Senate Select Committee on Superannuation and Financial Services

Main Inquiry
Reference (a) + (c)

Submission No. 19
Note: Also Submission No. 4 to Reference (b)

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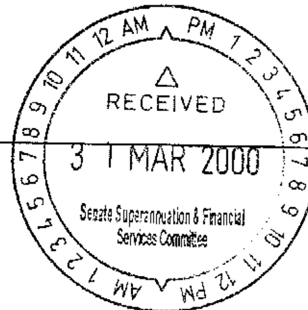

30 March 2000

Ms S Moreton
Secretary
Senate Committee on Superannuation and Financial Services
Parliament House
CANBERRA ACT 2600

Dear Ms Morton

SUBMISSION TO COMMITTEE

I refer to your letter of 1 March 2000 inviting our firm to make a submission to the Select Committee on Superannuation and Financial Services.

As you pointed out in your letter, we have already lodged a submission in respect of Choice of Fund (13 December 1999). We continue to hold the views expressed in that submission. We would now like to make a further submission on the three more general issues set out in your letter. For completeness we have also included a section on Choice of Fund to re-emphasise our main points.

We believe that superannuation has become far too complex. The issue of complexity comes out as a common theme in our attached comments. As the superannuation tax system is not part of the Committee's current terms of reference, we have not commented on this subject. Nevertheless, we believe that it is imperative that the Government instigates a major review of the current superannuation tax system with a view to simplification. In our view, a system which only taxes end benefits is more likely to result in not only simplification, but also a more equitable system. It is also more likely to encourage saving for retirement.

We would be happy to elaborate on any points raised in the following pages.

Yours Sincerely

John D Ward
Manager - Research & Information

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PRUDENTIAL SUPERVISION AND CONSUMER PROTECTION FOR SUPERANNUATION

In recent years, the legislative requirements for superannuation funds have mushroomed. The system has become far too complex and costly to administer. We currently have a number of concerns in this area.

1. Over Regulation

In our view, many of the current requirements are unnecessary. As an example, trustees are required to monitor the number of hours a week that members over age 65 are working. Depending on the number of hours worked, it may be necessary to refuse to accept further contributions (unless they are mandated contributions) and/or immediately pay out the member's benefits (except the member's post-65 employer-financed benefit which results from mandated contributions). APRA have recommended that this monitoring should be done monthly to determine whether the member has satisfied the work test in respect of each week! (We also note these particular requirements are in direct conflict with the Government's policy of encouraging people over 65 to remain in the workforce.)

Such monitoring is not only costly but also serves to divert trustees from more important issues affecting the management of the fund as a whole. This particular requirement does not improve the security of members' benefits. Likewise, it is unlikely to have a significant impact on Government revenue. Even if the revenue impact was significant, this could be protected by less frequent monitoring (say annually) or by other measures.

An analysis of the legislation would find many other issues that could be removed without impacting on security of benefits or Government revenue. As indicated above, the removal of these items would enable trustees to spend more time on significant issues which will enhance the security of members' benefits.

2. Reduction in time for Annual Returns

A further new requirement for 2000 is the reduction from 6 months to 4 months for funds to submit their annual returns. This occurs in a year where trustees and the business community need to come to grips with the major changes involved with the New Tax System. The timing also coincides with the Olympic Games for most funds.

Even without these additional issues in 2000, the four-month period is likely to be unachievable in many cases. The superannuation industry is desperately short of trained and experienced staff following major increases in regulatory requirements. Audit firms are already often forced to use superannuation funds as a 'training ground' whilst more experienced auditors concentrate on their corporate clients.

The 4 month requirement will result in hastily completed returns prepared by inexperienced staff. The potential for errors, and hence reductions in the security of members' benefits will increase. At the same time, funds will incur greater costs as additional or temporary staff will be required (if they can be found).

We recommend a return to the 6-month requirement.

3. Black letter requirements

Superannuation has become extremely complex. It is not well understood by the community. Superannuation funds should be encouraged to provide member communication material in plain English. Further, the use of alternative means of communication, such as the Internet, should be encouraged as options to the traditional print medium. Any legislation needs to take these issues into account. The application of black letter law to, for example, the production of member information will inhibit a proper understanding of superannuation and hence will limit the effectiveness of superannuation benefits financing the needs of our aging population.

It appears that the interpretation that ASIC is applying in respect of the member communication requirements is more rigid than was previously applied by the former ISC in respect of the same requirements over the preceding 4 years.

