ASFA Pre-Budget Submission for the 2021-22 Budget

February 2021

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 $2.9 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 16 million Australians with superannuation.

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Overview

The Association of Superannuation Funds of Australia (ASFA) Pre-Budget Submission focuses on the findings of the Retirement Income Review, which found Australia's retirement income system is effective, sound and its costs are broadly sustainable leaving it well-placed to deal with economic volatility and the challenge of an ageing society.

The Retirement Income Review (RIR) confirms that Australia's superannuation system is on track to deliver on its promise to allow Australians to face retirement with confidence. The RIR highlighted the role superannuation has played in keeping the burden of the Age Pension below 2.5 per cent of GDP (half the cost borne by our nearest OECD counterparts), allowing the Age Pension to be kept for those that need it most.

While ASFA agrees with a number of conclusions made by the RIR, we strongly disagree with the Review's views on the importance of increasing the Superannuation Guarantee (SG) to 12 per cent.

ASFA research has found that 75 per cent of Australians support the legislated phased increase to a 12 per cent SG. The initial increase to 10 per cent is a cost to business of less than one dollar a day for the average worker.

For many Australians the increase to 12 per cent SG is essential to offset the financial loss from super withdrawn under the COVID-19 early release scheme, which has impacted on younger and lower income Australians in particular. ASFA considers the legislated change in SG needs to go ahead as scheduled on 1 July 2021 with full implementation by 1 July 2025.

The RIR made a number of observations about the fairness of current tax concessions for superannuation and the amount of support provided to higher-income earners. The impact of earnings tax concessions means higher income earners receive more lifetime Government support in dollar terms than lower and middle income earners. Superannuation tax concessions in the retirement phase also represent a much higher proportion of lifetime tax concessions for higher income earners than middle income earners, particularly when large account balances are involved. However, the RIR also noted that the Age Pension has a significant role in reducing inequality in retirement incomes.

While the superannuation system is well-designed and working for the majority of Australians, ASFA acknowledges that there is merit in addressing a number of the concerns highlighted in the RIR about fairness in the system in regard to individuals with high incomes and/or relatively high account balances.

In addition, it is crucial to ensure that superannuation is delivering for low to middle income earners. In that context, recent changes to tax rates have created an unintended distortion where low-income earners between $37,000 and $45,000 pay a similar tax rate on superannuation contributions to the marginal tax they pay on wages. ASFA considers that it is important that such persons are not penalised for contributing to their retirement. ASFA accordingly recommends that the low-income superannuation tax offset should apply to individuals with taxable income of up to $45,000.

However, ASFA acknowledges that there is a fiscal impact from this crucial change and changes to equity in the system should not go only one way. There are equity grounds, identified by the RIR, for adjusting settings applicable to those with higher incomes and/or high account balances. In this regard, ASFA considers that equity across the system can be improved through a modest reduction in the Division 293 threshold from $250,000, removing indexation of the transfer balance cap and removing balances above $5 million from the concessionally taxed superannuation system.

Superannuation is about ensuring people are comfortable in retirement, it is not about facilitating excessive wealth transfers.

ASFA supports action to ensure a viable post-retirement framework that addresses longevity risks, is affordable and is used by those who need it. ASFA also considers that coverage for compulsory superannuation should be expanded to include gig economy workers and that in addition superannuation should be paid at the same time as wages given it is a worker entitlement and the presence of single touch payroll.

1 Assisting low-income earners contributing to their retirement

The low-income superannuation tax offset (LISTO) is designed to ensure that low-income earners are equitably treated and do not pay more tax in superannuation than if they had derived that income directly.

The current policy settings provide a LISTO up to $500 to members with adjustable taxable income of up to $37,000. This offset is calculated by the Australian Taxation Office (ATO) and is paid into the superannuation accounts of those who are eligible. The capped $500 amount is just below the tax paid on compulsory superannuation contributions (at 9.5 per cent) for a person on $37,000 a year.

