ASFA pre-Budget submission for the 2014 –15 Budget

January 2014

The Association of Superannuation Funds of Australia Limited (ASFA)

Level 6
66 Clarence Street
Sydney NSW 2000

PO Box 1485
Sydney NSW 1005
T +61 2 9264 9300
T 1800 812 798 (outside Sydney)
F +61 2 9264 8824 or 1300 926 484
W www.superannuation.asn.au

ABN 29 002 786 290 ACN 002 786 290

Contact
For enquiries on this submission, please contact Ross Clare, Director - Research and Resource Centre, on 02 8079 0809.

About ASFA
ASFA is a non-profit, non-politically aligned national organisation that is the peak policy and research body for the superannuation sector. Our mandate is to develop and advocate for policy in the best long-term interest of fund members. Our members – which include corporate, public sector, industry and retail superannuation funds, plus self-managed superannuation funds and small APRA funds through its service provider members – represent more than 90 per cent of the 12 million Australians with superannuation.

The context of the ASFA submission

Broad approach of the Government

The Government has committed to not making any detrimental unexpected changes to the superannuation (super) system in this Parliamentary term, so that the Australian community can plan for their retirement with confidence and certainty. ASFA is supportive of this policy position.

ASFA also acknowledges the budgetary challenges faced by the Government in terms of moving the budget back to balance or surplus.

Progress to date regarding meeting the objectives of the superannuation system

Retirement savings adequacy continues to be a concern for many Australians. While account balances are growing as the superannuation system matures, many people will still end up with inadequate superannuation savings to fund the lifestyle they want in retirement. In particular, most people retiring in the next few years will rely substantially on the Age Pension.

Adequacy is an even bigger problem when it comes to women. There is evidence that the gender gap is closing, however women of all ages still lag substantially when it comes to average account balances.

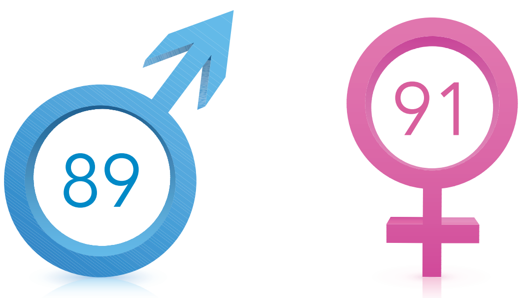
Despite the Government's commitment to increase the Superannuation Guarantee (SG) over time to 12 per cent, even younger people entering the workforce today will still need to make additional contributions to their super to ensure they have adequate retirement savings.

Of even greater concern is the fact that there is still a significant proportion of the population who do not have any superannuation, with one in four men and one in three women having no superannuation savings. The self-employed represent a big gap in the system, with one in four having no superannuation savings.

The ageing population will drive an increasing Government budget burden

Australia's ageing population is one of the greatest challenges facing policy makers now and in the future. Not only will the number of retirees increase dramatically over the next few decades, but the life span they are expected to have has also increased. In fact, Australian Bureau of Statistics (ABS) projections show that the rapid extension of life expectancy in recent years will only improve in future years. For males, the average life expectancy at age 65 is projected to increase from 17.4 years, as at 2001, to 24 years in 2031, and for females from 20.8 years to 26 years.

AVERAGE LIFE EXPECTANCY OF 65-YEAR-OLDS IN 2031



This means we will have more people surviving to retirement age, and most will live a longer life in retirement. This will have repercussions for Government budgets now and in the future, as they struggle to cope with the demand placed on public services as a result of this demographic shift.

There is broad community support for increasing retirement savings

Recent research conducted for ASFA indicated strong community support for the Government to encourage people to save more for their retirement and supporting them along the way by making the rules flexible and increasing incentives. However, this is balanced by the view that the Government should minimise the frequency of changes to the system in order to avoid confusion. Unsurprisingly, the community is also supportive of the tax incentives provided to super, and minimising the tax burden placed on retirement savings as much as possible.

There is also strong support for the increase in the SG to 12 per cent over the next few years, with 78 per cent of survey respondents supporting and 48 per cent strongly supporting this. There is also little support for a pause in the increase in the SG for two years, with less than one in five respondents indicating their support for the delay.

78%

OF PEOPLE SUPPORT THE SUPERANNUATION GUARANTEE INCREASE TO 12 PER CENT

However, there is strong evidence to suggest that a large portion of the Australian population lack the confidence required to manage their superannuation savings. This includes taking actions such as consolidating accounts, finding lost super and making choices about their investment and insurance options within their fund. Many also struggle with determining the level of retirement savings they will require to live comfortably and how they might go about achieving this. For example, one in five people do not know how to make additional super contributions, signalling the need for education around this.

A growing number of unclaimed accounts

There are 3.57 million unclaimed superannuation accounts now held by the Australian Taxation Office. Due to a change in the definition of unclaimed accounts, the number of such accounts increased by around 730,000 in 2012-13, leading to an additional $1.2 billion being transferred to unclaimed monies. The total amount in such accounts is now around $2.1 billion. This is money that should be returned to fund members to boost their retirement savings.

3.57 million

THE NUMBER OF UNCLAIMED SUPER ACCOUNTS HELD BY THE ATO

Compliance costs have a significant detrimental impact on retirement incomes

Given the number and extent of changes to the super system over the past few years, compliance costs have no doubt imposed a high cost on fund members. Therefore, it’s important these costs be reduced, to minimise the impact on retirement savings. For instance, if administration costs can be reduced by 0.1 percentage points, then after 30 years, the eventual benefit will be 3 per cent higher. If costs are reduced by 0.5 percentage points, there would a 16 per cent increase in retirement benefits.

