Investment & Financial Services Association Ltd
ACN 080 744 163

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Dr Sarah Bachelard
Secretary
Senate Economics Committee
Parliament House
CANBERRA ACT 2600

Dear Dr Bachelard

Reference:
Splitting of Superannuation Contributions

The Investment and Financial Services Association represents Australia's leading investment managers and life insurance companies who are responsible for investing approximately $670 billion on behalf of over 9 million Australians.

Objectives of Splitting Mandatory Superannuation

To consider the draft Bill and proposed regulations in context, it is useful to establish the objectives for splitting superannuation between members of a couple.

Significant splitting options already exist.

- If the couple separate, the new family law provisions will allow superannuation to be split.
- Voluntary contributions – and in particular undeducted contributions – can already be paid to a spouse's account, with a rebate available.
- Undeducted contributions can also be moved between spouses at retirement without tax consequences.

This means that only employer contributions (including mandatory contributions), and deductible self-employed contributions, cannot be split unless the couple separate.

Importantly, superannuation does not crystalise until: the end of the marriage; retirement of the member spouse after achieving preservation age; or death of the member spouse. While the superannuation account remains in the name of the member, accruals are assets of the marriage, as recognised by the family law provisions. In this sense, they already belong to both parties.

In this context, the principal objectives of the proposal, as identified in the Consultation Paper are to allow couples access to two ETP low-rate thresholds and

Level 24, 44 Market Street, Sydney NSW 2000 Ph: 61 2 9299 3022
Email: ifsa@ifsa.com.au Fax: 61 2 9299 3198

two Reasonable Benefit Limits (RBLs). The paper makes mention of this being an opportunity for single income couples where on spouse has significantly less superannuation than the other.

The other objectives of the Bill and Regulations are less relevant, when considering a voluntary split superannuation scheme.

The 'control' argument is not directly relevant to a voluntary scheme. Couples who are likely to choose to share superannuation via a voluntary splitting mechanism would also be likely to share decision-making about family assets, including superannuation in the name of only one spouse. If spouses do not currently share control over matrimonial assets, it seems highly unlikely they would use a voluntary scheme to split superannuation. If the couple separate, the Family court is able to order a fair split of superannuation (as with other matrimonial assets). Otherwise, Government rarely intrudes into the ordinary decision-making of couples – to use this argument in superannuation sits at odds with the usual distinction between private and public issues.

The insurance objective does not require split of contributions: it could be provided by other means, and probably within the existing sole purpose test.

Critically, the principal objectives – access to ETP low-rate threshold and RBL – take place only at retirement. There is no need to split contributions during the accumulation phase to achieve this outcome.

Cost Impact

In 2002, IFSA asked its members to assess the implementation and administration costs of contributions split options and benefits split options.

Feedback did not identify hard costs across all industry sectors, but did show a significant difference between contributions and benefits splits. Preliminary numbers showed that a contributions split option would be an order of magnitude more costly to implement than a benefits split option. We appreciate that some systems may incur lower implementation costs than others, however the scale of costs to implement contribution splits would be unacceptably high for many players.

Administration costs are a significant issue with the contribution split as envisaged in the Bill (and yet to be seen in the Regulations), roll-over processing costs would be significant. An annual rollover under these provisions would cost more than current annual account administration costs because of the cost of checking, risk management and compliance processes, and dealing with inevitable failed or rejected transfers, incomplete information, and other common administrative issues.

Administration costs are significantly lower on benefit splits – for example, one company suggested that to split a rollover would add only marginal cost to the process. Most importantly, a benefit split would only occur once, rather than every year, and then only if the benefits outweigh the costs.

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The regulation are likely to impose contributions splits as mandatory on all funds. This is very relevant in costs: we see very little
justification to select a higher cost option and then mandate that higher cost on superannuation funds.

Fiscal implications

A principal concern the Government appears to hold in the design of a split contributions regime is to limit the long-term cost to revenue. The Government's Consultation Paper assumed (in its comments on benefits split options) that cost to revenue could only be satisfactorily constrained if a split contributions option is selected.

This is not the case. Benefit split options can limit long-term cost to revenue in two ways, by limiting benefits that can be split to those which represent contributions made from the start date of the scheme.

