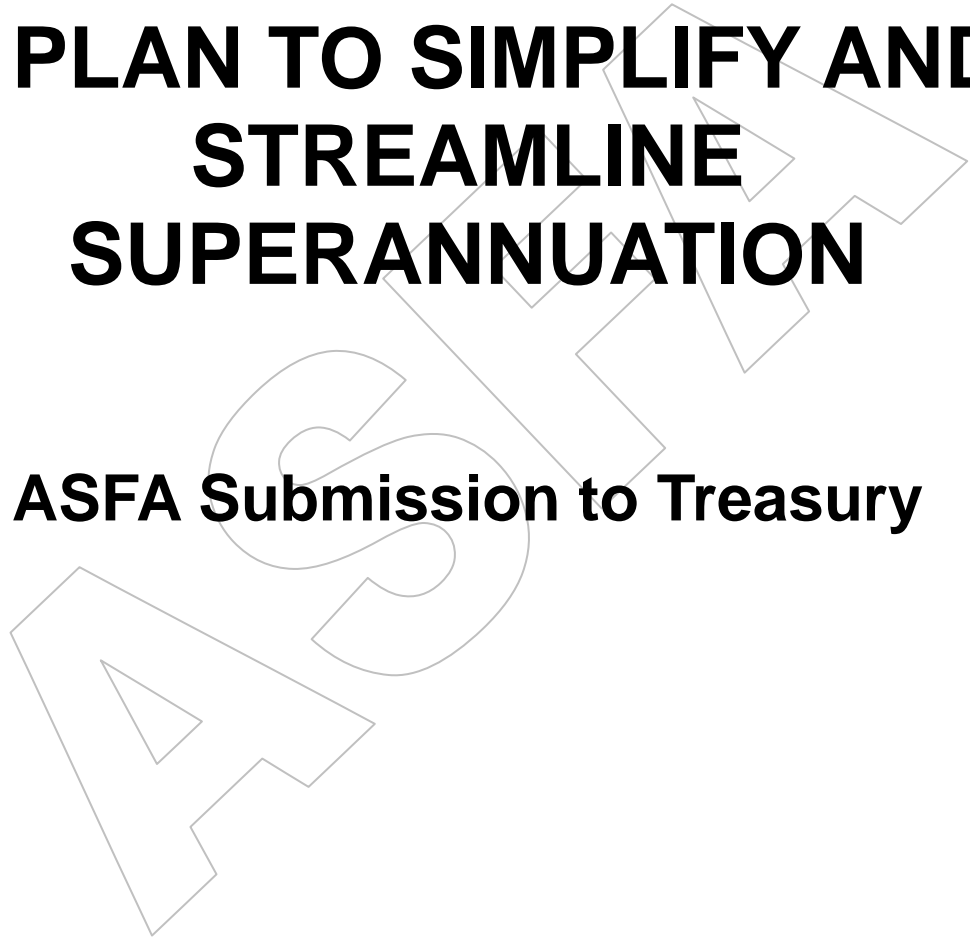




The Voice of Super

A PLAN TO SIMPLIFY AND STREAMLINE SUPERANNUATION

ASFA Submission to Treasury



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EXECUTIVE SUMMARY

The plan, as announced, represents a major simplification of the superannuation system. For fund members, and those considering contributing to superannuation, the proposed changes would make the system easier to understand. Improved community understanding should enable individuals to plan for their retirement and make better decisions about superannuation.

The removal of benefits taxes for most fund members accessing their superannuation age 60 and over should encourage individuals to contribute to superannuation throughout their working lives. We are also confident that individuals will draw down their retirement benefits in a measured manner, leading to improved retirement outcomes.

Despite the numerous simplifications and improvements for individuals, it is also important for the system to be simple to administer. For superannuation funds and their administrators, some of the proposed arrangements, rather than simplifying the superannuation system, could add to administrative complexity. The contribution limits, if poorly designed and implemented, have the potential to impose an unnecessary administrative burden and cost on funds and all fund members.

It is essential that any new administration arrangements be structured to both attain the stated policy outcomes as well as minimise administrative complexity. It is critical to avoid the problems encountered with previous measures of similar scale and significance such as the superannuation surcharge. ASFA is keen to work closely with Government, Treasury and the ATO to explore and develop appropriate administrative arrangements.

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2 TAXATION OF BENEFIT PAYMENTS

2.2 PROPOSED RULES FOR BENEFITS PAID TO INDIVIDUALS AGED 60 AND OVER

2.2.1 Lump sums - proposed arrangements

All lump sum benefits paid from a taxed source to an individual aged 60 or over would be tax free when paid. There would be no RBL.

ASFA COMMENT

ASFA supports the proposal to reduce the overall level of taxation of superannuation and supports the proposed simplification of the rules on taxing of benefits.

ASFA recommends that ordinarily the date for determining the tax treatment of a benefit payment be the member's appropriate birthday. Therefore, if a condition of release is satisfied, a member could withdraw their benefit on or after their 60th birthday tax-free. This should apply to both lump sums and incomes streams, so whether a pension payment is exempt or taxable should be determined by reference to the age of the person on the date of payment.

However, there may be instances where income streams may be easier to administer if the zero tax applies for the full financial year in which the member turns 60, to prevent two sets of deductible amounts and payment factors in the changeover year.

Similarly ASFA recommends that other tax treatments (under age 55, between age 55 and 59) should be dependent upon the person's age when the benefit is paid.

2.2.2 Pensions - proposed arrangements

All pension payments from a taxed source would be tax free when paid to individuals aged 60 or over, including pensions that commenced before 1 July 2007. There would be no RBL.

ASFA COMMENT

ASFA supports the proposal to reduce the overall level of taxation of superannuation and supports the proposed simplification of the rules on taxing of benefits.

2.2.3 Reporting - proposed arrangements

Individuals would not need to include details of lump sum superannuation benefits and superannuation pensions in their tax return.

Superannuation funds would not need to report benefit payments to the ATO for RBL purposes.

ASFA COMMENT

ASFA supports the simplification of the rules on the reporting of benefits.

2.3 PROPOSED RULES FOR BENEFITS PAID TO INDIVIDUALS AGED UNDER 60 YEARS

Although benefits would still be subject to tax if paid before age 60, the number of taxation components of a benefit would be reduced for those under age 60 to a maximum of two. This would mean some components would be taxed at a lower rate than previously.

