SUBMISSION

Submission to Treasury — Consultation on legacy retirement product conversions and reserves – draft regulations

8 October 2024

The Association of Superannuation Funds of Australia Limited
Level 11, 77 Castlereagh Street
Sydney NSW 2000

PO Box 1485
Sydney NSW 2001

T +61 2 9264 9300
1800 812 798 (outside Sydney)
F 1300 926 484
W www.superannuation.asn.au

ABN 29 002 786 290 CAN 002 786 290

File: 2024/38

Tax and Transfers Branch
Retirement Income and Superannuation Division
Treasury
Langton Cres
Parkes ACT 2600

Via email: superannuation@treasury.gov.au

8 October 2024

Dear Sir/Madam,

Consultation on legacy retirement product conversions and reserves – draft regulations

The Association of Superannuation Funds of Australia (ASFA) is pleased to provide this submission in response to Treasury's consultation on legacy retirement product conversions and reserves – draft regulations (Draft Regulations).

ABOUT ASFA

ASFA, the voice of super, has been operating since 1962 and is the peak policy, research and advocacy body for Australia's superannuation industry. ASFA represents the APRA regulated superannuation industry with over 100 organisations as members from corporate, industry, retail and public sector funds, and service providers.

We develop policy positions through collaboration with our diverse membership base and use our deep technical expertise and research capabilities to assist in advancing outcomes for Australians.

ASFA seeks to ensure that member outcomes are appropriate, optimised and there are no unintended consequences flowing from policy decisions relating to superannuation.

GENERAL COMMENTS

ASFA's member organisations welcomed the commutation relief announced in the 2021/22 Budget, as the proposed changes generally will provide members in legacy retirement products with the ability to transition to more contemporary and flexible retirement products.

There are, however, some areas of uncertainty in the Draft Regulations.

SPECIFIC COMMENTS

Our members have provided the following feedback on the Draft Regulations.

1. Scope/application of the Draft Regulations

1.1. Title of Draft Regulations

The title of the Draft Regulations refers to Self-Managed Superannuation Funds (SMSFs) and yet the regulations appear to have broader application, including to accounts within APRA regulated funds, Retirement Savings Accounts and to other superannuation products.

Given the title of the Draft Regulations, a number of our members have sought confirmation that the application of the Draft Regulations is not confined to SMSFs but extends to non-SMSF products.

The measure was introduced in the 2021/2022 Budget under an SMSF heading and the references to reserves suggested it may be limited to SMSFs. The accompanying Fact Sheet, however, contained two cameos that could relate to non-SMSF products and under the heading *Products covered* stated it would apply to "Market-linked, life-expectancy and lifetime products … from any provider, including … SMSFs".

ASFA sought clarification from Treasury with respect to the application/scope of the measure, who confirmed that:

- despite the description in the Budget papers, the measure was not confined to SMSFs and would extend to non-SMSF products
- products covered were to be market-linked, life-expectancy, and lifetime products which first commenced prior to 20 September 2007 from any provider, including SMSFs.

Given this, we recommend that the title of the Draft Regulations be amended by removing the words 'self managed'.

1.2. Defined benefit funds

Sub-regulation 1.05AA(2) states that the commutation relaxation applies to lifetime annuities purchased by superannuation funds that are not defined benefit funds, while sub-regulation 1.06C(2) provides that the five-year commutation relaxation applies if the fund providing the benefit is not a Defined Benefit (DB) fund.

While DB schemes themselves may be excluded, member organisations have queried why other lifetime products offered by a DB fund should also be excluded.

DB funds frequently are hybrid funds, with some DB members in a DB scheme, while the other members are considered to be 'accumulation' members. DB funds may offer one or more retirement income stream/pension products to their members that do not have their genesis within the DB scheme.

Further to this, not all DB funds offer a DB income stream/pension product.

A fund may provide a lump sum benefit on retirement that is a DB, as its value has been derived through the use of one or more formulae. This means it is a DB scheme but these DB members entering retirement are faced with the same choices and issues as accumulation members entering retirement and should not be excluded from the operation of the Draft Regulations.

In addition, where a hybrid DB fund is contemplating a successor fund transfer, having members in the types of products the subject of the Draft Regulations poses additional, significant, regulatory hurdles. Extending the relief to hybrid DB funds would reduce complexity risk and costs and improve the outcome for all of the members of the fund.

