



Law Council
OF AUSTRALIA

Consultation on the Superannuation Reform Measures – Exposure Draft Regulations

The Treasury – Retirement Income Policy Division

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The Law Council of Australia exists to represent the legal profession at the national level, to speak on behalf of its Constituent Bodies on national issues, and to promote the administration of justice, access to justice and general improvement of the law.

The Law Council advises governments, courts and federal agencies on ways in which the law and the justice system can be improved for the benefit of the community. The Law Council also represents the Australian legal profession overseas, and maintains close relationships with legal professional bodies throughout the world.

The Law Council was established in 1933, and represents 16 Australian State and Territory law societies and bar associations and the Law Firms Australia, which are known collectively as the Council's Constituent Bodies. The Law Council's Constituent Bodies are:

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- Australian Capital Territory Law Society
- Bar Association of Queensland Inc
- Law Institute of Victoria
- Law Society of New South Wales
- Law Society of South Australia
- Law Society of Tasmania
- Law Society Northern Territory
- Law Society of Western Australia
- New South Wales Bar Association
- Northern Territory Bar Association
- Queensland Law Society
- South Australian Bar Association
- Tasmanian Bar
- Law Firms Australia
- The Victorian Bar Inc
- Western Australian Bar Association

Through this representation, the Law Council effectively acts on behalf of more than 60,000 lawyers across Australia.

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The Secretariat serves the Law Council nationally and is based in Canberra.

Acknowledgement

This submission has been prepared by the Law Council of Australia's Superannuation Committee (**the Committee**), which is a committee of the Legal Practice Section of the Law Council of Australia.

The Committee's objectives are to ensure that the law relating to superannuation in Australia is sound, equitable and clear. The Committee makes submissions and provides comments on the legal aspects of virtually all proposed legislation, circulars, policy papers and other regulatory instruments which affect superannuation funds.

The Committee's response to the *Superannuation reform package - Exposure draft regulations* is guided by its objectives as identified above. The Committee has only made comments below where the Committee has identified issues within its remit.

Treasury Laws Amendment (Fair and Sustainable Superannuation) Regulations 2017

Schedule 1 – Transfer balance cap

Product disclosure statements

1. The Committee welcomes the amendment to sub regulation 7.9.04(1) of the Corporations Regulations such that the issue of an accumulation interest to a member following receipt of a commutation authority will not give rise to the need for completion of an application form in respect of a separate interest to be issued to the member and will give the provider three months to provide a product disclosure statement (**PDS**) to the member.
2. However, the Committee reiterates a point made in its previous submissions that the provider/trustee may also be placed in a difficult situation in terms of determining from which investment options a member's retirement phase interest should be commuted and to which investment options the new accumulation interest should be applied. The Committee had previously suggested that there should be a 'safe harbour' mechanism for trustees in determining these matters – particularly where it is likely that reasonable attempts to obtain direction from the member have not been successful.
3. Further, it is not clear whether there may be "MySuper" or "Accrued Default Amount" implications in respect of these amounts; for example, because these interests may not have previously been considered in this context – having prior to 1 July 2017 been in pension phase and not subject to MySuper (see section 20B (3) (d) of the *Superannuation Industry (Supervision) Act 1993*). A default investment option is likely to apply to these accumulation interests being issued to members as a consequence of a commutation authority – they are akin to the kinds of interests that funds are required to deal with as a MySuper product, unless defaulting to a cash only investment option. The Committee suggests that for the avoidance of doubt, consideration be given to these amounts being excluded from the operation of the MySuper provisions or further guidance is provided, particularly as some funds may not have a MySuper product to which the accumulation interest might be attributed.

Commutation of certain superannuation income streams

Amendments to pension standards

4. The Explanatory Statement (**ES**) states that the proposed amendments to the pension standards (and equivalent amendments for annuity standards) are designed to allow members/pensioners to instruct their provider/trustee to commute their pension or income stream if they are aware that continuing the pension or income stream would result in an excess transfer balance. It appears from the ES that these provisions are designed to operate regardless of whether the fund rules may permit such a commutation or partial commutation of the pension – noting that they are only designed to operate where "the relevant income stream was otherwise prevented from being commuted" (see ES, page 5 of 15). The provisions go further by enabling a member/pensioner to seek to commute a pension or income stream (otherwise not commutable under the fund rules) where they are seeking to "rearrange their affairs in anticipation of the transfer balance cap applying" (see ES, page 5 of 15).

