

12 April 2017

The Manager
Retirement Benefits Unit
Retirement Income Policy Division
The Treasury
Langton Crescent
Parkes ACT 2600

By email: superannuation@treasury.gov.au

Dear Sir/Madam

SUBMISSION ON DRAFT TREASURY LAWS AMENDMENT (INNOVATIVE SUPERANNUATION INCOME STREAMS) REGULATIONS 2017

1. This submission has been prepared by the Superannuation Committee of the Law Council's Legal Practice Section (**the Committee**).¹ 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 the majority of all proposed legislation, circulars, policy papers and other regulatory instruments which affect superannuation funds.
2. The Committee is pleased to have the opportunity to comment on the draft Treasury Laws Amendment (Innovative Superannuation Income Streams) Regulations 2017 released on 21 March 2017 (**Exposure Draft**). The Committee is guided by its objectives identified above and has only made comments below where the Committee has identified issues within its remit.
3. The Committee notes that the purpose of the regulations is to give trustees and life companies flexibility in designing new lifetime pension products. The Committee agrees that the regulations will do this. However, the flexibility will come with a reasonably high level of complexity and some degree of uncertainty for providers and members. Some of these difficulties are inherent in the complexity of the regime, but others are created by the complexity of the drafting. The Committee has discussed these below.

¹ The Law Council of Australia is a peak national representative body of the Australian legal profession. It represents the Australian legal profession on national and international issues, on federal law and the operation of federal courts and tribunals. The Law Council represents 60,000 Australian lawyers through state and territory bar associations and law societies, as well as Law Firms Australia.

Lifetime Pensions

In order to be a complying pension or annuity under regulation 1.06A the benefit must be payable throughout the life of the beneficiary (primary or reversionary) (regulation 1.06A(3)(c)). A trustee that offers a collective defined contribution scheme to members will face the ongoing risk that the scheme will not in fact be able to support lifetime pension payments. In the ordinary course, investment and longevity risks in a collective defined contribution scheme will be managed by adjusting pension payments downwards. But where the scheme is underfunded (for example because of poor investment performance, members living longer than anticipated or too few members contributing to the pool), it is unlikely to be in the interests of members to require the trustee to continue to pay a tiny annual amount to members in order to ensure the trustee complies with the standard that requires a benefit to be paid annually throughout the life of the member.

The disclosure will also be difficult. A trustee will need to explain the risks of contributing to a collective defined contribution pool. In order to meet the requirements of the standards, the trustee will need to say that the pool will fund a variable pension for life, but that it is possible that the pension will be a de minimus amount. There may also be a point at which a court or regulator might say that an amount is so small that it does not in fact meet the requirement that a benefit be paid throughout the member's life.

In other cases a trustee may provide a complying pension to members that is supported by a life policy. In that case the trustee and members will not only be exposed to the counterparty risk, but also to the risk that a pension will not in fact be a complying pension because it is not paid throughout the life of a member. Again, the trustee will be faced with a difficult disclosure problem. It will need to inform members that their entitlement to a life time pension under regulation 1.06A is subject to counterparty risk, but in doing so they will in effect say that the fund will pay a life time pension for so long as the life company does.

It is also possible, and potentially likely, that a life company will only agree to provide a lifetime product to a trustee if it has the right to terminate its obligations under the policy (subject of course to the return of funds), so as to mitigate the risk of being left with an uneconomic legacy product.

It is not clear that these circumstances would meet the requirement in regulation 1.06(3)(a) that the benefit is payable throughout the life of the beneficiary.

In the Committee's opinion, the regulations should recognise that the obligation to pay a life time benefit is subject to a number of qualifications.

As a point of drafting, the Committee submits that the reference in regulation 1.06A((3)(b) to a benefit being payable throughout the life of the 'primary or reversionary' should be to the 'primary and, if any, reversionary'.

Deferred Superannuation Income Streams entering Retirement Phase

Deferred superannuation income streams can have an accumulation phase and a retirement phase. The retirement phase will commence under regulation 1.03(1) of the *Superannuation Industry (Supervision) Regulations 1994 (Cth)* (**SIS Regulations**) on the day that the member ceases to have any cashing restrictions on their benefit. This is important because the value will at that point be credited to the member's transfer account balance and will be included in the fund's exempt asset pool. However, there is a real risk that in many cases the trustee

(and member) will not know that the member has satisfied a nil cashing restriction. It is unlikely that education, notices or even perhaps fines or penalties will be effective in removing this risk.

SIS Standards for Innovative Superannuation Income Streams

Regulation 1.06A(1) refers to a 'contract for the provision of a benefit supported by a superannuation interest' and the 'rules for the provision of a benefit supported by a superannuation interest'. It is then followed with what appears to be a defined term - 'governing conditions'.

