Pre-Budget Submission for the 2013-14 Budget

FEBRUARY 2013

The Association of Superannuation Funds of Australia Limited

Supporting document

Supporting information and analysis on this submission can be found on the ASFA website:
www.superannuation.asn.au/policy/submissions

Contacts

For enquiries on this submission, please contact Ross Clare, Director, Research and Resource Centre: 02 8079 0809
For media enquiries, please contact Pauline Vamos, CEO: 0433 169 342

About ASFA

ASFA is the peak policy, research and advocacy body for Australia's superannuation industry. It is a not-for-profit, sector-neutral, and non-party political national organisation whose aim is to advance effective retirement outcomes for members of funds through research, advocacy and the development of policy and industry best practice.

ASFA's focus is on whole of system issues and its core strategies are aimed at encouraging industry best practice, advocating for a system that plays a productive role in the Australian economy and ensuring the industry delivers on its primary purpose of delivering decent retirement incomes.

Our membership – which includes superannuation funds from the corporate, industry, retail and public sectors, and, through its service provider membership, self-managed and small APRA funds – represents over 90 per cent of Australians with superannuation.

$1.5tn

Total value of super funds

$117.5bn

Annual contribution to super funds 2011-2012

$70bn

Benefit payments made from super 2011-2012

$8.05bn

Forecast direct tax collections from super funds 2012-2013 (Treasury)

$9.05bn

Forecast direct tax collections from super funds 2013-2014 (Treasury)

At $1.5 trillion the Australian superannuation industry is worth more than the national gross domestic product (GDP).

Superannuation has the power to drive economic growth. Through its diversified investment there is enormous benefit to the nation from professionally managed funds which are allocated to productive activities in the economy. GDP will be over two per cent higher than it would otherwise be due to the combined impact of current contributions at nine per cent of wages and the prospective increase to 12 per cent.

The strengths of the Australian superannuation system are that it is:

SUSTAINABLE	in that the respective burdens on governments, employers and individuals are manageable both now and in the future.
COMPREHENSIVE	with near universal coverage of employees and substantial coverage of the self-employed.
BROADLY EQUITABLE	in that when all the elements of the system are looked at together, the amount of government assistance is broadly comparable across the income distribution. Reductions in contribution caps, the introduction of tax rebates for low-income earners and increases in the rate of the Age Pension, particularly for single persons, have substantially improved the equity of government assistance for retirement incomes.
STRENGTHENING THE FINANCIAL SYSTEM	in that assets in the super system are invested in the real economy rather in notional securities issued by a central government.
AN ASSET-BUILDING MECHANISM	for the great bulk of Australians, particularly assisting and empowering lower income individuals.

The Australian superannuation system is not without its shortcomings. Among other things, it is:

- Too complex, particularly in regard to the taxation of contributions and fund earnings.
- Not yet mature enough to deliver for most individuals and couples a comfortable standard of living in retirement.
- Providing more than enough tax assistance for a relatively few high account balance holders while some lower account balance holders arguably deserve more assistance.
- Not set up to deal well with the financial consequences of longevity for the large majority of members who are in defined contribution schemes.

Constant adjustments reduce consumer confidence in superannuation

Successive Commonwealth Government Budgets have made changes to superannuation and consequently raised an aggregate of $8.3 billion in revenue directly and indirectly on top of the substantial amounts already being collected, over the various forward estimate periods since 2009-2010.

Among other measures, significant sources of this additional revenue have been:

- tighter caps on concessional contributions; and
- changes to the Government co-contribution scheme.

Some core features of the superannuation system should not be touched

The core features and characteristics of the system should be maintained:

- Compulsory contributions should continue, including the phased increase to the eventual rate of 12 per cent.
- Superannuation contributions and fund earnings should continue to be concessionally taxed.
- There should be encouragement to take income streams in retirement with the system increasingly focused on the provision of income streams rather than lump sums.
- Tax and regulatory settings should support arrangements, such as deferred annuities, which provide protection for the financial consequences of longevity.
- Frequent changes to tax arrangements should be avoided as they undermine confidence in superannuation and will depress voluntary contributions.

Superannuation must do its job for the economy

Given its size and potential impact on the national economy, the superannuation industry must deliver economic growth in order for governments to continue to support tax concessions.

