File Name: 2016/18

17 November 2016

Senate Standing Committees on Economics
PO Box 6100
Parliament House
Canberra ACT 2600

economics.sen@aph.gov.au

Dear Sir/Madam

Treasury Laws Amendment (Fair and Sustainable Superannuation) Bill 2016 (the Bill)
Superannuation (Excess Transfer Balance Tax) Imposition Bill 2016 (the Imposition Bill)

The Association of Superannuation Funds of Australia (ASFA) is pleased to provide this submission to the Inquiry into the provisions of the *Treasury Laws Amendment (Fair and Sustainable Superannuation) Bill 2016 and the Superannuation (Excess Transfer Balance Tax) Imposition Bill 2016.*

About ASFA

ASFA is a non-profit, non-political national organisation whose mission is to continuously improve the superannuation system so people can live in retirement with increasing prosperity. We focus on the issues that affect the entire superannuation system. Our membership, which includes corporate, public sector, industry and retail superannuation funds, plus self-managed superannuation funds and small APRA funds through its service provider membership, represent over 90 per cent of the 14 million Australians with superannuation. ASFA has also established a specific sub-group - ASP services – whose function is to identify, develop and implement operational efficiency improvements for the administration of superannuation funds and their members.

The need to pass the legislation as soon as possible to ensure consumer confidence

AFSA is broadly supportive of this package of tax measures as a means to address the sustainability and equity of the superannuation system. In particular, we strongly support LISTO, which ensures low income earners are treated fairly, and the new ability for members to utilise the amount of unused concessional contributions cap and to claim a deduction for personal contributions, both of which introduce flexibility and provide members with the ability to make 'catch-up' contributions. ASFA was also pleased to see that some changes had been made as a result of consultation, including extending the periods to take action under the transfer balance cap measure, making the reset of the capital gains tax base permanent and the adoption of an annual non-concessional contribution cap of $100,000.

Importantly, given the proposed 1 July 2017 start date for the majority of the measures, it is critical that the legislation should be passed without undue delay, to provide consumer confidence in the system and certainty to funds that need to implement the necessary changes.

We do, however, have some concerns about the ability of funds to make the necessary system and process changes, with respect to a couple of the measures, by 1 July 2017. We have also raised some issues with respect to specific aspects of the proposed measures, which are outlined below.

We would encourage both Treasury and the Australian Taxation Office (ATO) engaging in ongoing consultation with the industry during the implementation/transition phase, in particular with respect to the changes to Transition to Retirement Income Streams and the operation of the Transfer Balance Cap.

1. General observations about the legislation

1.1. Start date

For many of the measures, as they represent amendments to existing rates or caps (where information technology infrastructure and processes have been built and simply need to be modified) the proposed implementation timetable of 1 July 2017 is achievable.

By way of contrast, however, the changes to Transition to Retirement Income Streams (TRIS) and the new Transfer Balance Cap – which are not based on existing settings - will pose a challenge to implement in time for a 1 July 2017 commencement date.

As a minimum superannuation funds need a 12-month lead time, from when legislative requirements have been finalised, to implement system changes. Fund need to settle the administrative design, determine the information technology specifications, build/code system changes, test them thoroughly in a test environment, release the changes into the production environment (during a finite window for system releases) and allow sufficient time to rectify any unintended consequences. Any shorter period introduces significant risk and imposes additional, unnecessary, costs which often are borne by the members.

There are a number of extensive and complex regulatory reforms scheduled for commencement over the coming 12 months, including changes to SuperStream/associated systems and to fee and cost disclosure, which means that project resourcing capacity is extremely limited. Funds have indicated that this, coupled with finite windows for system releases, mean that the likelihood of being able to meet the commencement date of 1 July 2017, with respect to the changes to TRIS, is limited.

1.1.1. Transition to Retirement Income Stream (TRIS) changes

A number of funds have expressed considerable concern about their ability to implement the proposed changes by 1 July 2017 and the additional cost and risk involved in implementing the changes within the relatively truncated time period.

This measure presents a fundamental shift away from the way in which pension products have been built and currently operate.

In particular, current registry systems, fund accounting, unit pricing and tax return processes generally were not developed to manage an earnings tax on an individual's pension assets, as earnings on all pensions were tax free. Funds will have to segregate their TRIS members from other members receiving income streams and may need to restructure their arrangements with respect to the underlying assets and rebuild their tax engine.

Some funds will be required to build systems to track earnings in the fund against each member, aggregate them and tax them at 15% which, given the number of investment options, will prove to be a complex and time consuming operational build. For many funds, tax is attributed into the unit price and there is segregation of accumulation and pension members and in order to apply the earnings tax to TRIS members, funds will be required to create a new subset of TRIS members and new, standalone, TRIS investment options. This will also lead to increased custodial costs with respect to the new suite of investment options which will need to be created.

Along with the considerable system changes that will need to be made there will considerable additional work required to implement this measure, including

- the design and implementation of appropriate processes to manage the operational risks created by the new categorisation of products and members;
- the determination and retention of the market values of affected assets to implement the CGT cost base relief; and
- changes to ATO reporting - currently TRIS member are reported as pension members but, as their account balance will not count towards the transfer balance cap, this will need to be changed in future reporting.

A number of funds have indicated to us that they believe it will take them between 18 and 24 months to make the necessary system and process changes to be able to administer this change. The alternative - to close their existing products - would take at least nine months to complete.

Costs

Funds have indicated that this will prove to be a costly measure to implement:

- one large fund has estimated that this measure alone will account for approximately two-thirds of their total compliance costs for the entire package;
- another large fund has indicated that its high level costing are that this measure, as currently drafted, will cost between three and five million dollars to implement;
- another large fund has indicated that a conservative estimate of their implementation costs is a minimum of two million dollars.

