



## SUBMISSION 20



House of representatives Standing Committee on  
Economics, Finance and Public Administration

Submission No: 20

Date Received: 25/7/05

Secretary: fb.

SMALL INDEPENDENT SUPERANNUATION ASSOCIATION

## **Inquiry into Improving the Superannuation Savings of People under 40**

## **Submission to the House of Representatives Standing Committee on Economics, Finance and Public Administration July 2005**

---

## **INTRODUCTION**

SISFA welcomes the opportunity to participate in the Committee's inquiry, the terms of reference of which we note are to inquire into improving the superannuation savings of people under 40 with particular reference to:

- Barriers and/or disincentives to contribute to superannuation;
- Current incentives in place to encourage voluntary superannuation contributions; and
- Improving their awareness of the importance of saving early for their retirement.

## **GENERAL SUPERANNUATION POLICY STATEMENT**

SISFA believes that ***"building an individual's wealth will ensure a healthy nation"***.

To do this, we suggest that:

- The principle of superannuation policy must be central to the fundamental relationship between government and its people. It must become the security for the Australian society, bonding the government, employers, self-employed and employees in a productive and robust relationship.
- Superannuation policy must give equal opportunity to all people wishing to participate and ensure that everyone receives the same incentive from legislation.
- The legislation and regulation of funds must be by an independent commission and give certainty by not being part of the annual Treasury budget process.
- Superannuation policy must be adaptable, meeting the changing needs of people without losing sight of its core purpose, that is the provision of an adequate retirement income, that ensures a smoothing of lifetime consumption, providing an equitable balance of wellbeing between the retired and non-retired sectors of the population.
- Employees should be compelled or actively encouraged to make contributions to supplement compulsory employer superannuation support.
- People must be encouraged to work to the capacity of their ability. Regulations, such as age restrictions, must not stymie those wishing to continue in paid employment. This will be of significant importance as our ageing population increases. At the same time, employers and businesses alike must be given incentive to retain the services of older Australians, appreciating what they have to offer.
- Individuals must be encouraged by superannuation policy to have choice and consequently participate in the investments that will allow for the growth of their assets.

- 
- During the accumulation phase, there could be limited or controlled access to funds through a closely regulated investment fund system. This could be used, for example, for the purchase or building of a place of personal residence, paying for personal and/or direct family tertiary educational expenses, or for the purchase or lease of business real property when the business is owned and conducted by the fund member.
  - A good superannuation policy will ensure that there will be sufficient assets available upon retirement to supply an income to the individual that will allow them to continue participating in the economic growth of the nation. This will guarantee that the widening gap between the number of those employed and those no longer involved in paid employment does not in reality shrink the economy by producing a lack of spending power by the latter.
  - A minimum amount of each fund must be retained upon retirement, guaranteeing the individual a basic income for life.
  - Above all else, good superannuation policy must give certainty to people, enabling them to make long-term plans that are not subject to constant change and ever-increasing costs of compliance.

We believe there needs to be a clear direction for review and reform. Issues to be considered should include:

- The need to have a full and open debate that will ensure multi-partisan support;
- Appropriate incentives for voluntary self-provision in retirement;
- A clear focus on increasing consumer confidence by ensuring that any reform is simple to understand;
- Good tax design that is consistent with recent general tax reforms, particularly the changes to personal income tax;
- Having fiscal stability over time;
- Adopting a practical proposal for transition to a new system;
- A uniform regime that does not discriminate between classes of funds; and
- The removal of impediments, to ensure the opportunity for small funds to invest locally.

## **ADEQUACY**

It is our position that superannuation should be the preferred means of providing for a person's retirement. The age pension (Government-provided) should only be an option for those individuals who are unable to provide for themselves from their superannuation alone.

---

Superannuation should be promoted as replacing, and not merely supplementing, the age pension in as many cases as possible in the long term. The age pension should serve only as a true safety net.

