ASFA Pre-Budget Submission for the 2018-19 Budget

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ASFA is a non-profit, non-political national organisation whose mission is to continuously improve the superannuation system, so all Australians can enjoy a comfortable and dignified retirement. We focus on the issues that affect the entire Australian superannuation system and its $2.5 trillion in retirement savings. Our membership is across all parts of the industry, including corporate, public sector, industry and retail superannuation funds, and associated service providers, representing over 90 per cent of the 14.8 million Australians with superannuation.

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Executive summary

Reinforcing public confidence in the retirement income system – the current settings are working

ASFA considers that given substantial changes to the taxation of superannuation and the provision of the Age Pension in recent years, including in the 2013-14, 2014-15 and 2016-17 Budgets, there should now be a period of consolidation to allow the various changes to be bedded down.

The May 2016 Budget changes have reduced the overall amount of tax concession for superannuation contributions by around $1.25 billion a year. As well, there has been a substantial change in the distribution of the tax concessions by income tax rate band. The changes decreased the proportion of the concessions going to those on the top income tax rate from 13.3 per cent of the concessions to 10.8 per cent. The proportion of the concessions going to those on $37,001 to $80,000 increased from 34.7 per cent to 36.9 per cent, while the proportion of the concessions going to those on $18,201 to $37,000 increased from 11.9 per cent to 12.4 per cent.

Following the January 2017 Age Pension changes, the number of Age Pension recipients fell from 2,570,072 in December 2016 to 2,494,060 in March 2017, a fall of 3 per cent. The number of full rate Age Pensioners rose marginally, from 1, 515,411 to 1,548,590 a rise of around 2 per cent.

The number of Age Pension recipients has continued to fall, with 2,489,591 in total in September 2017.

It is clear the recent changes to the Age Pension and to tax treatment of superannuation have substantially reduced expenditures and increased tax collections in the Budget. Most of the impact of the tax changes has been on those in the top two tax brackets, substantially realigning the equity of the provision of tax assistance in regard to superannuation.

Recommendation 1:

ASFA recommends no further adverse changes be made to superannuation tax provisions or to the Age Pension in the 2018-19 Budget and over the Forward Estimates period

Changes to the nature of work in Australia and how superannuation policy settings should be adjusted in response to those changes

The gig economy is set to become more pervasive. While economic activity and employment facilitated through web-based platforms currently represents only a small share of the broader economy, the volume of activity is growing fast and platforms are expanding to encompass a wider variety of professions and industries.

Greater certainty around the application of the legislative framework to gig economy workers could be achieved through legislative change that introduces a new category of worker subject to SG arrangements, that of "dependent contractor".

Also the fact SG contributions are not payable with respect to the self-employed (along with other entitlements/protection such as Workers Compensation) can be exploited by the artificial creation of arrangements whereby individuals are engaged as contractors. As research suggests there are around 50,000 so affected persons in Australia at any one time, there is a strong case to introduce measures to discourage sham contracting arrangements.

Recommendation 2:
ASFA recommends the Government:

Strengthen the sham contracting protections in the Fair Work Act 2009

Amend the current legislative framework in order to include dependent contractors within the scope of the Superannuation Guarantee

Extending coverage of the Superannuation Guarantee to the self employed

Almost one quarter of self-employed people have no superannuation, with no superannuation being more common for females than males. In addition, a considerable proportion of self-employed people do not own a business with any material goodwill or value, other than their labour.

The rise of the gig economy strengthens the case for extending the SG regime to formally include the self-employed. The rise of the gig economy will lead to a larger proportion of workers who have work arrangements not covered by current SG arrangements.

Recommendation 3:

ASFA recommends the Government extend the SG to the self-employed

Removing the $450-a-month threshold for SG payments

In general terms, the existence of the threshold penalises low-income earners, permanent part-time workers and those with multiple jobs, who receive little or nothing in the way of SG contributions.

ASFA estimates around 365,000 individuals (220,000 women and 145,000 men) would benefit from the removal of the threshold by receiving higher retirement savings. Adopting this measure would help redress the imbalance between average retirement balances of men and women.

Recommendation 4:

ASFA recommends removal of the $450 a month threshold for payment of the Superannuation Guarantee

Funding for the closure of the Superannuation Complaints Tribunal

The Government is currently undertaking a process to establish a new external dispute resolution (EDR) framework for the financial services industry. This will involve a newly established Australian Financial Complaints Authority (AFCA) to replace the existing EDR bodies, including the Superannuation Complaints Tribunal (SCT).

During this transition period it is important the SCT be appropriately funded, including funding needed for the formal closure of the SCT.

Recommendation 5:

ASFA recommends:

A. The amount of funding allocated to the SCT from the ASIC component of the 2018-19 supervisory levy should identify the funding needed for both the transition period and for the closure of the SCT

B. Treasury and ASIC should review the SCT's funding needs in light of the likely timetable for AFCA to become fully operational

Small inactive superannuation accounts and unclaimed monies

The threshold, below which small inactive superannuation accounts are required to be transferred to the Australian Taxation Office, was increased from $2,000 to $4,000 from 31 December 2015, and to $6,000 from 31 December 2016.