Funds have observed that, from an overall fund perspective, the cost of implementing the TRIS reforms is disproportionate to the number of members who have a TRIS in place.

Deferral or alternative approaches

While we appreciate the difficulties associated with deferring revenue measures, given that funds have indicated there is little likelihood of their being able to meet the commencement date of 1 July 2017 we submit that consideration may need to be given to the possibility of either

- deferring the commencement of the TRIS measure until 1 July 2018; or
- adopting an alternate approach to TRIS.

Two possible alternatives approaches to the TRIS changes that could be considered could be that

- the 15% tax offset for income paid to the member from a TRIS could be reduced for those members under 60. This change is significantly simpler for funds and would dramatically decrease implementation costs.
- the measure could be applied prospectively. This would enable funds to close their existing TRIS product to new members and either to
    - not offer a new TRIS to members after 1 July 2017 or,
    - offer a new TRIS from a later date, once the system has been developed.

1.1.2. Introduction of the Transfer Balance Cap measure

Implementation of the transfer balance cap is dependent on the development and delivery of ATO mechanisms/services.

The ATO and the superannuation industry are designing and building a new service - the Member Information Exchange (MIX) service – that would be ideal to support the implementation of the transfer balance cap. The MIX, however, is not scheduled to be completed until the end of 2017.

If the 1 July 2017 commencement date is adhered to this will require the ATO and the superannuation industry to design and build interim solutions, which introduces additional risk and unnecessary cost for both the ATO and industry.

Funds are concerned that, if there are reporting delays by funds (especially in circumstances where a member has multiple pension accounts or where a fund has difficulty segregating the assets and calculating the earnings tax), a member will be unfairly penalised through an unintended breach of the new requirements. Accordingly our recommendation is to provide a transitional period for members and funds by providing a 12 month amnesty on the proposed penalty provisions, including the excess balance transfer tax (on the notional earnings on the excess amount). This will allow members and the industry an adequate period during which to transition to the new regime and for system development to be completed.

1.2. Defined benefit fund issues

Defined benefit funds have a number of specific implementation issues that will need to be addressed. We would strongly support the establishment of a defined benefit working group as a matter of urgency to progress these issues and would welcome the opportunity to work with Treasury and the ATO to help resolve them.

2. <u>Observations about specific provisions of the legislation</u>

2.1. Transfer Balance Cap

2.1.1. Commutation authorities

ASFA welcomes the changes from the Exposure Draft legislation, where members now have 60 days to make an election to commute or object and six months to rectify where the excess transfer balance is less than $100,000 and is caused by an existing income stream as at 1 July 2017.

Funds have, however, expressed concern that, irrespective of when the commutation authority is not complied with, the Bill deems the income stream not to be in the retirement phase from the beginning of the financial year. This is inconsistent with the tax treatment of the excess transfer balance, where notional earnings only begin accruing from the day the member has exceeded their transfer balance cap.

2.1.2. Defined benefit funds

2.1.2.1. Valuing all DB pensions at 16 times the annual payment amount

Valuing all Defined Benefit (DB) pensions at 16 times the annual payment amount is simply inequitable for those in receipt of a DB pension at 30 June 2017 who are of an advanced age.

By way of example, where a member in receipt of a pension is 80 years of age, life expectancy tables would value the DB pension at approximately 7 times the annual payment. Valuing the DB pension at 16 times the annual pension amount is inconsistent with how an account based pension will be valued. For example, where a member aged 80 commenced an account based pension with $1.6 million ten years ago, the value of the account based pension would have diminished significantly during that period, and only the diminished value would count towards the cap as at 30 June 2017.

In trying to achieve simplicity, valuing DB pensions at 16 times the annual payment amount has produced a manifestly inequitable outcome between members of different ages - the notional value of a DB pension at, say, age 65 is significantly more than the notional value of the same DB pension at age 75 or 85.

One possibility may be to value the DB pension utilising the same method as is used in the tax component proportioning rules. Alternatively, a specific sliding scale of different valuation factors, with respect to different ages, could be established.

2.1.2.2. Uncertainty as to how DB pensions commencing before 60 are to be treated

It is unclear how DB pensions that commence before age 60 are to be treated. The provisions in the Bill which are with respect to the alternative treatment of DB pensions simply refer to sections in the tax act with respect to pensions where the recipient (or primary beneficiary with reversionary pensions) is over the age of 60. A DB pension of the same value commencing before age 60 would be valued higher than one commencing at age 60 but it appears as though there is no effect on these pensions and they are able to remain in the retirement phase, with the benefit tax remaining the same as it is now (marginal rates less 15% tax offset).

2.1.3. Indexation

In ASFA's view indexation of the cap should be linked to AWOTE as opposed to CPI, in line with like all other superannuation thresholds. This reflects increases in the standard of living, as opposed to merely keeping pace with inflation.

2.2. CGT Cost base relief (for TRIS & Transfer Balance Cap)

ASFA welcomes the permanent reset of the Capital Gains Tax cost basis, as this will serve to ensure that there is no detrimental market effect on members who will need to have part of their account balance switched to cash prior to it being transferred back to accumulation.

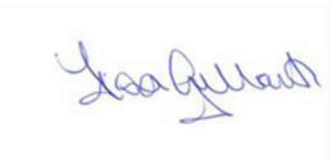
2.3. Administration

We support the plans to streamline and automate the release authority processes and would welcome the opportunity to participate in any consultation with respect to this measure.

*****

Should you have any queries with respect to this submission, please do not hesitate to contact me on (03) 9225 – 4021, 0431 490 240 or via fgalbraith@superannuation.asn.au.

Yours faithfully



Fiona Galbraith
Director, Policy