Superannuation investment directly supports the Australian economy

Superannuation has a substantial impact on real investment within the Australian economy, both directly and indirectly. The direct impact is through funds investing directly in real assets (like infrastructure projects or property) as part of their investment portfolios. Indirect investments include funds investing in the share and other capital markets.

Australian superannuation funds directly own hundreds of major commercial real estate properties, including office buildings, shopping centres and industrial parks. Australia is the country of domicile of seven out of the 20 largest infrastructure managers in the world, with superannuation funds the major source of investment for such managers.

Investment by Australian superannuation funds in infrastructure could rise to $200 billion or more by 2025 on the basis of likely asset allocations.

$200 billion

THE AMOUNT TO WHICH INFRASTRUCTURE INVESTMENT BY SUPER FUNDS COULD RISE

Specific ASFA recommendations for the 2014-15 Budget

Adequacy of retirement incomes

1 The current timetable for the phased increase in the rate of the Superannuation Guarantee be maintained.

The increase in the rate of compulsory super contributions to 12 per cent of wages will play an important role in supporting more adequate incomes in retirement.

While most of the cost of the increase will be ultimately paid by employees, research suggests that they welcome the move. A recent survey conducted for ASFA and other evidence indicates that the great bulk of employees see an increase in the rate of compulsory contributions as in their interest and that they are willing to forgo current take home pay in order for such increased contributions to be made by employers.

Maintaining the current timetable will help deliver adequate retirement savings for a larger portion of Australians. It will take pressure off future government budgets and improve the lifestyle of Australia's retirees.

2 Assistance for the superannuation savings of low income individuals continue to be provided through a low income superannuation contribution or another similar mechanism.

Without the low income superannuation contribution (LISC) there would be significant inequities when it comes to low-income earners, who would receive very little or no tax assistance in regard to superannuation contributions made on their behalf. Continuing to provide assistance to this group through the LISC, co-contribution or another similar mechanism also will help boost retirement savings for this vulnerable population group.

Consumer information and education

3 That the Government provide funding of $1 million in 2014-15 and $1 million in 2015-16 for research to be conducted by a superannuation consumer council.

Now is an opportune time for the industry and Government to focus on addressing the issues that the broader community encounter with their superannuation, and to build a national consensus on how the system will need to adjust to accommodate the challenges posed by an ageing population. However, at present there is no distinct body charged with the responsibility of serving the superannuation education needs of the Australian community.

The previous Government made an allowance in its forward estimates to provide $10 million over three years as a contribution to an investment fund, the earnings of which will be used to fund the on-going costs of a non-profit organisation with a primary focus on superannuation policy research and advocacy. The Government's contribution was contingent on funding being matched by the industry. For a variety of reasons, that organisation has not been established.

A superannuation consumer council would deliver a saving of $8 million over forward estimates.

ASFA is willing to provide secretariat and other support for such a superannuation consumer council so all funds provided by the Government would be spent on research with clear objectives and measurable outcomes.

Not proceeding with the initial investment and instead diverting $2 million of these funds to a superannuation consumer council would deliver a saving of $8 million over the forward estimates. Further details of how such a council would operate are outlined later in this submission.

Supporting take-up of post-retirement income streams and development of products dealing with the financial consequences of longevity

4 A timetable and terms of reference for both the review of the regulatory arrangements for retirement income streams and for the tax treatment of deferred lifetime annuities be announced as part of the Budget papers.

Current laws do not allow for a seamless transition into income streams at the time of retirement. We understand that the Government intends to review regulatory and other arrangements relating to retirement income streams.

That review should not delay the review of the tax treatment of deferred lifetime annuities, which are taxed punitively when compared to other income stream products. While the Assistant Treasurer has indicated that he is open to a review of such arrangements, the timing of this is yet to be announced.

It is ASFA's view that providing deferred lifetime annuities with the same concessional tax treatment that applies to investment earnings on superannuation assets that support retirement income streams would encourage the take up of such products. This is an important step towards ensuring Australia's retirees are guarded against the financial consequences of longevity. Removing such impediments would also encourage product innovation.

5 The proposed measure to include account-based income streams in the financial assets that are subject to deeming arrangements in the Age Pension income test not be proceeded with.

Currently, there is a proposal before the Senate to change the Age Pension income test to include account-based income streams. ASFA estimates that making such a change would impact around 20,000 future aged pensioners each year. This means a couple might receive up to $1,000 less a year in Age Pension than they would under the current means test arrangements. The proposed measure also provides an incentive to spend more in the earlier years of retirement in order to increase Age Pension entitlement.

In effect, this measure would effectively 'mortgage the future'. While it will reduce Age Pension expenditures in the immediate future, it's likely to lead to higher Age Pension expenditures down the track when retirees are age 80 or older and/or when they have run down superannuation savings.

Changes to income test will adversely impact around 20,000 future age pensioners each year.

The transfer of lost and inactive accounts to the Australian Tax Office

6 The legislative provisions relating to lost and inactive accounts should be such that:

- any unclaimed superannuation held by the Australian Taxation Office (ATO) is automatically paid into an active account of a fund member, if the ATO holds sufficient information to make the payment
- the upper threshold for accounts to be sent to the ATO is maintained at $2,000, rather than be increased to $4,000 and then $6,000, as proposed by the previous government.