While the ATO is active in identifying and contacting account owners and encouraging them to consolidate lost accounts with their other superannuation holdings, the amount of superannuation held by the ATO as unclaimed or as small and inactive continues to grow. The number of such accounts grew from 3.8 million in 2014-15 to 4.6 million in 2016-17, with the aggregate balances growing from $2 billion to $3.2 billion. In most cases the individuals concerned will have a superannuation account that is active and of which they are aware.

Recommendation 6:

ASFA recommends that priority be given to amending the *Superannuation (Unclaimed Money and Lost Members) Act 1999 Act* to permit the Commissioner of Taxation to pay unclaimed money to a complying superannuation plan where the Commissioner is satisfied as to the identity of the lost member account owner, and that the person holds an account in the proposed active destination fund

Superannuation payments owed by insolvent employers

The Fair Entitlements Guarantee (FEG) provides for the Commonwealth to pay an 'advance' on account of certain unpaid 'employment entitlements' in cases where an individual's employment ended in circumstances connected with the insolvency or bankruptcy of their employer and the individual cannot obtain payment of their entitlements from other sources.

Expanding FEG to include Superannuation Guarantee contributions would ensure employees' retirement savings are not improperly diminished in circumstances when their employer goes into liquidation without having met their obligations.

Recommendation 7:

ASFA recommends unpaid SG entitlements be included in the definition of unpaid employment entitlements for the purposes of the Fair Entitlements Guarantee

Extending tax relief for merging superannuation funds

The Government announced in the May 2017 Budget that it would extend the current tax relief for merging superannuation funds until 1 July 2020, but legislation is yet to be introduced. Extending this relief will remove tax as an impediment to mergers and facilitate industry consolidation. Consolidation should lead to better retirement outcomes through reduced costs.

ASFA also considers the relief should be on a permanent basis as there will be a continuing need to remove any tax impediments for mergers that will lead to better outcomes for fund members.

Recommendation 8:

ASFA recommends the previously announced extension of tax relief for merging superannuation funds be introduced as soon as possible and that this relief be permanent and ongoing

Restricting Limited Recourse Borrowing Arrangements for superannuation funds in the future

A long-standing position of ASFA, also endorsed by the Financial System Inquiry (FSI), is that the use of Limited Recourse Borrowing Arrangements (LRBAs) by superannuation funds is not appropriate.

The amount of funds borrowed using LRBAs has increased substantially, from $497 million in June 2009 to $25.4 billion in June 2016, an increase of around 5,000 per cent. Borrowing, even with LRBAs, magnifies the gains and losses from fluctuations in the prices of assets held in funds, and increases the probability of large losses within a fund. This puts individuals' superannuation at risk.

Recommendation 9:

ASFA recommends the Government restore the general prohibition on direct borrowing by superannuation funds by removing Section 67A of the *Superannuation Industry (Supervision) Act 1993* (SIS Act) on a prospective basis

Reinforcing public confidence in the retirement income system – the current settings are working

ASFA considers that given substantial changes to the taxation of superannuation and the provision of the Age Pension in recent years, including in the 2013-14, 2014-15 and 2016-17 Budgets, there should now be a period of consolidation to allow the various changes to be bedded down.

Our analysis, detailed below, shows the changes have had a substantial and positive impact on budget outcomes (in terms of reducing government expenditures and increasing tax revenue). The superannuation tax changes have also substantially reduced the tax assistance flowing to upper income earners.

The impact of recent changes to the Age Pension assets test

The changes to the assets test that took effect from 1 January 2017:

- increased the assets test-free areas to provide additional assistance to pensioners with relatively low asset holdings;
- provided an additional increase in the assets test free areas for non-homeowners; and
- increased the assets test taper (or withdrawal) rate for assets above the new free areas from $1.50 to $3.00 per fortnight for each extra $1,000 in assessable assets.

Pensioners who lost pension entitlement on 1 January 2017 as a result of the changes were automatically issued with a Commonwealth Seniors Health Card.

These changes were estimated to decrease expenditure on the Age Pension over the period of the Forward Estimates by around $2.4 billion. Around 100,000 persons were expected to lose entitlement to the Age Pension, around 330,000 were expected to receive less Age Pension while around 50,000 were expected to receive a larger Age Pension.

Following the changes, the number of Age Pension recipients fell from 2,570,072 in December 2016 to 2,494,060 in March 2017, a fall of 3 per cent. The number of full rate Age Pensioners rose marginally, from 1, 515,411 to 1,548,590, a rise of around 2 per cent.

The number of Age Pension recipients has continued to fall, with 2,489,591 in total in September 2017.

Total expenditure on the Age Pension in 2017-18 is expected to be $45.4 billion, up marginally from $44.5 billion in 2016-17. The assets test changes are helping contain future growth in Age Pension expenditures. Without these assets test changes, future growth in Age Pension expenditures would be much higher than is now projected.