4. Multiple Regulators

Superannuation funds (other than Self Managed Superannuation Funds) now have to deal with 3 Regulators (ATO, APRA and ASIC). In addition to these Regulators, the industry also has to deal with Treasury on policy matters.

There is still much confusion over the various roles, particularly in regard to the division of duties between APRA and ASIC.

There is also concern about the perceived differences between APRA's and ASIC's approach to the conduct of prudential reviews, both in the manner in which the reviews are run and the way in which review findings are dealt with.

We recommend that the approaches of ASIC and APRA to prudential reviews be harmonised as far as practicable.

RECOMMENDATIONS

1. Simplify or remove unduly complex legislation.
2. Revert to a 6-month requirement for completion of annual returns.
3. Encourage plain English and modern media rather than applying black letter law to communication and reporting to members.
4. Greater clarification of the roles of the various Regulators and greater harmonisation of their approach.

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OPPORTUNITIES AND CONSTRAINTS FOR AUSTRALIA TO BECOME A CENTRE FOR THE PROVISION OF GLOBAL FINANCIAL SERVICES

Australia is in an ideal position to become a financial services, administration and investment service centre for the rest of the world. It has a stable political environment, sophisticated financial markets, good infrastructure for banking and e-commerce and a well-educated employment market.

However there are also some negatives such as tax (including capital gains tax) and time differences with the rest of the world.

Even Australia's superannuation requirements provide numerous barriers to becoming a financial centre. As a financial centre, it is likely that there will be an increase in the transfer of employees to and from Australia. The current superannuation and related tax requirements make this more difficult than it needs to be. The requirements also make it difficult to use an Australian fund for all employees in say the Asian region. The main superannuation barriers are set out below:

1. Requirement to contribute to an Australian fund

Although there are some exemptions for employers paying Superannuation Guarantee contributions for some senior executives working in Australia with specified visas, the exemptions are limited. Exemptions do not apply for general, technical or sales staff or for New Zealanders (as they do not require a visa). We acknowledge the importance of ensuring that Australian companies do not employ foreign nationals because they may be cheaper to employ (eg if no superannuation costs were required). However, most employees transferred from overseas are already participating in their employer's fund overseas.

The Australian requirements result in either a doubling of superannuation provision (ie both here and overseas) or a need to adjust the overseas arrangements. As many overseas funds are defined benefit funds, such adjustments may not be straightforward, yet may only apply for a short period of time whilst the employee is in Australia.

We recommend that an exemption from SG requirements be granted where it can be ascertained that the employee is receiving suitable superannuation provision in an overseas fund. If necessary, such an exemption could be restricted to those who are not Australian citizens. However, it is becoming more and more likely that Australians will be transferring to and from overseas locations with their

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employment. The exemption could alternatively be limited to those expecting to be working in Australia for say less than 4 years.

2. Difficulties in contributing to an Overseas fund

If an Australian employer contributes to an overseas fund, then the contribution is either not tax deductible (assuming the employee is classified as an "exempt employee") or is subject to Fringe Benefits Tax. In either case, the treatment is inconsistent with the treatment of contributions to an Australian fund.

We recommend that employers be able to claim a tax deduction for contributions to an overseas fund for such internationally mobile employees, without the imposition of FBT. If necessary, this treatment could be restricted to contributions up to the SG level applying at the time.

3. Requirement to retain benefits in Australia

Even though a foreign national may only be working in Australia for a short period, any superannuation benefits built up in an Australian fund are subject to preservation requirements. It is not possible for the employee to transfer that benefit to their fund overseas (unless one of the preservation conditions of release is met). Thus it is often necessary to retain small benefits in Australian funds for many years in respect of former employees who have no intention of ever returning to Australia. This results in considerable anger from the affected employees and their employers and is likely to result in many such benefits eventually being forgotten and becoming lost. It also results in additional administration costs for Australian funds, at least some of which will be borne by other members or employers. This includes ongoing member reporting and difficulties in maintaining contact with a member who has not been in Australia for many years.

Australia stands out amongst other Western nations as having the most restrictive practice in this area. For example, transfers from UK and New Zealand funds to Australia are much easier to arrange.

We recommend that Australian funds be given the ability to transfer a benefit in an Australian fund to a suitable fund overseas where the member is leaving Australia permanently. In order to avoid abuse, such transfers should, in the case of preserved benefits, be restricted to an overseas fund rather than allowing a cash payment (ie similar to the UK requirements). Restricting such transfers to those who are not Australian citizens may also be a suitable compromise.

