18 March 2021

Mr Mark Fitt
Secretary
Senate Standing Committees on Economics
PO Box 6100
Parliament House
CANBERRA ACT 2600

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

Dear Mr Fitt

Treasury Laws Amendment (Your Future, Your Super) Bill 2021 [Provisions]

CPA Australia and Chartered Accountants Australia and New Zealand (Chartered Accountants ANZ) welcome the opportunity to provide comments on the *Miscellaneous amendments to Treasury portfolio laws 2020* consultation, presently underway at Treasury.

CPA Australia and Chartered Accountants ANZ represent almost 300,000 professional accountants globally. Our members work in diverse roles across public practice, commerce, industry, government and academia throughout Australia and internationally.

The *Treasury Laws Amendment (Your Future, Your Super) Bill 2021* ("the Bill") proposes three measures aimed at implementing the Government's Your Future Your Super reforms announced in the 2020-21 Budget in October 2020.

- Schedule 1: The 'stapling' measure, aimed at ensuring that employees who already have a superannuation fund are not unnecessarily made a member of a new fund as a result of changing jobs
- Schedule 2: The introduction of a new performance test to be undertaken by APRA in relation to MySuper products, and
- Schedule 3: A requirement for superannuation trustees to act in the best financial interests of their members in matters related to expenditure, decision-making and investment

Since the consultation, an additional measure has been introduced into the Bill:

- Removal of the five per cent holdings exemption from the portfolio holdings disclosure rules

CPA Australia and Chartered Accountants ANZ do not support this bill in its current form.

In principle, we generally support Schedules 1 and 2, however the Bill as presently written contains fourteen sections which would allow regulations to be written for the purposes of the Bill. We are concerned that to date, there has been no consultation in relation to exposure draft regulations, making it difficult for us to offer a definitive opinion on the operation of the proposed measures. We do not believe that there is sufficient information contained in either the Bill or the Explanatory Memorandum to assist a reasonably informed reader to determine the intended operation of most of these.

CPA Australia and Chartered Accountants ANZ do not support Schedule 3, as this would introduce a lower standard than the current best interests duty obligation for trustees.

In addition, we have concerns in relation to the references in the Bill to requirements 'in writing' which perpetuates problems identified in current consultation undertaken by Treasury, *Modernising Business Communications*.

Other concerns we raise in detail in the attached submission include:

- Employers must face no penalty for administrative failures made by the Australian Taxation Office (ATO) if the employer acts in good faith when making superannuation contributions under the choice of fund rules
- Trustees should have the right of redress to correct incorrect data published by the Australian Prudential Regulation Authority (APRA) if it results in an erroneous adverse determination
- The need to resolve considerations of whom relevant beneficiaries are, and how complex products such as 'glidepaths' are treated in the event of two subsequent failure notices
- The proposed record-keeping requirements may be potentially too broad for self-managed superannuation funds (SMSFs)
- Uncertainty in relation to how rules such as non-arm's length income restrictions intersect with the proposed best financial interests' duty
- Concerns in relation to the focus of the best financial interests duty on third-party payments
- Uneasiness regarding the potential restrictions in asset holdings as proposed by section 117A, and
- Conflicts with the sole purpose test, especially in the treatment of death insurance cover.

CHARTERED ACCOUNTANTS™
AUSTRALIA • NEW ZEALAND

Chartered Accountants
Australia and New Zealand
33 Erskine Street, Sydney, NSW 2000
P: +61 2 9290 1344
W: charteredaccountantsanz.com
ABN 50 084 642 571

CPA AUSTRALIA

CPA Australia
Level 20, 28 Freshwater Place,
Southbank Victoria 3006
P: 1300 73 73 73
W: cpaaustralia.com.au
ABN 64 008 392 452

For further information in relation to our submission, please contact Richard Webb, Policy Advisor Financial Planning and Superannuation at CPA Australia at [redacted] or Tony Negline, Superannuation Leader at Chartered Accountants ANZ at [redacted]

Yours sincerely

[redacted]

[redacted]

Dr Gary Pflugrath CPA

Executive General Manager, Policy and Advocacy
CPA Australia

Simon Grant FCA

Group Executive - Advocacy, Professional Standing and International Development
Chartered Accountants Australia and New Zealand

Submission

Introduction

Throughout the proposed Bill there is a reference for the need to provide communication between various parties 'in writing'.

We note in passing that the Treasury Department has recently concluded a consultation process titled *Modernising Business Communications - Improving the Technology Neutrality of Treasury Portfolio Laws*.

