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Committee Secretary
Senate Economics Legislation Committee
PO Box 6100
Parliament House
Canberra ACT 2600

17 November 2016

Subject: Superannuation (Excess Transfer Balance Tax) Bill 2016
Treasury Laws Amendment (Fair and Sustainable Superannuation) Bill 2016 ('the Bills')

Dear Committee Secretary

Thank you for inviting submissions on the draft Bills. We welcome this opportunity to provide comment because, as currently framed, we do not support the Bills.

The Bills propose substantial revisions of superannuation entitlements and arrangements, and include significant penalties for certain actions by individual taxpayers in the complicated area of superannuation. We are concerned at the continued complexity and inequity of some aspects of the Bills, and consider the proposed transition-to-retirement pension reform unworkable for a 1 July 2017 start date. We also request a widened period of grace from penalties for non-compliance. Attachment 1 elaborates our concerns. Please contact me on [redacted] or at [redacted] if you would like to discuss.

Who is Mercer?

Mercer is a global consulting leader in talent, health, retirement and investments. Mercer helps clients around the world advance the health, wealth and performance of their most vital asset – their people. Mercer Australia provides customised administration, technology and total benefits outsourcing solutions to a large number of employer clients and superannuation funds. We have over $50 billion in funds under administration locally and provide services to over 1.3 million super members and 15,000 private clients. Our own master trust in Australia, the Mercer Super Trust, has around 230 participating employers, 213,000 members and more than $20 billion in assets under management.

Yours sincerely,

Dr David Knox
Senior Partner

MARSH & McLENNAN COMPANIES

Attachment 1

1. Transition-to-retirement provision reform is not implementable by 1 July 2017

Mercer has indicated in every submission we made to the Treasury on the three 'tranches' of draft superannuation reform legislation and in further correspondence that the proposed transition-to-retirement (TTR) pension reform, as currently devised, is not implementable by 1 July 2017.

The reform will require trust deed amendments, redesign and change of member records, investment administration system alterations, tax record-keeping procedural changes and product documentation updates which are not practicable by 1 July 2017. In respect of investment administration systems and procedures, to illustrate what must occur, new series of unit prices may be required for some or all investment options provided on TTR pension accounts. In some cases, changes to underlying investment structures will also be required where assets backing pension liabilities have been designed for a zero tax environment and are different from the assets backing the accumulation liabilities.

Alternative option for funds with pooled investments

In a letter to Treasury dated 23 September 2016, we outlined an alternative approach to reform that we consider would satisfy the government's fiscal objective and be capable of implementation by 1 July 2017. Under this approach, funds that apply a pooled investment approach, where assets are not held at member level, would be permitted to:

- retain the tax exemption on investment earnings of assets backing TTR pension accounts; and
- calculate earnings tax based on the actual net earnings allocated to relevant member accounts for the year (allowing for changes in price and not distinguishing between income and realised or unrealised capital gains/ losses). Net earnings would be calculated as:

  Balance at year end
  minus Balance at year start
  plus withdrawals (pension payments)
  plus administration fees debited from the account

Earnings tax would be calculated as a set rate (e.g. 10 per cent) x net earnings where the set rate approximates the 15 per cent standard rate less an allowance for imputation credits and capital gains tax concessions.

We consider the Government has under-estimated the implementation costs and timeframes associated with its proposed reform. The Regulation Impact Statement appended to the Treasury

Laws Amendment (Fair and Sustainable Superannuation) Bill 2016 states at paragraphs 14.269 and 14.270, and in Table 14.13:

While it is recognised that system changes would be required, the extent of the changes would depend on the systems that superannuation providers currently have in place and the extent to which the new requirements could be incorporated into their current systems. This measure would be expected to have a low compliance burden with compliance costs estimated to be $21.3 million over ten years. This is based on estimated implementation costs of $21.3 million and no ongoing compliance costs.

Table 14.13 Regulatory Burden Table (1)

Potential compliance costs	Total ($m)	Per client
Implementation	$21.3	$125
Ongoing (p.a.)	$0	$0
Aggregate impact over 10 year duration	$21.3	
Per year (10 years)	$2.1	

This 'low compliance burden' assessment, and the suggestion of a $125 per client cost, are severely under-estimated for large funds and betray a misunderstanding of the systems and documentation changes required, and associated lead times necessary for development.

Recommendation
We ask the Committee to recommend Government adopt Mercer's proposed alternative option for TTR pensions' taxation (see above). If the Committee does not recommend incorporation of this option, we ask the Committee to recommend deferring the commencement of the Government reform to 1 July 2018.

2. Complexity of Government proposals and unnecessary proportional indexation plan

The Government proposes substantial revisions of superannuation rights and entitlements in the Bills. Superannuants will have to apply new thresholds on the amounts they can contribute to superannuation, understand associated definitions and learn new penalties. Initiatives such as the personal and general 'transfer balance cap', 'transfer balance account', 'total superannuation balance' and the right to carry forward unused concessional contributions are complex and only known to the ATO as members may have multiple superannuation holdings with different superannuation funds.

We are pleased the ATO has announced plans to release guidance on the transfer balance cap, proposed capital gains tax relief and total superannuation balance among other reform aspects. However, we consider further and ongoing communications from the ATO are necessary.

We also consider the proposal for 'proportional indexation' of the personal transfer balance cap should be replaced. By itself, the transfer balance cap is a complex reform. It will involve significant administrative changes, additional reporting obligations and detailed guidance for funds, advisers and individuals about how the cap will be administered and complied with. The costs are significant and the Government has compounded this complexity with its granular suggestion for proportional indexation of the personal transfer balance cap. We consider that proportional indexation is excessively complex and will be difficult for individuals and financial advisers to understand. We are concerned at the real possibility for error and mal-administration.

