



23 February 2024

Senate Standing Committees on Economics
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Canberra ACT 2600

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Dear Sir/Madam,

SMSF ASSOCIATION SUBMISSION – IMPROVING CONSUMER EXPERIENCES, CHOICE, AND OUTCOMES IN AUSTRALIA’S RETIREMENT SYSTEM

The SMSF Association welcomes the opportunity to provide this submission in response to the Senate Standing Committee on Economics Inquiry, “Improving consumer experiences, choice, and outcomes in Australia’s retirement system.” Our submission is limited to terms of reference items e), f) and j):

- e. policy options to support greater choice and quality of life in the retirement income system, including but not limited to the aged pension, financial advice, home ownership and downsizing, and insurance;
- f. progress on implementing the Retirement Income Covenant; and
- j. any other related matters.

Retirement Income System

Quite naturally, superannuation policy has until now focussed on accumulation. This has been necessary, particularly in the context of what could be viewed as transitional phase of the superannuation guarantee system.

The system now approaches an important maturity milestone, and we will start to see for the first time, people retiring who have benefited from compulsory superannuation throughout their entire working life.

The current system is highly complex and laden with jargon which makes it difficult for many consumers to engage with and understand. Some good foundation policies are present within the system, and others are yet to be legislated. These need to be given time to make their mark and deliver measurable benefits and outcomes.

It could be said that superannuation suffers from an identity crisis. It is not well understood by many consumers, is complex and difficult to engage with. It has its own language and terminology that is not intuitive. This is coupled with the fears of retirees about longevity risk and the need for good quality advice in an environment where advice is difficult to access and becoming increasingly unaffordable for many ordinary Australians. Yet the need for advice has never been greater if the superannuation system is to deliver on its original policy intent.

The discussion on the delivery of professional advice by suitable qualified professionals needs to continue and must be broadened.

A greater focus must be placed on member engagement and education, underpinned by quality tool kits and calculators. This will assist members to better understand and engage with their superannuation. In turn, a better understanding of their personal income needs through out the retirement income life cycle.

Retirement Income Covenant

The retirement income covenant is in its early stages and has not had sufficient time to achieve its policy objectives and deliver measurable outcomes. The benefits of the covenant will truly start to be realised once superannuation funds are able to have real conversations with their members and provide to them the advice needed under a limited advice framework.

Once legislated, tranche 1 of the Quality of Advice Review recommendations will take time to have any measurable impact. Funds will need time to on-board new advice systems and services, and to deliver advice to a sufficient number of members to have any meaningful impact.

The retirement income covenant and access to advice are both important levers in the broader superannuation system. We expect they will have a measurable impact in time. Advised clients will have greater confidence and are generally more engaged. For that reason, we support the retention of choice and flexibility in the system, to allow for client's individual circumstances to be catered for. Through advice and education, we would expect to see a dynamic shift in benefit draw down rates towards income needs and the adoption of recognised, international best practices.

The current policy settings for the retirement income covenant are appropriate and fit for purpose when we consider the arm's length relationship that exists between APRA fund trustees and their members. In an SMSF context, the members and trustees are one and the same. As such, the ability for SMSF trustees to formulate and give effect to a broad strategy, that is not intended to be member specific, or advice to members, becomes deeply problematic. SMSF members are highly engaged and have specific obligations under the existing investment strategy covenants. We therefore support the existing policy settings and legislative frameworks, which excludes SMSF trustees from having to comply with the retirement income covenant.

Retirement Income Policy Settings

We would caution against the introduction of policies that mandate and remove choice. The accumulation phase of superannuation took time to mature and achieve its long-term policy objectives. Current policies on the retirement phase of superannuation need sufficient time to make their mark. Attempts to accelerate or force policy outcomes risks poor outcomes for retirees, may instead discourage engagement with superannuation, result in poor product design or increased reliance on Government aged pension.

We do however support innovation and the modernisation of the retirement income system. A system that considers the broader retirement ecosystem and the individual needs and circumstances of retirees. One that provides genuine choice for retirees. Superannuation is just one component of the retirement income system. Policy development must consider the impacts it will have across the retirement system. A silo approach to policies here is no longer sustainable and adds further complexity.

Other Related Matters

Complexity

The current legislative and regulatory framework for superannuation is highly complex and a product of a proliferation of changes over time. Superannuation would benefit from simplification, a reduction in caps and thresholds and the removal of red tape, rather than persistent changes and increasing complexity.

The existing complexity already acts as a barrier for many individuals to engage with their superannuation savings. It also adds unnecessary cost into the system. Yet a need to consider simplicity, or to avoid complexity, is not considered in the proposed objective of superannuation.

Proposed amendments¹ are currently before the Parliament which propose significant changes to the taxation of superannuation, adding yet another cap into the existing plethora of caps and thresholds applicable to superannuation. It will also add significant complexity and cost to the administration and taxation of the superannuation system and introduce greater uncertainty for those affected. It will impact many more people over time than has been represented.

Further, elements of the proposed measures are heavily reliant upon regulations. Those regulations have not been made available at any stage of the consultation process and are yet to be released.

The timing of that Bill's presentation to the Parliament means that it is not subject to the requirements set out in *Superannuation (Objective) Bill 2023*.

It is an example of a policy that has been rushed, is ill considered, and is not simple despite the representations made to the alternative.

Stability, consistency, and certainty

Superannuation needs stability, consistency, and certainty. Continual changes to the superannuation system adds complexity to what is an already complex system. This erodes confidence and trust in the system.

The Financial System Inquiry noted:

The lack of clarity around the ultimate objective of superannuation policy contributes to ad hoc short-term policy making, which imposes unnecessary costs on superannuation funds and members, reduces long-term confidence in the system and impedes efficiency.²

The right framing of the objective of superannuation³ is vital. It is essential in ensuring that it provides appropriate and necessary guiderails and a fit for purpose anchor for Government policy. It should not

¹ Treasury Laws Amendment (Better targeted Superannuation Concessions and Other Measures) Bill 2023 (Cth).

² *Financial System Inquiry* (Final Report, November 2014) 25.

³ *Superannuation (Objective) Bill 2023*.

operate as a mechanism to allow continued changes or act as a means to justify any Government's short-term policies without proper consideration of the medium and long-term effects and consequences.

Superannuation is just one component of a broader retirement income system. The framing of the Retirement Income Review⁴ and the final report highlights the importance of considering the broader policy impacts across the retirement system.⁵ Indeed, the review recommended the introduction of an objective for the broader retirement income system.⁶

Superannuation policy must therefore be considered in the context of the overall retirement system, including the housing, personal investments, superannuation, age pension and related benefits, and aged care.

We welcome the opportunity to further discuss our submission. Please do not hesitate to contact us.

Thank you again for the opportunity to provide this submission.

Yours sincerely,

Peter Burgess
Chief Executive Officer

⁴ *Retirement Income Review* (Final Report, 24 July 2020) 1. Terms of reference.

⁵ *Retirement Income Review* (Final Report, 24 July 2020) 23. The objective of the [retirement income] system lacks an agreed objective.

⁶ *Retirement Income Review* (Final Report, 24 July 2020) 17. Key Observations – A clear objective for the system.



Improving consumer
experiences, choice, and
outcomes in Australia's
retirement system

Senate Inquiry

February 2024



About the SMSF Association

The SMSF Association is the peak body representing the self-managed superannuation fund (SMSF) sector which is comprised of over 1.1 million SMSF members and a diverse range of financial professionals servicing SMSFs. The SMSF Association continues to build integrity through professional and education standards for advisers and education standards for trustees. The SMSF Association consists of professional members, principally accountants, auditors, lawyers, financial advisers, 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.

