Consultation on amendments to commutation rules for certain income stream products

FSC Submission

December 2021

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1. About the Financial Services Council

The FSC is a peak body which sets mandatory Standards and develops policy for more than 100 member companies in one of Australia's largest industry sectors, financial services.

Our Full Members represent Australia's retail and wholesale funds management businesses, superannuation funds, life insurers, financial advice licensees and licensed trustee companies. Our Supporting Members represent the professional services firms such as ICT, consulting, accounting, legal, recruitment, actuarial and research houses.

The financial services industry is responsible for investing $3 trillion on behalf of more than 15.6 million Australians. The pool of funds under management is larger than Australia's GDP and the capitalisation of the Australian Securities Exchange, and is the fourth largest pool of managed funds in the world.

2. Initial comments

The FSC welcomes the opportunity to provide a comment on the amendments to commutation rules for certain income stream products.

These are included as a part of a broader consultation on Miscellaneous amendments to Treasury portfolio laws 2022.[1]

If implemented as drafted the FSC considers these amendments will broadly solve for the identified problems with commutation from a Superannuation Industry (Supervision) Act 1993 (**SIS Act**) and Tax perspective.

The potential costs of commutation are a consideration. If members are partly commuting fixed term products, this cost could be significant for them (the commutation value represents the present value of future payments contracted to be paid).

3. Specific comments

3.1. Amendment to law to accommodate change

We note Social Security law likely requires amendment to allow this law to be effective. Social Security Law allows for partial commutation of this type of income stream in very limited circumstances:

http://classic.austlii.edu.au/au/legis/cth/consol_act/ssa1991186/s9b.html

[1] See: https://treasury.gov.au/consultation/c2021-226955

These circumstances include:

- to the extent necessary to cover any superannuation contributions surcharge relating to the income stream; or
- to the extent necessary to give effect to an entitlement of the person's partner or former partner under a payment split under Part VIIIB of the Family Law Act 1975 ; or
- to the extent necessary to give effect to an order under Part VIIIAA of the Family Law Act 1975 ; or
- to the extent necessary to pay a hardship amount.

It would appear necessary to add an additional condition to facilitate this measure.

The consequences of a non-allowable commutation are described here:

http://classic.austlii.edu.au/au/legis/cth/consol_act/ssa1991186/s1223a.html

These consequences (the income stream losing its ATE status which may result in a debt being raised) are potentially significant and should be avoided.

3.2. Interaction with the Government's Budget legacy product announcement

While the Government's announcement and these draft amendments are not the same, we do appreciate that they overlap in that they are to do with certain legacy style income streams and annuities.

As such, we would submit that the Government consider first implementing the budget measure to allow individuals to move out of legacy products before enacting these changes as there might be unnecessary legislative implementation and burden for industry of fixing a gap regarding commutation exceptions, and then introducing legislation to allow people to fully exit these products. By first allowing individuals the opportunity to move out of these legacy style pensions and assessing the take up of ability to exit, there can then be consideration for whether there is a need to implement these draft amendments for the remainder in this manner.

3.3. Clarification of lifetime annuities and pensions

SIS Regulations 1.05(2) and 1.06(2) contain the rules pertaining to Lifetime annuities and pensions.

We note that the draft regulations introduce the new exception to commute from certain income streams:

- Market Linked annuities and pensions (SIS Reg 1.05(10) and SIS Reg 1.06(8)); and
- Life expectancy annuities and pensions (SIS Reg 1.05(9) and SIS Reg 1.06(7))

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Question

Is it treasury's intention to exclude introducing this new exception to commute from Lifetime annuities and pensions as defined under SIS Reg 1.05(2) and 1.06(2)?

3.4. Variation of total payment amounts

We note that draft SIS Regulation 1.06(7)(e)(iii) and 1.05(9)(e)(iii), there is the ability for life expectancy annuities and pensions to vary the total payment amounts to allow for the new commutation exception.

Question

The way the draft regs and explanatory material currently reads, the variation of payments relate to the fixed regular payment amounts (that is, income payments). Therefore, the amendment of those sections will allow these fixed amounts to be reduced following the allowable (presumably lump sum) commutation to meet the Commutation Authority.

Is this interpretation and assumption correct, if not, could Treasury clarify?

3.5. Sufficiency of capital after commutation in Market linked Pensions

We note that there are provisions to allow life expectancy annuities and pensions to have their total payments varied to allow commutations to address excess transfer balance cap issues. These amendments help to alleviate solvency problems that may arise after a commutation.

We note that market linked pensions have under Schedule 6, clause 2, an ability to still meet the minimum pension/annuity standards by paying out the remainder of the account balance if it becomes less that what was calculated.

Question

Is it Treasury's intention and understanding that where this new exception is inserted to allow commutations in response to Commutation Authorities, that if a commutation does occur, and the balance is insufficient to meet the annual calculated amount, that individuals can rely on Schedule 6, Clause 2, to comply with the minimum annual pension standards?

3.6. Impact on commutation formula for reporting purposes for CDBISs

Last year the Government slated changes to amend the commutation formula to report the debit value for commutations from Capped Defined Benefit Income Streams (**CDBISs**) to fix an unintended nil debit anomaly.

Question

Is it correct to assume that these proposed changes do not alter or amend the commutation formula slated last year?