For pensioners with assets above the assets test-free areas, their pension payment is reduced at a relatively high rate as assets increase. Above the free areas, people with higher levels of assets are expected, under the new arrangements, to draw down on those assets to support themselves in retirement.

Some commentators argue that over a certain range of assets held by retirees, additional private savings will lead to a reduction in retirement income, given the impact of those additional assets on Age Pension entitlement. It has been argued that this leads to a disincentive for additional retirement savings.

However, while the withdrawal rate of the Age Pension is higher than it was before 1 January, calculations that take into account drawdown of superannuation savings clearly indicate that additional private savings will lead to higher retirement incomes (which are a product of investment returns, any receipt of the Age Pension and the drawdown of the capital).

ASFA calculations suggest that over the range of assets subject to the assets test withdrawal rate, an additional $10,000 of retirement savings will lead to additional retirement income of around $300 a year. Most of this comes from the drawdown of the capital, as a reduced Age Pension is offset by any additional investment income associated with the retirement savings amount.

In ASFA's view, the changes made to the Age Pension, with effect from 1 January 2017, were substantial and appear to make the Age Pension fiscally sustainable for Australian governments in the years ahead, while not leaving the great bulk of retirees substantially worse off. This will be reinforced by rising superannuation account balances at retirement as the compulsory system matures. However, ASFA considers any further tightening of either the asset or income test could leave many Australians in retirement worse off. Tinkering with retirement income policy settings would also be likely to reduce individuals' confidence about saving for retirement.

It should also be observed that the take-up rate for the Age Pension is gradually declining as more people have significant superannuation balances and work past age 65. In 1997, the take-up rate for the Age Pension and the age-related Veterans Pension was 79 per cent. By 2007, this had fallen to 75 per cent and is now around 70 per cent. The take-up rate for the Age Pension will decrease further as superannuation balances increase (reinforced by a tighter assets test for the Age Pension), and the trend for people to remain in paid work after age 65 continues.

The superannuation and retirement system settings are working.

Going forward, the decrease in the take-up rate for the Age Pension will be particularly marked for those in their late 60s.

ASFA projections indicate that by 2025, around 20 per cent of those aged 67 will still be in paid employment with a further 40 per cent or so self-funded (or at least not eligible for the Age Pension). Currently, around 70 per cent of those aged more than 65 receive either a full or part Age Pension.

Of those, around 60 per cent are currently on the full Age Pension. This means that 42 per cent of those aged more than 65 are on the full Age Pension. ASFA expects the 42 per cent figure will fall to around 30 per cent by 2025. By 2055, it could be down to 25 per cent or less. This is driven by higher superannuation balances as the system matures.

In this context ASFA considers no further changes should be made to Age Pension settings in this Budget or over the course of the Forward Estimates.

Superannuation tax concessions - equity

A range of changes were made to superannuation policy settings in the May 2016 Budget with most of them taking effect from 1 July 2017.

Some of the key reforms to the super laws include the following:

- imposition of a $1.6 million cap on the asset value of all fund accounts in pension phase;
- reduction of the concessional superannuation contributions cap to $25,000 per annum;
- changes to the taxation of investment earnings supporting Transition to Retirement Pensions,
- a lowering of the threshold of income and concessional superannuation contributions combined, above which a higher rate of tax applies to concessional contributions;
- reduction of the non-concessional contributions cap to $100,000 per annum;
- increasing access to income tax deductions for all individuals making concessional superannuation contributions; and
- introduction of the ability to 'bring forward' unused concessional superannuation contribution caps that can be rolled over for up to 5 years.

ASFA has undertaken analysis of the impact of these various changes based on the distribution of contributions and account balances by income tax rate band as at 2014-15. It is likely the pattern of contributions and account balances would be very similar in 2017-18 although the levels of contributions and balances would now be slightly different. Wages growth and investment earnings have not been materially different across the various levels of income and account balances.

The May 2016 Budget changes have reduced the overall amount of tax concession for contributions by around $1.25 billion a year.

Additionally, as shown by Table 1, there has been a substantial change in the distribution of the tax concessions by income tax rate band.

The changes decreased the proportion of the total concession going to those on the top income tax rate, from 13.3 per cent of the concessions to 10.8 per cent.

The proportion of the concessions going to those on $37,001 to $80,000 increased from 34.7 per cent to 36.9 per cent, while the proportion of the concessions going to those on $18,201 to $37,000 increased from 11.9 per cent to 12.4 per cent. The share of the concessions going to those on $80,001 to $180,000 basically remains unchanged as this group has not been much affected by the tightening of contribution caps.

Table 1: Impact of the May 2016 Budget changes on tax concessions for contributions by income level

Taxable income	% of concession before May 2016 changes	Percentage of concession after changes
Less than $18,200	0.2	0.2
$18,201 to $37,000	11.9	12.4
$37,001 to $80,000	34.7	36.9
$80,001 to $180,000	39.9	39.8
$180,001 or more	13.3	10.8
Total	100.0	100.1

The May 2016 Budget changes also impact on the level of tax concessions for investment earnings associated with superannuation accounts. ASFA has in the past proposed that beyond a certain level of retirement savings, tax concessions related to investment earnings should be removed. ASFA suggested the threshold be $2.5 million with the Government adopting a threshold of $1.6 million.