Our Beliefs

- We believe that every Australian has the right to a good quality of life in retirement.
- We believe that every Australian has the right to control their own destiny.
- We believe that how well we live in retirement is a function of how well we have managed our super and who has advised us.
- We believe that better outcomes arise when professional advisors and trustees are armed with the best and latest information, especially in the growing and sometimes complex world of SMSFs.
- We believe that insisting on tight controls, accrediting, and educating advisors, and providing accurate and appropriate information to trustees is the best way to ensure that self-managed super funds continue to provide their promised benefits.
- We believe that a healthy SMSF sector contributes strongly to long term capital and national prosperity.
- We are here to improve the quality of advisors, the knowledge of trustees and the credibility and health of a vibrant SMSF community.
- **We are the SMSF Association.**

Table of Contents

About the SMSF Association	6
Our Beliefs.....	6
Table of Contents	7
Foreword.....	9
Table of Abbreviations	10
Abbreviation of Terms	10
Abbreviation of Legislation	10
1. Supporting members to navigate retirement income	11
1.1 Retirement income ecosystem	11
1.1 Simplification	11
1.2 Education and Member Engagement	11
1.3 Retirement Income Covenant.....	11
1.4 Self Managed Superannuation Funds	11
1.4.1 Retirement Income Covenant.....	11
1.4.2 Role of Regulators	12
1.4.3 Access to Advice.....	12
1.5 Better Targeted Superannuation Concessions	13
2. Supporting funds to deliver better retirement income strategies	16
2.1 Retirement Income Covenant	16
2.2 Focus on Income Needs in Retirement	16
2.2.1 Transfer Balance Cap Bias and Barriers	17
2.2.2 SMSF Trustees Access to Advice	18
2.2.3 Income Source Mixes	18
3 Making lifetime income products more accessible	19
3.1 Flexibility and Choice	19
3.2 Innovation and New Product Design	19
4 Other Issues	20
4.1 Receiving contributions – Members aged 65 years and over.....	20
4.1.1 Receiving Superannuation Guarantee Payments	20
4.1.2 Receiving contributions to an existing pension interest.....	21
4.2 Reform of foreign pension transfers rules.....	23
4.3 Deductibility of financial advice fees from a member’s interest in an SMSF	24
4.4 Personal Transfer Balance Cap complexity	25

4.5 Design and Distribution Obligations/Target Market Determinations	27
4.5.1 Background	28
4.5.2 Recommendation.....	31
4.6 Outstanding Measures.....	32
4.6.1 Legacy Pension Amnesty.....	32
4.6.2 Residency Rule Amendments – SMSFs and Small APRA Funds	33
4.7 Transition to Retirement Pension	33

Foreword

The SMSF Association welcomes the opportunity to put forward this submission to the Senate Standing Committees on Economics Inquiry – *Improving consumer experiences, choice, and outcomes in Australia's retirement system*.

In response to this inquiry, we formed a working group of members comprising experienced advisers and technical specialists who support advisers. The working group provided valuable insights about the shortcomings of the current regime, the issues and challenges being confronted by many retirees, and how the adviser community is responding to those challenges.

What was evident, is advised clients will often utilise a range of options available to them. The strategy implemented will be driven by their individual circumstances, such as their required income and capital needs, home ownership status, any personally held investments and the value of the superannuation benefits.

Other observations highlighted the impact of a range of systemic issues that unnaturally result in pension benefit payments that skew towards the minimum percentage rates. These are a by-product of the operation of the transfer balance cap regime, and the inability for some to access professional financial advice.

For SMSFs, around 44% of benefits are paid to members as lump sums⁷. These coupled with other income sources, such as home equity schemes need to be considered collectively, to better understand the broader retirement income system and behaviours of retirees.

Another driver for what is perceived as nest egging, is the desire to self-insure for a range of significant future life events. This includes illness, aged care, and housing security.

Crucially, we received strong feedback that there is a very real need for good quality information and member education, toolkits, and calculators to assist retirees to understand their income needs at retirement and into the future. This will go a long way to alleviating the fear and uncertainty that quite naturally and understandably arises around longevity risk. Better access to quality professional advice would likely have a substantive, beneficial impact on retirement income outcomes for retirees.

There are several elements either in their infancy or yet to be legislated that will need time to mature. We particularly refer to the retirement income covenant and the proposed Quality of Advice Review Tranche 1 reforms. These will take time to gain traction and provide any reliable data on the long-term impacts and outcomes.

We also encourage policy design that is sector neutral. Different legislative outcomes should be strongly discouraged. It must only be considered where it is fundamental to the delivery of equitable treatment under the law due to the unique characteristics that apply across the sector participants.

The SMSF Association has long held the view that consumer choice is a paramount element of superannuation. This is achieved through a robust superannuation sector with a range of participants and products to meet the varied needs of individual consumers. We support inclusive policies that appropriately consider and balance the needs of all, across the diverse range of sector participants.

⁷ Australian Taxation Office, *Self-managed superannuation funds: A statistical overview 2021-22*, (Report, 6 February 2024) Table 10 'Distribution of total SMSF benefit payments by benefit type' < <https://data.gov.au/data/dataset/self-managed-superannuation-funds> >.

Table of Abbreviations

Abbreviation of Terms

Abbreviation	Definition
AFE	Applicable Fund Earnings
APRA	Australian Prudential Regulation Authority
ATO	Australian Taxation Office
NCC	Non-concessional Contribution
NOI	Notice of Intent
RIC	Retirement Income Covenant
SG	Superannuation guarantee (payments)
SMSF	Self managed superannuation fund
TBA	Transfer Balance Account
TBAR	Transfer Balance Account Report
TBC	Transfer Balance Cap
TSB	Total Superannuation Balance
TTR	Transition to Retirement

Abbreviation of Legislation

Abbreviation	Definition
ITAA97	Income Tax Assessment Act 1997 (Cth)
SGAA	Superannuation Guarantee (Administration) Act 1992 (Cth)
SISA	Superannuation Industry (Supervision) Act 1993 (Cth)
SISR	Superannuation Industry (Supervision) Regulations 1994 (Cth)

1. Supporting members to navigate retirement income

1.1 Retirement income ecosystem

Planning for retirement is complex and involves many elements and is not the exclusive domain of superannuation. Superannuation only represents one element. Future policy decisions on superannuation cannot be considered in isolation of the other constituent parts of the retirement ecosystem. It must be included in a wider retirement and aging policy framework. A silo approach risks policy misalignment and the addition of further complexity, to an already complex system.

1.1 Simplification

Superannuation is made more complex than it needs to be with its many caps, rules, and tests. These are all then underpinned with its complex language and terms that are not intuitive or engageable.

Simplification, removal of red tape and complexity would be beneficial to consumers. It would add efficiencies to the system, better supporting the superannuation sector to provide products, services, and advice to members and clients.

Please refer to Section 4 'Other Issues' for further discussion on specific issues we have identified.

1.2 Education and Member Engagement

Superannuation is largely misunderstood and highlights the need for better financial education. Budgeting and retirement income needs are not always well understood. Particularly for those individuals who are not supported by a qualified, professional adviser.

Greater access is also needed to quality toolkits and calculators. Access to stochastic retirement income calculators will be an essential tool to assist retirees to better understand their retirement income needs and what their income looks like not only for today, but into the future.

1.3 Retirement Income Covenant

With its introduction on 1 July 2022, the retirement income covenant ('RIC') is still a relatively new element of superannuation policy. Many Funds are still finding their feet and exploring ways to best engage with members to fulfill their obligations under the RIC. The next logical step, and crucial element missing, is advice to members. We note the policy framework for superannuation funds to provide a form of limited advice to members is being considered as part of the Quality of Advice Review Tranche 1 reforms.

Further discussions on the RIC is included in other elements of this paper.

1.4 Self Managed Superannuation Funds

1.4.1 Retirement Income Covenant

SMSF members and trustees are one and the same. They do not have the same arm's length relationship to that of an APRA fund trustee and the classes or sub-classes of members that need to be considered in their retirement income strategies. Therefore, the ability to formulate and give effect to a broad strategy that is not intended to be member specific, or advice to members, becomes problematic.

Given that most SMSF trustees approaching or in retirement are highly engaged and actively involved in the management of their superannuation and retirement savings, the addition of the RIC measure for SMSFs would add cost and complexity to the administration of an SMSF for little benefit or gain.

Several components of the retirement income covenant are addressed within the existing investment strategy covenant, including risk, liquidity, investment objectives, cashflow requirements, and diversification. This can be documented at either the fund or the individual member level.

A RIC would likely broaden the scope of the audit undertaken by the ASIC approved SMSF auditor. Given that the covenant is to consider holistic retirement income considerations that encapsulates income sources both inside and outside the superannuation system, and the determination of members retirement income needs, auditors may need to consider information or matters external to the superannuation fund in determining whether the trustees have complied with the retirement income strategy.

We have historically seen Regulator compliance activities and education campaigns that have lifted the quality and standard of SMSF investment strategies. A similar process could be adopted here, to educate trustees and ensure that they are considering the income needs of the members in the fund.

1.4.2 Role of Regulators

Clients who have a relationship with a financial adviser will be actively engaged in discussions on their future income needs, and the various milestones to meet their goals. This applies equally to those who are members of a SMSF or an APRA fund.

Individuals who are not advised will rely on nudges or communications received from their APRA fund trustees. There is also an opportunity for the ATO to engage with taxpayers to reinforce that messaging, ensure nudges are occurring for any unadvised SMSF members or individuals who do not have a superannuation account. For example, there may be those who have pension fund interests in overseas jurisdictions but have not taken advice or steps to address their needs.

Simple direct comms from the ATO to members at different hurdle points, such as various ages could assist in flagging some of the things they should be thinking about. It is also important, to encourage members to seek advice from a suitable qualified professional.

As a professional association representing the interests of the SMSF sector, we see an opportunity for us to play an educative role with SMSF trustees who do not have a relationship with a financial adviser. Flagging key milestones and things they need to consider whilst encouraging them to seek professional advice.