CPA Australia and Chartered Accountants ANZ made a joint submission to that consultation in which we noted the widespread use of the term "in writing" in the *Superannuation Industry (Supervision) Act 1993* and its regulations and the need to provide greater flexibility in how communication must take place in the superannuation sector between all those involved – regulators, fund trustees, administrators, auditors and members.

We believe it is a missed opportunity for this proposed Bill if it effectively ignores this reform issue.

Additionally, throughout this Bill, there are at least fourteen proposed sections requiring regulations to be made before the provisions can be effective. To date, there has been no consultation in relation to the proposed regulations, and no public statement issued as to when this consultation will commence.

Without any currently scheduled consultation in relation to the various need for regulations to give effect to the provisions in this Bill, we are concerned that measures in this Bill are likely to be delayed in the same way that current policy in relation to product dashboards and portfolio holdings disclosure has been held up. ASIC has developed requirements for superannuation funds to provide consumers with product dashboards - information on the performance and costs of choice products in a simple format - as well as to disclose funds' total portfolio holdings. These were both scheduled to apply from 2017 but the application date was recently extended due to the need for regulations to be made to give effect to these requirements. The parallel in this case is that MySuper product dashboards are in effect and in use by funds with MySuper products, whereas choice products remain exempt.

The lack of information means that we are unable to comment favourably on many of the provisions, simply because we do not have a full view of what is being proposed.

Schedule 1: Single default account

CPA Australia and Chartered Accountants ANZ generally support the proposal to introduce the concept of a 'stapled' fund from 1 July 2021, which is intended to become the superannuation fund that an employee's superannuation contributions are paid into by their employer, if they have such a stapled fund and have not chosen a different fund.

This schedule contains two separate provisions where the use of regulations is envisaged to clarify stapled funds for the benefit of employers. The proposed section 32Q contains no information other than the statement that regulations will prescribe what a stapled fund is. The proposed section 32R outlines the process that employers will take in accessing the details of a stapled fund to which the employer must contribute.

Although the Explanatory Memorandum (EM) provides some information in relation to what is likely to be contained in the regulations for the benefit of the proposed sections, we again note that to date, no draft regulations have been made publicly available. This presents a problem as we are unable to tell what happens in the instance that the Australian Taxation Office (ATO) does not or cannot execute a request made by an employer for details of stapled funds for new employees.

Whilst we accept that employers must follow a minimum series of steps in order to satisfy the aims of this schedule, which is the reduction in the proliferation of multiple accounts, we note that ultimately, where a contribution is made which is not in accordance with the choice of fund rules, the employer may be subject to the Superannuation Guarantee Charge, which can include a director penalty, an administration penalty and/or the General Interest Charge (GIC). We note that the provisions inserted by item 3 of the Bill provide discretion for the Commissioner to reduce the superannuation guarantee shortfall to zero in the event that contributions are late. Circumstances that this is intended to cover are described in paragraphs 1.42 to 1.49 of the EM, but we note that at no point does the discretion cover a scenario where the payment was received late or incorrectly due to an ATO administrative error.

We recommend that where there is an ATO administrative error, where the ATO either:

- Fails to provide information in relation to an employee's stapled fund
- Provides late information in relation to a stapled fund, or
- Provides incorrect information in relation to a stapled fund

which results in the employer paying a contribution to an incorrect fund under the choice of fund rules, this does not result in a penalty to the employer.

Schedule 2: Addressing underperformance in superannuation

CPA Australia and Chartered Accountants ANZ believe that significant uncertainty still exists in relation to the operation of this measure, which will require the Australian Prudential Regulation Authority (APRA) to undertake an annual performance test for MySuper and other superannuation products (collectively, "Part 6A products"), with failure notices to be issued by trustees to affected members where a product fails the performance test once. Products failing the performance test in two consecutive years are to be prohibited from accepting new beneficiaries, until such a point where APRA is satisfied that the prohibition should be lifted.

A primary concern that we have is in relation to the perceived short-term nature of the measure. This proposal seeks to have a MySuper product excluded from accepting new investments from members after only two years of APRA-assessed underperformance where that sub-standard result may have arisen due to recent performance. Given that the audience for MySuper funds is predominantly disengaged members who may not have great confidence in managing their own investment affairs, this potentially sends out a message which may be inconsistent with the need to view one's investment through a medium to longer time horizon. Arguably, the need to send notices to members after failing the performance test after a single year is inconsistent with the message 'past performance is not a reliable indicator of future performance' or similar, which superannuation funds must routinely display on disclosure documentation and elsewhere.