### ***How much is enough?***

This is a subjective area, so instead of assigning a dollar value to the ideal end superannuation benefit, we should examine the effect of how a reduction in superannuation taxes and/or an increase in contribution levels would improve retirement outcomes.

In this context, we are aware of comprehensive research that has been previously commissioned by CPA Australia, and similar research has been conducted in the past by ASFA. Such research indicates that without reductions in superannuation taxes or increases to contribution levels, superannuation benefits will generally not be sufficient to achieve the identified benchmarks. SISFA concurs with those broad conclusions.

SISFA implores the Government to pursue the options identified, with a particular focus on how increased superannuation benefits in the long run reduce public reliance on the age pension. Increased superannuation benefits, particularly in the form of income streams, will also mean that more people can provide for their own health and aged care needs, thereby reducing the long-term burden on taxpayers.

To engender a desire for self-reliance, the public has to take an ownership interest in superannuation, and so a system of compulsory member contributions should be considered. Alternatively, increased incentives for voluntary contributions must be introduced and, in any event, all this should be complemented by an intensive national public awareness and education campaign (similar to the recent choice of fund promotion).

### **TAXATION OF SUPERANNUATION**

If there is to be any simplification of superannuation, then the starting point must be how superannuation is taxed. The principles of superannuation as embraced in the governing legislation (principally the Superannuation Industry (Supervision) Act 1993 (*SIS Act*)) are relatively straight forward, and most would accept a degree of complexity with any system subject to regulation by statutory law. The real complexity with superannuation lies in the layers of taxation—complexity, actual or perceived, results in negative public sentiment.

Treasury's valuation methodology of superannuation as a cost to revenue in terms of its concessional tax treatment must be reviewed. As identified by Treasury itself, the concessions conferred on superannuation will amount to savings to revenue in the longer term in the form of reduced age pension outlays. Such estimated savings must be factored into any assessment of the true cost of superannuation tax concessions as they represent an investment in the future (i.e. capital versus revenue expenditure). After all, the tax concessions are the trade-off for having moneys invested and inaccessible until age 60.

---

### ***Contributions***

We believe the Government should consider removing contributions from the taxable income of superannuation funds. The immediate cost to revenue of such a measure should be examined in the context of improved public sentiment towards superannuation (and therefore higher voluntary participation) and longer term savings to revenue as a result of higher end superannuation benefits (i.e. increased benefits means lower age pension outlays).

A further basis for this proposal is that we are the only country in the world that taxes superannuation at three levels. The removal of the tax on deductible contributions would achieve a number of positive outcomes, such as:

- An increase in the end benefits that a member will receive on retirement, alleviating reliance on the age pension;
- Encouraging additional contributions as those on lower incomes will come to see the benefits they will receive by making the contributions in the first place;
- Removing the inequities that currently exist for low income earners: those earning less than \$21,600 do not receive any tax benefit for putting additional before-tax money into a superannuation fund (their marginal rate of tax of 15% is equal to the tax applicable to their contributions). By removing deductible contributions from the taxable income of superannuation funds, low income earners will receive a benefit of up to 15%, whilst individuals on top marginal income tax rates will receive a benefit of up to 32%. There is still a relative advantage for the higher income earners, but this is more a matter for our personal income tax and social security systems than superannuation itself.

### ***Surcharge***

The Government's commitment to abolish the superannuation contributions and termination payments surcharge from 2005/06 onwards is commendable and clearly acknowledged as the removal of what has been a major disincentive to contribute to superannuation. We look forward to the re-introduction of the legislation to give effect to this measure at the earliest opportunity when Federal Parliament resumes. We believe that the removal of the surcharge will act as a significant incentive to contribute to superannuation for all age groups.

### ***Co-Contribution***

The Government co-contribution scheme is generous and has been successful since its introduction. The principle underpinning the scheme, whereby the effective tax benefit is returned to the taxpayer in the form of extra superannuation contributions instead of additional disposable income, has significant merit in our view. Indeed, this could form the platform for an extension of the regime in the future.