1.4.3 Access to Advice

Changes impacting the financial advice profession has meant that there are significantly reduced numbers of financial advisers remaining in the system. Of concern are future adviser numbers with the ongoing financial burdens including the ASIC industry funded financial adviser levy, the addition of the compensation scheme of last resort levy, professional indemnity insurance premiums and rising business operating costs.

We have an emerging advice gap, with many advisers limiting the number of clients they advise. Only clients with certain characteristics will fit their business model. This means that many individuals who were previously advised may no longer have access to an adviser.

To bridge that gap, the Quality of Advice Review recommended the introduction of a limited advice model for fund trustees. The objective being the enhanced servicing of, and advice given to APRA superannuation fund members.

This has however created a divide, as those in the middle will unlikely be able to access quality professional advice. This is a significant issue for unadvised SMSF trustees.

Accountants have an important role to play in providing advice to SMSF members. To do so, they need an urgent, legislative solution. Accountants have been overlooked by the Quality of Advice Review, despite being in scope. As a result, they have not been considered in the proposed package of reforms from Government.

This is an issue we have consistently raised with Government and Treasury, and we look forward to continuing our discussions on crucial reforms for accountants and the provision of limited advice. A legislative solution is needed to remedy the legislative misalignment between the provision of accounting and tax agent services, and financial advice. There is also a need for a fit for purpose licensing regime for qualified accountants. The current limited licensing model is a dying model. It is not fit for purpose and most accountants, regardless of their qualifications, are unable to enter the advice regime due to the operation of the professional year.

Appropriately qualified accountants have a role to play in helping to fill the advice gap that exists between financial advisers and the proposed advice regime that will apply to APRA regulated superannuation funds. This vital middle ground has been overlooked throughout the Quality of Advice Review, and financial advice reform agenda that has followed. This is despite the recommendations of the James Review, and the progress of other James Review recommendations through the Governments current policy agenda.

We therefore encourage Government to escalate this issue and include it as a policy priority. The adequacy of superannuation savings at retirement varies significantly. Clients who wish to access quality financial advice, on a range of issues, including Centrelink benefits such as the Age Pension or simple superannuation pension advice are inhibited in doing so, due to the cost of financial advice.

Not all clients who wish to seek financial advice will have access to a licensed financial adviser. Accountants can play a valuable role in improving financial literacy and often have a deep knowledge of their clients finances and family circumstances. They also have a vital role to play in addressing crucial structuring and tax related matters. The grey line that exists between what constitutes the provision of a tax agent service and financial advice therefore needs urgent remediation.

1.5 Better Targeted Superannuation Concessions⁸

The changes proposed in these Bills are significant and complex, yet this is a policy that has been rushed and has not considered any alternative design models in the consultation process. Legislative drafting errors and deficiencies in the policy design were identified during the consultation process remain in the Bills tabled. This is despite these issues being raised with Treasury through both direct engagement and the formal consultation processes.

Further, elements of the proposed measures are heavily reliant upon regulations. Those regulations have not been made available at any stage of the consultation process and are yet to be released for

⁸ Treasury Laws Amendment (Better Targeted Superannuation Concessions and Other Measures) Bill 2023 and the Superannuation (Better Targeted superannuation Concessions) Imposition Bill 2023.

consultation. This affects both our and the Parliament's ability to fully consider all elements of these proposed measures. This includes how the measures will impact Government and other defined benefit pension schemes.

The proposed measures will add further complexity, red tape, cost, and unintended outcomes to what is an already complex superannuation legislative framework. What is proposed is counter to both horizontal and vertical tax equity principles.

Under these concepts, horizontal taxation models treat taxpayers with the same type of income with the same tax treatment. Contrasted with vertical taxation models which will treat taxpayers differently based upon the amount of income earned. The result is a different tax treatment of taxpayers with different levels of taxable earnings.

The proposed model could result in a member who has a total superannuation balance of \$50 million paying no tax, despite the fund earning taxable earnings in accordance with existing tax law concepts.

Conversely, a member with a total superannuation balance of \$3.5 million may have no taxable income under the existing tax law concepts but would still be liable for taxation under Division 296.

It is greatly concerning that the introduction of such deep inequities are being considered for inclusion in the Australian Taxation System. A policy that is counter to the broader policies and operation of the Australian income tax system.

There is a risk that if legislated, this policy will provide a precedent and result in the broader taxation of unrealised gains from other personal investments such as rental property investments.

Representations made by Treasury that the taxation of unrealised gains are already a feature of our tax system are somewhat misleading. The only example within the Australian taxation system is the taxation of capital gains where an individual or a company ceases to be an Australian tax resident.⁹

A sound policy foundation exists for this tax to be applied in this manner. It recognises that there is a change in the taxation of the future capital gains as a non-resident. It therefore necessitates the valuation of the investments or assets subject to capital gains to assess the Australian resident income tax liability on the accrued capital gains.

This is a one-off event triggered by the change in tax residency status. It is not a tax applied year on year. When the investment is sold in the future, the realised capital gains earned after the change in residency will then be taxable as a non-resident. This is not a representative case study for the taxation of a person's total superannuation balance and does not support the case for the taxation model proposed in these Bills.

It must also be highlighted that not all investments are income producing with the income to be derived from the growth on those assets.

When Government first began positing the idea and need for these measures, reference was made to the relatively small number of individuals, with total superannuation balances exceeding \$50 million and \$100 million. We agree that balances of this size are outside of the original policy intent but are an unintended consequence of historical policy settings. It should be noted that these individuals J the policy position, from one that targets ultra-high net wealth individuals, to one that starts to capture

⁹ *Income Tax Assessment Act 1997* (Cth), s 104-160.

elements of middle Australia, small business owners and farmers. It has very different policy intentions and outcomes.

The lack of indexation of the threshold will over time, because of inflation and increasing wages (and therefore increased compulsory superannuation guarantee payments), see this measure impact many more ordinary Australians.

The policy does not consider a person's home ownership status, the combined balances of a couple or the level of wealth held outside of superannuation. It will impact many small business owners and farmers who have invested in their businesses through property acquisitions. Of deep concern is that despite being raised previously, the measure will impact some who suffer a total and permanent disability event.

The role that superannuation savings play in providing security in retirement should not be overlooked. It is a fiscal and resourcing benefit to Government where individuals are more self-reliant, self-managing and funding their individual care and accommodation needs.

The inclusion of unrealised gains in the measurement of earnings is not representative of actual taxable earnings within the superannuation fund. 'Taxation on unrealised capital gains is rare among OECD countries, and rarer still in OECD pension systems.'¹⁰ Given both the benchmarking to other OECD nations and Australia's own economic history, what is proposed is a radical departure from existing taxation policy, with potentially far broader consequences than just those outlined by Treasury.¹¹

This model will impose financial stress on a meaningful number of SMSF members. Research conducted by the University of Adelaide shows clear evidence of the liquidity stresses this methodology will cause.¹²

Recent studies show a substantial number of SMSFs that will be affected by this tax change hold property and, given many will be small business operators and farmers who hold their premises and land in an SMSF, it is not difficult to see how disruptive this new measure will be not only for the SMSF sector but for small business operators and the broader community.

An alternative measurement of earnings which reduces uncertainty and the severity of including unrealised capital gains, is needed as a matter of priority. We therefore strongly encourage Government to cease the progress of the proposed amendments and instead continue to engage with stakeholders and industry to ensure that the resulting policy and legislation delivers the right outcomes, which are fair and equitable.

¹⁰ George Mihaylov, Ivan Obaydin, and Ralf Zurbrugg, 'Evaluation of the proposed changes to superannuation tax concessions' (Research Report, University of Adelaide, October 2023) 13.

¹¹ Ibid.

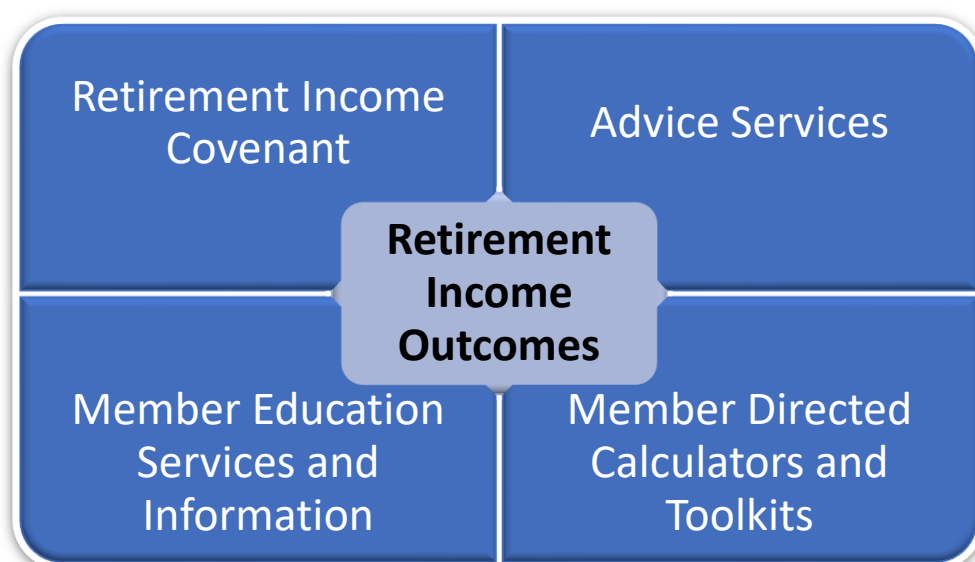
¹² Ibid. This research examined the Australian Government's proposal to reduce the tax concessions available to individuals whose total superannuation balance exceeds \$3 million. The scope of the report focusses on individuals who are SMSF members, and the analyses back test the proposal against a large sample of SMSF members for the financial years ending in 2021 and 2022.

