracts of insurance are liabilities in Australia and so whether the assets of NCR should be applied in priority in favour of the first group of creditors led by AssetInsure, or whether the latter group led by Faraday Underwriting should rank equally (with the first group) under section 116(3) of the *Insurance Act 1973* (Cth).
- whether section 562A of the Corporations Act permitted Faraday Underwriting to "trace" and then claim the benefit of any facultative retrocession coverage placed by NCR in the same way that an insured could claim the benefit of reinsurance coverage or whether such retrocession recoveries should be made available to NCR's creditors generally.

Decision

The High Court delivered its judgment on 7 April 2006. In relation to the first issue (the "Insurance Act issue"), the High Court by majority held that "liabilities in Australia" under section 116 did not only mean liabilities under contracts of insurance but all liabilities in Australia and that section 31 did not provide an exclusive list of contracts of insurance that could be liabilities in Australia.

The general law applied to determine if a liability was a liability in Australia. Under the general law a debt is normally situated where the debtor resides (unless there is a contrary provision in the contract). NCR resided in and entered into contracts in Australia so its debts were liabilities in Australia. This has the effect that its assets will be applied equally to discharge liabilities in respect of both risks involving events that can only happen in Australia and liabilities where the reinsurance was in respect of a risk involving events that could only occur outside Australia.

On the Corporations Act issue the High Court was unanimous. The judgment is essentially a discussion of the competing public policy arguments between allowing the fruits of facultative reinsurance/retrocession cover to be distributed equally amongst creditors, as against retaining those monies for the specific risk the subject of the reinsurance/retrocession coverage.

The High Court concluded that there was no reason that the use of the expression "insurance" should be read narrowly to refer only to primary insurance cover not to reinsurance. Accordingly, a cedent gets the benefit of the specific retrocession cover by tracing through the reinsurer (if resident in Australia).

The decision will have significance for the creditors of all insolvent reinsurance and insurance companies, including HIH. From the perspective of a global reinsurance market it will be important for the cedants to know and to have the certainty that, when it comes to distributing the assets of an insolvent Australian reinsurer, they will be treated equally according to where the debtor resides and not by reference to where the risk is located.

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NEWS IN BRIEF

Superannuation

- APRA released a media statement reminding superannuation trustees that did not apply for a Registrable Superannuation Entity (RSE) Licence that they had a legal duty to make other arrangements for fund members. For more information see APRA media release 06.12 at www.apra.gov.au/media-releases/06_12.cfm
- ASIC information release 06-09 (29 March) states it has "intensified" its review of superannuation disclosure practices, and outlines specific areas of interest.
- The Superannuation Complaints Tribunal has stated that the duty of superannuation trustees to act in the best interests of child beneficiaries may mean that they should not give a death benefit distribution to a parent/guardian where there is credible evidence they could use the money irresponsibly. (*Source:* CCH)

General insurance

- On 5 May APRA released new prudential standards (and practice guides) for the corporate governance of authorised deposit-taking institutions (ADIs), general and life insurers, which create further duties on the board of directors. The standards take effect on 1 October 2006. For further information see APRA media release 06.26.
- APRA released its second consultation package about its proposed response to the adoption of International Financial Reporting Standards by ADIs and general insurers. It contains a draft prudential standard and guidelines for ADIs, and will issue similar standards for general insurers once consultation of APRA's Stage 2 reforms is concluded.
  For more information see www.apra.gov.au/media-releases/06_20.cfm
- APRA released a discussion paper, draft prudential standards and a prudential practice guide on risk management in outsourcing. The standards are applicable to (ADIs), general insurers and life insurers. The standards and guide will be in force from 1 October 2006. For more information see APRA Press Release 06.14 at www.apra.gov.au/media-releases/06_14.cfm
- APRA signed a Memorandum of Understanding with De Nederlandsche Bank in relation to cooperation in prudential supervision and sharing of information about banks and insurance companies. For more information see the APRA website www.apra.gov.au

