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A Plan to Simplify and Streamline Superannuation

Submission No 8: Miscellaneous Issues

The Treasury

MERCER
Human Resource Consulting

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Pensions

The Government's proposals aim to simplify the taxation of pensions and to introduce a simpler set of standards governing the provision of pensions. These include:

- For a pension that commences to be paid to a person under age 60 after 1 July 2007, any pre-July 1983 component would be included in the undeducted purchase price (UPP). For pensions that commenced prior to 1 July 2007, the calculation of the deductible amount will not change.
- New minimum pension standards would be introduced that:
  - Would specify minimum annual pension payments;
  - Would not impose any maximum annual pension limits, apart from pensions paid under the transition to retirement condition of release;
  - Would limit the payment options on death.
- The social security assets test exemption would be removed from pension products purchased after 20 September 2007. "Complying" pensions purchased before 20 September 2004 would continue to be 100% exempt from the assets test, whilst "complying" pensions purchased between 20 September 2004 and 20 September 2007 would retain their 50% exemption.

Undeducted purchase price

From 1 July 2007, the pre-July 1983 component of a pension will be tax-free for a new pensioner aged under 60. For an existing pension, it appears that the pre-July 1983 component will continue to be taxed as income. This will result in a discrepancy in the taxation treatment of pensions that commence before and after 1 July 2007.

As a result, it will lead to existing pensioners under the age of 60 having to consider whether they should commute their existing pension (where possible) in order to take out a new pension. We note that this would also lead, in some cases, to a loss of any existing Social Security exemption from the assets test that would become available once the person reaches pension age.

Whether an existing pensioner should or should not commute their existing pension is likely to be a complex exercise, and, whilst only having transitional application, leads to increasing complexity for existing pensioners – most of whom would need assistance from an appropriately licensed adviser in order to make a sensible decision. In some cases, the costs of obtaining the necessary advice will outweigh the advantages of commuting the pension.

An alternative approach would be for the pension provider to automatically recalculate the unused undeducted purchase price (UUPP) to incorporate the pre-July 1983 portion.

This recalculation would only be necessary for pensioners under the age of 60.

(We note that the Government has proposed that where an existing pensioner dies after the age of 60, any reversionary pension will be tax free. This removes the need to recalculate the UUPP for pensioners over age 60 who have a potential reversionary beneficiary under age 60.)

The main disadvantage of this approach is the administrative burden that would be placed on trustees who would need to recalculate the unused undeducted purchase price for all pensioners under age 60 with a pre-July 1983 component. Affected pensioners would also need to be advised of the change. However, if this is restricted to pensioners under age 60, the task should generally not be large.

On the other hand, if the pre-July 1983 component for existing pensions is not included in the UUPP, there will be additional complexities in relation to the calculation of tax if the pension is commuted before age 60. If the Government intends that its proposal to freeze the pre-July 1983 component also applies to existing pensions, then presumably trustees would be required to reduce the pre-July 1983 component each time a pension payment or other withdrawal is made. We think that this may impose an even greater cost on trustees.

Recommendation 1.1: Funds should be required to recalculate the UUPP and the deductible amount of the pension for all existing pensioners under the age of 60 to reflect any pre-July 1983 component.

Care will need to be taken in recalculating the deductible amount. If the revised deductible amount has to be calculated by dividing the updated UUPP by the life expectancy factor, in some cases this could result in a reduced deductible amount. This would appear unreasonable. It would be preferable if the new deductible amount were determined by adding the increase in the UUPP divided by the current life expectancy factor to the existing deductible amount.

Recommendation 1.2: The revised deductible amount should be determined by adding an additional amount to the existing deductible amount. The additional amount will be calculated based on the pre-July 1983 component divided by the current life expectancy factor.

Special issues for non-commutable pensions

A person may have taken out a non-commutable complying pension prior to 1 July 2007 for three legislatively imposed reasons:

- to qualify for the Pension Reasonable Benefit Limit; and/or
- to qualify for exemption from the Social Security assets test (either a 50% or 100% exemption); or
- to qualify for a transition to retirement pension.

