

EXPLANATORY MEMORANDUM TO UPDATED PROFESSIONAL STANDARD 403 - PREPARATION OF BENEFIT CERTIFICATES

May 2022

1. ABOUT THIS EXPLANATORY MEMORANDUM

This Explanatory Memorandum has been prepared by the Superannuation and Investments Practice Committee (SIPC) to:

- ▶ assist Members in understanding the May 2022 updates to *Professional Standard 403 Preparation of Benefit Certificates (PS 403)*, which relates to the preparation of Benefit Certificates under the Superannuation Guarantee (Administration) Act 1992 (Cth) (the SG Act);
- ▶ assist Members in understanding the circumstances in which the update has been issued, which mean that a further update may be required shortly, depending on when anticipated legislative amendments are made (see Section 4); and
- ▶ comment on related matters and actions for Members to consider, including a request for reporting to the SIPC about the use of Non-Preferred Approaches (see Sections 7 and 8).

2. BACKGROUND

The SG Act was amended in October 2019 with the stated aim being 'to improve the integrity of the superannuation system by ensuring that an individual's salary sacrifice contributions cannot be used to reduce an employer's minimum superannuation guarantee (SG) contributions'. The amendments apply from 1 January 2020 to:

- ▶ prevent contributions made under salary sacrifice arrangements from satisfying an employer's SG obligations; and
- ▶ specifically include salary or wages sacrificed to superannuation in the earnings base for calculating an employer's SG obligations.

However, these amendments did not address SG obligations met via defined benefit (DB) funds i.e. they only changed the SG obligations met by contributions made to accumulation funds (or Retirement Savings Accounts).

Pending legislative change to address this deficiency, the Institute considers that it is likely to be in the best interests of all parties that new Benefit Certificates do not allow employers covered by the certificate to use salary sacrifice superannuation contributions (Sacrificed Contributions) to reduce their SG obligations.

The reasons for this, along with further background and considerations, were set out in the SPC's [June 2020 Discussion Note: SG Benefit Certificates and salary sacrifice contributions](#) (Discussion Note).

3. AUGUST 2021 EXPOSURE DRAFT

An Exposure Draft of proposed updates to PS 403 in response to the issues outlined in Section 2 was released for comment in August 2021.

The proposed updates set out in the August 2021 ED were designed to be consistent with the interim approach encouraged in the Discussion Note.

Key changes in the August 2021 ED included introducing the concept of a 'Preferred Approach' under which a Benefit Certificate is prepared on a basis that does not allow any employer covered by the certificate to use Sacrificed Contributions to reduce their SG obligations.

The August 2021 ED updates did not propose to make it mandatory to use the Preferred Approach, given the SG legislation does not prohibit the use of Sacrificed Contributions to reduce employer SG obligations met via DB funds. However the Preferred Approach was strongly encouraged and a number of conditions were required to be satisfied in order for the Preferred Approach not to be used (such as requiring the specific instructions of the Instructing Party and the inclusion in the certificate of prominent wording covering a number of matters relating to the approach used).

The Explanatory Memorandum specifically invited comment on the alternative of making the Preferred Approach mandatory (as well as any other issues).

4. FEEDBACK ON EXPOSURE DRAFT AND SUBSEQUENT ACTION

In response to the August 2021 ED, the SIPC received one submission (from a Member) which argued strongly for the Preferred Approach to be mandatory, as the only way to ensure that employees were not disadvantaged.

In addition, Member feedback was obtained via a number of polls conducted at an SIPC Insight session discussing the August 2021 ED. The poll results indicated that:

- ▶ While a majority supported the Preferred Approach not being mandatory (as proposed in the August 2021 ED), a significant minority favoured the mandatory approach.
- ▶ A small number of actuaries reported that they expected to sign one or more certificates using a Non-Preferred Approach.

The latter poll result cast doubt on the SIPC's previous expectation that use of a Non-Preferred Approach would, in practice, be rare or non-existent. This led to stronger consideration being given to a mandatory approach in order to prevent fund members potentially being disadvantaged.

