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Superannuation Update: How do the changes effect you?

PRICEWATERHOUSECOOPERS

This edition of *PNG* News & Views updates the new superannuation legislation that commenced in May 2002.

This new legislation has a significant impact on existing and prospective superannuation fund members and their employers

The Superannuation Act 2000, which was originally passed on 29 November 2000, finally commenced on 9 May 2002. A number of the concerns raised on the original Act were considered by the Superannuation Task Force in consultation with interested parties, and were addressed in the amendment act passed in February 2002.

The new legislation will have a significant impact on existing and prospective superannuation fund members and on their employers. It also has significant implications for superannuation funds and their service providers.

This bulletin focuses on the main changes that impact on fund members and their employers. In particular we review the changes regarding contributions, withdrawal of funds, housing advances, and transfers between funds. We also review how the changes will better protect members savings going forward.

Finally, we also review the impact on non-citizens, existing employer based funds, small superfunds, and offshore contributions.

Summary of main provisions

The new legislation:

- retains the existing coverage under the NPF Act. The exemption from compulsory superannuation for the agricultural sector has been retained for one year, whilst a 5 year delay has been regulated for non-citizens.
- increases the existing private sector contribution rates over time to equal those in the public sector, commencing from January 2005
- removes the monopoly position of the NPF and POSF and promotes competition by facilitating the establishment of new superannuation funds and transfers between funds
- limits members ability to access all their savings on unemployment
- restricts access to savings for housing loans and prohibits other forms of member advances
- regulates the licensing and operations of corporate trustees, investment managers and fund administrators
- requires trustees of all authorised superannuation funds to appoint licensed investment managers and fund administrators
- tightens the duties and liabilities of trustees and directors of license holders
- provides safeguards for the investment of members funds
- requires small funds to wind up within a period of 5 years
- restricts the ability of non-citizens to withdraw contributions made after the date of commencement of the Act on termination

Mandatory contributions

After much debate, the existing scope of mandatory superannuation has been retained, with agricultural workers and non-citizens excluded for the time being pending further discussion and consideration. Agricultural workers are initially exempted for 12 months whilst mandatory contributions for non-citizens is delayed for 5 years.

All employers employing 20 or more employees are required to contribute to an authorised superannuation fund, and strict anti-avoidance provisions have been introduced to prevent companies splitting into smaller entities to avoid the 20 employee rule. This limit may be reduced to 15 sometime in the future.

Private sector contribution rates will initially be at the existing NPF rates of 5% for employees and 7% for employers. However, as the intention is to achieve uniformity between the private and public sector funds, these rates will increase over time to match the current public sector rates. The first increase, to 5.5% and 7.7% respectively, will be in January 2005, with the final increase to 6% and 8.4% in January 2008.

A common waiting period of 3 months before contributions are required for a new employee has been brought in, which is in line with the current NPF rule. This was a very sensible change that will ensure short term employees are excluded.

The existing upper limit on employee contributions of 10% has been removed, allowing an employee to put more of their earnings into superannuation if the superfunds can demonstrate a track record of strong returns on members savings.

Choice of superannuation funds

The Bank of PNG can authorise the operation of any superannuation fund where it is satisfied that it is proper to do so, and the fund meets the strict licensing criteria.

The monopoly positions of the NPF, POSF and DFRBF have been removed, bringing them under the Superannuation Act and enabling competition between existing and new superannuation funds for members. Over time, we expect that there will be a limited number of superfunds available to choose from, using criteria such as investment returns, operating costs and quality of member services to retain and attract members. The number of superannuation funds in the market will generally be limited by the economies of scale available to larger funds and the small number of service providers.

A 12 month moratorium from the date of commencement of the Act on transfers from an existing fund has been introduced to ensure an orderly transition to the new regime and give existing funds time to demonstrate improved governance, fund performance and service levels. After the end of the moratorium, employers will be able to transfer their employees to another fund by giving the existing fund and their employees 6 months notice. Accumulated savings can be transferred to the new fund at no loss to the member.

Additional safeguards have been introduced to protect employees, including a requirement for contributions to be up to date for a transfer election to be effective, the ability for at least 90% of the existing employee members to block the transfer, or for at least 90% of employee members to initiate a transfer.

Withdrawal of funds

The rules on withdrawal of entitlements have been significantly tightened. A citizen member can only withdraw their full accumulated savings:

a) on ceasing employment after attaining eligible age of 55
b) on attaining eligible age having previously retired from employment
c) on death
d) if permanently or totally incapacitated
e) if they have permanently emigrated from PNG, after a 1 year waiting period
f) on termination of employment, after a period of 12 months continuous unemployment, or
g) when transferring to a new superannuation fund.

There was initially some concern at the 12 month waiting period on unemployment, and the possible hardship this may entail. As a result, amendments were introduced enabling a superfund to provide limited periodic drawdowns from the members account after only 3 months of unemployment. These drawdowns, which can be paid monthly or fortnightly on a pro-rata basis, would be the greater of 50% of the members last monthly salary or a minimum of K200. If the member is still unemployed after 12 months, any balance remaining can be paid as a lump sum. Where the member has less than K1,000 in their account, the whole amount can be withdrawn after 3 months.

Any public servants retrenched under the current public service retrenchment program can access their entitlements immediately on termination.

There is no longer any forfeiture of contributions on withdrawals or transfers between funds.