2. Supporting funds to deliver better retirement income strategies

2.1 Retirement Income Covenant

The retirement income covenant is still a relatively new lever within the superannuation system and is yet to reach its full potential. As such it is too soon to measure its efficacy or any direct outcomes from its implementation. This will need to be carefully monitored and measured over time.

Further, the proposed expansion of advice services to fund trustees under the Quality of Advice Review proposed reforms are yet to be legislated or implemented. This will be an important element alongside member education, quality calculators and toolkits. Each of these elements individually has a role to play. More importantly, they are complimentary, each supporting the other in achieving better outcomes for members.



2.2 Focus on Income Needs in Retirement

We agree that the conversation needs to shift from minimum pension draw down amounts to real discussions on actual income and capital needs in retirement. This is an individual need and will depend on a broad range of personal factors. For clients who are advised, the kind of analysis is undertaken with informed discussions held with clients and formal advice structured accordingly.

The tools required to reframe essential conversations with retirees on income needs in retirement are set out in section one. However, there are systemic issues and the inherent biases that need to be included in this discussion and better understood.

The *Retirement Income Review* recommended a replacement benchmark of 65-75% of disposable income as a measure of adequacy in retirement.¹³ As a benchmark this provides a sound foundation for discussions on the income required in retirement. This should become a feature of fund materials

¹³ *Retirement Income Review* (Final Report, July 2020) 167.

and member engagement. This will in turn frame discussions on the capital needed to support that income and the sources of income, both inside and outside of superannuation.

2.2.1 Transfer Balance Cap Bias and Barriers

The operation of the TBC introduces inherent biases, risk, and practical considerations into the discussion on pension draw down rates.

Where a member wishes to commence an account-based pension, or revise the drawdown rate of an existing pension, the operation of the TBC must be considered.

Pension payments do not reduce the amount recorded on an individual's TBA. However, a lump sum withdrawal has the effect of reducing the TBA balance, as it is capital withdrawn from the pension interest.¹⁴ This then becomes a risk management issue for the APRA funds, who may refer a member to receive financial advice prior to the implementation of their request to withdraw a lump sum from their pension interest instead of increasing their pension payment.

The underlying policy of the TBC is to limit the tax concessions available to members in the draw down phase of the superannuation lifecycle who commence retirement phase income streams. A direct outflow of the operation of the TBC and TBA is the shaping of draw down behaviours. When we use the SMSF sector as a case study, there is no question a material amount of lump sum withdrawn are a direct consequence of the operation of the TBC and TBA rules, and also those who are drawing additional sums from accumulation interests that exceed the transfer balance cap.

In the 2021-22 financial year, benefits totalling \$36.5 billion were paid out of the SMSF sector.¹⁵ This increased 20% from the previous year, where \$30.4 billion in total benefit payments were made. Of the benefits paid in the 2021-22 year 54.4% were income streams, 44.2% lump sums and 1.5% transition to retirement benefits.¹⁶

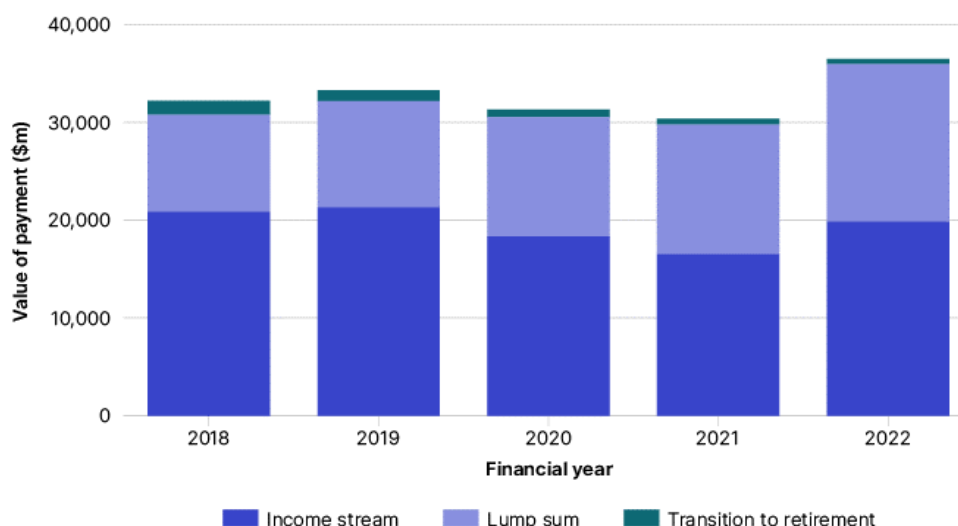
Refer to the table below:¹⁷

¹⁴ Credits to a transfer balance account are discussed in *ITAA97* s 294-25 and debit transactions in *ITAA97* s 294-80.

¹⁵ Australian Taxation Office, *Self-managed superannuation funds: A statistical overview 2021-22*, (Report, 6 February 2024) Table 10 < <https://data.gov.au/data/dataset/self-managed-superannuation-funds> >.

¹⁶ Australian Taxation Office, *Self-managed superannuation funds: A statistical overview 2021-22*, (Report, 6 February 2024) Table 10 'Distribution of total SMSF benefit payments by benefit type' < <https://data.gov.au/data/dataset/self-managed-superannuation-funds> >.

¹⁷ Australian Taxation Office, *Self-managed superannuation funds: A statistical overview 2021-22*, (Report, 6 February 2024) Table 10 'Graph 4: Benefit payments from SMSFs by type and total, 30 June 2018 to 2022' < <https://data.gov.au/data/dataset/self-managed-superannuation-funds> >.



What this also illustrates is the singular focus on pension benefits. An examination of all benefit payments is needed alongside member behaviours.

2.2.2 SMSF Trustees Access to Advice

For members of SMSFs, their accountant is responsible for the preparation of the fund's annual accounts and member statements. As part of that process, they will inform the client of their minimum draw down amount for the following financial year. This is essential in ensuring that the pension satisfies the minimum pension drawdown conditions. Failure to satisfy these requirements result in the pension failing, and the tax-free status of that member interest in the fund being lost. As a result, all of the fund income, including capital gains tax on the disposal of fund assets, that was previously tax free, will be wholly taxable in the fund. This is often determined after the end of the financial year when the financial statements for the fund are being prepared, providing no opportunity for rectification.

Unless the accountant is licensed to provide financial advice, they are unable to provide any personal advice to their clients. They are strictly limited to the provision of factual information only. Many trustees would like to be able to discuss how much they should be drawing from their pension account each year with their accountant. The limitation to the calculation of a minimum pension payment alone does not benefit clients and acts as a form of confirmation bias around minimum pension payments.

SMSF members would also like to better understand the impacts of drawing various amounts and would welcome comparative analysis, benefiting from scenario planning which would include elements such as cash flow needs, tax impacts, and longevity considerations from their accountants. As this kind of professional service would likely constitute the provision of personal financial advice, it is a service that is prohibited under the financial services regime and licensing requirements.

2.2.3 Income Source Mixes

When engaging with our member working group it became apparent that there are a broad range of strategies to provide income in retirement. They have observed an increase in the use of home equity

schemes, particularly at the early stage of retirement. This provides essential top up income to meet their income needs where their superannuation may not be enough to meet their long-term income needs alone.

3 Making lifetime income products more accessible

3.1 Flexibility and Choice

We would caution against the introduction of compulsion or default products and benefit structuring. This could result in detrimental outcomes for individuals when considering their unique and specific circumstances.

We would support the option of a broader suite of products being available to members. However, this needs to be facilitated via a robust consultation and advice process.

It will take time to monitor the real impacts of the retirement income covenant. Noting that the introduction of advice delivery from superannuation funds needs time to be legislated, on boarded and suitable operative time to measure the real impacts.

One of the key benefits of the SMSF sector is the level of engagement by members in their superannuation. In many ways, the nature of an SMSF has meant that the sector is ahead of the curve and provides a useful case study. We would expect a greater focus on educating superannuation members on financial matters, access to good information, RIC nudges coupled with some form of advice (either fund direct or financial advice), would have a substantive, positive impact.