The second tax bracket had its upper threshold increased to $45,000 from $37,000 for the financial year 2020-21 and beyond. In order for the tax concession for superannuation contributions made by all persons on the 19 cents in the dollar marginal rate to be maintained there should also be an increase in the upper threshold for the LISTO.

If the upper threshold for LISTO was increased as proposed, a member on $45,000 with a concessional contribution of $4,500 (10 per cent of $45,000) would be eligible for a LISTO of 15 per cent of $4,500 = $675.

RECOMMENDATION 1:

ASFA recommends the LISTO threshold be raised from $37,000 to $45,000 (being the threshold for the second tax bracket in 2020-21 and onwards) and that the LISTO cap be increased in order to offset any tax paid on compulsory superannuation contributions.

2

Improving equity by reducing the tax and Age Pension assistance for high-income earners and/or those with substantial assets

Reducing the tax concession for contributions made by high-income earners

The RIR Report observed that high-income earners enjoy a greater share of the tax concession in relation to concessional contributions.

Because tax on concessional contributions is levied on the superannuation fund at a flat rate of 15 per cent, those members on higher marginal tax rates enjoy a greater tax concession than those members on lower marginal tax rates.

Division 293 tax is an additional 15 per cent tax on concessional contributions that effectively reduces the tax concession on contributions for high income earners. The current threshold for the application of Division 293 tax is $250,000. When the measure was first introduced the threshold was $300,000.

ASFA is proposing that the tax concession for superannuation contributions accruing to high-income earners be decreased by lowering the threshold for imposition of the Division 293 tax by a modest amount.

The top marginal rate currently applies to taxable incomes of $180,000 or more. However, the base for Division 293 tax is adjusted taxable income (including, for example, the taxable value of some fringe benefits) plus concessional superannuation contributions. Given this, it is considered appropriate to set an imposition threshold somewhat above the threshold for the top tax bracket to allow for superannuation contributions and a modest amount of fringe benefits.

Reducing this threshold will mean that most high-income earners, that is, those on the top marginal income tax rate, will receive a tax concession in relation to concessional contributions of only 15 per cent rather than 30 per cent.

Increasing the number of superannuation fund members subject to the tax will involve a modest increase in the administration burden for funds, however there are well-established systems and processes for the assessment of liability by the ATO and payment by funds. Research commissioned by the RIR indicated that imposition of the Division 293 tax has had little impact on the amount saved for retirement.

RECOMMENDATION 2:

ASFA recommends that the threshold for imposition of the additional Division 293 tax on contributions could be reduced by a modest amount from the current $250,000.

Reducing the earnings tax concessions on very large balances

One of the concerns in relation to the sustainability of tax concessions within superannuation is the tax concession enjoyed in relation to investment earnings for high-balance members. This tax concession can be substantial for large accounts. The RIR Report observed that there are at least 11,000 superannuation fund members with balances within superannuation of over $5 million.

While the current caps on superannuation contributions limit the ability for members to build up excessive balances in the future there is a real question regarding the appropriate treatment of high balances that were achieved in the context of more generous contribution caps in the past.

The transfer balance cap regime limits the amount a member may take into pension phase. However, 'excessive' balances may still be present in accumulation accounts and therefore subject to a tax concession of up to 30 per cent of the tax on earnings (that is, 45 per cent personal tax rate less 15 per cent tax on fund earnings).

A balance of $5 million in concessionally taxed superannuation cannot reasonably be justified as necessary to support a comfortable lifestyle in retirement.

Consideration would need to be given to what arrangements, if any, would need to be in place to deal with defined benefit interests. However, there would be few if any defined benefit interests which would have a capital value in excess of $5 million.

ASFA proposes that those superannuation fund members aged 65 or over with total super balances exceeding $5 million on 1 July 2022 would be required to withdraw the excess from superannuation. Going forward, the withdrawal requirement would be applied to a member's excess balance as they reach age 65.

