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19 August 2009

The Secretary
Senate Economics Legislation Committee
PO Box 6100
Parliament House
CANBERRA ACT 2600

Subject: Inquiry into the Corporations Amendment (Improving Accountability on Termination Payments) Bill 2009

Dear Sir

We understand that submissions to this enquiry have closed, however we remain very concerned with some of the implications of this legislation. We hope that the Committee will be able to consider these concerns before finalising its report. In this letter, we particularly wish to highlight some of the difficulties in relation to the inclusion of superannuation benefits within the limits to be imposed by this Bill.

In June 2009 we made a submission to Treasury in relation to the Exposure Draft of the Bill illustrating many of our concerns. Whilst little was done in the final Bill to accommodate our concerns, we remained hopeful that they might have been reflected in the Regulations. We note our significant concern with the draft Regulations which were subsequently issued. We have already provided our comments to the Treasury on these draft Regulations.

In particular we note that under the Bill, superannuation trustees will be subject to civil and criminal penalties if a benefit is paid to a member where that benefit (taken together with other benefits covered by the proposed provisions) exceeds the new limits. These penalties will apply even thought the trustee is not aware that the limits are applicable to the particular member.

Where the trustee is aware of the restrictions in relation to the particular member, and withholds payment, this will result in a breach of other superannuation law.

In effect trustees will have no option but to breach one or other of the laws.

We also note that the draft Regulations relating to superannuation:

- are internally contradictory;
- do not exclude Superannuation Guarantee contributions as indicated in the EM (but rather specifically include them);
- double count certain superannuation benefits; and
- are generally unclear as to how amounts are to be calculated.

In addition we consider that, in many cases, it will not even be possible to ascertain the amounts involved.

Unless there are significant changes to the draft Regulations, the treatment of superannuation will be extremely unclear, and in many cases, illogical and unreasonable. Employers are likely to require expensive legal advice to try and interpret the legislation (and its intention) in relation to superannuation as well as incurring significant costs in ascertaining the amounts to be included in "Benefit".

Further detail on these concerns and our recommendations can be found in our submission to the Treasury (Appendix 1) in relation to the draft Regulations. We have also attached our earlier submission to the Treasury on the Exposure Draft of the Bill (Appendix 2).

Who is Mercer?

Mercer is a leading global provider of consulting, outsourcing and investment services, with more than 25,000 corporate and trustee clients worldwide. Mercer consultants help clients design and manage retirement, health and other benefits and optimise human capital. The firm also provides customised administration, technology and total benefit outsourcing solutions. Mercer's investment services include global leadership in investment consulting and multi-manager investment management.

Mercer's executive remuneration consultants are trusted advisors to leading companies globally. Our holistic approach, supported by our proven analytical tools and delivered through our global network of recognized consultants, considers the business, compensation, performance, regulatory and governance implications of executive total remuneration. The result is responsible executive remuneration plans that secure key talent, enhance business performance and stand up to external scrutiny. The scope of our executive remuneration services includes:

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- Executive Reward Strategy
- Assessment of competitiveness and reasonableness of executive pay levels - fixed pay, annual incentives, equity compensation, and total reward
- Pay-for-performance analysis
- Support to the Remuneration Committee
- Executive incentive plans
- Attraction and Retention strategies, including advice regarding the design and structure of
- Performance metrics assessment and Performance tracking
- Accounting valuations
- Review of Remuneration reports
- Chairman and Non-Executive Director Review.

In Australia, Mercer's outsourcing services include an integrated service platform for 320 superannuation plans, 600,000 members and private clients with $35 billion in assets under administration. We also provide our own master trust, the Mercer Super Trust, which has approximately 270 participating employers, over 200,000 members and more than $13 billion in assets under management.

Please contact me on 03 9623 5552 if you have any queries in relation to our comments.