A pensioner in receipt of a non-commutable pension may wish to transfer it to another provider.

If Recommendation 1.1 above is not adopted, a pensioner with pre-July 1983 service may also want to take advantage of the proposed changes to the rules regarding the calculation of the undeducted purchase price after 1 July 2007.

However, if the pensioner wants to change provider, the pensioner may find it difficult (if not impossible) to roll their pension over to another non-commutable pension after 1 July 2007. It would appear unlikely that these pensions will be readily available in the future, given that they are unlikely to be popular with new pensioners and, in some cases, may not meet the proposed minimum pension standards.

Even if a non-commutable pension product were available, it appears that the pensioner would lose the assets text exemption if they commute and take out a new non-commutable pension after 20 September 2007.

Another issue that should be considered is whether to allow a non-commutable pension to be cashed out or rolled over to a commutable pension.

We do not believe that trustees should be required to commute a non-commutable pension on request. The trustee has effectively entered into a contract with the pensioner and, particularly for pensions payable for life, there could be significant adverse selection against the trustee if it were required to commute on request.

However many trustees would be happy to allow commutation, particularly in cases where it would enable them to close down legacy products and simplify their operations.

If a trustee is able to offer existing pensioners with non-commutable pensions an option to commute the pension to cash or to roll it over to a commutable product, the important issues are:

- Would all pensions in the fund lose their assets text exemption? This would be unfair to those pensioners who do not cash out their pension.
- Would all pensions continue to be exempt from the assets test?
- Should pensioners be given the option to retain their non-commutable pension? This decision would need to be irrevocable so that pensioners who retain their non-commutable pension would also retain the asset test exemption.

- Should pensioners be given a limited opportunity to cash out their pension, say only during the year ending 30 June 2008? After this date, the pension would be non-commutable.

In our view, trustees should be given the opportunity to simplify their existing pension portfolio and hence should be able to commute, on request, any existing non-commutable pensions. Trustees should not be required to offer commutation. To maintain faith with the existing Social Security asset test requirements, the offer to commute should be for a limited duration, say up to 30 June 2008, after which the pension should revert to being non-commutable. Eligibility for the asset test exemption should not be affected by the short term commutation window.

Due to their special nature, any commutation should not be extended to transition to retirement pensions.

Recommendation 1.3: Trustees should be able to commute, on a voluntary basis, existing non-commutable pensions during a short period ending on say, 30 June 2008. Such commutations would normally be subject to the agreement of the pensioner. Any existing assets test exemption would continue for any continuing pensions.

Special issues for Defined Benefit Pensions

Currently, the UPP is generally calculated by dividing the lump sum amount of undeducted contributions by the pensioner's life expectancy. From 1 July 2007, it is proposed that the UPP will also include the pre-July 1983 component.

Where a member of a defined benefit fund is entitled to a pension on termination of service, it is not clear how the pre-July 1983 component of the pension to be included in the exempt component should be determined for the purposes of including it in the UPP.

In particular, there may be no equivalent lump sum value of the pension and hence there is no obvious means of determining the pre-July 1983 component of a defined benefit pension. To calculate the pre-July 1983 portion at the date the new pension commences, we recommend that the following formula be used:

> *Annual pension at date of commencement x Life expectation factor x pre-July 1983 service / total period from eligible service date to date of commencement*

This amount should be added to the undeducted contributions (and any other exempt amounts) to derive the total UPP. It should then be divided by the life expectancy factor to determine the exempt part of the pension each year.

This issue will also arise in respect of existing defined benefit pensions if Recommendation 1.1 is adopted. A similar approach could be adopted in such cases based on the annual pension at, say, 1 July 2007.

For existing pensioners the existing UUPP could be increased by adding an additional exempt amount (calculated using the above formula). This would then lead to a revised deductible amount of the pension.

Recommendation 1.4: A special method based on the annual pension rather than a lump sum value (as outlined above) should be adopted to determine the pre-July 1983 component for defined benefit pensions.