---

### ***Reasonable Benefit Limits (RBLs) and age-based superannuation contribution deduction limits***

As a general proposition, is there a need to limit deductible contributions when excessive benefits under the RBL system will ultimately be taxed at the top marginal rate? Alternatively, does the RBL system serve any purpose whilst deductible contributions continue to be limited by age?

Deductible contribution limits could generally be retained. However, there should be provision for a person to make "catch-up" contributions above their applicable age-based limit if it appears that they will be under-funded for superannuation purposes, or they have claimed less than the maximum limit in previous years (similar to the cumulative effect of the post age 55 low rate threshold for lump sums). This situation may apply to women who have spent many years out of the work force, or individuals whose businesses have only become profitable later in life.

Alternatively, contribution deduction limits could be removed with appropriate modifications made to the RBL system.

### ***Splitting of Superannuation Benefits/Contributions***

There should be consistency between divorcing couples and married couples as regards the splitting of superannuation benefits. This could be viewed as an adjunct or alternative to the Government's proposal to allow the splitting of superannuation contributions. In this context, consideration must be given to extending the superannuation splitting rules to all sections of the community.

### ***Form of Superannuation Benefits***

There must be an increased focus on encouraging retirement income streams in preference to lump sums – this could be achieved by increasing pension RBLs and tightening eligibility, or by capping lump sums (explicitly, or by implication through the introduction of harsher tax treatment).

In this context, the ban on small superannuation funds from paying defined benefit pensions (introduced in the 2004 Federal Budget) deserves some discussion. The regulations giving effect to that ban, which purported to address certain tax avoidance and estate planning strategies, are poorly targeted with grossly unjust consequences, particularly in relation to defined benefit pensions and small superannuation funds.

It is important to appreciate that, under those regulations, the fact remains that all new self managed superannuation funds (and small APRA funds) and many existing ones will have their number of choices of retirement income streams available under the superannuation legislation reduced from five to two – with the other three forms only available from large superannuation providers or life offices. This is clearly anti-competitive and discriminatory.

---

The regulations also contradict the Government's recently stated policy position on retirement income streams. When the Federal Treasurer released the Government's "A More Flexible and Adaptable Retirement Income System" on 25 February 2004, he said in his press release in relation to the new "market-linked" pensions that "The introduction of these products will give retirees more choice in how they can finance their retirement." They are discussed later in the paper accompanying that press release under the heading "Increased choice and competition in the income streams market". It is impossible to see how the reduction of choices available to small superannuation funds under the amending regulations is consistent with these policy objectives.

We appreciate that this is currently under review, but we stress that such measures do irreparable damage to any remaining confidence in the superannuation industry, particularly when they are introduced so stealthily. Less change, more certainty and better targeted integrity measures are the order of the day.

### **INVESTMENT RULES FOR SUPERANNUATION FUNDS**

SISFA endorses the objectives of the Government's retirement incomes policy, namely that superannuation should be invested prudently, in accordance with the requirements of the *SIS Act*, for the purpose of providing benefits consistent with the sole purpose test.

#### ***Background***

The broad policy underlying the *SIS Act* is to permit trustees to make such investments as they consider appropriate to the circumstances of the relevant superannuation fund. Trustees are generally required by the *SIS Act* to invest prudently in a properly diversified portfolio.

There are also a number of specific provisions in the *SIS Act* that operate to prohibit or limit certain investment practices that are inconsistent with the Government's retirement incomes policy or expose members' benefits to unnecessary risk.

In formulating and giving effect to their investment strategy, trustees must consider factors such as:

- the need for diversification;
- liquidity requirements; and
- risk versus return;

**all in the context of the whole of the circumstances of the relevant fund.** Investments should thus be **meaningful** to a fund and the circumstances of its members.

It follows that as circumstances differ from fund to fund, so too will trustees' investment strategies.