Yours sincerely

J D Ward

John Ward
Manager Research and Information

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6 August 2009

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Email: terminationbenefits@treasury.gov.au

Subject: **Corporations Amendment (Improving Accountability on Termination Payments) Bill 2009 and associated draft regulations**

Dear Sir/Madam

Corporations Amendment (Improving Accountability on Termination Payments) Bill 2009 and associated draft regulations

Thank you for the opportunity to comment on the draft regulations. We have previously provided comments on the exposure draft of the Bill.

Whilst some of the issues raised in our earlier submission have been addressed, we remain extremely concerned with the Bill and adequacy of the draft Regulations in relation to the treatment of superannuation.

The Bill

We note that in the vast majority of cases, superannuation funds:

- Would not know whether or not a member holds or has held a managerial or executive office;
- Would not know if the contributions have been given in circumstances prescribed by the proposed provisions of the Corporations Act;
- Would not know whether appropriate shareholder approval has been given; and
- May have no ability to reliably ascertain whether any of the above applies.

Yet the superannuation fund trustees would face criminal and civil penalties if certain benefits are paid (or rolled over for) the managerial or executive office holder where shareholder approval has not been obtained.

On the other hand, if the superannuation fund withheld the benefit payment, it would breach superannuation law which requires benefit payments to be made within strict timeframes!

The Bill, if enacted in its current form could significantly impact on the operation of superannuation funds and could potentially make superannuation unworkable. At the very least, it would require superannuation funds to obtain appropriate evidence before making **any** benefit payment or rollover payment for **any** member, to ascertain whether the proposed provisions apply. This would have a major impact on the cost of administering superannuation as well as adding intolerable delays to benefit payments.

> **Recommendation**
>
> The Bill needs to be amended to exclude superannuation funds as entities subject to this legislation or to at least be amended to protect superannuation fund trustees so that they do not face criminal and/or civil charges for breaching the proposed requirements. This is necessary because trustees will not be aware that any benefits need to be withheld and, further, they have no reliable means of ascertaining that fact.

The draft regulations

The Regulations relating to superannuation:

- are internally contradictory;
- do not exclude Superannuation Guarantee contributions as indicated in the EM (but rather specifically include them);
- double count certain superannuation benefits; and
- are generally unclear as to how amounts are to be calculated.

In addition we consider that, in many cases, it will not be possible to ascertain the amounts involved.

Unless there are significant changes to the draft Regulations, the treatment of superannuation will be extremely unclear, and in many cases, illogical and unreasonable. Employers are likely to require expensive legal advice to try and interpret the legislation (and its intention) in relation to superannuation as well as incurring significant costs in ascertaining the amounts to be included in "Benefit".

Recommendations

Before commenting on the very significant problems with the specific provisions of the draft Regulations, certain principles need to be clearly established.

1. We recommend that a clear statement be made as to whether the meaning of "Benefit" relates to:
   - benefit entitlements payable from a superannuation fund; **OR**
   - contributions to a superannuation fund.

   It is important that the Regulations clarify this point. "Benefit" cannot include both benefits and contributions. It has to be one or the other, otherwise there will be double counting. With most superannuation arrangements now on an accumulation basis, taking into account contributions rather than benefits would be most appropriate. (We note that it is proposed that existing defined benefit arrangements be excluded.)

2. We recommend that there be a clear statement that "Benefit" does not include the following contributions (or benefits financed by such contributions):
   - employee contributions from after tax salary; and
   - employee salary sacrifice contributions; and
   - contributions by other non-associated employers (including such amounts rolled over to the fund); and
   - contributions by an employee's spouse in respect of the member; and
   - Government co-contributions; and
   - amounts transferred from overseas superannuation funds.

   (We assume that this is consistent with the Government's intention, however it needs to be clearly stated.)

3. We recommend that only contributions (in excess of those referred to in Recommendation 2 above), in the three years before retirement from office be taken into account. The detail about past contributions is unlikely to be available in most cases and it will be impossible to reconstruct up to 40 years or more of history. Unless there are significant changes to the record keeping of superannuation funds and employers, the data will not be available in respect of future contributions either.

