Review of "A Plan to Simplify and Streamline Superannuation"

Submission to Treasury

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Executive Summary

ABN AMRO Morgans is recognised as one of Australia's largest regionally represented financial service providers, with 53 offices spanning all states and territories. We are the only full service stockbroking and wealth management group with this regional presence.

ABN AMRO Morgans is a leading provider of investment and superannuation advice to over 300,000 clients. Our advisers have significant expertise in advising clients on all aspects of superannuation with a special focus on Self Managed Superannuation Funds. Currently we manage over 13,000 active SMSF accounts, totaling more than $3.8 billion in funds under management.

We pride ourselves on the quality, knowledge and experience of our advisers, and our primary concern is for our clients financial well-being to ensure they are in the best position to achieve their financial and retirement goals.

Hence, the impact of superannuation proposals as outlined in the Budget on investors is of particular interest to us. For this reason, ABN AMRO Morgans is pleased to offer recommendations on the Government's detailed outline: *A Plan to Simplify and Streamline Superannuation*.

To develop this submission ABN AMRO Morgans brought together a number of its senior financial advisers for a focus group. This group of advisers has over 90 years combined practical experience of assisting clients with their financial strategies.

The agenda for this meeting focused on the practical implications of the proposed changes, how these changes positively impact on our clients and also how they negatively affect some individuals without the Government having any intent to do so.

Our comments are restricted to the detailed outline and subsequent Treasury announcements relevant to this document.

While we have some concerns about the cost and sustainability of the proposed legislative changes, our focus in this submission is on the practical implications for our clients.

Recommendations

The recommendations of the ABN AMRO Morgans group are:

Recommendation 1 - Contribution Rules

1.1 The $100,000 limit for concessional deductible contributions to superannuation be maintained for people over 50 years of age up to age 60.

1.2 The averaging period for undeducted contributions be increased from 3 years to 5 years.

Recommendation 2 - Benefit Payment Rules

2.1 To retain a cap, or maximum limit (other than the account balance) on lump sum and pension draw downs to avoid excessive drawings.

Recommendation 3 - Pension Benefits

3.1 To allow all existing allocated pensions and annuities to be subject to the new tax rules from 1 July 2007 and not just those pensions established by persons over age 60.

3.2 To allow Term Allocated Pensions (TAPs), where the primary reason for purchase was based on an RBL strategy, to be commuted after 1 July 2007.

3.3 To increase minimum annual pension percentage factors every 5 years instead of every 10 years.

Recommendation 4 - Bankruptcy Issues

4.1 To provide clarification on the issue of bankruptcy and superannuation now that Reasonable Benefit Limits will be abolished.

Recommendation 5 - Estate Planning / Death Benefits

5.1 To allow non-dependants to take death benefit payments in the form of either pension or lump sum.

5.2 To have a flat rate of 15% applied to untaxed insurance payouts to non-dependants.

Recommendation 6 - Work Test

6.1 To abolish the work test for persons over age 65, effective 10 May 2006.

Recommendation 1 - Contribution Rules

1.1 The $100,000 limit for concessional deductible contributions to superannuation be maintained for people over 50 years of age up to age 60.

1.2 The averaging period for undeducted contributions be increased from 3 years to 5 years.

We understand and support the need to encourage people to contribute to superannuation on a regular basis over the course of their working lives. The current "age-based" limits regarding concessional deductible contributions take into account the various stages of a financial lifecycle for a person, particularly in relation to disposable income.

The proposed new $50,000 limit will benefit younger individuals who have obtained high paid employment in the early stages of their life and then need to withdraw from the workforce for family or other reasons, thereby "losing" valuable contribution years. The new concessional limits will also provide an opportunity for many to improve their long term superannuation savings.

