26 June 2019

The Hon Josh Frydenberg MP
The Treasurer
PO Box 6022
House of Representatives
Parliament House
Canberra ACT 2600

Email: josh.frydenberg.mp@aph.gov.au

CC: Senator the Hon Jane Hume, Assistant Minister for Superannuation, Financial Services and Financial Technology
Email: senator.hume@aph.gov.au

Dear Treasurer,

SMSF ASSOCIATION SUBMISSION ON SUPERANNUATION POLICY PRIORITIES

The SMSF Association congratulates the Government on its re-election for a third term. We believe this provides a significant opportunity to pursue a policy platform to strengthen the superannuation sector, while seeking stability of the sector over the longer term to build confidence.

In doing so, we ask that the following policy priorities be considered:

1. Legislating the objective of superannuation
2. Maintaining ongoing stability
3. Increasing opportunities to contribute to superannuation
4. Creating a spousal rollover for superannuation assets
5. Ongoing simplification of superannuation, including:
    - An amnesty for legacy pensions
    - Addressing the superannuation residency test
    - Streamlining total superannuation balance thresholds
6. Strengthening SMSFs and choice of superannuation by:
    - Raising the standards of SMSF advice
    - Addressing limited recourse borrowing arrangement (LRBA) risk
    - Addressing issues with superannuation data
    - Addressing issues relating to extremely large superannuation balances

Legislating the objective of superannuation

The SMSF Association believes it is an opportune time to look to define the objective and role of superannuation, including what it is supposed to deliver and how all parts of the superannuation system should fit together.

The lack of a legislated objective of superannuation is in part responsible for the lack of a holistic policymaking approach to the retirement income system and some of the systemic issues uncovered by various inquiries.

It is essential that any objective not only has a focus on providing retirement income but also encourages members to build adequate retirement savings through the superannuation system to manage the financial risks of aging and retirement.

For the primary objective and guiding principles to effectively guide retirement income policy, there needs to be a direct link between new policy and the enshrined objective and principles. We believe that any new legislation that affects retirement income policy (e.g. superannuation, taxation, age pension, etc.) should be reviewed against the objective and principles similar to Regulatory Impact Statements or the Statement of Compatibility with Human Rights that are carried out in conjunction with introducing new legislation currently.

Additionally, the proposed inquiry into the retirement income system will also be able to benchmark proposals against the legislated objective and determine the areas of concern for improvement.

Building a successful retirement income and superannuation system requires public confidence in the efficiency and fairness of the system. Previous and numerous ad-hoc changes and lack of integration between all parts of the sector have degraded this confidence. A move to restart the conversation and make effective changes to improve the system only when necessary is essential to this process.

We encourage the Government to consult with the superannuation industry and legislate the objectives of superannuation in 2019.

Maintaining ongoing stability

After the introduction of the significant legislative changes which came into effect on 1 July 2017, the SMSF Association believes maintaining ongoing stability for the superannuation sector is essential.

We note that the Government has committed to guaranteeing no new taxes on superannuation. It is important that superannuation fund members continue to experience a period of sustained stability.

After a period of significant change, superannuation fund members need confidence that their retirement plans and strategies will not be significantly impacted every budget cycle or be subject to political and ideological based policy changes.

This would allow superannuation funds and their members greater confidence to ensure that they have the correct strategies in place to comply with the new rules and maximise their opportunities to build retirement savings.

This is also important in light of the Government's stated intention to undertake a review of the retirement income system that will be crucial for policy affecting SMSFs and superannuation more widely in the future. This is a reflection of the Productivity Commission's recommendation that the Government should commission an independent public inquiry into the role of compulsory superannuation in the broader retirement incomes system, including the net impact of compulsory superannuation on private and public savings, distributional impacts across the population and over time, interactions between superannuation and other sources of retirement income, the impact of superannuation on public finances, and the economic and distributional impacts of the non-indexed $450 a month contributions threshold.

Accordingly, to promote increased stability for superannuation we recommend that a legislated objective of superannuation should be enshrined before any inquiry progresses.

This is important because the superannuation sector has recently dealt with significant change. In addition, the superannuation and financial services industry is immersed in a period of regulatory change and heavy scrutiny resulting from the Financial Services Royal Commission and Productivity Commission inquiry into superannuation.

Increasing opportunities to contribute to superannuation

The SMSF Association believes that the current contribution caps are inadequate, particularly for Australians approaching retirement age. The current concessional contribution cap of $25,000 per year for older individuals has negatively affected their ability to save an adequate amount of superannuation to be self-sufficient in retirement. This is especially the case for people approaching retirement who have not had the benefit of a full career with compulsory superannuation or with broken work/contribution patterns.