   (We note that most employees affected by the proposed legislation are likely to be employed on a Total Remuneration Package. In such cases, any superannuation contributions will generally either be contributions to meet the employer's SG requirements or salary sacrifice contributions (both of which are to be excluded) and hence superannuation will generally not be considered to be a benefit. Any contributions to be counted will normally relate to:

   - "special" additional employer superannuation contributions including amounts paid as a superannuation contribution rather than a termination benefit at or around retirement; and
   - contributions made in any periods prior to the implementation of Total Remuneration Packaging.)

4. Further, we recommend that it be clarified that it is the employer's responsibility to determine what contributions are affected and where necessary advise the superannuation fund at the time of termination. We consider it inappropriate to require superannuation funds to incur significant additional costs (which would necessarily be passed on to all members) just for the purpose of this legislation. This would particularly be the case if additional contributions made many years before an employee is appointed to a managerial or executive office were required by this legislation to be identified.

5. The draft Regulations include many inconsistencies, contradictions and errors. These are highlighted below and need to be fixed.

Meaning of Benefit

Draft Regulation 2D.2.02(1) specifies that a Benefit includes:

(a) any kind of pension

(d) any superannuation contribution in excess of any charge imposed under the Superannuation Guarantee Charge Act 1992, by a person mentioned in paragraphs 200B(1)(a) to (c) of the Act, other than salary sacrifice contributions in excess of the contribution.

Draft Regulation 2D.2.02(2) specifies that certain payments are not to be considered to be a Benefit. These include:

(b) a payment from a defined benefits superannuation scheme that was in existence when this regulation commenced;

(c) an amount paid from base salary as a salary sacrifice contribution in relation to an employee.

Problems with draft wording

Regulation 2D.2.02(1)(a)

1. 2D.2.02(1)(a) specifically includes “any kind of pension”. Presumably this includes pensions from defined benefit superannuation schemes. However 2D.2.02(2)(b) specifically excludes pensions from a defined benefit superannuation scheme that was in existence when this regulation commences. It is unclear which of these Regulations takes precedence.

2. It is unclear how a defined benefit pension would be taken into account (assuming that there is an intention to count such pensions, even if it is only such pensions paid directly by an employer or payable from a defined benefit superannuation scheme which was not in place when this regulation commences). Is it the actual pension payments as they are made or is it intended that some form of actuarial value needs to be placed on the pension? If so what method of valuation is to be employed? These issues need to be clarified.

3. A superannuation pension will include amounts financed by employer contributions which are paid to meet the Superannuation Guarantee requirements. We had thought that, based on the explanatory notes issued with the draft regulations, such contributions were not to be included in the “benefit”. This results in another contradiction.

4. A superannuation pension will often include amounts which have been financed by employer contributions in excess of Superannuation Guarantee requirements. Yet such contributions appear to be included, in addition, under Regulation 2D.2.02(1)(d) (although refer to our concerns on this regulation below). This would appear to result in a double counting of these contributions.

5. A superannuation pension will often include amounts which have been financed by employee salary sacrifice contributions. To include this portion of the pension appears to be inconsistent with Regulation 2D.2.02(1)(d).

6. A superannuation pension will often include amounts which have been financed by employee after tax contributions, contributions from an unrelated employer etc. It is inappropriate that such amounts be included.

Summary

We recommend that the wording be changed to “any pension other than a pension paid from a superannuation fund or a superannuation annuity”.

Regulation 2D.2.02(1)(d)

7. The wording is totally inconsistent with the intention stated in the notes attached to the draft regulations (although these are also worded in an ambiguous manner). A charge is only imposed under the Superannuation Guarantee Charge Act 1992 if an employer does not pay the required contributions on time. Thus, for an employer who pays the required contributions on time, based on the wording in the draft Regulations, such contributions will be considered to be a benefit for the purposes of the draft Regulations. We also consider that the reference to paragraphs 200B(1)(a) to (c) is incorrect.