However, despite statistics* showing those aged between 40 and 55 years as having the greater proportion of total personal wealth in percentage terms, in our experience people aged between 50 and 60 have greater disposable income to contribute to superannuation. This is largely due to the fact they:

- have paid off their mortgage or other major debts, and
- no longer have to consider the cost of education for their children

Mortgage debt and child care costs represent a large proportion of the family budget for many people. Figures from the Australian Bureau of Statistics indicate that the average owner-occupier mortgage in March 2004 was $206,800 (for non-first home buyers). And previous studies indicate education and child care costs represent approximately 14% of an average Australian family household's weekly budget (source: NATSEM report 2002). The average Australian family is spending 2.3% more than it earns each week. "For the average Australian household, debt management is a careful balancing act and financial resources are stretched to their limits." (NATSEM report 2004)

Studies* have also shown that for people in the 25 to 39 year age group, total personal wealth has actually fallen in the past 15 years. (*Source: AMP.NATSEM Income and Wealth Report No 6)

Example:

A 55 year old couple work full time, have 2 children, own their home and have 1 investment property. Both children have completed their education and support themselves, no debt is owing on their home and investment property. The couple are both earning substantial incomes from their current jobs.

In contrast, a 35 year old couple who work full time and have 2 young children are looking at education costs for at least another 12 years, are still repaying a substantial mortgage, and therefore have relatively little disposable income available to make significant contributions to superannuation.

Summary

Notwithstanding the fact we welcome the $50,000 concessional deductible limit for people under age 50, our experience shows that clients are more likely to be able to utilise their concessional deductible contributions after the age of 50 as opposed to those under age 50. And surprisingly, it is this age group (50 to 60 years) that holds most of their wealth in the family home rather than superannuation. Therefore, it would be reasonable to assume it is this age group that needs to be persuaded to contribute more into super for retirement. For this reason, continuing to have a $100,000 concessional deductible limit for people over age 50 up to age 60 would be practical and still consistent with simplifying contributions.

However, we acknowledge the Government's proposal to allow people over age 60 to access their superannuation benefits tax free. Accordingly, we propose that once a person reaches age 60 the concessional deductible limit of $100,000 pa reduces back to $50,000 pa.

We see this as a logical compromise on the Government's initial recommendation for the following reasons.

- allowing a $100,000 deductible limit from the age of 50 up to age 60 allows the Government to realise additional contributions and earnings tax at 15% on the higher contributed amounts over a longer period of time.

- in our experience as advisers, taking into account our own clients' strategies, the opportunities are greater for people in the age group of 50 to 60 to contribute to superannuation. At this stage in life, most people are taking their pre-retirement planning more seriously. A greater number of small business owners and primary producers are either selling their businesses with the intent of using the proceeds to contribute towards their retirement, or they are transitioning into a pre-retirement period by implementing a financial strategy that includes their business structures.

> We respectively suggest it may not have been the Government's intent to restrict the long term retirement strategies for people in the small business/farming community who have traditionally injected most of their earned income back into their businesses, thereby limiting their own opportunities during this time to engage in adequate retirement planning strategies.

In relation to personal superannuation contributions from after-tax income, we believe the 3-year averaging rule advantages younger people rather than older people or pre-retirees. Our suggestion is to extend the averaging period over 5 years instead of 3 years, allowing a maximum contribution of $750,000 over the 5 year period.

Finally, we also recommend the deductible concessional limits be indexed in line with AWOTE each year as is currently the case with age based deduction limits.

Recommendation 2 - Benefit Payment Rules

2.1 To retain a cap, or maximum limit (other than the account balance) on lump sum and pension draw downs to avoid excessive drawings.

We congratulate the Government for attempting to simplify one of the most complex issues in the superannuation environment - that is, benefit payment rules.

However, we are concerned that a nil restriction clause for cashing of benefits for people aged 60 and over will encourage unnecessary or excessive withdrawals from funds that are meant to sustain a person's lifestyle throughout retirement.