5. The Committee anticipates there may be practical difficulties for many superannuation trustees and other providers who have offered non-commutable pensions and income streams who, from the passing of the proposed regulations (anticipated prior to 1 July 2017), may become subject to applications from pensioners (or annuitants) made pursuant to subparagraphs 1.06(2)(e)(viii), 1.06(7)(g)(x) and 1.06(8)(d)(ix) (and equivalent provisions for annuities) of the *Superannuation Industry (Supervision) Regulations (SIS Regulations)*.
6. It was the Committee's understanding that these kinds of "non-commutable" defined lifetime pensions would be classified as "capped defined benefit income streams" for the purposes of section 294-130 of ITAA97 in respect of which subdivision 303-A of ITAA97 applied to the superannuation income stream benefits in the hands of the pensioner rather than those amounts resulting in an excess transfer balance. The proposed amendments to the pension and annuity standards in the exposure draft affect the definition of a "capped defined benefit income stream" for the purposes of subdivision 294-D of ITAA97 and would not appear to align with the different treatment given to capped defined benefit income streams because they cannot be commuted.
7. The ES (at page 6 of 15) suggests that the provisions will apply notwithstanding the terms governing the relevant pension or income stream (or annuity); however in many instances the relevant trustees or providers will not be in a position to offer such a commutation.
8. The Committee considers that as a matter of law the proposed amendments would not operate to override a fund's governing rules to compel a trustee or provider to accept a pensioner's application for a commutation (or partial commutation), but that the amendments merely operate to facilitate the availability of such a commutation if a trustee or provider chose to offer it - for example, by amending their governing rules or the terms and conditions governing their pensions and annuities. The Committee notes that some trustees or other providers of pension products and annuities incorporate into their rules the terms of the pension or annuity standards by reference to the relevant legislative provisions and in these circumstances the proposed changes to the pension and annuity standards would automatically apply, despite a fund not being in a position to provide the commutation (including a partial commutation) being a specified capped amount under proposed new subparagraph 1.06(9D).
9. The Committee's observations do not appear to accord with the description of the provisions at pages 5 to 7 of 15 of the ES which imply that the pensioners (recipients) have an option to seek such commutations regardless of any requirements under the governing rules or a fund or the terms and conditions applicable to an existing pension or annuity. If the legislature intends for an overriding application of the pension standards to the effect that it would compel trustees and providers to offer commutations in respect of excess transfer balances then further legislative work is required to achieve this result. If not, it would be helpful for a carve-out equivalent to that applicable for commutation authorities under subsection 136-80(2) of the *Tax Administration Act 1953*, Schedule 1 to apply:

*(2) Despite subsection (1), if the specified * superannuation income stream is a * capped defined benefit income stream, the * superannuation income stream provider may choose not to comply with the commutation authority.*

10. As a minimum, the Committee considers this issue requires further clarification within the ES.
11. The regulations are intended to provide flexibility to permit commutations to reduce or avoid an excess transfer balance that would otherwise be "expected to arise". The drafting of the facility is uncertain in terms of the role and obligations of members and trustees to properly invoke and apply.
12. As drafted there is a discretion intended to be exercisable by a member where the member has formed an opinion (subjective) that they are likely to exceed the cap where the amount that can in fact be commuted appears to be restricted to an objectively determined measure (for which the super trustee will be responsible to correctly apply absent any modification in the draft regulations) of "the expected amount of excess transfer balance". In practice this may create unintended or undue obligations on trustees to enquire of a member seeking to invoke the facility as to their other superannuation investments to reasonably ascertain that the provision is being correctly invoked and applied by the member. Consideration should be given to providing a mechanism to protect the position of trustees in reasonably acting on representations from members in such circumstances.