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Summary

We assume that this paragraph was intended to state: “any superannuation contribution, other than salary sacrifice contributions, in excess of the amount which would have avoided the imposition of a charge under the Superannuation Guarantee Charge Act 1992 by a person mentioned in paragraphs 200B(1AA) (a) to (b).”

You will note that we have deliberately excluded 200B(1AA)(c), ie a prescribed superannuation fund. Superannuation funds do not make contributions and are not subject to the Superannuation Guarantee Charge Act (other than as an employer in their own right).

Regulation 2D.2.02(2)(b)

8. We note that “defined benefits superannuation scheme” is not defined. (It is also not defined in the Superannuation Industry (Supervision) Act or Regulations (SIS) or in Income Tax law). We note that SIS defines “defined benefit fund” however different definitions are used for different purposes. It is therefore unclear what is meant by “defined benefits superannuation scheme”.

9. Assuming that a defined benefits superannuation scheme is basically consistent with the definition of defined benefit fund in the SIS Regulations and in particular Modification Declaration 23, the draft Regulation will exclude all benefits from such schemes, including additional accumulation benefits for defined benefit members and all benefits for members who are not entitled to defined benefits. It is unclear whether this is the intention.

10. It would also appear that, as long as the fund was in existence when the Regulations commenced, it applies to any benefits provided by that fund, even if they have been increased after the Regulations commenced. It is unclear whether this is the intention.

11. As currently worded, the draft Regulation creates a barrier to the rationalisation of superannuation funds. Any exemption for a fund in existence at the date the Regulations came into existence should be carried across to any successor fund which provides the same benefits following the transfer of members from one fund to another.

12. By specifying that benefits from some defined benefits superannuation schemes are excluded, the draft Regulations imply that benefits from other superannuation schemes are not excluded. However, as noted above, benefits from such schemes will include amounts financed by employee contributions from after-tax income, employee salary sacrifice contributions, employer SG contributions and contributions from other non-associated employers – all of which should be excluded.

13. Further, even if it could be interpreted that the contributions referred to in point 12 above are not considered to be a "Benefit", this leaves the benefit provided by contributions in excess of the SG requirements. If counted as a benefit, this will result in double counting as these contributions themselves have also been counted under Regulation 2D.2.01(1).

14. We also note that, in respect of non-excluded defined benefit funds, it will be necessary to specify a method of determining the contributions to be counted (in excess of Superannuation Guarantee requirements and any employee financed benefits etc.)

Summary

In our view, this exclusion would be better addressed by excluding any benefit (or relevant contribution) in respect of a defined benefit interest (as defined in the Income Tax Assessment Act 1997) provided under the rules of a defined benefit fund which were in existence when the regulations commence (either in the current fund or a relevant predecessor fund).

Conclusion

We believe that at least a part of a person's superannuation entitlement needs to be taken into account as a "benefit" to minimise the opportunity for employers to evade the application of the proposed requirements by making additional superannuation contributions rather than a termination payment. However, the draft Regulations do not clearly set out what needs to be taken into account. We consider that the recommendations we have made above will effectively stop any evasion of the proposed requirements whilst taking into account the practical difficulties of maintaining records.

Nevertheless we remain concerned with the provisions of the proposed Bill which impose criminal and civil penalties on superannuation fund trustees who will generally have no knowledge of any amounts that cannot be paid under this legislation and no practical way of finding out such amounts.

If you have any queries, please contact me on 03 9623 5552.

Yours sincerely

John Ward
Manager Research and Information

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2 June 2009

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Email: terminationbenefits@treasury.gov.au.

Subject: **Comments on Exposure Draft: Corporations Amendment (Improving Accountability on Termination Payments) Bill 2009**

Dear Sir/Madam

We appreciate the opportunity to comment on this Bill which will facilitate the Government's aim to reduce inappropriate payments on termination of employment to Directors and those holding a managerial or executive office.

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Executive Summary

We support the Government's initiative in reforming the current prescribed limits on termination payments for directors of public companies and understand the Government's concern in extending those limits to other senior executives. In our view, any such reform must be proportionate so that legitimate remuneration practice is not inhibited.