---

By way of example, the investment strategy followed by the trustees of a single member fund may very well be significantly different to that implemented by the trustees of a fund with 10,000 members. In a single member fund, there may be a lower priority placed on liquidity as a benefit could be paid by way of transfer of assets. A member of a larger fund would typically have a lower average balance and the transfer of assets of equal value is less likely to be reasonable or possible.

Naturally, there are some investments or investment practices that do not meet the objectives of sound retirement incomes policy. Arguably, some such practices may not even be considered "investments" in the true sense of that term. We consider that the current regulatory environment already prohibits or limits such practices.

### ***SISFA's Philosophy***

The investment rules that apply to superannuation funds in Australia should establish **uniform** principles that encourage **flexibility** and **competition** at the same time as **reinforcing retirement incomes policy**.

**Uniformity** means that the investment environment should be the same for all funds. **Flexibility** means that trustees should have the freedom within that environment to make decisions on investments that they consider suit the circumstances of their fund (subject of course to the long-term objectives of retirement incomes policy). **Competition** refers to equal opportunity for investment among all superannuation funds, which should have a positive impact on capital market efficiency.

### ***Impact of 1999 Changes to Investment Rules***

The changes to superannuation investment rules as introduced by Superannuation Legislation Amendment Act (No.4) 1999 ('SLAA 4') are far-reaching, and prohibit or limit many investment arrangements that did in fact accord with the stated objectives of the Government's retirement incomes policy.

We refute any contention that certain investment practices identified by the Government at the time of the SLAA4 debate would have become so widespread as to jeopardise the integrity of the superannuation system.

If there was a problem, perceived or actual, with the potential use of non-SIS Act regulated entities by superannuation funds, then the legislation should allow for **greater transparency** rather than blanket prohibitions or limitations.

The Government must realise and acknowledge that there is a clear and fundamental distinction between investment arrangements involving related parties (including trusts) carried out on commercial terms, and direct investments in an employer-sponsor's or related party's business.

**The 5% limit on the use of related trusts by superannuation funds (particularly small superannuation funds) will have a significant detrimental impact on regional and rural communities.** Superannuation funds are an important source of infrastructure development capital in these areas, and the use of the trust structure facilitates such investment opportunities.



---

Typically, it is only the small superannuation funds that seek to invest in their local community, because the size of investment involved is usually small in relative terms. The larger superannuation funds or fund managers do not tend to invest in rural or regional Australia other than in large-scale developments. If changes to the post-SLAA4 investment rules are not considered, we will see the emergence of an investment vacuum in regional areas.

In this vein, SISFA was encouraged by the work conducted by the Senate Select Committee on Superannuation in the area of investing superannuation funds in regional and rural Australia, as encapsulated in its issues paper released in February 2002. Small superannuation funds, particularly self managed superannuation funds, could play a pivotal role in any development of the options identified by that Committee in its issues paper.

We also note that the results of any surveys conducted in the past, where certain investment practices were identified, did **not** provide any **conclusive evidence of a nexus between such practices and the failure or potential failure of small superannuation funds**. How then could the introduction of such blanket restrictions be justified?

#### ***Discrimination and anomalies***

There are a number of anomalies emerging in the wake of SLAA4, some of which are proving the discriminatory nature of the measures. The new investment rules do not limit the amount that a superannuation fund is permitted to invest in a widely held unit trust that leverages its assets. The question then is, why are these sorts of investments allowed, while investments in related trusts that borrow (or not) will be limited to 5%? We have posed this question before, but have yet to be given a specific answer.

This leads to a discussion of the risk associated with certain investments. If an investment in a related trust that borrows is to be limited to 5%, but one in a widely held trust that leverages its assets will be unlimited, only one conclusion can be drawn:

*The Government does not consider indirect borrowing of itself to pose a risk; rather, it is considered that a related trust is a riskier proposition than a widely held trust.*

Surely this is a matter for any investor to decide, not the Government. Risk tolerance varies from entity to entity and the use of indirect borrowing as part of a long-term investment strategy is likely to be the exception not the rule. This is because typically individuals are risk averse. Only those who are striving for higher returns and have a degree of expertise in investment matters are likely to explore indirect borrowing strategies.