The Committee suggests that this opening sub-regulation is overly complex and not entirely clear. An example of the difficulty of the proposed drafting is that a contract for the provision of a benefit supported by a superannuation interest could be both a contract of life insurance issued to an individual and a contract of life insurance issued to the trustee of a superannuation fund. The examples in the explanatory statement suggest that the regulations are only intended to apply to the former.

The Committee understands that the governing conditions are intended to refer to a life insurance contract that provides for an annuity to be paid to an individual on the one hand and the governing rules of a superannuation fund that provides for a pension to be paid to a member on the other. This is consistent with the explanatory statement which appears to contain a definition of governing conditions on page 3 in the third full paragraph being: 'A contract for the provision of an annuity benefit, or the rules for the provision of a pension benefit (the governing conditions).'

The Committee submits that it would assist readers to interpret these regulations if a simpler formulation was used. This could be in the way the explanatory statement does or, more simply again, by following the existing formulations in regulation 1.05 for annuities and 1.06 for pensions.

There would be considerable merit in following the existing formulation by setting out the rules applying to annuities and pensions separately. The industry is used to this approach and courts will seek to find meaning where different formulations are used in legislation. In this case we do not think the different formulation is intended to indicate any different treatment. Adopting the existing formulation would also simplify the drafting in some respects.

The definition of a complying innovative pension could expressly state that the trustee of a self-managed superannuation fund and a trustee of another fund with fewer than 50 members cannot issue an innovative superannuation income stream. This is likely to reduce the risk of inadvertent breach by trustees.

If the rules for annuities and pensions were separated, sub-regulation 1.06A(3)(e) would not need to be included in the definition of the complying innovative pension. As currently drafted the sub-regulation sits awkwardly because it requires the provider to hypothesise a set of facts that will be, in the case of a superannuation fund, real – the provider must treat the benefit 'as if it were a benefit in a regulated superannuation fund'. The sub-regulation then goes on to say that the SIS cashing restrictions apply. In the case of an actual pension, the regulations already apply, in the same way as they do for any other pension. They do not prevent the commutation of a pension and rolling back into the accumulation phase. In the case of an annuity, the cashing restrictions will prevent the annuitant commuting their annuity and could

be more simply expressed if they were contained in the regulations applying only to the annuity.

Unreasonable Deferral

Regulation 1.06A(3)(c) says that the amount of benefit payments is determined using a method that ensures that those payments are not unreasonably deferred after they start. It then goes on to prescribe the matters to which regard must be given in determining whether there is an unreasonable deferral. The concept of unreasonable deferral is very unclear. The explanatory statement says that the rule is intended to ensure that a 'genuine retirement income stream' is provided to the member. It may often be difficult for a trustee to determine the circumstances in which a court or regulator may conclude that a deferral of income was or was not unreasonable. The examples in the explanatory statement are reasonably extreme and it is more likely that trustees will be grappling with less clear examples.

The Superannuation Committee notes that it would assist trustees and members if the Commissioner of Taxation or perhaps the Australian Prudential Regulation Authority could provide a ruling or determination that a particular product did not provide for an unreasonable deferral.

Transition to Retirement

The draft regulations will replace regulation 6.01(2)(a)(i) and 6.01(2)(b)(i) in the definition of transition to retirement income stream. It is unclear what the purpose of these changes is given that there does not appear to be any change in the meaning of the existing subparagraphs and the replacements. If it is merely intended to change the drafting style and not the meaning, it would be helpful if the explanatory statement expressly said so.

Commencement Date

Regulation 14.15 says that the regulations will apply to a benefit arising under a contract entered into on or after 1 July 2017 or a benefit provided under rules made on or after 1 July 2017. We assume that the regulations are intended to apply to a benefit provided under the rules of a superannuation fund on or after 1 July 2017. The reference to the rules made after that date should be removed. It should not matter when the rules were made.

Adding to Pensions

Under existing paragraphs 1.05(1)(a)(ii) and 1.06(1)(a)(ii) of the SIS Regulations the governing conditions of an income stream cannot permit the capital supporting the income stream to be added to by way of contribution or rollover after the income stream has commenced. The Committee queries whether there is a need to maintain this prohibition.

Explanatory Memorandum

The Committee thinks that the Explanatory Memorandum should include an explanation of 'group self annuitised income streams', which term is used but not explained.

On page 8, the second last paragraph uses the term 'allocated pension', which the Committee suggests should be 'account based pension'.

Contact

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:

- Mr Luke Barrett, Chair, Superannuation Committee on (T) 03 9910 6145 or at (E) luke.barrett@unisuper.com.au; or
- Ms Michelle Levy, Tax Sub-Committee Chair, Superannuation Committee on (T) 02 9230 5170 or at (E) michelle.levy@allens.com.au.

Yours sincerely

A handwritten signature in black ink, appearing to read 'Jonathan Smithers', written over a horizontal line.

Jonathan Smithers
Chief Executive Officer