Special issues for existing allocated pensions

It is unclear whether it will be possible for a person who has commenced an allocated pension prior to 1 July 2007 to convert it to a pension that meets the new pension standards automatically. If the individual is **not** required to do anything to facilitate this change, it will simplify the process significantly.

For example, the new minimum standards will allow a lower minimum pension payment than the existing minimum requirement. The maximum pension amount will be removed.

Thus existing allocated pensions will automatically meet the new standards.

To avoid legacy allocated pension products, trustees should be able to automatically convert all existing allocated pensions to pensions which meet the new standards. Such pension conversions should not be considered to be a commutation and repurchase but merely a change of rules in relation to the maximum and minimum draw downs allowed.

Recommendation 1.5: Trustees should be able to automatically convert all existing allocated pensions to pensions which meet the new standards without treating them as new pensions.

Pensions that meet the new standard

One of the major criticisms of existing allocated pensions is that the pensioner cannot add additional amounts to the pension. If an additional amount is available to purchase an increased pension, this must be done by purchasing an additional pension.

The system would be considerably simplified if it were possible for a pensioner to add superannuation eligible termination payments to an existing pension.

The only additional complexity that would result from this would be the need to recalculate the UUPP, the deductible amount and the minimum draw down amount for the year.

For pensioners over age 60, the recalculations of the UUPP and deductible amount would only be necessary in case there is an eventual lump sum death benefit payable to a non-dependant. As recommended in Submission No. 3, we believe that all death benefits after age 60 should be tax free and if this applied, there would be no need to recalculate these amounts.

Thus recalculation would only be necessary for pensioners under age 60.

Where an additional amount is added to an existing pension, we consider that the deductible amount should be calculated as follows:

New deductible amount = Existing deductible amount plus
the exempt amount transferred / life expectancy factor

The life expectancy factor would be based on the current life tables (which could be different to the life expectancy tables used to calculate the original deductible amount). This avoids anomalies that could arise if the whole of the deductible amount had to be recalculated. (For example, if there was a small amount added to the pension, recalculating the whole of the deductible amount on the most recent life tables could result in a reduction in the deductible amount. Such a reduction would seem unfair.)

Recommendation 1.6: It should be possible to add additional superannuation eligible termination payment amounts to account-based pensions which meet the new requirements. For pensioners under age 60, the deductible amount relating to the additional undeducted purchase price should be added to the existing deductible amount.

Calculation of the minimum amount

The table in Section 3.2.3 of the Government's Plan to Simplify and Streamline Superannuation implies that the minimum draw down requirement will be based on the **average** account balance during the year.

If this is the intention, we would be very concerned with the complexity of such a requirement. In practice it would be impossible to achieve as asset values at year end would not be known until it was too late to perform the calculation and make the minimum payment.

It would be much simpler to base the minimum draw down on the asset value as at the start of the year or when the pension commenced. As with the current rules, where a pension commenced on or after 1 June in a year, there should be no requirement to draw down a minimum amount in that year.

Where an additional amount is added to the account, the minimum draw down for the year should be adjusted (unless the additional amount is received on or after 1 June in the year).

Under existing requirements, when a pension is commuted, the trustee must ensure that pension payments at least equal to the minimum proportionate draw down have been made. We note that this should not be necessary from age 60 under the new arrangements, as there is no difference in the tax treatment of lump sums and pensions after age 60.

Prior to age 60, the tax treatment will differ depending on whether the payment is a lump sum or pension. The Government could therefore consider applying a similar rule where a pension is commuted before age 60. (This could be simplified if the requirement did not apply to the years in which the pensioner turns 60 and in subsequent years.)

Rules may also be necessary to ensure that pensioners do not commute pensions during a year and roll-over the proceeds to another pension (say, in June) in order to avoid the minimum draw down rules.

This could be avoided by requiring the trustee to ensure that at least the proportionate minimum amount has been drawn down and paid as cash during the year where an amount is being rolled over. This would apply irrespective of age.