Australian Taxation Office data indicate that in 2015-16 there were 819 accounts in Self Managed Superannuation Funds with individual balances in excess of $10 million with associated average annual benefit payments of more than $1 million a year, with the bulk of the payments tax free in the hands of the recipients. There were around 37,000 individuals with account balances between $2 million and $10 million with annual benefit payments averaging around $210,000 a year. There were also individuals in APRA regulated funds who had relatively high account balances and large income stream payments.

There were around 54,610 accounts overall in SMSFs with balances over $2 million, with the bulk of these (as noted above) in pension phase. Around 18,140 of these accounts are held by females.

The $1.6 million transfer balance cap is reducing the tax concessions flowing to such individuals during the pension phase.

The changes to the Transition to Retirement pension arrangements, together with the tighter cap on non-concessional contributions, will further limit the tax concessions flowing to those with high account balances and who are on relatively high annual incomes. In 2016 there were 72,500 individuals in SMSFs with Transition to Retirement pension arrangements and a further 167,000 in APRA regulated funds.

The total impact of the measures described above is to reduce tax concessions related to the investment earnings of superannuation funds by around $1.1 billion a year, with most of the impact on taxpayers in the top two income tax brackets.

It is clear the recent changes to the Age Pension and to tax treatment of superannuation have substantially reduced expenditures and increased tax collections in the Budget. Most of the impact of the tax changes has been on those in the top two tax brackets, substantially realigning the equity in tax assistance in regard to superannuation.

These changes are doing some very heavy lifting in terms of contributing to the correction of budget imbalances and ensuring the ongoing equity and sustainability of government assistance for retirement incomes.

Accordingly, ASFA recommends there be no further substantive changes to either superannuation or the Age Pension over the course of the Forward Estimates for this Budget.

Recommendation 1:

ASFA recommends no further adverse changes be made to superannuation tax provisions or to the Age Pension in the 2018-19 Budget and over the Forward Estimates period

The remainder of this pre-Budget submission addresses a number of proposals aimed at enhancing the current superannuation system.

Changes to the nature of work in Australia and how superannuation policy settings should be adjusted in response to those changes

The gig economy is set to become more pervasive. While economic activity and employment facilitated through web-based platforms currently represents only a small share of the broader economy, the volume of activity is growing fast and platforms are expanding to encompass a wider variety of professions and industries. Platforms will engage a larger proportion of Australian workers. Currently around 150,000 persons in Australia work in what can be called gig economy jobs facilitated through platforms. This is an increase of around 50,000 from a year earlier.

Use of web-based platforms will often lead to individuals having more than one job. For example, a person may have a full-time job from Monday to Friday and another part-time job at nights or on weekends, or a person may have two or more part-time jobs. There may be a number of reasons for multiple-job holding, but likely to be key among these is a desire to earn more income than is derived from one job.

Prevalence of multiple-job holding is relatively common in Australia. Household, Income and Labour Dynamics in Australia (HILDA) data indicate that nearly eight per cent of workers have more than one job. Currently around half of multiple job holders are combining two or more part-time jobs in order to have overall employment approaching what could be achieved in one full-time job.

Some people have multiple job arrangements for relatively long periods. The HILDA data indicate that 35 per cent of people who start working in more than one job are still working in multiple jobs one year later, and 8 per cent have multiple-job spells of at least four years' duration.

Females have relatively higher representation among multiple-job holders, accounting for 55 per cent of all multiple-job holders, compared with 45 per cent of all single job holders.

The rise of the gig economy will see shifts in the structure of the Australian labour market. A larger proportion of people will have some form of independent work arrangements, such as independent contracting, where workers may not be covered by the Superannuation Guarantee (SG). For affected workers, and in the absence of reform, this will mean lower superannuation balances at retirement, which will reduce the broader adequacy of the superannuation and retirement income system.

Lower income workers might be particularly impacted by more employment taking the form of independent work arrangements, including those arranged through web platforms.

Recent research, also based on HILDA data[1], indicates that high-paid temporary agency workers often succeed in turning their flexibility into an asset and achieve a wage premium on top of their higher wage. This particularly applies to fixed-term contract agency workers, who additionally are entitled to similar working conditions (including leave provisions) as permanent workers.

In contrast, the research indicates low-paid casual workers are at a multiple disadvantage. These workers—who are not entitled to paid leave; are more likely to experience fluctuating earnings and involuntary job loss; and already earn a relatively low wage—are further disadvantaged by an earnings penalty compared to similar permanent workers. Missing out on superannuation contributions further compounds such disadvantage.

1. The Structure of the Wage Gap for Temporary Workers: Evidence from Australian Panel Data Inga Lass and Mark Wooden, Melbourne Institute Working Paper No. 8/17

Determining which workers are 'genuine' employees for SG purposes

A threshold issue is whether the SG regime—which is primarily concerned with employers making compulsory superannuation contributions for their employees—will, going forward, cover all 'genuine' employees.