ASFA believes that increasing the threshold will lead to billions of dollars of individuals' superannuation being paid into consolidated revenue rather than being reunited with fund members. In many cases, the ATO has sufficient information to pay unclaimed monies to the relevant active account of an individual and individuals should not be required to lodge a claim for this to happen.

The proposed increases in the upper threshold for the unclaimed superannuation provisions will also mean that a significant number of individuals who wish to maintain an account and any associated insurance cover will have their superannuation account closed without their consent.

Providing a stable investment environment

7 There should be a statement in the Budget papers indicating that there will be stability in taxation provisions relating to investment and that the imputation system will be maintained.

Rather than seeking any new concessions, ASFA is seeking stability in the current taxation settings that impact on investment decisions in order to have certainty to invest over the long term.

ASFA also believes caution is required when considering any new tax concessions for saving or investment, such as applying a lower rate of tax to income from say infrastructure bonds or bank deposits, given their potential to distort savings and investment decisions.

We also consider that there should be a statement in the Budget indicating that the imputation system for company tax should be maintained, given the favourable impact on the equity of taxation and on investment by companies in Australian-based activities.

Supporting infrastructure and other long-term investment

8 The Government should adopt a package of measures that will facilitate the financing of a variety of infrastructure and long-term investments.

- The Australian Government, in conjunction with the States and Territories, should establish a long term pipeline of infrastructure investments which would give superannuation funds and other long-term investors the confidence to develop infrastructure bidding teams.
- Support should be provided for the 'recycling of capital model' whereby governments use proceeds from asset sales to develop infrastructure assets where infrastructure investors are unwilling to take on patronage risk.
- Bidding arrangements for public-private partnerships (PPPs) should be refined and standardised in order to reduce bidding costs.

- Stability and certainty should apply to the taxation of income from infrastructure investments rather than the introduction of any new tax concessions.
- Infrastructure Australia should establish a financing and investment unit that would provide the Australian Government, and State and Territory governments, with a pool of investment expertise.
- The Australian presidency of the G20 should be used to promote Australia's infrastructure investment expertise by inviting global pension funds to attend key B20 and G20 events.

ASFA considers that the Federal Government has a significant role to play to support the development of infrastructure assets.

We are preparing a detailed submission to the Financial System Inquiry that will provide analysis of the roles that superannuation funds can play in the financial system and in supporting long-term investment. This submission provides preliminary analysis and recommendations in regard to infrastructure investment.

Reducing red tape and regulatory costs

9 The allocation of funding to the ATO for SuperStream be reduced by $170 million over the Forward Estimates period and that $10 million a year be reallocated to a governance body for superannuation data standards.

A major regulatory burden for APRA-regulated superannuation funds is the component of the supervisory levy that funds SuperStream implementation activities by the ATO.

Given substantial progress has been made in implementing SuperStream, ASFA believes that a better outcome for fund members, employers and funds could be achieved by reducing the overall funding to the ATO and reallocating this funding to a new governance body.

Details of the ASFA proposals for the Budget

Adequacy of retirement incomes

Recommendation 1
The current timetable for the phased increase in the rate of the Superannuation Guarantee be maintained.

Recommendation 2
Assistance for the superannuation savings of low income individuals continue to be provided through a low income superannuation contribution or similar mechanism.

The *Mineral Resource Rent Tax Repeal and Other Measures Bill 2013* in Schedules 6 and 7 proposes the 'rephasing' or pausing of the increase in the rate of the Superannuation Guarantee (SG) and the abolition of the low income super contribution (LISC) in regard to contributions made in the 2013-14 tax year and beyond.

The Bill has been passed by the House of Representatives but has not yet been substantively debated by the Senate.

ASFA is concerned that the pause in the SG increase will impact on the quality of retirement for a large proportion of Australians and we would like to see the SG increases occur as currently scheduled. However, ASFA is particularly concerned that the removal of the LISC will have an even more significant impact of the quality of retirement for many Australians with a low income, particularly women. We provide a detailed analysis of the likely consequences below.

The rephasing of the increase in the rate of the Superannuation Guarantee

The increases in the SG rate to 12 per cent unequivocally will assist future retirement incomes while having only a relatively minor impact on people's take-home pay. The increase in the SG to 12 per cent benefits around 8 million employees who previously received no more than 9 per cent contributions from their employer (around 25 per cent of employees currently benefit from standard employer contributions in excess of 9.25 per cent).

In terms of the quantitative impact on individuals, for a person earning $70,000 a year, around average full time earnings, the proposed pause leads to projected retirement savings after 35 years being around $10,000 lower (2.5 per cent), from $396,000 to $385,000 (all figures are in today's dollars).

The increase in the SG to 12 per cent benefits around 8 million employees.

However, a pause has a much smaller impact on eventual retirement savings than not increasing at all – around $10,000 detriment to retirement savings after 35 years, compared to nearly $100,000 detriment if the SG did not increase to 12 per cent.

According to the latest ABS figures for 2011-12 (that were specially prepared for ASFA), individuals with superannuation who earn around average full-time earnings ($70,000) have, around $98,000 in superannuation across all their accounts. The average amount for this income group aged 60 to 64, around the age most individuals retire, is $253,000. For those aged 40 to 44, the average amount for those on $70,000 a year is only $69,000. These average figures will substantially increase with an increase in the SG.

The ABS figures also show disparities in average superannuation balances between men and women. While the average woman and man on $70,000 a year has around the same amount of superannuation, women on incomes higher or lower than $70,000 tend to have less superannuation than men. There also are many more men than women who have an income around $70,000 a year.