3.2 Innovation and New Product Design

We welcome product innovation and greater choice for consumers. However, choice and flexibility must be retained. Compulsion on the structuring of retirement benefits should be avoided. The needs of individuals are unique and must be treated and considered accordingly.

The lessons of the past must also be carefully heeded. The issues arising from legacy term and lifetime pension products remain and need an urgent legislative solution.¹⁸ With this front of mind, any new products must consider, and clearly set out the available exit strategies and options available to members. Noting the ability to rollover to a similar product alone would not be considered an adequate response.

Those with older style market linked pensions are prohibited from commuting their pension account unless that commutation is to facilitate the rollover of benefits for the commencement of a new market linked pension. The issue here is the low number of providers in the market to facilitate rollovers. Access to these products is needed for those seeking to wind up their SMSF which holds the original market linked pension interest. Further restrictions are imposed in the market, such as minimum balance requirements. These minimum balance requirements are often unable to be met due to the age of the original pension account.

We would caution that the design of alternative products does not guarantee their success. Of concern would be the impacts to those that enter such products, which are later found to be unsustainable or

¹⁸ Refer to 4.8.1 Legacy Pension Amnesty.

marketable. A reasonable solution and exit strategy would need to be considered as part of the core product design parameters.

4 Other Issues

This consultation process provides the opportunity to consider other issues that need to be progressed, reviewed, or reformed. Doing so will improve outcomes, accessibility and engagement with superannuation and the associated retirement benefits.

Some of the key issues and opportunities we have observed are set out below.

4.1 Receiving contributions – Members aged 65 years and over

The integrity measures embedded in the superannuation guarantee system are vital at protecting employee entitlements and in ensuring that the system operates as intended. However, the operation of the superannuation guarantee system can create additional costs, administration, and complexity for older members, particularly those aged 65 years and over.

The work patterns and participation rates of older Australians are changing, with many more continuing or re-engaging with the workforce:

Australians are increasingly working to older ages. In January 2018, Australians aged 65 and over had a workforce participation rate of 13% (17% for men and 10% for women), compared with 8% in 2006 (12% for men and 4% for women). In 2016, 6% of centenarians were still working.¹⁹

Currently, members cannot elect to receive their superannuation guarantee benefits as a direct payment or as a component of their salary and wages. This is despite a nil cashing condition having been met.²⁰ Nor can they elect to have these contributions added directly to their pension account.

Members who have commenced pensions will be required to hold an additional accumulation account to receive their SG contributions. This results in additional fees paid from an account they did not wish to acquire in the first place. It is inefficient, costly, and impracticable, given these individuals have full access to all of their superannuation benefits.

4.1.1 Receiving Superannuation Guarantee Payments

Where an individual decides to continue employment in some capacity, or later seeks to reengage with the workforce (often as casual or part-time employment), their employer is still required to contribute SG to their nominated superannuation fund. This is despite having wholly met a condition of release.

Where a pension has been commenced, the member will require a separate accumulation account to receive the SG contributions. No alternative is available to those who would prefer to not have the amounts directed to their superannuation account. This should be a choice. Noting no age limit applies

¹⁹ Australian Human Rights Commission, *What's age got to do with it?* (Report, 14 September 2021) 101, quoting Australian Bureau of Statistics, *2071.0 – Census of Population and Housing: Reflecting Australia – Stories from the Census, 2016* (Web Page, 23 May 2019) ABS Table Builder data <<https://www.abs.gov.au/AUSSTATS/abs@.nsf/Lookup/2071.0Main+Features100012016?OpenDocument>>.

²⁰ *Superannuation Industry (Supervision) Regulations 1994* (Cth) sch 1, item 106. A nil cashing restriction applies once a member has reached aged 65 years.

to SG with payment compulsorily required to be made by the employer to the employee's nominated superannuation account.

Members have reported scenarios where clients in their 80's have continued to work part-time. These clients have stated that they don't want to receive the SG payments as superannuation contributions and would prefer to instead receive the SG proceeds as salary and wages.

A mechanism is currently available for those with more than one source of employment and where the SG from all sources would result in excess concessional contributions. Here the individual may elect to not receive SG from one or more employers, so long as they receive SG payments from at least one.²¹

A similar opt out system could apply here for those aged 65 years and over. By default, the employer is required to pay the SG amounts to the employees nominated superannuation fund. An application process would allow the employee to make an election with the Commissioner of Taxation to not receive SG payments. The Commissioner then issues a SG short fall exemption certificate²² to the employer. Amounts that relate to SG would instead need to be paid to the individual alongside their salary and wages.

Those who wish to receive the SG contribution in the usual way may continue to do so. No further action should be required, with an opt in requirement to apply for those who chose not to receive SG amounts inside superannuation.

4.1.2 Receiving contributions to an existing pension interest

Individuals in a similar situation to that outlined above may instead wish to have SG amounts added directly to their pension account. Doing so removes the need for duplication of superannuation accounts and the associated costs and provides a practical and efficient method for those who wish to retain their SG payments inside the superannuation system.

However, there are several practical issues that arise because of current operative provisions of the ITAA97. One is the reporting obligations arising from the TBAR regime and the other is the operation of the proportioning method for pension accounts.

Operation of Current Law

Under the current law, a member wishing to add the SG amounts received to a pension account, must either create a second pension account, or cease their existing pension, roll the proceeds to their accumulation account and then commence a new pension interest with the combined proceeds.

This can be detrimental to the member and result in a range of costs:

- The cost of administration
- Duplication of product fees
- Advice fees
- Risk of market movements
- Failure to meet the required minimum pension payment prior to the commutation of the pension account results in the loss of the pension concessions.

²¹ *Superannuation Guarantee (Administration) Act 1992* (Cth) s 19AB.

²² A similar example is available in *Superannuation Guarantee (Administration) Act 1992* (Cth) s 19AA.

Transfer Balance Account Reporting (TBAR)

TBAR is the mechanism by which amounts moved into a retirement phase pension interest are reported and recorded in an individual's TBA. The TBA is used to determine an individual's TBC and how much TBC is available to them or to flag any excess cap amounts.

Each time capital is moved into a retirement phase pension, it is a reportable event under TBAR. If contributions were permitted to be added to an existing pension interest, the contribution amount (net of tax) would be reportable. Under current law, this would mean that the pension fund receiving the SG contributions would need to report each contribution, net of tax, as capital added to a pension.

TBAR reporting cycles will be linked to the SG payment cycle which will be at least quarterly. Some employers may pay more frequently, such as monthly. The payment frequency would increase if the proposed pay-day superannuation reforms were legislated in the future. This would create significant administrative burden for the administration of all superannuation funds.

A simple solution to overcome this issue would be to exclude superannuation guarantee amounts as reportable amounts under TBAR where the member's TSB is less than the general transfer balance cap threshold for the year of income the contributions are made.

Proportioning Rule

The taxable and tax-free components of a member's account are calculated at the time a lump sum benefit is to be paid or on commencement of a pension. For pensions, those components are fixed for the life of the pension interest. Benefit payments must be taken proportionately from each component of the member's interest.²³

The ability to add contributions directly to a member's pension interest would disrupt the operation of the proportioning rule. If contributions were permitted to an existing pension interest, questions about how the proportioning rule would be applied, would need to be addressed.

Where a single contribution is received in a year, such as a member lump sum contribution, the member components could be updated to reflect the addition to either the taxable or tax-free component as applicable. However, this would quickly become impractical where the member is receiving regular and frequent superannuation guarantee payments.

The preservation age is currently between age 59 and 60. For those born on or after 1 July 1964, the preservation age is 60.

Superannuation benefits, both pension payments and lump sum are received tax free by the member where they are aged 60 years or over. Therefore, there is little mischief were the components of a member's interest are adjusted after year end for SG amounts received.

Minimum Pension Payments

The minimum pension payment required is calculated on 1 July each and is based on the member's closing balance on 30 June of the previous financial year.²⁴ Where a new pension commences part way through the financial year the minimum pension payment is calculated on the date of commencement.²⁵

²³ *Income Tax Assessment Act 1997* (Cth) s 307-125.

²⁴ *Superannuation Industry (Supervision) Regulations* (Cth) sch 7 cl 1(2)

²⁵ *Superannuation Industry (Supervision) Regulations* (Cth) sch 7 cl 3.

The addition of contributions to a pension on foot, presents challenges for minimum pension balances. For SG amounts, the simple solution would be to not require an adjustment to be made in the year the contributions are made. These will be captured in the closing member balance for the calculation of the minimum pension payment in the following year.

4.2 Reform of foreign pension transfers rules

This is a highly complex area of superannuation and individual tax law that is long overdue for review, reform, and modernisation. There is an expectation held by many that the transfer of benefits from one pension fund environment, which has the equivalent of our preservation rules and sole purpose test, to their Australian superannuation fund would be classed as a rollover. Instead, this is an area of superannuation that requires specialist tax and financial advice both here and in the country of origin. It is very costly, complex and can involve protracted processes in accessing and transferring benefits into Australia.