Another good example of the lack of rationale behind the measures in SLAA4 is the investment by a superannuation fund in the share market. Arguably, a fund can invest 100% of its assets in the share market, provided this accords with the trustees' adopted investment strategy.

---

Can this be considered a less risky proposition than an investment in a related unit trust, where that trust has then borrowed to purchase real property? We submit that a trustee who knows and is comfortable with the real property market would find the shares more risky.

With sufficient transparency, related unit trust arrangements are not circumvention mechanisms; instead, they are long-term investment vehicles that enable superannuation funds to take advantage of current investment opportunities with a view to maximising returns to members.

As discussed above, *SLAA4* has only served to limit the use of *related* trusts. Superannuation funds are still able to "circumvent" the existing borrowing restrictions using inter alia:

- widely held trusts;
- shares in public companies;
- instalment warrants.

All these investment vehicles are able to leverage their assets without jeopardising the compliance of any superannuation fund investors, and the latter in particular are now even being promoted and marketed as such.

In effect, such investments have been endorsed as prudent, while the use of related trusts that borrow has been categorised as inappropriate, or even a "rort". This reinforces our view that investments in related trusts per se should not be classified as in-house assets.

There are many other anomalies that have arisen since the 1999 changes that also highlight the failure of the increased restrictions to reflect the fundamental policy objectives. Generally speaking, there seems to be a lot of effort invested in preventing superannuation fund trustees from entering into certain types of transactions. Our view is that provided the fund is receiving a commercial rate of return that is commensurate with the risk, trustees should be able to enter into almost any type of investment. The exception would be assets that can be broadly categorised as "personal use or enjoyment" assets, which are clearly inappropriate investments for superannuation funds.

The Government and the regulators have had difficulties in the past with such an approach as they see the member obtaining a present-day benefit when superannuation is intended to be for retirement. A recent example of this attitude is the Coles-Myer discount card arrangement.

In addition to reviewing the reversal of many of the *SLAA4* measures, we believe the regional development fund concept identified in the Senate Select Committee's February 2002 issues paper should be pursued and even extended. A superannuation fund could then invest in a development fund, and the members would be able to apply to that development fund to borrow money to:

- 
- buy the family home;
  - fund tertiary education expenses;
  - purchase commercial property;
  - lease commercial equipment.

Provided the development fund was a regulated entity run on commercial terms, then any arrangement that the member entered into with that entity would be commercial. Accordingly the member would not be getting a non-arm's length return or benefit from the transaction.

Naturally, the opportunity to invest in any regional or special purpose development funds should be available to members of all superannuation funds.

### **INTEGRATION**

We need to ensure at all times that current retirement incomes policy reflected in the superannuation legislation is supported consistently and concurrently by related income tax and social security legislation. The current means tests under the social security legislation and the effect of the RBL system must be reviewed at the same time as any superannuation reform measures.

### **EQUALITY**

Our objective is to pursue reforms that achieve equal outcomes for all current and future superannuation participants, including for example members of the Commonwealth Public Sector Schemes whom we understand have limited flexibility and choice and unfavourable reversionary/residual pension benefit provisions. Public servants should not be excluded from transferring their fund membership to private sector funds, where they would be entitled to enter into the same retirement strategies as individuals in the private sector.

To the extent possible, all forms of discrimination should be removed from the superannuation industry. This includes, for example, marital status, age, and employment status.

We welcome the opportunity to discuss any aspect of this submission in further detail.

**Michael Lorimer**  
Director and Chair

**Carmel Riordan**  
Director, Chair of Technical & Policy  
Development Committee

For and behalf of SISFA