ASFA COMMENT

ASFA supports the proposed simplification of the rules on taxing of benefits

2.3.1 Lump sums

Proposed arrangements for those aged under 60.

For individuals aged under 60, lump sum payments would consist of two components — an exempt component and a taxable component.

The exempt component would be tax-free.

For individuals aged 55 to 59, the taxed component would be tax free up to the low-rate threshold (\$135,590 in 2006-07) and taxed at 15 per cent above the threshold.

For those aged under 55, the taxed component would be taxed at 20 per cent.

ASFA COMMENT

ASFA supports the proposed simplification of the rules on taxing of benefits.

The Association has, however, received representation from members in relation to the taxation of Total and Permanent Disability (TPD) payments made to people under age 60, who will pay more tax than if they waited until turning age 60. It has been suggested that consideration should be given to permitting TPD benefits to be taken tax-free from a superannuation fund.

Treasury has raised the issue of a suitable definition of TPD if this proposal were to be considered. In addition, the interpretation of TPD definitions in SIS and fund governing rules is a matter of significant interest to the Superannuation Complaints Tribunal.

In view of these complexities, ASFA recommends that the issue of a suitable definition of TPD and the tax treatment of such benefits been separately considered by Treasury, industry, APRA and the SCT.

Calculating the pre-July 83 component

All funds would be required to calculate a pre-July 83 component as at a particular date under the existing formula. That amount would then become a fixed component that would not change in the future and would become part of the exempt component.

ASFA COMMENT

ASFA supports the proposed simplification of the rules on the pre-July 83 component.

Crystallising the pre July 83 components will prove difficult for defined benefit funds. This calculation is already required for Family Law purposes, where there is a standard methodology with the option to use a different methodology and factors where approved by the Attorney-General's Department. Consideration should be given to using the same approach with further consideration of the approving authority in this situation.

For the crystallisation of the pre July 83 component to succeed and to minimise complaints and disputes, there will need to be time for superannuation funds to contact their members. Member may wish to amalgamate their accounts or to provide correct information on their service.

Often funds have incomplete information about a member's employment details. Accurate information only becomes available when the member intends to take the benefit. ASFA supports funds being able to recalculate a crystallised pre July 83 component particularly when new data is available or an error has been previously made.

2.3.2 Pensions

Proposed arrangements for those aged under 60

Pension payments for individuals aged under 60 would generally continue to be taxed under current arrangements.

However, the calculation of the undeducted purchase price of a pension commenced on or after 1 July 2007 would include all the new exempt components which may result in a higher undeducted purchase price, and thus deductible amount. For pensions that commenced prior to 1 July 2007, it is intended that the current arrangements for calculating the deductible amount remain.

The full superannuation pension rebate of 15 per cent would apply to all pensions paid from a taxed fund if the individual is aged 55 to 59 years.

Once the pension recipient turns 60, their pension would be tax free as outlined in section 2.2.2.

ASFA COMMENT

ASFA supports the continuation of current taxation arrangements in respect of individuals commencing pensions before age 60.

2.3.3 Reporting - proposed arrangements

Individuals aged under 60 would still be required to report details of ETPs and pensions in their tax return.

Benefit payments would no longer be reported to the ATO by superannuation funds for RBL purposes.

ASFA COMMENT

ASFA supports the simplification in the reporting requirements for superannuation funds.

2.4 DEATH BENEFITS

Proposed Death Benefit Arrangements – Lump sum

Under the proposed arrangements, all lump sum death benefit payments would be tax free if paid to a dependant.

ASFA COMMENT

ASFA supports the simplification in the taxation rules applying to the payment of a lump sum death benefit.

However, the current proposal, with different tax rates depending upon whether the death benefit is paid to a dependant or non-dependant, will likely result in a new version of the "recontribution" strategy. Members will withdraw their benefits at age 60 and re-contribute so that the new undeducted contribution becomes an exempt component and hence tax-free in case it is paid as a death benefit to a non-dependent adult child.

The differential tax treatment and likely resultant behaviour runs counter to the policy objective of permitting individuals to keep their money in super for as long as they want (as enabled by the abolition of the compulsory cashing requirements).

Consideration should be given to permitting death benefits to be paid tax-free where the member dies at age 60 or above, regardless of whether the recipient is a dependant or non-dependant under the ATO definitions. Consideration should also be given to a review of the *Income Tax Assessment Act 1936* and SIS definitions of 'dependant'. Consideration should also be given to review of the operation of the "anti-detriment" test (section 279D of the *Income Tax Assessment Act 1936*).

Proposed Death Benefit Arrangements – reversionary pension

The taxation of a death benefit paid as a reversionary pension would depend on the age of the primary and reversionary beneficiary. If the primary beneficiary was aged 60 or over at the time of death, then payments to the reversionary beneficiary would be exempt from tax. If the primary beneficiary were under age 60 at the time of death, the pension would be taxed at the reversionary beneficiary's marginal tax rate (less any deductible amount and pension rebate) until the reversionary beneficiary achieves aged 60.

A pension would not be able to revert to a non-dependant on death. A lump sum death benefit payment would be required to be made to the non-dependent reversionary beneficiary. The entire taxable component of a lump sum payment to a non-dependant would be taxed at 15 per cent, irrespective of their age.

ASFA COMMENT

Requiring non-dependants to be paid lump sums, and subjecting the taxable component of the lump sum to tax, will require funds to maintain information about the exempt and taxable components, even after the member turns 60 and / or a reversionary pension to a dependant has commenced. As noted above ASFA supports no differentiation as to the tax treatment of a death benefit, based on the status of the recipient, when the member is 60 or above.

2.5 TEMPORARY RESIDENTS

Reflecting the new simplified ETP components (see section 2.3.1), the rates would be:

- exempt component — 0 per cent; and
- taxable component — 30 per cent.

In practical effect, this is no change to the current system. If the payment is from an untaxed source, it would continue to be taxed at 40 per cent.

ASFA COMMENT

ASFA supports the retention of the current taxation arrangements for benefits released early to temporary residents.

3 PAYMENT RULES SIMPLIFIED

3.1 WHEN BENEFITS CAN, OR MUST BE PAID

Voluntary withdrawal

The preservation arrangements would not change. Members would still be able to take their superannuation once they have reached preservation age and retired or once they reach age 65.

ASFA COMMENT

ASFA supports the retention of the current preservation arrangements.