The current cap does not provide adequate opportunity or incentive for individuals to save for their retirement during the years in which such saving is financially affordable for them. The lack of a higher cap for older Australians fails to recognise that most people are able to make voluntary contributions to superannuation later in life when they have a greater financial capacity to do so. Individuals traditionally meet mortgage repayments, school fees and other immediate household expenses before considering the opportunity to build an adequate superannuation balance.

The lead up to retirement (beginning around age 50) is a critical time period for individuals to plan and grow their retirement savings. These are the final years of full-time work and provide the greatest opportunity with an intersection of financial capability and proximity to retirement.

The significant impact that personal contributions can have on superannuation balances at retirement should not be underestimated. The restriction to $25,000 not only lowers retirement savings, it encourages individuals to consider other forms of tax effective retirement planning such as investment bonds or negatively geared property investment. When considered with issues regarding the age pension taper rate, the disconnect between superannuation, social security policy and the objective of superannuation, individuals may neglect making adequate superannuation contributions.

We believe Government policy needs to incentivise, encourage and provide adequate opportunities for Australians to take ownership of their retirement savings and contribute to their superannuation, particularly when they have greater financial capacity to do so. For many individuals over 50, this is not currently the case.

We recommend that individuals over the age of 50 be able to access a higher concessional contribution cap. We suggest that the cap for individuals over 50 should be set at $35,000. This provides an extra $10,000 per year which can be used by those who are planning for retirement and result in a significant positive impact on retirement outcomes.

Creation of a spousal rollover for superannuation assets

The gender retirement gap is an ongoing problem for the superannuation system. Currently, the average balance for men is around $112,000 and for women around $68,000. According to the 2017 Household, Income and Labour Dynamics in Australia (HILDA) Survey, women retire with half the superannuation savings of men.

Additionally, the introduction of the $1.6 million transfer balance cap (TBC) and clarification of the meaning of 'cashing' death benefits has changed the importance of individual superannuation balances of a couple. The reforms now mean that on death of a member, death benefits are much more likely to leave the superannuation system earlier.

This is because when a member dies their TBC ceases. Therefore, in absence of any space that can be utilised in a spouse's $1.6 million TBC through a reversionary pension, sums of money must be 'cashed' out of the system as a death benefit lump sum. Previously, on death of an individual, the entire death benefit sum would normally revert to a spouse who was entitled to keep this amount in superannuation as a death benefit.

The introduction of the $1.6 million cap also significantly affected the taxable amounts of many superannuation balances. Individuals who exceeded this cap were forced to remove money from superannuation, move money into the 15% taxable accumulation phase or try shift balances to their spouse. This has had a significant impact on many individuals in retirement phase, who previously did not need to actively manage their superannuation balance exceeding a certain size.

Due to the recent introduction of the TBC and the lack of opportunity for couples to adjust for its introduction, most couples have balances which are heavily weighted to one member. Usually, the male member has had uninterrupted working patterns and a higher wage, benefiting from higher superannuation guarantee contributions to superannuation.

In most families, women are still the primary carers of children, which means they spend more time out of the workforce than men, and often return to work part time. There are also larger systemic issues such as the gender pay gap, rise of the gig economy and design of the superannuation system which means it is not as effective for part-time or low-income earners.

Therefore, fund member balance equalisation strategies are more important than ever to ensure members can each make the most of their $1.6 million TBC, and total superannuation balance thresholds.

Current strategies in this regard have been to employ a re-contribution strategy, use spouse contribution tax offsets, or spouse contribution splitting. However, these strategies are limited in effectiveness due to contribution threshold and cap restrictions, withdrawal restrictions, and the lack of flexibility and incentives with spousal contribution measures. The ability for individuals to even out superannuation balances is limited due to the gender pay gap and the current superannuation regulatory context.

This situation is inefficient, given that for most couples, retirement is not an individual equation but rather a function of both their savings. A more equal allocation of retirement savings between a couple can lead to more equitable retirement outcomes for women and simpler administration of the superannuation system. Therefore, the SMSF Association proposes that a spousal rollover measure be introduced for superannuation fund members.

In essence, the measure would allow an individual with a higher superannuation balance to rollover a portion of their superannuation balance to their spouse in order to help even out balances.