We have a number of concerns with the draft bill and draft regulations. In particular we consider that, whilst the proposals will prevent some inappropriate payments on termination of employment, the changes have gone too far and will make it more difficult for Australian employers to compete for appropriate executives and directors in the international market place.

We have made a number of recommendations to address our concerns. We believe that our recommendations do not diminish the Government's efforts but rather make them more workable. Our recommendations include:

1. *A higher level of termination payment cap "Standard Cap", say 2 to 3 times annual remuneration should be allowed without shareholder approval. Whilst better*

enabling Australian companies to compete for the right senior staff, such a limit would still enable a better alignment of rewards with real performance.

2. *If the Standard Cap is not increased to a more reasonable level, payments (up to a reasonable specified level) due to bona fide redundancy or in lieu of notice should be excluded from the proposed requirements so that they can be payable without the need for shareholder approval.*

3. *The Standard Cap should be based on regular remuneration (excluding bonuses) rather than base salary.*

4. *Greater flexibility should be allowed in the timing of obtaining shareholder approval.*

5. *The Bill should be amended to exclude payments under existing employment contracts in accordance with the Media Releases issued by the Treasurer and the Minister for Superannuation and Corporate Law.*

6. *Greater clarification of the exemption of deferred bonuses is required.*

7. *Greater flexibility is required in relation to excluding pro rata vesting of options to the extent that performance towards the hurdle has been achieved at termination where changes in ownership, capital or other commercial considerations make it unworkable to retain the options until the vesting date.*

8. *The Bill needs to provide more clarity as to the treatment of superannuation.*

9. *Only certain "excess" superannuation contributions (rather than benefit payments) should be included as part of the termination payment for approval purposes.*

10. *Only superannuation contributions made specifically as a result of termination of employment (including salary sacrifice contributions in respect of what would otherwise have been a termination payment) should be included for the proposed termination benefit limits. Other contributions should be excluded.*

11. *If the proposed changes proceed, then the Income Tax Assessment Act 1997 needs to be amended to allow a tax deduction for employer superannuation contributions made after termination of employment.*

12. *The Bill needs to clarify the obligation of superannuation funds and amend existing superannuation legislation to enable those obligations to be met.*

13. The Bill should specify how non-superannuation pension payments are to be valued for this purpose. Superannuation pensions should be specifically excluded.

We have set out further comment on these issues and our reasons in the Appendix.

If you have any queries on our submission, please contact John Ward on (03) 9263 5552.

Yours Sincerely

J D Ward

John Ward
Manager, Research and Information

APPENDIX

Key Principles

We understand that the key principles that the Government is trying to promote by the new measures (and the related Productivity Commission review of executive remuneration) are:

- improved accountability to shareholders;
- better alignment between “rewards” payable upon termination and “real” performance;
- responsible remuneration policies (this would include payments in all stages of employment, i.e. hiring, during employment and on termination).

The draft Explanatory Memorandum also indicates that the legislation will provide certainty for employers.

We also understand that the Government does not intend to:

- set inflexible limits (ie higher amounts can be paid subject to informed shareholder consent);
- create impractical mechanisms of shareholder approval.

Payment Limit

Whilst the proposed changes will provide some improvement in accountability to shareholders, we consider that the Government’s proposals have gone too far. We also consider that it would have been preferable to consider such payments as part of the Government’s announced review of executive remuneration rather than deal with them separately.

Australian companies will need to maintain a competitive position when:

- recruiting executives from overseas;
- attempting to retain Australian executives who may be considering overseas positions; and
- incentivising Australian expatriates to return to Australia.

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Common practice in the US and Europe has ranged from 2-3 times annual remuneration (plus bonus) for termination payments. Whilst we agree that the current limit of seven times total annual remuneration has led to some examples of excessive payments in Australia, limiting payment to one times base salary will restrict Australian corporations from competing for global talent as overseas executives will be reluctant to relocate to Australia with the guarantee of only one year's termination payment should business needs/strategy change.