To illustrate the difficulties, let us consider Example 3.4 from the explanatory memorandum (EM) where Nina commences an income stream of $1.2 million on 1 October 2017 and partially commutes $400,000 on 1 January 2018. This means her transfer balance account is $800,000 on 1 January 2018. The Example also notes the general transfer balance cap is indexed to $1.7 million for 2020-21 and $1.8 million for 2022-23.

The following table attempts to replicate the Example with the general transfer balance cap indexed every year to inflation such that it become $1.7 million in 2020-21 and $1.8 million in 2022-23. It is noted the available cap for Nina of $850,000 available in 2022-23 is the same as in Example 3.4. Annual indexation of the cap also makes it consistent with the asset test threshold for the Age Pension which is also indexed to CPI on a regular basis (normally six monthly).

	Inflation	General Transfer balance cap	Income stream indexed	Commutation not indexed (minus)	Available balance cap
(1)	(2)	(3)	(4)	(5)	(3) –(4)+(5)
1 July 2017		$1,600,000			$1,600,000
1 October 2017		$1,600,000	$1,200,000		$400,000
1 January 2018		$1,600,000	-	$400,000	$800,000
1 July 2018	2%	$1,632,000	$1,224,000	$400,000	$808,000
1 July 2019	2%	$1,664,640	$1,248,480	$400,000	$816,160
1 July 2020	2.124%	$1,700,000	$1,275,000	$400,000	$825,000
1 July 2021	2.5%	$1,742,500	$1,306,875	$400,000	$835,625
1 July 2022	3.3%	$1,800,003	$1,350,002	$400,000	$850,001

Adopting this indexation approach makes it much easier for Nina (or her adviser) to understand the unused cap available for her and is equivalent to the approach outlined in the EM. The effective lack of indexation for any partial or full commutation as operates under the Government's proposal and replicated above, appears to be an anomaly.

In the Example, Nina used 50 per cent of the transfer balance cap in 2017-18 (i.e. $800,000) and therefore should have 50 per cent available in the future; that is, $900,000 in 2022-23. However due to the non-indexation of the partial commutation, only $850,000 (47.2 per cent) is available. It is unreasonable that an individual who invests $1.2 million on one day and then partially commutes $400,000 in the same financial year (as Nina does) is treated differently from an individual who invests $800,000. We recommend proportional indexation be replaced by an annual indexation approach.

Recommendation
We request the Committee recommend the ATO make available to superannuants, at the start of each financial year, their 'total superannuation balance', 'personal transfer balance cap', 'general transfer balance cap' and unused concessional contributions cap from the preceding five years. This information could be made available via www.mygov.gov.au.

Recommendation
We recommend proportional indexation of the personal transfer balance cap be replaced by an annual indexation approach as set out above.

3. Inequity of proposed valuation factor of 16 times annual entitlement

The Government proposes, as part of its objective for 'broadly commensurate' taxation treatment of defined benefit interests, to multiply an individual's annual 'capped defined benefit income stream' entitlement by a factor of 16 to determine its 'special value' for the purposes of the transfer balance account. Explanatory memorandum paragraph 3.226 states:

The use of a single factor of 16 is consistent with the general transfer balance cap. The general transfer balance cap is set at $1.6 million regardless of the age or gender of a retiree, the earnings they are able to achieve on their assets or the rate at which these are drawn down. Using variable age-based factors would produce anomalous outcomes. For example, lower factors for older individuals would result in the individual having more cap space than their younger counterparts despite having lower life expectancy. It would also be inconsistent to use a single threshold above which income streams are subject to additional tax, while using different valuation factors.

We do not accept this analysis and consider a valuation factor of 16 times the annual entitlement for those in receipt of pension at 30 June 2017 would produce harsh outcomes for advanced age

individuals. The proposed treatment is particularly unfair when compared against the treatment of an account-based pensioner of the same age, who is permitted to have a balance of up to the full $1.6 million despite having a lower life expectancy than their younger counterparts. Whilst we understand the simplicity associated with using a single factor of 16, we consider amendment is necessary.

We believe a set of sliding scale age-based factors along the following lines would strike a much better balance between simplicity and fairness to older pensioners:

Age on 1 July 2017 or when the pension commences, if later	Factor
Under age 70	16
70-74	14
75-79	12
80-84	10
85-89	8
90 and over	6

Recommendation
We request that, in place of the proposed factor of 16, a sliding scale of age-based valuation factors as set out in the above table be adopted.

4. Widened 'period of grace'

The reforms in these Bills are complex. They introduce new concepts, new obligations, new penalties and some new entitlements for individuals contingent on satisfying detailed criteria. Examples are the concepts of 'transfer balance cap', 'general transfer balance cap', 'transfer balance debit', 'transfer balance credit', 'total superannuation balance', 'retirement phase recipient', 'capped defined benefit income stream' and 'crystallised reduction amount'. Individuals will require time to understand these concepts and are likely to seek advice in the context of a limited number of financial advisers with expertise to assist, at least initially.

Mistakes are inevitable, and we are concerned that individuals will be exposed to penalties and higher taxes if, for example, they unwittingly exceed the proposed new annual concessional or non-concessional contribution caps. We acknowledge the Government proposes limited relief for individuals that exceed the $1.6 million (indexed) transfer balance cap but consider wider relief is necessary.

Recommendation
The proposed reforms provide 6 months relief from penalties for individuals who breach the general transfer balance cap by $100,000 or less at 1 July 2017. We ask the Committee to recommend the Government extend this relief to a 12-month ‘period of grace’ for individuals from all penalties for non-compliance with new and revised obligations in these reforms.