Death benefits that are roll-over superannuation benefits

13. The proposed amendments to subparagraph 306-10.01 of ITAR97 will operate to restrict the new provisions under section 306-10 of the ITAA97 - allowing the roll-over of superannuation lump sum death benefits - from applying to adult children not otherwise permitted to receive a death benefit pension in respect of their deceased parent's superannuation interest.
14. This amendment is specified to apply from 1 July 2017, however the Committee notes that according to section 2 of the *Treasury Laws Amendment (TL) (Fair and Sustainable Superannuation) Act 2016 (FSS)* the relevant change to paragraph 306-10(a) (at item 5 of Schedule 1) commenced from 1 January 2017. The Committee merely queries the consistency of the timing of the commencement of these interlinking provisions.

Death benefit pension or annuity

15. The proposed amendments to subparagraphs 6.21(2) (b) (i) and (ii) of the SIS Regulations will provide that a pension and annuity must qualify as a superannuation income stream that is in the "retirement phase" for the purposes of satisfying the compulsory cashing restrictions.
16. The Committee queries why it should not be open to a trustee to cash death benefits in the form of a "taxable" pension -such that the pension would not be in "retirement phase" and might be taxed similarly to a transition to retirement pension or deferred pension. This would allow death benefits to be retained within the superannuation system, consistently with the Government's assertion that the reforms would not require benefits to be removed from the system, while ensuring that such pensions did not have the benefit of the earnings tax exemption. In the Committee's view there does not seem to be a policy reason why excess amounts should not be cashed in the form of a "taxable" pension.

17. Further, the Committee notes that in the context of these amendments the application of the definition of "retirement phase" appears somewhat circular and is likely to give rise to interpretative concerns.

Schedule 2 – Deducting personal contributions

18. The Committee expects there may be circumstances in which a trustee of a fund would be desirous of excluding the members of a particular sub-fund or division of a fund from the operation of these provisions by making an election pursuant to subsection 290-155(1) of ITAA97 and the proposed sub regulations 290.155-01 and 290.155-05, but would not be desirous of the exclusion operating with respect to other sub-funds or divisions of the fund. It appears that once the first limb of the exclusion under subsection 290-155(1) is satisfied – including via a trustee election, a contribution made to such fund would not satisfy the criteria for deductibility despite the operation of subsection 290-155(1)(b) which relates to prescribing the kind of contributions made. The Committee suggests that there might be scope for the provisions to operate in respect of sub-funds or divisions within a fund to the exclusion of other sub-funds or divisions within the same fund.
19. The Committee queries whether the Commissioner would propose notifying or otherwise communicating with defined benefit funds likely to be affected by these election provisions and desirous of making an election in order to ensure that elections are made prior to 1 July 2017 (noting the approved form is still to be prescribed by the Commissioner). The Committee notes that there would be numerous legacy private sector and State public sector defined benefit funds that would be desirous of avoiding costly restructuring and who would wish to take advantage of the election provisions. In this regard the Committee also notes the relatively tight time-frame for excluding the operation of these provisions to these defined benefit funds.
20. Further, the Committee queries whether regard has been given as to whether the circumstances of a successor fund transfer may affect the operation of these provisions and the availability of deductions to transferring members between those funds that are eligible for deductible contributions and those that are not, including due to the operation of subsection 290-155 of the ITAA97.

Schedule 3 – Fund capped contributions

21. The Committee notes the ES refers to these amendments taking effect for the financial year commencing 1 July 2017 and subsequent years, however under proposed regulation 2 the commencement of Schedule 3 is expressed as the day after the instrument is registered.
22. It is noted that Schedule 3 of the TL (FSS) Act dealing with non-concessional caps commenced on 1 January 2017 per section 2 of that Act.
23. There does not appear to be any adverse impact from the immediate commencement of the removal of the fund capped contribution provision as it largely operates to relieve a regulatory burden for funds. As such, the Committee suggests the ES be varied to conform with the proposed regulations so that it is described to commence the day after registration of the instrument.

Other

24. The Committee notes the definition of 'transition to retirement income stream' in regulation 6.01(2) of the SIS Regulations may need amendment to ensure that an income stream is not treated as a transition to retirement income stream once the recipient has satisfied a condition of release with a nil cashing restriction. Otherwise it appears that such an income stream would continue not to be a retirement phase income stream after that point, with what would appear to be unintended adverse tax consequences for the fund.