We note that this would result in a higher draw down requirement in a year when a pension is commuted and rolled over to a new pension. A proportionate draw down would be required from the original fund and a full draw down from the receiving fund. This could be avoided if the minimum draw down requirement for a new pension (or additional amounts credited to an existing pension) was also determined on a proportionate basis.

We have also been concerned with the complexity of the existing proportionate draw down requirements which are based on the number of days. A simpler approach should be considered. For example, for a pension in place at the start of the year, the proportionate minimum could be determined based on the following proportion:

The number of complete months that have elapsed since the start of the year/12

Recommendation 1.7: The minimum draw down amounts should be based on the account balance at the start of the year or the initial account balance for a new pension. The minimum draw down should be adjusted for new amounts credited to the account. For new pensions and new amounts credited, the minimum draw down should be determined on a proportionate basis. New amounts credited on or after 1 June in a year should not impact on the minimum draw down.

Recommendation 1.8: Where a pension is being commuted, the trustee must ensure that the proportionate minimum draw down has been met. For pensioners under age 60, this minimum draw down must have been met in pension form. For pensioners who have reached age 60 and the benefit is being rolled over, the form of the draw down could either be as a lump sum or as pension payments.

Recommendation 1.9: Where determining proportionate minimum draw downs, trustees should be able to determine the proportion using a simpler method than currently applies (for example, based on complete months).

Death Benefits

In Section 3.2.2 of the Government's Plan to Simplify and Streamline Superannuation, the new minimum standards for pensions commencing on or after 1 July 2007 are outlined. One of these standards is that a pension could be transferred only on the death of the pensioner to a dependant, or cashed out as a lump sum to the pensioner's estate. This suggests that it will not be possible to pay a lump sum to either a dependant or a non-dependant on the death of a pensioner.

However, Section 2.4 of the Government's Plan does not appear to preclude the payment of a lump sum to a dependant on the death of a pensioner. Further, in respect of payments to non-dependants, this Section indicates that the new rules would only prohibit the payment of a **pension** to a non-dependant. It is implied that a death benefit could be paid to a non-dependant, but only in lump sum form.

There is therefore an inconsistency between the comments in Sections 2.4 and 3.2.2.

Whilst we can understand the Government's reluctance to allow a continuation of pension benefits to a reversionary beneficiary who is not a dependant (refer to Recommendation 2.2 of Submission No. 4), we cannot understand why it should not be possible to pay any death benefit as a lump sum to either a dependant or a non-dependant.

We recommend that the minimum pension standards in Section 3.2.2 be amended to reflect the provisions in section 2.4.

Recommendation 1.10: It should be possible to pay a lump sum benefit to either a dependant or a non-dependant on the death of the pensioner.

As set out in Recommendation 2.1 of Submission No.4, we believe that all death benefits payable after age 60 should be tax free. This would remove the need for maintaining deductible amounts and UUPPs from age 60, including the updating of them when additional amounts are credited to the pension account. It would also clarify that there is no need to consider commuting an existing pension and starting a new pension in order to obtain a higher UUPP which might eventually result in a lower tax on an eventual death benefit.

Recommendation 1.11: We reiterate Recommendation 2.1 of Submission No.4. All death benefits in respect of a member or pensioner over age 60 should be tax free.

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Overseas Pensions

Currently pensions paid to an Australian resident from an overseas source are taxed as income.

This is consistent with the current treatment of pensions received from an "untaxed" fund and Australian Social Security pensions.

If the Government's proposed tax treatment of pensions from an "untaxed" fund is introduced, in particular the proposed 10% tax offset, this is likely to lead to pressure that pensions paid from an overseas source and/or Social Security pensions should also be entitled to a 10% tax offset.

Assuming that the Government does not intend that Australian Social Security pensions will be entitled to a tax offset, it would seem appropriate that Social Security pensions from overseas should also not be entitled to an offset.

However, it could be argued that benefits from an overseas superannuation fund should be taxed in a similar manner to benefits received from an Australian "untaxed" fund as neither the overseas fund nor the Australian "untaxed" fund have paid any Australian tax on contributions.