Housing and other advances

The primary purpose of superannuation is to provide for retirement, and allowing early access to funds for other purposes reduces the funds otherwise available at retirement. With this in mind, the original legislation prohibited any form of advances to members. However, following significant deliberation on the matter, and recognising the importance of access to housing in the economy, the Act has been amended to allow housing advances under the following conditions:

- advances can only be for buying or building a principle place of residence
- a minimum 5 years of contributions is required
- the advance is limited to 60% of the members accumulated savings
- the employee must make an additional 2% contribution until the loan has been reinstated in their account balance
- proof of ownership over the land is required
- if the house is sold, the proceeds must be used to reinstate any remaining balance of the original advance
- any further advances for a subsequent principle place of residence are limited to the original amount advanced
- the funds can only be paid by the superfund to another financial institution as a deposit for a housing loan or to a builder or building material supplier, but not directly to the member

Whilst these provisions are considerably more restrictive than the existing regime, the reintroduction of housing advances is to be welcomed. However, advances for educational and health purposes are still prohibited, whilst life insurance can only be provided from voluntary contributions. A six month grace period from commencement has been given for existing housing, educational, medical or life insurance withdrawals.

Duties and liabilities of trustees and directors

The directors of licensed trustees, investment managers and fund administrators must meet stringent fit and proper criteria, and they have a duty to the members of an authorised fund to act honestly, take reasonable care, and use due diligence, to see that the investment, administration and management of the fund complies with the Act, any prudential standards issued by the Bank of PNG and gives priority to the interests of members. The interests of members must take priority over the interests of the shareholders of the license holder.

If a director of a licence holder breaches this duty, and as a result the fund incurs a loss, then the director can be held personally liable to make good the loss. Other penalties for breach of the Act are a maximum fine of K500,000 and/or up to 5 years imprisonment. Directors and officers of licence holders are required to be covered by indemnity insurance to ensure that any losses caused by their negligent actions can be recovered.

The licensed trustee remains ultimately responsible for ensuring that the fund is properly managed in the interests of the members, and remains vicariously liable for the actions of the investment manager and fund administrator.

To enhance the independence of the directors of trustee companies, they have the right to seek independent legal advice at the cost to the fund and it is an offence for any person to seek to victimise a director in the performance of his duties or to influence their vote on some matter.

These provisions should help ensure that only properly qualified and diligent persons act as directors of licence holders.

Investment Decisions

The trustee of an authorised fund has a duty to formulate and give effect to an investment strategy that is appropriate for the circumstances of the fund. The investment manager is then responsible for implementing that strategy. The investment strategy should have regard to:

- the risks involved and likely returns from the investments
- the level of diversification required
- the investment liquidity having regards to cash flow requirements
- the ability of the fund to discharge its existing and prospective liabilities.

The relative roles of the trustee and the investment manager in making investment decisions has now been clarified in the amendments to the Act. Whilst the trustee approves the overall investment strategy, the investment manager is responsible for all decisions as to the purchase or disposal of an investment. The trustee can make investment suggestions, and can refuse to implement an investment purchase or sale decision of the investment manager. However, the investment manager is not obliged to adopt or accept any proposal of the trustee and is required to exercise independent judgement. In the event of any disagreement, the Bank of PNG is required to be informed and to provide a directive. The independent, professional role of the investment manager will go some way in preventing some of the inappropriate investment decisions seen in the past from happening again.

Approval of the investment strategy will be an important part of the Bank of PNG's licensing requirements. The existing investment guidelines for superannuation funds are likely to be revoked, enabling greater flexibility of investment choice.

Changes for Non - Citizens

It had originally been intended to make PNG superannuation compulsory for all non-citizen employees. However there was significant concern over the additional costs to business, the possible loss of expertise and a number of practical issues. The Task Force also recognised that non-citizens cannot retire in PNG and that provision for their retirement should be the concern of their country of citizenship rather than PNG. The introduction of compulsory superannuation for non-citizens has therefore been delayed for 5 years, pending further consideration of whether it is in the national interest. This is a practical move, and gives employers more time to prepare for any eventual change.

A number of non-citizens are currently covered by voluntary schemes, with contributions paid on their behalf into either a PNG based fund or an offshore fund. All PNG based funds must become authorised funds and comply with the provisions of the Act, including the provisions regarding withdrawal of funds. Any entitlements relating to contributions paid by a non-citizen into a PNG based fund after the commencement of the Act are subject to the 12 month waiting period on termination. However, a concessional provision has been introduced to grandfather entitlements arising from contributions made by non-citizens prior to the commencement of the Act, which can be withdrawn immediately on leaving PNG.

Contributions to an offshore fund, whether an employer group based fund or an individual fund, are not deductible to an employer for tax purposes. However, if compulsory superannuation for non-citizens is introduced after 5 years, an exemption is available where contributions are made to an offshore fund in order to prevent doubling up of contributions.

Other amendments

A number of other amendments have been made to the original legislation to increase protection of members and clarify other issues.

- Small superfunds (those with less than 10 members), which have primarily been set up for tax purposes, have been given a 5 year exemption from the provisions of the Act. However, by the end of that period, they must either have been wound up, transferred to a mutual type arrangement or rolled into a larger ASF. The amendments also prevent members of such funds from making any further contributions into the fund after the date of commencement. This appears to have been a drafting error, and we understand that it is intended to provide temporary relief from this prohibition in the regulations in order to give the members time to make alternative arrangements

- A probity officer, appointed by the Bank of PNG is required to oversee the appointment process for the fund administrator and investment manager

- Superfunds will be required to provide counselling for members on retirement

- It will be a requirement for all members to have identified a beneficiary on death. This is to avoid the need to resolve matters under customary law where no beneficiary is named.

- Audit requirements have been strengthened to require a compliance audit and for a copy of management reports to be sent to the Bank of PNG

Further information

For further information on the impact of the Superannuation Act on you or your business, contact one of the PricewaterhouseCoopers partners or directors below.

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