MILLS OAKLEY

# MOving Ahead

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**In this edition...**

- ASIC releases consultation papers in respect of self-reporting of contraventions by financial services and credit licensees and its proposal to establish a Financial Services Panel
- Bills were introduced into Parliament proposing to impose a levy on ASIC-regulated entities to recover ASIC's regulatory costs
- Draft regulations have been released, proposing to expand the range of capped defined benefit income streams under the transfer balance cap rules, and to provide tax relief to superannuation funds when mandatorily transferring assets as part of the transition to the MySuper rules
- The New South Wales Supreme Court has ordered that the trustee of a public offer superannuation fund was not compelled to pay a death benefit to the nominated beneficiary under a "non-lapsing" death benefit nomination
- The Productivity Commission released its Draft Report into Superannuation Alternative Default Models
- The ATO released guidelines outlining its compliance approach in respect of recent legislative amendments affecting various TRIS, and clarifying how the defined benefit income cap applies to superannuation income stream benefits that are paid from a non-commutable lifetime pensions or lifetime annuities
- The Insurance in Superannuation Working Group released a discussion paper examining group insurance claims handling
- The Commissioner of Taxation has determined that an advance paid under the Fair Entitlements Guarantee Act 2012 (Cth) to a former employee is "salary or wages" for the purposes of working out a liability for the superannuation guarantee charge

### 1. APRA AND ASIC UPDATES

#### 1.1 *ASIC Enforcement Review Position and Consultation Paper 1: Self-reporting of contraventions by financial services and credit licensees (11 April 2017)*

The ASIC Enforcement Review Taskforce released its consultation paper in respect of the AFSL self-reporting regime.

*The Current obligation to self-report*

If an AFS Licensee contravenes, or is likely to contravene in future, one or more of the relevant obligations, and the contravention or likely contravention is significant, the licensee has an obligation to report the matter to ASIC in writing, under section 912D within 10 business days. Failure to comply with this requirement is a criminal offence.

A number of concerns with the effectiveness of the existing self-reporting regime have been raised in recent years. Those concerns centre on:

(a) the subjectivity of the 'significance' test leading to inconsistent reporting of matters;

(b) ambiguity as to when the time for reporting commences and delays in reporting due to the time taken to assess whether the circumstances in question give rise to a breach that is significant;

(c) the obligation to report being confined to breaches of obligations by AFS licensees when the Act now places important obligations on employees and representatives as the providers of financial advice;

(d) the lack of flexibility in sanctioning failures to report (there is a single, criminal pecuniary penalty that is relatively low).

The consultation paper seeks feedback in respect of the following positions:

(a) Position 1: The "significance test" in section 912D of the Corporations Act should be retained but clarified to ensure that the significance of breaches is determined objectively.

  Position 1 Questions:

  (i) Would a requirement to report breaches that a reasonable person would regard as significant be an appropriate trigger for the breach reporting obligation?

  (ii) Would such a test reduce ambiguity around the triggering of the obligation to report?

(b) Position 2: The obligation for licensees to report should expressly include significant breaches or other significant misconduct by an employee or representative.

  Position 2 Question:

  (i) What would be the implications of this extension of the obligation of licensee's to report?

(c) Position 3: Breach to be reported within 10 business days from the time the obligation to report arises.

  Position Questions:

  (i) Would the threshold for the obligation to report outlined above be appropriate?

  (ii) Should the threshold extend to broader circumstances such as where a licensee "has information that reasonably suggests" a breach has or may have occurred, as in the United Kingdom?

  (iii) Is 10 business days from the time the obligation to report arises an appropriate limit? Or should the period be shorter or longer than 10 days?

  (iv) Would the adoption of such a regime have a cost impact, either positive or negative, for business?

(d) Position 4: Increase penalties for failure to report as and when required.

(e) Position 5: Introduce a civil penalty in addition to the criminal offence for failure to report as and when required.

(f) Position 6: Introduce an infringement notice regime for failure to report breaches as and when required.

(g) Position 7: Encourage a co-operative approach where licensees report breaches, suspected or potential breaches or employee or representative misconduct at the earliest opportunity.

  Positions 4 to 7 Questions:

  (i) What is the appropriate consequence for a failure to report breaches to ASIC?

(ii) Should a failure to report be a criminal offence? Are the current maximum prison term and monetary penalty sufficient deterrents?

(iii) Should a civil penalty regime be introduced?

(iv) Should an infringement notice regime be introduced?

(v) Should the self-reporting regime include incentives such as that outlined above? What will be effective to achieve this? What will be the practical implications for ASIC and licensees?

(h) Position 8: Prescribe the required content of reports under section 912D and require them to be delivered electronically.

Position 8 Questions:

(i) Is there a need to prescribe the form in which AFS licensees report breaches to ASIC?

(ii) What impact would this have on AFS licensees?

(i) Position 9: Introduce a self-reporting regime for credit licensees equivalent to the regime for AFS licensees under section 912D of the Corporations Act.

Position 9 Questions:

(i) Should the self-reporting regime for credit licensees and AFS licensees be aligned?

(ii) What will be the impact on industry?

(j) Position 10: Ensure qualified privilege continues to apply to licensees reporting under section 912D.

(k) Position 11: Remove the additional reporting requirement for responsible entities.

Positions 10 & 11 Questions:

(i) Should the self- reporting regime for responsible entities be streamlined?

(ii) Is it appropriate to remove the separate self-reporting obligation in section 601FC? If so, should the threshold for reporting be incorporated in the factors for assessing significance in section 912D?

(l) Position 12: Require annual publication by ASIC, of breach report data for licensees.

Position 12 Questions:

(i) What would be the implications for licensees of a requirement for ASIC to report breach data at the licensee level?

(ii) Should ASIC reporting on breaches at a licensee level be subject to a threshold? If so, what should that threshold be?

(iii) Should annual reports by ASIC on breaches include, in addition to the name of the licensee, the name of the relevant operational unit within the licensee's organisation? Or any other information?

The Taskforce states that it will provide its recommendations to Government by the end of September 2017.

Submissions are due to Treasury by 12 May 2017.

**1.2 *ASIC Consultation Paper 281 Financial Services Panel (11 April 2017)***

ASIC released a consultation paper seeking feedback on its proposal to establish a Financial Services Panel (**Panel**) to sit alongside ASIC's existing administrative processes. The Panel would add a strong element of peer review to a subset of ASIC's administrative decisions.