However, there are many differing arrangements and requirements operating overseas. In many cases it may be difficult to distinguish between an employer-provided pension and a social security-related pension. For example, in some countries, employers and employees may be required to contribute to a national pension (or Social Security scheme). We therefore do not consider that it would be feasible to allow a 10% offset in respect of overseas pensions.

This is a further reason why we disagree with the Government's proposals for "untaxed" schemes as the "special" treatment creates anomalies not only with pensions from Australian "taxed" schemes but also overseas arrangements. It supports our recommendations in Submission No. 5 to treat pensions from an “untaxed” fund more consistently with pensions from a “taxed” fund.

Recommendation 2.1: Overseas pensions should continue to be taxed as income. Although there are arguments for treating overseas pensions in a similar manner to “untaxed” pensions, it would be too difficult to implement. This highlights the need for “untaxed” pensions to be treated in a manner that is more consistent with the treatment of taxed pensions as recommended in Submission No. 5.

3

Self Employed Persons

Invalidity benefits

A person receiving a superannuation disability benefit is entitled to a tax-free invalidity component if, according to Section 27G of the Income Tax Assessment Act, the payment *"is made in consequence of the termination of any employment of the taxpayer"* and the termination of employment occurred because of the disability of the person *"where 2 legally qualified medical practitioners have certified that the disability is likely to result in the taxpayer being unable ever to be employed in a capacity for which the taxpayer is reasonably qualified because of education, training or experience"*.

The termination of employment must, generally, also arise before age 65.

Because of the requirement to terminate employment, it is generally not possible for a self-employed person to qualify for an invalidity component. We believe that it is inequitable that a person with employer support may be entitled to an invalidity component, whereas someone who is self-employed and may be similarly disabled, is not.

The ability to claim an invalidity component should be extended to self-employed persons.

Similarly, an unemployed person who becomes disabled would be unable to claim an invalidity component. Again, this appears to be inequitable.

Recommendation 3.1: The ability to claim an invalidity component should be extended to self-employed and unemployed persons by removing the termination of employment conditions from the current requirements.

Nomination of deductible contributions

The current method by which self-employed persons nominate deductible contributions is likely to add to the difficulties we have previously highlighted in relation to the administration of the proposed contribution limits.

Under current rules, contributions made by a self-employed person are initially assumed to be undeducted contributions. At a later date (normally **after** the end of the year), the person nominates the amount of the contributions that have been made during the year which are to be treated as deductible contributions. This may be after the fund has reported contributions to the ATO.

Where the fund receives the nomination after lodging its tax return, the fund is required to treat the deductible contribution as a taxable contribution in the year the nomination was received.

The time taken for the person to decide which contributions are deductible will make the proposed administration of the contribution limits difficult. Under the Government's proposal, if contributions paid into a fund by a self-employed person exceed the $150,000 limit, the trustee must return any additional contributions to the member. We understand that this refund will not be required until the ATO notifies the trustee of the refund requirement. This will not occur until after the end of the year.

If excess contributions are made, the trustee may be required to return the contributions, but it is possible that the member may then decide that the contributions should be treated as deductible, in which case no refund would have been required. But it may then be too late as the amount may have already been refunded and it would not be possible to make a further deductible contribution for that year.

Even if the fund and member liaise before the refund and the excess undeducted contributions are then treated as deductible contributions, this will require re-reporting to the ATO who will then need to consider whether the proposed $50,000 limit on concessionally taxed deductible contributions has been exceeded.

This process is another factor supporting our recommendations in Submissions No. 1 and No.2 that:

- there should be no refunding of excess undeducted contributions; and
- the ATO should deal directly with the individual (rather than the fund) about excess contributions.