Given the above it is difficult to see why DB funds as a whole should be excluded from the operation of the Draft Regulations.

We recommend that the Draft Regulations be amended such that they exclude DB income stream/pension products provide by a DB *scheme*, as opposed to excluding those provided by a DB *fund*. Retirement income stream/pension products offered by DB funds that are not DB income stream/pension products should not be excluded simply by virtue of the fact that they are being provided by a DB fund.

2. Need for broader product rationalisation framework

Member organisations have indicated that, in order to drive the desired simplification of products and to achieve efficiencies/economies and cost savings for members, further changes to the regulatory environment are required.

To support a broader rationalisation of legacy retirement products there is a need for a broader product rationalisation framework, including Capital Gains Tax (CGT) relief to support underlying investment structures and ensure members are not penalised.

Given this, we recommend that there be consultation on the design and implementation of a broader retirement income product rationalisation framework.

3. Use of capital resulting from commutation

Under the Draft Regulations, it appears as though, where a member exits a legacy retirement product, it would be open to them to use the resulting capital to commence any retirement income stream that may be suitable for them, including an account-based income stream or an innovative retirement income stream.

Member organisations have noted, however, that the Explanatory Statement (ES) specifically refers to commencing an account-based income stream only:

> *"The Regulations relax commutation restrictions so that legacy products can be exited with the resulting capital used to commence an account-based income stream, left in an accumulation interest account, or withdrawn from superannuation entirely"*.[1]

In order to provide certainty that members will be able to use the capital resulting from a commutation to purchase any product they consider suitable for their needs, we recommend that the ES is updated to clarify that members are able to purchase any retirement income stream product.

4. Social Security legislation

Member organisations have noted that legislation to amend relevant provisions in the social security law will be necessary, to provide for the treatment of commutations of legacy retirement products within the scope of the Draft Regulations.

Exposure draft legislation was not released as part of this consultation, nor has there been any commentary / guidance with respect to this.

Members have indicated that, at a minimum, they believe amendments will be required to

- sub-sections 9A(h), 9B(h) and 9BA(f) of the *Social Security Act 1991*; and
- sub-sections 5JA(h), 5JB(h) and 5JBA(f) of the *Veterans' Entitlement Act 1986*

although amendments to other provisions also may be required.

Given this, we recommend that there be consultation on amendments that will be required to the *Social Security Act 1991* and the *Veterans' Entitlement Act 1986*.

[1] Explanatory Statement, Page 2

5. Commutation values

Member organisations have requested an indication as to whether there will be any prescription or guidance with respect to determining the commutation value of a lifetime pension, or whether funds will be required to appoint an actuary to determine the basis/method for valuing commutations.

6. Issues with allocations from reserves

One of the measures in the Draft Regulations is to remove the parts of regulation 291-25.01 of the *Income Tax Assessment (1997 Act) Regulations 2021* that result in the allocation of fund reserves counting towards members' concessional contributions caps and have the effect that, instead, these allocations would count towards members' non-concessional contributions caps.

Member organisations have indicated that the effect of this amendment to the regulations generally should be positive.

There is, however, an issue with respect to the use of reserves where large, APRA regulated, funds utilise reserves to compensate members or to remediate errors or other relevant matters.

The most common circumstance in which a large, APRA regulated, superannuation fund and their members are affected by regulation 291-25.01 is where a fund compensates or remediates cohorts of its members and one or more of the fund's reserves is used as the source of funding.

6.1. Allocation from reserves for compensation and remediation of members

As large, APRA regulated, funds grow in size, sophistication, and complexity, and adopt even higher levels of governance and oversight over a broad range of functions, it is becoming more common that issues are identified where the trustee determines that it is appropriate to compensate/remediate affected members.

In some cases, a fund's compensation/remediation program may be funded from monies recovered from third parties. In other cases, however, it may be necessary to utilise a reserve held for the purpose of meeting the fund's Operational Risk Financial Requirement (ORFR), or another reserve, to fund the allocations to members or payments to former members.

As a function of the operation of sub-section 291-25(3) of the *Income Tax Assessment Act 1997*, in conjunction with regulation 291-25.01 (particularly sub-regulation 291-25.01(4)), where a fund undertakes these types of member compensation or remediation it faces the risk that the amounts allocated from fund reserves to affected member accounts or to fund payments to former members may count towards the members' concessional contributions caps.