The Panel would comprise financial services and credit industry participants and/or non-industry participants with relevant expertise (e.g. lawyers and academics) and at least one ASIC staff member. The Panel would make administrative decisions on certain matters relating to financial services and credit activities.

Initially, the Panel would be responsible for determining (in some circumstances), whether ASIC will make banning orders against individuals for misconduct in the financial services and credit industries. Over time ASIC may expand the range of matters that the Panel may make decisions on.

The consultation paper seeks feedback in respect of the following proposals:

(a) ASIC proposes that establishing the Panel may improve regulatory outcomes by:

(i) assisting ASIC with making administrative decisions on certain matters relating to financial services and credit activities; and

(ii) enhancing the impact of ASIC's administrative decisions.

Questions:

(i) How would the Panel improve regulatory outcomes?

(ii) How do you see the Panel, as a peer review mechanism, enhancing the impact of ASIC's administrative decisions?

(b) ASIC proposes that when a matter is referred to the Panel, the Panel would be responsible for determining whether ASIC will make a banning order against an individual for misconduct in the course of providing financial services (as defined in section 766A of the Corporations Act) and/or engaging in credit activities. Specifically, the Panel would consider banning orders for misconduct by financial services participants (excluding corporate AFS Licensees) and participants in the credit industry.

Questions:

(i) What are your views on the Panel initially only being referred matters to consider that relate to the making of banning orders?

(ii) What other areas of regulatory priority should be included in the scope of the matters to be considered by the Panel (in addition to individual misconduct in the financial services and credit industries) either now or in the future?

(c) In deciding whether to refer a matter to the Panel, ASIC would consider whether it is appropriate for peer review because of its significance, complexity or novelty. Whether a matter is appropriate will depend on the facts of each matter. In addition, ASIC would take into account:

(i) the objects of Chapter 7 of the Corporations Act, that is to promote:

(A) confident and informed decision making by consumers of financial products and services while facilitating efficiency, flexibility and innovation in the provision of those products and services; and

(B) fairness, honesty and professionalism by those who provide financial services; and

(ii) the objects of the *Consumer Credit Protection Act 2009* (Cth), that is to better inform consumers and prevent them from being in unsuitable credit contracts.

Questions:

(i) Is ‘complexity, significance or novelty’ an appropriate measure for the types of matters to be considered by the Panel?

(ii) What are your views on how ASIC should distinguish between ‘complex’ and ‘simple’ matters and which do you see as more appropriate to be considered by the Panel?

(iii) What alternative or additional criteria should be used to assist in determining which matters would be referred to the Panel?

(d) ASIC proposes that only matters that are contested by the notice recipient (Recipient) would be referred to the Panel.

Question:

(i) Should uncontested matters also be referred to the Panel?

(e) ASIC may consider expanding the Panel’s powers and/or the scope of the matters to be referred to the Panel in the future. Some examples of powers that we may delegate to the Panel in the future include the power to:

(i) issue infringement notices;

(ii) refuse an AFS licence or credit licence application;

(iii) impose conditions on an AFS licence or credit licence; and/or

(iv) cancel or suspend an AFS licence or credit licence.

Question:

(i) What other administrative powers should we delegate to the Panel (in addition to the power to make banning orders) now or in the future?

(f) ASIC proposes that one of the three options set out in the consultation paper would form the basis for selecting members of the Panel.

Question:

(i) Of the options for the Panel’s composition, which is the most suitable for the Panel’s purpose?

(ii) Are there other options for the Panel’s composition that we should consider? Please explain.

ASIC anticipates that the Panel will be established in August 2017.

*Submissions are due to ASIC by 23 May 2017.*

## 2. LEGISLATION

### 2.1 *ASIC Corporations (Repeal and Transitional) Instrument 2017/271(28 March 2017)*

The *ASIC Corporations (Repeal and Transitional) Instrument 2017/271* was registered to preserve the effect of ASIC Class Order [CO 04/526] Foreign collective investment schemes (**ASIC Class Order [CO 04/526]**) for two years, whilst repealing the Class Order.

ASIC Class Order [CO 04/526] provides relief for collective investment schemes from the requirement to register as a managed investment scheme or obtain an Australian Financial Services Licence (**AFSL**) where the relevant overseas regulatory regime delivers regulatory outcomes sufficiently equivalent the Australian regulatory regime. The Class Order was due to sunset on 1 April 2017.

*Mills Oakley comment:*

*The Repeal and Transitional Instrument does not directly impact superannuation fund trustees. However it impacts the issuers (fund managers) of certain foreign collective investment vehicles that superannuation funds directly invest into.*

### 2.2 *ASIC Supervisory Cost Recovery Levy Bill 2017; ASIC Supervisory Cost Recovery Levy (Collection) Bill 2017 & ASIC Supervisory Cost Recovery Levy (Consequential Amendments) Bill 2017 (30 March 2017)*

The Package of Bills was introduced into the House of Representatives and proposes to impose a levy on ASIC-regulated entities to recover ASIC's regulatory costs as follows:

(g) each financial year, ASIC will calculate the levy value applicable to each entity, retrospectively;

(h) regulations will provide methods and formulas for how ASIC's regulatory costs are to be apportioned across the various sectors and sub-sectors that it regulates so that the model's objectives are that the total levy paid by all leviable entities should not exceed ASIC's total regulatory costs for a particular financial year;

(i) entities may be required to give a return to ASIC that includes information that will be used to calculate the levy. Following this, ASIC will issue a legislative instrument that will set out what its regulatory costs were in relation to the financial year, as well as information on how those costs are apportioned across entities;

(j) ASIC will issue notices to entities setting out the amount of levy and when it will be due and payable. Failure to pay the levy by this date will attract a late payment penalty at the rate of 20% per annum, unless ASIC has granted the entity an extension;

(k) if a person fails to give a return to ASIC, or ASIC is not satisfied with the information provided to calculate the levy, then the entity may be given a default notice for the amount that, in ASIC's opinion, is the levy payable by the person. A person that fails to give a return will also be liable under a strict liability criminal offence;

(l) where a person has made a false or misleading statement to ASIC in a return and that statement results in them paying a lesser amount than if the statement was not false or misleading, they will be liable for a shortfall penalty of twice the amount of the shortfall;

(m) ASIC may give a person a notice requiring any information provided. Failure to comply with this notice is a strict liability criminal offence;

(n) where a levy, shortfall penalty, or late payment penalty remains unpaid for a period of 12 months, a range of administrative actions may be taken against the person, including deregistration, licence suspension or cancellation, as is appropriate in the case; and

(o) ASIC will be required to publish its regulatory costs in relation to each entity type that is required to pay the levy.

