14 July 2004

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The Secretary
Senate Economics Legislation Committee
Room SG.64
Parliament House
CANBERRA ACT 2600
By post and email: economics.sen@aph.gov.au

Dear Dr Bachelard

Inquiry into the Superannuation Industry (Supervision) Amendment Regulations 2004 (No. 2)

CPA Australia welcomes the opportunity to provide comments on the above regulations.

General Comments

Following the announcement of the superannuation integrity measures in the 2004-05 Federal Budget, CPA Australia has been actively working to have the impact of the measures on individuals who were legitimately planning for their retirements based on the rules of the day reduced and to provide alternative solutions for addressing possible avoidance strategies. This has included making personal representations, and correspondence, to the Minister for Revenue and Assistant Treasurer and attending an industry roundtable hosted by Treasury on 31 May 2004. This submission to the Senate Economics Legislation Committee builds on our correspondence to the Minister for Revenue and Assistant Treasurer on 7 June 2004.

CPA Australia is not in a position to provide comment on the extent to which self managed superannuation funds (SMSFs) have been used for the purposes outlined in the terms of reference of this enquiry as it is not easily quantifiable. However, we are able to provide comment on the impact the introduction of the integrity measures has had and will have on retirees and their superannuation funds. We also provide suggested solutions for addressing the issues identified by the integrity measures.

Defined Benefit Pension Measures

Many Australians begin planning their retirement months or even years in advance, often increasing their contributions to superannuation to fund their retirement accordingly. These plans are made in accordance with the superannuation rules of the day in the good faith that these rules would not change.

A common goal for these individuals is to maximise their retirement income through the legitimate use of complying income streams and for some, this has been facilitated through SMSFs. While it is appreciated that there are individuals who have attempted to flout the rules, the majority use their SMSFs legitimately for the purposes intended.

Before the transitional arrangements were announced on 23 June 2004, the only options available to those people retiring between 11 May and 20 September 2004, when the market linked income streams (MLISs) become available, were to purchase a life office annuity or commence an allocated pension. Unfortunately, for many retirees these were not viable options.

In the case of purchasing a life office annuity, individuals approaching retirement will have structured their fund investments, often over many years, with a view to commencing a complying income stream upon retirement. To purchase an annuity from a life office will require them to liquidate fund assets incurring not only the additional impost of capital gains tax but also the additional fees associated with the annuity. While the investments of an SMSF will be structured to have sufficient liquid assets to pay an income stream, they will often have high exposure to illiquid assets, particularly business real property. As these illiquid assets will often also support the benefits of accumulation members of the fund, to liquidate sufficient asset to purchase a life office annuity will impact on the future entitlements of all members of the fund and may also have a direct impact on the related small business. For these reasons, it would be impractical, if not impossible, in many situations to purchase a life office annuity.

The prohibition on SMSFs from commencing defined benefit pensions creates an uneven playing field whereby certain income streams will be available from retail providers but not through SMSFs. For the reasons illustrated above, retirees already committed to a SMSF will not have the same options or flexibility available to them as other retirees.

For these reasons, CPA Australia welcomed the announcement of the transitional arrangements, whereby SMSFs can continue to commence defined benefit pensions up until 30 June 2005 provided the member was a member of the fund on 11 May 2004. These arrangements provide more certainty for individuals approaching retirement and also provide an opportunity for the MLISs to be introduced and accepted by retirees and the superannuation industry.

CPA Australia believes the new MLISs will provide a viable alternative to the complying lifetime and life expectancy pensions for retirees who wish to access the higher pension RBL or social security benefits. However, these may not be suitable for all retirees and there will still be a need for a fixed term non-complying income stream, be it a MLIS or a defined benefit pension. We are looking forward to the opportunity to explore the feasibility of such income streams as part of Treasury's forthcoming review.

The transitional arrangements mentioned above do not, however, address the shortcomings of the superannuation integrity measures or the unintended impact these have on other superannuation funds with less than 50 members.

Alternative Solutions

One of the practices the integrity measures address is the use of the lifetime pension RBL calculation to reduce excessive benefits. Preventing SMSFs from providing defined benefit pensions does not address this issue. In fact, if an SMSF was to purchase a life office annuity, the RBL calculation would still be performed within the fund. Two solutions would be to update the pension valuation factors used in the calculation as these are now 10 years out of date and appear to be out of line with life expectancies, or to assign a value to the assets underlying the income stream when it first commences. This would be equivalent to the present value of the future income stream.