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4. Difficulties in transferring overseas benefits to Australia

Where an international employee wishes to live in Australia on a permanent basis, it is likely that at some stage, he or she will want to transfer any benefits in an overseas fund to Australia.

We note that there is effectively a six-month "tax free" period after becoming an Australian resident in which a benefit may be transferred. This period is often too short to arrange the appropriate transfer and should be extended to at least 12 months.

However, in many cases, the employee does not decide to remain permanently in Australia until much later. We can accept that some tax liability should apply in such circumstances, however, a major difficulty with the current legislation is the actual payment of the tax liability. Problems can arise as follows:

- Benefit transferred from UK. The UK requirements are such that the benefit must be transferred to an Australian superannuation fund. Once paid to the Australian fund, the amount transferred is subject to preservation. Despite the benefit being locked up in the fund, the employee is then required to find the money to pay what could be a significant Australian income tax liability, from other sources.
- Benefit transferred from, say New Zealand. Whilst there are no NZ legislative requirements for the benefit to be transferred to an Australian fund, this often occurs without the member being aware, until too late, of the potentially large personal tax liability incurred by the transfer. Again, the tax must be funded from other sources as the benefit is preserved in the fund.

We recommend that greater flexibility be built into the system so that the benefit in the fund can be accessed in order to pay the tax or alternatively that the tax be deferred (presumably with a reasonable interest rate applying) until the benefit can be paid from the Australian fund.

5. Difficulties in contributing to an Australian Fund for Australian employees working overseas

Contributing to an Australian fund for non-residents can have dire financial consequences for the fund. If the accumulated entitlements of non-residents who

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are active members of the fund increases to more than 50% of the entitlements for all active members, the fund is liable for tax of 47% of its assets.

If an Australian employer transfers some long serving senior executives to say, set up or manage an overseas subsidiary and continues to contribute to the Australian fund the fund could lose almost half of its assets in tax (if the 50% level is exceeded).

We recommend that these provisions be varied so that employers can continue to provide superannuation for Australians temporarily working overseas without such a potentially adverse impact on the fund.

RECOMMENDATIONS

1. Extend the exemption from Superannuation Guarantee to employees participating in their employer's superannuation fund overseas.
2. Improve the tax treatment of contributions made to overseas funds.
3. Allow greater access to preserved benefits for those leaving Australia permanently.
4. Allow a longer period in which to transfer an overseas benefit into Australia on a tax free basis.
5. Vary the tax treatment on benefits transferred to Australia so that the tax can be met from the benefit itself.
6. Allow greater flexibility to employers to provide superannuation for their overseas employees through an Australian superannuation fund without potentially significant tax penalties on the fund.

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31 March 2000
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ENFORCEMENT OF THE SUPERANNUATION GUARANTEE CHARGE

The requirements are currently too complex. The procedures for fixing errors are too cumbersome and the penalties are too extreme in the case of administrative error.

These issues become far more important if quarterly or monthly payments are required.

Choice of fund will also aggravate the problem for employers with many more honest administrative mistakes likely. Unless the proposed penalties are reduced significantly, honest employers will be penalised for failing to meet very complex timing requirements on contributions, particularly in respect of casual employees.

We believe that there are four main issues that need to be considered:

1. Timing of Payments

At present, contributions only need to be paid once a year, by 28 July for the year ending on the previous 30 June. It is our experience that most major employers make regular payments throughout the year rather than a once only payment in the following July.

However, where only annual payments are made, employees not only lose investment income but also run a greater risk that the appropriate payments may never be made if the employer is in financial difficulties.

A requirement for quarterly or monthly payments would however result in additional compliance costs for some employers. It would also increase the risk of penalties applying for non-compliance due to minor administrative errors.

We would therefore support the introduction of a requirement for either quarterly or monthly payments PROVIDED THAT the problems discussed in points 3 and 4 below are addressed.

2. Monitoring Compliance

At present, it appears that there is little done in the way of the ATO monitoring employers' compliance with the SG requirements. Employees do not appear to be able to easily instigate an investigation of any shortfall or non-payment of contributions by the ATO.

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This is a difficult issue as we consider that it would be inappropriate to require superannuation funds themselves to monitor compliance - the fund is potentially unaware of the earnings base to be used and may be unaware of contributions that are paid to other funds. Likewise, we would wish to avoid additional compliance monitoring to be imposed on the employer.