Compulsory withdrawal abolished

The requirement for compulsory payment of benefits to members over age 65 who do not meet the current work test would be removed.

ASFA COMMENT

ASFA supports the abolition of the compulsory cashing rules and welcomes the Treasurer's 13 June announcement and APRA Modification Declaration No. 3 of 2006 that has brought forward the abolition of compulsory cashing to 10 May 2006.

3.2 SIMPLIFYING PENSION RULES

3.2.1 **Overview of Proposed Arrangements**

Replacing multiple rules for multiple types of pensions with a simple set of rules

The proposed simple standard

All pensions that meet simplified minimum standards would be taxed the same on payment.

The new minimum standards for pensions commencing on or after 1 July 2007 would require:

- payments of a minimum amount to be made at least annually;
- no provision to be made for an amount to be left over when the pension ceases; and
- that the pension could be transferred only on the death of the pensioner to one of their dependants or cashed as a lump sum to the pensioner's estate.

The payment rules would specify minimum limits only. Maximums would only apply to pensions that commence under the transition to retirement condition of release.

Earnings on assets supporting these pensions would remain tax exempt.

Pensions that meet existing rules and commenced before 1 July 2007 would be deemed to meet the new minimum standards.

ASFA COMMENT

ASFA supports the simplification of the pension rules.

ASFA supports the flexibility the proposed arrangements will provide pensioners. Further clarification will be required on the proposed rules in particular the need that no amount be left over when a pension ceases.

ASFA notes that the detailed outline does not address the commutation of an existing pension and rolling it over to products issued under the new rules.

ASFA's view is that the SIS regulations should permit the transfer of current account-based income streams, such as allocated pensions, to the new rules without requiring commutation. Ideally members should be able to take advantage of the new rules. However further examination of particular issues in respect of commutability of complying income streams, such as risk-based products and pooled arrangements, is required, to ensure a fair balance between issuer concerns and likely consumer demands for commutability.

One factor determining whether an income stream is actually commutable will ultimately come down to the contractual arrangement between the product provider and the pensioner.

Where a member commutes an existing income stream and transfers to an income stream under the new rules, the new product should be assessed for Centrelink asset test purposes under the rules applying on the date the new income stream commences.

Where the rules permit commutation and transfer between products under the old and the new rules, this should be recognised in the Centrelink rules and not subject to the social security clawback rules.

It appears as though the new pension rules will commence on 1 July 2007. If the new products are treated, for asset test purposes, similar to an allocated pension, then the 1 July 2007 start date is appropriate. Otherwise, a 20 September 2007 start date would be more appropriate. It would be inappropriate for a person to have a 50% asset test exemption in a product in which there was an ability to access the capital.

Guaranteed lifetime pensions

Guaranteed lifetime pensions provided on an arm's length basis that meet relevant existing requirements would continue to be acceptable.

ASFA COMMENT

ASFA supports the retention of rules for guaranteed lifetime pensions products offered on an arm's length basis. The current restrictions on funds with fewer than 50 members should be retained with other funds able to provide these products.

3.3 TRANSITION TO RETIREMENT

The transition to retirement pension rules will be amended to allow pensions that meet the new minimum standards to be able to provide transition to retirement benefits.

The proposed new rule would allow no more than 10 per cent of the account balance (at the start of each year) to be withdrawn in any one year. The existing non-commutability rules for income streams purchased under the transition to retirement measure would continue to apply. Pensions commenced prior to 1 July 2007 which complied with relevant rules for the transition to retirement measure at the time would be deemed to satisfy the proposed requirements.

ASFA COMMENT

ASFA supports the simplification of the transition to retirement pension rules.

3.4 BENEFITS NOT WITHDRAWN

There would be no compulsory draw down rules under the new arrangements. A person would be able to keep their benefits in a fund indefinitely. Earnings on benefits retained in the accumulation phase would generally be subject to tax as assessable income of the fund at 15%.

ASFA COMMENT

ASFA supports the simplification of the compulsory cashing rules.

4 SIMPLIFIED CONTRIBUTION RULES

4.2 PROPOSED TAXATION ARRANGEMENTS

It is proposed to streamline the rules for deductible contributions by removing the age-based limits on deductible contributions.

A limit on concessional deductible contributions of \$50,000 per person per annum would apply. These contributions would be taxed at 15 per cent.

Where the ATO identifies that a person's deductible contributions have exceeded \$50,000 in a financial year, the amount in excess of \$50,000 would be taxed at the top marginal tax rate.

ASFA COMMENT

ASFA recognises that the contribution limits have been proposed, in light of the end benefits tax proposals, to enable the fiscal sustainability of the system.

However, it needs to be recognised that the changes to the contribution limits are more than merely a change in the thresholds but are a fundamental reworking of the system. Under the age-based contribution limits, the test was applied on the employer and any penalty for breaching the limits was loss of deductibility by the employer.

Under the proposed limits, the administration of the limits has been shifted to funds and any penalty will be borne by the member. Further, the penalty has gone from loss of deductibility to taxing of contributions at the highest marginal tax rate (for deductible contributions) or return to the contributor (for undeducted contributions).

This fundamental change, with a number of new processes, requires careful consideration of the administrative arrangements. As well, it will be important for the ATO to communicate the nature of the changes to employers and individuals to ensure the changes are understood and to minimise the thresholds being inadvertently breached.

Administrative arrangements for contributions tax

Assessments for additional tax on contributions in excess of \$50,000 per annum in respect of an individual would be determined by the ATO but levied on superannuation funds.

The assessments would be based on reports to the ATO by funds of taxable contributions (including notional taxable contributions) made for the benefit of an individual.

Where taxable contributions exceed the \$50,000 limit and are made to more than one superannuation fund, the most practical fund(s) on which to levy the tax would need to be determined.

It is anticipated that there would be few instances where this would be necessary.

Further details on the administrative arrangements would be determined in consultation with the superannuation industry.

ASFA COMMENT

ASFA welcomes the statement of intent to work with the industry in the development of the administrative arrangements.

Care needs to be taken to ensure that the majority of fund members are not burdened with administration costs that relate to the activity of a small number of members.

The mechanism proposed in the Detailed Outline effectively replicates the superannuation surcharge; funds report contribution data to the ATO and the ATO issues assessments in relation to individuals to funds, which the fund then deducts from the member's account and remits to the ATO.