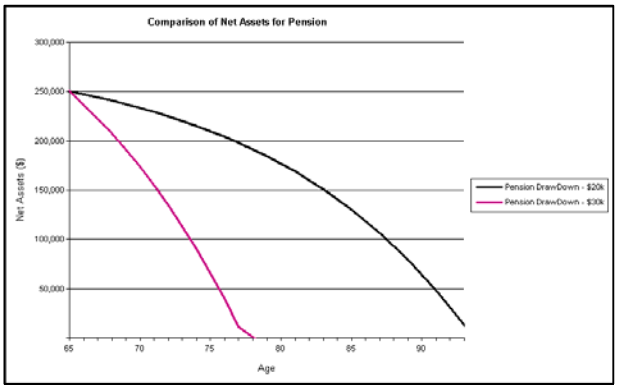
Currently, retirees aged 65+ years have an average superannuation account balance of between $200,000 - $299,000 (Census 2001). This level of money is expected to sustain a person in this age group for a period of at least 20 years (given the expected life expectancy age for females is now around 84 years), without having to rely too heavily on social security benefits.

Example

Sam is a 65 year old retiree who has $250,000 in superannuation. Consider two different scenarios :-

1) Sam commences a pension income drawing $20,000 (8% drawdown). He will also receive Age Pension support which will bring his annual income to approx. $30,000. We estimate the funds should last for approximately 27 years (or when Sam is 92 years), assuming 7.14% pa investment return for a "Balanced" investor, and assuming all surplus funds are spent.

2) Sam commences a pension income drawing $30,000 (12% drawdown). He will also receive Age Pension support which will bring his annual income to approx. $39,000. Funds are now only expected to last to at least age 76 (ie 11 years) assuming 7.14% pa investment return for a "Balanced" investor, and assuming all surplus funds are spent.



(Table source:ABN AMRO Morgans)

If we compare the above scenarios, by drawing an extra $10,000 per annum out of his superannuation Sam has effectively reduced the longevity of his funds by 16 years. Consider the impact if he had unlimited access.

Summary

We suggest a cap is retained on lump sum and/or pension draw downs to avoid the problem of excessive wastage of retirement funds. We recommend reinstating some type of limit on annual withdrawals from pensions rather than the account balance. It is our experience most clients prefer to have a limit on the maximum amount they can access each year.

Our recommendation is to introduce a formula, or system, to determine a cap.

- In relation to lump sum withdrawals, we suggest a cap on the level of undeducted contributions being withdrawn in line with contribution limits - that is, $150,000 pa, with 15% tax on any amount withdrawn over this $150,000 limit.
- In relation to pensions, we agree with the proposed percentage for minimum payments, and recommend a relative percentage for a maximum payment is also introduced – say, based on 3 times the minimum percentage factor.

Additionally, we see this recommendation - to retain a cap on withdrawals - complementing our first recommendation; that is, allowing people over age 50 and up to age 60 to contribute a higher concessional deductible amount into superannuation.

Our recommendation allows the above age group to maximimise their contributions to superannuation to achieve retirement goals, and also ensures these savings are not spent unnecessarily (effectively unravelling all the good intentions for superannuation savings in the first place).

Recommendation 3 - Pension Benefits

3.1 To allow all existing allocated pensions and annuities to be subject to the new tax rules from 1 July 2007 and not just those pensions established by persons over age 60.

3.2 To allow Term Allocated Pensions (TAPs), where the primary reason for purchase was based on an RBL strategy, to be commuted after 1 July 2007.

3.3 To increase minimum annual pension percentage factors every 5 years instead of every 10 years.

We understand that under the proposed rules, existing pensions and certain annuities owned by people over age 60 will automatically revert to the new pension type from 1 July 2007.

We welcome this proposal for its simplicity and logic.

However, we notice there is no such provision for existing pensions and annuities owned by people under age 60. We suggest the Government could include these people to further simplify the pension rules.

We also understand that currently the Government does not intend changing the commutation rules for non-commutable pensions. Whilst we can appreciate the reasoning behind the Government's decision on this matter, we suggest there are instances where allowing commutations would be appropriate.