With this in mind, ASFA has considered a number of options for changes to superannuation policy settings which are designed to:

- improve the equity of government assistance to superannuation;
- increase incentives to take out income streams in retirement and to make provision for the financial consequences of longevity;
- involve the least harm to incentives to save for retirement; and
- generate budget savings.

Superannuation must play its role for the Australian economy

The reality is that government and the community must be able to see a clear benefit to the economy from the tax concessions afforded to superannuation as part of the retirement incomes policy.

Specific recommendations for the 2013-14 Budget

1 ASFA calls for a parliamentary inquiry into the mobility of tax efficient investments

ASFA reiterates its call for a parliamentary inquiry into tax efficient investments, first called for in May 2012.

There needs to be a holistic review of taxation investment incentives in order to ensure the behavioural changes that inevitably result from any changes to taxation settings don't deliver unintended consequences which would negate in whole or part, the forecast increases to government revenues and/or impact adversely on markets and the economy.

Any move away from superannuation investing would mean a move away from a diversified investment approach in a highly regulated environment. Superannuation is an efficient allocator of capital to productive needs in the economy.

Superannuation is not about short-term collections of tax, it's about addressing a long-term, demographic time bomb.

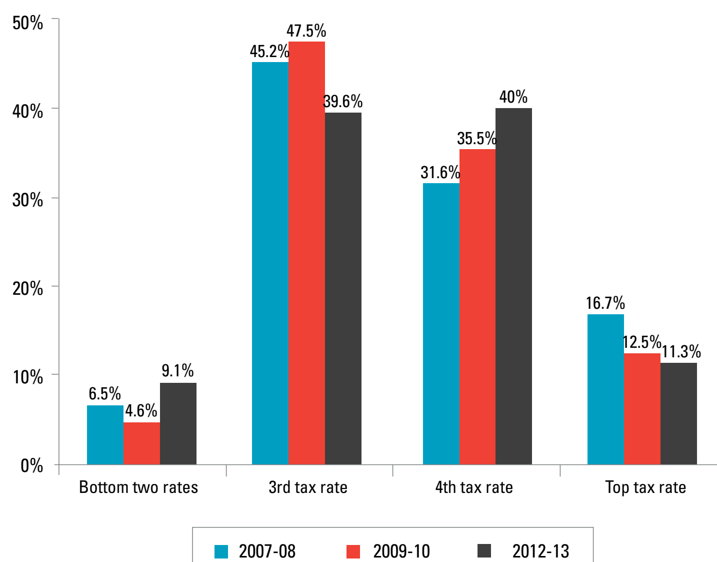
---

2 Improve the equity of tax concessions for superannuation

The equity challenge

Much of the public debate about equity in the superannuation system has focused on the top one or five per cent of income earners. In reality, nearly 90 per cent of the tax concessions for superannuation flow to individuals on less than the top marginal tax rate. The share of total concessions flowing to individuals on the top marginal tax rate was around 50 per cent in 2007-2008 with the reduction in the share since then due to the introduction of contribution caps, higher rates of tax on the contributions of certain upper income earners and the introduction of the tax rebate related to the contributions of lower income earners. The increase to the Age Pension following the Harmer Review has also increased the equity of the overall retirement system.

Chart 1 – Treasury estimates of contribution tax concession shares by tax bracket



Treasury estimates of the tax assistance given to the top one per cent and five per cent of taxpayers

There are two serious conceptual shortcomings in the Treasury analysis.

1. The tax concession estimate is calculated on the basis that investment earnings outside of superannuation would be taxed like interest from a bank account. The reality is that investment earnings outside of superannuation attract various concessions, including a 50 per cent discount on capital gains on assets held for more than 12 months. As a result the Treasury figures overestimate the tax concession that flows from the concessional treatment of investment earnings within a superannuation fund.
2. The more serious conceptual problem is that the Treasury analysis assumes that it is the same one or five per cent that stays at the top of the income distribution for a 37-year period from age 30 to 67. This is unrealistic and misleading.

The low-income tax rebate should be maintained

ASFA strongly supports the provision of tax concessions for superannuation. In particular, the low-income tax rebate should not be changed.

Superannuation for retirement income, not wealth management

ASFA supports the capping of concessional tax treatment of superannuation consistent with what might be reasonably needed for retirement income purposes, including what is needed to cope with future investment return uncertainty and with the financial consequences of longevity.