For those with superannuation who are aged 60 to 64 and earning an income of around $70,000 a year, women have an average balance of $170,000, compared to around $260,000 for men. All these figures are well below what will be delivered for the person on average earnings after 35 years of contributions at 12 per cent of wages.

The increase in the SG particularly benefits those on average and lower-than-average incomes given that they are the ones most likely to receive contributions no greater than the compulsory rate. Women are also particularly affected as they tend to work in part-time or lower-paid employment. As a result, those groups on average and below-average incomes generally have lower superannuation savings than are needed to support a comfortable standard of living in retirement or even to support living with dignity in retirement.

In addition, going forward there are likely to be increasing demands on retirees to meet a greater proportion of health and aged-care costs. Payment of such 'out of pocket' contributions will require greater retirement savings.

Even when individuals have private health insurance, there can be substantial payments required for the gap between the benefit paid and amounts charged by surgeons and medical specialists. Hip replacements, implants and various medical devices can also require large contributions by patients. In addition, there are likely to be increased pressures on retirees to make contributions to the cost of residential aged care. Accommodating these additional expenses will no doubt require greater retirement savings.

Increasing the rate of compulsory contributions, as originally proposed, is also an important factor in maintaining the community's confidence when it comes to the certainty of future superannuation arrangements. In this context, survey evidence indicates that both superannuation and the prospective adequacy of retirement incomes have become 'top of mind' topics for most Australians. For example, a recent survey of around 1,000 adult Australians conducted for ASFA indicates that 78 per cent of the adult population support the increase in the rate of SG, while just over 50 per cent of respondents are opposed to delaying the rate at which the increases occur.

There are also strong economic reasons for the increase in the SG. In 2011, ASFA commissioned The Allen Consulting Group to prepare a report, which among other things, confirmed through modelling, the large benefits to the Australian economy of increasing compulsory superannuation from 9 to 12 per cent.

Since compulsory superannuation was first introduced, there has been a significant increase in life expectancy. In 1983, an Australian female reaching the age of 65 could expect to live for another 18 years on average, while an Australian male could expect to live for a further 14 years. By 2002, these figures had risen to 21 years for females and 18 years for males. Even if nine per cent contributions were sufficient when the SG was announced, a substantial increase in the rate of the SG is required.

The analysis in this report indicates that in the long-run, there will be no negative impact on employers, because employers will pass on the burden of the increase either in the form of price rises on the goods and services they sell, or in the form of lowered wages (or wage growth) for their employees, or both.

Employer costs could be increased in the short-term but the impact in any given year would at most be 0.25 per cent or 0.5 per cent of wages. For a small employer with a wages bill of $100,000, this amounts to between $250 and $500.

In terms of budgetary impacts, the net fiscal cost of compulsory superannuation (including the increase in the SG) is estimated by Treasury to peak at less than 0.5 per cent of gross domestic product (GDP) before gradually falling to less than 0.2 per cent of GDP. In comparison, the current fiscal cost of the Age Pension is around 2.7 per cent of GDP and this is expected to increase to around 3.9 per cent of GDP by 2050.

In terms of the impact of the increase in the SG on the economy generally, econometric modelling indicates that an increase in the SG after 12 years (compared to the base case of leaving the SG at nine per cent) will:

- increase investment by 1.3 per cent
- increase exports by 1.04 per cent
- increase the capital stock by 0.9 per cent
- have no discernible impact on the Consumer Price Index (CPI) or the level of employment
- increase the real wage rate by 1.06 per cent
- increase the real GDP by 0.33 per cent (equivalent to around $200 a year for every Australian).

For these reasons, ASFA supports the current scheduled increases in the SG rate and does not support the proposed two-year pause.

The abolition of the low income superannuation contribution

In considering tax concessions for superannuation, two issues must be weighed:

- the importance of encouraging private provision so that future retirees can substantively achieve their goals of income in retirement and also contribute towards the country's future economic prosperity
- recognition that in a country that supports a progressive income tax system, appropriate levels of support should be provided for individuals across a range of incomes.

ASFA believes the LISC assists in meeting both these goals.

A number of commentators have observed that the tax arrangements that previously applied to individuals with taxable income less than $37,000 a year, prior to the introduction of the LISC, did not provide any real incentive for such individuals to make contributions.

The LISC currently benefits 3.6 million Australians on low and modest incomes, including 2.1 million women.

For very low-income earners, there was a tax disadvantage when it comes to superannuation contributions, which are taxed at 15 per cent, despite a zero marginal income tax rate applying.

For those in the next tax bracket, which currently has a marginal rate of 19 cents in the dollar, there was only a very small tax difference. For example, a member on $37,000 would only pay $214 less tax on salary and SG contributions compared to salary alone.

At the very least, individuals on a zero marginal tax rate should not be required to pay tax at a higher rate on their concessional superannuation contributions.

The LISC currently benefits 3.6 million Australians on low and modest incomes, including 2.1 million women. It benefits around 30 per cent of workers, who in 2009-10 only received around 1.2 per cent of total superannuation concessions. The introduction of the LISC nearly doubled the amount of tax assistance for people earning less than $37,000 a year.

For a person earning just $37,000 a year, aged 30 and retiring aged 65, if the LISC applied over their working life it would boost their superannuation balance, in today's dollars, by around 20 per cent, from $200,000 to $240,000.

According to the recent ABS figures for 2011-12, the average person earning $30,000 a year has only around $138,000 in superannuation at the age band of 60 to 64. For those aged 40 to 44 earning $30,000 a year, the average superannuation balance is only $36,000.