This measure would provide an effective and efficient way to significantly improve the superannuation retirement gap between genders and improve equalisation for couples, with particular benefit for women.

It would also provide an attractive opportunity for couples who would be able to restructure their superannuation to better make use of the TBC and reduce administrative complexity in retirement without providing a tax 'loophole'.

We would be happy to explore this proposal in more detail with your Government.

Ongoing simplification of superannuation

Simplifying the superannuation system should be an ongoing focus for Government in order to maximise the efficiency of superannuation so that it can continue to deliver the best retirement income outcomes for fund members.

We note the Government has committed to some efficiency measures in their 2019-20 Budget, including exempt current pension income changes and a partial reduction in the work-test.

Three priorities we believe the Government should focus on this term include:

1. An amnesty to allow SMSF trustees to convert their term allocated and legacy pensions to account based pensions.

With the introduction of the transfer balance cap, we believe it is sensible to grant an amnesty period to allow SMSF trustees to convert their term allocated and legacy pensions to account based pensions. A superannuation 'clean up' of these legacy pensions is desirable for the Government, regulators and the superannuation industry for the purposes of simplicity and efficiency.

Legacy pensions now exist in an environment where they have little relevance and one where many SMSF trustees currently do not fully comprehend their operation and the impact the TBC has on them. This is because they have not been able to be established in over a decade. They are difficult to administer, explain and advise on.

Their relevance in the superannuation industry is further diminished by the significant regulatory changes to superannuation laws. The introduction of the TBC results in some of the most complex laws and outcomes in financial services for these pensions. There are many legacy pensions where the costs of administering them is substantial given the relatively low balances.

An amnesty to 'flush out' legacy pensions would also give the opportunity for individuals to take up new more innovative retirement income products rather than being locked into legacy products.

2. Addressing inefficiencies in the current residency rules for Australian superannuation funds unfairly affecting SMSFs.

Currently, the definition of 'Australian Superannuation Fund' in section 295-95 of the *Income Tax Assessment Act 1997* creates administrative difficulties and red tape for members of SMSFs.

It involves situations where Australians who are temporarily resident overseas being prevented from making contributions to their SMSF due to the penalties involved and the fund being taxed as a non-complying superannuation fund. The alternative to not being able to make contributions to an SMSF is for the individual to make contributions to an Australian Prudential Regulatory Authority (APRA)-

regulated superannuation fund and on their return to Australia transfer those contributions back to their SMSF.

This is cumbersome as it involves making contributions to a fund which is not the preference of the individual and causes significant additional costs to be incurred by having an additional superannuation fund and subsequently transferring the benefit to their SMSF. This increases both fund administration and compliance costs for the individual affected, reducing their superannuation balance, which is something the Productivity Commission has condemned.

We believe a minor amendment to the residency test would ensure that SMSF members who are working overseas can still contribute to their fund. This would mean that, as long as the fund was established in Australia and the central control and management ordinarily remains in Australia, an SMSF member can contribute to their fund of our choice.

3. Streamlining the total superannuation balance thresholds

Introduced on 1 July 2017, an individual's total superannuation balance (TSB) has been used to determine an individual's ability to access certain superannuation measures. The SMSF Association has been supportive of this method as an effective way to target support to appropriate cohorts of superannuation members.

However, the introduction of multiple TSB thresholds is unnecessarily adding to the complexity of the superannuation system. This has made it increasingly difficult for individuals to understand the superannuation system and their options.

These thresholds have not only added complexity to trustees trying to understand and use the superannuation system but also for their advisers and administrators to manage. It also increases the costs for superannuation members as they need specialised advice to understand the multiple different thresholds that may apply to them and when they apply.

Currently, the following different TSB thresholds apply:

- $300,000 TSB for work-test exemption contributions.
- $500,000 TSB for catch-up contributions.
- $1,000,000 TSB threshold for quarterly transfer balance cap reporting.
- $1.4 million, $1.5 million and $1.6 million TSB limits for bring forward non-concessional contributions.
- $1.6 million TSB threshold for non-concessional, spousal and co-contributions.
- $1.6 million TSB threshold for segregated pension assets.

The SMSF Association believes that these amounts should be streamlined and simplified where possible so that the application of TSB thresholds is more understandable.

We would be happy to detail our solutions to these issues with your Government. These issues and other simplification measures were also detailed in our 2019-20 Budget submission.

Strengthening SMSFs and choice of superannuation

Finally, the Government has a significant opportunity in the next three years to further strengthen the SMSF sector. We believe positive policy measures can be implemented in the next term that focus on areas of concern and protect those individuals who have chosen to take control of their retirement through an SMSF.