ASFA recognises that funds are currently required to prepare and submit the Member Contributions Statement (MCS) for the purposes of the co-contribution. This should provide the ATO with most of the data required to determine whether an individual has exceeded their contribution limit. (Notional contributions in respect of defined benefits are discussed later in this submission.)

However, dealing with the assessments would require significant system changes to accommodate. One major administrator estimates costs of \$1 million to introduce changes to accommodate fund-directed assessments.

Unlike the surcharge, where often the member suffered the higher tax solely due

to their income level, for the most part, members should be able to control contributions so that they remain within the limits. As well, the Government accepts that a tax penalty will apply to individuals when the deductible contribution limit is breached or on earnings on excess undeducted contributions.

To this end ASFA does not support assessment for additional tax in respect of excessive deductible contributions being issued to funds.

Instead, ASFA considers it more appropriate that such assessments be made to the individual. The individual could then either pay the assessment, or direct the assessment to a superannuation fund for payment. The current treatment of departing overseas residents provides a precedent within the existing superannuation tax regime, where the assessment is given to the member who then either pays the tax themselves or passes the assessment onto the superannuation fund for payment.

Alternatively, consideration could be given to a system where employers report superannuation contributions on group certificates and individuals report to the ATO Office when filing their income tax returns.

In any regime, the role of superannuation funds in administering the cap on deductible contributions should be limited to reporting to the ATO the deductible contributions and paying a tax assessment when directed to do so by an individual.

However, if the decision is taken to issue assessments to funds then ASFA would like to see the self-assessment regime that existed under the surcharge requirements for Self Managed Superannuation Funds (SMSFs) made available to SMSFs. This would enable SMSFs to comply with all reporting requirements plus pay the debt during the course of one interaction with their accountant or tax agent.

4.4 AGE-BASED LIMITS AND DEDUCTION RULES

Employers

The age-based deduction limits would be abolished and employers would be able to claim a full deduction for all contributions to superannuation funds made on behalf of their employees under age 75.

ASFA COMMENT

ASFA supports this simplification of the contribution rule.

Employees

The proposed removal of age-based limits would provide scope for employees under age 35 to make larger contributions to superannuation through salary sacrifice arrangements. The current age-based limit for individuals less than age 35 is \$14,603 per annum, compared to the proposed limit of \$50,000 per annum.

ASFA COMMENT

ASFA recognises that the contribution limits have been proposed to ensure the fiscal sustainability of the package.

Unfortunately, there are some individuals who are adversely affected by the proposed contribution limit changes. This includes individuals who are receiving superannuation contributions in excess of the contribution limits due to pre-existing employment contractual arrangements or industrial instruments. For example, in the public and higher education sectors, employers are often obliged under existing industrial instruments or other obligations to make contributions in excess of the mandated 9% of salary. Often these arrangements are not easily “unwound”. It may be impossible for the individual affected to take as salary the excess contributions. While recognizing that grandfathering can often result in complexity, there needs to be some accommodation of such situations. Grandfathering may also be required in respect of defined benefit fund members (see below).

ASFA proposes that the cap on deductible contributions should be indexed over time. To maintain simplicity, the indexation should be by way of a ratchet mechanism, built into the legislation, where every few years the contribution limits was adjusted upwards to the next thousand-dollar amount. (This could be done every five years with an adjustment to the next highest five thousand dollar amount.) As well, if indexation is linked with AWOTE (as appears to be the case going forward for the low rate threshold) indexation should be based on 31 December AWOTE figures (rather than end of March) to give the ATO time to calculate and communicate the new threshold to enable proper planning.

There also remains the concern that the contribution limits will adversely impact on adequacy, if the desired behavioural changes in savings patterns do not eventuate. Often individuals are not able to save enough until their 50s due to other financial commitments between their 20s and 40s, such as mortgages and children. There also remain possible adequacy issues for persons with broken or intermittent work patterns. In addition to indexation, the actual contribution limits need to be closely monitored and reviewed by Government to ensure adequacy is not adversely affected.

Self-employed

Contributions made by the self-employed would be treated in the same way as contributions made by employers for the benefit of employees. Superannuation contributions would be eligible for a deduction until age 75.

ASFA COMMENT

See the next section for ASFA's comments on this proposal.

Personal deduction eligibility

It is proposed that the rule that determines a person's eligibility to claim a deduction for personal contributions be simplified, mirroring the test currently used for determining eligibility for a Government co-contribution. The test would be changed so that it would only be necessary to determine how much of a person's assessable income and reportable fringe benefits is attributable to employment as an employee.

ASFA COMMENT

While ASFA supports this simplification, clarification is needed as to whether the definition of employee that will apply is the common law definition or the extended definition contained in the *Superannuation Guarantee (Administration) Act 1992*.

Consideration should be given to reconsidering the operation and administration of Section 82AAT of the *Income Tax Assessment Act 1936* due to the fixed maximum contribution limits, the interaction between the limits that would occur as contributions are reclassified as s.82AAT notices are lodged and amended and the TFN requirements for personal contributions. In particular consideration should be given to limiting when a person can lodge an 82AAT notice to the end of the following financial year.

Transitional arrangements

Under transitional arrangements, persons who are over the age of 50 in any of the years 2007-08 through to 2011-12 inclusive could have \$100,000 of taxable contributions made to their account and taxed at the concessional 15 per cent rate.

Deductible contributions above this amount would be taxed at the top marginal rate.

ASFA COMMENT

ASFA recognises that the contribution limits have been proposed to ensure the fiscal sustainability of the package. However, certain pre-existing arrangements need to be recognised to ensure a fair transition to the new regime.

4.5 UNDEDUCTED CONTRIBUTIONS

A cap of \$150,000 a year would be imposed on the amount of post-tax superannuation contributions a person can make.

The cap may be averaged over three years. (Post budget announcement.)

The unused portion of a cap cannot be carried forward to future years. (Post budget announcement.)

ASFA COMMENT

ASFA supports the proposed averaging arrangement with its capacity to cater for lumpy contributions. It is unclear from the Treasurer's 13 June media release whether this is a permanent feature of the regime or merely a transitional provision. ASFA would support the three-year averaging as an on-going measure.

However the prospective application of the work test for post age 65 contributions, also announced on 13 June, presents significant administrative difficulties. As proposed, there would be some requirement to test whether a person is going to work in future years. Not only is this impossible to assess and police, there are significant complexities created about how to deal with those contributions if the person fails to meet those obligations in future years.