The individuals impacted include returning expats and migrants who would like to repatriate their overseas pension interests with them here in Australia and the security of the Australian superannuation system.

Concerns are held on exposure to sovereign risk, foreign currency movements, and the ability to have access or control of their benefits. Noting that liaising with fund providers and advisers in a foreign jurisdiction is extremely challenging with barriers that extend beyond time zone differences.

These individuals incur additional professional advice and services fees which are duplicated across jurisdictions. They will also incur duplication of product fees, as they will have at least one fund overseas and at least one here in Australia. It is inefficient and impractical.

The amounts that can be transferred into an Australian superannuation fund are strictly limited to the applicable fund earnings ('AFE')²⁶ and the NCC cap. Applicable fund earnings are received as taxable income of the recipient fund in Australia where the whole of the foreign pension interest is transferred at once. The remainder of the sum transferred classed as NCC and subject to operation of the contribution rules and caps.

Where foreign pension fund proceeds are transferred to Australia within 6 months of the date of residency, the applicable fund earnings amount is nil.²⁷

The calculation of the AFE is often not a straightforward process as not all foreign pension funds provide regular statements, and many funds are defined benefit funds rather than defined contribution funds. Historical member account valuations are often not provided or available.

More complex issues arise when determining historical values of defined benefit fund interests. These do not provide historical valuations and Australian tax law does not provide a formula or methodology to determine a date of residency value.²⁸ Often an application is required to the Commissioner of Taxation for a private binding ruling to determine the valuation. This is an extremely lengthy and protracted process. This delay is of considerable risk to the member as they are exposed to legislative risk, market, and currency movements in that time.

²⁶ *Income Tax Assessment Act 1997* (Cth) s 305-75.

²⁷ *Income Tax Assessment Act 1997* (Cth) s 305-60.

²⁸ *Income Tax Assessment Act 1997* (Cth) s 305-75(3)(i).

There are no Commissioner rulings or guidelines published on how to value a member's interest where it is a defined benefit fund, or the date of residency valuation of a defined contribution fund cannot otherwise be determined.

Due to the complexities and niche nature of this legislation, it is not an area that all accountants or tax agents would have the necessary expertise to advise. Due to the complexities involved, this is an area that has attracted scam and fraudulent activity and other unscrupulous operators.

We would welcome legislative changes that simplify the process and enable members to transfer their foreign pension interest into their Australian superannuation fund as a foreign pension rollover amount. Doing so provides cost efficiencies for impacted members, removes unnecessary complexities and red tape, providing much needed certainty, control, accessibility, and security.

The on benefits of such an arrangement include increased capital for investment in Australian markets, earnings on benefits would be taxable in Australia and other economic benefits. In removing sovereign and legislative risk this also minimises Government contingent age pension liabilities.

Rather than binding these transactions in red tape, individuals should instead be encouraged to repatriate overseas pension interests.

4.3 Deductibility of financial advice fees from a member's interest in an SMSF

Access to financial advice is crucial in the pre-retirement planning phase and the outcomes it will deliver when retirement occurs. As the members have not yet met a condition of release, the ability to deduct fees relating to their superannuation interest in a fund is crucial. For many Australians, superannuation will be their largest investment. Access to, and affordability of advice is therefore crucial to delivering better outcomes in retirement.

The proposed Tranche 1 reforms from the Quality Advice Review seek to 'facilitate better access to superannuation and retirement advice by clarifying the legal basis of existing practices in which superannuation trustees pay advice fees from a member's superannuation account at the request of the member.'²⁹ These are welcome reforms which seek to provide greater certainty and consistency for members and fund trustees in relation to advice received by the member regarding their interest in the fund.

The deductibility of advice fees afforded under these proposed amendments expressly exclude SMSFs. This is due to the operation of the current superannuation law.³⁰ The proposed reforms are built upon the existing legislative framework and seek to repeal the existing provision and replace them with a clearer and modernised legislative framework.³¹

Whilst these are important reforms, what has been overlooked in this process, is the need for the inclusion of an equitable legislative solution for members of SMSFs. SMSFs do not have a comparable

²⁹ Explanatory Memorandum, Treasury Laws Amendment (2024 Measures No. 1) Bill 2024: Quality of Advice Tranche 1 (Cth), Exposure Draft, pt 1 [1.8].

³⁰ *Superannuation Industry (Supervision) Act 1993* (Cth) s 99A.

³¹ Treasury Laws Amendment (2024 Measures No. 1) Bill 2024: Quality of Advice Tranche 1 (Cth), Exposure Draft sch 1 pt 1 s 99FA.

provision within the superannuation law³². As such, the sole purpose test,³³ the prohibition on the provision of financial assistance to a member of the fund,³⁴ and the operation of the early access tax penalty provisions³⁵ are impassable barriers.

This gap in the superannuation legislation has created a divide between members of APRA funds and members of SMSFs. When we compare the pair, one group of members can elect to have the superannuation account pay for the financial advice that relates to their interest in the fund, the others are prohibited from doing so. This also will exclude SMSF members from availing of the tax deductibility of certain advice fees as proposed.³⁶

While the members and trustees³⁷ of SMSFs are one and the same, the treatment of advice provided to these distinctly separate roles differs vastly. Advice received in the capacity of trustee where the advice relates to the operation of the fund will be an expense of the fund and a deductible expense that may be either revenue or capital in nature. As noted already, advice that is received by the member in relation to their personal interests in the fund cannot be paid by the fund itself or from the member's interest in the fund.

We would welcome the insertion of a comparable provision into the *Superannuation Industry (Supervision) Act 1993* (Cth) to allow SMSFs to deduct from the member's interest in the fund advice fees that relate to that interest in the Fund. Include SMSFs in the proposed amendments to the *Income Tax Assessment Act 1997* (Cth).

4.4 Personal Transfer Balance Cap complexity

With the indexation of the general transfer balance cap (TBC), individuals are now subject to a personal TBC. The value of an individual cap will depend on an individual's circumstances and will range from \$1.6 million to \$1.9 million, rather than one single cap for all individuals. This is causing significant complexity and is compounded by the lack of access for financial advisers and SMSF administrators to the ATO reports needed to obtain an individual's TBC.

Initially the general TBC was \$1.6 million, rising to \$1.7 million on 1 July 2021, and to \$1.9 million on 1 July 2023. Complexity will only continue to increase as indexation applies in future years.

A member's personal TBC will equal the general TBC in the year they first have a retirement phase income stream counted against their transfer balance account.

However, post indexation, a member's personal TBC may differ from the general TBC due to proportional indexation. Under proportional indexation, the unused portion of the member's personal TBC (based on the highest percentage usage of their TBC) will be indexed in line with the indexation of the general TBC.

³² Ibid n 1. "The Act."

³³ Ibid s 62.

³⁴ Ibid s 65(1)(b)(i).

³⁵ *Income Tax Assessment Act 1997* (Cth) s304-10.

³⁶ Treasury Laws Amendment (2024 Measures No. 1) Bill 2024: Quality of Advice Tranche 1 (Cth), Exposure Draft sch 1 div 2.

³⁷ Ibid n 1 s 17A. Trustees includes two or more individual trustees or one or more directors of a corporate trustee.

This is an overly complex situation which over time will result in most individuals with a retirement phase income stream having a personal TBC which is different to the general TBC maximum. This distortion will continue to grow in complexity as future indexation of the TBC is applied.

Individuals who haven't used their cap will have a maximum TBC of \$1.9 million, whereas those who have used a portion of their cap (based on their highest percentage usage) will fall somewhere between \$1.6 million and \$1.9 million. Those individuals who have used all their personal cap in a year will not be subject to indexation. Their maximum cap will remain fixed to the TBC that applied to them in the year their cap was wholly utilised.

Due to the complex nature of proportional indexation, it is inevitable that mistakes will be made leading to inadvertent breaches of the TBC.

The table below, published by the ATO, clearly illustrates the complexities associated with proportional indexation. The indexation which is applied to a member's TBC is dependent on the member's highest ever transfer balance which in-turn determines the amount of indexation (between nil and \$100,000) that is applied to their TBC. The information in this table is generic and does not determine an individual's exact TBC. It however highlights the significant variability resulting from individual TBCs.

This table illustrates the spread of individual TBCs under 1 July 2021 indexation. Following the indexation of the TBC to \$1.9 million on 1 July 2023, the range of individual TBCs have expanded significantly.