The Bills are intended to take effect from 1 July 2017.

### 2.3 *Treasury Instruments Autumn 2017: TSY/45/029 Capped defined benefit income stream (13 April 2017)*

The Minister for Revenue and Financial Services, the Honourable Kelly O'Dwyer MP, has released draft regulations to expand the range of capped defined benefit income streams under the transfer balance cap.

The regulations are intended to ensure pensions that cannot practically commute in response to the transfer balance cap are treated as capped defined benefit income streams under the transfer balance cap. This allows large pensions to be subject to additional tax instead of forced commutation.

The draft regulations propose to expand the definition of capped defined benefit income stream to cover additional defined benefit pensions that permit commutation or are subject to other restrictions that fall outside the scope of SIS Regulation 1.06(2). As defined benefit superannuation income streams have commutation restrictions which make commutation impractical, they are subject to modified income tax and valuation rules which ensure commensurate tax treatment with more common account-based superannuation income streams.

The changes are proposed to have effect from 1 July 2017.

*Expanding the definition of "capped defined benefit income stream"*

Under the SIS Regulation 1.06(2), lifetime pensions are required to be paid at least annually throughout the life of the primary beneficiary (and reversionary beneficiary, if any) with the size of the pension payments in a given year generally fixed with limited scope for payment variations. The sum paid by these pensions as a benefit in each year cannot reduce except in times of deflation. These income streams can only be commuted to lump sum amounts in very limited circumstances including within 6 months of the pension commencing or during a guarantee period following the death of a primary beneficiary.

Lifetime pensions that do not meet the strict standards of SIS Regulation 1.06(2) may still be superannuation income streams that meet the more general standards for defined benefit pensions in SIS Regulation 1.06(9A).

Proposed subregulation 294-130.01(2) of the *Income Tax Assessment Regulations 1997* (Cth) (**ITAR 1997**) therefore extends the definition of a capped defined benefit income stream for the purposes of subsection 294-130(2) of the *Income Tax Assessment Act 1997* (Cth) (**ITAA 1997**). This captures certain lifetime pensions that may be commuted in limited circumstances or where payments are ceased or varied for a child beneficiary. Pensions to be covered include:

(a) lifetime pensions where commutation is permitted in time periods outside of six months from the commencement day of the pension;

(b) pensions which let the child beneficiary commute at any time, even if the primary pensioner had very restricted commutation rights;

(c) lifetime pensions where the reversionary beneficiary may commute, even if the primary beneficiary has been receiving the pension for more than 20 years; and

(d) public sector superannuation scheme funded invalidity pensions that can be varied, suspended or ceased in certain circumstances.

*Valuation rules to apply to additional capped defined benefit income streams prescribed under regulations*

Proposed ITAR subregulations 294-135.01 and 294-145.01 ensure the modified valuation rules and debit value rules which apply in relation to capped defined benefit income streams in ITAA 1997, subsection 294-130(1) also apply in relation to the additional capped defined benefit income streams newly prescribed under ITAA 1997, subsection 294-130(2). The regulation making power in ITAA 1997, subsections 294-135(4) and 294-145(7) are also used to make regulations. The new subregulations specify that the special (modified) value of a capped defined benefit income stream is calculated by multiplying the annual entitlement by a factor of 16. Similarly, the debit value generally mirrors the treatment given to lifetime pensions. That is, the amount of the transfer balance credit arising in the member's account less the amount of any transfer balance debits.

All interested parties are invited to make submissions by 4 May 2017.

### 2.4 *Treasury Laws Amendments (2017 Measures No. 2) Bill 2017 (13 April 2017)*

The Government has released exposure draft legislation, for public consultation, that proposes to amend the ITAA 1997 to provide tax relief to superannuation funds when mandatorily transferring assets as part of the transition to the MySuper rules, between 29 June 2015 and 1 July 2017.

A trustee can choose an asset roll over to defer income tax consequences from a mandatory transfer to a MySuper product in another superannuation fund or within the same superannuation fund.

Interested parties are invited to make a submission by 27 April 2017.

### 2.5 *Family Law (Superannuation) (Interest Rate for Adjustment Period) Determination 2017 (24 April 2017)*

The Determination sets the interest rate, for the 2018 Financial Year, at 0.047 (increased from 0.041 for the 2017 Financial Year), for the purposes of regulation 45D(3) of the *Family Law (Superannuation) Regulations 2001* (Cth) in respect of the adjustment of superannuation entitlements of separated and divorced spouses, and of separated de facto couples (except in Western Australia), payable in respect of a defined benefit superannuation interest or an interest in a self-managed superannuation fund.

## 3. CASES

### 3.1 *Application by BT Funds Management Ltd [2017] NSWSC 45 (3 February 2017)*

The New South Wales Supreme Court has ordered that the trustee (**Trustee**) of a public offer superannuation fund was not compelled to pay a death benefit to the nominated beneficiary under a "non-lapsing" death benefit nomination, and instead was to treat the nomination as a "request".

*Facts*

On 25 August 2009, the member gave the Trustee a non-lapsing direction that his death benefit be paid to his wife. At some stage, between the member's direction and his death, on 3 November 2012, he and his wife separated.

Under the relevant Trust Deed, the Trustee could accept, non-lapsing directions (as allowed under SIS, section 59(1)(a)), subject to the Trustee providing its conditional consent. Under the Trust Deed, the Trustee was required to provide its conditional consent unless it had actual knowledge that the member did not understand the consequences of making the non-lapsing direction.

The Trust Deed also provided that on the death of a member, the Trustee must consider whether to make its conditional approval absolute and that it must form the view that its conditional consent was absolute unless, relevantly, it had actual knowledge that the member had separated on a permanent basis from his spouse. In that event, the Trustee's conditional consent would be revoked and the Trustee would be required to treat the direction as a "request". In other words, the non-lapsing nomination became a non-binding death benefit nomination. The Trustee was made aware of the separation.