The rise of the gig economy will be accompanied by an increase in the proportion of workers who could best be described as 'dependent contractors' – that is, workers who are engaged under a commercial contract for services, but who have little discretion in regard to how they carry out their role and have work arrangements that (in a variety of ways) resemble those of an employee.

For such workers, the key consideration is whether such workers could (or should) reasonably be considered 'genuine' employees, and whether the current legislative framework regarding the determination of different types of workers would recognise them as such. This is relevant for the payment of SG contributions, but also for general employee protections and employer obligations.

The absence of reform would have two major implications with respect to the current SG regime. First, it would enable some platform operators to structure their business models to avoid paying SG contributions to workers, and so gain commercial advantage for their customers at the expense of business entities that do not, or cannot, so structure their business models. Second, affected workers will miss out on SG contributions.

The Government could take action to provide greater certainty for platform operators and workers and to provide increased worker protections. This could include strengthening the sham contracting protections in the *Fair Work Act 2009*, and amending the current legislative framework for the SG to ensure it covers all dependent contractors along with more traditional employees.

Strengthen sham contracting provisions

The fact that SG contributions are not payable with respect to the self-employed (along with other entitlements/protection such as Workers Compensation) can be exploited by the artificial creation of arrangements whereby individuals who in essence are employees are engaged as contractors. Research suggests there are around 50,000 so affected persons in Australia at any one time, and it is reasonable to expect this number may increase with the rise of the gig economy.

There are legal protections (under the Fair Work Act) against sham contracting. However, these can and should be strengthened.

The Productivity Commission, in a recent report, noted the requirement that an employer must have been 'reckless' before they could be prosecuted for misrepresenting the nature of an employment contract appears to be a high hurdle for legal action.

As such, the Commission recommended the Government amend the Fair Work Act to make it unlawful to misrepresent an employment relationship or a proposed employment arrangement as an independent contracting arrangement where the employer could be reasonably expected to know otherwise. The Commission noted this would reduce the burden of proof in prosecutions and, more broadly, help discourage sham contracting. Such a change of course would provide increased protections for the broader workforce rather than just gig economy workers.

Increasing the penalties for sham contracting would also discourage sham contracting.

Amend the legislative framework for the Superannuation Guarantee

With respect to 'dependent contractors', greater certainty around the application of the legislative framework to gig economy workers could be achieved through legislative change that introduces a new category of worker subject to SG arrangements.

Other jurisdictions are going down a similar path in terms of extending the scope of employee protections and benefits to emerging forms of paid employment. For example, the UK Government recently released a broad review of work practices (the Taylor Review) that looked at this issue.

In terms of potential solutions, one approach could involve the introduction of a new intermediate category of worker who would sit between employee and independent contractor, and would confer particular rights and entitlements on those workers.

Recommendation 2:
ASFA recommends the Government:

Strengthen the sham contracting protections in the Fair Work Act 2009

Amend the current legislative framework in order to include dependent contractors within the scope of the Superannuation Guarantee

Extending coverage of the Superannuation Guarantee to the self employed

For many years, ASFA has highlighted the low balances of self-employed persons relative to employees and the absence of any significant retirement savings of many of the self employed.

Although tax concessions have led to some self-employed saving for retirement through superannuation, average balances and coverage have remained relatively low. It should be noted that the 2016–17 Budget changes to the tax treatment of superannuation make it easier for some gig economy and self-employed workers to claim income tax deductions for superannuation contributions through expanding the category of taxpayers who can claim a tax deduction for contributions to superannuation.

Almost one quarter of self-employed people have no superannuation, with no superannuation being more common for females than males. In addition, a considerable proportion of self-employed people do not own a business with any material goodwill or value, other than their labour. This is particularly relevant for gig economy workers.

In general, the self-employed have lower superannuation balances than employees across the entire age distribution. In the run-up to retirement—the 60–64 age cohort—the self employed have around half the superannuation of employees. In 2015–16, the average superannuation account balance for self-employed males in that age group was around $143,100, compared with $282,640 for male wage and salary earners. For women, the difference is just as stark – self-employed women aged 60 to 64 have roughly half the balance $83,000 versus $174,650 in 2015–16 (also noting that women typically have on average just over half the balance of men).

Low balances for the self-employed, women in particular, are important policy issues that need to be addressed.

The rise of the gig economy strengthens the case for extending the SG regime to formally include the self-employed. As noted above, the rise of the gig economy will be accompanied by a larger proportion of workers who have work arrangements not covered by the SG. For affected workers and in the absence of any policy reforms, this will mean lower superannuation balances at retirement.

Individuals' participation in the workforce is likely to become more varied. For example, a worker may be an employee and an independent contractor at different periods in his/her career. Accordingly, the worker would receive SG contributions while an employee, but may not make superannuation contributions while a contractor. Such work patterns are likely to have a significant effect on superannuation balances at retirement.

For example, consider the case of a woman who starts full-time work at 23 years of age, after, say, a period of full-time study, and retires at 67.

- If she earns average wages throughout her working life, she would retire with a substantial superannuation balance of around $710,000 in today's dollars.