At this point we understand that the assessment process will initially be for seven years and then subsequently for rolling eight-year periods of time. The eight-year timeframe appears to be a response to a comment by the Productivity Commission review into superannuation (published in January 2019, p 492). " Assessing performance over an 8-year period would abstract from much of the year-to-year volatility of investment markets, and thus not discourage funds from long-term investment strategies or from making investments that differ from those that constitute the market indexes." It is hard to disagree with trustees being asked to justify why their fund's investment performance is below an acceptable standard and/or their fellow trustees in other super funds.

However, we remain concerned about unintended consequences with these proposed periods of assessment. We believe that in some cases trustees may be willing to take on more investment risk in order to recover from poor investment periods and/or adjust their portfolios into more acceptable assessment benchmarks. In short, we are concerned about the system being gamed.

It may be that some trustees could successfully argue that some actions are in their members' *best financial interests* but may not be able to argue that those actions are in those members' *best interests* (see below for our discussion of this proposed change.)

We note that determinations made by APRA will not be 'reviewable decisions'. Paragraph 2.25 of the EM states that: 'This is because the test results are based on product performance compared to relevant benchmarks over the assessment period. The methodology to calculate a product's performance and benchmark will be clearly specified in regulations.'

CPA Australia and Chartered Accountants ANZ are concerned that, even with full transparency, this leaves no recourse by trustees in the event that APRA is acting on incorrect information or has processed information inaccurately, as once an incorrect determination is issued by APRA, it will be allowed to stand permanently and trustees have no right of redress.

The issuing of a determination where a fund has failed the performance test could potentially affect all members of a fund adversely, not just the members of the affected product(s), since a failure notice – required to be provided by the trustee within 28 days – which affects enough members of the fund could expose members of a fund to a liquidity risk event.

We recommend that a determination in relation to a Part 6A product must be reviewable in the event that APRA has used incorrect information in coming to a decision. Such a review must allow determinations issued in error to be revoked in full.

We note that there are seven proposed sections which require regulations to be made in order to give effect to the legislation. Regulations are required for the following:

- Section 60B, to identify Part 6A products (other than MySuper products) (to be subject to annual performance assessments) as other classes of beneficial interest subject to performance testing

- Section 60C, to specify the period after the financial year by which APRA must make their determination in writing in relation to a regulated product's determination under the performance test

- Section 60D, to specify a range of matters for which regulations can be made, including investment returns and other matters; APRA's discretionary powers and accompanying requirements; benchmark returns comparisons; methods for determining actual returns and benchmark returns; and assumptions for determining returns, including rates of fees, tax and other matters;

- Section 60E, to specify the contents of notices which trustees must provide to members in the event that a Part 6A product fails performance testing

- Section 60F, to specify circumstances in which a Part 6A product is exempt from the consequences of two consecutive fail assessments

- Section 60G, to specify circumstances where APRA can treat two or more Part 6A products as a combined product

- Section 60J, to specify formulas (sic) and methods which are to be used to rank Part 6A products

With the exception of regulations made for the purposes of section 60J, which have been inserted for the purposes of the proposed YourSuper website, regulations need to be made in a number of places in order to ensure that this legislation is able to be effective. Again, we are unable to offer an opinion in relation to how this this Bill is to be implemented without knowing what is to be contained in the regulations.

One question raised is in relation to treatment by regulations in respect of beneficiaries. Two consecutive failures brings about a prohibition, where a trustee must not accept any new beneficiaries into the product. 'Beneficiaries' is a widely defined term and under the SIS Act includes a member's spouse or dependent children. We note that where a family law split occurs, this is an event which is exempted by the Bill. However, how is the Bill intended to treat changes to a member's dependants, for example, due to having another child or commencing a new spousal arrangement?

There are additional complications which we anticipate arising from more sophisticated investment options such as those involving 'glidepaths', where the asset allocation of investment option is progressively tilted in stages away from longer term assets as members age. How does not accepting new beneficiaries apply to different phases of glidepaths which are prohibited, or is the entire MySuper/glidepath product prohibited if a single phase fails twice? These questions cannot be answered in the absence of consultation on regulations.

The proposed section 60J is required in order to allow for superannuation products to be ranked on the YourSuper site, a site that is intended to be available for superannuation fund members in the event that a trustee provides a failure notice to their members. Yet this will initially only apply to MySuper products, meaning that the only products initially available to be viewed at the YourSuper site will be the 100 or so MySuper products. It is imperative that this website be developed and available to cover all products ahead of the first failure notice.

We also note that the decision to commence this measure initially with MySuper products and choice products at a later point in time may incur problems, unless implementation is accompanied by assistance for disengaged members of superannuation funds. This is because MySuper products are a very small sample of the 44,000 or so superannuation products on the market. But regardless of the availability of products on the YourSuper website, the following questions do not appear to have been addressed, in the event of a failure notice being issued to affected members by a trustee:

- Are disengaged members likely to be engaged enough to read the failure notice?
- Is there a plan to address any liquidity risk in the event that a large amount of fund members are engaged enough to leave their fund following the issue of a failure notice?
- Will financial advice be made available to affected members to assist them with choice and who will pay for that advice?
- Is there a back-up plan in the event that the YourSuper website is unavailable by the time the first failure notice is issued to affected fund members?