IFSA proposed a simple method to limit benefits to contributions from July 2002 in the January 2002 consultations, and in a number of informal discussions with government officials since that time. We do not believe it would be difficult to limit the cost to revenue of a benefits split regime.

Equity Implications

There are significant equity issues arising from two outcomes of a requirement that couples choose to split superannuation at the time contributions are made.

The first outcome is that people are aware of the option, or of possible advantages on the ETP low rate threshold or RBL. Many people – and particularly those on lower incomes – will be unaware of the benefits of splitting superannuation until they take financial advice close to retirement.

The second outcome is that couples may not know whether splitting will be relevant or of benefit to them until closer to retirement. Both would tend to reduce the amount of splits, and thus reduce the cost to revenue.

Both outcomes raise equity issues:

- horizontal - between couples of the same income who do and do not realize that splitting could benefit them; and
- vertical – between couples who have the resources, income and awareness to realise splitting would benefit them, and those who lack those resources but who would still benefit (eg from two ETP low-tax thresholds).

We note that cost to revenue during the forward estimates period would be lower under a benefit split option than under a contribution split option. This is because costs to funds would be significantly lower, reducing the tax deductions claimed.

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IFSA Proposals
IFSA has suggested two options to Government, both of which would split benefits rather than contributions.

Option 1 – Simple phase-in over appropriate period
The simplest option to implement and to administer would be to allow any couple to split their superannuation benefit on retirement after preservation age of either the giving or receiving spouse.

- IFSA suggests the phase-in period be twenty years, however it could be longer to keep cost to revenue down.
- A maximum split of 50% could still apply (members be allowed to split up to this amount).
- Splits could occur on retirement of either party, and perhaps on rollover of benefit.
- Splits could be allowed once only, or progressively up to the maximum split number for the last day split (ie similar to ETP threshold and RBL rules now).
- Split benefits would follow the rules and systems established for split benefits under the Family Law provisions

This option would have very low implementation and administration costs. It would not require any new data to be maintained for fund members, with the possible exception of

- a "proportion already split" number to ensure compliance with the 50% maximum (were this limit adopted). This number could be reported to the ATO along with other ETP information and maintained in the RBL system to monitor compliance; or
- a simple flag could be applied if a "once-only" split has been made.

On any given day during the phase-in period, a maximum split would apply. Any member able to split on that day would be able to split up to this proportion. For example, exactly halfway through the phase-in period, the maximum split would be 25%.

The phase-in period could be set based on an acceptable cost to revenue. This would require some calculation, which IFSA would be happy to assist with should the option be selected. As a guide, we would suggest starting with a 20 year phase-in.

Option 2 – Benefit Split with contemporary notification
This is a slightly less simple option, with the addition of a contemporary notification to address cost to revenue concerns.

The option would split benefits in the proportions that the notified period comprises of membership in the fund (rollovers), or of the eligible service period (retirement).

- Members would have to notify a spouse they wished to split to during each year for which they wish to split (or soon thereafter – say on receipt of the annual report).
- Split could be effected on rollover (to avoid aggregating numbers across funds), or on retirement from a final fund.
- The split could be subject to a maximum 50%.

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The formula would simply divide the notified splitting period by the service period – ESP being the simplest option. This number could be multiplied by 0.5 to give a maximum split table proportion:

NSP / ESP x 0.5

We suggest the split be not mandatory: that is, the number given by the above formula is simply the proportion of the balance the member can roll out into the non member spouse's account, or have paid to the non member spouse as an ETP if he/she is over preservation age.

This option is not as simple to administer as the previous one, but it has the fiscal advantage of requiring contemporary notification of a split.

ISFA still regards the contemporary notification as undesirable, for the reasons we outlined above. It has negative equity consequences, and denies couples the sort of flexibility a lifetime savings regime such as superannuation should afford people. We have only contemplated this second benefits split option on the basis of its lower cost to revenue.

Conclusion

IFSA's strong preference is to achieve the objectives of splitting mandatory superannuation through a simple benefit split option, which does not require contemporary notification. Our first benefits split option would, we believe, give the best outcome for couples at acceptable cost to government, and has minimal administrative costs.

Yours sincerely

Richard Gilbert
Chief Executive Officer

Level 24, 44 Market Street, Sydney NSW 2000 Ph: 61 2 9299 3022
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