We note that this may also place additional pressure on increasing base salary. In other words, to be competitive in attracting the right talent, Australian employers may need to offer higher salaries (rather than a lower salary with a higher termination payment). This would then reduce the level of accountability to shareholders in relation to termination payments and would not necessarily promote a responsible remuneration policy overall.

> *Recommendation 1.*
>
> *A higher level of termination payment cap, say 2 to 3 times annual remuneration, whilst better enabling Australian companies to compete for the right senior staff, would still promote more responsible termination payment practice, proportionate to the concerns identified.*

Shareholders would be able to decline larger reward based payments yet would still be able to approve higher “rewards” in cases where the executive or director has assisted in generating real performance for the company.

Genuine payments

We also consider that, subject to reasonable limits, payments on bona fide redundancy and payments in lieu of notice should be possible without the need for shareholder approval. These are “normal” payments that are also made to other employees. It should not be necessary to obtain shareholder approval for such payments which are not in respect of a reward for services but are paid because of a loss of employment.

For example, we consider that payments on bona fide redundancy of say 4 week’s regular remuneration plus 3 week’s remuneration for each year of service would be a reasonable amount to be payable without the need for shareholder approval.

Likewise, payments in lieu of notice of up to 3 month’s regular remuneration should be payable without the need for shareholder approval.

If the limit on payments without shareholder approval is restricted to one year's base salary, then it would often not be possible to make such genuine payments without shareholder approval. A limit of 2 to 3 years annual remuneration (without shareholder approval) would generally enable such genuine payments to proceed.

Recommendation 2.

We recommend that if the general limits are not increased to a more reasonable level, payments (up to a reasonable specified level) due to bona fide redundancy or in lieu of notice be excluded from the proposed requirements so that they can be payable without the need for shareholder approval.

Base salary or regular remuneration

Base salary is an artificial amount determined after reducing the person's regular remuneration by items such as superannuation, salary sacrifice etc. It is more equitable to base payments on regular remuneration rather than base salary as it is a better reflection of the person's employment value. We note that base salary will vary depending on the use of salary sacrifice etc. If base salary is used, then two directors on the same package and with the same employment history could receive significantly different amounts (without shareholder approval) if they have adopted different remuneration packaging arrangements.

Tying any maximum benefit which can be paid (without shareholder approval) to base salary is likely to result in shareholder confusion. It will also lead to managerial and executive officers and directors needing to adjust their salary sacrifice arrangements in the three years before intended retirement in order to maximise their termination payment. This does not satisfy the principle of promoting responsible remuneration policies.

Recommendation 3.

We recommend that, the benefit that can be payable without shareholder approval be based on regular remuneration (excluding bonuses) rather than base salary.

Timing of Approval

The proposed requirements that shareholder approval can only be obtained at a general meeting after the termination of employment is a serious impediment to efficiency. It will also result in significant lack of clarity for employers (and employees) who will not know for some time after termination whether a particular payment will be possible.

In many cases, particularly for longer term employees, the employee's contribution to the organisation may be apparent even before termination of employment. Waiting until after termination, will in many cases not provide shareholders with any further information on the employee's performance.

> *Recommendation 4.*
>
> *We recommend that greater flexibility be allowed in the timing of obtaining shareholder approval.*

Existing employment contracts

We note that the Treasurer's Media Release 024 issued on 18 March 2009 included the words:

> *"Today's announcement will not prevent existing contracts on termination payments from proceeding."*

Further, the Minister for Superannuation and Corporate Law indicated in his Media Release 049 issued on 5 May 2009 that:

> "The Bill will implement each of these commitments by:
> ……; and
> not altering contractual arrangements entered into before the Bill becoming law."

However such exclusions do not appear to be provided in the draft Bill and are not referred to in the draft Explanatory Memorandum. There is merely a reference that "The new arrangements will not apply retrospectively to existing contracts which have already been settled."