However there are considerable doubts as to whether it would be appropriate for the Institute to mandate a standard in excess of the legislative requirements. The Institute therefore considers that the best way to resolve the issue and ensure prevention of member disadvantage is for the legislation to be amended.

Accordingly, the Institute wrote to the Minister for Superannuation (see [15 December 2021 submission](#)) formally requesting that the Government amends the SG requirements for DB funds from the earliest practicable date.

The Minister formally responded on 6 April 2022, advising that 'the Government intends to progress law change to address this potential integrity risk as part of its broader legislative program'.

The Institute is very pleased that the Government is committed to making appropriate regulatory amendments, however the timeframe is uncertain.

In the meantime, the Institute considers it appropriate that PS 403 be updated to incorporate the Preferred Approach on a strongly encouraged basis, as per the August 2021 ED, pending the regulatory amendments which will (in effect) make the Preferred Approach mandatory. When that occurs, a further update to PS 403 will be made to accommodate the revised legislation.

5. MAY 2022 PS 403

As per the August 2021 ED, the May 2022 PS 403 includes the following changes (from the current PS 403):

- ▶ The concept of a 'Preferred Approach' is introduced, under which a Benefit Certificate is prepared on a basis that does not allow any employer covered by the certificate to use Sacrificed Contributions to reduce their SG obligations. The Institute strongly encourages that the Preferred Approach be used, as stated in clause 5.6. Members' particular attention is drawn to:
 - clauses 5.2 to 5.7, which set out new expectations and requirements relating to the Preferred Approach, including the contents of the certificate
 - clause 5.8, which sets out conditions for using a Non-Preferred Approach.
- ▶ A definition of 'Instructing Party' has been added, being for the purposes of PS 403 the party which has engaged the Member to prepare a Benefit Certificate. It is noted that this is different from definition of 'Client' in the Code, which is 'the recipient of a Service provided by a Member'. As both the fund trustee and the sponsoring employer will receive copies of the certificate, the 'Instructing Party' definition is considered necessary to provide clarity where it is used in the proposed PS 403 updates.
- ▶ A definition of 'Employer Contributions' has been added, which excludes Sacrificed Contributions in order to meet the requirements of the Preferred Approach:
 - Corresponding changes have been made to the definitions of Member Contributions, DB Member Contributions and Voluntary Member Contributions, so that these items will be required to include relevant Sacrificed Contributions.
 - The definition of the rate of DB Member Contributions (MCR) in clause A1.4 has also been amended to specify that it is net of allowance for 15% contributions tax in respect of any relevant Sacrificed Contributions.
- ▶ A new "OTEM" earnings base definition has been inserted, which includes Sacrificed Contributions.

- ▶ Allowance for a Preferred Approach Start Date (which must not be later than the effective date of the Benefit Certificate) has been made so that, where considered appropriate, the treatment of Sacrificed Contributions as member contributions and inclusion in OTEM can be made prospective from that date.

Another noteworthy feature of the May 2022 PS 403 is that, as applied for the Preferred Approach in the August 2021 ED, some element of retrospectivity may be unavoidable for a defined benefit-style MRB based on average OTEM – refer clauses A1.8 to A1.10.

Additional requirements for use of a Non-Preferred Approach

Clause 5.8 of the August 2021 ED specified a number of conditions for the Preferred Approach not to be used, including:

- ▶ requiring the specific instructions of the Instructing Party (normally either the trustee or the employer sponsor) to the effect that the certificate be prepared on a basis that allows an employer covered by the certificate to use Sacrificed Contributions to reduce their SG obligations; and
- ▶ the inclusion in the certificate of prominent wording covering a number of matters relating to the approach used. Members may find the Appendix to this Explanatory Memorandum (which is based on paragraph 21 of the Discussion Note) helpful in identifying the main disadvantages of the certificate being prepared on this basis and why treating DB funds consistently with accumulation funds is the preferred practice of the Institute.