If the self-employed person makes contributions that exceed the limit in a particular year, the following procedure could be adopted:

- the ATO advises the individual that the $150,000 limit has been breached;
- if the individual intends to treat some of these contributions as deductible, but has not yet advised the fund:
    - the individual advises the ATO of the amount of deductible contributions;
    - the ATO informs the appropriate fund that the relevant contributions; should be treated as deductible;
    - the fund deducts 15% tax from the contributions;
    - the ATO issues a tax assessment to the member for the additional 30% tax on any excess deductible contributions; and
    - the ATO issues a tax assessment to the member for the additional penalty tax on any excess undeducted contributions (as per the recommendations in our Submission No. 1);
- if the individual intends to treat some of these contributions as deductible, and has already advised the fund:
    - the individual provides the ATO with a copy of the confirmation letter from the fund as evidence that the fund has been advised of the deductible contributions;
    - the ATO issues a tax assessment to the member for the additional 30% tax on any excess deductible contributions and the penalty tax (as recommended in Submission No.1) on any excess undeducted contributions.

Recommendation 3.2: The ATO should deal directly with self-employed persons to identify the split between deductible and undeducted contributions, and then issue an assessment to the individual for any additional tax on contributions in excess of the relevant limits.

4

Insurance

Over the last 40 years, many employers have been concerned about the lack of death and disablement insurance cover held by employees.

This concern has often been driven by a genuine concern for employees and their families. In other cases, employers may have also been concerned for their own self-interest – not wanting to be seen to be neglecting, for example, a widow of a former employee with young children.

Until recently, employers were able to ensure that all employees had at least a basic level of insurance cover through their employer sponsored superannuation fund provided on an automatic basis. Following the introduction of Choice of Fund, employers are no longer able to provide such insurance cover on a cost effective basis for all employees.

Prior to the introduction of Choice of Fund, most major employers knew their employees' level of insurance coverage (through the employer sponsored superannuation fund) and could therefore be satisfied that the employees and their dependents had appropriate protection.

Under the Choice of Fund regime, a typical employer will have employees who are members of many superannuation funds with a range of insurance cover. The employer will no longer know the level of their employees' cover. In some cases, employees who change funds may also unintentionally lose insurance cover as a result of changing funds. Hence, employers have the potential of being exposed to a moral financial obligation should an employee die or become disabled, including, but not limited, to an accident at work.

Under the Choice of Fund environment, all employers (including the Government) will therefore face the potential risk associated with the fact that some employees with dependants will have low or even zero insurance.

Whilst, to date, only a relatively small proportion of members have elected to move away from their employer's default fund, a much higher proportion of new employees are choosing to remain with their previous employer's fund. Over time, the proportion of employees participating in the employer's default fund is likely to reduce.

To minimise the risk of selection against the insurer, insurers generally require that at least 75% of eligible employees must participate in the default fund. If this participation rate is maintained, cover up to an automatic acceptance limit is provided automatically. If the participation rate falls below 75%, this can lead to one or more of the following:

- an increase in premium rates;
- the removal of automatic acceptance limits;
- the need for individual health assessments before cover is provided (which will result in more members encountering exclusions, limits and restrictions on cover as well as resulting in considerable additional cost).

This is likely to result in a reduction in insurance cover even for those who elect to remain in the default fund.

The Choice of Fund requirements have also triggered other changes to insurance provisions through superannuation funds. These include:

- the removal by some insurers of continuation options and extended cover in cases where a member leaves a superannuation fund by exercising fund choice; and
- the removal, in many cases, of interim cover for the period between a person joining a new employer and the date any membership application, contribution or premium is received by the fund.

Under current legislation, employers have several ways of ensuring that all of their employees have insurance protection. These include the following:

Inside the super fund

1. The provision of insurance within the employer's default superannuation fund as currently occurs. However, under fund choice this is not a satisfactory outcome for many employers as not all employees are members of the default fund.

2. The establishment of an insurance only section within the employer's default fund (or a separate fund) for all employees. This meets the primary objective of the employer but is complex and expensive as some employees would then be members of 2 sections of the default fund (or 2 funds). It is also likely to lead to confusion as the insurance-only members would be required to receive full disclosure as if they were full members of the superannuation fund. Insurance only members would need to be given a Product Disclosure Statement and periodic statements detailing transactions including contributions paid by their employer and premiums paid to the insurer.