Proportional indexation of your transfer balance cap³⁸

If your highest transfer balance was between	Your unused cap percentage will be between	Your personal TBC will increase between	Your personal TBC after indexation will be between
\$0.00 and \$159,999.99	100% and 91%	\$100,000 and \$91,000	\$1,700,000 and \$1,691,000
\$160,000 and \$319,999.99	90% and 81%	\$90,000 and \$81,000	\$1,690,000 and \$1,681,000
\$320,000 and \$479,999.99	80% and 71%	\$80,000 and \$71,000	\$1,680,000 and \$1,671,000
\$480,000 and \$639,999.99	70% and 61%	\$70,000 and \$61,000	\$1,670,000 and \$1,661,000
\$640,000 and \$799,999.99	60% and 51%	\$60,000 and \$51,000	\$1,660,000 and \$1,651,000
\$800,000 and \$959,999.99	50% and 41%	\$50,000 and \$41,000	\$1,650,000 and \$1,641,000

³⁸ Australian Taxation Office, 2021, *Indexation of the general transfer balance cap*, (10 February 2021) QC 60627.

\$960,000 and \$1,119,999.99	40% and 31%	\$40,000 and \$31,000	\$1,640,000 and \$1,631,000
\$1,120,000 and \$1,279,999.99	30% and 21%	\$30,000 and \$21,000	\$1,630,000 and \$1,621,000
\$1,280,000 and \$1,439,999.99	20% and 11%	\$20,000 and \$11,000	\$1,620,000 and \$1,611,000
\$1,440,000 and \$1,599,99.99	10% and 1%	\$10,000 and \$1,000	\$1,610,000 and \$1,601,000
\$1,600,000 or more	0%	nil	\$1,600,000

Proposed solution: Remove proportional indexation of the TBC. Indexation should apply equally to all holders of retirement pensions and income streams.

One simple way of addressing the complexities associated with proportional indexation would be to align all members TBC with the general TBC. This would provide certainty, reduce costs, and simplify the administration involved for the Australian Taxation Office, financial advisers, SMSF administrations and tax agents as well as the members themselves.

Indexing the TBC in this manner ensures that superannuation members in retirement are not disadvantaged by the impacts of inflation. Allowing members to retain more in the retirement phase, including on the death of a spouse.

The costs of allowing broad application of TBC indexation and the incremental loss of tax revenue are not expected to be significant, particularly when we consider the oncosts of indexation including the costs of administration and complex system redesign. These system costs will be incurred each time indexation falls due.

The need for access to timely and accurate data is fundamental to ensuring that members comply with their TBC. This highlights the need for Government to ensure that access to this data is not limited and can be accessed by all authorised advisers in a secure and efficient way.

4.5 Design and Distribution Obligations/Target Market Determinations

The design and distribution obligations (“DDO”) and target market determination (“TMD”) are now preventing, or adding significant red tape to the provision of financial advice to members of SMSFs. This is having a direct impact on those seeking financial advice in relation to their interests in the fund, including pension commencement or restructuring advice, estate planning and pre-retirement advice. This is an unintended consequence and a result of a misalignment in the legislative design.

Our members are reporting a concerning, and growing trend, with some Australian Financial Services Licensees requiring advisers to obtain or hold a TMD when advising SMSF clients. This includes existing SMSFs and new SMSF establishments.

Without a fund TMD, the advisers may be prohibited from advising the SMSF client or be required to attend to unnecessary compliance processes and seek approval from their AFSL. It is adding unnecessary red tape, regulatory burden, complexity, time, and cost to the advice process for SMSFs. This is counter to the objectives of the Quality of Advice Review and the Government's current policy agenda regarding the accessibility and affordability of financial advice.

Advisers are now also concerned about their risk exposure in this area. Noting they are not authorised to prepare or advise on the preparation of a TMD as they are not product developers or issuers.

A simple legislative amendment to clearly exclude SMSFs would remediate the issue and provide certainty for AFSLs, financial advisers and their clients, future and existing SMSF trustees.

4.5.1 Background

During the public consultation in 2018, ASIC noted that the proposed legislation, unless amended, would unlikely apply to SMSFs as *"the initial distribution of interests in SMSFs may not be captured by the revised exposure draft legislation"*³⁹.

Given the original drafting of the Bill and the fact the Senate Economics Legislation Committee made no mention of the need for SMSFs to be included, it is our belief that the DDO/TMD regime was not intended to apply to the establishment of an SMSF and financial dealings with regards to an SMSF.

The legislation and regulations are not sufficiently clear to enforce this intent.

Other parties noted during the various consultations that, in the context of the DDO and TMD legislation, an SMSF was a shell that needs to be considered distinctly differently to the financial products it acquires:

"There is one important financial product where there is a greater level of uncertainty about the applicability of the Design and Distribution Obligations legislation, and we would have liked to have seen this uncertainty addressed through this regulation. Self Managed Superannuation Funds (SMSF) are classified as a financial product, however they are different from other financial products in a number of ways.

*We believe that there are grounds for treating SMSFs differently, including the fact that they are more of a service than a product and are typically used to house other products that will be caught under the Design and Distributions Obligations legislation. In addition, the product provider is technically the trustees of the SMSF, who are also the members of the fund. Thus, the benefit of this legislation is less apparent in the case of SMSFs."*⁴⁰

Treasury in their evidence to the Senate Economics Legislation Committee inquiry into the Bill, noted the need to exclude SMSFs from the regime:

³⁹ ASIC, 2018, *Design and distribution obligations and product intervention power: Revised exposure draft legislation – Submission by the Australian Securities and Investments Commission*, Paragraph 75

⁴⁰ AFA, 2019, *AFA Submission – Corporations Amendment (Design and Distribution Obligations) Regulations 2019*

“...it would be inappropriate to include SMSFs because the design and distribution obligations require the issuer to determine a class of consumers, whereas a person designs an SMSF and in effect is 'selling it to themselves.’”⁴¹

The financial products acquired by and held in the SMSF are subject to the DDO and TMD requirements. This is entirely appropriate and aligns with the underlying policy intent.

Since the commencement of these provisions, conflicting views have emerged on whether the provisions apply to SMSFs and, if they do, how they should be applied in an SMSF context. It has been described as “a lawyer’s picnic”.

Proposed Solution: Expressly exclude SMSF establishments, addition of new members and commencement of pensions in an SMSF from the DDO/TMD requirements.

The DDO applies to issuers and distributors of financial products that are available for acquisition by issue or by regulated sale in Australia.

A product distributor is required to take reasonable steps that will, or are reasonably likely to, result in distribution of a financial product being consistent with the product’s TMD.

Financial advisers are expected to consider a product’s TMD when providing advice and meeting their best interest duty and complying with their obligations in the code of ethics.⁴²

Each SMSF is unique to its members. The members and trustees are one and the same. As such they will each have very different investment objectives, risk profiles, preferences, and needs.

An SMSF is a private fund and does not offer membership to the public at large. Therefore, the requirement to have a publicly available TMD as required under the legislation does not align to the principles or function of an SMSF.

SMSFs meet the definition of a financial product. However, when we look at how it resides within the DDO/TMD framework, it is a structure in which to house financial products. Those financial products will need to comply with the DDO/TMD regime obligations.

There are no consumer or public benefits to be gained by extending the DDO/TMD provisions specifically to the SMSF structure itself. Rather, including SMSFs will add unnecessary complexity and cost burdens for no benefit. The logic that applies to commercial product issuers does not apply in an SMSF context as the SMSF structure is not being offered to the public at large.

More concerning, the current ambiguities are camouflaging potential contingent liabilities that may arise for both financial advisers and licensees, were a different interpretation of the law is applied in the future. This may occur due to action of a regulator, litigation, or formal complaint with AFCA.

ASICs regulatory guide RG 274 *Product design and distribution obligations* is silent on SMSFs and the issues surrounding SMSFs. There is no clear, practical, interpretive guidance from the regulator as

⁴¹ Ms Kate O'Rourke, Principal Adviser, Consumer and Corporations Policy Division, The Treasury, Committee Hansard, 1 November 2018, p. 35

⁴² *Financial Planners and Advisers Code of Ethics 2019* (Cth).

there is no clear exemption in the current legislation and regulations. The legislation is silent on the express inclusion or exclusion of SMSFs from the DDO/TMD regime.

SMSFs are consumers of financial products and services. The financial products acquired by the fund will be subject to the DDO/TMD regime. In addition to a PDS, a TMD must also be provided to the trustees in relation to each financial product acquired. This is the appropriate point for the DDO/TMD regime to apply in an SMSF context.

The operation of the existing legislation, including the pre-existing PDS provisions, do not provide a sufficiently clear framework to assist with the interpretation and application of the DDO/TMD provisions to SMSFs.

Under Sub-section 1012D(2A) of the *Corporations Act 2001*, a product disclosures statement (PDS) does not have to be given to a new member of an SMSF where the trustee believes on reasonable grounds that the member has received, or knows they have access to, all the information that a PDS would be required to contain. Therefore, SMSFs and their trustees or firms advising SMSFs require disclosure but are exempted under reasonable grounds.

