8 October 2024

Adam Hawkins
Assistant Secretary
Tax and Transfers Branch
Treasury
Langton Cres
Parkes ACT 2600

Via email: superannuation@treasury.gov.au

Dear Mr Hawkins

RE: Legacy retirement product conversions and reserves – draft regulations

The Financial Services Council (FSC) welcomes the opportunity to make a submission on the *Treasury Laws Amendment (Self-managed superannuation funds—legacy retirement product conversions and reserves) Regulations 2024* (draft regulations) and associated explanatory statement.

The FSC supports the temporary retirement product conversion scheme, first announced through a 2021-22 Budget measure, which offers individuals invested in legacy retirement products a valuable opportunity to transition to more modern and flexible options that better suit their needs. The FSC urges the Government to make the regulations as soon as practicable. While this scheme is a positive step forward, it remains limited in scope. The Government must continue to develop ways in which products can be modernised across the superannuation and investments sector without serious tax or social security consequences. FSC research conducted by EY last year found that enabling superannuation trustees and fund managers to transition consumers to contemporary products would result in $16 billion more in retirement savings by 2050, delivering an additional $21 billion in retirement income for Australians.

The FSC is also seeking further clarification on how reserves resulting from the proposed product conversion scheme can be used. Additionally, providing rationale for the selected five-year conversion period would assist in enhancing the clarity of the proposed draft regulations. The FSC also notes the limitations of the draft regulations in relation to life insurance companies that support superannuation-based longevity products and suggests that these be considered by the Government.

The FSC notes that the full policy intent of the draft regulations would be better achieved with amendments to the *Socials Services Act 1991* (Social Security Act) and *Veterans' Entitlement Act 1986* (Veterans' Entitlements Act), as there could be significant financial burden impressed upon some consumers of the legacy pension products who wish to convert their product as a result of these legislation and therefore would act as a disincentive for some consumers to pursue retirement product conversion.

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

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Members represent Australia's retail and wholesale funds management businesses, superannuation funds, and financial advice licensees.

The financial services industry is responsible for investing more than $3 trillion on behalf of over 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 one of the largest pools of managed funds in the world.

Summary of Recommendations

1. The Government continues to develop product modernisation policies, with a focus on legacy superannuation and investment products to assist moving consumers into more efficient, better performing products;
2. The explanatory statement explicitly clarify that individuals can use the resulting capital to purchase any retirement income stream product that meets their needs, including both account-based and innovative retirement income streams;
3. The conversion period be extended or the scheme be made available on an indefinite basis to provide consumers with greater flexibility;
4. The Government consider amendments that provide the same concessions to reserves held within life insurance companies that support superannuation-based longevity products, to ensure that consumers holding these products are not adversely impacted when converting legacy retirement products under the proposed scheme in the draft regulations;
5. The Government should examine potential transfer balance cap (TBC) breaches caused by the commutation process and consider implementing a solution similar to the successor fund transfer (SFT) balance cap fix to address this issue effectively; and
6. The Government consider amendments to the relevant sections of the Social Security Act and Veterans' Entitlements Act to ensure consumers are not adversely impacted when converting legacy retirement products under the proposed scheme in the draft regulations.

Further legacy product modernisation is needed

Whilst the FSC recognises the introduction of the legacy retirement product scheme is a positive step towards achieving product modernisation, it has a very limited scope. The need to be able to modernise this limited scope of products does however highlight the importance of broader product modernisation across the superannuation and investment product suite. Some legacy superannuation investment products have become increasingly expensive to run and are no longer able to efficiently provide competitive net returns, but due to tax and social security consequences, in many cases it would not be in the best financial interests of consumers to move out of these products.

FSC research, conducted by EY last year, found there is $132 billion invested in superannuation and investment options that could benefit from modernisation, impacting over 1.8 million customer accounts, showing these draft regulations are only a drop in the ocean of the reform needed to move consumers into more efficient, fit-for-purpose products across industry.

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The FSC research also concluded that there would be benefits for all stakeholders if a wholesome product modernisation regime were to be implemented, including:

- **Benefits to Consumers** including access to equivalent products with higher net investment returns driven by both higher expected investment performance and lower fee structures obtained through efficiencies in modern products.
- **Benefits to Government** through greater tax receipts and savings due to reduced aged pension payments.
- **Benefits to Trustees** through operational and administrative efficiencies; and
- **Benefits to Regulators** through a more competitive industry driving better outcomes for the consumer thanks to operational efficiencies.

The Government should continue its efforts to promote the conversion of legacy products across the superannuation and investment sector. These products can be expensive to run and not suit the needs of consumers, who are effectively 'stuck' in them due to the current tax settings. Ultimately allowing consumers to move to more efficient, modern products can lead to a fiscal benefit for the Government, approaching $1 billion over the next 10 years. This is comprised of $700 million of increased revenue and $240 million of reduced age pension outlays.[2]

RECOMMENDATION 1

The Government continues to develop product modernisation policies, with a focus on legacy superannuation and investment products to assist moving consumers into more efficient, better performing products.