ASFA suggests that under the averaging arrangements for undeducted contributions, the work test for contributions should only apply to the year in which the contribution is made.

ASFA also proposes that the cap on undeducted contributions should be indexed over time. To maintain simplicity, the indexation should be by way of a ratchet mechanism, built into the legislation, where every few years the contribution limits was adjusted upwards to the next thousand dollars.

ASFA also supports the introduction of a regulation that would permit a fund to reject a contribution in excess of \$450,000.

4.5.1 Refund of excessive contributions

Contributions in excess of the cap would be returned to the individual. Any earnings on the excess would be effectively taxed at the top marginal tax rate.

ASFA COMMENT

ASFA recommends that a degree of certainty be provided to fund members in the operation of this provision. As well, administrative simplicity for funds is a paramount concern. ASFA would not support a process that required the penalty tax to be determined by reference to actual contribution dates and

actual fund earning rates. This would require funds to undertake complex calculations, effectively reconstructing a members' earnings over a period of time. Such calculations will be near impossible, particularly in a fund with member investment choice and frequent crediting or unit pricing.

Simplicity could be achieved by deeming through legislation the date from which interest will be accumulated (e.g. 1 July in the financial year in which the contribution is made) and a penalty rate of interest. In addition to providing certainty it would discourage deliberate breaches of the rules.

As well, the payment of the penalty tax on those excess earnings should be the responsibility of the individual member. The ATO would issue the assessment, including both the amounts to be returned and the tax payable, to the individual member. The member would present the assessment to the fund and the fund would return the amount on the assessment (entire excess contributions plus deemed earnings as calculated by the ATO) to the member. The member would then be expected to pay any tax penalty on the excess earnings to the ATO or if the fund agreed, it could pay the tax.

Under the current proposal, excess contributions are to be returned. One alternative is to apply a penalty tax on the excess undeducted contributions rather than to refund to the member. This is in line with treatment for excess deductible contributions. Given the proposal for no maximum, a person can take from a pension, this may be needed to avoid strategies where undeducted contributions well in excess of the limits are made and then taken from the fund, effectively leaving nothing to be returned to the member and avoiding the penalty tax on excess earnings. Any alternative penalty for excess undeducted contributions should not create any additional administrative burden for funds.

We have considered scenarios for a combined deductible and undeducted contribution limit and could not find one that was not over-engineered and met the simplicity test for fund administration and consumer understanding.

Administration

The ATO would collect the necessary information on contributions in order to determine when a person has exceeded the annual cap. This would trigger a return of the excessive contributions and earnings.

Rules would be developed to determine which contributions are refunded in the case of multiple contributions and funds.

ASFA COMMENT

As with the deductible contribution limit regime, ASFA supports an approach where the member, rather than the fund, is given the assessment. ASFA supports a process that would require the individual who is in breach of the contributions cap advise the fund from which the excessive contributions are to be returned. As noted above, the fund would return the entire excess contributions plus deemed earnings to the member and the member would ordinarily be expected to pay any tax penalty on the excess earnings to the ATO.

SIS would need to provide a condition of release so that funds are able to refund this money to members. Simplicity could be achieved by deeming through legislation the date from which interest will be accumulated (e.g. 1 July in the financial year in which the contribution is made) and the penalty rate of interest. In addition to providing certainty it would discourage deliberate breaches of the rules.

Exemptions to the cap

Scope would be provided for certain exemptions to the cap, such as the CGT exempt component from the sale of a small business (Subdivision 152-D of the *Income Tax Assessment Act 1997*).

ASFA COMMENT

ASFA supports the granting of exemptions from the contributions caps in respect of items that are currently exempt from the RBL regime.

Defined benefit funds

Special rules may be needed for defined benefit funds and would be developed in consultation with industry.

ASFA COMMENT

ASFA supports the development of special rules in respect of members with defined benefit interests in defined benefit funds.

The complexity of many existing arrangements, and their contractual nature, require specific consideration.

For defined benefit funds there is a need for a simple notional system for determining benefit accumulation amount. A significant number of people are in hybrid arrangements or in defined benefit arrangements and wish to make additional salary sacrifice contributions. There is therefore a need for individuals to have knowledge up front of their deductible contributions to the defined benefit fund, so they can make correct decisions about their accumulation fund contributions.

Consideration should be given to a DB scheme being able to set a standard contribution factor for a class of members that can be used over a number of years. The contribution factor would only need to be recalculated where there were changes to the scheme rules or in the member's personal circumstances, that specifically affected the contribution rate. One such change might be where a member reached their maximum benefit limit. Another might be where a member moved from one division of a scheme to another.

Consideration should also be given to special contribution rules covering defined benefit scheme members who were scheme members on 9 May 2006. Often the member and the scheme may be locked into a contractual arrangement. In some instances, the member has a very high notional contribution rate, effectively beyond their control, at the end of their career.

In situations where the member's benefit within a defined benefit fund is not voluntarily enhanced, ASFA would support defined benefit funds reporting contributions up to the member's upper contribution limit. For example, a 56-year old defined benefit member as of 9 May 2006 may have notional contributions of \$120,000 for 2007-08. However this would be reported to the ATO as \$100,000. A defined benefit member under the age of 50 with \$120,000 of notional contributions for 2007-08 would have reportable contributions of \$50,000. This treatment of reportable contributions should continue unless there are voluntary enhancements to the fund, at which point the higher notional contribution amount would be reported.

4.6 OTHER TAXABLE CONTRIBUTIONS

4.6.1 Transfers from overseas superannuation funds

Where a tax liability arises in respect of a superannuation benefit paid from an overseas fund to an Australian fund and the individual elects for the taxable amount to be treated as a taxable contribution, then the taxable amount would

be taxed in the fund at the flat rate of 15 per cent.

ASFA COMMENT

ASFA supports this continuation of the current tax regime. Though taxed at 15 per cent, transfers from overseas should not be treated as a contribution for the purposes of the contribution caps.

5 CONTRIBUTION INCENTIVES FOR THE SELF EMPLOYED

5.1 AGE-BASED LIMIT AND DEDUCTION RULES

5.1.2 Proposed arrangements

The deductibility of contributions by the self-employed (and other persons who are currently eligible for a deduction) is to be treated in the same way as contributions made for the benefit of employees. That is, the self-employed would be eligible to claim a full deduction for all contributions made to accumulation schemes on their own behalf up to age 75.