*Decision*

The Judge was satisfied that the Trustee would be justified in concluding that the direction was governed by SIS, section 59(1), rather than under the binding death benefit nominations rules under section 59(1A). Therefore, the nomination became non-binding on the Trustee.

*Mills Oakley comment*

*The death benefit rules that arise under SIS, section 59 provide a degree of uncertainty and ambiguity. In the case of Retail Employees Superannuation Pty Ltd v Pain [2016] SASC 121, the Court dedicated over 100 paragraphs to the issues surrounding the power of the REST Trustee to provide members with the right to make death benefit and reversionary pension nominations under REST Super's trust deed, whilst noting the ambiguity of the drafting of SIS, section 59.*

*Part of the confusion arises around the rules surrounding consent nominations under SIS, section 59(1)(a); the binding death benefit nomination rules under SIS, section 59(1A); and maybe the fact that self-managed superannuation funds can draft rules into their trust deeds that circumvent the binding death benefit rules, by virtue of the fact that section 59 excludes self-managed superannuation funds.*

*However, some of the confusion also arises from the terminology used to explain or disclose the offering of consent nominations (such as the one in this case) by some public offer superannuation fund trustees to members. In some cases, these nominations are referred to as "non-lapsing binding death benefit nominations", which appears to fly in the face of the SIS binding death benefit rules that require a binding death benefit nomination to lapse after 3 years.*

*APRA has previously stated that a consent nomination, under SIS, section 59(1)(a) 'permits members to determine, with greater certainty than the non-binding guidance, the persons to whom death benefits would be paid'. However, APRA then went on to state that 'as members' circumstances change over the period of membership, the consent process should include a periodical review mechanism to take into consideration any changes to members' circumstances. This would be consistent with the duty of the trustee to act in the best interests of members.' These statements were made in the 2006 Superannuation Circular No. I.C.2 Payment Standards for Regulated Superannuation Funds (**APRA Circular**), which was replaced in 2012 by SPG 280 – Payment standards for regulated superannuation funds and approved deposit funds (**SPG 280**). SPG 280 is silent on this issue, but does not contain any statement contrary to the APRA Circular's comments in respect of consent nominations.*

*We take the view (and this may be seen as overly cautious) that whilst we support trustees offering consent nominations, it would be risky to refer to and advertise or disclose these as being unequivocally "non-lapsing and binding", because the trustee is likely to have the right and power to revoke its consent at some stage in the future (even if unlikely). In other words, consent nominations do not provide members with "absolute" certainty as to whom death benefits will be distributed to. A member will only have certainty for so long as he or she is made aware of the trustee's consent, until such time as the Trustee revokes that consent.*

## 4. OTHER RECENT DEVELOPMENTS

### 4.1 *Productivity Commission Draft Report: Superannuation: Alternative Default Models (29 March 2017)*

The Productivity Commission's draft report identifies 4 alternative superannuation default models. The Productivity Commission confirmed that it is tasked to develop new competitive models for future consideration by the Australian Government. The Productivity Commission is not tasked to form a view on whether alternative models are better or worse than the current default arrangements, nor on the merits of the current default arrangements.

*Impact*

The Draft Report states that over 40% of superannuation fund members hold more than one account, due to turnovers in employment in which the employee typically defaults into the new employer's chosen superannuation fund (the Draft Report refers to this as the Turnover Pool).

The Productivity Commission is taking an alternative approach by considering alternative default models in respect of employees who both:

(a) fail to exercise choice; and

(b) do not have an existing superannuation account.

These would typically be new entrants to the workforce (**First Timer Pool**), and they will retain that account (including through a change in employer) unless they actively switch.

The Productivity Commission estimates that the First Timer Pool would comprise approximately 400,000 new default members each year, with about $800 million in annual contributions.

The key benefit of restricting the new default allocation models to the First Timer Pool is the immediate "circuit breaker" of reducing wasteful account proliferation, which erodes member balances via multiple sets of fees and insurance policies.

A fund whose product "wins" default status for contributions of new default members would have to extend the same fees and service terms to its existing members in the default product. The models in the Draft Report do not envisage moving the entire system's pre-existing default members to the new default product.

*The assessment framework*

Each model has been assessed against the following (mostly qualitative) criteria:

(a) Member benefits: Does the model create incentives for funds to maximise long term net returns and allocate members to products that meet their needs?

(b) Competition: Does the model encourage open participation (contestability) and rivalry between funds (competition) to drive innovation, cost reductions and more efficient long term outcomes for members?

(c) Integrity: Does the model promote a high degree of integrity in the selection and delivery of default superannuation products, and the ongoing behaviour of superannuation funds more broadly?

(d) Stability: Is the model likely to create instability in the superannuation system that leads to significant systemic risks?

(e) System wide costs: Does the model minimise overall system wide costs, taking into account costs on members, employers, funds and governments?

*Draft findings and recommendations*

Among the Draft Report's findings and recommendations are the following:

(a) DRAFT FINDING 1.2

Where there is third party involvement in the selection of a default product, there needs to be effective regulation or arrangements in place to ensure these third parties act in the best interests of members.

(b) DRAFT FINDING 1.3

For the purposes of this Inquiry, a formal competitive process for allocating default members constitutes any new alternative process that permits open participation (contestability), encourages rivalry between funds (competition) to the benefit of members, and involves products being selected for members based on merit.

(c) DRAFT RECOMMENDATION 3.1

To avoid perpetuating the legacy problems of the current system, any future alternative system for allocating members to default products should be premised on employees being assigned a default product only once, when they join the workforce.

(d) DRAFT RECOMMENDATION 3.2

The Government should establish a centralised online service for members, employers and the Government that builds on existing functionality of myGov and Single Touch Payroll. The service should:

(i) allow members to register online their choice to open, close or consolidate accounts when they are submitting their Tax File Number on starting a new job;

(ii) facilitate the carryover of existing member accounts when members change jobs; and

(iii) collect information about member choices (including on whether they are electing to open a default account) for their employer and the Government.

There should be universal participation in this process by employees and employers.

(e) DRAFT FINDING 3.3

The default product in all models will focus on the accumulation stage and include investment, administration of member accounts and intrafund advice. It will be a simple and low cost (but not conservative) product aimed at the needs of those who are disengaged from the system.