The need to remove excess balances from superannuation may have liquidity implications for some small funds with large, illiquid assets such as property. These impacts would be mitigated by having a start date for the measure of 1 July 2022 and allowing, as a transitional measure, excess balances to be retained within affected self-managed or small APRA funds but subject to tax on the earnings at the top marginal rate.

RECOMMENDATION 3:

ASFA recommends that those members aged 65 or older with a total superannuation balance as at 1 July 2022 in excess of $5 million, whether in accumulation, pension phase or a combination, could be required to withdraw the excess out of superannuation.

Superannuation tax compliance: Removal of indexation of the transfer balance cap

The RIR Report raised concerns over equity of the system, while ASFA considers that wholesale changes to the system are unwarranted, we consider that there is an opportunity for modest changes to ensure the system remains fair and efficient.

In this regard, the transfer balance cap (TBC) is due to be indexed for the first time with effect from 1 July 2021, increasing from $1.6 million to $1.7 million. When that occurs, there will not be a single TBC that applies to all individuals — every individual will have their own personal TBC of between $1.6 and $1.7 million, depending on their circumstances. This will be confusing for fund members and will raise a number of issues in how the change is communicated to members and administered.

The TBC is a limit on the total amount of superannuation that can be transferred into the retirement phase. It was introduced with effect from 1 July 2017 at $1.6 million, with indexation tied to movements in the Consumer Price Index (CPI).

Given the complexity of having multiple TBCs and to ensure the system remains equitable, indexation of the cap could be removed.

This decision could be reviewed after the SG has reached 12 per cent in 2025.

RECOMMENDATION 4:

ASFA recommends that indexation of the transfer balance cap could be removed to reduce complexity and maintain equity in the system.

3 Defining success and establishing a post-Retirement framework

Policy settings for the post-retirement phase are crucial to the achievement of good retirement incomes for Australians.

Legislate an objective for the retirement income system

The retirement income system lacks an agreed objective. ASFA agrees with the observation in the RIR Report that:

> *"an agreed objective is needed to anchor the direction of policy settings, help ensure the purpose of the system is understood, and provide a framework for assessing the performance of the system".*[1]

In this regard, ASFA has long supported a legislated objective for superannuation.[2]

A formal objective for the retirement income system would provide an anchor for future retirement incomes policy. As the system matures and the pool of private savings grows, future governments should be discouraged from trading away retirement objectives to achieve unrelated policy goals. An objective would help protect against this and give Australians confidence that their retirement savings are safe from such erosion now and into the future.

If policy makers act consistently with an appropriate objective for superannuation many more Australians will have an adequate income that meets their needs, both expected and unexpected, throughout retirement. This will minimise the number of retirees living in poverty or relative poverty, and maximise the number living in comfort and with dignity.

ASFA considers that the retirement income system should be framed by a formal objective that reflects the core purpose of the system in providing adequate retirement outcomes for all Australians. The Australian community deserves to be financially confident in retirement. Achieving a comfortable standard of living in retirement is the aspiration of all Australians, and the objective for the retirement income system should reflect that aspiration. The objective needs to enshrine an enduring commitment to the achievement of retirement outcomes that meet community expectations.

1 The Australian Government the Treasury 2020, *Retirement Income Review*.

2 For more details on ASFA's position see the ASFA submission on the *Superannuation (Objective) Bill 2016*. www.superannuation.asn.au/ArticleDocuments/278/161223_ASFASubmission_ObjectiveofSuperannuation_SenateEconomicsCommittee.pdf.aspx?Embed=Y

That said, ASFA agrees that a single primary objective cannot possibly encompass all aspects of the purpose and attributes of the retirement income system, and superannuation policy decisions should be required to meet the primary objective and fit within the terms of the subsidiary objectives. To effectively achieve this, subsidiary objectives should be incorporated in the legislation.

RECOMMENDATION 5:

ASFA recommends that the Government recognise in legislation that the primary objective of the retirement income system is to provide an adequate lifetime income to ensure all Australians achieve a comfortable standard of living in retirement, where superannuation and other private savings supplement or substitute the Age Pension.