- If she took a 10-year break from being an employee to work as a contractor at age 45, and did not make contributions during this period, her superannuation balance at retirement would instead be $560,000. A longer break—say of 16 years—would mean a lower balance at retirement of $495,000.

Extending coverage of the SG to the self-employed will of course require a definition of employment income against which compulsory superannuation is to be applied, and a mechanism and timelines for making the superannuation contributions.

With respect to the Commonwealth Budget, extending coverage of the SG would reduce personal income tax collections. At a superannuation contributions rate of 9.5 per cent, extending the SG would reduce revenue by around $800 million per year.

However, the contribution rate could be phased in over a number of years – as was the case for the SG rate for employees. If the initial contribution rate was set at a relatively low level, such as two per cent, the revenue impact would be smaller, at around $200 million. Phasing would also help the self-employed adjust to the change, with growth in employment earnings of the self employed being available to help fund the contributions with only a minimal impact on disposable income for the self-employed.

Recommendation 3:

ASFA recommends the Government extends the SG to the self-employed

Removing the $450-a-month threshold

ASFA has long advocated for removing the $450-a-month earnings threshold for payment of the SG.

In general terms, the existence of the threshold penalises low-income earners, permanent part-time workers, and those with multiple jobs who receive little or nothing in the way of SG contributions. In the context of the gig economy, affected workers would include some workers who have temporary employee arrangements. It would include people for whom this type of employment is their only source of income—such as students or people with significant family responsibilities—or people for whom this type of employment is a secondary income source.

For affected workers, and in the absence of any policy reforms, the existence of the threshold means lower superannuation balances at retirement. For example, consider the case of someone who obtains work as a short-term administrative assistant (as a secondary source of income), via a web-based, labour-matching platform. They work sporadically, and earn no more than $450 per month. If they earn $5,000 per year, then over four years they would miss out on $1,900 in SG contributions.

The longer the period without SG contributions, the larger the amount of forgone contributions. Further, some workers may have two such jobs and so would miss out on SG contributions for both.

ASFA estimates around 365,000 individuals (220,000 women and 145,000 men) would benefit from the removal of the threshold by receiving higher retirement savings. Adopting this measure would help redress the imbalance between men and women in average retirement balances.

The cost to employers and the Commonwealth Budget would be modest. On the assumption that the people missing out on superannuation contributions because of the $450 per-month threshold have average relevant wages of around $2,800 a year, total superannuation contributions (at the rate of 9.5 per cent) would amount to approximately $95 million a year. With respect to the Budget, the reduction in revenue would be around $25 million.

The ASFA proposal would involve the repeal of subsection 27(2) of the *Superannuation Guarantee (Administration) Act 1992*. Subsection 27(2) currently has the effect that if an employer pays an employee less than $450 (before tax) in salary/wages in a calendar month, the employer is not required to pay SG contributions for the employee in respect of those salary/wages. This would also simplify for employers the calculation and payment of SG contributions.

For individuals with low balances, one issue of concern related to removing the threshold is whether balances would be eroded by insurance premiums and account fees – particularly with respect to duplicate accounts.

Most Australians of workforce age now have a superannuation account and removal of the threshold would not lead to many new accounts being established.

For members, account consolidation is easier to undertake as a result of a range of recently implemented regulatory mechanisms, such as member initiated account consolidations through myGov, with the provision of information on how to consolidate superannuation accounts readily available on ASIC's MoneySmart website. Employees are also generally able to exercise choice of fund in regard to where future contributions are made.

With respect to insurance in particular, funds are introducing mechanisms to better deal with the duplication of insurance cover. Use of new communication technologies, combined with the advent of intra-fund advice, are gradually leading to increased levels of member engagement with their insurance, mitigating the potential for unintentional duplicate policies.

Recommendation 4:

ASFA recommends the $450 a month threshold for payment of the Superannuation Guarantee be removed

Funding for the closure of the Superannuation Complaints Tribunal

The Government is currently undertaking a process to establish a new external dispute resolution (EDR) framework for the financial services industry. This will involve a newly established Australian Financial Complaints Authority (AFCA) to replace the existing EDR bodies, including the Superannuation Complaints Tribunal (SCT).

Throughout the consultation process for the new EDR framework, ASFA has highlighted the need to ensure the SCT is adequately funded and resourced to enable it to clear its existing caseload in an orderly manner. In this respect, the announcement in the 2017-18 Mid Year Economic and Fiscal Outlook (MYEFO) statement that the SCT would be provided with funding of $9.5 million over three years, from 2017-18 to 2019-20, is welcome. We note, however, that this funding will be recouped via an increase in the financial institutions supervisory levy paid by APRA-regulated superannuation funds, and that those funds will also be required to directly fund the activities of AFCA through membership fees and user pays charges.

It is the Government's stated intention that AFCA will address all new complaints—including superannuation complaints—from 1 July 2018, and that the SCT will cease operations on 30 June 2020. However, the Bill to establish AFCA has not yet been passed by Parliament and, given the magnitude of the work yet to be done to implement the new EDR framework, a start date of 1 July 2018 may not be possible. Considerable changes and transition are involved, including the transition from a statutory tribunal model to a hybrid ombudsman scheme.