Further, in its detailed outline, the Government recommends the complete removal of Reasonable Benefit Limits (RBLs). Again, we welcome and applaud this initiative to remove an outdated restriction on superannuation benefits. Many clients, however, have implemented strategies to minimise the effect of excessive RBL amounts, including the purchase of a non-commutable long term income stream such as a Term Allocated Pension.

By removing Reasonable Benefit Limits, the reason for purchasing the Term Allocated Pensions, by effect, is also removed.

Summary

1. Allocated Pensions

Our recommendation is to recognise **all** existing allocated pensions/annuities under the new tax treatment rules and not just for those over age 60. We believe pensioners aged 55 – 59 should not have to commute their existing pensions in order to receive the new tax treatment.

Additionally, we suggest the time period for each increment to a higher percentage limit be reduced to 5 years rather than 10 years, so to reduce the impact the resultant "step up" will have on minimum pension payments over time.

The proposed minimum annual pension payment requirements are:

Age	Minimum Payment –% of Account Balance
55 - 64	4%
65 - 74	5%
75 - 84	6%
85 - 94	10%
95 +	14%

As an alternative, we recommend the following:

Age	Minimum Payment –% of Account Balance
55 - 59	4%
60 - 64	5%
65 - 69	6%
70 - 74	10%
75 - 79	12%
80 - 84	14%
85 +	16%

2. Term Allocated Pensions

We recommend these non-commutable pensions be allowed to be commuted under the new rules where the principal strategy was to meet Pension RBL limits.

(This recommendation does not include complying annuities purchased from a life company which bases annual payments on longevity risk and credit risk accepted by the life company.)

Recommendation 4 - Bankruptcy Issues

4.1 To provide clarification on the issue of bankruptcy and superannuation now that Reasonable Benefit Limits will be abolished.

We view the removal of the Reasonable Benefits Limits (RBLs) as a significant outcome for individuals as it will encourage a greater level of savings to be accumulated in a concessionally taxed environment.

Protection of superannuation in the event of Bankruptcy

Our only concern is that the removal of the Pension RBL, which was previously the benchmark for bankruptcy protection (sub-section 116(5) of the Bankruptcy Act), now leaves superannuation funds open to potential legal action.

Additionally, the removal of RBLs will have an impact on ownership of insurance within superannuation, and this again will have an indirect impact on bankruptcy issues and the question of asset protection of insurance policies.

Summary

With the removal of RBLs, we recommend the Government introduce a new benchmark for bankruptcy protection.

In the case of insurance policies, where the trustees of a super fund hold an insurance policy on trust for the member, we suggest the total payout value of the life policy be protected in the event of bankruptcy.

In the case of vested benefits, either accumulation or pension funds, we recommend the total balance at the time bankruptcy is invoked is the notional benchmark (notwithstanding and allowing for the Clawback Provisions of Sect 120 and Sec 121 of the Bankruptcy Act, and also the latest Bankruptcy and Family Law Legislation Amendment (Anti avoidance) Act 2006).

If any other notional limit is devised by the Government, we would recommend this new limit be indexed accordingly.

Recommendation 5 - Estate Planning / Death Benefits

5.1 To allow non-dependants to take death benefit payments in the form of either pension or lump sum.

5.2 To have a flat rate of 15% applied to untaxed insurance payouts to non-dependants.

Death is a compulsory cashing event for superannuation funds, so that a death benefit is required to be cashed as soon as practicable after the death of the member (SIS Reg. 6.21). Death benefits can only be paid to the estate of the member or to a dependant under the Superannuation Industry (Supervision) (SIS) legislation.

The definition of dependant under the SIS legislation includes any child of the deceased. This means adult children are dependants according to the SIS rules. For taxation purposes, however, adult children are not considered to be dependants.

Currently, a dependant or non-dependant (for tax purposes) can accept death benefit payments in the form of either a lump sum or pension payment.