Legislate a principles-based Retirement Income Covenant

The retirement income system needs to support consumers by providing suitable retirement income options that enable retirees to optimally consume their retirement savings. To this end, ASFA considers that fund trustees should develop a retirement income strategy and framework for their fund.

In this context, ASFA supports a principles-based Retirement Income Covenant.

The Retirement Income Covenant should provide principles for trustees in developing their retirement income framework. A principles-based approach rather than prescriptive approach would be in line with the existing covenants in the *Superannuation Industry (Supervision) Act 1993* (SIS Act).

In this regard, the Retirement Income Covenant should:

- provide fund trustees with impetus to develop a retirement income framework and approach
- reflect that the fundamental purpose of superannuation is to provide income in retirement
- be 'product neutral'
- encourage fund trustees to support their members to develop a personal retirement income strategy suited to their circumstances, needs and objectives that:
    - may include the acquisition of one or more products with a longevity component
    - provides members with comfort to optimally consume their retirement savings.

With respect to this latter point, the Retirement Income Covenant should recognise that members are heterogeneous with respect to their particular income/consumption preferences, and that aside from income in retirement, the optimal consumption of retirement savings for an individual may involve access to an appropriate amount of capital for contingencies, and a residual benefit at death. Many retirees have a spouse or other financial dependant.

There should be a transition period prior to the covenant coming into effect. For any fund trustee, developing a retirement income framework and strategy would be an iterative process, culminating in review and approval by the trustee board. Collectively this process would be expected to take at least 12 months to work through and complete.

RECOMMENDATION 6:

ASFA recommends that a Retirement Income Covenant be inserted into the *Superannuation Industry (Supervision) Act 1993* (SIS Act) which provides principles for trustees in developing their retirement income framework.

Helping members to optimise their consumption of retirement savings

Not all people consume their retirement savings in a manner that optimises their retirement outcomes. The RIR Report notes that there has been insufficient attention on assisting people to optimise their income in retirement.

The development and provision of retirement solutions to help members feel confident to optimise their retirement outcomes would help Australia's future retirees enjoy a higher standard of living in retirement than would otherwise be the case.

Helping members feel confident to optimise their retirement outcomes would involve a combination of further innovation of retirement income solutions and provision of information to members to improve their understanding of potential retirement income 'pathways' with respect to particular retirement income solutions.

This would recognise that members are heterogeneous with respect to their particular income and consumption preferences. As well, as noted above, retirees may also value access to an appropriate amount of capital for contingencies, and value a residual benefit at death.

ASFA supports further innovation to develop and make available a wider range of retirement income solutions to fund members. The key challenge is the development and provision of retirement solutions that better meet the retirement outcome needs of individual members. In particular, retirement solutions need to take better account of individual members' circumstances and preferences, the risks that individual members face, and individual members' (sometimes competing) retirement goals – all of which can change over time.

Innovation would be aided by the introduction of safe harbour legislation, alongside the Retirement Income Covenant, to enable trustees and product providers to more actively support and guide members regarding the range of retirement income strategies available.

In addition, having a successor fund transfer regime that operates effectively for all forms of retirement income strategies would help address the risk that a larger number of members' become "stuck" in unsustainable or legacy structures over time.

To improve member engagement with, and understanding of their retirement phase, funds could develop and make available a small number of cameo-style retirement-phase 'pathways'.

Separate cameos would involve differing retirement income strategies – such as combinations of products that may include a longevity component. Ideally, a fund's cameos would relate to retirement income strategies offered by the fund. Cameos would be designed to maximise consumer comprehension – including visual representations of income streams over time.

The general framework for the cameos would be developed together by industry and the regulator.

RECOMMENDATION 7:

ASFA recommends that the Government encourage ongoing innovation of retirement income solutions by:

- introducing safe harbour legislation alongside the Retirement Income Covenant
- extending the successor fund transfer regime that operates for accumulation products to all forms of retirement income strategies.