Strengthening the SMSF sector will help stakeholders and SMSF trustees in responding to unwarranted criticism and adverse proposals which are not of an equitable nature. The rising funds under management of industry superannuation funds means it is important that SMSFs maintain their role as a key sector of the superannuation system and an alternative choice for individuals to avoid the risk of any one sector dominating the superannuation system. The Productivity Commission noted that the existence of the SMSF sector provides competitive tension to the whole superannuation system.

We have highlighted four areas of concern where SMSFs have been scrutinised and where policy improvements would allow the sector to continue to be a key part of the superannuation system.

1. Raising the standards of SMSF advice through specific education requirements

The quality of financial advice provided to SMSF members is crucial to the integrity and performance of the sector. As the Productivity Commission stated, there are current issues with SMSF advice that must be rectified, but without prohibiting informed members from making their own decisions or overburdening them with excessive red tape.

Raising the standards of SMSF advice through specific education requirements has long been a policy advocated by the SMSF Association and a key focus of our mission to lead the professionalism, integrity and sustainability of the SMSF sector. The need to ensure SMSF advice providers are appropriately educated is also supported by both the Australian Securities and Investment Commission (ASIC) and the Productivity Commission.

This is essential given that SMSFs are a specialised retirement savings vehicle and are distinctly different to large superannuation funds. Unfortunately, the Financial Adviser Standards and Ethics Authority, the new education standards-setting body which is currently determining the education and training requirements, has determined that a financial adviser only needs to study a general subject in broad superannuation to provide SMSF financial advice. A broad high-level education approach does not give an adviser enough insight to reach a threshold where they can comprehensively advise on the complex aspects of SMSFs.

We support a requirement to increase financial adviser knowledge standards relating to specific and complex superannuation legislation and discourage advisers who have not undertaken specialist SMSF training but wish to give SMSF advice

2. Addressing limited recourse borrowing arrangement risk

The SMSF Association's long-held position regarding direct borrowing by superannuation funds has been to oppose a prohibition on borrowing. This is on the basis that SMSFs use limited recourse borrowing arrangements (LRBAs) to generate savings and retirement income. LRBAs used appropriately as a genuine retirement strategy can help build savings and also allow small business owners to utilise their business real property as a superannuation investment.

However, LRBAs have been under recent heightened scrutiny and as an Association we have regularly reviewed their risks across areas such as their use by property spruikers, lack of SMSF diversification, risk to SMSF sector and superannuation system integrity, LRBA growth and impact on the property market.

Recently the Council of Financial Regulators (CFR) Report into LRBAs was delivered to the Government. They found that LRBAs do not create a systemic risk for the financial system; a finding expected by the SMSF Association. In response, the Government announced that it will not be making any changes to the regulation of LRBAs.

However, we note that the CFR Report cites regulator concerns that LRBAs 'can represent a significant risk to some individuals' retirement savings, particularly where they have low-balance SMSFs with high asset concentration and/or personal guarantees. The Report stated that accordingly, the regulators' preferred position is to ban SMSFs from using LRBAs as an investment tool.

The SMSF Association believes that an outright ban on LRBAs, which has been called for by various stakeholders, is unnecessary and avoidable and we support the Government's decision to not ban LRBAs. However, we believe that known risks regarding the use of LRBAs should be mitigated before they threaten the integrity of the SMSF sector.

The two key measures to ensure LRBAs are used appropriately recommended by the SMSF Association include banning the use of personal guarantees supporting LRBAs and increasing the SMSF education requirements for advisers, which we have highlighted earlier.

Personal guarantees given by SMSF trustees allow the SMSF to undertake larger borrowings with higher loan to value ratios (LVR). While the SMSFA is comfortable that the vast majority of SMSF borrowing is being made within sensible LVR limits, prohibiting SMSF members from providing a personal guarantee for their SMSF's borrowings would make it more difficult for lenders to make risky, high LVR borrowings to SMSFs. Significantly, in the 2016-17 financial year, 30% of LRBAs were secured by a personal guarantee.

In effect, a restriction on personal guarantees would ensure that limited recourse loans remain limited to the SMSF asset for security without putting personal assets at risk.

3. Addressing issues with superannuation data

The SMSFA is concerned that recently recommendations, polices and proposed measures have been made using evidence bases which are not as accurate or timely as desired.