Additional information to assist in clarifying the use of the scheme

The FSC is broadly supportive of the proposed scheme, which aims to offer consumers greater flexibility. However, additional details would help provide more certainty on how the scheme can be applied. Under the proposed amendments, individuals eligible to exit a legacy retirement product would be allowed to use the resulting capital to start any retirement income stream that suits their circumstances, such as an account-based income stream or an innovative retirement income stream.

We note, however, that the explanatory statement only specifically mentions starting an account-based income stream. To ensure the scheme offers members flexibility to select a contemporary retirement product that meets their needs, the FSC recommends updating the explanatory statement to clearly state that individuals can use the resulting capital to purchase any retirement income stream product that suits their needs, including an account-based or innovative retirement income stream.

RECOMMENDATION 2

The explanatory statement explicitly clarify that individuals can use the resulting capital to purchase any retirement income stream product that meets their needs, including both account-based and innovative retirement income streams.

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The FSC notes that the proposed scheme limits product conversion to a fixed five-year period, with no justification provided in the explanatory statement for this restriction. While five years offers a reasonable window for consumers to act, extending the timeframe could benefit those unable to convert within this period. Providing a longer or indefinite period would ensure that all consumers have the flexibility to make decisions at their own pace.

RECOMMENDATION 3

The conversion period be extended or the scheme be made available on an indefinite basis to provide consumers with greater flexibility.

Releasing reserves

The FSC notes that the proposed amendments ensure that the allocation of reserves held within a superannuation fund that has been established to support the income stream will not be classified as a contribution under the *Income Tax Assessment (1997 Act) Regulations 2021*. However, many superannuation-based lifetime and life-expectancy income stream offerings are supported through life contracts held by the trustee with regulated life insurers, and the reserves that support them are held within the statutory funds of the insurers. Further amendments are needed to allow for commutations from legacy retirement products supported by life insurers under the proposed scheme, otherwise there will be a differential treatment for members depending on the underlying structure of the product.

RECOMMENDATION 4

The Government consider amendments that provide the same concessions to reserves held within life insurance companies that support superannuation-based longevity products, to ensure that consumers holding these products are not adversely impacted when converting legacy retirement products under the proposed scheme in the draft regulations.

Transfer Balance Cap may be impacted

The FSC notes that the commutation of legacy pensions is typically formula-driven and may not align with the actual dollar value of the benefit. As a result, the Modified Commutation Outcome debit may not equal the Superannuation Income Stream credit upon commencement, potentially leading negative impacts on consumer's Transfer Balance Cap (TBC). This issue warrants further examination to ensure no adverse TBC consequences for individuals opting to transition to more modern and flexible options. A solution similar to the Government's recent TBC fix for Successor Fund Transfers (SFT), implemented in July 2024, should be considered. The SFT reform ensures that individuals do not inadvertently breach the TBC when transferring capped defined benefit income streams between super funds. It retroactively adjusts affected transfer balances to ensure the values are aligned and prevent any negative consequences.

RECOMMENDATION 5

The Government should examine potential TBC breaches caused by the commutation process and consider implementing a solution similar to the SFT transfer balance cap fix to address this issue effectively.

Updates required for Social Security and Veterans' Affairs legislation

The FSC notes that while the proposed draft regulations amend key regulations, including the *Retirement Savings Account Regulations 1997*, *Superannuation Industry (Supervision) Regulations, and Income Tax Assessment Regulations 2021*, equivalent amendments could also be made to Social Security Act and Veterans' Entitlements Act to enhance the policy intent, and allow for more retirees to commute their retirement products without becoming financially worse-off.

Although existing debt waiver provisions could assist some consumers, these are applied on a case-by-case basis. Relying on such provisions would mean that each member exiting a legacy product would need to individually apply for a waiver of any debt, resulting from the loss of asset test exemptions. This approach would create a degree of uncertainty for consumers and act as a disincentive to use the scheme.

The FSC believes amendments to sections 9A(h), 9B(h), and 9BA(f) of the Social Security Act, as well as sections 5JA(h), 5JB(h), and 5JBA(f) of the Veterans' Entitlements Act should be made to allow the proposed conversion scheme to function more efficiently and allow for greater use if the scheme. Additional provisions may also benefit from amendments.

RECOMMENDATION 6

The Government consider amendments to the relevant sections of the Social Security Act and Veterans' Entitlements Act to ensure consumers are not adversely impacted when converting legacy retirement products under the proposed scheme in the draft regulations.

If you would like to discuss anything contained in this submission, please do not hesitate to contact me.

Yours sincerely,

Aidan Johnson

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