A bundled insurance product will not be a factor in the selection of products.

Funds will primarily compete on long term net investment returns and costs, subject to meeting a threshold quality of service, not on the quality or range of ancillary services per se.

(f) DRAFT FINDING 3.4

The desirable frequency for the selection process is between four and eight years, with the greater frequency best used in the early period.

(g) DRAFT FINDING 3.5

The selection of eligible default products should be administered by a government body, and be subject to strong governance rules.

(h) DRAFT RECOMMENDATION 3.3

The Government should introduce a formal framework that specifies the process and obligations of trustees when making or considering merger proposals. As part of the framework, trustees would be required to disclose all merger attempts involving their fund, as well as the reasons for any decisions.

*Model 1: Assisted Employer Choice*

(a) In this model, employees are required to choose a superannuation product themselves (active choice), but are assisted in doing so by a set of policy interventions.

(b) The primary feature is a non mandatory shortlist of carefully selected products that are deemed to be “good”. It would nudge employees towards good products without going as far as to impose one by default. The shortlist would consist of between 4 to 10 products, selected by a government body using a heavy administrative filter (see Model 2). The shortlist would be accompanied by simple information on key features of each product in a consistent and comparable format.

(c) A system of product accreditation would encourage funds to provide products which have a common, simple design that allows for easy comparisons across different products, and thereby makes it easier for employees to choose a product that meets their needs. Products would have to be accredited to be considered for shortlisting.

(d) A simple, low cost last resort fund (run by existing eligible rollover funds or possibly the Future Fund) would hold contributions from employees who fail to exercise choice and encourage them to choose their own product.

(e) The Assisted Employee Choice Model can be summarised against the relevant criteria, as follows:

(i) Member benefits:

(A) the shortlist would make it simpler and easier for employees to compare products and select a suitable product. It would also reduce the probability of employees relying on irrelevant or conflicted sources of information;

(B) product accreditation would make it easier to compare products from a wider set of providers and make decisions simpler;

(C) the shortlist and accreditation would make it more likely that employees exercise choice and the last resort fund would reduce the penalty associated with not exercising choice. But some risk remains that employees fail to exercise choice or choose a good product; and

(D) employees would not be forced to choose accredited or shortlisted products and would remain free to choose other products.

(ii) Competition:

(A) improved product comparability from accreditation would put downward pressure on fees. Accreditation would also encourage funds to provide a ‘no frills’ product for members who are not well placed to select specific investment options themselves;

(B) accreditation may curtail wasteful product proliferation in the market as a whole;

(C) shortlisting could raise barriers to entry, though would not be inefficient given the process would be contestable and repeated; and

(D) accreditation and shortlisting can potentially reduce innovation, and the associated compliance costs can discourage funds from participating.

(iii) Integrity:

(A) the integrity of the interventions would reflect both the efficacy of their design and the performance of the regulator and shortlisting body; and

(B) both shortlisting and product accreditation could reduce scope for employees to make bad decisions on the basis of conflicting advice or interests.

(iv) Stability:

(A) sudden large scale movements in balances or members are unlikely, and the model is not expected to result in excessive levels of market concentration.

(v) System wide costs:

(A) search costs are likely to be materially lower for many employees;

(B) there will be additional compliance costs to funds, which would be offset by a reduction in marketing expenditure (though marketing activity would likely remain significant); and

(C) there are relatively small monitoring and enforcement costs to government.

(f) The Productivity Commission is seeking the following information:

(i) In terms of a shortlist of superannuation products, what evidence is available on the size of the list that would best facilitate the majority of employees to choose a fund that meets their needs?

(ii) What specific information should be included alongside such a shortlist to help employees to choose between products? In what format should the information be presented? What evidence is there for how the metrics would assist employees to make decisions?

(iii) What institutional arrangements would best suit a last resort fund? Should it be managed by existing eligible rollover funds or the Future Fund?

(iv) Under a system of active employee choice, what would be the costs and benefits of prohibiting funds or related parties from offering prospective members a short term benefit that is unrelated to the superannuation product? What specific form should any such prohibitions take?

*Model 2: Assisted Employer Choice (with employee protections)*

(a) In this model, employers choose a default product for their employees who do not exercise choice. In doing so, employers must select a product from one of two lists. The model recognises that some (mainly larger) employers are well placed to choose a default product and negotiate favourable arrangements for their employees, while many (mainly small and medium size) employers are not well placed to select a default product.

(b) Employers must choose a product that meets mandatory minimum standards: a light filter. Mandatory minimum standards are important to protect member interests, given the principal–agent issues inherent in the employer choice environment. The light filter would be akin to a strengthened MySuper authorisation process (with a stronger emphasis on minimum performance standards).

(c) A heavy filter would apply stricter criteria around investment performance and other product features (similar to the tender criteria below) to identify a narrower "preferred default" list of the best performing products. The preferred default list would be voluntary for employers, and is designed to assist employers who are not well placed to select appropriate default products for their employees.

(d) The Assisted Employer Choice (with employee protections) Model can be summarised against the relevant criteria, as follows:

(i) Member benefits:

(A) presence of administrative filtering should result in more employees in better performing products;

(B) use of selection criteria relating to long-term net returns, fees and governance should provide incentives to improve performance; and

(C) greater involvement of employers could enable better tailoring of products to workplaces in some cases.

(ii) Competition:

(A) narrows the range of eligible products which could potentially reduce competition;

(B) however, can also generate ready comparability and competition as funds compete to have their products included on the preferred default list, and to be the default fund for large employers. Disclosure and improved comparability could promote active member engagement;

(C) will focus competition on aspects of value to members, like long-term net returns and fees, though there is still some scope for unhealthy and wasteful marketing to employers; and

(D) could provoke some market consolidation, which could benefit members by leading to more efficient providers and better member returns.

(iii) Integrity:

(A) the role of employers and the panel determining the preferred default list introduces principal–agent issues, meaning this model can be seen as raising more integrity issues; and

(B) in practice, the main integrity issue would relate to the process for appointing the panel determining preferred default eligibility. This requires effective appointment processes and governance and accountability arrangements.

(iv) Stability:

(A) unlikely to create instability, as the model would not lead to excessive market concentration, sudden movement of balances or a short-term focus by trustees.