The adequacy of the $9.5 million funding allocation for the SCT will be dependent on a number of factors, including whether AFCA will in fact be ready to take new superannuation complaints from 1 July 2018. Should the SCT be required to accept new complaints beyond this date, its caseload will continue to increase and this will have consequential impacts on its funding and resourcing needs and the time needed for the SCT to wind down. Other relevant considerations include:

- any reduction that can be achieved in the SCT's caseload as a result of the formal 'transfer' of existing complaints that have been made to the SCT but are not yet finalised. Transitional arrangements for such a transfer have been proposed at a very high level, but not yet implemented

- the extent to which complainants may choose to withdraw their complaint from the SCT and commence it afresh before AFCA. While this would reduce the SCT's caseload, ASFA is concerned that it raises the prospect of 'forum shopping' and a duplication of EDR effort and cost, and has therefore recommended, throughout the consultation process, that it be limited to those complaints the SCT has received but not yet commenced to hear.

While the SCT is intended to cease operations by 30 June 2020, a range of wind-up activities will then need to be completed and it is expected that costs will be incurred in relation to these activities. As the 2017-18 MYEFO statement provides no funding for the SCT beyond 30 June 2020, and the May 2017 Budget provided for a *reduction* in funding to ASIC in relation to the SCT of $7.2 million over the period 2017-18 to 2020-21, it is unclear to what extent funding has been allocated for the costs associated with the closure of the SCT.

In this context ASFA considers the allocation of funding to the SCT should be reviewed in 2018, in the light of progress in establishing AFCA and the extent to which new complaints are taken on by the SCT.

Recommendation 5:

ASFA recommends:

A. The amount of funding allocated to the SCT from the ASIC component of the 2018-19 supervisory levy should identify the funding needed for both the transition period and for the closure of the SCT

B. Treasury and ASIC should review the SCT's funding needs in light of the likely timetable for AFCA to become fully operational

Small inactive superannuation accounts and unclaimed monies

The threshold below which small inactive superannuation accounts are required to be transferred to the Australian Taxation Office was increased from $2,000 to $4,000 from 31 December 2015, and to $6,000 from 31 December 2016.

The stated aim of the measure was to protect the real value of these small transferred accounts. While the aim of protecting account balances may be appropriate for account balances under $2,000, there is far less certainty about the need for such protection under the higher thresholds.

While interest will be paid at the CPI rate on amounts held by the ATO, for a member invested in a fund's default investment option, based on long term average investment returns, it is probable that for account balances greater than $2,000 the member would be better off financially were the account balance to remain invested in an active superannuation account held by the member.

A further concern is these higher account balances are more likely to hold insured benefits. There is also an increased likelihood the member has consciously maintained an account for the explicit purpose of retaining insurance through that account. A significant number of superannuation funds, under their partial portability rules, have a 'retained balance' threshold—generally around $5,000—which insured members avail themselves of in order to retain insurance cover through their account. Some funds will also allow members to let their account balance fall below the threshold before they require them to top up the account in order to retain the insurance cover.

While the ATO is active in identifying and contacting account owners and encouraging them to consolidate these lost accounts with their other superannuation holdings, the amount of superannuation held by the ATO as unclaimed or as small and inactive continues to grow. The number of such accounts grew from 3.8 million in 2014-15 to 4.6 million in 2016-17, with the aggregate balances growing from $2 billion to $3.2 billion. In most cases the individuals concerned will have another superannuation account that is active and they are aware of.

Given that changes to superannuation reporting requirements have enhanced the information held by the Commissioner in regard to superannuation accounts, ASFA considers the opportunity should be taken to amend section 24G of the *Superannuation (Unclaimed Money and Lost Members) Act 1999* to empower the Commissioner to initiate the repatriation of lost member accounts. At the very least, any future account balance transferred to the ATO as unclaimed should be consolidated by the ATO into the active account of an individual where such an account exists.

Recommendation 6:

ASFA recommends priority be given to amending the *Superannuation (Unclaimed Money and Lost Members) Act 1999* to permit the Commissioner of Taxation to pay unclaimed money to a complying superannuation plan where the Commissioner is satisfied as to the identity of the lost member account owner and that the person holds an account in the proposed active destination fund

Superannuation payments owed by insolvent employers

The Fair Entitlements Guarantee (FEG) provides for the Commonwealth to pay an 'advance' on account of certain unpaid 'employment entitlements' in cases where an individual's employment ended in circumstances connected with the insolvency or bankruptcy of their employer and the individual cannot obtain payment of their entitlements from other sources.

The treatment of unpaid superannuation in the case of an employer insolvency/bankruptcy is currently subject to a complex combination of legislative provisions, including the *Superannuation Guarantee (Administration) Act 1992*, the *Corporations Act 2001*, the *Bankruptcy Act 1966*, and the 'director penalty notice' provisions of the *Taxation Administration Act 1953*.