ASFA COMMENT

ASFA supports the proposed change to the rules regarding deductibility of contributions.

5.2 EXTENSION OF THE GOVERNMENT CO-CONTRIBUTION SCHEME TO THE SELF-EMPLOYED

It is proposed to extend the Government co-contribution scheme to the self-employed, effective from 1 July 2007 provided they earn 10 per cent or more of their income from carrying on a business, eligible employment or a combination of both, their income must be under the Government co-contribution upper threshold, they are not a temporary resident and they are less than 71 years of age at the end of that income year.

To provide for the self-employed, income would be determined by adding the assessable income of an individual (including any reportable fringe benefits, if applicable) and then reducing that amount by their expenses incurred in carrying on a business.

From 1 July 2007, the co-contribution lower income threshold would be indexed in line with the growth in full-time adult average weekly ordinary time earnings. The upper income threshold would be adjusted to an amount \$30,000 greater than the lower threshold.

ASFA COMMENT

ASFA supports the extension of the co-contribution to the self-employed.

ASFA supports the indexation of the co-contribution lower threshold and the maintenance of the \$30,000 gap between the upper and lower thresholds.

6 AGE PENSION ARRANGEMENTS

6.1 PENSION ASSETS TEST

From 20 September 2007 the pension assets test taper rate would be halved so that recipients only lose \$1.50 per fortnight for every \$1,000 of assets above the relevant threshold.

ASFA COMMENT

ASFA supports the halving of the pension assets test taper rate. This is an important reform that reduces particular disincentives for individuals to save.

The pension rule simplification is silent as to how drawdowns will be treated under the income test. Currently, a distinction is made between income and withdrawal of capital by reference to the payment valuation factors.

If there is no distinction between income and capital, this could adversely impact age pension eligibility in a particular year where the individual draws down on capital to deal with a one-off expenditure.

6.2 ABOLITION OF THE 50 PER CENT ASSETS TEST EXEMPTION FOR 'COMPLYING' INCOME STREAMS

The current 50 per cent assets test exemption for 'complying' income streams would be removed for income streams purchased on or after 20 September 2007.

ASFA COMMENT

ASFA supports this simplification of the asset test rule.

7 OTHER MEASURES

7.1 EMPLOYER PAYMENTS

7.1.2 Proposed new arrangements for employer ETPs

It is proposed that employer ETPs be comprised of two components — exempt (from tax) and taxable. The exempt component would be any post-June 1994 invalidity amount and the pre-July 1983 amount exempt from tax. The taxable component would be the post-June 1983 amount. The first \$140,000 of the taxable component would be taxed at 15 per cent for recipients aged 55 and over and at 30 per cent for those aged under 55. Amounts in excess of \$140,000 would be taxed at the top marginal tax rate.

Employers would not be required to report these payments to the ATO.

ASFA COMMENT

ASFA supports the simplification of the payment arrangements. It is assumed that the current exempt component of a bona-fide redundancy and approved early retirement scheme ETP will remain exempt.

However, there are pre-existing employment contracts that often include an ETP as part of the total remuneration amount. This would mean that ETPs will be taxed more heavily and the contracts worth less to the employee involved. As with other adversely affected pre-existing arrangements, consideration should be given to permitting relief (for instance, over the next three years) for employment arrangements that were in place as of 9 May 2006.

7.2 NON-QUOTING OF TAX FILE NUMBERS

The tax system generally operates on the basis that the highest rate of tax is deducted where an individual has not quoted a tax file number.

ASFA COMMENT

ASFA supports the use of tax file numbers as a means of identifying superannuation fund members.

7.2.1 Tax on contributions

Where a tax file number has not been quoted to a taxed fund, the top marginal tax rate would apply where taxable contributions to that fund for a member exceed \$1,000.

ASFA COMMENT

ASFA supports the use of TFNs by superannuation funds. Funds devote considerable resources to TFN collection and make use of TFNs to assist fund administration and to reduce problems such as lost members.

However the proposed arrangement is inappropriate. Quoting of tax file numbers is essentially an administrative function. The ATO will use TFNs to collate contributions data for individuals so that assessments can be made. Consideration needs to be given to what genuine risks are presented by individuals seeking to contravene the contribution limits by making contributions to multiple funds. The cost to a member of contributing to more than 50 funds would be considerable and unlikely to be worth the benefit of making super contributions in excess of the cap.

The \$1,000 contribution threshold is equivalent to SG contribution on ordinary time earnings of only \$11,000. Those most likely affected by the penalty tax will be hundreds of thousands of low wage Australians, including part-time and casual workers. One major industry fund has indicated that they have 600,000 member accounts without a TFN. Often the non-quotation of the TFN is because the employer has failed to pass on the information in the employment declaration to the superannuation fund.

In addition to their inequitable impact, the TFN proposals will place significant administrative challenges on many superannuation funds. In multi-employer arrangements, including corporate master trust and industry funds, often the level of TFN quotation is less than desired. Based on anecdotal evidence from multi-employer funds that are ASFA members, the percentage of member accounts with TFNs range from between 60 and 90 per cent.

It would seem harsh to punish individuals with a penalty tax on compulsory contributions because of the actions (or inaction) of their employer.

To address the policy impact and alleviate potential administration problems ASFA proposes the following:

- Lifting the threshold from \$1000 to \$5000. This would require a person seeking to avoid the limits to contribute to more than 10 funds and would link the threshold to the amount of SG a person on average weekly earnings would receive in a year.
- The 'test time' for non-quotation of a TFN should be the final day of the Member Contribution Statement reporting period (30 June). Consideration should also be given to delaying the TFN requirements to give funds more time to collect TFNs, as long as the time table does not cause difficulties for funds.
- Where additional tax is imposed for non-quotation of a TFN and the member is able to seek a refund of that tax by providing the TFN at a later time, care needs to be taken in designing the rules to minimise the administrative burden faced by funds. For example, any capacity to seek a refund of the additional tax should only be available where the contribution remains in the fund to which it was contributed. Once the benefit is transferred at the request of the member to another fund the tax is irrecoverable.

ASFA also supports further initiatives to lift the level of TFN quotation. For instance, ASFA would strongly support measures placing greater obligations on employers to quote TFNs to superannuation funds. Superannuation fund members may believe that their employer has provided the TFN when they have not done so, and as a result, the employee would be excessively taxed as a result of the employer's failing.