(v) System wide costs:

(A) search costs lower for defaulting employees as they effectively have their choice of product decision made for them;

(B) total costs to employers increased, particularly if they use relatively expensive ways of choosing a product (such as via tender). However, their ongoing costs might be reduced if they subsequently dealt with fewer providers;

(C) overall search costs likely to be lower than under employee choice as there are fewer employers relative to the total number of employees;

(D) cost to funds higher as they incur the cost of participating in the filtering process and would be likely to incur costs from marketing their products to employers (although these latter costs may be lower than under the baseline); and

(E) total costs to government may be higher as they incur the implementation and administration costs of the administrative filter (although if the filter leads to higher balances, this is likely to reduce future Age Pension liabilities).

(e) The Productivity Commission is seeking the following information:

(i) What are the main drivers of costs to employers in selecting default products on behalf of their employees? Would a shortlist of 'no frills' default products make this task easier for employers? Is there an ideal minimum number of products that should be nominated on the preferred default list?

(ii) Are there other specific criteria in addition to those proposed under the minimum standards criteria that default products should meet to protect members and help to achieve better outcomes for them in the long term?

(iii) (Would a dual-list approach, allowing employers to select a product from one of two lists, provide them with sufficient flexibility to select tailored default products that best meet the needs of their employees?

(iv) Which types of employers prefer to retain a role in default product selection? To what extent are default products or corporate fund offerings considered important benefits offered to prospective employees in competitive labour markets?

*Model 3: Multi Criteria Tender*

(a) In this model, participants compete for rights to a share of the default pool by making proposals against a number of different assessment criteria, which are weighted by their relative importance. A well designed multi criteria tender could therefore engender a product that performs well on multiple characteristics that meet members' needs. The key features of this model are:

(i) a pre-qualification stage to ensure participating funds meet minimum criteria relating to governance and transparency

(ii) (the tendering stage, where participants submit tenders against the following criteria:

(A) past performance on net returns and member satisfaction;

(B) investment strategy;

(C) the quality of member services, engagement and intrafund advice;

(D) fee levels and transparency; and

(E) innovation in unspecified areas;

(iii) a comparative evaluation stage — tenders are evaluated against the criteria and assigned an index score, with up to 10 of the overall best performers being deemed as winners of the tender. A best and final offer stage could be used to encourage convergence where proposals are close, in the interest of members having near equivalence in standards despite being sequentially allocated to a product; and

(iv) a performance monitoring and enforcement stage, with winning providers self reporting against the commitments made in their winning offers, and a credible threat of losing default provider status in the absence of immediate remediation of a contractual breach.

(b) The Multi Criteria Tender Model can be summarised against the relevant criteria, as follows:

(i) Member benefits:

(A) the selection criteria, in particular the results of member satisfaction surveys and long term net returns, help to directly promote member benefits;

(B) these past performance measures provide ongoing incentives for good performance; and

(C) these benefits are likely to extend into the choice part of the superannuation product market through the winning bids providing a market-wide performance benchmark.

(ii) Competition:

(A) the tender would help achieve the competitive tension that would exist in a market with active and informed users;

(B) the tender opens up the competitive process to a broad range of funds;

(C) by issuing non-prescriptive criteria with no pre-defined solutions, the tender process provides some incentives for innovation;

(D) requiring a performance record of at least five years in any superannuation (or like) product would create a barrier to entry; and

(E) any market consolidation would be unlikely to reduce competition. Consolidation could bring benefits, through scale economies and greater competitive pressure on upstream providers.

(iii) Integrity:

(A) there are risks to integrity due to vulnerability to subjective judgments. Constituting a truly independent panel may encounter difficulties; and

(B) the tender has strong accountability mechanisms in the form of contractual obligations and the threat of future exclusion, and also more broadly from fiduciary and statutory obligations on trustees and other laws and regulations.

(iv) Stability:

(A) the tender is unlikely to create instability, since it would not lead to excessive market concentration, volatile movement of members and assets or a short-term focus.

(v) System wide costs:

(A) the high costs to government and funds are offset by lower costs for members and employers.

(c) The Productivity Commission is seeking the following information:

(i) Which aspects of member services should be included in the tender criteria? Do default members value the same services as choice members?

(ii) How should default members be allocated across the set of winning products? Are there problems with sequentially allocating members into products with different investment strategies, fees and services, as is implied by this model? What role could a best and final offer stage play in providing a select number of funds the opportunity to improve their offer?

(iii) Regarding transparency, are there any problems with only withholding information that can reasonably be shown to be commercially sensitive? What information would fall under this exemption?

*Model 4: Fee Based Auction*

(a) This model has products competing for default status by out bidding each other on member fees. A fee based auction is worthy of consideration for two reasons. First, there is evidence that variation in member fees explains a significant amount of variation in net returns. Second, realising economies of scale would allow the superannuation system to achieve lower member fees without diluting net returns. While both points may be contested, they are not without merit.

(b) A pre-qualification stage is used to ensure participants meet certain minimum standards. Fund level minimum standards relate to the fund's integrity and capacity to handle expected member inflows. Product level standards relate to a certain level of member and investment services.

(c) The auction's bidding metric is a composite fee that accounts for administration and investment fees, as these make up the bulk of member charges. The bidding format is a first price sealed bid.

(d) The auction would be able to produce multiple winners (but also a single winner). The advantage of multiple winners is the wider spread of the lowered fee across the market (noting the requirement cited earlier that winning funds must extend the new fee to their existing members of the default product). This would be done through a carefully managed best and final offer mechanism, whereby a select number of losing funds may have an opportunity to match the fee and service offering of the winner.

(e) Post auction monitoring and enforcement mechanisms will be needed to keep the winning fund(s) to the commitments made in the auction process, including a credible threat of losing default provider status in the absence of immediate remediation of a contractual breach.

(f) The Fee Based Auction Model can be summarised against the relevant criteria, as follows:

(i) Member benefits:

(A) to the extent that investment returns are largely market driven, focusing the nature of competition on fees would promote long term net returns, despite the potential for it to push funds away from particular higher cost asset classes; and

(B) the pre-qualification stage (if well designed), would reduce the risk of low fees coming at the expense of member services.