The types of 'employee entitlements' currently covered by the FEG are limited and do not include unpaid superannuation contributions. However, the entitlements that can be claimed include forms of employee remuneration not dissimilar to superannuation contributions:

- unpaid wages – up to 13 weeks
- unpaid annual leave and long service leave
- payment in lieu of notice – up to five weeks
- redundancy pay – up to four weeks per full year of service.

The Australian Taxation Office has indicated that some 50 per cent of superannuation debts they deal with relate to insolvency.

In ASFA's view, there is merit in reviewing the treatment of unpaid SG entitlements in insolvency/bankruptcy, with the objective of considering how to achieve the maximum possible recovery on behalf of affected employees. ASFA estimates it would cost around $150 million per year to include unpaid SG in the FEG, with around 55,000 individuals affected.

The Superannuation Guarantee Cross-Agency Working Group noted that expanding FEG to include Superannuation Guarantee contributions would ensure employees' retirement savings are not improperly diminished in circumstances when their employer goes into liquidation without having met its obligations.

However, the Working Group argued against inclusion on the basis that it would have a Budget impact and that superannuation contributions are not immediately accessible by employees, unlike wages. ASFA does not consider either argument compelling. The cost is manageable within the overall Budget context and other initiatives of the Government are likely to decrease the future level of SG non-compliance. Superannuation contributions in many instances have led to wages being lower than they would otherwise be and it is unfair to carve out unpaid SG contributions from worker entitlements covered by the FEG.

Recommendation 7:

ASFA recommends unpaid SG entitlements be included in the definition of unpaid employment entitlements for the purposes of the Fair Entitlements Guarantee

Extending tax relief for merging superannuation funds

The Government announced in the May 2017 Budget that it would extend the current tax relief for merging superannuation funds until 1 July 2020. Since December 2008, tax relief has been available for superannuation funds to transfer capital and revenue losses to a new merged fund, and to defer taxation consequences on gains and losses from revenue and capital assets. This tax relief lapsed on 1 July 2017.

Extending this relief would ensure superannuation fund members' balances are not reduced by tax when superannuation funds merge. It will remove tax as an impediment to mergers and facilitate industry consolidation. Consolidation should lead to better retirement outcomes through reduced costs.

Legislation to extend the relief has not yet been introduced in the parliament despite the lapsing of the previous arrangements. ASFA considers it should be introduced as a priority and passed as soon as possible in order to remove an impediment to mergers.

ASFA also considers the relief should be on a permanent basis as there will be a continuing need to remove any tax impediments for mergers that will lead to better outcomes for fund members.

Recommendation 8:

ASFA recommends the previously announced extension of tax relief for merging superannuation funds be introduced as soon as possible, and this relief be permanent and ongoing

Restricting Limited Recourse Borrowing Arrangements for superannuation funds in the future

A long-standing position of ASFA, also endorsed by the Financial System Inquiry (FSI), is that the use of Limited Recourse Borrowing Arrangements LRBAs) by superannuation funds is not appropriate.

The Financial System Inquiry argued the Government should restore the general prohibition on direct borrowing by superannuation funds by removing Section 67A of the *Superannuation Industry (Supervision) Act 1993* (SIS Act) on a prospective basis. This section allows superannuation funds (in effect SMSFs) to borrow directly using LRBAs. APRA regulated funds generally do not make use of this provision.

The FSI considered that further growth in superannuation funds' direct borrowing would, over time, increase risk in the financial system. The amount of funds borrowed using LRBAs increased substantially, from $497 million in June 2009 to $25.4 billion in June 2016, an increase of around 5,000 per cent. Borrowing, even with LRBAs, magnifies the gains and losses from fluctuations in the prices of assets held in funds, and increases the probability of large losses within a fund. This puts individual's superannuation at risk.

In a scenario where there has been a significant reduction in the valuation of an asset purchased using a loan, trustees are likely to sell other assets of the fund to repay a lender, particularly if a personal guarantee is involved. As a result, LRBAs are generally unlikely to be effective in limiting losses on one asset from flowing through to other assets, either inside or outside the fund. In addition, borrowing by superannuation funds implicitly transfers some of the downside risk to taxpayers, who underwrite adverse outcomes in the superannuation system through the provision of the Age Pension.

Superannuation funds use diversification to reduce risk. Selling the fund's other assets will concentrate the asset mix of the fund. This reduces the benefits of diversification and further increases the amount of risk in the fund's portfolio of assets.

LRBAs are currently used by around 7 per cent of SMSFs. Over half of the SMSFs making use of LRBAs have more than 80 per cent of their total assets in LRBAs. This indicates a lack of diversification within such funds.

Given the contractual arrangements that funds using LRBAs currently have in place and the difficulties that would be associated with the forced sales of more than $25 billion in assets, ASFA considers any changes to the arrangements should involve removing the ability to enter into LRBA arrangements in the future.

Recommendation 9:

ASFA recommends the Government should restore the general prohibition on direct borrowing by superannuation funds by removing Section 67A of the *Superannuation Industry (Supervision) Act 1993* (SIS Act) on a prospective basis