Again, there are differences in the average balances for men and women, particularly for younger women in age groups where they may have recently spent time out of the paid labour force due to family responsibilities. Women are far more likely to have incomes around the $30,000-a-year level than men. The average woman on $30,000 a year has around $33,000 in superannuation in the age group 40 to 44. For men, the figure is higher, at $44,000.

ASFA considers that the LISC is a sound long-term public policy in relation to superannuation and retirement incomes, especially given the financial implications of the aging population. We are very willing to have a discussion with Treasury and the Government about ways in which the LISC may be funded.

Consumer information and education

Recommendation 3

The government provide funding of $1 million in 2014-15 and $1 million in 2015-16 for research to be conducted by a Superannuation Consumer Council.

The previous government made an allowance in its forward estimates to provide $10 million over three years as a contribution to an investment fund, the earnings of which will be used to fund the on-going costs of a non-profit organisation with a primary focus on superannuation policy research and advocacy. The Government's contribution was contingent on matching funding being provided by industry.

For various reasons, the establishment of the proposed body did not proceed.

Now is an opportune time for the industry and government to focus on addressing the issues the broader community encounter with their superannuation and to build a national consensus on how the system will need to adjust to accommodate the challenges posed by an ageing population.

The proposed superannuation consumer council could help deliver better outcomes for fund members when it comes to superannuation policy by:

- producing research that is focused on addressing the needs of superannuation consumers
- seeking feedback from the community on proposed superannuation policies.

Such an approach would result in better-informed policy decisions and also help build a national consensus when it comes to superannuation policy settings.

The proposed superannuation consumer council could also help improve the consumer experience with superannuation by:

- delivering campaigns that address the key issues fund members have when it comes to super, for example how to consolidate accounts or make additional contributions
- establishing programs with an aim of delivering real consumer outcomes, for example establishing an Indigenous superannuation program to build financial literacy among Indigenous communities.

ASFA is willing to provide secretariat and other support for such a superannuation consumer council so all funds provided by the Government would be spent on research with clear objectives and measurable outcomes.

ASFA believes that, over time, a superannuation consumer council will receive significant financial support from the industry, which will ensure it would not require ongoing funding.

Proceeding with this recommendation would involve a saving of $8 million over the forward estimates.

Supporting take-up of post-retirement income streams and development of products dealing with the financial consequences of longevity

Recommendation 4

A timetable and terms of reference for both the review of the regulatory arrangements for retirement income streams and the tax treatment of deferred lifetime annuities be announced as part of the Budget papers.

Current laws do not allow a seamless transition into income streams at the time of retirement. We understand that the Government intends to review regulatory and other arrangements relating to retirement income streams. That review should not delay the review of the tax treatment of deferred lifetime annuities, which are taxed punitively when compared to other income stream products.

ASFA has previously identified seven impediments for longevity products and has suggested changes to policy settings that could lead to an increased take-up of products that deal with the financial consequences of longevity.

In the Assistant Treasurer's December 2013 statement on the outcome of consultations over the 92 announced but unlegislated tax and superannuation measures, there was a measure that intended to remove one of those impediments. While the measure did not proceed, the Assistant Treasurer did indicate that he was open to a review of the tax treatment of such products in order to encourage their take up and spur product innovation in this space.

It is ASFA's view that providing these products with the same concessional tax treatment that applies to investment earnings on superannuation assets supporting retirement income streams would encourage the take up of such products. This is an important step towards ensuring Australia's retirees are guarded against the financial consequences of longevity. Removing such impediments would also encourage product innovation.

Changes to the Age Pension income test treatment of account-based income streams

Recommendation 5

Do not proceed with the proposed measure to include account-based income streams in the financial assets that are subject to deeming arrangements in the Age Pension income test.

A proposal to change the income test treatment of account-based income streams was first announced as part of a package of measures in the Labor Government April 2013 statement on superannuation. Lower expenditure of $158 million over the Forward Estimates period was forecast.

The Bill proposes to include account-based income streams in the financial assets that are subject to deeming arrangements. The proposed deeming would replace a system where income is assessed as the actual amount paid to an account holder, less an estimated amount for return of capital based on life expectancy.

While the Coalition made no specific mention of this measure in any of its election documentation, it is included in a Bill dealing with a variety of social security measures, which was introduced into the House of Representatives on 20 November. The Bill has passed the House and is before the Senate.

The measure has the potential to substantially impact on the decisions retirees make about taking superannuation income streams.

While existing age and disability pensioners holding an account-based income stream are proposed to be exempted from the deeming arrangements in regard to any account-based income stream held prior to 1 January 2015, there are potentially thousands of other retirees who will be affected by the change.

Around 250,000 persons turn 65 each year and just over 40 per cent of these will be on a part Age Pension and subject to the asset and income test. ASFA Research Centre preliminary estimates indicate this will mean around 20,000 new Age Pensioners a year will be worse off as a result of the change, as they have superannuation assets in the range of the proposed measure ($240,000 to $310,00 for a couple or between $140,000 to $240,000 for a single person).

ASFA estimates future age pensioner couples who are affected by the change will receive up to $1,000 less a year than they would under the current means test arrangements. The exact amount will depend on their account balance, the amount they are drawing down each year and the deductible amount.

As a result, the measure, if adopted, would make account-based income streams less attractive than they previously were as:

- it will affect significant numbers of partially self-funded retirees, which has been the focus of some media attention
- from a more fundamental policy point of view, when a policy goal is to move more people to income streams, rather than lump sums, in order to deal with increased life expectancy, the change in the means test to make certain income streams less attractive is clearly a move in the wrong direction.