Prohibiting companies from meeting their liabilities under existing contracts is likely to cause considerable consternation for companies as well as their Directors and other employees caught by the new rules. Even delaying the payment of contractual entitlements until shareholder approval has been obtained will result in breaches of contract and potential legal action against the company.

Without a clear exemption, the legislation will not provide clarity for employers. In fact, employers will be placed in a dilemma as to whether or not they will be able to meet their contractual obligations.

Recommendation 5.

We recommend that the Bill be amended to exclude payments under existing employment contracts in accordance with the Media Releases issued by the Treasurer and the Minister for Superannuation and Corporate Law.

Bonuses

The draft legislation excludes deferred bonuses from the definition but it is not clear whether deferred annual bonuses that will be subject to an additional future performance hurdle will also be excluded. Clarification on this will be important in light of APRA's and other prudential regulators' push for bonuses to be deferred and subject to clawbacks.

Recommendation 6.

Greater clarification of the exemption of deferred bonuses is required.

Vesting of options

The draft legislation specifically includes accelerated or automatic vesting of options (and presumably restricted shares). Whilst we agree that it is often inappropriate to accelerate vesting of all options on termination where the vesting period has not been completed and performance hurdles not met, many companies reserve the right to vest the options/shares on a pro-rata basis to the extent performance toward the hurdle has been achieved at termination. This is necessary in some circumstances where there has been a change in ownership or capital or retaining the outstanding options/shares in the executive’s name until the vesting date is not possible due to dilution or other reasons. We feel that boards may require more flexibility in dealing with these situations.

Recommendation 7.

Greater flexibility is required in relation to excluding pro rata vesting of options to the extent that performance towards the hurdle has been achieved at termination where changes in ownership, capital or other commercial considerations make it unworkable to retain the options until the vesting date.

Superannuation

Benefit or contribution

The treatment of superannuation is difficult, particularly as superannuation generally consists of a two stage process – the payment of a contribution to a superannuation fund and the subsequent payment of a benefit to the individual which could be made many years after the contribution is paid.

The Bill is so unclear in relation to superannuation that it will create considerable confusion amongst employers. Significant changes are needed in relation to superannuation payments so that these are clarified.

It is our view that only certain excess contributions should be taken into account rather than any benefit payments.

This will

- Avoid the possibility of double counting (ie counting both the contribution and the resultant benefit)
- Avoid the need to place a value on superannuation pension benefits
- Avoid the counting of benefits which may have accrued before promotion to managerial or executive office or director
- Avoid the counting of benefits which may have accrued from employment with another employer
- Avoid the counting of benefits financed from personal employee contributions
- Avoid the need to consider whether a benefit is paid if it is not cashed but is instead retained in the superannuation fund or rolled over to another fund.

(Note that few, if any, superannuation funds would hold sufficient records to be able to split the benefit between that financed from each of the sources referred to above. In most funds, all of the above contributions are credited to the same account and it is not possible to determine how much of the benefit resulted from each source. Where there is more than one employer (as is often the case for Directors), contributions from each employer would generally not be maintained separately but would all form part of the same account. Voluntary employer contributions are also generally not separated out from Superannuation Guarantee contributions.)

Recommendation 8.

The Bill needs to provide more clarity as to the treatment of superannuation.

Recommendation 9.

Only certain excess superannuation contributions (rather than benefit payments) should be included as part of the termination payment for approval purposes.

Amount of contribution to be taken into account

It will also be necessary to clarify the amount of contributions which would be treated as a "termination payment" for the purpose of determining whether shareholder approval is required.

Again the draft Bill and Explanatory Memorandum need to be amended considerably to clarify what contributions are affected. The drafts refer to terms such as "statutory amount" (Para 2.23 of the EM) and "a payment of superannuation (however described), to the extent to which it is more that the maximum amount required or permitted by a law of the Commonwealth, a State or a Territory" (the Bill).

Neither of these terms are defined or used in superannuation legislation. Neither has an obvious meaning and no explanation is given.

Firstly we point out that superannuation is not compulsory in Australia. Employers do not have to make any contributions to superannuation, however if they don't they will be required to pay the Superannuation Guarantee Charge to the ATO together with associated penalties. Thus the use of the term "required" is inappropriate where no contributions are actually required.