Superannuation tax concessions should not extend to account balances which are being primarily used for estate planning. There is nothing wrong in itself with having a high superannuation account balance or other form of wealth; the relevant issue is whether such an account balance or wealth should attract a continuing tax concession.

$56,339

Minimum yearly income required by a couple for a comfortable standard of living.

ASFA Retirement Standard, December quarter 2012

For a person aged 65 to 74 taking the minimum drawdown from their account-based income stream, that would require $1.13 million in their account balance.

While the ASFA Retirement Standard sets a reasonable base for retirement planning for many individuals, it is also reasonable for individuals on incomes during their working years which are above average weekly earnings to have a higher standard of living in retirement than what is implied by expenditure of $56,339 a year.

A replacement rate in retirement that is commonly used as a measure of adequacy is 60 per cent of gross pre-retirement income. For a person on $200,000 a year, a reasonable upper income limit for the provision of taxation concessions or other government assistance, a drawdown in retirement of $120,000 is implied.

Again using the minimum drawdown factor for a person aged 65 to 74, this would require a superannuation balance of $2.4 million.

There has been recent media speculation that the Government has been considering additional taxation for individuals with superannuation account balances exceeding $1 million. The above analysis indicates that such a figure would be too low.

Other objective indicators that such a figure is too low include the following:

- The Age Pension asset test allows a couple to access at least a part-Age Pension if they are homeowners and have assets of $1.05 million. For a couple who are not home owners and are separated due to illness, the figure is higher still at $1.443 million. It would be very strange to tax more persons receiving a part-Age Pension on the basis that they are too rich.
- The now abolished reasonable benefit limits (RBLs) provided some indication of the amount of benefits regarded as deserving tax concessions. Indexation of the pension RBL would lead to a figure of $1.75 million in 2012-13. The RBL figure does not include non-concessional contributions, which form a significant part of most larger superannuation account balances.
- The cap on concessionally taxed benefits from an untaxed plan is $1.255 million in 2012-13.

If there were to be a cap on superannuation individual entitlements attracting tax concessions, then ASFA considers the figure should be in the order of **$2.5 million** and be indexed to average weekly ordinary time earnings (AWOTE) to reflect future increases in community and retirement living standards. The Age Pension is also in effect indexed to AWOTE over the longer term.

3 Move to an income-oriented system

The imminent retirement of baby boomers means that there is an urgent requirement for Government to address the structure of retirement income products. Over the next decade Australia's 4.4 million baby boomers will make financial decisions either in preparation for, or in execution of a retirement strategy.

The key risk with longevity is that members will spend all their financial wealth including superannuation before they die. Members often underestimate how long they will live and are largely oblivious to the impact of future improvements in longevity.

The rapid extension of life expectancy

Table 1 – Life expectancy at age 65

Year	Male	Female
1901–10	11.3	12.9
1920–22	12.0	13.6
1946–48	12.3	14.4
1960–62	12.5	15.7
1980–82	13.8	18.0
2000–02	17.4	20.8
2011	21	24
2031	24	26
2051	26	28

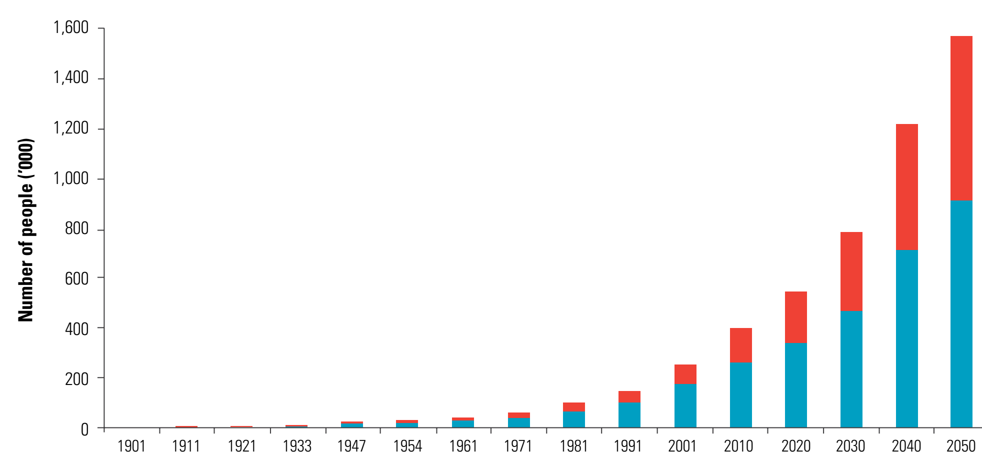
When considering the retirement needs of younger people, it is important to note that the vast majority will survive to retirement and most will then have an increasingly longer life in retirement.