Outside the super fund

3. The employer takes out an insurance policy in its name to insure all of its employees. Any claim payment is received by the employer and is therefore treated as assessable income in the hands of the employer. However, if the payment is distributed to the estate (in the case of death) or the beneficiary (in the case of disablement) in the same financial year, the payment is tax deductible for the employer. No FBT is payable as the right of the employee to receive a benefit does <u>not</u> arise under the insurance contract. We understand that several employers are currently considering this option following the introduction of fund choice. However, such an option provides the employee with no certainty of payment as the payment is made to the employer with the payment to the employee at the discretion of the employer.

4. An extension of Option 3 would be for the insurance cover to be specified in the employment contract. Whilst the payment would be defined within the employment contract, it is likely to depend on payment by the insurer to the employer. However the benefit may have no other direct link to the insurance contract that is taken out by the employer. In such a case, it is uncertain as to whether the premium paid by the employer would be subject to the FBT.

5. Employers who provide such insurance protection would prefer that their employees are both fully aware of the benefit and are confident of receiving the promised benefit. Options 3 and 4 do not meet this requirement. Hence the preferred option is that the payment to employees would be subject to a claim payment being paid directly by the insurer to the employee or the employee's estate. The premiums associated with such an insurance policy, where there is a direct link between the claim payment and the employee, are currently subject to the FBT.

The result is that the preferred Option 5 is not being adopted by employers due to the FBT. Instead employers are pursuing Option 3, which is not desirable from the employee's perspective in terms of security and communication.

Possible Solutions

We put forward two solutions which would result in greater efficiency and reduce costs for employers.

1. *Remove FBT on insurance policies taken out by the employer*

   This would enable employers to take out (on a cost effective basis) an insurance policy under which employees would have a clear right to the proceeds (ie Option 5 above). It would have little if any impact on Government revenue as the FBT cost is currently prohibitive and dissuades employers from adopting this option.

   The exemption from FBT could be limited to cases where the insurance cover is provided using a standard formula for all or a significant majority (say over 75%) of all permanent employees.

There could also be a requirement that the employer provide a statement to the employee, at least annually, which details the level of insurance provided. It should not be necessary to provide each employee with a Product Disclosure Statement PDS).

2. *Simplify the disclosure requirements for insurance only categories*

Another approach would be to reduce the costs of providing insurance only benefits through a superannuation fund. In this way, employers could provide protection for employees in an effective manner through superannuation.

In view of the requirements to offer employees a Choice of Fund, it would only be possible for employers to provide universal insurance coverage by voluntary employer contributions that are in excess of the employer's SG contributions.

In such cases (ie where the contributions are in excess of the SG requirements and are totally met by the employer), we believe that the disclosure requirements should be reduced considerably. In particular:

- The requirements in relation to PDSs should be relaxed so that trustees can issue an effective PDS that only covers the insurance **benefits**. There should be no need to provide details of fees, premium rates and other issues that must currently be set out in a PDS. This reflects the fact that the insurance cover is a benefit provided by the employer and that the employee does not have to make a decision about purchasing or continuing the product;
- The requirements in respect of periodic statements should be relaxed. Whilst the amount of cover should be disclosed, there should be no need to provide transaction details (ie voluntary employer contributions to meet the premiums and running costs and insurance premiums and costs paid);
- It should not be a requirement that insurance only members be given a copy of the fund's annual report (except on request – the majority of it will be irrelevant for such members);
- It should be possible for trustees to determine that insurance only members do not have the right to nominate for election as a trustee or vote in trustee elections.

Recommendation 4.1: The Government should:

a) Remove FBT from employer paid insurance premiums where insurance cover on a standard formula is provided for at least 75% of permanent employees; and/or

b) Significantly simplify the disclosure requirements for insurance only categories of superannuation funds where all premiums and expenses for that category are met by the employer and membership of that category is a condition of employment.

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