Where the affected member may have utilised their concessional contribution cap (via Super Guarantee (SG) contributions, salary sacrifice contributions or deductible member contributions), the counting of these additional amounts towards their cap can trigger issues with respect to excess concessional contributions. This can render the compensation/remediation significantly more complex, which imposes additional costs on the fund (e.g. need to calculate/pay grossed up amounts to take into account potential tax arising from excess concessional contributions) and often necessitates extensive discussions with the Australian Taxation Office (ATO).

As the number of members who utilise the non-concessional contributions cap typically is lower than the number who utilise the concessional contributions cap, and as the non-concessional contributions cap is higher than the concessional contributions cap, the amendment in the Draft Regulations that would see allocations from reserves count towards non-concessional contributions caps generally should be positive, as it may be expected there will be fewer instances which would result in a member being in excess of their cap.

It is likely, however, that in any compensation/remediation program involving a large number of members there would be member cohorts (e.g. who have triggered their non-concessional contributions cap 3-year bring forward rule) where this amendment may give rise to new complexities and still necessitate extensive discussions between the fund and the ATO.

Member organisations have suggested there is an argument that the allocation from a reserve created to meet a large, APRA regulated, fund's ORFR to meet the purpose for which it was established – i.e. to put a member back to the position they would have been had the error/matter being remediated not occurred – should not count towards either a member's concessional or non-concessional contributions cap.

Allocations from reserves for the purpose of compensation/remediation do not appear to be within the original legislative intent of section 291-25 or sub-section 292-90(4). The original regulations seem to have been drafted strictly without taking compensation/remediation programs into consideration, where an allocation from reserves does not increase a member's entitlement in the fund but instead places them back in the position they should have been. This represents a significant driver of costs in compensation/remediation program undertaken by funds.

Given this, we recommend that consideration be given to expanding the existing exclusions in the regulations to ensure that, in all instances where a reserve created for the purposes of a fund's ORFR is used to fund compensation/remediation of members, the allocation from the reserve does not count towards either the members' concessional or non-concessional contribution caps, unless the amount allocated exceeds the amount reasonably necessary to put the member back to the position they would have been had the error/matter being remediated not occurred.

6.2. Other allocations from reserves should continue to count as concessional contributions

Member organisations have indicated that it also will be important to ensure that in the case of certain other allocations from fund reserves (outside the compensation/remediation ORFR framework referred to above) – such as where a DB fund is able to use an existing DB surplus to allow employers to fund SG obligations for their accumulation members – these should continue to count towards affected members' concessional contributions caps.

We understand that existing sub-regulation 291-25.01(2), which is not proposed to be amended by the Draft Regulations, may have this effect, however, it would provide useful guidance to the industry if the ES for the final regulations were to make this clear.

7. Effective date for operation of change to treatment of allocations from reserves

Our members have advised that, with respect to the amendments that would result in allocations from reserves counting towards members' non-concessional contributions caps, a number of large, APRA regulated, funds presently have compensation/remediation programmes afoot, and in some instances are already in consultation with the regulators (ASIC, APRA and the ATO) and/or have commenced to communicate with affected members.

When compensating/remediating members there is an imperative to achieve this as soon as possible, and ASIC has determined that funds should endeavour to remediate affected members as soon as possible. There is an obvious tension between this imperative and the trustee's duty to act in the best interests of members, where there may be a cohort of member whose tax outcomes would be better if the fund were to delay the allocation until after the commencement of the change.

This risk would be mitigated if:

- the amendment to the treatment of the allocation from reserves were to be effective with respect to relevant allocations from 1 July 2024 onwards
- Treasury were to accept our submission above that allocations as part of compensation/remediation programs should not count towards either contribution cap.

Given this, we recommend that Treasury consults further with respect to this, including with ASIC, APRA and the ATO, and consider whether allocations as part of compensation/remediation programs should not count towards either contribution cap and, if they are to count to the non-concessional cap, whether the amendment should be effective from 1 July 2024.

8. Timing of making of final regulations

Our member organisations have advised that they would appreciate an indication as to the likely timing for the making and registration of the final regulations.

9. Further consultation

Given the above issues outlined above, we recommend that consideration be given to there being further consultation with the sector with respect to the Draft Regulations.

*****

If you have any queries or comments in relation to the content of our submission, please contact Fiona Galbraith, Director Policy, on 0431 490 240 or by email fgalbraith@superannuation.asn.au.

Yours sincerely

James Koval

Head of Policy and Advocacy