We propose that these questions be resolved to ensure that the intended policy outcome of this measure does not have unforeseen consequences.

Schedule 3: Best financial interests duty

Our comments in this submission in relation to the best financial interests duty have been kept concise. We provide greater detail regarding our reservations in relation to this measure in the submission made by CPA Australia to Treasury in their consultation in relation to the exposure draft of this Bill.

CPA Australia and Chartered Accountants ANZ do not support the duty proposed in this measure for trustees to act in the best financial interests of members. The proposed duty, to replace the existing duty to act in the best interests of members, is not a higher hurdle, but rather, a subset of the existing members' best interests duty. A singular statutory best financial interests duty would therefore be a lower standard than the existing duty.

CPA Australia and Chartered Accountants ANZ do not support the reduced scope of the duty. We agree with comments made by Commissioner Hayne in the final report of the *Royal Commission Into Misconduct In The Banking, Superannuation And Financial Services Industry* where he wrote at page 235:

> *I consider that the existing rules, especially the best interests covenant and the sole purpose test, set the necessary standards. Those standards should be applied according to their terms and without more specific elaboration.*

We note that the sole purpose test itself allows a number of payments which may conflict with the best financial interests duty. One example of this is the provision of death benefits to a member's dependents: Superannuation funds can provide death insurance but the cost of this insurance may not be in the best financial interests of all beneficiaries of the fund. This conflict must be resolved.

The implementation of this new measure includes a specific reversal of the evidential burden of proof and is not subject to a materiality threshold, essentially requiring a few cents of postage to be justified by trustees in the event that this is queried by the relevant regulator. This is manifestly not in the best financial interests of members, and is not supported by CPA Australia and Chartered Accountants ANZ, although we welcome the fact that the reverse onus does not apply to trustees of Self-Managed Superannuation Funds (SMSFs).

However, we also note that SMSF trustees who breach other regulatory provisions could be penalised for breaching the best financial interests duty, leading to concerning outcomes. One such problem is the interaction between the proposals and the Non-Arm's Length Income (NALI) requirements for superannuation fund trustees. Indemnifying trustees (and directors of corporate trustees) for normal fund expenses is common across all types of trusts, including APRA-regulated funds. A trustee which is unable to obtain evidence that a payment to a trustee (or director) or any other party is in members' best financial interests may decide not to indemnify that expense. It is possible that a trustee or director who is unable to be indemnified may instead cause the fund to breach the NALI provisions as a result. This would be an unacceptable outcome.

CPA Australia and Chartered Accountants ANZ are uneasy about the implications of the proposed section 117A. This would seek to outlaw certain payments or investments made by trustees in circumstances prescribed by the regulations. The business of wealth management, of which superannuation is a part, involves trustees and investment managers taking calculated investment risks on behalf of fund members. Although great lengths can be gone to, to manage investment and other risks, it is risk that is assumed to pursue greater investment returns. This provision echoes in many ways a requirement, long abolished, where Australian superannuation funds were required by law to invest a proportion of their portfolios in Government bonds in order to access a tax preferred status.

CPA Australia and Chartered Accountants ANZ are also concerned in relation to the record-keeping requirements becoming a strict liability offence under additions to section 34 proposed in this Bill. We consider that this may place onerous requirements on SMSF trustees and note that the regulators of this provision are proposed to be APRA and ASIC, but not the ATO.

We support efforts to increase the transparency of and accountability by trustees, and applaud the Government's commitment to these objectives. We welcome the addition of the measure which would see the removal of the exemption from the portfolio holdings disclosure rules for up to five per cent of superannuation holdings, as we believe this is in the best interests of members, if not necessarily the best financial interests of members. We note, however, that the portfolio holdings disclosure requirements are presently on hold awaiting regulations to be made to give effect to them, and have been for some time.

CHARTERED ACCOUNTANTS™
AUSTRALIA • NEW ZEALAND

Chartered Accountants
Australia and New Zealand
33 Erskine Street, Sydney, NSW 2000
P: +61 2 9290 1344
W: charteredaccountantsanz.com
ABN 50 084 642 571

CPA AUSTRALIA

CPA Australia
Level 20, 28 Freshwater Place,
Southbank Victoria 3006
P: 1300 73 73 73
W: cpaaustralia.com.au
ABN 64 008 392 452