Clause 5.8 of the May 2022 PS 403 includes the conditions in the August 2021 ED for use of a Non-Preferred Approach, plus three additional requirements. Added paragraphs (v), (vi) and (vii) of Clause 5.8:

- ▶ impose additional conditions in cases where use of a Non-Preferred Approach would be a change of practice for the employer or the certificate relates to a Deemed Defined Benefit Fund, and
- ▶ **require certain details relating to the certificate (not including client details) to be reported to the Chair of the SIPC within 30 days of issue of the certificate**. Members may elect to provide additional information they consider is relevant.

The reporting requirement is aimed at building an accurate picture of the extent of the use of Non-Preferred Approaches, which will assist the SIPC in considering further action if the anticipated regulatory amendments take some time to be made.

6. APPLICATION

The May 2022 PS 403 applies to Benefit Certificates signed on or after its Commencement Date of 1 July 2022.

7. CERTIFICATES ISSUED PRIOR TO 1 JULY 2022

The May 2022 PS 403 does not include any requirements relating to early review or replacement of existing Benefit Certificates due to the salary sacrifice changes.

However actuaries who have not already done so are encouraged to contact their clients to confirm that the employer does not use salary sacrifice contributions to reduce their SG obligations, or to review practices and disclosure obligations if they do or are unsure. Some trustees and/or employers may request early replacement with a new certificate that provides for salary sacrifice treatment in line with the requirements for members of accumulation funds.

The Institute strongly encourages Members to use the Preferred Approach for any Benefit Certificates signed before the May 2022 PS 403 Commencement Date of 1 July 2022. Benefit Certificates prepared in accordance with the August 2021 ED or the May 2022 PS 403 will also meet the requirements of the current (March 2021) PS 403.

Whilst reporting to the SIPC is not mandatory where a Non-Preferred Approach has been used for a Benefit Certificate signed before 1 July 2022, if a Member has issued a new Benefit Certificate using a Non-Preferred Approach since June 2020, the SIPC requests that some details of the circumstances (as per Clause 5.8(vii) of the May 2022 PS 403) be provided to the SIPC Chair (timothy.jenkins@mercer.com) or another SIPC member, by 31 July 2022 if possible. The SIPC would also appreciate notification where a Member is or becomes aware that an employer is using salary sacrifice contributions to reduce their SG obligations under an existing Benefit Certificate.

8. PENDING REGULATORY CHANGE

The Institute's 15 December 2021 submission requested that the amendments to the SG Regulations (which the Government has now undertaken to make) include transition arrangements to provide the time necessary for the substantial number of Benefit Certificates to be replaced.

Ideally certificates that align with the Preferred Approach will not need to be replaced. However the requirements will depend on the arrangements specified in the regulatory amendments.

Therefore actuaries should be prepared for the possibility that all Benefit Certificates will need to be replaced within a relatively short period. It is likely to be more straightforward to replace certificates which have been prepared using the Preferred Approach.

END OF EXPLANATORY MEMORANDUM APPENDIX – ADVANTAGES OF PREFERRED APPROACH

It is difficult to envisage circumstances where use of the Preferred Approach would not be supported by an informed employer, for reasons including the following:

- ▶ It does not seem feasible that an employer would want to provide less favourable treatment of salary sacrifice contributions in its own fund than it would be required

to provide where the employee chose another fund. If the treatment is less favourable, this would seem a relevant matter for the employer or the trustee, or both, to disclose to employees/members;

- ▶ If the employer used salary sacrifice contributions to reduce their SG obligations, an informed employee (who nonetheless wished to remain in the employer fund) would consider using post tax contributions and claiming a deduction, rather than using salary sacrifice, so the employer would be likely to damage employee relations and the standing of the employer fund while gaining no benefit;
- ▶ A trustee of an accumulation fund is unlikely to agree to the Deemed Defined Benefit Fund provisions being used to enable SG contributions to be met from reserves if the Benefit Certificate allows less favourable treatment of salary sacrifice contributions than would normally be required;
- ▶ The employer's payroll system would need to cater for two different calculations of the SG earnings base and two different treatments of salary sacrifice contributions; and
- ▶ The employer may suffer reputational damage if it uses a practice which has been characterised by Government as unscrupulous, and which the Government has committed to prohibit via further amendments to the SG legislation.