ASFA would also support the ATO being able to provide a fund with the member's TFN where the ATO has clearly identified the member. Further, ASFA would strongly encourage the ATO to inform and educate the community about the importance of TFN quotation to their superannuation fund.

7.2.2 Undeducted contributions

Superannuation fund trustees would, in future, only be able to accept undeducted contributions for or on behalf of a member, if the member's tax file number has been quoted to the trustee.

ASFA COMMENT

ASFA supports the use of tax file numbers as a means of identifying fund members.

However, there may be instances, particularly where the member is making undeducted contributions via payroll deduction to get the co-contributions or where there is an obligation to make after tax contributions, where the fund does not have the TFN and will be unable to accept the contribution.

As well, the TFN requirement has the potential to adversely impact on individuals being able to receive the co-contribution. One ASFA member, a major industry fund, has indicated that it received over 43,000 undeducted contributions in the last two weeks of June 2006 from members for whom no TFN was recorded. Under the proposal, the fund could not have accepted these contributions and the members concerned denied the co-contribution. This fund also indicated that the absence of TFNs has not in the past severely inhibited the ability of the ATO to pay out the co-contribution. 78% of members of this fund without a TFN, who had made a contribution in 2005, did receive the co-contribution.

The current proposals could lead to tens of thousands of individuals potentially missing out on the co-contribution. Consideration should be given to changing the TFN obligation on accepting undeducted contributions, for instance permitting a fund to accept the undeducted contribution without a TFN if the contributions are below a particular threshold, for example \$5000.

7.2.3 Benefit payments

Under the new arrangements, where a tax file number is not quoted only the taxable element (the post-June 1983 component) of an ETP would be subject to withholding at the top marginal tax rate.

ASFA COMMENT

ASFA supports this simplification of the withholding rules.

8 UNTAXED SCHEMES

8.2 PROPOSED ARRANGEMENTS FOR BENEFITS PAID TO INDIVIDUALS AGED 60 AND OVER

8.2.1 Lump sums

Under the proposed arrangements, the post-June 1983 untaxed element of a benefit paid from an untaxed scheme would be taxed at 15 per cent up to \$700,000 (approximately the lump sum RBL) and the top marginal tax rate above that amount.

ASF COMMENT

ASF considers the \$700,000 threshold on benefits paid from untaxed funds as too low.

The \$700,000 threshold attempts to create some rough equity between contributions tax to taxed schemes (that are subject to the contribution limits) and untaxed funds. However, there is some inequity in terms of the effective timing of each measure. The contribution limits (and the tax free benefit age 60 and above) have a prospective impact. Individuals near, at or above the age of 60 may have already accumulated significant amounts of superannuation that can be taken after 1 July 2007, tax-free.

However a person in a similar situation within an untaxed fund would be subject to significant tax on benefits above the \$700,000 threshold.

Ideally the threshold should not significantly disadvantage these individuals, particularly to the point where they modify their behaviour in opposition to the policy objectives of the proposals (public sector workers taking benefits early to avoid the effect of post 1 July 2007 tax penalties).

The threshold should align with the higher pension RBL, rather than the lump sum RBL to ensure more equitable and intended outcomes.

8.2.2 Pensions

Pension payments would continue to be included in assessable income and taxed at marginal rates. However, pension payments (including where the pension commenced before 1 July 2007) would be eligible for a 10 per cent taxation offset. A deduction would continue to be allowed in respect of the undeducted purchase price of the pension.

ASFA COMMENT

ASFA supports the proposal to grant a taxation relief to pensions paid from untaxed schemes to persons aged 60 and over.

Consideration could also be given to capping the tax rate on pensions from an untaxed source.

8.2.3 Reporting

Individuals would still be required to include ETPs and pensions in their tax return. Schemes would not need to report benefit payments to the ATO for RBL purposes.

ASFA COMMENT

ASFA supports the removal of the reporting requirement from the paying fund.

The tax requirements on recipients of pensions from untaxed sources have the effect of subjecting them to higher tax on other income. Known as “income stacking”, this has an unfortunate effect and should be addressed.

8.3 PROPOSED ARRANGEMENTS FOR BENEFITS PAID TO INDIVIDUALS AGED UNDER 60

8.3.1 Lump sums

For untaxed post-June 1983 elements paid to those aged 55 to 59, a rate of 15 per cent would apply for payments up to the low-rate ETP threshold (currently \$135,590), a rate of 30 per cent above this amount up to \$700,000 and the top marginal tax rate above that amount. For those aged under 55, a rate of 30 per cent would apply up to \$700,000 and the top marginal tax rate above this amount.

ASFA COMMENT

ASFA considers the \$700,000 threshold at which the top marginal rate applies to be too low.

8.3.2 Pensions

Pension payments would continue to be included in assessable income and taxed at marginal rates. Unlike payments for those aged 60 and over, they would not be eligible for the proposed 10 per cent pension offset (until the recipient turns age 60).

ASFA COMMENT

ASFA considers the \$700,000 limit to be too low both now and going forward.

8.3.3 Reporting

Individuals who receive benefit payments from untaxed schemes would be required to lodge a tax return and report these payments in the return as assessable income (as currently). Schemes would not need to report benefit payments to the ATO for RBL purposes

ASFA COMMENT

ASFA supports the removal of this reporting requirement from superannuation funds.

The tax requirements on recipients of pensions from untaxed sources have the effect of subjecting them to higher tax on other income. This is known as “income stacking” and is an unfortunate outworking of the proposals that should be addressed.

8.3.4 Death benefits

Under the proposed arrangements, all lump sum death benefit payments would be tax free if paid to a dependant.

The taxation of death benefit payments as a reversionary pension would depend on the age of the primary and reversionary beneficiary. Where the primary beneficiary was aged 60 or over on death, payments to the reversionary

beneficiary would be taxed at marginal tax rates less any deductible amount and less the 10 per cent offset. If the primary beneficiary were under age 60 at death, the pension would continue to be taxed at the reversionary beneficiary's marginal tax rate (less any deductible amount), unless the reversionary beneficiary is aged 60 or over, in which case the 10 per cent offset would apply.

A pension would not be able to revert to a non-dependant on death; rather, death benefit payments to non-dependants would have to be made as a lump sum.

