



Law Council
OF AUSTRALIA

Legal Practice Section

5 October 2017

Senate Standing Committees on Economics
PO Box 6100
Parliament House
CANBERRA ACT 2600

By email: economics.sen@aph.gov.au

Dear Sir/Madam

SUBMISSION ON TREASURY LAWS AMENDMENT (IMPROVING ACCOUNTABILITY AND MEMBER OUTCOMES IN SUPERANNUATION MEASURES NO 2) BILL 2017

The Law Council is grateful for the opportunity to make a submission in regard to the Treasury Laws Amendment (Improving Accountability And Member Outcomes In Superannuation Measures No 2) Bill 2017 (Cth) (**the Bill**).

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 most proposed legislation, circulars, policy papers and other regulatory instruments which affect superannuation funds.

Schedule 1 – Choice of fund for workplace determinations and enterprise agreements

The removal of the exemption in relation to workplace determinations and enterprise agreements from 1 July 2018 (s 32C(6) of the Bill) exacerbates an existing problem with s 32NA(9) of the *Superannuation Guarantee (Administration) Act 1992* (Cth) (**SG Act**) for defined benefit funds which are open to new members.

Section 32NA(9) speaks of an employee who is a defined benefit member. The Committee strongly recommends that this provision should also contemplate employees who are eligible to be, and will shortly become, a defined benefit member because the employer is bound by an agreement to put its members into a defined benefit fund. Otherwise, there is an issue if the employer is bound by an industrial arrangement to put new employees in a defined benefit fund, but there is (as is inevitable) a delay between commencing employment and the employer sending the first contribution to the defined benefit scheme (which is when the new employee actually becomes a member).

New s 20(3A) proposed in the Bill, together with existing s 32NA(9)(b), indicate an intention that in this situation the employer should not be subject to 'double jeopardy' of the employee choosing another fund but while also being entitled to defined benefits. However, the threshold for s 32NA(9) is the wording in sub-section (1) that the employee is (in the present tense) already a defined benefit fund member.

This in turn leads to a heightened risk of adverse selection against an 'open' defined benefit fund.

Open defined benefit funds rely on the new members joining the defined benefit fund having profiles which are broadly representative of the relevant population – in terms of age profile, salary earning potential, prospects for salary increases during their membership, health and longevity and so forth. These factors are relevant to the likely costs of funding members' defined benefits upon retirement. Arrangements whereby new employees are enrolled in a defined benefit fund by default achieve this important end.

The existing exemption which precludes an existing defined benefit member from choosing a different fund with the benefit of hindsight recognises the problem of adverse selection. However, the removal of the exemption in relation to workplace determinations and enterprise agreements (which are the mechanisms by which new employees are defaulted into defined benefit funds) creates a risk of adverse selection which does not currently exist. Specifically, it creates a risk that the new members joining open defined benefit funds will no longer have a profile which is representative of the relevant population. This, coupled with the simple fact that there may be less cash flow into those defined benefit funds as a result of new employees choosing other funds, could be detrimental for the ability of those defined benefit funds to continue financing members' defined benefits into the future.

This detriment can be avoided by a relatively minor syntactical change to the legislative drafting. Given how few open, defined benefit funds there are in Australia, such a change would presumably be unlikely to significantly diminish the number of Australians who would enjoy choice-of-fund under the reforms.

Schedule 2 – Salary sacrifice integrity

The Committee supports the salary sacrifice measures in principle. However, it is concerned that the operation of the Bill in relation to some types of 'Total Remuneration' or 'Total Package' arrangements is uncertain and may have unintended consequences.

Under these arrangements, the employee is entitled to an agreed amount of total remuneration which will comprise cash salary and superannuation contributions, and often includes other benefits (such as vehicle leasing or other fringe benefits). The employee is then free to choose their preferred allocation of the agreed total remuneration between salary, superannuation and other benefits, at the employee's discretion but subject to some restrictions

For many of these arrangements, the contract includes a provision to the effect that the employer will pay superannuation contributions of no less than the amount prescribed under superannuation guarantee legislation and these contributions are included in the agreed amount of total remuneration (that is, the contract states that an employee cannot select less than the superannuation guarantee minimum). In these circumstances, the Committee suggests that it is clear that the employee's ordinary time earnings will comprise the total remuneration less superannuation guarantee contributions.

The position is less clear for arrangements where the contract simply specifies the agreed amount of total remuneration, with the employee able to select any combination of cash salary or superannuation (or, if applicable, other benefits). Arrangements are drafted in this way on the assumption that superannuation guarantee contributions are 'compulsory' (which under the legislation they are not) and that the employee will always select more than the superannuation guarantee minimum.

The Committee is also concerned that the salary sacrifice integrity provisions in the Bill could be interpreted as requiring that all superannuation contributions made under such arrangements are considered to be made under a 'salary sacrifice arrangement', because all superannuation contributions are agreed by the employee and reduce the amount of their package that is received in cash. The effect would be that for these employees their total package is 'ordinary time earnings' and superannuation guarantee would then have to be calculated on the total package and paid in addition. This appears to be an unintended consequence.

Contact

The Committee would welcome the opportunity to discuss the submission further. Please contact John Farrell, Policy Lawyer, at john.farrell@lawcouncil.asn.au or (02) 6246 3714, if you would like further information or clarification in the first instance.

Yours sincerely

A handwritten signature in blue ink, appearing to read 'Jonathan Smithers', with a long horizontal stroke extending to the right.

Jonathan Smithers
Chief Executive Officer