Proof reading changes

There appear to be words missing in the following sentences:

- On page 10, second paragraph, the sentence starting 'These changes apply...'
- On page 10, fifth paragraph, the sentence starting 'This outcome is inconsistent...'

Superannuation (Objective) Regulation 2016

25. Our comments on each subsidiary objective are as follows.

To facilitate consumption smoothing over the course of an individual's life

26. An individual's life comprises both the pre and post retirement phases, and this subsidiary objective would appear to be concerned with consumption smoothing during both of those phases.

27. Consumption smoothing can occur when making regular contributions (i.e. current consumption is moderated by reducing consumption and making contributions) and when accessing retirement savings (i.e. current consumption is moderated by encouraging retirement savings to be accessed in the form of income streams rather than lump sums).

28. We note for completeness that there are aspects of the superannuation system which do not necessarily align with a consumption smoothing purpose - for example, the ability to take lump sum benefits, to commute pensions and the ability to access benefits early on compassionate grounds and in the event of severe financial hardship and the ability to split benefits upon dissolution of marriage.

29. We assume there is no intent to legislate against the continuance of those aspects.

30. That said, the Committee acknowledges that this subsidiary objective is "to facilitate consumption smoothing", which is different from "to require consumption smoothing", which is helpful drafting. You may wish to clarify, either in the regulation or in the explanatory statement, that the objective of facilitation is not intended to mean that all future reforms must compel consumption smoothing in order to be consistent with the subsidiary objective.

To manage risks in retirement

31. The superannuation system is intrinsically concerned with managing risks in retirement and this subsidiary objective is therefore a rational inclusion. We note for

completeness that trustees of superannuation funds are also very much concerned with managing risks during the accumulation phase. You might consider expanding the objective to as to encompass the pre-retirement phase as well.

To be invested in the best interests of superannuation fund members

32. The best interests duty is a critical aspect of trustee governance and is rightly enshrined in legislation already. We have no quarrel with such an important duty being reflected in the (subsidiary) objectives. That said, we would suggest a minor change to the phrasing of this subsidiary objective so as to align with what the trustee duty is in law. It would be more accurate to say that the subsidiary objective of the superannuation system is "to ensure that investment decisions are made in the best interests of superannuation fund members".
33. A trustee's duty is to act in the best interests of members when making investment decisions, which is different from ensuring that investments are in the best interests of members. To illustrate the point, a trustee may act in the best interests of members (for example, by making an investment decision which is within power and which is free from any conflict of interest, after real and genuine consideration of relevant factors) even if the investment turns out to be financially unsuccessful (in which case, it would be difficult to say that the investment *was* in the best interests of members). Since trustees cannot guarantee that every investment will be successful and – in hindsight – in the best interests of members, we would suggest modifying the objective so that it is focussed on decision makers *acting* in the best interests of members.

To alleviate fiscal pressures on the Australian Government from the retirement income system

34. Of all the subsidiary objectives that have been proposed, this is the one that, in our opinion, calls for further review, consideration and either refinement or deletion.
35. The proposed primary objective of superannuation already establishes that the superannuation system's objective is to provide income in retirement to substitute or supplement the Age Pension. It would seem to us that the primary objective already encompasses the kind of alleviation of fiscal pressure that is being contemplated.
36. A subsidiary objective of the kind proposed seems both unnecessary and unnecessarily broad. Apart from alleviating reliance upon the Age Pension, we query how else the superannuation system could be called upon to alleviate the Australian Government's fiscal pressures. Taken to the extreme, this would seem to encompass the imposition of higher taxes and potentially even direct recourse to trust property, subject to constitutional limitations on the acquisition of property on other than just terms.
37. Since the Committee assumes that none of these **extreme** outcomes is contemplated, we suggest refining the subsidiary objective or, since the primary objective would seem to encapsulate the intention already, the deletion of this particular subsidiary objective.

To be simple and efficient, and to provide safeguards

38. We endorse this subsidiary objective and look forward to its implementation.

Contacts

39. The Committee would welcome the opportunity to discuss its submission further and to provide additional information in respect of the comments made above. In the first instance, please contact:

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- Ms Heather Gray, Chair, Tax Subcommittee of the Superannuation Committee
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