(ii) Competition:

(A) funds mainly compete on member fees;

(B) the inclusion of both administration and investment fees opens up competition to a broader set of funds than if bidding were only on the basis of administration or investment fees; and

(C) to the extent there is some market consolidation, this is unlikely to substantially affect competition. Fewer competitors could even provide benefits, including improved productive efficiency and greater competitive pressure on upstream providers.

(iii) Integrity:

(A) the risk of the outcome being manipulated by funds or the panel is low, as the bidding metric is objective and collusion is unlikely; and

(B) funds are held accountable by many mechanisms, including mechanisms specific to the auction like a contractual obligation and potential exclusion from future processes, as well as existing regulations and reputation risk.

(iv) Stability:

(A) unlikely to create instability, because the model would not lead to excessive market concentration or volatile movement of members and assets.

(v) System wide costs:

(A) high costs for government and funds are likely to be offset by the lower costs for members and employers.

(g) The Productivity Commission is seeking the following information:

(i) Is the format of a first price sealed bid with a best and final offer stage and potentially multiple winners the best fit for a fee based auction? Are there any risks associated with these design elements that have not been identified?

(ii) Regarding transparency, what would fall under the exemption of information that, if it were disclosed, could reasonably be expected to have commercially adverse consequences for the bidder?

(iii) Could a fee based auction be designed to facilitate second order competition between funds on non-fee aspects of performance, such as member services?

*Submissions and public hearings*

Submissions are due to the Productivity Commission by Friday 28 April 2017. Further, the Productivity Commission is holding public hearings in Melbourne on 3 May 2017 and Sydney on 8 May 2017.

### 4.2 *ATO Practical Compliance Guideline PCG 2017/3 Income tax - supporting the implementation of the changes to the taxation of transition to retirement income streams (30 March 2017)*

The Guideline outlines the ATO's compliance approach for certain APRA-regulated superannuation funds facing practical difficulties in complying with recent legislative amendments affecting various transition to retirement income stream (**TRIS**) products during the transition period as a result of the removal of the tax exemption afforded to the income attributable to assets supporting the payment of a TRIS.

The Guideline has effect from its date of issue for funds that:

(a) hold assets in segregated current pension asset pools or segregated exempt asset pools (Segregated Asset Pools) before the 2018 Financial Year and those assets include assets supporting the payment of TRIS that are unable to be transferred or otherwise distinguished from the segregated asset pool(s) at the start of the 2018 Financial Year; and

(b) have deployed a full system solution by the end of 30 June 2018

Where these difficulties exist, a trustee is unlikely to be able to calculate assessable income and exempt income for that interim period before they deploy a full solution to address these implementation issues, and this has potential to impact on tax compliance.

To facilitate earliest feasible adoption of full system solutions, the ATO recognises that trustees may apply interim arrangements in respect of some products or platforms and not others, or to deploy full system solutions for different products or platforms at different times.

*Determining Fund assessable income*

In calculating assessable income for the 2018 Financial Year, funds may have the following two periods:

(a) the intermin period – from the commencement of the fund's 2018 Financial Year to the time at which the Fund deploys a full solution, which must not be later than 30 June 2018. This is the period when assets that support payment of TRIS continue to be allocated to an asset pool with assets that support payment of superannuation income streams in the retirement phase, and the fund is not able to calculate assessable income through its existing systems; and

(b) the remainder period – from the deployment of a full solution system to 30 June 2018, where assessable income and tax on earnings from assets that support payment of TRIS is calculated normally. This is the period when the systems in place will recognise assets supporting payment of TRIS are segregated from assets supporting payment of superannuation income streams in the retirement phase. We note that in some cases a Fund may not have a remainder period because the full solution is not deployed until 30 June 2018.

Where the full solution system deployed is forward looking only, and is unable to determine assessable income retrospectively from a reconstruction of the correct Segregated Asset Pool with effect from the commencement of the 2018 Financial Year, a specific calculation will be necessary to reflect the assessable income attributable to TRIS assets for the interim period (**Interim Method**). An Interim Method consists of the following steps:

Step 1: determine the ordinary and statutory income for the interim period of the asset pool that was a Segregated Asset Pool immediately before the 2018 Financial Year began;

Step 2: determine the average value of assets in this asset pool that support the payment of TRIS for the interim period;

Step 3: determine the proportion this value represents to the average value of the total assets in the pool for the interim period; and

Step 4: apply that proportion to the sum of the income amounts determined at Step 1 to determine the assessable income attributable to assets supporting the payment of TRIS during the interim period.

In determining assessable income in respect of the 2018 Financial Year, a fund's assessable income will include three separately calculated components:

(a) assessable income referrable to the interim period, determined using the fund's ordinary systems. This amount should be correct other than that it excludes income derived in relation to TRIS assets which the ordinary systems continue to recognise as exempt during that interim period;

(b) the amount of assessable income reflecting income referrable to TRIS assets during the interim period using the Interim Method; and

(c) (assessable income referrable to the remainder period (if any), determined using the fund's full solution system. As this period represents that period for which the fund has deployed a full solution system, this amount will accurately include assessable income derived in relation to assets supporting payment of TRIS that will have been transferred from the fund's segregated asset pool(s).

Where the full solution system deployed is capable of retrospectively calculating the fund's assessable income, including assessable income derived from assets supporting payment of TRIS, based on reconstruction of a fully compliant segregated asset pool from the commencement of the 2018 Financial Year, no separate Interim Method will be required.

Where a fund adopts either approaches outlined above, the ATO will not allocate compliance resources to review the calculation of the actual assessable income and exempt income of the fund's asset pools for the 2018 Financial Year, to the extent that the calculations are related to the implementation of the TRIS amendments and/or interim measures to facilitate that implementation.

*Pay As You Go Instalments*

For the 2018 Financial Year, the ATO will not allocate compliance resources to review whether a fund has correctly reported its instalment income for the purposes of imposing a penalty under subsection 284-75(1) of *Schedule 1 to the Taxation Administration Act 1953* (Cth) where:

(a) during the interim period, the trustee calculates instalment income without including an amount reflecting the income derived in relation to assets supporting payment of TRIS and uses the instalment rate that would ordinarily be applied for the relevant instalments to work out its PAYG instalment;

(b) where the fund has both an interim and remainder period within the 2018 Financial Year, the trustee works out the fund's first PAYG instalment during the remainder period by including the amount of assessable income calculated at Step 4 of the Interim Method with its other instalment income and uses the instalment rate that would be ordinarily applied; and

(c) where the fund has no remainder period within the 2018 Financial Year, the trustee works out the fund's PAYG instalment for the period that includes the end of the 2018 Financial Year by including the amount of assessable income calculated at Step 4 of the Interim Method with its other instalment income and uses the instalment rate that would be ordinarily applied.