On the other hand, some contributions may be required by an Award or industrial agreement but these are not laws of the Commonwealth, State or Territory.

The use of the word “maximum” in conjunction with “required” is also confusing. If an amount is “required”, then surely there cannot be a “maximum amount required”. If it is required, then the word “maximum” would be redundant.

The term “permitted” is also confusing as there is currently no limit on the amount of contributions (or benefits) permitted by Australian law.

In our view, the following contributions should not be taken into account:

- contributions to meet an employer’s Superannuation Guarantee requirements;
- salary sacrifice contributions coming from regular remuneration;
- salary sacrifice contributions coming from what would otherwise have been a bonus which would have been excluded from these termination benefit provisions;
- regular voluntary employer contributions based on regular remuneration; and
- contributions to provide defined benefits.

It would also be appropriate to exclude special contributions which are paid under an existing contractual arrangement (this could include contributions required to achieve a target defined benefit in an accumulation fund).

We consider that requiring shareholder approval for the above contributions would be inconsistent with the key principles underlying the proposed changes. In particular, shareholders should not need to approve a decision by a managerial or executive officer or director to salary sacrifice part of their regular remuneration or annual bonus. In fact it may lead to less responsible remuneration policies as these employees would argue that they need a higher salary to compensate them for the loss of ability to make salary sacrifice contributions (due to the risk of them not being approved by shareholders).

We also note that all of these contributions would have been included in the annual remuneration reported by the employer to shareholders. As these contributions have already been disclosed as remuneration we therefore consider that they should not be subject to the limits on benefits paid on termination of employment. We also note that with the proposed reduction in the concessional contribution caps, there will be very limited capacity for such voluntary arrangements on a tax effective basis.

Recommendation 10.

Only superannuation contributions other than those referred to above should be included as a termination payment (in particular, payments made specifically as a result of termination of employment including salary sacrifice contributions in respect of what would otherwise have been a termination payment).

Tax issues

We also note that employers are generally unable to obtain a tax deduction for contributions made after an employee has left service. It is therefore unreasonable if additional superannuation contributions have to be deferred until after shareholder approval has been obtained at some time after termination of employment.

Recommendation 11.

If the proposed changes proceed, then the Income Tax Assessment Act 1997 needs to be amended to allow a tax deduction for employer contributions made after termination of employment.

Protection of superannuation funds

The liability of superannuation funds is very unclear in the draft Bill and Explanatory Memorandum.

In the first place, it is unclear how a superannuation fund would know that it was a prescribed superannuation fund in relation to a particular company or employee.

Secondly, it is unclear how a superannuation fund could refuse to pay (or even defer) part or all of the members' total benefit entitlement as this would generally breach the requirements of the SIS Act and Regulations.

Thirdly, it is generally not possible to reduce a member's account balance or refund contributions to the employer.

Recommendation 12.

The Bill needs to clarify the obligation of superannuation funds and amend existing superannuation legislation to enable those obligations to be met.

Pensions

It is appropriate that pensions (other than superannuation pensions which would be covered by our comments on superannuation above) are treated as benefit payments that are subject to the proposed restrictions.

However, it is unclear what amount is taken into account to determine whether it exceeds the limit at which shareholder approval is required. For example, assume Company A is allowed to pay a benefit of up to $100,000 without seeking shareholder approval. It decides to pay a pension of $20,000 a year. Can it pay the pension for 5 years and then gain shareholder approval for further pension payments or does it need to obtain shareholder approval before the pension commences (as the value of the pension is more than the $100,000 limit available in this case)?

If it is required to value the pension, neither the Bill nor the draft Regulations specify how the valuation is to be performed.

Recommendation 13.

We recommend that the Bill specify how such payments are to be valued for this purpose.

The Bill should also specifically exclude superannuation pensions from the definition of pension as superannuation pensions are more appropriately covered under our superannuation proposal.