4 Extending the coverage of compulsory superannuation and ensuring that people's superannuation entitlements are paid with wages

SG and the self-employed

The self-employed generally are not covered by the Superannuation Guarantee (SG) regime, which has led to a disparity in retirement outcomes between the self-employed and wage and salary earners.

On average, self-employed people have lower superannuation balances than wage and salary earners across the entire age distribution. Around 20 per cent of self-employed people have no superannuation, and the self-employed typically have lower superannuation balances than employees. While business assets can be a source of retirement savings for many self-employed people, some do not own a business with any material goodwill or value other than their labour.

Looking ahead, self-employment will become more prevalent in the Australian workforce with the rise of the gig economy. Most new gig workers will be self-employed contractors. In the absence of reform, this will mean there will be a lower proportion of jobs for which workers will receive compulsory SG contributions, and lower superannuation balances at retirement for affected workers.

Requiring self-employed people to make SG payments (on their own behalf) would boost their superannuation balances and diversify their retirement savings.

One potential mechanism for SG contributions is a scheme similar to the Medicare surcharge, whereby a surcharge amount is payable unless a minimum amount of taxable income is contributed to superannuation for the specific assessment period. Quarterly payments would be practical as it would align with existing business reporting requirements (with an annual reconciliation).

With respect to gig economy workers in particular, many new jobs are those that could best be described as 'dependent contractors' – that is, workers who are engaged under a commercial contract for services, but who have little discretion regarding how they carry out their role and have work arrangements that (in a variety of ways) resemble those of an employee.

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 – for whom SG contributions are paid on their behalf.

RECOMMENDATION 8:

ASFA recommends that the Government extend the SG regime to self-employed people and that for workers who are best described as 'dependent contractors' a new category of worker be introduced for whom SG contributions are paid on their behalf.

SG and broken work patterns

People spend periods out of paid employment, or work part-time/casually, for a variety of reasons. These include to care for family members; illness or injury; study; redundancy; or an inability to find suitable employment. There are at least one million Australians experiencing a break in work at any point in time, around three-quarters of whom are women.

Periods of lower or no superannuation contributions will lead to lower balances at retirement.

ASFA advocates a number of policies that would help workers with broken work patterns boost their superannuation balances:

- Increase SG rate as legislated. This will help people with broken work patterns achieve a higher superannuation balance at retirement than otherwise would be the case.
- Apply SG in all circumstances where income is replaced as a result of a workplace or legislative entitlement to receive a salary or wage, such as paid parental leave, salary continuance payments or workers' compensation.
- Abolish the $450-a-month threshold. 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. The existence of the threshold affects roles predominantly performed by women, such as the caring professions, hospitality, retail, and cleaning. Often this affects women who desire to work casually due to child raising, or who are forced to do so through a lack of adequate or affordable childcare.
- Extend the time period for unused concessional caps on SG contributions, from 5 to 10 years. Younger workers currently on lower incomes – when working full-time – may have greater capacity to make catch-up contributions in the future when older and on higher incomes. The current 5-year period is only likely to assist a very small number of workers.

RECOMMENDATION 9:

ASFA recommends that the Government enhance a range of existing superannuation settings to help boost the superannuation balances of workers with broken work patterns (and also casual workers).

SG compliance: Pay SG at the same time as wages

The RIR Report observed that requiring employers pay SG contributions at the same time as wages would make it easier for employees to monitor the SG compliance of their employer.

It would also limit build-up of SG liabilities of employers. In effect, the policy change would reduce the terms of payment on SG liabilities from up to four months to potentially one week. This would mean that in instances of business insolvency, the stock of any unpaid SG entitlements would be lower than otherwise. This would limit the circumstances under which employees would not receive their SG entitlements.

While this would reduce the time employers have to meet their SG obligations, standard payroll systems should be able to easily accommodate such payment arrangements.

RECOMMENDATION 10:

ASFA recommends that the Government require employers to make SG payments at the same time as wages.

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