This exemption may not be able to reasonably be relied upon in the context of the DDO/TMD when we consider other situations that regularly arise in an SMSF context:

1. A member requests the payment of a pension from the SMSF trustee. A PDS is required to be issued by the Fund.
2. The trustee voluntarily executes a PDS on establishment or addition of a new member, although not required to do so.

By default, a PDS will be included as part of the standard document package provided. It is then up to the trustee to determine whether they require or use the PDS provided. As a result, it is not uncommon for the PDS to automatically included in the documents adopted or executed by the trustees and members.

If a PDS was not required, would the SMSF be captured under the DDO/TMD provisions for the mere fact a PDS has been prepared, executed and/or adopted?

The SMSF structure itself addresses a range of issues that form part of the operative intent of the DDO/TMD regime.

Under the existing legislative framework that applies to SMSFs, the trustees have obligations imposed by way of trustee covenants under SISA s.52B. Of particular relevance is the covenant in SISA s.52B(2)(f) and SISR 4.09 that require the SMSF trustees to *formulate, review regularly and give effect to an investment strategy*.

The trustees must ensure that the investment strategy is documented, monitored, complied with, and maintained by the SMSF trustees. The investment strategy must have regard to whole of the circumstances of the fund, including, but not limited to:

- a) the **risk** involved in making, holding and realising, and the **likely return** from, the entity's investments, having regard to its **objectives** and expected **cash flow requirements**;
- b) the **composition** of the entity's investments as a whole, including the extent to which they are diverse or involve exposure of the entity to risks from inadequate **diversification**;

- c) the **liquidity** of the entity's investments, having regard to its **expected cash flow** requirements;
- d) the ability of the entity to discharge its existing and prospective **liabilities**;
- e) whether the trustees of the fund should hold a contract of insurance that provides **insurance cover for one or more members** of the fund.

In addition to the above and the trustee's fiduciary duty, the legislation also requires the trustees to consider the 'best financial interests' of all fund members.

The trustees of the SMSF are directly responsible for the operation of the fund, including ongoing fund compliance, formulating investment strategies, and making investment decisions. Indeed, they may engage various professionals and services to assist them in fulfilling their duties and obligations. However, this does not alleviate or remove the core trustee duties and obligations.

SMSF trustees are not required to be licensed financial advisers, product manufacturers, issuers, or providers. Further, they do not engage in retail product distribution. Although they may engage these services and acquire financial products from an appropriately licensed provider.

The trustee's duties and obligations ensure that the needs of individual members are appropriately considered, documented, and actioned. These all align with the policy objective of the DDO/TMD obligations. Noting that the DDO/TMD obligations would still apply to financial products acquired by the Fund.

The requirement for a TMD to be publicly available does not align with SMSFs which are a private, closely held fund, as the members and trustees are one in the same.

Since 1 July 2021, SMSFs are permitted a maximum of 6 members. The number of SMSFs using these updated measures are low. Prior to this legislative amendment, membership was limited to a maximum of 4 members. A significant majority of funds have two members. We do not expect this to significantly change.

Australian Taxation Office data⁴³ extracted on 25 July 2023 shows the distribution of SMSFs based on the number of members:

Number of members	2021-22
1	24.8%
2	68.3%
3	3.3%
4	3.4%
5	0.1%
6	<0.1%
Total	100%

If SMSFs are to be included in the DDO obligations, this could include unreasonable design parameters and restricted distribution obligations for trustees dealing with themselves or entities which deal with SMSFs.

4.5.2 Recommendation

⁴³ Australian Taxation Office, 2023, *Self-managed super fund quarterly statistical report – September 2023*, [online] <<https://data.gov.au/data/dataset/self-managed-superannuation-funds>> , Table 4: Membership Size

Given the current legislative uncertainty, and the apparent intent to exclude SMSFs, we believe it is appropriate for the legislation and regulations to be amended to specifically exclude SMSFs from the DDO/TMD regime with regards to:

1. Establishment of an SMSF
2. Admission of new members to an SMSF
3. Commencement of a pension in an SMSF

This will align the legislation to the policy intent, reduce red tape and compliance costs for the SMSF sector and provide important clarity for financial advisers, document providers and SMSF trustees.

4.6 Outstanding Measures

Important superannuation measures included in the May 2021 Budget, are still to be legislated or opened for consultation. These are the two-year amnesty for legacy pensions conversions, and the reform of the SMSF residency rules with the removal of the active member test and the extension of the temporary absence rule for non-residents from 2 to 5 years.

It is acknowledged that these announcements were made by the former Government. We thank the Government for the October 2022 Budget announcement which confirmed that the reform of the residency rules has been incorporated into the Government's policy agenda.

Both measures are important reforms for the SMSF sector, and we ask the Government and Treasury to undertake the necessary industry consultation and progress the required legislation as a matter of priority.

4.6.1 Legacy Pension Amnesty

We thank Government and Treasury for considering our recommendations to progress the previous Government's reforms. We acknowledge the policy agenda for Government has been very full. However, for SMSF members trapped in these products urgently need a legislated solution.

Legacy pensions have created distorted outcomes for individuals trapped in these products. They have been left stranded because of significant legislative reform that occurred after the commencement of their pension accounts. Due to the balance of their account, many are unable to access an alternative product to rollover their benefits.

There are limited options available in the market, providing little choice or opportunity to access an alternative product provider. They are unable to simply withdraw their benefits due to the strict regulatory restrictions that apply to these products. In some cases, the cost to administer is more than the pension payments they receive each year.

The SMSF Association supports a diverse superannuation ecosystem that allows consumer choice. While SMSFs have an important role to play we also advocate that they are not suitable for everyone. This includes where an individual's circumstances have changed and an SMSF ceases to be fit for purpose.

Feedback from our members shows there are individuals trapped with these legacy pensions, in an SMSF where the product and/or the SMSF itself are no longer fit for purpose. It is clearly in their best interests to exit these arrangements, but legislative barriers prevent them from doing so. The situation is becoming untenable for affected pensioners with relief needed as a matter of urgency.

We look forward to having the opportunity to work with Government and Treasury to progress these measures with good policy design and a framework that is fit for purpose.

4.6.2 Residency Rule Amendments – SMSFs and Small APRA Funds

The concessions made during Covid-19 around SMSF temporary absence rules showed that the proposed changes to the residency rules are practical and workable, with trustees operating in a compliant matter. The modernisation of the temporary absence rules and the abolition of the active member test aligns to the broader policy objective of ensuring that the superannuation system operates efficiently and cost effectively, removing the need for the unnecessary duplication of superannuation accounts.

The modernisation of the temporary absence rules and the abolition of the active member test aligns to the broader policy objective of ensuring that the superannuation system operates efficiently and cost effectively. It removes the need for the unnecessary duplication of superannuation accounts, the associated costs of which have a direct impact on a member's end retirement benefits. Inadvertent breaches of the contribution rules, such as failing to seek reimbursement for a small fund expense can result in a breach of the active member test. Failure results in the SMSF ceasing to be an Australian superannuation fund and classed as a non-complying fund, with the market value of the fund assets taxed at 45%, and future fund earnings similarly taxed.

We encourage the Government to urgently progress both limbs of these proposed reforms.

A legislative solution to these outstanding measures would be a quick win for Government and, with the appropriate policy settings, provide vital solutions and certainty for impacted individuals.

4.7 Transition to Retirement Pension

The transition to retirement ('TTR') pension plays an important role in assisting those who have attained their preservation age but not yet met the conditions of retirement or another condition of release. This can occur where an individual has commenced reducing their working hours as they approach retirement.

A TTR is not a retirement phase pension and does not count towards a member's TBA, where a condition of release has not been met.

As a full condition of release has not been met, TTR pension payments are limited to a minimum of 4% and a maximum of 10% of the pension account balance. Where a pension commences or ceases part way through a financial year, the minimum payment required is prorated. However, prorating does not apply to the maximum amount.

The operation of the maximum benefit payment could result in a circumstance where a pension is commenced then ceased several times over in a financial year, allowing the maximum amount to be withdrawn in each instance. This would seem to be outside the policy intent and risks the leakage of significant benefits for some individuals who inappropriately use the TTR system.

Since the implementation of the *Fair and Sustainable Superannuation* reforms, TTRs have become less popular due to the loss of the exempt pension income within the superannuation fund and only

represent 1.5% of the total benefits paid.⁴⁴ However, on an individual level, the inappropriate use of TTR pensions puts at risk the adequacy of their superannuation benefits in retirement.

A review of the operation of TTR pensions is needed to ensure they operate as intended and achieve their policy objective, supporting individuals in their transition to retirement.

⁴⁴ Australian Taxation Office, *Self-managed superannuation funds: A statistical overview 2021-22*, (Report, 6 February 2024) Table 10 'Distribution of total SMSF benefit payments by benefit type' < <https://data.gov.au/data/dataset/self-managed-superannuation-funds> >.