Table 2 – Percentage of 20-year olds who reach 65

Year	Male	Female
1901	57.6%	65.1%
2012	89.6%	93.7%

One of the consequences of improving mortality is that the number of very old retirees, who are predominantly frail, is growing considerably. This cohort has special needs, particularly around aged care.

Chart 2 – The over 85s



The table below shows the longevity for males, females and couples. It shows that there is a 50 per cent chance that one member of a couple (usually the female) will live to age 95.

Table 3 – Age of survival for 65 year olds

% surviving	Females	Males	Joint-life
90	76.1	72.9	85.9
80	81.7	78.1	88.4
70	85.2	81.7	90.2
60	87.9	84.6	92.4
50	90.1	87.1	94.8
40	92.1	89.4	95.2
30	94.2	81.7	97.5
20	96.4	94.2	99.5
10	99.5	97.7	102.7

4 Remove impediments to the development of post-retirement products

ASFA considers that there are a number of impediments, including taxation and regulatory provisions, that are preventing the financial services industry from developing products that can better serve the diverse retirement needs of Australians.

There are seven key recommendations for legislative and other changes which would remove current substantial impediments to the development of financial products, providing individuals with better protection against the financial consequences of longevity:

1. The *Superannuation Industry (Supervision) Regulations 1994* (SIS regulations) be amended to:
   - Provide equivalent treatment of post-retirement products offered by life insurance companies and by superannuation funds, preferably through development of regulations which apply to both.
   - Set out general required characteristics for longevity products rather than mirror the specific characteristics of existing products in the market.
   - Allow products which provide a deferred benefit past normal retirement age to be offered.
2. The APRA prudential standard applying to minimum surrender values of pension and annuity products be amended to reflect the special characteristics of such products.
3. The means test applied by Centrelink should be amended to exempt deferred annuities from both the asset and income tests during the period prior to payment.
4. A new administrative arrangement be put in place so that the ATO, APRA, ASIC and Centrelink undertake the assessment of new post-retirement products on a consistent and co-ordinated basis.
5. The scaled advice operating guidelines to be developed by ASIC allow for funds to provide members with limited advice relating to retirement products.
6. Legislative amendments should be made to provide tax treatment for deferred annuities and other products which are comparable to that provided for existing post-retirement products. Specifically:
   - there should be clarification that benefits from deferred lifetime annuities and other longevity products purchased with superannuation monies are tax free when received at age 60 and over; and
   - the investment earnings supporting deferred annuities and other longevity products should be tax free within the superannuation fund or life company.
7. Trustees of a self-managed superannuation fund (SMSF) should be permitted to purchase deferred annuities and like products on behalf of a member of the SMSF.

The cost to the Budget of the recommendations is negligible in that in the absence of the new longevity products being available, retirement savings will continue to be directed to account-based income streams which have tax free investment earnings and benefit payments, which are also tax free for those aged 60 and over.

5 Funding for a Superannuation Consumer Council

Existing bodies such as ASIC, ACTU and ASFA advocate consumer policy with respect to superannuation. There is extensive consumer research carried out and consumer advisory services are available.

In the Government's 2012 Mid-year Economic and Fiscal Outlook (MYEFO) statement they committed to provide $10 million over three years as a contribution to a non-government investment fund, the earnings of which will be used to fund the ongoing costs of a new Superannuation Consumer Centre (SCC).

The Government stated that its contribution would be contingent on matching funds being provided by the industry.

ASFA has consulted with senior executives across the superannuation industry about a proposed model that is being advocated by consumer representatives. The industry has provided feedback that it is concerned the proposed SCC model would be funded by pooled members' money but would focus on addressing the range of consumer issues emerging from the SMSF sector. While APRA-regulated funds contribute directly and indirectly to the oversight of this sector, there is concern about the use of pooled members' money for such a purpose. APRA-regulated funds already contribute significant resources to consumer education. The industry was concerned that the proposed SCC model did not recognise the existing work done by funds, as well as other bodies such as ASIC and NICRI. Pooled fund members already bear the burden of the Trio levy (twice), the SuperStream levy, the increase in the general industry supervisory levy and *Stronger Super* implementation costs.