We understand it is the Government's intention that death benefit payments to non-dependants will in future only be in the form of a lump sum payment.

Child Allocated Pensions
We also raise the issue of Child Allocated Pensions and how they may be affected under the proposal. Child Allocated Pensions have been used to continue a pension income stream to a minor in the event of a parent's death. The income payment is currently worked out using PVF tables which allow for ages less than 55 years. We note there has been no allowance for minimum annual pension payments under the new rules for those under age 55.

Insurance
What is also unclear is the issue of tax on insurance held within superannuation. In particular, how will post 83 untaxed amounts be treated when paid to non-dependants? We understand the tax rate proposed in the Detailed Outline is $700,000 at 30% and the balance taxed at top marginal tax rate.

Summary

We suggest non-dependants should be able to nominate a pension if that better suits their circumstances.

We also suggest that if the pension option is selected then that pension be subject to similar rules proposed for a pension paid to a person under age 60 - albeit without a tax offset.

That is, taxable income less a deductible amount based on the new formula but without a tax offset. We feel this is a reasonable compromise for non-dependants.

To allow persons under age 55 to access pension payments for whatever reason (eg Child Allocated Pensions), we recommend minimum percentage factors should be made available.

Our suggestion is to use the current proposed minimum 4% factor as a flat rate for these individuals.

In relation to insurance payouts from life policies held within superannuation, we recommend there should be a flat rate of 15% applied to benefits paid.

Additionally, we recommend existing governing rules for Income protection policies within superannuation be amended . The current regulations still only allow a person to claim up to 2 years' premiums as a deduction. We suggest the Government consider extending this claim to a longer term in accordance with income protection policies held in a person's own name.

Recommendation 6 - Work Test

6.1 To abolish the work test for persons over age 65, effective 10 May 2006.

The proposed changes are all about simplifying and streamlining superannuation for retirees, "making it easier to understand". It's also about continuing the Government's policy for a more flexible and adaptable retirement system.

In 2004, when the Government released its policy paper "A more flexible and adaptable retirement income system", it was to address the Government's concerns about a rapidly ageing population and the impact soon-to-be retired baby boomers with insufficient savings may have on the economy. The Treasurer emphasised in this paper the need for people to prepare and plan for the lifestyle they want in retirement, with the resultant proposed measures aimed at making that lifestyle attainable.

Incentivising retirees to build their superannuation savings so they can be self-funded and thereby reducing their reliance on welfare benefits was and still is an important objective for the Government.

Retaining a work test on contributions, therefore, for people over age 65 contradicts this very policy and objective. The idea should be to encourage individuals to contribute to superannuation. Instead the work test of 40 hrs over 30 consecutive days constrains a retiree's ability to build their retirement savings further.

Example

John the Farmer, 66 years of age, sold his farm in June 2006 (FY05/06) after a lifetime of working. His retirement plan is to contribute the proceeds from the sale of the farm into a superannuation account, from which he will draw an appropriate income stream to enable him to live comfortably in retirement.

Settlement of the contract does not occur until September 2006 - which is a new financial year 06/07 - at which time the sale proceeds are credited to John's bank account.

However, because John is over age 65 and has not worked in the 06/07 financial year he is unable to contribute the funds into superannuation unless he meets the 40hr work test for that year.

Summary

While we respect the Government's reasons for introducing a work test, we suggest it may not have been their intention to penalise someone, such as John in our example, who has contributed significantly to the Australian economy and only wants to ensure sufficient superannuation savings for retirement.

Accordingly, we recommend the removal of the 40 hour over 30 consecutive day work test on contributions for people over age 65 following the removal of cashing restrictions for this same age group.

We believe it would provide a simpler solution to remove all provisions on work tests. We suggest the existing work test is an impractical work test.

Further, we suggest the removal of this contribution work test be effective from 10 May 2006 in accordance with the recent announcement by the Government relating to the cashing rule.

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