The measure is, in effect, 'mortgaging the future' in that the change to the income test will reduce Age Pension expenditures in the immediate future, although it will lead to higher Age Pension expenditures when retirees are age 80 or older and/or when they have run down their superannuation savings. The proposed measure also provides an incentive for people to spend more in the earlier years of retirement in order to increase their Age Pension entitlement.

The transfer of lost and inactive accounts to the Australian Tax Office

Recommendation 6

The legislative provisions relating to lost and inactive accounts should be such that:

- any unclaimed superannuation held by the ATO is automatically paid into an active account of a fund member if the ATO holds sufficient information to make the payment
- the upper threshold for accounts to be sent to the ATO is maintained at $2,000 rather than be increased to $4,000 and then $6,000, as proposed by the previous government.

A number of changes have been made to the provisions relating to unclaimed superannuation and further changes have been proposed. From 31 December 2012, this included increasing the threshold for inactive accounts and members who cannot be contacted from $200 to $2,000 and reducing the period of inactivity from 5 years to 12 months.

As a result, at 30 June 2013, there were 730,000 more unclaimed accounts than at 30 June 2012 and the value of these accounts has increased by around $1.2 billion. This is more than double then $555 million increase that was expected when the measure was announced.

The Government has released for public consultation an exposure draft of the *Tax and Superannuation Laws Amendment (2014 Measures No. 2) Bill 2014: lost member small account threshold*.

The exposure draft legislation flows from the Government's decision, announced on 6 November 2013, to proceed with the former government's 2 August 2013 Mid-year Economic and Fiscal Outlook (MYEFO) proposal to increase the lost member small account threshold in two stages. It is proposed that the threshold will increase from $2,000 to $4,000 on 31 December 2015 and then to $6,000 on 31 December 2016. This was a further increase from that proposed for the same dates in the 2013-14 Budget. The new thresholds are expected to lead to a further $816 million being transferred to the ATO over the forward estimates period.

> *At 30 June 2013, there were 730,000 more unclaimed accounts than at 30 June 2012 and the value of these accounts has increased by around $1.2 billion.*

These various measures appear to be designed to generate strong inward cash flows to consolidated revenue, rather than to reunite individuals with their superannuation. In 2012-13, there were over 610,000 payments – totalling $44.5 million – to members of unclaimed superannuation accounts with values of less than $200. However, in regard to more significant account balances (those over $200) the ATO only actioned around 39,000 electronic-portability forms and just over 16,000 paper-portability forms to consolidate accounts or transfer ATO-held monies to superannuation funds.

In 2012-13, the ATO was able to match over one million tax file numbers to lost and unclaimed accounts and notified funds with details of 945,000 accounts but, due to legislative restrictions in section 24G of the *Superannuation (Unclaimed Money and Lost Members) Act 1999*, (SUMLM Act), it was unable to take the further step of paying unclaimed accounts into the identified active accounts of the individuals concerned.

This is in contrast to the ATO's practice of actively making payments of the Superannuation Co-contribution and the LISC when they are able to identify an active account for an individual. As well, the ATO has the legal capacity to transfer amounts they hold in superannuation holding accounts related to employer SG payments to active accounts.

Given the definition of 'lost member account', the nature of these accounts and recent changes to superannuation reporting requirements that have enhanced the Commissioner's information about superannuation accounts, the necessary legislative amendments to empower the Commissioner to initiate the repatriation of lost member accounts should be a priority. Such a change would be consistent with the higher policy objective of reducing the number of unnecessary accounts the superannuation system

As well, the proposed increases in the upper threshold for the unclaimed superannuation provisions will mean that a significant number of individuals who wish to maintain an account and any associated insurance cover will have their superannuation account closed without their consent. Hence, for all the reasons stated above, it is ASFA's view that the current upper threshold of $2,000 should not be increased.

Taxation and other policy settings for investments by superannuation funds

Recommendation 7

There should be a statement in the Budget papers indicating that there will be stability in taxation provisions relating to investment and that the imputation system will be maintained.

Ensuring superannuation funds can invest with stability and certainty over the long term requires a degree of policy stability. Hence, rather than seeking any new concessions, ASFA is seeking a commitment of stability when it comes to the current taxation settings that impact on investment decisions. ASFA also believe considerable caution is required when deciding whether any new tax concessions for saving or investment are to be introduced, such as to apply a lower rate of tax to income from say infrastructure bonds or bank deposits, given their potential to distort savings and investment decisions.

ASFA also considers that there should be a statement in the Budget indicating a commitment to the maintenance of the company dividend imputation tax system.

The dividend imputation system is relatively long standing. When it was introduced in 1987, it brought to an end the double taxation paid by Australian resident taxpayers on Australian resident company profits. The system operates to ensure that company profits distributed to shareholders are generally taxed only once.

The imputation system is equitable at the individual shareholder level as the dividend income is effectively taxed at the recipient's marginal tax rate. For shareholders on a tax rate lower than the company tax rate, the excess credits are offset against other income tax liabilities the shareholders may have, and, in some cases, are refundable to shareholders. For other taxpayers, additional tax (above the company tax already paid) is levied.

The current dividend imputation system provides a fair outcome for all shareholders. It also is a major reason why Australian superannuation funds invest a substantial proportion of their assets in Australian companies.

Superannuation pensions, together with dividends on shares directly held, are a source of income for many Australian retirees. The benefits of dividend imputation flow through to those retirees in the form of higher incomes. This assists in the generation of adequate retirement incomes for Australians.