ASFA is proposing that the Government fund an independent Superannuation Consumer Council that would consist of representatives from the superannuation industry, Treasury, regulatory bodies, consumer representatives and academia.

There is the potential that such a council would be able to collaborate in a range of ways to produce better outcomes for superannuation fund members. Examples of potential areas of collaboration include:

- Producing academic research that is focused on consumer needs. There is a dearth of academic research in respect to superannuation fund members aged over 60. In particular ASFA is supporting the Monash University – CSIRO Superannuation Research Alliance which aims to address this gap. CSIRO is currently in the process of tendering for a superannuation research cluster that could be linked in to the work of a Superannuation Consumer Council.
- Sharing best practice around consumer initiatives. A Superannuation Consumer Council could collaborate with existing superannuation consumer initiatives including ASFA's Super Guru and ASIC's MoneySmart Week.
- Establishing programs with an aim of delivering real consumer outcomes. One example could be to establish an Indigenous superannuation program to build financial capability among Indigenous communities.

ASFA is confident that over time a Superannuation Consumer Council would receive significant financial support from the industry that would ensure it would not require ongoing funding.

It is recommended that the Government provide funding of $1 million in 2012-13 and $1 million in 2013-14. This would be a saving of $8 million over the forward estimates.

Principles that should be adopted in assessing tax changes to superannuation

Taxation is a key driver of superannuation policy. In setting a superannuation tax policy ASFA considers that the Government should have regard to the importance of encouraging private provision to ensure Australians can retire with dignity and retirees can contribute towards the country's future economic prosperity.

However ASFA does support the capping of superannuation tax benefits and concessions and supports the Government providing equitable treatment of taxation of superannuation contributions, investment earnings and benefits.

In considering any changes to the taxation and regulation of superannuation ASFA considers that the following high-level principles should apply.

A focus should be on improving adequacy of retirement incomes, particularly for low and middle-income earners:

- The goal should be for Australians to achieve a comfortable standard of living in retirement as specified in the ASFA Retirement Standard or at the very least exceed the modest standard of living as specified in the Standard.
- Contribution caps should reflect the diversity of life experiences of Australians, including the need for many mature age workers to catch up on superannuation contributions.

The system should be cost effective to administer:

- Tax provisions should be simple to understand by consumers so that costly taxation and financial planning advice is not necessary.
- Particularly important in regard to implementation of any changes should be the recognition by the Government that there are three types of superannuation arrangements, namely defined benefit (DB) funds, pooled superannuation funds, and self-managed superannuation funds (SMSFs). Each of these arrangements is impacted differently by changes in policy settings and the implications of this must be considered before any changes are made.
- The design of measures should take into account the administrative burden on funds given that the costs of administration directly impact on members' retirement savings.
- Any changes should take into account the considerable system changes already underway in the ATO. Although the ATO has information on super fund members' income and super account balances, helped in particular by new reporting requirements implemented in 2012, it does not have knowledge of members' investment earnings.

Opportunities for regulatory and tax arbitrage should be avoided:

- The tax treatment of saving for retirement through superannuation should not be made less favourable than, say, negative gearing or other tax-preferred forms of saving outside of superannuation.
- Increasing taxation on superannuation would drive changes in investment behaviour. For example, changing superannuation tax concessions would lead to higher income investors elsewhere, including negative gearing of property and other investments. This would have the potential to create a bubble in property prices. There would also likely be a detrimental effect on equity markets and in the ability of Australian firms to access financing if significant amounts were switched into other investments.
- Investments available outside superannuation should also generally be available within the superannuation environment.

The system of tax concessions should be sustainable:

- The focus should not just be on the forward estimates period.
- The impact of changes to superannuation on Government expenditure on the Age Pension and the like should be taken into account.
- Leakages to other tax-preferred investments should also be considered.

The Association of Superannuation Funds of Australia Limited

Level 6, 66 Clarence Street, Sydney NSW 2000
PO Box 1485, Sydney NSW 2001
T 02 9264 9300 or 1800 812 798 (outside Sydney)
F 1300 926 484
W www.superannuation.asn.au
ABN 29 002 786 290 ACN 002 786 290