The second practice to be addressed by the integrity measure is inappropriate access to the age pension. CPA Australia believes the reduction in the assets test exemption from 20 September will remove the attractiveness of this practice except for those who are in genuine need of the age pension.

While the integrity measures attempt to address the issues above for small funds, these practices will still continue with larger funds and life office provided annuities. CPA Australia believes that changes to the RBL calculation and the reduction in the assets test exemption will largely address the Government's concerns for the superannuation system as a whole without the need for a blanket prohibition on small funds providing defined benefit pensions.

50 member minimum for defined benefit funds

We understand that this measure is intended to address concerns about the solvency of small funds that provide defined benefits or defined benefit pensions. Unfortunately, CPA Australia believes these measures may have a significant detrimental impact on small to medium sized employer sponsored defined benefit funds. In particular, an employer who operates a defined benefit fund of less than 50 members will no longer be able to admit a new or replacement employee or an employee who has been promoted and now qualifies for membership to the fund, thus creating inequity amongst employees of the one employer.

Further, many employers have in the past rationalised their stand-alone defined benefit funds through successor fund arrangements. This has been achieved by transferring them into Masterfund arrangements while maintaining the defined benefit structure and equivalent rights for the members. The new provisions in Division 9.2A of the SIS Regulations make no allowance for such continuation of a fund structure.

The explanatory memorandum accompanying the SIS Regulation amendments states that the regulator may provide an exemption from these requirements in limited circumstances. However, this means each employer sponsored fund will have to apply to APRA for an exemption each time they take on a new member, lose a member and fall below 50 members, or make a successor fund transfer. This is likely to be criticised as requiring taking great time and expense. Given that the solvency of an employer sponsored fund is dependent on the solvency of the employer and not the fund itself, CPA Australia suggests that consideration be given to having APRA issue a class exemption to the minimum 50 member requirement for all employer sponsored funds with greater than 4 members.

Full vesting of contributions

We understand the requirement for all contributions to fully vest in the member is aimed at addressing superannuation surcharge avoidance and deductions claimed inappropriately for contributions. However, these issues do not generally arise through vesting, but in the way contributions are allocated within a fund. We believe the provisions in the amended SIS Regulations will not fully address these issues and are unworkable.

Firstly, Division 7.2 of the amended SIS Regulations requires a contribution received in a month to be allocated to a member within 28 days of the end of the month. However, it does not require the contribution to be allocated to the member for whom it was intended or for whom a tax deduction was claimed. That is, an employer will still able to claim a deduction for a contribution made for a particular member but then have it allocated to another member possibly avoiding a surcharge liability or excessive benefit.

CPA Australia suggests a more appropriate measure to address these issues would be to deny the tax deduction upfront. As an example, an employer can only claim a tax deduction on contributions made up to the age-based limits if they have identified the relevant member to receive those contributions and provided written notification to the fund. Most employers would be doing this now so very little change in administration would be needed for legitimate arrangements. Where there are concerns, the Australian Tax Office could include a review of this notification as part of their audit processes.

Secondly, the grandfathering provision allowing previous vesting arrangements (e.g. a sliding vesting scale based on years of service) to continue relies on evidence that there was a written agreement between the employee and the employer. Generally, these arrangements are not found in any employment agreement but are usually in a fund's governing rules based on an agreement between the employer and the trustee and are linked to a particular position or level of employment. If such an employment agreement did exist, the privacy legislation may prevent the trustee from sighting the agreement to verify its existence.

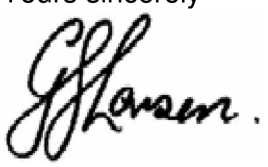
Further, variable vesting scales for voluntary employer contributions are in place to reward employee loyalty. By requiring the contributions of any new members to be fully vested, inequity will be created between new and existing employees in similar positions or on similar employment levels. Ultimately, this will act as a disincentive for many employers to make voluntary contributions above the superannuation guarantee minimum, not only impacting on employee loyalty and turnover but also resulting in lower retirement benefits for many workers.

If full vesting of contributions is going to be required, CPA Australia suggests that any grandfathering arrangement should instead be applied to arrangements that were in place between an employer and the fund trustee before May 12. This would ensure equity is maintained between new and existing employees.

The transitional arrangements provide the opportunity to put measures in place that will address practices that may impact on the integrity of the retirement incomes system while minimising the impact on those retirees genuinely trying to do the right thing.

Should you have queries or require further information, please contact CPA Australia's Superannuation Policy Adviser, Michael Davison on Tel: (02) 6267 8585 or by email michael.davison@cpaaustralia.com.au

Yours sincerely



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