Payments to non-dependants (irrespective of their age) would be taxed in the same manner as other superannuation fund payments to someone under age 55 (see section 8.3.1). That is, the post-June 1983 untaxed element would be taxed at 30 per cent up to \$700,000 and the top marginal tax rate above that amount.

ASFA COMMENT

See comments provided in Section One on death benefits.

8.4 ROLLOVERS TO TAXED SCHEMES

The transferring fund would withhold tax at the top marginal tax rate for amounts above \$700,000.

The first \$700,000 of the benefit to be transferred would be treated as a taxable contribution by the receiving fund. The remainder of the transferred amount would form part of the exempt component in the receiving fund and not be taxed further.

ASFA COMMENT

ASFA supports the proposed taxation rules applying to the payment of a reversionary pension death benefit.

However, ASFA considers the \$700,000 threshold to be too low.

9

MAKING IT EASIER TO FIND AND TRANSFER SUPERANNUATION

9.2 PROPOSED ARRANGEMENTS

9.2.1 Portability

The maximum time limit for completion of a rollover or transfer request is to be reduced from 90 days to 30 days and that the ‘retriggering’ provisions are to be removed so that in all cases benefits must be transferred within 30 days from the date of the initial request.

All funds must use a standard form for portability requests and use standard proof of identity requirements.

ASFA COMMENT

ASFA supports the proposal to reduce the maximum time limit and would support the removal of the ‘retriggering’ provisions provided the new 30-day time limit commenced only in situations where the transfer or rollover request application form was properly completed. APRA’s capacity to grant relief from the time limits, for example where the fund has illiquid assets, need to be retained.

ASFA will work with the Government and industry to develop an industry standard form.

ASFA will work with the Government and relevant regulators to develop standard identification requirements for moving money between funds that are broadly consistent with AML/CTF requirements and current industry practices. It is important that any standard identification requirements recognise the different processes and types of data held by funds. In particular, any standard identification requirement needs to recognise that, for example, in the case of a public offer member, the member’s signature would be on file due to completion of the application form. As such some funds have adopted particular procedures to satisfy themselves that the person who they are paying in respect of is actually

the member concerned. Therefore, the standard identification requirements should be such that a fund may request from a member but is not obliged to follow in all circumstances.

9.2.2 Lost Members Register

It is proposed that the ATO be given a more active role in arranging transfers on behalf of lost members. To simplify the consolidation process for members and reduce the need for their involvement the ATO would:

- Write to lost members advising them of the existence of their lost account, and
- Offer them a number of choices, including consolidating the account with an active account, or indicating that they are satisfied with the account's inactive status, and on the request of the member consolidated the accounts by dealing with the relevant funds and arrange the transfer on the member's behalf.

The process would be facilitated by the development of a standard portability form and standardised proof of identity requirements that could be included with the ATO mail out.

ASFA COMMENT

ASFA is concerned that the proposal as set out may result in uninformed decisions being made that may potentially disadvantage the fund member. Caution is needed to ensure that the proposed arrangements do not breach Corporations Act requirements for informed consent when members are being advised to move money between funds.

Consideration should also be given to redrafting the rules on lost members and unclaimed benefits reporting to better reflect reality and also to revising the administration rules for the register to improve its integrity both now and on an ongoing basis.

ASFA is concerned about the quality of the information currently held on the Lost Members' Register and believes there may be merit in 'rebuilding' the Lost Members' Register by requesting funds report afresh on their current lost member information.

APPENDIX 1

COST OF PROPOSALS ON SUPERANNUATION INDUSTRY

The “Simpler Super” proposals will simplify superannuation for individuals, particularly in respect of the taking of benefits. The abolition of the RBLs, removal of end benefits tax and going from eight to two components will greatly assist individuals understand superannuation and should assist in the quality of member decision-making.

However, the proposals are not be without cost implications for industry. Any additional costs are often borne directly by members.

Below is a summary of the likely impact of the proposals on funds and the likely costs involved.

Savings

The proposals will see some savings as a result of certain reporting obligations being dropped. Most notably, there will be no more RBL reporting, no PAYG reporting for most over 60s and the abolition of compulsory cashing / work test obligations.

Administration

Any change of this magnitude requires system changes that impose costs. If simple enough, these are one off costs that get absorbed back into the ordinary cost of running a fund. The actual design of the system will have a significant impact on costs.

If assessment for contribution limit breaches are sent to funds rather than to members, we can expect considerable costs borne by funds, not unlike the costs faced as part of administering surcharge. Similarly, the complexity / simplicity / frequency for calculating notional contributions will have a significant impact on the cost borne by funds. One major administrator has estimated that to merely introduce the fund assessment system proposed would cost approximately \$1 million.

Individual assessments, simplified notional contributions processes and simple

processes for calculating earnings on excess undeducted contributions will lead to considerable and long term containment of possible costs.

If the reporting requirements are able to effectively piggyback off of the Member Contribution Statement process (used for co-contributions) then much of this cost can be minimised.

Another significant cost will be TFN collection, in particular additional resources involved in contacting members and employers. As well a complex refund system could lead to considerable costs. Again changes to the proposals as recommended in this submission will help alleviate many of those costs.

Other aspects of the proposals will require specific changes to how member data is collected and kept. Funds will need to closely monitor members' ages and ensure that tax treatment depends on age. The cost of this will often depend on the age and sophistication of the administration software used. For some legacy products using older systems, there could be considerable one-off expenses in the tens or even hundreds of thousands of dollars per provider. For newer systems, the costs would be more modest.

Communication

Communication will be the other significant cost for industry.

Most funds will be required under their significant event reporting obligations under the *Corporations Act 2001* to inform members of the changes. Given the likely timing of the final changes (early 2007) and the difficulty of including any reporting within the standard member reporting, many funds will be required to do a special mail out to members about the changes.

Though it depends on the specifics, we would estimate that it would cost a minimum of between \$3 and \$4 per member to contact members about these changes. This would include developing material, sign-off, printing and postage. Spread over 10 million plus accounts, the cost would be in the range of \$30 to \$40 million.

Training

There will also be staff training obligations as a result of the changes.

Call centre and other contact staff will likely need to be trained to ensure they understand the changes and are able to correctly inform members.

Training costs could be approximately \$200 per call centre staff person.

There are now several thousand call centre staff in Australia handling

superannuation inquiries and the training costs could be upwards of \$1 million.