Consideration should be given to the introduction of a Tribunal to investigate claims of non-compliance. Such a Tribunal may also be suitable to investigate issues of non-compliance with Choice of Fund.

3. Payment of SG Charge

The system for rectifying contribution shortfalls is far too cumbersome, is not well understood and results in further benefits being "lost".

Where an employer discovers that it has underpaid the contributions to the fund, there is no option but to make the payment of the SG Charge to the ATO, including the completion of the appropriate form. The ATO will then provide an SG voucher to the employee who can then pass this on to the superannuation fund which then needs to redeem the voucher from the ATO. All of this leads to increased work for the employer, the ATO, the member and the fund. In the meantime, the member is losing interest on the money.

We consider that it would be much more appropriate if the employer could rectify any underpayment by making a payment (with an interest adjustment) direct to the fund. If necessary, the employer could be required to notify the ATO, say on an annual basis, of any underpayments made during the previous year and of their correction.

4. Penalties

We consider that the current penalty system for non-compliance with SG is inappropriate.

At present, there are 6 separate penalties that are imposed on an employer for not complying with the SG requirements. These are as follows:

- $50
- $30 for each employee for whom the correct contributions have not been paid

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- Superannuation guarantee charge is based on the generally higher "salary and wages" rather than Ordinary Time Earnings (or other applicable notional earnings base).
- Interest must be added from the start of the relevant year, rather than from the date the contribution should have been made. This is potentially an interest penalty of almost 13 months.
- The payment of the SG charge is not tax deductible
- Further penalties of up to twice the SG charge apply for failing to keep records, and certain other offences.

The first 5 penalties are automatic and apply even if the relevant contributions were paid in full after the due date. Only the sixth is at the discretion of the ATO.

In our view, the first five automatic penalties, in combination, are extreme for what might be a minor technical breach of the payment requirements. The calculations required are also complex, particularly where most (but not all) of the required contributions were paid.

If SG payments are required quarterly or monthly, the difficulties for employers will compound. The situation becomes even more complex and difficult if the penalties for administrative breaches of any Choice of Fund legislation are applied in a similar manner.

RECOMMENDATIONS

1. Require either quarterly or monthly contributions (provided that the following recommendations are also adopted).

2. Allow contribution shortfalls to be made up by the employer by making a contribution (including interest) to the fund within say 3 months of the end of the year. (Note that as well as addressing the administrative problems of employers, this approach would reduce the loss of benefits by employees when SGC vouchers are not cashed.)

3. Remove the first 5 penalties mentioned in item 3 above. Apply the sixth penalty in cases where the employer is consistently tardy with contributions (eg if more than, say 90% of contributions are outstanding for more than 3 months).

4. Establish a simple Tribunal system to investigate member claims of unpaid contributions.

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CHOICE OF FUND

We have already provided the Committee with our submission on Choice of Fund. The following points highlight our major issues.

1. **Timing**

   It is important that a reasonable lead time be allowed. There should be at least 12 months after the passage of legislation and associated regulations to enable employers and funds to set up appropriate procedures and for an appropriate education program to be effective.

2. **Disclosure**

   Education is very important. Small variations in investment return over a long period can have a much greater impact than fees and charges. Provided that there is competition and adequate disclosure the key decision is not the fund decision. It is the investment decision. If the objective is about maximising outcomes under a choice of fund or a non choice of fund environment, the key prerequisite is education so that people make better decisions.

3. **Cost**

   Cost is a significant issue. Administration costs for employers, superannuation funds and members could increase significantly under a Choice environment. E-commerce offers the potential for dramatic cost savings but a large part of Australia is not ready to actually use it. (We deal with some 600 or 700 employers around the country and to date the great limiting factor for us in implementing the e-commerce solutions we have is the administration capability within these employer organisations.)

4. **Life Insurance**

   Care needs to be taken to avoid loss of cover on joining a new fund or changing from one fund to another. There is also a concern that some employees will inappropriately decide to opt out of the life insurance component.

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Simplification of the tax treatment of group non-superannuation insurance policies would assist concerned employers to provide, at the employer's cost, at least a minimum level of cover for all employees outside the Choice of Fund requirements.

5. **Enforcement Powers**

The proposed penalties are too harsh in cases where minor administration errors have occurred. These need to be reviewed in conjunction with a review of the penalties for minor breaches of the SG requirements.

6. **Defined Benefit Fund**

Special consideration needs to be given to the special circumstances of defined benefit funds.