*Segregated current pension assets and segregated exempt assets*

Where funds continue to have assets supporting the payment of both TRIS and income streams in the retirement phase co-mingled in an asset pool after the commencement of the 2018 Financial Year, the assets will not meet the definition of segregated current pension assets or segregated exempt assets.

For the 2018 Financial Year, the ATO will not allocate compliance resources to review whether the funds' asset pools that have co-mingled assets that supports the payment of both TRIS and retirement phase income streams meet the definition of segregated current pension assets or segregated exempt assets.

*Alternative methods*

Funds are entitled to self-assess tax liability using an alternative method they believe satisfies their tax obligations under the law. The ATO's compliance response does not apply in circumstances where such other methods are used, and these funds may be subject to more detailed review by the ATO.

**4.3 *ATO LCG 2016/10 Superannuation reform: capped defined benefit income streams – non-commutable, lifetime pensions and lifetime annuities (6 April 2017)***

The Guideline clarifies how the defined benefit income cap applies to superannuation income stream benefits that are paid from a non-commutable lifetime pension or lifetime annuity that is non-commutable. The guidance follows changes made to the income tax treatment of certain defined benefit income stream benefits from the 2018 Financial Year.

The Guideline covers the following capped defined benefit income streams that cannot be commuted in full or in part:

(a) lifetime pensions that are provided for under rules that meet the standards of SIS Regulation 1.06(2); and

(b) lifetime annuities that that are provided under a contract that meets the standards SIS Regulation 1.05(2) and was payable just before 1 July 2017.

As with other types of superannuation income streams, the value of capped defined benefit income streams count towards your transfer balance cap.

Capped defined benefit income streams cannot, of themselves, result in members having an excess transfer balance. Instead, modifications to the general transfer balance cap rules apply.

Instead of excess capped defined benefit income streams causing a breach of a member's transfer balance cap that needs to be remedied by removing the excess transfer balance, modifications result in certain amounts being included in assessable income and adjustments to the availability of tax offsets. The reason for the different treatment arises because capped defined benefit income streams generally cannot be commuted and cashed as a lump sum.

The following modifications apply for capped defined benefit income streams:

(a) the application of a statutory formula to work out the value of your superannuation interest that supports a capped defined benefit income stream. This value is called the "special value" and gives rise to a credit in a member's transfer balance account; and

(a) the defined benefit income cap, which affects the defined benefit income that is included in your assessable income. It also limits the tax offset available in respect of the untaxed element of certain benefits that are defined benefit income.

**4.4 *Discussion Paper: Claims Handling (7 April 2017)***

The Insurance in Superannuation Working Group (**ISWG**) has released a discussion paper examining existing practices and issues associated with insurance claims handling and outlines some changes in timeframes to improve the member experience.

The ISWG proposes that the Superannuation Industry devise a Code of Practice in respect of Group Life and Salary Continuance Insurance which will address:

(a) principles to be applied in the handling of claims;

(b) time frames within which certain activities that the fund is responsible for in the claims journey should be undertaken;

(c) minimum standards in relation to communicating with people claiming; and

(d) good practice guidance in relation to governance structures and approaches to claims handling.

The ISWG is seeking feedback in respect of the discussion paper by 5 May 2017.

### 4.5 *Superannuation Guarantee Determination SGD 2017/1: Superannuation guarantee: is an advance paid under section 28 of the Fair Entitlements Guarantee Act 2012 to a former employee 'salary or wages' paid by the employer to the employee for the purposes of working out a superannuation guarantee charge liability under the Superannuation Guarantee (Administration) Act 1992? (19 April 2017)*

The Commissioner of Taxation has determined that an advance paid under section 28 of the Fair Entitlements Guarantee Act 2012 (Cth) (**FEG Act**), to a former employee is "salary or wages" paid by the employer to an employee for the purposes of working out a liability for the superannuation guarantee charge.

The determination replaces:

(a) ATO Interpretative Decision ATOID 2015/13 *Superannuation Guarantee: liability of company in liquidation for superannuation guarantee charge in respect of a Fair Entitlements Guarantee advance paid by a third party;*

(b) ATOID 2015/14 *Superannuation guarantee: liability of company in liquidation for superannuation guarantee charge in respect of a Fair Entitlements Guarantee advance paid by a liquidator; and*

(c) ATOID 2015/15 *Superannuation guarantee: liability of liquidator for superannuation guarantee charge in respect of a Fair Entitlements Guarantee advance.*

*Explanation – "Salary or wages"*

The primary objective of the FEG Act is to provide financial assistance (called an "advance") to former employees, where the end of their employment is linked to the insolvency or bankruptcy of their employer. An advance is paid in respect of certain unpaid employee entitlements when there are insufficient funds or assets available to the employer to pay those entitlements.

An advance is considered to be "salary or wages" within the ordinary meaning of those terms because the advance is paid in consideration of the services rendered by the former employee to the company, prior to the company entering into liquidation.

A payment that falls within the ordinary meaning of salary or wages will be "salary or wages" for the purposes of the *Superannuation Guarantee (Administration) Act 1992* (Cth) (**SGAA**). An employer's superannuation guarantee shortfall for the relevant quarter is calculated under Part 3 of the SGAA. Section 15B extends the application of Part 3 to former employees.

While the payment of the advance does not extinguish the salary or wages debt owed by the company to the former employee, the advance still constitutes "salary or wages" within the ordinary meaning of those terms.

*Explanation – "On behalf of the employer"*

Subsection 6(3) of the SGAA states that, for the purposes of the Act:

'...*a reference to salary or wages paid by an employer to an employee includes a reference to a payment made on behalf of the employer*.'

The advance is still considered to be paid "on behalf of the employer" by the Department of

Employment even though there is no agency relationship between the Department of Employment and the company and even if the advance is ultimately paid to the employee by a third party, such as an accounting firm.

Similarly, where the department makes the payment directly to the employee, such payments are still considered to be "on behalf of" the employer.


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