The current dividend imputation system also operates as an anti-avoidance regime by providing Australian companies with an incentive to pay income tax in Australia, rather than off shore and thus are able to pay fully franked dividends to their shareholders.

In the absence of a dividend imputation regime, Australian companies would be more likely to move taxation obligations off shore to lower taxing regimes. Australian companies would also be more inclined to use debt rather than equity financing, both reducing company tax paid and increasing the risks of instability in financing arrangements associated with volatility of interest rates and availability of debt finance.

Major superannuation funds currently provide a significant source of long-term capital funding for Australian companies. The removal of the dividend imputation regime could see a reduction in this source of long-term capital as superannuation funds may look to invest more off shore. This could have a significant impact on the Australian stock market and financial system.

Abolishing the current imputation system and using the proceeds to, say, reduce the company tax rate would certainly make Australia a more attractive market for foreign investors. However, there is no certainty that such a change would increase the net supply of capital in Australia. In particular, small and medium-sized businesses in Australia would be extremely unlikely to be able to attract more (or any) foreign capital. What is certain is that it would remove a major incentive for individual Australians and superannuation funds to focus their investment decisions on Australian companies.

Supporting infrastructure and other long-term investment

Recommendation 8

The Government should adopt a package of measures that will facilitate the financing of a variety of infrastructure and long term investments.

- The Australian Government, in conjunction with the States and Territories, should establish a long-term pipeline of infrastructure investments which would give superannuation funds and other long-term investors the confidence to develop infrastructure bidding teams.
- Support should be provided for the ‘recycling of capital model’, whereby governments use proceeds from asset sales to develop infrastructure assets where infrastructure investors are unwilling to take on patronage risk.
- Bidding arrangements for PPPs should be refined and standardised in order to reduce bidding costs.
- Stability and certainty should apply to taxation of income from infrastructure investments rather than the introduction of any new tax concessions.
- Infrastructure Australia should establish a financing and investment unit that would provide the Australian Government, and State and Territory Governments, with a pool of investment expertise.
- The Australian presidency of the G20 should be used to promote Australia’s infrastructure investment expertise by inviting global pension funds to attend key B20 and G20 events.

ASFA considers that the Federal Government has a significant role to play to support the development of infrastructure assets.

We are preparing a detailed submission to the Financial System Inquiry that will provide analysis of the roles that superannuation funds can play in the financial system and in supporting long-term investment. This submission provides preliminary analysis and recommendations in regard to infrastructure investment.

Investment pipeline

Infrastructure is an attractive asset class for superannuation funds. Australian superannuation funds are invested in infrastructure assets across the country, including airports, ports, toll roads, energy pipelines, wind farms, and water treatment and desalination plants.

An important point to stress is that there is no shortage of available capital when it comes to infrastructure. There is only a shortage of well-structured deals. Where an infrastructure deal has been put on the table, there has been no shortage of superannuation funds that have been willing to invest.

ASFA supports an infrastructure investment environment where superannuation funds are encouraged, but not obligated, to invest in infrastructure assets according to their investment strategies.

We have long expressed the need for certainty around the pipeline for infrastructure investments. This should not be confused with an infrastructure construction pipeline. ASFA's argument is that there is a need for certainty around the role of investors in infrastructure projects. This is particularly important in respect to larger infrastructure projects where superannuation funds need to plan future investments if they are to be accommodated in their overall portfolio due to the 'lumpiness' of such investments.

The establishment of a long-term pipeline of infrastructure investments would provide superannuation funds with the confidence needed to support the development of infrastructure bidding teams. This adds to the competitiveness of the infrastructure market with potential benefits to governments through competitive tendering.

Recycling of capital

ASFA supports the 'recycling of capital model', whereby governments use proceeds from asset sales to develop those infrastructure assets when infrastructure investors are unwilling to take on patronage risk. There has been much discussion around the Government recycling capital. The NSW Ports deal demonstrated that super funds are very interested in stable, mature assets. For sales to be electorally sustainable, there needs to be a demonstration that recycled capital is invested into new projects.

Public sector infrastructure investment skills

While there is strong support for the 'recycling of capital' model, superannuation funds also have some appetite to invest in greenfield assets that are not yet constructed and which may have patronage risk attached to them. There are a range of innovations that can reduce or minimise financial risks for investors.

However, one of the obstacles to innovation is that the public sector needs to be highly skilled at infrastructure financing in order to be receptive to ideas from the private sector. By working with the finance sector, ASFA believes that there is the potential for the Government to create innovative structures that reflect the risk/return demands of investors, while providing the public sector with good value.

One option is for Infrastructure Australia to establish a financing and investment unit that would draw on private sector expertise.

Refinement of PPP models

The PPP frameworks currently used in Australia have tended to encourage bids to be structured by consortiums largely made up of banks and constructors. A consistent view that has been expressed to ASFA is that the interests of such consortiums do not necessarily coincide with the interests of superannuation funds. Superannuation funds are long term investors in infrastructure with 25 to 40-year timeframes.

In contrast, the current PPP frameworks have encouraged a transactional approach to infrastructure investment that can be focused on short-term interests. Taxation discounts on infrastructure projects can primarily provide benefits to constructors who wish to 'flip' investments once the construction stage is complete, rather than leading to any significant increase in infrastructure projects.

As well, the more expensive, and time consuming, a bidding process is, the less likelihood there is that superannuation funds, and their investment managers, will be able to directly participate. Where a superannuation fund incurs costs in a bidding process, and the bid is unsuccessful, those costs must be recouped from other investments.