Financial services

- The Treasury issued a *Discussion Paper on Proposed Financial Sector Levies for 2006–07*, which discusses the possible effects of the levies on the industries regulated by APRA. The Treasury is inviting comments by 9 June 2006. For further information see the Treasury website: www.treasury.gov.au/contentitem.asp?NavId=035&ContentID=1110
- ASIC released *Licensing: Administrative action against financial services providers* – a guide on ASIC's powers of administrative action in financial services law enforcement. See ASIC information release IR 06-13.
- ASIC released a discussion paper in relation to dealing with conflicts of interest in the financial service industry. Public comments are invited by 9 June 2006, with the ultimate aim of adding the concepts outlined in the paper into ASIC Policy Statement 181: Managing conflicts of interest. See ASIC media release 06-121.
- ASIC released its report, Overview of decisions on relief applications from financial services providers (September to December 2005) which gives a summary of its decisions on relief applications by financial service providers. See ASIC information release 06-10.
- ASIC released a guide in relation to the application of the "enhanced fee disclosure regulations" made in March last year. The guide aims to assist product issuers in complying with the regulations. See ASIC information release 06-07.
- The Prime Minister and Treasurer issued the Government's interim response to the report of the Taskforce on Reducing The Regulatory Burdens on Business, with a complete response to be issued by the end of July 2006. In responding to some of the recommendations of the Taskforce, the Ministers emphasised that the aim is to prevent any unnecessary regulation. For further information, and the government responses, see www.treasurer.gov.au/tsr/content/pressreleases/2006/019.asp
- The Parliamentary Secretary to the Treasurer released a *Corporate and Financial Services Regulation Review Consultation Paper*, which proposes changes for identified issues in corporate regulation and compliance. For further information see parlsec.treasurer.gov.au/cjp/content/pressreleases/2006/014.asp

Anti-money laundering update

Senator Ellison agreed, after a meeting with the ICAA, to re-examine the definitions of "designated services" in the Anti-Money Laundering and Counter-Terrorism Financing Bill to ensure that they are not too wide or onerous. For more information, see ICAA Press Release at www.icaa.org.au/news/index.cfm?menu=297&id=A117434667

Also, after a review of recent public consultations and the Senate Legal and Constitutional Committee Report on the Bill, the Attorney-General's Department intends to release an amended exposure Bill and Sample with a subsequent three weeks available for public comment.

AUSTRAC has issued Information Circular No 43 and Information Circular No 44 (circular No 44 supersedes circulars 15, 22, 23, 24, 34 and 35), outlining obligations of Australian cash dealers.

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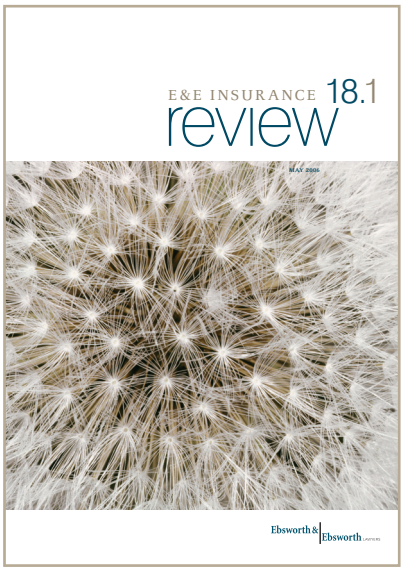

Hot off the press: *E&E Insurance Review*, volume 18, number 1

Our flagship industry publication, the *E&E Insurance Review*, is produced biannually by our insurance and financial services team. This year we reach two important milestones: we celebrate 110 years of practice and its is 20 years since the first issue of the *E&E Insurance Review* was published in 1986.

In the May 2006 issue of the *E&E Insurance Review* we take a look at the Australian Securities & Investments Commission's drive to ensure its role in Australia's regulatory framework has a positive influence. We discuss how the Government is attempting to reduce the collateral damage with its anti-money laundering and counter-terrorism financing legislation. We also review developments in how DOFIs and DMFs, which are marketing insurance in Australia, are regulated.

Our case reviews provide a comprehensive overview of recent significant decisions of interest to the industry. We aim to provide insightful and concise articles and case reviews to keep our clients and contacts up-to-date with legal developments in insurance.

Our national insurance and financial services team, which is proud to be one of the few Australian legal teams servicing all aspects of the insurance industry – marine, non-marine, life and reinsurance – provides commercial, transactional and litigious advice.

Our *E&E Insurance Review* (including back issues) is available online at **www.ebsworth.com.au**. We hope you find this issue informative and useful.

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