For example, the Productivity Commission's draft finding that SMSFs with less than $1 million are not cost-effective was based on inconsistent Australian Tax Office (ATO) data, which we note was also recognised by the Commission. Through alternative data sources the SMSF Association and others were able to provide, this finding was reduced a more realistic figure of $500,000.

Furthermore, the Australian Labor Party's proposal to remove refundable franking credits was based on 2014/15 ATO data, which was utilised by the Parliamentary Budget Office with various adjustments. Not only was this data significantly outdated to be making policy decisions in 2019, it was based on data before the introduction of the $1.6 million TBC which has significantly impacted the refundable franking credits received by SMSFs.

The SMSF Association recognises the difficulties policymakers face in data collection and analysis, however, we believe there is a significant opportunity for improvement.

Currently the quality of ATO SMSF data and the ATO SMSF statistics derived from it are questionable, especially in regards to costs and returns. Problems with this data are exacerbated by differences in ATO and APRA statistical methodologies, such as the definition of net earnings and the treatment of contributions tax used to determine rate of return (ROR) for APRA-regulated fund and the return on assets (ROA) for SMSFs.

Furthermore, another significant issue in comparing investment returns, especially at a sector level, is that SMSFs have a significant proportion of members in retirement phase compared to APRA-regulated funds which can distort comparisons.

The different costs that are included in SMSF ROA compared to APRA-regulated fund ROR also make it difficult to compare investment returns across the sector and conclude what level of assets are required by SMSFs to achieve similar returns to APRA-regulated funds. This includes establishment, windup, investment, administration, insurance and indirect investment costs.

Furthermore, when compared with data from large SMSF software administrators, SMSF ATO statistics do not seem to correlate well. For example, alternative data from BGL and Class indicate that SMSF costs are lower than described in ATO data.

We believe this data is more accurate than that gathered by the ATO through the SMSF annual return as it is used to generate financial statements which allow trustees to monitor their fund's financial performance whereas the ATO data is primarily used to assess the tax outcomes for the fund.

We believe that these data problems make it difficult for policymakers to propose timely, effective and equitable measures for the betterment of the superannuation sector.

The SMSF Association encourages the Government to explore improving the data collection relating to superannuation entities and also look to the Productivity Commission's recommendation to establish a permanent superannuation data working group, comprised of APRA, ASIC, the ATO, the ABS, the Commonwealth Treasury and a new member advocacy body to identify ways to improve the consistency and scope of data collection and release across the system, with a focus on member outcomes.

4. Addressing issues relating to large superannuation balances

Another criticism of SMSFs is the existence of large superannuation balances. Curiously, when this policy debate is undertaken it is always focused on SMSF members, rather than acknowledging that large superannuation balances also exist for members in APRA-regulated funds.

The SMSF Association acknowledges and supports the proposed objective that superannuation is primarily for the purpose of retirement and should not just be an estate planning tool to protect assets in a concessional environment.

Specifically, with regards to SMSFs, 0.7% of SMSFs had assets greater than $10 million at 30 June 2017 which represented 10% of total SMSF assets. This portion of SMSFs is constantly used by detractors to attack the SMSF sector.

For comparison, in 2016, Australian Tax Office figures showed that there were 990 people with SMSFs worth $10 million or more and 944 people in large superannuation funds with $10 million or more.

We note that the significant changes introduced on 1 July 2017 implementing a $1.6 million TBC impacted the ability to shelter significant assets in superannuation tax-free. However, there is an argument that these large superannuation balances in both SMSFs and APRA regulated funds would be beyond the intention of the proposed objective of superannuation discussed above.

The SMSF Association believes it is worth including large superannuation balances in the proposed review of the retirement income system. Policy measures to discourage the retention of such balances indefinitely within the superannuation system could be considered.

We are happy to explore this issue in more detail with your Government.

If you have any questions about our submission please do not hesitate in contacting us.

Yours sincerely,

John L Maroney

John Maroney
CEO
SMSF Association

ABOUT THE SMSF ASSOCIATION

The SMSF Association is the peak professional body representing SMSF sector which is comprised of over 1.1 million SMSF members who have $747 billion of funds under management and a diverse range of financial professionals servicing SMSFs. The SMSF Association continues to build integrity through professional and education standards for advisors and education standards for trustees. The SMSF Association consists of professional members, principally accountants, auditors, lawyers, financial planners and other professionals such as tax professionals and actuaries. Additionally, the SMSF Association represents SMSF trustee members and provides them access to independent education materials to assist them in the running of their SMSF.