There are number of possible options that could be explored to reduce bid costs including:

- an independent body could be established that would oversee bids, establish standardised conditions and seek to remove forecasting error risk in regard to patronage or revenue forecasts in bidding processes by commissioning independent forecasts
- a process could be established for governments to deal with preferred parties. This could be appropriate in the case of smaller infrastructure projects
- consideration could be given to separating the tender process of design and construction from financing in the case of projects where design is an important element of the tender process.

There are also a number of ways that the PPP framework could better represent the interests of long-term investors. One way would be to have sustainability considerations factored into the PPP frameworks. As long-term investors, superannuation funds integrate environmental, social and governance factors into their investment processes.

There are many ways in which sustainability can be factored into infrastructure. In particular, ASFA notes the work being done by the Australian Green Infrastructure Council to develop a series of green rating tools, in a similar way to the way that green star ratings have been developed for the built environment.

Taxation

Superannuation funds are not looking for taxation incentives to invest in infrastructure. ASFA's feedback from superannuation funds is that taxation incentives do not influence their overall investment decision, and, in fact, there is concern about whether incentives can be maintained in the long term in a fiscally difficult environment.

There is no real restriction on the availability of infrastructure capital to finance Australia's infrastructure needs. The global nature of capital means that there is significant appetite from international funds for unlisted infrastructure assets. In this regard, if there is no market failure in terms of the availability of capital then, while there are arguments that there can be changes to taxation treatment in specific areas, there is no need to use taxation as an incentive to attract capital to the table.

Government support can be used not just to make a project commercial by providing capital but to address investors' core issues around risk. Government guarantees in regard to various investment risks, particularly in small-scale infrastructure, need to be considered in more detail.

It is to be expected that the ownership of infrastructure assets will change over time as super funds regularly review their portfolios, factoring in such considerations as concentration risk, to determine whether an asset suits the risk/return profile of the fund. The taxation regime, as it applies to infrastructure investments, should enable assets to be traded as efficiently as possible.

Australia and the G20 and B20

Australian superannuation funds were among the first in the world to invest in infrastructure. Australian funds have built a well-deserved international reputation as global infrastructure investment experts, with funds such as IFM Investors, AMP, QIC, Colonial First State and Macquarie ranked among the largest infrastructure investment managers in the world.

ASFA notes the significant attention the role of private sector infrastructure has had from governments around the world. Australia, as the current host of the G20, will lead the debate on the role of private infrastructure investment as it is one of the core themes of the upcoming G20 summit in November 2014 in Brisbane.

We consider that the G20 provides Australia with the opportunity to showcase our infrastructure investment expertise to a global audience. ASFA itself is organising a pension fund infrastructure investment forum that will be held in Sydney from 15-16 July to coincide with the B20. The B20 leads engagement with G20 governments on behalf of the international business community. One of the goals for the B20 is to help identify practical actions countries can take to support the G20's growth and employment agenda.

Reducing red tape and regulatory costs

Recommendation 9

The allocation of funding to the ATO for SuperStream be reduced by $170 million over the forward estimates period and that $10 million a year be allocated to a data standards governance body for superannuation data standards.

The Government has indicated that it will reduce the regulatory burden for individuals, businesses and community organisations by establishing and meeting a red and green tape reduction target of at least $1 billion a year.

A major regulatory burden for APRA-regulated superannuation funds is the portion of the supervisory levy that funds the ATO to oversee the implementation of SuperStream. The ATO has been allocated $429 million over a period of years for these activities and at present around $230 million has already been collected and spent.

A consistent and reliable method for processing superannuation payments is just one of the benefits of the new superannuation data and payment standard introduced last year. The new data standard is aimed at improving the efficiency of the superannuation system and improving long-term retirement incomes. Following extensive industry consultation, the standard was largely finalised in 2012 and implemented from July 2013. ASFA has been very supportive of the introduction of such standards.

Now the rollover data standard has been implemented, the majority of funds are now sending and receiving standard-compliant rollovers. This includes meeting the agreed performance standards, including processing a rollover request within three days of receipt. The focus is now turning to superannuation contributions. Employers with 20 or more employees are required to use the standard from 1 July 2014. Self-managed super funds (SMSFs) will also be required to accept contributions in the standard from these employers from this date. Employers with fewer than 20 employees will have an extra year to come on board.

Given that much of the work of the ATO in this area has largely been completed and that the ATO will also achieve efficiency gains through the introduction of the data standards in its transactions with funds, ASFA considers that the future payments to the ATO for SuperStream can be substantially reduced.

More specifically, ASFA estimates that payments to the ATO for the implementation of SuperStream could be reduced from $210 million to $50 million in aggregate over the next four years.

This would provide scope to further shift the governance of data standards to the private sector. More specifically, ASFA recommends allocating funding to the formation and ongoing activities of a data governance body, operating under legislated powers but also working closely with the private sector to maintain the current data standards and identify and realise opportunities for the development of additional data standards.

In creating additional data standards based on the Government's Standard Business Reporting (SBR) program, such a body would be in a position to create significant economic efficiencies while encouraging involvement in the SBR program. We believe an appropriate level of funding would be $10 million per annum. Given that this would replace around $210 million in ATO spending over the forward estimates period, there would be a substantial contribution to the Government's goal of reducing the burden of red tape.

ASFA estimates that payments to the ATO for the implementation of SuperStream could be reduced from $210 million to $50 million in aggregate over the next four years.